Sierra Leone: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

March 8, 2006

The following item is a Letter of Intent of the government of Sierra Leone, which describes the policies that Sierra Leone intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Sierra Leone, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.
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.\(^1\) 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 7\(\frac{1}{3}\) 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

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\(^1\) 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. 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-anticipated improvement in the banking system net foreign assets, as well as higher than

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2 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.
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. 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 part by actively pursuing overdue tax liabilities from private and public corporations (in

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3 Two Fund technical assistance missions, covering tax administration and mineral sector regulations, have been scheduled for early 2006.
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 GDP 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.⁴

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.⁵ 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.⁶ Furthermore, the government has included

⁴ These are the AfDB, DfID, EU, and the World Bank.
⁵ At the rate of 1.25 percent of the c.i.f. value of goods.
⁶ Poverty-related outlays are projected to rise by about 1 percent of GDP in 2006.
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.\(^7\) 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 \(\frac{3}{4}\) 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 strengthened, particularly when liquidity emanates from the fiscal sector. Furthermore, a key

\(^7\) Predictable resources are defined as domestic revenues, domestic borrowing, HIPC grants, and one-half of foreign program support.
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. 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 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.

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8 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).
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). 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 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.10

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9 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.

10 The main areas for structural reforms in the medium-term are illustrated in Table 3.
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.
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<th>Performance criteria</th>
<th>January - December 2005 17/</th>
<th>September</th>
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<td>Net domestic bank credit to the central government</td>
<td>15,375</td>
<td>28,783</td>
<td>32,505</td>
</tr>
<tr>
<td>Indicated targets</td>
<td>48,418</td>
<td>64,873</td>
<td>Not met</td>
</tr>
<tr>
<td>Adjusted targets</td>
<td>21,180</td>
<td>36,403</td>
<td>Not met</td>
</tr>
<tr>
<td>Net domestic assets of the central bank</td>
<td>31,474</td>
<td>33,978</td>
<td>49,134</td>
</tr>
<tr>
<td>Indicated targets</td>
<td>65,255</td>
<td>103,432</td>
<td>Not met</td>
</tr>
<tr>
<td>Adjusted targets</td>
<td>65,255</td>
<td>103,432</td>
<td>Not met</td>
</tr>
<tr>
<td>Domestic primary budget balance of the central government</td>
<td>-13,259</td>
<td>-24,960</td>
<td>-26,034</td>
</tr>
<tr>
<td>Indicated targets</td>
<td>-24,960</td>
<td>-26,034</td>
<td>Not met</td>
</tr>
<tr>
<td>Gross foreign exchange reserves of the central bank</td>
<td>-10.66</td>
<td>-4.25</td>
<td>-11.06</td>
</tr>
<tr>
<td>Indicated targets</td>
<td>-4.25</td>
<td>-11.06</td>
<td>Not met</td>
</tr>
<tr>
<td>Adjusted targets</td>
<td>-4.25</td>
<td>-11.06</td>
<td>Not met</td>
</tr>
<tr>
<td>Outstanding stock of external debt owed or guaranteed by the public sector (ceiling)</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Indicated targets</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total domestic government revenue (floor)</td>
<td>93,919</td>
<td>104,606</td>
<td>105,529</td>
</tr>
<tr>
<td>Government wage bill (ceiling)</td>
<td>48,532</td>
<td>48,532</td>
<td>49,599</td>
</tr>
<tr>
<td>Poverty-related expenditures (floor)</td>
<td>32,031</td>
<td>32,031</td>
<td>32,031</td>
</tr>
<tr>
<td>External budgetary assistance</td>
<td>28,348</td>
<td>10,916</td>
<td>57,488</td>
</tr>
<tr>
<td>Net credit to the central government by nonbank private sector</td>
<td>23,063</td>
<td>23,063</td>
<td>23,063</td>
</tr>
</tbody>
</table>

**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, 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 loans with a grant element equivalent to 25 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

<table>
<thead>
<tr>
<th>Measure</th>
<th>Timing</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Prior actions for approval of the PRGF arrangement</strong></td>
<td></td>
</tr>
<tr>
<td>Deputy Auditor General has been appointed.</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td>A plan for transforming the Establishment Secretary’s Office into Human Resources Management office has been approved by Cabinet.</td>
<td></td>
</tr>
<tr>
<td>A medium-term revenue projection has been finalized for diamonds, rutile, and bauxite, and incorporated in the overall fiscal framework.</td>
<td></td>
</tr>
<tr>
<td>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.</td>
<td></td>
</tr>
<tr>
<td><strong>Structural performance criteria</strong></td>
<td></td>
</tr>
<tr>
<td>Implementation of a new reporting system, developed with Fund technical assistance in 2005, for the reconciliation of fiscal data with monetary data has started.</td>
<td>March 31</td>
</tr>
<tr>
<td>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.</td>
<td>June 30</td>
</tr>
<tr>
<td>An assessment of bank capitalization and credit quality for all commercial banks has been finalized by the Bank of Sierra Leone.</td>
<td>September 30</td>
</tr>
</tbody>
</table>
**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.

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.

A review of existing tax exemptions has been conducted and a plan approved for minimizing the exemptions.

- March 31
- March 31
- March 31
- April 30
- June 30
Table 3. Sierra Leone: Main Areas for Structural Reforms, 2006–08

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

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

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).

<table>
<thead>
<tr>
<th>Currency Pair</th>
<th>Exchange Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leone/US$</td>
<td>2.933</td>
</tr>
<tr>
<td>USS/Euro</td>
<td>1.180</td>
</tr>
<tr>
<td>USS/Pound</td>
<td>1.722</td>
</tr>
<tr>
<td>USS/SDR</td>
<td>1.429</td>
</tr>
</tbody>
</table>

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;\(^{11}\) (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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\(^{11}\) External budgetary assistance is defined as program grants and program loans, but excluding external financing for the Disarmament, 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.\(^{12}\) 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.

\(^{12}\) 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 maturing in less than 15 years.
Subsidies to the NPA

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

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

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

Government Accounts Data

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.