



PAN AFRICAN CAPITAL GROUP, LLC

Outlook Note
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Liberia – Commercial Debt Payment Finalized

On April 16, 2009, negotiations with the holders of the Republic of Liberia's \$1.2 billion commercial debt were successfully concluded, resulting in a payment of \$38 million, or 3 cents on the dollar, for nearly all* of the outstanding commercial loans. The World Bank funded half of the agreed amount, while the governments of the United States, United Kingdom, Germany, and Norway contributed the remaining amount required.¹ President Ellen Johnson Sirleaf's government has worked towards this goal for three years and is now on the brink of achieving the benchmarks for the IMF led Highly Indebted Poor Countries (HIPC) Initiative which will cancel the majority of the remaining \$1.7 billion of outstanding debt.

Upon taking office in 2006, after decades of civil conflict and economic mismanagement, the current government faced a crippling debt burden of \$4.9 billion, equivalent to over 700% of GDP.² This debt buy-back follows on the heels of official forgiveness of multilateral and bilateral debt that has been negotiated over the past two years. Advising for the GoL on its economic and debt issues has been the Center for Global Development Senior Fellow Steve Radelet, who has strongly championed Liberian debt relief in Washington, DC and Europe.³ In addition, the advocacy of financial luminaries such as George Soros and celebrities like Bono have highlighted the

* Holders representing 2.5% of the Liberian commercial debt did not participate in the rescheduling.

¹ ["Liberia Cuts Foreign Debt by \\$1.2 Billion," Wall Street Journal, 17 April 2009.](#)

² ["Liberia Financial Sector and Investment Review," Pan African Capital Group Research Note, June 2008.](#)

³ ["Liberia Cuts its Debt with \\$1.2 Billion Buy-Back at 97 Percent Discount," Steve Radelet, Center for Global Development, 16 April 2009.](#)



Liberian President Ellen Johnson Sirleaf announcing the debt buy-back with World Bank President Robert Zoellick.

widespread support Liberia has received from the international financial community and wider public in its negotiations for debt cancellations. The resolution of its debt burden significantly brightens the economic outlook for the West African nation.

For Liberia this is an important step towards legitimacy in the international arena. This benchmark solidifies the progress made since the election of President Ellen Johnson Sirleaf and will hasten its return to the world stage. In the medium term this is critical step towards access to the international financial system to support much needed improvements in the local financial infrastructure. However, a number of important steps must be taken to build upon the debt relief for Liberia to be a qualified participant in the financial arena and attract greater foreign direct investment. These macro-economic steps include improving the local financial infrastructure, the judiciary, the tax code, and the insurance industry, as well as establishing a track record of creditworthiness, leading to a sovereign credit rating.

Lowering the Cost of Capital

Liberia has been unable to raise sufficient capital for reconstruction and development efforts geared towards its economic revitalization due to the stranglehold of its debt burden. With its

commercial debt burden now resolved, the country is on track to meet the requirements to qualify for HIPC debt relief in the next 8-12 months. Once completed, the remaining \$1.7 billion in Liberian debt will effectively be resolved and the country will be better able to access credit at reasonable terms for large infrastructure programs that are the key to its reconstruction. When Liberia has established a track record of creditworthiness, financial partners will continue to reduce the Liberia risk premium accompanying debt to fund its reconstruction.

External Debt Profile (in \$ millions)				
Sourced from the Liberian Ministry of Finance				
		Jun-07	Apr-09	Post-HIPC
Multilateral Debt				
	IMF	809.2	858.0	0.0
	World Bank	442.6	70.2	0.0
	AfDB	271.3	28.4	0.0
	BADEA	19.1	19.8	19.8
	OFID	25.2	25.2	25.2
	IFAD	25.1	26.2	26.2
	ECOWAS	5.0	5.0	5.0
	EIB/EU	21.7	19.4	19.4
Total Multilateral		1,619.2	1,052.2	95.6
Bilateral				
Paris Club*				
	USA	393.6	0.0	0.0
	Germany	387.3	40.2	0.0
	Denmark	29.2	0.0	0.0
	Netherlands	42.7	41.7	0.0
	Norway	43.3	3.6	0.0
	Italy	77.4	0.0	0.0
	Japan	128.2	157.7	0.0
	France	223.4	208.0	0.0
	Belgium	45.9	44.9	0.0
	United Kingdom	50.6	5.1	0.0
	Sweden	30.3	10.0	0.0
	Finland	2.7	2.7	0.0
	Switzerland	2.7	2.7	0.0
Total Paris Club		1,457.3	516.6	0.0
Non-Paris Club				
	China	16.2	5.1	0.0
	Saudi Arabia	27.2	27.2	27.2
	Kuwait	11.3	12.2	12.2
	Taiwan	75.1	75.1	75.1
Total Non-Paris Club		129.8	119.5	119.5
Total Bilateral		1,587.1	636.1	119.5
Commercial				
	Financial Institutions	1,340.8	20.5	20.5
	Supplier's Credits	345.6	0.0	0.0
Total Commercial		1,686.4	20.5	20.5
Total External Debt		4,892.7	1,708.8	235.6

*Some of the Paris Club members will maintain some debt holdings with Liberia Post-HIPC, but it is not clear which countries will do this or for what amount.

Many critical and economically feasible projects in the pipeline have been delayed due to credit restriction. These include the construction of power plants and an accompanying power distribution grid, the rehabilitation of ports and

airports, and the completion of roads and bridges. The ability to fund these projects will mark a major step towards economic recovery and job creation that will be essential to long-term social and economic stability.

The local financial infrastructure requires a number of improvements to make these large-scale projects feasible, while also promoting business growth driven by local Liberians. As it currently stands, the difficulty of securing an affordable letter of credit makes importing common staples as simple as rice a daunting process. This is due to a variety of factors, including high insurance premiums and the absence of local credit agencies which will establish credit ratings for both businesses and the government. Improved security at seaports and the airport will decrease the cost of insurance premiums for trade finance and operations in the country, encouraging shipping companies and multi-nationals to take a closer look at Liberia. LCs and other financial products, and especially locally focused financial services will be made more affordable and accessible if a local credit rating is established that will encourage transparency in the market. A local credit rating will also increase the ability of the local financial institutions to manage their loan portfolios, raising the lending capacity within the country.

Establishing these institutions and providing a secure economic environment will enable the fast improving banking sector in Liberia to source larger lines of capital for on lending to the Liberian business community. In the improved situation, the international banking sector is reestablishing its commercial links with the Liberian financial industry. Liberia will now benefit from increased lending for large infrastructure projects while its business community will be able to build their operating platforms with enhanced commercial credit. The results of the commercial debt payment and the HIPC cancellation are two-tiered, with the commercial expansions and government expenditures combining to jumpstart the economy.

Multiplying Foreign Direct Investment Opportunities

Countries with large debt burdens are typically less attractive candidates for foreign direct investment. When Nigeria paid its debt obligations to the Paris Club in 2006, foreign direct investment increased substantially, even when controlling for increases in oil prices and the associated investment in that sector. The largest economic beneficiaries from the national debt reduction were the service industries such as telecoms, transportation, and banking. Admittedly, the financial regulatory environment was unable to keep up with the boom in the financial services sector, but regardless, investment in all sectors of the Nigerian economy increased significantly after the debt was paid down.

A large reason for this was the increase in investor confidence that occurs when a country has demonstrated ability and willingness to work within the global financial infrastructure. Liberia has been demonstrating this commitment for the past few years and is now starting to realize the reward for these efforts in increased foreign direct investment and heightened interest in future commitments to the country. The West African nation serves as the gateway to a very large and resource abundant region with high prospects for growth. As the investment environment becomes more secure, capital flows are increasingly drawn to the high returns offered in the country.

Regulatory Environment Will Improve With Increased Capital Flows

One of the largest obstacles standing in the way of increased capital flows is that of low regulatory capacity. The Liberian economy was previously driven by unregulated underground markets, allowing them to flourish in a country that provided access to the greater West African region. In just a short period of time, Liberia's economy is being transformed from one hindered by illegitimate forces to one driven by legitimate markets. As the country continues to

develop its regulatory frameworks, the financial sector will benefit from increasingly uniform legal mandates that apply to how business is conducted. With an increase in capital available to the government and the banking industry, regulations will necessarily be improved. Lenders require knowledge of industry standards, as well as adherence to these standards. When the country is given access to these capital markets, it will be in its self-interest to promote greater transparency and regulatory certainty in order to retain this access and improve its credit ratings.

The reinforcing nature of increased capital availability with increased regulatory regimes will promote an improved lending and business environment in a country that continues to experience large capital shortfalls. Improved regulations will decrease the commercial risk of lending in the country when lenders are better able to pursue delinquencies and more easily distinguish good candidates for lending from high credit risks. Over the medium term, the cost of capital will decrease and allow for greater economic expansion in the country.

In order to sustain regulatory reform, the Liberian government will also have to implement sound macro-economic policies. One of the most pressing needs is a revision of the current tax policy. The Liberian economy is no longer based on underground market forces, which were un-taxable by their very nature, and legitimate market forces have now replaced them as the main drivers in the economy. With an updated and enforced tax policy, Liberia will be able to expand its revenue collection base while lowering tariffs and gross revenue based tax schemes. Until this issue, along with others, is addressed, the macro outlook for the country will remain uncertain. When the Liberian government, which has been running a balanced budget, can demonstrably manage these aspects of the economy it will have taken the next step in its redevelopment.

Building a National Credit Rating

As Liberia builds its reputation and capacity for credit, it is taking steps towards receiving an independent credit rating. This will not be an immediate result of the debt reductions, but it is a very important step towards the goal of independently assessed creditworthiness of the Liberian government. A reliable credit rating opens up the possibility for revolving lines of credit, and eventually, sovereign bond issues. This may not occur in the near to medium term, but it is a worthwhile goal that should keep the Liberian government on a path towards a strong credit track record.

An example that should be noted is Ghana, which was able to eliminate its debt burdens through HIPC in 2004 and then issued a \$750 million Eurobond in 2007. Ghana is an example of a more advanced case in that it had established a strong regulatory environment built upon many years of structural adjustment programs and heavy investment in public works coupled with foreign direct investment. As a result of the financial crisis, Ghana has experienced some fiscal difficulties, but due to its creditworthiness, it is close to securing a semi-flexible \$1 billion credit facility from the IMF to cover some of its imbalances, and if market conditions improve, we would expect Ghana to tap international debt markets again as the medium-term prospects are strong due to expected oil revenues coming on line in 2011. This would have been impossible if the country had not established itself as a financially responsible and benefited from its credit rating. This demonstrates the importance of countries establishing benchmarks for success, and then adhering to these goals in a transparent manner. Liberia will hold up Ghana as an example of what is possible with sound fiscal management from this point forward.

In the meantime, other countries which have passed the completion point for HIPC such as Rwanda and Malawi have been able to issue local currency bonds. These countries are gaining the required experience and necessary

credit history to issue their own international bonds. Upon completing HIPC, Zambia later issued a small Eurobond (€23 million) through the European Investment Bank. While Uganda and Tanzania had made substantial progress towards issuing bonds for \$1 billion and \$500 million, respectively, before the current financial crisis postponed the floats. For Liberia, the issuance of its own bond is a possibility as long as it follows the proper steps of building its reputation, and when the current financial crisis is over the country will have the tools to enter the international capital markets.

Conclusion

Liberia's commercial debt buy back of \$1.2 billion is a significant step in the revitalization of this West African economy. Liberia has long benefited from a blessing of natural resources, but a curse of economic mismanagement. The country has turned the corner on its past missteps and is quickly becoming an integral economic player in the region. The international community has signaled its confidence in the country by working with it to deal with these past debts, many of them made in less than ideal circumstances and without sufficient due diligence.

With assistance from the World Bank, the IMF, the US, EU, and organizations such as the Center for Global Development, Liberia has worked hard to settle its outstanding accounts. The \$1.7 billion remaining in external national debt will soon be resolved and the country can continue to accelerate its development under its improved credit conditions.

Pan African Capital Group, LLC (PACG) is a US-based investment company focused exclusively on investment opportunities in Sub-Saharan Africa. PACG provides investment banking and advisory services, asset management, and private equity across the region. The firm is primarily focused on the financial services, telecommunications, manufacturing, and agribusiness sectors, and manages a diversified private equity portfolio.

Most recently, PACG, alongside partners Databank (Ghana) and Trust Bank Limited (The Gambia), acquired majority control of International Bank (Liberia) Limited, Liberia's oldest commercial bank and the preeminent business-focused financial institution.

PACG and its affiliates maintain a nexus of offices throughout West Africa and have strategic alliances in East Africa, North Africa and the United Kingdom.

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