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SIXTH GOVERNANCE REFORM AND GROWTH CREDIT

LETTER OF DEVELOPMENT POLICY

I am writing on behalf of the Government of Sierra Leone to request the approval of the Sixth Governance Reform and Growth Credit (GRGC VI) in the sum of US$25 million equivalent to support the financing of Government’s development agenda articulated in the Agenda for Prosperity, which will be implemented over the period 2013-18. The proposed credit will support the: (i) improvement in the allocation and efficiency of public expenditure to support poverty reduction; (b) strengthening domestic resource mobilization and management; and (c) increase in the provision of electricity in the country.

2. Mr. President, Government achieved tremendous progress under the second Poverty Reduction Strategy, the Agenda for Change (2008-12). During the period, Sierra Leone recorded strong economic growth, maintained relatively stable macroeconomic environment, achieved significant improvement in infrastructure (roads, electricity and water supply), increased agricultural production and improved delivery of social services underpinned by good governance and political stability.

3. To consolidate these gains and address the remaining challenges, Government prepared the third poverty reduction strategy-the Agenda for Prosperity (AfP). The overarching objective of the AfP is to promote sustainable inclusive green growth and poverty reduction. The AfP has eight sectoral pillars: (i) economic diversification to promote inclusive growth; (ii) managing natural resources; (iii) accelerating human development; (iv) international competitiveness; (v) labour and employment; (vi) strengthening social protection systems; (vii) governance and public sector reforms; and (viii) gender equality and women’s empowerment.
I. RECENT ECONOMIC DEVELOPMENTS - 2010-2012 FISCAL YEARS

4. The economy recorded impressive growth rates averaging 5.7 percent per annum during 2010-11 driven by increased activities in agriculture, construction, manufacturing and the services sectors. The economy grew by an impressive 15.2 percent in 2012, following the commencement of iron ore mining and exports by two large mining projects. Excluding iron ore, the economy grew by a healthy 5.3 percent in 2012.

5. Inflationary pressures, which surged during 2010 - 2011 due to the food, fuel and financial crises, and the one-off effect of the introduction of the Goods and Services Tax in 2010 started to decline in 2012 reflecting the stability of exchange rates, increased domestic food supply and proactive monetary policy. Inflation declined from 16.9 percent at end 2011 to 12.0 percent at end 2012.

6. The external position of the economy also improved following the surge in exports in 2012. Exports recovered from a decline of 3 percent in 2008 to grow by 147 percent in 2012 supported largely by export of minerals especially iron ore. Hence, notwithstanding the high level of mining and construction related imports, the current account deficit narrowed from 45 percent of GDP in 2011 to 39.5 percent of GDP in 2012. The external current account deficit was financed largely by FDI inflows. The overall balance of payments recorded a surplus in 2012, thereby contributing to the accumulation of foreign reserves to about three months of imports. This trend continued into the first half of 2013, with the value of exports almost doubling relative to the corresponding period in 2012.

7. Despite the increase in external borrowing to finance key infrastructure projects, Sierra Leone’s external debt remains sustainable at 27.8 percent of GDP in 2012. The 2012 Debt Sustainability Analysis carried out jointly by the IMF and World Bank confirmed that Sierra Leone’s risk of debt distress remains moderate.

8. The local currency, the Leone, which depreciated massively in 2009 triggered by the negative impact of the global financial crisis on mineral exports regained its strength in 2010 and has remained stable since then on account of the increase in FDI inflows, increased exports and inward remittances.

9. Domestic revenue collection also gradually improved from 9.9 percent of GDP in 2010 to 12.2 percent of GDP in 2012 following the implementation of reforms to strengthen tax administration including the installation of the Automated System of Customs Data (ASYCUDA ++); establishment of the Domestic Tax Department (DTD); introduction of the Tax Payer Identification numbers (TIN) to tackle tax evasion and tax avoidance; and broadening the tax base with the introduction of the Goods and Services Tax.

10. Government expenditures have been shifted in favour of capital spending as Government scaled up investment in roads, electricity and water supply as part of an overall strategy to support sustainable economic growth and poverty reduction. Accordingly, capital expenditure increased from 7.7 percent of GDP in 2010 to 8.2
percent of GDP in 2012 while efforts continue to rationalize recurrent spending. Domestically funded capital expenditure increased from less than 1.0 percent of GDP in 2007 to average 3.1 percent during 2010-12.

Economic and Budgetary Performance – January to September 2013

11. Available data indicate that macroeconomic developments were positive in the first half of 2013. Economic activity was strong; hence the projected growth rate of 13.3 percent in 2013 is likely to be achieved as indicated by the higher than anticipated output from the mining sector in the first half of the year.

12. Inflationary pressures continued to decline in 2013 supported by stable exchange rate, increased domestic food supply and proactive monetary policy. Inflation as measured by the Freetown Consumer Price Index fell to single digit of 9.5 percent in July for the first time in four years and continued to decline to 9.1 percent in September. The national inflation also fell to single digit of 9.9 percent in September from 11.4 percent in December 2012.

13. Domestic revenue collection continued to improve in 2013, exceeding the half-yearly target, reflecting strict monitoring of tax compliance and efforts to reduce tax and duty waivers. Domestic revenue increased to 6.4 percent of GDP during the first half of the year from 5.5 percent of GDP for the same period in 2012. Government expenditures were rationalized and remained within budgeted allocations during the first half of the year. This was made possible by the strengthening of expenditure control measures, improved cash management and better coordination of monetary and fiscal policies.

14. The exchange rate, which is market-determined, remained stable reflecting the increase in exports, remittances, and increases in Foreign Direct Investments inflows.

15. Recognizing the high domestic debt burden and the associated huge debt service payments, Government adopted a policy stance of zero borrowing from the domestic securities market in 2013. As a result, interest rates on Government securities, which had remained sticky during the past few years declined sharply in 2013. The interest rate on the 91-day Treasury bills dropped from 19.0 percent in December 2012 to 3.5 percent in September 2013.

16. The improved performance of the economy combined with implementation of structural reforms and sectoral projects and programmes resulted in significant reduction in poverty. The Sierra Leone Integrated Household Survey (2011) estimated that the incidence of poverty declined to 52.9 percent of the population compared to 66.4 percent in 2003. Poverty in the rural areas also decreased to 66.1 percent compared to 78.7 percent in 2003. Similarly urban poverty declined from 46.9 percent in 2003 to 31.2 percent in 2011. However, poverty in the capital, Freetown increased from 13.6 percent in 2003 to 20.7 in 2011.
II. MEDIUM-TERM MACROECONOMIC OBJECTIVES AND POLICIES

17. The outlook of the Sierra Leone economy is favourable with sustained economic growth, low inflation and improved fiscal and external positions. The key objectives of Government’s medium term policy framework are to reduce poverty and create job opportunities through sustained policy and inclusive growth.

18. The medium-term objectives are: (i) to achieve real GDP growth (excluding iron ore) of 7.0 percent by 2017; Including iron ore, GDP is expected to grow by 14 percent in 2014, 12.4 percent in 2015 before moderating to 7.7 percent in 2016; (ii) reduce inflation from 12 percent in 2012 to 5.4 percent by 2017; and (iii) improve gross reserves coverage to about four months of non-iron ore imports.

19. Economic growth will be supported by the continued increase in iron ore production and export, increased productivity in agriculture, continued public investment especially in infrastructure and expansion in activities in the services and construction sectors.

20. Monetary policy will continue to target price stability over the medium term. The expected decline in inflation will be supported by proactive monetary policy, stable exchange rate and an increase of domestic supply of food items.

21. The exchange rate will remain market determined and foreign currency reserves are programmed to increase in light of the economy’s vulnerability to external shocks.

20. The medium-term fiscal strategy aims to strengthen revenue collection, improve expenditure management, and reduce domestic debt. Domestic revenue will increase from 12.4 percent of GDP in 2014 to 13.4 percent of GDP in 2016. Revenue performance will be supported by continued sustained economic activity in the non-iron ore economy and the projected increase in royalties from the mineral sector. Government expenditures will continue to be rationalised and re-oriented towards capital investments. Total expenditures will average around 20.3 percent of GDP as capital expenditures increase from 8.1 percent of GDP to 8.3 percent of GDP over 2014-16.

22. The current account deficit (including official transfers) will narrow down to 7.2 percent of GDP in 2016 from 10.5 percent of GDP in 2014 as exports surge and mining related imports moderate.

23. Public Debt policy in the medium term prioritises grants and highly concessional loans to ensure debt sustainability in the medium to long term.

III. PROGRESS IN THE IMPLEMENTATION OF THE AGENDA FOR CHANGE

24. Mr. President, as mentioned earlier, Government made considerable progress in the implementation of the Agenda for Change, which contributed to the strong economic growth and reduction in the incidence of poverty. The Agenda for Change focused on
five strategic priorities: (i) Roads; (ii) Electricity; (iii) Agriculture; (iv) Health; and (v) Education. Below are highlights of achievements made in each of the strategic priorities.

25. Roads:- During the period of the Agenda for Change, several kilometres of trunk, feeder and township streets were constructed, reconstructed and or rehabilitated. The Freetown-Conakry Highway (86Km), the Makeni - Matotoka Highway (35 Km) and the Bo-Kenema Highway (65Km) were reconstructed with support from the development partners including the European Union and the World Bank. Rehabilitation work involving the reconstruction of total length of 175Km of pavement and drainage works on streets in Freetown and in the district headquarter towns is almost complete. The construction of the Hillside By-pass Road and the Lumley-Tokeh Road is in progress. With support from the Chinese Government, work on the Jui-Regent road is progressing well. As of June 2013, a total of 1,350 Km of feeder roads throughout the country was upgraded.

26. Electricity:- In September 2007, the total electricity generation in the country was under 10 megawatts. By end 2012, total national electricity generation capacity increased to over 75 MW following the completion of phase 1 of the 50MW Bumbuna Hydro Power Project, and installation of two (8.5 MW each) thermal plants at Black Hall Road as well as the installation of a 10Mw thermal plant at Kingtom with support from the Japanese Government. Solar Street lights have also been erected in some parts in Freetown and in the district headquarter towns.

27. Agriculture:- Agricultural productivity significantly increased through the implementation of the Smallholder Commercialisation Programme (SCP). Nearly 500 farmer-based organizations and nearly 300 Agricultural Business Centres (ABCs) were established. Over four thousand hectares of inland valley swamps were rehabilitated during 2008-12. Thousands of kilometers of feeder roads linking ABCs to production centres and markets were constructed. About 60 Financial Services Associations and 20 Community Banks have been established throughout the country to improve rural financial intermediation.

28. Health:- Government introduced the Free Health Care Initiative in April 2010 to improve access to health services to vulnerable groups (pregnant women, lactating mothers and children under five years of age) and make progress towards achieving Millennium Development Goals (MDGs). Implementation of the Free Healthcare Initiative sharply improved access (by over 250%) to basic health care for these vulnerable groups. The percentage of deliveries taking place in public health facilities increased from 17.8 percent of total deliveries in 2008 to 54 percent in 2011 and further to 60.9 percent in 2012. Similarly, the proportion of children immunised against diphtheria, pertussis and tetanus (penta 3) increased from 54.6 percent of total number of children to 83.8 percent in 2011 and further to 87.3 percent in 2012. The percentage of children sleeping under insecticide treated bed nets increased three-fold following the distribution of insecticide treated bed nets by Government and development partners. The conditions of service of health sector workers were also improved.
29. **Education:** During 2008-12, Government took measures to improve the working conditions of teachers and increased its support to tertiary education in order to improve the quality of education. The salaries of teachers were increased, ranging from 200 to 400 percent, depending on the grade of the teachers. Government subvention to the University of Sierra Leone and Njala University has been increased five-fold. Over 4,000 additional teachers were recruited based on the new National Policy on Teacher Training and Development. A teacher biometric verification exercise was completed in 2012 with aim of cleaning the teacher payroll. Government is taking action to update the teacher payroll by removing the names of the unverified and retired teachers from the payroll. A total of 35,305 Personnel Files have been created, which are being updated regularly. Government continues to pay for public examinations at the primary, junior and secondary schools levels; and also supporting the Girl-Child Education program.

**Structural Reforms**

30. In addition to macroeconomic and sectoral policies and programmes, Government implemented wide-ranging structural reforms including public financial management, financial sector, business regulatory, governance and public sector reforms. With the support of development partners, Government undertook several public financial management (PFM) reforms at both the central Government and Local Councils to ensure efficiency, transparency and accountability in the use of public resources. These include the installation of an Integrated Financial Management Information System (IFMIS) and its roll-out to high spending Ministries, Agencies and Departments; the establishment of internal audit units in MDAs and the Local Councils, improvement of the procurement function of Government, strengthening budget planning and execution, as well as Government accounting and reporting.

**IV. THE SIXTH GOVERNANCE REFORM AND GROWTH CREDIT**

31. Mr. President, the sixth Governance Reform and Growth Credit will support the strategic priorities of Government articulated in the *Agenda for Prosperity*. The proposed operations will focus on: (i) improving the allocation and efficiency of public spending to support the overall objective of poverty reduction; (ii) strengthening domestic resource mobilization and management; and (iii) increasing the provision of electricity in the country.

(i) **Improving the Allocation and Efficiency of Public Expenditure**

32. In recent years, extra-budgetary expenditures resulted in the accumulation of huge unpaid bills. To address these slippages; Government introduced measures to re-assert fiscal discipline in 2013 to clear these outstanding arrears. As a first step, Government prepared a strategy and an accounting framework for the clearance of these unpaid obligations. Secondly, to ensure that the clearance of these arrears does not displace the planned 2013 expenditures, Government submitted a supplementary budget in Parliament in July 2013 consistent with the provisions of the 1991 Constitution and the Government Budgeting...
and Accountability Act, 2005. The supplementary budget made provision for the clearance of the outstanding bills.

33. The instability and unpredictability of the teacher payroll have also been of concern to Government and development partners. In this regard, Government designed a programme to clean up the teacher payroll. These include the creation of a file for every teacher updated with the relevant supporting documents and the physical verification of teachers to determine genuine teachers on the payroll. A total of 35,505 teacher files were created in 2010. The biometric verification of teachers, which, was completed in 2012, revealed that 4,068 teachers whose names appeared in the teacher payroll could not be verified.

34. In August 2013, Government took action to remove the names of the 4,068 unverified teachers from the payroll as well 939 teachers whose retirement was long overdue. However, following subsequent re-verification, 772 were reinstated in September and another 1,362 in October 2013. In tandem, Government took the actions to terminate the services of the teachers who were due for retirement. The Ministry of Education, Science and Technology issued out letters of retirement to the affected 939 teachers in August 2013. The payment of salaries to these teachers was subsequently stopped in September 2013.

35. As at October 2013, 32,091 teachers were on the payroll with a corresponding wage bill of Le27.6 billion, resulting in a saving of Le851.3 million. This number took into consideration new recruitments of 31 teachers, 3 teachers that left the teaching service to become civil servants and 1 teacher that retired in September 2013.

(ii) Strengthening Domestic Resource Mobilization and Management

36. Domestic resource mobilization remains an important element in Government’s reform programme. In particular, there is an urgent need to improve the collection of revenues from the non-mining sector given the uncertainty and volatility associated with mineral revenues and the attendant effect on budget planning and execution. One of the factors attributed to the weak revenue performance especially from the non-mining sector is the low compliance rate by tax payers. An estimated 80 percent of corporate tax returns and 50 percent of individual tax returns remained outstanding at the end of the year. Moreover, tax payers file income tax returns late. To overcome this challenge, and in addition, to the introduction of self-assessment in 2009, the National Revenue Authority took administrative and enforcement action to enhance compliance with respect to the timeliness of filing of Income Tax returns. These actions include press releases, bill board notices, warning letters and attempts to seal off the premises of tax defaulters.

37. Another factor undermining domestic revenue collection is the non-collection of accumulated tax arrears. As a first step, NRA ascertained the stock of tax arrears estimated at between Le10 to Le 20 billion. Subsequently, NRA initiated recovery proceedings in all cases of tax arrears.
Mineral revenues will constitute a significant proportion of domestic revenues in the medium-term. Hence, it is important to monitor the performance of revenues from the mining sector. To this end, Government is committed to disclosing publicly revenue collected from the top extractive industries covering at least 90 percent of total collections. As a demonstration of this commitment, and consistent with the requirements under the Extractive Industry Transparency Initiative (EITI), Government published in the first quarter 2012 and the first quarter of 2013, revenues collected from the 10 top and 20 top extractive industries in 2011 and 2012, respectively.

38. The growing importance of the mining sector in the economy of Sierra Leone calls for the establishment of effective and efficient institutional arrangements to oversee and coordinate and supervise activities in the sector. To this end, Government submitted the National Minerals Agency Bill to Parliament in March 2012. The National Minerals Agency (NMA) was subsequently established and made operational in early 2013. Among other activities, the NMA collaborates with the NRA in the assessment of revenues due from the mining sector.

(iii) Increasing the Provision of Electricity in the Country

39. Access to electricity remains limited in Sierra Leone, estimated at around 5-6 percent of the population. Therefore, the provision of increased, reliable and efficient electricity supply under the Agenda for Change as well as the Agenda for Prosperity remains a top priority of Government. The Ministry of Energy, in collaboration with the defunct National Power Authority, which is responsible for the generation, transmission and distribution of electricity, is not financially and operationally viable due to high operating cost and weak governance. Government remains committed to reform the energy sector in general and improving the performance of the electricity generating agency in particular. To this end, Government enacted the National Electricity Act, 2011, the implementation of which is expected to commence soon. In the Interim, the Ministry of Energy has prepared an operational loss reduction plan to improve the efficiency of revenue collection and the reduction of non-technical losses. This plan focused mainly on the installation of pre-paid meters. As at end 2012, over 40,000 pre-paid meters had been installed.

40. Government has also reached full internal consensus on the objectives and actions required to fund the Ministry of Energy in line with the National Electricity Act 2011. The National Electricity Act establishes the unbundling of the electricity sector through the creation of the Electricity Generation and Transmission Company (EGTC) and the Electricity Distribution and Supply Authority (EDSA). Government is also determined to encourage privately financed generation in the form of Independent Power Producers (IPP) and sell their output to Electricity Distribution and Supply Authority.
V. CONCLUSION

42. Mr. President, Government is determined to implement the programmes and policies articulated in the AfP to achieve inclusive green economic growth for poverty reduction and greater income equality. This would require the provision of continued financial and technical assistance by our development partners including the World Bank.

43. Your approval, therefore, of this credit will facilitate the implementation of programmes, projects and policies aimed at addressing the challenges of low domestic revenues, weak infrastructure, high incidence of poverty and high unemployment in the country.

Yours Sincerely,

Kaifala Marah (Dr.)
Minister of Finance and Economic Development