

## International Monetary Fund

[Sierra Leone](#) and the  
IMF

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[IMF Executive Board  
Completes Second  
Review Under PRGF  
Arrangement for  
Sierra Leone,  
Approves Extension  
of Arrangement and  
US\\$7.2 Million  
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July 7, 2008

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

June 5, 2008

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.

## SIERRA LEONE: LETTER OF INTENT

June 5, 2008

Mr. Dominique Strauss-Kahn  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431  
U.S.A.

Dear Mr. Strauss-Kahn:

1. On December 15, 2006, the Executive Board completed the first review under the three-year arrangement for Sierra Leone under the Poverty Reduction and Growth Facility (PRGF). On the same date, our country reached the completion point under the enhanced HIPC Initiative and qualified for MDRI relief.
2. In the attached Memorandum on Economic and Financial Policies (MEFP), we review recent economic developments and progress in the implementation of the PRGF-supported program during 2007 and sets out our main economic objectives over the medium term, as well as the policies that we intend to implement during the remainder of 2008.
3. Important fiscal slippages during the second half of 2006 prevented the completion of the second review as three end-December 2006 quantitative performance criteria (PCs) were missed. Owing to political inertia in the period surrounding the 2007 legislative and presidential elections, performance on the structural front was weak, but notable progress has been made since the beginning of 2008.
4. In order to address the fiscal situation and bring the PRGF-supported program back on track, the government took corrective actions, including the adoption of a cash–budget management system in April 2007. The cash–budget management system enabled the government to meet all quantitative PCs for end-June and end-December 2007 and most of the indicative targets for end-September. Also, the three structural PCs missed in 2007 have been implemented as prior actions for this second review, as were four structural benchmarks for 2007.
5. With the PRGF-supported program back on track and the promising progress in 2008 that will be consolidated in the period ahead, we are requesting waivers for the nonobservance of the three end-2006 quantitative PCs.

6. In support of our policies described in the MEFP, the government of Sierra Leone requests the completion of the second review under the PRGF arrangement and the disbursement of the third loan of SDR 4.4 million. The government also requests a one-year extension of the PRGF arrangement to provide sufficient time to complement the fifth and sixth reviews.

7. The government of Sierra Leone believes that the policies set forth in the attached MEFP are adequate to achieve the objectives of its program for 2008, but stands ready to take any further measures that become necessary for this purpose, in close consultation with the Fund. The third and fourth reviews shall take place in November 2008 and May 2009, respectively based on the end-June 2008 and end-December 2008 quantitative PCs and the applicable structural PCs. The government of Sierra Leone will also continue to provide the staff of the Fund with the information required to accurately assess Sierra Leone's progress in executing the policies contained in the attached MEFP. Furthermore, it will continue to consult with the IMF on its economic and financial policies, in accordance with the Fund's policies on such consultations.

8. The government of Sierra Leone agrees, in line with its commitment to transparency and accountability, to the publication of this letter, its attachments, and the related staff report.

Very truly yours,

/s/

David O. Carew  
Minister of Finance and Economic Development

Attachments

**ATTACHMENT I. SIERRA LEONE: MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES  
FOR 2008**

June 5, 2008

**I. INTRODUCTION**

1. Sierra Leone continues making progress in consolidating political stability as demonstrated by the smooth and peaceful Presidential and Parliamentary elections held in August and September of 2007. However, important challenges remain, including widespread poverty, high unemployment, poor infrastructure and weak institutional and human capacity. The government is committed to addressing these challenges through policies aimed at maintaining a stable macroeconomic environment, strengthening public financial management, improving transparency and governance, and stimulating pro-poor economic growth.

2. In this memorandum, the government of Sierra Leone describes recent economic and financial developments and performance under the program in 2007, and the economic and financial policies to be implemented during 2008 in the context of the Poverty Reduction and Growth Facility (PRGF) arrangement with the Fund.

**II. RECENT ECONOMIC DEVELOPMENTS AND PERFORMANCE UNDER THE PROGRAM**

3. **Macroeconomic performance in 2007 was uneven.** Output growth is estimated to have reached 6.8 percent based on solid agricultural and mining production and buoyant construction and service sectors. Consumer price inflation reverted to double digits, increasing to 13.8 percent year-on-year in December, and driven by higher food and petroleum prices.<sup>1</sup> The external current account deficit, including official transfers, is estimated to have slightly increased (from 3.5 percent of GDP in 2006 to 3.8 percent of GDP in 2007), owing to the continued deterioration in our terms of trade. International reserves were accumulated, reaching US\$208 million (4.5 months of imports coverage). The nominal exchange rate of the Leone against the US dollar, as well as the real effective exchange rate remained broadly stable.

4. **Shortfalls in revenue and delays in the disbursement of external budgetary support complicated budget execution.** The shortfall in domestic revenue that occurred during the second half of 2006 continued in 2007 and reached 2.4 percent of GDP. The shortfalls were mainly explained by: (i) uncertainties created by the prolonged election process, which led businesses to adopt a “wait-and-see” attitude; (ii) the adverse impact of the energy crisis on corporate profits; (iii) discretionary duty waivers and other tax exemptions granted to selected importers; (iv) late enactment of the 2007 finance bill which prevented the timely

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<sup>1</sup> Partly caused by supply disruptions resulting from a ban on export of agricultural products by Guinea and a shortage of imported goods during the election period.

implementation of new rates for royalties and excise taxes; (v) a reduction in the taxation of petroleum products that was adopted to limit increases in pump prices; and (vi) inadequate collection efforts across all revenue departments. Delays in external budgetary assistance<sup>2</sup> were caused in part by a lack of adequate fiduciary controls by the Sierra Leone government (unpublished audited financial statements). Donors also adopted a cautious stance as the second PRGF review could not be completed.

5. **The government adopted in April 2007 a cash-budget management system to preserve macroeconomic stability in the face of continued shortfalls in revenue and delays in external budget support.**<sup>3</sup> Adherence to the cash–budget system prompted the government to severely curtail expenditure payments and limit bank financing, resulting in a lower-than-programmed overall fiscal deficit on a cash basis. However, due to absence of appropriate mechanisms to control expenditure commitments, cuts in cash expenditures were not accompanied by a commensurate compression in spending commitments. As a result, unpaid claims amounting to Le 41.1 billion (0.8 percent of GDP) were accumulated throughout the year.

6. **The cash-budget management system enabled the government to meet the quantitative performance criteria (PCs) under the PRGF-supported program.** All quantitative PCs for end-June and end-December 2007, and most of the indicative targets for end-September 2007 were met. However, the cash-budget management system deprived the government of the fiscal space to meaningfully implement its poverty reduction strategy. Thus, the target for poverty-reducing spending was missed at all test dates.

7. **On the other hand, there were notable delays in structural reforms in 2007.** In particular, a comprehensive strategy for the reform of the financial sector was not adopted (end-September PC), and fiscal and monetary data were not reconciled (end-December PC). Also, four of eight structural benchmarks were missed. The government has given a new impetus to the structural reform agenda and has made significant progress since the beginning of 2008 (¶ 40).

8. **Growth in monetary aggregates on a year-on-year basis to end-December 2007 was significantly higher than the program targets, reflecting primarily an increase in foreign assets.** As of end-December 2007, reserve money grew by 26 percent against projections of 15.6 percent due to higher-than-anticipated banks' reserves. Growth in broad money, at 25.9 percent, was higher than projected, partly due to increased demand for currency during the festive season, which translated into an increase in currency in circulation. Inward remittances were also significant causing an increase in the net foreign assets of the commercial banks, which in turn translated into an increase in foreign deposits at the commercial banks.

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<sup>2</sup> From the European Union, the World Bank, and the United Kingdom's Department for International Development (DfID).

<sup>3</sup> Budgetary assistance expected in the fourth quarter of 2007 from DfID was disbursed towards end-December and budgetary assistance expected from the European Union was delayed until March 2008.

While the expansion of bank credit to government was contained, private sector credit largely exceeded projections as commercial banks continued to increase their lending activities. The year-on-year growth in bank credit to the private sector reached almost 40 percent at end-December 2007.

**9. Nonperforming loans have risen alongside the expansion of private sector credit.**

Medium-term loans to finance construction activities took a larger part of banks' lending portfolios—traditionally dominated by short-term commercial credits (in the form of lines of credit to finance imports). This increase along with the growing number of non-performing loans in banks' balance sheet has raised concerns about asset quality (nonperforming loans accounted for 31.7 percent of gross loans at end-2007). Further compounding the situation was the delay in government payment to suppliers, which has led the latter to default on their loans. In addition, capacity constraints continue to hamper the BSL's banking supervision efforts, particularly in enforcing prudential norms and regulations. In accordance with the BSL Act 2000 and on the basis of the memorandum of outstanding (MOU) reached with the government on October 14, 2006, a five-year interest-bearing bond equivalent to Le 50 billion was issued in January 2008 to partially recapitalize the BSL by providing it with the minimum paid-up capital.

**10. We maintained budget discipline during the first quarter of 2008.** Domestic revenue collection improved in quarter 1, 2008 with total revenue collected exceeding the quarterly target of Le 149.5 billion by Le 1.4 billion. The better outturn is mainly due to a stricter enforcement of tax laws. Total expenditures were less than budgeted due to under-spending in recurrent and externally-funded capital expenditures. Domestically-financed capital expenditure was, however, higher-than-budgeted due to the payment of Government's contribution (of Le 22.2 billion ) towards the completion of the Bumbuna Hydroelectric Project. The overall budget deficit, on a commitment basis, and the domestic primary deficit were within targets. Domestic financing of the budget deficit was less than projected.

**11. Growth in monetary aggregates slowed down in the first quarter of 2008, due to a reduction in net foreign assets.** On a year-on-year basis, broad money and reserve money grew by 17.5 and 18.4 percent respectively (against projections of 19.0 and 19.8 percent, respectively) as the increase in net foreign assets was lower than anticipated due to the nondisbursement of anticipated budgetary assistance.

### **III. MEDIUM-TERM MACROECONOMIC FRAMEWORK**

**12. Our main objectives over 2008-10 are to maintain a stable macroeconomic environment, promote sustained and broad-based high real growth, and revitalize the structural reform agenda.** The macroeconomic framework projects average real growth of around 6 percent during 2008–10, driven by the agricultural, mining, construction, and services sectors. Economic activity will be sustained by increased public investment in infrastructure,

more reliable power supplies,<sup>4</sup> and reforms geared to improving the business environment. End-of-period inflation will be reduced to single digits by 2010 and gross external reserves are programmed to remain in the range of 3.5–4 months of imports coverage.

**13. Fiscal policy over the medium term will aim at limiting debt-creating domestic financing while stepping up investment in infrastructure.** Domestic revenue is expected to improve, rising from 10.8 percent of GDP in 2007 to 13.4 percent by 2010 predicated on an improvement in the tax and customs administrations and a broadening of the tax base (¶ 14). Current expenditure will be stabilized at about 15 percent of GDP while making room for a gradual increase in poverty-related expenditures from 3 percent of GDP in 2007 to 6 percent by 2010 and will be targeted to improving access to basic social services (education, health) and public facilities (water, electricity, feeder roads). The domestic primary fiscal deficit will be lowered to 1.5 percent of GDP by 2010. Program financing will mostly rely on donor support of the government's poverty reduction strategy and the use of MDRI resources.

**14. Improvement in domestic revenue mobilization will remain a key objective of fiscal policy.** The government approved the NRA modernization plan in February 2008 and commenced its implementation, drawing on recommendations of recent IMF technical assistance missions. The NRA will be strengthened to enable it to improve field audits, enforce tax payment, collect tax arrears, and step up anti-smuggling activities. The design and plans for implementation in early 2009 of a value added tax (called the Goods and Services tax—GST) are at a very advanced stage. The government will also seek to minimize tax incentives and holidays that narrow the tax base, notably by reviewing existing mining contracts. The government has established a Mining Agreement Review Committee, comprising key ministers and heads of government agencies to examine the terms of each agreement, and assess the extent to which the government of Sierra Leone is deriving optimal benefits from the exploitation of its natural resources.

**15. Monetary policy will aim at controlling base money growth so as to contain inflation.** The government will continue to strengthen the operational capacity of the BSL by: (i) recapitalizing it; (ii) looking at ways to improve its income situation until full recapitalization is achieved; and (iii) providing it with additional interest bearing securities to support its monetary policy operations. Monetary policy will continue to be conducted using market-based instruments, mainly interventions on the weekly foreign exchange auctions, and open market operations using treasury bills and bearer bonds.

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<sup>4</sup> Since the World Bank-supported EPP became operational in late December 2007, there has been a marked improvement in power generation. Also, the Bumbuna Hydroelectric Project is expected to be completed in early 2009.

16. **Public financial management (PFM) will be improved to ensure greater transparency, accountability and efficiency in the use of public resources.** The government recognizes that the efficient and strategic use of public resources is critical to fighting poverty. In this context, the legal and regulatory framework for PFM will continue to be strengthened, in light of Fund TA recommendations. Efforts will continue to deepen the medium-term expenditure framework process, with emphasis on strategic planning and performance-based budgeting to ensure that the budget activities are consistent with the PRSP objectives. Due to technical problems, only a few ministries are currently using the Integrated Financial Management Information System (IFMIS) to process transactions. Efforts to extend the system to strengthen commitments and expenditure controls will be accelerated. Internal audit capacity will also be fortified by establishing functional internal audit units in key MDAs. An update of the PFM national action plan (NAP) reflecting these priorities and taking into account the finding of the recent World Bank-led Public Expenditure and Financial Accountability Assessment is being prepared with donors' assistance and should be completed by end-2008. An integrated and prioritized PFM reform program is under preparation with support from our development partners to consolidate the progress made in the first phase of PFM reforms.

17. **The government will continue reforming the public procurement system.** To this end, the National Public Procurement Authority (NPPA) will be adequately staffed and made operational. Also, as required by the Public Procurement Act, quarterly procurement bulletins will be issued on a timely basis and information on approved procurement plans, notice of invitations to bid, contracts awarded and unit prices for contracts will be published on the NPPA website.

18. **A new generation poverty reduction strategy (PRS) that will anchor our economic policies for the next three years is being prepared.** The first PRS, which covered 2005–07, had three main pillars. Pillar I focused on achieving good governance, peace and security, Pillar II on achieving sustainable economic growth for food security and job creation, and Pillar III on human development. Preparations are underway to finalize by end-2008 a second PRSP following wide public consultation. The new PRSP will cover up to 2011 and will aim at consolidating the progress made in implementing the programs and policies outlined in the first PRSP with a shift in priorities towards growth-enhancing sectors, in particular infrastructure (roads, energy) and agriculture, while facilitating private sector development.

#### IV. POLICIES FOR THE REMAINDER OF 2008

19. The economic program for 2008 aims to achieve real GDP growth of 6 percent, based on a projected significant increase in public and private investment. Average inflation is now targeted at 14.1 percent (against the original 8 percent and 11.7 percent in 2007), to take into account price surges in late 2007 and continued increases in world oil and food prices. The

external current account deficit is expected to widen because of a drop in exports<sup>1</sup> and an increase in investment-related imports as well as fuel and food imports. Gross official reserves are expected to drop to 3.5 months of imports coverage.

### **Fiscal policy**

20. **Fiscal policy in 2008 will be geared at laying solid foundations for achieving higher economic growth and improving the welfare of the population.** The 2008 budget reflects policy aspirations of the new government and draws largely on Sierra Leone's PRS and donor-supported policy initiatives. Its key objectives are to (i) preserve macroeconomic stability through enhanced domestic revenue collection; (ii) promote sustainable economic growth through higher investments in basic infrastructures; (iii) strengthen capacities of public sector institutions; and (iv) enhance the quality of service delivery by improved efficiency, transparency, and accountability in public financial management.

21. **Measures are being taken to reverse the weak domestic revenue performance of the past two years and create fiscal space.** Projected domestic revenue for 2008 (11.9 percent of GDP) is predicated on the full impact of increases in licenses fees and royalties specified in the 2007 finance bill<sup>2</sup> and a steadfast implementation of new revenue-enhancing measures introduced in the budget for 2008. To ensure that the revenue target will be reached, the government will take the following additional short-term measures: (i) strengthening of fiscal controls, especially for enterprises that have declared successive losses over the course of several years; (ii) transferring all off-budget revenue items into the Consolidated Revenue Fund (proceeds from the sale of essential drugs at cost-recovery and fees paid by telecom services providers are yet to be transferred); (iii) eliminating discretionary tax and customs exemptions; (iv) requiring oil importers to pay duty upfront before the product is lifted to minimize revenue leakage resulting from under-declaration and pilferage; (v) strict enforcement of the tax code to ensure the payment of current tax liabilities and a significant amount of arrears owed by private enterprises; and (vi) adoption and enforcement of a code of conduct for all NRA staff. In May 2008, the government reinstated the import duty on petroleum products from a specific to an ad-valorem rate to protect revenue expected from the petroleum sector.

22. **On the expenditure side, the government will reallocate the 2008 budget envelope approved by parliament to make room for the clearance of arrears accumulated in 2007.** The budget provides for an increase in total expenditures of 3.1 percentage points of GDP from the depressed level in 2007 and reorients allocations to poverty-reducing programs and infrastructure projects. The wage bill, to be held at 6.1 percent of GDP, includes a 10 percent

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<sup>1</sup> Brought about by a temporary shutdown of the kimberlite mine to allow excavation work in 2008.

<sup>2</sup> The finance bill and statutory instrument for 2007 were enacted very late in the year.

increase in basic pay for civil servants and the hiring of more teachers and security personnel. Poverty-related expenditures would increase from 3 percent of GDP in 2007 to 5.6 percent in 2008, helped by MDRI resources (1.7 percent of GDP). Domestic interest payments are projected to increase slightly to finance the interest cost associated with the conversion of the non-interest bearing securities held by the BSL into interest bearing securities. Capital expenditure will rise from 3.5 percent of GDP in 2007 to 5.7 percent. The expenditure envelope is in line with conservative projections of external budget support and the need to limit domestic bank financing. The domestic primary fiscal deficit would be contained at 2.4 percent of GDP.

**23. The 2008 budget will be protected from any contingent liability stemming from the contract we entered into with a second independent power provider (IPP) in December 2007.** To this end, we have taken the following steps: (i) renegotiate the contract, with a view to reducing its cost and protecting the budget from any contingent liability; (ii) strengthen the billing and collection capacity of the NPA to enhance its ability to meet obligations; and (iii) initiate discussions with donors to seek additional financing if needed. In parallel, we have brought the contract before the Anti-corruption Commission (ACC) for investigation and possible prosecution if the legal procurement rules have been breached.

**24. Existing weaknesses in budget process and execution will be corrected.** Controlling expenditure commitment has been particularly challenging due in part to a lack of appropriate mechanisms requiring MDAs to seek prior approval by the MoFED. Thus, the government will adopt by end-June 2008 a decree that forbids MDAs from issuing local purchase orders or committing any other spending outside the commitment controls system at the Accountant General's Department. The government will, in addition, implement the following short-term measures to improve budget process and execution: (i) review commitment control procedures for different types of expenditures, including bulk purchasing, and strengthen adherence through training; (ii) streamline budget execution procedures and forms to improve efficiency and reduce delays; (iii) strengthen the functioning of Budget Committees to improve the management of budget execution in MDAs; and (iv) involve MDAs in cash flow planning through a modified PETS 1 form.

**25. The government will monitor closely budgetary developments to avoid the recurrence of domestic payment arrears.** The government will prepare and follow monthly cash flow plans consistent with available financial resources. A supplementary budget will be prepared in consultation with Fund staff if additional budget support becomes available. Should the government experience revenue and grant shortfalls in 2008, measures will be taken to cut nonessential current expenditures.

26. **The government will continue to conduct regular public expenditure tracking surveys (PETS).** Two surveys will be conducted in 2008 covering poverty reducing lines of expenditure. In addition, a special survey will be conducted to ascertain the number of health centers and primary schools that post information on their notice boards regarding resources received from the central government, local councils, and donors. Appropriate and stringent follow-ups will be instituted to ensure the full implementation of PETS recommendations by all concerned MDAs.

### **Monetary Policy and Exchange Rate Policy**

27. **Monetary policy in 2008 will aim at preventing inflation expectations from becoming entrenched.** The disbursement of external budgetary support and the use of MDRI resources are expected to increase inflationary pressures given their potential impact on money supply.<sup>3</sup> The BSL will conduct open market operations to control the growth of reserve money. The central bank's capacity to conduct monetary operations in 2008 will be enhanced by the conversion of an additional Le 47.5 billion from the outstanding non-interest bearing securities into marketable securities, in the context of the October 2006 MOU. In addition, the government is considering options to provide the BSL with a new capital injection, based on estimates of its streamlined medium-term expenditure needs and income-generating potential by converting an additional part of the BSL's holding of noninterest-bearing debt into interest-bearing securities. Secondary market operations will be enhanced and the spread in the BSL rediscount window will be reviewed to further deepen the inter-bank market. The Treasury bill and the Treasury bearer bond auction systems will be harmonized by end-2008, and the BSL will examine the market demand for the newly introduced one-year Treasury bill with a view to introducing more medium-term government papers. The BSL will pursue its efforts to create an efficient national payments system and will also explore the possibility of initiating a Real Time Gross Settlement System (RTGS), which is better suited for high-value transactions with lower settlement risks.

28. **The authorities will aim at increasing the flexibility of the exchange rate while minimizing short-term volatility.** The official exchange rate will continue to be determined through weekly foreign exchange auctions to meet the gross reserve target of the program. The foreign exchange market will remain free from restrictions on the making of payments and transfers for current transactions. Official foreign reserves are programmed to slightly decrease to US\$185.9 million at end-2008, equivalent to 3.5 months of imports (against 4.5 months of imports at end-2007).

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<sup>3</sup> Resumption of normal commercial activities by importers and the lifting of the ban on export of agricultural products by Guinea should alleviate some of the pressures on food prices in 2008.

## External Sector Policies

29. **The government will continue to improve external debt management capacity and will adhere to its commitment to avoid nonconcessional external borrowing.** It will remain current on its obligations to multilateral creditors. The government is continuing negotiations with non-Paris Club creditors to reach debt relief agreements consistent with the enhanced HIPC Initiative framework and on comparable terms to those that were granted by the Paris Club in January 2007. Preparations for another IDA supported debt buyback operation to extinguish long outstanding commercial and pipeline debts are in progress.

30. **The government remains committed to a liberal trade regime.** Sierra Leone's trade regime is already substantially liberalized and the alignment of external tariffs to the ECOWAS common external tariff has been completed. The government will rescind the ban imposed on exports of rice and palm oil by end-September 2008.

## Other structural reforms

31. **The government will implement structural measures supportive of the private sector.** With the private sector expected to play a larger role in economic development, our structural reform agenda will be directed at strengthening the financial sector, reestablishing the financial viability of public utility companies, reinforcing governance and the judicial system, and privatization of public enterprises. The support of our development partners will remain critical to implementing the structural reforms envisaged in each of these areas.

32. **The government will actively pursue reform of the financial sector to deepen financial intermediation and ensure a more competitive and vibrant financial environment.** A comprehensive strategy for the reform of the financial sector, which benefited from the results of the 2006 FSAP, was finalized by the central bank in May 2008. We also plan to finalize by end-2008 a broader financial sector development plan with the support from the Fund and the World Bank. Specific actions that will be taken to improve financial intermediation include: (i) establishing the administrative and regulatory structures for the commencement of full-fledged stock market trading in 2008; (ii) increases in required capital for banks; (iii) improvement to the check clearing system; (iv) introduction of RTGS and enhancement of the domestic payments platform; (v) establishment of community banks; (vi) development of an operational securities market, and (vii) establishment of a Financial Intelligence Unit to underpin implementation of the Anti-Money Laundering Act.

33. **The government is committed to strengthening the financial situation of the power and water utilities.** The NPA will be made more efficient and its financial viability reestablished. NPA's management will be strengthened and a comprehensive electricity tariff policy with a view to cover the generation and distribution costs will be adopted by end-December 2008 on the basis of detailed quarterly financial reports, for the first and second

quarters of 2008; these reports will be finalized by end-September. The new tariff structure will include automatic adjustments for changes in NPA's costs and an acceptable power purchase agreement between the owners of the Bumbuna Hydroelectric Project and NPA, which should ensure that the full cost of the power is passed on to the consumers. With regard to the water company, the government will undertake a tariff review as well as improve billing and fee collection and put in place legislation to prevent illegal connections.

34. **The government is committed to promoting good governance.** A key component is strengthening the ACC. We have already appointed a new Commissioner and revised the Anti-Corruption Act. An important constraint is that the ACC is not responsible for prosecution as cases of corruption are referred to the Attorney-General and the Minister of Justice. The government has adopted a revised Anti-corruption Act and tabled it before Parliament. The revised ACC Act allows for more efficient resolution of corruption cases and brings the Act into conformity with the UN and African Union conventions. A new national anti-corruption strategy and action plan have been prepared and agreed on by all stakeholders (ACC, government, and civil society).

35. **The privatization program will be revitalized.** The scheduled 2007 privatization of three state-owned enterprises, two of them commercial banks, was delayed. With funding from DfID, work is in progress to commence the privatization of these two commercial banks. A number of other state-owned enterprises are scheduled to be privatized in the medium term. The National Commission for Privatization has prepared terms of reference for consultancy studies on three other state-owned enterprises. The government will ensure that the privatization program remains on track and that the divestiture process be conducted in a transparent way in line with existing regulations.

36. **The legal framework governing the operation and output of the mining sector will be revised.** The government will update the general fiscal regime for the mining sector as reflected in relevant legislations such as the Mines and Minerals Act, the Income Tax Act, and the Customs Tariff Act. The aim will be to increase transparency and accountability in the sector's fiscal regime and to make the sector internationally competitive. The government will also fulfill its commitments under the EITI, including the establishment of an operational secretariat which will be in charge of the implementation of the EITI in Sierra Leone.

## V. RISKS

37. **Two major risks may affect the implementation of the program but measures are being taken to mitigate them.** First, adverse external shocks, such as continued increases in world oil and food prices, may fuel demands to reduce tax and import duties on certain products, further undermining revenue performance. Second, public pressures to quickly improve social indicators, including wage increases could make it difficult for the government to adhere to the agreed spending envelope for 2008. The government continues to endeavor to

strengthen consensus among political and social players concerning the need to quickly improve revenue mobilization. The government will enhance its capacity to deal with exogenous shocks by taking proactive monetary and fiscal policies and seeking to mobilize additional external resources.

## VI. PROGRAM MONITORING

38. The program will be monitored based on quantitative performance criteria and benchmarks set for end-June and end-December 2008 and structural performance criteria and benchmarks during 2008, as indicated in Tables 1 and 2 annexed to this attachment.

39. To ensure effective monitoring, the Economic Policy and Research Unit (EPRU) in the Ministry of Finance will be restructured to undertake a more proactive role in program monitoring and consistent with the new broader ministerial structure. The EPRU's activities will be supported by weekly meetings of the Net Domestic Financing (NDF) Technical Committee. The Inter-Agency Committee for National Statistics will meet monthly with a view to improving the timeliness and reliability of relevant statistics. The government will provide the statistical data and information as described in the Technical Memorandum of Understanding (Attachment II), as well as any other information deemed necessary or requested by Fund staff for program monitoring.

40. **To keep the program firmly on track, we have completed a number of the prior actions agreed with the staff.** In the fiscal sector,

- a three-year modernization plan for the NRA has been adopted by the cabinet and approved by parliament;
- the 2008 finance bill and the statutory instrument have been enacted; and
- the revenue target for the first quarter of 2008 (Le 149.5 billion) has been met.

On the structural front,

- a comprehensive strategy for the reform of the financial sector has been adopted by the BSL, drawing on the recommendations of the FSAP;
- the fiscal data and the expanded monetary data produced by the BSL for end-June 2007 have been reconciled;
- a Steering Committee for the implementation of the Plan for National Anti-Corruption Strategy Agreement has been established; and
- statistics units have been established in key MDAs to collect and assemble information relevant for the compilation of socio-macroeconomic data by Statistics Sierra Leone (SSL); a framework for cooperation between SSL and these units has been agreed upon.

**Table 1. Sierra Leone: Quantitative Performance Criteria and Indicative Targets for 2008–09**(Cumulative change from beginning of calendar year to end of month indicated; Le millions , unless otherwise indicated)<sup>1</sup>

	2008					2009
	March		June	September	December	March
	Proj.	Act.	Performance Criteria	Indicative Targets	Performance Criteria	Indicative Targets
<b>Performance criteria</b>						
Net domestic bank credit to the central government (ceiling)	50,871	52,124	116,820	85,039	127,200	153,709
Net domestic assets of the central bank (ceiling)	37,565	21,810	90,080	58,043	179,209	138,436
Domestic primary budget balance of the central government (floor)	-46,798	-31,787	-81,355	-107,265	-137,446	-10,569
Subsidies to National Power Authority (ceiling) <sup>2</sup>	0	0	0	0	0	0
Gross foreign exchange reserves of the central bank, US\$ millions (floor)	-2.8	-1.2	4.5	-9.8	-23.2	7.3
Contracting or guaranteeing of new nonconcessional external debt by the public sector with maturities of one year or more (ceiling) <sup>2</sup>	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) <sup>2</sup>	0	0	0	0	0	0
External payment arrears of the public sector (ceiling) <sup>2</sup>	0	0	0	0	0	0
Total domestic government revenue (floor)	149,492	150,955	326,874	508,354	692,697	181,108
<b>Indicative target</b>						
Poverty-related expenditures (floor)	70,247	67,619	157,680	243,362	326,700	80,292
<b>Memorandum items:</b>						
External budgetary assistance <sup>3</sup>	32,230	0	0	143,043	211,200	26,900
Net credit to government by nonbank private sector <sup>4</sup>	-1,036	20,646	10,574	14,258	-6,909	-1,684
Disbursements under the PRGF (US\$ millions)	0.00	0.00	6.92	0.00	13.84	0.00

Sources: Sierra Leonean authorities; and IMF staff calculations.

<sup>1</sup> The performance criteria and indicatives targets shown in this table are defined in the Technical Memorandum of Understanding (TMU).<sup>2</sup> These apply on a continuous basis.<sup>3</sup> Including program grants and program loans.<sup>4</sup> Comprises treasury bills purchased by the National Social Security and Insurance Trust (NASSIT) and the nonfinancial private sector.

**Table 2. Sierra Leone: Structural Conditionality, 2008**

<b>Structural performance criteria</b>	<b>Timing</b>	<b>Macroeconomic Rationale</b>
<ul style="list-style-type: none"> <li>Provide to Fund staff the Monetary and Policy Committee (MPC) monthly minutes that include the monthly projections for government revenue and expenditures made available by the Ministry of Finance to the Bank of Sierra Leone to produce a monthly liquidity forecast</li> </ul>	On a continuous basis, starting in June.	To enhance liquidity management at the AGD and monetary forecasting at the BSL
<ul style="list-style-type: none"> <li>Promulgate the interest rate and penalties for under/late payment of tax and make them effective starting October 1, 2008.</li> </ul>	End-September	To raise taxpayer compliance
<ul style="list-style-type: none"> <li>Adoption by the cabinet of the implementation decree for the Goods and services tax (GST).</li> </ul>	End-December	To broaden the tax base and improve the efficiency of indirect taxation.
<b>Structural Benchmarks</b>		
<ul style="list-style-type: none"> <li>Adoption by cabinet and submission to parliament of the legislation for the introduction of the GST.</li> </ul>	End-June	To ensure that the introduction of the GST in early 2009 is on track.
<ul style="list-style-type: none"> <li>Introduce a Tax Identification Number (TIN) system and make it effective.</li> </ul>	End-September	To enhance taxpayer compliance.
<ul style="list-style-type: none"> <li>Adopt a comprehensive tariff policy for the electricity sector that will strengthen the financial position of the National Power Authority.</li> </ul>	End-December	To improve financial viability of the public utility and prevent potential fallout on public finances.

## ATTACHMENT II. SIERRA LEONE: TECHNICAL MEMORANDUM OF UNDERSTANDING

June 5, 2008

### I. 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 and structural performance criteria (PCs) and benchmarks for the remainder of the program supported by the Poverty Reduction and Growth Facility (PRGF) arrangement, as well as the related reporting requirements. Unless otherwise specified, all quantitative PCs and indicative targets will be evaluated in terms of cumulative flows from the beginning of the period, as specified in Table 1 of the Memorandum of Economic and Financial Policies (MEFP) of the Government of Sierra Leone (GoSL) for 2008.
2. **Program exchange rates.** For the purpose of this TMU, foreign currency denominated transactions will be converted into Sierra Leonean currency (leones) using the program exchange rates shown in the box below and the market exchange rate against the US\$ in effect on March 31, 2008 (as published in *International Financial Statistics*) for transactions in other currencies than the US dollar, the Euro, the U.K. Pound, and the Special Drawing Rights (SDR).

Leone/US\$	3,223
US\$/Euro	1.41
US\$/Pound	2.01
US\$/SDR	1.64

### II. QUANTITATIVE PERFORMANCE CRITERIA

#### A. 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) are defined as reserve assets of the BSL. Reserve assets are defined in the IMF's *Balance of Payments Manual* (5<sup>th</sup> 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. **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—the downward adjustment will be capped at the equivalent of US\$20 million while the upward adjustment will be equal to the amount—if

any, exceeding US\$20 million;<sup>8</sup> (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-denominated liabilities (to residents and nonresidents).

### **B. Net Domestic Assets of the BSL**

5. **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). 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.

6. **Adjustment clauses.** The ceiling on the NDA of the BSL will be adjusted upward by the amount of the shortfall in the external budgetary assistance at the test dates, up to a maximum of US\$20 million. In the event of an excess in the external budgetary assistance greater than US\$20 million, the NDA ceiling will be adjusted downward by the amount exceeding US\$20 million. The leone value of the cumulative shortfall or excess in external budgetary assistance will be converted at the program exchange rates.

### **C. Net Domestic Bank Credit to the Central Government (NCG)**

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

- the net position of the government with commercial banks, including: (a) treasury bills; (b) bonds issued by the GoSL; (c) loans and advances; less (a) Central government deposits (defined to include account balances under the authority of controlling officers, but excluding deposits in the sterilization account); plus
- BSL holdings of (a) GoSL statutory bonds; (b) ordinary GoSL 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 (a) special noninterest-bearing government stocks to cover foreign exchange valuation losses; (b) treasury bills and treasury bearer bonds held by the BSL for monetary policy operations; and (c) bonds issued by the GoSL in subscription to the paid-up capital of the BSL.

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<sup>8</sup> External budgetary assistance is defined as program grants and program loans, excluding HIPC assistance.

8. **Adjustment clauses.** The ceiling on the increase in NCG will be adjusted upward (downward) by up to the amount of the shortfall (excess) in external budgetary assistance. The upward adjustment will be capped at the equivalent of US\$20 million while the downward adjustment will be equal to the amount—if any, exceeding US\$20 million. 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 1 of the MEFP).

9. **Data source.** The data source for the above will be the series “Claims on Government (Net)” submitted to Fund staff and reconciled with the monthly monetary survey prepared by the BSL. These data will be reconciled with monthly reports with the monetary data (Treasury bill transactions, ways-and-means account, and Treasury bearer bond transactions).

10. **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 and public enterprises are excluded from this definition of central government.

#### **D. Domestic Revenue of Central Government**

11. **Definition. The floor on total domestic central government revenue** is defined as total central government revenue, as presented in the central government financial operations table, excluding external grants.

#### **E. Domestic Primary Budget Balance of Central Government**

12. **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, and externally-financed capital expenditure.

#### **F. Subsidies to the National Power Authority (NPA)**

13. **Definition.** The term “subsidy” refers to any financial government support (i.e., unrequited transfers) to the 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 PC will apply on a continuous basis.

### **G. External Payment Arrears of the Public Sector**

14. **Definition.** External payment arrears of the public sector are defined as the stock of new external overdue debt-service payments by the public sector. For the purposes of this PC, the public sector comprises 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 PC are those debts subject to rescheduling. This PC will apply on a continuous basis.

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

15. **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.<sup>9</sup> This PC 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. Excluded from this PC are disbursements from the IMF and those debts subject to rescheduling. For the purposes of this PC, the “public sector” is as defined in ¶ 14 above. This PC will apply on a continuous basis.

### **I. External Short-Term Debt Contracted or Guaranteed by the Public Sector**

16. **Definition.** 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 I 1 of this TMU. For this purpose, short-term debt will exclude normal trade credit for imports. For the purposes of this PC, the public sector is as defined above. This PC will apply on a continuous basis.

## **III. QUANTITATIVE PERFORMANCE INDICATORS**

### **Poverty-related Expenditures**

17. **Definition.** Poverty-related expenditures refer to those expenditures in the areas identified in Table 2 of the Sierra Leone HIPC Decision Point Document (EBS/02/30). 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.

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<sup>9</sup> 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.

#### **IV. STRUCTURAL PERFORMANCE CRITERIA**

18. The government will complete the following actions:
- The Ministry of Finance will provide monthly projections for government revenue and expenditures to the BSL for use in producing a monthly liquidity forecast to be transmitted to the Monetary Policy Committee, which will meet monthly to provide guidance on the stance of monetary policy in the month ahead. Minutes of each meeting will be transmitted to Fund staff (on a continuous basis).
  - Promulgate the interest rate and penalties for under/late payment of tax and make them effective starting October 1, 2008 (by end-September 2008); and
  - Adoption by the cabinet of the implementation decree for the Goods and services tax (GST) (by end-December 2008).

#### **V. STRUCTURAL BENCHMARKS**

19. The government will complete the following actions by the specified dates:
- Adoption by cabinet and submission to parliament of the legislation for the introduction of the GST (by end-June 2008);
  - Introduce a Tax Identification Number (TIN) system and make it effective (by end-September 2008); and
  - Adopt, with assistance from the World Bank, a comprehensive tariff policy for the electricity sector that will strengthen the financial position of the NPA (by end-December 2008).

#### **VI. PROGRAM MONITORING**

20. The Sierra Leonean authorities shall maintain a program-monitoring committee composed of senior officials from the Ministry of Finance and Economic Development; the Bank of Sierra Leone, and other relevant agencies. The committee shall be responsible for monitoring performance under 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 PCs and benchmarks. In addition, the Net Domestic Financing Technical Committee shall provide the Fund with weekly minutes of its meetings complemented with the minutes of the monthly meetings of the Inter-Agency Committee for National Statistics progress report on the program on a monthly basis within four weeks of the end of each month, using the latest available data.

## **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: Summary of Data to Be Reported to IMF Staff

Type of Data	Tables	Frequency	Reporting Deadline
Real sector	National accounts	Annual	End of year + 9 months
	Revisions of national accounts	Variable	End of revision + 2 months
	Disaggregated consumer price index	Monthly	End of month + 2 weeks
Public finance	Net government position and details of nonbank financing, including the stock of the float, treasury bills, and bonds, as well as privatization receipts	Monthly	End of month + 4 weeks
	Government flow-of-funds table (Government Financial Operations Table) with supporting documentation (final) and presented on commitment and cash basis	Monthly	End of month + 4 weeks
	Petroleum product pricing formula, tax receipts by categories of petroleum products	Monthly	End of month + 4 weeks
	Stock of outstanding payment commitments with a breakdown between current and capital expenditures	Monthly	End of month + 4 weeks
	Import duty exemptions by end-users and tariff regimes and estimates of corresponding revenue losses	Quarterly	End of quarter + 6 weeks
Monetary and financial data	Monetary survey	Monthly	End of month + 6 weeks
	Balance sheet of the central bank	Monthly	End of month + 6 weeks
	Consolidated balance sheets of commercial banks	Monthly	End of month + 6 weeks
	Borrowing and lending interest rates	Monthly	End of month + 6 weeks
	Results of foreign exchange and Treasury Bills auctions	Weekly	End of week + 3 days
	Stocks of government securities	Monthly	End of month + 6 weeks
	Banking supervision ratios	Quarterly	End of quarter + 8 weeks
	Gross official foreign reserves	Weekly	End of week + 3 days
	Foreign exchange cashflow table	Quarterly	End of quarter + 4 weeks

## Sierra Leone: Summary of Data to Be Reported to IMF Staff (continued)

Type of Data	Tables	Frequency	Reporting Deadline
Balance of payments	Balance of payments	Annual	End of year + 3 months
	Revised balance of payments data	Variable	When revisions occur
	Exports and imports of goods (including a volume of key minerals and fuels)	Monthly	End of month + 3 months
External debt	Outstanding external arrears and repayments (if applicable)	Monthly	End of month + 4 weeks
	Details of all new external borrowing and guarantees provided by government on new borrowing	Monthly	End of month + 4 weeks
	External debt service payments (separately on principal and interest payment) to each creditor	Monthly	End of month + 4 weeks
HIPC Initiative and MDRI Monitoring	Statement of special account at the BSL, that receives resources generated by the HIPC Initiative and tracks their use	Monthly	End of month + 4 weeks
	Statement of special MDRI account at the BSL and the corresponding poverty-reducing spending financed	Monthly	End of month + 4 weeks
	Minutes of the meeting of the Net Domestic Financing (NDF) Technical Committee	Weekly	End of meeting + 2 weeks
	Minutes of the meeting of the Monetary Policy Committee	Monthly	Date of meeting + 2 weeks