DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

EBS/84/2
Correction 1

CONFIDENTIAL

February 2, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Sierra Leone - Request for Stand-By Arrangement

The following corrections have been made in EBS/84/2 (1/5/84):

Page 1, para. 1, line 5: for "SDR 26.08 million" read "SDR 26.14 million"
lines 6 and 7: for "SDR 24.12 million" read "SDR 24.06 million"

Page 2, para. 1, line 2: for "(77.8 percent of new quota)" read "(77.7 percent of new quota)"

Page 3, column 1, line 2: for "5.98" read "6.04"
line 3: for "4.02" read "3.96"
line 6: for "113.5" read "113.4"
line 8: for "77.8" read "77.7"

column 5, line 2: for "26.08" read "26.14"
line 3: for "24.12" read "24.06"

Page 15, column 4, line 1: for "57.4" read "857.4"

Page 29, para. no. 1, line 1: for "January ___, 1984, to January ___, 1985," read "February ___, 1984, to February ___, 1985"

para. no. 2(a), line 3: for "until March 31, 1983;" read "until March 31, 1984;"

para. no. 3, lines 2-4: for "ratio of 1 to 1 until...resources only, provided" read "ratio of 2 to 1 until...resources in the ratio of 1 to 1, provided"

Page 30, para. (b): for "January ___, 1985" read "February ___, 1985"

Att: (6)

EBS/84/2
Corrected: 2/1/84

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

SIERRA LEONE

Request for Stand-By Arrangement

Prepared by the African Department and the Exchange and Trade Relations Department 1/

(In consultation with the Fiscal Affairs, Legal, and Treasurer's Departments)

Approved by Oumar B. Makalou and S. Kanesa-Thasan

January 4, 1983

I. Introduction

In the attached letter dated December 3, 1983, the Government of Sierra Leone requests a stand-by arrangement for a period of 12 months in support of a stabilization program covering the second half of 1983 and the calendar year 1984, in an amount equivalent to SDR 50.2 million, representing 86.7 percent of new quota. Of this amount, SDR 26.14 million would be made available from the Fund's ordinary resources and SDR 24.06 million from borrowed resources. Under the three-year extended arrangement that the Fund approved for Sierra Leone in March 1981 (SDR 186.0 million or 400 percent of former quota), Sierra Leone purchased a total of SDR 33.5 million before the arrangement became inoperative in June 1981, and was subsequently cancelled on April 6, 1982. In February 1983 Sierra Leone purchased an amount of SDR 20.7 million (35.8 percent of new quota) under the compensatory financing facility in respect of an export shortfall for the year ended June 1982.

1/ Discussions that provided the basis for the proposed stand-by arrangement were held in Freetown during the periods February 21-March 2, 1983; June 8-24, 1983; July 27-30, 1983; and November 9-15, 1983; discussions were also held in Washington during the 1983 Annual Meetings, and the negotiations were concluded in Washington during November 28-December 3, 1983. Staff members participating in the missions were Mr. Enweze (head-AFR), Mrs. Mitchell (ETR), Mr. Duran (AFR), Mr. Kakoza (AFR), Mr. Fetherston (FAD), Mr. Sukachevin (ETR), Mr. Dublin (AFR), Mr. Abrams (ETR), Mr. Yao (BUR), Mrs. Selassie (secretary-AFR), Mrs. Buggs (secretary-AFR), and Miss Wood (secretary-AFR); Mr. Calamitsis (AFR) participated in the discussions in February/March. Messrs. Makalou (AFR), Bhatia (AFR), and Kanesa-Thasan (ETR) participated in the concluding negotiations in Washington during November/December. Mr. Sangaré, Executive Director for Sierra Leone, and Mr. Mtei, Alternate Executive Director for Sierra Leone, participated in parts of the June and the November discussions, respectively, in Freetown.

As of November 30, 1983, Fund holdings of leones subject to repurchase amounted to SDR 45.0 million (77.7 percent of new quota), excluding SDR 20.7 million (35.7 percent of quota), purchased under the CFF. Full use of the requested stand-by arrangement, together with scheduled repurchases, would raise Fund holdings of leones subject to repurchase to SDR 83.6 million (or 144.4 percent of new quota), excluding purchases under the CFF.

According to the phasing of the proposed stand-by arrangement (Table 1) purchases may be made in four installments. An amount equivalent to SDR 10.0 million (19.9 percent of the amount of the stand-by arrangement) would be available upon Executive Board approval of the arrangement. The second purchase of SDR 9.0 million may be made by Sierra Leone after meeting the performance criteria for end-March 1984. The third purchase of SDR 17.6 million will be subject to the satisfaction of the end-June performance criteria and the completion of the review of the program by July 31, 1984, at which time understandings will be reached with the Fund on producer prices, incomes policies, exchange rate, interest rate, budgetary and other policies. The final purchase of SDR 13.6 million will be effected after successful compliance with the end-September performance criteria to be established at the time of the mid-term review of the program.

II. Performance under the 1980/81 Program and Recent Economic Developments 1/

In early 1981 the Sierra Leone Government embarked on a program of structural adjustment covering the period 1980/81-1983/84 (July-June). Performance under the program in 1980/81 was not satisfactory; adverse external developments invalidated some of the major assumptions underlying the program and there were also slippages in policy implementation. As a result, the budget deficit/GDP ratio was twice the programed level, and was financed mainly by domestic bank borrowing. Thus, the end-June 1981 ceilings on net credit to the Government and on total domestic credit were greatly exceeded, though private sector credit expansion was kept within its implicit limit. The external payments position also deteriorated: the current account deficit, including official transfers, exceeded program targets by about 3 percentage points of GDP, and as net capital inflows were lower than had been foreseen, the overall balance of payments deficit exceeded the program target by a wide margin. The performance criteria on external arrears and external borrowings in the one-to-five years' maturity were also not met. Efforts to initiate corrective action were largely stalled by a failure to reach understandings with the Fund on the exchange rate question, and the extended arrangement became inoperative in July 1981.

1/ For detailed analysis of recent developments and performance under the 1980/81 program, see SM/83/200 (9/7/83) and SM/83/202 (9/21/83).

Table 1. Sierra Leone: Proposed Schedule of Purchases and Repurchases during the Stand-By Period

(In millions of SDRs)

	Operations in 1984				
	Jan.-March	April-June	July-Sept.	Oct.-Dec.	Total
Purchases	10.00	9.00	17.60	13.60	50.20
Ordinary resources	6.04	4.50	8.80	6.80	26.14
Borrowed resources	3.96	4.50	8.80	6.80	24.06
Repurchases					
Stand-by and extended arrangements	2.13	2.13	2.13	4.28	10.67
Net purchases	7.87	6.87	15.47	9.32	39.53
	(In percent of new quota) 1/				
	November 1983	March 1984	June 1984	Sept. 1984	Dec. 1984
Fund holdings subject to repurchase (end of period)	113.4	125.4	137.3	164.0	180.1
Under compensatory financing facility	35.7	35.7	35.7	35.7	35.7
Under tranche policy	77.7	89.7	101.6	128.3	144.4

Sources: IMF, Treasurer's Department; and the stand-by arrangement contained in Attachment A.

1/ New quota of SDR 57.9 million under the Eighth General Review.

During 1981/82 and 1982/83, Sierra Leone's economic and financial situation continued to deteriorate (Table 2): observed real growth stagnated, as diamond production and agricultural output (measured by the official purchases of these commodities for export) continued to be depressed, in part because of the high incidence of smuggling; expansionary budgetary and credit policies continued to exacerbate internal and external imbalances; the foreign exchange situation remained very tight, in part because of high import prices, but also because of the weak enforcement of surrender requirements for export proceeds. As a result of these factors, the inflation rate accelerated sharply, the debt servicing problem became more acute, gross reserves were virtually depleted, and external arrears continued to accumulate rapidly.

III. Adjustment Program for 1983/84

1. Introduction

Against this background, the Sierra Leonean authorities commenced discussions with the Fund staff on the elements of a stabilization program. As a result of these discussions, effective December 17, 1982, a dual exchange rate system was introduced under which approximately half of Sierra Leone's total foreign exchange transactions were to be effected in a commercial market, where the rate was to be determined by the forces of supply and demand, in the context of fortnightly foreign exchange auctions (EBS/82/240). During these auctions, the rate struck remained in the narrow range between Le 2.40 = US$1.00 and Le 2.50 = US$1.00; the base rate remained unchanged at Le 1.25 = US$1.00. Effective July 1, 1983, Sierra Leone unified the official and commercial rates of exchange for the leone at the rate of Le 2.50 = US$1.00; this rate implies a devaluation of 50 percent (100 percent in local currency terms) of the exchange rate (EBS/83/149). At the same time several key policy measures were enacted in the framework of a stabilization program: the measures were both far-reaching and wide-ranging, and encompassed substantive actions in the areas of exchange rate, producer pricing, fiscal, and monetary policies.

2. Production and investment policies

The producer price increases in the agricultural sector granted during 1982/83 proved insufficient to discourage smuggling to neighboring countries, given the shortage of foreign exchange and implicit leone prices which could be obtained from trading in the parallel market. Accordingly, the Government announced substantial increases in producer prices on July 1, 1983 well in advance of the 1983/84 crop season. Specifically, these increases were 82 percent for coffee, 93 percent for cocoa, 82 percent for palm kernels and 118 percent for ginger. As a result of these increases the smuggling of agricultural exports is expected to be sharply curbed as Sierra Leone's producer prices have become more competitive in U.S. dollar terms with those in neighboring countries. With the assistance of the World Bank and other donors, the Government is also pursuing efforts to increase the production of these export crops.

Table 6. Sierra Leone: Stand-By Arrangement--Quantitative Performance Criteria for March and June 1984

	Actual June 1983	Actual Sept. 1983	Projected Dec. 1983	March 1984	June 1984
			(In millions of leones)		
Net credit to Government from the banking system	732.5	747.4	812.4	857.4	910.2
Total domestic bank credit	850.3	875.5	967.4	1,007.4	1,052.8
			(In millions of U.S. dollars)		
External public debt					
Ceilings on new loans of maturities between 1-12 years 1/	--	--	10.0	10.0	10.0
Ceilings on new non-trade credits of maturities less than 1 year	--	--	15.0	15.0	15.0
			(In millions of SDRs)		
External payments arrears					
Minimum cash reduction by end of period 2/	--	--	--	0.5	1.0

1/ *For Kimberlite and Bumbuna projects only.*
2/ From the November 18, 1983 level of SDR 259.4 million. It is expected that there will be an additional reduction through consolidation and rescheduling.

The change in the exchange rate has enabled the Government to increase producer prices for coffee, cocoa, ginger and palm kernels as already noted, and the authorities expect that there will be a favorable supply response to the increased prices, and a diversion into official channels of agricultural exports, much of which were previously smuggled. At the same time, Sierra Leone is expected to benefit from improved world prices for all of its major agricultural exports, especially cocoa, palm kernels and ginger. Export volumes of coffee and palm kernels are also expected to increase substantially from the depressed levels of 1982/83, while cocoa export volumes should be maintained. Official exports of alluvial diamonds had already shown some increase in response to the creation of the dual exchange market in late 1982; it is expected that the trend will be maintained. Negotiations for the financing of the Kimberlite project are going forward with a view to starting construction as well as production in July 1984. The program also assumes that the volume of iron ore exports will double as activity at the Marampa mine is stepped up, while the new facility for drying bauxite will also come into operation. Total exports are projected to grow by 39 percent in value terms (Table 7).

Despite the programed improvement in exports, foreign exchange resources will continue to be severely constrained because of the heavy burden of debt service and the overhang of payments arrears. Reflecting this constraint as well as the devaluation of the leone and tighter demand management policies, imports are expected to show a further decline of 8 percent in 1983/84. After provision for necessary items, especially crude oil and rice, less essential imports are being licensed restrictively at present, on the basis of foreign exchange availability. Imports of crude oil will show an increase from the unusually low level of 1982/83, when foreign exchange constraints led to an interruption of the supply of crude oil and temporary reliance on imports of refined products. The Government is seeking to conserve supplies of petroleum products by increasing retail prices, and by improving the efficiency of the energy sector with the help of the IBRD. Imports of rice are being discouraged by enforcement of a 10 percent duty, and the Government is considering an increase in this levy. At the same time, the domestic producer price has been raised and will be raised again in February 1984, to stimulate import substitution. The overall result of these developments relating to exports and imports is expected to be a reduction in the trade deficit to less than half of its amount in the pre-program year.

Sierra Leone has been accumulating external payments arrears during the past few years, especially since the 1980 OAU conference for which heavy expenditures were undertaken. At the end of June 1983, these arrears amounted to SDR 255 million, more than twice the level of 1982/83 exports. From June until mid-November, total arrears rose further to SDR 259 million on account of unpaid official debt service obligations. In view of the extremely tight foreign exchange position, the program provides only for a token minimum cash reduction of SDR 1 million in arrears by June 30; a

Sierra Leone--Stand-By Arrangement

Annexed hereto is a letter, with attached memoranda, dated December 3, 1983, from the Minister of Finance and the Governor of the Bank of Sierra Leone requesting a stand-by arrangement and setting forth:

a. the objectives and policies that the authorities of Sierra Leone intend to pursue for the period of this stand-by arrangement;

b. the policies and measures that the authorities of Sierra Leone intend to pursue during the first six months of this stand-by arrangement; and

c. understandings of Sierra Leone with the Fund regarding reviews that will be made of progress made in realizing the objectives of the program and of the policies and measures that the authorities of Sierra Leone will pursue for the remaining period of this stand-by arrangement.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from February __, 1984, to February __, 1985, Sierra Leone will have the right to make purchases from the Fund in an amount equivalent to SDR 50.2 million, subject to paragraphs 2,3,4, and 5 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 10.0 million until March 31, 1983; the equivalent of SDR 19.0 million until June 30, 1984; the equivalent of SDR 36.6 million until September 30, 1984.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Sierra Leone's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from borrowed resources beyond 12.5 percent of quota.

3. Purchases under the stand-by arrangement shall be made from ordinary and borrowed resources in the ratio of 2 to 1 until purchases under the arrangement reach the equivalent of SDR 6,243,750 and thereafter from ordinary and borrowed resources in the ratio of 1 to 1, provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Sierra Leone will not make purchases under this arrangement other than the initial purchase in an amount equivalent to SDR 10.0 million, that would increase the Fund's holdings of Sierra Leone's currency

in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period in which the data at the end of the preceding calendar quarter falling within the period of this arrangement indicate that:

(i) the ceiling on total domestic credit from the banking system described in paragraph 2c of Section II of the Memorandum on the Economic and Financial Program of the Government of Sierra Leone attached to the annexed letter (hereafter referred to as the Economic Memorandum); or

(ii) the ceiling on net domestic credit to the Government from the banking system described in paragraph 2c of Section II of the Economic Memorandum attached to the annexed letter; or

(iii) the target for the reduction of external payments arrears described in paragraph 3a of Section II of the Economic Memorandum attached to the annexed letter; or

(iv) the ceiling on contracting and guaranteeing of new nonconcessional external borrowing with a maturity of between 1 and 12 years described in paragraph 3a of Section II of the Economic Memorandum attached to the annexed letter; or

(v) the ceiling on the contracting and guaranteeing of new non-trade credits with a maturity of less than one year described in paragraph 3a of Section II of the Economic Memorandum attached to the annexed letter, is not observed;

(b) during the period June 30 to February ___, 1985, until understandings have been reached on the economic and financial policies and suitable performance criteria have been established for the remainder of the program period in consultation with the Fund as contemplated in paragraph 2 of the annexed Letter or after such understandings and performance criteria have been established, while they are not being observed;

(c) during the entire period of this stand-by arrangement if Sierra Leone

(i) imposes or intensifies restrictions on payments and transfers for current international transactions; or

(ii) introduces or modifies multiple currency practices;

(iii) concludes bilateral payments agreements that are inconsistent with Article VIII; or