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EBS/86/243

CONFIDENTIAL

November 3, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Sierra Leone - Staff Report for the 1986 Article IV Consultation and Requests for Stand-By Arrangement and for Arrangement Under the Structural Adjustment Facility

Attached for consideration by the Executive Directors is the staff report for the 1986 Article IV consultation with Sierra Leone and Sierra Leone's requests for a stand-by arrangement equivalent to SDR 23.156 million and for an arrangement under the structural adjustment facility. Draft decisions appear on pages 40 and 41.

This subject will be brought to the agenda for discussion on a date to be announced.

Mr. Enweze (ext. 8650) or Mr. Martey (ext. 6514) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

SIERRA LEONE

Staff Report for the 1986 Article IV Consultation, Request for Stand-By Arrangement, and Request for Arrangement Under the Structural Adjustment Facility

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

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

Approved by A.D. Ouattara and Eduard Brau

October 31, 1986

I. Introduction

A staff team 1/ visited Freetown 2/ during the period July 21-August 4 and September 19-26 to conduct the 1986 Article IV consultation discussions, and to negotiate an economic and financial program to be supported by the use of Fund resources under a stand-by arrangement and the structural adjustment facility (SAF). The Sierra Leone representatives included the Honorable S. Kanu, Minister of Finance; the Honorable S. Sesay, Minister of Development; the Honorable C. Green, Deputy Minister of Finance; the late Mr. V. Bruce, then Governor of the Bank of Sierra Leone; Mr. S. Wright, Deputy Governor of the Bank of Sierra Leone; Mr. P. Kuyembeh, Financial Secretary; and other senior officials concerned with economic and financial matters. Mr. Enweze was received by the President, His Excellency J. Momoh during both missions.

The one-year stand-by arrangement for Sierra Leone which was approved by the Fund on February 3, 1984, provided for total purchases of SDR 50.2 million, representing 86.7 percent of quota. Under that arrangement, Sierra Leone made only two purchases totaling SDR 19 million. The third purchase was subject to the observance of performance criteria for end-June 1984 and the completion of a mid-term review of

1/ The staff team consisted of Mr. Enweze (head-AFR), Mr. Martey (AFR), and Mr. Johnston (ETR), Ms. Bartoli (FAD), Ms. Sudo (secretary-MED) (July/August mission) and Ms. Tirbany (secretary-TRE) (September mission). Mr. R. Faruqee (IBRD) participated in both missions, in each case for a part of the period. The missions were assisted by Mr. Kalinga, the Fund resident representative in Sierra Leone.

2/ Discussions were also held in Washington following the 1986 Annual Meetings, through October 7, with a Sierra Leone delegation, headed by the Honorable S. Kanu, the Minister of Finance.

the program by July 31, 1984, but the mid-term review was not completed, largely because understandings could not be reached on exchange rate policy. Since late 1984, Sierra Leone has been experiencing difficulties in meeting its financial obligations to the Fund. On June 28, 1985, the Executive Board decided to limit Sierra Leone's use of the Fund's general resources. At the fifth review that took place on July 16, 1986 of Sierra Leone's overdue obligations to the Fund, the Executive Board decided that, unless Sierra Leone had become current in its financial obligations to the Fund in the General Resources Account by September 19, 1986, with effect on that date, Sierra Leone would be ineligible to use Fund resources. In the meantime, on August 8, the Executive Board took up the matter of Sierra Leone's overdue obligations to the Fund, and reaffirmed the September 19 cutoff date. On September 18, 1986 Sierra Leone settled its overdue obligations to the Fund, which, on that date, amounted to SDR 25.12 million, or 43.4 percent of quota, and is now current in its financial obligations to the Fund.

In the attached letter dated October 7, 1986 (Attachment I), to which is annexed a memorandum on economic and financial policies, the Government of Sierra Leone requests a stand-by arrangement for a period of 12 months, in an amount of SDR 23.156 million, or 40 percent of Sierra Leone's quota of SDR 57.9 million (Appendix I) and a three-year structural arrangement in an amount that will be available to Sierra Leone under the structural adjustment facility (SAF) (SDR 27.2 million), and the first annual arrangement thereunder (SDR 11.6 million, or 20 percent of quota) (Appendix II). In a letter dated October 15, 1986, the Sierra Leone Government has also transmitted to the Managing Director of the Fund a medium-term policy framework paper, prepared in close collaboration with the staff of the Fund and the World Bank. Since the Fund's holdings of the leone would exceed 200 percent of quota, a waiver of the limitation in Article V, Section 3b(iii) is proposed.

As of September 30, 1986, Fund holdings of leones subject to repurchase amounted to SDR 56.69 million, or 97.9 percent of quota; of this amount, SDR 15.52 million, or 26.8 percent of quota represents purchases under the compensatory financing facility (CFF). Assuming that all purchases under the proposed arrangement are made, together with scheduled repurchases, Fund credit outstanding would be SDR 63.47 million, or 109.62 percent of quota (Table 1). The stand-by arrangement envisages five purchases. The initial purchase, available upon Fund approval, would be for SDR 8 million; the remaining purchases would be for SDR 3.79 million each. The second, third, fourth, and fifth purchases would be subject to Sierra Leone meeting the performance criteria for December 1986, March, June, and September 1987, respectively; in addition, the second and the fourth purchases are subject to the completion of the first review with the Fund (by March 31, 1987) and the second review with the Fund (by September 15, 1987), respectively. The proposed phasing takes into account the fact that many of the measures have already been implemented by the authorities as prior actions. All of the purchases would be from ordinary resources.

Table 1. Sierra Leone: Net Use of Fund Resources, October 1986-December 1987

	Outstanding at Sept. 30, 1986	1986 October-December	1987 January March	April-June	July-September	October-December
			(In millions of SDRs)			
Stand-by and extended arrangements 1/	...	4.49	3.79	-0.48	1.98	-1.60
Purchases	...	8.00	3.79	3.79	3.79	3.79
Ordinary resources	...	(8.00)	(3.79)	(3.79)	(3.79)	(3.79)
Repurchases	...	-3.51	--	-4.26	-1.81	-5.39
Ordinary resources		(-1.36)	(--)	(-2.11)	(-1.32)	(-2.68)
Borrowed resources		(-2.15)	(--)	(-2.15)	(-0.49)	(-2.71)
Special facilities 2/	...	-2.59	-2.59	-2.59	-2.59	-2.59
Purchases	...	(--)	(--)	(--)	(--)	(--)
Repurchases	...	(-2.59)	(-2.59)	(-2.59)	(-2.59)	(-2.59)
SAF loan disbursements	...	11.58	--	--	--	-- 3/
Total Fund credit outstanding 1/	56.69	70.17	71.37	68.31	67.70	63.47 3/
Stand-by and extended arrangements	41.17	45.66	49.45	48.98	50.96	49.36
Special facilities 2/	15.52	12.93	10.34	7.75	5.16	2.57
Structural adjustment facility	--	11.58	11.58	11.58	11.58	11.58 3/
			(As a percentage of quota)			
Total Fund credit outstanding 1/	97.91	121.19	123.26	117.98	116.92	109.62 3/
Stand-by and extended arrangements	71.10	78.86	85.40	84.59	88.01	85.25
Special facilities 2/	26.80	22.33	17.86	13.39	8.91	4.44
Structural adjustment facility	--	20.00	20.00	20.00	20.00	20.00 3/

1/ Including other credit tranche purchases.
2/ CFF and buffer stocks facilities.
3/ Excludes possible SAF drawing of SDR 7.82 million.

Sierra Leone continues to avail itself of the transitional arrangements of Article XIV; the last Article IV consultation (SM/85/307) was discussed by the Executive Board on December 4, 1985. Summaries of Sierra Leone's relations with the Fund and the World Bank Group and of outstanding statistical issues are provided in Attachments IV, V, and VI, respectively.

II. Recent Economic Developments

In the five years ended June 1986, the Sierra Leone economy has been characterized by economic stagnation, with declining output in the major export-oriented sectors of the economy. Meanwhile, domestic absorption continued to increase, giving rise to widening internal and external imbalances. Gross reserves were depleted to less than one month's imports, with a large part of these reserves encumbered. External arrears continued to increase, including overdue obligations to the Fund. The parallel market in foreign exchange continued unabated, the inflation rate accelerated, and, with the interruption of aid disbursements by a number of donors and multilateral agencies, development projects came to a virtual halt. Indeed a process of deterioration began to set in as the physical infrastructure fell into disrepair with the increasing foreign exchange difficulties.

The deterioration in the fiscal situation which re-emerged in 1984/85 (following a partial reversal in 1983/84, 1/ with the implementation of a Fund-supported adjustment program), worsened in 1985/86 (Table 2). The overall fiscal deficit (on a commitment basis and including grants) rose further from 11.5 percent of GDP in 1984/85 to 14.5 percent of GDP in 1985/86. 2/ These deficits were accompanied by a substantial accumulation of domestic and external arrears. The financing of the deficits (on a cash basis) entailed a sharp increase in the recourse to the domestic banking system. Thus, in 1985/86, domestic bank financing as a ratio of beginning money stock (at end-June 1985) rose to 85.7 percent from 47.1 percent in the previous fiscal year (Table 3). While revenue increased broadly in line with the increase in nominal GDP in 1985/86 (by about 49 percent), total expenditures rose even faster, by about 76 percent. The increase in revenues was largely on account of international trade related taxes (particularly import duties), reflecting the impact of the February 1985 devaluation of the leone, although taxes on net income and profit also showed a marked gain. On the expenditure side, the bulk of the increase by Le 620.4 million, also reflected the impact of the exchange rate action. In particular, there was a sharp increase in subsidies on oil by Le 335 million (as domestic prices were not adjusted), in foreign interest payments and in development expenditures.

1/ Fiscal year July-June.

2/ Prior to 1985/86, data on expenditure do not include accumulation of arrears on external interest.

Table 2. Sierra Leone: Selected Economic and Financial Indicators, 1981/82-1986/87 1/

	1981/82	1982/83	1983/84	1984/85 Revised	1985/86 Prel.	1986/87 2/ Prog.
	(Annual percentage change, unless otherwise specified)					
Income and expenditure						
GDP at constant prices	-1.4	0.5	8.0	0.8	-1.4	2.0
GDP at current market prices	17.5	28.7	50.2	44.3	49.3	63.2
Gross domestic expenditure at current prices 3/	24.2	12.9	45.4	41.7	48.8	54.6
Consumer prices	25.1	44.6	78.7	61.8	70.4	90.0
External sector (on the basis of SDRs)						
Exports, f.o.b.	-10.0	-25.9	22.7	27.2	-17.5	22.8
Imports, f.o.b.	2.0	-34.8	-24.5	18.2	-20.0	0.9
Oil imports, f.o.b.	68.6	-34.6	14.7	-6.4	-50.7	-12.8
Diamond export volume	-29.4	27.6	-33.8	17.3	10.7	1.2
Terms of trade (deterioration -)	-13.7	-25.3	9.2	8.8	-8.6	25.5
Nominal effective exchange rate 4/ (depreciation -)	7.1	5.0	-44.8	-12.9	-45.7	...
Real effective exchange rate 4/ (depreciation -)	23.3	42.3	-3.2	26.5	-6.2	...
Government finance						
Total revenue and grants	-9.6	-12.0	46.0	22.5	57.5	294.3
Total revenue	-13.6	-14.8	31.6	32.3	49.6	238.7
Total expenditure 5/	0.4	0.3	15.5	71.7	76.5	128.4
Money and credit						
Domestic credit	30.8	38.4	20.6	30.1	57.5	35.0
Government	36.5	42.8	23.1	29.1	63.5	31.6
Private sector	7.8	15.4	4.6	37.3	15.2	68.9
Money and quasi-money (M2)	25.5	36.8	28.5	54.7	75.8	33.7
Velocity (GDP relative to M2)	4.7	4.4	5.2	4.8	4.1	5.0
Interest rate 6/ (annual rate on one-year deposits)	11.5	11.5	13.5	13.5	13.5	...
	(In percent of GDP, unless otherwise specified)					
Overall government deficit 7/ (commitment basis)	13.2	11.6	7.1	11.5	14.5	11.1
Overall government deficit 7/ (cash basis)	10.5	13.7	6.9	7.9	12.8	11.2
Domestic bank financing	9.2	11.5	5.9	6.3	11.9	5.9
Percent of initial money stock	54.1	69.3	39.0	47.1	85.7	39.7
Foreign financing	2.1	2.1	-0.3	1.1	0.6	0.8
Gross domestic investment 3/	14.4	10.6	8.9	7.7	7.1	15.2
Gross domestic savings	-6.1	6.0	6.6	7.2	6.9	8.8
External sector						
Current account deficit (-)	-15.8	-8.0	-3.4	-4.9	-3.0	-1.8
Balance of payments (deficit -)	-10.8	-5.1	-3.9	-3.2	-6.2	-15.3
External debt 9/						
Exclusive of IMF	26.8	24.8	34.5	26.7	28.6	111.1
Inclusive of IMF	31.3	28.1	40.5	32.7	34.6	130.0
External debt service as percent of exports						
Excluding IMF 8/						
Before debt relief	50.4	57.9	41.5	45.4	67.6	76.9
After debt relief	43.8	19.0	32.8	40.1	67.6	40.0
Including IMF						
Before debt relief	58.2	66.0	50.6	56.9	81.9	95.0
After debt relief	51.6	27.1	41.8	51.6	81.9	58.0
Gross official foreign reserves (months of imports) 6/	0.4	0.6	0.5	0.5	0.7	1.2
	(In millions of SDRs)					
Balance of payments deficit (-)	-120.2	-73.8	-43.6	-43.3	-69.7	-49.1
External current account deficit (-)	-176.0	-114.5	-37.8	-67.5	-33.1	-5.6
External payments arrears	199.5	239.9	236.2	269.0	312.0	63.9 10/

Sources: Data provided by the Sierra Leone authorities; and staff estimates and adjustments.

1/ Fiscal years July-June.
2/ Assumes an average exchange rate of Le 28 = US$1 for 1986/87. Owing to sharp drop in GDP in foreign currency terms, entailed in the large depreciation of the leone in the context of the new floating exchange rate system, there may be marked shifts in the ratios of a number of aggregates in relation to GDP.
3/ Includes changes in stocks.
4/ Trade-weighted. Changes in four quarter averages.
5/ Commitment basis. Prior to 1985/86, data do not include accumulated arrears on external interest.
6/ End of period.
7/ Data for 1986/87 are on a before debt relief basis; for 1985/86 there was no debt relief; and for 1981/82-1984/85, data are on an after debt relief basis.
8/ Disbursed medium term and long term only.
9/ Exports of goods only.
10/ Assumes that arrears are consolidated and rescheduled along Paris Club lines.

Table 3. Sierra Leone: Central Government Operations, 1981/82-1986/87 1/

Fiscal year ending June 30	1981/82	1982/83	1983/84	1984/85 Prov. actuals	1985/86 Prov. actuals	1986/87 Program
	(In millions of leones)					
Revenue and grants	206.3	181.5	264.9	324.4	511.0	2,014.8
Of which: Tax revenue	174.3	143.7	192.9	256.9	379.2	1,335.6
Grants	23.1	25.5	59.6	52.9	104.8	639.1
Total expenditure	408.0	409.1	472.7	811.4	1,431.8	3,269.9
Current expenditure	248.8	261.7	332.6	541.9	1,063.1	1,971.9
Development expenditure	94.9	99.2	103.1	126.2	212.8	1,093.5
Other expenditure 2/	64.3	48.2	37.0	143.3 3/	155.9	204.5
Additional fiscal measures	--	--	--	--	--	104.0
Overall deficit (commitment basis)	-201.7	-227.6	-207.8	-487.0	-920.8	-1,151.2
Change in expenditure-related arrears (reduction -) 4/	41.2	-42.1	4.3	149.5	106.7	-10.0 5/
Overall deficit (cash basis)	-160.5	-269.7	-203.5	-337.5	-814.1	-1,161.2
Financing						
Foreign financing (net)	31.9	42.0	-8.0	44.7	36.3	-145.8
Drawings	(63.6)	(69.0)	(40.0)	(75.0)	(65.4)	(580.0)
Amortization (-)	(-31.7)	(-27.0)	(-48.0)	(-30.3)	(-29.1)	(-725.8)
Domestic financing (net)	128.6	227.6	211.5	292.8	777.8	677.2
Banking system	(140.3)	(224.9)	(173.1)	(268.7)	(756.5)	(616.2)
Nonbank sector	(-11.7)	(2.8)	(38.5)	(24.1)	(21.3)	(61.0)
Financing gap	--	--	--	--	--	629.8 6/
	(In percent of GDP)					
Revenue and grants	13.5	9.2	9.0	7.6	8.0	19.4
Revenue	(12.0)	(7.9)	(7.0)	(6.4)	(6.4)	(13.3)
Tax revenue	(11.4)	(7.3)	(6.5)	(6.0)	(6.0)	(12.9)
Total expenditure	26.7	20.8	16.0	19.1	22.5	31.6
Current expenditure	(16.3)	(13.3)	(11.3)	(12.7)	(16.7)	(19.0)
Development expenditure	(6.2)	(5.1)	(3.5)	(3.0)	(3.4)	(10.6)
Other expenditure	(4.2)	(2.5)	(1.3)	(3.4)	(2.5)	(2.0)
Additional fiscal measures	--	--	--	--	--	1.0
Overall deficit (commitment basis)						
Before debt relief	...	...	...	...	-14.5	-11.1
After debt relief	-13.2	-11.6	-7.1	-11.5	-14.5	-7.4
Overall deficit (cash basis)						
Before debt relief	...	...	...	...	-12.8	-11.2
After debt relief	-10.5	-13.7	-6.9	-7.9	-12.8	-7.5
Financing gap	--	--	--	--	--	6.1 6/
	(In percent of beginning stock of broad money)					
Bank financing	54.1	69.3	39.0	47.1	85.7	39.7

Sources: Data provided by the Sierra Leone authorities; and staff estimates.

1/ Government accounts have not been fully finalized and audited since 1978/79. For the period 1981/82-1985/86 revenue and expenditure data do not include transactions between the Central Government and the SLPMB on a gross basis.

2/ For the period 1981/82-1985/86 this is a residual derived from available data on financing, revenue, and expenditures. For 1986/87, the figure of Le 204.5 million represents known extrabudgetary expenditure already incurred.

3/ Includes payments of equity contribution to the Precious Metals Marketing Company (PMMC) and suspense account transactions as well as the residual mentioned in footnote 2 above.

4/ Prior to 1985/86 data do not include accumulation of arrears on foreign interest payments.

5/ Represents reductions in domestic arrears through cash payments.

6/ Expected to be filled through partial rescheduling of external arrears expected to accumulate during the first five months of 1986/87, and of external obligations falling due during the remainder of 1986/87.

Monetary and credit developments in 1985/86 reflected the widening budget deficit and its reliance on financing from the banking system: total domestic credit increased by 57 percent reflecting the acceleration in the rate of increase in net credit to Government. In order to accommodate the Government's excessively high demand for bank credit, the authorities, on September 4, 1985, raised the statutory ceiling on ways and means advances to the Government from 10 percent to 20 percent of estimated recurrent budgetary revenue. Thus, while net credit to Government had increased by 63 percent in 1985/86, compared with 29 percent in the previous year, the rate of increase in credit to the private sector fell from 37 percent in 1984/85 to 15 percent in 1985/86. Money supply, broadly defined, which increased by 55 percent in 1984/85, rose by a further 76 percent in 1985/86 (Table 4). These developments were accompanied by an acceleration in the rate of inflation (as measured by the consumer price index) from 62 percent in 1984/85 to 70 percent in 1985/86. Meanwhile the structure of interest rates remained fixed with deposit rates and lending rates averaging 12.5 percent and 24 percent respectively, and, in light of the sharp increases in consumer prices, highly negative in real terms.

Sierra Leone's external position deteriorated sharply in 1985/86. While the current account deficit (including official transfers) improved from SDR 67 million (4.9 percent of GDP) in 1984/85 to SDR 33 million (3 percent of GDP) in 1985/86, and the deficit on the trade balance fell to SDR 2 million, these seeming improvements reflected the effects of the severe shortage of foreign exchange and the suspension of loan disbursements on imports, which fell by 20 percent. The value of exports declined by 17.5 percent in 1985/86, largely reflecting a decline in average unit prices in SDR terms of 12.6 percent, one half of which is due to a 30 percent drop in diamond unit values. The service balance improved by SDR 20 million, reflecting much lower investment income remittances; however, official debt service (including the Fund), continued to increase, rising to 82 percent of exports and 8 percent of GDP in 1985/86. Net transfers from abroad increased by SDR 10 million to SDR 29 million in 1985/86 (Table 5). However, the capital account deteriorated sharply, registering a deficit of about SDR 37 million, compared with a surplus of SDR 24 million in the preceding year; the short-term capital account (including errors and omissions) worsened sharply, and drawings on long-term loans fell from SDR 33 million in 1984/85 to SDR 12 million in 1985/86, largely because of arrears to a number of aid-disbursing agencies. The overall balance of payments deficit widened from SDR 43 million (3.2 percent of GDP) in 1984/85 to SDR 70 million (6.2 percent of GDP) in 1985/86. This deficit, along with a net repurchase obligation to the Fund of SDR 9.9 million, was financed mainly through an accumulation of arrears of SDR 74.4 million, including SDR 16.1 million in arrears to the Fund. By end-June 1986, external arrears are estimated to have amounted to about SDR 312 million (including SDR 22.8 million to the Fund), or more than twice the value of exports for the year.

Table 4. Sierra Leone: Monetary Survey, June 1981–June 1987

(In millions of leones)

	1981	1982	1983	1984	1985	1986	1987
	June						
Foreign assets (net)	-196.9	-269.6	-292.1	-730.4	-1,547.4	-3,386.7	-7,292.5 2/
Central bank	-206.8	-275.8	-314.3	-761.6	-1,582.2	-3,426.9	-7,332.7
Commercial banks	9.9	6.2	22.2	31.2	34.8	40.2	40.2
Domestic credit	479.4	627.1	867.7	1,046.1	1,360.7	2,142.9	2,893.3
Claims on Government (net)	384.7	525.0	749.9	922.9	1,191.6	1,948.1	2,564.3
Claims on private sector	94.7	102.1	117.8	123.2	169.1	194.8	329.0
Public enterprises	(3.6)	(3.6)	(3.9)	(3.0)	(4.6)	(17.4)	(...)
Other private	(91.0)	(98.5)	(113.9)	(120.2)	(164.5)	(177.4)	(...)
Money and quasi-money	258.6	324.5	443.8	570.2	882.3	1,551.2	2,074.0
Other items (net) 1/	23.9	33.0	131.8	-254.5	-1,069.0	-2,795.0	-6,473.2 2/

Source: Data provided by the Sierra Leone authorities; and staff estimates.

1/ Includes exchange rate-related valuation adjustments for exchange rate changes in 1983, 1985, and 1986 on external arrears and Treasury IMF accounts; counterpart funds; and blocked accounts.

2/ Reflects valuation adjustments associated with the depreciation of the leone vis-à-vis the U.S. dollar.

Table 5. Sierra Leone: Balance of Payments, 1981/82-1986/87

(In millions of SDRs, unless otherwise stated)

	1981/82	1982/83	1983/84	Revised actual 1984/85	Prelim-inary 1985/86	Program 1986/87
Trade balance	-128.8	-73.4	-14.1	-6.9	-2.1	22.6
Exports	(118.3)	(87.7)	(107.6)	(136.9)	(112.9)	(138.6)
Imports	(-247.1)	(-161.1)	(-121.7)	(-143.8)	(-115.1)	(-116.1)
Services balance	-78.0	-63.2	-49.0	-80.0	-60.0	-65.0
Freight and insurance	(-39.5)	(-25.7)	(-19.8)	(-23.4)	(-18.7)	(-18.9)
Other transportation	(12.4)	(10.1)	(6.9)	(5.3)	(7.0)	(7.5)
Travel	(0.4)	(2.0)	(1.1)	(1.1)	(0.5)	(5.5)
Debt service	(-12.9)	(-13.9)	(-14.3)	(-36.7)	(-42.3)	(-42.3)
Official interest (inc. interest on arrears)	/-7.0/	/-9.1/	/-9.0/	/-30.4/	/-36.0/	/-35.3/
IMF charges	/-5.9/	/-4.8/	/-5.3/	/-6.3/	/-6.3/	/-7.0/
Other Government	(-3.8)	(-4.8)	(-5.5)	(-5.3)	(-2.3)	(-2.3)
Other services	(-11.0)	(-12.0)	(-5.0)	(-6.5)	(-3.7)	(-8.1)
Investment income	(-23.6)	(-18.9)	(-12.4)	(-14.5)	(-0.5)	(-6.4)
Transfers 1/	30.8	22.1	25.3	19.4	29.0	36.8
Private	(8.0)	(3.8)	(2.6)	(1.9)	(2.5)	(2.7)
Official	(22.8)	(18.3)	(22.7)	(17.5)	(26.6)	(34.1)
Current account	-176.0	-114.5	-37.8	-67.5	-33.1	-5.6
Capital account	55.8	40.7	-5.8	24.2	-36.6	-43.5
Long-term (net)	-6.6	-7.0	-28.8	4.3	-26.5	-6.0
Official	(-6.1)	(0.7)	(-17.0)	(1.0)	(-28.4)	(-9.2)
Drawings	/46.5/	/42.4/	/18.7/	/32.8/	/11.9/	/22.5/
Repayments due	/-52.6/	/-41.7/	/-35.7/	/-31.8/	/-40.3/	/-31.7/
Private	(-0.5)	(-7.7)	(-11.8)	(3.3)	(1.9)	(3.2)
Short-term (including errors and omissions)	62.4	47.7	23.0	19.9	-10.1	-37.5
Allocation of SDRs	--	--	--	--	--	--
Overall balance	-120.2	-73.8	-43.6	-43.3	-69.7	-49.1
Debt relief	7.8	34.1	9.4	7.3	--	--
Arrears	86.2	40.4	-3.7	35.7	43.0	-25.4
Accrual	(...)	(...)	(...)	(...)	(74.4)	(--)
Rescheduling	(...)	(...)	(...)	(...)	(-0.5)	(--)
Valuation adjustment 2/	(...)	(...)	(...)	(...)	(-30.9)	(--)
Cash payment	(...)	(...)	(...)	(...)	(--)	(-25.4) 3/
Net Fund credit	-3.4	18.4	14.6	-9.4	-9.9	-2.5
Purchase	(--)	(20.7)	(19.0)	(--)	(--)	(15.6)
Repurchase	(-3.4)	(-2.3)	(-4.4)	(-9.4)	(-9.9)	(-18.1)
Reserve items (- increase)	29.6	-19.1	23.3	9.7	5.7	-6.4
SAF	--	--	--	--	--	11.6
Gap finance	--	--	--	--	--	71.9
Memorandum items:						
Stock of foreign exchange reserves (end period)	10.3	9.7	6.4	7.8	8.1	14.5
Foreign exchange reserves/Imports (months cover)	0.4	0.5	0.5	0.5	0.7	1.2

Sources: Data provided by the Sierra Leone authorities; and staff estimates and projections.

1/ Includes PL 480 grant rice.
2/ The valuation adjustment in 1985/86 is derived from the reconciliation of the change (SDR 43.0 million) in stock of arrears at end-June 1985 and end-June 1986 in SDRs; a large part of the adjustment is attributable to the depreciation of the dollar during this period.
3/ Includes clearing of arrears to Fund of SDR 22.8 million in June 1986, and a further net cash reduction in arrears of SDR 2.6 million for the fiscal year.

As of end-June 1986, Sierra Leone's external public debt outstanding (disbursed), including use of Fund credit and arrears on external debt, amounted to SDR 766 million, or 238 percent of estimated 1986/87 GDP. The debt service burden (including the Fund), amounted to about 82 percent of exports of goods. Gross foreign exchange reserves at end-June 1986 were SDR 8.1 million, equivalent to 0.7 months imports; however, overdrawn balances in foreign currencies were SDR 3.6 million, and a further amount of the balance is encumbered, being held against specific advances. Liquid usable foreign exchange reserves have since been practically exhausted.

In recent years the exchange and trade system in Sierra Leone had become increasingly distorted. The value of the leone, which was pegged to the SDR at Le 5.72 in February 1985, had appreciated by 58 percent in real effective terms by early June 1986 (Chart). Most private sector external transactions were carried out in a thriving parallel market in foreign exchange. However, as noted above, the official foreign exchange market was largely drained of foreign exchange. In addition, as payments on external debts fell into arrears, Sierra Leone found it increasingly difficult to obtain normal trade credit except on unfavorable terms, usually requiring the mortgaging of future export proceeds of the Sierra Leone Produce Marketing Board (SLPMB) and the payment of high finance charges.

III. Medium-Term Structural Adjustment Program and Policies

1. Summary of medium-term objectives

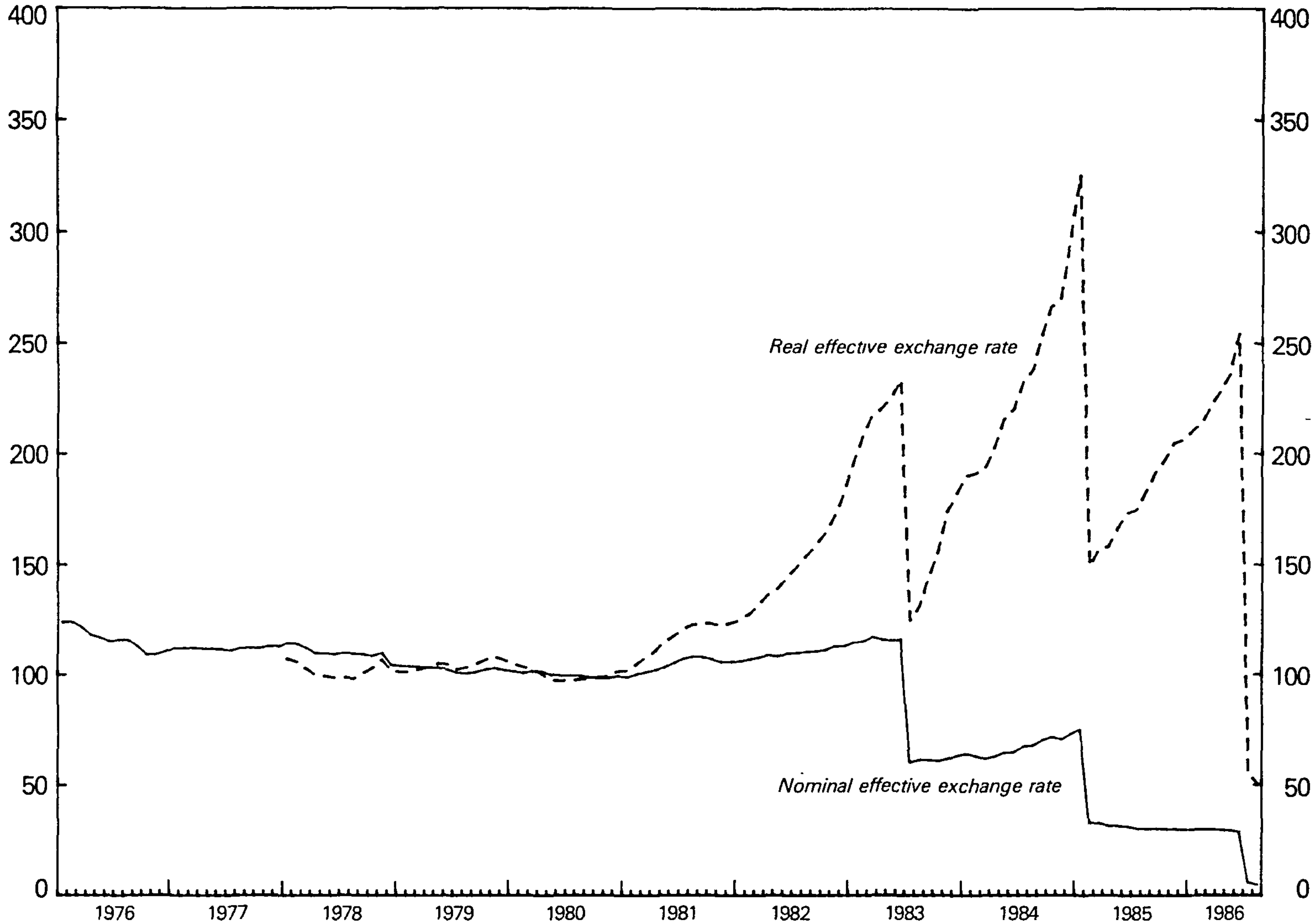
In light of the increasingly difficult economic and financial situation, the new Government commenced discussions with the Fund and the Bank staffs on the main components of an adjustment program designed to redress existing imbalances, reverse the economic decline which Sierra Leone has suffered over the past several years, and restore the economy to positive growth. These efforts, delineated in the context of an overall policy framework for the three years 1986/87-1988/89, aim at an annual average rate of growth of about 3 percent while at the same time substantially reducing the rate of inflation from about 90 percent in 1986/87 to about 10 percent by 1988/89; the external current account deficit (including official transfers) in the balance of payments is also programmed to decrease, from about 2 percent of GDP in 1986/87 to less than 1 percent of GDP in 1988/89 (Table 6). To this end, the authorities' medium-term policy framework during this period will emphasize the following: (i) the encouragement of private sector production, particularly in the agricultural and industrial sectors, through the implementation of appropriate pricing and other incentive policies; (ii) the attainment of increased efficiency in public resource management through improvements in the allocation and management of resources; (iii) substantive reform of the public enterprise sector (including a reduction over the medium term, in the scope of the sector);

CHART

SIERRA LEONE

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, JAN. 1978-AUG. 1986[1]

(1980 = 100)



Source Information Notice System

[1] Trade-weighted

Table 6. Sierra Leone: Key Elements of the Macroeconomic Adjustment Framework 1985/86-1988/89 1/

	1985/86	1986/87	1987/88	1988/89
	(Annual percentage change)			
Income and expenditure				
GDP at constant prices	-1.5	2.0	3.5	3.5
Consumer prices	70.4	90.0	30.0	10.0
	(Percent of GDP)			
Overall government deficit (commitment basis before debt relief) 1/	14.5	11.1	8.0	5.0
External sector				
Current account deficit (-)	-3.0	-1.8	-1.3	-0.5
Balance of payments deficit (-)	-6.2	-15.3	1.3	0.6
Gross official reserves (months of imports)	0.7	1.2	1.5	3.0

Sources: Annex to attachment II.

1/ The programmed deficit for 1986/87 is 7.5 percent of GDP after debt relief.

(iv) considerably strengthened fiscal and monetary policies; (v) extensive institution-building efforts including in the areas of agriculture and budgetary and investment planning, as well as civil service reform; (vi) the attainment of balance of payments viability in the context of a liberal trade and payments system.

2. Details of the structural adjustment program for 1986/87 and the policies for the medium-term

The implementation of the bulk of the substantive policy measures which underpin the authorities' medium-term structural adjustment program has been frontloaded to take place very early in the program period. These measures, which are both far-reaching and wide-ranging include: a flexible market-determined exchange system complemented by supporting liberalization of the trade and payments system; decontrol of the retail prices of imported and locally produced consumer goods; phased decontrol of the retail price of rice, in the context of an accelerated program of privatization of rice imports; removal of subsidies on petroleum products; increases in the producer prices of major agricultural export crops; a considerably tightened stance of fiscal and monetary policies; and a treasury bill auction system accompanied by decontrol of deposit and lending rates. The measures are also being implemented side by side with the ongoing reform and restructuring of the parastatal sector and by a number of institutional and other structural policy measures in various sectors of the economy, including in particular mining and agriculture.

a. External sector policies and medium-term prospects

In broad terms, the authorities' adjustment program aims at a reduction in the current account deficit of the balance of payments from about 3 percent of GDP in 1985/86 to 2 percent in 1986/87; by 1988/89, the current account deficit would be reduced to less than 1 percent of GDP. The authorities also plan to raise the presently low level of reserves (less than 0.7 months' imports) to about 1.2 months' imports by 1986/87 and about 3 months' imports by 1988/89. In addition, the authorities' adjustment program aim at substantial and sustainable progress during the three-year period toward an overall balance of payments position which would be consistent with orderly relations with creditors.

(1) External sector policies

The floating exchange rate system implemented by the authorities in June 1986 is operating freely; the import licensing regime has been liberalized and replaced by a system of open general licenses, except for a list of four items (ammunition, drugs, cartridges, and gambling machines), which have been proscribed on health and security grounds, and imports from South Africa and Namibia; all restrictions on current account transactions and inward remittances of capital have been lifted; retention privileges have been abolished; and customs valuation takes place at the exchange rate determined at the weekly fixing sessions between the Bank of Sierra Leone and the commercial banks. As of the end of September 1986, the exchange rate has depreciated to Le 30 = US$1 (or by 84 percent in foreign currency terms), relative to the previous official fixed rate of Le 5.7 = SDR 1, which prevailed before the float, and compared with a parallel market exchange rate reportedly around Le 31-32 = US$1. The commercial banks are fully free to buy and sell foreign exchange on a freely negotiable basis, and there is a spread in the buying rates quoted by the commercial banks ranging from Le 29.5 to Le 31.5 per US$1. A Fund-recruited technical expert is assisting the authorities in implementing the new exchange system.

The Sierra Leone authorities noted that, although, as of the end-September 1986 fixing session there were no offers of foreign exchange for sale, it was still too early to judge the new exchange system for a number of reasons. They explained that the period between July and December was traditionally the lean period for foreign exchange inflows and that a substantial part of the foreign exchange earnings of the SLPMB and certain bauxite export proceeds were mortgaged on account of either previous commitments on behalf of the Government or its rice import operations. In addition, a reduced inflow of foreign exchange from embassies and other international organizations has resulted from the large depreciation of the leone, while the abolition of retention privileges was initially strongly resisted by a number of powerful foreign companies in the mining sector, although these are now working out detailed arrangements with the authorities, to facilitate the surrender of export proceeds. They noted that there were weaknesses in fully enforcing surrender obligations, particularly in the fisheries sector, due to the Government's present limited surveillance capability. Nevertheless, the authorities stated that they have been taking additional steps to stimulate the inflow of foreign exchange resources into the system: the SLPMB's foreign liabilities are presently being reviewed by the Bank of Sierra Leone, with a view to taking them over and rescheduling some of them where appropriate; arrangements, including on-site inspections to ensure full surrender of foreign exchange by the hotels and other tourist operators are being introduced; the rice import operations of the SLPMB are now being privatized; previous centralized buying arrangements for diamonds under the Government Gold and Diamond Office (GGDO) are being restructured, as well as the management of the National Diamond Mining Company (NDMC). The Diamond Corporation (DICOR) has opened a new office in Freetown and resumed diamond purchasing; they plan to reopen their Kenema office in the near future. Meanwhile, the authorities feel that, consistent with the design of the exchange system, on those occasions when there are no offers of foreign exchange for sale at the interbank fixings, and when there has been no interbank transactions, the rate at the weekly fixing session should reflect market forces as much as possible; to this end, it should be the weighted average of the rates determined between the commercial banks and their customers during the previous week.

Debt management policies will aim at reducing the external debt burden in the medium term, both in the context of the Government's overall adjustment strategy, as well as in the context of an improved machinery for screening and selecting projects in order to improve overall economic growth. In view of Sierra Leone's very high debt service burden, all new debts contracted by the Government or central bank or guaranteed by them, except for import related credits, will only be on concessional terms. External payments arrears will be reduced through rescheduling and consolidation, as well as through cash payments, with a view to eliminating these arrears within five years. The Government's adjustment program has as a performance criterion a net cash reduction in external payments arrears (excluding the Fund) of SDR 2 million by end-December 1986 based on the inventory of arrears compiled in November 1986. For the fiscal year 1986/87 as a whole, the program provides for a target net reduction of arrears of SDR 2.6 million, which would involve clearing all the increase in arrears during the fiscal year prior to the start of the arrangement, totaling about SDR 23 million.

The authorities consider that the critical shortage of liquid foreign exchange reserves requires that urgent priority be given to a buildup of the stock of gross liquid foreign exchange reserves. To this end, the 1986/87 program aims at an increase in reserves of SDR 6.4 million, to the equivalent of about 1.2 months' imports. The authorities also intend that by the end of 1988/89, the stock of foreign exchange reserves would be equivalent to about three months of imports.

(2) Medium-term prospects

Sierra Leone faces a critical external position. In 1986/87, debt service payments (including the Fund, interest on arrears and before debt relief) are projected at SDR 131 million, 1/ or 95 percent of exports; debt service to the Fund amounts to SDR 25.1 million or about 18 percent of exports. Although the Sierra Leone authorities have stressed that liquid foreign exchange reserves have been practically exhausted and that there is an urgent need to replenish these, it may be noted that a large part of export proceeds over the next few months have been mortgaged to meet essential foreign obligations incurred in 1985/86, providing little scope for large foreign currency inflows by end-calendar year 1986. However, significant net inflows are in prospect beginning during the January-June 1987 period, which should facilitate the attainment of the authorities' reserve objectives for 1986/87 as a whole, as well as their commitment to remain current with the Fund.

The adjustment measures adopted by the Sierra Leone authorities and the sharp depreciation in the exchange rate are expected to lead to an improvement in export proceeds, while constraining imports in the 1986/87 program period and over the medium term. Imports will also be con-

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1/ These figures include short-term and Eurodollar loans amounting to SDR 26.1 million which fall due every year, but which, in the past, have been rolled over on a month-to-month basis, and which may be reschedulable.

strained by a continuing shortage of foreign exchange for at least the first half of 1986/87. The projection of export volumes is based on industry forecasts of exports and likely export trends in light of the new floating exchange rate system. In 1986/87, export unit values are expected to increase, as higher unit values for mineral exports offset lower projected unit values of agricultural commodities. The recovery in the unit values of diamonds mainly reflects the very low unit values realized in 1985/86. The higher projected price for rutile is based on the information provided to the Sierra Leone rutile company, Sierra Rutile, by its parent company in the United States, while the higher price for bauxite exports reflects the current prices on world markets. Import unit values are projected to drop sharply, partly in response to the regularization of commercial arrangements and reduced finance charges. Thus, the terms of trade are projected to improve by about 26 percent in 1986/87. As a result, the trade balance is forecast to register a surplus of SDR 23 million in 1986/87, compared with deficits in previous years, with some further improvements in the trade surplus in 1987/88-1988/89 (Table 7) due largely to increases in agricultural and rutile export volumes (Table 8). The projections allow for an annual average increase in the value of imports of 7.1 percent in 1987/88-1988/89, compared with an annual average decline of 10.5 percent in the three years ended June 1986.

These projections are clearly sensitive to the underlying assumptions. For example, if the projected higher prices for rutile are not maintained or if diamond export volume declines, annual export values and the projected trade surplus would decline. However, under the floating exchange system, this would mean that the projected recovery in imports in 1987/88 and 1988/89 would also be restricted. Despite the projected improvements in the trade balance, staff estimates indicate that there would still be large ex ante financing gaps during the program period, reflecting the very high debt service burden. Allowing for lower interest payments, such as under the SAF, the Structural Adjustment Loan (SAL), and other concessional resources that would be forthcoming to finance the residual gap in the context of a stand-by arrangement, the programmed current account deficit for 1986/87 would be reduced to SDR 5.6 million or 1.8 percent of GDP. 1/ Thereafter, using the financing assumptions outlined by the authorities in the policy framework paper for the SAF, the current account deficit (including official transfers) is projected to decline from SDR 6.0 million (1.3 percent of GDP) in 1987/88 to SDR 2.5 million (0.5 percent of GDP) in 1988/89 (Table 6). 2/ The capital account of the balance of payments is

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1/ Excluding official transfers (but including PL 480 grant rice) the programmed current account deficit in 1986/87 would be SDR 32.9 million (10.2 percent of GDP).

2/ Excluding official transfers (but including PL 480 grant rice) the current account deficit is projected to decline to 6.2 percent of GDP by 1988/89.

Table 7. Sierra Leone: Balance of Payments, 1981/82-1990/91

(In millions of SDRs, unless otherwise stated)

	1981/82	1982/83	1983/84	Revised actual 1984/85	Prelim-inary 1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Trade balance	-128.8	-73.4	-14.1	-6.9	-2.1	22.6	23.2	26.6	26.4	24.7
Exports	(118.3)	(87.7)	(107.6)	(136.9)	(112.9)	(138.6)	(150.9)	(158.9)	(163.9)	(166.7)
Imports	(-247.1)	(-161.1)	(-121.7)	(-143.8)	(-115.1)	(-116.1)	(-127.7)	(-132.3)	(-137.4)	(-142.0)
Services balance	-78.0	-63.2	-49.0	-80.0	-60.0	-65.0	-69.1	-68.1	-72.3	-76.0
Freight and insurance	(-39.5)	(-25.7)	(-19.8)	(-23.4)	(-18.7)	(-18.9)	(-20.8)	(-21.5)	(-22.4)	(-23.1)
Other transportation	(12.4)	(10.1)	(6.9)	(5.3)	(7.0)	(7.5)	(7.5)	(7.5)	(7.5)	(7.5)
Travel	(0.4)	(2.0)	(1.1)	(1.1)	(0.5)	(5.5)	(6.5)	(7.2)	(7.9)	(8.7)
Debt service	(-12.9)	(-13.9)	(-14.3)	(-36.7)	(-42.3)	(-42.3)	(-43.1)	(-42.5)	(-45.4)	(-48.1)
Official interest (inc. interest on arrears)	/-7.0/	/-9.1/	/-9.0/	/-30.4/	/-36.0/	/-35.3/	/-35.3/	/-36.0/	/-39.9/	/-44.3/
IMF charges	/-5.9/	/-4.8/	/-5.3/	/-6.3/	/-6.3/	/-7.0/	/-7.8/	/-6.5/	/-5.5/	/-3.8/
Other government	(-3.8)	(-4.8)	(-5.5)	(-5.3)	(-2.3)	(-2.3)	(-2.3)	(-2.3)	(-2.3)	(-2.3)
Other services	(-11.0)	(-12.0)	(-5.0)	(-6.5)	(-3.7)	(-8.1)	(-8.0)	(-5.7)	(-5.7)	(-5.7)
Investment income	(-23.6)	(-18.9)	(-12.4)	(-14.5)	(-0.5)	(-6.4)	(-9.0)	(-10.7)	(-12.0)	(-12.9)
Transfers	30.8	22.1	25.3	19.4	29.0	36.8	39.9	39.1	39.1	34.0
Private	(8.0)	(3.8)	(2.6)	(1.9)	(2.5)	(2.7)	(3.1)	(3.1)	(3.1)	(3.1)
Official	(22.8)	(18.3)	(22.7)	(16.3)	(25.0)	(27.3)	(30.8)	(30.8)	(30.8)	(30.8)
Grant rice	(...)	(...)	(...)	(1.2)	(1.6)	(6.8)	(5.9)	(5.1)	(5.1)	(--)
Current account	-176.0	-114.5	-37.8	-67.5	-33.1	-5.6	-6.0	-2.5	-6.8	-17.3
Capital account	55.8	40.7	-5.8	24.2	-36.6	-43.5	11.7	5.8	9.3	6.6
Long-term (net)	-6.6	-7.0	-28.8	4.3	-26.5	-6.0	13.8	5.8	9.3	6.6
Official	(-6.1)	(0.7)	(-17.0)	(1.0)	(-28.4)	(-9.2)	(9.3)	(0.5)	(3.3)	(0.1)
Drawings	/46.5/	/42.4/	/18.7/	/32.8/	/11.9/	/22.5/	/43.4/	/30.7/	/30.7/	/30.7/
Repayments due	/-52.6/	/-41.7/	/-35.7/	/-31.8/	/-40.3/	/-31.7/	/-34.1/	/-30.3/	/-22.5/	/-30.6/
Private	(-0.5)	(-7.7)	(-11.8)	(3.3)	(1.9)	(3.2)	(4.5)	(5.4)	(6.0)	(6.5)
Short-term (including errors and omissions)	62.4	47.7	23.0	19.9	-10.1	-37.5	-2.1	--	--	--
Allocation of SDRs	--	--	--	--	--	--	--	--	--	--
Overall balance	-120.2	-73.8	-43.6	-43.3	-69.7	-49.1	5.7	3.3	2.4	-10.7
Debt relief	7.8	34.1	9.4	7.3	--	--	--	--	--	--
Arrears	86.2	40.4	-3.7	35.7	43.0	-25.4	-32.2	-19.2	-6.3	-6.3
Accrual	(...)	(...)	(...)	(...)	(74.4) 1/	(--)	(--)	(--)	(--)	(--)
Rescheduling	(...)	(...)	(...)	(...)	(-0.5)	(--)	(--)	(--)	(--)	(--)
Valuation adjustment	(...)	(...)	(...)	(...)	(-30.9)	(--)	(--)	(--)	(--)	(--)
Cash payment	(...)	(...)	(...)	(...)	(--)	(-25.4)	(-32.2)	(-19.2)	(-6.3)	(-6.3)
Net Fund credit	-3.4	18.4	14.6	-9.4	-9.9	-2.5	-21.6	-14.5	-15.1	-9.9
Purchase	(--)	(20.7)	(19.0)	(--)	(--)	(15.6)	(--)	(--)	(--)	(--)
Repurchase	(-3.4)	(-2.3)	(-4.4)	(-9.4)	(-9.9)	(-18.1)	(-21.6)	(-14.5)	(-15.1)	(-9.9)
Reserve items	29.6	-19.1	23.3	9.7	5.7	-6.4	-5.5	-20.0	--	--
Monetary auth.	(26.8)	(-7.4)	(16.5)	(2.5)	(-0.3)	(...)	(...)	(...)	(...)	(...)
Commercial banks	(2.8)	(-11.7)	(6.8)	(7.2)	(6.0)	(...)	(...)	(...)	(...)	(...)
SAF	--	--	--	--	--	11.6	--	--	--	--
Gap finance	--	--	--	--	--	71.9	53.6	50.4	21.4	26.9
Memorandum items:										
Stock of foreign exchange reserves (end period)	10.3	9.7	6.4	7.8	8.1	14.5	20.0	40.0	40.0	40.0
Foreign exchange Res/ Imports (months cover)	0.4	0.5	0.5	0.5	0.7	1.2	1.5	3.0	2.9	2.8
					(In percent)					
Debt service ratio (before debt relief)										
Including the IMF	58.2	66.0	50.6	56.9	81.9	95.0	65.4	54.9	53.6	53.2
Excluding the IMF	50.4	57.9	41.5	45.4	67.6	76.9	46.0	41.7	41.1	44.9
Current account/GDP	-15.8	-8.0	-3.4	-4.9	-3.0	-1.8	-1.3	-0.5	-1.1	-2.7
Overall balance/GDP	-10.8	-5.1	-3.9	-3.2	-6.2	-15.3	1.3	0.6	0.4	-1.7
Export Growth	-1.0	-25.9	22.7	27.2	-17.5	22.8	8.9	5.3	3.1	1.7
Import Growth	2.0	-34.8	-24.5	18.2	-20.0	0.9	10.0	3.6	3.9	3.3
Change in terms of trade	-13.7	-25.3	9.2	8.8	-8.6	25.5	1.4	-1.9	-1.7	-1.7

Sources: Data provided by the Sierra Leone authorities; and staff estimates and projections.

1/ The valuation adjustment in 1985/86 is derived from the reconciliation of the change (SDR 43.0 million) in stock of arrears at end-June 1985 and end-June 1986 in SDRs; a large part of the adjustment is attributable to the depreciation of the dollar during this period.

Table 8. Sierra Leone: Medium-Term Projections
of the Composition of Exports, 1984/85-1990/91

	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Minerals							
Diamonds							
Volume ('000 carats)	311.5	344.8	349.0	345.0	345.0	345.0	345.0
Value (SDR mn.)	32.9	25.3	33.2	32.8	32.8	32.8	32.8
Unit price (SDR/carat)	105.5	73.5	95.1	95.1	95.1	95.1	95.1
Bauxite							
Volume ('000 tons)	1,286.6	1,176.3	1,200.0	1,200.0	1,200.0	1,200.0	1,200.0
Value (SDR mn.)	24.4	19.6	20.9	21.9	23.0	24.2	25.4
Unit price (SDR/ton)	19.2	16.7	17.4	18.3	19.2	20.1	21.1
Rutile							
Volume ('000 tons)	98.5	85.5	105.0	115.0	120.0	120.0	120.0
Value (SDR mn.)	28.0	25.4	34.7	39.0	40.7	40.7	40.7
Unit price (SDR/ton)	284.3	297.3	330.0	338.9	338.9	338.9	338.9
Iron ore							
Volume ('000 tons)	100.0	--	--	--	--	--	--
Value (SDR mn.)	0.8	--	--	--	--	--	--
Unit price (SDR/ton)	8.4	--	--	--	--	--	--
Gold							
Volume ('000 tons)	16.7	17.8	25.0	25.0	25.0	25.0	25.0
Value (SDR mn.)	5.4	4.8	8.1	8.1	8.1	8.1	8.1
Unit price (SDR/ton)	322.1	269.0	325.2	325.2	325.2	325.2	325.2
Agricultural goods							
Coffee							
Volume ('000 tons)	7.4	7.7	9.0	11.0	12.0	13.0	13.0
Value (SDR mn.)	16.8	18.2	19.0	22.3	24.8	27.4	28.0
Unit price (SDR/ton)	2,270.3	2,363.0	2,115.0	2,028.3	2,068.0	2,110.2	2,152.4
Cocoa							
Volume ('000 tons)	10.9	9.1	11.0	12.0	13.0	13.0	13.0
Value (SDR mn.)	24.0	17.7	17.6	21.0	23.2	23.9	24.6
Unit price (SDR/ton)	2,204.5	1,947.0	1,600.0	1,752.0	1,787.0	1,840.7	1,895.9
Palm kernels							
Volume ('000 tons)	8.5	5.7	8.5	8.6	9.0	10.0	10.0
Value (SDR mn.)	3.1	0.7	0.5	0.6	0.6	0.7	0.7
Unit price (SDR/ton)	364.7	124.6	56.0	67.4	68.8	70.1	71.6
Other (SDR mn.)	1.4	1.1	2.5	2.9	3.1	3.4	3.6
Re-exports (SDR mn.)	0.1	--	2.2	2.3	2.5	2.7	2.8
Total value (SDR mn.)	136.9	112.9	138.6	150.9	158.9	163.9	166.7

Sources: Data provided by the Sierra Leone authorities; and staff estimates and projections.

projected to register a deficit of SDR 44 million in 1986/87 including the maturing of Eurodollar loans amounting to SDR 27.9 million. 1/ Nevertheless, drawings (all on existing commitments) are projected to recover sharply, beginning in the second half of 1986/87, from the low levels in 1985/86 when there was considerable interruption in disbursements as a result of Sierra Leone's arrears to a number of multilateral agencies and to bilateral donors. For 1987/88-1990/91, average project-related commitments of about SDR 34 million per annum are projected (all assumed to be on concessional terms). Although these projections are considerably less than the average commitments of US$60 million per annum over the previous five years, those high levels included substantial amounts of nonconcessional borrowing, which have contributed to the present excruciating debt service burden of Sierra Leone. 2/ On the basis of current projections, the ratio of external debt to GDP would amount to 137 percent, and debt service as a ratio of exports (including the Fund, and without rescheduling) would decline to 55 percent by 1988/89 (Table 9).

The overall balance of payments deficit in 1986/87 is estimated at SDR 49 million. 3/ Allowing for payments to the Fund (SDR 22.8 million of arrears at end-June 1986 and SDR 18.1 million in repurchases) and a programmed SDR 6.4 million accumulation in gross foreign exchange reserves, would lead to an unfinanced gap, after taking account of SAF resources, of SDR 71.9 million, 4/ to be financed, in addition to drawings under the stand-by arrangement (SDR 15.6 million in the 1986/87 fiscal year), by a World Bank SAL (about SDR 14.4 million), a donors' conference scheduled for the first quarter of calendar year 1987, as well as an estimated SDR 51.3 million in debt relief, including rescheduling within the framework of the Paris Club, comparable agreements with official creditors and the rescheduling of at least the principal falling due on the Eurodollar loans. The rescheduling arrangements are projected to reduce the debt service burden (excluding the Fund) from 77 percent of exports to 40 percent of exports in 1986/87. Allowing for the lower interest charges on the SAF and concessional loans under the program projections, there would be scope for an additional net cash reduction in arrears of about SDR 2.6 million over and above the cash payment of SDR 25.1 million already made by Sierra Leone in clearing the arrears to the Fund on September 18, 1986. To this end, the performance criteria for end-December 1986 include an

1/ Including the SDR 26.1 million which, in the past, had been rolled over by the commercial bank concerned.

2/ In any event, higher than assumed commitments and drawings (which would have to be on concessional terms) would be reflected in the balance of payments mainly in a faster growth of imports, and the relatively weaker current account would be more than offset in the short-term by a stronger capital account.

3/ Including the assumed repayment of the short-term Eurodollar loans.

4/ Excluding the short-term Eurodollar loan repayment, the unfinanced gap would amount to SDR 46 million.

Table 9. Sierra Leone: External Debt and Debt Service Projections, 1985/86-1990/91

(In millions of SDRs, unless otherwise stated)

	Estimated	Projections				
	1985/86	1986/87	1987/88	1988/89	1989/90	1990/91
Total external debt outstanding (end period) 1/	766	771	797	821	826	837
In percent of following year GDP	(238.1)	(171.1)	(148.6)	(137.3)	(127.9)	(119.4)
Debt service	92.5	131.7 2/	98.8	87.2	87.9	88.6
Principal	50.2	89.4 2/	55.7	44.7	42.5	40.5
Of which: repurchases	(9.9)	(18.1)	(21.6)	(14.5)	(15.1)	(9.9)
Interest 3/	42.3	42.3	43.1	42.5	45.4	48.1
Of which: charges	(6.3)	(7.0)	(7.8)	(6.5)	(5.5)	(3.8)
Debt service ratio 4/						
Including IMF	81.9	95.0	65.4	54.9	53.6	53.2
Excluding IMF	67.6	76.9	46.0	41.7	41.1	44.9
Memorandum item:						
Exports of goods 5/	112.9	138.6	150.9	158.9	163.9	166.7

Sources: Bank of Sierra Leone; and staff estimates and projections.

1/ Includes medium- and long-term disbursed debt, external arrears, use of Fund credit, new program drawings including assumptions about cash reductions in arrears, and residual gap finance. The figures should be treated with caution owing to the highly tentative nature of GDP estimates.
2/ Includes falling due of short-term Eurodollar loans amounting to SDR 26.1 million which in the past have been rolled over on a month-to-month basis.
3/ Assumes for 1986/87 that the gap is financed as outlined under the program; for 1987/88-1988/89 financing is consistent with the policy framework.
4/ In percent of exports of goods.
5/ Data on exports of services are unavailable.

SDR 2 million cash reduction in the arrears stock as at the beginning of the arrangement in November. The targets for end-June 1987 aim at a cash reduction in arrears for the 1986/87 fiscal year by SDR 2.6 million (excluding the clearing of SDR 25.12 million of arrears to the Fund in September but including cash payments associated with Paris Club rescheduling). Attainment of this target involves clearing the net accrual of arrears in the first half of the 1986/87 fiscal year (existing prior to the start of the arrangement) as noted earlier, estimated at about SDR 23 million, and, in addition, meeting estimated current payments of SDR 19 million after the impact of the rescheduling arrangements. On these bases, staff estimates indicate that the total reduction in arrears (including the effects of rescheduling, but excluding the liquidation of arrears to the Fund), is projected at SDR 226 million.

In 1987/88 and 1988/89 the financing gaps, are projected to decline to an average of about SDR 52 million. A key element of the program is that, in order to ensure external viability in the medium term, Sierra Leone will make a continuous and determined effort to clear external arrears through consolidation, rescheduling and cash payments. Of the stock of external arrears of about SDR 289 million at end-June 1986 (excluding the Fund), it is estimated that SDR 223 million may be eligible for rescheduling and that SDR 66 million would be cleared through cash payments. 1/ In making projections of the likely resource gaps in 1987/88 and 1988/89 consistent with the assumptions in the 1986/87 program period, as well as the SAF policy framework, it has been assumed that the nonrescheduled arrears (SDR 66 million) are cleared through biannual payments over two years. 2/ The resulting schedule of cash reductions in arrears necessary to clear arrears by 1990/91, including cash payments associated with debts rescheduled in the framework of the Paris Club and other agreements, is SDR 32.2 million in 1987/88, SDR 19.2 million in 1988/89, and SDR 6.3 million in 1989/90 and 1990/91.

It may be noted that these assumptions imply a very heavy burden on Sierra Leone's already difficult external position, particularly as further substantial reductions in the already very low current account deficit/GDP ratio would be unlikely without constraining imports and growth to intolerably low and unsustainable levels. Consequently, for the schedule to be attained, Sierra Leone would need to continue to eschew nonconcessional borrowing. In addition, it is assumed that Sierra Leone would continue to receive international financial support, including through annual reschedulings within the framework of the Paris

1/ About SDR 10 million of the SDR 66 million reflects arrears of interest to commercial banks and other financial institutions which are assumed not to be rescheduled.

2/ Except for the assumed nonrescheduled portion of the commercial pipeline of arrears (estimated at SDR 27 million), which is assumed to be cleared over five years, and arrears to multilaterals (SDR 8.7 million) which are assumed to be cleared during the first year of the program.

Club and with other official creditors, including the rescheduling of previously rescheduled debts; further drawings under the SAF and World Bank SAL are also assumed. After making allowance for these possible sources of assistance, there would still be projected unfinanced gaps of about SDR 22 million in 1987/88 and SDR 14 million in 1988/89. Therefore, apart from possible recourse to Fund-supported adjustment programs (which would serve as catalysts for the required external resources), Sierra Leone is likely to have to approach donors again for further concessional assistance in future years, including debt relief.

b. Production and investment policies

The Sierra Leone authorities are giving effect to the medium-term growth and structural adjustment program within the framework of a new three-year investment program covering the period 1986/87-1988/89. In this context, a small number of high priority projects have been designated, in consultation with the World Bank, as a core program which will have relatively firm financing. The Sierra Leone authorities explained that, hitherto, a major problem had been the dispersion of a small development budget over too many projects, with the result that many of these projects were not completed. To overcome this problem, the core program, accounting for 80 percent of the projected development budget is being finalized with the assistance of the World Bank, while the number of noncore projects under way is being sharply reduced.

Under the Government's investment program, some 40-50 percent of resources would be devoted to the agricultural and related sectors. The authorities stated that measures under way or contemplated in the agricultural sector include the following: (a) the ongoing policy of competitive and realistic producer pricing for agricultural exports and for rice; (b) the ongoing process of privatization of rice import operations, side by side with measures aimed at encouraging local rice production; (c) development of supporting institutions in the agricultural sector, usually with the assistance of external donors; and (d) a review of the agricultural sector, with the assistance of the World Bank, with a view to identifying specific areas of potential growth and constraints in the sector, and to delineate a comprehensive development strategy which is best suited for the sector. Industrial (including manufacturing) activities will continue to take place in an atmosphere of increased reliance on the price mechanism, reduced administrative intervention and protection. Private foreign investment would be encouraged through the implementation of appropriate policies as well as in the context of the prospective review of the Industrial Development Act, by June 1987. With regard to the mining sector, the Sierra Leone authorities are concerned that one of the critical issues facing the Government is to arrest the decline in the overall performance of the sector. To this end, increased competition will be fostered in the diamond mining sector through the continued maintenance of the floating exchange arrangements. Efforts will also be made to increase the contribution of the diamond mining sector to growth. The authorities explained that the proposed Kimberlite diamond mining project (the financing of which a number of reputable prospective foreign investors had hitherto withdrawn from) will be reviewed, with a view to attracting appropriate foreign financing. Meanwhile, they stated that the scope of the project is being revised, and the likely size of the investment has been scaled down. Efforts will also be made to increase the contribution of other minerals notably rutile and bauxite to the growth of the economy as well as to the generation of foreign exchange resources. By December 1986, the Government plans to review the existing arrangements in the fishing sector, with a view to exploiting this important resource for the development of the economy.

c. Prices and incomes policies

The Sierra Leone authorities intend to continue the policy of full and complete price decontrol implemented at the time of the 1986/87 budget speech. They stated that there is no list of controlled items, and that they expect shortly to dismantle the now redundant price control unit in the Ministry of Trade and Industry. They were reasonably satisfied that the new policy is having the intended effect of improving the allocation of resources, although there was some concern that a number of commercial houses were exploiting the scarcity situation by charging exorbitant prices. The authorities expect that with the increased liberalization of the economy and its attendant salutary effects in fostering increased competition, and with improved supply of goods, the inflationary pressures in the economy will begin to abate. In the case of rice, the Government has already started the process of encouraging competition, through the privatization of the hitherto monopoly rice import operations of the SLPMB. The authorities have repeatedly reaffirmed the commitment of the Government to fully phase out the role of the SLPMB in rice import operations by end-December 1986, except for the holding of a strategic stock at the level of some 20,000 tons, equivalent to approximately two months of Sierra Leone's rice import needs. The retail price of rice is also being decontrolled; as an interim step, the retail price of rice was doubled in August 1986, to Le 170 per 50 kg. bag, with the result that the subsidy on rice should be contained to Le 44 million in 1986/87. Sales of grant rice, as well as rice from the strategic stock, will be made at the going market price of rice.

The authorities are fully cognizant of the important role of the energy sector in the rehabilitation of the economy. Consequently, pending the development of alternative sources of local supply, energy policies are geared toward the curtailment of energy consumption, by eliminating price subsidies. To this end, the prices of petroleum products have been increased twice already, by substantial amounts, since the floating of the exchange rate on June 27, 1986. The Sierra Leone authorities explained that on that date, the prices of petrol, diesel fuel and kerosene were increased by 88 percent, 86 percent and 200 percent, respectively, thereby eliminating the subsidy on petroleum products at the floating rate of about Le 13-14 = US$1 at the time. Subsequently, however, the exchange rate depreciated further, necessitating further adjustment in the prices of petroleum products. Consistent with the stated policy stance of the Government, the prices of petroleum products were increased again on September 16, 1986 by 100 percent, 76.9 percent and 83.3 percent for petrol, diesel fuel, and kerosene, respectively. These latest adjustments brought the total increases in the prices of petroleum products in the three-month period since the float began to a range of 257 percent (diesel) and 475 percent (kerosene). Prices will be adjusted further, in line with the policy to avoid subsidies, every time costs increase by more than 10 percent, or quarterly to eliminate any subsidies. In order to attain possible significant gains in petroleum product prices, the Sierra Leone authorities plan to regularize Sierra Leone's relations with its oil creditors; they expect to work out a rescheduling arrangement as well as reach other understandings on Sierra Leone's debts to the oil companies, in a way that could permit the latter to resume supplying oil to Sierra Leone at prices relatively more favorable than what obtains at present. Other administrative prices (the telephone tariffs, telephone rentals, water rates, telex and international telephone calls, as well as road transport corporation intercity fares) have been raised by amounts ranging from 50 percent (intercity fares) to 100 percent (international telephone calls). As recommended by the World Bank, electricity tariffs were increased by 300 percent, effective October 1, 1986.

In the agricultural sector, effective July 1986, the Government announced increases in the producer prices of coffee, cocoa, and palm kernels by 100 percent, 200 percent, and 88 percent, respectively; when account is taken of the earlier increases in February 1986 of 100 percent and 33 percent, respectively, in the producer prices of coffee and cocoa, agricultural export producer prices have been increased by amounts ranging from 88 percent to 300 percent. As a result, Sierra Leone is now broadly competitive with neighboring countries at the prevailing exchange rate; the producer price of rice was also increased by 74 percent, as a step toward encouraging local production. Nevertheless, producer price developments will continue to be monitored closely by the Government, in light of its commitment to remain competitive, and in the context of the existing interministerial producer price committee, which includes representatives of the SLPMB, the Ministry of Agriculture, the Ministry of Trade and Industry, and the Ministry of Finance.

As stated in the 1986/87 budget speech, wages and salaries were increased by an average of 35 percent, with effect from July 1, 1986, and the authorities are determined to exercise moderation in this area. However, they are also concerned that, despite the recent increase, salaries in the civil service remain very low. Nevertheless, the authorities are determined that, unless there are compelling reasons to the contrary, the Government will not award a further general salary increase in 1986/87, without prior consultation with the Fund's management. The matter will be reviewed at the time of the first mid-term review in December 1986.

d. Fiscal policies

The 1986/87 program targets an overall fiscal deficit (on a commitment basis and before debt relief) of Le 1,151 million, implying a reduction in the deficit/GDP ratio from 14.5 percent in 1985/86 to 11.1 percent in 1986/87. On a cash basis, taking into account the programmed reduction in domestic expenditure-related arrears of Le 10.0 million, the overall deficit amounts to Le 1,161 million. 1/ Net foreign financing is projected at negative Le 146 million, reflecting disbursements of Le 580 million and principal due of Le 726 million. Domestic bank financing of the government deficit is to be limited in 1986/87 to Le 616.2 million (39.7 percent of beginning money stock) compared with Le 757 million (85.7 percent of beginning money stock) in 1985/86. Domestic nonbank financing is projected at Le 61 million. This leaves a financing gap of about Le 630 million (6 percent of GDP) expected to be filled through partial rescheduling of external arrears accumulated during July-November and of external obligaions falling due during the period December 1986-June 1987. 2/ Taking into account the expected rescheduling of interest, the overall deficit on a cash basis is estimated at 7.5 percent of GDP. The Sierra Leone authorities' Memorandum on Economic and Financial Policies includes, in an accompanying separate attachment, a more detailed statement delineating the main underpinnings of fiscal policy in 1986/87. This separate memorandum of understanding on fiscal policies specifies the need to implement new fiscal measures amounting to about 1 percent of GDP, in the context of the revised budget for 1986/87, to be announced on January 1, 1987, in order to ensure the attainment of the fiscal targets under the program. Meanwhile, the targets described above are being used for planning, monitoring and implementation purposes under the program, pending a comprehensive review of the budgetary situation during the first review under the program in December 1986. At that time, the fiscal targets will be reviewed, with a view to maintaining, and, if necessary, strengthening them further.

Pending the above, total revenue and grants are programmed to increase about fourfold, from Le 511.0 million in 1985/86 to Le 2,014.8 million in 1986/87. Of the projected increase (Le 1,503.8 million), slightly over one third (Le 534.8 million) would be due to the impact on grant receipts of the substantial depreciation of the leone (from Le 5 = US$1 in June 1986, to the assumed average exchange rate of Le 28 = US$1 for 1986/87), as these are expected to increase by roughly the amount of the almost sixfold depreciation in the

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1/ The fiscal program for 1986/87 as presented in Table 3 assumes no change in the stock of government external arrears outstanding at the end of June 1986. However, it is estimated that about Le 700 million in government interest arrears and about Le 2,240 million in government principal arrears may be eligible for rescheduling.

2/ During the period July-November 1986, the Government is expected to accumulate external interest arrears of Le 142 million and principal arrears of Le 670 million.

exchange rate. Tax revenues are programmed to increase about threefold, reflecting, in large part, the impact of the exchange rate depreciation on foreign trade related receipts, albeit on a relatively smaller scale than the impact on grant receipts. It is also programmed that the SLPMB, which has not paid any export duties in the past few years (with the exception of 1983/84, in connection with the last Fund-supported adjustment program), will pay both the export taxes due in 1986/87, as well as the 10 percent import duties on its rice operations this fiscal year, prior to the phasing out of these operations by December 31, 1986. In addition, the Sierra Leone authorities have decided to undertake major efforts to restructure and improve the revenue potential of the tax system, in light of the major reforms now taking place in the economy, including the exchange system and price decontrol. Accordingly, they have requested a Fund technical assistance tax mission to visit Freetown in October/November 1986 to assist them in this effort. It is expected that some of the results of that tax technical mission will form part of the fiscal input into the revised budget to be announced on January 1, 1987. Meanwhile, however, the authorities are stepping up their efforts to increase revenue collections of income tax as well as excise taxes and customs duties.

Where expenditures are concerned, the authorities intend to exercise very firm control. Despite the sixfold depreciation of the exchange rate and an inflation rate of 90 percent, total expenditures are programmed to increase by Le 1,838.1 million (or 128.4 percent) to Le 3,269.9 million. Of this increase, Le 880.7 million is attributable to the programmed fivefold increase in development expenditures from Le 212.8 million in 1985/86 to Le 1,093.5 million in 1986/87. Current expenditures are programmed to increase by 85 percent, or less than the inflation rate; non interest payments are expected to increase moderately in part because the large subsidies on oil and rice last year have been sharply reduced. Consequently, the authorities intend to adhere strictly to, and to tighten further the expenditure control measures initiated in earlier years, with respect to procurement and management of supplies. Furthermore, as delineated in the authorities' separate memorandum of understanding on fiscal policies, the authorities have targeted budgetary savings in a number of areas.

The Sierra Leone authorities are implementing a number of other measures, in order to ensure the attainment of the overall fiscal targets under the program. The retail prices of petroleum products have been increased, and will continue to be adjusted, as necessary, to ensure the continued elimination of petroleum subsidies. Subsidies on account of rice and power supply are being phased out, the former by December 1986, the latter in the context of the authorities' ongoing reforms in the public enterprise sector, with the assistance of the World Bank. The authorities expect to implement a number of proposals by the World Bank concerning the divestment of loss-making enterprises, according to a time schedule being worked out by the Bank. The

Government will also use its best endeavors to avoid an increase in extrabudgetary expenditures, 1/ except for compelling emergencies. Furthermore, as noted earlier, no salary increase is envisaged for the rest of fiscal year 1986/87, without prior consultation with the Fund's management; this matter will be reviewed during the first review of the program in December 1986. The authorities are also committed to ensure that the wage increase currently being negotiated with the relevant trade unions for a small number of daily paid government wage laborers will be consistent with the increase granted to salaried government employees in July 1986. Meanwhile, the authorities are pressing ahead with their review of wage personnel, with a view to reducing the size of the daily work force by 15 percent by June 1987, as agreed with the World Bank.

The Sierra Leone authorities are also strengthening financial management, in order to enhance the implementation of appropriate expenditure restraint under the program. A system of quarterly allotments of current expenditures has been set up, and will be monitored through regular reporting to the staff. Domestic arrears will not be permitted to increase during the program period, except on a temporary basis in respect of the domestic counterpart of external debt service payments which are expected to be rescheduled. In addition to the fiscal performance criteria on net credit from the banking system to the Government for end-December 1986, indicative targets have been set for end-June 1987. In order to assist the monitoring of budgetary developments and prevent the accumulation of domestic arrears in respect of nonreschedulable external debt service payments, the authorities have established a special blocked account for the domestic counterpart of official debt service payments. Transfers to this account have been calculated such that adequate provision is made from budgetary resources for the programmed leone counterpart of external debt service payments, after allowing for the impact of debt rescheduling (Table 10); however, should there be any shortfalls in payments into the blocked account, the ceiling on net credit to Government will be adjusted downward pro tanto.

Consistent with the authorities' policy framework paper, they expect that, by 1988/89, the overall fiscal deficit will be reduced substantially to about 5 percent of GDP (on a commitment basis and before debt relief). Consequently, the level of bank credit to Government will also be reduced. The authorities recognize that the attainment of these targets would imply a substantial fiscal effort. In this effort, it is expected that the findings and recommendations of the October/November Fund tax technical assistance mission would be useful. In addition, the authorities expect to maintain and strengthen expenditure control measures throughout the period; domestic arrears will be reduced, and extrabudgetary expenditures will continue to be eschewed, except for compelling emergencies.

1/ Known extrabudgetary expenditures already incurred in 1986/87 amount to an estimated Le 204.5 million.

Table 10. Sierra Leone: Provision for Domestic Counterpart of Official External Debt Service, 1986/87

(In millions of leones)

	Total for year				
	Originally due	After re-scheduling	First half	Third quarter	Fourth quarter
Interest					
On nonrescheduled obligations	621.6	141.9	45.2	48.4	48.9
On arrears	...	93.5	12.9	40.3	40.3
Amortization on medium- and long-term loans					
On nonrescheduled obligations	725.8	106.1	51.9	27.1	27.1
On arrears	...	375.2	60.0	157.6	157.6
Total	1,347.4	716.7	170.0	273.4	273.9

Sources: Data provided by the Sierra Leone authorities; and staff projections.

e. Money and credit

In order to reduce inflationary pressures, while at the same time making adequate allowance for productive private sector credit, total domestic credit has been programmed to increase by 35 percent in 1986/87, a rate of increase substantially less than the increase in nominal GDP and which is also considerably less than the increase of 57 percent in domestic credit in 1985/86. Credit to Government will be limited to an increase of Le 616.2 million or 32 percent, at which level it will represent 40 percent of beginning money stock; the programmed increase in credit to Government in 1986/87 compares with an increase of 63 percent in 1985/86, or 86 percent of beginning money stock. With regard to credit to the private sector, the Bank of Sierra Leone has issued directives to the commercial banks which would assist in limiting the total increase in bank credit to the private sector in 1986/87 to Le 134.2 million or 69 percent, compared with an increase of 15 percent in 1985/86. Within the programmed increase, the Sierra Leone authorities expect that the improved pricing policies of parastatals will reduce their demand for credit, thus making allowance for a high growth in productive private sector credit, in line with ongoing efforts to rehabilitate the economy. In addition, measures are being implemented to increase the scope and efficiency of rural banks; two new such banks are planned for 1986/87. The National Development Bank is also being restructured and recapitalized, under new management, in order to promote efficient intermediation. A study of Sierra Leone's financial system will be initiated by end-June 1987.

Quarterly ceilings for domestic credit and for net credit to the Government, both of which constitute performance criteria, have been set for end-December 1986; the limits on the expansion of total domestic credit will be reduced by the amounts of any approved withdrawals of blocked deposits from the commercial arrears pipeline. Indicative targets have been set for end-June 1987. The ceilings for end-March 1987 and end-June 1987 will be set during the first review of the program in the first half of December 1986.

The programmed increase in total domestic credit in 1986/87, together with the targeted decline in net foreign assets, would be accompanied by an increase in money supply, broadly defined, of Le 523 million or 34 percent, compared with an increase in 1985/86 of 73 percent, and with a projected increase in nominal GDP of 63 percent in 1986/87. Accordingly, the program assumes that velocity, which declined in 1985/86, will increase in 1986/87, in line with the greatly restrictive stance of monetary and credit policies.

With regard to interest rates, the Sierra Leone authorities stated that after reviewing the previous structure of interest rates, under which the Bank of Sierra Leone set minimum lending and deposit rates, it had been decided in July 1986 to implement a flexible interest rate structure. This approach was deemed to be in line with the Government's policy stance of deregulation, as well as necessary to mobilize domestic savings and enhance the allocation of resources in the economy. To this end, on September 4, the authorities introduced an auction system for treasury bills, with a view to achieving positive real deposit and lending rates within a short period. The auctions are held bi-weekly. As of end-September, an average of about Le 118 million had been auctioned, at an average rate of about 19 percent. Lending rates, which averaged 24 percent in June 1985, are currently as high as 32 percent; and deposit rates, which ranged from 11-14.5 percent in June 1985, now range from 19-23 percent. However, with an inflation rate of about 90 percent, interest rates continue to be strongly negative in real terms, reflecting the relatively slack demand for credit, and the fact that the Government has so far not attempted to raise large amounts of new money through the auctions, although substantial new treasury bill sales are in prospect. In any event, the authorities will continue to monitor the operations of the treasury bill auction system. The staff will also review the operations of the system in December, as well as in the context of the proposed study of the financial system, by end-June 1987.

The Government's adjustment program for 1986/87 is summarized in Table 11.

Table 11. Summary of adjustment program for 1986/87 under the stand-by arrangement and under the structural adjustment facility

	(Changes in percent)
I. Targets and assumptions	
Real GDP growth	2.0
Consumer price index increase	90.0
Increase in GDP deflator	60.0
Terms of trade change	25.0
Export volume growth	17.2
Import volume growth	14.2
External current account deficit 1986/87, SDR 5.6 million, or 1.8 percent of GDP	
Overall balance of payments surplus or deficit (-) 1986/87, -SDR 49.1 million	
Gross international reserves 1986/87, 1.2 months of imports	

II. Principal policy elements

1. Budget

In 1986/87, the overall fiscal deficit (on a commitment basis, and before debt relief) will be limited to Le 1,151.2 million, or

11.1 percent of GDP. To achieve this target, new fiscal measures equivalent to about 1.0 percent of GDP will be incorporated in the revised budget to be announced on January 1, 1987. The expected financing gap in the fiscal accounts of about Le 630 million or 6.1 percent of GDP is expected to be closed through debt rescheduling.

Expenditure restraint to limit current expenditure to the equivalent of about 19 percent of GDP, in addition to reduction in domestic arrears; the number of daily wage laborers is to be reduced by about 15 percent by March 1987; the wage increase currently being negotiated with relevant unions for government workers should be consistent with the increase granted to salaried government employees effective July 1986; Government will avoid any further increase in extrabudgetary expenditure in 1986/87, except for compelling emergencies. The Government will ensure that subsidies on fuel and rice are not re-introduced.

2. Expenditure monitoring and control

A system of quarterly allotments for current expenditures will be used to facilitate the monitoring of government outlays; the allotments will be regularly monitored by the Ministry of Finance and the Bank of Sierra Leone to ensure that no excess expenditures are incurred, and all expenditures authorized by local purchase orders will be subject to preaudit in the Expenditure Control Unit of the Ministry of Finance.

3. Arrears

To prevent accumulation of arrears on domestic counterpart of external payments, a special blocked account for the domestic counterpart of scheduled official external payments, established at the central bank, is to be credited with the local counterparts of principal and interest on government external debt. The Government has undertaken to incur no net increase in domestic arrears in 1986/87. Moreover, the revised budget for 1986/87 provides for a reduction in domestic arrears by Le 10 million in 1986/87, as well as the settlement of external arrears accumulated during July-November 1986.

4. Public enterprises

The Government intends to request Fund technical assistance in establishing a framework for determining the extent of inter-parastatal arrears, as well as arrears between the public enterprises and the Government by March 1987. Within the context of the ongoing full privatization of rice imports by end-1986, the Sierra Leone Produce Marketing Board will pay the 10 percent import duty on rice for its strategic rice imports. Moreover, the Government will rationalize its role vis-à-vis the public enterprises, through the divestiture, restructuring, and/or closure of relevant enterprises, as agreed with the World Bank, and to restore the operational efficiency of those it retains.

5. Public sector investment program

The Government is implementing a new three-year investment program, covering the period 1986/87-1988/89, in consultation with the World Bank.

6. Exchange rate and payments system

The current system of floating exchange rates, and liberalized trade and payments regime are to continue.

7. Agricultural producer prices

Government has announced for this buying season large producer price increases for coffee (100 percent), cocoa (200 percent), palm kernels (88 percent), and rice (74 percent). The authorities will continue to keep producer prices under constant review, and will ensure that prices remain competitive with those of neighboring countries; in addition, a producer price committee will give effect to government policy in this area.

8. Fuel, rice and other administered prices

Government is implementing a program of price decontrol, including privatization of rice import operations away from the SLPMB. In the transitional period through December 1986, the SLPMB will confine itself to importation of a total of 45,000 tons (including a strategic stock of 20,000 tons). Meanwhile, the retail price of rice imported by the SLPMB was increased by 100 percent effective August 1, 1986; on August 6 the Government publicly invited the private sector to apply for licences to import rice.

In line with government policy on the avoidance of subsidies on petroleum products, effective June 27, 1986 retail prices of petroleum products were raised sharply, eliminating subsidies: petrol (88 percent), diesel (86 percent), and kerosene (200 percent). With further subsequent depreciation of the leone, full pass-through was again effected September 16, 1986, entailing further increases in prices of petroleum products as follows: petrol (100 percent), diesel (77 percent), and kerosene (83 percent). These two price adjustments have resulted in increases in the prices of petroleum products ranging from 257 percent (diesel) to 475 percent (kerosene).

On the basis of consultations with the World Bank, electricity tariffs were increased by 300 percent effective October 1, 1986. Other administered prices were increased as follows: telephone tariffs (60 percent); telephone rentals (60 percent); water rates (87.5 percent); telex and international telephone calls (100 percent); and intercity road transport (50 percent).

Fuel prices are to be adjusted regularly to fully cover all costs, as well as allow a profit margin to the refinery, every time costs increase by more than 10 percent, or quarterly, to eliminate any subsidies. All other administered prices will be adjusted quarterly; in the case of utilities and transport, this will be done in consultation with the World Bank.

9. Money and credit

In 1986/87 total domestic credit is to increase by 35.0 percent, while net banking system claims on Government is programmed to increase by 31.6 percent. Ceilings permit private sector credit to increase by 68.9 percent. Broad money is projected to increase by 33.7 percent. The Bank of Sierra Leone will continue to implement the flexible interest rate policy, introduced on September 4, 1986 in the context of a treasury bill auction system, under which banks are free to set lending and deposit rates. Study of financial system to be initiated in 1986/87.

10. External debt

During the period of the arrangement, except for import-related credit, new external loans with maturity of under one year contracted by the Government and the Central Bank or authorized or guaranteed by them, is limited to bridging finance secured to discharge Sierra Leone's overdue obligations to the Fund. No new nonconcessional borrowing of 1-12 years' maturity is to be contracted or guaranteed.

11. Rescheduling and external arrears

The authorities will seek debt rescheduling under the Paris Club in November; other reschedulable arrears will be rescheduled on comparable terms. Cash reduction of SDR 2.0 million by end-December 1986, and a net cash reduction of arrears for 1986/87 of SDR 2.6 million by end-June 1987. This reduction in arrears involves an estimated total cash payment on arrears between November 1986 and June 1987 of SDR 25.6 million, made up of the accrual of SDR 23 million in arrears during June-November 1986, and the net cash reduction of SDR 2.6 million.

IV. Performance Criteria, Indicative Targets, Benchmarks, and Reviews

1. Performance criteria under the stand-by arrangement

As specified in Table 12, the performance criteria for end-December 1986 under the proposed stand-by arrangement include: (i) a ceiling on total domestic credit by the banking system; (ii) a subceiling on net credit to the Government by the banking system (in this context, the ceilings will be adjusted downwards on account of any shortfalls in government payments into the blocked account for debt service);

Table 12. Sierra Leone: Performance Criteria for end-December, 1986 and Indicative Targets for June 1987

End of Period	1985 Actuals Dec.	1986 Actuals March	1986 Actuals June	1986 1/ Indicative targets Sept.	1986 1/ Ceilings Dec.	1987 1/ Indicative targets June
			(In millions of leones)			
Net claims on Government by the banking system 2/	1,597.7	1,759.0	1,948.1	2,320.7	2,298.0 2/	2,564.3
Total domestic bank credit 3/	1,750.4	1,940.3	2,142.9	2,565.6	2,610.0 2/	2,893.3
			(In millions of SDRs)			
Cash reduction in external arrears excluding IMF					2.0 4/	2.6 4/
New external borrowing contracted by the Government and the central bank, or authorized or guaranteed by them, with an original maturity of under one year except for the SDR 37.73 million of bridging finance which has already been agreed, but excluding import-related credits and debt reschedulings	...	...	...	...	--	--
New nonconcessional external borrowing with an initial maturity of between 1 and 12 years contracted by the Government or the Bank of Sierra Leone, or authorized or guaranteed by them	...	...	...	...	--	--
Subceiling on maturities of 1-5 years	...	...	...	...	--	--

1/ See technical notes.
2/ These ceilings will be adjusted downwards for any shortfalls in programmed payments into the blocked account for debt service payments
3/ These limits will be reduced by the amounts of any approved withdrawals of blocked deposits from the commercial arrears pipeline.
4/ The ceiling for December is based on the stock of arrears at the time of the Paris Club meeting, scheduled for mid-November, while the June target is based on the stock at June 1986.

(iii) limits on official external borrowing with an initial maturity of one year or less, incurred or guaranteed by the Government or the Bank of Sierra Leone; (iv) limits on nonconcessional external borrowing with an initial maturity between 1 and 12 years incurred or guaranteed by the Government or the Bank of Sierra Leone, including a subceiling on maturities between 1 and 5 years; and (v) a net cash reduction in external arrears, and no incurrence of new arrears; and (vi) the avoidance of new restrictions or the intensification of existing ones on payments and transfers for current international transactions or on imports for balance of payments reasons.

2. Indicative targets

Indicative targets have been set for end-June 1987 on all the items (i) to (vi) above.

3. Benchmarks under the first year arrangement under the SAF

The benchmarks under the first annual arrangement under the structural adjustment facility (SAF) are as follows: (i) the performance criteria for December 1986 under the stand-by arrangement, as listed in subsection 1 above; (ii) the indicative targets for June 1987 as listed in subsection (2) above; and (iii) understandings on the revised budget for 1986/87 to be announced on January 1, 1987. The structural policy benchmarks for 1986/87 are listed in Table 13.

4. Reviews

Two reviews are envisaged under the program: (i) Before March 31, 1987, the Government of Sierra Leone will consult with the Fund on the implementation of the program, including, in particular, the revised budget for 1986/87 and the results of the debt rescheduling exercise presently scheduled for about mid-November 1986; the authorities will also reach understandings with the Fund on the performance criteria for March 1987 and June 1987. (ii) Before September 15, 1987 the Government of Sierra Leone will consult with the Fund on the policies for 1987/88, and reach understandings with the Fund on the performance criteria for September 1987.

Table 13. Sierra Leone: Structural Policy Benchmarks for 1986/87, the First Year Under the Structural Adjustment Policy

Policy measures	Dates
Agricultural policy reform	
Cereal policy (rice - complete privatization)	End-December 1986
Industrial and mining policy reform	
Revised Industrial Development Act	End-June 1987
Fiscal policies	
Complete study of tax system	Mid-November 1986
Implement revised budget	January 1987
Draw up initial public expenditure core program	Mid-March 1987
Public enterprises	
Establish Public Enterprise Commission (PEC)	End-June 1987
Delineate a schedule and time frame for eliminating inter-enterprise arrears	March 1987

Source: Annex to Attachment II.

V. Staff Appraisal

For the greater part of the last five years (with the exception of brief periods in the context of Fund-supported adjustment programs), the Sierra Leone economy has been characterized by economic stagnation and major distortions in the foreign exchange system, resulting in a thriving parallel market in foreign exchange and in goods and services, a substantial erosion of the tax base, accelerating inflation, and growing external payments arrears. Ad hoc arrangements were prevalent, including the provision of preferential exchange rates and retention facilities to key exporters. The restrictions in the exchange system, including the restrictive import licensing system, were intensified, while normal trade credits dried up. Measures initiated by the authorities in early 1985 to cope with these difficulties were either inadequate (for example, the extent of the increases in producer prices and in the retail prices of petroleum products), or inappropriate under the circumstances (such as the discrete devaluation of the leone, instead of the recommended float, as well as the continued expansionary fiscal and monetary policies). Consequently, the economic and financial problems of Sierra Leone worsened; by mid-1986, the economic and financial malaise had deepened to near crisis proportions. The Government became virtually unable to mobilize needed foreign exchange resources either to purchase essential imports such as oil, or to meet critical debt service obligations, including obligations to the Fund. The accumulation of external arrears led, in many instances, to the suspension of aid disbursements. Consequently, the Government's ability to embark on a sustained development effort became practically circumscribed and the physical infrastructure began to slip into a state of involuntary neglect and disrepair.

These problems were compounded by earlier political uncertainties surrounding the question of presidential succession. Although the succession was completed by early 1986, problems of transition remained, including the need to hold parliamentary elections. Meanwhile, however, the new administration had commenced discussions with the Fund and Bank staffs on the main elements of an appropriate adjustment program. By June 1986, the political transition was largely complete and a new economic team installed. Almost simultaneously, in the context of the Budget Speech for 1986/87, the Sierra Leone authorities launched a major program of economic and financial reform. The reforms encompass substantive policy actions, consistent with the views of Executive Directors in concluding the 1985 Article IV consultation with Sierra Leone: a flexible market-determined exchange system, underpinned by supporting liberalization of the trade and payments system, has been introduced; prices of imported and locally produced consumer goods have been decontrolled; petroleum subsidies have been eliminated through full pass-through of exchange rate effects; the privatization process for rice imports has been accelerated and has been accompanied by a phased decontrol of rice prices; substantial increases in producer prices have been awarded to farmers; the stance of fiscal and monetary policies has been considerably tightened; and interest rates have been decontrolled.

In addition, the reform and restructuring of public enterprises has been accelerated, with the assistance of the World Bank. The staff welcomes the implementation of these measures.

Furthermore, the Sierra Leone authorities have cleared the relatively large overhang of arrears to the Fund in the context of a bridging arrangement. The staff welcomes the discharge of the overdue obligations to the Fund, and strongly urges the authorities to remain current with the Fund. The staff is satisfied that firm arrangements have been made by the Sierra Leone authorities to ensure that Sierra Leone remains current with the Fund through the period of tight foreign exchange inflows (i.e. until December 1986). Thereafter, cash flow estimates prepared with the assistance of the authorities indicate that adequate resources would be available to enable Sierra Leone to remain current with the Fund; it is also expected that the adjustment program of the authorities would have taken firmer hold by then, thereby assuring an increased availability of foreign exchange in the system. Indeed, the programmed build up in gross external reserves should take place during the second half of 1986/87; this, as well as the authorities' undertaking to buy foreign exchange in the interbank market whenever necessary, underscore the authorities' determination to remain current with the Fund.

While it is clearly evident that the authorities have charted a strong course of adjustment, three main points may be noted in this regard. First, a number of potential problem areas require continued vigilance and effort by the authorities. In the exchange sector, the arrangements presently under way to stimulate the inflow of foreign exchange into the banking system must be accelerated and implemented, without exception. The operation of the present treasury bill auction system and the system of flexible determination of commercial bank interest rates will need to be monitored closely, and will be reviewed both in the context of the first review under the program, and the study of the financial system slated to take place by June 1987. The authorities will also need to continue and intensify their efforts to keep the budget under very tight control, mobilize additional resources, and avoid slippages, including through the incurrence of subsidies or extrabudgetary expenditures. In this context, the staff feels reasonably reassured by the authorities' stated commitment to take any additional measures that will be necessary to meet the fiscal targets of the adjustment program, including the additional fiscal measures, amounting to about 1 percent of GDP, in the context of the revised budget to be announced on January 1, 1987. Second, the authorities will need to continue to monitor the program carefully, and to follow up on the measures already in place. Hitherto, sporadic and tentative implementation of economic and financial policies have tended to give the wrong signals while only grazing the surface of the very deep-seated problems of the economy. In the end, strong vested interests were able to abort the measures, and the economy reverted to the distorted form under which large rents could be appropriated by advantageously placed economic agents. In this regard, the staff notes that the far-reaching nature of the economic, financial, and other measures being implemented by the authorities should, with sustained strong implementation, put the economy back onto a well-balanced, competitive growth path in the context of a liberal trade and exchange system. Third, staff estimates indicate that, despite the sustained implementation of strong adjustment policies in the medium term, Sierra Leone will continue to face an extremely difficult economic and financial situation, which would require continuous and significant levels of international financial and other support. In this connection, continued Fund support must be viewed in a catalytic context; Sierra Leone's external debt burden is already quite onerous, and the need for the continued avoidance of nonconcessional borrowing as well as the need for concessional financial assistance, including through debt relief on generous terms, cannot be overemphasized. Specifically, Sierra Leone would have a continuous need to approach donors for concessional balance of payments support in future years, as well as to roll over its rescheduled debts as they fall due; this presupposes that the authorities continue to implement strong adjustment policies. At the same time, the Sierra Leone authorities would need to monitor the implementation of the floating exchange rate system very closely, in light of the evolution of exports, imports, and the overall balance of payments position. Given the above ingredients, it is the staff's view that Sierra Leone has sufficient potential to halt the deterioration in the economic and financial situation, redress existing imbalances, and efficiently exploit its considerable resource base to generate sustained growth.

On the basis of the measures already in place, and those which are being implemented, the staff believes that the programs for which the Sierra Leone authorities have requested Fund assistance in the forms of stand-by and SAF arrangements are deserving of Fund support. The authorities have also indicated that they will review the programs and adopt additional appropriate measures, when necessary, to ensure that the objectives of the programs are achieved. The staff considers that the proposed level of access to Fund resources under the stand-by arrangement is appropriate to Sierra Leone's circumstances in view of the adjustment measures adopted under the program. A large part of these measures are already in place, and together with other steps to be taken, they constitute a significant move toward balance of payments viability in the medium term.

Sierra Leone's exchange system involves restrictions on the making of payments and transfers for current international transactions, subject to Fund approval, including restrictions evidenced by external payments arrears, and a multiple currency practice arising from the nonpayment of interest on deposits of the leone counterpart of commercial arrears. The Sierra Leone authorities have indicated their intentions to eliminate these restrictions as soon as possible. The staff recommends approval of the restrictions and multiple currency practice on a temporary basis, until September 15, 1987 or the completion of the

1987 Article IV consultation with Sierra leone, whichever is the earlier. Sierra Leone also continues to maintain bilateral payments agreements with two Fund members.

It is expected to hold the next Article IV consultation discussions with Sierra Leone on the standard 12-month cycle.

VI. Proposed Decisions

In light of the above, the following draft decisions are proposed for adoption by the Executive Board:

(i) 1986 Consultation

1. The Fund takes this decision relating to Sierra Leone's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1986 Article XIV consultation with Sierra Leone, in the light of the 1986 Article IV consultation with Sierra Leone conducted under Decision No. 5392-(77/63), adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. Sierra Leone maintains the restrictive exchange measures described in SM/86/---, in accordance with Article XIV, Section 2, except that the restrictions evidenced by the accumulation of commercial external payments arrears and the multiple currency practice arising from the cost to purchasers of foreign exchange of counterpart deposits required for payments of arrears, are subject to approval by the Fund under Article VIII, Sections 2 (a) and 3. The Fund notes the intention of the authorities to remove these restrictions as soon as possible. In the meantime, the Fund grants approval for their retention until September 15, 1987 or the completion of the 1987 Article IV consultation with Sierra Leone, whichever is the earlier. Sierra Leone also maintains bilateral payments agreements with Fund members. The Fund urges Sierra Leone to eliminate the restrictive features of these agreements as soon as possible.

(ii) Stand-By Arrangement

1. The Government of Sierra Leone has requested a stand-by arrangement for a period of 12 months from November ---, 1986 through November ---, 1987, in an amount equivalent to SDR 23.156 million.

2. The Fund approves the stand-by arrangement set forth in EBS/86/243.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

(iii) Structural Adjustment Facility: Three-Year and First Annual Arrangement

1. The Government of Sierra Leone has requested a three-year structural adjustment arrangement, and the first annual arrangement thereunder, under the structural adjustment facility.

2. The Fund approves the arrangement set forth in EBS/86/243.

SIERRA LEONE - Stand-By Arrangement

Attached hereto is a letter and annexed Memorandum dated October 7, 1986, 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; and (b) understandings of the Sierra Leone authorities with the Fund regarding reviews that will be made of progress 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 November --, 1986 to November --, 1987, Sierra Leone will have the right to make purchases from the Fund in an amount equivalent to SDR 23.16 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 8 million until February 20, 1987, SDR 11.79 million until April 15, 1987, SDR 15.58 million until July 31, 1987, and SDR 19.37 million until October 15, 1987.

   (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.

3. Purchases under this stand-by arrangement shall be made from ordinary resources.

4. Sierra Leone will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Sierra Leone's currency in the credit tranches beyond 25 percent of quota:

   (a) during any period in which the data at the end of the preceding period indicate that

      (i) the limits on total domestic bank credit referred to in paragraph 29 and the table in the memorandum annexed to the attached letter, or

      (ii) the net credit to the Government referred to in paragraph 29 and the table in the memorandum annexed to the attached letter, or

(iii) the cash reduction in external payments arrears described in paragraph 29 and the table in the memorandum annexed to the attached letter, or

(iv) the limit on the contracting of new public and publicly guaranteed foreign borrowing described in paragraph 29 and the table in the memorandum annexed to the attached letter, or

(v) the limit on the outstanding stock of short-term external debt described in paragraph 29 and the table in the memorandum annexed to the attached letter, have not been observed;

(b) after February 19, 1987 until satisfactory understandings on the revised budget for 1986/87 have been reached and suitable performance criteria for end-March and end-June 1987 have been established pursuant to the first review contemplated in paragraph 3 of the attached letter, or after such performance criteria having been established, while they are not being observed;

(c) after July 30, 1987, until satisfactory understandings on the budget for 1987/88 have been reached and suitable performance criteria for end-September 1987 have been established pursuant to the second review contemplated in paragraph 3, or after such performance criteria having been established while they are not being observed;

(d) 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, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Sierra Leone is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Sierra Leone, and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Sierra Leone will not make purchases under this stand-by arrangement during any period of the arrangement in which the member has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the Guidelines on Corrective Action in respect of a noncomplying purchase.

6. Sierra Leone's right to engage in the transactions covered by this stand-by arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Sierra Leone. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Sierra Leone and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this stand-by arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Sierra Leone, the Fund agrees to provide them at the time of the purchase.

8. Sierra Leone shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Sierra Leone shall repurchase the outstanding amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Sierra Leone's balance of payments and reserve position improves.

(b) Any reductions in Sierra Leone's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement Sierra Leone shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Sierra Leone or of representatives of Sierra Leone to the Fund. Sierra Leone shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Sierra Leone in achieving the objectives and policies set forth in the attached letter and annexed memorandum.

11. In accordance with paragraph 6 of the attached letter, Sierra Leone will consult with the Fund on the adoption of any measures that may be

appropriate at the initiative of the Government or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Sierra Leone has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Sierra Leone's balance of payments policies.

Washington, D.C.
October 7, 1986

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Larosière,

1. The attached memorandum sets forth the economic and financial objectives of the Government's one-year adjustment programme for 1986/87, in the context of Sierra Leone's ongoing programme of structural reform; together with the attached policy framework paper (PFP), it also delineates the nature of additional measures which the Government intends to take during the three-year programme period in order to meet the programme targets. The memorandum includes measures which the Government has already taken in a number of areas. These measures cover a broad spectrum, and include: (a) a flexible market-determined exchange system, underpinned by a liberalized trade and payments system; (b) decontrol of the retail prices of basic consumer goods; (c) phased decontrol of the retail price of rice and the privatization of rice imports; (d) removal of the subsidies on petroleum products (the last price increases were effected on September 16); (e) substantial and competitive increases in the producer prices of major export crops--coffee, cocoa, and palm kernels; (f) a treasury bill auction system accompanied by decontrol of deposit and lending rates, which was preceded by a large initial increase in average deposit and lending rates; (g) ongoing reform and restructuring of the parastatal sector; (h) a considerably tightened stance of fiscal and monetary policies; and (i) institutional and other structural policy measures in various sectors of the economy, including in particular mining and agriculture.

2. As a result of these and other policies which the Government proposes to implement, preliminary calculations indicate that Sierra Leone should progressively attain a substantial reduction in the external current account deficit of the balance of payments, maintain a strong growth performance (averaging 3 percent per annum), effect significant reductions in external arrears, and gradually build up gross reserves from the low level of 0.7 months imports in 1985/86 to about three months imports in 1988/89. In order to build up reserves, the authorities are prepared to make purchases in the foreign exchange market. However, over this period, Sierra Leone will still continue to need significant amounts of external resources (including balance of payments support from the Fund and donors), particularly on concessional terms, as well as debt relief on terms similar to those for countries in comparable difficult economic and financial circumstances, i.e., including

the rescheduling of previously rescheduled debt. In support of its adjustment programme, the Government of Sierra Leone requests use of Fund resources under a one-year stand-by arrangement in the amount of SDR 23.12 million; Sierra Leone also hereby requests a three-year structural adjustment arrangement in support of its structural adjustment programme covering the three-year period of 1986/87-1988/89, as described in the attached PFP, in the amount that will be available to Sierra Leone under the SAF and the first annual arrangement thereunder. The PFP, which outlines the objectives and policies of the Sierra Leone Government during the three-year period to end-June 1989, has been prepared in close collaboration between the staffs of the Fund and the World Bank.

3. The attached memorandum delineates the performance criteria of the programme for December 1986 and the indicative targets for end-June 1987, under the requested stand-by arrangement. These performance criteria include: (1) a ceiling on the increase in total domestic credit by the banking system; (2) a subceiling on the increase in net credit to the Government by the banking system (in this context, the ceilings will be adjusted downwards for exceptional financing, including debt relief, in excess of what is programmed, or on account of any shortfalls in payments into the blocked account for debt service); (3) limits on official external debt with an initial maturity of one year or less, incurred or guaranteed by the Government or the Bank of Sierra Leone; (4) limits on nonconcessional external borrowing with an initial maturity between 1-12 years incurred or guaranteed by the Government or the Bank of Sierra Leone, including a subceiling on maturities between 1-5 years; and (5) some net cash reduction in external arrears. The performance criteria for December 1986 under the stand-by arrangement, and the indicative targets for June 1987 will also serve as benchmarks under the SAF, as will the revised budget for 1986/87 to be announced on January 1, 1987. Before March 31, 1987 the Government of Sierra Leone will consult with the Fund on the implementation of the programme, including in particular, the revised budget for 1986/87 and the results of the debt rescheduling exercise presently scheduled for around mid-November 1986; the authorities will also reach understandings with the Fund on the performance criteria for March 1987 and June 1987. Before September 15, 1987 the Government of Sierra Leone will consult with the Fund on the policies for 1987/88, and reach understandings on the performance criteria for September 1987.

4. During the programme period, no new restrictions on payments and transfers for current international transactions or import restrictions for balance of payments reasons will be introduced or existing ones intensified.

5. The Government of Sierra Leone will remain in close contact with the staffs of the Fund and the World Bank regarding the implementation of the structural adjustment programme and the PFP will be updated annually as the policies and SAF programme are implemented. Sierra Leone will provide the Fund with such information as the Fund requests

in connection with Sierra Leone's progress in implementing the policies and achieving the objectives of the programme.

6. The Government believes that the policies described in the attached memorandum are adequate to achieve the objectives of the programme. However, it will take any additional measures that might become necessary for this purpose. Furthermore, Sierra Leone will consult with the Fund, in accordance with the policies of the Fund on the adoption of any measures that may be appropriate at the initiative of the Government of Sierra Leone or whenever the Managing Director requests such consultation. In particular, the Government will periodically review with the Fund the progress made in implementing the programme. In this context, during the second review under the stand-by arrangement, the Government will also update its PFP and submit the second annual programme to be supported by the second annual arrangement under the structural adjustment facility.

7. We have been instructed by His Excellency the President to transmit to you this letter as reflecting the policies and intentions of the Government of Sierra Leone.

Sincerely yours,

/s/
Victor Bruce
Governor
Bank of Sierra Leone

/s/
Dr. Sheka Kanu
Minister of Finance

Attachments

CONFIDENTIAL

Memorandum on Economic and Financial Policies of Sierra Leone

I. Introduction

1. In the past several years, well-known external factors such as weak prices for Sierra Leone's exports and declining terms of trade have contributed at various times to the severely depressed state of the Sierra Leone economy; however, a lack of strong consistent government action in the implementation of appropriate economic and financial policies has been a substantial contributory factor. As a result, in the past five years the Sierra Leone economy has been characterized by economic stagnation in most sectors, including agriculture, mining, industry, and services; growing fiscal deficits with the associated expansionary monetary policies; accelerating inflation; a thriving parallel market for foreign currency; increased smuggling of export commodities, notably diamonds; a persistent reluctance on the part of exporters to surrender export proceeds to the banking system; an increasing inability by the Government to mobilize the foreign exchange resources needed to ensure continued supplies of essential imports, including petroleum products, and to discharge debt service obligations; large and increasing external payments arrears (including to the Fund); and greatly reduced ability by the Government to mobilize aid resources with which to embark on a sustained development effort.

2. In the five years ended June 1986, there was virtually no growth of the economy except for a temporary spurt in activity in 1983/84 (July-June) associated largely with better weather conditions for food crops and increased mineral production. The agricultural and mining sectors, which together account for a large share of gross domestic product (GDP) and almost all of the country's domestic exports, had been aided by favorable producer prices and by special access to foreign exchange either through the parallel market or through foreign exchange retention facilities. By contrast, other sectors, including manufacturing, construction, and electricity and water, have not performed well.

3. In the fiscal sector, the highly expansionary trends which were partially reversed in 1983/84 (with the implementation of a Fund-supported program), re-emerged and intensified in 1984/85 and worsened in 1985/86. The overall fiscal deficit (commitment basis, 1/ including grants), which declined from 11.6 percent of GDP in 1982/83 to 7.1 percent in 1983/84 (program target 8.4 percent of GDP), rose sharply in 1984/85 and 1985/86 to about 11.5 and 14.5 percent of GDP, respectively.

1/ Prior to 1985/86, the data do not include arrears on foreign interest payments.

The associated bank financing of the deficit, which had dropped from 11.6 percent of GDP in 1982/83 to 5.9 percent in 1983/84, increased to 6.3 percent in 1984/85 and 11.9 percent in 1985/86, respectively, largely on account of exchange rate-related items. Domestic arrears, as well as arrears on government interest payments increased.

4. Total domestic credit, which rose by 21 percent in 1983/84, increased by 30 percent in 1984/85 and by 57 percent in 1985/86; private sector credit, which expanded by 37 percent in 1984/85, increased by an estimated 15 percent in 1985/86. Money supply, broadly defined, which rose by 28 percent in 1983/84, expanded by 55 percent in 1984/85 and by 76 percent in 1985/86; and the inflation rate (as measured by the consumer price index) averaged 66 percent in 1984/85 and 1985/86.

5. Sierra Leone's external position also continued to deteriorate. While some progress was made under the 1983/84 program when the external current account deficit was brought down to about 3.4 percent of GDP and external arrears were reduced by SDR 6 million (as against a program requirement of SDR 1 million), these efforts were not sustained. By mid-1984, the Government had virtually abandoned its adjustment efforts. The volume of exchange and trade transactions channeled through the banking system practically disappeared. As a result, external payments arrears (including overdue financial obligations to the Fund) reached an estimated SDR 312 million by end-June 1986 (or twice the projected 1986/87 export earnings, of which SDR 22.9 million comprised arrears to the Fund).

6. As of end-June 1986, Sierra Leone's external public debt outstanding (disbursed), including use of Fund credit (but excluding arrears at the time), amounted to about SDR 454 million. The debt service burden (including the Fund), which had been reduced somewhat in 1984/85 (partly as a result of the rescheduling exercise completed with Paris Club creditors, commercial banks, and supplier creditors), increased to about 82 percent of exports of goods in 1985/86.

7. At the core of Sierra Leone's increasingly difficult economic and financial situation was the severe dislocations in the exchange system as evidenced by the existence of substantial external payments arrears, including arrears to the Fund, and a very low level of foreign exchange availability in the official market for ongoing payments needs. The scarcity of foreign exchange to the official sector was a direct consequence of the wide spread between the official exchange rate and the rate in the parallel market, retention privileges, and the Government's consequent inability to enforce the surrender of foreign exchange by exporters, particularly the diamond and gold exporters. On a number of occasions, attempts were made to tackle these problems but in an inadequate or inappropriate manner. On February 21, 1985, the Government initiated a devaluation of the official exchange rate of the leone by 58.3 percent with respect to the U.S. dollar, the intervention currency (from Le 2.5 = US$1 to Le 6 = US$1), together with a change in the exchange rate peg from the U.S. dollar to the SDR. On April 25,

1985, the Government published a new licensing procedure which, while providing for the importation of goods under open general licenses, also excepted a large number of items that are listed under specific import licenses. In May 1985, the exchange arrangements were modified to permit gold and diamond exporters to retain all their foreign exchange earnings or to sell some of these earnings to importers at an exchange rate determined directly between the two parties. As a result of these modifications, and the continuing wide spreads between the official and parallel market exchange rates, most of Sierra Leone's foreign exchange proceeds continued to flow outside the banking system, while the inflow of foreign exchange into official channels (for official uses, including payments for imports of oil and debt service) continued to dwindle. As a result, with the exception of a large part of the imports of oil and some rice imports by the Sierra Leone Produce Marketing Board (SLPMB), all private imports were channeled through the parallel market. More recent efforts to correct the difficult foreign exchange problem through the formation of the Government Gold and Diamond Office (GGDO) proved equally futile, as parallel market activities continued unabated, while the banking system continued to be starved of official foreign exchange resources.

II. Medium-Term Macroeconomic Framework, 1986/87-1988/89

8. Against this background, the new Government considers that appropriate bold, decisive, strong, and sustained economic and financial policies are necessary to redress the existing imbalances and facilitate growth. Such policies would enable Sierra Leone to take advantage of its considerable resource base and facilitate the resumption of concessional capital inflows and exceptional financing, including debt relief. The Government's adjustment effort will be pursued in the context of an overall policy framework for the three years 1986/87-1988/89, developed in close consultation with the staffs of the Fund and the World Bank and which has been transmitted under separate cover in support of the Government's request for arrangementS under the Structural Adjustment Facility (SAF). The Government's medium-term policies are geared to attain: (a) an average real growth rate of some 3 percent per annum; (b) a sharp deceleration in the rate of inflation from an estimated 90 percent in 1986/87 to some 10 percent, in 1988/89; and (c) a substantial reduction in the current account deficit (including official transfers) of the balance of payments from an estimated 2 percent of GDP in 1986/87 to about 0.5 percent in 1988/89. In sum, the Government's medium-term objective is to achieve a viable external payments position in the context of sustained growth, such that, barring unforeseen developments, by the end of 1988/89, per capita real income would have increased significantly, while at the same time orderly relations with Sierra Leone's external creditors would have been restored, in the context of an unrestricted system of trade and payments.

9. In pursuit of its medium term macroeconomic objectives, the Government is implementing a new three-year <u>investment program</u>, covering the

period 1986/87-1988/89, aimed at rehabilitating the economy's productive capacity; this program is being implemented as agreed with the World Bank, in the context of a Core Program, for which there is relatively firm financing. In the agricultural sector, the producer pricing policy for all major agricultural export crops as well as for rice will be geared to maintaining competitive levels. The Government also plans to continue its strategies in the agricultural sector through diversification and privatization as well as the implementation of the six Integrated Agricultural Development Projects (IADPs) and the Agricultural Sector Support Project (ASSP), introduced in June 1985, with the assistance of the World Bank; both the IADPs and the ASSP are designed to strengthen the institutional framework in the agricultural sector, as well as to reduce excess manpower in the Ministry of Agriculture. Where the industrial and manufacturing sectors are concerned, the Government will continue to place increased reliance on market mechanisms for the allocation of resources, and will review the Industrial Development Act, by June 1987, with a view to improving the policy environment for private foreign investment in Sierra Leone. In the diamond mining sector, the Government will continue to encourage increased open competition by the continued implementation of a free, fully floating, flexible exchange arrangement. The Government intends to review, with the assistance of the World Bank, the financing arrangements for the Kimberlite underground diamond mining project with a view to attracting reputable foreign investors. The Government will also accelerate its efforts to increase the contribution of other minerals (notably rutile and bauxite) to the economy. Energy policies will be geared toward the development of local sources of supply, and the curtailment of energy consumption in order to reduce the oil import bill.

10. Fiscal policies will aim at a reduction in the scope of the public sector, as well as the impact of the budget on the economy. However, simultaneously, in order to rectify the severe under-funding of economic sectors in recent years, the Government will increase budgetary allocations for maintenance-related expenditures over the next three years, along the lines recommended by the World Bank. These efforts should assist in improving the utilization of resources in the economy and in increasing the returns to public investment. With respect to the public enterprises sector the government will rationalize its role, through the divestiture, restructuring and/or closure, of relevant enterprises, as agreed with the World Bank, so that only enterprises which are essential to the provision of public services or which are economically viable are operated by the Government. At the same time, the Government intends to restore the operational efficiency of a number of public enterprises through greatly improved management, financial planning and control, monitoring, accountability, appropriate pricing policies, and institutional reform. Under the medium-term program, monetary policies are aimed at reducing inflationary pressures; in this context, total bank credit will be targeted to increase at rates which permit a substantial deceleration in the growth of the liabilities of the banking system. However, in line with the Government's objective of rehabilitating and increasing the role of the private sector, care will be taken to ensure

that adequate provision is made for the private sector's genuine productive credit needs, including, in particular, crop financing. A flexible interest rate policy will be continued under the newly introduced tender system for Treasury bills, in order to enhance the mobilization and utilization of financial resources.

11. In view of the critical importance of a competitive liberal exchange system for confidence in the economy, as well as for the efficient allocation of resources, the Government is fully committed to the principle that external sector policies will continue to be implemented in the context of the freely floating exchange system implemented on June 27, 1986; the trade and payments regime will remain liberalized. Debt management policies will aim at reducing the external debt burden in the medium term, both in the context of the Government's overall adjustment strategy, as well as in the context of an improved machinery for screening and selecting projects in order to improve overall economic growth. External payments arrears will be reduced through rescheduling and consolidation, as well as through cash payments, with a view to eliminating these arrears over five years. In the context of the medium-term growth and adjustment program delineated for the period 1986/87-1988/89, Sierra Leone's external financing requirement (before taking account of debt relief, the use of Fund resources, the SAF loan, and the World Bank's SAL resources), ranges from SDR 98 million in 1986/87 to SDR 34 million in 1988/89. However, as a result of the impact of policies designed to support the new free floating exchange rate system, the overall deficit, before debt rescheduling, would continue to decline each year during the period 1986/87-1988/89. Nevertheless, Sierra Leone will continue to need significant amounts of external resources, particularly on concessional terms, during the period. These resources, as well as debt relief on terms similar to those for countries in comparable circumstances, should permit Sierra Leone to maintain a strong growth performance, effect further reductions in arrears each year, and build up gross reserves further, from 1.2 months' imports in 1986/87, to 3 months in 1988/89, compared with the low level of 0.7 months' imports in 1985/86.

III. The Adjustment Program for 1986/87

12. The Government's adjustment program for 1986/87, which is described in this memorandum, is delineated in the medium-term context noted above, with an outline for 1986/87 and with details mainly for the first half of the year. The program includes: (1) a greatly tightened stance of demand management policies, which would complement the floating exchange system; (2) supply-oriented measures to promote growth and exports; and (3) a regularization of Sierra Leone's relations with its external creditors within the context of an unrestricted system of trade and payments. In broad macroeconomic terms, the program aims at reducing the current account deficit in the balance of payments from SDR 33 million (3 percent of GDP in 1985/86) to SDR 6 million (2 percent of GDP in 1986/87 because of the sharp drop in GDP of some

71 percent in SDR terms entailed in the large recent depreciation of the leone in the context of the new interbank float). The overall balance of payments deficit (before debt relief) is projected to decline from SDR 70 million in 1985/86 to SDR 49 million in 1986/87. This deficit would be financed through debt relief and net purchases from the Fund and the World Bank, while at the same time permitting a cash reduction in arrears, as well as a buildup of gross reserves by SDR 6.4 million. Furthermore, in view of the major reform of the exchange system launched by the Government in June, including the need to fully ascertain its implications for the fiscal and monetary sectors, fiscal policies will be reviewed at midyear in the context of a revised budget, which would maintain the principal fiscal targets under the program. In order to ensure a very tightly controlled start-up to the Government's economic and financial program, quantitative indicative targets were specified for end-September 1986; performance criteria have been set for end-December 1986.

External sector policies

13. The Government is fully aware of the critical importance of a competitive liberal exchange system for confidence in the economy, as well as for the efficient allocation of resources. Consequently, on the basis of recommendations and technical assistance provided by the Fund, the Government introduced on June 27, 1986 a freely floating exchange rate system. Under this system, the value of the leone no longer bears a fixed relationship to any other currency, but assumes a rate which may vary on an hourly and on a daily basis to reflect the forces of supply and demand for foreign exchange in the economy. All foreign exchange earnings from the exports of goods and services from Sierra Leone must be surrendered in full to the commercial banking system in Sierra Leone at market-determined rates within specified periods; the Bank of Sierra Leone now holds weekly sessions with commercial banks at which a weekly indicative rate is determined, to be applied during the following week for all official transactions, including valuation for customs duty. Commercial banks may also transact between themselves, during normal working hours, at mutually agreed exchange rates that are free to vary from hour to hour and day to day. Transactions in foreign exchange by individual commercial banks are subject to certain exposure and volume limits determined and monitored by the Bank of Sierra Leone. In support of the new exchange system, retention facilities previously accorded various exports of goods and services have been abolished, and full surrender obligations are being enforced under the aegis of the Bank of Sierra Leone with no exceptions whatsoever; the import licensing regime has been virtually fully liberalized (as stated below, only restrictions for health and security reasons remain); every operator in the economy now has free access to the foreign exchange market through the banking system for all legitimate current transactions (excluding a list of 4 prohibited items); all restrictions on current account transactions and inward remittances of capital have been lifted; and controls on outward capital account transactions were strengthened and streamlined.

14. Under the new exchange system, each customer is required to establish his creditworthiness, if other than cash payment is involved, at the time that a foreign exchange purchase order is drawn up. In the event that the customer is unable to make the leone payment or otherwise fulfill the regulatory obligations regarding the purchase of foreign exchange, the transaction will be reversed and the customer will assume all exchange losses as well as a charge of 0.25 percent of the leone amount per day. Delivery of foreign exchange for a valid purchase order must take place within three working days from the day of payment in local currency. (Holidays in the country of origin of the currency traded are not counted as working days.) If a bank fails to make delivery of foreign exchange within three working days from the day of payment in local currency, a penalty of 2 percent per week over the U.S. prime interest rate will be paid by the bank to the customer until delivery takes place. Customers are required to submit to the commercial banks export and import licenses with other appropriate documentation as specified at the time of placing the sales or purchase order for foreign exchange. Foreign exchange may be purchased only for a bona fide current transaction; purchases of foreign exchange for capital transactions require the express permission of the Bank of Sierra Leone. All purchases of foreign exchange are subject to the requirement that the basic payment obligation was not already due and payable as at June 30, 1986.

15. Prior to the first weekly fixing session under the new exchange system, the Bank of Sierra Leone set the benchmark rate for the leone at Le 14 = US$1, representing an initial depreciation (in foreign currency terms) of 65 percent from the prefloat exchange rate of Le 5.7 = SDR 1; by the latest fixing session on September 26, 1986, the leone rate was determined at Le 30 = US$1, or a total depreciation of about 84 percent in foreign currency terms relative to the prefloat exchange rate, and compared with a parallel market rate reportedly of about Le 31-32 = US$1. Although the new exchange system has been in operation for about three months, there are very strong indications that it is already having some beneficial effects on the export sector: the depreciation of the leone has permitted the provision of increased and competitive incentives for exporters of coffee, cocoa, and palm kernels thereby increasing the intakes of these commodities; a major international diamond exporter, Diamond Corporation, has reopened operations in Sierra Leone; other international exporters are also commencing operations, while operators in the hitherto illegal parallel market are beginning to rechannel their diamonds to the new official system; the new floating exchange system has also facilitated the enforcement, for the first time in recent memory, of the requirements of full surrender of export proceeds with respect to rutile and bauxite exports, as well as the agricultural exports of the SLPMB. The Government has also embarked on a major reorganization of the marketing arrangements under the former unsuccessful GGDO, as well as the managerial and organizational structure of the National Diamond Mining Company (NDMC). In light of these developments in the diamond sector since the float, a number of large foreign investors, who had hitherto been uninterested in the Kimberlite

diamond project, have recently indicated broad new interest in the project.

16. As noted above, the import licensing regime has been liberalized such that, except for a list of 4 items which have been proscribed on health and national security grounds, all commodities have been put under open general license and are now freely importable; hitherto, some 40 percent of the value of imports, including oil and encompassing over 86 separate import items, were listed under specific import licenses. The allocation of foreign exchange is now being done through the market rather than through administrative controls. All bona fide transactions relating to imports continue to be arranged on a letter of credit basis. Applications for purchase of foreign exchange for importation of goods must be accompanied by valid import licenses and pro forma invoices relating to the goods. With regard to invisibles, foreign exchange can be purchased from commercial banks for bona fide current transactions such as foreign travel, education, and health care. Exchange control approval will not be required for imports once they have been established as bona fide. The foreign exchange allocation system for imports was eliminated with the introduction of the new exchange system. The Government Diamond Office has been reinstituted and located at the Bank of Sierra Leone; this office values all diamonds and monitors diamond exports. The Ministry of Mines continues to value gold and to monitor exports of the same. The Fisheries Division of the Ministry of Agricultural and Natural Resources values and certifies the value of exports of fish and shrimps. 1/ In the 1986/87 budget, all hitherto exempt imports have been subject to duty, and a number of other changes in the taxation of foreign trade (including export taxes of 20 percent and 22 percent on fish and scrap metal, respectively) have been implemented. In view of the revised budget envisaged at midyear, the Government has requested technical assistance from the Fund to review the tax system and make recommendations, taking into account the recent changes in the exchange system. This review will be completed by mid-November in time for incorporation of the salient recommendations into the budget.

17. The Government strongly believes that the success of the new exchange system depends critically on the effectiveness with which it is implemented; consequently, the Government is strongly committed to ensure that the determination of the exchange rate continues to be free. In this regard, ad hoc and administrative manipulation of the system will be eschewed completely, as this would undermine confidence, which is vital in ensuring the effectiveness of the new system. In addition, we have obtained the services of a technical expert from the International Monetary Fund to assist in the day-to-day operations of the system.

1/ In order to increase the mobilization of foreign exchange resources from the fisheries sector, the Government will intensify its monitoring of this sector; in this context, the Government plans to approach the IBRD and its affiliate, by end-December 1986, to seek assistance.

18. Sierra Leone's pipeline of commercial arrears is estimated at end-June 1986 at about SDR 94 million, representing about 30 percent of Sierra Leone's total external arrears. In the context of the Fund-supported program, arrangements are being made to regularize Sierra Leone's arrears situation either through rescheduling, to be agreed within the framework of the Paris Club and comparable agreements with other official creditors, or through consolidation. External arrears are being reduced through a schedule of cash payments, as well as by permitting withdrawals from the commercial pipeline.

Pricing and production policies

19. As announced in the budget speech of June 27, 1986, the Government's present policy stance is one of full and complete price decontrol. In the past, price controls had been introduced with a view to protecting consumers' real incomes. However, in the face of continued shortages, large budget deficits, expansionary monetary policies, and distortions which characterized the economy, the Government has now abandoned the policy of price controls; accordingly, prices are being determined by supply and demand so as to promote efficiency in the allocation of scarce resources.

20. In the agricultural sector, the Government has announced, effective July 1986, large increases in the producer prices of all major export crops. In this context, the producer prices of coffee, cocoa, and palm kernels were increased by 100 percent, 200 percent, and 88 percent, respectively; the increases in the case of coffee and cocoa were in addition to the increases of 100 percent and 33 percent, respectively, effected in February 1986. In total, the producer prices of these commodities have been increased by amounts ranging from 88 percent to 300 percent since February 1986. As a result of the higher levels of producer prices, Sierra Leone is now broadly competitive with neighboring countries at the present prevailing parallel market exchange rate. Consequently, purchases of export crops by the SLPMB have been increasing. Nevertheless, while these increases are broadly adequate in light of prevailing world market prices and of recent developments in the foreign exchange market, the Government will continue to keep producer prices under constant review, and we are committed to ensuring that our producer pricing policy will remain competitive with those of neighboring countries. However, we are concerned that preannounced and publicized statements by the Government to the effect that producer prices will be adjusted frequently, will give rise to speculative developments in agricultural export commodities. Accordingly, producer price developments will continue to be monitored closely by the Government in light of the Government's commitment to remain competitive in this area; in addition, a producer price committee, which includes representatives of the SLPMB, the Ministry of Agriculture, the Ministry of Finance, and the Ministry of Trade and Industry, will give effect to government policy in this area. The producer price of rice was also increased by 74 percent in July 1986, in order to encourage the domestic production of rice.

21. Regarding the retail price of rice and the role of the SLPMB in rice import operations, the Government has now articulated the envisaged program of price decontrol, as well as of privatization of rice import operations. In the context of a transitional period through December 1986, the SLPMB will confine itself to the importation of a total of 45,000 tons of rice by December 1986; this total includes a strategic stock of 20,000 tons. Meanwhile, consistent with the Government's policy of rice price decontrol, the retail price of rice imported by the SLPMB has been increased by 100 percent, from Le 85 per kg bag to Le 170 per kg bag effective August 1, 1986, thereby reducing the subsidy on rice substantially to Le 44 million. Simultaneously, arrangements to phase in the private sector to replace the SLPMB in rice import operations are fully on course: on August 6, the Government made the necessary announcement inviting the private sector to apply for licenses to import rice. In sum, apart from the stated import quantities of rice by the SLPMB, its import operations in this sector have now ceased except for the holding of the strategic stock. In this context, apart from the strategic stock levels, official importation of rice has been limited to amounts obtained through aid arrangements, and sales of receipts of grant rice or rice from the strategic stock will be made to the public at the prevailing freely determined market price.

22. On the basis of the recent changes in producer prices, and in light of the Government's policy on rice import operations, it has also become necessary to make a number of changes which have a bearing on the financial position of the SLPMB. First, as discussed with the Fund and World Bank staffs in February 1986, at substantially higher levels of producer prices, the SLPMB would not be in a position to pay export taxes on coffee and cocoa at 30 percent and 10 percent for palm kernels without recourse to bank financing; accordingly, such taxes have been reduced to 6.8 percent for both coffee and cocoa, while the export tax on palm kernels remains at 10 percent. On this basis, the SLPMB'S financial position will show an overall surplus even after the nonstrategic portion of the rice imports already contracted up to December 1986. Second, the SLPMB's Le 87 million loss on rice operations in 1985/86 has been transferred to the budget for 1986/87 (as an integral part of the Government's efforts to clarify the position with regard to interagency arrears, as well as to get a true picture of the cost of a number of critical government decisions, including those on subsidies for rice). Third, in line with the Government's policy to fully implement the abolition of retention facilities, arrangements have now been completed for the Bank of Sierra Leone to take over the SLPMB's external liabilities incurred on behalf of the Government, and to work out a suitable arrangement for their regularization, including rescheduling, in appropriate cases. The transfer of these encumbrances from the SLPMB will facilitate the Government's efforts to enforce surrender obligations by the SLPMB; in turn, this would release resources which would contribute to the rice privatization process by augmenting the total pool of foreign exchange resources available in the banking system.

23. In line with the Government's policy to eliminate the subsidy on petroleum products, the relevant prices were increased as follows at the time of the budget speech on June 27, 1986: petrol, from Le 8 to Le 15 per gallon (or about 88 percent); diesel fuel, from Le 7 to Le 13 per gallon (or about 86 percent); kerosene, from Le 4 to Le 12 per gallon (or 200 percent). However, the benchmark exchange rate of Le 14 = US$1 at which the pass-through prices were calculated at the time had depreciated in the context of the float to Le 30 = US$1 at the last fixing session on September 21, 1986. In the event, consistent with the stated policy stance of the Government, it was considered necessary to adjust the petroleum prices further to eliminate the subsidy on the budget (after taking account of customs and excise duties on oil). Accordingly, petroleum prices have been increased again, effective September 16 1986, thereby eliminating petroleum subsidies; prices of petroleum products have been increased as follows: petrol (100 percent), diesel fuel (76.9 percent), kerosene (83.3 percent). With these latest round of adjustments, the prices of petroleum products have been increased by a range of 257 percent (diesel) to 475 percent (kerosene), since the float in June 1987. The Government is also fully committed to reinstitute a more efficient supply arrangement for crude oil. In this context, the Government intends to begin the process of regularizing its relations with its creditors in the oil sector with a view to achieving significant savings on oil import prices thereby conserving much needed foreign exchange resources, while at the same time passing the benefits to consumers in the form of relatively smaller future adjustments, if any, in various prices than would be the case at the present high cost of procuring crude oil. Thereafter, the Government intends to adjust fuel prices regularly to fully cover all costs, as well as allow a profit margin to the refinery, every time costs increase by more than 10 percent, or quarterly to eliminate any subsidies. Finally, at the time of the change in the exchange rate system, utility tariffs were not adjusted to reflect the increased costs of imports at the new exchange rate. However, on the basis of earlier consultations with the World Bank, the Government has increased electricity tariffs by 300 percent, effective October 1, 1986. Furthermore, the Government has increased other administered prices as follows: telephone tariffs (60 percent); telephone rentals (60 percent); water rates (87.5 percent); telex and international telephone calls (100 percent); road transport corporation inter-city fares were increased in many cases by at least 50 percent. Further increases in these administered prices will be made every quarter, as required, in consultation with the World Bank.

Domestic financial policies

24. In 1986/87, the government targets to reduce the overall fiscal deficit after debt rescheduling 1/ (on a commitment basis) from 14.5 percent of GDP in 1985/86 to 7.5 percent; on this basis, bank

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1/ The programmed reduction in the deficit before debt rescheduling is from an estimated 14.5 percent of GDP in 1985/86 to 11.1 percent of GDP in 1986/87.

financing of the deficit must not exceed 39.7 percent of beginning money stock, compared with 88.7 percent in 1985/86; these targets will be used for planning and monitoring purposes, pending a comprehensive review of the budgetary situation at midyear. In this context, the budget incorporates a number of revenue measures, such as the abolition or reduction of several duty exemptions and the introduction of export duties on fish and scrap metal. At the time of the midyear review of the budgetary situation, the Government envisages that a revised budget will be implemented, which would take into account the evolution of economic and financial aggregates following the reform of the exchange system; the revised budget will underscore the budgetary targets delineated above and, if necessary, strengthen those targets. Consistent with the reforms taking place in a number of areas in the economy, including the exchange system, the Government considers that it must undertake, in October/November, a major review to restructure Sierra Leone's tax system in order to improve the elasticity of the tax system and to accelerate economic growth; the tax reform effort would also aim at minimizing distortions in resource allocation. Similarly, additional structural changes in the tax system will be undertaken where necessary. In this context, an important step in the rationalization of the tax system, which is already being implemented in light of earlier discussions with the Fund and World Bank staffs, has been a reduction in agricultural export tax rates for coffee and cocoa, as the previous tax rates are no longer consistent with the new exchange rate system and the Government's new producer pricing policies. Other measures designed to restructure the tax system will be considered in the context of the work of the technical assistance mission which the Government has requested from the International Monetary Fund for October. Recommendations from the fiscal mission will, to the extent possible, form an integral part of the revised budget which will be implemented at midyear.

25. On the expenditure side, the Government is committed to a curtailment of current expenditures not connected with maintenance and rehabilitation needs, as delineated in the proposed World Bank structural adjustment loan. In addition, extrabudgetary expenditures which represent quasi-permanent commitments have been incorporated in the budgetary targets for 1986/87, but on a greatly scaled-down basis. Concerning external debt service payments, the Government has resumed payments, each month retroactive to July 1, of the local currency counterpart of government external debt obligations into the blocked account at the central bank as obligations fall due. Amounts in this account have been excluded from the definition of net credit to the Government for the purpose of determining the credit targets under the Government's program; the targets would also be reduced in respect of any shortfall in the scheduled payments into these accounts. In addition, the Government has also reinstated the quarterly allotment scheme for monitoring and controlling government expenditure. The Government is pressing ahead with its review of wage personnel to determine the number of redundant workers; in this context, consistent with the Government's understandings with the World Bank, the size of the daily work force will be reduced by 15 percent from an agreed base by June 1987; the modalities,

including the phasing to ensure that the targeted reduction is effected by the scheduled date, has been agreed with the World Bank appraisal mission, which visited Freetown during the period September 2-19, 1986.

26. Meanwhile, the Government has continued its efforts to contain the budgetary situation in a number of ways. First, the Government is stepping up its revenue collection efforts in the areas of income tax and customs and excises through improvements in tax administration. Second, the Government continues to adhere to the expenditure restraint measures adopted in earlier years, especially with respect to the procurement and management of supplies. Third, unless there were compelling reasons to the contrary, the Government will not award a further general salary increase in this fiscal year, without prior consultation with the Fund's management. Fourth, as part of the ongoing preparations for a possible structural adjustment program, the Government is reviewing the World Bank's proposals concerning the divestment of loss-making public enterprises and the revision of the tariffs of some enterprises that are presently dependent on budgetary subsidies (e.g., power supply), with a view to implementing the recommendations; the reform of the public enterprise sector has also commenced, with a view to reducing the Government's involvement in this sector, while at the same time increasing the efficiency of public enterprises. Fifth, the Government is fully aware of the adverse impact of the fuel subsidy on the overall fiscal deficit and, as noted earlier, has increased retail prices of petroleum products, thereby eliminating the subsidy. Sixth, in line with the Government's commitment to reduce cross-arrears among enterprises, including arrears between enterprises and the Government, a study of the stock of arrears, including a schedule for offsetting them as well as for liquidating any remaining balances, will be undertaken by March 1987. A separate memorandum (attached), delineates in additional detail certain aspects of fiscal policies in 1986/87.

27. In support of the Government's fiscal policy, the stance of credit policies has been considerably tightened; this would reduce inflationary pressures, while at the same time making adequate allowance for productive credit. In this context, total domestic credit has been programmed to increase by 35 percent in 1986/87, compared with an increase of 57.5 percent in the previous year; this rate of increase in domestic credit is substantially less than the nominal increase in GDP. Net credit to the Government would increase by 31.6 percent, compared with an increase of 63.5 percent in 1985/86. The improved pricing policies for parastatals will result in a reduced rate of increase in credit to that sector, thus making allowance for a higher growth in productive private sector credit. In order to ensure that bank credit to the private sector is consistent with the overall credit targets, commercial banks will be required to continue to observe the central bank's quarterly quantitative credit guidelines.

28. For some time since the floating of the leone, the Government had been concerned with the operations of interest rate policies under which the Bank of Sierra Leone regulated interest rates, which are now

substantially negative in real terms; in addition, until September 4, 1986, the interest rate structure represented the most important single remaining rigid regime given the Government's present market-oriented approach to macroeconomic policy formulation. That anomalous situation has been corrected: the Bank of Sierra Leone has implemented a flexible interest rate policy effective September 4, 1986 in the context of a Treasury bill auction system, under which banks are free to set deposit and lending rates; as a first step, deposit rates had been increased by 8-10 percentage points on average, effective August 8, with the banks being allowed to make appropriate adjustments to their lending rates. Institutional developments in the monetary sector in 1986/87 include the opening of a number of rural banks, and Government's decision to restructure and recapitalize the National Development Bank under a new management.

29. To ensure that the Government's program will get off on a very strong initial start, which would be closely monitored, this memorandum includes targets on total domestic credit and on net credit to Government for end-September 1986, as well as performance criteria on these aggregates, external arrears, and new borrowing for end-December 1986. In this context, total domestic credit, which amounted to Le 2,142.9 million at end-June 1986, will not exceed Le 2,565.6 million by end-September and Le 2,610.0 million by end-December. The limits on the expansion of total domestic credit will be reduced by the amounts of any approved withdrawals of blocked deposits from the commercial arrears pipeline. Net credit to the Government, which amounted to Le 1,948.1 million at end-June 1986, will not exceed Le 2,320.7 million at end-September and Le 2,298.0 million by end-December. In this context, the ceilings will be adjusted downwards for exceptional financing, including debt-relief, in excess of what is programmed, or on account of any shortfalls in payments into the blocked account for debt service payments. Satisfactory understandings on the revised budget for 1986/87 with the Fund review mission in December 1986, would also be required for successful completion of the review. Official external debt with an initial maturity of one year or less by the Government or the Bank of Sierra Leone, or authorized or guaranteed by them, is limited to obtaining bridging finance and trade credits. Also, there will be no new nonconcessional external borrowing by the Government or by the Bank of Sierra Leone, or authorized or guaranteed by them. This memorandum does not include a target for end-September on a minimum net cash reduction in external arrears, but includes a net cash reduction of SDR 2 million in external arrears by end-December 1986, as a performance criterion. This cash reduction would be based on the inventory of arrears made at the time of a meeting of Paris Club creditors, scheduled for mid-November 1986. The performance criteria for December 1986 on credit and on external indebtedness and arrears reduction will serve as benchmarks for the SAF program. Furthermore, as additional benchmarks under the SAF (as well as indicative ceilings under the stand-by arrangement), total domestic credit, and net credit to Government, will not exceed Le 2,893.4 million and Le 2,564.4 million, respectively, by end-June 1987, and there will be a net cash reduction in external

arrears (excluding the Fund), of SDR 2.6 million for 1986/87. In addition, if the indicative quarterly targets on the Central Government's wage expenditure and on other recurrent expenditure are not observed, Sierra Leone will consult with the Managing Director of the Fund.

30. These targets will be reviewed at the time of the midyear budget review on the revised budget for January-June 1987. The first review mission will take place by end-December 1986; the review will be deemed to be successful if the revised budget for 1986/87 reflects the understandings reached with the review mission, in addition to Sierra Leone satisfying the performance criteria for end-December. At the first review, performance criteria will be established for end-March 1987 and end-June 1987. The second review mission would need to take place by end-June 1987. At that review, understandings would be reached on the 1987/88 budget, and on the performance criteria for end-September. This review will also provide the occasion for reviewing the benchmarks under the SAF program, for updating the Government's policy framework paper and for submitting the second annual program to be supported by the second annual arrangement under the SAF.

Sierra Leone: Performance Criteria for end-December, 1986 and Indicative Targets for June 1987

End of Period	1985 Actuals Dec.	1986 Actuals March	1986 Actuals June	1986 Indcative target Sept.	1986 Ceiling Dec.	1987 1/ Indicative targets June
			(In millions of leones)			
Net claims on Government by the banking system 2/	1,597.7	1,759.0	1,948.1	2,320.7	2,298.0 2/	2,564.4
Total domestic bank credit	1,750.4	1,940.3	2,142.9	2,565.6	2,610.0 2/	2,893.4
			(In millions of SDRs)			
Cash reduction in external arrears excluding IMF					2.0	2.6
New external borrowing by the Government and the central bank, or authorized or guaranteed by them, with an original maturity of under one year except for the SDR 37.73 million of bridging finance which has already been agreed, but excluding import-related credits.	...	...	...	...	--	--
New nonconcessional external borrowing of an initial maturity of between 1-12 years by the Government or the Bank of Sierra Leone, or authorized or guaranteed by them	...	...	...	...	--	--
Subceiling on maturities of 1-5 years	...	...	...	...	--	--

1/ See technical notes.
2/ These ceilings will be adjusted downwards on account of any shortfalls in programmed payments into the blocked account for debt service payments.

Technical Memorandum of Understanding

Total domestic credit as specified in the Memorandum on Economic and Financial Policies of Sierra Leone is defined to include net credit to Government and credit to the private sector.

Net credit to Government is defined as:

1. Bank of Sierra Leone

    Ways and means advances
    Holdings of government securities
    Other advances
    SDR allocation held by Treasury

    Less: Government deposits
    Current account plus
    Blocked account plus 1/
    Bonds
    Net credit to Government

2. Commercial banks

    Holdings of Treasury bills
    Holdings of government stocks
    Advances to Government

    Less: Government deposits
    Net credit to Government

3. Total net credit to Government

Credit to the private sector is defined as:

1. Bank of Sierra Leone

    Claims on private sector (line 12d) 2/

1/ Excluding the blocked account for the leone counterpart of the Government's external debt service payments and also the existing 1982/83 domestic arrears fund.

2/ Reference to IFS line numbers.

2. Commercial banks

Claims on official entities (line 22b) 1/
- Loans and advances to SLPMB
- Loans and advances to other government corporations
- Loans and advances to the Registrar of Cooperatives
- Investment in other securities in Sierra Leone (N.D.B.)

3. Cash reduction in arrears

The targeted net reduction in external arrears by end-December 1986 refers to the inventory of arrears which will be prepared for the Paris Club debt rescheduling meeting in November 1986. The targeted net reduction in external arrears for end-June 1987, refers to the whole fiscal year.

1/ Reference to *IFS* line numbers.

Memorandum of Understanding on Fiscal Policies
Between the Government of Sierra Leone and
the International Monetary Fund

The purpose of this memorandum is to delineate in greater detail certain aspects of the fiscal policies for 1986/87 contained in the Memorandum on the Economic and Financial Policies of Sierra Leone, which supports Sierra Leone's request for use of Fund resources. This memorandum also establishes a reporting schedule for monitoring current expenditures in the remainder of FY 1986/87.

1. Total development expenditure will be limited to Le 1,093.5 million in FY 1986/87.

2. Total development expenditure excludes the figure of Le 59 million for vehicles and equipment included in the 1986/87 development estimates which has been transferred to the recurrent budget. Receipts from sales of food aid will be used for general budgetary support in 1986/87.

3. In line with the recommendations of the World Bank, a reduction in the number of daily wage laborers by about 15 percent will take place by March 1987 and, as a consequence, the provision for wages will be limited to Le 103.2 million.

4. In view of the tight budgetary situation, the wage increase currently being negotiated with the relevant trade unions for government workers should be consistent with the increase granted to salaried government employees effective July 1986.

5. The revised estimates of current expenditures and extrabudgetary expenditures together entail an increase from Le 1,131.5 million in 1985/86 to Le 1,789.5 million in 1986/87, after debt rescheduling.

Current expenditure on subsidies and transfers comprises:

1. Subventions to educational institutions.

2. Subsidies for rice and oil, and

3. Subsidies to the National Power Authority (NPA).

The Government feels that savings can be achieved as follows:

i. Le 8.5 million on account of subventions to educational institutions, thus limiting the subventions to these institutions to the budgeted amount of Le 32 million.

ii. In line with the Government's decision to eliminate petroleum subsidies as stated in the 1986/87 Budget Speech, the Government implemented a full pass-through of petroleum product prices on September 16, 1986. With regard to rice, the Government has undertaken to completely privatize rice operations by the end of CY 1986 when subsidies on rice will be eliminated. Consequently, the budget provides for subsidies on account of fuel amounting to Le 35 million during July-September 1986, and LE 45 million on account of rice subsidies to be incurred during the period July-December 1986. The Government will ensure that subsidies for fuel and rice are not re-introduced.

iii. As agreed with the World Bank, electricity tariffs by the NPA have been increased by 300 percent, effective October 1, 1986. As a result, subventions to the NPA will be limited to Le 5 million to cover the cost of the subsidies for the period July-September 1986.

6. The Government will use its best endeavours to avoid an increase in extrabudgetary expenditures in FY 1986/87, except for compelling emergencies.

7. In view of the difficult financial situation, the Government has targeted savings of Le 70 million to be attained from reductions on expenditures on goods and services.

8. A system of allotments for current expenditures will be used to facilitate the monitoring of expenditures under the program. The allotment system is designed to ensure that expenditure authorizations during 1986/87 are consistent with the overall targets of the program. It is planned that actual allocations to the vote controllers will be updated at the beginning of the third and fourth quarters of 1986/87 such that the aggregates of allocations for (a) wages and salaries, (b) goods and services, (c) subsidies and transfers, and (d) current expenditures at the end of any quarter do not exceed the corresponding cumulative total of the quarterly allocations specified in the attached table. The allotments will be regularly monitored by the Ministry of Finance and the Bank of Sierra Leone to ensure that no excess expenditures are incurred.

9. The smooth functioning of the quarterly allotments system will be facilitated by the operation of the expenditure control procedures at the Ministry of Finance. Under these procedures, all expenditures authorized by local purchase orders are subject to pre-audit in the Expenditure Control Unit, so that prior Ministry of Finance approval is required before departments make commitments.

10. To improve the monitoring of budgetary performance and to prevent the accumulation of arrears on the domestic counterpart of external payments, a special blocked account for the domestic counterpart of scheduled official external payments has been established at the Bank of Sierra Leone. This account is designed to ensure that adequate provision is made from domestic budgetary resources for the domestic counterpart of such obligations, regardless of the availability of foreign exchange to complete the externalization of these payments. Beginning

from the date of establishment of the account, all principal and interest payments on official external debt service chargeable to the budget will be debited to the blocked accounts.

11. The Government has undertaken to incur no net increase in domestic arrears in 1986/87. Meanwhile, the revised budget for 1986/87 provides for a reduction of these arrears by Le 10 million in 1986/87.

12. The Government intends to request the Fund to assist in establishing a framework for determining the extent of inter-parastatal arrears, as well as arrears between the public enterprises and the Government by March 1987.

13. The authorities agree to introduce additional fiscal measures in FY 1986/87 to raise additional revenues amounting to about 1 percent of GDP; in this context, it is expected that the findings of a Fund tax mission scheduled to visit Freetown in October/November 1986, will be helpful.

14. On the basis of all the above, net bank credit to the Government is targeted not to exceed Le 2,564.3 million by end-June 1987. The ceilings on net credit to Government (which are performance criteria under the program) have been delineated on the basis of the above target.

15. The attainment of the fiscal targets under the program is predicated on full implementation of all the revenue and expenditures measures. In this context, the revenue estimates include payment of all export taxes on the basis of the new rates, and the 10 percent import duty on rice imports by the Sierra Leone Produce Marketing Board.

16. In order to improve the monitoring of government finances, the Bank of Sierra Leone will collect data on government borrowing (net) from the banking system (including the commercial banks, as well as the Bank of Sierra Leone) on a daily basis, with immediate effect. Such data for each week will be reported to the Ministry of Finance and the Fund Representative at the beginning of the following week.

17. Data on actual expenditures and revenues will be reported to the Fund on a quarterly basis, as soon as possible after the figures become available, but in any event no later than one month after the end of the quarter. The Sierra Leonean authorities will consult with the Fund if total expenditures, expenditures on wages and salaries, expenditures on goods and services, expenditure on subsidies and transfers, and interest payments are deemed likely to significantly exceed the specified allotments (as set out in the attached table), in order to agree on additional fiscal policy measures (revenue or expenditure) required to enable the Government to meet its overall fiscal targets.

Sierra Leone: Quarterly Allotment of Current Expenditure, 1986/87

(In millions of leones)

	First	Second	Third	Fourth	Programme Total
	Quarter				
Wages	25.8	25.8	25.8	25.8	103.2
Salaries	66.1	66.1	66.1	66.1	264.5
Goods and Services	130.7	130.7	130.7	130.7	522.6
Subsidies transfers	72.5	35.7	12.0	12.0	132.1
Electricity	3.4	1.6	0.0	0.0	5.0
Education	8.0	8.0	8.0	8.0	32.0
Rice	22.1	22.1	0.0	0.0	44.2
Oil	35.0	0.0	0.0	0.0	35.0
Pensions	4.0	4.0	4.0	4.0	15.9
Interest payments 1/	157.7	154.3	253.8	201.2	766.9
Total current expenditure 1/	452.8	412.6	488.4	435.8	1,789.3

Source: Data provided by the Sierra Leone authorities.

1/ Assumes debt rescheduling.

Sierra Leone - Structural Adjustment Facility: Three-Year and First Annual Arrangement

Attached hereto is a letter with an annexed policy framework paper and a letter with an annexed memorandum of economic policies dated October 15, 1986 from the Minister of Finance and the Acting Minister of National Development and Economic Planning of Sierra Leone requesting from the Fund a three-year structural adjustment arrangement and the first annual arrangement thereunder, and setting forth

1. the objectives and policies of the program to be supported by the three-year arrangement, and

2. the objectives and policies of the program to be supported by the first annual arrangement.

To support these objectives and policies, the International Monetary Fund grants the requested arrangements in accordance with the following provisions and subject to the regulations for the administration of the structural adjustment facility:

a. For a period of three years from November --, 1986, Sierra Leone will have the right to obtain three successive loans from the Fund under the structural adjustment facility in a total amount equivalent to SDR 27.21 million.

b. The first loan, in an amount equivalent to SDR 11.58 million, is available for disbursement at the request of Sierra Leone.

c. The second and third loans will be available upon approval by the Fund of the corresponding annual arrangements and will be disbursed at the request of Sierra Leone. The amount of the second loan will be equivalent to SDR 7.82 million, and the amount of the third loan will be equivalent to SDR 7.82 million.

d. Before approving the second annual arrangement, the Fund will appraise the progress of Sierra Leone in implementing the policies and reaching the objectives of the program supported by the first annual arrangement, taking into account primarily the following:

(i) the indicators relating to total domestic bank credit, net claims on Government by the banking system, cash reduction in external arrears, and the contracting or guaranteeing of new medium- and short-term public debt by the Government or the Bank of Sierra Leone described in Table 12 of EBS/86/243,

(ii) the indicators described in Table 12 of EBS/86/243,

(iii) imposition or intensification of restrictions on payments and transfers for current international transactions,

(iv) introduction or modification of multiple currency practices,

(v) conclusion of bilateral payments agreements which are inconsistent with Article VIII,

(vi) imposition or intensification of import restrictions for balance of payments reasons.

e. In accordance with paragraph 5 of the attached letter trans mitting the memorandum of economic policies, Sierra Leone will provide the Fund with such information as the Fund requests in connection with the progress of Sierra Leone in implementing the policies and reaching the objectives supported by the first annual arrangement.

f. In accordance with paragraph 6 of the attached letter transmitting the memorandum of economic policies, Sierra Leone will consult with the Managing Director on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests such consultation. These consultations may include correspondence and visits of officials of the Fund to Sierra Leone or of representatives of Sierra Leone to the Fund.

Freetown, Sierra Leone

October 15. 1986

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière:

On behalf of the Government of Sierra Leone, we are pleased to transmit herewith a policy framework paper, prepared in collaboration with the staff of the Fund and the World Bank, setting forth the Government's basic economic objectives for the next three years and the macroeconomic and structural adjustment policies designed to achieve them. These policies are an integral part, and hence fully consistent with, our financial program for 1986/87 in support of which we have requested a one-year stand-by arrangement from the Fund, and with our adjustment program under our prospective Structural Adjustment Loan from the World Bank.

We are forwarding today the same letter and attached paper to the President of the World Bank.

Sincerely yours,

/s/
Dr. Shamsu Mustapha
Acting Minister of National
Development and Economic Planning

/s/
Dr. Sheka Kanu
Minister of Finance

SIERRA LEONE

Economic and Financial Policy Framework 1986/87-1988/89

October 15, 1986

I. Background

1. Sierra Leone's population of 3.7 million is growing at about 2.7 percent per year. Its per capita income is about $300 and two thirds of the population live below the absolute poverty line. 1/ Agriculture, although it employs 65 percent of the labor force, contributes only 35 percent of the GNP, largely because of the dominance of subsistence farming. Domestic production meets only about 70 percent of the domestic demand for rice, the main staple. Cocoa, coffee, and palm kernels are the main export crops. The importance of mining, especially diamonds, which has been a key sector, has diminished in recent years. The manufacturing sector is small and largely for import substitution. The economic and social infrastructure is inadequate, and the development of human resources has been limited: life expectancy is only 38 years, infant mortality is 200 per 1,000 live births, and the literacy rate is 15 percent, among the poorest levels in the world. Similarly, the primary school enrollment ratio of 41 percent is well below the average even for the low-income sub-Saharan countries. There is serious shortage of skilled manpower at the middle and lower levels of public administration.

2. Despite its underdeveloped economic and social infrastructure and limited human resource base, Sierra Leone achieved a steady economic growth rate of 5 percent a year during its first decade of independence (1962-72), primarily because of its mineral resources (especially diamonds) and relatively favorable agricultural potential. During 1972-75, despite the oil price shock in 1973, the economy still managed to grow at over 3 percent a year. GDP growth slowed to under 2 percent a year during 1975-80, however, mainly because of the depletion of alluvial diamond deposits and the closure in 1975 of the only iron ore mine, then the country's second largest source of export earnings.

3. The situation worsened during 1980-83: agricultural output fell and mineral output fell further; the terms of trade declined sharply; and the parallel market in foreign exchange thrived, diverting most trade and foreign exchange away from the official channels; at the same

1/ This per capita income estimate in dollar terms does not reflect the drastic decline in the value of the leone in recent months (see paragraph 14).

time, the debt service obligations of the Government increased sharply because of imprudent borrowing in the late 1970s. GDP growth stagnated, per capita income declined and the economic crisis deepened.

4. Sierra Leone's economic crisis of the early 1980s can be attributed to three causes. First was a series of external shocks that lowered the purchasing power of Sierra Leone's exports, among other effects. The unfavorable events were: the first oil price hike in 1973; the decline in the price of exports in the late 1970s and early 1980s; and the second oil price hike in 1979. Second was the gradual depletion of Sierra Leone's resource base for its important mineral export commodities, alluvial diamonds and iron ore. Third, the Government's policy responses to the external shocks were often inadequate and poorly conceived. For example, it did not adjust the exchange rate in a timely and sufficient manner, and it continued to keep agricultural producer prices and the prices of petroleum products low and incurred huge budget deficits. In 1979, when the terms of trade drastically turned against Sierra Leone, instead of managing demand, the Government, as a host of the OAU summit conference of 1980, increased its expenditure program sharply. Domestic inflation soared, and the spread between the official and parallel market exchange rate widened sharply. With the leone grossly overvalued in the official market, most trade and foreign exchange was attracted away from that market.

5. Since 1983, the situation has continued to deteriorate, despite some measures by the Government. The total government expenditures in nominal terms increased four fold between FY1983 and FY1986, largely because of huge increases in foreign exchange-related subsidies (such as for oil). An overstaffed and inefficient civil service, as well as the budgetary cost of poorly managed state enterprises, has continued to aggravate the fiscal problem. At the same time, the Government continued to rely to a large extent on external borrowing, much of it at highly nonconcessionary terms, and on the accumulation of arrears in external payments to sustain domestic absorption. Although in the past three years the Sierra Leone Government has initiated a number of measures aimed at halting the decline in the economic and financial situation, these measures have been sporadic and limited. For example, in early 1985, the Government initiated a discrete and inadequate devaluation of the leone. Similarly the 1985 increases in energy and food prices proved inadequate, and the budget deficit widened further. The economic situation has generally continued to worsen.

II. Medium-Term Structural Adjustment Program

Objectives

6. Against the background just described, the new Government considers that bold, appropriate, and sustained economic and financial policies are urgently necessary to redress the various imbalances, reverse the economic decline and restore the economy to positive growth. It intends

to pursue a structural adjustment effort within a broad policy framework, developed in close consultation with the staffs of the Fund and the World Bank; the medium-term program addressed here covers the three years 1986/87-1988/89. The Government expects that a large part of the growth in the medium term will come from the agricultural sector, which will benefit from reforms in pricing policies. Likewise, it anticipates that as a result of appropriate policy reforms the overall performance of the mining sector will improve through increased mining of gold, rutile, bauxite, and possibly kimberlite diamonds. Other measures during the program period will be designed to facilitate the resumption of concessional capital inflows, including debt relief.

7. Overall, the medium-term program aims at the following objectives: (a) an average annual real growth rate of GDP of some 3 percent, a level that will modestly improve real per capita incomes; (b) a substantial reduction in the rate of inflation from an estimated 90 percent in 1986/87 to some 10 percent in 1988/89; 1/ and (c) a reduction in the external current account deficit from an estimated 2.0 percent of GDP in 1986/87 to about 1.0 percent in 1988/89.

8. The medium-term adjustment program will include actions both to stabilize the economy and to achieve and sustain growth. The actions being initiated at the start of the program are: (a) exchange rate adjustment; (b) import liberalization; (c) correction of price distortions; (d) reduction of the budget deficit; and (e) containment of monetary growth. These actions will lay the foundation for economic recovery and growth, which will also be the goal of the structural adjustment program supported by the Bank.

9. The medium-term adjustment program will: (a) stimulate further agricultural and industrial output by strengthening the initial reforms, and will be accomplished by maintaining an appropriate exchange rate, ensuring continued adequate agricultural producer prices, maintaining price liberalization and rationalizing tariff policy; (b) improve public sector efficiency by rationalizing and overhauling public enterprises and reforming the Government's budgeting system and the expenditure program; and (c) rehabilitate the transport and communications infrastructure (roads, electricity, and so on) so as to bring it up to a satisfactory standard. In sum, the objective of the Government's medium-term adjustment program is to put the economy back onto a path of growth and development and to regain a viable external payments position, in the context of a liberal trade and exchange system.

10. In sum, the Government's medium-term adjustment program will be growth-oriented. Agriculture will be the principal source of growth,

1/ This reduction will be attained through the tightened fiscal and monetary policies as described in paragraph 23 and 27. In addition, the high rate of inflation in 1986/87 reflects the substantial (six-fold) depreciation of the leone. The exchange rate is now expected to stabilize.

but increased output from mining, especially of gold, rutile and bauxite, and from fishing will also greatly help. The medium-term adjustment program will also help the economy regain a viable external payments position. In the short run, the recorded exports will grow because a market-determined exchange rate policy will drastically curb the parallel market. In the medium term, the increased prices will boost most exports, especially coffee, cocoa, fish, and gold.

11. A summary of the timeframe for the Government's adjustment program is provided in the attached table. As can be noted, the bulk of the substantive policy actions are being implemented in the first year of the program. Some elements of the program, however, will take a longer time to complete. For example, the reform and rationalization of public enterprises should take several years. Extensive institution-building efforts--from better budgeting and investment planning to civil service reform in general--are expected to extend beyond the three-year program period.

12. Since implementation of the critical policy measures is front-loaded, an important objective of the Government's program in the period ahead is to ensure regular reviews of the implementation of the reforms. Based on these reviews, additional measures, as necessary, will be designed and implemented.

13. It is expected that the Government's program will receive support from the international community, including the Fund, the World Bank, and bilateral donors. Fund-supported adjustment programs would be accompanied by use of Fund resources, including the the Structural Adjustment Facility, to serve as catalysts in mobilizing external resources. The World Bank is considering supporting the growth-oriented adjustment program with SAL, and related technical assistance. The Bank supported structural adjustment program will include rehabilitation of some public enterprises. In addition, the Bank expects to continue to assist Sierra Leone in rehabilitating and expanding the economic and social infrastructure (such as roads, power supply, and education and health services) needed to support the adjustment effort and to accelerate agricultural growth. A number of bilateral aid donors have also expressed intentions to expand and better coordinate their financial support through regular bilateral aid programs and exceptional financing (such as debt rescheduling). A donors' round Table Conference has been tentatively planned for the first quarter of 1987.

Actions already initiated

14. Within the broad framework outlined above, in the first year of the program (1986/87), the Government is implementing a number of strong adjustment measures. It has introduced a flexible, market-determined exchange rate system, under which the exchange rate depreciated sharply from Le 5 = US$1 in June 1986 to Le 30 = US$1 by the end of September

1986. 1/ To complement the new exchange rate system, the trade system is being liberalized, as the previously restrictive import licensing system has been replaced with a system of open general licenses. All trade transactions are now valued at the market-determined exchange rate for import duty purposes. The retail prices of basic consumer goods are being decontrolled. The subsidies on petroleum products have been removed through a full pass-through of the import costs at the market-determined exchange rate. The retail price of rice is being fully decontrolled in the context of arrangements for the private importation of rice. Substantial increases in the producer prices of the major export crops--coffee, cocoa, and palm kernels--to levels comparable to those in neighboring countries have been effected. Fiscal and monetary policies have been considerably tightened. Interest rates have been decontrolled.

Further actions

15. The structural adjustment program includes implementation of a revised three-year public investment program covering the period 1986/87-1988/89. The overall investment strategy is to restore the economy's productive capacity through the rehabilitation of the basic infrastructure and the development of efficient input delivery and extension service systems in the agricultural sector. Accordingly, more than 50 percent of the investment resources are earmarked for projects in agriculture and supporting infrastructure. Hitherto, a major problem had been the dispersion of a small development budget over too many projects, with the result that many of these projects could not be completed. To overcome this problem, the Ministry of Planning and National Development has, in consultation with the World Bank, selected a small number of high priority projects to be included in a core program, which will have priority funding under the budget. The core program will account for at least 80 percent of the development budgets. For 1986/87, the core program has been finalized in consultation with the SAL appraisal mission. In the future, the Ministry of Planning and National Development will have a stronger role in planning and coordinating the public investment program and the criteria for selecting core projects will be determined by a Project Review Committee, to be formed by the Ministry by December 1986. In addition, the number of noncore projects underway will be sharply reduced. The largest share in the core program would be for agriculture (40 percent of expenditures), followed by power (19 percent), and transport and communications (18 percent).

16. Agriculture, which historically has been the mainstay of the economy, will have to be the principal source of future growth in output and employment. To this end, the Government's agricultural policy is predicated on competitive and realistic producer pricing for all major

1/ Under the exchange system, the leone no longer bears a fixed relationship to any other currency but has a varying rate that reflects the supply and demand of foreign exchange in the economy.

agricultural export crops as well as for rice. In line with this approach, the Government has recently increased agricultural producer prices for commodities now solely exported by the SLPMB. The new prices are nearly 60 percent of the f.o.b. export prices on average at the recent market-determined exchange rate under the floating system. Sierra Leone's producer prices are now competitive with those in neighboring countries. The Government intends to increase the ratio of producer prices to export prices during the program period to provide stronger incentives to farmers.

17. The Government's agricultural policy also involves increasing privatization of marketing and the supply of farm inputs, and the development of supporting institutions and infrastructure (e.g., research, extension services, and roads). These efforts should boost the production of coffee, cocoa, and rice. The Government has already started to encourage private sector participation in rice importing, with a view to fully phasing out the role of the SLPMB in that operation by the end of December 1986, except that it will hold strategic stocks of 20,000 tons. The rice price will be market-determined and SLPMB's purchase of rice from the domestic market, which has been negligible in the past, will also be phased out. And any grant rice received (including all PL 480 rice from the United States), as well as sales from the strategic stock, will be at the prevailing free market price for rice. The Bank and the Government have agreed on a study that will evaluate the efficiency of the SLPMB and recommend the best approach to marketing export crops. Meanwhile, the Government will consider opening up the export market to the private sector.

18. In addition, the Government will, by the end of 1986, review existing arrangements in the fishing sector with the assistance of the Bank and its affiliates. The purpose is to determine how better to exploit this important resources for national development.

19. In the industrial (including manufacturing) sector, the Government plans to place greater reliance on market mechanisms to allocate resources. It will do so by ending administrative intervention and reducing the protection given to largely inefficient domestic industries through the fiscal and exchange rate systems. To this end, during the program period, the Government will continue to implement policies of price decontrol, abolition of exemptions from taxes, and a liberalized import licensing regime. The Government plans to review the Industrial Development Act of 1980 with a view to minimizing administrative intervention, while at the same time providing a stable policy environment that will encourage competitive pricing in industries and provide increased support for small-scale eneterprises.

20. A critical issue in the mining sector is to arrest the decline in overall performance and in the contribution of this sector to growth and the generation of foreign exchange. The Government will continue to promote increased incentives to diamond mining and export by maintaining a floating exchange arrangement in the economy. The proposed Kimberlite

diamond mining project will be reviewed, with a view to attracting appropriate foreign investors.

21. Sierra Leone's economic recovery will depend to an important extent upon the rehabilitation of its energy sector. The most urgent short-term needs are to: improve the supply of electricity and petroleum products; strengthen the responsible institutions; and better manage energy demand, mainly through economic pricing. Significant price increases for petroleum products were announced on June 27, 1986, and again on September 16, 1986. The cumulative increases, ranging from a total of 257 percent (diesel) to 475 percent (kerosene), have now eliminated subsidies on petroleum products. The system for procuring crude oil needs to be reorganized as early as possible by, inter alia, putting procurement on an internationally competitive basis. Work has already begun on resolving the problem of the refinery's accumulated debt and its future role.

22. In the electricity sub-sector, the Government will, in collaboration with the World Bank, detail a program for rehabilitating facilities that are badly run down and in need of spare parts, and for improving the National Power Authority's (NPA) effectiveness, including by modifying its basic charter to give it greater management autonomy. Meanwhile, electricity tariffs have been increased by 300 percent, effective October 1, 1986. The NPA will develop a master plan for the least-cost development of the power Sierra Leone will require in the future, to include a review of the design and timing of the proposed Bumbuna hydroelectric scheme and a number of identifed small hydro projects.

23. Fiscal policies will be directed toward lessening the scope of the public sector and the impact of the budget on the economy. Here the emphasis is on reducing the overall budget deficit (on a commitment basis and after debt relief) from a programmed 7.5 percent of GDP in 1986/87 to about 3 percent of GDP in 1988/89. With regard to tax policy, the Government aims to widen and strengthen the tax base and to enhance the elasticity and efficiency of the tax system. In the current fiscal year, the Government, with technical assistance from the Fund, will initiate in October/November 1986 a review of the tax system to identify new sources of revenue and revenue instruments, review modifications to the present tax and tariff structures in light of the new exchange system and economic liberalization program, consider appropriate methods for taxing the mineral sector, and review tax administration procedures. It is expected that the results of this review will be ready by mid-November, in time for implementation in the context of a revised budget for FY 1987, scheduled for completion by the end of December 1986.

24. Expenditure policies will aim at strictly limiting the growth of government spending. The system of monitoring expenditures on a quarterly basis and the control mechanisms reintroduced recently are to be strengthened. The Government recognizes that its efforts to reduce expenditures must take into account the serious imbalances in current expenditures (such as rapidly increasing expenditures on wages and

salaries with decreasing allocations for operation and maintenance) and the unproductive investments of recent years, both of which have contributed to a decline in the productivity of public expenditures. To improve both the Government's financial position and the productivity of its work force, these trends are to be reversed and more emphasis put on vital supplies and other nonpersonnel recurrent costs. The Government has decided that, as a first priority, total daily wage labor will be reduced by 30 percent by June 30, 1988. Simultaneously, it will raise budgetary allocations for operation and maintenance, as recommended by the Bank. These efforts will improve resource utilization in the economy and increase the returns on public investment. As noted earlier, development expenditures will be focused on the core program.

25. The Government is deeply concerned that the worsening financial situation of public enterprises has led to a decline in the quality of their services and an increased burden on the budget through subsidies and lost revenues and dividends. Consequently, a comprehensive reform of this sector will be initiated in 1986/87. The objectives of the reform are: (a) to rationalize the role of the Government in the public enterprise sector through divestiture, 1/ restructuring, and/or closure, so that enterprises which are essential to the provision of public services will be retained; and (b) to restore the operational efficiency of enterprises in the public sector through greatly improved financial planning and management, monitoring and control, institutional reform, accountability, appropriate pricing and other measures. A rehabilitation program in a small number of public enterprises is being undertaken in collaboration with the World Bank.

26. In addition to the continued implementation of policies to improve the performance of the public enterprise sector, by June 30, 1987 the Government will, as announced in the budget speech for 1986/87, establish a Public Enterprises Commission (PEC) as a Cabinet subcommittee. Its functions will be to establish general policy guidelines for the sector with regard to the creation and divestiture of enterprises, liquidation, pricing, and employment policies, along the lines being discussed by the Government and the Bank in the context of the proposed SAL. Also, as indicated in the budget speech for 1986/87, this Commission will be supported by a technical secretariat known as the Public Enterprises Monitoring Unit (PEMU), already established in August 1986 by the Cabinet. There is also a vital need to reduce inter-enterprise arrears. For this purpose, the Government is undertaking a study of the arrears, and is to establish a schedule for offsetting them and eliminating any remaining balances.

27. The tightening of fiscal policies and the new exchange system will be complemented by stringent monetary policies aimed at reducing inflationary pressures, while making adequate allowances for productive credit. Accordingly, total bank credit will be targeted to increase at rates that

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1/ Seven of the twenty-six public enterprises have already been identified for divestiture.

permit a substantial deceleration in the growth of the liabilities to the banking system. However, to facilitate the Government's objective of rehabilitating and expanding the role of the private sector, adequate provision will be made for the private sector's genuine needs for credit for productive activities, with special emphasis on crop financing. To assist the smallholder agricultural sector, measures are being taken to ensure that the scope and efficiency of rural banks are improved. In this connection, the Government plans to extend the network of the rural banks to all agricultural project areas by 1988/89. As a first step, two new rural banks are being launched this fiscal year, as called for in the budget speech for 1986/87.

28. The Government will also undertake a comprehensive review of the financial sector. Following that review, it will suggest measures to promote efficient financial intermediation, in view of the low savings rates and decline in recent years of the proportion of investment financed from domestic resources. The review is to be initiated by the second half of 1986/87, with the assistance of the Fund, and is to be implemented in subsequent years of the program. In the interim, the Government will restructure and recapitalize the National Development Bank, under new management already appointed.

29. External sector policies will continue to be implemented under the freely floating exchange rate system. The policies underpining the new system--the abolition of all retention facilities, the lifting of restrictions on current account transactions and on inward capital remittances and the liberalization of the import licensing regime--will be maintained. Ad hoc and administrative manipulation of the operation of the exchange system will be eschewed completely, as these will undermine confidence and give rise to all of the problems of the previous exchange arrangements.

30. In view of Sierra Leone's current large debt service burden (68 percent of exports, 1/ including obligations to the Fund and before debt relief), debt management policies will aim at reducing the external debt service burden in the medium term by avoiding further commercial borrowing.

31. External payments arrears, which rose sharply in the last few years, reaching about SDR 312 million by the end of June 1986, or about twice the level of annual exports, will be partly paid and partly rescheduled. At present the Government's plans call for debt rescheduling under the Paris Club and for rescheduling soon thereafter other eligible debt on terms comparable to those obtained from the Paris Club. In the context of the proposed stand-by arrangement, the Fund staff is working with the Sierra Leone authorities on various plans for liquidating arrears, including cash payments. The authorities recognize that successful resolution of the

1/ Estimated for the fiscal year 1985/86 arrears problem is essential to restoring confidence in the economy, eliminating the excessive finance charges on imports, re-establishing normal trade credits and increasing private capital inflows.

III. The Social Impact of the Program

32. A significant impact of the Government's adjustment program will be a relative improvement in the income of a large part of the rural population as compared to that in urban areas. The rise in the prices of agricultural products, the elimination of retail subsidies, the decontrol of prices and liberalization of marketing--coupled with the impact of the floating of the leone on export crop prices--will result in higher farm incomes. Given its relatively low consumption of imported goods, the rural population will be relatively less affected by the increases in the prices of imports occasioned by the leone's float than will the urban population. At the other end of the spectrum, those who now exploit the scarcity and distortions in the market will lose, as the adjustment program will reduce the rents they currently enjoy. Nevertheless some traders will, in the long run, benefit from the increased growth fostered by the adjustment.

33. Urban dwellers in general will be adversely affected by the greatly increased costs of electricity and transportation, as the prices of imports rise and the subsidies for petroleum products are ended. The majority, however, have already felt most of the impact of recent measures, since they have been paying scarcity prices far above the hitherto controlled official ones. Moreover, the supply of electricity, petroleum products and other goods had become so limited and erratic that only the higher income groups who could afford to purchase their own electric generators and pay black market prices for petroleum products and other goods could regularly enjoy them. Workers released from the public sector will be hard pressed initially, but the growth of agriculture and manufacturing and the revival of the mining sector are expected to lead to increased employment opportunities and offset the hardships.

IV. External Financing Requirements

34. Present indications are that foreign aid disbursements will increase significantly as a result of the continued implementation of a strong and comprehensive adjustment program. A one-year Fund-supported adjustment program has been requested along with the request for use of Fund resources under the SAF. As already mentioned, the World Bank is considering a possible IDA credit for a structural adjustment program and expects to work with the Government to develop supporting agricultural and related infrastructure projects for external financing. Regarding other donors, the Government, in collaboration with the UNDP and the World Bank, intends to convene a donors' Round Table Conference in the first quarter of 1987 to review the scope for increased donor commitments. The Government plans to request a shift, to the extent possible, in the composition of aid in favor of balance of payment support, such as commodity and

program aid that can be used directly to finance imports of investment goods and services not linked to specific projects. An increase in such aid flows should assist Sierra Leone to accommodate the additional imports which are essential for the restoration of the economy to strong sustained growth.

35. The external financing requirement (before taking into account the proposed debt relief, the use of Fund resources, the SAF loan, and the World Bank's SAL resources) will average about SDR 55 million a year during 1986/87-1988/89, including projected obligations to the Fund. 1/ To this amount must be added necessary reserve buildup and the reductions in arrears during the period. Additional resources flows from the Bank and Fund will cover some of these financing requirements. The remaining gap in the balance of payments could be filled either by quick-disbursing bilateral external aid and/or by more generous debt relief. The prospects for such financing seem good.

36. The financing requirement is highest in 1986/87, the first year of the program--it is presently estimated at around SDR 90 million, which includes obligations to the Fund estimated at SDR 18.1 million. Possible resources include: purchases under the stand-by arrangement, amounting to SDR 15.6 million; drawings under the SAF of SDR 11.6 million, and the first tranche of the World Bank's proposed SAL, for about SDR 12-14 million; and debt relief which, it is hoped will be SDR 35-40 million. The balance of resources, SDR 15-20 million, will be sought from other official donors under the prospective donors' Round Table Conference. Although these additional resources reflect a 30-35 percent increase over the average annual level of disbursements of the last five years, the initial contacts with some donors indicate the increase will be possible. During the last few years, several donors had suspended disbursements and will now resume or increase aid in support of the adjustment program. The support from other donors could also be used to buildup the present unsustainably low level of reserves (about 0.7 months' imports, a large part of which is encumbered) to about 1.2 months' imports.

37. In 1987/88 and 1988/89, Sierra Leone will continue to need Fund resources under both the stand-by arrangements and the SAF. The World Bank is expected to disburse the second tranche of the proposed SAL in 1987/88 and will consider in FY 1988/89 an increased lending program in the agricultural and other productive sectors, as well as a program of related infrastructural development. With these resources and further support from other donors, including debt relief, Sierra Leone should be able to continue to achieve reasonably strong growth and effect further reductions in arrears each year, as well as, to buildup gross reserves

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1/ The external financing requirement represents the overall balance of payments gap after considering current account and capital account balances. The capital accounts include, inter alia, the anticipated capital inflows from existing aid pipeline, and normal level of new commitments of project aid, and net private capital transfers and transactions.

further in 1987/88 and 1988/89. In this context, it might be noted that Sierra Leone, compared with many neighboring countries, is relatively well-endowed with natural resources, particularly in agriculture, fisheries, and minerals. Consequently, it is expected that, on the basis of the policies outlined above, Sierra Leone should be able to attain its medium-term objectives.

Sierra Leone: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1986/87-1988/89

Areas	Objectives and Targets	Measures	Phasing of Implementation
1. Agricultural policy reform			
a. Agricultural producer prices	Expand and diversify domestic production and exports.	* Continue competitive producer pricing for major export crops. Establish principles and procedures for fixing cash crop prices.	In addition to increases already announced for 1986/87, further adjustments as and when necessary. Continuous monitoring process.
		* Announce cocoa price each year in October and coffee price in December, both to be agreed with the Fund and the World Bank.	During the program period.
		* Carry out study of marketing to evaluate efficiency of Sierra Leone Produce Marketing Board and recommend best approach to marketing of export crops.	In 1987/88.
		* Develop action plan for improving marketing arrangements based on results of study.	In 1987/88.
		* Initiate action plan.	By 1988/89.
b. Cereals policy (rice)	Promote food security and reduce reliance on rice imports.	* Continue incentive producer pricing. Adopt policy that rice price will be market-determined. Decontrol retail price of rice and eliminate retail price subsidies. * Complete privatization of rice imports.	In addition to the increase already announced for 1986/87, further adjustments as and when necessary to producer prices; retail price of rice to be decontrolled by end-December 1986; privatization process started and to continue, with a view to completion by end-December 1986.
c. Institutional developments.	Strengthen the institutional framework.	* Complete reorganization of Ministry of Agriculture.	In consultation with the World Bank; also reduce excess manpower in the Ministry of Agriculture by 35 nercent in 1986/1987.
		* Formulate action program to strengthen institutions.	During 1987/88.
2. Industrial and mining policy reform			
a. Industrial and manufacturing sectors	Improve the economic and financial environment for industry and manufacturing so as to enhance resource allocation and promote exports.	Remove administration intervention. Continue liberal import licensing and allow prices of imported goods to be determined by tariffs alone.	Policies already initiated, and will continue throughout program period.
		Study tariff structure and take actions to rationalize structure to meet goals of increased revenue and administration and uniform incentives.	In 1987/88.
		* Review Industrial Development Act and put in place revised policy to give less incentives to imported capital equipment and intermediate products and move to industries which over time should become competitive with imports.	Industrial Development Act review to be initiated by March 1987; put revised policy in place no later than 1987/88.

* Included in World Bank Structural Adjustment Program, some of these are also included in Fund program.

Sierra Leone: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1986/87-1988/89

Areas	Objectives and Targets	Measures	Phasing of Implementation
b. Mining sector (diamonds)	Encourage production and increased competition.	Government Gold and Diamond Office (GGDO) restructed; management of National Diamond Mining Company (NDMC) through Precious Minerals Mining Company (PMMC), replaced; accelerate work on Kimberlite project.	GGDO replacement by auction and NDMC restructuring already done; World Bank to be contacted by December 1986 for assistance with Kimberlite project during 1986/87.
c. Other minerals	Increase their contribution to the economy.	Maintain free-floating exchange system.	Throughout the program period.
3. Energy policy	Improve supply of electricity and petroleum products. Strengthen institutions and management of demand for energy.	* Rehabilitate existing power-generating plants and distribution facilities, and import spare parts for maintenance.	Beginning in 1986/87, throughout program period.
		* Revise pricing policies and structure to reflect economic costs and avoid distortions from cross subsidies.	In addition to full pass-through prices implemented in July and September, government now implementing flexible, quarterly pricing policies; increase electricity tariffs.
		* Review National Power Authority Act, strengthen NPA's finances and management and autonomy.	Beginning in 1986/87, through 1987/88.
		* Reorganize system for procuring crude oil and shipping.	Change already made in system will be reviewed by March 1987, and any further modifications initiated after that.
		* Formulate least-cost power development strategy, and review design and sequence of Bumbuna scheme.	Beginning in 1986/87, throughout program period.
h. Retail prices	Enhance resource allocation and demand management.	Maintain liberal price regime.	Throughout the program period.
4. Fiscal policies			
a. Budget deficit	Reduce impact of the budget on the economy.	Progressive reduction in overall deficit (commitment basis).	Annually, throughout the program period; for 1986/87 implement revised budget by January 1987.
b. Tax reform.	Align tax system (with particular emphasis to international trade taxes) to the new exchange system.	Using technical assistance from the Fund, review tax system.	Tax study to be completed by mid-November 1986, for consideration in the context of the revised budget by January 1987.
c. Expenditure control	To foster adherence to the budgetary targets.	Continue quarterly expenditure monitoring and control system.	Throughout the program period.

* Included in World Bank Structural Adjustment Program; some of these are also included in Fund program.

Sierra Leone: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1986/87-1988/89

Areas	Objectives and Targets	Measures	Phasing of Implementation
d. Public expenditure policy reform	Improve development planning and budgeting, increase efficiency of government expenditure by restoring balance between personnel and non-personnel expenditure.	* Establish inter-ministerial committee responsible for approving projects in a rolling three-year investment program.	December 1986.
		* Present development and recurrent budgets to Parliament at same time.	Submit bill to Parliament by March 15, 1987 requiring both budgets be submitted to Parliament jointly.
		* Reduce total number of projects in development program; formulate Core Investment Program of high priority projects requiring no more than 60 percent of total development budget.	Initial core program will be drawn up by March 15, 1987.
		* Contain expenditure in daily wage later by deleting fictitious workers from daily wage list, retiring workers over 50 years old and laying off redundant workers.	Establish task force to assess minimum daily wage labor requirements of Ministries of Works, Agriculture and Health and have its recommendations take effect by December 31, 1986.
		* Increase budget allocations to non-personnel expenditures in line with World Bank recommendations.	Estabish annual and quarterly ceilings on outlays for wages in above three ministries.
e. Domestic arrears	Reduce domestic arrears, including arrears between the government and public enterprises.	Compile data on domestic arrears; make adequate budgetary provisions during program period for reducing arrears.	Throughout the program period.
5. Public enterprises			
a. Enterprise reform and policy	Rationalize role of the government in the sector, restore operational efficiency and viability of relevant enterprises.	* In collaboration with the World Bank, embark on divestiture, restructuring/closure.	Government divest itself of seven enterprises recommended by World Bank Report by October 31, 1987. Complete liquidation of National Trading Company and initiate liquidation of Marampa Iron Ore Mines (unless further analysis establishes its economic viability) by end-1986. Carry out review of Sierra Leone Produce Marketing Board by October 31, 1987.
		* Permit public enterprises to pass on effects of exchange rate adjustments.	Agree on price increases and actions to pass-through exchange rate changes to date by end-1986.
		* Provide approprite capitalization for selected enterprises (recommended in World Bank review).	Government employ by end-1986 consultants to study financial restructuring.
		* Modernize Companies Act.	Review, revise and submit to Parliament by March 15, 1987.
		* Harmonize and update corporate statutes and articles of association.	Review and revise by end-October, 1987.
		* Prepare policy guidelines on key areas of public enterprises.	Approve guidelines on staff and procurement by March 15, 1987.
		* Establish a Public Enterprise Commission (PEC) as a cabinet sub-committee, and a Public Enterprise Monitoring Unit (PEMU) to develop an implement a system for monitoring and evaluating performance of public enterprises.	Create PEMU by March 15, 1987 and PEC by June 30, 1987.
		* Take steps to improve management and operations of key public enterprises (National Power Authority, Road Transport Telecommunications and Guma Valley Water).	Throughout the program period. Agree by end-1986 on staff reductions in three enterprises.

*Included in World Bank Structural Adjustment Program, some of these are also included in Fund program.

Sierra Leone: Summary and Time Frame for Implementation of Structural Adjustment Policies, 1986/87-1988/89

Areas	Objectives and Targets	Measures	Phasing of Implementation
b. Inter-Enterprise arrears	Enhance enterprise financial planning.	* Delineate a schedule and timeframe for eliminating inter-enterprise arrears.	Arrears schedule to be delineated by March 1987; elimination progressively throughout the program period.
6. Monetary and credit policies			
a. Credit policies	Foster monetary restraint and alleviate inflationary pressures.	Adopt tightened stance on credit policies, while making adequate allowance for productive credit.	Throughout the program period.
b. Interest rates	Complement adjustment policies, enhance savings and resource allocation.	Implement flexible interest rate policies in the context of a tender system for Treasury bills.	Throughout the program period; Treasury bill tender system started in September 1986; preceeded and accompanied by increases in interest in August and September 1986.
c. Institutional reforms	Strengthen institutional framework for monetary and credit policies.	Broaden rural banking scope for small-holder agriculture and strengthen the National Development Bank (NDB).	Throughout the program period; establishment of the first rural banks have started with the 1986/87 budget; The NDB is setting up a new management, and restructuring and recapitalization of the NDB will be started, preferably by June 1987.
7. External Policies			
a. Exchange rate	Enhance resource mobilization and allocation.	Continued implementation of the freely floating exchange rate system introduced in June 1986.	Throughout the program period.
b. Exchange and trade system	Promote liberal system of trade and payments.	Continued implementation of liberal foreign exchange and trade system, including the maintenance of a liberalized import licencing regime.	Throughout the program period.
c. External debt management	Contain debt service burden, restore orderly relations with creditors and increase trade credits and private capital inflows.	Impose appropriate limits on the contracting of nonconcessional external borrowing; conclude required rescheduling agreements and reduce external arrears, in a manner agreed with the Fund.	Throughout the program period.

* Included in World Bank Structural Adjustment Program; some of these are also included in Fund program.

SIERRA LEONE - Basic Data (continued)

Area, population, and GDP per capita

Area	72,326 square kilometers
Population:	
Total (1986 estimate)	3.722 million
Growth rate	2.7 percent
GDP per capita	SDR 300

	1981/82	1982/83	1983/84	1984/85	1985/86
	(In millions of leones)				
Gross domestic product, expenditure and prices					
GDP at constant 1980-81 prices	1,279.6	1,286.6	1,390.1	1,401.5	1,381.9
Agriculture, forestry, and fishing	429.4	447.4	473.7	488.5	480.0
Mining and quarrying	111.1	115.8	130.0	140.1	145.1
Manufacturing and handicrafts	95.4	90.7	85.4	81.1	75.0
All others	643.7	632.7	701.0	809.7	681.8
GDP at current market prices	1,525.6	1,962.7	2,947.2	4,253.1	6,349.9
Gross domestic expenditure	1,837.8	2,074.5	3,016.4	4,274.8	6,361.4
Gross investment	219.1	208.9	263.5	326.2	452.4
Gross savings	-93.1	117.1	194.3	304.5	440.9
	(Annual percentage change)				
GDP at constant 1980/81 prices	-1.4	0.5	8.0	0.8	-1.4
GDP at current prices	17.5	28.7	50.2	44.3	49.3
GDP deflator	19.1	26.5	40.5	43.2	51.2
Consumer price index	25.1	44.6	78.7	61.8	70.4
	(In percent of GDP)				
Gross consumption	106.1	94.0	93.4	92.8	93.1
Gross investment	14.4	10.6	8.9	7.7	7.1
Resource gap	-20.5	-5.7	-2.3	-0.5	-0.2

	1981/82	1982/83	1983/84	Prov. actuals 1984/85	Prov. actuals 1985/86
	(In millions of leones)				
Revenue and grants	206.3	181.5	264.9	324.4	511.0
Tax revenue	174.3	143.7	192.9	256.9	379.2
Nontax revenue	8.9	12.3	12.4	14.6	27.0
Grants	23.1	25.5	59.6	52.9	104.8
Total expenditure	408.0	409.1	472.7	811.4	1,431.8
Current expenditure	248.8	261.7	332.6	541.9	1,063.1
Development expenditure	94.9	99.2	103.1	126.2	212.8
Other expenditure	64.3	48.2	37.0	143.3	155.9
Overall deficit (commitment basis)	-201.7	-227.6	-207.8	-487.0	-920.8
Change in expenditure-related arrears (increase +)	41.2	-42.1	4.3	149.5	106.7
Additional fiscal measures	--	--	--	--	--
Overall deficit (cash basis)	-160.5	-269.7	-203.5	-337.5	-814.1
Financing	160.5	269.7	203.5	337.5	814.1
Foreign	31.9	42.0	-8.0	44.7	36.3
Drawings	63.6	69.0	40.0	75.0	65.4
Amortization	-31.7	-27.0	-48.0	-30.3	-29.1
Domestic	128.6	227.7	211.5	292.8	777.8
Bank financing (cash basis)	140.3	224.9	173.0	268.7	756.5
Monetary authority	(139.7)	(217.4)	(115.5)	(135.2)	(508.0)
Commercial banks	(0.6)	(7.5)	(57.5)	(133.5)	(248.5)
Nonbank	-11.7	2.8	38.5	24.1	21.3
	(In percent of GDP)				
Revenue and grants	13.5	9.2	9.0	7.6	8.0
Total expenditure	26.7	20.8	16.0	19.1	22.5
Current expenditure	16.3	13.3	11.3	12.7	16.7
Development expenditure	6.2	5.1	3.5	3.0	3.4
Other expenditure	4.2	2.5	1.3	3.4	2.5
Overall deficit (commitment basis)	-13.2	-11.6	-7.1	-11.5	-14.5
Overall deficit (cash basis)	-10.5	-13.9	-6.9	-7.9	-12.8

SIERRA LEONE - Basic Data (Concluded)

	1981/82	1982/83	1983/84	1984/85	1985/86
			(In millions of leones)		
Money and credit (end of period)					
Foreign assets (net)	-269.6	-292.1	-730.4	-1,547.4	-3,386.7
Domestic credit	627.1	867.7	1,046.1	1,360.7	2,142.9
Claims on Government	525.0	749.9	922.9	1,191.6	1,948.1
Claims on private enterprises	3.6	3.9	3.0	4.6	17.4
Claims on private sector	98.5	113.9	120.2	164.5	177.4
Money and quasi-money	324.5	443.8	570.2	882.3	1,551.2
Other items (net)	33.0	131.8	-254,2	-1,069.0	-2,795.0
			(In percent of GDP)		
Domestic credit	41.1	44.2	35.5	32.0	33.7
Claims on Government (net)	34.4	38.2	31.3	28.0	30.7
Money and quasi-money	21.3	22.6	19.3	20.7	24.4
			(In millions of SDRs)		
Balance of payments					
Exports, f.o.b.	118.3	87.7	107.6	136.9	112.9
Imports, f.o.b.	-247.1	-161.1	-121.7	-143.8	-115.1
Trade balance	-128.8	-73.4	-14.1	-6.9	-2.1
Services	-78.0	-63.2	-49.0	-80.0	-60.0
Private transfers	8.0	3.8	2.6	1.9	2.5
Official transfers	22.8	18.3	22.7	17.5	26.6
Current account balance	-176.0	-114.5	-37.8	-67.5	-33.1
Long-term capital	-6.6	-7.0	-28.8	4.3	-26.5
Short-term capital and errors and omissions	62.4	47.7	23.0	19.9	-10.1
Allocation of SDRs	--	--	--	--	--
Overall balance	-120.2	-73.8	-43.6	-43.3	-69.7
			(In percent of GDP)		
Exports	10.6	6.1	9.6	10.0	10.1
Imports	22.1	11.2	10.9	10.5	10.3
Current account deficit	15.8	8.0	3.4	4.9	3.0
Overall deficit	10.8	5.1	3.9	3.2	6.2
			(In millions of SDRs)		
Gross official foreign reserves (end of period)					
Holdings of SDRs	--	--	--	--	--
IMF reserve position	--	--	--	--	--
Foreign exchange	10.3	9.7	6.4	7.8	8.1
Total	10.3	9.7	6.4	7.8	8.1
External medium- and long-term public debt (disbursed at end of period)	353.4	372.1	350.1 1/	350.0	350.0
			(Four quarter averages; 1980 = 100)		
Effective exchange rates 2/					
Nominal trade-weighted	107.6	113.7	62.7	54.6	29.7
Real trade-weighted	128.6	183.0	177.1	224.1	210.3

1/ Some loans are denominated in local currency so that debt outstanding in terms of SDRs declined after the devaluations in July 1983 and in February 1985.
2/ A downward movement indicates a depreciation.

Sierra Leone--Relations with the Fund
(As of September 30, 1986)

I. Membership status

(a) Date of membership: September 20, 1962

(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 57.9 million

(b) Fund holdings of leones: SDR 114.58 million (197.9 percent of quota)

		SDR million	Percent of quota
(c) Fund holdings subject to repurchase and charges		56.69	97.91
Of which:	compensatory financing facility	(15.53)	(26.81)
	credit tranches	(10 54)	(18.20)
	extended Fund facility	(13.56)	(23.42)
	supplementary financing facility	(8.60)	(14.85)
	enlarged access resources	(8.46)	(14.61)

(d) Reserve tranche position SDR 24,146

III. Latest stand-by arrangement and special facilities

(a) Latest stand-by arrangement:

(i) Duration From February 3, 1984 to February 2, 1985

(ii) Amount SDR 50.2 million

Sierra Leone--Relations with the Fund (continued)

(iii) Utilization	SDR 19.0 million
(iv) Undrawn balance	SDR 31.2 million
(b) Extended arrangement:	
(i) Duration	From March 30, 1981 to April 6, 1982
(ii) Amount	SDR 186.0 million
(iii) Utilization	SDR 33.5 million
(iv) Undrawn balance	SDR 152.5 million
(c) Compensatory financing facility:	
(i) Date of purchase	February 14, 1983
(ii) Amount	SDR 20.7 million
IV. SDR Department	
(a) Net cumulative allocation:	SDR 17.46 million
(b) Holdings:	--
V. Administered accounts	
(a) Trust Fund loans:	
(i) Disbursed	SDR 24.43 million
(ii) Outstanding	SDR 14.56 million
(b) SFF Subsidy Account:	
(i) Donations to Fund	--
(ii) Loans to Fund	--
(iii) Payments by Fund	SDR 2.11 million
VI. Overdue obligations to the Fund (as of September 30, 1986)	--

Sierra Leone--Relations with the Fund (continued)

B. Nonfinancial Relations

VII. Exchange rate arrangement

Sierra Leone's exchange arrangements have been modified on a number of occasions in recent years. The leone was pegged to the SDR at the rate of SDR 1 = Le 1.37 until December 17, 1982 when a dual exchange rate system was introduced. On July 1, 1983 the exchange system was unified when the leone was devalued by 50 percent in foreign currency terms and pegged to the U.S. dollar at the rate of US$1 = Le 2.50. In early 1984 a dual exchange system was reintroduced by the authorities: this system consisted of importers negotiating directly for foreign exchange proceeds of gold and diamond exports, and an official market for all other transactions in which the exchange rate remained fixed at US$1 = Le 2.50. All imports and exports continued to be valued for customs purposes at the official exchange rate. This system continued to operate until September 1984. From September 1984, limited allocations of foreign exchange for private sector payments were made under an arrangement whereby a newly formed company (the Precious Minerals Marketing Company), accepted applications for foreign exchange at rates differing from the official rate. Other sources of foreign exchange to the Sierra Leonean economy included official aid and grants, the required surrender of foreign exchange proceeds to the central bank for official uses, a very small amount of surrender to commercial banks, retention allowances for own use by certain exporters, and an extensive parallel market.

On February 21, 1985, the official exchange rate for the leone was devalued to Le 6 = US$1 from Le 2.5 = US$1, representing a 58.3 percent depreciation with respect to the U.S. dollar, the intervention currency. From that date, the leone was pegged to the SDR, with the Bank of Sierra Leone issuing daily equivalent exchange rates for the leone in terms of all major currencies.

On June 27, 1986, the Sierra Leone authorities adopted a freely floating interbank exchange system.

VIII. Article IV consultation

The 1985 Article IV consultation discussions with Sierra Leone were held in Freetown during the period September 9-20, 1985. The staff report (SM/85/307) was discussed by the Executive Board on December 4, 1985, and the following decision was taken:

1. The Fund takes this decision relating to Sierra Leone's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1985 Article XIV consultation with Sierra Leone, in the light of

Sierra Leone--Relations with the Fund (concluded)

the 1985 Article IV consultation with Sierra Leone conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Sierra Leone's exchange system involves restrictions on payments and transfers for current international transactions, including external payments arrears, and a multiple currency practice, as described in SM/85/307. Sierra Leone continues to maintain bilateral payments agreements with Fund members. The Fund urges the authorities to reduce reliance on exchange restrictions, including the multiple currency practices, and to eliminate the bilateral payments agreements with Fund members.

IX. Technical assistance

Between April 1983 and October 1985, an FAD panel expert had been assigned to the Ministry of Finance as Budget Advisor.

During January 21-February 1, 1985, a Fund staff team visited Sierra Leone and discussed with the authorities the design of a flexible exchange rate system.

At the request of the Sierra Leone authorities, a Fund technical expert has been assisting the authorities in the operation of the new interbank exchange system.

X. Resident representative

Mr. Kalinga, the new Fund resident representative, took up his assignment in late July, 1986.

Sierra Leone - Relations with the World Bank Group

In recent years, the main focus of World Bank activities in Sierra Leone has been on sectoral programs and projects, particularly in the agriculture, education, transportation, and power sectors. In the context of these operations, the World Bank has, in collaboration with the authorities, and in consultation with the Fund staff, evolved complementary incentive policies and supporting institutions which formed important components of past Fund programs. In addition to the sectoral programs and projects, the World Bank has already appraised a Structural Adjustment Program (SAP), which will address four main areas of reform: public enterprises, public expenditures, industrial incentives, and agricultural incentives. The main elements of the proposed SAP reform package are broadly consistent with the adjustment policies presently being implemented by the authorities.

Sierra Leone - Financial Relations with the World Bank Group, as of August 31, 1986

(In millions of U.S. dollars)

	Disbursed		Undisbursed	
	IBRD	IDA	IBRD	IDA
IBRD/IDA lending operations				
Population and Health	--	--	--	5.3
Agriculture	5.0	25.0	--	25.4
Education	--	14.4	--	17.6
Transportation	6.0	10.9	--	1.7
Power	7.7	12.0	--	1.2
Technical assistance	--	1.9	--	--
Total	18.7	64.7	--	51.3
Of which: repaid	(10.4)	(0.7)	(--)	(--)
exchange adjustment	(--)	(4.2)	(--)	(--)
Total outstanding	9.1	68.2	--	--
IFC				
Investment		2.1		

Source: World Bank Group.

Sierra Leone--Statistical Issues

1. Outstanding statistical issues

a. General economic data

The report of a technical assistance mission that visited Sierra Leone in April 1986 contained a number of recommendations for improving the quality and currentness of data on prices and external trade.

The Bureau of Statistics was informed during the recent Annual Meetings in Washington that the mission's recommendations are under study by the authorities.

b. Government finance

A technical assistance mission took place in May 1986 and concluded that improvements need to be made in the recording of grant receipts and development expenditure. The report of the mission is in the process of preparation and will be forwarded shortly to the authorities for comment.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Sierra Leone in the October 1986 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Sierra Leone, which during the past year have been provided on a timely basis.

Status of IFS Data

		Latest Data in October 1986 IFS
Real sector	- National accounts	AA 1984
	- Prices: CPI	QI 1986
	WPI	Q4 1985
	- Production	n.a.
	- Employment	n.a.
	- Earnings	
Government finance	- Deficit/Surplus	1985
	- Financing	1985
	- Debt	1985

Sierra Leone: Statistical Issues (Concluded)

Monetary accounts	- Monetary authorities	June 1986
	- Deposit money banks	June 1986
	- Other financial institutions	June 1979 1/
Interest rates	- Discount rate	May 1986 2/
	- Bank lending/Deposit rate	May 1986
	- Bond yield	--
External sector	- Merchandise trade: Value exports	March 1986 2/
	imports	June 1986
	Prices	--
	- Balance of payments	1984
	- International reserves	June 1986
	- Exchange rates	June 1986

1/ Post office savings only.
2/ June 1986, for diamonds, coffee, and cocoa bean exports.