International Monetary Fund

Sierra Leone and the IMF

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

May 18, 2010

May 18, 2010

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

Dear Mr. Strauss-Kahn:

The attached Memorandum of Economic and Financial Policies (MEFP) describes recent economic developments and progress in the implementation of the ECF-supported program during the second half of 2009 and presents our policies for the medium-term under a new ECF-supported program. To support the implementation of the program, the Government of Sierra Leone (GoSL) requests a new three-year arrangement under the ECF in a total amount equivalent to SDR 31.11 million (30 percent of quota). We also request that the first disbursement, in an amount equivalent to SDR 4.44 million, be made available after the approval of the ECF arrangement by the Executive Board of the IMF.

All quantitative performance criteria for end-December 2009 were met, except for one. The target on domestic primary fiscal balance was moderately exceeded, reflecting in part the use of higher external budget support. Higher government spending towards the end of the year and difficulties in rolling over treasury securities led to an expansion of liquidity. However, monetary policy was tightened in the first quarter of 2010, where reserve money was kept unchanged despite a 7 percent jump in the price level related to the introduction of the goods and services tax.

On the structural reform program, the continuous structural benchmark on the monthly meeting of the Monetary Policy Committee was met, so was the introduction of the GST on January 1, 2010. The structural benchmark on recruitment of budget officers was not met on time, but it has now been completed. Two unmet benchmarks on tax administration will be included as structural benchmarks in the new program.

In light of the above, the GoSL requests a waiver related to non-observance of one performance criterion and that the seventh disbursement be made available upon completion of the sixth review under the ECF arrangement.

The GoSL believes that the policies set forth in the attached MEFP and Technical Memorandum of Understanding (TMU) are adequate to achieve the objectives of the new program, but stands ready to take any further measures that become necessary for this purpose, in consultation with the Fund. The GoSL will consult with the Fund in advance of revisions to the policies contained in the MEFP and continue to provide the staff of the IMF the information required to accurately assess Sierra Leone's progress in executing the policies in the MEFP. The first and second review under the new program shall take place in December 2010 and June 2011, respectively. Furthermore, the GoSL will continue to consult with the IMF on its economic and financial policies, in accordance with the IMF's policies on such consultations.

The GoSL agrees, in line with its commitment to transparency and accountability, to the publication of this letter, its attachments, and the related staff report in accordance with the procedures for publication.

Very truly yours,

/s/
Samura M. W. Kamara
Minister of Finance and Economic Development

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

Memorandum of Economic and Financial Policies

I. Introduction

1. This memorandum reviews recent economic developments and outlines the macroeconomic policies and structural reforms that the Government of Sierra Leone (GoSL) will pursue under a new three-year Extended Credit Facility (ECF).

II. Recent Economic Developments

2. **Macroeconomic performance in 2009 weakened due to the global recession.** Economic growth continued to decline in the first half of 2009 due to falling global demand and declining foreign inflows from remittances. Despite a pickup in exports of diamonds and cash crops in the second half of 2009 and buoyant domestic food production, real GDP growth is estimated to have slowed down to 4 percent in 2009 compared with 5.5 percent in 2008. Lower fuel and domestic food prices eased inflationary pressures in the first half of 2009. However, the depreciation of the leone in the second half contributed to a rebound in inflation to 10.8 percent in December. During the first two months of 2010, inflation jumped to about 17 percent, reflecting the introduction of GST on January 1 and higher domestic fuel prices.

3. **Fiscal policy performance during 2009 was broadly satisfactory.** The domestic revenue target was met by a solid margin as import duties rose significantly. While current expenditures were slightly higher than envisaged, capital expenditures were lower due to a shortfall in externally financed projects. Higher budget grants and domestic revenue collections along with a moderate increase in expenditures reduced the overall deficit to 3.2 percent of GDP in 2009 from 4.7 percent in 2008 and 4.4 percent in the program. However, the domestic primary fiscal deficit, at 4.0 percent of GDP, was slightly higher than programmed.

4. **Monetary policy became more expansionary towards the end of 2009.** Reserve money grew faster than anticipated in 2009 (about 20 percent) with most of the expansion attributed to the last couple of months of the year. The increase in liquidity was due to significant government spending ahead of expected inflow of external budget support and difficulties in rolling over treasury bills towards the end of the year. The average interest rate on treasury bills increased from 9 percent end-2008 to 14 percent end-2009. However, the pace of credit growth to the private sector remained high in 2009 but the quality of the bank's loan portfolio improved reflected by a decline in the ratio of nonperforming loans (NPLs) to gross loans from 17.9 percent at end-2008 to 10.6 percent at end-2009.

5. **Exchange rate depreciated by about 28 percent against the US dollar in 2009.** This depreciation was mainly caused by a decline in export proceeds and transfers due to the global economic crisis. However, the exchange rate has stabilized around the levels observed in November-December 2009.

6. **All quantitative performance criteria for end-December 2009 were met, except for one (Table 1).** The target on domestic primary fiscal balance was moderately exceeded, reflecting in part the use of higher external budget support. Higher government spending towards the end of the year and difficulties in rolling over treasury securities led to an expansion of liquidity.

7. **Two of the seven structural benchmarks for the second half of 2009 were met (Table 2).** The continuous structural benchmark on the monthly meeting of the Monetary Policy Committee was observed, so was the introduction of the Goods and Services Tax (GST). The benchmark on recruitment of budget officers was observed but with delay due to late start of the Integrated Public Financial Management Reform Program. The benchmark for adoption by the BSL of new off-site surveillance guidelines for banks was not observed. Completion of this benchmark requires additional technical assistance, which is currently being provided. The restructuring of the NRA was delayed partly due to the challenges in implementing the GST; therefore, the benchmarks for the establishment of the Domestic Tax Department (DTD) and the integration of GST administration within the Large Taxpayer Office (LTO) were not met. Finally, the benchmark for adoption of a new tariff policy framework was not observed due to a change in strategy—the GoSL intends to adopt a cost-based formula for pricing electricity, which will be developed with technical assistance from the World Bank.

III. TAKING STOCK

8. **Since the end of the civil conflict, economic policies in Sierra Leone have focused on rebuilding the economy and laying the basis for long term growth**. The emphasis of the previous ECF-supported program was on strengthening the long-term basis for poverty reduction and development by maintaining macroeconomic stability and improving public services. Macroeconomic performance has been good in recent years: growth remained robust despite the global financial crisis, inflation came down to single digits, domestic revenue performance improved and international reserves increased.

9. **Progress has been made in implementing our structural reform program:**

- To improve the efficiency of revenue collections and broaden the tax base, a tax identification number (TIN) system was introduced, a new and modernized customs law consistent with the WTO agreement was adopted by Cabinet, and a small and medium taxpayer regime was put in place. Moreover, the GST was introduced and replaced seven other taxes to simplify and broaden the tax base.

- For better expenditure control, the rollout of the Integrated Financial Management Information System (IFMIS) now covers more than half of all transactions by the ministries, departments and agencies (MDAs) and the public expenditure tracking surveys (PETS) was integrated into the broader public financial management (PFM).

- Financial sector vulnerabilities were addressed by assessing the bank capitalization and credit quality of all commercial banks and raising the minimum paid-up capital requirement for licensed financial institutions. Credit to private sector has been growing rapidly reflecting financial sector deepening.

10. **While progress has been made over the last decade, significant challenges remain**. Sierra Leone remains a post-conflict country suffering from lack of infrastructure (roads, electricity, and water) and weak institutions. Despite economic growth in recent years, per capita income remains low, poverty is pervasive (at 60 percent of population), and Sierra Leone ranks at the bottom of UN's Human Development Index. Gross domestic investment is currently at about 15 percent of GDP, significantly lower than the sub-Saharan African average of 22 percent. Also, private sector development is constrained by limited access to financial services. While growing, credit to the private sector, at 9 percent of GDP, remains low compared to the sub-Saharan African average of 17 percent.

IV. Medium-Term Challenges and Policies

11. **The GoSL's key economic objective is to raise growth by increasing investments in infrastructure and developing an accessible financial sector.** In order to reduce poverty significantly and improve the lives of the majority of Sierra Leoneans, an annual growth rate of 6–10 percent is required for a sustained period of time. Consistent with the second Poverty Reduction Strategy Paper (PRSP II), the three-year program will focus on (i) creating fiscal space for improving basic infrastructure and social services while maintaining macroeconomic stability; (ii) strengthening tax performance and improving public financial management (PFM) systems; and (iii) developing the private sector.

12. **The medium term outlook for the Sierra Leonean economy is favorable.** Real GDP growth is expected to recover to 4.8 percent in 2010 and increase to at least 6 percent by 2012, benefiting from the recent completion of the Bumbuna power station, investment in basic infrastructure, and initiatives to improve the business climate and raise agricultural productivity. The global economic recovery will increase export demand for minerals and cash crops, which should contribute to exchange rate stability. Combined with expanding domestic food production, this should ease inflationary pressures. Monetary and exchange rate policies will also aim at returning to single-digit inflation, with inflation projected to decline from 12.5 percent in 2010 to 8 percent in 2012. However, import coverage of gross foreign exchange reserves will decline from the current relatively high level as imports recover with economic recovery and expansion in investment.

13. **Fiscal space will be achieved through several channels.** While pressing for scaling up of donor inflows, fiscal space will be created by broadening tax bases, containing non-priority spending, and raising public sector efficiency, especially on project selection and implementation.

14. **Domestic revenue is expected to increase over the medium term and expenditure will shift towards capital spending.** Reflecting efficiency gains from the introduction of GST and improvement in tax administration, the aim is to raise domestic revenue above 13.5 percent of GDP by 2012. To achieve this target, the GoSL will fully apply the fiscal regime stipulated in existing tax and customs acts and will resist issuing discretionary tax exemptions. In particular, new investment agreements in the mining sector will adhere to the fiscal regime stipulated in the Mines and Minerals Act 2009 and the Consolidated Income Tax Act 2000. With the emphasis on investment in infrastructure, the composition of expenditure will shift toward capital spending, which is projected to increase from 7 percent of GDP in 2009 to 9 percent of GDP by 2012. Non-wage current expenditures are expected to decline by about 1 percentage point of GDP because of the termination of the emergency power project. Although the wage bill is envisaged to be contained at around 6.7 percent of GDP, adjustments may have to be made in connection with the implementation of the public service pay reform in 2011–12. The GoSL is committed to ensuring that the overall central government deficit remains below 5 percent of GDP in 2010–12.

15. **The GoSL has launched a new free health care initiative for children under five years of age, pregnant women and lactating mothers.** The objective is to reduce the high infant and maternal mortality rates and achieve the Millennium Development Goals 4 and 5. The initiative involves the provision of cost-free medical care and drugs to these vulnerable groups. It provides significant improvements in the compensation to professional health workers to ensure the elimination of user fees in all government hospitals and health centers. While costs initially are largely borne by donors, the permanent additional cost of the initiative is currently estimated at 1.2 percent of GDP. The increase in staffing and wages in the health sector will raise the budgetary wage bill by about Le 28 billion in 2010 (0.4 percent of GDP) and by about Le 35 billion on a permanent basis taking into account the full year effect.

16. **Monetary policy will strive to achieve single-digit inflation**. Improvement in the coordination between the Ministry of Finance and Economic Development (MOFED) and the BSL will enhance the liquidity management framework. Moreover, the monetary policy framework will be strengthened by the introduction of a policy interest rate to guide the market. The BSL will also enhance foreign exchange management and promote an interbank foreign exchange market by moving to a wholesale foreign exchange auction system.

17. **The structural reform program will complement the improvements in infrastructure to promote higher sustainable private sector-led economic growth.** The program will focus on: (i) improving tax administration by making revenue collections more

efficient and effective to achieve domestic revenue target; (ii) improving public financial management to raise efficiency in public spending, particularly for capital spending, by improving Medium-Term Expenditure Framework (MTEF) process and rolling out IFMIS to more MDAs; and (iii) strengthening monetary operations and deepening the financial sector to enhance financial stability. In addition, policies will be implemented to ensure full pass-through of international market prices on fuel to the domestic market price to safeguard budget resources.

18. **To improve working conditions for the public service and to attract staff of high caliber, a multiyear pay reform will be implemented.** The reform will (i) realign current discrepancies in qualifications and grade placements; (ii) decompress the wage structure; (iii) retrench redundant staff; and (iv) gradually raise compensation to competitive levels financed partly from the restructuring and, if necessary, a moderate increase in the total public sector wage bill. The GoSL is seeking assistance from development partners to finance temporary costs for retrenchment and implementation. In contrast to the recent changes in pay conditions to the health sector, the pay reform will target the whole public service. The implementation of the pay reform will be budget neutral in 2010.

19. **Debt sustainability will remain a priority.** We are committed to a conservative strategy of external borrowing on concessional terms. A comprehensive national debt law and procedures manual will be adopted in 2010. In collaboration with the Public Debt Unit of MOFED, government agencies are working on improving the quality of debt data and reporting in order to better monitor commitments, disbursements, and debt service obligations. The Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) will be electronically linked with IFMIS. In order to further improve on debt management, the Government is requesting assistance from the World Bank and the Fund with respect to developing a comprehensive Medium-Term Debt Management Strategy (MTDS).

V. Policies for 2010

A. Fiscal Policy

20. **The overall fiscal deficit is projected to increase in 2010 despite higher domestic revenue.** The overall fiscal deficit is projected to increase from 3.2 percent of GDP in 2009 to 3.9 percent of GDP in 2010. Domestic revenue is projected to increase 0.7 percentage points to 12.4 percent of GDP because of higher imports, the full year effect of the increase in fuel excises by mid-2009, higher royalties on diamonds, and moderate efficiency gains across several tax categories. However, budget support grants are expected to decline by 1 percentage points to 3.9 percent of GDP, partly reflecting an unusually high level of support in 2009 to alleviate the effects of the global economic crisis.

21. **Expenditures will shift from current to capital spending.** Current expenditures are projected to decline from 15.6 percent of GDP in 2009 to 15.1 percent of GDP in 2010, while capital expenditures will increase from 7.1 percent in 2009 to 8.2 percent, mostly due to higher spending on basic infrastructure (roads and water supply projects). Wages and salaries are envisaged to increase from 6.3 percent of GDP in 2009 to 6.6 percent of GDP because of a more than doubling of salaries to health care workers from March 1 and hiring of about 1,300 new health care professionals. The wage bill for other public servants is expected to increase by about 15 percent, reflecting a 30 percent increase in basic salaries (basic salaries make up about half of the total compensation including various allowances).

22. **The GoSL has adopted a new tax incentive policy to attract new investments in several sectors.** Although relatively few new incentives have been introduced, the new policy consolidates several existing incentives from a number of sector-specific acts into the tax and customs acts and it promotes elimination of discretionary tax incentives and exemptions. To evaluate the costs and benefits of this policy, the GoSL will prepare a policy review by March every year covering the previous calendar year. This review will contain a list of all projects that have benefited from the catalogue of incentives, specify the purpose of the projects, and report foregone revenue. The review will be made publicly available and submitted to the Parliament.

23. **A new Mines and Minerals Act came into effect on January 1, 2010.** Together with the Consolidated Income Tax Act 2000, this new act defines the fiscal terms for mining operations in Sierra Leone. The key fiscal terms comprise royalties of 3–15 percent (depending on mineral type) and a 30 percent corporate tax. This new fiscal regime will apply to all future mining contracts. At present, diamonds produced by Koidu Holdings attract a royalty of 5 percent according to the development agreement. Consistent with the Mines and Minerals Act 2010, the revised royalty rate of 6.5 percent will be applied to all other diamond mining operators in 2010. All royalties will be collected by NRA and deposited into the Consolidated Revenue Fund.

24. **The GoSL has committed to the principles of Extractive Industries Transparency Initiative (EITI).** It launched in March 2010, the first EITI report on payments made by mining companies and revenues received by MDAs from the extractive sector for the fiscal years 2006–07. To enhance the transparency and accountability process, the EITI report and its findings are currently being disseminated to MDAs, mining companies, chiefdom leaders, civil society, and the general public. The next objective is to undertake a validation exercise to enable Sierra Leone become an EITI compliant country. In the medium-term, EITI reports will incorporate the oil, fisheries and timber sub-sectors.

B. Monetary and Exchange Rate Policy

25. **Monetary policy will aim to achieve an inflation rate of 12.5 percent by end-2010.** Monetary policy will be challenged by the first round effects on inflation arising from

the introduction of GST and expected higher domestic fuel prices. Reserve money is targeted to grow by 8 percent in 2010. This will still accommodate a robust expansion in credit to the private sector of about 30 percent, with unchanged international reserves. The BSL stands ready to use its monetary instruments more actively and raise interest rates, if necessary, to achieve the program targets.

26. **Exchange rate flexibility will be maintained.** The BSL will sell foreign exchange only to absorb foreign-financed budget spending and reduce short-term market volatility. The BSL will gradually reduce the amount offered on the foreign exchange auction as the effects from the global economic downturn dissipate.

C. Structural Reforms

27. **The overall pace of our reforms needs to be accelerated to complement the scaling up of public investments**. Policies for 2010 will focus on improving tax administration, strengthening PFM and developing the financial sector. Policies for the two latter areas will be based on the Integrated Public Financial Management Reform Program (IPFMRP) and the Financial Sector Development Plan (FSDP), respectively.

Improving tax administration

28. **The GoSL will step up efforts to improve tax administration and broaden the tax base**. The National Revenue Authority (NRA) will establish a DTD to bring all domestic tax administration under one organization (*Structural Benchmark for September 2010*). The current tax administration suffers from inefficiencies arising from separate tax departments for GST and income and it is not conducive to enhance tax compliance. The NRA will appoint a commissioner, DTD and a deputy commissioner for design and monitoring and bring the Income Tax Department (ITD) and GST departments under the umbrella of the DTD. In addition, the operations (taxpayer services, filing and returns processing, and coordinated audit operations) of GST and the LTO will be integrated (*Structural Benchmark for December 2010*).

29. **The NRA will step up efforts to improve tax collection and compliance.** In the past, penalties on overdue tax were promulgated but rarely imposed, hence compliance has been low. The NRA will work towards increasing compliance by providing information to taxpayers on what they need to pay and then following up through phone calls and letters. The MOFED will also assist the NRA in this endeavor to enforce tax compliance by providing specific product lists when approving duty free exemptions.

Strengthening public financial management

30. **The GoSL will strengthen the Medium-Term Expenditure Framework (MTEF) by enhancing the planning, monitoring and evaluation process for capital projects.** The legal framework governing the entry of projects into the budget and monitoring is

insufficient. Given the accelerated capital spending, planning, monitoring and evaluation of projects becomes even more important. With the assistance from the World Bank, GoSL intends to amend the legal framework to require that strategic priorities be set out in monitorable progress indicators for each MDA and project selection criteria be established such that only viable projects enter into the budget. The necessary legal amendments will be submitted to the Parliament (*Structural Benchmark for September 2010*).

31. **The Macro-Economic Fiscal Framework (MEFF) will be strengthened by developing an integrated macroeconomic forecasting model.** Budget planning is weak in the absence of credible forecasts. In a coordinated effort involving MOFED, the BSL, the SSL and the NRA, work is currently underway to develop a framework for producing fiscal forecasts that will help in preparing future budgets. A full set of forecasts is expected to be completed by June in order to feed into the 2011 budget cycle.

32. **The roll out of IFMIS to MDAs will continue to strengthen budget execution.** So far, IFMIS has been rolled out to 11 key MDAs with 2 additional MDAs in the process, accounting for about 65 percent of expenditures. The MOFED will continue to provide training and support to IFMIS users across MDAs to ensure that activities are properly and adequately captured within the system.

Financial sector measures

33. **The BSL will improve the conduct of monetary policy by establishing a benchmark interest rate** (*Structural Benchmark for September 2010*)**.** The reverse repo rate will be used as the benchmark rate and this rate will be announced after every Monetary Policy Committee meeting. This interest rate will be used to signal the stance of the monetary policy to the market.

34. **The independence of the BSL will be strengthened.** The GoSL commits to ensuring the operational independence of the BSL. To this end, the BSL and Banking Acts will be amended to ensure efficient management of monetary policy and to make the Banking Act consistent with international best practices in line with the Basel core principle. The government will continue to recapitalize the BSL by converting non-negotiable non-interest bearing securities into marketable instruments. In order to minimize the losses from its engagement in community banks, the BSL will expedite its exit.

35. **To develop a long-term capital market,** the MOFED and the BSL will engage market participants, including the commercial banks, NASSIT and other non-bank financial institutions, to develop a long-term bond market consistent with the government’s financing need. The GoSL will also strengthen the capital market regulatory structure and governance by enacting the Securities and Exchange Commission’s (SEC) Act and implement associated regulations, and deepen the long- term capital market with the privatization and divestiture of slated public enterprises.

36. **The BSL will strengthen its supervisory role to reduce the vulnerabilities arising in the financial sector from NPLs.** To this end, the BSL will adopt new off-site surveillance guidelines for banks (*Structural Benchmark June 2010*). The BSL will also build capacity to move towards risk-based supervision.

37. **Private sector development is constrained by limited access to financial services.** Lack of financial development is evident in low credit to the private sector. Access to credit will be enhanced by strengthening information structure through establishing a credit reference bureau (*Structural Benchmark for December 2010*). To improve efficiency of transactions in the economy, the BSL will work towards strengthening the payments and settlements system.

Domestic fuel pricing

38. ***The* GoSL will improve the transparency of the pricing framework for petroleum products by implementing an automatic price adjustment mechanism.** The present system of ad-hoc price adjustment poses a fiscal risk to the budget should international fuel prices continue their recent upward trend. To maintain fiscal prudence and depoliticize fuel pricing, the GoSL will adopt an automatic price adjustment mechanism to ensure full pass-through of changes in international prices (*Structural Benchmark for June 2010*). This new mechanism comprises (i) at least monthly domestic retail fuel price adjustments; (ii) a Le 1,000 per gallon cap on retail price changes (up or down) for each monthly adjustment; (iii) adjustment in fuel excises (up or down) to cover for the less than full pass through in the short term implied by the cap. The Strategic Petroleum Stock Fund, which was originally intended for financing a physical stock reserve of fuel and has now been depleted, will be eliminated. This will allow for the removal of the current Le 200 contribution to strategic stocks in the current formula.

D. Economic Statistics

39. **There is a need to strengthen Sierra Leone's capacity to collect and disseminate economic statistics.** Statistics of Sierra Leone (SSL) is seeking technical assistance from the IMF to improve the reporting of national account and price statistics. There is a particular need to improve collection of agriculture output and compute one single reliable consumer price index.

VI. Program Monitoring

40. The program for the first year will be monitored based on quantitative performance criteria for end-June and end–December 2010 (Table 3) and structural benchmarks for 2010 (Table 4).

Table 1. Sierra Leone: Quantitative Performance Criteria and Indicative Targets for 2009

(Cumulative change from beginning of calendar year to end of month indicated; Le millions, unless otherwise indicated) [1]

	December 2009			
	Perf. criteria *Prog.* [2]	Adjusted *targets*	*Prel.*	Met or Not met
Performance criteria				
Net domestic bank credit to the central government (ceiling)	151,223	179,497	108,994	Met
Unadjusted target (ceiling)		151,223		
Adjustment for the shortfall (excess) in external budget support		-4,381		
Adjustment for the issuance of treasury securities to the private sector		32,655		
Net domestic assets of the central bank (ceiling)	-368,577	-418,135	-429,852	Met
Unadjusted target (ceiling)		-368,577		
Adjustment for the shortfall (excess) in external budget support		-4,381		
Adjustment for exchange rate depreciation (appreciation)		-45,177		
Domestic primary fiscal balance of the central government (floor)	-246,785	-246,785	-254,191	Not met
Subsidies to National Power Authority (ceiling) [3]	0		0	Met
Gross foreign exchange reserves of the central bank, US$ millions (floor)	124	112.58	126.9	Met
Unadjusted target (floor)		124.08		
Adjustment for the shortfall (excess) in external budget support [4]		1.24		
Adjustment for the shortfall in the US$ value of IMF disbursement		-18.29		
Adjustment for the increase (decrease) in BSL short-term foreign currency liabilities		5.55		
Contracting or guaranteeing of new nonconcessional external debt by the public sector with maturities of one year or more (ceiling) [3]	0	0	0	Met
Outstanding stock of external debt owed or guaranteed by the public sector with maturities of less than one year (ceiling) [3]	0	0	0	Met
External payment arrears of the public sector (ceiling) [3]	0	0	0	Met
Total domestic government revenue (floor)	724,790	724,790	749,195	Met
Indicative target				
Poverty-related expenditures (floor)	337,474		361,615	Met
Memorandum items:				
External budgetary assistance [4]	254,789		328,696	
Net credit to government by nonbank sector [5]	7,500		-25,155	
PRGF disbursements (US$ millions)	37		19	
Exchange rate (Leones/US$)	3,543		3,856	

Sources: IMF staff projections and data from the authorities.

[1] The performance criteria and indicative targets shown in this table are defined in the Technical Memorandum of Understanding (TMU).
[2] IMF Country Report No. 10/15.
[3] These apply on a continuous basis.
[4] Including program grants and program loans.
[5] Comprises treasury bills purchased by the National Social Security and Insurance Trust (NASSIT) and the nonfinancial private sector.

Table 2. Sierra Leone: Structural Benchmarks for 2009

Measures	Timing	Macro Rationale	Status
Macroeconomic policy coordination			
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.	On a continuous basis	To strengthen liquidity management and enhance monetary and fiscal policy coordination.	Met
Tax administration and policy			
• Establish a Domestic Tax Department (DTD) as the vehicle for achieving integration of domestic tax collection and make it functional.	End–December	To improve efficiency of revenue collection efforts.	Not met, but expected to be met by end-September 2010 in the new program.
• Integrate the Goods and Services Tax (GST) administration within the Large Taxpayer Office (LTO).	End–December	To ensure full and efficient implementation of the GST to achieve domestic revenue target.	Not met. Will be met by end-December in the new program.
• Introduce the Goods and Services Tax (GST).	January 1, 2010	To broaden the tax base and improve efficiency of revenue collection.	Met.
Public financial management			
• Recruit and assign budget officers to MDAs that have IFMIS 'rolled out' and ensure their budget committees are fully operational.	End–December	Improve spending efficiency by enhancing public financial management and budget execution.	Not met, but was implemented in March 2010.
Financial supervision			
• Adoption by the BSL of new off-site surveillance guidelines for banks consistent with the requirements of the revised Banking and Other Financial Services Act, and introduction of new reporting requirements based on these guidelines.	End–September	Financial deepening which is vital to achieve the growth objective of the program.	Not met. This measure will be met by end-June in the new program.
Public enterprise reform			
• Adopt a comprehensive tariff policy for the electricity sector that will strengthen the financial position of the National Power Authority.	End-December	To improve financial viability of the public electricity. This will ensure an efficient and sustainable power supply, critical for the growth objectives of the program.	Not met. The World Bank is becoming more involved in the electricity sector and has advised the authorities to conduct a new tariff study before a policy is decided. Also, since tariffs were increased in 2009, likely well above the long-term marginal cost, there is no urgency to adopt a policy to safeguard budget resources.

Table 3. Sierra Leone: Quantitative Performance Criteria and Indicative Targets for 2010[1]
(Cumulative change from beginning of calendar year to end of month indicated; Le billions, unless otherwise indicated)

	2009	2010		
	Actual Stock	*Jun.*	*Sept.* [2]	*Dec.*
Performance criteria				
Net domestic bank credit to the central government (ceiling)	105.7	191.5	202.7	180.4
Net domestic assets of the central bank (ceiling)	-442.3	198.6	235.5	235.1
Gross foreign exchange reserves of the central bank, US$ millions (floor)	336.4	-8.7	-11.8	0.0
Contracting or guaranteeing of new nonconcessional external debt by the public sector with maturities of one year or more (ceiling) [3]	…	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) [3]	0.0	0.0	0.0	0.0
External payment arrears of the public sector (ceiling) [3]	…	0.0	0.0	0.0
Indicative target				
Total domestic government revenue (floor)	…	432.8	676.8	946.3
Poverty-related expenditures (floor)	…	252.2	337.9	417.0
Memorandum items:				
External budgetary assistance (US$ million) [4]	…	29.6	52.1	77.8
Net credit to government by nonbank sector [5]	…	44.0	-8.8	-27.1
PRGF disbursements (SDR millions)		11.4	11.4	15.9
Exchange rate (Leones/US$)	…	3,990	3,990	3,990

Sources: IMF staff projections.

[1] The performance criteria and indicative targets are defined in the Technical Memorandum of Understanding (TMU).
[2] Indicative target.
[3] These apply on a continuous basis.
[4] Including grants and loans.
[5] Comprises treasury bills purchased by the National Social Security and Insurance Trust (NASSIT) and the nonfinancial private sector.

Table 4. Sierra Leone: Structural Benchmarks for 2010

Measures	Timing	Macro Rationale
• Adopt a domestic fuel pricing formula that reflects full pass-through of international oil prices.	End–June	To enhance transparency and eliminate risks for the budget in case of external shocks.
• Adoption by the BSL of new off-site surveillance guidelines for banks.	End–June	To enhance the supervisory role of the BSL for financial sector development.
• Establish a Domestic Tax Department (DTD) as the vehicle for achieving integration of domestic tax collection and make it functional, including recruiting Commissioner and Deputy Commissioner.	End-September	To improve efficiency of revenue collection efforts.
• Submit to parliament amendments of the Government Budgeting and Accountability Act (2005) and Financial Management Regulation to ensure that only viable capital projects enter into the budget.	End-September	To improve efficiency of public investments and achieve the program growth targets.
• Establish reverse repo rate as the benchmark interest rate and announce the rate after every Monetary Policy Committee meeting.	Continuous from end-September	To increase the effectiveness of monetary policy and help develop a yield curve.
• Establish a credit reference bureau.	End–December	To improve informational infrastructural and promote credit access for credit-worthy customers.
• Integrate the Goods and Services Tax (GST) administration within the Large Taxpayer Office (LTO).	End-December	To ensure full and efficient implementation of the GST to achieve domestic revenue target

TECHNICAL MEMORANDUM OF UNDERSTANDING

May 18, 2010

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 performance criteria (PCs) and structural benchmarks (SBs) for the program supported by the Extended Credit facility (ECF) 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 3 of the Memorandum of Economic and Financial Policies (MEFP).

2. **Program exchange rates.** For the purpose of the program, foreign currency denominated *transactions* in 2010 will be converted from their U.S. dollar denominated value into Sierra Leonean currency (leones) using a program exchange rate of Le 3,990/US$.

II. QUANTITATIVE PERFORMANCE CRITERIA

A. Gross Foreign Exchange Reserves of the Bank of Sierra Leone (BSL)

3. **Definition**. Unless otherwise noted, 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* (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.

Adjustment clauses.

4. The floor on the change in gross foreign exchange reserves will be adjusted (a) downward (upward) by the amount in U.S. dollars of the shortfall (excess) in programmed external budgetary assistance[1]—the downward adjustment will be capped at the equivalent of US$20 million; (b) downward (upward) for any shortfall (excess) in the U.S. dollar value of disbursements from the IMF under the ECF arrangement; and (c) upward (downward) for any increase (decrease) in BSL short-term (one year or less in original maturity) foreign currency-denominated liabilities (to residents and nonresidents).

[1] External budgetary assistance is defined as program grants and program loans, excluding HIPC assistance.

B. Net Domestic Assets of the BSL

5. **Definition.** Net domestic assets (NDA) of the BSL are defined as the end-period stock of the reserve money less the end-period stock of net foreign assets calculated at the program exchange rates. Reserve money includes currency issued (equal to currency outside banks plus cash in vaults) and deposits of commercial banks with the BSL. Net foreign assets of the BSL are defined as gross foreign exchange reserves (defined above) minus foreign liabilities. Foreign liabilities are defined as foreign currency-denominated liabilities of the BSL to nonresidents and the outstanding use of Fund credit. For program purposes, foreign liabilities exclude SDR allocation.

6. **Adjustment clauses.** The ceiling on NDA of the BSL will be adjusted upward (downward) by the leone value of the shortfall (excess) in the external budgetary assistance at the test dates—the upward adjustment will be capped at the equivalent of US$20 million.

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 as calculated by the BSL. It is defined as follows:

- the net position of the government with commercial banks, including: (a) treasury bills, excluding holdings of treasury bills for monetary operations; (b) treasury bearer bonds; and (c) loan and advances of commercial banks to the government; less government deposits in commercial banks;

- the net position of the government with the BSL, including: (a) treasury bills, excluding holdings of treasury bills for monetary operations; (b) treasury bearer bonds; and (c) ways and means; less (a) central government deposits; and (b) HIPC and MDRI relief deposits.

8. **Adjustment clauses.** The ceiling on NCG will be adjusted (a) upward (downward) by up to the leone value of the shortfall (excess) in external budgetary assistance—the upward adjustment will be capped at the equivalent of US$20 million; (b) 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 assumption (as specified in the memorandum items in Table 3 of the MEFP).

9. **Data source**. The data source for the above will be the series "Claims on government (net)", submitted to the IMF staff and reconciled with the monthly monetary survey prepared by the BSL, excluding transactions related to monetary policy operations as defined by BSL.

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. External Payment Arrears of the Public Sector

11. **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.

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

12. **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 (see paragraph 11 for definition of public sector) based on the residency criterion. This PC applies not only to debt as defined in the Guidelines on Performance Criteria with Respect to Foreign Debt (Decision No. 12274 (00/85), August 24, 2000, Point 9, as revised on August 31, 2009, (Decision No. 14416-(09/91)) 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 ¶11 above. This PC will apply on a continuous basis.

13. Any external debt of which the net present value, calculated with the reference interest rates mentioned hereafter, is greater than 65 percent of the nominal value (grant element of less than 35 percent) is considered nonconcessional, with the exception of IMF lending. For debt with a maturity of more than 15 years, the average of the ten-year commercial interest reference rates (CIRRs) published by the OECD is used to calculate the grant element. The average of the six-month CIRRs is used for debt with shorter maturities. For loans in foreign currencies for which the OECD does not calculate a CIRR, calculation of the grant element should be based on the CIRR in SDRs. The Government will report any new external borrowing and its terms to Fund staff as soon as external debt is contracted or guaranteed by the government.

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

14. **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 (see paragraph 11 for definition of public sector). Debt is defined in Annex I 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 in ¶11 above. This PC will apply on a continuous basis.

III. Quantitative Indicative target

A. Domestic Revenue of Central Government

15. **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.

B. Poverty-Related Expenditures

16. **Definition**. Poverty-related expenditures refer to those expenditures in the areas identified in Table 2 of the Sierra Leone HIPC Decision Point Document.

IV. Program Monitoring

17. The Sierra Leonean authorities shall maintain a program-monitoring committee composed of senior officials from the MoFED, the BSL, and other relevant agencies. The committee shall be responsible for monitoring performance under the program, recommending policy responses, informing the IMF regularly about the progress of the program, and transmitting the supporting materials necessary for the evaluation of PCs and benchmarks. The committee will provide monthly reports to the IMF on progress in implementing the program's quantitative targets and structural benchmarks.

ANNEX 1: 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 sometime 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 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". (c) 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 + 6 weeks
	Government flow-of-funds table (Government Financial Operations Table) with supporting documentation (final) and presented on commitment and cash bases	Monthly	End of month + 6 weeks
	Petroleum product prices and tax receipts by categories of petroleum products	Monthly	End of month + 6 weeks
	Stock of outstanding payment commitments with a breakdown between current and capital expenditures	Monthly	End of month + 6 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 BSL	Monthly	End of month + 6 weeks
	Consolidated balance sheets of commercial banks	Monthly	End of month + 6 weeks
	BSL monitoring sheet of net financing of the financial sector to the government	Monthly	End of month + 6 weeks
	BSL monitoring sheet of treasury bills and bonds holdings	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

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

Type of Data	Tables	Frequency	Reporting Deadline
Monetary and financial data			
	Gross official foreign reserves	Weekly	End of week + 1 week
	Foreign exchange cashflow table	Monthly	End of quarter + 4 weeks
	Revised balance of payments data	Monthly	When revisions occur
	Exports and imports of goods (including the 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, including the associated concessionality calculation (percentage) for each new loan.	Monthly	End of month + 4 weeks
	External debt service payments (separately on principal and interest payment) to each creditor, including and excluding new disbursements in the debt recording system. Also, including and excluding HIPC relief.	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 Monetary Policy Committee	Monthly	Date of meeting + 2 weeks