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AGENDA

EBS/85/288

CONFIDENTIAL

December 24, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Sierra Leone - Further Review of Decision to Limit Use of
the Fund's General Resources, and Consideration of Report
and Complaint Under Rule S-1

There is attached for consideration by the Executive Directors a paper on the review of the decision to limit Sierra Leone's use of the Fund's general resources and consideration of the report and complaint under Rule S-1. Draft decisions appear on pages 5 and 6.

Mr. Blalock (ext. 8341) or Mr. von Numers (ext. 6620) is available to answer technical or factual questions relating to this paper prior to the Board discussion on Monday, January 6, 1986.

Att: (1)

INTERNATIONAL MONETARY FUND

Sierra Leone - Further Review of Decision to Limit Use
of the Fund's General Resources, and Consideration of Report
and Complaint Under Rule S-1

Prepared by the Treasurer's, African, and Legal Departments

Approved by A.D. Ouattara, G.P. Nicoletopoulos, and Thomas Leddy

December 24, 1985

1. On September 27, 1985 (EBM/85/152) the Executive Board reviewed Decision No. 8014-(85/101), adopted June 28, 1985, relating to Sierra Leone's overdue financial obligations to the Fund, and agreed to review that decision again not later than January 6, 1986. In accordance with the June decision, Sierra Leone shall not make use of the general resources of the Fund until such time as Sierra Leone is current in its obligations to the General Department. ^{1/} In the September decision, while the partial payments made by Sierra Leone were welcomed, the Fund urged the authorities to make full and prompt settlement of all the overdue obligations and called on Sierra Leone to adopt urgently a strong and comprehensive adjustment program (see Attachment I). A report and complaint by the Managing Director with regard to an overdue obligation of Sierra Leone in the SDR Department (the third such report in six months) was issued to the Executive Board on December 13, 1985 (see EBS/85/278 and Attachment II). This complaint was noted by the Board through a lapse-of-time decision on December 18, 1985; the decision provided for substantive consideration of this complaint by the Board at the meeting on January 6, 1986.

2. Since the Board meeting on September 27, 1985, further obligations totaling SDR 5.75 million have become overdue. ^{2/} On December 20, 1985 Sierra Leone's arrears to the Fund totaled SDR 13.32 million (Attachment III), compared to SDR 8.49 million on September 27, 1985. Forthcoming obligations are shown in Attachment IV. Sierra Leone's payments to the Fund since the issuance of the complaint under Rule K-1 and Trust Fund notice on April 30, 1985 have totaled SDR 3.93 million.

^{1/} Decision No. 8014-(85/101) provided further that, if Sierra Leone were otherwise eligible to use the Fund's general resources, overdue obligations to the Trust Fund would be taken into account in considering any request by Sierra Leone to use the general resources.

^{2/} As indicated orally by the staff at EBM/85/152, an indication had been received from the Sierra Leonean authorities that a payment of SDR 0.94 million was being made. This payment was received on October 3, 1985 (EBS/85/229). No other payments have been made since September 27, 1985.

3. Following the Executive Board review of September 27, the Managing Director informed the Minister of Finance of Sierra Leone, *inter alia*, that Executive Directors had stressed that prompt action should be taken to overcome the arrears problem. ^{1/} He added that Directors had also emphasised that, among other measures needed to tackle the economic and financial imbalances facing Sierra Leone, there existed considerable potential for enhancing the flow of foreign exchange into official channels by prompt action to reform the foreign exchange system. He noted also that Directors had particularly stressed that the period until the next review was not to be seen as a basis for further delays in payment but should be used constructively by the authorities to become current with the Fund.

In his reply of October 9, 1985, the Minister of Finance referred to the payment of SDR 0.94 million received by the Fund on October 3, 1985 and expressed the view that the pending transition of political leadership in Sierra Leone was affecting the attitude of prospective lenders. As the political orientation would crystalize in December 1985, it was hoped that sustained efforts would be made to facilitate Sierra Leone's becoming current with the Fund.

In the course of discussions with the management and staff in Seoul, the authorities reiterated their regret about the arrears to the Fund and their intention to clear them as soon as possible. They indicated that a comprehensive adjustment program could be implemented once the new administration took office on December 15, 1985. The staff stressed that if the authorities' objective of increasing the inflow of foreign exchange receipts from the mining sector was to be accomplished, a major adjustment in the exchange rate would be necessary in addition to possible new and tightly controlled surrender requirements for foreign exchange.

Subsequently, in a telex of November 21, 1985 to the staff, the authorities stated that the matter of Sierra Leone's overdue obligations to the Fund was receiving the Government's closest attention. On December 19, 1985, the Minister of Finance indicated that the matter of Sierra Leone's arrears to the Fund continued to receive his close personal attention and that of the new administration. He also expressed the hope that Sierra Leone would substantially settle its overdue obligations to the Fund before January 6, 1986. (See Attachment V.)

4. The most recent detailed description of Sierra Leone's economic situation and policies is contained in the staff report for the 1985 Article IV consultation (SM/85/307, 11/14/85), which was discussed by

^{1/} The Managing Director's cable and the Minister of Finance's reply were issued to Executive Directors in EBS/85/223, Supplement 1 (10/17/85).

the Executive Board on December 4, 1985. As reflected in the Chairman's summing up of the discussion, Executive Directors urged the authorities to implement strong and comprehensive adjustment policies, including the introduction of a market-determined flexible exchange rate system and appropriate fiscal, monetary, and pricing measures, in order to redress existing imbalances and improve Sierra Leone's external position.

As a result of inertia in economic and financial decision-making since mid-1984, the limited gains made by the Sierra Leonean economy in 1983/84 (fiscal year ending June), when the external current account deficit was reduced to 4.7 percent of GDP from 8.5 percent in 1982/83, were reversed in 1984/85, when the problems of economic stagnation, accelerating inflation, and growing internal and external imbalances all intensified markedly. Dislocations in the foreign exchange system have increased, and the spread between the official exchange rate and the parallel market rate has widened with the result that the volume of activity occurring outside the official sector has risen substantially. The economy is now functioning largely on the parallel market: virtually all private transactions take place in this market, and the Government is also increasingly relying on the market for its foreign exchange requirements, including those for oil and some debt service. The widespread parallel market activities have resulted in endemic smuggling, and a shrinking of the tax base; the erosion of the tax base has been compounded by the present system of customs taxation on the basis of the official exchange rate.

Reflecting these developments, the overall fiscal deficit on a commitment basis rose sharply from 6.9 percent of GDP in 1983/84 to 12.2 percent in 1984/85; the associated bank financing amounted to 47 percent of beginning money stock in 1984/85 compared to 38 percent of beginning money stock in 1983/84; and the growth in the money supply accelerated sharply from 26 percent in 1983/84 to 55 percent in 1984/85. As a result, the consumer price index, which rose by 81 percent in 1983/84, increased by 109 percent in 1984/85. In the external sector, the current account deficit deteriorated from 5 percent of GDP in 1983/84 to 6 percent in 1984/85, and external payments arrears rose by SDR 23 million to more than double the level of recorded exports. At the same time, the authorities have continued to experience major difficulties in mobilizing foreign exchange resources for the purchase of oil and the discharge of debt service obligations, including those to the Fund, and external disbursements for development projects have declined substantially.

Faced with these problems, the Sierra Leonean authorities have responded over the past 18 months in a sporadic and limited fashion. Thus, in early 1985, they effected a discrete and inadequate devaluation of the leone, instead of implementing the flexible exchange rate system recommended by the Fund since late 1984. The increases in agricultural producer prices and in energy and food prices proved to be inadequate,

and the budget that has been adopted for 1985/86 is likely to lead to a record overall deficit. The fiscal outcome during the first quarter (ended September 1985) of 1985/86 was very expansionary, as reflected in the sharp increase in bank financing of the Government equivalent to 26 percent of beginning money stock during the first quarter of 1985/86 compared to 6 percent of beginning money stock during the corresponding period of 1984/85. On the basis of present policies, the economic and financial problems facing the economy are likely to continue to intensify, and the prospects are that, in the absence of a reform of the exchange system and the implementation of strong supporting policies, these problems could reach critical proportions by the end of this fiscal year.

5. In considering the case of Sierra Leone's arrears to the Fund, it is useful to compare Sierra Leone's situation with that of other members in arrears at the comparable stage (i.e., the second review) under the Fund's procedures for overdue financial obligations. ^{1/}

In the case of Guyana, between the first and second reviews, the member made payments amounting to SDR 6.9 million and the arrears outstanding decreased from SDR 18.6 million to SDR 14.8 million. In Nicaragua's case, no payments were made between the two reviews and the amount of arrears outstanding increased slightly from SDR 9.0 million to SDR 9.7 million. In the case of Sudan, SDR 9.7 million was paid between the two reviews, and Sudan's arrears to the Fund increased from SDR 119.6 million to SDR 145.1 million. In Liberia's case, between the first and second reviews two payments were made totaling SDR 17.7 million and the arrears outstanding decreased from SDR 40.2 million to SDR 34.3 million. (The total amounts paid between the issuance of complaints and the second reviews were: Guyana SDR 11.3 million; Nicaragua, SDR 7.3 million; Sudan, SDR 45.2 million; and Liberia, SDR 17.7 million).

On the occasions of the second reviews of Guyana, Nicaragua, and Sudan, the Executive Board adopted decisions that included provision for a further review at which time consideration would be given to the appropriateness of further steps, including the possibility of declaring the member ineligible to use the general resources. In the cases of Guyana and Sudan, the period provided for the further review was about 2 1/2 months, whereas in Nicaragua's case, reflecting in part the lack of payments between the first and second reviews, the period provided for the third review was a little less than two months. With respect to Liberia, at the second review the Executive Board took into account the payments made and agreed not to put into effect immediately the expectation of a declaration of ineligibility contained in the decision

^{1/} In each of the cases discussed, the period provided between the first and second reviews was three months, except for Sudan where the period was two months, the first review having been postponed for a month at the request of the authorities.

adopted at the first review. Instead, the decision adopted at the second review provided that Liberia would be ineligible to use the general resources of the Fund and its right to use SDRs would be suspended on January 24, 1986 (two months later), if Liberia were not current in its obligations to the Fund at that time.

On balance, Sierra Leone's position would appear to be broadly similar to those of Sudan, Guyana, and Nicaragua. In this light, the Executive Board may wish to consider a decision similar to those taken in these three cases at the time of the second review, i.e., to hold a further review at which time the appropriateness of further steps including the possibility of a declaration of ineligibility would be considered. With regard to the period provided for the next review, in each of the four cases discussed above the period between the second and third reviews (in Liberia's case between the second review and the effective date of the declaration of ineligibility) was less than three months. On this basis, the staff would suggest that the next review of Sierra Leone be held not later than March 5, 1986 (i.e., within two months).

6. With respect to the current complaint under Rule S-1, it is proposed that a decision be adopted similar to those initially adopted in other cases of Rule S-1 complaints, i.e., providing for the suspension of the member's right to use SDRs it acquires after the suspension until such time as the member has become current in its obligations in the SDR Department. Accordingly, the following draft decisions are proposed for adoption by the Executive Board:

I. Sierra Leone - Complaint Under Rule S-1

1. The Managing Director has reported under Rule S-1 of the Fund's Rules and Regulations to the Executive Board the facts on the basis of which it appeared to him that Sierra Leone was not fulfilling its obligations under the Articles of Agreement in the SDR Department and submitted a complaint on December 13, 1985 (EBS/85/278). The complaint under Rule S-1 was that as of December 13, 1985 Sierra Leone was not fulfilling its obligation to pay charges in the SDR Department in the total amount of SDR 330,160. These facts, and the complaint of the Managing Director, were communicated to the authorities of Sierra Leone on December 18, 1985.

2. Having considered the report of the Managing Director and the complaint under Rule S-1 and the views of Sierra Leone, the Fund finds that Sierra Leone has failed to fulfill its obligations under the Articles of Agreement as stated in paragraph 1.

3. The Fund regrets the nonobservance by Sierra Leone of its obligations and urges Sierra Leone to resume their observance

forthwith. The Fund decides, pursuant to Article XXIII, Section 2(b) of the Articles of Agreement, to suspend the right of Sierra Leone to use SDRs it acquires after the suspension until such time as Sierra Leone has become current in its obligations to which that provision applies.

II. Sierra Leone - Further Review of Decision
to Limit Use of Fund's General Resources

1. The Fund has reviewed further Decision No. 8014-(85/101), adopted June 28, 1985, in light of the facts described in EBS/85/288, December 24, 1985, pertaining to Sierra Leone's overdue financial obligations to the Fund.

2. The Fund welcomes the payment by Sierra Leone on October 3, 1985. However, the Fund regrets the continuing nonobservance by Sierra Leone of its financial obligations to the Fund and notes that further obligations will fall due in the near future. The Fund again urges the Sierra Leonean authorities to make full and prompt settlement of the overdue financial obligations to the Fund.

3. The Fund reiterates the need for Sierra Leone to adopt urgently a strong and comprehensive program of economic adjustment.

4. The Fund shall review again Decision No. 8014-(85/101) and review the Decision set out in I above not later than March 5, 1986, taking into account further developments. Unless at the time of that review Sierra Leone is current in its financial obligations to the Fund, the Fund will consider the appropriateness of further steps, including the possibility of declaring Sierra Leone ineligible to use the general resources of the Fund pursuant to Article XXVI, Section 2 and suspending the right of Sierra Leone to use SDRs it acquires after March 5, 1986 pursuant to Article XXIII, Section 2(b).

Attachments

Sierra Leone: Overdue Financial Obligations to the Fund - Review
of Decision to Limit Use of Fund's General Resources

Executive Board Decision No. 8099-(85/152)
Adopted September 27, 1985

1. The Fund has reviewed Decision No. 8014-(85/101), June 28, 1985 in light of the facts described in EBS/85/223, September 25, 1985 pertaining to Sierra Leone's overdue financial obligations to the Fund.
2. Although the partial payments that have been made by Sierra Leone are welcome, the Fund regrets the continuing non-observance by Sierra Leone of its financial obligations to the Fund and notes that further obligations will fall due in the near future. The Fund urges the Sierra Leonean authorities to make full and prompt settlement of the overdue financial obligations to the Fund.
3. The Fund calls upon Sierra Leone to adopt urgently a strong and comprehensive program that would result in necessary economic adjustment.
4. The Fund shall review further Decision No. 8014-(85/101) not later than January 6, 1986 taking into account the authorities' response and any further developments.

Sierra Leone - Overdue Financial Obligations to the Fund
Report and Complaint under Rule S-1

Executive Board Decision No. 8155-(85/184)
Adopted December 18, 1985

1. The complaint of the Managing Director dated December 13, 1985 regarding Sierra Leone's overdue obligation in the SDR Department, in EBS/85/278 (12/13/85), is noted. It shall be placed on the agenda of the Executive Board for January 6, 1986. If at that time Sierra Leone is not current in its obligations to pay charges in the SDR Department, the Fund will consider suspending the right of Sierra Leone to use SDRs it acquires after the suspension pursuant to Article XXIII, Section 2(b).

2. Consideration of the complaint in accordance with Rule S-1 particularly affects Sierra Leone. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative.

Sierra Leone - Overdue Financial Obligations to the Fund

(December 20, 1985) 1/

Type of Obligation	Date of Purchase or Loan	Due Date	Days Late	SDR Amount
<u>General Department</u>				
CT repurchase	02/28/80	02/27/85	296	562,500
CT repurchase	06/26/80	03/25/85	270	375,000
EF repurchase	04/02/81	04/01/85	263	229,093
CT repurchase	08/01/80	04/30/85	234	250,000
Quarterly charges		05/08/85	226	847,211
EF repurchase	05/19/81	05/17/85	217	837,500
Semiannual charges		07/12/85	161	838,527
Semiannual charges		07/18/85	155	426,205
CT repurchase	08/01/80	07/31/85	142	250,000
Quarterly charges		08/06/85	136	868,867
EF repurchase	04/02/81	10/01/85	80	799,417
EF repurchase	04/02/81	10/01/85	80	1,313,375
Quarterly charges		11/06/85	44	863,761
EF repurchase	05/19/81	11/18/85	32	837,500
EF repurchase	05/19/81	11/18/85	32	558,333
Subtotal				9,857,289
<u>Trust Fund</u>				
Repayment(balance)	07/28/77	01/25/85	329	4,972
Repayment	11/13/79	05/10/85	224	757,500
Interest		06/28/85	175	53,450
Repayment	01/26/78	07/25/85	148	165,000
Repayment	07/27/78	07/26/85	147	603,686
Repayment	07/28/77	07/26/85	147	267,500
Repayment	01/31/80	07/30/85	143	212,500
Repayment	04/30/85	10/29/85	52	307,500
Repayment	11/13/79	11/12/85	38	757,500
Subtotal				3,129,608
<u>SDR Department</u>				
Net SDR charges		11/01/85	49	330,160
Total				13,317,057
				=====

1/ Trust Fund interest of SDR 46,707 will become due at the end of December 1985.

Sierra Leone - Overdue and Forthcoming Obligations
as of December 20, 1985

(In millions of SDRs)

Type of Obligation	Outstand- ing as of December 20, 1985	Forthcoming ^{1/}							Total ^{3/}
		1985 ^{2/}	1986	1987	1988	1989	1990	1991	
Repurchases	6.01	0.00	14.78	21.81	14.84	6.71	4.83	2.40	71.38
Quarterly charges ^{4/}	2.58	0.00	3.43	2.42	1.16	0.52	0.26	0.05	10.42
Semiannual charges ^{4/}	1.26	0.00	1.85	1.47	0.93	0.49	0.30	0.00	6.30
Net SDR charges	0.33	0.00	1.34	1.34	1.34	1.34	1.34	1.34	8.37
Trust Fund									
Repayments	3.08	0.00	4.87	4.87	4.17	2.79	0.76	0.09	20.63
Interest	<u>0.05</u>	<u>0.05</u>	<u>0.07</u>	<u>0.05</u>	<u>0.03</u>	<u>0.01</u>	<u>0.00</u>	<u>0.00</u>	<u>0.26</u>
Total ^{3/}	13.32	0.05	26.33	31.96	22.46	11.87	7.49	3.88	117.36

^{1/} On the basis of present use of Fund credit, Trust Fund loans outstanding, and Sierra Leone's present position in the SDR Department. Charges are projected on the basis of current rates of charge.

^{2/} Due after December 20, 1985.

^{3/} Totals may not add due to rounding.

^{4/} Forthcoming charges estimated on the assumption that overdue obligations are paid promptly; actual charges may be higher.

J. DE LAROSIERE
MANAGING DIRECTOR
INTERFUND
WASHINGTON

REF. YOUR TELEX RELATING TO SIERRA LEONE'S OVERDUE FINANCIAL OBLIGATIONS TO THE FUND, I WISH TO CONFIRM THAT THIS MATTER CONTINUES TO RECEIVE NOT ONLY MY CLOSE PERSONAL ATTENTION, BUT ALSO THAT OF THE NEW ADMINISTRATION WHICH HAS ALREADY TRIGGERED THE EFFECTIVENESS OF NEW ENERGETIC ECONOMIC MEASURES, DESIGNED TO PROVIDE STRONG CREDIBLE BASIS THAT WILL IMPROVE SIERRA LEONE'S EXTERNAL POSITION.

TO THIS END, GOVERNMENT CONTINUES TO USE ITS BEST EFFORTS TO SUBSTANTIALLY SETTLE ITS OVERDUE OBLIGATIONS BEFORE JANUARY 6, 1986, IN THE HOPE OF RENDERING ISSUANCE OF COMPLAINT UNNECESSARY.

PROFOUND REGARDS
J. AMARA-BANGALI
MINISTER OF FINANCE, DEV. ECONOMIC PLANNING

Received in Cable Room: December 19, 1985

