FOR AGENDA

SM/85/307

CONTAINS CONFIDENTIAL
INFORMATION

November 14, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Sierra Leone - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1985 Article IV consultation with Sierra Leone, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 22.

Mr. Enweze (ext. 8650) or Mr. Kalinga (ext. 8656) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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Department Heads

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

SIERRA LEONE

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the
1985 Consultation with Sierra Leone

Approved by A.D. Ouattara and Eduard Brau

November 13, 1985

I. Introduction

The 1985 Article IV consultation discussions with Sierra Leone were held in Freetown during the period September 9-20, 1985. The Sierra Leonean representatives included the Honorable J. Amara Bangali, Minister of Finance; 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. A. Abdallah, Alternate Executive Director for Sierra Leone, participated in the discussions. The staff representatives were Mr. C. Enweze (head-AFR), Mr. J. Modi (FAD), Mr. G. Kalinga (AFR), Mr. T. Sasaki (ETR), and Ms. E. Fundafunda (secretary-AFR). Mr. G. Dahl, Fund resident representative in Sierra Leone, also took part in the discussions. Messrs. Abdallah and Enweze were received by the President, His Excellency Siaka P. Stevens; the President-Elect, Major-General J. Momoh; and the Acting First Vice-President and Attorney General and Minister of Justice, the Honorable F. Minah.

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 the arrangement, Sierra Leone made only two purchases totaling SDR 19 million. The third purchase was subject to observance of the performance criteria for end-June 1984 and the completion of a mid-term review of 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. As of October 31, 1985, the Fund's holdings of leones subject to repurchase amounted to SDR 71.39 million, or 123.3 percent of quota; these holdings include SDR 20.70 million, or 35.8 percent of quota, under the compensatory financing facility.

Since late 1984, Sierra Leone has been experiencing increasing difficulties in meeting its financial obligations to the Fund. A report and complaint on Sierra Leone's overdue obligations to the Fund (EBS/85/106, April 30, 1985) were noted by the Executive Board on May 29, 1985. On June 28, 1985 the Board decided to limit Sierra Leone's use of the Fund's general resources until Sierra Leone has become current in

its obligations to the Fund (Decision No. 8014-(85/101). At its first review of the Decision on September 27, 1985, the Board decided to hold a second review of the Decision not later than January 6, 1986, in the absence of full settlement (EBS/85/223). As of October 31, 1985, Sierra Leone's overdue obligations to the Fund amounted to SDR 9.97 million.

Sierra Leone continues to avail itself of the transitional arrangements of Article XIV. Summaries of Sierra Leone's relations with the Fund and the World Bank Group and of outstanding statistical issues are contained in Appendices I, II, and III, respectively. Basic data are presented in Appendix IV.

Sierra Leone is on the standard 12-month consultation cycle. The staff report for the 1984 Article IV consultation (SM/84/222) was discussed by the Executive Board on November 5, 1984.

II. Recent Economic Developments

With the exception of brief periods usually in the context of Fund-supported adjustment programs, during the greater part of the past five years the Sierra Leonean economy has been characterized by economic stagnation, accelerating inflation, a thriving parallel market for foreign currency, and increased smuggling of export commodities, notably diamonds. As a result, the authorities have increasingly been unable to mobilize the foreign exchange needed to ensure continued supplies of essential imports, including petroleum products, and to discharge debt service obligations, and external payments arrears have risen sharply.

In the five years ended June 1985, there was virtually no growth of the economy, 1/ 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 (Table 1). The agricultural and mining sectors, which together account for an estimated 43 percent of gross domestic product (GDP) and almost all of the country's domestic exports, have also 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.

1/ On the basis of detailed information provided to the last mission by the authorities on the performance of various sectors of the economy during the period 1980/81-1984/85, including some preliminary drafts of the national accounts statistics now under preparation, the staff has revised the national accounts estimates for the past five years. Although the information remains tentative, these revisions, which incorporate major adjustments to the data on the GDP deflator for 1983/84 and 1984/85, provide useful indications on the performance of the economy during the last five years (for details see the report on recent economic developments).

Table 1. Sierra Leone: Selected Economic and Financial Indicators, 1979/80-1984/85 1/

	1979/80	1980/81	1981/82	1982/83	1983/84 Program	1983/84 Revised actuals	1984/85 Prel. est.
	(Annual percent change, unless otherwise specified)						
Income and expenditure							
GDP at constant prices	3.0	3.0	-1.4	0.6	1.0	8.0	0.8
GDP at current market prices	12.3	12.3	17.5	27.3	25.2	51.7	44.3
Gross domestic expenditure at current prices 2/	19.7	12.9	24.2	12.9	23.0	45.4	42.3
Consumer prices	19.3	25.6	22.4	60.4	40.0	81.1	109.4
External sector (on the basis of SDRs)							
Exports, f.o.b.	44.7	-25.7	-10.0	-25.9	39.2	21.7	19.5
Imports, f.o.b.	24.3	-10.4	2.0	-34.8	-8.0	-24.6	16.1
Oil imports, f.o.b.	37.1	25.7	68.6	-34.6	14.7	14.7	--
Diamond export volume	-20.5	-32.9	-29.4	27.6	1.0	-33.8	-21.8
Terms of trade (deterioration -)	9.8	-15.9	-13.7	-25.3	...	9.2	8.8
Nominal effective exchange rate 3/ (depreciation -)	-1.2	5.9	2.4	5.6	...	8.0	-53.7
Real effective exchange rate 3/ (depreciation -)	-5.2	20.9	19.4	56.8	...	76.6	-8.4
Government finance							
Total revenue and grants	10.3	18.9	-9.6	-12.0	55.3	46.0	22.5
Total revenue	--	25.4	-13.6	-14.8	36.4	31.6	32.3
Total expenditure 4/	15.1	21.7	0.4	0.4	17.6	14.4	80.6
Money and credit							
Domestic credit	26.5	33.9	31.9	39.4	23.8	20.7	30.9
Government	34.9	37.2	38.1	44.3	24.3	23.2	30.0
Private sector	-1.1	23.5	8.2	15.3	21.2	5.7	36.7
Money and quasi-money (M_2)	16.8	3.6	25.9	36.8	29.3	26.0	54.7
Velocity (GDP relative to M_2)	4.6	5.0	4.7	4.4	4.4	4.5	4.8
Interest rate 5/ (annual rate on one-year deposits)	11.5	11.5	11.5	11.5	13.5	13.5	13.5
	(In percent of GDP, unless otherwise specified)						
Overall government deficit (cash basis)	12.3	11.9	10.6	13.9	8.0	6.7	8.7
Overall government deficit (commitment basis)	12.3	13.7	13.2	11.7	8.0	6.9	12.2
Domestic bank financing	4.8	8.7	9.2	11.6	7.1	5.7	6.4
Percent of initial money stock	26.1	45.5	54.1	69.3	40.3	38.0	47.5
Foreign financing	6.1	2.5	2.1	2.2	0.7	-0.3	1.1
Gross domestic investment 2/	16.2	19.0	14.4	10.8	9.8	8.9	7.3
Gross domestic savings	2.8	5.0	-6.1	5.0	5.2	6.6	6.5
External sector							
Current account deficit (millions of SDRs)	145.1	157.9	181.8	121.2	75.6	52.5	80.8
Ratio to GDP	17.2	16.6	16.3	8.5	8.0	4.7	5.9
Balance of payments deficit (millions of SDRs)	45.6	122.2	120.2	73.8	75.0	43.6	31.9
Ratio to GDP	5.4	12.9	10.8	5.2	7.9	3.9	2.3
External debt 5/	31.2	30.8	27.2	36.3	46.8	26.4	33.1
Inclusive of use of Fund credit 5/	34.3	35.1	30.5	42.2	49.2	32.4	40.0
External debt service as percent of exports 6/	24.8	40.5	40.3	59.9	50.1 7/	51.0 8/	52.3 8/
Gross official foreign reserves (months of imports) 5/	1.3	0.8	0.5	0.6	...	0.6	0.1
External payments arrears (millions of SDRs) 5/	54.7	113.3	199.5	239.9	153.9	236.2	258.9

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

1/ Fiscal years July/June.
2/ Includes changes in stocks.
3/ Trade-weighted.
4/ Commitment basis, i.e., including unpaid obligations.
5/ End of period.
6/ Exports of goods only.
7/ Does not include impact of rescheduling.
8/ Includes impact of 1984 rescheduling.

In the fiscal sector, the highly expansionary trends which were prevalent in the early 1980s and which were partially reversed in 1983/84 (with the implementation of a Fund-supported program) re-emerged and intensified in 1984/85 (Table 2). In 1983/84, the overall fiscal deficit, on both commitment and cash bases (the change in domestic arrears having been small) was reduced to about Le 200 million, or 7 percent of GDP, while the associated bank financing fell to Le 168 million, or 38 percent of beginning money stock. However, in 1984/85 the overall fiscal deficit (commitment basis) widened markedly to Le 521 million, or 12 percent of GDP, largely on account of exchange rate related subsidies, particularly oil, and bank financing of the deficit reached Le 271 million, equivalent to 48 percent of beginning money stock; meanwhile, there was an arrears accumulation of almost Le 150 million. Although the 1985/86 budget provides for an overall fiscal deficit of Le 190 million, or 3 percent of GDP, and bank financing of Le 171 million, or 19 percent of beginning money stock, preliminary indications are that both the deficit and bank financing will be considerably higher.

Total domestic credit, which rose by 21 percent in 1983/84, increased by 31 percent in 1984/85, while credit to the private sector, which rose by 6 percent in 1983/84, grew by 37 percent (Table 3). Money supply, broadly defined, which rose by 26 percent in 1983/84, expanded by 55 percent in 1984/85, and the inflation rate (as measured by the consumer price index) reached 109 percent in 1984/85, compared with 81 percent in the preceding year.

Sierra Leone's external position has 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 5 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 (Table 4). In 1984/85, exports increased by about 20 percent, but the increase was almost offset by a rise in imports. The export value of diamonds decreased sharply, by about 35 percent from the level in 1983/84, because of a substantial decline in volume and also in unit price, the latter owing to the glut in the world market; other mineral exports, especially bauxite and gold, increased substantially. Among agricultural commodities, the export value of coffee almost tripled, owing to a sharp rise in export volume as well as in unit price, which increased by 20 percent. The rise in imports in 1984/85 was attributable to a sharp increase in rice imports: the volume of rice imported by the Sierra Leone Produce Marketing Board (SLPMB) practically tripled, mainly because of low domestic production and smuggling to neighboring countries. These trends, combined with a high deficit on the services account, resulted in a sharp deterioration of the current account deficit, from SDR 53 million in 1983/84 to SDR 81 million in 1984/85. In the capital account, long-term capital (net) amounted to SDR 14 million in 1984/85, reflecting mainly the cancellation in March 1985 of loans (SDR 9.5 million) from the Federal Republic of Germany; however, if this special element is excluded, loan disbursements in 1984/85 amounted to only SDR 23 million (about one half of the average level in 1980/81 and 1981/82), as project loan disbursements

Table 2. Sierra Leone: Central Government Operations, 1980/81-1985/86 1/

Fiscal year ending June 30	1980/81	1981/82	1982/83	1983/84	1984/85 Budget	1984/85 Provisional actuals	1985/86 Budget
			(In millions of leones)				
Revenue and grants	228.3	206.3	181.5	264.9	317.1	324.6	525.4
Tax revenue	200.0	174.3	143.7	188.9	245.5	257.6	405.4
Nontax revenue	12.0	8.9	12.3	16.4	16.6	14.1	21.3
Grants	16.3	23.1	25.5	59.6	55.0	52.9	98.7
Total expenditure	406.6	408.3	409.0	468.0	507.1	845.3	771.8
Current expenditure	246.3	248.8	261.7	332.6	387.1	381.9	556.1
Development expenditure	63.9	94.9	99.2	103.1	120.0	126.2	215.7
Other expenditure 2/	96.4	64.6	48.1	32.3	--	337.2 3/	--
Additional fiscal measures 4/	--	--	--	--	--	--	56.4
Overall deficit (commitment basis)	-178.3	-202.0	-227.5	-203.1	-190.0	-520.7	-190.0
Change in arrears (reduction -)	24.3	41.2	-42.1	4.3	--	149.5	--
Overall deficit (cash basis)	-154.0	-160.8	-269.6	-198.8	-190.0	-371.2	-190.0
Financing	154.0	160.8	269.6	198.8	190.0	371.2	190.0
Foreign	32.4	31.9	42.0	-8.3	5.4	44.7	-20.7
Drawings	(64.1)	(63.6)	(69.0)	(40.0)	(50.0)	(75.0)	(107.0)
Amortization	(-31.7)	(-31.7)	(-27.0)	(-48.3)	(-44.6)	(-30.3)	(-127.7)
Domestic	121.6	128.9	227.6	207.1	184.6	326.5	210.7
Bank financing (cash basis)	(113.6)	(140.0)	(224.8)	(168.3)	(164.6)	(270.6)	(170.7)
Monetary authority	112.8	142.1	214.6	110.7	...	137.1	--
Commercial banks	0.8	-2.1	10.2	57.6	...	133.5	--
Nonbank	(8.0)	(-11.1)	(2.8)	(38.8)	(20.0)	(55.9)	(40.0)
			(In percent of GDP)				
Revenue and grants	17.6	13.5	9.3	9.0	7.4	7.6	8.7
Total expenditure	31.3	26.7	21.0	15.9	11.9	19.8	12.8
Current expenditure	(19.0)	(16.3)	(13.5)	(11.3)	(9.1)	(9.0)	(9.2)
Development expenditure	(4.9)	(6.2)	(5.1)	(3.5)	(2.8)	(3.0)	(3.6)
Other expenditure	(7.4)	(4.2)	(2.4)	(--)	(1.1)	(7.8)	(--)
Overall deficit (commitment basis)	13.7	13.2	11.7	6.9	4.5	12.2	4.1
Overall deficit (cash basis)	11.9	10.6	13.9	6.7	4.5	8.7	3.1
Bank financing	8.7	9.2	11.6	5.7	3.9	6.4	3.5
Foreign financing	2.5	2.1	2.2	-0.3	0.1	1.1	-0.3
			(In percent of beginning stock of broad money)				
Bank financing	45.5	54.1	69.3	38.0	38.7	47.5	19.4

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

1/ Provisional estimates; government accounts have not been fully finalized and audited since 1978/79. These data do not include financial transactions between the Central Government and the SLPMB which are determined to be large; the transactions include, among other things, tax revenue collected by the SLPMB totaling Le 24 million, used to offset rice subsidies totaling Le 34 million in 1984/85, with the balance Le 10 million effectively an arrear of the Central Government.

2/ Residual derived from data on financing, revenue, and cash expenditures, on a commitment basis. The available data do not permit the classification of accumulated unpaid commitments for past years across expenditure categories. However, it includes a large and growing subsidy on oil, amounting to Le 160 million in 1984/85.

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

4/ The measures needed to yield Le 56.4 million have still not been implemented.

Table 3. Sierra Leone: Monetary Survey, June 1980-June 1985 1/

(In millions of leones)

	1980	1981	1982	1983	1984	1985
Foreign assets (net)	-49.6	-163.3	-237.0	-258.0	-692.1	-1,518.6 2/3/
Central bank	-60.6	-173.3	-243.2	-280.2	-723.2	-1,553.4 2/
Commercial banks	11.0	9.9	6.2	22.2	31.1	34.8
Domestic credit	345.1	462.0	609.9	850.3	1,024.1	1,340.6 2/
Claims on Government (net)	267.7	367.3	507.8	732.6	900.9	1,171.5 2/
Claims on public enterprises	3.7	3.7	3.6	3.9	3.0	4.6
Claims on private sector	73.7	91.0	98.5	113.8	120.3	164.5
Money and quasi-money	249.6	258.6	324.5	443.9	570.2	882.2
Other items (net)	45.8	40.1	48.4	148.4	-238.2	-1,060.2

Source: Bank of Sierra Leone.

1/ End of June.
2/ These figures exclude external public debt service payments due but not effected in FY 1984/85 amounting to Le 124.5 million.
3/ Net foreign assets are revalued at the exchange rate of US$1 = Le 6.0. The revaluation counterpart is reflected in other items (net).

Table 4. Sierra Leone: Balance of Payments, 1980/81-1984/85

(In millions of SDRs)

	1980/81	1981/82	1982/83	1983/84 Program	1983/84 Revised	1984/85 Preliminary estimate
Trade balance	-110.8	-128.8	-73.4	-30.6	-14.8	-13.6
Exports	131.4	118.3	87.7	132.1	106.7	127.5
Imports	-242.2	-247.1	-161.1	-162.7	-121.5	-141.1
Services balance	-54.8	-61.0	-51.6	-55.0	-40.3	-69.1
Of which: official interest	(-7.3)	(-7.0)	(-9.1)	(-10.8)	(-9.0)	(-28.5)1/
IMF charges	(-3.2)	(-5.9)	(-4.8)	(-3.8)	(-5.3)	(-6.3)
Private transfers (net)	7.7	8.0	3.8	10.0	2.6	1.9
Current account balance	-157.9	-181.8	-121.2	-75.6	-52.5	-80.8
Government transfers (net)	30.7	22.8	18.3	26.2	23.5	19.3
Long-term capital (net)	9.9	-6.7	-7.0	-10.4	-28.8	13.6
Official (net)	3.4	-6.1	0.7	-16.6	-17.0	10.3
Drawings	(46.9)	(46.5)	(42.4)	(28.8)	(18.7)	(32.8)2/
Repayments	(-43.6)	(-52.6)	(-41.7)	(-45.4)	(-35.7)	(-22.5)
Private (net)	6.5	-0.5	-7.7	6.2	-11.8	3.3
Export earnings retained	(-6.7)	(-15.1)	(-17.3)	(-16.3)	(-26.6)	(-12.4)
Short-term capital and errors and omissions	-4.9	45.5	36.1	-15.3	14.2	16.0
Overall balance before rescheduling	-122.2	-120.2	-73.8	-75.0	-43.6	-31.9
Net impact of rescheduling of debt and arrears	6.0	7.8	34.1	43.7	9.4 3/	7.3 3/
Overall balance after rescheduling	-116.2	-112.4	-39.7	-31.3	-34.2	-24.6
Financing	116.2	112.4	39.7	31.3	34.2	24.6
Arrears (decrease -) 4/	58.6	86.2	40.4	3.5	-3.7	22.7 5/
Fund credit (net)	20.6	-3.4	18.4	12.8	14.6	-9.4
Purchases	(35.5)	(--)	(20.7)	(19.0)	(19.0)	(--)
Repurchases	(-14.9)	(3.4)	(-2.3)	(-6.2)	(-4.4)	(-9.4)
Reserves (increase -)	37.0	29.6	-19.1	15.0	23.3	11.3

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

1/ Includes interest payments due on outstanding arrears.

2/ Includes cancellation of German loans (SDR 9.5 million) which was agreed in March 1985.

3/ Consists of four bilateral loans agreed to be rescheduled (Switzerland, signed in April 1984; Norway and Belgium, signed in May 1984; and Germany, signed in August 1984).

4/ Arrears change shown on a cash basis. For the 1983/84 program, the figure includes a buildup of SDR 4.5 million in arrears before the beginning of the stand-by arrangement, in February 1984, and a reduction of SDR 6.0 million during the remainder of the year.

5/ Includes overdue obligations to the Fund.

declined during the year. The overall balance of payments deficit of some SDR 32 million was financed partly by debt relief provided by the few Paris Club creditors who had signed the bilateral rescheduling agreements, but largely by an increase in external arrears, including overdue obligations to the Fund. As of end-June 1985, external payments arrears amounted to SDR 259 million, more than double the level of 1984/85 exports.

As of end-June 1985, Sierra Leone's external public debt outstanding (disbursed), including use of Fund credit, amounted to about SDR 421.6 million, or 40 percent of GDP. The debt service burden (including the Fund), which had been reduced in 1983/84 (partly as a result of the rescheduling exercises completed with Paris Club creditors, commercial banks, and supplier creditors), increased to an estimated 52 percent of exports of goods in 1984/85.

The leone is pegged to the SDR, and the exchange rate was last adjusted in February 1985, when the leone was devalued by 58.3 percent against the U.S. dollar. Since then, the nominal effective exchange rate has depreciated by 8 percent, despite an appreciation of the leone by 6 percent against the U.S. dollar. However, in view of the very high domestic inflation, the real effective exchange rate appreciated by 25 percent between February 1985 and August 1985 (see Chart).

III. Report on the Discussions

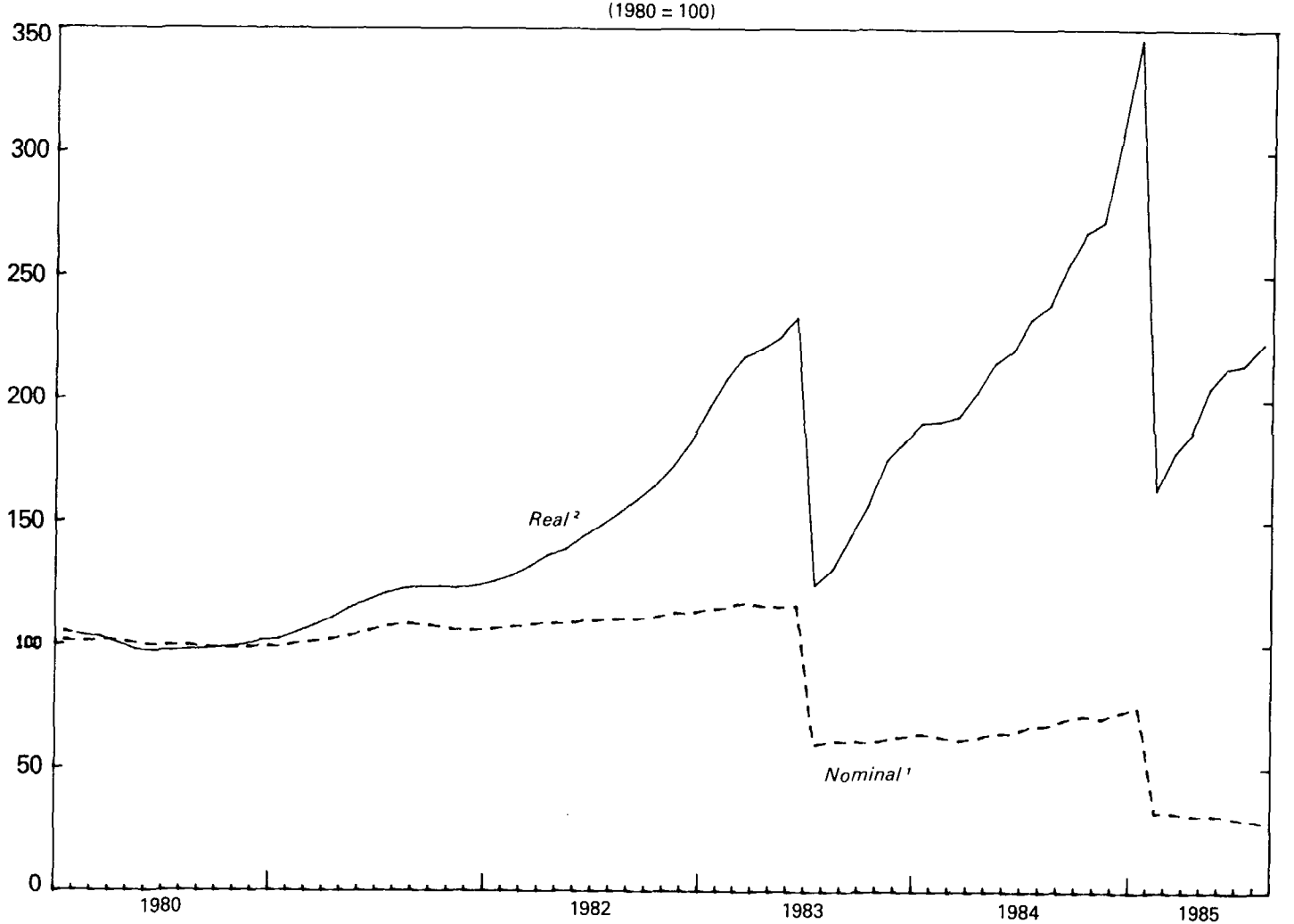
From about the beginning of 1984/85, Sierra Leone's overall economic and financial situation has deteriorated sharply, as the Government relaxed its adjustment efforts: largely as a result of the authorities' reluctance to implement an appropriate flexible exchange rate system, the volume of exchange and trade transactions channeled through the domestic banking system declined considerably; the Government began to experience increasing difficulties in mobilizing foreign exchange for priority imports and debt service payments; and external payments arrears, including overdue obligations to the Fund, rose substantially. The overall fiscal deficit and the associated bank financing increased sharply as the tax base shrank dramatically and government outlays on exchange rate-related subsidies, particularly on oil, rose, and the rate of inflation accelerated again.

During the second half of 1984/85, the authorities initiated some partial steps to contain the situation, but these have proved inadequate to deal with the large internal and external imbalances. The consultation discussions centered on a review of the increasingly difficult economic and financial situation, the inadequacy of the measures initiated by the authorities to deal with the rapidly deteriorating economic and financial situation, the outlook for 1985/86, and the pressing need for Sierra Leone to clear the arrears to the Fund. During the discussions, the mission was guided by the views of the Executive Board, as reflected in the Chairman's Summing Up of the 1984 Article IV consultation with

CHART
SIERRA LEONE

NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, TRADE WEIGHTED, 1980-85

(1980 = 100)



Note: An increase in the index indicates an appreciation of the leone.
[1]Trade weighted index of nominal exchange rates for twenty eight partner countries.
[2]Nominal effective exchange rate deflated by the consumer price index.

Sierra Leone (SUR/84/109), urging the authorities to adopt urgently a comprehensive adjustment program, including measures to reverse the deteriorating economic and financial situation, and an appropriate flexible exchange rate system to correct the severe overvaluation of the leone.

1. External sector policies

Sierra Leone's exchange system is at present experiencing serious dislocations, 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 is a direct consequence of the wide spread between the official exchange rate and the rate in the parallel market, 1/ and the authorities' consequent inability to enforce the surrender of foreign exchange by exporters, particularly the diamond and gold exporters.

Sierra Leone's exchange system has undergone a number of modifications since the last Article IV consultation. On February 21, 1985, the official exchange rate of the leone was devalued 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. Other actions taken in February 1985 included an official statement that all existing regulations for provision of documentation of foreign exchange earnings and for surrender of foreign exchange must be strictly complied with. On April 25, 1985, the authorities published a new licensing procedure which provides for the importation of all goods under Open General License, with the exception of a number of items (including petroleum) that are listed under Specific Import Licenses, 2/ and accounting for about 40 percent of the value of imports. 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 betweeen 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 continue 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), continues to dwindle. During 1984/85, foreign exchange receipts flowing into the banking system are estimated, by the authorities to have totaled SDR 27 million as against projected total export earnings for the period, of SDR 128 million. With the exception of a large part of the imports of oil, and some rice imports by the SLPMB, all private imports are channeled through the parallel market. Meanwhile, certain proposals including the setting of export targets for exporters and the reorganization of the present marketing arrangements

1/ The official exchange rate is Le 6 = US$1, compared with the present parallel market rate of Le 12-13 = US$1.

2/ In the list there are approximately 80 items to which 6 items were added on July 4, 1985.

for diamonds, are under consideration, ostensibly to improve the inflow of foreign exchange to the official sector.

In view of the continuing rapid deterioration in the economic and financial situation, the mission recommended an early introduction of a market-determined flexible exchange rate system. Such a system would need to be coupled with a liberalization of the import licensing regime, the valuation of transactions for customs purposes at the exchange rate prevailing under the flexible exchange system, and appropriate demand management and structural adjustment policies. In light of the above, the mission stressed that the proposals under consideration by the authorities were inadequate. In particular, the setting of specific but different export targets and foreign exchange retention ratios for exporters would involve considerable technical and administrative problems, while entrenching further the existing rigidities in the exchange system. In addition, the proposals, which seem to be predicated implicitly on differential prices for foreign exchange applicable to the different exporters, would continue to be open to abuse and to exacerbate economic distortions and the erosion of the tax base, with adverse repercussions for the budget deficit, among other things. Finally, the selective and partial nature of the proposals runs the risk of being unsuccessful, as was the February 1985 discrete devaluation of the leone, and would lead to further complication of the existing exchange system.

During the consultation discussions, the staff urged the authorities to promptly discharge Sierra Leone's overdue obligations to the Fund. The Sierra Leonean authorities stated that they have been implementing a number of measures, including renegotiating retention provisions in the mining sector, in order to improve the inflow of foreign exchange into the banking system. While the authorities attached a very high priority to the settlement of overdue obligations to the Fund, the foreign exchange situation remained critical and no indication could be provided, at the time, with regard to an expected reduction in the level of these arrears prior to the Executive Board meeting of September 27, 1985. The authorities stated they would continue to keep the situation under close and constant review. As in the past discussions since the overdue payments arose in February 1985, the Fund staff reiterated its view that the critical foreign exchange situation could only be resolved within the context of comprehensive adjustment measures, including a reform of the exchange system, which should be implemented without delay. The staff urged that, in the meantime, every effort should be made by the authorities to settle the overdue obligations to the Fund urgently, by September 27, and remain current thereafter. In the event, the authorities made a payment of SDR 0.942 million on October 3, 1985; since then, however, Sierra Leone's overdue obligations to the Fund have increased to SDR 9.97 million as of October 31, 1985.

Sierra Leone's exchange system involves restrictions on payments and transfers for current international transactions subject to Fund approval, including a system of foreign exchange budgeting, limits on payments for invisibles, and external payments arrears. Sierra Leone also

maintains multiple currency practices subject to Fund approval arising from the nonpayment of interest on deposits of the leone counterpart of commercial arrears and the existence of an officially recognized parallel exchange market. Sierra Leone also continues to maintain bilateral payments agreements with two Fund members, Guinea and the People's Republic of China.

2. Domestic financial policies

Regarding budgetary developments, the mission emphasized that recent trends were most disquieting: the tax base has continued to shrink; the overall fiscal deficit had widened markedly in 1984/85 and bank financing had grown rapidly; similarly, the prospects were for another large deficit and substantial bank financing in 1985/86. In this context, the mission noted that a staff team which visited Freetown in June 1985 had discussed with the authorities broad budgetary targets for 1985/86, notably an overall deficit of Le 190 million and bank financing of Le 171 million, equivalent to 19 percent of beginning money stock. The measures underpinning the attainment of these targets included a flexible exchange rate system, the pass-through of petroleum price increases, revenue measures amounting to Le 56 million, and a possible increase in wages and salaries averaging 25 percent, in view of the potential impact of the recommended exchange rate reform. However, while the revenue and expenditure targets were broadly reflected in the 1985/86 budget presented to Parliament on June 28, 1985, the basic underpinning measures have not been implemented, whereas the increase in wages and salaries has been put into effect, from July 1, 1985. Consequently, present indications are that the overall fiscal deficit could reach three times the intended level, requiring considerable bank financing; as in 1984/85, a large part of the deficit would again be due to the continuing inappropriate exchange rate and pricing policies, and the absence of new revenue measures in the budget. Meanwhile, in September, a commission was appointed by the Government to review wages and salaries.

The Sierra Leonean representatives explained that the deterioration of fiscal performance in 1984/85 had occurred despite the significant growth (23 percent in nominal terms) of revenue and grants, arising from increased receipts from income taxes, excises, and import duties. However, a sharp increase in total expenditure (81 percent) substantially outpaced this revenue performance, largely as a result of a rise in extrabudgetary spending associated with the subsidy on fuel (from Le 41 million in 1983/84 to Le 160 million in 1984/85) as well as of increased budgetary expenditure on development and personnel outlays, including the bonus award of one month's salary to civil servants in March 1985. In addition to the extrabudgetary expenditures on account of the oil subsidy, other extrabudgetary outlays had also been incurred in connection with supplies and equipment for defense, scholarships and foreign travel, and the Government's equity contribution to the Precious Metals Marketing Company (PMMC). Furthermore, the rice subsidy rose by Le 24 million to Le 34 million, mainly as a result of the poor domestic harvest and the higher import price; this subsidy was not, however, reflected in the growth of

expenditure, because it was offset by the SLPMB against its export tax liability to the Government.

While acknowledging the worrisome budgetary prospects for 1985/86, the Sierra Leonean representatives stated that they had been endeavoring to contain the situation in a number of ways. First, they had stepped up their revenue collection efforts in the areas of income tax and customs and excise through improvements in tax administration. Second, the Government intends to adhere to the expenditure restraint measures adopted in earlier years, especially with respect to the procurement and management of supplies. They explained that the salary and wage commission recently appointed in line with the recommendations of the World Bank's Structural Adjustment Program Pre-investment Appraisal Mission in April/May 1985 would be concerned largely with a broad review of the terms and conditions of service, and, unless there were compelling reasons to the contrary, it is not expected that the commission's recommendations would lead to a further general salary increase in this fiscal year, over and above the 25 percent increase already granted in July 1985. Third, the price of rice would continue to be progressively increased, to bring it more in line with the free market price and reduce the implicit budgetary subsidy. Fourth, as part of ongoing preparations for a possible structural adjustment program, the Government was 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). Fifth, the Government was aware of the adverse impact of the fuel subsidy on the overall fiscal deficit and it was attempting to reduce its impact, in the first instance, by stretching the regular four-week fuel supplies over six weeks; it was also reviewing retail prices of petroleum products with a view to eliminating the subsidy.

Where monetary and credit developments are concerned, the Sierra Leonean representatives concurred that a substantial part of the recent large credit and monetary expansion is attributable to the increasing recourse of the Government to domestic bank financing. The Government's demand for credit has been inordinately high, and the authorities, on September 4, 1985, raised the statutory ceiling on ways and means advances to the Government (retroactive to 1975), from 10 percent to 20 percent of estimated recurrent budgetary revenue, in order to facilitate still higher levels of bank financing of the overall fiscal deficit. Credit to the private sector, particularly the commercial sector, also rose considerably in 1984/85, although the individual commercial banks remained within the credit ceilings stipulated by the Bank of Sierra Leone.

In reviewing the appropriateness of the present fixed structure of interest rates (which, in light of the sharp increases in consumer prices in each of the past two years, are presently highly negative in real terms), the Sierra Leonean representatives noted that lending and savings rates are now at an all-time high; consequently, they did not find it necessary to implement the 2 percentage point increase in interest rates approved by the Cabinet for 1984/85. In response to

the mission's suggestions regarding the need for a flexible interest rate policy, they said that, under present conditions, the Bank of Sierra Leone sets minimum lending and savings rates, and that commercial banks are free to apply much higher rates in their operations. However, there is considerable collusion on interest rates between the commercial banks, and it was felt that private businessmen are unlikely to change the patronage of their present banks solely for interest rate considerations. It was also considered doubtful that lending rates, on which there are no ceilings, would rise significantly beyond their present average level of 24 percent. The mission stated that, in the context of a flexible exchange rate system, interest rate policies would have to be reviewed.

3. Production and pricing policies

The Sierra Leonean representatives indicated that they were encouraged by the increase in purchases of export crops (particularly coffee and cocoa) by the SLPMB, following the increases in producer prices introduced during 1984/85. In addition to the increases in the producer prices for coffee, cocoa, ginger, and palm kernels by 26 percent, 63 percent, 41 percent, and 50 percent, respectively, effected in July 1984, these prices were raised again in February 1985, at the time of the valuation of the leone, by 67 percent, 14 percent, 36 percent, and 33 percent, respectively. Purchases of coffee and cocoa by the marketing board amounted to 10,000 tons and 10,900 tons, respectively, in 1984/85, compared with the 1983/84 levels of 2,100 tons and 9,000 tons, respectively; by contrast, purchases of ginger and palm kernels were only 44 tons and 8,500 tons, respectively, in 1984/85, as against 100 tons and 16,200 tons, respectively, in the previous year. The authorities explained that purchases of palm kernels, which is a residual crop, had suffered from the increased attention given by farmers to the production of coffee and cocoa, while ginger purchases had declined because of increased domestic consumption.

At the time of the consultation discussions, the outlook for increased purchases of coffee and cocoa by the SLPMB in 1985/86 was not encouraging, largely because, as the parallel exchange rate of the leone continues to depreciate, the producer prices in Sierra Leone will continue to lag behind comparable prices in neighboring countries; consequently, the scope for private traders to offer substantially more attractive prices for produce has been increased. However, the Sierra Leonean representatives hoped that their intensified border surveillance and the further increases in producer prices of cocoa and ginger by 20 percent and 60 percent, respectively, in September 1985 would assist in boosting official purchases of export crops. Nevertheless, in the absence of appropriate exchange rate actions, the ability of the marketing board to offer higher producer prices, without recourse to bank financing, has become very limited.

The overall financial position of the SLPMB, which registered a small pre-tax profit in 1983/84, is estimated to have shown no improvement in 1984/85, largely because of the substantial increase in losses on account of rice operations and of higher overhead costs. Where rice operations are concerned, the Sierra Leonean representatives explained that the marketing board had imported 103,700 tons of rice in 1984/85, compared with 36,200 tons in 1983/84 (including 14,799 tons of grant aid rice), mainly because of the decline in domestic paddy production, by an estimated 10 percent in FY 1984/85. Although the Government continued to encourage private sector participation in the rice import trade, imports of rice by the private sector had declined from 15,000 tons in 1983/84 to 11,800 tons in 1984/85. Nevertheless, the Sierra Leonean representatives reaffirmed the authorities' intention to reduce the role of the marketing board in rice operations. In this context, they stated that the Government's policy intention of gradually increasing the ex-SLPMB wholesale price of rice to Le 110 1/ per 50-kilo bag in December 1985 should assist in enhancing the role of the private sector. Consistent with this policy intention, the price of rice had been increased from Le 50 per bag in January 1985 to Le 80 per bag in September 1985. Similarly, recent PL-480 grant rice received from the United States had been sold, through a private Sierra Leonean businessman, at Le 115 per bag. The staff urged the authorities to privatize rice imports, except for a strategic stock of about 25,000 tons to be imported by the SLPMB.

Concerning institutional developments in the agricultural sector, the Sierra Leonean representatives explained that, in addition to the technical and financial assistance received from the World Bank, EEC, and ADB, the Government had reached understandings with the U.S. Government to use the proceeds from the sale of PL-480 rice (estimated at about US$4 million in 1985/86) to finance rural projects aimed at increasing local rice production. The Government also continues to pursue its strategies in the agricultural sector through 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. The objectives of the ASSP include the improvement of the agricultural delivery system (especially the agricultural extension services) and the streamlining of the activities of the IADPs and the Ministry of Agriculture. Under the project, the Government plans to reduce excess manpower in the Ministry of Agriculture by 50 percent by end-December 1985 and to phase out, by 1987, fertilizer subsidies, which are currently funded by donor agencies.

Where the mining sector is concerned, the authorities indicated that the decline in total diamond production from 265,000 carats in 1983/84 to an estimated 253,000 carats in 1984/85 was primarily due to the collapse of the exchange scheme supported by the PMMC and the inability of reputable diamond dealers, such as the Diamond Corporation (DICOR), to operate at

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1/ The prevailing retail price of rice is Le 130 per bag.

the official exchange rate. They explained that, from September 1984, the then newly-formed PMMC (which included participation by both the Government and the private sector) had been given the responsibility of marketing all official exports of gold and diamonds. Under that arrangement, the effective supply price of gold and diamonds to the PMMC was at the parallel market exchange rate, while the company sold foreign exchange at rates of exchange substantially below the parallel market exchange rate, with the PMMC being compensated for the differential. In addition to the budgetary cost, the PMMC-based exchange system under which the exchange rate was arbitrarily fixed involved a multiple currency practice; these shortcomings were discussed with the Fund staff in late 1984, and the PMMC-supported scheme became inoperative in early 1985. Meanwhile, as the spread between the official rate and the parallel rate widened after the February 1985 devaluation, many exporters found it difficult to operate; consequently, only a few operators renewed their export licenses for 1985. Following the changes in the exchange arrangements in May 1985, whereby gold and diamond exporters were permitted 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, recorded purchases of both gold and diamonds rose sharply during the period April-June 1985: purchases of alluvial diamonds, at 154,000 carats in 1984/85, exceeded the 1983/84 level of 92,000 carats, while recorded purchases of gold at 19,200 ounces in 1984/85 were substantially higher than the 1983/84 level of 7,300 ounces. In the meantime, since late 1984, DICOR, which operates at the official exchange rate, has been unable to compete under these exchange systems and has since suspended its diamond operations.

The prospects for other minerals are uncertain. The Marampa iron ore mine, which ceased operations in early 1985 following the departure of the technical partners, has remained closed; the authorities are reviewing the situation with a view to resuming operations when new technical partners are identified. Production of bauxite rose by 30 percent to 1,229,000 tons in 1984/85, but it is expected to decline in 1985/86 because of a glut in the world market. Rutile production, which stabilized at the 1983/84 level of 88,000 tons in 1984/85, is projected to decline by about 10 percent during the next two years as the company begins to mine less concentrated ores.

The Sierra Leonean representatives stated that there had been a few institutional developments in the mining sector since late 1984: the Government, operating through the PMMC, bought out British Petroleum's (BP) 49 percent share in the National Diamond Mining Company (DIMINCO) in October 1984. Subsequently, in early 1985, Altadeen International, which is 60 percent owned by the PMMC and 40 percent by Bin Rafaah, bought all the 49 percent shares in DIMINCO held by the PMMC, which now manages DIMINCO's operations, including diamond exports. Meanwhile, DIMINCO is proceeding with the kimberlite underground mining project. However, the scope of the kimberlite project is being revised, the prospective size of the investment has been scaled down (from an earlier estimate of US$110 million to about US$76 million), and the timing for

implementing the project may be determined in December 1985, assuming that potential investors have been assembled by then.

4. Energy policies

On January 7, 1985 the authorities increased the retail prices of various petroleum products by amounts ranging between 22 percent and 70 percent, with a view to reducing the subsidy on these products. However, following the devaluation of February 1985 and the authorities' failure to raise fuel prices in line with the increased cost of importation, the subsidy is estimated to have increased to about 50 percent of the c.i.f. price of fuel, accounting for a very large proportion of the budget deficit. Sierra Leone's present fuel supply arrangements, through a company registered abroad, involve purchasing fuel at higher than spot market prices, because of the reportedly favorable credit arrangements provided by the suppliers.

Owing to overuse and frequent breakages, Freetown's electricity generating capacity has deteriorated to below 50 percent of the estimated requirement of 24 megawatts a day. In order to alleviate the situation, the authorities have bought 4 additional generators of 3 megawatts each from Germany at an estimated US$5.3 million, which are scheduled to be installed in February 1986. Meanwhile, in the context of the World Bank and European Investment Bank supported US$25 million Power Rehabilitation Project, the authorities are contemplating an increase in electricity tariffs by about 200 percent, sometime in the first quarter of calendar year 1986.

5. Medium-term balance of payments

The medium-term balance of payments projections are presented under two broad scenarios (Table 5). Scenario A assumes a continuation of present policies, including the present exchange and trade arrangements under which a large proportion of transactions are channeled through the parallel market, and the existing weak enforcement of surrender obligations. Scenario B represents a normative scenario, incorporating the broad and tentative outlines of what appears feasible, if the authorities were to implement a comprehensive adjustment program based on a flexible exchange system, together with import liberalization; under this scenario, it is assumed that the new exchange system would be put in place in January 1986.

Scenario A indicates that on present policies, a continued critical and nonviable balance of payments situation is inevitable. Although the current account deficit is projected to remain stable at around SDR 90 million per annum, this is due to a severe compression in imports in real terms which is expected to continue to take place, reflecting the absence of new trade credits and limited inflows of developmental resources. Scheduled amortization payments are expected, in the absence of debt

Table 5. Sierra Leone: Medium-Term Balance of Payments Projections, 1984/85-1989/90

(In millions of SDRs)

	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Trade balance	-13.6	-14.5	-19.0	-19.4	-19.7	-20.1
Exports	127.5	125.7	127.1	133.0	139.3	145.9
Imports 1/	141.1	140.2	146.1	152.4	159.0	166.0
Services balance	-69.1	-74.6	-73.8	-73.4	-72.6	-72.8
Of which:						
Official interest 2/	-28.5	-36.0	-35.9	-36.2	-35.9	-35.8
IMF charges	-6.3	-6.2	-4.6	-3.1	-1.6	-1.0
Private transfers	1.9	1.8	1.9	2.0	2.1	2.2
Current account balance	-80.8	-87.3	-90.9	-90.8	-90.2	-90.7
Long-term capital (net)	32.9	21.3	23.6	23.9	28.1	33.1
Official	29.6	19.1	21.4	21.7	25.9	30.9
Transfers	(19.3)	(18.2)	(18.7)	(19.3)	(19.9)	(20.5)
Official drawings	(32.8) 3/	(24.2)	(25.2)	(26.2)	(27.3)	(28.4)
Repayments	(-22.5)	(-23.3)	(-22.5)	(-23.8)	(-21.3)	(-18.0)
Private capital	3.3	2.2	2.2	2.2	2.2	2.2
Short-term capital and errors and omissions	16.0	--	--	--	--	--
Overall balance	-31.9	-66.0	-67.3	-66.9	-62.1	-57.6
Financing	31.9	66.0	67.3	66.9	62.1	57.6
Fund repurchases	-9.4	-13.6	-18.1	-22.6	-9.3	-4.8
Financing gap	41.3	79.6	85.4	89.5	71.4	62.4
Memorandum item:						
Financing gap (including interest payments on commercial financing for financing gap)	41.3	88.5	103.4	117.1	107.9	106.2

Sources: Sierra Leonean authorities; and Fund staff projections.

1/ Excludes Kimberlite project and IBRD sectoral project.
2/ Excludes interest payments on balance of payments financing to clear the financing gap, but includes interest payments on outstanding arrears.
3/ Includes cancellation of German loans (SDR 9.5 million).

relief, to remain very high (Table 6), with the result that the overall balance of payments deficit is projected to increase sharply. When repurchases to the Fund are taken into account, there would be substantial financing gaps, averaging about SDR 76 million per annum over the next five years. However, in view of the expected continued dearth of foreign exchange, the financing gaps essentially represent a projection of Sierra Leone's nonpayment of its external debt obligations during the period.

Under Scenario B, the value of exports is assumed to grow by about 6 percent annually in the medium term, reflecting a number of factors: in the mineral sector, these include a return of DIMINCO's operations to normal levels; the resumption of operations by exporters (such as DICOR and others, as well as those in the gold sectors) presently unable to compete legally at the prevailing inappropriate official exchange rate. Similarly, exports of agricultural commodities, including coffee, cocoa, and palm kernels, are projected to increase significantly under an appropriate flexible exchange arrangement.

Regarding imports, their value is assumed to increase by about 3.5 percent annually from 1984/85. In this context, it is assumed that the value of oil imports will average SDR 45 million, reflecting the limited scope for further significant economies in the consumption of petroleum products. Rice imports are projected to decline gradually over the period, in line with an assumption of increased domestic production, including under project assistance, in the context of appropriate domestic policies. The remaining non-oil, non-rice imports are assumed to increase by an annual average of 6 percent, reflecting a resumption of bilateral and multilateral development inflows under Scenario B, as well as the assumed liberalization of the import regime.

Consequently, the current account deficit under Scenario B would average SDR 88 million in the medium term. However, in view of the expected higher inflows of development receipts, as well as the impact of policies designed to eliminate retention privileges, the overall deficit, before debt rescheduling, would be considerably lower, averaging SDR 35 million under Scenario B, compared with an average of SDR 60 million under Scenario A. After taking account of repurchases to the Fund, a financing gap averaging SDR 48 million remains under Scenario B, compared with an average financing gap under Scenario A of SDR 75 million. However, unlike under Scenario A, the financing gap under Scenario B could be filled, under the assumption of appropriate policies and a continued strong adjustment effort, through concessional and exceptional financing, including debt relief.

Table 6. Sierra Leone: External Debt Service Projections, 1984/85-1989/90

(In millions of SDRs)

	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Debt service (scheduled)	66.7	79.1	81.1	85.7	68.1	59.6
Amortization	31.9	36.9	40.6	46.4	30.6	22.8
Medium- and long-term debt	22.5	23.3	22.5	23.8	21.3	18.0
Repurchases from Fund	9.4	13.6	18.1	22.6	9.3	4.8
Interest payments	34.8	42.2	40.5	39.3	37.5	36.8
Medium- and long-term debt 1/	28.5	36.0	35.9	36.2	35.9	35.8
Fund charges	6.3	6.2	4.6	3.1	1.6	1.0
Memorandum items:						
Outstanding disbursed debt (end of period)	421.6	416.5	402.3	376.1	358.1	341.9
Medium- and long-term debt	348.7	356.3	360.2	356.6	347.9	336.5
Use of Fund credit	72.9	60.2	42.1	19.5	10.2	5.4
Debt service payments						
Scenario A						
Ratio to exports of goods	52.3	62.9	63.8	64.4	48.9	40.8
Exclusive of Fund credit	40.0	47.2	45.9	45.1	41.1	36.9
Scenario B						
Ratio to exports of goods	52.3	53.5	51.3	52.3	40.3	34.5
Exclusive of Fund credit	40.0	40.1	37.0	36.6	33.8	31.1

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

1/ Excludes interest payments on exceptional financing to close the financing gap, but includes interest payments on outstanding arrears.

IV. Staff Appraisal

As a result of the inertia in substantive economic and financial decision making since about mid-1984, the limited gains made by the Sierra Leonean economy in 1983/84 were reversed in 1984/85, as the problems of economic stagnation, accelerating inflation, and growing internal and external imbalances all intensified markedly. The economy continues to function largely on the parallel market: virtually all private transactions take place in this market, and the Government is increasingly relying on the parallel market for a large proportion of 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, more than doubled from the level a year earlier, the associated bank financing increased sharply, and domestic arrears rose. Credit to the private sector also increased substantially. Monetary expansion accelerated sharply, and, for the first time in recent years, the inflation rate exceeded the 100 percent mark, which in turn was reflected in the movements in the parallel market exchange rate. In the external sector, the current account deficit worsened substantially, and external arrears increased to more than double the level of recorded exports. At the same time, the authorities 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 disbursements from several bilateral and multilateral agencies for development projects have declined.

Faced with these problems, the Sierra Leonean authorities have responded over the past 15 to 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 level deficit that, again, would be monetized through the central bank. Furthermore, the economic and financial problems facing the economy have continued to intensify, and arrears to the Fund, which at the time of the consultation discussions amounted to SDR 8.49 million, now stand at SDR 9.97 million, as of October 31, and are likely to continue to increase on the basis of present policies. Consequently, 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.

Although Sierra Leone is presently confronted with economic and financial problems of daunting magnitudes, timely and sustained implementation of strong and comprehensive adjustment policies would enable the authorities to become current with the Fund, to redress the existing

imbalances, facilitate growth, and thus make possible more promising medium-term prospects, and enable the country to take advantage of its considerable resource base. The implementation of such policies would also facilitate the resumption of concessional capital inflows and exceptional financing, including debt relief; but the pressing need to embark urgently on the revitalization and restructuring of the economy cannot be overemphasized. The basic elements of a comprehensive adjustment program must include a flexible exchange rate system, a liberalization of the import licensing regime, a further substantial increase in producer prices of export crops, and appropriate valuation of imports for customs purposes. These measures, which would allow for an expansion of the tax base, would also need to be complemented by other policies to drastically reduce the overall fiscal deficit from its unsustainably high level. In this context, the elimination of the subsidy on petroleum products, which remains a major contributory factor to the growing fiscal deficit, would be vital; electricity tariffs would also need to be substantially increased. Furthermore, a major review and overhaul of the interest rate structure would be essential. The staff welcomes the authorities' intention to eliminate the subsidies on rice by end-December 1985; this policy would need to be accompanied by the privatization of rice imports.

The staff notes the authorities' intentions to continue discussions with the Fund staff, early in the new year, possibly sooner, on an appropriate adjustment program, and urges the authorities to discharge Sierra Leone's overdue obligations as soon as possible, and to remain current with the Fund thereafter.

Sierra Leone's exchange system involves restrictions on payments and transfers for current international transactions subject to Fund approval, including a system of foreign exchange budgeting, limits on payments for invisibles, and external payments arrears. Sierra Leone also maintains multiple currency practices subject to Fund approval arising from the non-payment of interest on deposits of the leone counterpart of commercial arrears and the existence of a pervasive parallel exchange market. The staff urges the authorities to undertake the removal of the exchange restrictions and the multiple currency practices at an early date. Sierra Leone also continues to maintain bilateral payments agreements with two Fund members, Guinea and the People's Republic of China. The staff does not recommend that the Executive Board grant approval of these exchange restrictions and multiple currency practices at this time.

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

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

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 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 multiple currency practices, 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.

Sierra Leone - Relations with the Fund
(As of October 31, 1985)

I. Membership status

(a) Date of membership:	September 10, 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 129.28 million (223.27 percent of quota)

	SDR million	Percent of quota
(c) Fund holdings subject to repurchase and charges:	71.39	123.3
Of which: compensatory financing facility	(20.70)	(35.8)
credit tranches	(11.98)	(20.7)
extended Fund facility	(16.28)	(28.1)
supplementary financing facility	(13.97)	(24.1)
enlarged access resources	(8.46)	(14.6)

(d) Reserve tranche position:	SDR 24,145

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
(iii) Utilization	SDR 19.0 million
(iv) Undrawn balance	SDR 31.2 million

(b) (1) Previous stand-by arrangement	
(i) Duration	From June 3, 1977 to June 2, 1978
(ii) Amount	SDR 9.0 million
(iii) Utilization	SDR 7.0 million
(iv) Undrawn balance	SDR 2.02 million
(2) Previous stand-by arrangement	
(i) Duration	From November 2, 1979 to November 1, 1980
(ii) Amount	SDR 17.0 million
(iii) Utilization	SDR 17.0 million
(c) Previous 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
(d) Compensatory financing facility:	
(i) Date of approval	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 20.63 million
(b) SFF Subsidy account:	
(i) Donations to Fund	--
(ii) Loans to Fund	--
(iii) Payments by Fund	SDR 1.74 million
VI. Overdue obligations to the Fund (as of October 31, 1985)	SDR 9.97 million

B. Nonfinancial Relations

VII. Exchange practices

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. Around March/April 1984, an experimental scheme was introduced by the authorities: this system consisted of importers negotiating directly with exporters for all or part of the 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 Metals 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 has been pegged to the SDR, with the Bank of Sierra Leone issuing daily equivalent exchange rates for the leone in terms of all major currencies. There exists a large parallel market in foreign exchange.

VIII. Article IV consultation

The 1984 Article IV consultation discussions with Sierra Leone were held in Freetown during the periods March 7-22, 1984 and May 16-June 1, 1984. The staff report (SM/84/222) was discussed by the Executive Board on November 5, 1984, 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 1984 Article XIV consultation with Sierra Leone conducted under Decision No. 5392-(77/63) adopted April 24, 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/84/222. Sierra Leone continues to maintain bilateral payments agreements

with Fund members. The Fund urges the authorities to reduce reliance on exchange restrictions, including the associated multiple currency practice, and to eliminate the bilateral payments agreements with Fund members.

IX. Technical assistance

From April 1983 to October 1985, an FAD panel expert was assigned to the Ministry of Finance as Budget Advisor.

From 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.

X. Resident representative

Mr. Dahl was appointed Fund resident representative in Freetown on May 23, 1984.

Sierra Leone - Relations with the World Bank

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, during the past year, also been working with the authorities in preparing a Structural Adjustment Program (SAC), which will address four main areas of reform: public enterprises, public expenditures, industrial incentives, and agricultural incentives. The main elements of the proposed SAC reform package are broadly consistent with the adjustment policies which the Executive Directors of the Fund urged the authorities to implement, and which are contained in the Chairman's summing up of the 1984 Article IV consultation discussions.

Sierra Leone - Financial Relations with the World Bank Group, as of June 30, 1985

(In millions of U.S. dollars)

	Disbursed		Undisbursed	
	IBRD	IDA	IBRD	IDA
IBRD/IDA lending operations				
Agriculture	5.0	22.0	--	29.3 1/
Education	--	12.2	--	18.1
Transportation	6.0	7.4	...	6.3
Power	7.7	11.0	...	2.2
Technical assistance	--	1.9	--	0.6
Total	18.7	54.5	--	56.5
Of which: repaid	(9.2)	(0.4)	(--)	(--)
exchange adjustment	(--)	(0.9)	(--)	(8.8)
Total outstanding	9.5	53.2	--	47.7
IFC investment		2.1		

Source: World Bank Group

1/ Includes a loan of US$21.5 million, which was approved on June 14, 1984 in support of a project (US$30 million) to reform the agricultural sector.

Sierra Leone - Statistical Issues

1. Coverage, Currentness, and Reporting Data in IFS

		Latest Data in August 1985 IFS
Real Sector	- National Accounts	1981 (GDP total only through 1983)
	- Prices	Q 4 1984
	- Production	n.a.
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	1983
	- Financing	1983
	- Debt	1982
Monetary Accounts	- Central Bank	April 1985
	- Deposit Money Banks	April 1985
	- Other Financial Institutions (Post Office Savings Deposits only)	1979
External Sector	- Merchandise Trade:	
	Values (exports)	Dec. 1984
	Values (imports)	Q3 1984 1/
	Prices	n.a.
	- Balance of Payments	1983
	- International Reserves	May 1985
	- Exchange Rates	June 1985

2. Outstanding Statistical Issues

a. Prices and merchandise trade

The weights of the consumer price index and the wholesale price index (base 1975 = 100) have become somewhat outdated. No trade indices are published. Import value data are provided only on a quarterly basis and lag behind export data.

b. Government finance

Data on government finance for 1984 have been received in response to the GFS questionnaire. However, development expenditures financed with external loans and grants appear to be included in the unallocated category. The authorities have been requested to provide a breakdown of this category by function.

1/ For 1984, only quarterly import data were provided; previously, the data were monthly.

c. Exchange rates

In February 1985, computer prints of various exchange rate time series and descriptive notes on Sierra Leone's multiple exchange rate system were sent to the authorities requesting that they provide comments and updates of the time series as part of the proposal, approved by the Executive Board, to publish multiple exchange rates in IFS. This information will be incorporated in IFS as soon as a full series is available.

Sierra Leone - Basic Data

Area, population, and GDP per capita	
Area	72,326 square kilometers
Population	
Total (1985 estimate)	3.624 million
Growth rate	2.7 percent per annum
GDP per capita	SDR 204.4

	1980/81	1981/82	1982/83	1983/84	1984/85
			(In millions of leones)		
Gross domestic product, expenditure, and prices					
GDP at constant 1980-81 prices	1,298.0	1,279.6	1,286.6	1,390.1	1,401.5
Agriculture, forestry, and fishing	405.2	429.4	447.4	473.7	488.5
Mining and quarrying	121.8	111.1	115.8	130.0	140.1
Manufacturing and handicrafts	93.7	95.4	90.7	85.4	81.1
All others	677.3	643.7	632.7	701.0	809.7
GDP at current market prices	1,298.0	1,525.6	1,962.7	2,947.2	4,253.1
Gross domestic expenditure	1,479.9	1,837.8	2,074.5	3,016.4	4,287.9
Gross investment	246.7	219.1	208.9	263.5	309.2
Gross savings	64.8	-93.1	97.1	194.3	274.4
			(Annual percentage change)		
GDP at constant 1980/81 prices	3.0	-1.4	0.6	8.0	0.8
GDP at current prices	12.3	17.5	27.3	51.7	44.3
GDP deflator	9.0	19.1	26.5	40.5	43.2
Consumer price index	25.6	22.4	60.4	81.1	109.4
			(In percent of GDP)		
Gross consumption	95.0	106.1	94.0	93.4	93.5
Gross investment	19.0	14.4	10.8	8.9	7.3
Resource gap	-14.0	-20.5	-5.8	-2.3	-0.8

	1980/81	1981/82	1982/83	1983/84	Prov. Actuals 1984/85
			(In millions of leones)		
Revenue and grants	228.3	206.3	181.5	264.9	324.6
Tax revenue	200.0	174.3	143.7	188.9	257.6
Nontax revenue	12.0	8.9	12.3	16.4	14.1
Grants	16.3	23.1	25.5	59.6	52.9
Total expenditure	406.6	408.3	409.0	468.0	845.3
Current expenditure	246.3	248.8	261.7	332.6	381.9
Development expenditure	63.9	94.9	99.2	103.1	126.2
Other expenditure	96.4	64.6	48.1	32.3	337.2
Overall deficit (commitment basis)	-178.3	-202.0	-227.5	-203.1	-495.7
Change in arrears (increase +)	24.3	41.2	-42.1	4.3	149.5
Additional fiscal measures	--	--	--	--	--
Overall deficit (cash basis)	-154.0	-160.8	-269.6	-198.8	-371.2
Financing	154.0	160.8	269.6	198.8	371.2
Foreign	32.4	31.9	42.0	-8.3	44.7
Drawings	64.1	63.6	69.0	40.0	75.0
Amortization	-31.7	-31.7	-27.0	-48.3	-30.3
Domestic	121.6	128.9	227.6	207.1	326.5
Bank financing (cash basis)	113.6	140.0	224.8	168.3	270.6
Monetary authority	(112.8)	(142.1)	(214.6)	(110.7)	(137.1)
Commercial banks	(0.8)	(-2.1)	(10.2)	(57.6)	(133.5)
Nonbank	8.0	-11.1	2.8	38.8	55.9
			(In percent of GDP)		
Revenue and grants	17.6	13.5	9.2	9.0	7.6
Total expenditure	31.3	26.7	21.0	15.9	19.8
Current expenditure	19.0	16.3	13.5	11.3	9.0
Development expenditure	4.9	6.2	5.1	3.5	3.0
Other expenditure	7.4	4.2	2.4	1.1	7.8
Overall deficit (commitment basis)	13.7	13.2	11.7	6.9	12.2
Overall deficit (cash basis)	11.9	10.6	13.9	6.7	8.7

Sierra Leone - Basic Data (concluded)

	1980/81	1981/82	1982/83	1983/84	1984/85 1/
			(In millions of leones)		
Money and credit (end of period)					
Foreign assets (net)	-163.3	-237.0	-258.0	-692.1	-1,518.6
Domestic credit	462.0	609.9	850.3	1,024.1	1,340.6
Claims on Government	367.3	507.8	732.6	900.9	1,171.5
Claims on public enterprises	3.7	3.6	3.9	3.0	4.6
Claims on private sector	91.0	98.5	113.8	120.3	164.5
Money and quasi-money	258.6	324.5	443.9	570.2	882.2
Other items (net)	-40.1	-48.4	148.4	238.2	1,060.2
			(In percent of GDP)		
Domestic credit	35.6	40.0	43.8	34.8	31.5
Claims on Government (net)	28.3	33.3	37.7	30.6	27.5
Money and quasi-money	19.9	21.3	22.9	19.4	20.7
			(In millions of SDRs)		
Balance of payments					
Exports, f.o.b.	131.4	118.3	87.7	106.7	127.5
Imports, f.o.b.	-242.2	-247.1	-161.1	-121.5	-141.1
Trade balance	-110.8	-128.8	-73.4	-14.8	-13.6
Services	-54.8	-61.0	-51.6	-40.3	-69.1
Private transfers	7.7	8.0	3.8	2.6	1.9
Current account balance	-157.9	-181.8	-121.2	-52.5	-80.8
Government transfers	30.7	22.8	18.3	23.5	19.3
Long-term capital	9.9	-6.7	-7.0	-28.8	13.6
Short-term capital and errors and omissions	-8.1	45.5	36.1	14.2	16.0
Allocation of SDRs	3.2	--	--	--	--
Overall balance	-122.2	-120.2	-73.8	-43.6	-31.9
Of which: covered by arrears accumulation	(58.6)	(86.2)	(40.4)	(-3.7)	(22.7)
			(In percent of GDP)		
Exports	13.8	10.6	6.2	9.5	9.3
Imports	25.5	22.1	11.3	10.9	10.3
Current account deficit	16.6	16.3	8.5	4.7	5.9
Overall deficit	12.9	10.8	5.2	3.9	2.3
			(In millions of SDRs)		
Gross official foreign reserves (end of period)					
Holdings of SDRs	0.1	--	--	--	--
IMF reserve position	--	--	--	--	--
Foreign exchange	16.5	15.5	10.4	6.7	1.3
Total	16.6	15.5	10.4	6.7	1.3
External public debt (disbursed at end of period)	396.0	421.3	433.0	372.3 3/	348.1 3/
			(Fourth quarter averages; 1980 = 100)		
Effective exchange rates 4/					
Nominal trade-weighted	100.5	107.6	113.7	62.7	54.6
Real trade-weighted	104.3	128.6	190.1	177.0	238.7

1/ The balance of payments data are provisional estimates.
2/ At end-June 1985.
3/ 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.
4/ A downward movement indicates a depreciation.