Center for Global Development

Working Paper Number 133
November 2007

Reviving Economic Growth in Liberia

By Steve Radelet

Abstract

Liberia was decimated by 25 years of gross economic mismanagement and 14 years of brutal civil war. GDP fell by over 90% in less than two decades, one of the largest economic collapses in the world since World War II. This paper explores the challenges in reinvigorating rapid, inclusive, and sustained economic growth in the post-war environment. It stresses the importance of not just re-igniting growth, but rebuilding the economy in a way that avoids the substantial income concentration of the past and creates significant economic opportunities to groups that were marginalized and excluded in the past. It examines the new government's progress so far, including the major steps it has taken in its first 18 months and the unique way that it has organized government-donor relations.

The paper traces the extent of Liberia's collapse compared to other African countries, and examines the patterns of post-conflict recovery in several other African cases as a basis for examining the *potential* for renewed growth in Liberia. It suggests that Liberia's recovery is likely to proceed in three phases (i) an immediate phase driven by donor flows and a rebound in urban services, (ii) the renewal of traditional natural resource-based activities, and (iii) medium-term development of downstream processed products, other manufactures, and services that can compete on global markets.

The paper argues that the single highest priority for the economy is rebuilding infrastructure, and especially roads, which are crucial to nearly every aspect of Liberia's recovery: maintaining security, connecting farmers to markets, creating jobs, opening concession areas, reducing costs for manufacturing, and effectively delivering basic health and education services. Financing road construction is a major challenge, however, since most donors provide relatively little financing for roads compared to other activities. Other key issues are effectively managing natural resource production in order to gain the key benefits and avoid some problems that other countries have faced, improve the business climate, and invest in education and training programs to improve the skills of Liberian workers over time.

www.cgdev.org

Reviving Economic Growth in Liberia

Steven Radelet[1]
Center for Global Development

November 2007

I. Introduction

Liberia was decimated by 25 years of gross economic mismanagement and 14 years of brutal civil war. More than 270,000 Liberians were killed, and over 500,000 more were forced to flee their homes as either internally displaced persons or refugees in neighboring countries. Families were shattered; entire communities were uprooted; and social, political, economic, and governance systems were destroyed. Commercial and productive activities collapsed as warlords looted and vandalized the country. GDP fell by over 90% in less than two decades, one of the largest economic collapses in the world since World War II.

Liberia's nightmare is finally over. The country has been at peace since 2003, and a new democratically-elected government took the reins in January 2006. The new government is introducing a broad set of policies to foster peace, launch reconstruction and development, and build strong systems for governance.

One of the most critical issues for Liberia's recovery and the consolidation of peace is to establish the foundation for rapid, inclusive, and sustainable economic growth. This paper examines Liberia's potential for growth, its likely patterns, the key issues, and the most important policy steps that can be taken to help facilitate the economic recovery.

II. Liberia's Conflict and Economic Collapse

The origins of Liberia's conflict can be traced to the political and economic exclusion of large segments of society that have characterized the country for most of its existence. The founding constitution was designed for the needs of the settler population, which subjugated the indigenous people for over a century. Land and property rights of the majority of Liberians were severely limited. Political power was concentrated essentially in the capital city of Monrovia and primarily at the Presidency, with few checks and balances and little accountability. Most infrastructure and basic services were concentrated in Monrovia and a few other cities, fuelling uneven development, a dualistic economy, and a major dichotomy between urban and rural areas. The political and economic elite controlled the country's resources for their own use and to consolidate their power. These factors led to wide gaps in the distribution of the nation's wealth and fuelled deep ethnic and class animosities and rivalries that divided the country.

The economy began to unravel in the 1970s with the combination of the sharp increase in world petroleum prices and the decline in the prices of key export commodities. By the

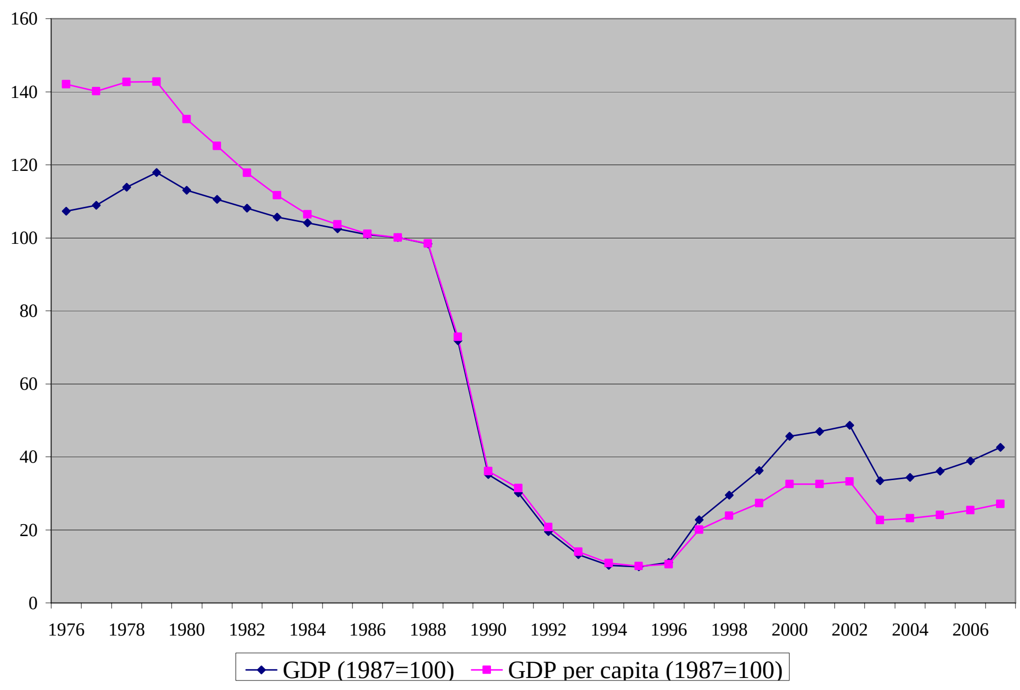
[1] I would like to thank Sami Bazzi and Rebecca Schutte for their assistance with the background research; Alan Gelb, Malcolm McPherson, and David Wheeler for very helpful comments on an earlier draft; and the Open Society Institute for generous financial support. All views expressed here are my own.

latter part of the decade all indicators pointed to a looming crisis. Unemployment, consumer prices, and food prices in particular all rose at alarming rates. The combination of the deteriorating economy, long-standing political and economic repression, social exclusion and corruption sowed the seeds for conflict.

Samuel Doe's April 1980 coup d'etat marked the beginning of Liberia's steep descent into crisis. A decade of gross mismanagement and dictatorship led to Doe's assassination and the outbreak of civil war and 14 years of chaos, plunder, and violence, mostly under governments led by Charles Taylor. The war did not end until international peacekeepers finally ousted Taylor in 2003 and established the basis for stability, peaceful elections, and the beginning of recovery.

The economy completely collapsed during the conflict. Liberia's GDP peaked in 1979, began to decline after the 1980 coup, and collapsed outright after the beginning of the war in 1989 (Figure 1). GDP fell a stunning 90% between 1987 and 1995. The economy initially began to rebound after violence subsided in 1996 and elections were held in 1997. But the war soon re-ignited, and the violence reached extreme levels in 2002 and 2003 until the peacekeepers arrived in mid-2003. By the time of the elections in 2005, average income in Liberia was just one-quarter of what it had been in 1987, and just one-sixth of its level in 1979. It nominal terms, GDP per capita was $160 in 2005.

Figure 1: GDP and GDP per capita in Liberia, 1976-2007
(constant prices; 1987=100)



Source: World Bank, *World Development Indicators*
Note: The indices of GDP and GDP per capita track each other almost exactly between 1988 and 1996 because official data show essentially zero net population growth during that period.

Following the elections in late 2005 and the inauguration of the Sirleaf government, the pace of economic recovery accelerated. The IMF has estimated that economic growth reached 7.8 percent during 2006 and project that it will exceed 9% in 2007. Storefronts in Monrovia, Buchanan, and other towns are newly painted, restocked, and open for business; families are repairing homes; trucks are lining up at building supply stores for cement, gravel, and tools; road and port traffic have increased markedly; and small construction projects are sprouting throughout the country.

In considering the data on Liberia's collapse, three caveats are worth noting. First, the data are estimates, since solid information on economic activity from during the war is scarce. Second, as with many low-income countries, informal sector activity is almost certainly under-reported, so total GDP is probably somewhat higher than these figures suggest. Third, with respect to GDP per capita, while these data show the estimated average impact, the collapse almost certainly was more concentrated in some income groups than in others. Unfortunately there are no data on income distribution during or after the conflict, so one cannot know for certain. Those with high incomes certainly lost significant amounts, but the wealthiest may have been able to protect themselves by moving themselves or their assets offshore. Those in the middle- and upper-middle income range may have been hit hardest, as they had much to lose but probably fewer options to protect themselves. There probably was a less drastic percentage decline for those with lower incomes that may have been just above subsistence levels to begin with, but they were clearly hard hit. In any case, there is no doubt that the drop in income was enormous, and that it affected everyone in Liberia in dramatic ways.

In fact, Liberia's cumulative 91% decline in GDP between its peak in 1979 and its nadir in 1996 was by far the largest of the many protracted declines in sub-Saharan Africa over the last several decades. By comparison, the next closest was Rwanda's 54% collapse between 1992 and 1994 (Table 1). (Zimbabwe's collapse unfortunately is still underway, but through 2006 was still significantly smaller than Liberia's). Liberia's collapse stands out as one of the largest, if not the largest, in the world since World War II.

Table 1. Cumulative Decline in GDP

Country	Decline	Period	Country	Decline	Period
Liberia	91%	1979-96	Uganda	28%	1977-81
Rwanda	54%	1992-94	Guinea-Bissau	28%	1997-98
Congo, Dem. Rep	47%	1974-01	Gabon	27%	1977-87
Sierra Leone	42%	1991-99	Angola	27%	1988-93
Zimbabwe	38%	1998-06	Chad	26%	1977-81
Mozambique	28%	1981-86	Burundi	25%	1992-97

Source: World Bank, World Development Indicators, except Uganda which is from the Penn World Tables.

As the Liberian economy imploded, poverty increased sharply, and more than 75 percent of Liberians now live below the poverty line of $1 per day. Unemployment and underemployment are high, as ex-combatants, returning refugees and internally displaced persons are struggling to find work. Refugees returning to their farms face a lack of seeds, fertilizers and tools, and in some cases uncertain land tenure. Schools, hospitals, and clinics were badly damaged, and most government buildings were left in shambles. Today there are less than 50 Liberian physicians to cover the nation's public health needs, equal to one for every 70,000 Liberians. About 70 percent of school buildings were partially or wholly destroyed, and over half of Liberian children and youth are estimated to be out of school. A whole generation of Liberians has spent more time at war than in school.

Exports (at least officially-recorded exports) nearly ceased entirely, dropping from $486 million in 1978 to about $10 million in 2004. The United Nations Security Council imposed sanctions on Liberian exports of timber and diamonds because they were being used to finance arms purchases, and as a result activity in these areas nearly ceased. Actual exports in the latter years undoubtedly were higher than these figures indicate, as the sanctions forced some trade underground, but there is little doubt that legitimate export activity dropped very sharply.

The war left basic infrastructure in ruins. There was no electricity (other than private generators) or piped water anywhere in the country for 15 years after 1991. Many roads became impassable, which today seriously constrains peace building efforts; weakens economic activity in agriculture, timber, and mining; isolates entire sections of the country, and undermines the delivery of basic health and education services.

Government finances collapsed in tandem with the economy. Government revenue fell to less than US$85 million a year between 2000 and 2005, translating into public spending of only about US$25 per person per year, one of the lowest levels in the world. At the same time, years of mismanagement left a huge external debt burden, mostly as a result of large borrowing and expenditures in the 1980s and steady accumulation of arrears since then. Liberia's total debt is estimated at about US$4.5 billion, equivalent to an astonishing 800 percent of GDP and 3,100 percent of exports. Domestic debt and arrears total at least $304 million, with an additional US$317 million in claims deemed contestable.

The decline was nearly universal across all economic activities (Table 2). Agricultural production dropped as people fled their farms and the supporting infrastructure collapsed, mining and timber activities shut down, rubber plantations closed, manufacturing essentially stopped, and services ground to a halt. Production of iron ore, timber, and mining and panning ceased completely. Rice production fell 73% between 1987 and 2005, financial services fell 93%, and electricity and water fell 85%. Transportation and communication, trade and hotels, and construction all fell around 70%. Only the production of charcoal and wood increased as Liberians turned to these products to meet their basic energy needs.

Table 2: Value Added by Sector in Liberia, 1987-2005 (constant 1992 US$)

	1987	2005	Decline		1987	2005	Decline
Real GDP	**1,167**	**402**	**66%**				
Agriculture & fisheries	369	185	50%	**Manufacturing**	87	52	41%
Rubber	60	41	31%	Cement	23	15	36%
Coffee	1	0	91%	Beverages & beer	53	34	36%
Cocoa	6	1	79%	Other	11	3	72%
Rice	117	32	73%	**Services**	530	93	82%
Cassava	57	38	35%	Electricity & water	18	3	85%
Other	128	72	43%	Construction	39	8	79%
Forestry	57	71	-26%	Trade, hotels, etc	71	20	72%
Logs & timber	34	0	100%	Transportation & communication	90	29	68%
Charcoal & wood	22	71	-221%	Financial institutions	142	10	93%
Mining & panning	125	1	99%	Government services	129	10	92%
Iron ore	116	0	100%	Other services	41	14	67%
Other	9	1	92%				

Source: Government of Liberia; IMF estimates

There is a tiny silver lining in the extent of Liberia's collapse: it provides an indication of Liberia's upside economic potential. Current production is far below Liberia's proven capacity, so there is significant room to expand. For example, based on the data in Table 2, if Liberia is able to recover to 1987 levels of production in rubber, rice, timber, and iron ore, GDP would increase by more than 60%. Liberia clearly has the *potential* for very rapid economic growth, and to sustain that growth for many years. The challenge is to turn that potential into reality. But Liberia must do so in a way that does not just rebuild the economic structures of the past, but rather creates the dynamic for more inclusive and equitable growth that can be sustained over time. This will require not just rebuilding what was destroyed, but also providing the basis for individuals and businesses to take advantage of new opportunities that may not have existed in the past. We return to these issues later in the paper.

III. Progress During the First 18 Months of the New Government

The Basic Reconstruction and Development Framework

Following the inauguration, the new government faced the daunting task of rebuilding Liberia from the ashes of the war. It recognized that to be successful, it would need to implement policies aimed at both political stability and inclusive economic recovery that were mutually reinforcing, and that to sustain development over time, it would have to rebuild institutions and physical infrastructure and invest in human capacity through strong health and education programs. Its initial strategy following the inauguration was articulated in its "First 150-Day Action Plan," which described in detail the steps that both it and the donor community would take in the period between January and June 2006. This was followed by the development of an Interim Poverty Reduction Strategy (iPRS), which was finalized in early 2007 and is meant to cover the period from late 2006 through mid-2008. The government is current working on a full Poverty Reduction Strategy (PRS) to cover the period 2008-2010. All three of these strategies are organized around a framework with four basic pillars.

- Expanding peace and security.
- Revitalizing economic activity
- Strengthening governance and the rule of law
- Rebuilding infrastructure and providing basic services

Because of the government's precarious financial situation and limited personnel capacity, it was clear that the international community would play a prominent role in Liberia's reconstruction. At an early stage, the government introduced an unusual mechanism to closely coordinate government and donor activities. Most developing countries follow one of two broad models: (1) Donors consult and coordinate amongst themselves in a group chaired by one of the donors (often the World Bank) and coordinate with the government on a regular basis, or (2) A senior government official (usually the Minister of Finance or Planning) chairs a regular meeting with all the donors.

The new Liberian government wanted a different model that ensured effective coordination and consistent approaches both between the government and key donors and across government agencies. It wanted a structure in which key decisions were made by a small group, chaired by the government rather than a donor, that could execute decisions more quickly and easily than in a larger and more cumbersome group. It also wanted an administrative structure that was consistent with the substantive structure of the four pillars of its reconstruction framework.

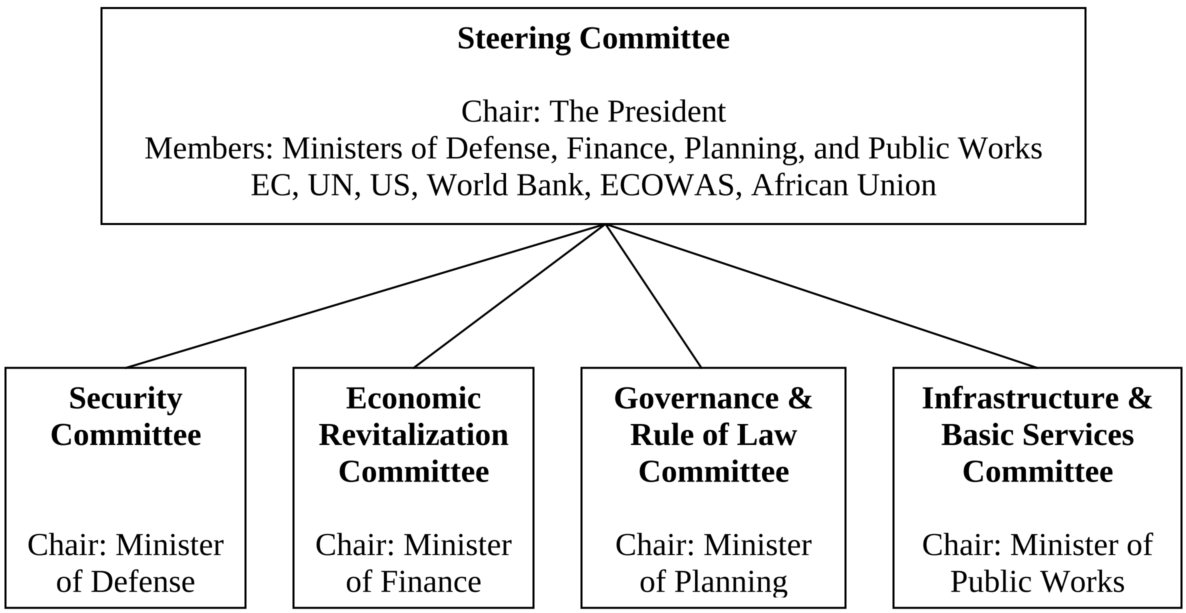
With these principles in mind, the government established the Liberian Reconstruction and Development Committee (LRDC). At the apex of the LRDC is a relatively small Steering Committee chaired by the President and consisting of four key Ministers (Defense, Finance, Planning, and Public Works) and the four largest donors (US, UN, World Bank, and the EC), as shown in Figure 2. Representatives from the African Union and ECOWAS also join the group. The Steering Committee is designed to make broad policy decisions and to ensure broad coordination across key ministries and between the government and the donors. The small group of core government decision-makers is in some ways reminiscent of the small group of technocrats that provided major policy direction in Korea, Indonesia, Thailand, Malaysia, and Chile, among other places. The Steering Committee originally met once every two weeks at the beginning of the administration; it now meets once a month.

More detailed work is carried out in four "Pillar Groups" that are chaired by each of the four key government ministers in the Steering Committee and are responsible for the substantive work in each of the four areas of the reconstruction framework (security, economic revitalization, governance, and infrastructure and basic services). The Pillar

Groups consist of representatives all of the relevant government ministries and departments alongside key donors and UN agencies.

This structure is intended to allow for all key government agencies and donors involved in any particular issue to meet regularly and coordinate their activities. The parallel structures of the substantive reconstruction framework and the LRDC provides a mechanism for making key decisions, setting priorities, and tracking progress over time that are consistent with the governments broader strategies. This structure generally has been seen as successful during its first 18 months, and its operations may be a useful model for other countries as they manage donor-government relations.

Figure 2. Liberia Reconstruction and Development Committee (LRDC)



Progress to Date

Despite significant constraints in physical infrastructure and human capacity in the aftermath of the war, the new government, working in close collaboration with its partners, has made important progress in each of the four pillars of its strategy through both the “First 150-Day Action Plan” and the iPRS.

Pillar 1: Expanding peace and security. Without peace and security, there will be little new investment, economic rebound, or job creation, which in turn will undermine stability and threaten a return to conflict. Since the ouster of the Taylor regime in 2003, a force of approximately 15,000 UN peacekeepers – the second largest such force in the world -- have done an outstanding job of maintaining peace, helping to rebuild communities, supporting two rounds of successful elections, and otherwise establishing the foundation for Liberia’s recovery. Going forward, the government must build new security and police forces that are sufficiently strong to maintain peace and security, but that remain firmly under democratic civilian control. It must fully re-integrate returning refugees, internally displaced persons, and ex-combatants. It must also take other steps aimed at reconciliation, bridging ethnic divides, and rebuilding communities.

In its first year, the government:

- Demobilized and reintegrated over 75,000 ex-combatants through formal reintegration programs, including placing 36,000 ex-combatants in formal 3-year education programs.
- Deactivated or retired over 17,000 members of the Armed Forces of Liberia, the Liberian National Police, and the Special Security Service.
- Began recruiting and training a new Armed Forces of the Liberia, which will eventually number 2,000 troops.
- Recruited and began to train over 500 police officers as a first step towards building a force of 6,000 police and security officers.
- Facilitated the arrest and detention of Charles Taylor, and brought charges against several other former high-ranking officials.
- Repatriated over 40,000 refugees back to Liberia and returned over 50,000 internally displaced persons through organized programs; tens of thousands more have returned to their communities spontaneously outside of formal programs.

Pillar 2: Revitalizing economic activity. The government has placed an initial strong focus on putting its financial house in order by strengthening both government budget operations and central bank functions. It is aiming to quickly restore agricultural production, where the majority of Liberians are employed, and to reinvigorate the natural resource-based activities that were once the engines of Liberia's economy: rubber, timber, mining and cash crops. One key objective is to quickly create as many jobs as possible for ex-combatants, returning refugees, and unemployed youth, either through new private sector opportunities or employment programs. By opening the economy to trade and reducing barriers to investment, over time the government hopes to attract new investment in manufacturing and services to create large numbers of jobs for low skilled workers and to produce exports for the region and the world. We discuss these issues in greater detail in the next section.

To date the government has:

- Introduced a cash-based budget, introduced new expenditure control mechanisms, and strengthened enforcement and collection of custom duties. As a result of these steps, the government increased its revenues by 48 percent in 2006 compared with 2005, and its expected revenues for FY 2007/08 are more than double what it inherited for 2005/06. The government also balanced its budget within four months of taking office.
- Cancelled all contracts and concession agreements entered into by the 2003-05 Transitional Government, and completed the review and initiated renegotiation of 95 contract and concessions.
- Passed a Forest Reform Act aimed at strengthening oversight and regulation of the forestry sector, which paved the way for the lifting of United Nations sanctions on timber.

- Endorsed and began to implement the Governance and Economic Management Assistance Program (GEMAP), which provides international experts with co-signing authority in several key financial agencies of the government.
- Completed negotiations with Arcelor Mittal Steel for a major iron ore concession that will provide investments of $1 billion over seven years.
- Distributed over 40,000 tools and 20 metric tonnes of seed rice to some 33,000 farmers throughout the country in 2006, and began to distribute a larger amount in early 2007.
- Initiated a voluntary severance program for employees of the Liberian Petroleum Refining Corporation, which led to the voluntary retirement of 400 employees, and helped return the Corporation to profitability for the first time in many years.

Pillar 3: Strengthening governance and the rule of law. Liberia's institutions were left in ruins by the war, and they must be rebuilt nearly from scratch. The government is aiming to build a more professional and better paid civil service, and introduce systems that guard against corruption and ensure transparency and accountability. An important piece will be to strengthen both parliament and the judiciary to move away from the system of supreme executive powers as in the past. The government aims to strengthen the judiciary system to gain legitimacy and credibility as the foundation for the rule of law. The government must also build the foundation for democracy, including strengthening the media, civil society groups, and local government institutions.

Key achievements to date include:

- Introduced a requirement that the President, all Cabinet Ministers, and all commissioned officers publicly declare their assets, and submitted to Parliament a new Code of Conduct for all public officials.
- Developed and began to implement a comprehensive anti-corruption strategy.
- Initiated the process of civil service reform, including completing a civil service census, removing a large number of "ghost" employees from the government payroll, initiating pilot projects in four Ministries to determine the appropriate number of personnel, and facilitating the retirement of long-tenured civil servants.
- Strengthened the monitoring of the governance reform process, including completion of Governance Reform Commission Management study.
- Inaugurated the Truth and Reconciliation Commission (TRC).
- Rehabilitated prisons in Gbarnga, Buchanan, Harper, Zwedru, Kakata, and Monrovia.
- Strengthened the Legislature, including by giving the legislature more power over budgetary issues and through the establishment of Women's Legislative Caucus' for both Upper and Lower Houses.
- Appointed County Superintendents and Assistant Superintendents and established County Support Teams in all 15 counties.

Pillar 4: Rebuilding infrastructure and providing basic services. The war brought widespread destruction of roads, bridges, power supplies, water, schools, clinics, and government buildings throughout the country. Rebuilding this infrastructure is central to the recovery. In particular, roads (including rural feeder roads) are essential to supporting peace, reinvigorating agriculture and natural resource based industries, creating jobs, and ensuring access to health and education services. Health and education services need to be rebuilt for their immediate benefit, but also to as the foundation for sustained growth and development over time.

Key actions so far include:

- Initiated the rehabilitation of four major highways, many secondary roads, and bridges, culverts, and drainage facilities in several areas around the country.
- Reestablished electricity connections and the supply of pipe-borne water to parts of Monrovia for the first time in 15 years.
- Began to increase employment throughout the country through community development projects, food for work programs, road building programs, urban clean-up projects, and the revitalization of agriculture.
- Abolished all tuition and fees for primary schools, and significantly reduced tuition and fees for secondary schools, which has led to a dramatic 50 percent increase in school enrolments.
- Awarded nearly 2,000 scholarships to students in all 15 counties.
- Rebuilt and reopened several schools, and provided over 13,000 pieces of school furniture to schools throughout the country.
- Restored services to over 350 health facilities around the country, and rehabilitated more than 20 clinics and several hospitals and health centers, including the JFK hospital in Monrovia.
- Immunized over 95% of children under five years old against measles.
- Distributed over 125,000 mosquito nets, and trained over 3,500 health workers in malaria case management.
- Renewed postal services to some parts of the country for the first time in many years.

IV. Patterns of Growth in Other Post-Conflict Countries

Outside of maintaining peace and preventing a return to war, the most important issue for Liberia is to achieve rapid, inclusive, and sustainable growth. One way to begin to glimpse the potential future of and possibilities for economic growth in Liberia is to examine the patterns of post-conflict growth in other African countries. Several countries have been able to turn the potential for rapid post-conflict growth into the reality for at least a decade or more. The experiences of Uganda (after 1986), Ethiopia (after 1991), Mozambique (after 1992), and provide Rwanda (after 1994) provide some indication of what might be expected in Liberia. Sierra Leone (after 2000) and the Democratic Republic of Congo (DROC) provide more recent examples that are instructive, although they have not yet achieved the same longevity as the other examples.

We focus on countries that have been successful in accelerating growth because the purpose is to explore the upside *potential* for growth in Liberia, and its possible patterns across sectors and over time. Obviously recovery is far from automatic, and many post-conflict countries either never achieve rapid growth, or the growth stalls after a few years.

Many revert to conflict, particularly those that do not accelerate or sustain growth.[2] It would be particularly useful to understand more about the policy choices and other characteristics that distinguish the successful form less successful countries, but that kind of in-depth investigation of these other countries is beyond the scope of the present paper. Nevertheless, for our immediate purposes, the basic patterns in the countries that have succeeded in the initial stages are instructive for Liberia as it moves forward.

While each country is different, some clear patterns emerge. Figure 3 shows the average growth for three of these countries in the years just prior to and after the crisis, with the year zero corresponding to the year of the end of the conflict. We exclude Rwanda and Sierra Leone because of the very large fluctuations in growth around the time of the crisis, and DROC because of the relatively short period since the end of the crisis.

Figure 3: Pre- and Post-Crisis Average rate of GDP growth: Ethiopia (1991), Mozambique (1992), and Uganda (1986)

Three broad patterns are evident:

- First, GDP contracted sharply in the final years of the crisis in each country, with the contraction averaging 5% in the final year.
- Second, once the conflict ended, growth rebounded relatively quickly within two years. This rebound is not surprising: typically there is significant idle capacity at the end of conflict (unused farm land, empty warehouses, etc.), and countries are operating well within their "production possibilities frontier."
- Third, these countries were able to sustain relatively rapid growth for more than ten years (and still counting), generally fluctuating between 6-9% per year. Excluding the first post-conflict year, growth averaged 7.2% for years 2-10 in the three

[2] Paul Collier describes some of the characteristics associated with countries that are prone to conflict in The Bottom Billion: Why the Poorest Countries are Failing and What Can Be Done About It (Oxford: Oxford University Press), 2007.

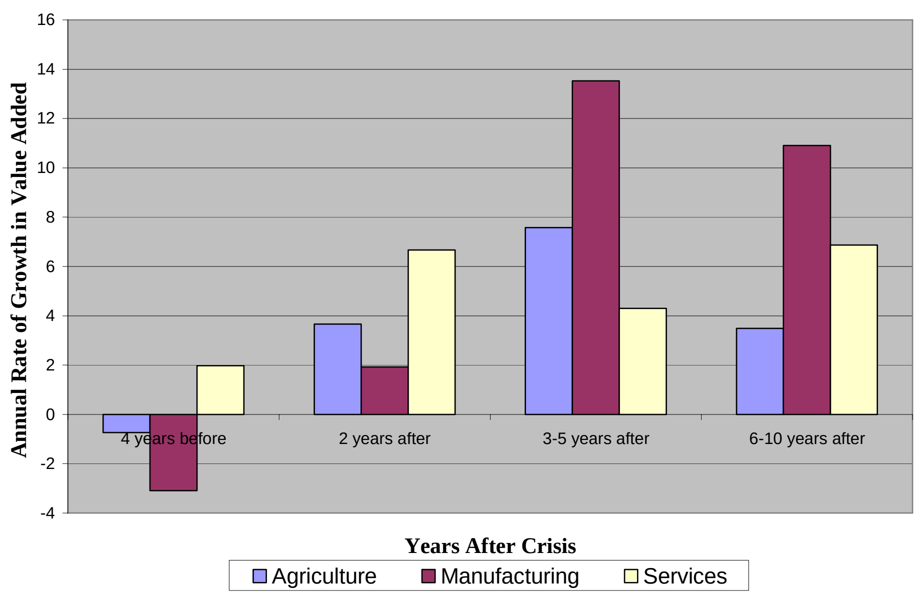
countries. Ethiopia recorded the slowest average growth rate between years 2-10 at 6.4% (which includes the period of the border conflict with Eritrea), Uganda grew at 7.3%, and Mozambique at 8.0%. It is worth noting that GDP growth of 7.2% for ten years is sufficient to double total GDP and (typically) to increase GDP per capita by over 60%.

In the three countries not shown because of much larger volatility (Rwanda and Sierra Leone) and less than ten years since the end of the crisis (Sierra Leone and DROC), the average annual growth rates after two years through to the most recent year available were similar: Rwanda 7.8%; Sierra Leone 8.0%, and DROC 6.3%.

The patterns and timing of recovery differed across sectors (Figure 4):

- Services were the first to recover, with growth jumping to an average of 6% in the second year after the end of conflict, led by construction, hotels, and restaurants. Much of the recovery in services was spurred directly or indirectly by donor funds. Average growth rates in services tended to fluctuate during the following decade, but typically remained at around 5-6%.
- Agricultural growth started somewhat slower, reaching 4% two years after the end of conflict. But agricultural growth continued to accelerate, reaching an average of nearly 8% in years 3 through 5 after the crisis. Agricultural growth then decelerated to just under 4% in years 6 through 10, which is a more typical long-run growth rate for agriculture in many developing countries.
- Manufacturing was the slowest to rebound, but generated the fastest growth over the medium term. The manufacturing sector recorded average growth of just 2% two years after then conflict, but jumped to over 13% in years 3 through 5. It then continued at a robust 11% in years 6 through 10.

Figure 4. Composition of Post-Crisis Growth in Value Added by Sector: Ethiopia, Mozambique, and Uganda



Each of these countries received significant aid flows, especially in the early years, which helped support the economic recovery. Aid receipts averaged:

- approximately $67 per person in the first two years, and
- approximately $50 per person for the remainder of the decade (in Mozambique aid receipts averaged over $60 per person).[3]

In Liberia, these figures would be the equivalent of about $235 million per year in the first two years and $175 million per year thereafter. Note that these figures correspond to aid actually disbursed, rather than just commitments. They are also limited to assistance for development-oriented activities, not for security purposes, and thus do not include payments to UN Peacekeepers, training of security forces, or other related flows.

V. Generating Rapid, Inclusive, and Sustainable Growth in Liberia

Liberia must rebuild its economy nearly from scratch in the aftermath of the war. This challenge would be daunting for any post-conflict country, since about 40 percent of them return to conflict within five years, and the odds are higher when the economy does not grow quickly.[4] The challenge of rebuilding the economy is even greater for Liberia given the extent of its collapse. Ex-combatants and returning refugees must quickly find jobs or other sources of economic livelihood and see a return of basic services, or disenchantment and resentment could grow rapidly. Liberia must capitalize on its current moment of peace and good will to build a positive, reinforcing cycle between peace, stability, investment, and growth. Thus, the first challenge for Liberia is to rapidly revitalize economic growth.

Crucially, however, for Liberia to be successful it cannot simply recreate the economic and political structures of the past that led to widespread income disparities, economic and political marginalization, and deep social cleavages. If it does so, there is much greater likelihood of a return to war. Thus Liberia's second challenge is to create much more equitable and inclusive economic and political opportunities for Liberians that are not just accumulated for a small elite class. Economically, more equitable and inclusive growth will require a more robust agricultural sector and eventually labor-intensive manufactured (including processed downstream natural resource products) and service exports that create large numbers of jobs for low-skilled workers, with less dependency on primary products and extractive industries over time. Creating jobs for low-skilled workers, especially youth, through new private sector opportunities or employment programs will be central. Politically, Liberia must decentralize political structures, provide more political power to the regions and districts, build transparency and accountability into government decision-making, and create stronger systems of checks and balances across all three branches of government. Failure to do so will significantly increase the chances of a return to conflict.

---

[3] The aid per capita figures exclude Ethiopia, which has a much larger population, so the aid per capita figures in Ethiopia were much smaller.

[4] Paul Collier and Anke Hoeffler (2004), "Conflicts and Arms Proliferation," in Bjorn Lomborg (ed.) Global Crises, Global Solutions (Cambridge: Cambridge University Press).

The third challenge is to make growth sustainable. Over time this will require building a diversified economy that creates a large number of jobs for low-skilled workers, and creates the dynamic for productivity gains (and therefore wage gains) over time. Liberia has a rich resource base, including timber, ore, rubber, diamonds, fertile lands for agriculture, and the ocean and coastal areas. Agriculture is particularly central given the large number of people involved, its share in the economy, and the importance of food security in ensuring sustained development. As a starting point, these sectors have the potential to create significant numbers of jobs relatively quickly, help rebuild infrastructure in the context of re-opening concessions, and provide substantial budget revenues. Agriculture is particularly important since it can create employment for so many people and because productivity gains in agriculture typically provide the foundation for successfully shifting workers to manufacturing and services.

But Liberia cannot rely solely on these activities, for two reasons. First, very few developing countries that have relied heavily on natural resource exports and extractive industries have achieved sustained economic growth over the last several decades. There are a few exceptions, such as Botswana, Chile, Indonesia, Malaysia, Mauritius, and Thailand. Most of these (with the exception of Botswana) relied on a diversified natural resource base coupled with manufacturing (including downstream use of natural resource products) and services, and Liberia has the potential to follow that pattern. Heavily reliance on primary products and extractive industries (without competitive downstream manufacturing) tends to create incentives for corruption, creates Dutch Disease effects that undermine other export activities, and generally does not create mechanisms for sustained productive growth over time.

The most successful developing countries have relied more heavily on labor-intensive manufactured exports (including Indonesia, Malaysia, Mauritius, and Thailand as they diversified away from natural resource exports). These activities provide the proven basis for generating sustained growth in productivity, skill levels, wages, and income over time. Manufactured products have much greater potential (relative to unprocessed natural resource products) for nearly continuous upgrading in product quality as the skills of the workforce improve and as new technologies become available, allowing for steady growth in productivity and wages over a very long time. Producing for export is essential, as export markets can expand over time, provide competition to ensure efficiency, and provide access to new technologies that are central to productivity growth.

Labor-intensive manufactured exports have been the foundation for long-term income growth and poverty reduction in nearly all of the most successful developing countries of the last several decades, including China, Indonesia, Thailand, Malaysia, Korea, Mauritius, the Dominican Republic, and Costa Rica, among others. In almost all cases this has occurred through the creation of production enclaves (such as export processing zones), supported by appropriate infrastructure and regulatory climate, in which firms can quickly compete on world markets. In time, these enclaves spread throughout the economy.

Liberia has the potential to create a similar diversified economy and join the rapid and sustained growth of these other countries. It has the potential for vibrant economic activity in agro-processing, horticulture, biomass fuels, furniture and other downstream wood products, sandals and other downstream rubber products, toys, simple jewelry, and eventually in data entry and other offshore services using the internet. These activities have the potential to create a very large number of jobs throughout the country for low-skilled workers, which is perhaps the most effective tool for Liberia to fight poverty over the long term. Importantly, these activities also provide opportunities for upgrading products over time as skills and productivity grow, which is the critical basis for sustaining dynamic growth in wages and income over time.

The second reason why Liberia should not rely exclusively on unprocessed natural resource products is that it risks recreating the structure of growth and income distribution from the past, and thus risks a return to conflict. Liberia must generate economic opportunities for those that were marginalized in the past, including the poor, low-skilled workers, rural workers, and women, amongst others, and not allow income gains to become concentrated among a few. A diversified economy along with a decentralized governance system is the best way to achieve these goals.

Thus, Liberia's overriding economic objective is to create the basis for rapid, inclusive, and sustained economic growth. It must adroitly manage its natural resources and diversify the economy over time, following the examples of Chile, Indonesia, Malaysia, Mauritius, and Thailand. We return to key policies to begin to move in this direction below.

VI. The Likely Phases of Liberia's Growth Recovery

Before turning to policy issues, it is worth considering the likely timing and pattern across sectors of Liberia's recovery. The country's economic structure, coupled with the patterns of growth from other post-conflict countries, suggest that the process of restoring economic growth in Liberia is likely to evolve in three broad phases:

Phase I: Growth in the earliest years is likely to be driven mainly by donor inflows and a rebound in urban services, an initial revival in agriculture, some limited manufacturing (mainly cement and beverages), and programs aimed at direct employment creation (e.g., small public works projects). These patterns are already beginning to emerge (Table 3).

- In services, construction has been a key driver of growth over the last two years and is likely to continue to be in the near future as buildings, roads, and other infrastructure are repaired and rebuilt. In addition, retail trade, hotels, restaurants, communications, transport, and some limited financial services are already expanding quickly and are likely to continue to do so as donor funds are disbursed, remittances from abroad grow, and related activities expand.
- Within manufacturing, production of beverages already has rebounded quickly. Production of cement increased in 2005, but it fell in 2006. Making cement widely and easily available, whether from domestic production or imports, will be critical to ensuring continued rapid reconstruction in the next several years. Other manufacturing activities have been limited to date, and are likely to remain so until stability and peace are more firmly consolidated.

- Agricultural production is beginning to expand, particularly in rice and cassava. Rubber production (which accounts for 10 percent of GDP) declined in 2006, which significantly slowed the overall GDP growth rate, but rubber production is showing signs of recovery in 2007 (exports of rubber were up 37 percent in the first five months of 2007 relative to the same period of 2006). Agricultural production remains constrained by poor roads and uneven availability of key inputs.

The economic recovery is off to a strong start, as shown in Table 4. The IMF estimated growth in 2006 at 7.8% and is projecting 9.4% growth for 2007.

Table 4: Growth in Value Added by Sector in Liberia, 2005-07 (percent)

	2005 est.	2006 est.	2007 projected		2005 est.	2006 est.	2007 projected
GDP	**5.3**	**7.8**	**9.4**				
Agriculture & fisheries	6.0	4.4	9.1	**Manufacturing**	8.2	16.0	5.0
Rubber	24.6	-25.0	20.0	Cement	34.0	-8.0	5.0
Coffee	2.0	2.0	2.0	Beverages & beer	0.3	27.7	5.0
Cocoa	-47.7	5.0	5.0	Other	2.0	5.0	5.0
Rice	-10.0	15.0	10.0	**Services**	9.9	12.0	10.4
Cassava	19.0	24.0	10.0	Electricity & water	2.0	20.0	15.0
Other	1.3	5.3	3.0	Construction	6.0	25.0	15.0
Forestry	-6.2	2.9	1.0	Trade, hotels, etc	5.0	20.0	15.0
Logs & timber	-100.0	0.0	0.0	Transportation & communication	2.0	7.0	7.0
Charcoal & wood	-3.2	2.9	1.0	Financial institutions	2.0	7.0	10.0
Mining & panning	-15.0	0.0	**	Government services	32.5	10.0	10.0
Iron ore	0.0	0.0	0.0	Other services	2 .0	10.0	7.0
Diamonds	0.0	0.0	**				
Other	-15.0	0.0	0.0				

Source: IMF estimates.
** Recorded diamond sector production was $0 in 2006, so a growth rate for 2007 (when recorded output increased to an estimated $7 million) cannot be calculated.

Phase II: During the next five years or more as both peace and the economic recovery are consolidated, the primary economic drivers are likely to be agricultural and other natural resources sectors, supported by continued growth in urban services. Construction will play a key role, both in terms of immediate growth and to help lay the foundation for sustained growth thereafter. Manufacturing activities may begin to accelerate, particularly those based on natural resource products. For example, in late 2007 a major biomass fuel company commenced operations using old stock rubber trees to produce woods chips to export to Europe. Because of the current depressed levels of production, Liberia could average 10% growth or more during this period. UN peacekeepers are likely to remain on the ground throughout this period, which will help maintain security (and boost the economy through the finances that support them), but is likely to make investors in downstream processing, other manufacturing, and services reluctant to make substantial long-term commitments.

- Rice, cassava, and other food production could continue to expand rapidly for several years, although the rebound could be limited by poor roads that inhibit availability of inputs and marketing options.
- Rubber, oil palm, and other plantation agriculture activities, along with timber, forest products, and biomass fuels have the potential to accelerate very quickly in the next few years as new concession agreements are signed. However, once again, growth in these sectors could be constrained by poor roads and other infrastructure.
- Iron ore, diamonds, and other mining activities will begin to expand, led by the Arcelor Mittal ore mine concession (which is expected to bring $1 billion in investment over seven years) and other mining concessions that are likely to come on line, augmented by a range of supporting activities.
- Services should continue to expand, especially construction, retail trade, communications, hotels, and restaurants.

Phase III: Over the medium and long run, the key to sustainable and equitable economic growth in Liberia will be to encourage production of labor-intensive downstream processing, other manufacturing, and services, particularly for export. Liberia has the potential to become a vibrant, diversified economy with production of a wide range of manufactured goods, particularly those based on processing of natural resource products, including furniture, wood products, agro-processing, horticulture, downstream rubber products (such as sandals), tourism, toys, simple jewelry, and eventually "back office" service exports, such as data entry and accounting for firms in Europe and the U.S. via the internet. With the right environment, Liberian firms could compete on world markets for export to the region, Europe, and the United States.

These activities have the potential to create jobs for a large number of low-skilled workers. As such, they are the foundation for widespread poverty reduction and a more equitable distribution of income. They hold the key for diversifying the economy away from dependence on natural resources and overcoming the income disparities of the past. Because they have the potential to create so many jobs across the country for workers with limited skills, accelerating growth in these activities over time will be a crucial component of Liberia's drive to overcome the income disparities of the past, dramatically reduce poverty, and provide greater economic opportunities for all Liberians.

However, Liberia is unlikely to attract significant amounts of investments in these kinds of activities for several years – realistically not until at least a year or two after UNMIL peacekeepers have departed and investors perceive that long-term stability has been achieved. Even then these investments will materialize only if the government has rebuilt adequate basic infrastructure and created a friendly and competitive business environment that keeps production costs low. They key is to begin to take the steps now to create the environment that will attract private investment when the long-term security situation becomes more certain.

VII. Key Policy Actions

To meet the challenge of achieving rapid, inclusive, and sustained growth, Liberia must both take advantage of the near-term opportunities from agriculture and natural resource-based activities and establish the foundation for diversification into processing downstream products, other manufacturing and service exports over time. Doing so will not be easy, as Liberia starts from a basis of destroyed infrastructure, a legacy of deep social divisions, limited finances, and weak implementation capacity. Success will require clear prioritization, getting some basic choices right, and strong support from the international community (both in terms of supporting the government's priorities and in providing financial support). Liberia cannot do everything at once, and trying to do so will overwhelm decision makers and risk not achieving some of the highest priorities. The government -- and donors – must avoid the temptation of trying to fix every problem, and concentrate on a small number of key issues with the greatest potential to unleash growth, create jobs, and generate opportunities for large numbers of people. The choices that the government makes will have both economic and political implications, as they will provide the foundation for different kinds of opportunities for the traditional elite and historically marginalized groups. To move forward, the government must balance the need to draw on the expertise and resources of the traditional elite with the need to avoid concentration of income and political power and to create much more inclusive economic and political opportunities for indigenous Liberians.

To achieve these goals, four sets of actions stand out as key priorities to accelerating economic growth: building infrastructure (most especially roads), adroitly managing natural resources and the potential side effects of their production, keeping business and production costs low through a favorable business climate, and building strong training and education programs to develop workers with appropriate skills.

1. Building Infrastructure. Probably the single most important action to stimulate equitable growth in agriculture, natural resource products, downstream processing, other manufacturing, and services is rebuilding roads and ports. Roads throughout the country are in very poor condition, with only about 6% of Liberia's 10,000 km of roads currently paved, and most of those are full of potholes. Yet roads are crucial to nearly every aspect of Liberia's recovery: maintaining security, connecting farmers to markets, creating jobs, opening concession areas, reducing costs for manufacturing, effectively delivering basic health and education services, and reducing population pressures in Monrovia. Roads are key to reducing rural poverty, as they allow rural consumers to buy goods more cheaply (increasing their purchasing power) and open new markets and economic opportunities for farmers and other rural producers. They can also help create jobs directly (through road construction) and indirectly (by creating new economic opportunities. They are central to reducing costs for timber, rubber, oil palm, and other agricultural products. The also keep production costs low for labor-intensive manufactured products that Liberian would like to develop in the coming years, including agro-processing, horticulture, furniture, rubber products, jewelry, and other products. In addition, a strong road network will enable a more decentralized governance structure, with stronger county, district and local governments that can deliver services and attract skilled personnel. At a very basic level, it is very hard to imagine vibrant economic activity throughout Liberia expanding over time without a strong road network.

There are key choices to be made, especially around which roads to build and repair first, how to finance them, and how to establish a system that ensures repair and upkeep over time. While the main urban roads need to be repaired quickly since they carry huge amounts of traffic and connect the country to its few ports, inclusive growth will require building roads to re-connect rural areas and create opportunities for historically excluded groups. The government is on its way to creating that balance with its current efforts to begin to build roads in several regions across the country.

However, financing is a major challenge, as most donors do not place a high priority on building roads. Liberia has had to push very hard for some of the donors to begin to finance road construction, with some success, but the amounts committed fall far short of the requirements over the crucial next few years. One donor that would be willing to finance more roads is China, but it provides the bulk of its financing as concessional loans, and Liberia cannot borrow until it works through its debt relief process, which is likely to take two years or more. A key issue for the government as it begins to rebuild roads is to create systems to ensure that maintenance and repair costs can be adequately covered over time, such as through a sinking fund or other similar mechanisms.

Ports are nearly as central as roads, since they are the connection between Liberian markets and the rest of the world. The pier at the Port of Monrovia is in extremely fragile condition, and its collapse would bring the economy nearly to a halt. Repairing it must be at or near the top of the list of priorities.

Other infrastructure such as electricity and water also will be crucial. However, they should be secondary to roads and ports as immediate priorities, since private companies and individuals can obtain electricity and water when it is not provided by the public sector, but they cannot provide roads and ports. Nevertheless, reliable and moderately-priced electricity will be an important ingredient in making manufacturing and services competitive over time.

2. Managing Natural Resource Production. Liberia's natural resource-based activities and related downstream activities will provide significant revenues for the government and will create new job opportunities for many Liberians, which is a critical first step towards poverty reduction. But recovery in these sectors will not, on their own, ensure equitable economic opportunities for all Liberians, and overdependence on this sectors risks undermining the incentives for manufactured and service exports that are even more critical in the long run. Four steps can be taken to ensure the gains from these activities are widely shared and to lay the foundation for a more diversified economy going forward.

- First, concession agreements must be negotiated differently than in the past and ensure that the government receives fair compensation Royalty payments should be publicly, transparently, and fully reported, in the spirit of the Extractive Industries Transparency Initiative (EITI). The more transparent the agreements and the revenues, the less incentives for corruption or other mismanagement, and the less appearance that the government is following the patterns of the past of providing sweetheart deals to favored investors. The government's successful renegotiation of the iron ore concession agreement with Arcelor Mittal steel is a huge first step forward in this process.

- Second, Liberia must effectively manage the macroeconomy to mitigate the potential negative incentive effects from natural resource exports on other sectors. It cannot allow the Liberian dollar to become overvalued (if anything it should err on the side of slightly undervaluing the currency). It will also need to keep inflation (and therefore local production costs) under control through prudent monetary and fiscal policies. In other words, it must maintain a real exchange rate that allows firms to be competitive on world markets. Perhaps most importantly, it should follow the example of other successful resource-rich countries like Indonesia, Thailand and Chile and use the funds generated by natural resource exports to finance infrastructure and other investments that reduce the production costs for manufactures and allow them to be competitive on world markets.
- Third, the government must shift away from the old model of large centralized plantation agriculture to models that encourage smallholder production such a through out-grower production schemes or encouraging smallholder, rubber, palm oil, coffee and cocoa production. Moving in this direction is critical to creating jobs and building a more inclusive rural economy.
- Fourth, concession agreements can *directly* help finance roads and other infrastructure that can reduce production costs for other sectors and help them become competitive. There are two ways to do this:
  - Royalty payments paid to the government can help finance investments in infrastructure and health and education programs.
  - As part of most concession agreements, concessionaires should be required to build roads, schools, and other infrastructure in areas surrounding the concession. This should include not only the direct roads that support the concession, but feeder roads off of the main routes to support local economic activity in nearby villages. This approach will provide an important non-debt method to finance infrastructure investments, and will introduce private sector capabilities to expand the national capacity to build infrastructure beyond the limited capacity of the Ministry of Public Works.

3. Creating a favorable business climate. A third important action will be to establish a business environment that keep production costs low and does not inhibit production (especially for key inputs such as cement and capital goods). It is critical that Liberia take advantage of the period of rebuilding to establish a climate for investment in manufacturing in services over the medium term, even if many of those investments may not materialize until after the UN peacekeepers depart.

One important way to keep manufactured exports competitive even in the context of natural resource exports is to aggressively reduce red tape and unnecessary regulation. Unnecessary restrictions and delays only add to business costs, which reduced investment, exports, and the wages that firms can pay. Experience from other countries shows that smooth customs clearance and port facilitation are particularly crucial for exporters. Unnecessary restrictions on imports or price controls (such as on cement) should be removed.

In addition, Liberia must revise its outdated tax and investment codes in ways that balance the need for revenues with the need for economic efficiency, vibrant private sector growth, and competitiveness. This implies moving over time towards lower tax income tax and duty rates with a wider tax base, combined with strong and fair tax administration. As a first step, the structure of import duties and taxes should be reviewed and appropriately revised. Over time taxes should shift away from import duties and towards a consumption tax, probably a value-added tax. Manufactured exports must have access to duty-free imports of inputs, and the tariff rate on imported capital goods should be low or even zero. With an appropriate tax structure in place, tax holidays and special tax treatment will not be necessary.

Essentially every developing country that has been successful in establishing labor intensive exports over the last 40 years has done so by establishing some sort of enclave for producers where they can compete on world markets.[5] The prototype enclave is an export processing zone, but bonded warehouses and duty exemption systems have also been used. The basic rationale is that no country can fix everything at once that raises business costs – infrastructure, red tape, tariff rates, etc – and an enclave provides a temporary platform from which firms can compete at lower costs and compete on world markets. Thus, for Liberia to be successful in manufactured exports, it should develop over the medium term one or more well-functioning export processing zones or similar enclaves to provide firms a platform to produce competitively for world markets.

4. Developing Strong Education and Training Programs. An entire generation of Liberians has spent more time at war than in a classroom. Over the medium and long-term, Liberia will need to rebuild its education and training programs to provide today's workers and future graduates with the skills they need to become productive members of the workforce. This will require a combination of literacy training, technical training for skills in specific sectors, and rebuilding the formal education system. This change will take a generation, but the government is already off to a strong start by re-opening schools and substantially increasing school enrollments.

[5] See Steven Radelet and Jeffrey Sachs. 1997. "Reemerging Asia." *Foreign Affairs* Vol. 76 no. 6 (November/December), pp. 44-59.