

SOME POSITIVE RESULTS ACHIEVED IN A COMPLEX ENVIRONMENT

SUPPORT TO INVESTMENT CLIMATE REFORMS

The World Bank Group's (WBG) work on investment climate (IC) reform in Liberia started in early 2006, less than three years after the end of the second civil war. The program adopted a two pronged approach, aiming at: (i) rebuilding the basic legal and institutional framework for business activities; and (ii) attracting foreign direct investments (FDI), which in the pre civil war period accounted for a large share of economic activity, especially in agriculture and mining.

After some initial diagnostic activities, WBG operational work was articulated into two phases. Over the 2007-2011 period, WBG assistance targeted a broad range of themes, including the reform of business registration, the improvement of trade logistics, investment policy & promotion, the development of special economic zones (SEZ), legal reforms linked to Doing Business (DB) indicators, as well as the setting up of a platform for public private dialogue (PPD). During the subsequent 2011-2014 period, the scope of work was further expanded, with the inclusion of components targeting business taxation reform and the improvement of business regulations, with focus on the reform of business inspections, and industry specific reform work, with special emphasis on agri-business. The value of the WBG assistance is quite significant, with a total budget of some US\$ 9.5 million. In line with the broad IC reform approach, resources

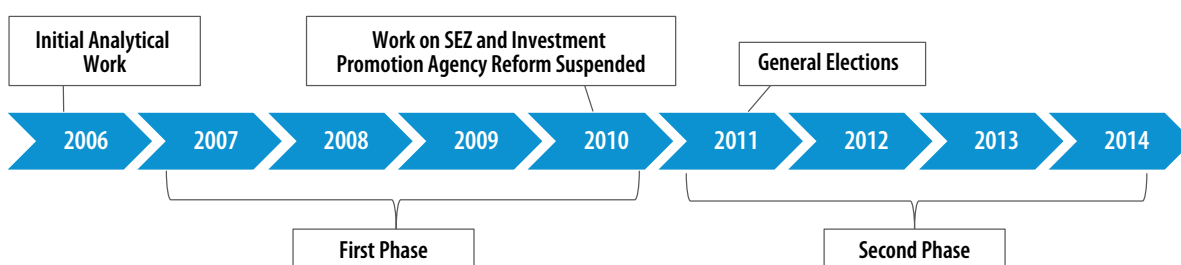
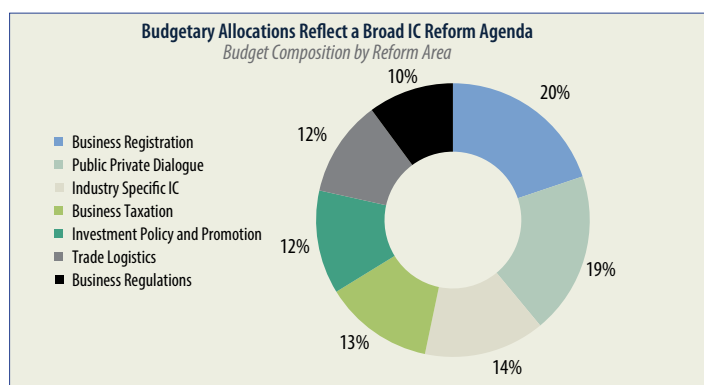
LIBERIA – KEY FACTS

Africa's second oldest independent nation, Liberia is a small country with a population of 4.3 million. After the end of the civil war and the return to democracy in the mid-2000s, Liberia experienced a significant economic recovery, with real GDP growing at an average 11.4% over the 2006-2013 period and nominal GDP reaching US\$ 2 billion in 2013. Economic growth was largely driven by large scale foreign investments in mining and commercial agriculture, with the rehabilitation of operations that had been destroyed during the civil war and the launch of some greenfield projects. However, due to the capital intensive nature of most investments in natural resources, the rapid GDP growth only partly translated into new employment opportunities and the country is still afflicted by pervasive poverty. In 2013, Liberia had a per capita GNI (Atlas method) of just US\$ 410, one of the lowest in the world. In recent times, social and economic conditions were further aggravated by the Ebola epidemics, which by end 2014 had caused some 3,500 deaths.

were allocated to seven reform areas of similar importance, each accounting for between 10% and 20% of total funding.

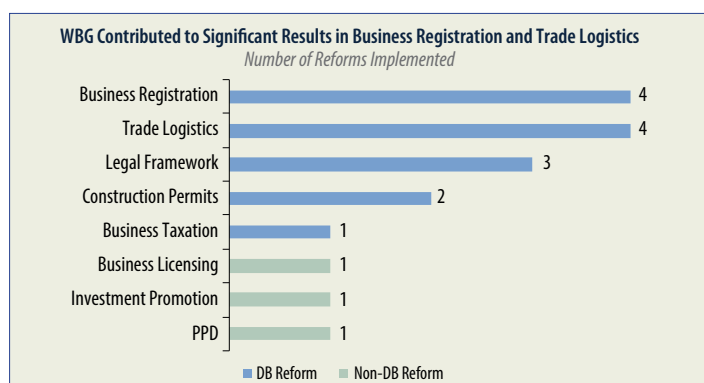
The WBG program was implemented in parallel with other IC reform initiatives funded by various donors. In particular, WBG reform activities were actively supported by the Investment Climate Facility for Africa (ICF), which provided about US\$ 2.5 million to finance technical assistance and investments in IC reform-related infrastructure (e.g. refurbishment of the business registry).

During the first phase, the program was implemented in a difficult environment, characterized by extremely weak capabilities in counterpart institutions and changes in policy priorities, which led to the discontinuation of assistance in some areas (SEZ legislation, reform of the investment promotion agency). Conditions improved during the second phase, although activities were slowed down by the general elections and securing and maintaining support from key decision makers has remained quite challenging.



RESULTS OF IC REFORM EFFORTS

The WBG program was quite successful, contributing to the implementation of 17 IC reforms over the 2008-2013 period. The vast majority of reforms refer to DB-related themes, with business registration and trade logistics cumulatively accounting for almost half of all reforms. Non-DB related reforms include the enactment of a new investment code, the improvement of business inspections mechanisms, and the setting up of a platform for PPD. WBG-supported reforms contributed to improve Liberia's positioning in DB rankings, with the country moving from the 170th position in 2007 to the 144th place in 2013. A similar improvement is also shown by other indicators used to measure the quality of the business environment, such as the World Bank's Regulatory Quality Indicator and the Heritage Foundation's Economic Freedom Index.



ACHIEVEMENTS IN SELECTED REFORM AREAS

Business Registration. WBG played a major role in the reform of business registration procedures. Improvements concerned: (i) the progressive concentration of responsibilities in one single office, eventually leading to the establishment of the Liberia Business Registry (LBR) in April 2011; (ii) the simplification of procedures and documentation (e.g. elimination of the business trading license, elimination of physical inspections prior to registration); and (iii) the elimination of certain fees and other out-of-pocket expenses (e.g. introduction of standardized forms for Articles of Incorporation, which in principle enables businesses to register without the assistance from an attorney). As a result, registration times and costs were significantly reduced, leading to significant cost savings for the business community.

Trade Logistics. The first reform in trade logistics concerned the reduction the Pre-Shipment Inspection (PSI) fee, which in mid-2008 was lowered from 1.5% of FOB value of imports to 1.1%. While the reform does not apply to certain imported goods (rice, fuel and vegetable oil), it nonetheless resulted in considerable savings for importers. Additional simplification measures included the elimination of the fee to obtain an import permit, followed by a drastic reduction in the number of goods for which import or export permits are required. In addition, WBG supported a series of improvements in customs procedures, aimed at reducing customs

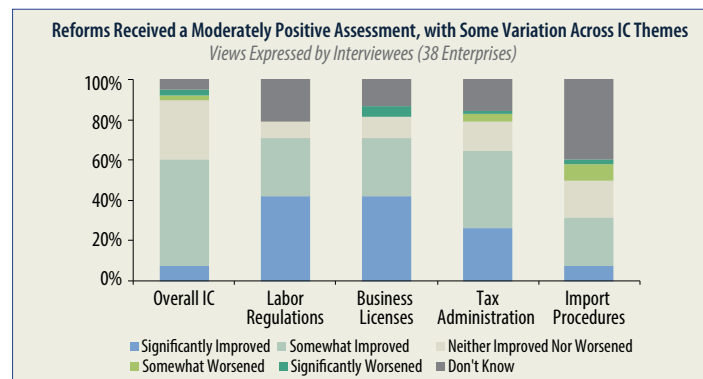
clearance times. As a result, the average waiting time for imported goods passing through the Monrovia Freeport (which handles about 90% of all merchandise traffic) declined by 54 hours in 2010, 9 hours in 2011, 15 hours in 2012 and another 3 hours in 2013.

Investment Policy & Promotion. WBG played a crucial role in the adoption of the Investment Act of 2010, which considerably improved the legal framework for foreign direct investment (FDI), namely through a reduction in the number of activities reserved for nationals. The WBG also provided considerable assistance to the National Investment Commission (NIC) to support its transformation from an eminently regulatory body (in charge of managing investment incentives) into a promotional agency. However, early reform efforts met with considerable opposition from NIC management, fearful of losing power, and assistance was discontinued. Work with NIC was recently resumed and WBG is currently assisting in attracting investments in selected priority sub-sectors (fruits and vegetables; fisheries and aquaculture; and coastal and road transport).

Public Private Dialogue. The WBG program contributed to the establishment of the Liberia Better Business Forum (LBBF), intended to facilitate policy dialogue on IC reform. Established in 2007, the LBBF has been quite active in promoting reforms in various areas. Major achievements include the adoption of a series of laws that led to the adoption of Liberia's first commercial code in 2010, and the elimination of the advance turnover tax, which, however, was subsequently reinstated.

PRIVATE SECTOR'S VIEWS ON IC REFORMS

Attitudes towards IC reforms were assessed through interviews with local small and medium enterprises (SME) and selected foreign investors. IC reforms are generally appreciated by the business community, but with a prevalence of moderately positive views and some variations across IC themes. In fact, while 60% of the firms did notice an overall improvement in the IC, one quarter of interviewees did not perceive any appreciable change, and the rest expressed a negative view. Regarding specific IC themes, labor regulations (an area in which WBG was not involved) and business licensing (in which instead WBG played a role, with the recent elimination of the trade license) are the areas with the

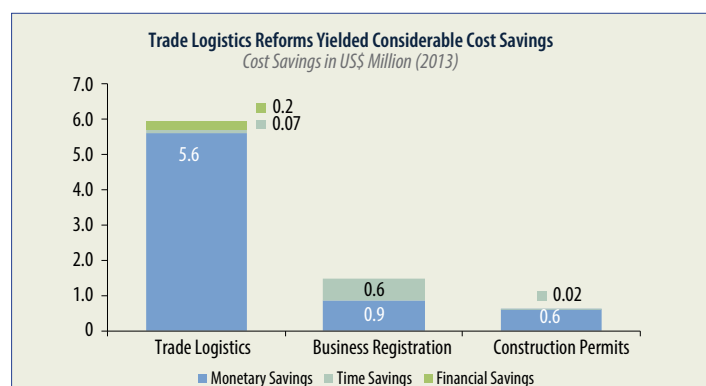


highest proportion of positive views, more than two thirds. Views are also positive regarding tax administration (in which WBG was not involved) whereas opinions are much more divided regarding import transactions: while two fifths of interviewees were unable to comment, the others were almost equally divided between those observing improvements and those noticing no change or, sometimes, a worsening of the situation.

IMPACT OF IC REFORMS – REDUCTION OF COMPLIANCE COSTS

WBG-supported reforms greatly contributed to reduce the administrative burden faced by the private sector in complying with business regulations, resulting in significant cost savings. Over the 2008-2013 period, 10 reforms generated cost savings worth a total of some US\$ 8.1 million. The bulk of cost savings consists of ‘monetary savings’, related to the elimination or reduction of fees and other out-of-pocket expenses. However, some reforms also achieved ‘time savings’, determined by the reduction in the time required to handle administrative procedures, and/or ‘financial savings’, linked to the cash flow benefits resulting from reduced waiting time at the customs.

Reforms in trade logistics are by far the main earners of cost savings (nearly US\$ 6 million), accounting for nearly three quarters of total cost savings. One single reform, the reduction of the PSI fee, resulted in cost savings worth some US\$ 4.6 million, making it one of the ‘highest yield’ IC reforms implemented by WBG programs in Africa. Positive results were also achieved by reforms in business registration, generating cost savings of about US\$ 1.5 million. Some savings (US\$ 0.5 million) were also achieved in the area of construction permits, thanks to the reduction of the fees levied by the Monrovia City Corporation and the Ministry of Public Works.

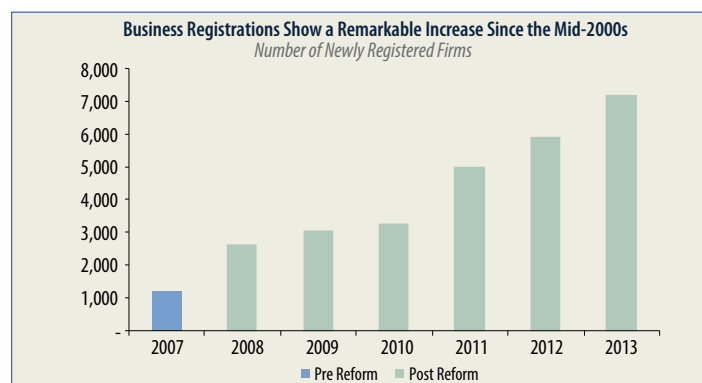


The value of cost savings has been increasing overtime, due to the coming on stream of new reforms and the increasing number of firms/transactions benefiting from earlier reforms. In relative terms, over the 2008-2012 period cost savings accounted for about

0.4% of private investment, and their importance grew from 0.1% in 2008 to 0.5% in 2011 and 2012.

IMPACT OF IC REFORMS – ENTERPRISE FORMATION

In Liberia, the number of business registrations has seen a six fold increase between 2007 and 2013, with newly registered firms passing from little more than 1,000 in 2007 to more than 7,200 in 2013. This remarkable increase coincides with the deployment of IC reform efforts, but also with the end of the civil war and the ensuing economic recovery, and the influence of these two factors is difficult to disentangle. The scarcity of data for the pre reform period (figures are available just for 2007) does not allow to compare the historic trend with registrations in the post reform period. However, taking into account the results of earlier work on the impact of IC reforms on business registrations,¹ it can be grossly estimated that incremental registrations attributable to IC reforms account for about 10% of the firms registered after the start of the reform process, i.e. about 2,700 firms.



However, new registrations do not necessarily involve the launch of new business activities and newly established firms may go out of business shortly after their establishment. Available evidence suggests that the share of non-operational firms is quite substantial. In fact, the survey of local firms carried out for the study suggests that in early 2014 only 63% of the firms registered in 2008-2009 were (still) in operation. Based on this result, it can be estimated that IC reforms have plausibly facilitated the establishment of about 1,700 new operational firms.

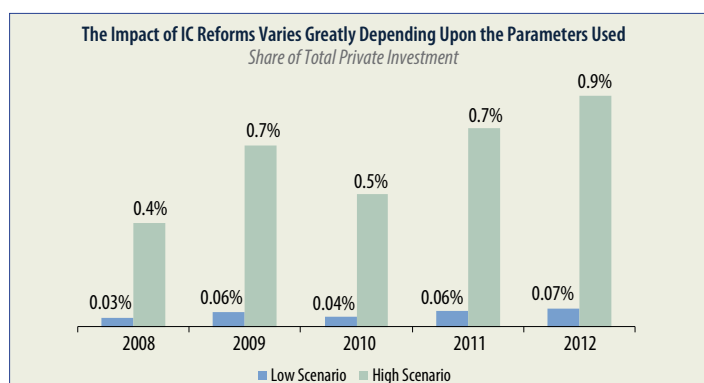
IMPACT OF IC REFORMS – INVESTMENT AND EMPLOYMENT GENERATION

Impact via the Enterprise Formation Process. The acceleration of the enterprise formation process induced by IC reforms translated into an increase in both investment and employment levels. Information on the investments made and jobs created by newly established firms was collected through the survey of local firms, which provided data

¹ See in particular, Bruhn M, “License to Sell: The Effect of Business Registration Reform on Entrepreneurial Activity in Mexico.” Policy Research Working Paper 4538, World Bank, 2008; Philippe A, R Burgess, S J Redding, and F Zilibotti, The Unequal Effects of Liberalization: Evidence from Dismantling the License Raj in India, American Economic Review, 2008; and Motta M, A M Oviedo, and M Santini, An Open Door for Firms, Viewpoint, Note N° 323, June 2010. According to these studies the share of incremental registrations is in the order of 5%, but they only focus on the effects of simplification of business registration procedures. As in Liberia business registration reforms were accompanied by several other IC reforms potentially impacting on the enterprise formation process, a 10% share appears more realistic.

for investment and job creation both at the moment of establishment and in subsequent years. The total investment associated with IC reforms can be estimated at between US\$ 1 million and US\$ 12 million. The difference between the two estimates depends upon the parameters used, with the 'low scenario' being based on median values per firm and the 'high scenario' making use of (much higher) average values. Estimates of job creation range from some 4,100 jobs in the 'low scenario' to 4,700 in the 'high scenario'.

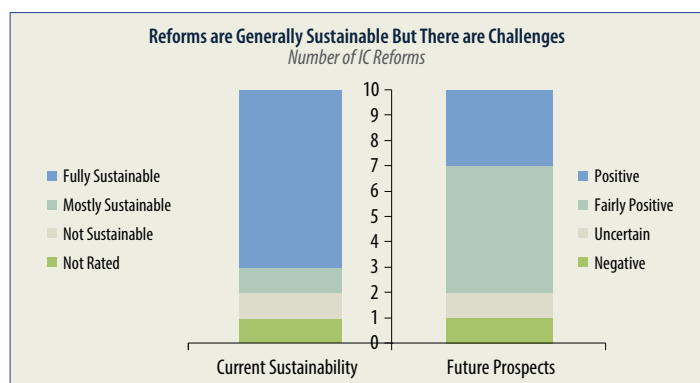
The value of investment associated with IC reforms increased overtime. However, in relative terms the impact is fairly modest, as even in the most optimistic scenario the investments associated with IC reforms account for 0.9% of total private investment at the most.



Impact of Investment Promotion and Industry Specific Reforms. In Liberia, FDI has increased dramatically since the mid-2000s, rising from US\$ 100-150 million/year in 2006-2007 to about US\$ 450-500 million/year in 2010-2011, and doubling to about US\$ 1 billion/year in 2012-2013. However, the surge is largely attributable to a limited number of very large investments in agriculture and mining made by multinational corporations (e.g. Arcelor Mittal, BHP Billiton, and Firestone) that are mostly unconnected to the WBG program. WBG assistance aimed at attracting smaller investors into agri-business and related sectors is still ongoing. While prospects are fairly promising, by end 2013 promotional work had not yet translated into tangible investments.

SUSTAINABILITY OF IC REFORMS

The majority of IC reforms are sustainable, but there are also negative cases and doubts regarding future prospects. Out of the ten reforms analyzed in detail, eight can currently be regarded as fully or mostly sustainable, with one reform clearly unsustainable and one not rated due to its recent implementation. Future prospects are also generally positive, although the majority of reform are expected to face some mild problems and two reforms are regarded as uncertain or not sustainable.



The situation is quite positive for reforms in trade logistics and business registration. In trade logistics, all the measures aimed at streamlining import-export transactions are still fully in force and the reform process is actually continuing, again with WBG support, as witnessed by the introduction in mid-2014 of measures to further simplify customs clearance procedures for larger importers. In business registration, the LBR is now well-established and, despite some operational problems (the software package is showing important limitations and will need to be upgraded in the future), it is able to discharge its functions in a reasonably effective manner. The initial enthusiasm for the reform has somewhat lessened and the envisaged elimination of the annual renewal of registrations did not materialize. The sustainability of past reforms is, however, not in question.

A case of clear policy reversal is found in the area of business taxation. In October 2013, the Government reinstated the 2% advance turnover tax that had been abolished by the Consolidated Tax Amendments Act of 2011. This was in response to a significant shortfall in overall tax receipts (see box). The move prompted a strong, negative reaction in business circles. Nonetheless, all indications are that the turnover tax will remain in force also in the future (at least until a new simplified taxation regime for micro and small enterprises has been developed). Prospects also appear somewhat problematic for the LBBF. While the forum has proved a useful instrument to influence government policy towards the private sector (as illustrated above), there are doubts that sufficient funds can be mobilized (around US\$ 200,000 per year) to ensure its continued existence.

LIBERIA'S ADVANCE TURNOVER TAX

In principle, payments under the 2% turnover tax are considered as an advance to be deducted from the total profit tax payable by business taxpayers. However, the turnover tax is also a sort of minimum tax: in case the advance payment is greater than the total tax to be paid, the difference is retained by the treasury. The abolishment of the tax was aimed at correcting this imbalance, but seemingly opened the door to opportunistic behavior. In fact, according to government sources, in 2012 no less than 98% of enterprises previously subject to the turnover tax declared that they were operating at a loss. As a result, they did not pay any tax at all, causing a major drop in tax proceeds.