Case Study of Liberian Economic Growth: Pertinent Lessons for Developing Countries

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16 March 2009

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Abstract

Liberia has been the victim of 14 years of civil war due to which GDP experienced a downfall by over 90% making the economic growth process halted. This paper traces the extent of Liberia's collapse, and examines the patterns of post-conflict recovery as a model which can be followed by other conflict confronting developing countries. Paper explores the challenges faced by Liberia in strengthening rapid, inclusive, and sustained economic growth and how these challenges were converted into opportunities through institutional process. It examines the policy framework and institutional reforms which set the pace for sustainable economic growth in Liberia. Because of these steps, the economic growth, which was very low before 1999, showed positive improvement. In 2003 there was 32% increase in economic growth, but that growth has now been pushed up by at least 4.8% further. Overall this paper presents an excellent study to understand the challenges of economic growth and mechanism for its revival in poor and developing countries.

Keywords: Economic, Growth, Policy, Development, Infrastructure, Production, Natural, Resources.

1. Introduction

Liberia was decimated by 25 years of economic mishandling 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 neighbouring countries. Families were shattered; entire communities were uprooted; and social, political, economic, and governance systems were destroyed. Commercial and productive activities collapsed due to the bad law and order situation. GDP fell by over 90% in less than two decades which has been termed as one of the largest economic collapses in the world since World War II [1]. However, after election in 2005, Liberia's nightmare is relatively over. The new government is introducing a broad set of policies to foster peace, launch reconstruction and development, and build strong systems for governance [2].

One of the most critical issues for Liberia's recovery was 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 [2].

2. Literature Review

Liberia is Africa's oldest republic in West Africa; it became better known in the 1990s for its long-running, ruinous civil war. Liberia is situated in West Africa, bordering the North Atlantic Ocean to the country's southwest. It has Guinea in the north, Sierra Leone in the east Cote D' Ivory in the West and North Atlantic Ocean in the south. It lies between latitudes 4° and 9°N, and longitudes 7° and 12°W. The landscape is characterized by mostly flat to rolling coastal plains that contain mangroves and swamps, which rise to a rolling plateau and low mountains in the northeast. Tropical rainforests cover the hills, while elephant grass and semi-deciduous forests make up the dominant vegetation in the northern sections. The equatorial climate is hot year-round with heavy rainfall from May to October with a short interlude in mid-July to August.

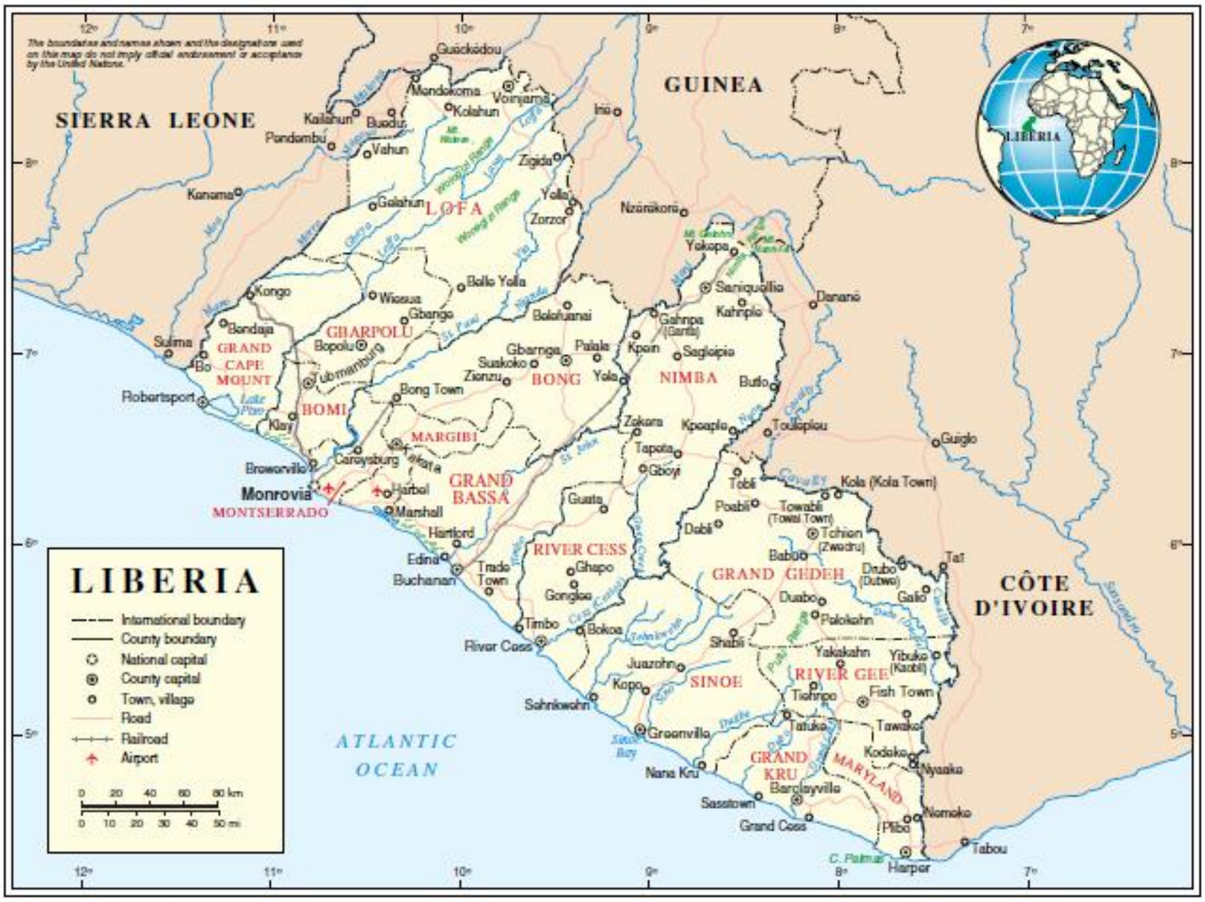

Figure 1: Map of study area, Liberia

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. Political power was concentrated essentially in the capital city of Monrovia, 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. 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 [3].

Samuel Doe's April 1980 coup 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 14 years civil war. Liberia's GDP began to decline after the 1980 coup, and collapsed after the beginning of the war in 1989. GDP dropped by 90% between 1987 and 1995. The violence reached extreme levels in 2002 and 2003 until the peacekeepers arrived in mid-2003 [4].

As the Liberian economy imploded, poverty increased sharply, and more than 75 % of Liberians now live below the poverty line of $1 per day. Unemployment and underemployment was high, returning refugees and internally displaced persons were struggling to find work. Refugees returning to their farms faced a lack of seeds, fertilizers and tools. 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 % of school buildings were partially or wholly destroyed. A whole generation of Liberians has spent more time at war than in school [4].

The war left basic infrastructure in ruins. There was no electricity or piped water anywhere in the country for 15 years after 1991. Many roads became impassable which weakened economic activity and undermined the delivery of basic health and education services [4].

Exports ceased entirely, dropping to about $10 million in 2004. 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 [4].

Agricultural production dropped as people fled their farms. Production of iron ore, timber, and mining ceased completely. Electricity and water fell by 85%. Transportation and communication, trade and construction all fell by around 70% [4].

3. Four Pillar Model

The new government faced the daunting task of rebuilding Liberia from the ashes of the war. Many tasks were to be handled simultaneously which was not possible. A focused and coherent approach was required to tackle essential core issues of economic rebuilding. A simple and straight forward prioritization was done and thus, the government worked out a strategy organized around a framework with four basic pillars [5].

- Establishing law and order.
- Revitalizing economic activity.
- Strengthening governance.

- Rebuilding infrastructure and providing basic services.

A decentralized working approach was adopted for all the four pillars. Separate group was formed for each pillar which consisted representatives from relevant government ministries and departments alongside key donors and UN agencies. Each group was given specific mandate and goals to achieve. Monitoring of progress of each pillar group was inbuilt in the working mechanism. The cumulative progress of all the groups reflected a great improvement within short period of time. The model is described in Figure 2.

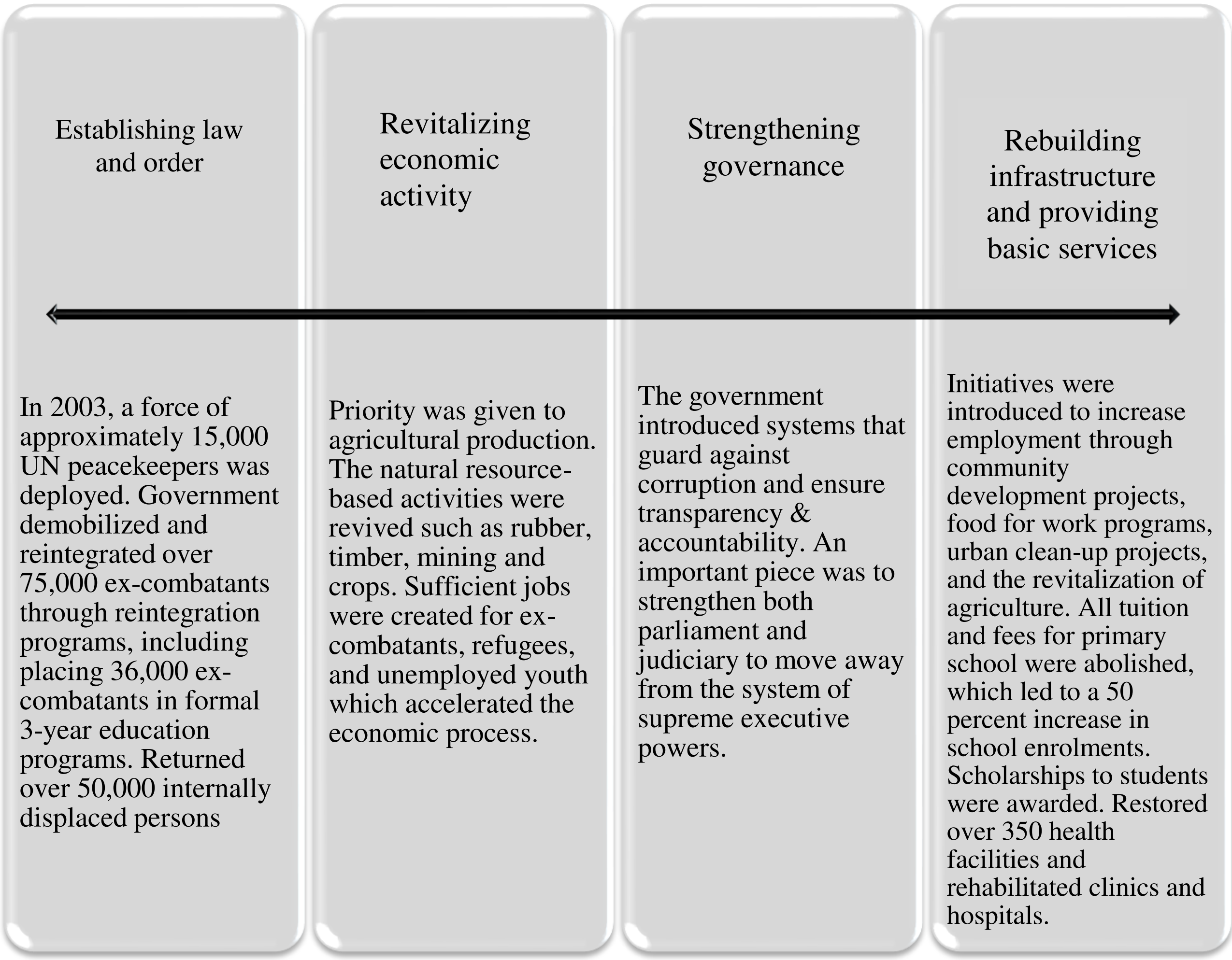

Figure 2: Four Pillar Model of Liberia

4. Comparative Analysis

The most important issue for Liberia was to achieve rapid, inclusive, and sustainable growth. Let us examine the patterns of post-conflict growth in other African countries. The experiences of Uganda (after 1986), Ethiopia (after 1991), Mozambique (after 1992), and Rwanda (after 1994) provide some indications of what might be expected in Liberia. Sierra Leone (after 2000) and the Democratic Republic of Congo (DROC) provide more recent examples of recovery [5]. While each country is different, some clear patterns emerge. Three broad patterns are evident:

- First, GDP contracted sharply infinal years of the crisis in each country [6].
- Second, once the conflict ended, growth rebounded relatively quickly within two years. This rebound is not surprising because 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 [5].
- Third, these countries were able to sustain relatively rapid growth for more than ten years, generally fluctuating between 6 - 9% per year [6].

The patterns and timing of recovery differed across various sectors. Services were the first to recover, with growth jumping to an average of 6% 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 typically remained at around 5 - 6%. Agricultural growth started somewhat slower, but continued to accelerate, reaching an average of 4%. Manufacturing was the slowest to rebound, but generated the fastest growth over the medium term. The manufacturing sector continued at 11% most of the years [7].

5. Challenges for Generating Sustainable Growth

Liberia was to capitalize on its peace and good will to build a positive, reinforcing cycle between peace, stability, investment, and growth. Thus, the first challenge for Liberia was to rapidly revitalize economic growth.

Liberia could not depend on the economic and political structures of the past that led to widespread income disparities, economic and political marginalization, and deep social cleavages. Thus Liberia’s second challenge was to create much more equitable and inclusive economic and political opportunities for Liberians and not for a small elite class. Economically, more equitable and inclusive growth required a more robust agricultural sector and eventually labour-intensive manufactured and service exports that create large numbers of jobs for low-skilled workers. Creating jobs for low-skilled workers, especially youth, through new private sector opportunities or employment programs was central. Politically, Liberia built transparency and accountability into government decision-making, and created stronger systems of checks and balances across all branches of government.

The third challenge was to make growth sustainable. Liberia has a rich resource base, including timber, ore, rubber, and 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 could not rely solely on these activities, since very few developing countries that have relied heavily on natural resource exports and extractive industries have achieved sustained economic growth.

The most successful developing countries have relied more heavily on labour-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. Labour-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, among others.

Liberia has the potential to create a similar diversified economy and join the rapid and sustained growth of these other countries. 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.

6. Phases of Liberia's Growth Recovery

The process of restoring economic growth in Liberia involved three broad phases which are shown in Figure 3.

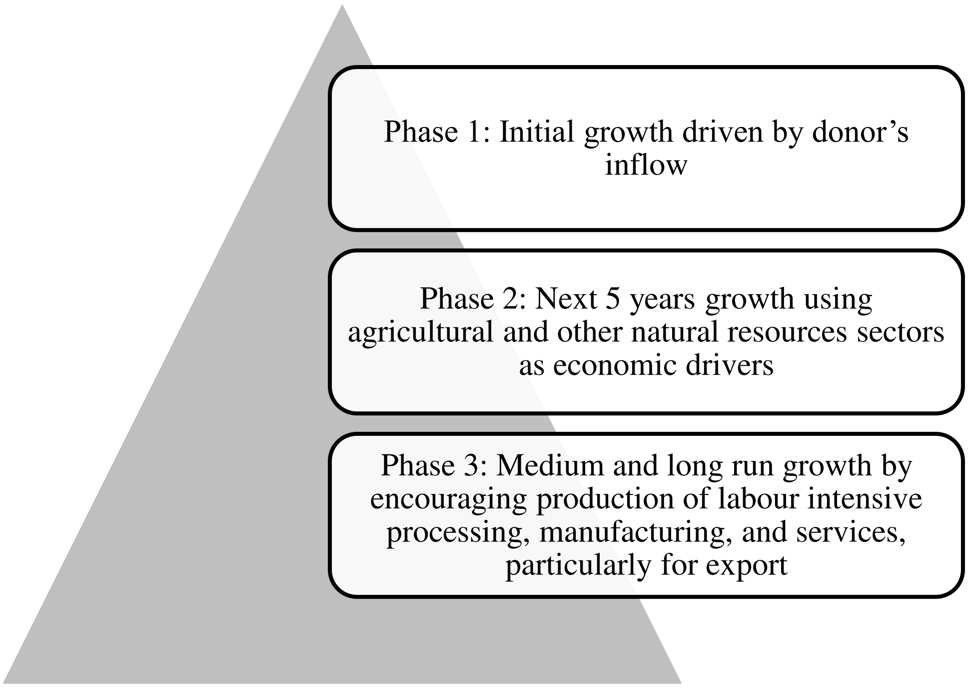

Figure 3: Three Phases of Liberian Economic Growth

Phase I: Growth in the earliest years was driven mainly by donor inflows and a rebound in urban services. An initial revival in agriculture along with some limited manufacturing and programs aimed at direct employment creation (e.g., small public works projects) was emphasized.

- In services, construction has been a key driver of growth and is likely to continue to be in the near future as buildings, roads, and other infrastructure are repaired and rebuilt.
- Within manufacturing, production of beverages has rebounded quickly. Production of cement increased in 2005. Making cement widely and easily available, was critical to ensuring continued rapid reconstruction in the next several years [8].
- Agricultural production expanded. Rubber production (which accounts for 10 percent of GDP) showed signs of recovery. Agricultural production remains constrained by poor roads and uneven availability of key inputs. The IMF estimated growth in 2006 at 7.8% and is projecting 9.4% growth for 2012 [9].

Phase II: During the next five years or more as both peace and the economic recovery were consolidated, the primary economic drivers were agricultural and other natural resources sectors, supported by continued growth in urban services. Construction played a key role, both in terms of immediate growth and to help lay the foundation for sustained growth thereafter. Manufacturing activities accelerated, particularly those based on natural resource products. UN peacekeepers helped maintain security (and boost the economy through the finances that support them).

- 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 were signed. However, once again, growth in these sectors could be constrained by poor roads and other infrastructure.

- Iron ore, diamonds, and other mining activities began 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 continued 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 was to encourage production of labour intensive 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 jewellery, 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 were 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..

7. Key Policy Actions

To meet the challenges of achieving rapid, inclusive, and sustained growth, Liberia took advantage of the near-term opportunities from agriculture and natural resource based activities and established the foundation for diversification into processing downstream products, other manufacturing and service exports over time. Doing was not easy, as Liberia starts from a basis of destroyed infrastructure, a legacy of deep social divisions, limited finances, and weak implementation capacity. Success was achieved through clear prioritization, getting some basic choices right, and strong support from the international community.

The government and donors avoided 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 made had both economic and political implications, as they provide the foundation for different kinds of opportunities for the traditional elite and historically marginalized groups.

To achieve these goals, four sets of actions stood out as key priorities to accelerating economic growth the same is shown in Figure 4.

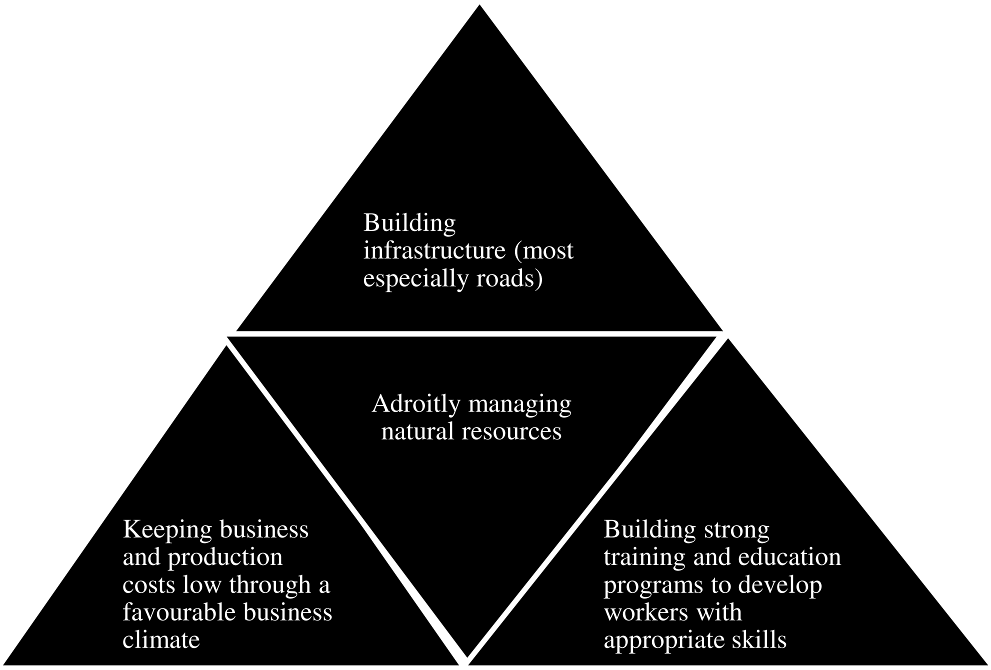

Figure 4: Key Priorities for Accelerating the Economic Growth

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 were 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 such as maintaining security, connecting farmers to markets, creating jobs, opening concession areas, reducing costs for manufacturing, effectively delivering basic health and education services. Roads are essential for reducing rural poverty, as they allow rural consumers to buy goods more cheaply and open new markets and economic opportunities for farmers and other rural producers. 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 18 personnel. 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. Ports are nearly as central as roads, since they are the connection between Liberian markets and the rest of the world. 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.

It was envisaged that 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 overdependence on this sector risk undermining the incentives for manufactured and service exports that are even more critical in the long run. Two 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, Liberia must effectively manage the macro economy to mitigate the potential negative incentive effects from natural resource exports. In other words, it must maintain a real exchange rate that allows firms to be competitive on world markets. It should 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. Second, the government must shift away from the old model of large centralized plantation agriculture to models that encourage smallholder production such a throughout-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.

A third important action will be to establish a business environment that keep production costs low and does not inhibit production. 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 was to aggressively reduce unnecessary regulation. Unnecessary restrictions and delays only add to business costs, which reduced investment, exports, and the wages that firms can pay. 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. Manufactured exports must have access to duty-free imports of inputs, and the tariff rate on imported capital goods should be low.

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. The government is already off to a strong start by re-opening schools and substantially increasing school enrolments.

8. Results

Liberia's economy recovered from the global economic downturn. Growth in 2010 was estimated at 6.1%, driven by an increase in exports and foreign direct investment (FDI). Growth is projected to reach 8.9% in 2012. The rise in exports was thanks to an increase in commodity prices, particularly rubber, palm oil and minerals.

The security situation is generally stable, though fragile, and a sizeable United Nations Mission in Liberia (UNMIL) peacekeeping force remains in the country.

The overall challenge for Liberia is to make the transition from a period of post-conflict reconstruction to sustainable development. This would require not only a long-term vision as articulated in the Liberia Rising 2030 development plan, but also strong emphasis on regional integration. As Liberia is a small country with limited purchasing power, a strong export policy to regional markets and shared regional infrastructure projects would boost development. Such a policy could be integrated into the next cycle of the country's poverty reduction strategy.

Non-African and African emerging partners are active in Liberia. Non-African countries are mainly active in the private sector and extractive industries, including iron ore and palm oil plantations. Of the non-African emerging partners group, China is the largest public donor giving an estimated USD 20 million annually to Liberia, mainly in the form of tied aid. This aid – which is primarily bilateral – is being used to build infrastructure, and to improve healthcare and education.

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