May 2006
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Sierra Leone: Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Sierra Leone

In the context of the request for a three-year arrangement under the Poverty Reduction and Growth Facility for Sierra Leone, the following documents have been released and are included in this package:

- the staff report for the Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility, prepared by a staff team of the IMF, following discussions that ended on October 31, 2005, with the officials of Sierra Leone on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 10, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff supplement of May 2, 2006 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its May 10, 2006 discussion of the staff report that completed the request.

- a statement by the Executive Director for Sierra Leone.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Sierra Leone*
Memorandum of Economic and Financial Policies by the authorities of Sierra Leone*
Technical Memorandum of Understanding*
*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

SIERRA LEONE

Request for a Three–Year Arrangement
Under the Poverty Reduction and Growth Facility

Prepared by the African Department
(In consultation with other departments)

Approved by Siddharth Tiwari and Adnan Mazarei

March 10, 2006

- Discussions on a new three-year Poverty Reduction and Growth Facility (PRGF)-supported program were held in Freetown during October 17–31, 2005. The staff team comprised Messrs. Rwegasira (Head), Kovanen, Köhler (all AFR), Kikuchi (PDR); and Ms. Ena Baldwin, Administrative Assistant (AFR). The IMF resident representative to Sierra Leone, Mr. Dennis Jones, who is stationed in Guinea, also joined the mission. The mission team met with President Kabbah, the Minister of Finance, and the Governor of the Bank of Sierra Leone, other senior government officials, and representatives of the donor community.

- The previous PRGF arrangement with the Fund expired on June 25, 2005, and was fully disbursed following a successful completion of the sixth and final review of the program. Fund credit outstanding as of end-December 2005 is SDR 134.4 million (130 percent of quota).

- The mission team reached understandings with Sierra Leonean authorities on key macroeconomic and structural policies for 2006–08, reflecting priorities set out in the government's Poverty Reduction Strategy Paper (PRSP) and the conclusions of the ex post assessment (EPA), carried out last year. Key elements of the new PRGF-supported program include fiscal consolidation, to support macroeconomic stability, as well as increased allocation of expenditures toward poverty alleviation; and financial sector reforms aimed at raising the domestic savings rate and promoting investment and growth.

- In support of a new three-year program, the authorities are requesting a successor PRGF arrangement in an amount of SDR 31.11 million (30 percent of quota). The proposed access strikes a balance between the need to support Sierra Leone's efforts to achieve sustained growth for poverty alleviation and the risks to the Fund.

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EXECUTIVE SUMMARY

- **Sierra Leone has made considerable progress during the last PRGF-supported program toward macroeconomic stability.** Macroeconomic performance was generally strong, and structural reforms sought to establish a foundation for sound public finances and the effective conduct of macroeconomic policies. There were slippages in fiscal performance in 2005, but the government took corrective actions during the last quarter of the year to bring performance in line with the budget. The authorities also implemented several prior actions, comprising the unfinished agenda from the previous PRGF-supported program.

- **The government has accelerated the implementation of measures to address poverty within the context of a full poverty reduction strategy (PRSP).** Donors also confirmed their continued support to Sierra Leone in the Consultative Group meeting in November 2005. These should facilitate the reaching of the HIPC Initiative completion point sometime in 2006, which would provide access to resources under the Multilateral Debt Relief Initiative (MDRI), and also help mobilize additional external resources for supporting growth and poverty reduction.

- **The key objectives of the proposed PRGF-supported program are closely aligned with the government's poverty reduction strategy.** Several areas will be critical for a successful implementation of the new program. They include fiscal consolidation, which would be essential for safeguarding macroeconomic stability, and improved fiscal management to systematically identify predictable resources and allocating these resources to priority spending. The effectiveness of monetary policy needs to be improved through the broadening of the central bank's policy instruments. Sustained efforts are required to raise savings and investment to support growth. Financial sector reforms, in part guided by the recommendations of the envisaged FSAP, should support progress in this direction.

- **The authorities will need to actively implement a structural reform agenda under the program**, which will be driven by the PRSP's vision of channeling more resources to poverty reduction.

- **The key risk to the program implementation arises from the substantial reliance of the budget on external support, which is not fully predictable.** There is also a need to substantially strengthen macroeconomic management, and to improve transparency and address governance issues during the coming years.

- **Sierra Leone's external debt burden is expected to remain substantial in the coming years, even after taking into account the envisioned debt relief under the HIPC Initiative and MDRI.** As a result, grant resources and borrowing at highly concessional terms would be desirable for financing the balance of payments.

I. Introduction

1. **The Sierra Leonean authorities are requesting a successor PRGF arrangement to help consolidate past advances in macroeconomic stabilization and structural reforms.** The attached letter of intent (LOI) and accompanying memorandum of economic and financial policies (MEFP) outline the government's medium-term (2006–08) strategy and policy objectives, together with a detailed macroeconomic and structural agenda for 2006, including the government budget (Appendix I). A successor arrangement was supported by the Fund's Executive Board at the conclusion of the final review under the PRGF arrangement that expired in June 2005, provided that policies were adequate, to help Sierra Leone reach the completion point under the enhanced initiative for Heavily Indebted Poor Countries (HIPC).[1]

2. **Continued Fund involvement in Sierra Leone is warranted by the sizeable development needs in the country and the relatively large external financing gap that is projected.** An ex post assessment (EPA)[2] for Sierra Leone was conducted in 2005, covering ten years of almost continuous involvement with Fund programs under several arrangements (Appendix II). The EPA concluded that all Fund-supported programs during the period had underscored the importance of sound macroeconomic policies and structural reforms for achieving higher long-run output growth and reducing poverty. Conditionality under these programs helped strengthen program implementation. Performance was strongest under the recent PRGF arrangement, in part because the social situation was more secure, external conditions stronger, and the government enjoyed broad public support. Building on the lessons from the EPA, **the new PRGF-supported program aims at enhancing macroeconomic stability, with structural reforms focusing on laying the ground work for scaled up aid inflows to support achieving the Millennium Development Goals (MDGs).** As medium-term macroeconomic stability in Sierra Leone hinges critically on fiscal consolidation, structural reforms would in part aim at strengthening the management of public resources and at channeling these resources to poverty-reducing activities. Financial sector reforms, on the other hand, would seek to increase private saving and investment in support of real sector growth.

3. **In supporting the authorities' efforts, the Fund would continue to collaborate closely with the World Bank and other donors.** The World Bank has finalized a country assistance strategy (CAS) for 2006–09 and approved in June 2005 the fourth economic recovery and rehabilitation grant (ERRG IV) for Sierra Leone (Appendix III). Other main

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[1] The sixth and final review was completed on June 1, 2005, and the resources under the PRGF arrangement were fully disbursed (IMF Country Report No. 05/194). The arrangement was approved on September 26, 2001, in the amount of SDR 130.84 million (126 percent of quota), and was extended twice, by a total of nine months. Fund credit outstanding as of end-December 2005 is SDR 134.4 million (130 percent of quota).

[2] See IMF Country Report No. 05/195.

donors providing budgetary support to the country and technical assistance include the African Development Bank (AfDB), the European Union (EU), and the U.K. Department for International Development (DfID).

II. Recent Political and Economic Developments

4. **During the last PRGF-supported program the authorities made good progress towards macroeconomic stability, but many socio-economic challenges remain.** Progress towards lasting peace allowed the full withdrawal of the United Nations mission in Sierra Leone (UNAMSIL) at end-2005. The UN will, however, continue to support the country in enhancing political and economic governance and rebuilding national capacity for conflict prevention through the UNIOSIL (UN Integrated Office in Sierra Leone), established for the purpose by the Security Council. The successful presidential election in Liberia in October 2005 should also help strengthen stability in the region. Relatedly, the May 2004 local government elections in Sierra Leone also represented an important advance in the government's strategy to empower local authorities and engage the population in the political process. Poverty, however, remains pervasive, particularly in rural areas, where about 80 percent of the population lives below the equivalent of one U.S. dollar per day.

5. **Sierra Leone's macroeconomic performance during 2001–04 was, on the whole, strong.** The government's broad macroeconomic objectives for these years, as outlined in the PRGF-supported program in 2001,[3] included a real GDP annual growth of about 6–7 percent and an inflation of about 5 percent per annum; a significant lowering of fiscal and external current account deficits; and a rebuilding of gross international reserves to 2⅓ months of import cover. Against these objectives, actual performance was as summarized below:[4]

- Annual output growth substantially exceeded the program objectives, averaging 15½ percent during the post-conflict period. The recovery was broad-based.
- After a period of low inflation during 2001–02, reflecting in part the normalization of the economy and improvements in the domestic supply situation, inflation rose during 2003–04 with the annual average exceeding 14 percent in 2004. The increase was due largely to higher fuel costs, expansionary fiscal and monetary policies, and a depreciation of the currency.
- Fiscal performance improved on the whole, which was due to lower than envisaged expenditures throughout the period. But that reflected in part the overoptimistic

[3] Refer to the Letter of Intent, Memorandum of Economic Policies and the Technical Memorandum of Understanding dated June 21, 2001.

[4] See IMF Country Report No. 05/192 for further discussion on Sierra Leone's performance during this period.

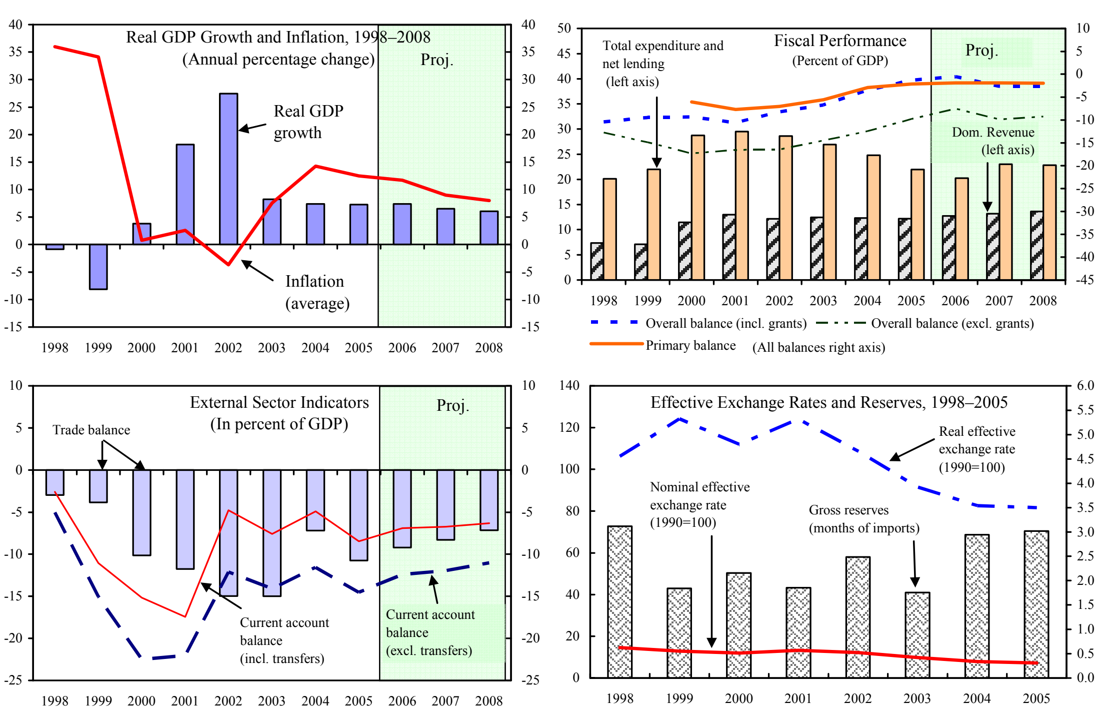
assumptions in the original budgets about implementing externally financed development projects. Revenue as a proportion of GDP was, however, generally lower than targeted.

- External sector objectives were largely achieved. This reflected, for the most part, a strong improvement in export performance, particularly for diamonds. Import growth was lower than envisioned under the program, in part owing to delays in refurbishing the rutile and bauxite mining complexes. At end-2004, gross international reserves had reached 2.9 months of imports.

- Structural reforms during 2001–04 sought to establish a foundation for sound public finances and the effective conduct of macroeconomic policies, in part through strengthening public sector governance and administrative capacity. Structural reforms also promoted financial intermediation and strengthened the financial system. However, progress in these areas was in part held back by capacity limitations and delays in technical assistance from donors.

6. **In 2005, economic expansion continued to be robust, but significant policy challenges remained.** During the first three quarters of the year, economic expansion was

Figure 1. Sierra Leone: Key Macroeconomic Indicators, 1998–2008



Sources: Sierra Leonean authorities and Fund staff estimates.

strong and broad-based, with output growth projected at 7⅓ percent in 2005 as a whole. This reflected increased activity in agriculture, mining, manufacturing, construction, and services. Inflation in 2005 is projected to average 12.5 percent—lower than in 2004 but higher than envisioned in June 2006 program review (IMF Country Report No. 05/194), fueled to a large extent by higher fuel prices and monetary expansion.[5] Prices of essential products were also higher due to temporary supply constraints.[6] Inflationary pressures moderated toward year-end, in part assisted by the receipt of donor funding and restrained government outlays in the last quarter of the year.

7. **There were slippages in fiscal performance in 2005, but the overall fiscal targets for the full year remained achievable.** Total domestic revenues fell short of the budget (by about 0.5 percent of GDP) owing to, in particular, shortfalls in custom receipts as a result of shifts in the composition of imports toward lower tariff capital goods. Total expenditure was also below the budgeted level, largely because foreign-financed capital projects were not implemented as envisioned. On the other hand, aggregate recurrent outlays were broadly in line with the budget. However, the wage bill and domestic debt service exceeded budgeted levels at year-end. The increase in the wage bill reflected unbudgeted payments of pension and gratuity pertaining to the restructuring of the police force and military, while the shortfall in poverty outlays (by about 1 percent of GDP) was in part due to weak planning in respect of allocating available fiscal resources to the priority areas.

8. **However, the government took corrective actions in the last quarter of 2005 to bring overall fiscal performance broadly in line with the budget.** To increase revenue collections, the National Revenue Authority (NRA) is enforcing tax regulations, specifically related to a 10 percent sales tax on local phone calls and a 3 percent advance payment of income tax on importers (MEFP, paragraph 6). The government also committed to closely monitoring fiscal outlays to prevent slippages, while increasing its efforts to raise allocations to poverty-related activities (also, see paragraph 33). Reflecting the tightening of fiscal policies, the deficit for the full year (excluding grants) is expected to be about 3 percentage points lower than in 2004 (in GDP terms). External budgetary support exceeded the targeted amounts and helped to close the remaining fiscal financing gap.[7] However, delays in the receipts of external support complicated fiscal management during the year and led to higher-than-envisioned domestic borrowing—which was only reversed toward end-2005.

[5] Year-on-year inflation in November was 12.3 percent, down from its peak of 15.9 percent in September.

[6] For example, higher fuel prices have constrained the transport of commodities to markets, resulting in pricing pressures. This has been especially the case for rice, fish, and sweet potatoes. Furthermore, agricultural products are traded across Guinea and Liberia borders, which affects the supply situation on the local food markets.

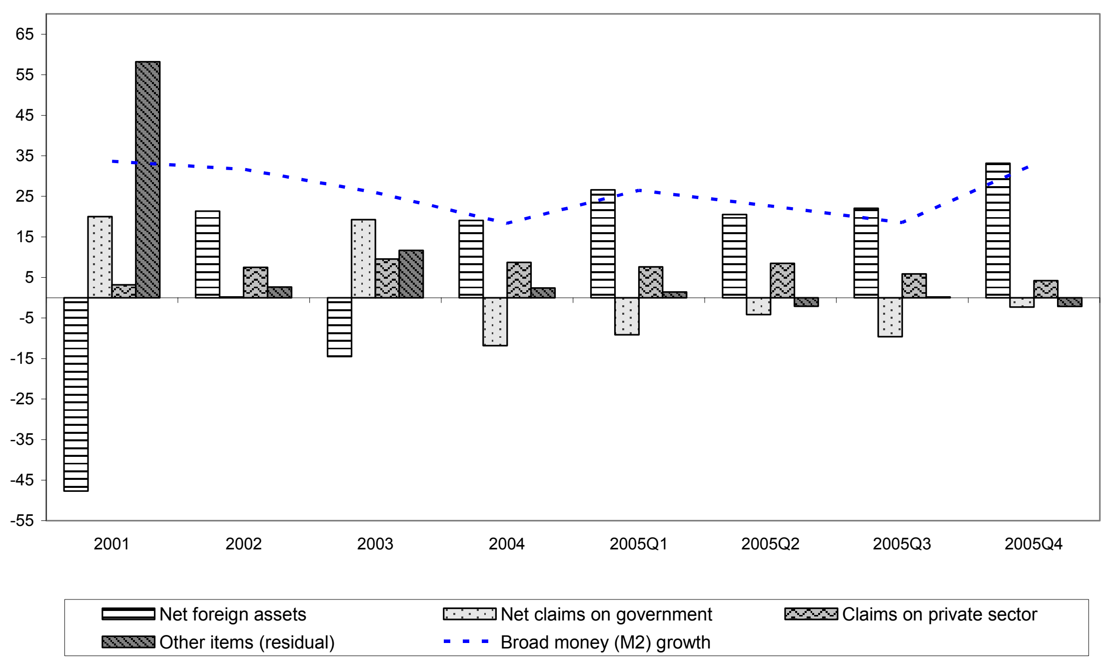
[7] The DfID disbursed £5 million (announced at the Consultative Group meeting in London in November). This is additional to what was initially budgeted and offset the disbursement of SDR 5.33 million from AfDB, postponed to early January 2006. The EU also disbursed € 17.5 million in December 2005, which exceeded the budgeted € 15 million.

9. **Broad money growth is expected to have exceeded its target.** This is, for the most part, due to stronger-than-envisioned expansion of the banking system net foreign assets (reflecting higher-than-anticipated external budgetary support). Credit to the private sector is expected to have remained broadly in line with the projected level.

10. **The exchange rate appreciated in real terms in 2005 after a steady depreciation since 2002** (Figure 2; page 42). The nominal exchange rate of the leone vis-à-vis the U.S. dollar has depreciated steadily since the middle of 2002, suggesting that the rate has been managed through the participation of the BSL in the weekly foreign exchange auctions (Figure 3; page 43). The parallel market exchange rate depreciated in line with the official exchange rate and traded at about two percent premium. This in part reflected transactions demand pertaining to informal alluvial diamond trading and capital outflows. In 2005, the official exchange rate against the U.S. dollar remained broadly unchanged in part through the continuous intervention by the BSL, but inflation remained at double-digit levels. As a result, the real exchange rate appreciated.

11. **Improved export performance continued, but the external current account deficit is projected to have widened in 2005.** In particular, diamond exports continued to expand rapidly. Import growth was, however, stronger than anticipated, owing in part to the higher cost of imported fuels as well as capital goods imports associated with the refurbishment of bauxite and rutile mining projects. The current account is, therefore, expected to widen significantly, to 8½ percent of GDP (including official transfers) from

Figure 2. Sierra Leone: Contributions to Broad Money, 2001-2005Q4
(Annual contributions in percent)



about 5 percent in 2004. External gross reserves are projected to reach US$149 million by year-end (about three months of import cover), reflecting better than anticipated external budgetary support.

12. **Following the implementation of corrective fiscal measures and the receipts of projected external budgetary support, the staff expects the authorities to observe the indicative targets set for end-December 2005 (Appendix I, Attachment II, Table 1)**, except, as already indicated, for the floors on domestic revenues and poverty-related expenditures, as well as the ceiling on the government wage bill.

III. MAIN ELEMENTS OF A PRGF-SUPPORTED PROGRAM FOR 2006–08

A. Medium-Term Strategy and Objectives

13. **Extensive discussions on the medium-term framework for Sierra Leone have recently been conducted** through the 2004 Article IV consultations (November 2004), the PRSP (February 2005), and an ex post assessment (June 2005).

14. **As highlighted in the PRSP, the medium-term economic strategy for Sierra Leone underscores the acute need to address poverty and to provide a basis for high economic growth**. Against the background of continued social stability, the poverty strategy articulated in the PRSP, and endorsed in the EPA report, highlights the importance of nation building (including the need to strengthen law and order and rebuild the basic infrastructure) and macroeconomic stability.

15. **Medium-term macroeconomic stability hinges critically on fiscal policy.** Fiscal consolidation and the achievement of a better balance between available fiscal resources and budgeted outlays will be central for the policy framework under the PRGF with the view of containing domestic primary deficit at about 2 percent of GDP. In addition, the government needs to shift resources increasingly toward poverty spending. A better fiscal balance would also help reduce the domestic debt burden which at about 30 percent of GDP is expensive to service and crowds out private sector credit.

16. **Sustained high growth in Sierra Leone will require significantly higher domestic savings and investment rates.**[8] Experience in other developing countries suggests that raising the domestic savings rate substantially would take time and therefore only a modest increase (to about 1 percent of GDP) is envisioned during the program period. Investment activity would continue to be financed to a large extent from external sources. In the longer run, Sierra Leone should target a domestic savings rate in the range of 8–10 percent of GDP, which would merely restore its historical average in the mid-1980s (and that would be about half of the average level for sub-Saharan Africa). Financial sector reforms will be

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[8] Domestic savings and investment rates were estimated at –5 and 10½ percent of GDP in 2004.

instrumental in this regard. As well, private sector development and an improved investment climate will be vital for raising investment levels to support high sustained output growth.

17. **Improved governance is being supported by ongoing reforms in the public sector.** Promoting good governance is one of the three pillars underpinning the PRSP**.** The main focus of structural measures in the PRGF-supported program will be on reforms of the public sector and civil service, strengthened capacity for data collection, analysis, and reporting to support policy-making, and strengthened public finance management to assist the budgetary process. The strengthening of the Anti-Corruption Commission will be supported mainly by the DfID in the form of experts and technical assistance. Continued reforms aimed at attracting private sector investment, including in the mineral sector, will be pursued in the coming years, led by the DfID and the World Bank.[9] In addition, the government would expand the availability of information on public sector activities in parliament and to the public at large.

18. **The focus of structural measures is on strengthening fiscal management to channel resources toward poverty-related spending, and on financial sector reform to promote saving, investment, and growth (Appendix I, Attachment II, Tables 2 and 3).** The medium-term structural reform agenda will be driven by the authorities' vision in the PRSP (Box 1).

19. **The authorities' medium-term fiscal strategy focuses on the following key areas, and is elaborated in the MEFP (paragraphs 16–20):**

- **Increased domestic revenue collection.** This goal is to be achieved through continued strengthening of the National Revenue Authority; tapping revenues from the mineral sector; introducing a value-added tax (VAT) system with the aim of widening the tax base; significantly narrowing import duty and sales tax exemptions by giving primary responsibility to NRA in this area; and collecting overdue tax liabilities from private and public corporations. These measures, excluding VAT, are estimated to raise domestic revenue collection to about 13.6 percent of GDP by 2008.[10]

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[9] Sierra Leone ratified the agreement on the certification of the origin of diamond exports in May 2004 (the Kimberley process), which is aimed at facilitating the tracking of diamonds from the origin of production. Sierra Leone is in compliance with the Kimberley process and the implementation of the cadastral system for artisanal mining would strengthen the tracking of small-scale diamond exports. In 2005 the government expressed interest in participating in the Extractive Industries Transparency Initiative (EITI), and a joint mission from the World Bank and the DfID is planned for early 2006 to explore Sierra Leone's participation in the initiative.

[10] However, this would still leave that share below the average for HIPC countries and hence further efforts will be necessary (including a successful implementation of VAT) to boost domestic revenue collection, which would also reduce dependency on donor financing. The average revenue collection for HIPC completion point countries, excluding grants, is about 15½-16 percent of GDP.

Box 1. Sierra Leone: Structural Conditionality Under the PRGF Arrangement

1. Coverage of Structural Conditionality in the Current Program

Prior actions focus on the implementation of the deferred structural agenda from the earlier PRGF-supported program. Structural performance criteria and benchmarks for the new PRGF-supported program (Appendix I, Attachment II, Tables 2 and 3) focus on reform areas critical for achieving the program's objectives and supporting the government's poverty-reduction efforts. These include:

- Enhanced management of public resources, including the management of the wage bill, fiscal reporting and data collection, and public financial audits;

- Improved revenue collection and tax administration, including through the elimination of discretionary tax exemptions and the introduction of a value-added tax system; and

- Increased private savings and investment in support of sustained high growth through financial sector reforms.

2. Status of Structural Conditionality Included in the Earlier Program

- Structural conditionality in the earlier PRGF arrangement that expired in June 2005 focused on establishing a foundation for sound public finances, including enhancing governance and administrative capacity; civil service reforms; and reforms to strengthen the transparency of mining sector operations. Structural reforms also aimed at promoting financial intermediation and strengthening the financial system. Improved statistics and data collection were also pursued through various reforms and technical assistance. Reforms in the external sector were limited owing to the relatively liberal trade and exchange regimes. Most of the reforms under the earlier PRGF arrangement were completed, albeit some with a delay, in part reflecting limited capacity to implement these reforms and delays in the provision of technical assistance from donors.

3. Other Structural Reforms

- **World Bank Lending and Conditionality:** The World Bank is taking the lead in the reforms related to: (i) economic governance and public finance management (in conjunction with the Fund), including strengthening the budgeting and procurement processes; (ii) civil service reform and decentralization; (iii) privatization and regulatory reforms, including enhancing the investment climate, competitiveness, and trade; (iv) mineral sector reforms; and (v) health and education reforms. The World Bank has also several infrastructure projects in Sierra Leone, which focus on roads, power, and water. A ERRG IV grant was approved by the World Bank Board in June 2005.

- Structural reforms supported by other core donors (**AfDB, DfID, and the EU)** focus on institutional reforms in the public sector, in particular in the public finance management; governance reforms and measures aimed at strengthening the legal system; as well as on reforms to improve service delivery in the health and education sectors.

- **Strengthened public expenditure management.** Expenditure management has in the past reflected weaknesses, which were also highlighted in the EPA. In particular, the management of the public sector wage bill remained weak while poverty outlays frequently fell short of the program objectives.[11] In coordination with the World

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[11] For example, in January 2005 the wage bill was raised substantially after the presentation of the budget in parliament due to concessions to labor unions following a two-day general strike.

Bank, and in the context of the medium-term expenditure framework (MTEF), the PRGF-supported program will aim at strengthening public expenditure management through structural measures aimed at the wage bill, including personnel and payroll systems; the avoidance of domestic payment arrears and establishing a time table for the clearance of outstanding arrears;[12] improving the quality and timeliness of financial audits of the government; and strengthening fiscal and monetary reporting systems to ensure timely reconciliation of data (the Fund is providing technical assistance in this area).

- **Accelerated privatization**. This will be an important medium-term objective. Twenty four state-owned enterprises in various economic sectors are being targeted, including financial institutions. The World Bank will assist the authorities in the implementation of the privatization strategy.

- **Strengthened governance and public expenditure management systems for further mobilization and effective management of donor aid flows.** Enhanced transparency and accountability in the education and core social sectors will be critically important as will be continued reforms in key ministries. At a more general level, public accounting and auditing functions as well as public expenditure management would need to be strengthened. Part of the increased aid could usefully target these areas.

20. **The overall fiscal balance is projected to improve slightly over the medium term.** The resource envelope is expected to remain broadly unchanged, as the envisioned increase in domestic revenues from 12.2 percent of GDP in 2005 to 13.6 percent in 2008 would be offset by the projected fall (in GDP terms) in external budgetary support. Total expenditures would increase slightly in GDP terms, while recurrent expenditures are projected to fall. Therefore, resources to support higher recurrent poverty expenditures would have to come from savings elsewhere, in particular from the containment of the wage bill. The overall deficit (excluding grants) is expected to improve by about ½ percent of GDP by 2008. Domestic financing of the budget is projected to remain small, below 0.3 percent of GDP annually during 2006–08, in part assisted by expected privatization proceeds.

21. **The medium-term financial sector strategy is aimed at enhancing the mobilization of domestic savings and increasing access to medium-to-longer term credit (MEFP, paragraphs 21–22).** Structural reforms in this area would aim at enhancing confidence, efficiency, as well as expanding the sector's capacity to offer financial services, particularly in rural areas. In the short-term, specific measures would be needed to address potential solvency and profitability problems in the banking system. Reforms would also focus on the mobilization of longer-term resources through suitable institutions, such as

[12] Domestic payments arrears totaled about 1.5 percent of GDP at end-2004.

insurance companies and pension funds; specific reforms would be guided by the conclusions of the Financial Sector Assessment Program (FSAP), which is now envisioned in early 2006.

22. **A number of measures would also aim at strengthening Bank of Sierra Leone's (BSL) operations.** They pertain to improving existing open market operations[13] (see paragraph 35) and to widening the menu of instruments to enhance policy effectiveness.[14] The noncompliance with international financial reporting standards by BSL and the latter's recapitalization would also need to be addressed over the medium term.

23. **Exchange rate flexibility needs to be enhanced (MEFP, paragraph 23).** Since Sierra Leone is vulnerable to external shocks, a flexible exchange rate regime is needed to facilitate timely adjustments to external developments. In the past, the BSL has been a major participant in the foreign exchange market, reflecting a persistent shortage of foreign exchange in the post-conflict environment. The central bank should become a less important player as the economic situation normalizes and private participants assume a bigger role. The BSL interventions in the market should only be aimed at meeting the gross reserve target of the program. The BSL should not target a specific exchange rate level.

24. **While Sierra Leone's external outlook is expected to improve over the medium term, substantial financing needs in the balance of payments remain.** The outlook will depend on export growth and further debt relief after Sierra Leone reaches the HIPC completion point. In addition to continued growth of officially recorded diamond exports, the recommencement of rutile and bauxite mining will further boost exports. Import growth, on the other hand, is projected to moderate due to the completion of the large mineral sector rehabilitation projects. However, fuel imports are projected to rise in part reflecting increased activity in the mineral sector. As a result, the external current account deficit is expected to narrow to about 6½ percent of GDP (including grants) in 2008 from 8½ percent in 2005.

25. **Efforts to diversify and expand exports are being pursued.** There is considerable potential for increasing exports outside mining—in agriculture, agro-processing, fishing, and tourism. These labor-intensive activities are also important for job creation. The country is also expected to benefit from ongoing international trade initiatives, including the U.S. African Growth Opportunity Act (AGOA) and the EU's Everything-but-Arms (EBA). The ongoing harmonization of tariffs within ECOWAS would also promote trade within the West Africa region. The World Bank is planning to conduct a diagnostic trade integration study to analyze key constraints to trade and growth and to develop a trade integration action plan consistent with the PRSP. The authorities have also requested funding from the EU to

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[13] At present, BSL uses reserve money as the primary intermediate monetary policy target. The main policy instrument is the auctions of treasury bills and bearer bonds. In addition, the BSL imposes reserve requirements on domestic currency deposits held with commercial banks.

[14] The BSL is planning to establish a liquidity-forecasting framework and to begin secondary market trading of treasury bills, with technical assistance from the Fund.

complete an economic impact study, in the context of negotiations on the EU-ECOWAS Economic Partnership Agreement.

B. Medium-Term Macroeconomic Framework

26. **Key macroeconomic objectives underlying the medium-term strategy include the maintenance of a sustained high real growth and a stable macroeconomic environment.** In this regard, two economic sectors, agriculture and mining, are central for Sierra Leone's development. Agricultural expansion is a key medium-term objective, given its importance for food security and job creation. Sierra Leone's considerable mineral endowments will continue to support the balance of payments and output growth, and should be utilized to enhance fiscal sustainability. Mining and related activities would also facilitate job creation.

27. **The medium-term macroeconomic framework projects that output growth will stabilize in the range of 6–7 percent by 2008**, underpinned by broad-based sectoral growth. Inflation is expected to converge to middle single digits by the end of the period, supported by prudent macroeconomic policies. The gross official reserves are expected to stabilize at 3 months of import cover.

Table 1. Sierra Leone: Medium-Term Indicators, 2005-08
(In percent of GDP, unless otherwise indicated)

	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
Real GDP (annual percentage change)	7.3	7.4	6.5	6.1
Nominal GDP (annual percentage change)	21.6	21.5	15.7	14.5
Consumer prices (annual percentage change; end of period)	15.0	9.5	8.5	7.5
Consumer prices (annual percentage change; period average)	12.5	11.7	9.0	8.0
Broad money (annual percentage change)	16.5	9.8	14.6	15.9
Domestic credit (annual percentage change)	4.2	4.0	3.0	2.5
Of which: credit to private sector (annual percentage change)	16.5	18.7	12.8	10.9
Government domestic revenue	12.2	12.6	13.2	13.6
Total expenditure and net lending	22.0	22.0	23.0	22.8
Overall fiscal balance				
(commitment basis; excluding grants)	-9.8	-9.4	-9.9	-9.2
(commitment basis; including grants)	-1.3	-0.5	-2.6	-2.7
Domestic primary fiscal balance	-2.2	-1.9	-1.9	-2.0
External current account balance				
(excluding official grants)	-14.5	-12.4	-11.9	-11.0
(including official grants)	-8.5	-6.9	-6.7	-6.3
Gross official reserves (in months of imports)	3.0	2.8	2.9	3.0
Domestic debt	27.5	23.1	20.1	17.6
External debt	50.5	47.1	45.8	44.2

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

28. **Fiscal policy in the medium term will be geared towards containing the primary fiscal deficit at around 2 percent of GDP.** This will assist monetary policy in lowering inflation and ensuring that the domestic public debt would remain at a sustainable level. Lower public sector borrowing would also provide scope for expanding private sector credit and contribute to lower domestic interest rates.

29. **The debt sustainability analysis (DSA) suggests that Sierra Leone's external and domestic debt would remain sustainable over the medium term, provided that macroeconomic policies remain adequate and the authorities implement a prudent external financing strategy (Box 2).**[15] The NPV of external debt-to-GDP and debt-to-export ratios would remain high for a few years after the receipt of final debt relief under the HIPC (in the second half of 2006), placing Sierra Leone at a moderate risk of debt distress (Appendix IV).[16] The MDRI is expected to create room to absorb additional donor assistance in the form of concessional loans without undermining debt sustainability. However, since some stress tests, particularly an export shock bound test, indicate sharply higher debt ratios, Sierra Leone's external financing should continue to be largely in the form of official grants or highly concessional loans. Regarding fiscal debt sustainability (this also incorporates the domestic public debt), staff projects that NPV of debt-to-GDP ratio could be halved by 2025, to about 35 percent, if government's domestic borrowing is contained. However, debt-to-revenue ratio would stabilize at about 150 percent in the longer-run.[17] In particular, temporary or permanently lower real GDP growth, leading to rapidly rising debt-to-GDP and debt-to-revenue ratios, pose the most significant risk to debt sustainability. Therefore, strong macroeconomic policies in the medium term would be essential.

C. Program for 2006

30. **The macroeconomic framework for 2006 envisions steady real GDP growth and lower inflation (Table 1).** Real output is expected to grow at 7½ percent, reflecting the restart of rutile and bauxite production and exports, and further expansion of agricultural, manufacturing and service activities. Average inflation is projected to fall only modestly, to 12 percent, with supportive monetary and fiscal policies. However, there would be a more substantial fall in year-on-year inflation, from 15 percent at end-2005 to 9½ percent at end-2006. The external current account deficit (excluding official transfers) is projected to narrow to 12 percent in 2006 from 15 percent of GDP in 2005, reflecting the resumption of rutile and bauxite exports, while import growth is projected to remain moderate.

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[15] Projections in the DSA exercise run up to 2025.

[16] External debt-to-GDP and debt-to-exports ratios are projected to stabilize at about 25 and 80 percent, respectively.

[17] The baseline scenario is consistent with stable domestic and external debt projections. Substantial vulnerabilities arise when the fiscal debt sustainability scenario is subjected to stress testing.

Box 2. Achieving Debt Sustainability under the MDRI

Sierra Leone will become eligible for the MDRI once it reaches the HIPC completion point. The debt relief under the MDRI would lower Sierra Leone's NPV of external debt-to-export ratio to 58 percent compared to 111 percent under the baseline scenario in 2006, and the NPV of external debt-to-GDP ratio to 16 percent in 2006 from 31 percent under the baseline scenario. The results in the MDRI scenario are well below the indicative thresholds for low income countries.

Sierra Leone: Debt Indicator After Implementing the MDRI
(in percent)

	2005 1/ Est.	2006 (Proj.) Before MDRI	2006 (Proj.) After MDRI	2010 (Proj.) After MDRI
NPV of PPG external debt to GDP 2/	88	31	16	20
NPV of PPG external debt to exports	364	111	58	67
Debt service to exports	9	7	6	2

Source: Staff estimates in the LIC DSA exercise.
1/ Before unconditional HIPC completion point relief.
2/ PPG refer to public and publicly guaranteed external debt.

The staffs of the World Bank and the Fund have classified Sierra Leone as having a moderate risk of debt distress in the context of the DSA (Appendix IV). Debt relief under the MDRI is expected to increase protection against shocks and provide room for concessional borrowing to finance MDG-related outlays. Sierra Leone currently ranks as a weak performer according to the World Bank's CPIA; therefore, stronger macroeconomic policies and institutions and enhance capacity would be needed to allow more effective absorption of aid. The country needs to periodically review the implication of scaled-up donor assistance on debt sustainability, and continue its efforts to strengthen its debt management capacity.

31. **The budget for 2006, which was presented to parliament in November, has been formulated in the context of a medium-term fiscal framework (MEFP, paragraphs 27–33).** It reflects existing revenue trends and external support already indicated by traditional donors.

32. **Key objectives of the budget are continued fiscal consolidation and increased poverty-related outlays (Tables 2 and 3).** Domestic revenues are projected to rise by 0.4 percent of GDP to 12.6 percent as a result of tax collection efforts (0.2 percentage points) and higher royalties from the mineral sector (0.2 percentage points). Total spending would remain at 22 percent of GDP, mainly reflecting higher development outlays while recurrent outlays are projected to decline in GDP terms. The domestic primary deficit would remain at about 2 percent of GDP to reflect the shift toward higher poverty-related spending (projected to rise by 1 percent of GDP from the previous year's level). The overall deficit (including grants) is projected to narrow to 0.5 percent of GDP. Domestic bank and nonbank financing of the budget are also projected to decline, which would reduce the ratio of domestic debt to GDP.

33. **A new framework has been adopted in the context of the 2006 budget that would help allocate scarce resources first to priority areas, in particular to programs that directly address poverty reduction.** Shortfalls in external support, together with slower

than anticipated utilization of funds earmarked for poverty alleviation, have in the past resulted in deviations from programmed spending targets and complicated fiscal management.[18] The proposed framework is intended to address these problems by identifying those resources that may be considered relatively predictable (including domestic revenues, domestic borrowing, and a portion of external budgetary support against which the government may borrow within the context of the PRGF-supported program).[19] It is also necessary for the government to strengthen the system to adequately track the utilization of funds related to poverty programs and take remedial actions in respect of underutilization.

34. **The management of the wage bill will be strengthened.** The wage bill is projected to rise by 17 percent in 2006, in part to accommodate the hiring of additional 3,000 teachers and 1,000 police officers during the year. The rise in salaries also reflects a 10 percent partial adjustment on account of past inflation.[20] In order to enhance the management of the wage bill, the government intends to audit the database containing all job grades and salary levels for civil servants and teachers and develop internal guidelines for annual adjustments in salaries within grade ranges (this is a structural performance criterion under the program).

35. **The authorities also aim at strengthening the central bank's operational capacity for conducting monetary policy (Tables 4 and 5; MEFP, paragraphs 34–36).** The BSL will conduct monetary policy to meet its reserve money target. In light of this, the central bank will begin to convert balances in the government's Ways and Means Account to Treasury securities at its discretion while encouraging the government to finance its deficit primarily through the issuance of Treasury securities in the primary market rather than borrowing directly from the central bank. Furthermore, the BSL will eliminate the non-market interest rate (fixed at 20 percent per annum) used for the Ways and Means Account and begin charging a market interest rate on these balances (three-month Treasury bills rate). These changes are expected to improve BSL's management of reserve money, thereby strengthening BSL's effectiveness in managing inflationary pressures (inflation is projected to revert to single digit levels by year-end). Money growth in 2006 would be driven mainly by the improvement in net foreign assets, while net domestic credit expansion, including to the private sector, would remain moderate. Government domestic financing would be contained at 0.3 percent of GDP.

36. **The PRGF-supported program is expected to be fully financed in 2006 (Table 6; MEFP, paragraphs 37–38).** The main sources of financing include official grants and

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[18] External grants and loans (including HIPC resources) in 2006 would represent about 40 percent of the budgeted resources (about 8 percent of GDP).

[19] Under the PRGF-supported program the government can borrow 50 percent of the shortfall in programmed external budget support.

[20] The 2005 budget comprised a general salary increase of 4.5 percent. Average inflation in 2005 is envisioned at 12.5 percent and in 2006 only slightly lower.

concessional loans, and interim HIPC debt relief. The authorities have requested Paris Club creditors to provide debt rescheduling retroactively on Cologne terms from the end of the last consolidation period once the new PRGF arrangement has been approved. In response, in January 18, 2006, Paris Club creditors agreed to provide financing assurances to Sierra Leone in support of its request for the new PRGF arrangement with the IMF. Relationships with other external creditors remain broadly unchanged since the previous PRGF arrangement expired in June 2005.[21] The authorities have also made continued efforts to engage external commercial creditors and they are making goodwill payments to some of them (Box 3). No new litigations have been initiated by commercial creditors since the last program review under the previous PRGF arrangement. Preparations are also under way for another IDA debt buyback operation. The staff considers that, in light of collaborative approach the authorities have taken, they have made good-faith efforts to resolve the claims by commercial creditors on external sovereign debt for which servicing is in arrears.

37. **Regarding structural reforms, the unfinished reform agenda from the previous program has been addressed upfront in the new PRGF-supported program (Appendix I, Attachment II, Tables 2 and 3; and MEFP, paragraph 39).** These prior actions are envisaged to ensure continued improvements in the efficiency and transparency of government operations—through the strengthening of the Auditor General's office, reforms in key ministries, and streamlining human resource management. In addition, the authorities are expected to make further progress in systematically incorporating mineral revenue projections in the overall fiscal framework, and in consistently reporting monetary and fiscal data (related to the latter, a new fiscal and monetary reporting system will be implemented in early 2006 as a structural performance criterion).

38. **Further structural reforms in 2006 will aim at containing the wage bill to protect poverty-related expenditures, and at ascertaining the financial health of the commercial banking system.** An audited database for all civil service job grades and guidelines for wage and salary increases are required as a performance criterion. An assessment by the BSL of commercial bank capitalization and credit quality is also a performance criterion. Among structural benchmarks, an action plan to implement the Budgeting and Accountability Act, and the establishment of internal audit units in key ministries are aimed at strengthening the public expenditure management system. The authorities also intend to review existing tax and tariff exemptions and approve a plan to minimize their use.

[21] Japan has yet to sign a bilateral rescheduling agreement with Sierra Leone. Negotiations with China on debt rescheduling have started.

Box 3: Review of Financing Assurances—Commercial Creditors

The first IDA debt buyback was conducted in 1995 eliminating about US$235 million in debt. However, there remains outstanding commercial debt due to the nonparticipation of some creditors in the buyback program. In addition, the authorities continue to receive claims from commercial creditors. To date, total commercial creditors' claims, validated and non-validated, have reached about US$250 million.

Most of those commercial creditors have recently remained passive, and there is no new litigation initiated since the last review of financing assurance completed at the time of the sixth review of the previous PRGF-supported program. The authorities have engaged those creditors repeatedly, and continued to make good-will payments of small amounts in local currency to some creditors that are operating in the country. However, they have failed to reach long-term debt rescheduling agreements that would be comparable to the signed Paris Club agreements on Cologne terms and consistent with the HIPC Initiative.

To address the situation, preparations are being made for a second debt buyback supported by the Debt Reduction Facility of the World Bank for IDA-only countries. The authorities have already initiated a selection of legal advisors, and are continuing a validation process, aiming at conducting the buyback at the HIPC completion point, which is expected in the second half of 2006. The authorities expect that this will be the final debt buyback needed.

The proposed PRGF-supported program assumes no new financing from commercial sources. The existence of arrears to commercial creditors does not undermine program implementation, and does not put the recovery of the Fund's credits at risk.

IV. Poverty Reduction Strategy

39. **In order to reach the HIPC completion point and to receive final debt relief under the HIPC Initiative, Sierra Leone has to be on-track with a current PRGF arrangement as well as satisfy the HIPC completion point triggers.** The government has made substantial progress towards meeting the triggers. Implementation of the full PRSP started in mid- 2005. A key remaining one relates to the implementation of the PRSP, and the government has accelerated this in the context of the 2006 budget (Table 7).[22] It is envisioned that the government could reach the completion point under the HIPC Initiative during the second half of 2006.

40. **Donors confirmed their continued support to Sierra Leone in the Consultative Group meeting in November 2005, but the implementation of the full PRSP requires a clear prioritization of poverty outlays.** Pledges by donors, mainly in the form of project grants, are estimated to have totaled US$800 million for the period 2005–07, to finance PRSP-related activities. This represents a nominal increase of about 25 percent compared to the level committed at the previous Consultative Group meeting in 2002. Relatively few new resources were pledged in the meeting, although nontraditional donors indicated that

[22] The staffs of the World Bank and the Fund issued a Joint Staff Advisory Note (JSAN) on the full PRSP, which was considered by the IMF Executive Board in June 2005 (IMF Country Report No. 05/193).

additional support could be forthcoming. Reflecting the substantial resource gap that remains, estimated at about US$150 million per year (13 percent of 2005 GDP), the authorities need to effectively prioritize the PRSP outlays.

41. **Beyond the PRSP, the challenges to reach the MDGs are formidable.** Sierra Leone's low starting point after a decade-long conflict combined with the enormous institutional and financial requirements suggest that achieving the MDGs by 2015 is unlikely, except, perhaps, in the area of education. There are no cost estimates for meeting the MDGs, but it is clear that this task would require a sustained large-scale financing from donors. Substantial additional resources could be available to Sierra Leone, however, once it reaches the HIPC Initiative completion point. Additional debt relief could become available in the context of the MDRI.

42. **The authorities acknowledged the policy challenges associated with a substantial increase in aid flows.** The need for scaled up aid has been indicated both in the context of financing the PRSP and for approaching the MDGs. Related to this, the staff emphasized to the authorities the importance of continued tax effort (Box 4) in order to support the government's poverty-reduction efforts as well as to pave way to a gradual exit from aid dependency. The staff also underscored that macroeconomic stability would be critical with substantially increased aid flow. The authorities plan to implement fiscal policy in the medium-term context, with a view to maintaining a sustainable fiscal position. Monetary policy would be aimed at supporting macroeconomic stability and would target a reduction in inflation to single digits in the medium term. However, the BSL's capacity to sterilize large inflows remains limited. Therefore, in order to support monetary management while allowing aid to be spent and absorbed, the central bank may need to sell foreign exchange in the market and allow some real appreciation in the exchange rate. The central bank would also target higher official reserves in the medium term. Increased aid inflows are projected to lead to a larger external current account deficit, partly in response to real appreciation of the exchange rate (either nominal or through higher inflation), while higher real activity levels and the high dependence on imported capital and intermediate goods would also raise the demand for imports. Public sector debt sustainability should be monitored closely—the staff analysis suggests that external financing should be in the form of official grants or at highly concessional terms.[23]

43. **The scaled up aid assumes significantly higher expenditures including poverty outlays.** The procurement procedures, including in the social and health sectors, are being strengthened. The staff advised the authorities that increased aid should be appropriately spent and absorbed, while national and local institutions need to be strengthened to facilitate the absorption of targeted spending. The staff estimates that real growth could be higher by 2 percentage points under the scaled up scenario (by 2010), reflecting positive effects on output growth associated with spending on health and education. The authorities would

[23] See further discussion in paragraph 29.

maintain a liberal trade regime and increase allocations to infrastructure spending, as indicated in the PRSP, in order to raise productivity, contain inflationary pressures, and support export-led growth.

V. Prior Actions, Program Monitoring, and Capacity to Repay to the Fund

44. **It is envisaged that the framework for monitoring quantitative performance under the new PRGF-supported program will remain broadly the same as under the previous program.** Quantitative performance criteria subject to the first review under the PRGF arrangement will be set for end-March 2006, scheduled for completion before end-August 2006, and those subject to the second review will be set for end-September 2006, scheduled for completion before end-February 2007. Indicative targets will be set for end-June and end-December 2006. (Appendix I, Attachment II, Table 4).

45. **The authorities have implemented the following prior actions from the unfinished agenda from the previous PRGF arrangement (Appendix I, Attachment II, Table 2):**

- A Deputy Auditor General has been appointed.
- Action plans to reform five key ministries are under execution, and Cabinet has approved the sixth action plan for the ministry of local government.
- Cabinet has approved a plan for transforming the Establishment Secretary's Office into a Human Resources Management office.
- Medium-term revenue projections have been made for each major mineral and incorporated in the overall fiscal framework.
- All government units and accounts that will be included in the new reporting system for monetary and fiscal data have been identified, and benchmark annual data for 2004 established.

46. **In addition, the authorities plan to meet three structural performance criteria during 2006**, comprising the launching of a new fiscal and monetary reporting system, the updating and auditing of the database containing all job grades and salary levels for all civil servants and teachers and obtaining cabinet approval of guidelines for annual salary adjustments within grade ranges, and the finalization of an assessment of bank capitalization and credit quality for all commercial banks (Appendix I, Attachment II, Table 2).

Box 4: Scaling Up Scenario

To highlight the macroeconomic implications of scaling up, staff has developed an illustrative scenario that assumes a doubling of program and budget support in U.S. dollar terms over a five-year period, from about US$140 million at end-2005, and staying at that higher level until 2015. In GDP terms, the rise would be from 8 percent of GDP in 2005 to about 11 percent over 2006–10, followed by a gradual decline to about 9 percent by 2015. Under the scaled up scenario, there would be significantly higher expenditures and poverty outlays by 2010 (as aid would be fully absorbed and channeled toward poverty-related programs). Furthermore, domestic revenue efforts would be sustained. A higher sustained rate of output growth is envisioned, as public spending on health and education, together with infrastructure investments, would be expected to enhance Sierra Leone's growth potential. Inflation would also be slightly higher, owing in part to the increased level of public spending. The external current account deficit would widen substantially due to increased import demand associated with the scaling up (partly reflecting the high import content of development spending). A modest appreciation of the real effective exchange rate is also projected in the scaling up scenario.

	2004	2005	Baseline		Scaled Up	
	Act.	Rev. proj.	2010	2015	2010	2015
			(In percent of GDP, unless otherwise indicated)			
Government domestic revenue	12.3	12.2	14.0	14.3	14.0	14.3
Total expenditure and net lending	24.8	21.8	22.6	21.3	27.8	23.8
Of which : recurrent expenditure	20.2	18.1	16.3	14.7	18.9	15.6
Of which : wages and salaries	6.1	6.4	5.5	5.5	6.8	5.9
Overall fiscal balance						
(excluding grants)	-12.5	-9.6	-8.6	-6.9	-13.7	-9.4
(including grants)	-3.5	-1.9	-2.5	-2.6	-9.6	-8.0
Domestic primary fiscal balance	-2.8	-2.0	-2.0	-2.6	-5.0	-3.8
Current account balance, including official transfers	-4.9	-8.5	-5.1	-5.1	-8.5	-7.3
Current account balance, excluding official transfers	-11.6	-14.5	-9.3	-7.8	-15.2	-11.7
Net present value of external debt-to-export ratio	151.3	141.4	97.4	87.4	107.2	94.6
(in percent of exports of goods and nonfactor services)						
Memorandum items:						
Poverty outlays (excluding wages and salaries)	4.7	3.8	8.0	8.0	11.8	10.0
			(Annual percentage change, unless otherwise indicated)			
Real GDP	7.4	7.3	6.6	5.8	8.1	7.8
Real GDP per capita (in U.S. dollars at 1990 prices)	107	112	140	170	148	197
Consumer prices (period average)	14.2	12.5	6.8	5.8	7.8	6.3
Memorandum item						
Grants and loans (percent of GDP)	14.1	9.8	10.2	7.4	15.4	9.9
Program and project grants and loans	10.9	8.1	8.6	6.9	13.7	9.4
HIPC grants	3.2	1.7	1.6	0.6	1.6	0.6

47. **Identified gross financing needs are estimated to average around US$244 million each year during 2006–08; support from the Fund and other donors is therefore needed to close the remaining financing gap (Table 8).** The staff proposes that **access under the PRGF arrangement be set at 30 percent of Sierra Leone's quota (SDR 31.11 million).**[24] This will increase the Fund's exposure to Sierra Leone slightly over the medium term beyond current debt service projections[25] while ensuring that the net present value of debt-to-export ratio (after HIPC relief) remains sustainable (see paragraph 29 on DSA). Sierra Leone is

[24] Sierra Leone's quota is SDR103.7 million. Disbursements under this scenario are shown in Table 9.

[25] The projected debt service to the Fund (including HIPC assistance) during 2006–08 would amount to 21.55 percent of Sierra Leone's quota.

eligible for debt relief under the MDRI, after it has reached the HIPC completion point; this is expected to substantially lower debt service to the Fund.

48. **A key risk during the medium-term arises from the high dependency of the budget on external support.** This risk could be compounded by inadequate donor coordination. Furthermore, the authorities need to significantly strengthen macroeconomic management, address governance issues, and improve transparency during the coming years to facilitate necessary progress.

VI. Other Issues

49. **The coverage and consistency of statistics will continue to be addressed in the context of the program (Appendix V).** The importance of adequate statistics in monitoring progress in implementing the PRSP is fully recognized by the authorities (JSAN; IMF Country Report No. 05/193). The PRSP also incorporates elements of the General Data Dissemination Standards (GDDS). Moreover, a new framework for fiscal and monetary data reporting will be operationalized, supported by Fund technical assistance. A general plan for improving statistics was costed and the total costs have been incorporated in the medium-term expenditure program of the PRSP. It is expected that Sierra Leone's participation in the GDDS will assist in enhancing the quality of data, especially in the area of the national accounts, and that its statistical infrastructure will benefit from enhanced domestic and external support.

50. **A safeguards assessment in the context of the proposed PRGF arrangement has been initiated by the Fund.** The latest safeguards assessment was completed in July 2002.

VII. Staff Appraisal

51. **In the context of the previous PRGF-supported program, the authorities have made substantial progress in laying the foundation for sustained real growth and poverty reduction.** In addition, they have managed the period following the expiration of the previous PRGF arrangement in a manner that has demonstrated determination to move towards indicative targets set for 2005 as a whole. There were slippages in fiscal performance in the course of the year, but the government took corrective actions during the last quarter to bring performance in line with the budget. The authorities have also implemented several prior actions from the unfinished agenda from the previous PRGF-supported program.

52. **The objectives of the authorities' medium-term program are realistic and well founded in the full PRSP.** For a post-conflict country in particular, the emphasis on nation building, the restoration of macroeconomic stability, and fiscal management centered on poverty-reduction is appropriate. These are to be supplemented by policies to strengthen the financial sector for enhancing private savings and investment. Progress has also been made in implementing the PRSP, which should facilitate the reaching of the HIPC Initiative completion point sometime this year, and access to additional resources under the MDRI. Relatedly, the reconfirmation of future support by Sierra Leone's main donors, at the Consultative Group meeting last November, augurs well for the mobilization of external resources for supporting growth and poverty reduction.

53. Beyond these domestic and international efforts, several areas will be critical for a successful implementation of the new program under the PRGF arrangement. **First, fiscal consolidation will be essential for safeguarding macroeconomic stability.** The authorities need to further strengthen domestic revenue efforts, including in the mineral sector, through improvements in tax and customs administration, the reduction or elimination of tax exemptions, and the broadening of the tax base—especially via the introduction of a value-added tax. Expenditures should be better prioritized and adequately monitored to avoid unplanned domestic financing of the budget and unsustainable growth in domestic debt.

54. **Second, fiscal management needs further strengthening in systematically identifying predictable resources and allocating them to priority spending.** The practice, started in the context of the 2006 budget, of initially allowing for partial projected budgetary support and of allocating the predictable resource envelope to priority spending should be institutionalized, as it would assist stability while protecting poverty-related spending. The latter should also be helped by measures aimed at containing the growth of the wage bill.

55. **Third, the effectiveness of monetary policy should be improved through improving the instruments of the BSL.** In this regard, the ongoing Fund technical assistance in the areas of open market operations and liquidity forecasting has been helpful. Envisaged measures to strengthen the BSL, including through adequate capitalization, are also important in enhancing the ability of the central bank to effectively conduct its day-to-day monetary operations. In this context, the BSL needs to take additional steps towards implementing the recommendations of the 2002 safeguards assessment mission, including the adoption of International Financial Reporting Standards.

56. **Fourth, the authorities need to enhance exchange rate flexibility to facilitate timely adjustments to external developments.** The exchange rate level is judged to be broadly appropriate, given that the premium on the parallel market has been small and narrowing, and is not adversely affecting competitiveness. In order to ensure that the exchange rate continues to remain at an appropriate level, the central bank's interventions in the market (carried out through the weekly auctions) should be aimed at meeting the gross reserve target under the program, but not target a specific exchange rate level.

57. **Fifth, sustained effort is required to raise savings and investment to support growth.** Financial sector reforms, in part guided by the recommendations of the envisaged FSAP, should support progress in this direction. However, based on experiences in other developing countries, a significant increase in the domestic savings rate is likely to take time. The promotion of private sector activities and an improved investment climate would be supportive of both domestic and foreign investment.

58. **Sixth, the authorities will need to actively implement a structural reform agenda under the program to channel more resources to poverty reduction and strengthen the basis for output growth.** A major aspect of the agenda pertains to strengthening fiscal and public expenditure management. The latter is particularly important for Sierra Leone not only for efficiency reasons, but also for the mobilization of much needed external support.

59. **In view of the authorities' recent efforts and commitments made in the LOI, and based on the prior actions taken, the staff recommends approval of the request for a new three-year arrangement under the PRGF.** The risks to program implementation, notably the substantial reliance on external budgetary support that is not fully predictable, and the internal coordination demands for implementing domestic policy, will need to be carefully managed by the authorities. The proposed access and phasing strike an appropriate balance between the need to support Sierra Leone's efforts to achieve sustained growth for alleviating poverty and the risks to the Fund.

Table 1. Sierra Leone: Selected Economic and Financial Indicators, 2001-08

	2001	2002	2003	2004	2005		2006	2007	2008
	Act.	Est.	Est.	Est.	Proj. 1/	Rev. Proj.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)								
Income and expenditure									
Real GDP	18.2	27.5	9.3	7.4	7.5	7.3	7.4	6.5	6.1
GDP deflator	1.8	-3.6	8.2	16.0	7.6	13.3	13.1	8.7	8.0
Nominal GDP	20.3	22.8	18.3	24.6	15.8	21.6	21.5	15.7	14.5
Consumer prices (end of period)	3.4	-3.1	11.3	14.4	9.0	15.0	9.5	8.5	7.5
Consumer prices (annual average)	2.6	-3.7	7.5	14.2	8.5	12.5	11.7	9.0	8.0
Money and credit									
Broad money									
(including foreign currency deposits)	33.7	30.1	26.2	18.9	11.6	16.5	9.8	14.6	15.9
(excluding foreign currency deposits)	30.8	32.0	25.6	16.9	11.6	12.7	7.0	16.1	18.8
Velocity (level; excl. foreign currency deposits)	6.5	6.1	5.7	6.1	6.3	6.6	7.5	7.4	7.2
Velocity (level; incl. foreign currency deposits)	5.5	5.2	4.9	5.1	5.3	5.3	5.9	5.9	5.9
Domestic credit 2/	22.5	7.9	27.5	-2.1	8.6	6.4	5.6	3.9	2.9
Government 2/	19.4	0.2	17.1	-10.9	2.2	2.2	1.1	0.6	0.2
Private sector 2/	3.2	7.5	9.7	8.8	6.4	3.9	4.5	3.3	2.8
(annual percentage change)	24.6	62.3	64.5	45.2	27.0	16.5	18.7	12.8	10.9
Reserve money	29.4	24.9	22.4	12.6	10.5	9.8	10.1	11.8	12.8
Interest rate 3/	14.7	15.0	20.2	28.0	18.5	16.9	...	...	...
External sector									
Exports (U.S. dollars)	6.1	48.9	27.4	17.1	18.5	23.0	32.6	15.3	13.5
Imports (U.S. dollars) 4/	20.6	54.4	15.6	-15.7	17.6	36.4	18.8	10.6	9.0
Terms of trade (- deterioration)	2.4	0.0	-1.9	-4.6	2.4	-2.3	-3.9	0.9	0.1
Real effective exchange rate (- depreciation; end of period)	-15.3	-9.7	-17.2	-7.1	...	…	…	…	…
	(In percent of GDP)								
Gross domestic investment	6.7	10.1	13.9	10.6	20.7	15.0	15.0	15.1	15.2
Government	4.4	4.4	4.8	4.6	7.4	3.7	5.2	6.3	6.2
Private	2.2	5.7	9.0	5.9	13.3	11.3	9.8	8.8	9.0
Gross national saving	-10.8	5.3	6.3	5.6	12.7	6.6	8.1	8.3	8.8
Gross domestic saving	-11.6	-9.4	-7.4	-5.0	3.6	-3.6	-1.4	-0.4	1.0
Government	-4.6	-4.3	-3.2	-1.2	0.0	-0.7	-0.2	0.4	0.5
Private	-7.0	-5.1	-4.2	-3.8	3.6	-2.9	-1.2	-0.8	0.5
Current account balance, including official transfers	-17.4	-4.8	-7.6	-4.9	-8.0	-8.5	-6.9	-6.7	-6.3
Current account balance, excluding official transfers	-22.0	-12.1	-14.1	-11.6	-13.0	-14.5	-12.4	-11.9	-11.0
Goods and nonfactor services (net)	-19.6	-19.5	-21.3	-15.6	-17.2	-18.7	-16.4	-15.5	-14.2
Unrequited private transfers and factor services (net)	-3.5	7.1	7.0	3.8	3.9	3.9	3.8	3.4	3.0
Overall balance of payments	1.7	-0.3	-4.6	1.4	-5.8	-1.8	-2.4	-1.0	-0.4
Government domestic revenue	13.0	12.1	12.4	12.3	13.0	12.2	12.6	13.2	13.6
Total expenditure and net lending	29.5	28.6	26.9	24.8	27.0	22.0	22.0	23.0	22.8
Of which : recurrent expenditure	24.8	24.2	22.1	20.2	19.1	18.3	16.8	16.7	16.7
Overall fiscal balance									
(commitment basis, excluding grants)	-16.5	-16.5	-14.5	-12.5	-14.0	-9.8	-9.4	-9.9	-9.2
(commitment basis, including grants)	-10.6	-8.3	-6.7	-3.5	-4.6	-1.3	-0.5	-2.6	-2.7
Domestic primary fiscal balance 5/	-7.7	-7.0	-5.6	-2.8	-2.3	-2.2	-1.9	-1.9	-2.0
Domestic financing	3.2	0.9	4.3	-0.1	0.9	0.7	0.3	0.1	0.0
Financing gap	...	...	...	...	0.6	0.0	...	...	...
	(In percent of exports of goods and nonfactor services)								
Debt service due (incl. to the Fund) after debt relief 6/	73.0	9.3	7.3	10.2	14.7	10.2	8.1	3.4	6.5
Debt service due (incl. to the Fund) before debt relief	86.0	52.7	48.1	38.3	29.4	28.1	18.7	17.8	17.3
Net present value of debt-to-exports ratio 7/ 8/	150.6	162.3	153.6	151.3	147.3	141.4	110.7	107.5	103.6
	(In millions of U.S. dollars, unless otherwise indicated)								
Memorandum items:									
External current account balance, excluding official transfers	-165.0	-113.6	-139.7	-123.7	-151.3	-173.4	-165.5	-177.6	-184.7
Gross international reserves	51.9	84.6	59.4	124.9	123.1	148.9	153.9	173.9	193.9
(in months of imports) 9/	1.9	2.5	1.8	2.9	2.8	3.0	2.8	2.9	3.0
GDP (billions of leones)	1,600.2	1,964.6	2,323.6	2,894.3	3,350.0	3,518.2	4,274.0	4,946.2	5,664.0
GDP (millions of U.S. dollars)	805.6	936.0	989.6	1,070.7	1,136.4	1,192.6	1,335.6	1,487.1	1,677.7

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.
1/ As in IMF Country Report No. 05/194. Ratios as percent of nominal GDP reflect revised national gross domestic product data.
2/ Changes as a percentage of beginning-of-period money stock (including foreign currency deposits)
3/ Treasury bill rate (end of period); in percent.
4/ Includes imports purchased with bilateral aid, those related to rehabilitation and reconstruction programs, and imports of embassies and the UN peacekeeping force (UNAMSIL).
5/ Domestic revenue minus total expenditure and net lending, excluding interest payments, and externally financed capital expenditure and disarmament, demobilization, and reintegration (DDR) program.
6/ As percent of exports of goods and services; after Naples (2001) and Cologne flow reschedulings (2002-04), and delivery of full HIPC initiative assistance.
7/ Net present value (NPV) of debt relative to backward-looking three-year average of exports of goods and services.
8/ Assumed unconditional delivery of enhanced HIPC initiative assistance in 2000.
9/ In months of imports of goods and services of subsequent year.

Table 2. Sierra Leone: Central Government Financial Operations, 2001-05 1/

	2001	2002	2003	2004	2005						
					Q1	Q2	Q3	Q4		Full year	
	Act.	Act.	Act.	Act.	Act.	Act.	Act.	Staff report	Rev.proj.	Staff report	Rev.proj.
	(In millions of leones, unless otherwise indicated)										
Total revenue and grants	302,692	400,027	467,001	616,342	136,070	138,051	152,859	227,439	300,562	748,261	727,542
Domestic revenue	207,669	238,691	287,657	356,966	90,345	110,296	104,414	113,523	123,293	434,982	428,347
Income Tax Department	54,395	62,881	75,581	97,676	26,494	26,550	33,812	28,484	35,144	112,423	122,000
Customs and Excise Department	138,181	160,589	192,379	221,591	51,041	60,006	57,591	71,126	74,385	263,430	243,023
Mines Department	1,196	2,034	3,040	7,721	2,720	3,227	2,585	2,731	4,468	13,654	13,000
Other departments	7,712	6,262	6,811	13,125	4,203	13,410	4,690	5,311	2,896	23,733	25,199
Road user charges	6,185	6,925	9,847	16,853	5,886	7,103	5,736	5,870	6,400	21,741	25,125
Grants	95,023	161,336	179,344	259,376	45,726	27,755	48,445	113,916	177,269	313,279	299,194
Program	57,268	118,199	144,843	206,172	20,761	13,599	48,445	85,960	157,708	208,314	240,512
Of which: HIPC Initiative	0	75,326	106,617	93,650	9,845	13,599	6,034	26,532	31,854	62,865	61,331
Projects	37,756	43,137	34,501	53,204	24,965	14,156	0	27,956	19,561	104,965	58,682
Total expenditure and net lending	472,263	562,252	622,392	717,554	202,625	182,128	183,316	229,771	204,761	903,941	772,831
Recurrent expenditure	397,186	474,811	509,760	583,519	149,278	149,398	176,776	163,895	167,315	640,831	642,768
Wages and salaries	111,856	142,769	160,092	177,243	49,599	55,930	58,023	61,188	62,388	222,982	225,940
Of which : social security payments	0	15,300	9,361	7,777	4,490	2,679	2,599	2,822	2,822	11,288	12,591
Recurrent noninterest, nonwage expenditure	186,480	227,245	234,505	247,250	49,694	54,680	71,473	69,971	76,351	258,582	252,199
Goods and services	136,734	154,606	192,389	191,690	33,510	36,885	57,746	55,682	61,532	197,805	189,673
Of which: additional poverty-related outlays	...	...	...	...	...	...	0	10,000	0	20,000	0
Of which: security-related expenditures	54,620	51,446	63,091	58,792	10,077	11,995	17,730	17,426	17,426	63,064	57,227
Of which: defense	37,868	33,371	40,774	35,243	5,073	6,604	11,156	11,208	11,208	39,270	34,041
Transfers to local councils	...	...	...	...	2,678	5,410	2,586	3,019	3,019	16,994	13,693
Democratization and DDR	28,566	33,736	9,512	9,065	0	0	0	0	0	0	0
Of which : domestic contribution	16,751	18,075	1,000	0	0	0	0	0	0	0	0
Grants to educational institutions	13,141	14,041	19,000	21,188	5,072	5,283	5,405	5,200	5,200	21,065	20,959
Transfers to Road Fund	6,180	6,925	9,847	16,853	5,886	7,103	5,736	5,870	6,400	21,741	25,125
Socially oriented outlays (soc. safety net)	1,365	0	3,007	1,868	2,548	0	0	200	200	977	2,748
Elections	495	17,937	750	6,586	0	0	0	0	0	0	0
Interest payments	72,796	104,797	115,163	159,026	49,985	38,788	47,280	32,735	28,576	159,267	164,629
Domestic	44,263	51,020	64,316	103,708	24,440	29,055	27,015	21,161	17,661	95,193	98,171
Foreign	28,533	53,777	50,847	55,318	25,545	9,733	20,265	11,574	10,915	64,074	66,457
Capital expenditure and net lending	75,077	87,441	112,632	134,035	53,347	32,730	6,540	65,876	37,446	263,110	130,063
Development expenditure	71,144	85,768	112,315	134,522	53,347	32,730	6,540	65,876	37,446	263,110	130,063
Foreign	56,542	65,227	81,943	108,436	45,031	24,275	0	62,206	34,654	231,815	103,960
Loans	43,823	53,827	55,955	64,297	20,066	10,119	0	34,250	15,093	126,850	45,278
Grants	12,719	11,400	25,988	44,139	24,965	14,156	0	27,956	19,561	104,965	58,682
Domestic	14,602	20,541	30,372	26,086	8,316	8,455	6,540	3,670	2,792	31,295	26,103
Subsidies	3,449	450	500	0	0	0	0	0	0	0	0
Lending minus repayments	484	1,223	-183	-487	0	0	0	0	0	0	0
Overall balance (commitment basis)											
Excluding grants	-264,594	-323,561	-334,735	-360,588	-112,280	-71,832	-78,902	-116,248	-81,468	-468,959	-344,483
Including grants	-169,571	-162,225	-155,391	-101,212	-66,555	-44,078	-30,457	-2,332	95,801	-155,680	-45,289
Total financing	169,571	162,225	155,391	101,212	66,555	44,078	30,457	2,332	-95,801	155,680	45,289
Foreign	624,766	143,734	66,764	110,772	10,020	386	27,422	13,450	-5,262	106,289	32,566
Borrowing	95,370	141,605	93,628	150,971	20,066	10,119	30,027	34,250	15,093	156,350	75,305
Project	43,823	53,827	55,955	64,297	20,066	10,119	0	34,250	15,093	126,850	45,278
Program	51,547	87,778	37,673	86,674	0	0	30,027	0	0	29,500	30,027
Amortization 2/	-38,515	-48,284	-89,590	-126,625	-53,960	-16,603	-42,846	-25,700	-24,780	-152,869	-138,188
Change in foreign arrears	...	...	-51,146	-25,093	0	0	0	0	0	0	0
Debt relief obtained 2/ 3/	567,911	50,413	113,871	111,518	43,914	6,870	40,241	4,900	4,425	102,808	95,450
Domestic	51,791	18,600	100,104	-2,107	61,490	50,251	4,367	-22,618	-90,539	30,890	25,569
Of which: bank	42,197	601	56,074	-51,635	32,505	32,368	-19,069	-9,047	-33,500	12,356	12,304
Privatization receipts	2,060	472	270	52	0	0	0	1,500	0	3,000	0
Change in arrears	-533,199	-3,586	-13,539	-7,361	-2,973	-544	-1,331	0	0	-4,500	-4,848
Unaccounted (– = overfinancing of the budget)	24,152	3,004	1,792	-143	-1,982	-6,017	0	0	0	0	-7,999
Financing gap	0	0	0	0	0	0	0	10,000	0	20,000	0
Memorandum items:											
Nominal GDP	1,600,169	1,964,627	2,310,767	2,894,262	3,518,154	3,518,154	3,518,154	3,518,154	3,518,154	3,518,154	3,518,154
Total HIPC Initiative interim assistance	0	75,326	106,617	93,650	9,845	13,599	6,034	26,532	31,854	61,920	61,331
Total HIPC Initiative interim assistance (as percent of GDP)	0.0	3.8	4.6	3.2	0.3	0.4	0.2	0.8	0.9	1.8	1.7
Total poverty expenditures (percent of tot. expenditures)	15.4	21.4	22.5	18.8	12.7	13.7	21.1	19.3	24.6	18.5	18.1
(in millions of leones)	72,833	120,555	140,158	134,691	25,748	25,020	38,767	44,429	50,279	167,471	139,814
	(In percent of GDP, unless otherwise indicated)										
Domestic revenue	13.0	12.1	12.4	12.3	2.6	3.1	3.0	3.2	3.5	12.4	12.2
Total expenditure and net lending	29.5	28.6	26.9	24.8	5.8	5.2	5.2	6.5	5.8	25.7	22.0
Of which: recurrent expenditure	24.8	24.2	22.1	20.2	4.2	4.2	5.0	4.7	4.8	18.2	18.3
Of which: domestic interest expenditure	2.8	2.6	2.8	3.6	0.7	0.8	0.8	0.6	0.5	2.7	2.8
Overall fiscal balance (commitment basis)											
Including grants	-10.6	-8.3	-6.7	-3.5	-1.9	-1.3	-0.9	-0.1	2.7	-4.4	-1.3
Excluding grants	-16.5	-16.5	-14.5	-12.5	-3.2	-2.0	-2.2	-3.3	-2.3	-13.3	-9.8
Domestic primary balance 5/	-7.7	-7.0	-5.6	-2.8	-0.5	-0.2	-0.9	-0.6	-0.5	-2.2	-2.2
(in millions of leones)	-123,442	-137,876	-129,117	-84,061	-17,264	-8,770	-31,622	-21,307	-18,238	-77,878	-75,894
Domestic financing	3.2	0.9	4.3	-0.1	1.7	1.4	0.1	-0.6	-2.6	0.9	0.7
Domestic debt stock	50.2	44.8	40.9	32.6	...	...	...	...	...	27.7	27.5
Total wages and salaries	7.0	7.3	6.9	6.1	1.4	1.6	1.6	1.7	1.8	6.3	6.4
Total wages and salaries (percent of dom. revenue)	53.9	59.8	55.7	49.7	54.9	50.7	55.6	53.9	50.6	51.3	52.7

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.
1/ Includes the disarmament, demobilization, and reintegration (DDR) program, which is managed outside the budget by a private firm hired by the DDR donors.
4/ Debt-service payments in the 2002 program refer to programmed debt service payments after debt relief granted by Paris Club and other bilateral creditors.
2/ To enhance transparency, actual debt-service payments in 2002 and projections beyond refer to debt service due before debt relief, and debt relief obtained is shown separately as a financing item.
Debt relief obtained encompasses a rescheduling on Naples terms following the agreed minutes with the Paris Club from October 2001 onward,
Cologne flow rescheduling for 2002-04 agreed by the Paris Club at the decision point in February 2002, and comparable relief by other creditors. Interim HIPC Initiative assistance by multilateral creditors is
3/ Debt relief obtained in 2001 includes rescheduling of outstanding arrears of $239 million by Paris Club and other creditors.
4/ In this presentation of the overall fiscal balance, HIPC Initiative relief is shown as program grants consistent with revised presentation in the balance of payments from 2002 onward.
In the 2002 program, HIPC Initiative relief was presented as external
5/ Domestic revenue minus total expenditure and net lending, excluding interest payments, externally financed capital expenditures, and the DDR program.

Table 3. Sierra Leone: Central Government Financial Operations, 2005-08 1/

	2005		2006					2007	2008
	Full year		Budget	Q1	Q2	Q3	Q4		
	Staff report 5/	Rev.proj.		Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In millions of leones, unless otherwise indicated)								
Total revenue and grants	748,261	727,542	917,526	185,676	232,445	277,719	221,686	1,008,410	1,143,341
Domestic revenue	434,982	428,347	538,808	111,409	136,990	134,897	155,512	650,954	771,250
Income Tax Department	112,423	122,000	163,470	35,473	40,214	43,156	44,627	198,223	235,484
Customs and Excise Department	263,430	243,023	292,673	58,535	68,778	74,631	90,729	339,134	396,844
Mines Department	13,654	13,000	19,293	5,358	5,196	4,408	4,331	29,735	31,563
Other departments	23,733	25,199	31,966	4,820	14,008	5,479	7,659	42,257	54,054
Road user charges	21,741	25,125	31,406	7,223	8,794	7,223	8,166	41,604	53,305
Grants	313,279	299,194	378,718	74,267	95,455	142,822	66,174	357,457	372,091
Program	208,314	240,512	240,479	36,447	50,624	113,792	39,616	267,319	276,213
Of which: HIPC Initiative	62,865	61,331	50,880	11,520	11,840	11,200	16,320	102,645	103,092
Projects	104,965	58,682	138,239	37,820	44,831	29,030	26,558	90,138	95,879
Total expenditure and net lending	903,941	772,831	940,377	218,791	223,337	231,245	267,005	1,138,348	1,293,658
Recurrent expenditure	640,831	642,768	718,124	170,015	167,550	189,069	191,491	826,341	943,579
Wages and salaries	222,982	225,940	265,089	66,500	65,750	67,000	65,839	299,535	331,674
Of which : social security payments	11,288	12,591	14,365	3,160	3,591	3,735	3,879	16,768	19,201
Recurrent noninterest, nonwage expenditure	258,582	252,199	310,362	63,134	72,095	79,602	95,531	363,697	446,684
Goods and services	197,805	189,673	221,418	44,137	50,543	56,016	70,722	274,711	356,112
Of which: additional poverty-related outlays	20,000	0	...	...	...	...	0	...	...
Of which: security-related expenditures	63,064	57,227	67,792	17,222	16,402	17,907	16,261	91,296	104,545
Of which: defense	39,270	34,041	41,859	11,000	10,500	10,179	10,179	56,673	64,897
Transfers to local councils	16,994	13,693	21,564	3,450	4,205	6,790	7,119	...	...
Democratization and DDR	0	0	0	0	0	0	0	0	0
Of which : domestic contribution	0	0	0	0	0	0	0	0	0
Grants to educational institutions	21,065	20,959	27,774	6,944	6,944	6,944	6,944	31,100	35,613
Transfers to Road Fund	21,741	25,125	31,406	7,223	8,794	7,223	8,166	41,604	53,305
Socially oriented outlays (soc. safety net)	977	2,748	200	100	50	50	0	1,443	1,653
Elections	0	0	8,000	1,280	1,560	2,580	2,580	14,839	0
Interest payments	159,267	164,629	142,673	40,381	29,705	42,466	30,121	163,109	165,221
Domestic	95,193	98,171	73,969	17,661	19,465	19,426	17,417	77,738	79,042
Foreign	64,074	66,457	68,704	22,720	10,240	23,040	12,704	85,371	86,179
Capital expenditure and net lending	263,110	130,063	222,252	48,775	55,786	42,176	75,514	312,007	350,079
Development expenditure	263,110	130,063	222,252	48,775	55,786	42,176	75,514	312,007	350,079
Foreign	231,815	103,960	178,431	37,820	44,831	29,030	66,750	231,179	246,193
Loans	126,850	45,278	40,192	0	0	0	40,192	141,041	150,315
Grants	104,965	58,682	138,239	37,820	44,831	29,030	26,558	90,138	95,879
Domestic	31,295	26,103	43,821	10,955	10,955	13,146	8,764	80,828	103,885
Subsidies	0	0	0	0	0	0	0	0	0
Lending minus repayments	0	0	0	0	0	0	0	0	0
Overall balance (commitment basis)									
Excluding grants	-468,959	-344,483	-401,568	-107,381	-86,347	-96,348	-111,493	-487,395	-522,408
Including grants	-155,680	-45,289	-22,851	-33,115	9,108	46,474	-45,319	-129,938	-150,317
Total financing	155,680	45,289	22,851	33,115	-9,108	-46,474	45,319	129,938	150,317
Foreign	106,289	32,566	-4,352	-6,784	-12,672	-3,648	18,752	144,639	152,883
Borrowing	156,350	75,305	40,192	0	0	0	40,192	141,041	150,315
Project	126,850	45,278	40,192	0	0	0	40,192	141,041	150,315
Program	29,500	30,027	0	0	0	0	0	0	0
Amortization 2/	-152,869	-138,188	-136,352	-52,320	-16,864	-36,448	-30,720	-121,047	-123,883
Change in foreign arrears	0	0	0	0	0	0	0	0	0
Debt relief obtained 2/	102,808	95,450	91,808	45,536	4,192	32,800	9,280	124,644	126,451
Domestic	30,890	25,569	14,282	40,432	-903	-47,292	22,045	7,261	2,510
Of which: bank	12,356	12,304	7,410	20,216	-451	-23,646	11,292	4,261	1,510
Privatization receipts	3,000	0	15,056	0	5,000	5,000	5,056	24,731	28,320
Change in arrears	-4,500	-4,848	-2,135	-534	-534	-534	-534	-2,135	-2,135
Unaccounted (– = overfinancing of the budget)	0	-7,999	0	0	0	0	0	0	0
Financing gap	20,000	0	0	0	0	0	0	0	0
Memorandum items:									
Nominal GDP	3,518,154	3,518,154	4,273,954	4,273,954	4,273,954	4,273,954	4,273,954	4,946,210	5,663,985
Total HIPC Initiative interim assistance	61,920	61,331	50,880	11,520	11,840	11,200	16,320	102,645	103,092
Total HIPC Initiative interim assistance (as percent of GDP)	1.8	1.7	1.2	0.3	0.3	0.3	0.4	2.1	1.8
Total poverty expenditures (percent of tot. expenditures)	18.5	18.1	22.1	19.8	20.6	28.6	19.7	30.4	35.0
(in millions of leones)	167,471	139,814	207,873	43,320	45,934	66,115	52,504	346,235	453,119
	(In percent of GDP, unless otherwise indicated)								
Domestic revenue	12.4	12.2	12.6	2.6	3.2	3.2	3.6	13.2	13.6
Total expenditure and net lending	25.7	22.0	22.0	5.1	5.2	5.4	6.2	23.0	22.8
Of which: recurrent expenditure	18.2	18.3	16.8	4.0	3.9	4.4	4.5	16.7	16.7
Of which: domestic interest expenditure	2.7	2.8	1.7	0.4	0.5	0.5	0.4	1.6	1.4
Overall fiscal balance (commitment basis) 3/									
Including grants	-4.4	-1.3	-0.5	-0.8	0.2	1.1	-1.1	-2.6	-2.7
Excluding grants	-13.3	-9.8	-9.4	-2.5	-2.0	-2.3	-2.6	-9.9	-9.2
Domestic primary balance 4/	-2.2	-2.2	-1.9	-0.7	-0.3	-0.6	-0.3	-1.9	-2.0
(in millions of leones)	-77,878	-75,894	-80,465	-29,180	-11,811	-24,852	-14,623	-93,107	-110,993
Domestic financing	0.9	0.7	0.3	0.9	0.0	-1.1	0.5	0.1	0.0
Domestic debt stock	27.7	27.5	23.1	23.6	23.1	22.5	23.6	20.1	17.6
Total wages and salaries	6.3	6.4	6.2	1.6	1.5	1.6	1.5	6.1	5.9
Total wages and salaries (percent of dom. revenue)	51.3	52.7	49.2	59.7	48.0	49.7	42.3	46.0	43.0

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ Includes the disarmament, demobilization, and reintegration (DDR) program, which is managed outside the budget by a private firm hired by the DDR donors.

2/ To enhance transparency, actual debt-service payments in 2002 and projections beyond refer to debt service due before debt relief, and debt relief obtained is shown separately as a financing item. Debt relief obtained encompasses a rescheduling on Naples terms following the agreed minutes with the Paris Club from October 2001 onward, Cologne flow rescheduling for 2002-04 agreed by the Paris Club at the decision point in February 2002, and comparable relief by other creditors. Interim HIPC Initiative assistance by multilateral creditors is shown as grants.

3/ In this presentation of the overall fiscal balance, HIPC Initiative relief is shown as program grants consistent with revised presentation in the balance of payments from 2002 onward. In the 2002 program, HIPC Initiative relief was presented as external

4/ Domestic revenue minus total expenditure and net lending, excluding interest payments, externally financed capital expenditures, and the DDR program.

Table 4. Sierra Leone: Monetary Survey, December 2001-December 2005
(In millions of leones; at actual exchange rates unless otherwise indicated)

	2001	2002	2003	2004	2005							
	Dec.	Dec.	Dec.	Dec.	Mar.		Jun.		Sep.		Dec.	
	Act.	Act.	Act.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Act.	Proj.	Rev. Proj. 4/
Monetary survey												
Net foreign assets	-202,292	-140,521	-195,880	-103,823	-123,416	-78,159	-140,574	-98,475	-153,483	-70,328	-88,076	-5,417
Net domestic assets	493,155	519,035	673,691	671,944	699,145	705,777	715,008	742,500	737,891	732,834	722,102	667,402
Domestic credit	762,458	785,300	889,340	879,411	905,504	920,094	921,392	966,064	944,320	948,184	928,414	916,050
Claims on government (net)	727,016	727,617	792,362	740,471	755,846	772,976	761,651	805,344	776,874	786,275	752,827	752,775
Claims on government (net) 1/ 2/	194,991	195,592	261,325	209,591	224,966	242,657	230,771	275,026	245,994	255,956	221,947	222,456
Claims on nonfinancial public enterprises	499	963	3,661	3,453	3,503	3,731	3,503	3,276	3,503	5,355	3,553	5,405
Claims on private sector	34,943	56,719	93,317	135,486	146,155	143,387	156,238	157,444	163,943	156,555	172,034	157,871
Other items (net)	-269,302	-266,264	-215,649	-207,467	-206,359	-214,317	-206,383	-223,564	-206,430	-215,351	-206,312	-248,649
Broad money	290,864	378,514	477,811	568,120	575,730	627,618	574,434	644,025	584,408	662,506	634,027	661,985
Money	189,437	247,478	292,950	344,523	328,195	358,925	327,456	358,132	333,141	373,249	361,427	343,023
Quasi money	101,427	131,037	184,861	223,597	247,535	268,692	246,978	285,893	251,266	289,257	272,600	318,962
Bank of Sierra Leone												
Net foreign assets	-249,587	-198,904	-274,719	-203,878	-236,927	-208,509	-268,836	-237,406	-302,394	-195,920	-248,787	-136,348
Foreign assets	115,454	191,179	168,696	365,530	345,511	344,339	364,443	360,486	330,838	393,026	371,706	436,775
Foreign liabilities	-365,041	-390,083	-443,415	-569,409	-582,438	-552,848	-633,279	-597,892	-633,232	-588,946	-620,493	-573,122
Net domestic assets	391,690	376,345	491,936	448,501	479,968	467,540	513,748	497,634	551,925	455,145	518,996	404,936
Claims on government (net)	637,163	612,623	670,622	589,194	619,069	614,711	652,874	650,801	691,097	605,390	658,050	587,890
Claims on government (net) 2/ 3/	105,138	80,598	139,585	58,314	88,189	84,393	121,994	120,482	160,217	75,072	127,170	57,572
Claims on nonfinancial public enterprises	13	13	13	13	13	13	13	13	13	13	13	13
Claims on private sector	1,969	6,161	1,911	2,125	2,125	5,551	2,125	3,963	2,125	2,505	2,125	2,505
Claims on deposit money banks	969	278	59	3,163	3,163	1,782	3,163	34	3,136	2,686	3,163	2,686
Other items (net)	-248,423	-242,730	-180,670	-145,994	-144,402	-154,517	-144,426	-157,177	-144,473	-155,449	-144,355	-188,158
Reserve money	142,103	177,441	217,217	244,622	243,040	259,031	244,913	260,228	249,531	259,225	270,209	268,589
Currency outside banks	116,153	148,015	188,448	204,733	207,475	200,999	207,008	205,074	210,602	205,908	228,483	205,747
Reserves of deposit money banks	20,118	20,772	18,682	27,515	23,025	29,759	25,393	35,969	26,199	37,590	27,916	47,128
Other deposits	5,833	8,654	10,087	12,375	12,540	28,272	12,512	19,185	12,729	15,726	13,810	15,714
Deposit money banks												
Net foreign assets	47,295	58,383	78,839	100,055	113,511	130,350	128,261	138,932	148,911	125,592	160,711	130,931
Net domestic assets	118,220	163,462	200,437	250,958	242,203	267,996	226,652	280,835	212,165	315,278	231,022	309,594
Claims on government (net)	89,854	114,994	121,740	151,277	136,777	158,264	108,777	154,544	85,777	180,884	94,777	164,884
Claims on nonfinancial public enterprises	486	950	3,647	3,440	3,490	3,718	3,490	3,263	3,490	5,342	3,540	5,392
Claims on private sector	32,974	50,559	91,406	133,362	144,031	137,837	154,113	153,480	161,818	154,050	169,909	155,366
Reserves	17,047	21,696	20,099	27,999	23,025	34,145	25,393	32,691	26,199	38,179	27,916	47,128
Other items (net)	-22,140	-24,737	-36,455	-65,120	-65,120	-65,967	-65,120	-63,143	-65,120	-63,176	-65,120	-63,176
Total deposits	165,516	221,845	279,275	351,013	355,714	398,346	354,914	419,766	361,076	440,871	391,733	440,525
Local currency deposits	119,493	166,577	207,545	257,459	260,907	276,660	260,320	280,533	264,839	317,139	287,326	313,335
Foreign currency deposits	46,023	55,268	71,731	93,555	94,808	121,686	94,594	139,233	96,237	123,732	104,408	127,189
Memorandum items:					Annual percentage growth							
Net foreign assets	13.1	-30.5	39.4	-47.0	-41.5	-62.9	-32.0	-52.4	-21.1	-63.8	-15.2	-94.8
Net domestic assets	24.4	5.2	29.8	-0.3	-1.1	-0.2	-2.1	1.6	-1.9	-2.6	7.5	-0.7
of which: Claims on government (net)	6.2	0.1	8.9	-6.5	-7.6	-5.5	-8.0	-2.7	-7.6	-6.5	1.7	1.7
Broad money	33.7	30.1	26.2	18.9	16.0	26.5	9.7	23.0	14.8	18.8	11.6	16.5
Reserve money	29.4	24.9	22.4	12.6	12.6	20.0	13.1	20.1	15.6	20.0	10.5	9.8
Banks' reserves	-17.0	27.3	-7.4	39.3	15.4	71.2	25.7	61.8	5.3	53.5	-0.3	68.3
Banks' claims on private sector	22.0	53.3	80.8	45.9	44.5	38.3	42.9	42.3	35.4	28.9	27.4	16.5

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.
1/ New special non-interest-bearing government stocks were issued by the Bank of Sierra Leone to cover foreign exchange valuation losses incurred.
2/ Excluding non-interest-bearing stock.
3/ Including foreign currency deposits.
4/ Items denominated in foreign currencies are valued at end-December 2005 rates.

Table 5. Sierra Leone: Monetary Survey, December 2005-December 2008
(In millions of leones; at actual exchange rates unless otherwise indicated)

	2005	2006				2007	2008
	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.	Dec
Proj. 6/	Rev. Proj. 4/	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Net foreign assets	-5,417	-18,710	7,782	53,884	21,160	100,576	209,533
Net domestic assets	667,402	698,689	713,940	692,507	705,415	732,315	756,067
Domestic credit	916,050	946,354	961,605	940,172	953,080	981,426	1,005,968
Claims on government (net)	752,775	772,991	772,539	748,893	760,185	764,446	765,956
Claims on government (net) 1/ 2/	222,456	242,673	242,221	218,575	229,866	234,127	235,637
Claims on nonfinancial public enterprises	5,405	5,455	5,455	5,455	5,505	5,555	5,605
Claims on private sector	157,871	167,909	183,611	185,824	187,391	211,426	234,407
Other items (net)	-248,649	-247,665	-247,665	-247,665	-247,665	-249,112	-249,901
Broad money	661,985	679,979	721,722	746,391	726,574	832,891	965,600
Money	343,023	345,547	366,759	375,564	361,960	423,253	510,004
Quasi money	318,962	334,432	354,962	370,827	364,615	409,638	455,596
Net foreign assets	-136,348	-159,241	-142,349	-105,847	-148,171	-72,081	33,500
Foreign assets	436,775	435,480	445,390	502,064	452,753	519,276	586,796
Foreign liabilities	-573,122	-594,721	-587,740	-607,911	-600,925	-591,356	-553,295
Net domestic assets	404,936	436,136	430,684	405,038	443,829	402,644	339,365
Claims on government (net)	587,890	618,107	612,655	587,009	625,800	586,061	523,571
Claims on government (net) 2/ 3/	57,572	87,788	82,337	56,691	95,482	55,743	-6,747
Claims on nonfinancial public enterprises	13	13	13	13	13	13	13
Claims on private sector	2,505	2,505	2,505	2,505	2,505	2,505	2,505
Claims on deposit money banks	2,686	2,686	2,686	2,686	2,686	2,686	2,686
Other items (net)	-188,158	-187,175	-187,175	-187,175	-187,175	-188,621	-189,410
Reserve money	268,589	276,895	288,335	299,191	295,658	330,563	372,865
Currency outside banks	205,747	211,339	224,313	231,980	225,821	258,865	300,111
Reserves of deposit money banks	47,128	49,414	46,890	49,493	52,590	51,928	49,833
Other deposits	15,714	16,141	17,132	17,718	17,247	19,771	22,921
Net foreign assets	130,931	140,531	150,131	159,731	169,331	172,657	176,033
Net domestic assets	309,594	311,968	330,146	336,962	314,175	381,598	466,535
Claims on government (net)	164,884	154,884	159,884	161,884	134,384	178,384	242,384
Claims on nonfinancial public enterprises	5,392	5,442	5,442	5,442	5,492	5,542	5,592
Claims on private sector	155,366	165,404	181,107	183,319	184,886	208,921	231,903
Reserves	47,128	49,414	46,890	49,493	52,590	51,928	49,833
Other items (net)	-63,176	-63,176	-63,176	-63,176	-63,176	-63,176	-63,176
Total deposits	440,525	452,499	480,277	496,693	483,506	554,255	642,568
Local currency deposits	313,335	315,052	334,393	342,091	329,375	385,900	466,700
Foreign currency deposits	127,189	137,446	145,884	154,602	154,131	168,355	175,868
Memorandum items:							
			Annual percentage growth				
Net foreign assets	-94.8	-76.1	-107.9	-176.6	-490.6	375.3	108.3
Net domestic assets	-0.7	-1.0	-3.8	-5.5	5.7	3.8	3.2
of which: Claims on government (net)	1.7	0.0	-4.1	-4.8	1.0	0.6	0.2
Broad money	16.5	8.3	12.1	12.7	9.8	14.6	15.9
Reserve money	9.8	6.9	10.8	15.4	10.1	11.8	12.8
Banks' reserves	68.3	44.7	43.4	29.6	11.6	-1.3	-4.0
Banks' claims on private sector	16.5	20.0	18.0	19.0	19.0	13.0	11.0

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ New special non-interest-bearing government stocks were issued by the Bank of Sierra Leone to cover foreign exchange valuation losses incurred.

2/ Excluding non-interest-bearing stock.

3/ Including foreign currency deposits.

4/ Items denominated in foreign currencies are valued at end-December 2005 rates.

Table 6. Sierra Leone: Balance of Payments, 2002-10
(In millions of U.S. dollars, unless otherwise indicated)

	2002 Act. 1/	2003 Act.	2004 Prog.	2004 Est.	2005 Prog.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.
Current account balance	-44.6	-75.1	-120.4	-52.6	-93.0	-101.1	-92.3	-100.2	-106.1	-98.0	-100.8
Balance on goods	-140.1	-148.5	-177.2	-77.0	-109.3	-128.1	-123.0	-123.3	-120.0	-105.2	-98.7
Exports, f.o.b.	114.8	146.3	184.6	171.3	203.6	210.7	279.5	322.2	365.6	407.9	449.7
of which: Rutile	0.0	0.0	0.0	0.0	0.0	0.0	47.4	62.6	78.8	96.1	113.7
of which: Bauxite	0.0	0.0	0.0	0.0	0.0	0.0	10.0	27.3	30.3	33.6	36.5
of which: Diamonds 2/	96.7	126.2	162.3	157.9	178.7	182.9	186.8	189.9	195.8	205.8	213.3
of which: Kimberlite	0.0	0.0	19.0	17.3	23.0	25.0	40.0	43.0	46.4	48.8	51.2
Imports, f.o.b.	-254.9	-294.8	-361.8	-248.4	-312.9	-338.8	-402.5	-445.4	-485.7	-513.1	-548.4
of which: Petroleum products	-35.3	-46.2	-82.3	-59.7	-113.8	-107.5	-142.3	-159.9	-166.8	-175.2	-183.9
of which: Rice	-23.4	-23.2	-24.6	-24.9	-22.1	-24.0	-19.4	-19.6	-19.7	-19.9	-20.1
Balance on services	-42.4	-62.6	-65.2	-89.8	-89.7	-94.6	-96.5	-107.2	-117.5	-131.7	-147.7
Credit	38.3	51.0	53.8	67.5	79.4	75.9	92.5	106.4	120.9	133.1	146.5
Debit	-80.8	-113.6	-119.0	-157.4	-169.0	-170.5	-189.1	-213.7	-238.4	-264.8	-294.1
Income	-29.2	-27.0	-27.6	-31.4	-30.3	-31.0	-29.8	-33.6	-37.2	-39.1	-40.8
Credit	18.3	19.8	20.3	21.3	20.7	21.7	22.5	23.3	24.1	25.0	25.9
Debit	-47.5	-46.9	-47.9	-52.7	-51.0	-52.7	-52.3	-56.9	-61.3	-64.1	-66.7
Interest payments due before debt relief 3/	-26.3	-22.8	-21.5	-21.4	-22.7	-24.4	-22.5	-24.3	-23.4	-22.4	-21.4
Current transfers	167.2	163.0	149.7	145.7	136.3	152.5	157.1	163.8	168.6	178.0	186.4
Public (net) 4/	69.0	64.7	64.9	71.2	58.3	72.3	73.3	77.4	78.7	81.0	83.8
of which: HIPC grants	35.8	45.4	35.0	35.0	21.3	21.0	17.1	30.9	30.5	31.2	32.2
Private (net) 5/	98.2	98.4	84.8	74.5	77.9	80.2	83.7	86.3	89.8	96.9	102.4
Current account balance, excl. public transfers	-113.6	-139.7	-185.2	-123.7	-151.3	-173.4	-165.5	-177.6	-184.7	-179.0	-184.7
Capital and financial account	41.7	29.7	93.1	67.8	25.8	79.7	59.9	85.6	99.9	96.6	94.7
Capital account	7.6	16.4	28.2	28.2	37.8	22.2	20.9	29.6	31.0	32.7	34.8
Project grants	5.5	14.2	26.1	26.1	35.6	19.9	18.5	27.1	28.4	30.0	32.0
Private capital transfers	2.1	2.2	2.2	2.2	2.3	2.3	2.4	2.5	2.6	2.7	2.8
Financial account	34.1	13.3	64.9	39.6	-12.0	57.5	39.0	56.0	68.9	63.9	60.0
Direct investment and portfolio investment 6/	1.7	21.0	29.5	12.5	27.2	39.1	26.2	17.5	19.5	23.1	24.2
Other investment	32.4	-7.7	35.4	27.1	-39.2	18.4	12.8	38.5	49.4	40.8	35.8
Public sector loans (net)	43.9	10.8	41.4	43.2	1.3	13.8	-5.4	16.0	17.8	18.8	25.1
of which: disbursements	66.8	48.4	88.4	90.3	53.1	61.7	37.2	52.4	54.5	56.8	61.1
of which: program loans	40.9	15.9	29.5	31.3	10.1	18.7	0.0	10.0	10.0	10.0	12.0
of which: project loans	25.9	32.5	58.9	58.9	43.0	43.0	37.2	42.4	44.5	46.8	49.1
of which: amortization due before debt relief 7/	-22.9	-37.5	-47.0	-47.0	-51.8	-47.9	-42.6	-36.4	-36.7	-38.0	-36.0
Private sector loans (net) 8/	0.0	0.0	26.4	38.4	5.6	15.6	22.9	10.0	22.2	16.6	3.7
Change in net foreign assets of commercial banks	-5.3	-8.7	-17.4	-7.8	-20.6	-16.7	-19.0	-1.0	-3.0	-8.0	-8.0
Other, including errors and omissions	-6.2	-9.8	-15.0	-46.8	-25.5	5.7	14.3	13.5	12.4	13.4	15.0
Overall balance	-2.9	-45.4	-27.2	15.3	-67.2	-21.4	-32.4	-14.6	-6.2	-1.4	-6.1
Financing	2.9	45.4	27.2	-15.3	67.2	21.4	32.4	14.6	6.2	1.4	6.1
Change in net foreign assets of the central bank (- increase)	-27.7	10.2	-4.9	-47.4	14.6	-11.7	-9.4	-35.5	-43.9	-47.5	-54.7
Change in reserve assets (- increase)	-32.3	25.2	-22.5	-65.5	1.8	-24.1	-5.0	-20.0	-20.0	-20.0	-15.0
Net Fund credit	4.6	-15.1	17.6	18.1	12.8	12.3	-4.4	-15.5	-23.9	-27.5	-39.7
Disbursements	36.0	19.6	41.1	41.2	21.6	20.7	0.0	0.0	0.0	0.0	0.0
Repayments	-31.4	-34.6	-23.5	-23.1	-8.7	-8.4	-4.4	-15.5	-23.9	-27.5	-39.7
Exceptional financing	30.6	35.2	32.1	32.1	34.9	33.2	0.0	0.0	0.0	0.0	0.0
Change in arrears (+ increase) 9/	6.7	-13.8	-9.5	-9.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief 10/	23.9	49.1	41.6	41.6	34.9	33.2	0.0	0.0	0.0	0.0	0.0
Financing gap	0.0	0.0	0.0	0.0	0.0	0.0	41.7	50.1	50.1	48.9	60.7
Debt relief 10/ 11/	0.0	0.0	0.0	0.0	0.0	0.0	28.7	37.5	37.5	36.3	38.6
Fund disbursement under new PRGF	0.0	0.0	0.0	0.0	0.0	0.0	13.0	12.6	12.6	6.3	0.0
Remaining gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.3	22.1
Memorandum items:						(in percent of GDP)					
Current account	-4.8	-7.6	-11.5	-4.9	-8.0	-8.5	-6.9	-6.7	-6.3	-5.4	-5.1
Current account, excluding public transfers	-12.1	-14.1	-17.7	-11.6	-13.0	-14.5	-12.4	-11.9	-11.0	-9.8	-9.3
Overall balance of payments	-0.3	-4.6	-2.6	1.4	-5.8	-1.8	-2.4	-1.0	-0.4	-0.1	-0.3
Exports, f.o.b.	12.3	14.8	17.7	16.0	17.6	17.7	20.9	21.7	21.8	22.4	22.6
Imports, c.i.f.	31.7	35.0	40.7	26.4	31.6	32.4	34.4	34.1	33.0	32.1	31.5
Gross official reserves (in millions of US dollars)	84.6	59.4	81.9	124.9	123.1	148.9	153.9	173.9	193.9	213.9	228.9
Gross official reserves (in months of imports)	2.5	1.8	2.0	2.9	2.8	3.0	2.8	2.9	3.0	3.0	3.1

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ BOP data for 2002 were compiled for the first time on the basis of the Balance of Payment Manual Fifth Edition (BPM5), which has led to a number of significant changes including a better measurement of non-dutiable imports and private transfers through the use of new surveys.
2/ Includes unrecorded diamond exports estimated from partner-country data.
3/ Official interest payments due, including Fund charges.
4/ Includes mostly program grants.
5/ Includes worker remittances and transfers to NGOs.
6/ Includes investment related to the rehabilitation of the Koidu Kimberlite mine and assumes investment into rutile mining, financed by foreign loans, foreign investment, and government on-lending of an EU grant.
7/ Amortization due increases in 2003 and beyond because of debt service payments falling due on previously rescheduled arrears.
8/ Includes capital outflows associated with unrecorded diamond exports, and change in trade credits.
9/ The arrears accumulation in 2002 is due to technical arrears that were accumulated while negotiations with bilateral creditors on rescheduling were not yet concluded. The arrears reduction in 2003 results from the implementation of arrears rescheduling agreements with the EU, the Saudi Fund for Economic Development, and the OPEC Fund. In 2004, arrear clearance operations with the EU and the OPEC Fund are completed.
10/ This reflects the rescheduling on Cologne terms for the period 2002-05 agreed by the Paris Club at the decision point in February 2002, and assumptions of the extended consolidation period retroactively from July 2005 under the new PRGF program. Comparable relief by other creditors is assumed.
11/ Includes Japanese Debt cancellation under the TDB Resolution.

Table 7. Sierra Leone: Status of HIPC Initiative Completion Point Triggers
(As of October 2005)

Triggers	**Status**
PRSP. Preparation of a full PRSP and implementation for at least one year, as evidenced by the satisfactory joint staff assessment of the PRSP and the country's annual progress report.	**Partially met**. The PRSP was presented to the World Bank and Fund in February 2005. The implementation of the PRSP started in July 2005, and the 2006 budget was framed in the context of the PRSP activities.
Macroeconomic stability. Continued maintenance of macroeconomic stability as evidenced by satisfactory implementation of the PRGF-supported program.	**Fully met.** The sixth and final review of the PRGF was concluded in June 2005. Discussions with the IMF on a successor PRGF were conducted in October 2005.
Use of budgetary savings. The budgetary savings from interim debt-service relief in 2002 have been used in the priority areas indicated in Table 2 of the *Enhanced Initiative for HIPC—Decision Point Document* and monitored in the framework for poverty-reduction expenditures. The increase in total spending on these priorities will be proportionate to HIPC Initiative relief. Budgetary savings from interim debt-service relief in subsequent years will be used in accordance with the agreed annual budgets for those years.	**Partially met.** Budgetary savings from the interim HIPC relief allowed government to more than double expenditures on poverty reducing programs and projects relative to the level of spending in 2001. However, shortfalls and delays in the receipt of non-HIPC external assistance has reduced spending below the budgeted in all categories, including poverty programs (by about 20 percent less than the level of spending if all HIPC savings during 2002-04 had been fully applied to poverty-reducing programs).
Governance and decentralization of government functions	
Completion of disarmament and demobilization, and provision of reintegration assistance to all former combatants under the DDR program.	**Fully met.** By the end of February 2004 over 56,000 ex-combatants had received financial and material support for reintegration into active community life.
Bi-annual tracking of public expenditures on priority areas within the PETS framework, including development expenditures, dissemination, and publication of results.	**Partially met.** The report of the FY2003 PETS on Education, Health, and Agriculture has been published. The PETS for FY2004 expenditures was conducted in September 2005. The data collected are being processed and analyzed. A draft report is expected to be available in January 2006.
Adoption and implementation of the Medium Term Expenditure Framework (MTEF), and budget system for tracking expenditures at the regional levels.	**Fully met.** Government began publishing the annual budget in the context of the MTEF in 2002. The expenditure codes for the Financial Management Information System include regional designations.
Structural measures	
A Bill has been passed to introduce new privatization legislation that establishes an independent National Commission for Privatization to implement the government's divestiture strategy that was approved by the Cabinet in May 2000.	**Fully met.** The National Commission for Privatization (NCP) Act was enacted in November 2002. The NCP is mandated to divest government ownership and control over these and other public enterprises. The Commission completed its divestiture plan in September 2003 and issued a revised plan in December 2004.
Adoption by the government of a revised mining policy to promote formal activities (including artisanal mining) and attract private investment for medium- and large-scale mining.	**Fully met.** The Ministry of Mineral Resources (MMR) adopted a new Core Mineral Policy in late 2003. The MMR has subsequently formed a technical sub-committee of the Law Reform Commission to identify and propose changes in the legal and regulatory framework for consistency with the new Core Mineral Policy.

Table 7. Sierra Leone: Status of HIPC Initiative Completion Point Triggers (concluded)
(as of October 2005)

Triggers	Status
Education	
The primary gross enrollment rates for girls will have been increased to at least 65 percent.	**Fully met.** The gross enrollment rate for girls in primary school in 2004/ 05 school year is approximately 152 percent.
At least 1,500 unqualified teachers will have received formal in-service training in primary schools and at least 500 unqualified will have received in-service training in secondary schools.	**Partially met.** In-service training for unqualified teachers in primary schools was 3,240 teachers (1,700 under REBEP and 1,540 with UNICEF). In-service training for unqualified teachers in secondary schools was completed for only 150. As part of the Sababu Education Project, an additional 1,488 unqualified teachers were trained in August 2005. A further training for unqualified teachers is scheduled for November 2005 and this will include teachers in secondary schools.
Health	
Distribution of insecticide-treated bed nets will have increased from 18,482 in 2000 to 60,000.	**Fully Met.** Concerted efforts of government of Sierra Leone, UNICEF, World Bank, and AfDB, have led to the distribution of 250,000 bed nets this year. Through October 2005, UNICEF had distributed 143,289 insecticide-treated bed nets and they expect to increase this number to 250,000 in 2006. The EU intends to distribute 30,000 bed nets in 3 districts in 2006 while the World Bank will distribute 160,000 (60,000 to under five and pregnant mothers and 100,000 for social marketing) bed nets in 2006.
At least 200 persons, including professionals and staff from line ministries and health and civil society organizations, will have been provided by the National HIV/AIDS Secretariat with HIV/AIDS and STIs education and training on prevention and basic care, in order to encourage HIV/AIDS and STIs avoidance behavior, destigmatize the disease, and support those infected or otherwise affected by the disease.	**Fully Met.** 495 health staff trained on management of STIs. 454 health staff trained on Medical Waste Management. 476 health staff trained on management of opportunistic infections. 147 health staff trained on VCCT on HIV/AIDS. 102 health staff trained on PMTCT on HIV/AIDS. 25 health staff trained on sentinel monitoring of HIV/AIDS. A) Number of clients who visited VCCT(Voluntary Confidential Counseling and Testing) services: 2005 Total = 10,904 B) Number of clients who visited PMTCT (Prevention of Mother to Child Transmission) services: 2005 Total = 8,295 C) Number of PLWHAs receiving ARVs: 2005 Total = 491
Immunization coverage (percentage of children aged 12 to 23 months immunized against diphtheria, pertussis, and tetanus) will have increased to at least 55 percent.	**Partially met.** Immunization coverage for children aged under 12 months against diphtheria, pertussis, and tetanus (DPT third immunization) through September 2005 was 105,371 of a total population of 229,088 (about 46 percent). Figures for the age group 12 to 23 months are obtained from surveys (the latest survey was carried out in 2001).

Table 8. Sierra Leone: External Financing Requirements and Sources, 2001-2010
(In millions of U.S. dollars)

	2001	2002	2003	2004	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.
Current account										
(excluding interest and official transfers)	-150.2	-87.2	-116.9	-102.3	-149.0	-143.1	-153.3	-161.3	-156.6	-163.3
Debt-service obligations (before relief)	111.0	80.7	94.9	91.6	80.6	69.4	76.2	84.0	87.9	97.0
Interest	14.8	26.3	22.8	21.4	24.4	22.5	24.3	23.4	22.4	21.4
Amortization	96.2	54.3	72.1	70.2	56.3	47.0	51.9	60.6	65.5	75.6
of which IMF	75.4	31.4	34.6	23.1	8.4	4.4	15.5	23.9	27.5	39.7
Reduction of arrears 1/	239.1	-6.7	13.8	9.5	0.0	0.0	0.0	0.0	0.0	0.0
Increase in gross reserves	13.9	32.3	-25.2	65.5	24.1	5.0	20.0	20.0	20.0	15.0
Gross financing requirement	-514.1	-193.5	-200.5	-268.9	-253.7	-217.5	-249.5	-265.3	-264.5	-275.3
Identified disbursements	514.1	193.5	200.5	268.9	253.7	217.5	249.5	265.3	258.2	253.2
Loans for balance of payments support	93.5	76.9	35.4	72.5	39.4	13.0	22.6	22.6	16.3	12.0
IMF	59.6	36.0	19.6	41.2	20.7	13.0	12.6	12.6	6.3	0.0
World Bank/IDA	27.5	28.5	15.9	16.9	0.0	0.0	10.0	10.0	10.0	12.0
African Development Bank	6.3	12.3	0.0	14.5	18.7	0.0	0.0	0.0	0.0	0.0
Grants	41.0	74.5	78.8	97.2	92.1	91.8	104.5	107.1	111.0	115.8
Program	22.3	53.7	59.2	71.2	72.3	73.3	77.4	78.7	81.0	83.8
Of which: HIPC Initiative grants	0.0	35.8	45.4	35.0	21.0	17.1	30.9	30.5	31.2	32.2
Project	18.6	20.8	19.7	26.1	19.9	18.5	27.1	28.4	30.0	32.0
Project loans	22.9	25.9	32.5	58.9	43.0	37.2	42.4	44.5	46.8	49.1
Foreign direct investment & private sector loans	-12.0	1.6	21.0	50.9	54.7	42.1	39.3	44.5	39.7	27.9
Debt relief 2/	255.9	23.9	49.1	41.6	33.2	28.7	37.5	37.5	36.3	38.6
Other capital, including errors and omissions	112.8	-9.3	-16.4	-52.4	-8.7	4.7	3.2	9.2	8.1	9.8
Remaining Financing gap 3/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-6.3	-22.1

Sources: Sierra Leonean authorities; and staff estimates and projections.

1/ Rescheduling of arrears by the Paris Club; assumes comparable treatment by other creditors, including military contractors.
2/ Include Naples flow rescheduling provided by the Paris Club in October 2001, Cologne flow rescheduling for 2002-05 agreed by the Paris Club at the decision point in February 2002, and retroactive extention of Cologne flow terms until the HIPC completion point in 2006. Comparable relief by other creditors are also assumed. For 2001, the amount includes the rescheduling of arrears of $239.1 million.
3/ After identified disbursements, debt reschedulings, HIPC Initiative assistance, and short-term capital movements.

Table 9. Sierra Leone: Disbursements Under the PRGF Arrangement, 2006–09
(In millions of SDRs)

Date	Disbursements	Subject to
March 24, 2006	4.71	Approval of arrangement
August 2006	4.40	First review and performance criteria (PCs) for end-March 2006
February 2007	4.40	Second review and PCs for end-September 2006
August 2007	4.40	Third review and PCs for end-March 2007
February 2008	4.40	Fourth review and PCs for end-September 2007
August 2008	4.40	Fifth review and PCs for end-March 2008
March 23, 2009	4.40	Sixth review and PCs for end-September 2008
Total disbursements	31.11[1]	

Source: IMF.

[1] The total disbursement is equivalent to 30 percent of Sierra Leone's quota.

Table 10. Sierra Leone: Indicators of Capacity to Repay the Fund, 2001-2010 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2001	2002	2003	2004	2005 Est.	2006 Proj.	2007 Proj.	2008 Proj.	2009 Proj.	2010 Proj.
Fund credit outstanding (end of period) 1/										
In millions of SDRs	120.8	124.5	113.8	126.0	134.4	140.5	138.4	130.6	115.8	91.1
In millions of U.S. dollars	153.8	161.3	159.1	185.4	198.6	201.2	198.5	187.4	166.2	130.6
In percent of quota	116.5	120.1	109.7	121.6	129.6	135.4	133.5	125.9	111.7	87.8
				In millions of US dollars						
Fund obligations	78.1	32.2	35.5	24.0	9.3	5.4	16.5	24.4	28.3	36.2
Fund total charges and interests	2.7	0.8	0.9	0.9	1.0	1.0	1.0	0.5	0.8	0.7
Existing drawings	2.7	0.8	0.9	0.9	1.0	1.0	0.9	0.4	0.7	0.5
Prospective drawings	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.2	0.2
Fund total repayments/repurchases	75.4	31.4	34.6	23.1	8.4	4.4	15.5	23.9	27.5	35.5
Existing drawings	75.4	31.4	34.6	23.1	8.4	4.4	15.5	23.9	27.5	35.5
Prospective drawings	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Fund credit outstanding in percent of:										
Exports of goods and services	119.1	105.3	80.6	77.6	69.3	54.1	46.3	38.5	30.7	21.9
Total external debt 2/	59.6	46.0	32.0	35.8	33.0	32.0	29.2	25.3	21.1	15.6
Gross official reserves	296.6	190.6	267.9	148.5	133.3	130.7	114.1	96.6	77.7	57.0
Fund obligations in percent of:										
Exports of goods and services	60.5	21.0	18.0	10.0	3.3	1.4	3.8	5.0	5.2	6.1
External debt service 2/	70.4	39.9	37.4	26.2	11.6	7.7	21.6	29.1	32.2	37.3
Gross international reserves	150.6	38.1	59.8	19.2	6.3	3.5	9.5	12.6	13.2	15.8
Memorandum items:										
Exports of goods and services (in millions of U.S. dollars)	129.1	153.2	197.3	238.9	286.7	372.0	428.6	486.5	540.9	596.1
Gross official reserves (in months of imports of goods and services)	1.9	2.5	1.8	2.9	3.0	2.8	2.9	3.0	3.0	3.1

Sources: Sierra Leonean authorities; and Fund staff estimates and projections.

1/ All numbers are before HIPC Initiative assistance.
2/ Before rescheduling.

Table 11. Sierra Leone: Poverty-Related Expenditure by Activity, 2001-05
(In millions of leones)

	2001	2002	2003	2004					2005	
	Act.	Act.	Act.	Quarter 1 Act.	Quarter 2 Act.	Quarter 3 Act.	Quarter 4 Act.	Full year Act.	Budget Speech	Prop.
Total poverty-targeted expenditure	72,832.5	120,555.1	140,158.0	29,048.5	39,118.5	38,156.8	28,366.8	134,690.6	166,269.6	167,470.9
Recurrent poverty-targeted expenditure	69,840.5	108,193.4	120,834.4	27,799.8	36,202.1	35,932.2	25,966.0	125,900.1	147,219.6	148,770.9
General services										
Ministry of Local Government and Community Development	...	...	...	180.8	305.4	1,057.6	426.4	1,970.2	845.3	845.3
Security services	15,450.5	15,272.2	26,158.5	8,582.4	6,189.5	7,000.2	6,264.1	28,036.2	26,176.7	25,176.7
Police	10,815.6	10,278.9	16,275.9	4,288.5	4,288.5	4,390.0	4,026.3	16,993.3	18,094.0	17,094.0
Prisons Department	3,969.1	4,588.6	5,237.0	876.5	1,695.7	1,823.4	2,150.1	6,545.7	6,699.6	6,699.6
National Fire Authority	665.8	404.7	4,645.5	3,417.4	205.3	786.8	87.7	4,497.2	1,383.1	1,383.1
Social services	45,802.5	73,955.6	75,783.1	14,389.0	23,617.6	22,603.1	17,132.5	77,742.2	81,795.6	68,251.9
Ministry of Education, Science and Technology	29,014.9	44,096.8	43,089.9	11,438.1	16,778.9	12,129.5	9,608.3	49,954.8	50,162.3	41,980.5
Ministry of Health and Sanitation	15,573.9	27,366.4	29,962.0	1,420.5	5,599.1	9,410.2	5,040.4	21,470.2	25,603.1	22,188.6
Ministry of Social Welfare, Gender and Children's Affairs (Social Welfare Division)	811.5	886.5	1,097.0	284.3	306.4	156.6	309.3	1,056.6	1,194.9	1,019.7
Gender and Children's Affairs Division	402.2	1,605.9	1,634.2	482.5	281.6	343.6	291.3	1,399.0	1,060.3	904.9
Ministry of Youth and Sports	...	...	...	632.5	583.2	563.2	337.5	2,116.4	1,552.0	1,324.5
Socially-oriented projects	...	...	...	131.1	68.4	0.0	1,545.7	1,745.2	2,223.0	833.8
Economic services	8,587.5	18,965.6	18,892.8	4,647.6	6,089.6	5,271.3	2,143.0	18,151.5	20,407.6	17,502.7
Ministry of Agriculture and Food Security	1,988.5	4,230.5	8,835.7	2,807.5	4,845.2	2,323.3	1,326.8	11,302.8	14,539.9	12,470.2
Ministry of Transport and Communications	3,880.0	3,252.0	2,182.6	890.6	228.0	711.2	133.7	1,963.5	1,196.3	1,026.0
Ministry of Energy and Power	2,719.0	2,929.4	3,602.7	949.5	1,016.4	11.9	642.5	2,620.3	3,671.4	3,148.8
Domestic debt payback program		8,553.7	4,271.9	0.0	0.0	2,224.9	40.0	2,264.9	1,000.0	857.7
Transfers to local councils	...	...	...	...	...	...	...	...	17,994.4	16,994.4
Unallocated recurrent poverty-related outlays	...	...	...	...	...	...	...	...	...	20,000.0
Development poverty-targeted expenditure	2,992.0	12,361.7	19,323.6	1,248.7	2,916.4	2,224.6	2,400.8	8,790.5	19,050.0	18,700.0
General services	2,442.0	2,379.5	1,076.9	160.5	463.7	757.5	97.3	1,479.0	200.0	100.0
Ministry of Rural Development and Local Government	2,442.0	2,379.5	1,076.9	135.5	418.7	732.5	72.3	1,359.0	0.0	0.0
Office of the President	...	...	...	25.0	45.0	25.0	25.0	120.0	200.0	100.0
Security services			1,038.7	0.0	0.0	100.0	0.0	100.0	200.0	50.0
Prison Department	...	179.8	914.7	0.0	0.0	100.0	0.0	100.0	200.0	50.0
Fire Force Authority	...	...	124.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Social services	550.0	3,947.5	9,267.4	438.8	612.5	538.4	346.0	1,935.7	4,370.0	4,270.0
Ministry of Education, Youth and Sport	350.0	3,688.7	4,558.1	55.0	362.5	170.0	10.0	597.5	1,200.0	1,100.0
Ministry of Health and Sanitation	...	162.8	4,393.3	0.0	150.0	179.6	172.0	501.6	480.0	480.0
Ministry of Social Welfare, Gender and Children Affairs	200.0	96.0	316.0	0.0	0.0	50.0	0.0	50.0	100.0	100.0
National Commission for Social Action (NaCSA)	...	...	...	383.8	100.0	138.8	164.0	786.6	2,590.0	2,590.0
Economic services	...	6,034.7	7,940.7	649.4	1,840.2	828.7	1,957.5	5,275.8	13,280.0	13,280.0
Ministry of Agriculture and Food Security	...	2,788.0	2,190.1	0.0	0.0	43.7	12.5	56.2	830.0	830.0
Ministry of Marine Resources	...	449.7	970.5	49.4	75.2	50.0	0.0	174.6	250.0	250.0
Ministry of Energy and Power	...	...	272.9	0.0	0.0	300.0	0.0	300.0	2,000.0	2,000.0
Ministry of Works, Housing and Technical Maintenance	...	2,797.0	4,507.1	600.0	1,765.0	435.0	1,945.0	4,745.0	10,200.0	10,200.0
Local government development grants	...	...	...	...	...	...	...	...	1,000.0	1,000.0

Source: Sierra Leone, Ministry of Finance, Budget Bureau.

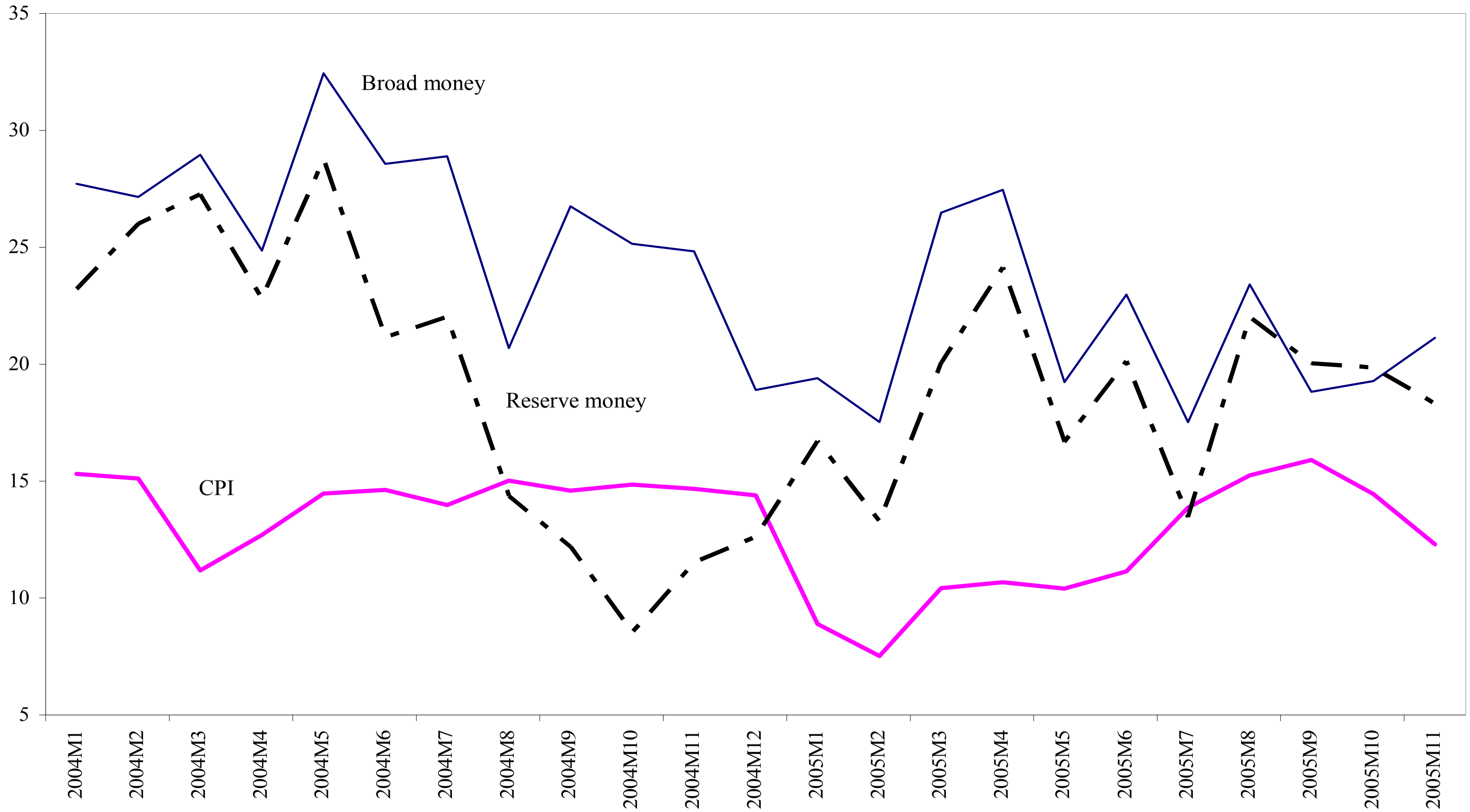
Table 12. Sierra Leone: Selected Social and Demographic Indicators

	Sierra Leone	Sub-Saharan Africa
Total land area (thousands of square kilometers)	71.6	23,628.4
Agricultural land (in percent of total)	74	53
Population and vital statistics (1999, unless otherwise indicated)		
Total population (in millions)	5	644
Population growth rate (in percent)	2	3
Urban population (in percent of total)	34	34
Population density (inhabitants per square kilometer)	65	27
Population age structure (in percent; 1996)		
0-14 years	45	44
15-64 years	52	53
65 years and above	3	3
Infant mortality rate (per thousand)	182	107
Life expectancy at birth (years)	38	49
Male	36	46
Female	41	48
GDP per capita in U.S. dollars (2000)	134	500
Poverty rate (in percent) 1/	82	…
Health and nutrition (2000, unless otherwise indicated)		
Access to safe water (in percent of population)		
Total	34	46
Urban	58	64
Rural	21	29
Population per physician	20,695	14,347
Population per hospital bed	…	1,310
Daily per capita calorie supply	2,035	…
Percent of requirement	85	…
Protein intake per capita (1990; grams per day)	44	…
Labor force (in millions; 1999)		
Total labor force (1999)	3	275
Percent of formal labor force (1997)		
Female	32	42
Agriculture	61	70
Industry	17	8
Services	22	…
Education (1999)		
Percent of age group enrolled in		
Primary school	42	78
Secondary school	16	27
Tertiary education	1	3
Adult literacy rate (in percent)	30	41

Sources: Statistics Sierra Leone; draft Sierra Leone 2000 "National Human Development and Related Indicators"; UNDP, *Human Development Indicators* , 2001; Government of Sierra Leone, "Household Survey Report on Women and Children 2000."

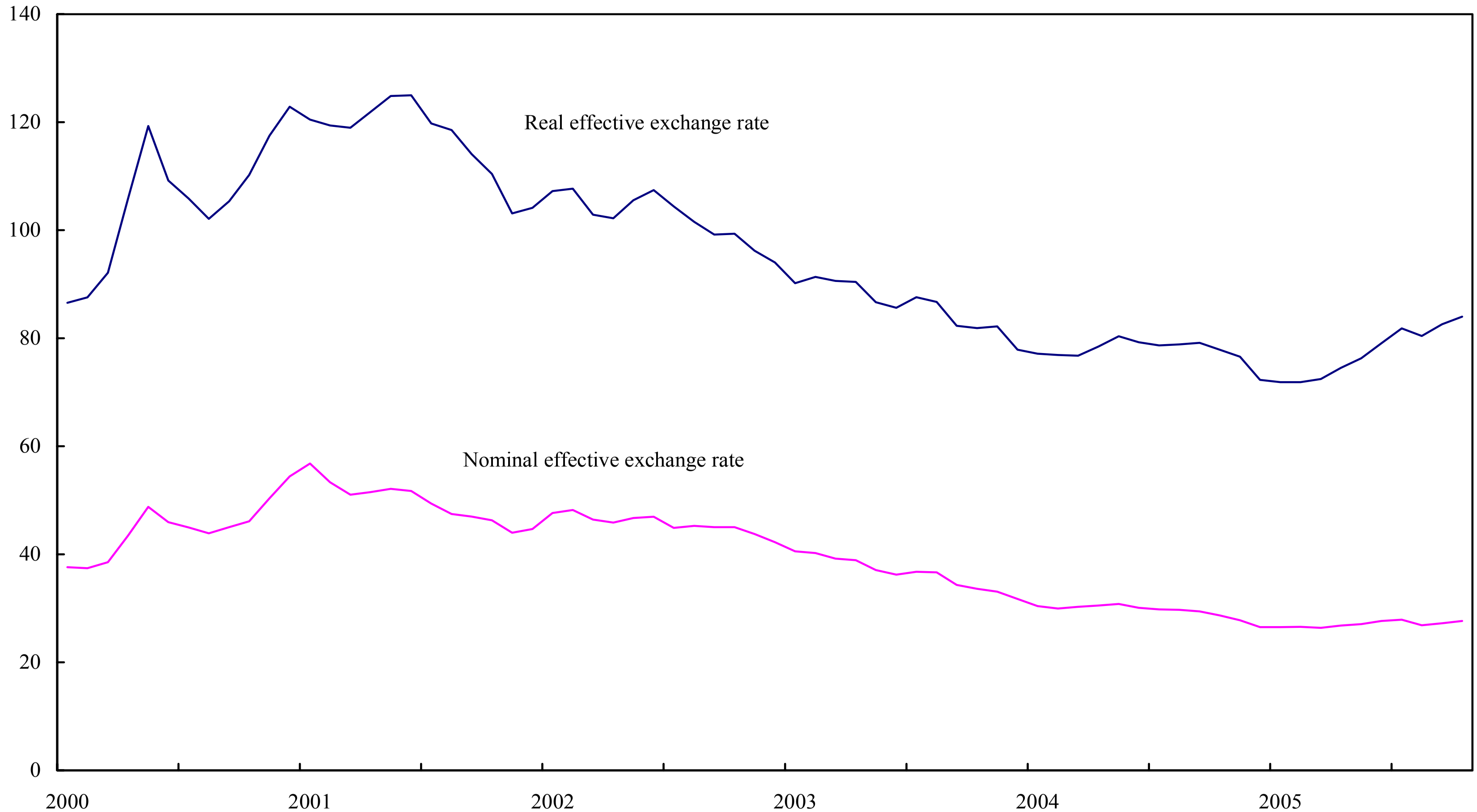
1/ This figure is for 1989-90. It measures the percentage of the total population living on the equivalent of under US$1 per day in 1989-90.

Figure 1: Inflation and Money Growth, January 2004-November 2005
(In percent; year-on-year changes)



Sources: Sierra Leonean authorities; and IMF staff estimates.

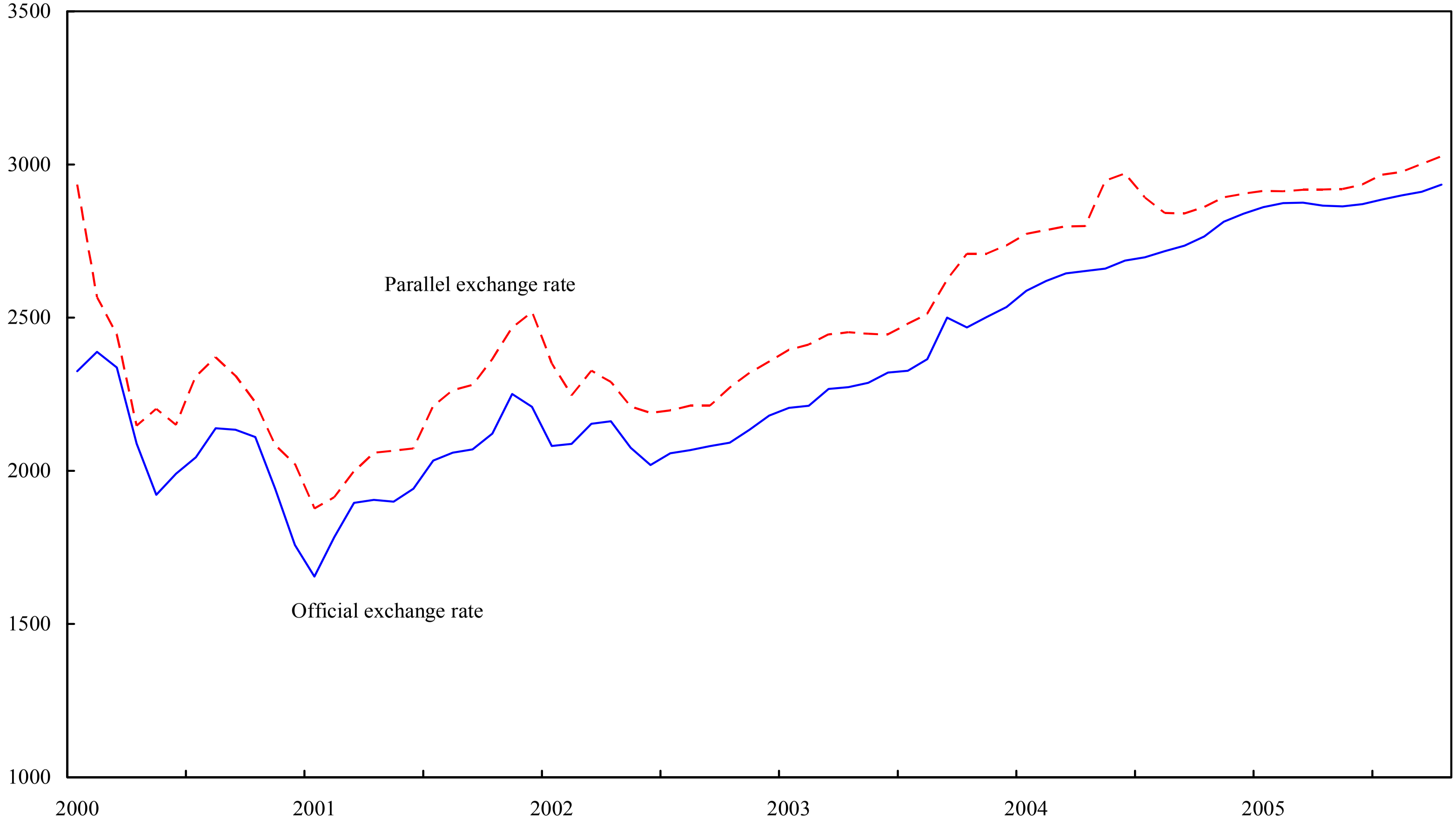
Figure 2. Sierra Leone: Nominal and Real Effective Exchange Rates, January 2000 - October 2005 1/
(1995=100)



Source: IMF, Information Notice System.

1/ An increase in the indices implies an appreciation.

Figure 3. Sierra Leone: Official and Parallel Exchange Rates, January 2000 - October 2005
(Leones per U.S. dollar)



Sources: Sierra Leonean authorities; and staff estimates.

March 8, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. de Rato:

1. On behalf of the government of Sierra Leone, I am pleased to submit herewith the memorandum on economic and financial policies covering the period 2006–08, for which Sierra Leone requests a three-year arrangement with the International Monetary Fund (IMF) under the Poverty Reduction and Growth Facility (PRGF). The objectives of this program and the measures envisaged to achieve them are described in the attached memorandum. The main pillars of the program, reflecting the government's poverty reduction objectives, are as follows: (i) promotion of macroeconomic stability through prudent fiscal and monetary policies; (ii) strengthening fiscal management to channel resources toward poverty-related spending; and (iii) financial sector reforms to promote saving, investment, and growth.

2. The government of Sierra Leone has made substantial progress during 2001–05 in laying the foundation for sustained real growth and poverty reduction in the context of the previous PRGF-supported program. Macroeconomic performance has continued to be strong in 2005 and demonstrates government's commitment to meet the indicative targets set for 2005 (Memorandum of Economic and Financial Policies (MEFP), Table 1). There were slippages in fiscal performance during the year, but the government took corrective actions in the last quarter to bring fiscal performance in line with the budget. In light of this, and following the receipt of substantial external budgetary support towards the year-end, monetary conditions improved, which also contributed to the lowering of inflation. We have implemented several prior actions comprising the unfinished agenda from the previous PRGF-supported program.

3. The government started the implementation of its poverty reduction strategy paper (PRSP) last year. Donors also confirmed, in the Consultative Group meeting in November 2005, their continued support for Sierra Leone's poverty reduction strategy. In this context, the government wishes to thank the IMF and the World Bank for their support, which was instrumental in garnering assistance from the international community for Sierra Leone's development efforts. The implementation of the PRS has been accelerated, with the view of enabling Sierra Leone to reach the HIPC completion point in 2006.

4. In support of the implementation of its medium-term program, the government requests a new three-year arrangement under the PRGF in an amount equivalent to SDR 31.11 million (or 30 percent of quota).

5. Furthermore, the government of Sierra Leone will continue to provide the Fund with such information as the Fund require in order to assess Sierra Leone's progress in carrying

out policies outlined in the attached MEFP. The government will also continue to consult with the Fund on its economic and financial policies in accordance with IMF policies and practices on such consultations. Reviews under the PRGF-supported program will be conducted throughout the arrangement to evaluate implementation of macroeconomic and structural policies. The first review is expected to take place by end-August 2006 and the second review before end-February 2007.

6. The government of Sierra Leone also authorizes the publication of this letter by the Fund, including the posting of the document on the IMF website, subsequent to Executive Board approval.

Sincerely yours,

/s/

John O. Benjamin
Minister of Finance
Freetown, Sierra Leone

Attachments: - Memorandum on Economic and Financial Policies
- Technical Memorandum of Understanding

SIERRA LEONE

MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES OF THE GOVERNMENT OF SIERRA LEONE FOR 2006-08

March 8, 2006

I. INTRODUCTION

1. Sierra Leone has made substantial progress with its post-conflict transition. The UNAMSIL peacekeeping mission was phased out at end-2005 and replaced by UNIOSIL (United Nations Integrated Office in Sierra Leone), to assist in nation building and conflict prevention. Local government elections in May 2004 also represented an important advance in the government's strategy to empower local authorities.

2. The economy sustained a robust real growth during 2001–04, but inflation also rose. Moreover, poverty remains widespread and efforts to reduce it have yet to make notable progress.[26] Sierra Leone has had almost continuous involvement with Fund programs since 1994 under a variety of arrangements. This notwithstanding, the government believes that a continued close involvement of the Fund in Sierra Leone is warranted to assist in addressing the country's sizeable development needs and the relatively large external financing gap that is projected over the medium term.

3. In this memorandum, the government of Sierra Leone describes the economic and financial policies to be implemented during 2006–08 within the context of a new Poverty Reduction and Growth Facility (PRGF) arrangement with the Fund.

II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE

4. Broad-based economic recovery continued in 2005. Output is estimated to have grown 7⅓ percent, reflecting robust activity in agriculture, diamond mining, manufacturing, construction and services. However, inflation rose during the year, reaching nearly 16 percent in September. In part, this was caused by higher fuel prices and monetary expansion during the first half of the year. Inflationary pressures subsided in the subsequent months and in November year-on-year inflation was down to 12.3 percent, as a result of improving monetary conditions and the inflow of external budgetary support. Average inflation for the year as a whole is projected at 12.5 percent.

5. Fiscal performance during 2005 was mixed. Revenues measured in terms of GDP were below the budget during January-September, reflecting shortfalls in collections, in

[26] An estimated 80 percent of the population is living in poverty (below the national poverty line of about US$1 per day).

particular in respect of customs and excise revenues.[27] Some recovery in revenue performance was targeted in the last quarter of the year, as the National Revenue Authority intensified its tax efforts. Regarding external budgetary support, receipts exceeded the budget by about Le 5.5 billion in 2005; however, fiscal management was complicated by delays in the receipts during January-September, which then spilled over to domestic borrowing. Total outlays are projected to remain below budget for the year as a whole, due to weaknesses in implementing development projects. Recurrent outlays are expected to reach the budgeted targets. Within this category, the wage bill and the cost of debt service, however, are projected to exceed budgeted amounts. The former reflects payment to the National Social Security Insurance Trust (NASSIT) in the first quarter (Le 2.2 billion), which was not budgeted, and an increase in pensions and gratuity payments to the military and police as a result of the restructuring exercise and to a lesser extent the higher than anticipated cost of hiring new police personnel. Higher debt-service is a reflection of higher-than-projected domestic borrowing in the first half of the year. Poverty outlays fell significantly short of target (the projected shortfall in 2005 is about Le 34 billion or 1 percent of GDP). This is explained in most part by weak planning in respect of allocating available fiscal resources to the priority areas (education and health). The overall fiscal deficit (including grants) is projected at 1.3 percent of GDP for the full year, compared to 3.5 percent of GDP in 2004. The primary deficit is expected to be contained at slightly above 2 percent of GDP in 2005, down from 2.8 percent in 2004. The domestic financing of the budget will be contained at about 0.7 percent of GDP, which is less than budgeted. Additional budgetary support from the AfDB (US$5.33 million), which was projected for the last quarter of 2005, was only disbursed in January 2006. However, funding for poverty programs to close the financing gap in the budget was provided by the DfID which disbursed an additional 5 million pounds (equivalent of US$9 million) in December.

6. The government is committed to correcting the slippages in fiscal performance to bring the budget closer to year-end targets. On the revenue side, additional efforts by the National Revenue Authority to strengthen the enforcement of tax regulations are expected to increase revenue collections in the last quarter of the year**.** These include the enforcement of the 10 percent sales tax on local telephone and mobile phone calls; a 3 percent advance income tax on importers; as well as the collection of tax arrears (mainly withholding tax) from parastatals. Regarding expenditures, the government will closely monitor outlays to prevent slippages in the fourth quarter, while at the same time increasing efforts to allocate outlays to poverty-related areas.

7. Monetary policy was not fully effective in containing inflation pressures in 2005. Both reserve and broad money growth exceeded their targets, reflecting in part a better-than-

[27] Customs duty collections were lower than envisioned reflecting in part reduced volumes of dutiable imports, a shift in the composition of imports towards lower tariff goods, the impact of the implementation of the Common External Tariff, and higher administrative charges at the ports, which encouraged trade diversion to the neighboring countries.

anticipated improvement in the banking system net foreign assets, as well as higher than projected borrowing by the government. The rapid growth of credit to the private sector also continued, although the Bank of Sierra Leone tightened monetary conditions in late 2004 by increasing commercial bank cash statutory reserve requirements from 10 to 12 percent.

8. The external current account deficit (excluding official transfers) is projected to have widened in 2005. There was a significant improvement in export performance, in particular for diamonds, which account for over 90 percent of total receipts, but other exports (agricultural and manufactured products) also rose. Import growth, on the other hand, was substantially stronger than projected. This reflected, in part, the higher cost of imported fuels and capital goods imports associated with the refurbishment of bauxite and rutile mining projects. Official reserves are projected to reach US$149 million by year-end (about 3 months of import cover).

III. Medium-Term Strategy and Objectives

9. As highlighted in the PRSP, a medium-term economic strategy for Sierra Leone underscores the acute need to reduce poverty and to provide a basis for high economic growth. Furthermore, nation building, which includes the need to strengthen law and order, improve infrastructure, and enhance macroeconomic stability, will be key for successfully implementing the strategy.

10. The major macroeconomic objectives underlying the medium-term strategy include the maintenance of sustained high real growth and a stable macroeconomic environment. In this regard, agricultural expansion and food security are key medium-term objectives reflecting, in part, agriculture's importance for job creation. The country's considerable mineral endowments will continue to support the balance of payments and will be utilized to enhance fiscal sustainability and to facilitate job creation.

11. Sustained high growth in Sierra Leone will require significantly higher domestic savings and investment rates. Therefore, the government's medium-term objective is to reverse the negative domestic savings rate to about 1 percent of GDP by 2008. The aim for the subsequent years will be to reach Sierra Leone's historical savings ratio of 8–10 percent. Financial sector reforms will be instrumental in this regard.

12. Furthermore, private sector development and an improved investment climate will be vital for the achievement of high-sustained output growth. With this in mind, the government will pursue reforms to raise private investment, including in the mineral sector, in the coming years. The government also plans to allocate resources to power generation and infrastructure over the medium term to ease bottlenecks that negatively affect private business activities.

13. Medium-term macroeconomic stability hinges critically on fiscal policy. The centerpiece of the policy framework under the PRGF-supported program will be fiscal consolidation while shifting resources increasingly toward spending on priority areas. In particular, a better balanced between available resources and budgeted outlays and a move towards a broadly balance primary position is necessary to contain domestic borrowing. The

domestic debt stock, which is currently about 30 percent of GDP, is expensive to service and crowds out private sector credit.

14. The government expects the annual rate of output growth to 2008 to remain in the range of 6–7 percent underpinned by broad-based sectoral growth. Inflation is expected to revert to middle single digits by the end of the period, supported by prudent macroeconomic policies. The external current account balance (excluding official grants) is projected to narrow to 11 percent of GDP by 2008. The central bank will aim at maintaining Sierra Leone's gross official reserves about three months of imports over the program period.

15. The government is committed to addressing governance issues and enhancing transparency. Reflecting this, the main focus of structural reforms in the PRGF-supported program will be on continued strengthening of the public sector and civil service; enhanced capacity for data collection, analysis, and reporting to support policymaking; and on strengthening public finance management to assist the budgetary process and expenditure management. The government recognizes that further efforts are required to fight corruption. With other stakeholders, and assistance from the DfID, the government will therefore continue to strengthen the Anti-Corruption Commission and ensure that it is adequately equipped to meet its challenges. Furthermore, the government understands that openness and access to information on public sector activities would enhance transparency and accountability. In light of this, the government is committed to expanding the availability of information on its activities in parliament and the public at large. Regarding the mineral sector, the government has already endorsed the international initiative to enhance transparency in the utilization of Sierra Leone's mineral endowment (the Extractive Industries Transparency Initiative; EITI), and plans to adopt it in 2006.

Medium-term fiscal strategy

16. The medium-term fiscal strategy aims at raising domestic revenues to support priority spending. In this context, the government will focus on five specific areas. First, the continued strengthening of the National Revenue Authority, for which the government has requested technical assistance from the Fund.[28] Second, the tapping of increased revenues from the mineral sector. Estimated incremental revenues of about 0.3 percent of GDP per annum could be collected during 2006–08, mainly from royalties. Third, the introduction of a value-added tax (VAT), scheduled for 2007, in order to widen the tax base. However, a portion of the additional revenues will have to offset the fall in customs revenue, in part resulting from the phased introduction of the ECOWAS common external tariff (CET). The latter is estimated to reduce customs revenues by about 0.4 percent of GDP per annum. Fourth, the significant narrowing of the scope of import duty and sales tax exemptions, which the government is progressively effecting. Finally, the strengthening of tax compliance, in

[28] Two Fund technical assistance missions, covering tax administration and mineral sector regulations, have been scheduled for early 2006.

part by actively pursuing overdue tax liabilities from private and public corporations (in particular, PAYE liabilities), and settling related arrears (as part of cross-liability deals between government and state-owned enterprises). An action plan for settling the wage and utility arrears is a benchmark for end-March 2006.

17. The government envisions further strengthening of public expenditure management, particularly in containing the public sector wage bill and meeting targets for poverty outlays. Some progress had been achieved in verifying the number of teachers and civil servants in the government payroll and issuing them identification cards. In addition, the database of teachers and civil servants and the payroll database of the Accounting General's Office are being updated monthly. More broadly, structural reforms to further strengthen public expenditure management in the medium term will focus on: strengthening the control of the wage bill, including further measures to strengthen personnel and payroll systems; the avoidance of domestic payment arrears and the establishment of a time table for the clearance of all outstanding arrears; improving the quality and timeliness of financial audits of the government; and strengthening fiscal and monetary reporting to ensure timely reconciliation of data.

18. The overall deficit is projected to fall over the medium term. While the share of domestic revenues is expected to rise from 12.2 percent of GDP in 2005 to 13.6 percent in 2008, the rise could be offset partially by the projected decline (in GDP terms) in budgetary support from donors. Total expenditures would remain broadly unchanged at about 22 percent of GDP over the program period, while the composition of spending is expected to change in light of the PRSP priorities. Therefore, the government envisions that additional resources to support poverty-related programs will come from savings elsewhere, which underscores the importance of keeping the wage bill under control. The overall deficit (excluding grants) is expected to fall to about ½ percent of GPD by 2008. Domestic financing of the budget is projected to remain small, averaging about 0.2 percent of GDP annually during 2006–08, and this would help reduce the domestic debt-to-GDP ratio.

19. The government recognizes the privatization of state-owned enterprises as an important medium-term objective, which could enhance the efficiency of government operations and collection of additional revenues. Twenty-four state-owned enterprises, covering several economic sectors, including financial institutions, are targeted for privatization. However, progress has been slow. To expedite the process, government has sought technical assistance from DfID to support the National Commission for Privatization (NCP). DfID will provide resident consultants in the NCP to accelerate the implementation of the program. This project will commence in early 2006 and run to mid-2008. The World Bank will also be assisting the government in respect of implementation.

20. Substantial scaled up aid is indicated both in the context of financing PRSP activities and in terms of the efforts required for approaching the MDGs. The government will, therefore continue to work with its development partners to increase aid inflows. In this regard, the government recognizes that appropriate policies should be pursued to protect the economy against any adverse effects of large aid inflows and to ensure aid effectiveness for

accelerated growth and poverty reduction. The government is committed to ensuring that domestic tax efforts will be continued, even with increased external assistance, in order to reinforce poverty-reduction efforts and prepare for a gradual exit from aid dependency. In respect of monetary management, the central bank will need to consider appropriately sterilizing higher aid inflows in part by selling foreign exchange. Exchange rate stability would need to be safeguarded in this overall context, in part through maintaining a liberal trade and exchange regime. The government would also continue its efforts to strengthen national and local institutions for increased aid absorption, and channel more resources to infrastructure and other productivity-enhancing activities to support faster growth. Efforts to contain wage pressures must also be sustained. Enhanced transparency and accountability in the educational and other social sectors will be pursued, together with continued reforms in key ministries. Public accounting and auditing functions would also be strengthened. Fiscal policy would be executed in a medium-term context while public sector debt sustainability will be regularly reviewed.

Medium-term financial sector strategy

21. Key goals for the government's medium-term financial sector strategy are to enhance the mobilization of domestic savings and increase access to medium-to-longer term credit. Structural reforms in this area will be aimed at enhancing confidence, efficiency, and the sector's capacity to offer financial services. Particularly in rural areas, in the short term, specific measures would also be introduced to address potential solvency and profitability problems in the banking system. Further reforms would include the mobilization of longer-term funds through suitable institutions, such as insurance companies and pension funds, and by developing an efficient domestic capital market. These could in part be guided by the recommendations of the envisaged FSAP, which the government has requested from the Fund and the World Bank.

22. A strong central bank is essential for the conduct of effective monetary policy. In this context, the government is committed to ensuring that the Bank of Sierra Leone would be adequately capitalized so that the Bank would have appropriate resources for conducting its day-to-day monetary and other operations. Technical assistance from the Fund is also ongoing, aimed at improving the central bank's open market operations and liquidity forecasting capability.

Exchange rate policy and the balance of payments

23. The government believes that exchange rate flexibility will continue to serve the country's interest, as it will facilitate timely adjustments to external developments. The official exchange rate is expected to continue being determined through weekly auctions. Furthermore, the Bank of Sierra Leone will aim at strengthening its external reserve position over the medium term (gross reserves are projected to reach US$194 million by the end of the program period). The exchange system will remain free from restrictions on the making of payments and transfers for current international transactions.

24. Sierra Leone's external outlook is expected to improve over the medium term, but a substantial financing gap remains. Key contributing factors will be a strong export growth and further debt relief once Sierra Leone reaches the HIPC completion point. In addition to the continued growth of officially recorded diamond exports, the recommencement of rutile and bauxite mining will further boost exports. Import growth, on the other hand, is projected to moderate as a result of the completion of the large mineral sector rehabilitation projects. Consequently, the external current account deficit is expected to narrow to about 6½ percent of GDP (including official transfers) in 2008 from 8½ percent in 2005. The government's medium-term strategy to broaden the export base beyond the mineral sector will hinge on the success in addressing the key structural impediments (power, infrastructure, and access to credit).

Medium-term structural reforms

25. The medium-term structural reform agenda included in the PRGF has been derived from the government's vision in the PRSP. The focus of the reforms is on strengthening fiscal management to channel more resources to poverty-reduction, and on the financial sector to promote saving, investment, and growth. The government has completed upfront the unfinished structural reform agenda from the expired PRGF arrangement by implementing several prior actions. These are envisaged to ensure continued improvements in the efficiency and transparency of government operations, through the strengthening of the Auditor General's office, reforms in key ministries, and streamlining human resource management. The government will also make progress in systematically incorporating mineral sector revenues in the overall fiscal framework, and in consistently reporting monetary and fiscal data.

IV. Policies and Measures for 2006

26. The macroeconomic framework for 2006 envisions steady real GDP growth and lower inflation. Real output is expected to grow at 7½ percent, reflecting further expansion in the agricultural, manufacturing and service sectors, as well as the restart of rutile and bauxite production and exports. Average inflation is projected to fall slightly, to 11.7 percent, with supportive monetary and fiscal policies while end-year inflation is projected at a single digit level. The external current account deficit (excluding official grants) is projected to narrow to 12½ percent of GDP in 2006 from 14½ percent in 2005, owing to rising mineral exports and moderating import growth.

Fiscal policy

27. The key objective of the 2006 budget would be further fiscal consolidation while targeting higher poverty-related outlays. The budget will be formulated in the context of a medium-term fiscal framework. Related to this, however, donors confirmed the continued support to Sierra Leone in the Consultative Group (CG) meeting in November, which aimed at raising additional external resources for the implementation of the PRSP (the identified resource gap is about 55 percent of the total program costs), but indicated relatively little new

financing in the coming years. Therefore, the 2006 budget is based on existing revenue trends and external support already indicated by key donors.[29]

28. Domestic revenues are projected to rise by 0.4 percent of GDP, equivalent of Le 538.8 billion, based on a combination of enhanced tax collection efforts and new taxes. The National Revenue Authority (NRA) will fully enforce existing tax regulations (including a 3 percent turnover tax on diamonds; a 10 percent tax on phone calls; a 3 percent standard assessment on corporations and the enforcement of tax clearance certification on government contracts). The NRA will also pursue actively the collections of past due taxes and fully implement the license and fee increases included in the 2005 budget to cover all ministries. In addition, customs collections will be enhanced through better enforcement (strengthened border controls and transferring the processing of duty waivers to NRA to minimize the granting of discretionary exemptions).

29. In respect of new taxes, the government will begin charging a specific fee on duty-free imports to recover administrative costs.[30] Furthermore, the government will reimpose duty and sales taxes on large-scale fishing and convert the current specific fuel tax into ad valorem tariff. In addition, nontax revenue (about Le 8 billion) in the form of royalty and PAYE payments is expected from bauxite production and exports in 2006.

30. However, part of the increase in domestic revenue collection will have to offset the fall in external budgetary support. The government envisions that the external budgetary support in 2006 (all in the form of grant financing) from the key donors to total US$59 million (about 4.3 percent of GDP), which will be lower than in 2005. Furthermore, HIPC budgetary support is expected to fall significantly (about 0.5 percent of GDP) because of the delays in reaching the HIPC Completion Point. The government projects that development grants would total Le 138 billion (US$43 million) in 2006.

31. The government envisions that total expenditures will rise slightly in 2006 compared to 2005, reaching Le 940 billion. However, there will be a shift from recurrent to development spending, as the increase in fiscal resources will be channeled mainly to the development budget, which is expected to rise substantially (both domestic and foreign-financed). This, in part, reflects the government's objectives to increase domestic investment as well as the need to strengthen infrastructure to support private sector activities. The government is expecting to begin implementing several large infrastructure projects in 2006 (involving roads and power generation), with substantial assistance from donors. The recurrent expenditures, on the other hand, are expected to contract in terms of GDP, reflecting the limited resource envelope. There will, however, be a reallocation of resources towards poverty areas, consistent with the PRSP.[31] Furthermore, the government has

[29] These are the AfDB, DfID, EU, and the World Bank.

[30] At the rate of 1.25 percent of the c.i.f. value of goods.

[31] Poverty-related outlays are projected to rise by about 1 percent of GDP in 2006.

included Le 8 billion (0.3 percent of GDP) in the budget to cover costs associated with the 2007 presidential election (domestic portion).

32. In order to protect poverty outlays, the government will adopt initially in the context of the 2006 budget, a framework that would help to allocate scarce resources first to priority areas, in particular to those programs that directly address poverty reduction. Unanticipated shortfalls in external budgetary support, together with slower than anticipated utilization of funds earmarked for poverty outlays, have in the past caused deviations from programmed spending targets. This needs to be avoided. To address these issues, the government will identify predictable resources and also track the utilization of these resources for poverty-related programs.[32] Regarding the uncertainty related to external aid inflows, the government would be able to borrow one-half of the budgetary support through the adjustment to the ceiling on net bank credit to the government. Therefore, this portion of external budgetary support could be considered secure before the assistance has been actually received. On the expenditure side, the government will identifying the priority outlays in the budgeting process that should be protected while indicating clearly that other spending may only be effected when less certain resources have been obtained. The government realized, however, that flexibility is limited because several budgeted outlays cannot be easily postponed or reduced, including interest and amortization on domestic and foreign debt, the wage bill, statutory transfers to NRA and the road user fund, as well as various security-related outlays. These outlays represent a substantial portion of total expenditures (estimated at about ¾ in 2006). The government will also improve the system to adequately track the utilization of funds related to poverty programs and take remedial action in respect of underutilization.

33. The overall fiscal deficit (including grants) in 2006 is projected to narrow to 0.5 percent of GDP, from 1.3 percent expected in 2005. The primary deficit is expected to be marginally lower than in 2005. Domestic financing is projected to be contained at 0.3 percent of GDP.

Monetary and financial sector policies

34. Effective monetary policy will be critical in ensuring macroeconomic stability in 2006, assisted by appropriate fiscal policy. However, the Bank of Sierra Leone's ability to contain the growth of reserve money has been hampered owing to the limited menu of instruments at its disposal. Therefore, the government will work together with the Bank of Sierra Leone to strengthen the central bank's operational capacity. Specific steps include the elimination of the spread between interest paid on treasury bills and on the Ways and Means Account, and making the latter market-determined by linking it to the three-month Treasury bill rate. By allowing the central bank to convert balances on the Ways and Means Account to treasury bills at its own discretion, the control over high-powered money would be

[32] Predictable resources are defined as domestic revenues, domestic borrowing, HIPC grants, and one-half of foreign program support.

strengthened, particularly when liquidity emanates from the fiscal sector. Furthermore, a key source of money growth in 2006 is anticipated to arise from the external sector, as the banking system net foreign asset position is projected to improve substantially. Reflecting this, the Bank of Sierra Leone needs to study alternatives for enhancing liquidity control, including imposing a reserve requirement on commercial bank foreign-currency deposits.

35. Based on the outcome of the assessment of commercial bank capitalization in 2005, and in order to safeguard the operations of these banks, the Bank of Sierra Leone raised the minimum capital from Le 800 million (S$0.25 million) to Le 6 billion ($1.9 million), to be attained by end-2006. The minimum capital has been raised further in phases to Le 15 billion (US$4.6 million) by end-2009.

36. Beginning in 2006, the government envisions a number of measures to enhance financial intermediation and expand the availability of medium-to long-term credit. These include the establishment of community banks, which will be important for extending banking services to rural areas. Furthermore, the government is expanding micro financing to rural areas with the support of development partners.[33] A Microfinance Investment and Technical Assistance Facility (MITAF) has been established and is projected to assist the government in developing a competitive financial sector that would expand access to financial services to poor and low-income people. The facility will provide direct technical assistance, training and financial support to microfinance institutions, facilitate the role of investors and donors in the promotion of microfinance, and assist the Bank of Sierra Leone in its financial sector deepening efforts. Other stakeholders in this partnership include the Bank of Sierra Leone, the Ministry of Development and Economic Planning and the Ministry of Finance. The government is also developing a domestic capital market, with the Bank of Sierra Leone taking the lead, assisted by the Commonwealth Secretariat and the First Initiative (U.K.). Efforts are also underway to develop a regulatory framework for these activities.

External sector policies

37. The government is seeking to reach a rescheduling agreement with the Paris Club creditors on Cologne terms under the new PRGF program, retroactively extending consolidation period from July 2005. Progress on negotiations with commercial creditors has to date been limited despite efforts to contact some of the creditors and to make goodwill payments to some of them. To address the situation, government has requested the World Bank to support a second IDA debt buy-back operation. Preparations for the debt buyback are in progress, targeting the timing of the HIPC completion point for finalization (expected in the second half of 2006). The government is continuing negotiations with non-Paris Club

[33] These include Kredit Anstalt für Wiederaufbau, Germany; the United National Capital Development Fund (UNCDF); the United Nations Development Programme (UNDP); and the Microfinance Investment and Technical Assistance Facility (MITAF).

creditors to reach debt-relief agreements consistent with the HIPC Initiative and on comparable terms to those that would be granted by the Paris Club.

38. Sierra Leone's trade policy is influenced by the ECOWAS integration process. The country's trade and exchange regimes are already substantially liberalized. The government plans to implement medium-term tariff reductions in a regional context, through the adoption of the ECOWAS common external tariff (CET). Full implementation of the CET is projected to reduce the average tariff rate from 14 percent currently to 12 percent by 2008. Other aspects which would impact on Sierra Leone include a broad trade law reform process, the ongoing EU-ECOWAS Economic Partnership Agreement negotiations, and a diagnostic trade integration study (DTIS) that is being prepared under the Integrated Framework (IF).[34] The DTIS aims at promoting the country's export development by analyzing the key constrains to expansion, providing a comprehensive picture of how current and planned initiatives can be combined in a prioritized and sequenced ways, and developing a prioritized trade integration action plan consistent with the PRSP. The government is also working to implement the Automated System for Customs Data (ASYCUDA), with assistance from donors.

Structural reforms

39. The structural reform agenda for 2006 will focus on three areas (Table 2). First, the government will launch a new fiscal and monetary reporting system as a main structural performance criterion to the new PRFG arrangement by end-March. The purpose of this new framework is to ensure a full reconciliation of fiscal and monetary data. Second, fiscal management will be strengthened through a number of measures. In order to enhance the management of the wage bill, the government intends to update and audit the database containing all job grades and salary levels for civil servants and teachers and develop internal guidelines for annual salary adjustments within grade ranges. This will be a structural performance criterion for end-June 2006. The government also plans to continue its efforts to convert the Establishment Secretary's Office into a Human Resource Management office, by identifying specific measures needed to complete the task. Furthermore, the Cabinet will adopt an action plan related to the implementation of the Budgeting and Accountability Act. For the purpose of clearing outstanding utility and wage arrears, the government will take stock of these arrears and develop an action plan for Cabinet approval. The government also envisions a review of existing tax exemptions to guide it on how to minimize their impact on domestic revenue collection. It will also establish internal audit units in key ministries, reporting to the chief internal auditor of the Ministry of Finance. Third, the Bank of

[34] The IF is a multi-agency multi-donor program aimed at coordinating technical assistance to the least developed countries (LDC) to assist them in enhancing their trade opportunities and integrate them into regional and global economies.

Sierra Leone will finalize an assessment of bank capitalization and credit quality for all commercial banks; this will be a structural performance criterion for end-September.[35]

V. Prior Actions and Program Monitoring

40. The government has completed five prior actions pertaining to this request for the PRGF arrangement. These comprise: (i) the appointment of a Deputy Auditor General; (ii) the approval by Cabinet of an action plan to reform the ministry of local government, apart from the ongoing implementation of previously approved action plans for five other key ministries; (iii) the approval by Cabinet of a plan to transform the Establishment Secretary's Office into Human Resource Management office; (iv) the finalization of a medium-term fiscal revenue projection for diamonds, rutile, and bauxite and its incorporation in the overall fiscal framework; and (v) the identification of all government units and accounts that should be included in the new reporting system for monetary and fiscal data, and the establishment of benchmark annual data for 2004. These measures were completed as of January 31, 2006.

41. To monitor progress in program implementation, the government has reached understandings with the IMF staff on the quantitative and structural performance criteria and benchmarks for 2006 (Tables 2 and 4), and on the medium-term structural reform agenda for 2006-08 to underpin the PRGF program. On a monthly basis, the government will provide the IMF with the statistical data and information as described in the technical memorandum of understanding (attached), as well as any other information deemed necessary or requested by Fund staff in order to monitor the program.

42. To evaluate progress in implementing the PRGF during the first year of the program, the government, together with the IMF staff, will undertake two reviews of the program with the Fund. The first program review will be based on the quantitative performance criteria and benchmarks set for end-March 2006, and structural performance criteria set for end-March and end-June 2006, and is scheduled for completion by end-August 2006. The second program review will be based on the quantitative performance criteria and a structural performance criterion set for end-September 2006. The second review is expected to be completed by end-February 2007. Indicative quantitative performance targets have also been set for end-June and end-December 2006.

[35] The main areas for structural reforms in the medium-term are illustrated in Table 3.

Table 1. Sierra Leone: Indicative Targets (January-December 2005)

(Cumulative change from beginning of calendar year to end of month indicated; in millions of leones, unless otherwise indicated) 1/

	January - December 2005 16/ 17/												
	March				June				September				December
	Indicative Targets	Adjusted Targets	Act.	Met or Not met	Indicative Targets	Adjusted targets	Act.	Met or Not met	Indicative Targets	Adjusted targets	Act.	Met or Not met	Indicative Targets
Performance criteria													
Net domestic bank credit to the central government (ceiling) 2/ 3/	15,375	28,783	32,505	Not met	21,180	44,218	64,873	Not met	36,403	28,956	45,804	Not met	12,356
Unadjusted target (ceiling)		15,375				21,180				36,403			
Adjustment for the shortfall (excess) external budget support		-8,716				-23,466				-16,084			
Adjustment for the issuance of treasury securities to the private sector		-4,692				428				23,531			
Net domestic assets of the central bank (ceiling) 2/ 4/ 5/	31,474	33,978	19,039	Met	65,255	83,256	49,134	Met	103,432	116,873	6,645	Met	70,503
Unadjusted target (ceiling)		31,474				65,255				103,432			
Adjustment for the shortfall (excess) external budget support		-8,716				-23,466				-16,084			
Adjustment for exchange rate depreciation (appreciation)		-6,212				-5,465				-2,643			
Domestic primary budget balance of the central government (floor) 6/	-13,259	-13,259	-17,264	Not met	-24,960	-24,960	-26,034	Not met	-56,571	-56,571	-57,656	Not met	-77,878
Subsidies to National Power Authority (ceiling)	0.00	0.00	0.00	Met	0.0	0.0	0.0	Met	0.0	0.0	0.0	Met	0.0
Gross foreign exchange reserves of the central bank (in millions of U.S. dollars (floor)) 7/	-10.66	-16.75	-1.51	Met	-4.25	-20.52	-11.06	Met	-15.64	-26.69	3.96	Met	-1.88
Unadjusted target (floor)		-10.66				-4.25				-15.64			
Adjustment for the shortfall (excess) external budget support		6.09				16.28				11.05			
Adjustment for the shortfall in the U.S. dollar value of IMF disbursement		0.0				0.0				0.0			
Contracting or guaranteeing of nonconcessional external debt 8/ by the public sector (ceiling) with maturities of one year or more 9/ 10/	0.0	0.0	0.0	Met	0.0	0.0	0.0	Met	0.0	0.0		Met	0.0
Outstanding stock of external debt owed or guaranteed by the public sector 11/ with maturities of less than one year (ceiling) 12/	0.0	0.0	0.0	Met	0.0	0.0	0.0	Met	0.0	0.0	0.0	Met	0.0
External payment arrears of the public sector (ceiling) 13/	0.0	0.0	0.0	Met	0.0	0.0	0.0	Met	0.0	0.0	0.0	Met	0.0
Indicative targets													
Total domestic government revenue (floor)	93,919	93,919	90,345	Not met	209,750	209,750	200,640	Not met	321,459	321,459	305,054	Not met	434,982
Government wage bill (ceiling)	48,532	48,532	49,599	Not met	104,606	104,606	105,529	Not met	161,794	161,794	163,552	Not met	222,982
Poverty-related expenditures (floor)	32,031	32,031	25,748	Not met	71,549	71,549	50,768	Not met	123,041	123,041	89,535	Not met	167,471
Memorandum items:													
External budgetary assistance 14/	28,348		10,916		57,848		10,916		115,521		83,354		174,949
Net credit to the central government by nonbank private sector 15/	23,063		18,371		31,771		32,199		32,105		55,635		18,534

Sources: Sierra Leonean authorities; and IMF staff calculations.

1/ Variables are based on definitions in the technical memorandum of understanding (TMU) of October 2004.
2/ The ceilings will be adjusted downward by the amount of any excess in programmed external budgetary assistance (see footnote 16). The ceiling will also be adjusted upward by up to 50 percent of the amount of any shortfall in external budgetary assistance (as defined in the TMU; see footnote 16).
3/ Defined as claims on government (net) in the monetary survey. To be adjusted downward (upward) by any net issues of government securities, vis-à-vis the program target, to the nonbank private sector up to the ceiling on net domestic bank credit to the central government.
4/ The program benchmarks for 2005 are valued at the program exchange rate of Le 2,950 per US$ 1.
5/ Defined as the difference between the net foreign assets of the central bank (valued at the program exchange rate) and reserve money.
6/ Defined as domestic revenue minus total expenditure and net lending, excluding interest payments, externally financed capital expenditures, and the externally financed DDR program.
7/ In the event of an excess (shortfall) in external budgetary assistance (as defined above), the floor will be adjusted upward (downward) by the amount of the excess (shortfall).
8/ This performance criterion applies to debt as defined in Annex 1 of the TMU of October 2004.
9/ Excluded from this performance criterion are disbursements from the Fund and rescheduling arrangements.
10/ Excluded from this performance criterion are external loans with a grant element equivalent to 35 percent or more, calculated using a discount rate based on OECD commercial interest reference rates (CIRRs).
11/ The term "debt" has the meaning set forth in Annex 1 of the TMU of October 2004.
12/ Excluded from this performance criterion are normal import-related credits.
13/ To be applied on a continuous basis. Excluded from this performance criterion are those debts subject to rescheduling arrangements.
14/ Including program grants and program loans.
15/ Comprises treasury bills purchased by the National Social Security and Insurance Trust (NASSIT) and the non-financial private sector.
16/ Quantitative performance criteria and indicative targets as specified in Table 3, Appendix I, IMF Country Report No. 05/194).
17/ Cumulative changes have been calculated on the basis of actual end-December 2004 data.

Table 2. Sierra Leone: Proposed Structural Conditionality for 2006

Measure	Timing
Prior actions for approval of the PRGF arrangement	
Deputy Auditor General has been appointed.	
The implementation of action plans to reform five key ministries has commenced, and Cabinet has approved the sixth action plan for the ministry of local government.	
A plan for transforming the Establishment Secretary's Office into Human Resources Management office has been approved by Cabinet.	
A medium-term revenue projection has been finalized for diamonds, rutile, and bauxite, and incorporated in the overall fiscal framework.	
All government units and accounts that should be included in the new reporting system for monetary and fiscal data have been identified, and benchmark annual data for 2004 established.	
Structural performance criteria	
Implementation of a new reporting system, developed with Fund technical assistance in 2005, for the reconciliation of fiscal data with monetary data has started.	March 31
The database containing all job grades and salary levels for all civil servants and teachers has been updated and audited, and guidelines for annual salary adjustments within grade ranges approved by the cabinet.	June 30
An assessment of bank capitalization and credit quality for all commercial banks has been finalized by the Bank of Sierra Leone.	September 30
Structural benchmarks	
Specific measures to be taken during the period through end-2006 to convert the Establishment Secretary's Office into a Human Resource Management Office have been identified.	March 31
An action plan for the implementation of the Government's Budgeting and Accountability Act has been approved by Cabinet.	March 31
The stock as of February 28, 2006, of outstanding utility and wage arrears has been identified and an action plan to clear these arrears has been approved.	March 31
Key ministries and agencies have established internal audit units under the control of the chief internal auditor of the Ministry of Finance.	April 30
A review of existing tax exemptions has been conducted and a plan approved for minimizing the exemptions.	June 30

Table 3. Sierra Leone: Main Areas for Structural Reforms, 2006–08

	Timing
The public sector	
Continue reforms of the public sector and civil service for effective service delivery	2006–08
Strengthen the capacity for data collection, analysis, and reporting to support policy-making	2006–08
Strengthen public financial management and fiscal decentralization	2006–08
Fiscal Policy and Debt Management	
Introduce a value-added tax system	2007
Eliminate discretionary tax exemptions	2007
Collect tax arrears	2006–07
Strengthen tax administration and revenue collection	2006–08
Strengthen the capacities of the public debt units in the MOF and BSL	2006–08
Public Expenditure Management	
Improve medium-term fiscal planning	2006–07
Strengthen management of the wage bill	2006–07
Strengthen the auditing function of government financial accounts	2006–07
Strengthen fiscal and monetary reporting to ensure timely reconciliation of data	2006–07
The Financial Sector	
Develop and implement a strategy to address undercapitalization and credit quality issues in commercial banks	2006–07
Strengthen the bank supervision function in the BSL	2006–07
Establish a regulatory framework for microfinance services	2006–07
Develop a strategy to adequately capitalize the BSL	2007
Strengthen the payments and clearing systems	2007-08

Table 4. Sierra Leone: Proposed Quantitative Performance Criteria and Indicative Targets
Under the Poverty Reduction and Growth Facility Arrangement (January-December 2006)

(Cumulative change from beginning of calendar year to end of month indicated; in millions of leones, unless otherwise indicated.) 1/

	2005 Sept. Act.	2005 Dec. Proj.	March Performance Criteria	June Indicative Targets	September Performance Criteria	December Indicative Targets
	End-period stocks					
Performance criteria:						
Net domestic bank credit to the central government (ceiling)	786,275	752,775	20,216	19,765	-3,882	7,410
Net domestic assets of the central bank (ceiling)	455,145	404,936	30,216	24,765	-882	37,910
Domestic primary budget balance of the central government (floor)			-29,180	-40,991	-65,842	-80,465
Subsidies to National Power Authority (ceiling) 2/			0.0	0.0	0.0	0.0
Gross foreign exchange reserves of the central bank, in million U.S. dollars (floor)	135.03	148.94	-0.40	2.69	20.40	4.99
Contracting or guaranteeing of new nonconcessional external debt by the public sector (ceiling) with maturities of one year or more 2/	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding stock of external debt owed or guaranteed by the public sector with maturities of less than one year (ceiling) 2/	0.0	0.0	0.0	0.0	0.0	0.0
External payment arrears of the public sector (ceiling) 2/	0.0	0.0	0.0	0.0	0.0	0.0
Indicative targets:						
Total domestic government revenue (floor)			111,409	248,399	383,296	538,808
Government wage bill (ceiling)			66,500	132,250	199,250	265,089
Poverty-related expenditures (floor)			43,320	89,254	155,369	207,873
Memorandum item:						
External budgetary assistance 3/			22,424	57,019	150,211	173,507
Net credit to government by nonbank private sector 4/			20,782	21,982	2,490	17,595
Disbursements under the PRGF, in millions U.S. dollars			6.73	6.73	13.02	13.02

Sources: Statistics Sierra Leone; and IMF staff estimates.

1/ Variables are based on definitions in the TMU of February 2006.
2/ These apply on a continuous basis.
3/ Including program grants and program loans.
4/ Comprises treasury bills purchased by the National Social Security and Insurance Trust (NASSIT) and the non-financial private sector.

SIERRA LEONE: TECHNICAL MEMORANDUM OF UNDERSTANDING

March 2006

INTRODUCTION

1. This memorandum sets out the understandings between the Sierra Leonean authorities and the International Monetary Fund (IMF) regarding the definitions of the quantitative performance criteria and indicative targets for the program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement, as well as the related reporting requirements. The definitions have been revised to ensure that the memorandum continues to reflect the best understanding of the Sierra Leonean authorities and the Fund staff in monitoring the program. Unless otherwise specified, all quantitative performance criteria and indicative targets will be evaluated in terms of cumulative flows from the beginning of the period, as specified in Table 4 of the attached Memorandum of Economic and Financial Policies of the Government of Sierra Leone for January 1–December 31, 2006.

Definition

2. **Program exchange rates.** For the purpose of this Memorandum of Understanding, foreign currency denominated transactions will be converted into Sierra Leonean currency (leones) using the program exchange rates. For the 2006 program, the program exchange rates are specified as those at December 31, 2005 (the key exchange rates are shown in the box below).

Leone/US$	2,933
US$/Euro	1.180
US$/Pound	1.722
US$/SDR	1.429

Quantitative Performance Criteria: Definitions and Data Sources
Gross Foreign Exchange Reserves of the Bank of Sierra Leone (BSL)

3. **Definition.** Unless otherwise noted here, gross foreign exchange reserves of the Bank of Sierra Leone (BSL) will be defined as reserve assets of the BSL. Reserve assets are defined in the IMF's *Balance of Payments Manual* (5th ed.) and elaborated in the reserve template of the Fund's International Reserves and Foreign Currency Liquidity: Guidelines for a Data Template. They exclude foreign assets not readily available to, or controlled by, the monetary authorities.

4. Gross foreign exchange reserves consist of (a) monetary gold; (b) foreign currency in cash; (c) unencumbered foreign currency deposits at non-resident banks; (d) foreign securities and deposits; (e) SDR holdings and Sierra Leone's reserve position with the Fund; and (f) balances in the Bank of England account related to debt service to Paris Club creditors. Gross reserves will exclude nonconvertible currencies and pledged, swapped, or

any encumbered reserves assets including but not limited to reserve assets used as collateral or guarantees for third party external liabilities.

5. **Adjustment clauses.** The floor on gross foreign exchange reserves will be adjusted (a) downward (or upward) by the amount in U.S. dollars of the shortfall/excess in programmed external budgetary assistance;[36] (b) downward (upward) for any shortfall/excess in the U.S. dollar value of disbursements from the IMF under the PRGF arrangement; and (c) upward (or downward) for any increase (or decrease) in BSL short-term (one year or less in original maturity) foreign currency-liabilities (to residents and nonresidents).

6. **Supporting material**. Data on gross foreign exchange reserves, including its components, will be transmitted by the BSL to the Fund on a weekly basis within ten days of the end of each week.

Net Domestic Assets of the BSL

7. **Definition.** Net domestic assets (NDA) of the BSL are defined as the end-period (based on daily data) stocks, during the month of the test dates, of the reserve money less net foreign assets calculated at the program exchange rates. Reserve money includes currency in circulation and required reserves on leone deposits. Net foreign assets of the BSL are defined as gross foreign exchange reserves (defined above) minus foreign liabilities (defined below). The program definition of net domestic assets will be adjusted upward by the amount of debt relief received by the BSL under the Multilateral Debt Relief Initiative.

8. Foreign liabilities are defined as short-term (one year or less in original maturity) foreign currency-denominated liabilities of the BSL to nonresidents and the outstanding use of Fund credit.

9. **Adjustment clauses.** The ceiling on the NDA of the BSL will be adjusted upward by fifty percent of the amount of the shortfall in the external budgetary assistance at the test dates. The ceiling will be adjusted downward by the amount of the excess in the external budgetary assistance at the test dates.

10. **Supporting material.** Net domestic assets of the BSL will be transmitted to the Fund on a monthly basis within four weeks of the end of the month. This report will include foreign assets excluded from the definition of gross foreign exchange reserves in Section IIA above.

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[36] External budgetary assistance is defined as program grants and program loans, but excluding external financing for the Disarmamanent, Demobilization and Reintegration (DDR) Program, and project-related grants and loans. The leone value of the cumulative shortfall (excess) of external budgetary assistance will be calculated at the program exchange rates.

Net Domestic Bank Credit to the Central Government (NCG)

11. **Definition.** NCG refers to the net banking system's claims on the central government and is defined as the following:

- the net position of the government with commercial banks, including: (a) treasury bills; (b) bonds issued by the Government of the Republic of Sierra Leone (GSL); (c) loans and advances; less (d) Central government deposits (defined to include account balances under the authority of controlling officers); plus

- BSL holdings of (a) GSL statutory bonds; (b) ordinary GSL bonds; (c) bonds in respect of loans to current and former parastatals; (d) treasury bills on the trading portfolio of BSL; (e) other government stock; (f) HIPC debt relief deposits; less (g) special non-interest-bearing government stocks to cover foreign exchange valuation losses.

12. **Adjustment clauses.** The ceiling on the increase in NCG will be adjusted upward by up to fifty percent of the amount of the shortfall in external budgetary assistance. The ceiling will be adjusted downward by the amount of the excess in external budgetary assistance. The leone value of the cumulative shortfall or excess in external budgetary assistance will be converted at the program exchange rates. The ceiling will also be adjusted downward (upward) by the excess (shortfall) in the leone value of net issues of government securities to the nonbank private sector vis-à-vis the program target (specified in the memorandum items in Table 4 of the MEFP).

13. **Supporting material.** The data source for the above will be the series "Claims on Government (Net)" submitted to Fund staff on a weekly basis and reconciled with the monthly BSL monetary survey to be submitted to the Fund within six weeks of the end of each month. These data will be reconciled with monthly reports on treasury bill transactions and the ways-and-means account, and with treasury bearer bond transactions to be submitted to the Fund staff by the Ministry of Finance, within six weeks of the end of each month.

Domestic Primary Budget Balance of Central Government

14. **Definition of Central government.** Central government is defined for the purposes of this memorandum to comprise the central government and those special accounts that are classified as central government in the BSL statement of accounts. The National Social Security and Insurance Trust (NASSIT) and public enterprises are excluded from this definition of central government.

15. The **floor on the domestic primary budget balance** of the central government is defined as domestic revenue minus total expenditure and net lending, excluding interest payments, externally financed capital expenditure, and the externally financed DDR program.

16. **Supporting material.** The data will be submitted to Fund staff by the Budget Unit of the Ministry of Finance (MFIN) within six weeks of the end of each month.

Domestic Revenue of Central Government

17. The **floor on total domestic central government revenue** is defined as total central government revenue, excluding external grants.

18. **Supporting material.** The data will be submitted to Fund staff by the Budget Unit of MFIN within six weeks of the end of each month.

Central Government Wage Bill

19. The **ceiling on the government wage bill** is defined as total expenditure outlays on wages, salaries, pensions, payments to NASSIT and cash allowances by the government.

20. **Supporting material.** The data will be submitted to Fund staff by the Budget Unit of the Ministry of Finance within six weeks of the end of each month.

Poverty-related Expenditures

21. Poverty-related expenditures refer to those expenditures in those areas identified in Table 2 of the Sierra Leone HIPC Decision Point Document. These budgetary expenditures include but are not limited to those sub-components that are financed by drawdown from the HIPC Relief Account at the BSL.

External Payment Arrears of the Public Sector

22. **Definition.** Official external payment arrears are defined as the stock of new external overdue debt-service payments by the public sector. For the purposes of this performance criterion, the public sector will comprise the central government, regional government, all public enterprises and the BSL. The **nonaccumulation of external arrears is a performance criterion during the program** period. Excluded from this performance criterion are those debts subject to rescheduling. This performance criterion will apply on a continuous basis.

23. **Supporting material.** Data on arrears are compiled jointly by the MFIN and the BSL and will be reported to Fund staff by the Budget Director of the MFIN on a quarterly basis within six weeks of the end of each quarter.

New Nonconcessional External Debt Contracted or Guaranteed by the Public Sector with an Original Maturity of One Year or More

24. **Definition.** Those are defined as all forms of new debt with original maturity of one year or more contracted or guaranteed by the public sector.[37] This performance criterion applies not only to debt as defined in point 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274 (00/85), August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received. This performance criterion will apply on a continuous basis. Excluded from this performance criterion are disbursements from the IMF and those debt subject to rescheduling. For the purposes of this performance criterion, the "public sector" consists of the central and regional governments and other public agencies, including the BSL.

25. **Supporting material.** Detailed data on all new concessional and non-concessional debt contracted or guaranteed will be provided to Fund staff by BSL/the Ministry of Finance on a quarterly basis within six weeks of the end of each quarter.

External Short-Term Debt Contracted or Guaranteed by the Public Sector

26. External short-term debt is defined as external debt stock with a maturity of less than one year contracted or guaranteed by the public sector. Debt is defined in Annex 1 of this Technical Memorandum of Understanding. For this purpose, short-term debt will exclude normal trade credit for imports. This performance criterion will apply on a continuous basis. For the purposes of this performance criterion, the public sector consists of the central and regional governments and other public agencies, including the BSL.

27. **Supporting material.** A comprehensive report on all new external debt with original maturity of less than one year owed or contracted by the public sector will be transmitted to Fund staff by the BSL on a quarterly basis within four weeks of the end of each quarter.

[37] Debt is considered concessional if it has a grant element equivalent to 35 percent or more. Calculation of the degree of concessionality of new external borrowing is based on the last 10-year average commercial interest reference rate (CIRR) of the Organization for Economic Cooperation and Development (OECD) for loans with maturities of at least 15 years and on the last six-month average CIRR for loans maturiting in less than 15 years.

Subsidies to the NPA

28. The term "subsidy" refers to any financial government support (i.e., unrequited transfers) to the National Power Authority (NPA). It does not include the government's on-lending of external loans for capital expenditure of the enterprise. The subsidy is to be reduced by the amount of arrears accumulating in regard to the charges for government's electricity consumption. This performance criterion will apply on a continuous basis.

Program–Monitoring Committee

29. **Definition.** The Sierra Leonean authorities shall maintain a program-monitoring committee composed of senior officials from the Ministry of Finance, the Ministry of Economic Development and Planning; the Bank of Sierra Leone, and other relevant agencies. The committee shall be responsible for monitoring the performance of the program, recommending policy responses, informing the Fund regularly about the progress of the program, and transmitting the supporting materials necessary for the evaluation of performance criteria and benchmarks. The committee shall provide the Fund with a progress report on the program on a monthly basis within four weeks of the end of each month, using the latest available data.

Data Reporting to the Fund
Domestic Prices

30. **Reporting standard.** the monthly disaggregated consumer price index will be transmitted within four weeks of the end of each month.

Government Accounts Data

31. **Reporting standard.** A consolidated budget report of the central government comprising (a) the revenue data by each major item, including those collected by the National Revenue Authority, as well as privatization receipts to the budget; (b) details of the recurrent and capital expenditure of the central government; (c) details of budget financing (domestic and external), which will be transmitted on a monthly basis within six weeks of the end of each month; and (d) details on the government's outstanding arrears outstanding, including payments and other arrangements to discharge them (these data will be transmitted on a monthly basis within six weeks of the end of each quarter).

Monetary Sector Data

32. **Reporting standard.** The balance sheet of the central bank and the consolidated balance sheets of the commercial banks will be transmitted on a monthly basis within six weeks of the end of each month. A special report on transactions in the HIPC relief account at the BSL will be provided to the Fund on a monthly basis within six weeks of the end of each month. The results of the treasury bill auctions will be transmitted on a biweekly basis within five business days. The stocks of government securities, balances in the divestiture account, detailed information on interbank loans (terms, duration, and participating institutions), and interest rate developments will be transmitted on a monthly basis within two weeks of the end of each month.

External Sector Data

33. **Reporting standard.** The following standard will be adhered to: (a) the interbank market exchange rate, as the simple average of the daily-weighted average buying and selling rates, will be transmitted on a weekly basis within five business days of the end of the week; (b) the results of foreign exchange auctions (on a weekly or more frequent basis) will be transmitted on a weekly basis within five business days of the end of each week; and (c) the foreign exchange cash flow data will be transmitted on a quarterly basis within six weeks of the end of each quarter.

Implementation of the Revised Guidelines on Performance Criteria with Respect to Foreign Debt

The term “debt” has the meaning set forth in point No. 9 of the Guidelines on Performance Criteria with Respect to Foreign Debt adopted on August 24, 2000 which reads as follows: “(a) For the purpose of this guideline, the term “debt” will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers’ credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair or maintenance of the property.
(b) Under the definition of debt set out in point 9(a) above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt”].
(B) Excluded from this performance criterion are normal import-related credits, disbursements from the IMF, and those debts subject to rescheduling arrangements.

Sierra Leone: Relations with the Fund
(As of December 31, 2005)

I. Membership Status: Joined 9/10/62; Article VIII

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	103.70	100.00
Fund holdings of currency	103.69	99.99
Reserve position	0.02	0.02

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	17.45	100.00
Holdings	22.93	131.36

IV. Outstanding Purchases and Loans:	**SDR Million**	**% Quota**
PRGF Arrangements	134.39	129.60

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
PRGF	9/26/01	6/25/05	130.84	130.84
PRGF	3/28/94	5/04/98	101.90	96.85
SAF	3/28/94	3/27/95	27.02	27.02

VI. Projected Payments to Fund (without HIPC assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2006	2007	2008	2009	2010
Principal	3.05	10.81	16.37	19.17	24.77
Charges/interest	0.67	0.63	0.56	0.48	0.37
Total	3.71	11.44	16.93	19.64	25.14

Projected Payments to Fund (with Board-approved HIPC Initiative Assistance)
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	0.09	3.05	10.81	16.37	19.17
Charges/interest	0.34	0.67	0.63	0.56	0.48
Total	0.44	3.71	11.44	16.93	19.64

VII. Implementation of HIPC Initiative

	Enhanced Framework
Commitment of HIPC Initiative assistance	
Decision point date	March 2002
Assistance committed (NPV terms)[38]	end-2000
Total assistance by all creditors (F94million)	600.00
Of which: IMF assistance (US$ million)	123.30
(SDR equivalent in millions)	98.48
Completion point date	Floating
Disbursement of IMF assistance (SDR million)	
Amount disbursed	66.03
Interim assistance	66.03
Completion point balance	0.0
Total disbursements	66.03

VIII. Safeguards Assessment

Under the Fund's safeguards assessment policy, the Bank of Sierra Leone (BSL) is subject to an assessment with respect to the proposed PRGF arrangement. A safeguards assessment was completed in July 2002 with respect to the PRGF arrangement approved on September 26, 2001.

IX. Exchange Rate Arrangement

The exchange ratea system is officially classified as independently floating. However, the nominal exchange rate of the leone vis-à-vis the U.S. dollar has depreciated steadily since the middle of 2002, suggesting that the rate has been managed through the participation of the BSL in the foreign exchange market through weekly auctions. The BSL calculates the official exchange rate every Friday morning as the weighted average of the auction rate, the

[38] Net present value (NPV) terms at the decision point under the enhanced framework.

comercial banks’mid-rate, and the bureaus’mid-rate in the previous week, for customs valuation purposes and for official transactions. As of January 18, 2006, the BSL mid-rate was Le 2,927.93=US$1. Commercial banks may buy and sell foreign exchange from/to individual customers, as well as trade among themselves or with the BSL on a freely negotiable basis. The exchange rate regime classification will be reviewed in the context of the next Article IV Consultations.

With effect from December 14, 1995, Sierra Leone has accepted the obligations of Article VIII, Sections 2, 3, and 4. On June 29, 2001, Sierra Leone removed the remaining exchange restriction, in the form of a tax clearance certificate required for payments and transfers of certain types of current international transactions.

X. Article IV Consultation

The 2004 Article IV consultation was concluded by the Executive Board on November 12, 2004. The next Article IV consultation with Sierra Leone will be held in accordance with the provisions of the decision on consultation cycles approved on July 15, 2002.

XI. Technical Assistance

Missions	**Date**
MFD mission on improving foreign exchange auction.	January/February 2000
FAD mission to conduct fiscal sector review and to recommend reforms in expenditure management and revenue administration.	May 2001
MFD mission on financial sector issues.	October 1999
MFD mission on banking supervision and regulation; monetary operations and framework; and payment systems.	May/June 2001
MFD mission to assess TA needs of the BSL, banking supervision, and central bank management.	November 2001
FAD mission to review public expenditure management systems.	June 2002
STA mission to assess the legal-institutional framework for statistics. MFD mission on banking supervision and regulation and monetary operations and framework.	June 2002 December 2002
STA GDDS project mission on monetary and financial accounts.	April 2003
STA GDDS project mission on BOP.	April 2003
MFD mission on monetary operations, banking supervision, and payment systems.	May/June 2003
STA GDDS follow-up project mission on BOP.	November 2003

Missions	Date
MFD mission to provide and plan follow-up TA to the BSL on monetary operations, banking supervision, and payment systems.	November 2003
FAD mission to review the tariff and indirect tax system, National Revenue Authority, and tax and customs administration.	February 2004
STA GDDS project mission on strategic planning.	March 2004
FAD mission to review the system of fiscal incentives, especially the special tax regimes applied to mining and petroleum sectors.	March/April 2004
STA GDDS project mission on national accounts.	April 2004
STA GDDS project study tour for Sierra Leonean officials to Kenya on strategic planning.	August 2004
STA GDDS project mission on national accounts.	September 2004
STA GDDS project mission on BOP issues.	September/October 2004
STA GDDS project mission on monetary-fiscal accounts reconciliation.	October 2004
MFD multi-topic technical assistance mission.	November 2004
STA GDDS project mission on monetary-fiscal accounts reconciliation.	February 2005
STA GDDS project mission on national accounts.	February 2005
MFD multi-topic technical assistance mission.	November 2005
STA GDDS project mission on national accounts.	January 2006

XII. Resident Representative

Mr. Dennis Jones assumed responsibility for the Fund office in August 2005. Mr. Jones is also the Fund's resident representative in Guinea and stationed in Conakry.

SIERRA LEONE: RELATIONS WITH THE WORLD BANK GROUP

The Bank's Board endorsed a Transitional Support Strategy (TSS) for Sierra Leone for FY 2002–03 on March 26, 2002. Under the TSS, the World Bank, through IDA, has assisted the government in pursuing four main objectives: (i) consolidating peace; (ii) resettlement, reconstruction and reintegration; (iii) improving governance; and (iv) maintaining a macroeconomic framework conducive to recovery. Instruments used in supporting these objectives include the second Public Sector Management Support Project (PSMS II), the Second and Third Economic Rehabilitation and Recovery Credits (ERRC II and III), the Basic Education Project, the Health Sector Reconstruction Project, the Transport Sector project (now called Power and Water), the Institutional Reform and Capacity Building Project (IRCB), and the National Social Action Project. The Bank also supports the Government's HIV/AIDS Program through the Multi-Sector HIV/AIDS Response Project approved in 2002 under the MAP II.

The Bank has prepared a new Country Assistance Strategy (CAS) following continued progress in establishing security and governance as well as the completion of the new PRSP. The new CAS, approved in June 2005, supports the strategy outlined in the PRSP for a transition to policies and programs for sustained growth and poverty reduction with gradually decreasing emphasis on post-conflict needs. The continued maintenance of a stable macroeconomic framework is considered to be a prerequisite for World Bank program support.

In FY 2005, the Bank provided a US$35 million credit for the Power and Water Project, a US$15 million grant for adjustment support (ERRC IV), and a US$12.5 million grant for the Completion of the Bumbuna Hydroelectric Dam (along with a US$30 million partial risk guarantee). In FY 2006, operations include only the US$44 million grant for the Infrastructure Development Project (Transport). In FY07, the operational program includes US$10 million in adjustment support, a small US$5 million mining technical assistance operation and a US$28 million investment in the PSD/rural sector.

As of December 31, 2005, the World Bank Group has approved 50 loans, credits and grants for a total of US$795.9 million, with an undisbursed amount of US$154.9 million. The current portfolio consists of eight operations, as summarized in the table below, in the areas of poverty reduction, education, health, HIV/AIDS, transportation, and power totaling about US$206.5 million.

Sierra Leone: Financial Relations with the World Bank Group

(As of December 31, 2005; in millions of U.S. dollars)

	Commitments			Of which:
	IBRD	IDA		Undisbursed
IBRD/IDA Lending Operations				
HIV/AIDS Response Project	0.00	15.0		6.08
Rehabilitation of Basic Education	0.00	20.0	G/	11.69
Health Sector Reconstruction	0.00	20.0	G/	14.55
National Social Action Project	0.00	35.0		20.31
Institutional Reform and Capacity Building	0.00	25.0	G/	15.22
Power and Water	0.00	35.0		31.92
Completion of Bumbuna Hydroelectric Project	0.00	12.5		12.01
Infrastructure Development Project (Transport)	0.00	44.0	G/	43.99
Total	0.00	206.5		155.77
Total disbursed (IBRD and IDA)*	18.7	612.0		
Of which: repaid	18.16	42.6		
* of which: Total disbursed IDA Grants		41.8		

Source: World Bank Group.G/ Loan type = IDA Grant (all others are IDA Credits).

World Bank Contact: Douglas M. Addison, Senior Economist, Macroeconomics 4, Africa Region, the World Bank (phone: 202-473-1188).

SIERRA LEONE: DEBT SUSTAINABILITY ANALYSIS

This appendix assesses the sustainability of Sierra Leone's external and domestic public debt. The debt sustainability analysis (DSA) was conducted jointly by the staffs of the World Bank and the International Monetary Fund (IMF) using the new Debt Sustainability Framework (DSF) for low-income countries. The external and domestic debt data underlying this DSA were provided by the authorities of Sierra Leone and reconciled in the case of its three main multilateral creditors.[39] A full reconciliation of external debt will be conducted by the time Sierra Leone reaches the HIPC completion point. On the basis of the analysis of the baseline scenario and several alternative scenarios, the staffs conclude that Sierra Leone faces a moderate risk of external debt distress. In the case of domestic obligations, the staffs recommend that the Sierra Leonean authorities further review the fiscal implications of converting non-interest bearing obligations to the Bank of Sierra Leone into interest-bearing government liabilities.

I. Background

1. **Sierra Leone reached the HIPC Decision Point in 2002. Since then, it has received HIPC interim assistance from various multilateral and bilateral creditors.** Based on external debt data for end-2000, the Boards of IDA and the IMF approved debt relief worth US$600 million in end-2000 NPV terms. Interim relief in the form of debt service reductions was provided by IDA, the IMF, the AfDB, and the European Union.[40] The OPEC Fund provided interim relief through an arrears clearance and the Paris Club provided interim assistance on Cologne terms on maturities falling due in the interim period. Some Paris Club creditors, like Italy, Norway, Switzerland, the United Kingdom, and the United States, agreed to cancel in full debt service payments falling due during the interim period. Of the non-Paris Club bilateral creditors China and Morocco have provided assistance outside the HIPC Initiative through debt cancellations.[41]

2. **The government also benefited from a debt buy-back under the IDA debt reduction facility in 1995.** At that time, the program received financial support from IDA, EU, and the government of Sierra Leone. A second IDA debt reduction program, currently in the procurement phase, would cover the currently outstanding commercial debt which is estimated at US$251 million at end-2004.[42]

3. **At end 2004, Sierra Leone's nominal public external debt including arrears stood at US$ 1,720 million (161 percent of GDP).** Two-thirds were owed to multilateral creditors and the remainder to bilateral and commercial creditors (Table 1). Sierra Leone's external debt stock has increased by 43 percent since 2000, the base year of the HIPC Decision Point. Part of this increase can be explained with new disbursements between 2000 and 2004 which are estimated to have been in the range of US$414 million. The debt stock also rose due to commercial debt

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[39] The African Development Bank (AfDB), the IMF, and the World Bank.

[40] Interim relief by AfDB lapsed at end-2004. This was due to an exhaustion of the HIPC Trust Fund. The trust fund was replenished in 2005, which allowed the resumption of interim debt relief.

[41] China cancelled all disbursed outstanding debt that had matured in 1999 under a special Chinese Initiative. Similarly in 2004, Morocco cancelled the entire outstanding debt amounting to US$10 million.

[42] The DSA assumes that a buy-back will take place at the beginning of 2007.

that was not known at the Decision Point.[43] This substantial increase is a result of contractor-related arrears which were identified as the country emerged from the period of conflict to peace.

Table 1: Debt Outstanding at End-2004

Creditor	US$	Percent
Multilateral, of which:	**1,061,796,494**	**62**
IDA	564,727,787	33
AfDB	206,373,425	12
IMF	194,159,605	11
Bilateral	**397,203,546**	**23**
Commercial 1/	**261,080,731**	**15**
Total	**1,720,080,770**	**100**

1/ Of which, US$251 million are in arrears.

Sources: Government of Sierra Leone and staff estimates.

4. **Sierra Leone's domestic debt stock has fallen to 33 percent of GDP in 2004 from 57 percent of GDP in 2000.**[44] This decline was the result of high GDP growth after the civil war, as well as the reduction in the fiscal deficit to 3 ½ percent of GDP in 2004 from almost 11 percent of GDP in 2001. Domestic borrowing has been costly, however, with interest rates on treasury bills fluctuating between 15 and 27 percent between 2000 and 2004. Interest payments on domestic debt consumed a substantial portion of government revenues (30 percent, excluding all grants) in 2004.

5. Gross domestic debt is mainly held by the Bank of Sierra Leone, commercial banks, and the National Social Security Investment Trust (NASSIT). Just over half of the end-2004 stock of domestic debt comprises non-interest bearing, non-negotiable securities with no maturity (about US$185 million using end-2004 exchange rate), which the government issued in 1996 and 2000 to the central bank (BSL) to cover the central bank's foreign currency revaluation and operational losses from the conflict period.[45] The remainder of the domestic debt stock is predominantly short-term in nature and therefore subject to a significant roll-over risk.[46]

[43] At the Decision Point, commercial debt (entirely in arrears) was estimated at US$85.6 million. As of end-2004, the stock of commercial arrears is estimated at US$251 million.
[44] In addition, the government has accumulated arrears owed to private suppliers and utility companies. These totaled US$ 15.9 million (1.5 percent of GDP) at end-2004.
[45] The baseline scenario assumes the continuity of the status quo, that is, no interest will be accumulated on this debt.
[46] If a country's debt is heavily concentrated in short-term maturities of less than one year, the government is exposed to a "bunching problem," with a high volume of obligations maturing on certain dates that may all have to be refinanced at the same time.

II Methodology and Key Assumptions

6. **Under the new DSF, the evolution of the external and domestic public debt stock and debt service indicators are analyzed under a baseline scenario and a series of stress tests in order to assess a country's probability of facing debt distress in the future.**[47] The assessment of external debt sustainability is guided by indicative, country-specific debt burden thresholds related to a country's quality of policies and institutions as measured by the World Bank's Country Policy and Institutional Assessment (CPIA). According to the 2004 CPIA, Sierra Leone ranks as a "weak performer" in the quality of its policies and institutions. Indicative external debt burden thresholds for countries in this category are a NPV of debt-to-exports ratio of 100 percent, NPV of debt-to-revenue ratio of 200 percent, a NPV of debt-to-GDP ratio of 30 percent, and debt-service-to-exports and revenues ratios of 15 and 25 percent, respectively.[48]

7. **The analysis underlying the DSA is subject to a number of assumptions.** The external debt numbers underlying the analysis assume the full delivery of HIPC debt relief (including a buy-back of external commercial debt anticipated for 2007) and additional bilateral debt relief after the expected HIPC completion point in July 2006. New borrowing is assumed to come predominantly from external resources and is driven by fiscal assumptions on grant assistance, revenues and expenditures. New external borrowing is projected to be contracted primarily on IDA terms throughout the entire projections period. New domestic borrowing is assumed to continue to be available only at very short maturities (no more than a year). The share of grants (program and project) in the fiscal financing is assumed to fall over time as the economy becomes less aid dependent: from almost 7 percent of GDP in 2004 to just under 3 percent of GDP by 2025 (excluding HIPC assistance). The underlying macroeconomic assumptions are outlined in Box 1 below.

8. **Staffs' assessment of the country's risk for future debt distress is informed by both the external and fiscal debt sustainability analysis.** In addition to the baseline scenario and stress tests of the DSA, staffs have considered three additional stress tests: one entertains the implications of the Multilateral Debt Relief Initiative (MDRI), a second simulates the effect of a two-year delay in the restart of the rutile and bauxite mines which is scheduled for 2006 under the baseline and the third simulates the impact of paying interest and amortization on what is currently non-interest bearing domestic public debt with no maturity owed to the Bank of Sierra Leone.

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[47] See Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations. The new framework introduces some methodological change in the calculation of the NPV of debt compared to the HIPC methodology by using (a) a fixed 5 percent discount rate instead of currency specific discount rates (under HIPC), (b) WEO exchange rate projections instead of fixed exchange rates as of end of the base date, and (c) annual exports instead of a three-year average of exports as the denominator in the NPV of debt-to-exports ratio.

[48] The NPV of external debt-to-revenue ratio excludes all grants. By contrast, the revenue ratios quoted in the fiscal analysis in Section IV below assume the inclusion of grants.

Box 1: Macroeconomic Assumptions 2006-2025

The medium-term assumptions in the baseline scenario for 2006-2025 are consistent with the proposed IMF PRGF supported program. Key macroeconomic assumptions include the maintenance of a sustained high real GDP growth rate and a stable macroeconomic environment. Substantial mineral endowments, which are expected to be fully rehabilitated in the medium-term, combined with growing exports of cash crops would support the balance of payments and growth, as well as enhance fiscal sustainability.

- The baseline scenario assumes a sustained high output growth and low inflation. Output growth is projected to slow gradually to 5 percent annually by 2025 from 7.4 percent in 2006. Consumer price inflation is projected to decline to 5 percent towards the end of the period from 9.5 percent in 2006.

- The external trade balance would improve by 5 percentage points of GDP between 2006 and 2014 and then stabilize at a deficit of 11 percent of GDP, reflecting robust export growth. This reflects, initially, the restart of rutile and bauxite production and exports as well as continued strong growth in diamond exports. Imports of goods and services would grow in line with the nominal GDP, following some additional investment-related imports in the initial years for the expansion of the newly restarted rutile and bauxite mines. The current account deficit is projected to narrow to 4½ percent of GDP by 2025 from just less than 7 percent of GDP in 2006 as interest obligations gradually fall as a share of GDP.

- External grants to government were equivalent to an average of 5 percent of GDP per annum in the initial years after the end of the conflict (2002–2005). Following a successful consultative group meeting in London in November 2005, grants are expected to rise to 7.7 percent of GDP in 2006 from 6.8 percent of GDP in 2005 in support of the government's Poverty Reduction Strategy. For the remainder of the projection period, the baseline scenario includes the conservative assumption that grants will fall gradually to 3 percent of GDP by 2025 as post-conflict needs fade.

- A reversion of external grant assistance to traditional levels will require fiscal adjustment. The main elements of the envisioned adjustment include steady gains in revenue collection through improved administration and augmentation of the revenue base. Revenues collected would steadily rise from 12.6 percent in 2006 to the average for HIPC completion point countries of 15 percent by the end of the period. Revenues would fully cover all recurrent expenditures from 2018 onward rather than the 67 percent covered in 2005. Recurrent expenditures, excluding interest, would rise from 13.5 percent of GDP in 2006 to 14 percent of GDP in 2010 and then stabilize at that level. Development spending would increase to a peak of 6.6 percent of GDP by 2015 from 3.4 percent in 2006 and then gradually fall to 5.8 percent of GDP by 2025, with some increase in domestic development expenditures to offset the fall in donor-funded projects. The reduction in development expenditures is consistent with the deceleration of the rate of real growth in the economy in the outer years.

III External Debt Sustainability

9. **Under the baseline scenario, Sierra Leone's external debt burden indicators would sharply decline following the delivery of full debt relief at the HIPC completion point.** The NPV of public and publicly guaranteed debt-to-GDP ratio stood at 88 percent in 2005 and would fall to about 31 percent in 2006 following debt relief (reaching the threshold) and gradually further to about 23 percent by 2025 (Table 4). The NPV of debt-to-exports ratio would fall to 111 percent in 2006 and below 100 percent by 2010 from 364 percent in 2005. It would then gradually decline to about 72 percent by 2025. The external debt service-to-export ratio would remain well below its threshold for the entire period, both under the baseline and under most

stress tests. The NPV of external debt-to-revenue ratio (excluding all grants) would fall from 719 percent in 2005 to 243 percent after the projected Completion Point and then gradually decline until it would fall below the indicative debt burden threshold of 200 in 2012.

10. **The MDRI would further reduce Sierra Leone's external debt burden.** The NPV of debt-to-GDP ratio would fall to an average of 21 percent for the period 2006–2025 (Table 4). The NPV of debt-to-exports ratio would fall to 58 percent in 2006 and then gradually rise to 66 percent by 2025. The external debt-service-to-export ratio would fall even further below its threshold. The NPV of external debt-to-revenue ratio (excluding all grants) would fall to 128 percent in 2006 and remain below the threshold of 200 percent thereafter.

11. **Stress tests reveal that Sierra Leone's external debt sustainability is vulnerable to a number of down-side risks (Figure 1).** The debt burden indicators are close to or above the indicative thresholds for nearly all stress tests.[49] Most strikingly, under the historical values test Table 4), the NPV of debt-to-export ratio rises rapidly to levels four times as high as those of the baseline by 2025.

12. **These stress tests must be interpreted with some care. While the magnitude of the shocks lies within the realm of possibility, the probability of such shocks occurring is low for some.** In particular, in staffs' view of the staffs, the historical and export shock scenarios (labeled A1 and B2 in Table 4 below) both overstate risks to the economy. Both scenarios include data for the most violent episodes in the country's civil conflict (which ended in January 2002) and also include the costly reconstruction that followed the end of the conflict.[50] For example, as shown in Table 2 below, the historical average for the non-interest current account balance was 2 percentage points of GDP higher than the projected share for 2005–10. The historical growth rates for real GDP and exports are also substantially lower (and display very high standard deviations) than the projected rates—by roughly 3 and 14 percentage points respectively. In the judgment of the staffs, the likelihood that this historical pattern would be repeated is quite low.[51]

[49] The documentation for the DSF is clear that the stress tests do not allow for internal and external adjustment in response to shocks. The implication is that the tests could over-state the consequences of the shocks.

[50] Under the historical scenario key variables (real GDP growth, the GDP deflator, the non-interest current account balance and net foreign investment) are held at historical levels for the period 1995–2004.

[51] Empirical studies such as Collier (2000) have shown that the probability of a conflict resuming decreases over time. Other studies such as Collier and Hoeffler (2002) and Mason *et al* (2005) also show that the probability of a conflict being restarted is strongly reduced by external aid and the prolonged presence of peace-keepers, as was the case for Sierra Leone between 2002 and 2005.

Table 2: Historical and Projected Economic Indicators

	Historical 1995-2004		2005-10	2011-25
	Average	Standard Deviation	Average	Average
Non-interest current account balance (in percent of GDP)	-7.0	5.1	-5.8	-4.2
Real GDP growth	3.8	13.2	6.6	5.5
GDP deflator in U.S. dollars	-1.1	9.2	4.0	1.2
Export growth (US dollar terms, in percent)	3.1	23.4	16.6	7.0
Net transfers to GDP ratio	5.3	7.6	10.8	7.5
Net non-debt creating flows (FDI) to GDP ratio	0.5	0.8	1.6	1.6

Source: Staff calculations.

13. **A delay in the projected recovery of the export base could undermine external debt sustainability.** In the extreme event that export value growth stays at historically low levels in 2006 and 2007 (Table 4), the NPV of debt to export ratio could reach levels approaching 400 in 2007 and declining to 200 percent by 2025. In the more realistic but also less dramatic case where the restart of bauxite and rutile is simply delayed by two years (programmed to start from 2006 onwards), the debt burden indicators would deteriorate significantly in the short term (200 percent in 2007) before falling to 100 percent by 2021 (bound test B2b).

IV. Fiscal Debt Sustainability

14. **Sierra Leone's large domestic debt represents a significant additional burden.** Adding the NPV of domestic debt, including arrears, to the NPV of external obligations raises the debt-to-GDP ratio in 2004 by 33 percentage points of GDP for a total of 115 percent of GDP. (Table 5). The NPV of debt-to-revenue ratio for 2004 stands at 692 percent (if the revenue base includes grants) while the debt-service-to-revenue ratio is 27 percent.

15. **The NPV of debt would fall rapidly after the Completion Point and then stabilize by 2017.** Table 6 shows that the NPV of debt-to-GDP ratio drops to 54 percent by 2006 and falls further to an average of 28 percent from 2015 onward. The NPV of debt-to-revenue ratio (including grants) follows a similar trend, falling to 291 percent by 2006 and further to an average of 154 percent from 2015 onward. The debt-service-to-revenue ratio (including grants) falls gradually to 14 percent in 2025 from 21 percent in 2005.

16. **A lower primary deficit would help reduce debt but hinder PRSP implementation.** The primary deficit in 2004 was 1.2 percent of GDP, while a surplus of 1.6 percent of GDP is projected in 2005. The baseline scenario assumes a primary deficit of 1.0 percent of GDP in 2006, which would slowly rise to 2.7 percent of GDP by 2015, reflects the initial costs of PRSP implementation in a post-conflict country. After that the primary deficit would gradually fall to 2 percent of GDP by 2025. By contrast, bound test A2 (Table 6) maintains the primary deficit constant at the 2004 GDP share of 1.2 percent. As a result, the NPV of debt-to-GDP ratio falls from 54 percent of GDP in 2006 to 15 percent in 2025, compared to 27 percent in the baseline scenario. The tension between high spending requirements and debt sustainability can only be resolved through a combination of concessional borrowing, grant financing, stronger revenue effort and efficiency gains in the delivery of public services.

17. **Temporary or permanently lower GDP growth represents the most significant risk to fiscal debt sustainability in Sierra Leone.** Reflecting the limited room to adjust expenditures and collect additional revenue, the government would have to increase its new borrowing significantly in the face of lower GDP growth. If real GDP growth were permanently lower (by 3 percentage points below the baseline rate), then the NPV of debt-to-GDP ratio would increase to 101 percent of GDP by 2025 rather than 27 percent of GDP in the baseline scenario (see bound test A3 in Table 6). If real GDP growth were temporarily negative (-9.5 percent in 2006 and 2007), then the NPV of debt-to-GDP ratio would increase to 79 percent of GDP by 2025 (see bound test B1 in Table 6).

18. **Debt service obligations resulting from half of the current domestic debt stock may be thought of as an implicit contingent liability.** As of end-2005, approximately 55 percent of the domestic stock included under the fiscal baseline represents non-interest bearing, non-negotiable securities with no maturity, which the government issued to help capitalize the Bank of Sierra Leone. Currently, this loan does not represent any real fiscal burden to the government. Ultimately, the government may wish to convert the loan into a bond and start repaying it. Depending on the terms of the bond, this conversion would lead to a significant increase in the domestic debt service obligations of the government and would weaken the fiscal stance if not implemented with care.

19. **The impact of converting non-interest bearing liabilities to a bond could be substantial.** Table 6 illustrates one possible solution (labeled bound test C1). In this scenario, it is assumed that the current non-interest bearing liability is replaced in 2009 by a 10-year floating interest rate bond (interest rate is linked to the short-term Treasury bill rate). The additional debt service requirements are assumed to be financed by higher domestic borrowing without any compression in fiscal expenditures or increased revenue effort. As a consequence, the NPV debt-to-GDP ratio begins to rise over time and eventually reaches 45 percent of GDP by 2025, almost 18 percentage points higher than the baseline scenario. Similarly, the NPV of debt-to-revenue ratio (including grants) rises to 253 percent of GDP at the end of the projection period, 98 percentage points higher than the baseline scenario. Debt service as a share of revenues (including grants) rises to 27 percent of revenues by 2025, double the baseline scenario rate.

V. Conclusions

20. **In staffs' assessment, Sierra Leone faces a moderate risk of debt distress if HIPC and MDRI debt relief are taken into account.** Under the baseline that assumes the full delivery of HIPC debt relief, three external debt indicators (NPV of debt-to-GDP, exports, and revenues) rise above the indicative debt burden thresholds in the first years but rapidly decline and improve further over the projection period. The implementation of the MDRI in connection with the HIPC completion point would improve the external debt situation of the country sufficiently to ensure all debt indicators remain below their indicative thresholds. However, several stress tests reveal that the baseline is vulnerable to a multitude of potential shocks, in particular delays in the revival of bauxite and rutile exports, the servicing of non-interest bearing obligations and lower than anticipated real GDP growth.

21. **To ensure future debt sustainability a gradual reduction of the domestic debt stock is as vital as the successful fiscal adjustment programmed under the baseline.** A lower

domestic debt stock would lessen the liquidity and the rollover risks associated with the short maturities of this debt. In order to extend the maturity of domestic borrowing, the government should promote the development of the domestic debt market, which would also facilitate the conversion of the current non-interest bearing, non-maturing domestic debt into a longer-term security. Depending on the terms at which the government will be able to convert this liability, the debt service could rise substantially and lead to additional borrowing. In light of this, and also to avoid crowding out of the private sector, a fiscal tightening or new external borrowing could become necessary. These considerations would warrant a reassessment of Sierra Leone's risk of debt distress at a later stage.

Table 3. Sierra Leone: External Debt Sustainability Framework, Baseline Scenario, 2002-2025 1/
(In percent of GDP, unless otherwise indicated)

	actual	Historical Average 6/	Standard Deviation 6/	Projections									
	2004			2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2025	2011-25 Average
External debt (nominal) 1/	**193.4**			**170.4**	**152.3**	**120.6**	**106.9**	**98.2**	**89.7**		**61.7**	**38.4**	
o/w public and publicly guaranteed (PPG)	160.6			140.9	126.4	97.6	87.0	80.5	74.3		54.0	37.9	
Change in external debt	27.9			-23.0	-18.0	-31.7	-13.7	-8.7	-8.5		-4.0	-1.4	
Identified net debt-creating flows	-8.8			-14.6	-12.8	-10.1	-8.7	-4.3	-4.4		-0.7	0.0	
Non-interest current account deficit	**4.2**	**7.0**	**4.9**	**7.6**	**5.9**	**6.4**	**5.8**	**4.8**	**4.5**	**5.8**	**4.6**	**3.9**	**4.2**
Deficit in balance of goods and services	15.6			18.7	16.4	15.5	14.2	13.0	12.4		11.3	11.2	
Exports	22.3			24.0	27.9	28.8	29.0	29.7	30.0		29.8	31.3	
Imports	37.9			42.7	44.3	44.3	43.2	42.7	42.4		41.1	42.5	
Net current transfers (negative = inflow)	-13.6	**-5.3**	**7.4**	-12.8	-11.8	-11.0	-10.1	-9.8	-9.4	**-10.8**	-7.5	-7.4	**-7.5**
Other current account flows (negative = net inflow)	2.3			1.7	1.3	1.9	1.7	1.6	1.5		0.7	0.0	
Net FDI (negative = inflow)	**-1.2**	**-0.5**	**0.7**	**-3.3**	**-1.4**	**-1.3**	**-1.3**	**-1.3**	**-1.2**	**-1.6**	**-1.3**	**-2.3**	**-1.6**
Endogenous debt dynamics 2/	**-11.9**			**-18.9**	**-17.3**	**-15.2**	**-13.2**	**-7.8**	**-7.7**		**-4.0**	**-1.7**	
Contribution from nominal interest rate	0.7			0.9	1.0	0.4	0.5	0.5	0.5		0.5	0.5	
Contribution from real GDP growth	-11.3			-12.6	-11.2	-8.9	-6.5	-6.0	-5.9		-3.5	-1.9	
Contribution from price and exchange rate changes	-1.3			-7.2	-7.0	-6.6	-7.2	-2.4	-2.3 #		-0.9	-0.3	
Residual (3-4) 3/	**36.7**			**-8.5**	**-5.3**	**-21.6**	**-5.0**	**-4.4**	**-4.1**		**-3.3**	**-1.4**	
o/w exceptional financing	-3.0			-2.8	-2.1	-2.5	-2.2	-2.0	-1.9		-1.7	-0.8	
NPV of external debt 4/	125.1			117.0	56.8	54.1	49.9	47.6	44.7		33.7	23.2	
In percent of exports	**560.6**			**486.8**	**204.1**	**187.5**	**172.1**	**160.0**	**148.9**		**113.1**	**74.1**	
NPV of PPG external debt	**92.3**			**87.6**	**30.8**	**31.0**	**30.0**	**29.9**	**29.2**		**26.0**	**22.7**	
In percent of exports	**413.6**			**364.3**	**110.7**	**107.5**	**103.6**	**100.6**	**97.4**		**87.2**	**72.5**	
In percent of revenues	**748.2**			**719.2**	**242.7**	**235.4**	**220.6**	**217.3**	**208.2**		**180.9**	**150.3**	
Debt service-to-exports ratio (in percent)	9.9			10.2	8.1	3.4	6.5	7.2	9.0		6.8	7.7	
PPG debt service-to-exports ratio (in percent)	9.4			9.5	6.6	2.2	3.7	4.3	5.7		4.4	5.5	
PPG debt service-to-revenue ratio (in percent)	16.9			18.7	14.4	4.7	7.9	9.3	12.2		9.1	11.4	
Total gross financing need (billions of U.S. dollars)	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.2	
Non-interest current account deficit that stabilizes debt ratio	-23.7			30.6	24.0	38.1	19.5	13.5	13.0		8.6	5.3	
Key macroeconomic assumptions													
Real GDP growth (in percent)	7.4	3.8	12.7	7.2	7.4	6.5	6.1	6.1	6.6	6.6	5.8	5.1	5.5
GDP deflator in US dollar terms (change in percent)	0.8	-1.1	11.4	3.9	4.3	4.5	6.4	2.3	2.4	4.0	1.4	0.7	1.2
Effective interest rate (percent) 5/	0.4	1.0	0.5	0.5	0.6	0.3	0.5	0.5	0.6	0.5	0.8	1.4	1.0
Growth of exports of G&S (US dollar terms, in percent)	21.1	3.1	23.4	20.0	29.8	15.2	13.5	11.2	10.2	16.6	7.3	6.1	7.0
Growth of imports of G&S (US dollar terms, in percent)	-0.6	14.2	12.9	25.5	16.2	11.4	9.9	7.4	8.3	13.1	7.5	6.2	6.8
Grant element of new public sector borrowing (in percent)	...	...	...	43.9	39.5	42.7	42.8	45.0	47.5	43.6	47.1	47.0	47.1
Memorandum item:													
Nominal GDP (billions of US dollars)	1.1			1.2	1.3	1.5	1.7	1.8	2.0		2.9	5.3	

Source: Staff simulations.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.
4/ Includes private sector debt.
5/ Current-year interest payments devided by previous period debt stock.
6/ Historical averages and standard deviations are generally derived over the past 10 years (1995-2004), subject to data availability.

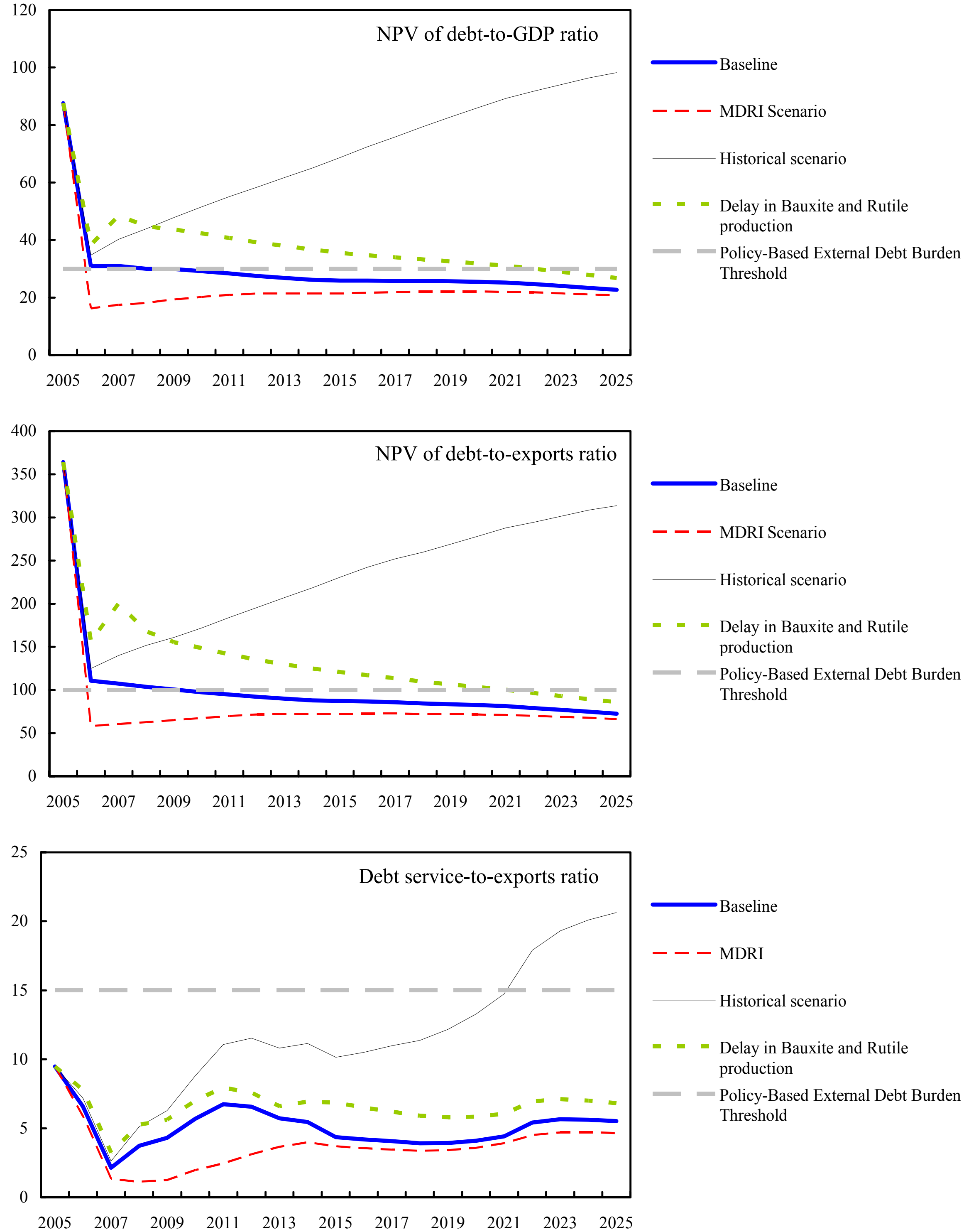
Table 4. Sierra Leone: Sensitivity Analyses for Key Indicators of Public and Publicly Guaranteed External Debt, 2005-25
(In percent)

	Estimate	Projections							
	2005	2006	2007	2008	2009	2010	2015	2020	2025
NPV of debt-to-GDP ratio									
Baseline	88	31	31	30	30	29	26	25	23
MDRI Scenario	88	16	17	18	19	20	21	22	21
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2006-25 1/	88	35	40	44	48	52	69	86	98
A2. New public sector loans on less favorable terms in 2006-25 2/	88	32	33	32	33	33	34	36	35
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	88	37	43	42	42	41	36	36	32
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	88	37	46	43	43	41	35	32	27
B2b: Delay in bauxite and rutile production by two years (starting 2008 instead of 2006)	88	38	48	45	44	42	36	32	27
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	88	36	42	41	40	40	35	35	31
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	88	39	47	45	44	43	36	32	27
B5. Combination of B1-B4 using one-half standard deviation shocks	88	50	79	75	73	71	60	52	43
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	88	43	43	42	42	41	36	36	32
NPV of debt-to-exports ratio									
Baseline	364	111	107	104	101	97	87	82	72
MDRI Scenario	364	58	61	63	65	67	72	72	66
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2006-25 1/	364	125	140	152	161	172	231	278	314
A2. New public sector loans on less favorable terms in 2006-25 2/	364	113	113	112	111	111	114	117	113
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	364	111	107	104	101	97	87	82	72
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	364	215	371	352	338	325	280	242	201
B2b: Delay in bauxite and rutile production by two years (starting 2008 instead of 2006)	364	156	200	168	155	148	121	103	86
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	364	111	107	104	101	97	87	82	72
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	364	142	164	155	149	143	122	105	87
B5. Combination of B1-B4 using one-half standard deviation shocks	364	210	329	310	297	285	241	203	165
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	364	111	107	104	101	97	87	82	72
Debt service to exports ratio									
Baseline	9	7	2	4	4	6	4	4	6
MDRI Scenario	9	6	1	1	1	2	4	4	5
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2006-25 1/	9	7	3	5	6	9	10	13	21
A2. New public sector loans on less favorable terms in 2006-25 2/	9	7	2	4	5	6	5	6	8
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2006-07	9	7	2	4	4	6	4	4	6
B2. Export value growth at historical average minus one standard deviation in 2006-07 3/	9	11	6	11	12	15	16	14	16
B2 -b: Delay in bauxite and rutile production by two years (starting 2008 instead of 2006)	9	8	3	5	6	7	7	6	7
B3. US dollar GDP deflator at historical average minus one standard deviation in 2006-07	9	7	2	4	4	6	4	4	6
B4. Net non-debt creating flows at historical average minus one standard deviation in 2006-07 4/	9	7	3	5	5	7	7	6	7
B5. Combination of B1-B4 using one-half standard deviation shocks	9	9	5	9	10	12	14	12	13
B6. One-time 30 percent nominal depreciation relative to the baseline in 2006 5/	9	7	2	4	4	6	4	4	6
Memorandum item:									
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	45	45	45	45	45	45	45	45	45

Source: Staff projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Figure 1. Sierra Leone: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2005-25
(In percent)



Source: IMF and WB Staff projections and simulations.

Table 5. Sierra Leone: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005-2025
(In percent of GDP, unless otherwise indicated)

	Actual			Estimate	Projections								
	2004	Historical Average 5/	Standard Deviation 5/	2005	2006	2007	2008	2009	2010	2005-10 Average	2015	2025	2011-25 Average
Public sector debt 1/	237.4	222.0	35.4	203.8	182.6	143.4	126.9	111.6	97.1	144.2	65.4	43.8	59.9
o/w foreign-currency denominated	204.7	177.9	30.5	176.2	159.5	123.3	109.3	97.3	86.5	125.3	63.0	39.2	56.6
Change in public sector debt	16.0	13.2	43.4	-33.6	-21.2	-39.2	-16.5	-15.3	-14.5	-23.4	-4.7	-0.9	-3.6
Identified debt-creating flows	-20.8	-20.9	41.5	-29.5	-16.7	-17.7	-11.7	-9.6	-8.1	-15.6	-1.3	0.4	-0.6
Primary deficit	1.2	4.7	1.7	-1.6	1.0	1.4	1.6	1.6	2.0	1.0	2.7	2.0	2.3
Revenue and grants	18.1	14.1	4.3	18.9	18.5	18.3	18.4	18.3	18.4	18.5	18.1	17.9	18.1
of which : grants	5.7	3.3	2.1	6.8	5.8	5.2	4.7	4.6	4.4	5.2	3.7	2.8	3.5
Primary (noninterest) expenditure	19.3	18.9	4.8	17.3	19.5	19.7	19.9	19.9	20.5	19.5	20.7	19.9	20.4
Automatic debt dynamics	-22.0	-25.5	41.4	-27.9	-17.4	-18.6	-12.8	-10.9	-9.8	-16.2	-3.9	-1.6	-2.9
Contribution from interest rate/growth differential	-19.2	-28.3	20.2	-23.0	-16.1	-11.7	-8.1	-7.5	-7.1	-12.2	-4.3	-2.1	-3.6
of which : contribution from average real interest rate	-4.0	-4.9	6.1	-6.9	-2.1	-0.5	0.1	-0.2	-0.2	-1.6	-0.4	0.1	-0.2
of which : contribution from real GDP growth	-15.2	-7.2	25.6	-16.0	-14.0	-11.2	-8.2	-7.3	-6.9	-10.6	-3.8	-2.2	-3.4
Contribution from real exchange rate depreciation	-2.8	2.8	32.9	-4.9	-1.3	-7.0	-4.7	-3.4	-2.7	-4.0	...	...	1.2
Other identified debt-creating flows	0.0	-0.1	0.1	0.0	-0.4	-0.5	-0.5	-0.3	-0.3	-0.3	0.0	0.0	0.0
Privatization receipts (negative)	0.0	-0.1	0.1	0.0	-0.4	-0.5	-0.5	-0.3	-0.3	-0.3	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes	36.7	34.1	30.0	-4.1	-4.5	-21.4	-4.8	-5.7	-6.4	-7.8	-3.4	-1.3	-3.0
NPV of public sector debt	125.0	53.3	29.6	115.2	53.9	51.1	47.6	44.2	39.8	58.6	28.3	27.3	28.8
o/w foreign-currency denominated	92.3	9.2	29.2	87.6	30.8	31.0	30.0	29.9	29.2	39.8	26.0	22.7	25.6
NPV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross financing need 2/	20.6	22.0	9.0	14.1	14.8	14.1	12.9	10.8	9.8	12.8	3.3	6.6	4.3
NPV of public sector debt-to-revenue ratio (in percent)													
Base is Revenues and grants 3/	692.1	415.5	263.7	608.3	291.0	278.9	259.3	241.3	216.1	315.8	157.0	152.1	159.8
Base is Revenues excluding grants (as used in external DSA table)	1013.4	542.9	328.3	946.2	424.3	388.1	349.8	321.5	283.6	452.2	197.5	180.5	198.0
o/w external	.. ..	.. ..	.. ..	719.2	242.7	235.4	220.6	217.3	208.2	307.2	180.9	150.3	175.5
Debt service-to-revenue ratio (in percent) 4/													
Base is Revenues and grants 3/	27.2	49.5	22.5	21.1	19.0	19.3	17.4	10.9	13.3	16.8	10.8	13.9	10.9
Base is Revenues excluding grants (as used in external DSA table)	39.9	64.6	29.3	32.8	27.6	26.9	23.5	14.5	17.5	23.8	13.6	16.5	13.5
Primary deficit that stabilizes the debt-to-GDP ratio 6/	-14.8	7.4	25.3	32.0	22.2	40.6	18.1	16.9	16.5	24.4	7.3	2.9	5.9
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	7.4	3.8	13.2	7.2	7.4	6.5	6.1	6.1	6.6	6.6	5.8	5.1	5.5
Average nominal interest rate on forex debt (in percent)	0.7	0.9	0.5	0.2	0.4	0.5	0.7	0.3	0.5	0.4	0.8	1.3	0.9
Average real effective interest rate on domestic currency debt (in percent) 7/	-4.4	-3.8	10.4	-2.6	3.3	7.7	8.4	8.9	8.7	5.7	11.8	9.1	11.7
Real exchange rate depreciation (in percent, + indicates depreciation)	-1.7	5.2	19.8	-2.6	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	16.0	15.5	12.1	13.3	13.1	8.7	8.0	7.1	6.8	9.5	5.8	5.0	5.5
Growth of real primary spending (deflated by GDP deflator, in percent)	-5.1	7.7	27.9	-3.9	21.4	7.5	7.2	6.1	9.4	7.9	6.4	4.7	5.3
Grant element of new external borrowing (in percent)	0.0	0.0	0.0	43.9	39.5	42.7	42.8	45.0	47.5	43.6	47.1	47.0	...

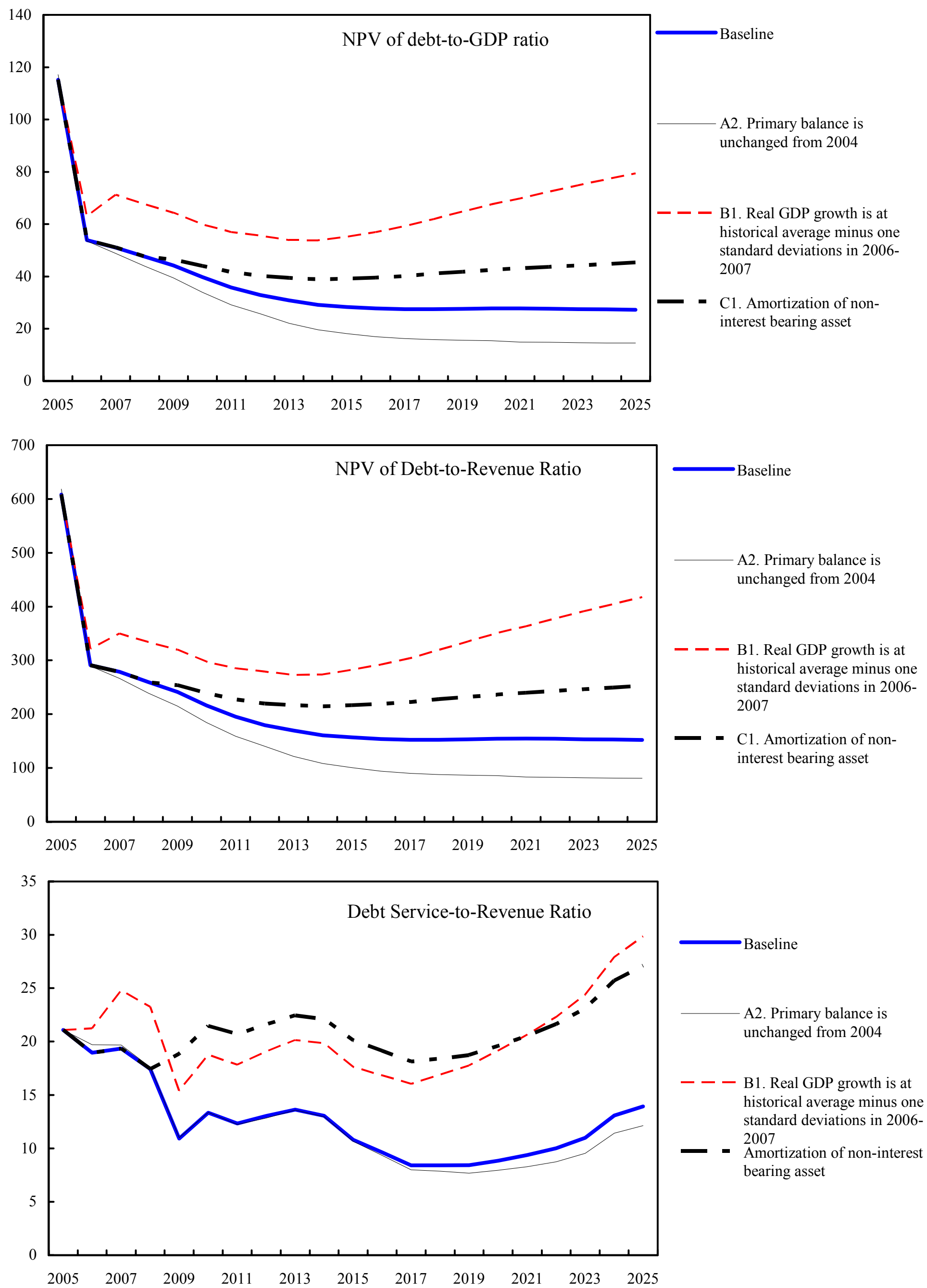
Sources: Country authorities; and Fund staff estimates and projections.
1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]
2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.
3/ Revenues including grants.
4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.
5/ Historical averages and standard deviations are generally derived over the past 10 years (1995-2004), subject to data availability.
6/ Calculated to show what is required for stablization at the level of each preceding year.
7/ Inferred from the total stock of domestic debt including non-interest bearing asset in the BSL balance sheet.

Table 6. Sierra Leone: Sensitivity Analysis for Key Indicators of Public Debt 2005-25

	Estimate	Projections						
	2005	2006	2007	2008	2009	2010	2015	2025
NPV of Debt-to-GDP Ratio								
Baseline	115	54	51	48	44	40	28	27
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	115	56	55	52	50	47	39	51
A2. Primary balance is unchanged from 2004	117	54	49	44	39	34	18	15
A3. Permanently lower GDP growth 1/	115	54	51	48	46	42	42	101
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-2007	115	63	71	68	64	60	55	79
B2. Primary balance is at historical average minus one standard deviations in 2006-2007	115	55	54	48	43	38	25	25
B3. Combination of B1-B2 using one half standard deviation shocks	115	60	63	55	49	42	23	19
B4. One-time 30 percent real depreciation in 2006	115	67	71	65	60	55	38	35
B5. 10 percent of GDP increase in other debt-creating flows in 2006	115	59	53	48	43	38	25	24
C1. Amortization of non-interest bearing BSL asset.	115	54	51	48	46	44	39	45
NPV of Debt-to-Revenue Ratio 2/								
Baseline	608	291	279	259	241	216	157	152
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	608	299	293	278	266	244	206	265
A2. Primary balance is unchanged from 2004	619	289	267	239	215	184	100	81
A3. Permanently lower GDP growth 1/	608	286	273	256	242	222	217	502
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-2007	608	322	350	334	320	298	283	418
B2. Primary balance is at historical average minus one standard deviations in 2006-2007	608	299	294	262	237	207	138	138
B3. Combination of B1-B2 using one half standard deviation shocks	608	315	323	286	255	219	124	103
B4. One-time 30 percent real depreciation in 2006	608	363	390	356	330	297	210	193
B5. 10 percent of GDP increase in other debt-creating flows in 2006	608	316	288	259	235	205	136	137
C1. Amortization of non-interest bearing BSL asset.	608	291	279	259	254	239	217	253
Debt Service-to-Revenue Ratio 2/								
Baseline	21	19	19	17	11	13	11	14
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	21	19	21	20	13	16	15	24
A2. Primary balance is unchanged from 2004	21	20	20	18	11	13	11	12
A3. Permanently lower GDP growth 1/	21	19	20	19	12	15	15	33
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2006-2007	21	21	25	23	15	19	18	30
B2. Primary balance is at historical average minus one standard deviations in 2006-2007	21	19	20	19	12	14	12	15
B3. Combination of B1-B2 using one half standard deviation shocks	21	20	23	21	13	16	13	15
B4. One-time 30 percent real depreciation in 2006	21	20	21	20	12	15	12	16
B5. 10 percent of GDP increase in other debt-creating flows in 2006	21	19	21	18	12	14	12	15
C1. Amortization of non-interest bearing BSL asset.	21	19	19	17	19	21	20	27

Sources: Country authorities; and Fund staff estimates and projections.
1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of 20 (i.e., the length of the projection period).
2/ Revenues are defined inclusive of grants.

Figure 2. Sierra Leone: Indicators of Public Debt Under Alternative Scenarios, 2005-2025



Source: IMF and WB Staff projections and simulations.

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Sierra Leone: Statistical Issues

1. The prolonged civil war has resulted in serious deficiencies in the macroeconomic database, particularly in the areas of the balance of payments, national accounts, and social indicators. From the May 1997 coup to March 1998, statistical compilation virtually collapsed because of institutional damage and the departure of key skilled personnel from the administration. Since April 1998, however, the authorities have endeavored to rehabilitate the data collection and compilation systems. The authorities are cooperating fully in providing data to the Fund for the purposes of policy formulation and program monitoring. The authorities are also trying to disseminate economic and financial data to the public on a regular basis.

2. A major and sustained improvement in the coverage and timeliness of economic data will require the restructuring of the institutional framework following recommendations of the March 2004 IMF/World Bank mission on the development of a strategic plan for the statistical system. Budgetary resources remain scarce for the main statistical unit, the Statistics Sierra Leone (SSL); this situation most adversely affects the compilation of national accounts and price statistics. Cooperation and coordination between the main statistical agencies should also be improved. Sierra Leone participates in the GDDS regional project for Anglophone African countries, funded by the UK Department for International Development (DfID). The authorities have prepared an initial set of metadata that include detailed plans for improvement over the short and medium term; these were posted on the Fund's DSBB on May 29, 2003 and updated in August 2004. Sierra Leone has received Fund technical assistance in priority areas and a request for additional assistance is expected in the context of the GDDS project.

National accounts

3. National accounts data are prepared by the SSL using data received from government ministries and agencies, public enterprises, and through small annual sample surveys of economic activity, although based on outdated lists and with extremely low response rates. Thus, the private sector has not been adequately represented in the national accounts compilations, especially small businesses, which represent a very high proportion of business activity in Sierra Leone. The consumer price index (CPI) is used extensively to derive estimates of GDP at constant prices. A project to improve the system of national income and social accounts was undertaken with Fund/United Nations Development Program (UNDP) technical support. As a result, a set of revised national accounts for the period 1986/87–1994/95 was published in December 1995. The main revisions involved the adjustment of trade figures to reflect illegal diamond mining and fishing activity. However, large adjustments were also made to the exports of nonfactor services, for which the SSL was unable to provide sufficient explanation. Data on the exports and imports of both goods and services need further improvement and efforts are ongoing to strengthen direct estimation techniques. The series were updated to 1998, followed by a break in the estimates due to disruptions in staff continuity and loss of records at SSL. An effort to reconstruct the national accounts estimates under new staff commenced during 2003/04 and is continuing, with the

main effort now focusing on preparing new estimates for 2001 and beyond. Resource constraints have significantly delayed data production of firm estimates and only preliminary data for the 2001-2004 period have been made available. These are in the final stages of revision, but will be relatively weak because of the lack of adequate source data, especially for 2001 and 2002. The SSL should focus on the development of a new benchmark for the current price estimates and to rebase the constant price estimates to a new base (current base year is 1990).

4. Fund missions continue to make their own estimates and projections of key national accounts aggregates, as well as adjustments to historical data using available information.

5. Since March 2204 and with support from the GDDS Anglophone Africa Project, a national accounts expert visited Freetown five times. The last visit was in January 2006. The expert reviewed the source data, methodologies, and compilation issues and assisted with data development and improvements in methodology. The expert prepared and coordinated with the authorities on a short-term action plan that would bridge the gap to the longer-term improvements that are to be incorporated in the strategic plan. Plans are underway to prepare revised national accounts based on a 2005 benchmark and using 2005 prices to compile constant price estimates. However, shortages of resources and staff continue to pose major constraints in the crucial area of data development for economic statistics within SSL.

Prices

6. The CPI is compiled on a monthly basis by the SSL and published with a lag of about three weeks. The CPI covers the capital city and three towns. The 1992 base period was derived from a supplemental survey to the 1989/90 Household Expenditure Survey. Plans are underway to re-base the CPI to 2004; using the 2003, Sierra Leone integrated household survey and extends the geographic coverage of the CPI so that a national CPI can be compiled. SSL plans to complete this work during 2006 following the end of the field work on the ICP in June 2006. The production of producer price indices remains a medium-term goal.

Government finance statistics

7. The budget reporting system was established with technical assistance provided under the Fund/UNDP technical assistance project. Monthly data on central government revenue, current expenditure, and financing are provided, with appropriate desegregation. The European Commission (EC) is providing technical assistance to the Accountant General's Office that will improve the timeliness and quality of fiscal data. Data on capital expenditure are poor. While Sierra Leone has reported fiscal data to AFR, it has not provided annual data for publication in the *GFS Yearbook* since 1999 (revenue and expense data were reported for the 2005 GFS Yearbook; however, deficiencies in the data on financial assets and liabilities precluded the publication of these data). Fiscal data only cover the budgetary central government, excluding extrabudgetary agencies and local governments.

8. There is an urgent need for greater timeliness and accuracy of data on foreign-financed development projects. Reports on the implementation of the development budget and its financing are currently not produced in a format that is suitable for budget analysis. In particular, data on implementation are missing. There is also need for assuring quality control of the final data. The authorities are currently considering the introduction of a flash reporting system for government expenditure in general- and foreign aid-financed projects. In the context of the GDDS regional project for Anglophone African countries DfID, work has been undertaken to reconcile fiscal and monetary data, and to improve the coverage and classification of these two data sets (see below). This reconciliation is a performance criterion in Sierra Leone's PRGF program with the Fund.

Monetary statistics

9. The main components of the central bank balance sheet are available on a daily and weekly basis; this system provides an early warning system on key financial targets. The full monetary survey is prepared with a lag of about six weeks, with comprehensive coverage of commercial banks.

10. The Bank of Sierra Leone (BSL) compiles monetary data using a system established by the 1996 STA mission for data reporting to AFR and STA. Most of the mission's recommendations have been implemented, resulting in substantial improvements to the quality of the monetary data. However, commercial banks continue to distinguish between their foreign and domestic positions based only on the currency of denomination and not on residency. In addition, the April–May 2003 GDDS metadata and monetary and financial statistics mission identified that (i) the institutional coverage of monetary statistics does not include those financial corporations that accept nontransferable deposits and (ii) the BSL records the counterpart to the foreign exchange received through foreign grants and loans to the central government as foreign liabilities instead of liabilities to the central government. Some other data problems result from mispostings in the balance sheet of the BSL and misclassifications of new accounts. Also, bank reserves as reported by the BSL and commercial banks do not match. After considerable work by the authorities and commercial banks, misclassifications of government deposits have only been resolved for 2003.

11. The October 2004 mission on the reconciliation of fiscal and monetary statistics indicated that such reconciliation is very difficult due in part to (i) fiscal data compilation solely on a cash basis, and (ii) incomplete definition of the central government. Even though the authorities undertook an exercise in 2003 to identify government accounts in the banking system, the review of the list of government agencies revealed significant shortcomings. The mission recommended that the authorities develop a reliable definition of the central government for statistical purposes.

Balance of payments statistics

12. The BSL is responsible for the compilation of the balance of payments. The BSL obtains the data for the balance of payments estimates from various sources including the

SSL, government ministries, the Customs and Excise Department (Customs), and the "Financial Survey of Major Limited Companies," for data on foreign direct investment. Goods estimates are based on the import and export data compiled by Customs and are adjusted for coverage, valuation, and timing to fit balance of payments definitions. However, the BSL does not make adjustments to BOP data using supplementary information to take account of unreported data.

13. External transactions are characterized by a large volume of activity in the informal sector, principally the smuggling of diamonds. A considerable portion of imports is financed by these unrecorded exports. As a result, official balance of payments statistics tend to substantially understate transactions. The staff has been addressing this problem through the use of third-country (principally EC member) import data. The Fund's Statistics Department (STA) has been providing technical assistance on BOP issues under the GDDS project to help the authorities with the implementation of the *Balance of Payments Manual, Fifth Edition (BPM5)*—the most recent technical assistance mission took place in September/October 2004.

14. Outstanding data problems exist for trade in services, income statistics, current transfers, and in the financial and capital accounts. Regarding the latter, there are, in principle, substantial difficulties in tracking financial transactions of the public and private sectors that are not routed through the central bank but through commercial banks. While the authorities are able to report accurately what public sector debt service payments are after debt relief, they have difficulty in estimating debt service due before debt relief. These difficulties are manifested in reconciling flow data in the balance of payments and stocks in the international investment position. In particular, the impact of external debt relief on the international investment position is not recorded correctly. Estimates of smuggled imports and exports, in particular diamonds, are also not available.

15. Against this background, information on official program grant and loan receipts is relatively good and is prepared by the staff on the basis of contact with the authorities and donor agencies. In contrast, data on private capital flows are very poor. Some information on private banking flows can be derived from the monetary survey. Other private capital flows, especially those linked to the informal diamond trade, are effectively captured only in "Errors and omissions." Data on the gross and net official reserves positions of the BSL are provided monthly to the Fund with a short lag. STA is in contact with the authorities in an effort to reconcile balance of payments flow data with stock data in the international investment position.

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Sierra Leone: Table of Common Indicators Required for Surveillance
(As of February 1, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]
Exchange Rates	3/05	4/05	D	W	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	8/04	9/04	M[7]	M	W
Reserve/Base Money	12/05	1/06	M[8]	M	M
Broad Money	12/05	1/06	M[7]	M	M
Central Bank Balance Sheet	12/05	1/06	M[8]	M	M
Consolidated Balance Sheet of the Banking System	12/05	1/06	M[8]	M	M
Interest Rates[2]	2/05	3/06	W	M	W
Consumer Price Index	10/05	12/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	12/04	2/05	M	M	N/A
Revenue, Expenditure, Balance and Composition of Financing[3]– Central Government	12/04	2/05	M	M	N/A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/04	2/05	M	M	N/A
External Current Account Balance	2004	9/05	A	V	A
Exports and Imports of Goods and Services	2004	9/05	M	M	M
GDP/GNP	2003	7/04	A	V	A
Gross External Debt	2004 Q1	7/04	M	M	M

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially determined, including discounts rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); Irregular (I); Not Available (NA)
[7] Weekly estimates provided in Bank of Sierra Leone’s “Daily Indicators”
[8] Daily estimates provided in Bank of Sierra Leone’s “Daily Indicators”

INTERNATIONAL MONETARY FUND

SIERRA LEONE

Request for a Three-Year Arrangement Under the Poverty Reduction and Growth Facility Supplement

Prepared by the African Department

(In consultation with the Finance, Fiscal Affairs, Legal, and Policy Development and Review Departments)

Approved by Siddharth Tiwari and Adnan Mazarei

May 2, 2006

I. Introduction

1. In this supplement, the staff provides updates on economic developments in Sierra Leone since the issuance of the request for a three-year PRGF-supported program (www.imf.org). Furthermore, following the issuance of the staff report, staff received from the authorities provisional fiscal data for 2005, which indicated substantial deviations from the projections agreed previously. The deviations have made it necessary to revisit the 2006 fiscal, monetary, and other macroeconomic targets underpinning the PRGF-supported program. The Sierra Leonean authorities and the staff have reached understandings on adjustments in the fiscal and monetary targets and policy measures to bring the key parameters of the PRGF-supported program broadly in line with those outlined in the staff report (a supplementary letter of intent is attached).[1]

II. Economic Developments During 2005

2. **Macroeconomic performance in 2005 was mixed (Table 1).** Average inflation for the year as a whole was 12.1 percent, compared to 12.5 percent projected by staff, reflecting the easing of inflation pressures towards year-end. Net bank credit to the government grew by 1 percent during the year, compared to 4 percent projected by staff. However, monetary

[1] The staff held discussions in Washington on April 11–12, 2006 with the Sierra Leonean delegation headed by the Financial Secretary, Mr. Samura Kamara.

expansion was stronger than projected in the staff report.[2] Gross international reserves at end-2005 reached US$168 million (3.4 months of imports), exceeding staff projection by about US$19½ million.[3]

3. **Revenue outturn in 2005 was weaker than anticipated (Table 2).** The revenues fell short of the 12.2 percent of GDP target by 0.3 percentage points. The government was unable to enforce the collection of a 10 percent sales tax on telephone companies (announced in the second half of 2005) in the absence of a specific finance bill, while the 3 percent turnover tax payable by diamond companies fell short of the projected target (as set by the National Revenue Authority (NRA)).[4] A number of companies paying their taxes through a tax consultant (KPMG) also fell behind in their payments due to delays by the consultancy firm; the taxes were paid in January 2006. Furthermore, there were specific delays related to the payment of import taxes. In response to the government's announcement to raise the tax on imported tobacco with immediate effect (in the context of the 2006 Budget Speech in November 2005), tobacco importers postponed their importation and clearance of tobacco products until February 2006 when agreement was reached to revisit the decision on the tax rate.[5] Other importers also delayed their customs clearance in anticipation of lower import tariffs, which became effective as of January 2006.[6]

4. **While poverty and development expenditures accelerated in 2005, they adversely affected the fiscal deficit.** Total expenditures reached 24.6 percent of GDP, exceeding staff projection by 2.6 percentage points. Spending on poverty-related activities accelerated (particularly in the areas of health and education), following a strengthening of procurement processes as well as concerted efforts by the government to increase outlays in these areas. In addition, the implementation of project spending improved toward the year-end. The overall deficit (including grants) was 1½ percent of GDP higher than envisioned and the domestic

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[2] On the basis of provisional monetary data, the staff report noted that money growth was likely to exceed the projection (see paragraph 9 and Figure 2 of the Staff Report). Tables 1 – 3 of this supplement present revised and consistent data after the end-2005 fiscal outturn became available.

[3] Foreign exchange outflows in the last quarter of 2005 were also lower than projected, due in part to lower auction volume at the central bank weekly auctions and lower imports by the government. Foreign funding for projects is channeled through commercial banks and therefore does not affect central bank reserves.

[4] The major diamond exporters have submitted financial accounts for 2005, which indicate significantly lower profits than anticipated by the NRA. The latter has therefore ordered a comprehensive and detailed field audit of these accounts.

[5] The original tax rate was 25 percent, and had been raised to about 80 percent. It has subsequently been lowered to 38 percent.

[6] As part of the implementation of the Common External Tariffs (CET) of the ECOWAS, the government announced a reduction in the sales tax on imports from 17.5 percent to 15 percent together with the lowering of other tariffs (effective in January 2006).

primary deficit exceeded staff projection by 1 percentage point of GDP. Domestic financing of the government (mainly from nonbank sources) was only 0.5 percent of GDP higher than projected, as the shortfall in domestic revenues was in part offset by higher external grant financing.[7]

III. Adjustments in the 2006 Program

5. **Movement toward the original program targets began in the first quarter of 2006.** Preliminary fiscal data for the quarter indicate that the revenue targets set out in the staff report were exceeded by about 0.1 percent of GDP, in part due to the effect of delayed measures for 2005.[8] The Parliament passed, in mid-April, the Finance Bill, which provides legislative support for the tax measures included in the 2006 budget. Preliminary indications are that government spending during the first quarter was below the programmed target (by about 0.3 percent of GDP), but the pace of implementation of government programs usually picks up later in the year. The overall deficit (including grants) and domestic primary deficit were in each case estimated to be about 0.5 percent of GDP below the targets for the quarter. External budgetary support was disbursed, as expected and domestic bank financing of the budget was lower during the period (by about 0.5 percent of GDP).

6. **The staff has lowered the revenue outlook for 2006 to reflect the delayed passage of key legislation.** Domestic revenues are projected to reach 12.4 percent of GDP in 2006, from the lower-than-anticipated level (11.9 percent of GDP) of 2005. This is 0.2 of a percentage point below the projection in the staff report and reflects the staff's assessment that the shortfall in the revenue outturn during 2005 was due largely to temporary factors (legislative and administrative delays), which would be reversed and therefore allow some catching up in the course of the year.[9] The delayed passage of the Finance Bill in April is expected to result in some revenue losses during the fiscal year and hence the staff projects a lower increase of 0.3 percent of GDP in revenue collection (reflecting the nine-month basis for the 0.4 percent of GDP increase originally envisaged for the full year).[10] A further estimated increase of 0.2 percent of GDP reflects the delayed implementation of 2005 measures, including retroactive enforcement of some taxes effective in 2005, as well the carry-over from 2005 (related to income taxes and customs duties). The staff has adjusted the

[7] Government borrowing from domestic banks declined in 2005.

[8] The increase above the target, however, was significantly less than the revenue shortfall in 2005 (0.3 of a percentage point of GDP).

[9] Given the 2005-06 experience, it is also prudent to exercise some caution going forward; increases in revenue in the medium term have been slightly revised with corresponding reductions in expenditures (Table 2).

[10] Some of the measures included in the Finance Bill will take effect retroactively from the beginning of the calendar year.

schedule of projected disbursements of budgetary support to reflect more recent information from donors.[11]

7. **Expenditures in 2006 will be based on revised revenues and the need to include contingent expenditures to address revenue uncertainties.** Total expenditures in 2006 are to be contained at 21.7 percent of GDP, which is 0.2 percent lower than in the government budget. Expenditure cuts in both recurrent and capital outlays are necessary to achieve this target. There would be expenditure savings during the first quarter, and spending in the second quarter would not be increased above the budgeted level even with the earlier-than-expected budgetary support from DfID.[12] During the subsequent quarters, a portion of budgeted outlays would be contingent upon the receipt of projected domestic revenues (Table 2). The overall deficit (including grants) is projected at 0.5 percent of GDP (same as in the staff report), and the domestic primary deficit at 1.8 percent of GDP remains broadly unchanged from the staff report. Government domestic borrowing would be contained at 0.3 percent of GDP, as in the budget.

8. **Monetary adjustment during 2006 will take into account the strong expansion in 2005 and the need to contain inflation.** Some downward adjustment in the monetary aggregates has already occurred during the first quarter, as broad and reserve money have been declining from their respective end-2005 levels (Table 3). In order to ensure that the inflationary pressures generated by end-2005 would be contained, the central bank should in the second half of the year steer reserve money close to the level set out in the staff report. In particular, central bank credit to the government should be limited. As indicated in the staff report, the central bank should also be ready to increase the amount of foreign exchange sold in the weekly foreign currency auctions while safeguarding its gross reserves target, and to sell available Treasury securities. Broad money growth in 2006 is projected to be lower than in the staff report, while allowing adequate room for private sector credit expansion. Over a two-year period from end-2004 to end-2006 as projected, broad money would grow by about 19 percent annually.[13] Staff has raised its inflation projection for 2006 to reflect the delayed impact of the higher-than-projected money growth during 2005. Average inflation is projected to rise to 12.4 percent in 2006 (compared to 11.7 percent in the staff report), but year-end inflation is projected to fall to 10.1 percent (from 13.1 percent actual in 2005).

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[11] Based on indications from the key donors, the disbursement of £10 million from the U.K. Department for International Development (DfID) has been moved to the second quarter from the third quarter and the disbursement of US$10 million from the World Bank has been moved to the fourth quarter from the third quarter.

[12] Originally expected in the third quarter of the year (amounting to 1.3 percent of GDP).

[13] However, velocity rises in 2006 because of the relative low monetary growth, but declines subsequently.

IV. Prior Actions and Program monitoring

9. **The government has implemented all structural measures scheduled up to end-April as prior actions (Attachment I, Table 2).** This is in addition to those outlined in the staff report.

10. **The performance criteria test dates for disbursements during the first year of the program have been revised (Table 4).** The second disbursement will be based on quantitative performance criteria set for end-June 2006 and subject to the first program review scheduled to be completed before end-November 2006. The third disbursement will be based on quantitative performance criteria set for end-December 2006 and subject to the second program review scheduled to be completed before end-May 2007. The end-March 2006 and end-September 2006 quantitative targets will be indicative.

V. Other Developments

11. **Fund technical assistance to Sierra Leone during the first quarter of 2006 was aimed at supporting the authorities' fiscal and financial sector reforms, as set out in the proposed PRGF-supported program.** On the fiscal side, advice was provided on mineral revenue taxation and projections, tax administration, and preparations for launching a value-added tax system in 2007. A pre-FSAP mission took place in February, and the primary assessment mission is scheduled for May.

12. **The Fund safeguard assessment mission, which visited Freetown in March 2006, noted several areas where further progress in strengthening the central bank's internal controls and audit functions is necessary.**

VI. Staff Appraisal

13. **The fiscal outturn in 2005 underscores the importance of strengthening the domestic revenue effort and public expenditure management in Sierra Leone, as emphasized in the earlier staff appraisal.** Revenue mobilization will need to be supported by timely legislation and improved tax administration. As noted in the staff report and also discussed above (paragraph 8), it will be essential to ensure that the Bank of Sierra Leone is well equipped to effectively conduct monetary policy. Continued technical assistance from the Fund would be required in both the fiscal and monetary areas.

14. In light of the authorities' efforts and commitments made in the supplemental LOI regarding adjustment measures, and reflecting the implementation of additional prior actions, the staff recommends approval of the government's request for a new three-year arrangement under the PRGF.

Table 1. Sierra Leone: Selected Economic and Financial Indicators, 2001-08

	2001	2002	2003	2004	2005		2006	2007	2008
	Act.	Est.	Est.	Est.	Proj. 1/	Est.	Proj.	Proj.	Proj.
	(Annual percentage change, unless otherwise indicated)								
Income and expenditure									
Real GDP	18.2	27.5	9.3	7.4	7.3	7.3	7.4	6.5	6.1
GDP deflator	1.8	-3.6	8.2	16.0	13.3	12.9	14.1	10.0	8.2
Nominal GDP	20.3	22.8	18.3	24.6	21.6	21.1	22.5	17.1	14.8
Consumer prices (end of period)	3.4	-3.1	11.3	14.4	15.0	13.1	10.1	8.5	7.5
Consumer prices (annual average)	2.6	-3.7	7.5	14.2	12.5	12.1	12.4	9.3	8.0
Money and credit									
Broad money									
(including foreign currency deposits)	33.7	30.1	26.2	18.9	16.5	32.8	6.4	17.1	16.2
(excluding foreign currency deposits)	30.8	32.0	25.6	16.9	12.7	28.4	3.3	19.8	19.1
Velocity (level; excl. foreign currency deposits)	6.5	6.1	5.7	6.1	6.6	5.8	6.8	6.7	6.4
Velocity (level; incl. foreign currency deposits)	5.5	5.2	4.9	5.1	5.3	4.6	5.3	5.3	5.3
Domestic credit 2/	22.5	7.9	27.5	-2.1	6.4	1.5	6.0	6.6	4.0
Government 2/	19.4	0.2	17.1	-10.9	2.2	-2.9	0.9	0.5	0.2
Private sector 2/	3.2	7.5	9.7	8.8	3.9	4.3	5.1	6.1	3.8
(annual percentage change)	24.6	62.3	64.5	45.2	16.5	17.8	24.1	24.6	14.7
Reserve money	29.4	24.9	22.4	12.6	9.8	24.3	1.3	14.2	12.5
Interest rate 3/	14.7	15.0	20.2	28.0	16.9	16.0	...	...	...
External sector									
Exports (U.S. dollars)	6.1	48.9	27.4	17.1	23.0	22.8	32.7	15.3	13.5
Imports (U.S. dollars) 4/	20.6	54.4	15.6	-15.7	36.4	36.0	19.4	10.0	9.1
Terms of trade (- deterioration)	2.4	0.0	-1.9	-4.6	-2.3	-2.3	-4.6	-1.8	-0.6
Real effective exchange rate (- depreciation; end of period)	-15.3	-9.7	-18.2	-7.9	...	20.9	…	…	…
	(In percent of GDP)								
Gross domestic investment	6.7	10.1	13.9	10.6	15.0	17.2	15.0	14.9	15.2
Government	4.4	4.4	4.8	4.6	3.7	5.8	5.1	6.1	6.1
Private	2.2	5.7	9.0	5.9	11.3	11.4	9.9	8.8	9.1
Gross national saving	-10.8	5.3	6.3	5.6	6.6	9.9	8.1	8.6	9.3
Gross domestic saving	-11.6	-9.4	-7.4	-5.0	-3.6	-1.4	-1.4	-0.1	1.5
Government	-4.6	-4.3	-3.2	-1.2	-0.7	-1.6	-0.2	0.3	0.5
Private	-7.0	-5.1	-4.2	-3.8	-2.9	0.2	-1.2	-0.4	1.0
Current account balance, including official transfers	-17.4	-4.8	-7.6	-4.9	-8.5	-7.3	-6.9	-6.4	-6.0
Current account balance, excluding official transfers	-22.0	-12.1	-14.1	-11.6	-14.5	-14.3	-12.3	-11.5	-10.6
Goods and nonfactor services (net)	-19.6	-19.5	-21.3	-15.6	-18.7	-18.5	-16.3	-15.0	-13.7
Unrequited private transfers and factor services (net)	-3.5	7.1	7.0	3.8	3.9	4.0	3.9	3.3	2.9
Overall balance of payments	1.7	-0.3	-4.6	1.4	-1.8	-0.2	-2.8	-1.0	-0.4
Government domestic revenue	13.0	12.1	12.4	12.3	12.2	11.9	12.4	12.8	13.2
Total expenditure and net lending	29.5	28.6	26.9	24.8	22.0	24.6	21.7	22.6	22.4
Of which : recurrent expenditure	24.8	24.2	22.1	20.2	18.3	18.7	16.6	16.5	16.3
Overall fiscal balance									
(commitment basis, excluding grants)	-16.5	-16.5	-14.5	-12.5	-9.8	-12.8	-9.3	-9.8	-9.1
(commitment basis, including grants)	-10.6	-8.3	-6.7	-3.5	-1.3	-2.7	-0.5	-2.7	-2.7
Domestic primary fiscal balance 5/	-7.7	-7.0	-5.6	-2.8	-2.2	-3.1	-1.8	-1.9	-2.0
Domestic financing	3.2	0.9	4.3	-0.1	0.7	1.2	0.3	0.1	0.0
Financing gap	...	...	...	...	0.0	0.0	...	...	...
	(In percent of exports of goods and nonfactor services)								
Debt service due (incl. to the Fund) after debt relief 6/	73.0	9.3	7.3	10.2	10.2	10.3	8.2	3.4	6.5
Debt service due (incl. to the Fund) before debt relief	86.0	52.7	48.1	38.3	28.1	28.3	18.6	17.8	17.3
Net present value of debt-to-exports ratio 7/ 8/	150.6	162.3	153.6	151.3	141.4	141.7	110.2	107.0	103.2
	(In millions of U.S. dollars, unless otherwise indicated)								
Memorandum items:									
External current account balance, excluding									
official transfers	-165.0	-113.6	-139.7	-123.7	-173.4	-170.5	-164.7	-174.2	-181.1
Gross international reserves	51.9	84.6	59.4	124.9	148.9	168.3	168.2	188.2	208.2
(in months of imports) 9/	1.9	2.5	1.8	3.0	3.0	3.4	3.1	3.1	3.2
GDP (billions of leones)	1,600.2	1,964.6	2,323.6	2,894.3	3,518.2	3,504.9	4,294.8	5,029.9	5,773.1
GDP (millions of U.S. dollars)	805.6	936.0	989.6	1,070.7	1,192.6	1,188.1	1,342.1	1,512.2	1,710.0

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ IMF Country Report No. 05/194.
2/ Changes as a percentage of beginning-of-period money stock (including foreign currency deposits).
3/ Treasury bill rate (end of period); in percent.
4/ Includes imports purchased with bilateral aid, those related to rehabilitation and reconstruction programs, and imports of embassies and the UN peacekeeping force (UNAMSIL).
5/ Domestic revenue minus total expenditure and net lending, excluding interest payments, and externally financed capital expenditure and disarmament, demobilization, and reintegration (DDR) program.
6/ As percent of exports of goods and services; after Naples (2001) and Cologne flow reschedulings (2002-04), and delivery of full HIPC initiative assistance.
7/ Net present value (NPV) of debt relative to backward-looking three-year average of exports of goods and services.
8/ Assumed unconditional delivery of enhanced HIPC initiative assistance in 2000.
9/ In months of imports of goods and services of subsequent year.

Table 2. Sierra Leone: Central Government Financial Operations, 2005-08

	2005		2006							2007	2008
					Q1		Q2	Q3	Q4		
	Staff Report	Prel.	Budget	Proj.	Proj.	Prel.	Proj.	Proj.	Proj.	Proj.	Proj.
Total revenue and grants	727,542	767,852	917,526	910,699	185,676	192,058	282,637	185,229	250,775	1,000,644	1,136,632
Domestic revenue	428,347	415,981	538,808	532,573	111,409	117,791	131,182	131,000	152,601	641,572	762,727
Income Tax Department	122,000	114,441	163,470	154,502	35,473	34,711	35,906	39,259	44,627	189,001	219,816
Customs and Excise Department	243,023	235,980	292,673	299,918	58,535	68,280	68,778	74,631	88,229	342,356	401,604
Mines Department	13,000	10,244	19,293	14,905	5,358	2,470	3,696	4,408	4,331	29,965	37,652
Other departments	25,199	31,381	31,966	31,842	4,820	4,696	14,008	5,479	7,659	42,972	55,095
Road user charges	25,125	23,935	31,406	31,406	7,223	7,634	8,794	7,223	7,755	37,278	48,559
Grants	299,194	351,870	378,718	378,126	74,267	74,267	151,455	54,230	98,174	359,072	373,906
Program	240,512	250,568	240,479	239,887	36,447	36,447	106,624	25,200	71,616	268,934	278,027
Of which: HIPC Initiative	61,331	60,786	50,880	50,880	11,520	11,520	11,840	11,200	16,320	102,645	103,092
Projects	58,682	101,302	138,239	138,239	37,820	37,820	44,831	29,030	26,558	90,138	95,879
Total expenditure and net lending	772,831	863,828	940,377	932,893	218,790	204,200	224,450	231,403	272,839	1,136,142	1,290,950
Recurrent expenditure	642,768	656,253	718,124	714,013	170,015	155,797	168,663	192,227	197,325	827,797	938,870
Wages and salaries	225,940	229,439	265,089	265,005	66,500	63,916	65,750	67,000	68,339	304,602	338,066
Of which : social security payments	12,591	12,612	14,365	14,365	3,160	3,160	3,591	3,735	3,879	17,051	19,571
Recurrent noninterest, nonwage expenditure	252,199	265,699	310,362	304,661	63,134	51,749	72,489	84,127	96,295	356,771	432,583
Goods and services	189,673	202,467	221,418	215,691	44,137	35,016	50,937	59,016	70,722	271,310	346,040
Of which: additional poverty-related outlays 1/	0	0	...	6,690	...	...	...	4,295	2,395	...	...
Of which: security-related expenditures	57,227	57,451	67,792	67,618	17,222	13,548	16,402	19,657	18,011	92,840	106,559
Of which: defense	34,041	33,975	41,859	41,596	11,000	7,237	10,500	11,929	11,929	57,631	66,147
Transfers to local councils	13,693	15,507	21,564	21,583	3,450	869	4,205	8,290	8,219	...	...
Democratization and DDR	0	0	0	0	0	0	0	0	0	0	0
Of which : domestic contribution	0	0	0	0	0	0	0	0	0	0	0
Grants to educational institutions	20,959	20,548	27,774	27,781	6,944	6,950	6,944	6,944	6,944	31,626	36,300
Transfers to Road Fund	25,125	23,935	31,406	31,406	7,223	7,634	8,794	7,223	7,755	37,278	48,559
Socially oriented outlays (soc. safety net)	2,748	2,548	200	200	100	0	50	75	75	1,468	1,684
Elections	0	693	8,000	8,000	1,280	1,280	1,560	2,580	2,580	15,090	0
Interest payments	164,629	161,115	142,673	144,347	40,381	40,132	30,424	41,100	32,691	166,424	168,221
Domestic	98,171	94,658	73,969	75,643	17,661	17,412	20,184	18,060	19,987	81,258	82,248
Foreign	66,457	66,457	68,704	68,704	22,720	22,720	10,240	23,040	12,704	85,166	85,973
Capital expenditure and net lending	130,063	207,575	222,252	218,880	48,775	48,403	55,786	39,176	75,514	308,344	352,081
Development expenditure	130,063	203,993	222,252	218,880	48,775	48,403	55,786	39,176	75,514	308,344	352,081
Foreign	103,960	176,411	178,431	178,431	37,820	37,820	44,831	29,030	66,750	231,179	246,193
Loans	45,278	75,109	40,192	40,192	0	0	0	0	40,192	141,041	150,315
Grants	58,682	101,302	138,239	138,239	37,820	37,820	44,831	29,030	26,558	90,138	95,879
Domestic	26,103	27,582	43,821	40,449	10,955	10,583	10,955	10,146	8,764	77,165	105,887
Subsidies	0	0	0	0	0	0	0	0	0	0	0
Lending minus repayments	0	3,582	0	0	0	0	0	0	0	0	0
Overall balance (commitment basis)											
Excluding grants	-344,483	-447,846	-401,568	-400,320	-107,381	-86,409	-93,268	-100,404	-120,239	-494,570	-528,224
Including grants	-45,289	-95,976	-22,851	-22,194	-33,114	-12,142	58,187	-46,174	-22,065	-135,498	-154,318
Total financing	45,289	95,976	22,851	22,194	33,114	12,142	-58,187	46,174	22,065	135,498	154,318
Foreign	32,566	62,397	-4,352	2,432	-6,784	-6,784	-12,672	-3,648	25,536	144,627	152,871
Borrowing	75,305	105,136	40,192	40,192	0	0	0	0	40,192	141,041	150,315
Project	45,278	75,109	40,192	40,192	0	0	0	0	40,192	141,041	150,315
Program	30,027	30,027	0	0	0	0	0	0	0	0	0
Amortization 2/	-138,188	-138,188	-136,352	-84,032	-52,320	-52,320	-16,864	-36,448	21,600	-121,034	-123,869
Change in foreign arrears	0	0	0	0	0	0	0	0	0	0	0
Debt relief obtained 2/	95,450	95,450	91,808	91,808	45,536	45,536	4,192	32,800	9,280	124,619	126,426
Domestic	25,569	42,737	14,282	13,116	40,432	19,024	-49,981	45,356	-1,283	7,261	2,510
Of which: bank	12,304	-16,369	7,410	6,558	20,216	9,512	-24,991	22,678	-641	4,261	1,510
Privatization receipts	0	0	15,056	15,129	0	0	5,000	5,000	5,129	25,149	28,866
Change in arrears	-4,848	-5,983	-2,135	-1,699	-534	-98	-534	-534	-534	-2,135	-2,135
Unaccounted (– = overfinancing of the budget)	-7,999	-3,175	0	0	0	0	0	0	0	0	0
Financing gap	0	0	0	0	0	0	0	0	0	0	0
Memorandum items:											
Nominal GDP	3,518,154	3,504,887	4,294,759	4,294,759	4,294,759	4,294,759	4,294,759	4,294,759	4,294,759	5,029,874	5,773,128
Total HIPC Initiative interim assistance	61,331	60,786	50,880	50,880	11,520	11,520	11,840	11,200	16,320	102,645	103,092
Total HIPC Initiative interim assistance (as percent of GDP)	1.7	1.7	1.2	1.2	0.3	0.3	0.3	0.3	0.4	2.0	1.8
Total poverty expenditures (percent of tot. expenditures)	18.1	17.9	22.1	21.7	19.8	...	20.5	21.6	23.1	31.0	35.8
(in millions of leones)	139,814	154,563	207,873	202,254	43,320	0	45,934	50,000	63,000	352,091	461,850
	(In percent of GDP, unless otherwise indicated)										
Domestic revenue	12.2	11.9	12.5	12.4	2.6	2.7	3.1	3.1	3.6	12.8	13.2
Total expenditure and net lending	22.0	24.6	21.9	21.7	5.1	4.8	5.2	5.4	6.4	22.6	22.4
Of which: recurrent expenditure	18.3	18.7	16.7	16.6	4.0	3.6	3.9	4.5	4.6	16.5	16.3
Of which: domestic interest expenditure	2.8	2.7	1.7	1.8	0.4	0.4	0.5	0.4	0.5	1.6	1.4
Overall fiscal balance (commitment basis)											
Including grants	-1.3	-2.7	-0.5	-0.5	-0.8	-0.3	1.4	-1.1	-0.5	-2.7	-2.7
Excluding grants	-9.8	-12.8	-9.4	-9.3	-2.5	-2.0	-2.2	-2.3	-2.8	-9.8	-9.1
Domestic primary balance 3/	-2.2	-3.1	-1.9	-1.8	-0.7	-0.2	-0.4	-0.7	-0.5	-1.9	-2.0
(in millions of leones)	-75,894	-110,320	-80,464	-77,542	-29,180	-8,457	-18,013	-30,274	-20,798	-96,966	-113,810
Domestic financing	0.7	1.2	0.3	0.3	0.9	0.4	-1.2	1.1	0.0	0.1	0.0
Domestic debt stock	27.5	28.1	22.2	22.8	23.9	23.5	21.9	25.0	21.8	19.8	17.3
Total wages and salaries	6.4	6.5	6.2	6.2	1.5	1.5	1.5	1.6	1.6	6.1	5.9
Total wages and salaries (percent of dom. revenue)	52.7	55.2	49.2	49.8	59.7	54.3	50.1	51.1	44.8	47.5	44.3

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ Contingent upon the receipt of domestic revenue.

2/ In this presentation of the overall fiscal balance, HIPC Initiative relief is shown as program grants consistent with revised presentation in the balance of payments from 2002 onward.

3/ Domestic revenue minus total expenditure and net lending, excluding interest payments, externally financed capital expenditures, and the DDR program.

Table 3. Sierra Leone: Monetary Survey, December 2005-December 2008

(In millions of leones; at actual exchange rates unless otherwise indicated)

	2005		2006										2007	2008
	Dec.		Jan.	Feb.	Mar.		Jun.		Sep.		Dec.		Dec.	Dec.
	Staff Report 4/	Act.	Act.	Act.	Staff Report 4/	Proj. 3/	Staff Report 4/	Proj. 3/	Staff Report 4/	Proj. 3/	Staff Report 4/	Proj. 3/	Proj. 3/	Proj. 3/
Monetary survey														
Net foreign assets	-5,417	85,928	79,890	64,846	-18,710	42,334	7,782	97,415	53,884	74,294	21,160	87,748	173,607	289,009
Net domestic assets	667,402	668,312	661,194	674,026	698,689	697,727	713,940	692,274	692,507	715,664	705,415	715,080	766,657	803,584
Domestic credit	916,050	888,015	869,327	910,324	946,354	915,821	961,605	910,385	940,172	933,774	953,080	933,186	986,215	1,023,968
Claims on government (net)	752,775	724,017	704,955	736,630	772,991	733,529	772,539	708,538	748,893	731,216	760,185	730,575	734,836	736,346
Claims on government (net) 1/ 2/	222,456	193,784	174,722	206,397	242,673	203,296	242,221	178,305	218,575	200,983	229,866	200,342	204,603	206,113
Claims on nonfinancial public enterprises	5,405	4,351	6,599	5,243	5,455	4,401	5,455	4,401	5,455	4,401	5,505	4,451	4,501	4,551
Claims on private sector	157,871	159,647	157,773	168,451	167,909	177,891	183,611	197,445	185,824	198,157	187,391	198,160	246,879	283,071
Other items (net)	-248,649	-219,702	-208,132	-236,298	-247,665	-218,094	-247,665	-218,111	-247,665	-218,111	-247,665	-218,105	-219,558	-220,384
Broad money	661,985	754,240	741,085	738,873	679,979	740,061	721,722	789,689	746,391	789,958	726,574	802,828	940,264	1,092,594
Money	343,023	424,173	416,114	413,690	345,547	384,033	366,759	409,786	375,564	394,127	361,960	381,280	469,117	565,877
Quasi money	318,962	330,066	324,971	325,183	334,432	356,028	354,962	379,903	370,827	395,831	364,615	421,548	471,146	526,716
Bank of Sierra Leone														
Net foreign assets	-136,348	-63,956	-52,173	-66,260	-159,241	-98,590	-142,349	-53,109	-105,847	-91,910	-148,171	-100,856	-24,975	80,299
Foreign assets	436,775	505,489	543,732	532,808	435,480	470,855	445,390	530,997	502,064	492,196	452,753	496,483	563,005	630,525
Foreign liabilities	-573,122	-569,445	-595,904	-599,068	-594,721	-569,445	-587,740	-584,106	-607,911	-584,106	-600,925	-597,338	-587,980	-550,226
Net domestic assets	404,936	367,917	336,757	358,714	436,136	392,877	430,684	369,870	405,038	398,548	443,829	408,912	376,719	315,404
Claims on government (net)	587,890	518,440	482,337	508,344	618,107	541,952	612,655	518,962	587,009	547,639	625,800	557,998	527,259	466,769
Claims on government (net) 1/ 2/	57,572	-11,793	-47,895	-21,889	87,788	11,719	82,337	-11,271	56,691	17,406	95,482	27,765	-2,974	-63,464
Claims on nonfinancial public enterprises	13	13	13	13	13	13	13	13	13	13	13	13	13	13
Claims on private sector	2,505	5,595	3,747	3,440	2,505	5,595	2,505	5,595	2,505	5,595	2,505	5,595	5,595	5,595
Claims on deposit money banks	2,686	3,356	4,859	261	2,686	3,356	2,686	3,356	2,686	3,356	2,686	3,356	3,356	3,356
Other items (net)	-188,158	-159,487	-154,199	-153,344	-187,175	-158,039	-187,175	-158,056	-187,175	-158,056	-187,175	-158,051	-159,504	-160,329
Reserve money	268,589	303,961	284,584	292,454	276,895	294,287	288,335	316,761	299,191	306,638	295,658	308,056	351,744	395,703
Currency outside banks	205,747	231,274	217,916	223,947	211,339	226,926	224,313	242,144	231,980	242,226	225,821	246,173	288,315	335,024
Reserves of deposit money banks	47,128	56,437	50,176	52,566	49,414	51,416	46,890	57,603	49,493	47,391	52,590	44,586	43,171	37,139
Other deposits	15,714	16,251	16,492	15,940	16,141	15,945	17,132	17,014	17,718	17,020	17,247	17,297	20,258	23,541
Deposit money banks														
Net foreign assets	130,931	149,884	132,063	131,106	140,531	140,924	150,131	150,524	159,731	166,204	169,331	188,604	198,582	208,710
Net domestic assets	309,594	356,832	374,614	367,879	311,968	356,266	330,146	380,007	336,962	364,508	314,175	350,755	433,108	525,319
Claims on government (net)	164,884	205,577	222,618	228,286	154,884	191,577	159,884	189,577	161,884	183,577	134,384	172,577	207,577	269,577
Claims on nonfinancial public enterprises	5,392	4,338	6,586	5,229	5,442	4,388	5,442	4,388	5,442	4,388	5,492	4,438	4,488	4,538
Claims on private sector	155,366	154,052	154,026	165,011	165,404	172,296	181,107	191,850	183,319	192,562	184,886	192,565	241,284	277,476
Reserves	47,128	56,276	47,444	50,232	49,414	51,416	46,890	57,603	49,493	47,391	52,590	44,586	43,171	37,139
Other items (net)	-63,176	-63,411	-56,059	-80,880	-63,176	-63,411	-63,176	-63,411	-63,176	-63,411	-63,176	-63,411	-63,411	-63,411
Total deposits	440,525	506,715	506,677	498,985	452,499	497,189	480,277	530,531	496,693	530,711	483,506	539,358	631,690	734,029
Local currency deposits	313,335	361,793	370,275	366,189	315,052	357,952	334,393	381,956	342,091	366,287	329,375	352,987	435,980	527,372
Foreign currency deposits	127,189	144,923	136,402	132,796	137,446	139,238	145,884	148,575	154,602	164,425	154,131	186,372	195,710	206,657
Memorandum items:							Annual percentage growth							
Net foreign assets	-94.8	-182.8	-182.6	-158.6	-76.1	-151.4	-107.9	-198.9	-176.6	-205.6	-490.6	2.1	97.8	66.5
Net domestic assets	-0.7	-0.5	-1.5	-2.5	-1.0	-1.7	-3.8	-6.8	-5.5	-2.3	5.7	7.0	7.2	4.8
of which: Claims on government (net)	1.7	-2.2	-5.6	-4.7	0.0	-5.1	-4.1	-12.0	-4.8	-7.0	1.0	0.9	0.6	0.2
Broad money	16.5	32.8	29.0	27.2	8.3	17.9	12.1	22.6	12.7	19.2	9.8	6.4	17.1	16.2
Reserve money	9.8	24.3	17.5	21.9	6.9	13.6	10.8	21.7	15.4	18.3	10.1	1.3	14.2	12.5
Banks' reserves	68.3	101.0	32.7	69.8	44.7	50.6	43.4	76.2	29.6	24.1	11.6	-20.8	-3.2	-14.0
Banks' claims on private sector	16.5	15.5	18.7	26.4	20.0	25.0	18.0	25.0	19.0	25.0	19.0	25.0	25.3	15.0

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ Special non-interest-bearing government stocks issued by the Bank of Sierra Leone to cover foreign exchange valuation losses.

2/ Excluding non-interest-bearing stock.

3/ Items denominated in foreign currencies are valued at program exchange rates.

4/ IMF Country Report No. 05/194.

Table 4. Sierra Leone: Disbursements Under the PRGF Arrangement, 2006–09 (Revised)
(In millions of SDRs)

Date	Disbursements	Subject to
May 10, 2006	4.71	Approval of arrangement
November 2006	4.40	First review and performance criteria (PCs) for end-June 2006
May 2007	4.40	Second review and PCs for end-December 2006
November 2007	4.40	Third review and PCs for end-June 2007
May 2008	4.40	Fourth review and PCs for end-December 2007
November 2008	4.40	Fifth review and PCs for end-June 2008
May 9, 2009	4.40	Sixth review and PCs for end-December 2008
Total disbursements	31.11[1]	

Source: IMF

[1] The total disbursement is equivalent to 30 percent of Sierra Leone's quota.

May 1, 2006

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. de Rato:

1. This supplements my letter to you dated March 8, 2006. Following discussions in Washington between the Sierra Leonean delegation and Fund staff during April 11-12, understandings were reached on adjustment measures and on changes to the quantitative performance criteria and indicative targets for 2006 (Table 1), which would bring the key parameters broadly in line with the PRGF-supported program requested in my March 8 letter.

2. The adjustments were necessitated by the end-2005 fiscal outturns, which indicated sizeable deviations from the projections that had been agreed earlier with the Fund staff. While the government was successful in raising poverty-related and development spending during 2005, as it pursued the implementation of its poverty reduction strategy, the unexpected drop in domestic revenue performance in the last quarter of 2005 weakened the fiscal position markedly. The lower-than-projected revenue outturn was caused for the most part by the delay in parliament to enact the relevant legislation to support tax collection. In addition, there were temporary factors beyond the control of the government, which led to the postponement of corporate tax payments and customs duty collections until early this year. Furthermore, the Bank of Sierra Leone's ability to manage domestic liquidity was complicated by a stronger than expected improvement in the banking system net foreign assets, which led to a rapid monetary expansion in 2005.

3. Regarding 2006, the preliminary fiscal and monetary data indicate that convergence towards the original program targets has begun during the first quarter. Revenue performance appears to have been better than projected, in part reflecting the spillover from last fiscal year. Parliament also enacted, in mid-April, the Finance Bill, which provides the key legislative vehicle for tax collection. Furthermore, monetary expansion has started to subside, in part assisted by the improvement in the overall fiscal position. The adjustments envisioned for this year will build on the encouraging performance in the first quarter.

4. Government has continued to implement the agreed structural measures. A structural performance criterion on the new reporting system for fiscal and monetary data, targeted for implementation by end-March, as well as four structural benchmarks, scheduled for March and April, have been completed as prior actions to the program request (in addition to those outlined in my March 8 letter). Table 2 provides an updated structural reform program for 2006.

5. Reflecting the delay in bringing the government's request for a three-year PRGF-supported program for consideration by the IMF Executive Board, the first review is expected to be conducted before end-November 2006 and the second review is expected to be conducted before end-May 2007.

Sincerely yours,

/s/

John O. Benjamin

Minister of Finance

Freetown, Sierra Leone

Attachments: Table 1. Proposed Quantitative Performance Criteria and Indicative Targets Under the PRFG Arrangement for 2006 (Revised)

Table 2. Proposed Structural Conditionality for 2006 (Revised)

Table 1. Sierra Leone: Proposed Quantitative Performance Criteria and Indicative Targets
Under the Poverty Reduction and Growth Facility Arrangement (January-December 2006, revised)

(Cumulative change from beginning of calendar year to end of month indicated; in millions of leones, unless otherwise indicated.) 1/

	2005		March	June	September	December
	Sept. Act.	Dec. Act.	Indicative Targets	Performance Criteria	Indicative Targets	Performance Criteria
Performance criteria:						
	Stocks					
Net domestic bank credit to the central government (ceiling)	786,275	724,017	20,216	-15,478	7,199	6,558
Net domestic assets of the central bank (ceiling)	455,145	367,917	30,216	522	29,199	39,558
Domestic primary budget balance of the central government (floor)			-29,180	-26,470	-56,744	-77,542
Subsidies to National Power Authority (ceiling) 2/			0.0	0.0	0.0	0.0
Gross foreign exchange reserves of the central bank, in million U.S. dollars (floor)	135.03	168.29	-0.40	10.67	-1.46	-0.12
Contracting or guaranteeing of new nonconcessional external debt by the public sector (ceiling) with maturities of one year or more 2/	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding stock of external debt owed or guaranteed by the public sector with maturities of less than one year (ceiling) 2/	0.0	0.0	0.0	0.0	0.0	0.0
External payment arrears of the public sector (ceiling) 2/	0.0	0.0	0.0	0.0	0.0	0.0
Indicative targets:						
Total domestic government revenue (floor)			111,409	248,973	379,972	532,573
Government wage bill (ceiling)			66,500	129,666	196,666	265,005
Poverty-related expenditures (floor)			43,320	89,254	139,254	202,254
Memorandum item:						
External budgetary assistance 3/			22,424	107,514	120,138	170,420
Net credit to government by nonbank private sector 4/			20,782	-15,478	7,199	6,558
Disbursements under the PRGF, in millions U.S. dollars			6.73	6.73	6.73	13.02

Sources: Statistics Sierra Leone; and IMF staff estimates.

1/ Variables are based on definitions in the TMU of February 2006.
2/ These apply on a continuous basis.
3/ Including program grants and program loans.
4/ Comprises treasury bills purchased by the National Social Security and Insurance Trust (NASSIT) and the non-financial private sector.

Table 2. Sierra Leone: Proposed Structural Conditionality for 2006 (Revised)

Measure	Timing
Prior actions for approval of the PRGF arrangement	
Deputy Auditor General has been appointed.	
The implementation of action plans to reform five key ministries has commenced, and Cabinet has approved the sixth action plan for the ministry of local government.	
A plan for transforming the Establishment Secretary's Office into Human Resources Management office has been approved by Cabinet.	
A medium-term revenue projection has been finalized for diamonds, rutile, and bauxite, and incorporated in the overall fiscal framework.	
All government units and accounts that should be included in the new reporting system for monetary and fiscal data have been identified, and benchmark annual data for 2004 established.	
Implementation of a new fiscal and monetary reporting system, developed with Fund technical assistance in 2005, for the reconciliation of fiscal data with monetary data has started.	
Specific measures to be taken during the period through end-2006 to convert the Establishment Secretary's Office into a Human Resource Management Office have been identified.	
An action plan for the implementation of the Government's Budgeting and Accountability Act has been approved by Cabinet.	
The stock as of February 28, 2006, of outstanding utility and wage arrears has been identified and an action plan to clear these arrears has been approved.	
Key ministries and agencies have established internal audit units under the control of the chief internal auditor of the Ministry of Finance.	
Structural performance criteria	
The database containing all job grades and salary levels for all civil servants and teachers has been updated and audited, and guidelines for annual salary adjustments within grade ranges approved by the cabinet.	June 30
An assessment of bank capitalization and credit quality for all commercial banks has been finalized by the Bank of Sierra Leone.	September 30
Structural benchmarks	
A review of existing tax exemptions has been conducted and a plan approved for minimizing the exemptions.	June 30

INTERNATIONAL MONETARY FUND
EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
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IMF Executive Board Approves US$46.3 Million PRGF Arrangement for Sierra Leone

The Executive Board of the International Monetary Fund (IMF) approved a three-year arrangement for Sierra Leone under the Poverty Reduction and Growth Facility (PRGF) in a total amount equivalent to SDR 31.1 million (about US$46.3 million) to support the government's 2006–08 economic program. An initial disbursement of SDR 4.7 million (about US$7 million) under the arrangement will become available immediately.

The Board agreed to waive the nonobservance of a performance criterion on the accumulation of new external arrears under the previous PRGF arrangement that expired in June 2005 (see Press Release No. 05/130) that resulted in a noncomplying disbursement under that arrangement.

The PRGF is the IMF's concessional facility for low-income countries. It is intended that PRGF-supported programs are based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners and articulated in a Poverty Reduction Strategy Paper (PRSP). This is intended to ensure that PRGF-supported programs are consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty. PRGF loans carry an annual interest rate of 0.5 percent and are repayable over 10 years with a 5½-year grace period on principal payments.

Following the Executive Board's discussion on Sierra Leone on May 10, 2006, Agustín Carstens, Deputy Managing Director and Acting Chairman, said:

"The Sierra Leonean authorities are to be commended for the satisfactory performance under the previous PRGF-supported program, which helped consolidate the post-conflict transition and laid the foundation for sustained real growth and poverty reduction, while ensuring continued donor support.

"The authorities' economic program for 2006-08 draws on the government's Poverty Reduction Strategy Paper's vision of channeling more resources to poverty reduction, and places a welcome emphasis on nation building, the restoration of macroeconomic stability through sound fiscal management and improved effectiveness of monetary policy, and the creation of an investment climate conducive to private sector growth.

"In the fiscal area, the authorities' emphasis on revenue mobilization is well placed. Measures to improve revenue administration, increase collections from the minerals sector, and enforce tax compliance will be critical for a successful policy implementation and help protect poverty-related spending. It will also be necessary to contain the growth of the wage bill and continue applying the budgetary framework that allocates predictable fiscal resources to priority spending areas.

"Sound fiscal management will have to be supported by appropriate monetary and exchange rate policies. For this purpose, the authorities intend to strengthen the central bank's operational capacity for conducting monetary policy and apply a more flexible exchange rate policy. This will have to be reinforced through financial sector reforms to enhance private savings, investment, and growth.

"Structural reforms will help limit the challenges that lie ahead. The promotion of good governance, including the strengthening of the government's anti-corruption efforts, will remain vital for the efficient use of resources, the improvement in the investment climate, and the mobilization of much needed external support.

"Reaching the HIPC Completion Point and qualifying for MDRI relief will provide access to additional resources for poverty reduction. However, Sierra Leone's external debt will remain substantial in the coming years and adequate macroeconomic policies, a prudent external financing strategy, and increased highly concessional donor support will remain essential to help attain debt sustainability over the medium-term and to progress toward achieving the Millennium Development Goals.

"The Executive Board reviewed the noncomplying purchases made by Sierra Leone under the previous Poverty Reduction and Growth Facility Arrangement with the Fund, which arose as a result of misreporting on external arrears. In light of the steps taken by the authorities to clear these arrears and to avoid their recurrence in the future, the Executive Board decided to grant a waiver for the non-observance of a performance criterion on the accumulation of new external payments arrears that gave rise to the noncomplying purchase," Mr. Carstens said.

Recent Economic Developments

Sierra Leone has made substantial progress with its post-conflict transition. Macroeconomic performance during the last PRGF-supported program (2001-04) was on the whole strong, and structural reforms sought to establish a foundation for sound public finances and the effective conduct of macroeconomic policies.

During 2005, economic expansion continued to be robust, with output growth projected at 7.3 percent in 2005, reflecting healthy activity in agriculture, diamond mining, manufacturing, construction and services. Inflation averaged 12.1 percent during the year, as a result of higher fuel prices and monetary expansion. There were fiscal and monetary slippages toward the end of the year, and the government intended to implement corrective measures and policies for 2006 in the context of the proposed PRGF-supported program. The exchange rate appreciated in real terms in 2005 after a steady depreciation since 2002. While export performance continued to improve, the external current account deficit (including official transfers) widened in 2005, to

7.3 percent of GDP from about 5 percent in 2004 because of strong import growth. External gross reserves reached US$168 million by year-end, reflecting better than anticipated external budgetary support.

Many socio-economic challenges remain, however. Poverty remains pervasive, particularly in rural areas, and poverty-reducing efforts have yet to make notable progress.

Program Summary

The new PRGF program for 2006-08 aims at enhancing macroeconomic stability, with structural reforms focusing on laying the ground work for scaled up aid inflows to support achieving the Millennium Development Goals (MDGs).

The medium-term macroeconomic framework projects that output growth will stabilize in the range of 6-7 percent by 2008, underpinned by broad-based sectoral growth. Inflation is expected to converge to single digits by the end of the period, supported by prudent macroeconomic policies. The external current account balance (including official transfers) is projected to narrow to 6 percent of GDP by 2008. Gross official reserves are expected to stabilize at about 3 months of import cover.

Effective monetary and fiscal policies will be critical in ensuring macroeconomic stability. Strengthening the Bank of Sierra Leone's (BSL) operational capacity, including by improving existing money market operations and widening the menu of instruments, will help to improve the effectiveness of monetary policy. Fiscal consolidation and the achievement of a better balance between available fiscal resources and budgeted outlays will be central for the policy framework under the PRGF. The government intends to contain the primary deficit at about 2 percent of GDP in 2006 while shifting resources increasingly toward poverty-reducing activities. Fiscal consolidation would assist monetary policy in lowering inflation while ensuring that the domestic public debt would remain at a sustainable level.

The main focus of structural measures in the PRGF-supported program will be on reforming the public sector and civil service, strengthening capacity for data collection, analysis, and reporting to support policy-making, and strengthening public finance management to assist the budgetary process. Financial sector reforms will be aimed at enhancing domestic savings and investment. Further efforts will also be made to fight corruption, including by strengthening the Anti-Corruption Commission.

Progress has also been made in implementing the Poverty Reduction Strategy Paper, which should help Sierra Leone reach the HIPC Initiative completion point this year and gain access to additional resources under the MDRI.

Sierra Leone: Selected Economic and Financial Indicators, 2002–08

	2002 Est.	2003 Est.	2004 Est.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
	(Annual percentage change, unless otherwise indicated)						
National Income and Prices							
Real GDP	27.5	9.3	7.4	7.3	7.4	6.5	6.1
Nominal GDP	22.8	18.3	24.6	21.1	22.5	17.1	14.8
Consumer prices (end of period)	-3.1	11.3	14.4	13.1	10.1	8.5	7.5
Consumer prices (annual average)	-3.7	7.5	14.2	12.1	12.4	9.3	8.0
Money and credit							
Broad money (including foreign currency deposits)	30.1	26.2	18.9	32.8	6.4	17.1	16.2
Velocity (GDP/broad money)	5.2	4.9	5.1	4.6	5.3	5.3	5.3
Domestic credit 1/	7.9	27.5	-2.1	1.5	6.0	6.6	4.0
Government 1/	0.2	17.1	-10.9	-2.9	0.9	0.5	0.2
Private sector 1/	7.5	9.7	8.8	4.3	5.1	6.1	3.8
Reserve money	24.9	22.4	12.6	24.3	1.3	14.2	12.5
Interest rate 2/	15.0	20.2	28.0	16.0	...	...	...
External sector							
Exports (U.S. dollars)	48.9	27.4	17.1	22.8	32.7	15.3	13.5
Imports (U.S. dollars)	54.4	15.6	-15.7	36.0	19.4	10.0	9.1
Terms of trade (- deterioration)	0.0	-1.9	-4.6	-2.3	-4.6	-1.8	-0.6
Real effective exchange rate (- depreciation; end of period)	-9.7	-18.2	-7.9	20.9	…	…	…
Exchange rate (leones per U.S. dollar; period average)	2,099.0	2,347.9	2,735.0	2,893.8	...	...	...
	(In percent of GDP)						
Gross domestic investment	10.1	13.9	10.6	17.2	15.0	14.9	15.2
Government	4.4	4.8	4.6	5.8	5.1	6.1	6.1
Private	5.7	9.0	5.9	11.4	9.9	8.8	9.1
Gross national saving	5.3	6.3	5.6	9.9	8.1	8.6	9.3
Gross domestic saving	-9.4	-7.4	-5.0	-1.4	-1.4	-0.1	1.5
Government	-4.3	-3.2	-1.2	-1.6	-0.2	0.3	0.5
Private	-5.1	-4.2	-3.8	0.2	-1.2	-0.4	1.0
Current account balance, including official transfers	-4.8	-7.6	-4.9	-7.3	-6.9	-6.4	-6.0
Overall balance of payments	-0.3	-4.6	1.4	-0.2	-2.8	-1.0	-0.4
Net present value of debt-to-exports ratio 3/	162.3	153.6	151.3	141.7	110.2	107.0	103.2
Government budget							
Domestic revenue	12.1	12.4	12.3	11.9	12.4	12.8	13.2
Total expenditure and net lending	28.6	26.9	24.8	24.6	21.7	22.6	22.4
Overall fiscal balance (commitment basis, including grants)	-8.3	-6.7	-3.5	-2.7	-0.5	-2.7	-2.7
Domestic primary fiscal balance 4/	-7.0	-5.6	-2.8	-3.1	-1.8	-1.9	-2.0
Domestic financing	0.9	4.3	-0.1	1.2	0.3	0.1	0.0

Sierra Leone: Selected Economic and Financial Indicators, 2002-08

	2002 Est.	2003 Est.	2004 Est.	2005 Proj.	2006 Proj.	2007 Proj.	2008 Proj.
	(In millions of U.S. dollars, unless otherwise indicated)						
External current account balance, excluding official transfers	-113.6	-139.7	-123.7	-170.5	-164.7	-174.2	-181.1
Gross international reserves	84.6	59.4	124.9	168.3	168.2	188.2	208.2
(in months of imports of goods and services) 5/	2.5	1.8	3.0	3.4	3.1	3.1	3.2
GDP (billions of leones)	1,964.6	2,323.6	2,894.3	3,504.9	4,294.8	5,029.9	5,773.1

Sources: Sierra Leonean authorities; and IMF staff estimates and projections.

1/ Changes as a percentage of beginning-of-period money stock.

2/ Treasury bill rate (end of period); in percent.

3/ Net present value (NPV) of debt relative to backward-looking three-year average of exports of goods and services.

4/ Domestic revenue minus total expenditure and net lending, excluding interest payments, and externally financed capital expenditure and disarmament, demobilization, and reintegration (DDR) program.

5/ In months of imports of goods and services of subsequent year.

Statement by Peter Ngumbullu, Executive Director for Sierra Leone and Joseph Tekman Kanu, Senior Advisor to Executive Director
May 10, 2006

Introduction

1. On behalf of the Sierra Leonean authorities, we thank staff for their constructive dialogue with Sierra Leone and for the well written reports which clearly identify challenges for macroeconomic stabilization and policy options facing the country. The authorities are determined to strengthen the gains in macroeconomic stabilization and structural reforms despite the many challenges. The current decentralization strategy is a clear reflection of the authorities' efforts to empower local communities and involve them in the political process in order to restore confidence in the reform agenda. The positive political outcomes in neighboring Liberia are expected to strengthen stability and restore investor confidence in the region .In view of the sizeable development needs and the large external financing gap projected, the authorities are requesting a new PRGF program to help anchor their pursuit of sound macroeconomic policies and continued implementation of structural reforms and enable them attain higher output growth, poverty reduction and meet the MDGs in the long-run. The authorities remain confident that the Fund and other development partners will continue to assist them to ensure that the objectives of the reform agenda are achieved.

Recent Economic Developments

2. Macroeconomic performance during 2001–04 has been strong, with real GDP growth of about 6–7 percent being achieved; inflation of about 5 percent per annum; substantial reduction in the fiscal and external current account deficits; as well as an increase in gross international reserves. Although robust economic expansion continued in 2005, significant policy challenges remain. Inflation, which increased to 16 percent by September 2005 was higher than expected due to higher fuel prices and the temporary supply constraints of essential products. However, disbursement of donor resources towards the end of the year and government's freeze on expenditures in the last quarter resulted in moderate inflationary pressures.

3. The authorities expect to achieve fiscal targets set for 2005 despite the mixed performance, as corrective actions have already been taken to bring overall fiscal performance in line with the budget. On revenues, although the NRA has made extra efforts to strengthen regulations for tax enforcement to increase revenue generation, the outturn was weaker than anticipated. Notwithstanding this, net bank credit to the government only grew by 1 percent during the year, compared to 4 percent projected by staff**.** On the expenditure side, **t**he authorities are strongly committed to monitor closely fiscal outlays and forestall slippages in future, while ensuring that increased revenues are directed towards raising allocations to pro-poor activities. The increase in both poverty and development expenditures in 2005, adversely affected the fiscal deficit position as revenue generation was below target.

4. Given these developments, the authorities are taking additional efforts to ensure effective monetary policy in view of the strong expansion of the net foreign assets of the banking system, which has contributed to stronger monetary expansion than projected in the staff report. Credit to the private sector is expected to remain broadly in line with projected levels. Although the exchange rate appreciated in real terms in 2005, the nominal exchange rate continues to depreciate, an indication of appropriate monetary management by the authorities. The parallel market exchange rate also narrowed in line with the official exchange rate, and is being traded at around two percent premium, reflecting transactions demand pertaining to informal alluvial diamond trading and capital outflows. Export performance continues to improve despite an expected widening of the external current account deficit. Import growth is stronger than projected due to higher fuel costs and capital goods for refurbishing existing bauxite and rutile mines. External gross reserves are projected to reach about 3.4 months of import cover, a reflection of better than anticipated external budgetary support.

Outlook for 2006 and Medium-Term Strategy

5. In 2006, growth performance is expected to be steady with low inflation and real output projected to grow at 7.5 percent, due to resumption of rutile and bauxite production and export, in addition to the expansion of agricultural, manufacturing and service activities. Inflation is expected to decline to 9.5 percent from 15 percent as at end-2005, while the external current account deficit, excluding official transfers is projected to narrow to 12 percent in 2006 from 15 percent of GDP in 2005. Import growth is however, expected to remain moderate. The 2006 budget, has been formulated in the context of the medium-term fiscal framework that reflects projected revenue trends and indicative external support by traditional donors. The authorities are expected to continue with the fiscal consolidation, increase poverty-related outlays given that domestic revenues are projected to increase to 12.4 percent of GDP essentially resulting from enhanced tax collection efforts and higher royalties from the mineral sector.

6. Projected expenditures for 2006 are based on revised revenues and the need to include contingent expenditures to address revenue uncertainties. In this context, total expenditures will be contained at 21.7 percent of GDP, which is 0.2 percent lower than budgeted, thereby necessitating cuts in both recurrent and capital outlays to achieve this target. The authorities will also target expenditure savings during the first quarter, and spending in the second quarter would not be increased above the budgeted level, even with the earlier-than expected budgetary support from DfID. During the subsequent quarters, a portion of budgeted outlays would be contingent upon the receipt of projected domestic revenues. With these measures, the overall deficit (including grants) is projected at 0.5 percent of GDP, and domestic primary deficit at 1.8 percent of GDP. Government domestic borrowing would be contained at 0.3 percent of GDP, as budgeted

7. In addition, the authorities intend to further strengthen public expenditure management, through containing the public sector wage bill and meeting targets for poverty reduction outlays. Progress has been achieved in the verification of teachers and civil

servants in the government payroll and identification cards issued. The database of teachers and civil servants and the payroll database of the Accountant General's Office are being updated monthly. In addition, structural reforms to further strengthen public expenditure management will focus on; strengthening the control of the wage bill, including further measures to strengthen personnel and payroll systems; the avoidance of domestic payment arrears and the establishment of a time table for the clearance of all outstanding arrears; improving the quality and timeliness of financial audits of the government; and strengthening fiscal and monetary reporting to ensure timely reconciliation of data.

8. The unfinished reform agenda from the previous program has been addressed upfront and incorporated in the new PRGF-supported program and the authorities have expressed their strong commitment to ensuring continued improvements in the efficiency and transparency of government operations by strengthening the Auditor General's office, undertaking reforms in key ministries, and streamlining human resource management. Further progress is planned to be made to incorporate mineral revenue projections in the overall fiscal framework and ensure consistent reporting of the monetary and fiscal data. The PRGF-supported program is expected to be fully financed from official grants and concessional loans, and interim HIPC debt relief in 2006. Debt rescheduling will be retroactively provided on Cologne terms upon approval of the new PRGF arrangement and Paris Club creditors have agreed to provide financing assurances to the authorities in support of their request for the new arrangement with the Fund. The authorities have also made efforts to engage external commercial creditors in this process and preparations are also under way for another IDA debt buyback operation.

9. The authorities'medium-term economic strategy is an important element in addressing poverty and providing the basis for high economic growth, given that prudent fiscal policy will facilitate achievement of macroeconomic stability and ensure more resources are channelled toward poverty spending.The medium-term fiscal strategy is intended to focus on the key areas, of increased revenue collection, strengthened public expenditure management, accelerated privatization, and strengthening of governance systems and institutions for further mobilization and effective management of donor resources. A better fiscal balance is anticipated to assist in the reduction of the high domestic debt burden and avoid crowding out credit to the private sector. In order, to achieve high and sustained growth, the authorities intend to increase domestic savings and investment rates to enable them target a domestic savings rate in the range of 8–10 percent of GDP in the longer term.

10. The financial sector strategy will focus on enhancing mobilization of domestic savings and increase access to medium-to-longer term credit, thereby boosting confidence, ensure efficiency, as well as expand the sector's capacity to offer financial services, particularly in rural areas. The reform of the financial sector is, therefore, considered by the authorities very critical in achieving this objective. In order to raise investment levels in support of the required level of growth, the authorities will facilitate and create environment for private sector development and an improved investment climate. This will improve the overall fiscal balance, with potential solvency and profitability problems in the banking

system being addressed, and more attention being paid to the mobilization of longer-term resources through institutions like insurance companies and pension funds.

11. The Bank of Sierra Leone (BSL) operations are to be strengthened, especially in improving open market operations and widening the menu of instruments for policy effectiveness. Given the countries' vulnerability to external shocks, flexibility of the exchange rate is expected to be enhanced. The central bank is targeted to take a lesser role as the economic situation normalizes, while private participants assume a much bigger role. Interventions in the market are to be undertaken only to meet the gross reserve target of the program and to correct any adverse imbalances. Efforts are being directed at strengthening the central bank's operational capacity for conducting monetary policy and meeting its reserve money target. Modalities for conversion of the balances in the government's Ways and Means Account into Treasury securities is well underway and is intended to be done at the Bank's discretion while the authorities are encouraged to finance the deficit through the issuance of treasury securities in the primary market. The non-market interest rate will be eliminated and a market interest rate charged on these balances. These measures are expected to improve the BSL's management of reserve money and strengthen its effectiveness in managing inflationary pressures. Money growth is expected to be driven mainly by the improvement in net foreign assets, while net domestic credit expansion, including to the private sector, is expected to remain moderate.

12. The structural reform agenda in respect of the public sector is to support governance, which is one of the three pillars underpinning the PRSP**.** Structural measures will in addition, focus on reforms of the public sector and civil service, strengthening of capacity for data collection, analysis and reporting to support policy-making, and strengthening of public finance management and assist the budgetary process. Other reforms to attract private sector investment, including in the mineral sector will also be undertaken. Resources will be allocated towards power generation and infrastructure over the medium term to ease bottlenecks and remove existing impediments to doing business.

13. The authorities recognize the need for enhanced efforts in the fight against corruption; and with other stakeholders; and with the assistance from DfID, they will continue to strengthen the Anti-Corruption Commission to meet its challenges in this area. Given the importance of transparency, and accountability in governance, the authorities are committed to expanding the availability of information on their activities to parliament and the public at large. Regarding the mineral sector, the government has already endorsed the international initiative (the Extractive Industries Transparency Initiative; EITI), in order to enhance transparency in the utilization of the countrys' mineral endowment and they expect to adopt the initiative during 2006. The authorities are aware of the need to strengthen law and order, improve infrastructure, and enhance macroeconomic stability which are key for successful implementation of the strategy.

14. As there is potential for promoting exports outside the mining sector, efforts will be directed at diversifying and expanding exports in order to facilitate job creation and ensure increased benefits from the ongoing international trade initiatives, including the United States

African Growth Opportunity Act (AGOA) and the EU's Everything-but-Arms (EBA). Harmonization of tariffs within ECOWAS is also expected to promote trade within the West African region.

Macroeconomic and Fiscal Policy Framework for 2007 and Beyond

15. The mineral sector is expected to continue supporting the balance of payments and output growth, and is therefore expected to enhance fiscal sustainability in the economy in the longer term. The medium-term macroeconomic framework projects output growth to stabilize in the range of 6–7 percent by 2008, through broad-based sectoral growth. Prudent macroeconomic policies will help reduce inflation to a single digit by the end of the period, while gross official external reserves will stabilize at 3 months of import cover. Fiscal consolidation, achievement of a better balance between available fiscal resources and budgeted outlays are central in the policy framework under the PRGF with the objective of containing domestic primary deficit at about 2 percent of GDP.

16. The authorities intend to raise more domestic revenues to support priority spending, and in this respect they plan to focus on five specific areas: (i) continued strengthening of the National Revenue Authority, for which technical assistance has been requested; (ii) tapping of increased revenues from the mineral sector which has estimated incremental revenues mainly from royalties to about 0.3 percent of GDP per annum during 2006–08, (iii) introduction of a value-added tax (VAT), to widen the tax base scheduled for 2007; (iv) narrowing the scope of import duty and sales tax exemptions which is progressively being effected, and (v) strengthening of tax compliance, in part by actively pursuing overdue tax liabilities from private and public corporations, in particular, PAYE liabilities, and settling related arrears, as part of cross-liability deals between government and state-owned enterprises.

17. Monetary policy stability will be attained through lowering inflation and ensuring that domestic public debt remains at sustainable levels. On the external front, the external outlook is expected to improve over the medium-term despite the substantial financing needs in the balance of payments. Exports are projected to increase while imports will decline, with the exception of fuel imports which are envisaged to rise due to increased activity in the mineral sector. This development is expected to narrow the external current account deficit (including grants) to about 6.5 percent of GDP in 2008 from 8.5 percent in 2005. Monetary policy would continue to support macroeconomic stability, although the BSL's capacity to sterilize large inflows remains limited. Thus, in order to support monetary management while allowing aid to be spent and absorbed, the central bank will sell foreign exchange in the market to allow some real appreciation in the exchange rate. It will also target higher official reserves in the medium term. Increased aid inflows are projected to lead to a larger external current account deficit, partly in response to real appreciation of the exchange rate, while higher real activity levels and the high dependency on imported capital and intermediate goods would also raise the demand for imports.

18. Pursuit of an appropriate external financing strategy guarantees the sustainability of the external and domestic debts over the medium term**.** The multilateral debt relief initiative (MDRI) is expected to create the necessary fiscal space for absorption of additional donor assistance in the form of concessional loans without undermining debt sustainability. To this end, the authorities' domestic borrowing requirements will be contained in order to halve NPV of debt-to-GDP ratio by 2025 to about 35 percent and strong macroeconomic policies will be pursued in the medium term.

Poverty Reduction Strategy

19. The authorities have made substantial progress towards meeting the HIPC completion point triggers. While PRSP implementation commenced in mid- 2005, a key outstanding component relates to its full implementation, which is being accelerated in the context of the 2006 budget. The authorities envisage reaching the HIPC completion point during the second half of 2006, thus buttressing the need for a clear prioritization of pro-poor spending outlays in the budget process. Within the context of the PRSP, the challenges to reach the MDGs are formidable, in view of the enormous institutional and financial requirements, suggesting that with the exception of universal primary education, achievement of the MDGs by 2015 is very much unlikely. The authorities realize the policy challenges associated with substantial increase in aid flows, especially resulting from scaled up aid expected from the HIPC debt relief and upon attaining qualification for access to MDRI, both in the context of financing the PRSP and for meeting the MDGs. They also recognize the importance of strengthening tax efforts in order to support their poverty-reduction objectives, including paving the way to gradual exit from aid dependency.

20. The authorities are agreeable to the envisaged framework for monitoring quantitative performance under the new PRGF-supported program as it is broadly in line with the program objectives. They have implemented all required prior actions under the program and plan to meet the two structural performance criteria during 2006, on the updating and auditing of the database containing all job grades and salary levels for all civil servants and teachers, including obtaining cabinet approval of guidelines for annual salary adjustments within grade ranges, and the finalization of an assessment of bank capitalization and credit quality for all commercial banks.

Other issues

21. The coverage and consistency of statistics will continue to be addressed in the context of the program, given the importance of adequate statistics in monitoring progress in implementing the PRSP, which also incorporates elements of the General Data Dissemination Standards (GDDS). Efforts will be made to operationalize the new framework for fiscal and monetary data reporting supported by the Fund. This exercise is supported by the findings of the recent Fund safeguard assessment mission which noted several areas where further progress in strengthening the central bank's internal controls and audit functions is needed. In view of the above developments, it is also expected that Sierra Leone's participation in the GDDS will assist in enhancing the quality of data, especially in

the area of the national accounts, and that its statistical infrastructure will benefit from enhanced domestic and external support.

Conclusion

22. In conclusion, we wish to reiterate that the Sierra Leonean authorities have continued to make substantial progress in setting the basis for sustained real growth and poverty reduction. The medium-term objectives are realistic and well founded in the full PRSP which takes on board all key elements, including fiscal consolidation which is essential for safeguarding macroeconomic stability, and a critical component for successful implementation of the new program under the PRGF arrangement. In addition, fiscal management will be strengthened to ensure and identify predictable resources for allocation to priority spending and the effectiveness of monetary policy through improvement of the instruments of the BSL will also be strengthened, with the exchange rate flexibility being enhanced to facilitate timely adjustments to external developments, and ensure sustained effort towards raising savings and investment in support of growth and poverty reduction.

23. In view of the identified financing needs estimated at US$244 million each year during 2006–08, the authorities are convinced that continuous support from the Fund and other development partners is needed. However, the authorities are fully aware of the key risk during the medium-term which may arise from the high dependency of the budget on external support. In this respect, the authorities are pursuing efforts to significantly strengthen macroeconomic management, address governance issues, and improve transparency during the coming years to facilitate the necessary progress to achieve the key objectives of the program.

24 As regards the issue of non-complying disbursement, the authorities have demonstrated that settlement of the undisputed arrears did take place on June 2, 2005, thus ensuring that the deviation did not endanger the achievement of the objectives of the program supported under the PRGF arrangement. In this situation, the authorities request the Executive Board's approval to waive the nonobservance of the continuous performance criterion on the nonaccumulation of new external payment arrears that gave rise to the noncomplying disbursement.

25. Finally, given the authorities efforts and commitments made, and actions already taken, they are requesting approval of a new three-year PRGF arrangement. The above request will support their efforts to achieve sustained growth for alleviating poverty and meet the objectives of the program.