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INTERNATIONAL DEVELOPMENT ASSOCIATION

SUPPLEMENTAL FINANCING DOCUMENT

FOR PROPOSED SUPPLEMENTAL FINANCING

IN THE AMOUNT OF SDR 21.5 MILLION

(US$30 MILLION EQUIVALENT)

TO THE

REPUBLIC OF SIERRA LEONE

FOR THE

EMERGENCY ECONOMIC AND FISCAL SUPPORT OPERATION

November 23, 2015

Macroeconomics and Fiscal Management
Africa Region

REPUBLIC OF SIERRA LEONE—GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective as of October 31, 2015)

Currency Unit	= Leone
US$1.00	= Le 5,384
US$1.00	= SDR 0.7158

WEIGHTS AND MEASURES
Metric System

ABBREVIATION AND ACRONYMS

AfDB	African Development Bank
BSL	Bank of Sierra Leone
CPI	Consumer Price Index
CRW	Crisis Response Window
DPF	Development Policy Financing
DSA	Debt Sustainability Assessment
ECF	Extended Credit Facility
EEFSO	Emergency Economic and Fiscal Support Operation
EU	European Union
GDP	Gross Domestic Product
HSDSSP	Health Services Delivery and System Support Project
IDA	International Development Association
IMF	International Monetary Fund
MDAs	Ministries, Departments and Agencies
MOFED	Ministry of Finance and Economic Development
NERC	National Ebola Response Center
PFM	Public Financial Management
PRSP	Poverty Reduction Strategy Paper
SDR	Special Drawing Rights
TA	Technical Assistance
WHO	World Health Organization

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REPUBLIC OF SIERRA LEONE
SUPPLEMENTAL FINANCING FOR THE
EMERGENCY ECONOMIC AND FISCAL SUPPORT OPERATION

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SUPPLEMENTAL FINANCING FOR THE

EMERGENCY ECONOMIC AND FISCAL SUPPORT OPERATION

Borrower	Republic of Sierra Leone
Implementing Agency	Ministry of Finance and Economic Development
Financing Data	IDA Grant
Amount:	SDR 21.5 million (US$30 million equivalent)
Terms:	Standard IDA Grant terms
Operation Type	Single tranche supplemental financing
Operation ID	P157333

PROGRAM DOCUMENT FOR A

PROPOSED SUPPLEMENTAL FINANCING TO THE

EMERGENCY ECONOMIC AND FISCAL SUPPORT OPERATION

TO THE REPUBLIC OF SIERRA LEONE

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1. BACKGROUND

1.1 **This program document seeks the approval of the Executive Directors for a proposed Supplemental Development Policy Financing (DPF) to the stand-alone Emergency Economic and Fiscal Support Operation (EEFSO) DPF to the Republic of Sierra Leone approved by the Board on December 17, 2014**. The proposed Supplemental DPF is in response to recent exceptional developments largely related to the epidemic caused by the Ebola Virus Disease[1] which afflicted Sierra Leone and its neighbors Liberia and Guinea in 2014. These have adversely impacted economic activity more than originally expected, sharply reducing government revenues, increasing essential fiscal expenditures even while overall expenditure has been curtailed which has resulted in an unanticipated financing gap that, if not filled, will jeopardize the reform program supported by the EEFSO, which otherwise is proceeding on schedule and in accordance with the agreed policy agenda.

1.2 **These adverse developments have resulted from both the longer-than-expected persistence of Ebola that has led to a revenue collapse and increased essential expenditures, and the collapse in global commodity prices, particularly iron ore, which in turn has led to the previously unanticipated closure of both large iron ore mines and heightened fiscal and macroeconomic risks**. The Supplemental DPF will support the objectives of the original program where the Government remains in compliance with the provisions of the legal agreement with the Bank. The unanticipated financing gap has been confirmed recently following a September 2015 IMF Review Mission under the Extended Credit Facility (ECF) with Sierra Leone. As a result, and reflecting the urgency of the situation, the IMF has substantially revised the ECF program and underlying macroeconomic framework to account for the changed economic circumstances and *inter alia* to provide for budgetary support through the ECF arrangement in both 2015 and 2016. The African Development Bank (AfDB) and the European Union (EU) have also increased their budgetary support in 2015, reflecting their recognition of the change in the economic situation and the unanticipated financing gap.

1.3 **At this critical juncture Sierra Leone needs increased budget support to offset the revenue loss due to the Ebola-induced economic downturn**. The significant international support for the Ebola response and recovery program, has been largely through specific project/program support. Additionally, the closure of the iron ore industry for most of 2015, which had not been anticipated at the time the EEFSO was prepared has compounded the revenue downturn. Sierra Leone has been unable to obtain additional budget support funds from other lenders, apart from those noted above, in the required timeframe and is constrained in borrowing additional funds from the domestic financial system. Moreover the time available is too short to prepare and process a new standalone DPF operation. Sierra Leone remains

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[1] Hereafter the term Ebola is used to refer to the virus, the disease or the epidemic outbreak.

committed to the EEFSO and the implementing agencies have demonstrated competence in carrying it out despite challenging circumstances.

1.4 **The Ebola epidemic has posed unprecedented challenges for Sierra Leone and the costs to halt the disease and achieve and maintain a zero infection rate have been substantial.** This has resulted in the need to redirect funds from the Government's medium term development plan, "An Agenda for Prosperity", the third Poverty Reduction Strategy Paper (PRSP-3) covering the period 2013-18. The main aim of the PRSP-3 is to promote inclusive growth, economic diversification and value-addition. In the first half of 2015, the Government compiled a bold economic recovery plan to achieve and maintain zero Ebola infection rates and as a foundation for rapid transition back to Sierra Leone's Agenda for Prosperity plan.

2. IMPACT OF THE EBOLA CRISIS

A. ECONOMIC DEVELOPMENTS

2.1 **The economic impact of Ebola stems from the direct effects of the disease on the labor force through illness and death, the effects on public service delivery and public resources through diversion of resources and also from indirect effects**. To date, the epidemic has resulted in 3,955 fatalities in Sierra Leone (of which 221 were health workers) with 14,089 having contracted the disease.[2] There remains, however, a near-term risk of further cases among both registered and untraced contacts. Despite the recent improvement in the incidence of the disease, getting to zero incidence in all three afflicted countries and maintaining that incidence remains an ongoing challenge. The indirect effects of Ebola on economic performance stem from fear of contracting the deadly disease which results in avoidance or aversion behavior—as markets and businesses close or are interrupted by quarantines and other measures imposed to contain the disease and as transport is disrupted.

2.2 **The Ebola crisis has exacted a heavy economic toll on Sierra Leone in 2014 and 2015, with the brunt of the economic impact still unfolding in 2015.** With the advent of Ebola in mid-2014, real GDP contracted over the second half of 2014 at an annualized rate of -1.3 percent, compared with an impressive annualized growth rate of +11.3 percent in the first half of 2014 and 20.7 percent in 2013. The robust first half performance followed by the sharp reversal over the second half resulted in the overall outcome for the year being an increase in real GDP of 4.6 percent. Notably the strong performance of the iron ore sector over most of the year masked weak underlying economic performance especially in agriculture and services which were particularly adversely affected by Ebola (Table 2.1).

[2] WHO Situation Report, November 4, 2015.

Table 2.1: Sierra Leone - Estimated GDP impact of Ebola in 2014

	Initial Projection (June 2014)	Preliminary
Real GDP Growth	*11.3*	*4.6*
Agriculture	4.8	0.8
Industry	24.9	13.8
of which Mining	(27.3)	(17.1)
Services	7.7	1.7

Source: Statistics Sierra Leone, IMF, and Bank Staff estimates.

2.3 **Economic performance in 2015 is now expected to be much weaker than previously projected due to unanticipated events concerning Ebola and the iron ore sector and real GDP is now expected to contract by an estimated -21.5 percent in 2015 reflecting a weakened economy (Table 2.2)**. At the time the EEFSO was prepared, in the third quarter of 2014, Government's aim reinforced by the consensus of international partners was to eradicate Ebola by the end of the first quarter of 2015. That goal eluded the authorities until November 7, 2015, when the WHO formally declared Sierra Leone to be free of Ebola. Government remains mindful of the significant challenges that it will take to maintain this hard fought designation. Largely because of this, non-iron ore GDP growth in 2015 is projected to be much lower at 1.0 percent than at the time of preparing the EEFSO when it was forecast to be 5.5 percent.

2.4 **International iron ore prices declined by 50 percent over the course of 2014, which adversely impacted iron ore production in Sierra Leone**. The impact of the price decline led the smaller of the two mines (Marampa) to be placed under administration for a few weeks in October, after which it resumed production under new ownership. Little production was lost during this time and there were no indications of wider distress. In early December 2014, the larger mine (Tonkolili) halted production reportedly to conserve working capital and to secure additional working capital. This was not foreseen to lead to extensive problems as the workforce was retained and continued to be paid. In February 2015 these problems came to a head as the Board placed the operating company under voluntary administration in the United Kingdom. Subsequently the mine was acquired by Shandong Iron and Steel in March 2015, amid expectations of an early resumption of operations which has not transpired due to the continued decline in international iron ore prices and reportedly the company's inability to date to negotiate lower prices with suppliers. At the end of March 2015, the Marampa mine shut down production as it lost access to a rail line under control of Shandong. Thus, iron ore production and hence its contribution to GDP in 2015 have been much lower than projected at the time of the EEFSO, with revenues being sharply lower. The cessation of iron ore production over most of 2015 is projected to result in an overall growth contraction of almost 22 percent. This projected sharp deterioration in economic performance, along with an associated depreciation in the Leone exchange rate, will result in a fall in per capita GDP from US$800 in 2013 to an estimated US$680 in 2015.

2.5 **The effects on poverty of such an income shock are likely to erode much of the gains that Sierra Leone has made since the end of the civil war thirteen years ago**. Indeed, high frequency cell phone surveys undertaken during the depths of the crisis indicated rising unemployment as the epidemic unfolded with income losses reported from both self-employment and wage employment.[3] In late 2014, non-farm enterprise households reported a decline in average revenues of 40 percent while the number of enterprise closures had tripled. By May 2015 a mixed picture of economic recovery had emerged, with some indications of a return to pre-crisis employment levels but also of a significant reduction in wages and hours worked. While the employment situation in Freetown was improving relative to November 2014, there was a 10 percent decline in employment relative to the pre-Ebola period. The result of these job and income losses in the face of higher prices has been a general decline in welfare.

Table 2.2: Sierra Leone – Selected Economic Indicators, 2010-18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Estimate	-----------------	Projected	--------------------	
	--------------Annual Percentage Change, unless otherwise indicated------------------								
National accounts and prices									
GDP at constant prices	5.3	6.0	15.2	20.7	4.6	-21.5	0.1	19.6	17.5
GDP at market prices (billion leone)	10,161	12,755	16,460	21,154	22,091	22,260	24,582	28,821	33,565
Consumer prices (end-period)	18.4	16.9	12.0	8.5	9.8	12.0	9.5	9.5	8.5
External Sector									
Terms of Trade	6.8	-5.6	5.4	-5.0	-16.0	-18.0	0.4	-0.5	-1.2
Exports of goods (US$)	33.8	6.2	171.4	47.4	-15.4	-55.1	-0.3	72.5	47.5
Imports of goods (US$)	60.7	85.2	20.2	-19.9	4.7	-14.9	-3.8	8.9	9.8
Average exchange rate (Le/US$)	3,988	4,349	4,344	4,345	4,655	..	..	..	..
Nominal efferctive exchange rate	-8.9	-4.1	-1.0	-2.4	-7.1	..	..	..	..
Real effective exchange rate	2.2	8.7	8.0	3.6	0.7	..	..	..	..
Gross International reserves (mths of im	2.0	1.8	2.2	2.0	3.5	4.0	3.6	3.6	3.6
Money and Credit									
Domestic credit to the private sector	31.5	21.8	-6.9	11.9	5.4	1.0	2.1	4.5	5.8
Base money	34.6	13.0	18.5	17.7	30.2	7.1	8.0	15.4	16.7
M2	21.8	20.0	23.1	21.2	22.9	13.0	13.3	16.5	18.6
91 day treasury bill yield (percent)	24.5	24.5	22.4	8.0	2.4	..	..	..	..
	--------------------------------Percent of non-iron ore GDP-------------------------------------								
National Accounts									
Gross capital formation	24.3	42.2	30.0	15.1	14.9	16.0	15.2	15.5	16.1
Government	7.7	9.0	8.2	6.4	6.0	7.0	6.2	6.0	6.1
Private	16.5	33.1	21.8	8.7	8.9	9.0	9.0	9.5	10.0
National savings	5.0	-17.0	5.0	2.7	-6.3	2.5	3.1	4.5	7.8
External Sector									
Current account balance (incl official gra	-19.3	-45.0	-34.3	-20.8	-21.2	-13.5	-12.1	-10.9	-8.3
Current account balance (excl official gra	-24.5	-48.8	-36.9	-22.0	-37.5	-25.1	-19.4	-13.3	-10.7
External public debt (incl IMF)	30.7	32.6	27.8	25.2	26.2	30.9	32.5	30.6	29.0
Central Government Budget									
Revenue	9.9	11.5	12.2	12.7	11.1	9.8	10.4	10.7	11.1
Grants	5.3	5.6	4.1	3.0	4.8	5.4	3.2	3.3	3.3
Total expenditure and net lending	20.4	21.6	21.9	17.6	20.1	20.0	19.0	17.3	17.7
Overall balance (before grants)	-10.5	-10.1	-9.7	-4.9	-8.9	-10.1	-8.6	-6.5	-6.6
Overall balance (incl grants)	-5.1	-4.6	-5.6	-1.9	-4.1	-4.8	-5.3	-3.2	-3.3
Memorandum Items:									
GDP (US$million)	*2,548*	*2,933*	*3,789*	*4,920*	*4,981*	*4,494*	*4,963*	*5,819*	*6,777*
Non-iron ore GDP (US$ million)	*2,548*	*2,933*	*3,529*	*4,139*	*4,298*	*4,310*	*4,513*	*4,931*	*5,394*

Source: IMF Staff Report Third and Fourth ECF Review, October 2015.

[3] The Socio-Economic Impacts of Ebola in Sierra Leone, Results from a High Frequency Cell Phone Survey, Rounds 1-3, World Bank, January 12, 2015, April 15, 2015 and June 15, 2015.

2.6 **Unemployment, a major issue in Sierra Leone, worsened significantly in 2015**. The iron ore mine closures and the recent closure of a large bio-ethanol complex have affected nearly 9,000 persons in direct formal employment—about 21 percent of the total private employment nationwide. There would be significant spillovers from the increase in unemployment as many of those affected are household heads. Moreover financial distress elsewhere in the mining and business sectors has the potential to add considerably to the unemployment toll. With the nascent tourism industry all but halted by the combination of Ebola and reduced commercial air services to the country, the prospects for the hospitality sub-sector and the substantial indirect employment it generates are poor.

2.7 **Consumer price inflation (Freetown CPI) increased to 9.8 percent at end-2014 from 7.8 percent at end-June 2014 with the higher rate clearly due to supply disruptions from the Ebola crisis.** Reflecting the lingering effects of Ebola and significant depreciation of the Leone over 2015, inflation has remained stubbornly high over the first 9 months of 2015 averaging 8.6 percent per month. Those CPI components that have been adversely affected by Ebola such as personal transport, education, entertainment and services have experienced very low, in some cases, negative price increases, while imported goods particularly fuel, power, transport, clothing, footwear and furniture have seen excessive price increases. Food inflation is running around 4.6 percent with the currency depreciation effects offset to some extent by the continuing decline in world rice prices over the past year or so. With food prices remaining depressed and input cost prices rising, this will continue to impact adversely on the agricultural sector so important to recovery efforts.

2.8 **The impact of the crisis on food security has been significant, but famine has been averted due to a combination of coping strategies employed by affected households, intensified feeding programs especially in quarantined areas, and continual monitoring by the international community**. Food insecurity and household vulnerability have been heightened as incomes have declined. An emergency food security assessment in June 2015 found that 43 percent of the population or approximately 2.6 million people were food insecure, including 7 percent which were severely food insecure.[4] The situation is far more severe in the eastern part of the country (Kailahun: 74.4 percent; Kenema: 57.9 percent; and Bo: 57.4 percent) where market operations and economic activity remain very much at reduced levels due to Ebola containment measures put in place by the Government. Notably, Kailahun, known for its production and export of cash crops, has had to endure months of quarantines as it is also close to the border with Guinea and Liberia, and is near the epicenter of the initial outbreak in Guinea. Latest indications are of a deterioration in food security in July followed by an improvement in August which marks the end of the lean agricultural season.[5] This issue may linger beyond 2015 as there were indications at mid-year of a 2015 rice harvest that appears to be some 37 percent lower than that in 2014.

2.9 **The fiscal impact of the Ebola crisis has been more severe than expected, with revenue in 2015 declining substantially more than projected and with continual spending needs due to the ongoing crisis**. Already low by international standards, domestic revenues declined from 12.7 percent of non-iron ore GDP in 2013 to 11.1 percent in 2014, and are projected at 9.8 percent in 2015. Lower revenues in 2014 reflected lower levels of economic

[4] Sierra Leone: Emergency Food Security Assessment, World Food Program, June 2015.
[5] Guinea, Liberia and Sierra Leone—mVAM Regional Bulletin #9 & 10, World Food Program, July & August 2015.

activity, lower compliance and possibly reduced effort. Increased tax collection efforts in 2015 have yielded solid collections over the first half of the year. Despite this effort collections in the second half are projected to be lower due to the absence of a number of one-off factors that impacted positively on first half receipts. These included income tax back payments for 2014 prior to the closure of the iron ore mines and from departing suppliers to the mines as they wound up operations. Moreover since the closures, royalty payments and payroll taxes have fallen dramatically, because other mining enterprises are also experiencing financial distress resulting from Ebola and from lower world commodity prices.

2.10 **Ebola has had a significant impact in 2015 on personal and company income taxes, excise duties and non-tax revenues which are now projected to be Le486 billion lower than when the EEFSO was prepared, a year earlier**. Similarly the impact of the closure of the iron ore mines and lower production of other minerals due to commodity price falls can be seen from the decline in mining royalties which are now projected to be down Le259 billion (77 percent lower) on what had been projected a year earlier. The above data indicates that around two-thirds of the decline in domestic revenue in 2015 could be attributed to Ebola, with one-third attributed to the fall in commodity prices. With the much lower level of economic activity in the non-mineral economy adding to mineral revenue shortfalls, overall revenues in 2015 are expected to be flat in nominal terms.

2.11 **Spending needs of the Ebola crisis extend well beyond the narrow health response to the full range of public services required to support the Ebola response and in 2015 include critical support for the economic recovery**. Ebola related spending in 2015 has been much higher than originally projected, as the achievement of zero incidence did not take place by the end of the first quarter as originally anticipated. Seven months beyond that point, zero incidence now appears within reach. Spending priorities have had to be addressed as they arose, including for social protection and support for the vulnerable and sick, for survivors who count among them more than 8,000 orphans, for costs of re-opening schools, and for other needs related to the crisis.

2.12 **The balance of payments came under pressure in 2014 due to higher imports and reduced export receipts, with a similar trend unfolding in 2015 albeit with sharply lower export receipts**. Lower commodity prices in 2014 led to the fall in mineral export receipts, while higher import levels from an increase in essential goods to combat the EVD, resulted in a widening of the trade deficit to US$339 million from near balance in 2013. The current account deficit also increased to US$911 million, much more than projected and would have deteriorated further had it not been for the US$536 million increase in mostly Ebola related aid transfers. In 2015, with the closure of the iron ore mines, lower non-iron ore mineral production and further reductions in commodity prices and exports, the trade deficit is projected to deteriorate much further. In contrast, in 2015, the current account deficit is projected to narrow to US$582 million as falling exports and transfers are more than offset by lower imports, services and income outflows, as well as higher than projected official transfers, including from the proposed Supplemental DPF. The overall balance of payments is expected to decline by US$76 million in 2015 with the consequent adverse impact on central bank net reserves. Reserve cover, however, is expected to increase to 4.0 months reflecting the expected decline in import values.

2.13 **Monetary trends evident since the outbreak of Ebola in mid-2014 continued over the calendar year to date (July 2015) with broad money growth low at 2.7 percent**. Growth in demand and savings deposits at commercial banks over the 7 months resulting from government deficit financing were offset by lower time and foreign currency deposits due to the increase in uncertainty from the Ebola epidemic, halt of iron ore production and possibly some capital flight. Net credit to the central government continues to mount and is up a further 17 percent over the 7 months to July 2015 with credit provided by the Bank of Sierra Leone up 65 percent and commercial banks up 15 percent. Commercial banks continue to increase Treasury bill holdings which have increased by Le257 billion in the 7 months to July 2015 and by Le475 billion since June 2014.

2.14 **The 2014 trends in the composition of Treasury bill redemptions and issuances continued in 2015, with the duration of bills shifting towards higher yielding 12 month bills and with the yield differential increasing to 4.6 percent in July 2015 from 3.0 percent in mid-2014.** The domestic interest costs to the budget will therefore rise significantly from 2016 onward. In historical terms, yields remain very low across maturities and negative in real terms, which reflects excess liquidity in the system and challenges in increasing private sector credit. Non-bank holdings of treasury bills continue to decline (in part reflecting the effects of Ebola and its impact on risk premiums), reaching Le128 billion at end-July 2015, down from Le140 billion at end-2014.

2.15 **Commercial bank credit to the private sector remains subdued at around 4.7 percent of GDP, rising by only 4 percent between June 2014 and July 2015**. Lending rates have not declined despite the marked decline in deposit rates and yields on government securities (at least over 2013-15) which probably reflects heightened risk premiums from the Ebola epidemic and decline in iron ore production. Credit to public enterprises and non-bank financial institutions by the banks remains low and stagnant. Bank liquidity picked up strongly by Le190 billion over the six months to July 2015 reflecting unsterilized foreign exchange transfers to Sierra Leone which have kept monetary policy accommodative and yields on treasury bills relatively low.

2.16 **Challenges facing the domestic financial system pre-date Ebola with the epidemic serving to highlight many of these structural issues**. Nevertheless the narrow and shallow structure of the financial sector in Sierra Leone, where banks have a very high proportion of government securities on their balance sheets with little lending to domestic businesses, has tended to insulate the sector to some degree from the adverse impact of the Ebola virus. The banking industry's pre-tax profit level was Le80.9 billion at end-June 2015 compared with Le38.8 billion at end-June 2014. The ratio of non-performing loans to regulatory capital was 47.5 percent across all banks at end-June 2015, and exceeded 50 percent in two. There has been no run on deposits, only a shift by business from time deposits into demand and foreign currency deposits.

2.17 **Despite the increase in reported profitability levels, Ebola could be expected to have increased branch network costs, accelerated the underlying trend increase in non-performing loans, frustrated recovery efforts by the ailing state banks and halted most new lending**. Higher profitability levels reflect increased foreign exchange transactions at wider margins, increases in the duration of treasury bill holdings (towards longer term higher yielding securities), a shift in deposits from higher cost time deposits to lower cost demand deposits, and wider lending interest margins (deposit rates were lowered and lending interest rates were maintained). The sustainability of these trends, however, remains uncertain and banks would appear to have taken on greater market risk—both foreign exchange and interest rate risk—and there may also be greater sovereign risk if government security yields increase dramatically and the Government is unable or unwilling to use central bank financing to settle claims.

2.18 **Over the first 6 months of 2015 the ratio of non-performing loans to gross loans has increased to 39.6 percent from 35.7 percent in 2014**. The large borrower exposure limit and minimum unimpaired paid up capital requirements were exceeded in June 2015 by some banks. The Ebola crisis, coupled with pre-existing weaknesses in the sector, will make recovery of the financial sector and its important role in underpinning a return to robust economic growth rates, much more difficult.

B. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

2.19 **The macroeconomic outlook remains uncertain, being predicated on the assumption that iron ore production does not restart until 2017**. With no iron ore production in 2016 and lower non-iron ore minerals production, coupled with only modest recovery in the non-mineral sector due to the lagged adverse impact of Ebola, real GDP is projected to increase by a marginal 0.1 percent in 2016. The current account deficit is projected to remain around the 2015 level of US$582 million with lower official transfer inflows offset by lower services outflows. Gross international reserves are expected to increase modestly over the projection period and import cover to be about 3.6 months.

2.20 **A significant package of revenue enhancing measures for 2016 has been put before parliament with the 2016 budget, which aims to lift domestic revenue by an estimated 0.6 percent of non-iron ore GDP in 2016**. Three core measures in this package are expected to raise Le150 billion in additional revenue in 2016, representing a 6-7 percent increase over actual and projected collections in 2014 and 2015, respectively: (i) Elimination of the fuel subsidy now in place for retail consumers is estimated to raise Le104 billion; (ii) termination of the practice of granting discretionary exemptions from import duty, excises and GST are expected to raise Le30 billion; and (iii) increasing the top marginal tax rate for personal income taxes from 30 percent to 35 percent is expected to raise about Le12 billion in additional revenue.

2.21 **Prospects for the reopening of the iron ore mines will hinge on international prices as the closure of the two mines in late 2014 and early 2015 was clearly the result of the sharp and sustained decline in international iron ore prices**. Whilst both mines experienced some technical issues in the ramping up of production in 2014, these were minor in comparison to the impact on revenues from the decline in world prices for iron ore which reflected both falling demand, particularly from China, and a substantial and continuing increase in production from the large lost-cost producers. Both mines in Sierra Leone are around the mid-point on the cost curve for iron ore producers and both had relatively high debt/equity ratios and, as with just about all mines in this category, have been closed in recent quarters. In early 2015 the new mine owner Shandong Iron and Steel had assured the authorities that the large mine would reopen in the first half of 2015. Despite these assurances the mine has failed to reopen, a consequence of the continued decline in iron ore prices. Local factors had very little to do with the mine closures, although the Ebola epidemic imposed additional costs on mines at this critical stage. Difficulties in agreeing on an alternative access agreement with the smaller mine may have also contributed to a higher cost structure for this mine, but this again is considered immaterial to overall costs.

2.22 **The continued closure of the iron ore mines will have a more severe fiscal impact in 2016 given the full negative impact on income tax receipts, a consequence of the lag in collections and iron ore mining royalties which are assumed to be zero**. Despite the subdued iron ore price projections over the medium term, mine owners' estimates of available operating cost reductions and demand conditions have provided the authorities with some confidence that the mines will reopen in 2017. The projections under the macroeconomic framework for the proposed Supplemental assume the consequent increase in iron ore taxes and royalties from 2017. The closure of the mines has had significant adverse impacts on fiscal revenues, private sector employment and activity levels, country risk and confidence in the economic outlook. Nevertheless, the sector tended to be an enclave sector and its (assumed) temporary closure should not have a major impact on the expected recovery of the non-mining sector. Undoubtedly, there remains a significant risk that the two mines will not reopen from 2017.

2.23 **With mining royalties not expected to recover until 2017-18, fiscal revenues will be dependent on the ability of the Government to improve both collection efforts and accountability**. The projections assume a significant improvement in these efforts with domestic revenues, excluding royalties, projected to increase by over 50 percent between 2015 and 2018. Current expenditures are expected to grow at around 10 percent per year over the 2015-18 period with wages growth expected to expand at half this rate, thereby providing fiscal space for higher expenditures on supporting goods and services, domestically financed capital expenditure and for the expected significant increase in domestic interest payments. In contrast to recent trends, this will mean that Government maintain strong discipline over public sector wages growth and domestically financed capital spending. This discipline is likely to require revisions to the Government's development plans and much greater attention to ensuring an enhanced approach to public investment management. While the overall fiscal balance is expected to remain around the Le1 trillion mark over the 2015-18 period, it is expected to decline as a proportion of non-iron ore GDP (from 4.8 percent in 2015 to 3.3 percent in 2018). The domestic primary deficit is also expected to decline from 5.5 percent to 3.0 percent over the same period.

2.24 **The adjustment required will be challenging for the Government, and heightened fiscal and macroeconomic risks need to be evaluated and monitored**. These include: risks of further Ebola outbreaks and other contagious diseases; risks to fiscal adjustment from the lack of control over public sector wages growth and domestically financed capital spending; risks that public enterprise performance will remain poor; risks that the expected commodity price cycle uptrend will not eventuate over the medium term negating prospects for the recommencement of iron ore production and the potential oil and gas developments; and financial sector risks related to the potential sharp increase in domestic interest rates and depreciation in the exchange rate.

2.25 **Despite ongoing corruption concerns progress can be made to achieve the required adjustment with continued improvements in accountability and transparency**. The challenge for the Government will be to deal effectively with Ebola and to establish a disciplined fiscal framework, as well as address heightened community expectations of mineral and post-election boom aspirations and the dire need to increase poverty-related and public infrastructure spending. In this respect it is imperative to address structural policy and infrastructure issues and improve Public Financial Management (PFM) to provide Sierra Leone the best opportunity for a speedy post-Ebola recovery and to maintain recovery efforts over the medium term.

2.26 **A debt sustainability analysis (DSA) conducted jointly with the IMF in October 2015 concluded that Sierra Leone remains at moderate risk of debt distress**. The update took account of the expected 21.5 percent contraction in real GDP in 2015, relating to the suspension of iron ore production, increase in inflation rates, the expected widening of the fiscal and current account deficits in 2015, the expected increase in external debt to 34 percent of GDP in 2015, the expected increase in domestic debt to around 20 percent of GDP by 2018 and a significant depreciation of the Leone currency rate. The DSA, however, highlighted that stress tests point to vulnerability to adverse shocks affecting key macroeconomic variables, particularly exports, commodity prices, Foreign Direct Investment inflows, government revenue and borrowing conditions.

2.27 **The macroeconomic policy framework summarized below provides an adequate basis for the proposed operation, with a high degree of associated risk as noted above**. The costs of the Ebola outbreak have been assessed by the IMF and a financing plan agreed for 2015 involving an augmented ECF program that also provides budget financing in 2015 and 2016. To combat the fiscal deterioration, the government has elevated revenue collection efforts, prepared and submitted to parliament new PFM legislation to enhance the efficiency and accountability of spending, replaced the boards of the state banks with management teams, placed tight controls on non-essential spending and public sector wage growth, introduced a treasury single account and is managing domestic debt prudently. Government remains committed to greater revenue efforts, tighter expenditure controls and mitigation of fiscal risk, including a more coherent wage policy, restructuring of the state banks and improved frameworks for public investment and financial risk management. If the Government undertakes its reform commitments, as expected, and the ongoing costs of the Ebola epidemic are largely financed externally, the macroeconomic framework should be sustainable over the medium term (Table 2.3). The IMF is conducting close program monitoring, and Government has re-affirmed its commitment to adhere closely to the agreed macro-fiscal program.

Table 2.3: Sierra Leone – External Financing Sources and Uses, 2010-18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
					Estimate	-----------------	Projected	--------------------	
Gross Financing Requirements	**518**	**1,197**	**1,278**	**876**	**1,590**	**1,172**	**968**	**623**	**522**
A. Current account balance /a	473	1,208	1,297	903	1,605	1,069	866	647	569
B. Debt service due /b	14	17	16	20	24	27	32	34	33
C. Debt stock reductions	0	0	0	0	0	0	0	0	0
D. Increase in reserves	32	-28	-35	-47	-39	76	70	-58	-80
Financing Sources	**518**	**1,197**	**1,278**	**876**	**1,590**	**1,172**	**968**	**623**	**522**
A. Government budget	267	212	284	214	284	362	284	313	356
1. Grants	136	128	146	126	206	256	171	198	225
a. Program support	61	44	47	39	141	141	90	103	117
b. Projects	69	85	70	87	59	105	82	95	108
b. Other	6	0	29	0	6	10	0	0	0
2. Loans	56	84	138	87	78	107	113	116	131
a. Program support	17	10	24	6	0	0	0	0	0
b. Projects	39	74	114	81	78	107	113	116	131
B. Net IMF Credit to Bank of Sierra Leone	41	9	3	7	41	106	70	-18	-19
C. All Other (including FDI)	210	977	991	655	1,265	704	614	328	185

/a Net of interest and official grants.
/b Debt service is shown before traditional relief and after MDRI relief.
Source: IMF Staff Report Third and Fourth ECF Review, October 2015 and Bank staff estimates.

C. IMF RELATIONS

2.28 **The ECF Arrangement with the IMF remains in good standing with completion of the combined Third and Fourth Reviews upon approval by the Executive Board on November 16, 2015**. Policies under the program are to entrench macroeconomic stability, build fiscal and external buffers and improve prospects for inclusive growth, in the context of the PRSP-3. The Arrangement has been augmented three times—in September 2014, March 2015, and November 2015—reflecting the evolving needs of the Ebola crisis. More recently the IMF program has been modified to provide for part of the ECF disbursement in 2015 to support the 2015 and 2016 Budgets, in the amount of SDR 15.6 million, equivalent to US$22.6 million and thereafter SDR 31.1 million (US$45.1 million) in the first half of 2016.

3. GOVERNMENT'S RESPONSE TO THE CRISIS

3.1 **Sierra Leone's response to the Ebola epidemic has evolved with the fluid situation and has for the past year been led by the National Ebola Response Center (NERC), which works closely with international and bilateral agencies, and others**. The initially fragmented response was led by the Ministry of Health in conjunction with the Emergency Operations Center and was quickly superseded by NERC as the scale and severity of the epidemic became evident. NERC works closely with the UN Mission for Emergency Ebola Response, UN agencies including the World Health Organization (WHO), the United Nations Children's Fund, the World Food Program, the Ministry of Health and Sanitation and other government ministries, departments and agencies.

3.2 **NERC is implementing a national Ebola response plan in Sierra Leone as well as relevant aspects of a regional Ebola strategy, both prepared in conjunction with WHO**. The national plan aimed to achieve a declining case rate within 90 days, which has been achieved, but has taken much longer than planned. The importance of a regional strategy and of taking coordinated regional actions is underscored by the recurrence of Ebola cases in border areas believed to have been clear of the disease, and in light of the porous nature of the land borders. At the national level the response has resulted in the establishment of *District Ebola Response Centers* which are the operational units responsible on the ground. These were constituted to coordinate and take the Ebola response forward at decentralized levels. Expectations in late 2014 when the EEFSO was prepared were that an incidence of zero cases of Ebola would be achieved by the end of the first quarter of 2015, but breaking the transmission chain has taken considerably longer than expected. Notably, however, in the fourth quarter of 2015, the contagion has clearly been contained.

3.3 **Given the scale of the epidemic most of the financing for the health response to date has come from foreign sources—multilateral, bilateral and private sector—despite which the call on government budgetary resources has been continuous**. Initially in 2014 the Government allocated about US$41 million equivalent from the budget for the health and social responses, with the latter being mainly for food. Since that time, the call on the budget has continued for a variety of expenditures related to the epidemic, including for example, to deploy and pay for personnel posted to the NERC, costs relating to the re-opening of schools in 2015, noted above. In aggregate these have added to expenditure pressures in both 2014 and 2015.

3.4 **An unanticipated financing gap emerged in 2015, estimated at Le2,166 billion as a result of the revenue shortfall of Le745 billion, noted above** (Table 3.1). The underlying fiscal data compare the relevant fiscal projections for 2015 that formed the basis for the frameworks underlying the EEFSO and the proposed Supplemental DPF—both based on the macroeconomic frameworks agreed with the IMF, in September 2014 and October 2015[6]—are instructive in this regard. They show that this gap arose as a result of the sharply lower revenues, relative to what had been projected when the EEFSO was prepared a year earlier. The financing gap has been filled through a combination of above-the-line adjustments in terms of expenditure reduction and an increase in budget support grants and through below-the-line-adjustments to financing the deficit. In terms of burden sharing, the AfDB (21 percent), EU (16 percent), IMF (31 percent) and World Bank (32 percent) are providing increased grant support. Additionally, the IMF is also extending below-the-line financing through the ECF, as noted above.

Table 3.1: Sierra Leone – Fiscal Financing Gap, 2015

Leones billion	-----2015 projection----	
	Sep. 2014	Oct. 2015
Macro-framework Data		
Total Revenue and Grants	3,665	3,372
Domestic Revenue	2,926	2,181
Grants	739	1,191
Budget support	195	657
Project	512	488
Other	32	46
Total Expenditure & Net Lending	5,086	4,431
Deficit (including grants)	-1,421	-1,058
Financing	1,421	1,059
External Financing (net)	976	361
Domestic Financing (net)	445	697
Estimation of Unanticipated Financing Gap in 2015		
A. Original gap to be financed (as of Sep. 2014)	1,421	
B. Unanticipated revenue decline (2,926 minus 2,181)	745	
New Gap (A plus B)	**2,166**	
Financed by:		
Above the line adjustments:		
Adjustment to expenditures	655	
Additional grants	452	
of which:		
-- African Development Bank	99	
-- European Union	77	
-- IMF - CCR Debt Relief	145	
-- World Bank	149	
-- Other	-17	
Below the line financing:		
Foreign financing	361	
Domestic financing	697	
Total	**2,166**	

Source: IMF Country Report No. 14/300, September 2014 and IMF Staff Report Third and Fourth ECF Review, October 2015, and underlying data for grants.

[6] IMF Staff Report no. 14/300, September 2014, and IMF Staff Report Third and Fourth ECF Review, October 2015.

3.5 **Government has prepared an ambitious post-Ebola recovery plan for 2015-17, to be funded predominantly by donors, which simultaneously aims to achieve stabilization, stimulate economic activity, promote diversification and build medium term resilience**. The plan maintains a strong focus on the health sector to ensure that an incidence of zero cases is achieved and maintained, while rebuilding a more robust and effective health system. The near term focus is on restoration of basic services in health and education, and consolidation and expansion of social protection focused on supporting vulnerable groups through establishment of sustainable social welfare. An emphasis on the large rural population aims to support farmers, small and medium enterprises and small traders with quick impact strategic investments in agriculture and provision of critical infrastructure including electricity, roads, water and sanitation. Implementation of the recovery plan is complicated by challenges relating to ongoing Ebola cases, securing the required US$1.3 billion financing for the plan and planning and sequencing the same.

4. BANK'S RESPONSE AND STRATEGY

4.1 **The World Bank responded to the escalating Ebola crisis in 2014 by launching a regional Ebola emergency response project that provided US$145.8 million to Sierra Leone mainly for the immediate health response, including US$139.8 million in IDA Crisis Response Window (CRW) resources.**[7] The project provided the first substantial protective gears, essential medicines, logistics equipment and food items in September 2014 to Sierra Leone and the other two afflicted countries which enabled them to commence intensive responses to the epidemic. It is the largest source of government owned funds and has also been the most flexible source of funds for financing priority activities as they have arisen in each phase of the Ebola response.

4.2 **The Bank project supported operations of Ebola Treatment Centers and the procurement and distribution of an extensive list of goods and services critical to the** response. This included personal protective equipment, essential medicines and hygiene kits, community surveillance and contact tracing mobilization of approximately 37,000 community health and social mobilization staff for door-to-door communications and case identification. It also supported safe burials, infection prevention and control materials and training at regular public and private health facilities, procurement of vehicles including ambulances and motorcycles and hazard payments and death benefits to approximately 40,000 Ebola response workers and workers at health facilities, deployment of 580 foreign medical staff from the African Union and other countries, food supply to nearly 800,000 quarantined and Ebola-affected households, support to cash transfer projects for the poor, seed distribution to farmers, and educational materials for schools. The last stage of this project will focus on the recovery of essential health services and is expected to run through 2017.

4.3 **A US$300 million West Africa regional disease surveillance and response project currently under preparation will include a US$30 million component for Sierra Leone and will be complemented by a Health Services Delivery and System Support Project (HSDSSP) of US$35 million as part of the post-Ebola Health Sector recovery effort**. HSDSSP will facilitate service delivery through community-level engagement with the

[7] The amount includes US$6 million from an existing health project that was restructured to make the resources available immediately to the authorities.

implementation of a community health workers program and facilitation of public health aides to support environmental health and sanitation in districts as well as a facility-level strengthening through the introduction of multidisciplinary clinical teams and the establishment of a national ambulance service. The other component of HSDSSP will focus on strengthening the health system by supporting the development of human resources for health through the training of healthcare workers and supporting sector coordination and management at the central and district level. Covering ten countries, the regional surveillance project will strengthen public health laboratory and disease surveillance capabilities throughout West Africa.

4.4 **The Bank also provided increased budgetary support in 2014 through a stand-alone DPF for an emergency economic and fiscal support operation in the amount of US$30 million, including US$10 million in IDA CRW resources**. The amount reflected a doubling of the amount originally planned with a view to increasing the fiscal space available to government to implement its national Ebola response plan. The operation included a strong emphasis on budget management, reduction of fiscal risks and transparency and accountability for public resources. These risks have surfaced in the sphere of public debate as a result of the Ebola epidemic. Additionally the Bank is front-loading its 2015-16 program in support of the economic recovery and to continue to mitigate the social and economic costs of the epidemic. These activities are closely coordinated with relevant donors also active in the respective sectors/areas.

4.5 **The Bank provided technical and financial assistance to the education sector for the re-opening of the schools in the second quarter of 2015**.[8] This included, in many cases, provision of disinfectants, latrines and water at the schools for the first time. Additional support provided to train teachers and students on the disease prevention and sanitation techniques, deliver an accelerated learning program to catch up lost time, while improving student safety and well-being.

4.6 **Social protection support through both technical and financial assistance to mitigate immediate impacts on poor and Ebola affected families by providing critical social safety net support** involving provision of cash transfers and labor-intensive public works to the poorest and Ebola-affected households. The program is currently providing cash transfers to 21,000 households in nine districts. In 2015, 12,000 youth in poor and Ebola-affected households are expected to participate in public works financed by this activity. The Bank is also supporting government efforts to ensure a coordinated approach in the social protection recovery efforts, as well as child protection and psychosocial support.

4.7 **Economic recovery efforts are to be boosted through a smallholder commercialization and agribusiness project and an urban revitalization project in six cities in Sierra Leone.** The agriculture project aims to stimulate productivity and improve market access to support a quick recovery from the epidemic. An urban revitalization project will focus on job creation in labor intensive construction activities by financing urgent needs arising from the Ebola crisis in major urban areas. This will include Water, Sanitation and Hygiene—WASH—investments in public facilities in the six City Councils of Sierra Leone. The project will also finance technical assistance (TA), studies and detailed technical designs that are needed for the six city councils to start addressing fundamental challenges related to storm water

[8] Most of the schools had been closed for more than 7 months.

drainage, solid and liquid waste management. These studies and TA will be followed by investments in infrastructure works.

4.8 **A power generation project in support of private sector energy through an Independent Power Producer will give a much needed boost to energy production in Sierra Leone**. The project will also include components for rehabilitation and expansion of the network and institutional strengthening. This will link up to another Bank supported project to strengthen the capacity of the power distribution utility. These activities tie in directly to the overall economic recovery efforts.

5. REFORM PROGRAM SUPPORTED THROUGH EEFSO: AN UPDATE

A. REFORM PROGRESS SINCE THE APPROVAL OF THE EEFSO

5.1 **The reform program being supported under the EEFSO has been well implemented and remains on track** (Table 5.1). All prior actions remain in place with additional progress made to deepen and institutionalize the reforms through further policy and institutional actions. This section provides a summary of developments concerning the relevant prior actions and the related reform agenda supported under the EEFSO.

Table 5.1: Summary Status of Prior Actions

Action	Status Update
Strengthen Budget Management and Reduce Fiscal Risks Heightened by Ebola	
1. The Recipient's Ministry of Finance and Economic Development has established a formal hazard payment system for clinical and non-clinical workers responding to the Ebola crisis.	*Formal hazard payment system remains in place with considerable improvements to its functioning to date. Payments are now electronic, recipients required to have photo identification and possess a contract.*
2. The Recipient's Ministry of Finance and Economic Development has appointed a fiduciary agent to ensure that the clinical and non-clinical workers receiving hazard payments are entitled to receive said hazard payments and are providing appropriate services.	*Fiduciary agent remains appointed, with contract renewed through two cycles. Fiduciary agent works closely with NERC.*
3. The Recipient's Ministry of Finance and Economic Development has executed a Loans and Fiscal Agency Agreement with the Bank of Sierra Leone as part of the implementation of phase one of the Treasury Single Account.	*Loans and Fiscal Agency Agreement remains valid and in place. TSA implementation proceeding to second phase.*
4. The Recipient's Ministry of Finance and Economic Development has received audited financial statements for year ended 2013 for Sierra Leone Commercial Bank Limited and Rokel Commercial Bank (Sierra Leone) Limited, respectively, with a view to assessing the contingent liability implications for said Sierra Leone Commercial Bank Limited and Rokel Commercial Bank (Sierra Leone) Limited.	*Work to adequately assess the contingent liability implications requires additional and more up to date information so 2014 audited financial statements have been prepared and received and a diagnostic review of the banks is commencing with the support of the IMF and the Bank.*

Action	Status Update
Improve Transparency and Accountability for Public Resources	
5. The Recipient's Ministry of Finance and Economic Development has submitted a Supplementary Budget for extra-budgetary expenditure in Fiscal Year 2014 to Parliament.	*This action was undertaken and valid for 2014, no further action is indicated.*
6. The Recipient's Ministry of Mines and Minerals has published all signed Mineral Lease Agreements, with a view to increasing transparency and accountability in the mineral sector.	*Disclosure about signed Mineral Lease Agreements remains valid and up to date.*
7. The Recipient's Ministry of Finance and Economic Development has published in Fiscal Year 2014, data on revenue collected in Fiscal Year 2013 from top extractive industries consistent with §159 of the Mines and Minerals Act.	*Disclosure about extractives revenue in 2013 has been complemented by disclosure of 2014 revenues.*

B. POVERTY AND SOCIAL IMPACT

5.2 **Measures supported by the proposed EEFSO and the proposed Supplemental are expected to have a positive direct and indirect impacts on poverty reduction and social welfare**. The EEFSO is designed to support Sierra Leone's efforts to bring the Ebola epidemic under control. First and foremost the resources under the Supplemental financing will go directly to the Government's budget thereby increasing fiscal space in support of government efforts to maintain essential social services particularly for the poor and those hardest hit by Ebola. To the extent that the poor are more vulnerable to Ebola, having little recourse in terms of financial resources or mobility to mitigate it, they would benefit more from this operation. The direct beneficiaries of the proposed Supplemental include those in Ebola-affected areas, which are widespread in Sierra Leone covering both rural areas and urban centers including the capital. *No significant adverse social or poverty impacts are expected from the prior actions supported by the operation.*

6. RATIONALE FOR PROPOSED SUPPLEMENTAL FINANCING

6.1 **Unanticipated financing need.** The request for supplemental financing is consistent with OP 8.60. The protracted nature and impact of the Ebola epidemic has created an unanticipated financing gap due to a collapse in domestic revenues which could jeopardize the EEFSO which was proceeding on schedule and the Government's post-Ebola economic recovery plan. These effects have been exacerbated by the effects of the global commodity price downturn, particularly for iron ore, which has led the sub-sector to shut down. The still on-going Ebola epidemic and global commodity price downturn represent exceptional external shocks beyond the control of the authorities, threatening original program objectives for 2015. An unanticipated financing gap has emerged in 2015, estimated at Le2,166 billion, the result of an unanticipated revenue shortfall of Le745 billion (Table 3.1). The gap was derived by comparing the relevant fiscal projections for 2015, which formed the underlying basis for the framework underlying the EEFSO and the proposed Supplemental DPF both based on the macroeconomic frameworks agreed with the IMF, in September 2014 and October 2015.[9]

6.2 **The program remains broadly on track and government commitment is firm with the implementing agencies having demonstrated competence in carrying out the reform program.** Implementation of the program supported under EEFSO has proceeded as anticipated and remains on track with government implementing agreed structural reforms. As noted above it has also maintained an adequate macroeconomic framework throughout and is making efforts to improve fiduciary arrangements. Government commitment is measured by the successful completion of two preceding series of three annual development policy operations. To date, government remains in compliance with all the covenants embedded in the Legal Agreement for the financing of the EEFSO.[10]

6.3 **The Borrower is unable to obtain sufficient funds from other lenders on reasonable terms and in a reasonable time.** The Government has actively sought additional financing to cover the unanticipated financing gap and as noted above, has received some commitments with regard to additional financing with discussions still ongoing with respect to others. The proposed Supplemental DPF is therefore a critical element to close the fiscal gap due to the sharply lower budget revenues than originally programmed and the need to safeguard budget financing and contain rising macroeconomic risks. Accessing non-concessional external financing is not a viable option as it would be inconsistent with the recommendations of the most recent debt sustainability analysis as well as the program agreed with the IMF.

6.4 **The time available is too short to process a freestanding Bank operation**. The time required for preparation of a freestanding Bank operation would be so lengthy as to severely disrupt the program and could further heighten macroeconomic risks. The procedures available through a Supplemental for a DPF offer the opportunity to respond quickly to the urgent needs of the country generated by the Ebola epidemic and the on-going economic downturn, compounded by the global commodity price decline.

7. IMPLEMENTATION ARRANGEMENTS

A. TERMS OF THE SUPPLEMENTAL FINANCING

7.1 **The recipient is the Republic of Sierra Leone and this Supplemental Financing is a single-tranche IDA grant of SDR 21.5 million (US$30 million equivalent) that would be made available upon grant effectiveness, so long as the borrower continues to make satisfactory progress with respect to implementing its program supported under the original EEFSO DPF and continues to maintain a satisfactory macroeconomic policy framework.** No other conditions, except for the standard requirement for a legal opinion will apply to this Supplemental Financing. The closing date for the Supplemental Financing is June 30, 2016. The proposed supplemental financing continues to support the full program of actions set out in the program document for EEFSO.

[9] IMF Staff Report no. 14/300, September 2014, and IMF Staff Report Third and Fourth ECF Review, October 2015.
[10] Financing Agreement for Grant Numbers D026-SL and D027-SL, December 17, 2014, between the Republic of Sierra Leone and the Association.

B. FUNDS FLOW AND AUDITING REQUIREMENTS FOR THE SUPPLEMENTAL FINANCING

Fiduciary Aspects

7.2 **The fiduciary arrangements outlined in the EEFSO DPF, which rely on government systems and institutions, will continue to apply for this supplemental financing in light of a specific review of fiduciary arrangements undertaken for the EEFSO and some improvements in the fiduciary environment noted below**. The most notable recent improvement has been in the areas of management of payment obligations and buildup of arrears between budget years, which has in the past had an adverse effect on budget management. Indications of a deterioration in PFM at the height of the Ebola crisis as noted in a report by the Auditor General,[11] suggest a heightening of fiduciary risks consistent with the scale and severity of the emergency at the time. Support to reversing the established signs of deterioration is being rendered under the auspices of the new donor-supported PFM Improvement and Consolidation project which seeks, inter alia, to strengthen the internal audit and procurement functions.

7.3 **Improvements in the overall PFM environment in Sierra Leone have been slow, and progress has been uneven. Substantial analytical work[12] has served to confirm this while documenting progressive improvements in key areas and drawing attention to weaknesses requiring attention**. Many of the weaknesses are associated with the inconsistencies in the enabling legal framework, the Government Budgeting and Accountability Act, 2005. As noted above, new PFM legislation which addresses these inconsistencies and introduces further budget management and oversight improvements, has recently been submitted to parliament. This should go a long way towards addressing the key sources of weak performance. Capacity constraints on the part of PFM actors ascribed to historical fragility will require a more concerted effort and more time to overcome. PFM reform has achieved measurable progress in critical reform areas, due also to the concerted efforts of key development partners acting in concert around a common platform, notably the implementation of the Government's Integrated PFM Project, and more recently its successor, the PFM Improvement and Consolidation Project which aims to improve budget planning and credibility, financial control, accountability and oversight of government finances.

7.4 **The establishment of the National Public Procurement Authority and procurement units in Ministries, Departments and Agencies (MDAs) under the 2004 Public Procurement Act and regulations established the institutional basis for strong value for money procurement arrangements across government**. Building on these achievements an amended Procurement Act was prepared and submitted to Parliament in 2015, to address issues of coverage and consistency which had emerged following a comprehensive review. Priorities remain strengthening the capacity of procurement staff assigned to MDAs, and that of the Procurement Authority to monitor performance and compliance as well as strengthening the complaints mechanisms and appeals processes.

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[11] Report on the Management of Ebola Funds, Audit Service Sierra Leone, 2014.

[12] This included Public Expenditure and Financial Accountability assessments in 2007, 2010 and 2012; a Country Procurement Assessment Review, 2011; IMF Fiscal Affairs Department PFM Review, March 2008; IMF Fiscal Affairs Department Report on Determination and Implementation of Fiscal Rules, 2012; Tax Administration Reforms for Successful VAT Implementation, 2008; and a Review of the Government Budgeting and Accountability Act and Financial Management Regulations, 2010.

7.5 **The IMF conducted Safeguards Assessments of the Bank of Sierra Leone (BSL) in 2002, 2006, 2010, 2014 and 2015**. Overall the safeguards framework of the BSL been strengthened since 2010 in the areas of internal audit and legal, and the accountability framework remains adequate. The 2015 assessment found that essential operations and critical controls were maintained despite the Ebola epidemic, with governance bodies reconstituted on a timely basis and the Audit Committee functioning. Government issued long term bonds to recapitalize the BSL. The assessment also found that previously recommended modernization of internal audit remained underway, and lags in external audit had yet to be fully eliminated. The 2015 assessment made further recommendations with respect to strengthening the Audit Committee and appointment of external auditors.

7.6 **Overall, the fiduciary risk of the proposed operation is rated "substantial"**. This rating is based on the current status of Sierra Leone's PFM system (including the findings of the external audit report on the Ebola financial operations), the reforms currently in place covering the entire budget management and oversight areas and supported under the PFM Improvement and Consolidation project, and the BSL safeguards framework, accounting systems and auditing arrangements. Notably, the Government remains committed to make critical progress in strengthening underlying PFM systems and budget management, supported by the AfDB, EU, the Department for International Development (United Kingdom) and the World Bank. As a result, no additional fiduciary arrangements are considered necessary for this operation.

Flow of Funds and Auditing Requirements

7.7 **Funds flow arrangements**. The Government of Sierra Leone shall identify a Foreign Exchange Account with the Bank of Sierra Leone, and which forms part of the country's official foreign exchange reserves, into which the proceeds of the grant will be disbursed upon grant effectiveness, subject to meeting the agreed prior actions. The Sierra Leone 'Leones' equivalent of the funds in the account will, within two working days, be transferred into the Consolidated Fund of the Government of Sierra Leone, and the amount recorded appropriately in the budget management system of the Government.

7.8 **Disbursements from the Consolidated Fund by the Government of Sierra Leone shall not be tied to any specific purchases and no special procurement requirement shall be needed**. The proceeds of the grant shall, however, not be applied to finance expenditures on the negative list as defined in Schedule 1 of the Financing Agreement. If any portion of the grant is used to finance ineligible expenditures as so defined in Schedule 1 of the Financing Agreement, IDA shall require the Government to promptly, upon notice from IDA, refund an amount equal to the amount of the said payment to IDA. Amounts refunded to IDA upon such request shall be cancelled from the grant.

7.9 **Assurance requirements**. Based on the substantial fiduciary risk associated with the operation, there will be no special or additional fiduciary arrangements established for the grant in terms of a requirement for an audit, in as much as an audit remains an option. Within 30 days of the disbursement of the grant by IDA, however, the Financial Secretary of the MOFED of Sierra Leone shall provide written confirmation to IDA, certifying the receipt of the 'Leones' equivalent of the grant into the Consolidated Fund Account of the Government of Sierra Leone, the number of the account, the date of the receipt, and the exchange rate applied to translate the grant currency into *Leones*. In addition, as the Auditor General is required by law to submit its annual report and the audited accounts on the public consolidated fund to Parliament within 12 months of the end of the fiscal year, a copy of the said reports and accounts shall be provided to IDA within one month after the lapse of the 12-month period. The Government shall equally ensure that the annual entity financial statements of the Bank of Sierra Leone, audited in accordance with international standards on auditing as promulgated by the International Federation of Accountants, are publicly available.

8. BENEFITS AND RISKS

A. BENEFITS

8.1 **The benefits of the proposed Supplemental DPF financing are considerable for Sierra Leone**. The relief that the resources would provide to the already strained public finances would in effect increase the fiscal space for the authorities to better respond to the needs generated by the Ebola epidemic and in particular, to allow for its Ebola response plan to be executed. It will also allow for a reduction in macroeconomic risk which has been heightened by the collapse of revenues in 2015. A related benefit, which is critical at this juncture is that it will also provide for the economic recovery plan to commence implementation. In turn, this will underpin the return to normalcy, so important to the population.

B. RISKS

8.2 **The risk rating conducted for the EEFSO remains valid but with higher ratings for political and governance as well as fiduciary risks**. The accompanying mitigation measures also remain valid and the overall risk rating for the proposed Supplemental DPF is ‘substantial’. There remain five main sources of risk that could potentially jeopardize the expected outcomes and benefits of the operation: (i) political and governance risks; (ii) macroeconomic risks; (iii) risks from institutional capacity for implementation and sustainability; (iv) fiduciary risk; and (v) epidemiological risk (Table 8.1). This section only touches on the risks that are judged to have changed since the original operation was prepared. Despite these changes, the potential benefits of the proposed Supplemental outweigh the residual risks and warrant IDA’s assistance to provide critical financial support at this difficult time for Sierra Leone and for implementing reforms and policy actions in coordination with other development partners.

Table 8.1: Risk Rating

Risk Categories	**Rating (H, S, M or L)**
1. Political and governance	H
2. Macroeconomic	S
3. Sector strategies and policies	L
4. Technical design of project or program	L
5. Institutional capacity for implementation and sustainability	M
6. Fiduciary	S
7. Environment and social	L
8. Stakeholders	L
9. Other: Epidemiological	H
Overall	S

Political and Governance Risks

8.3 **Political and governance risk are judged to be high in terms of their effect on the project development objectives**. Political risk in particular is considered low as the Government is completely committed to the operation which is an important element in its fight against Ebola and subsequent economic recovery. Governance risks remain a concern especially when it comes to fraud and corruption which have been articulated by the responsible domestic institutions and are with the legislature for follow up.[13] An important mitigating factor under the present emergency-like circumstances are the direct international response and the intense scrutiny and spotlight which this brings.

Fiduciary Risk

8.4 **Fiduciary Risk due to weak institutional capacity and linked to poor governance is considered to be substantial**. Weak institutional capacity, coupled with corruption, generally hampers reform implementation and outcomes. On the institutional side, weaknesses include a lack of skills and inadequate training with respect to procurement procedures, and limited accounting and reporting skills, especially at the sub-national level. These risks are mitigated by robust PFM support measures calibrated to existing capacity, including the provision of extensive TA and capacity building through ongoing (PFM Improvement and Consolidation) or planned projects, and the growing involvement of civil society in oversight activities. An important additional element in mitigation is that with the relative isolation that resulted from the epidemic now largely over, there will be increased scrutiny and oversight applied from both internal and external actors.

[13] Report on the Management of Ebola Funds May-October 2014, Audit Service Sierra Leone, 2014; and, Report of the Public Accounts Committee on the Auditor General's Report on the Management of Ebola Funds, May-October 2014, 2015.

Annex 1: Fund Relations Note

IMF Executive Board Completes Third and Fourth Review of Sierra Leone's Arrangement under the Extended Credit Facility, and Approves US$46.14 million Disbursement

Press Release No. 15/521
November 16, 2015

The Executive Board of the International Monetary Fund (IMF) today completed the third and fourth reviews of Sierra Leone's performance under a three-year arrangement under the Extended Credit Facility (ECF) and approved an augmentation of access of 45 percent of quota, equivalent to SDR 46.665 million (about US$64.59 million), to be distributed in three tranches. The completion of the third and fourth reviews enables the immediate disbursement of SDR 33.335 million (about US$46.14 million). This amount includes the first tranche of the augmentation in an amount of SDR 15.555 million (about US$21.53 million). The Executive Board also approved the authorities' request for rephasing of the fifth and sixth disbursements under the arrangement.

In completing the review, the Executive, Board additionally approved the authorities' request for waivers of non-observance of the end-December 2014 performance criteria on the ceiling on Net Domestic Bank Credit to Government Ceiling, the ceiling on Net Domestic Assets of the Central Bank Ceiling, and the floor on Gross Foreign Exchange Reserves of the Central Bank on the basis of corrective action taken.

The ECF arrangement for SDR 62.22 million (about US$95.9 million) was approved on October 21, 2013 (see Press Release No. 13/410) and was augmented twice (see Press Release 15/86 and Press Release 14/441).

Following the Executive Board's discussion on Sierra Leone, Mr. Min Zhu, Deputy Managing Director and Acting Chair, made the following statement:

"With the World Health Organization declaring Sierra Leone Ebola free on November 7, the country now faces the difficult challenge of economic recovery. Complicating that task, the decline in iron ore prices has led to the shutdown of the main iron ore mines, with consequent sharp declines in GDP and exports, and reduced fiscal revenues.

"As a result, the fiscal challenges in 2016 will be substantial. It will be critical for the authorities to ensure sufficient revenues and financing to cover priority spending, especially for the post-Ebola Economic Recovery Strategy (ERS). This will require strong moves on tax policies and continued efforts on tax administration. Containing the wage bill will also be critical to increase the resources available for the ERS, which will be strengthened by enhancing the transparency and efficiency of expenditures.

"The Bank of Sierra Leone (BSL) should continue targeting price stability in support of economic recovery. With depreciation pressures stemming from the lost iron ore exports, the BSL should enhance monetary policy instruments and liquidity forecasting to increase its ability to respond to any second round inflationary pressures. BSL should also enhance supervision of the financial sector, and seek to understand and resolve any underlying stress through a timely diagnostic of key troubled banks.

"The updated debt sustainability analysis shows that, while Sierra Leone's risk of debt distress is moderate, the economy is increasingly vulnerable to further shocks. Thus, borrowing policies should remain prudent in view of the narrow export base and fragile fiscal position. Financing needs, particularly for investment projects, should continue to be covered mostly with grants and concessional loans."

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