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MONEY AND BANKING SYSTEM IN LIBERIA AND THE CASE FOR A CENTRAL BANK.

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1. Sterling was legal tender in Liberia until after the second World war, when U.S. dollars up to $20 notes replaced sterling as legal tender. One of the commercial banks is responsible for importing and distributing the currency. In 1966 $1.5 million of Liberian coins in denominations up to $1 were sold by the Treasury to the banks, another $0.8 million of Liberian coins were issued in 1968. The U.S. coins have gradually gone out of circulation and bankers tody estimate U.S. coins to make up for only 3-5 percent of coins in circulation. The issue of Liberian $1 coins has however not put U.S. $1 notes out of circulation.

Seven commercial banks operate in Liberia. One bank is an independent Liberian bank, although 49% of the capital stock is owned by an American holding company. One bank is a branch of an American bank, the other five subsidiaries of foreign banks. American banks or holding companies holds a major, if not complete interest in five of the seven banks, the other two are owned by Lebanese banks. The oldest of the existing banks was established in 1935, the other six came into operation after 1955. Four of the commercial banks have all together 10 branches outside Monrovia.

There are considerable differences in the operational structure and activities of the banks. In some cases the combination of activities is unusual and would not be acceptable in most countries with a more advanced banking system. A fluctuating "Offshore" business is important activity of some of the banks. Finally one of the banks, beside being responsible for providing the other banks with cash, also handles the Governments' accounts and provides an overdraft facility to the Government of up to $4 million.

The following table gives figures for some of the more important banking series over the last five years and should in principle exclude "Offshore" activities not related to bank operations in Libera.

However, it must be borne in mind that aggregate figures are of limited value in characterising the structure of the Liberian commercial banking system because of the differences between banks in important aspects of their operations.

From 1964 to 1968 the gross National Product within the monetary sector, excluding depreciation on foreign owned capital, appears to have increased with approximately $40 million - $50 million. In the same period loans to the private sector increased by less than $2 million, and private deposits probably increased by $4 million.

Table I SELECTED INDICATORS IN BANKING

1964 - 1968

(million dollars)

Item	31/12/64	31/12/65	31/12/66	31/12/67	31/12/68
Cash................	3.1	3.3	5.0	(3.8)	-
New series*				3.7	2.8
Loans to Private....	20.8	18.2	17.8	20.1	22.6
Loans to Government	16.7	19.7	19.9	22.5	21.8
Capital and Reserves	5.9	5.9	4.3	5.8	5.9
Private Deposits	24.4	24.4	26.6	(27.7)	-
New series				26.1	27.6
Government deposit..	3.2	6.0	5.4	13.2	11.0
Net foreign loans...	11.5	8.6	10.2	(5.8)	-
New series........				7.3	9.9

*Changes in the reporting system in 1967 makes comparability with previous years difficult. Figures in brackets are estimates of comparable figures.

During the same period Government's revenues rose by approximately $10 million or 25%. Loans to Government minus deposits decreased by $3 million and Government overdraft facilities remained constant at $4 million. Such a relationship between the growth of the economy, Government's activities and banking activities must be fairly unique to Liberia.

With some important modifications the Liberian monetary system functions as a 100% reserve system. The most important modification is that the banks can to some degree finance an

overall deficit in the balance of payments by drawing on their overdraft facilities with parent banks abroad.

This has also been done in the past, but when there is a deficit, one year, a surplus is usually created the following year through credit contraction and transferred back to parent banks. (See Table II).

If one consider the Liberian banks overdraft facilities with parent banks as a sort of a foreign exchange reserve to Liberia, the net effect over the last five years had been that the Liberian banking system has supplied the foreign banking system with $1 million as table II shows. It is therefore a somewhat special typed of foreign exchange reserve.

2. The money and banking system in Liberia has recently been the object of two studies by consultants of the Harvard Advisory Group. After survey of the money and banking system in Liberia, Dr. G. Maynard submitted his report to the Department of Planning and Economic Affairs in April 1967. The purpose of the study was to sketch out the operation of the Liberian commercial banking system and to identify the main problems and policy issues for a more detailed investigation later in the year. The ultimate object was to appraise and to suggest improvements in the functioning of the monetary system.

The second study was made by Professor J.S.G. Wilson, who submitted his report to the Department of Planning and Economic Affairs in September 1967. Professor Wilson's report falls into

The following table gives the cash flows between the foreign banking sector, the Liberian Banking, the Government and the private sector.

CASH FLOWS

	Foreign Banking		Liberian Banks		Government Sector		Private Sector		Mixed, Goverment, Private & Foreign		Errors	
	Rec'd from Liberian Banks.	Transfd to Liberian Banks.	Recd from Other Sects.	Transfd to Other Sectors.	Rec'd from Liberian Banks	Transfd to Liberian Banks	Rec'd From Lib. Banks.	Transfd to Lib. Banks	Rec'd From Lib. Banks.	Transfd to Lib. Banks.	Rec'd	Transfd
1964		2.1		0.5		1.3	2.5		2.5			0.1
1965	3.0		0.1		1.1			3.0		3.0		0.4
1966		1.7	3.3		0.8			2.6		2.6	0.5	
1967	4.4			2.7		5.2	1.2		1.2			0.3
1968		2.6		0.7	1.5		1.0		1.0		-	-
TOTAL 1964-68	1.0			0.5		3.1		0.9		0.9		0.3

The mixed sector was necessary to introduce in the table because "Other Assets" and "Other Liabilities" in banking statistics before 1968 was a mixture of Government, private and foreign.

two main sections. The first section describe the banking structure and the types of business undertaken by the commercial banks, including the special role played by Bank of Monrovia as banker to the Government. The second part relates to policy recommendations with a view to the further development of banking and financial institutions in Liberia.

3. Dr. Maynard in his appraisal of the banking system in Liberia points out that the banks' overdraft facilities with their parent organisations enable them to increase their local lending over and above increases in deposits and that in fact the banks have done so since 1961. He goes on to say that "the ability of larger banks to move funds and currency in and out of the country according to needs means that in effect the banking system automatically finances deficits and surpluses in the Liberian balance of payments. In other words, the fact that Liberia does not have a national currency but uses the U.S. dollar, does not necessarily imply that the domestic money supply adjusts rigidly and passively to the balance of autonomous items in the balance of payments. The banks can maintain their local loans, despite a loss of deposits occasioned by an autonomous balance of payments deficit, by increasing their borrowing from parent organisations. The real foreign exchange reserve of their Liberian economy is not therefore the amount of U.S. currency in banks or in circulation, but the willingness of the commercial banks to accommodate."

In principle this is correct, but the period Dr. Maynard was reviewing was a period when most of the banks were new and establishing themselves, and the first part of this period was a boom period. Since 1964 the "willingness of the commercial banks to accommodate" has for the period as a whole been negative, as shown in table II.

As far as the question of a central bank is concerned, Dr. Maynard concludes with the following statement:

Given the importance of foreign capital in Liberia economic development (the inflow of which has undoubtedly been encouraged by the stability of the currency and the monetary system, derived from adherence to the U.S. dollar), and the fact that the room for effective short run stabilisation policy is limited at the present time by the very unbalanced nature of the economy, the balance of the argument would now seem to be against the setting up of a central bank with full powers of note issue. This does not mean to say that measures should not be taken, and institutions set up, to provide some government influence over the monetary and financial system. The government clearly has interest in:

(a) the stability and solvency of the financial system; and

(b) the amount and distribution of bank credit and medium and long term capital, in the interest of Liberian economic development."

In order for the Government to have some influence over the monetary and financial system Dr. Maynard suggest however that:

"the establishment of a Money and Credit Committee (representing government, banking, financial and - possibly - industrial interests) backed by a small technical staff. The functions he envisaged for it included statistical collection, analysis of monetary developments, guidance of bank lending operations, advice on banking regulations, and the training of personnel in banking expertise."

He also suggest that the committee might be responsible for:

Managing a reserve fund subscribed to by banks and to other financial institutions, the purpose of which would be to provide discount facilites for member institutions providing loans for purpose approved by the committee;

making fiduciary issues of notes (small denominations) and coins, the proceeds of which would be incorporated in the reserve fund or for any other approved use.

4. Professor Wilson on the other hand seems to favour the establishment of a central bank but without power to issue notes. He argued that there is no necessary connection between the issuing of a national currency and the setting up of a central bank. He finds proof for this in the fact that national notes have been issued prior to a central bank coming into existence in many instances and states that there is no logical reason why the reverse should not be true.

Alternatively he suggest the creation of the post of commissioner of banking which presumably in substance is very much the same as Dr. Maynard proposal. With a gradual development of a central bank without authority to issue note Professor Wilson believe that the money market will begin to develop and that the central bank in this way "would be given the opportunity to grow up with its own financial community. On this basis understanding and cooperation is likely to be closer, making it easier for the

central bank in the course of time to develop moral authority which will enable it to exercise moral suassion."

It is true that it has been possible to develop a well functioning money and credit market system in many of the previous British colonies in Africa more based on cooperation between the bank and the local administration than anything else, but this was hardly based on the local bank managers sensitivity for the moral standard of the local authority dealing with banking and money matters whatever institutional forms it was given.

The local administration could always through the Colonial Department in London tell the managers of the local British Banks to fall in line.

5. Underlying the objections against an independent monetary system and a central bank with full central banking authority are first of all the assumption that the Liberian Government would be tempted to mis-use fiduciary issues to cover budget deficits. Professor Wilson goes even further and argue that there is a lack of confidence in the Liberian Government's financial responsibility that would have to be overcomed through prompt payment of foreign debt obligations for several years to come before the issue of a local currency would be met with required confidence. It is assumed that a basic condition for the success of the "open door" policy is the use of a freely convertable currency in which foreign investors have a maximum of confidence. A Liberian currency not being met with necessary confidence will force the Government

to introduce currency control to stop capital flight. This would destroy the favourable investment climate, even if the Government showed necessary discipline in the use of fiduciary issues. Professor Wilson is also concerned with the lack of "backing" of a Liberian currency and operate with what he calls an economy" virtually without foreign exchange reserves, except in a negative sense."

Professor Wilson makes it an important issue that the only way in which investors can be reasonably sure of being able to move their capital freely out of the country is the use of U.S. dollar as local currency.

He consider this an important incentive for investors to re-invest their profit. It is also a really unique situation, that the U.S. dollar can move more freely out of Liberia than of U.S.A.

Another type of objection against creating a central bank with full central banking responsibilities is that the successful creation of a central bank would mean increased demand for those administrative and technical skills which are in such short supply that their shortage is one of the major bottlenecks inhibiting Liberian development. Creating the central bank to undertake operations today carried out by the Treasury and one of the commercial banks would likely mean a decrease in the efficiency of those operations in the formative years of the bank.

6. The financial difficulties of the Liberian Government were created in a period when Government revenues increased from $1 million to $40 million in less than 15 years. The fact that the

Liberian Government was unable to upgrade and expand the administrative and institutional setup quickly enough to meet this entirely new situation should not surprise anyone. Since 1963 the Government has been able to reform its budgetary procedures, improve its tax administration, expenditure control and debt management to such a degree that it has been able to observe in letter and spirit all the obligations it undertook in 1963 in connection with the IMF standby agreement.

Since 1964 the Government has been able to increase revenues from $40 million to $60 million in spite of an extremely unfavourable development of prices of Liberia's main export commodities.

Not only has Liberia been able to increase revenues by 50% during this period of unfavourable price developments but the trade surplus has increased from $15 million in 1964 to $60 million in 1968.

A possible independent Liberian currency would be 100%, backed by U.S. dollars. With a trade surplus in 1968 of $60 million, despite depressed commodity prices, Liberia can now hope for substantially higher prices on rubber, its second most important export commodity. New exports are now finally coming into the picture, like fish and timber.

One might question how many central banks established during the last 10 years were able to issue their currency with a better "backing" in the initial stage and a better prospect for creating currency reserves in the future.

The argument that the use of the U.S. dollar is essential to the investment climate is highly questionable. It might have made it easier for the foreign concessionnaire type of investors to decide to go to Liberia in the early fifties but not today. The large concession type foreign investment of extractive nature goes anywhere where deposits are easily accessible, if they can get satisfactory agreement with the Government on taxation and have a reasonable guarantee of not being nationalized in the near future. Statistics on private investments in developing countries show no correlation at all between stable local currency and level of foreign investments. It is very likely that large scale mining operation will start up in Guinea in the nearest future, just to mention one example of the lack of relationship between free convertibility, stable currency and this type of private investments. During the construction period over-evaluation of local currency may be a disadvantage for investors, but when in operation, earning is done in other currencies. A weak local currency would then usually give the concessionnaires a strong bargaining position with the local government.

The argument about the advantage of a strong and fully convertible local currency is however more relevant if the policy is to attract foreign investors for the purpose of establishing processing industry for the local market. In that case it can be a special advantage to use an over-valued currency such as the U.S. dollar. The same would also apply if the policy is to

attract foreign investors in wholesale and retail trade. Serious objections can however be raised against making the attraction of this type of foreign investor a priority aim in the economic policy of Liberia. The incentives that have been necessary to attract investment in processing industry for the local market represent in fact in many cases subsidies of such a magnitude that there are good reasons to question the rationality of this policy.

Private foreign investment will not play any important role if rural development and increased cash crop production, both for local and export markets is to have priority. Such a development will first of all depend on public support and a credit market organized in a way that it is more instrumental to rural and agricultural development than to investments in the Euro-dollar market.

One of the arguments of the Prophets of doom is that the introduction of an independent Liberian monetary system would lead to a heavy capital flight. This is however overlooking the fact that there is currently a capital flight to the maximum of what the banks are willing to finance. Only if the banks are willing to increase credit to the private sector during the period of transition from one currency to another would there be any substantial increase in capital flight. There is, however, one important reservation. Capital flight could be financed without the assistance of the banking system through a decrease in cash holdings. If the capital exporters

want to continue their business in Liberia there would however be narrow limits for how much they can run down cash as long as the banks do not increase local credit. Again the banks can only increase their local credit to any substantial degree if parent banks are willing to accommodate with overdraft facilities. It would be in the interest of all the commercial banks in Liberia to cooperate with the Government during the transition period to avoid that the bank finance increase capital flight.

It is of course true that shortage of skilled manpower is one of the main bottlenecks in the upgrading of the civil service administration. Far from making this problem worse the creation of a central bank could be an important tool in improving the financial administration of the Government. A central bank could be created without having to follow the existing patern of the civil service. Most central banks have their own salary scale and rightly so. The use of expatriate staff in executive posts is more acceptable for a central bank than a regular department. A central bank taking over the management of Government accounts could recruit its semi-skilled staff from the commercial bank handling these accounts today. A central bank would naturally take over some of the activities for which the Treasury is responsible today. The central bank would have all possibilities of handling this affairs in a more rational way than the Treasury can, since it would not have to work under those rules and regulations of the civil service which

today obviously are an obstacle to good administration, but difficult to change in the nearest future.

7. The creation of a central bank with an independent monetary system would first of all have the obvious benefit that the U.S. currency now in circulation could be invested, and with the present interest rate on Euro-dollar market give a return which probably would cover the cost of creating a bank and issuing notes. With the establishment of a central bank the Government would be able to get away from a situation where it is paying one of the highest, if not highest interest rate any Government in the world pays for a short term borrowing. (New York prime + 1½%).

The Government has a reputation for being a slow payer because revenues and expenditures no more in Liberia than in any other countries in the world are balanced from day to day. With the establishment of a central bank as the Government banker, the Government could get out of the impossible situation it is today when it only can pay bills when it has receive revenues in spite of balanced budget. In the present situation the business community naturally charges the Government higher prices than the private sector, while it ought to be the opposite.

The establishment of a central bank with the power to conduct all usual central banking activities is the only

way in which Liberia can get in control with the operation of a banking system and start building up a more comprehensive credit market. Professor Wilson's and Dr. Maynard's suggestions would not have much of a chance to work in an independent country where all the commercial banks are owned by big foreign banks. Without giving the central bank all the usual functions there would be little the bank could do to develop a monetary policy more suitable to Liberian condition than the existing monetary system.

Without full sovereignty over its own monetary system, Liberia will be unable to defend itself against changes in the exchange rate of the currency of other countries which might have a direct impact on Liberian economy. With the present structure of Liberia's exports the recent devaluation of the CFA franc was not very important for Liberian economy. Should, however, Liberia succeed in developing agricultural products for export to European market a similar situation could be very harmful if Liberia was without any sovereignty over its own currency. It would be stressed in this connection that the freedom to change the par value of the country's currency is not inconsistent with the Open Door Policy nor would it endanger the investment climate for those foreign investors Liberia so far has succeeded in attracting.

A large part of the foreign aid is given on the condition that the local cost should be covered by the receiving country.

There is a lot to be said in favour of a technique were, were foreign aid is given in kind and the receiving country met the local cost through fiduciary issues. In the case of Liberia the local cost has in fact to be met with foreign currency. This limits the effect of this type of aid, and restrict Liberia's ability to accept this type of aid.

Finally, without an independent currency Liberia has no possibility to improve its position with the International Monetary Fund above the gold tranche by making its currency available for purchase by third members during years of surplus. In recent years there has been a trend towards the use of currencies of developing nations in IMF operations. As a major world supplier of such basic commodities as rubber and iron ore a Liberian currency should be very suitable for Fund Operations. Even if no oil should be found prospects are that Liberia in a not too distant future may find itself in a position where creating a "super tranche" would be possible if an independent currency existed.