

SIERRA LEONE'S DEBT AUDIT

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1.0 Executive Summary

According to the UNDP Human Development Index, Sierra Leone is classified as the second least developed country with one of the highest mortality rate on the globe. In spite of several support in the form of grants and loan, development seem to be progressing at snail pace and yet to be impacted on the livelihood of more than 70 percent of the population.

As part of the Civil Society initiative, NMJD and its partners in and outside Sierra Leone are keen to have a better insight into the status of debt in the country. The purpose of this audit is to generate adequate and reliable information that would inform the tracking and following-up of the national debt portfolio and processes. The information generated would be documented for utilization by the public leading to in some cases constructive debates, lobbying and advocacy.

The audit report begins with country's external debt historical evolution in Section Two. In section three, the report continues with outlining the nation's major creditors throwing light on Disbursed and Outstanding External Debt (DOD). In the following section, key items relating to credit contacts and respective terms of conditions of the donors were discussed. The legal and institutional framework for debt contracting including the level of involvement of parliament in debt contracting and its subsequent is presented in Section Five. Section Six analyses the country's current debt situation looking at the status of Sierra Leone's debt with creditor institutions like the World Bank. The concluding section summarizes emerging issues from the audit with proposed recommendations and next steps.

2.0 The Evolution of Sierra Leone's External Debt

2.1 Country Overview

Sierra Leone is a small nation of about 71,740 square kilometres located on the west coast of Africa. The December 2004 population census which is the most recent puts the country's population at 4, 976,871.

The country is poor and described as one of the heavily indebted poor countries with significant inequality in income distribution. While it possesses substantial mineral, agricultural, and marine resources, its economic and social infrastructure is under-developed. Other social disorders like attitude, mindset and rampant corruption continue to hamper the country's economic development. About two-thirds of the working-age population is engaged in subsistence non-mechanised agriculture. Manufacturing consists mainly of the processing of raw materials and of light manufacturing for the domestic market. Alluvial diamond mining remains one of the major sources of foreign earnings, accounting for nearly half of Sierra Leone's exports.

The fate of the economy depends upon the maintenance of domestic peace and the continued receipt of substantial external aid either in the form of grants or loan, which is essential to offset the severe trade imbalance and supplement government revenues. The IMF has completed a Poverty Reduction and Growth Facility (PRGF) program that helped stabilize economic growth and reduce inflation. A recent increase in political stability has led to a revival of economic activity, such as the rehabilitation of bauxite mining.

With the help of the United Nations' Peacekeepers, the government has succeeded in re-establishing its authority after the 1991 to 2002 civil war that resulted in tens of thousands of deaths, the displacement of more than 2 million people and the loss of properties millions of dollars. Before withdrawing from the country in December 2005, the UN peacekeeping mission provided substantial support in security hardware and security man-power training. With their withdrawal, state security was handed over to the nation's security apparatus including the Sierra Leone Police and the military. A new civilian UN office – the United Nations Integrated Office in Sierra Leone (UNIOSIL) remains to further support the government to consolidate peace.

Tensions related to planned presidential and parliamentary elections in July 2007, deteriorating political and economic conditions in Guinea, and the tenuous security situation in neighbouring Liberia are concerns that may present challenges to continuing progress in Sierra Leone's socio-economic and political stability.

2.2 Historical Analysis of Sierra Leone's Debt Evolution

In most economies, borrowing is essential for financing development and is a fundamental aspect of the global economic system. In ideal circumstances, a country borrows to promote long-term productivity and economic output, thereby advancing human development, with the accompanying result of economic growth and a booming export sector that further stimulate the economy and increase the ability to repay lenders the principal and interest owed. As a result of this anticipated overall goal, countries are enticed to enter in huge loan contracts even when they do not have the absorptive capacity to adequately manage the loan and achieve the desired goal. The accumulation of this undesirable situation, over years, of huge loan contract, inability to repay principal and interest, and subsequent mismanagement of the resources with zero or negative impact on the economy lead to 'debt burden', especially on poor countries who always go hand-in-gloves asking for debt rescheduling and forgiveness.

When a country's debt becomes disproportionately large compared to its gross national product (GNP) and export earnings, instead of stimulating growth and human development, debt begins to weaken the nation's economic vitality and divert resources from critical social sectors. To repay such high levels of debt so as not to default or add arrears to the total debt, countries are most times under pressure to divert already scarce resources. In most cases,

the poor, especially children, pay the highest price of being deprived of basic health care, nutrition and education because a significant proportion of government resources go to servicing debt.

While a majority of countries have huge debt overhangs, others like Brunei, Hong Kong, Liechtenstein, Netherlands and Norway had external debt figures of US \$ 0.0 million in 1999. It is socially difficult to measure the levels of debt that can be sustained because of the argument that many definitions of what constitutes 'sustainable debt' put the thresholds so high at the expense of basic social services like health and education.

Therefore, the issue of debt is a case by case phenomenon as there is no universal model for public debt management. However, a standard model is a 'best-fit' one that works within a given country's socio-economic context, institutional arrangement and historical antecedents. To be able to manage debt well, one should ensure that the government's degree of financing through 'debt' is at the lowest possible socio-economic and financial cost, consistent with low risk.

In Sierra Leone, total Disbursed and Outstanding External Debt (DOD) stock stood at US\$59 million in 1970 but increased to US\$433 in 1980. The increase, which was more than 600 percent, was due to the country's compelling need for foreign exchange to pay for the increase cost of oil imports, a situation caused by the:

- 1973 and 1979 oil price shocks;
- collapse of commodity prices; and
- exorbitant expenses incurred in hosting the Organization of African Unity (OAU) Summit in 1980.

By 1990, a year after an IMF/World Bank programme was agreed, external debt rose to US\$1.2 billion, and further to US\$1.5 billion in 1994 but averaged around US\$1.2 billion by the end of 2000. The rise in the debt stock in the 1990s was attributed to increased disbursements under the IMF supported Structural Adjustment Programme as well as the acquisition of new loans from the IMF, World Bank and African Development Bank to finance critical imports and development activities. In addition, the increase in the 'debt stock' could be attributed to the civil war in Sierra Leone which caused tremendous damage to the economic and social infrastructure, and inflicted extensive suffering on the population.

A modest recovery following the restoration of the democratically elected government in March 1998 was sharply reversed by the rebel invasion of Freetown in January 1999. Economic activities shrank, with rebels holding all the mineral rich and export crop production districts. This contributed to a collapse in the fiscal revenue base and to significant increases, in the budget deficit, bank financing, and external payments arrears. Inflation surged, and the exchange rate depreciated sharply. As a result, besides the humanitarian assistance that the country received from various sources, it had to go into series of loan contracts and deferred loan repayments.

2.3 Composition of Sierra Leone's Debt Stock (2000 – 2005)

As standard practice, a nation's debt profile is classified into two broad categories of External and Domestic Debt. Under each of these profiles, there are further classifications of debt by way of identifying the creditor as a multilateral organization, bilateral arrangements (between one creditor nation and a debtor nation), commercial (mostly non-governmental and private) institutions; or in the case of domestic debt by way of financial instruments used to obtain the loan. Tables 1 and 2 give the composition of Sierra Leone's External and Domestic Debt Stock, covering the period 2000 to 2005.

Table 1, categories 2 and 3 are bilateral creditors distinguished as Paris Club (PC) Creditors and Non-Paris Club Creditors. The Paris Club is an informal group of creditor governments that has regularly met in Paris, France, since 1956 to reschedule bilateral debts. The French Treasury provides the Secretariat for the PC of Creditors. The Creditors meet with a debtor nation to reschedule its debt as part of the international support to countries

experiencing severe debt service burdens and implementing an adjustment programme supported by the IMF. The PC does not have a fixed membership and its meetings are open to all official creditors that accept its practices and procedures. The core creditors are mainly Organization for Economic Cooperation and Development (OECD) member countries but other creditors attend as relevant to a debtor nation. Non-Paris Club countries are those outside the membership of the PC.

Table 1 – Composition of Sierra Leone's External Debt Stock (in million US \$)

No.	Creditor Category	2000	2001	2002	2003	2004	2005
1	Multilateral	759.00	784.10	878.64	945.90	1,043.50	1,050.00
2	Paris Club	281.88	311.10	343.90	371.60	362.00	348.30
3	Non-Paris Club	64.12	60.20	62.80	63.10	53.70	55.00
4	Commercial	116.36	272.20	250.70	249.80	253.60	245.00
	Total	1,221.36	1,427.60	1,536.04	1,630.40	1,712.80	1,698.30

Source: Ministry of Finance & Bank of Sierra Leone

Since debt is a stock, it reduces as principal repayments and interest payments are honoured, given that additional debt is not contracted. In this case, it will be noticed in Table 2 that domestic debt stock under Ways and Means Advances (in million Leones) is zero for the 6-year period. This does not mean that no debt under this category was obtained during a given year, but that it was reduced to zero by the end of that year. For instance, in Quarter 1 of 2004, Ways and Means Advances was Le 27,072 million, in Quarter 1 of 2005, it was Le 25,368 million and at end of Quarter 2 of 2005, it was Le 512,962 million. The emphasis is that the figures in Tables 1 and 2 show debt stock as at end of each year.

Table 2 – Composition of Sierra Leone's Domestic Debt Stock (in million Leones)

No.	Category	2000	2001	2002	2003	2004	2005
1	Treasury Bills	94,783	139,354	187,646	231,532	304,447	375,444
2	Treasury Bearer Bonds	47,397	69,614	85,253	114,042	131,488	137,518
3	Ways & Means Advances	0	0	0	0	0	0
	Total	142,180	208,968	272,899	345,574	435,935	512,962

Source: Ministry of Finance & Bank of Sierra Leone

3.0 Major Multilateral, Bilateral and Commercial Creditors

3.1 Disbursed and Outstanding External Debt

The graphical distribution of Sierra Leone's external creditors is illustrated in Fig. 1:

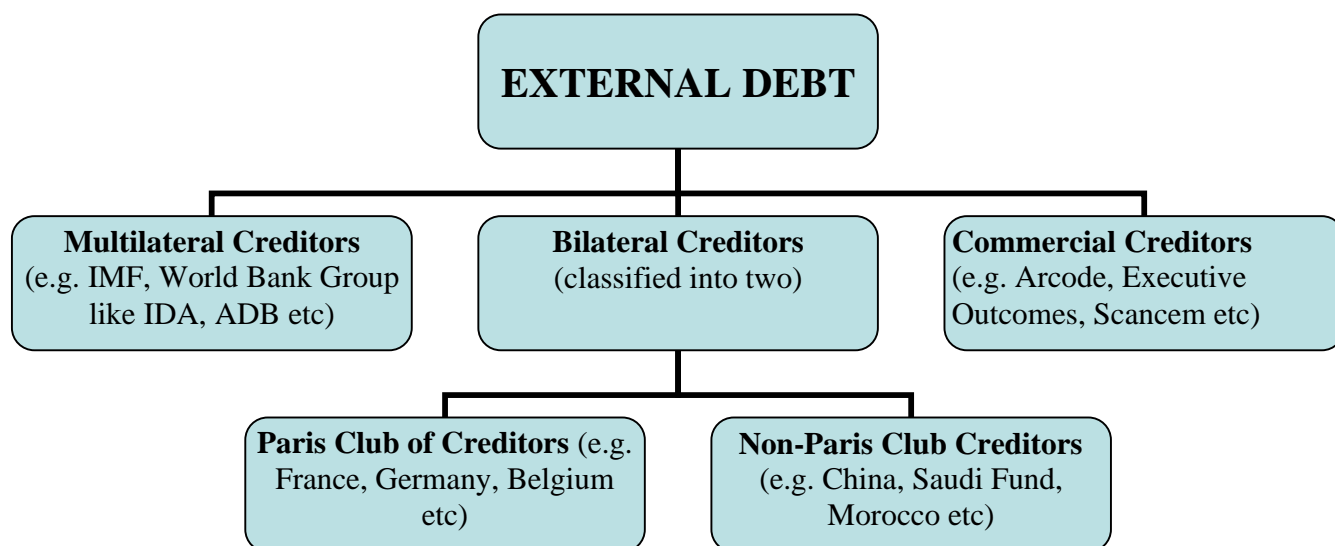


Figure 1 – Structure of Sierra Leone's External Creditors

The total Disbursed and Outstanding External Debt (DOD), including principal arrears, stood at US \$ 1.698 billion at end of December 2005, compared to US \$ 1.713 billion at the end of December 2004. The drop in the debt stock was as a result of a reduction in the Paris Club (PC) debt due to debt cancellation. Though there were substantial disbursements of loan resources from other creditor categories, the reduction in debts owed to Paris Club outweighed the increase in disbursements from other creditors. As a result, the net effect was a drop in debt stock from December 2004 to December 2005.

At the end of 2005, debt owed to multilateral creditors was 62% of total outstanding debt stock. This was followed by the bilateral Creditors (24%) and commercial Creditors (14%). The same trend, 61%, 24% and 15% respectively was indicated in the 2004 debt figures as illustrated in Table 3.

Table 3: DOD in millions of US Dollar (Sierra Leone 2004 – 2005)

Creditor Category	Q1 2004	Q2 2004	Q3 2004	Q4 2004	Q1 2005	Q2 2005	Q3 2005	Q4 2005
Total	1,673.8	1,660.6	1,658.5	1,712.8	1,733.2	1,721.9	1,724.4	1,698.3
Multilateral	979.7	969.6	978.6	1,043.5	1,052.3	1,051.4	1,063.6	1,050
PC Bilateral	374.1	372.1	360.5	362.0	377.3	367.1	357.6	348.3
Other Bilateral	66.5	66.0	65.8	53.7	53.3	54.2	54.0	55.0
Commercial	253.5	252.9	253.6	253.6	250.3	249.2	249.2	245.0

Source: Public Debt Unit – Ministry of Finance and Bank of Sierra Leone

Note: Q1 = End March Q2 = End June Q3 = End September Q4 = End December

3.2 Multilateral Debt

The International Development Association (IDA) window of the World Bank has over the past ten years accounted for the largest share of multilateral debt, as it is the soft lending arm of the Bank. At the end of December 2005, IDA share of total multilateral debt (US \$ 1,050 million) was 52.2%, followed by the African Development Bank (ADB) through the African Development Fund (ADF) and the International Monetary Fund (IMF) under the PRGF at 19.7% and 18.7% respectively. This 'share-trend' was the same for 2004. Other multilateral creditors include the IFAD (International Fund for Agricultural Development), EEC (European Economic Community), EIB (European Investment Bank), BADEA (Arab Bank for Economic Development in Africa), IDB (Islamic Development Bank), OPEC (Organization of Petroleum Exporting Countries) Fund for International Development. It will be noticed in Table 4 that the debt stock owed to the OPEC Fund for International Development remained unchanged for the entire period because the creditor did not make new disbursements. In addition, debt service to this creditor was in respect of interest payments only.

Table 4: Share of Total Multilateral Debt by Creditor Category (million US \$) 2004 – 2005

No.	Multilateral Organisation	End of Q4 2004	End of Q1 2005	End of Q2 2005	End of Q3 2005	End of Q4 2005	% of Total Multilateral (Q4 2005)
1	IDA	564.8	580.3	552.1	561.1	548.4	52.2
2	IMF	184.5	184.5	202.6	202.6	196.7	18.7
3	ADB	193.8	193.1	195.4	201.6	206.4	19.7
4	EEC	21.7	16.6	15.1	15	14.5	1.4
5	EIB	19.3	11.5	13.9	10.6	9.2	0.9
6	IFAD	25.9	25.5	25.2	22.9	22.7	2.2
7	BADEA	11.8	14.8	14.4	14.8	14.9	1.4
8	IDB	12.2	16.5	23.2	25.5	27.7	2.6
9	OPEC	9.5	9.5	9.5	9.5	9.5	0.9
TOTAL		1,043.50	1,052.30	1,051.40	1,063.60	1,050.00	100.0

3.3 Bilateral Debt

Sierra Leone's bilateral debt profile is categorized into Paris and Non-Paris Club. The total official bilateral debt owed by Sierra Leone was US \$ 415.7 million at the end of Q4 2004. This amount declined by 2.98% to US \$ 403.3 million at end of Q4 2005. The decline was attributed to the phased debt cancellations of US \$ 10 million owed to Morocco, the debt cancellation of about US \$ 4 million under UK debt relief programme for the former Commonwealth Development Cooperation (CDC) and the amortization of debts. In addition, no new disbursements were made by the PC creditors during this period.

3.3.1 Paris Club Bilateral Creditors

Sierra Leone's total PC debt owed to 11 OECD countries stood at US \$ 348.3 million at the end of Quarter 4 of 2005. This represents 86.45 of the total official bilateral debt of Q4 of 2005 which was US \$ 403.3 million. One year earlier, end Q4 2004, the total PC debt was US \$ 362.0 which represented 87.1% of all official bilateral debt.

Sierra Leone's PC creditors are Austria, Belgium, France, Germany, Italy, Japan, The Netherlands, Norway, Switzerland, United Kingdom, and United States of America.

3.3.2 Non-Paris Club (N-PC) Creditors

Over the past two years, there has been decline in the N-PC debt stock. At the end of Q4 2004, the N-PC debt stock was US \$ 53.7 million, while that for Q4 2005 was US \$ 55.0 million. As a result of the cancellation of debt owed to Morocco, only three N-PC creditors remained in Sierra Leone's debt stock at the end of q4 of 2005. These were China (US \$ 31.1 million), Kuwait Fund (US 4 23.0 million) and Saudi Fund (US \$ 1.0 million)

3.3.3 External Commercial Debt

Most countries do not contract commercial loans on a large scale due to the attached high risk. They are: mostly without concession; hardly rescheduled; and carry minimal possibility of cancellation. The external commercial creditors, mostly private institutions, refused to grant the anticipated debt relief under the enhanced heavily indebted poor countries initiatives. In most cases, the debtor country face litigation actions when they default to service the debt in the terms and conditions set out in the agreement or memorandum.

Identified and verified commercial external debts, including pipeline¹ and direct military and contractors claims, as well as validated and non validated claims, were estimated at US \$ 245 million as at end of 2005, while the Q4 figure for 2004 was US \$ 253.6 million (a fall from 2004 to 2005 of US \$ 8.6 million). The drop was accounted for by Sierra Leone Government's goodwill repayment strategies agreed under the PRGF arrangement with the IMF, in an effort to salvage litigations.

¹ Under the current foreign exchange controls, importers in Sierra Leone needing to make payments overseas in foreign currency were required to deposit Leone amounts with their local commercial banks in the country. Since the Bank of Sierra Leone was not approving foreign exchange, these funds remain held in blocked accounts with the commercial banks and became known as pipeline claims. It also included bulk transfers by commercial banks to the Bank of Sierra Leone for which approvals had been given by and importers deposited funds at commercial banks but no foreign exchange was made available to importers.

4.0 Debt Contract Formats

The format of contract entered into by the Government of Sierra Leone in external loan acquisition varies from one creditor to the other. Each creditor has its own practices and procedures. However, what remain standard are: the loan amount; interest rate; repayment maturity; and repayment terms. Other details about the mode of procurement or utilization of the fund, for instance, are laid out in consonance with the creditor's terms, conditions, procedures or regulations.

In general, the contract format is in the form of a loan agreement between the Government of the Republic of Sierra Leone and the creditor institution for the specified type of programme. The programme or loan is normally given a code or project number by the creditor. Some of the critical elements of the contract include:

- a) General Conditions and Definitions – defines some of the key terms in the agreement such as the general conditions applicable to loan and guarantee agreements of the creditor, loan amount, principal amount, interest/service fees and executing agency.
- b) The Loan Amount – specifies the amount of credit granted and the currency in which it is applied.
- c) Amortization, Service or Interest Fees and placement of payments – specifies terms of the repayment of principal, indicating the grace period. The placement of payments specifies the bank(s) and account number(s) to be used by the borrower to service the debt.
- d) Withdrawal and utilization of the proceeds of the loan – indicates purpose of the loan and on what it should be utilized; date of first disbursement and closing date of disbursement.
- e) The execution of the project and reporting requirements
- f) Loan Effectiveness – Specifies when the loan becomes effective for the creditor to honour first disbursement, and the conditions precedent to loan effectiveness
- g) Termination of agreement
- h) Miscellaneous provisions like authorized representatives of the creditor and borrower and their addresses; date of agreement; signatories of the parties to the agreement.

4.1 Timetable, amounts and final destination of resources borrowed

The final destination of resources borrowed by the Government of Sierra Leone is contingent upon the government development strategy, and for the next few years, the Poverty Reduction Strategy (PRSP). With some creditors, especially the bilateral and multilateral creditors, they maintain a 3 to 5 year rolling programme wherein programmes identified within a debtor country are developed, negotiated, funded and implemented. Most of the resources are utilized in development programmes in the social sectors like health, education and the economic sectors like agriculture, fisheries, energy and roads, while the IMF provides funds for the government's budgetary support.

Total disbursements in Quarter 1 of 2005, amounted to US\$7.0 million; of which US\$5.4 million, 77 percent, was disbursed largely by the World Bank in support of the National Social Action project implemented by National Commission for Social Action (NaCSA), HIV/AIDS Response Project, and the Power and Water Sector Project. The remaining 23 percent was disbursed by the Islamic Development Bank in support of Construction & Reconstruction of Primary Schools and Rural Water and Sanitation projects. Table 5 shows disbursement by project:

Table 5 – Disbursement of Loans (in US Dollar) in Q1 2005

Project	Creditor	Amount Disbursed
Social Action Support Project of NaCSA	IDA	3,184,841
HIV/AIDS Response Project	IDA	909,247
Power and Water Sector	IDA	850,000
Completion of Bumbuna Hydroelectric	IDA	123,647
Institutional Reform and Capacity Building Project (IRCB)	IDA	329,618

Subtotal		5,397,353
Bumbuna Hydroelectric Power	AfDB	718
Subtotal		718
Construction and Reconstruction of Primary Schools	IDB	809,109
Kissy Mental Hospital Rehabilitation	IDB	16,200
Rural Water and Sanitation	IDB	792,750
Subtotal		1,618,059
Total		7,016,130

Source: Various Project Implementation Units in MDAs

4.2 Amounts Actually Repaid

A debt service payment is one key economic indicator of a nation's budget, and becomes one of the key functions of the debt unit/department of the government. The amortization scheme comprises the repayment of principal, the payment of interest and sometimes depending on the creditor, the payment of a services fee. The payment terms and schedules depend on what is contained in the loan agreement.

Table 6 shows total debt service for the country in 2004 and 2005, with quarterly disaggregates. These figures are calculated as the sum of the loan repayment and interest payment. However, it is of interest to government and other stakeholders to know the net flows and net transfers against actual disbursements made within a given period.

Disbursement for the two years amounted to US \$ 125.64 million, of which Q2 of 2005 recorded the highest inflow of loan disbursement. Disbursements were mainly from the IMF, amounting to US \$ 20 million in 2005 under the Poverty Reduction and Growth Facility (PRGF). In Q3 of 2005, the African Development Bank made several disbursements amounting to US \$ 13.3 million for projects like the Economic Rehabilitation and Recovery Loan, and the Social Sector Support Project.

In comparison with the 2-year disbursement figure, total amortization for the two years was US \$ 86.98 million, with a resultant Net Inflows of US \$ 38.66 million. The interest payment on external debt during these two years amounted to US \$ 21.91 million. The interpretation is that during the two years of 2004 and 2005, the country experienced positive Net Transfers of US \$ 16.75 million.

Table 6 – Sierra Leone’s Debt Flows (in million US \$) – 2004 to 2005

	Q1-2004	Q2-2004	Q3-2004	Q4-2004	Q1-2005	Q2-2005	Q3-2005	Q4-2005	2-Year Total
<i>Disbursement</i>	11.70	37.30	10.90	2.30	6.91	25.37	22.44	8.72	125.64
<i>Amortization</i>	18.60	17.80	4.80	10.80	7.87	7.35	6.10	13.66	86.98
Net Flows	(6.90)	19.50	6.10	(8.50)	(0.96)	18.02	16.34	(4.94)	38.66
<i>Interest</i>	2.30	2.40	2.00	2.80	3.42	3.14	2.21	3.64	21.91
Net Transfer	(9.20)	17.10	4.10	(11.30)	(4.38)	14.88	14.13	(8.58)	16.75
Debt Service	20.90	20.20	6.80	13.60	11.29	10.49	8.31	17.30	108.89

Source: Various Publications of the MoF and BSL

See footnote for Explanatory Notes on debt flow terms and how these figures were arrived at.²

² Disbursement: The amount of foreign currency (converted to US \$ if not already in that currency) released by the creditor to the government or otherwise for utilization for and on behalf of the Government of Sierra Leone

Amortisation: The amount repaid by the Government of Sierra Leone to creditors as principal

Net Flows: Calculated as Disbursement less Amortization (repayment of part or all of principal)

Interest: Payments as interest and other charges to the creditor

Net Transfer: Calculated as Net Flows less Interest paid

In Table 7, debt service payments, as principal and interest payment, are disaggregated by creditor category. The table shows that there is a weak functional proportionality relationship between debt stock owed to creditors and debt service payment to creditors. This is as a result of variations in repayment and interest payment modes in loan agreements and the subsequent rescheduling or cancellation of loans by some creditors.

Table 7 – Quarterly Debt service Payment in 2005 (thousand US \$)

Creditor Category	Q1-2005		Q2-2005		Q3-2005		Q4-2005		2005 Total	
	PR	IN	PR	IN	PR	IN	PR	IN	PR	IN
Multilateral	5,432.3	3,215.8	7,096.9	2,894.1	3,342.7	2,021.4	10,777.6	3,303.4	26,649.5	11,434.7
Paris Club	47.4	31.6	10.7	167.4	41.9	9.7	11.8	260.5	111.8	469.2
Non-Paris Club	451.7	176.7	239.1	79.4	455.6	176.9	243.6	78.5	1,390.0	511.5
Commercial	1,939.9	0.0	0.0	0.0	2,250.0	0.0	2,622.2	0.0	6,812.1	0.0
TOTAL	7,871.3	3,424.1	7,346.7	3,140.9	6,090.2	2,208.0	13,655.2	3,642.4	34,963.4	12,415.4

Source: Ministry of Finance & Bank of Sierra Leone

4.3 Portion of the Country's Budget Committed to Debt Service and Repayment

The proportion of the country's budget committed to debt service and principal repayment are projections allowed for in government's annual recurrent and development estimates. The level of adherence to this commitment is reflected in debt service figures. Table 8 shows the amount of leones budgeted for public debt service from 2001 to 2004, indicating the percentage of GDP that was committed to servicing the debt.

Table 8: Budget Committed to Debt Servicing

	2001	2002	2003	2004
Budgeted for Public Debt Servicing	68,461	106,974	141,266	165,521
GDP (in billion leones)	1,507.9	1,678.9	1,885.2	2,125.3
% of GDP	4.5%	6.4%	7.5%	7.8%

Source: Recurrent and Development Estimate Financial Years 2002 – 2004 Volume I

The table shows a steady increase in the percentage of GDP committed to servicing debt for the four year period.

4.4 Debt Contracted for Investment Purposes vs Debt Contracted for Other Purposes

The study attempted to distinguish between debt contracted for investment purposes and debt for other purposes. For the purpose of this audit, debts for investment purposes are classified as those programmes in the government development estimates whose proceeds are utilized to develop the country's social and economic infrastructure. On the other hand debts contracted for other purposes are classified as loans contracted for recurrent expenditure such as budgetary support.

Table 9 below shows the actual government expenditure on development. Foreign loans as a percentage of Government Development Expenditure show consistent reduction for the six year period from 2000 to 2005 except 2001/2002. The reduction emanated from the significant and consistent increase in foreign grants utilized for development.

Table 9 - Government Development Expenditure (in Million Leones, unless otherwise indicated)

Category of Sources	2000	2001	2002	2003	2004	2005
Foreign Loans (L)	53,082	43,823	53,827	55,955	64,297	75,109
Foreign Grants (G)	9,382	12,719	11,400	25,988	44,139	101,302
Total Foreign (L + G)	62,464	56,542	65,227	81,943	108,436	176,411
Domestic	6,400	14,602	20,541	30,372	26,086	27,582
Total Development Expenditure	68,864	71,144	85,768	112,315	134,522	203,993
Foreign Loans as % of Govt. Dev. Expenditure	77.1	61.6	62.8	49.8	47.8	36.8

4.5 Agreed Interest and Actual Paid Interest

Under 'Amounts Actually Repaid', Table 6 – Sierra Leone's External Debt Flows, a two-year interest payment was recorded at US \$ 21.91 million. Each creditor has its own terms and conditions of loan granting. This includes the maturity period, grace period and interest rate in percentage. Some of the loans are highly concessional, bearing longer period of maturity, sometimes as long as 40 years, with a grace period of 10 years and interest rate as low as 0.75%. It is worth mentioning that as a way of relieving some of the debt burden on debtor nations, the creditor sometimes allows a grant element to be attached to the loan. The grant becomes money that the Government does not repay and has no interest attached.

4.6 Average Terms and Conditions of Loan by Creditor

Over the years, Sierra Leone has endeavoured to contract only concessional loans with no less than 35 percent Grant Element (GE). As shown in the table below, except for loans from OPEC Fund for International Development, all other loans contracted have a GE greater than 45 percent, with IDA providing the most concessional loans with minimum GE of at least 83 percent, followed by the ADB and IFAD with 82 percent each.

The IDA, ADB, IFAD provide similar loan terms of 40 years maturity period, including 10 years grace period, at an interest rate of 0.75 percent per annum. The IDB charges the highest interest rate, at 2.5 percent per annum, followed by OPEC Fund (2%) and Kuwait Fund (1.5%). On average, the OPEC Fund provides the least favourable loan terms and conditions followed by the International Monetary Fund, whose credits are for balance of payments support.

Table 10: Average Terms and Conditions of Loans by Creditor

Creditor	Maturity (yr)	Grace (yr)	Interest (%)	Standard Grant Element (%)
IDA/World Bank	40	10	0.75	83
ADF	40	10	0.75	82
IFAD	40	10	0.75	82
EEC	40	10	1	80
BADEA	30	10	1	74
IDB(Ordinary Loan)	25	7	2.5	56

IDB (LDMC ³ Loan)	30	10	0.75	30
Kuwait	25	3	1.5	52
IMF	10	5	0.5	47
EIB	20	5	2	45
OPEC Fund	20	5	2	39
Average Terms	29	7.5	1.3	64

Source: Various Loan Agreements and Creditor Home Pages

4.7 Unilateral Alterations of the Contract Clauses

Unilateral alterations to contract clause is an unacceptable action by the party that undertakes the alteration. Since the contract has been entered into by the two parties, the creditor and the debtor, it is contractually incumbent upon both parties to consult the party for any amendments to the loan agreement. There have been situations wherein the debtor, in the execution of the activities under the terms and conditions of the loan, contravenes the established procedures of the creditor. This will lead to mis-procurement by the implementing government. Most times the creditor disapproves of such actions often leading to the suspension or cancellation of the loan as a result of the breach of contract.

4.8 Conditions Unforeseen by Contracts

Activities precedent to the signing of a loan agreement may for one reason or the other, either by way of omission or commission, not been adequately dealt with or understood by one or both parties. Where this is identified after the signing of the agreement, the party identifying brings it to the notice of the other party for an amendment to be done to the referred clause in. Most times, it might result to protracted communications and seeking of legal and legislative opinions before the amendment is effected. This has been one of the causes of delays in disbursement and implementation or completion of development projects.

³ Least Developed Member Country

5.0 Legal and Institutional Framework

5.1 Relationship between Economic Policy and the General Evolution in the Debt Contracting Process

The generation or mobilization of resources to carry out government development plans is very crucial. The effectiveness of any change management within an economy is contingent upon the development of sound economic policies, backed by the political, social and people will to implement the activities and the available of resources to effect the change. Irrespective of the level of resources within an economy, there are a number of sectors that need to be given high priority on the nation's development agenda. Such sectors include the health and agricultural sectors to name a few. Where expenditure in these inevitable sectors weighs heavily on the national budget, ways and means through loan contraction become one of the major options. The government's inability to generate enough resources to finance its domestic and foreign expenditure will result to debt contracting. Sound, realistic and feasible fiscal and monetary policies aimed at increasing the mobilization and availability of domestic resources and reducing the level of expenditure on non-essential budgetary support items would lead to a reduction in the nation's debt stock.

In establishing a relationship between economic policy and debt contracting, there are two schools of thought: On one hand, it would be safe to say that there is negative relationship between sound economic policies (with the right will of the people to implement them given the level of matching implementation resources) and debt contracting, especially considering the level of developing countries. In other words, the expected change as a result of successfully implementing the policies would lead to less loan contracting and a subsequent reduction in the debt stock. The second school of thought focuses on the fact that because nations do not have sufficient funds to implement whatever sound economic policies they put forward, the need for debt contraction to obtain the needed foreign resources becomes inevitable. For this reason and in this context, it is argued that there is a positive relation between the economic policy and debt contracting.

In the present country context of Sierra Leone, the pre-war external debt burden, coupled with eleven year war, enervated economic growth is the reason the country is the second least on the human development index. During this period and prior to the establishment of some viable public revenue generating institutions like the National Revenue Authority (NRA) and the National Social Security Scheme (NASSIT), the issue of debt has been and still remains to be critical to the Government of Sierra Leone. All government economic policies over these years, as far back as the 80s, have been addressing the issue of external debt – especially with the IMF, World Bank, the Paris Club and other bilateral nations. Given the above situations, the government still continues to heavily depend on external creditors for both disbursement (to provide the needed foreign currency) and loan cancellation or rescheduling.

5.2 National Legal Framework for Contraction and Debt Repayment

Public debt management is a specialized function, which is carried out within the overall macroeconomic framework. The current administrative arrangements for public debt management in Sierra Leone are covered mainly by the 1991 Constitution and the Loans Amendment Act of 1992, vesting the responsibility for contracting loans to the Minister of Finance. In this regard, the Ministry of Finance plays the lead role in putting in place policies governing loan contracting. Administratively, the Ministry of Finance and the Bank of Sierra Leone discharge the main functions of debt management, including loan negotiations, renegotiations and loan restructuring, loan disbursement, and amortisation. During the past two decades and in particular, beginning 1994, these arrangements have contributed significantly to improving debt management capacity in Sierra Leone in conformity with acceptable international standards.

On the inception of legally rationalizing debt management, two debt Units were established in 1994: one at the Ministry of Finance and the other at the Bank of Sierra Leone. The operations of the units have been complementary with interlocking responsibilities. The current mandate of the External Debt Policy Section at the Bank of Sierra Leone is mainly to maintain the debt database; prepare the foreign exchange cash flow budget including debt service obligations; externalize debt service payments; monitor private sector debt; and participate in debt negotiations under the Paris Club arrangement. There is also the Domestic Debt Division of the Bank, which conducts a weekly auction of treasury bills and bearer bonds. The Public Debt Management Unit at the Ministry of Finance serves as the nerve centre for debt management in terms of the formulation of debt strategies, policies and implementation consistent with the macroeconomic and fiscal framework and with a view to achieving debt sustainability.

It is the responsibility of the Government of Sierra Leone to develop sound and bankable projects for the country. This duty is discharged through line ministries or parastatals like the National Commission for Social Action (NaCSA) or National Power Authority (NPA). When the development of a project or programme is completed, it is officially submitted to the Ministry of Finance for further review and submission to interested donors. The interested creditor sends an appraisal mission to the country to fine-tune the proposal. The finalized appraisal document replaces the project proposal which is taken to the creditor nation or institution for approval by the Board. In collaboration with the creditor, the GoSL prepares a loan agreement for submission to the creditor. Sometimes the project is single-handedly funded by one creditor. In other cases, a project could be funded by two or more creditors. In all these arrangements, especially in the financial composition of the programme, the creditor requests the inclusion of Government contribution - counterpart funding – to demonstrate government's commitment. A delegation, comprising the Minister of Finance, officials of the Ministry of Finance, Bank of Sierra Leone and the Judiciary, a Member of the Sierra Leone Parliament (hardly ever though) and an official of the implementing agency in Sierra Leone would travel to the creditor country or institution for loan negotiation. In the case where the negotiation is concluded, they would effect the subsequent signing of the loan agreement. The Ministry of Finance takes the loan documents to the Sierra Leone Cabinet and Parliament for ratification and codification to include it into the national legislation. The documents are then taken to the Attorney General's office for legal opinion and clearance, and then to the Bank of Sierra Leone for modalities on the externalization of debt service payments.

In some instances, the Sierra Leone Ambassador or High Commissioner in the creditor nation signs the loan agreement with the creditor for and on behalf of the Sierra Leone Government. Upon the completion of activities precedent to the first disbursement by the creditor, the loan becomes effective for the utilization of its proceeds for the desired goal. Such activities prior to the disbursement of the first tranche of the loan amount include the setting up a Project Management Unit (PMU) within the executing agency, usually, the concerned line ministry or parastatal. The PMU is charged with the responsibility of the day-to-day management of the loan resources to produce the desired end state; and the opening of bank account(s) for the transfer of the resources by the creditor.

5.3 The Parliament and its Role in Loan Contracting and its Handling

Parliamentary involvement in matters relating to loan contracting, grants or any other goodwill whether in the form of materials or equipment is mandated by Section 93, Act No. 6 of the 1991 Constitution of Sierra Leone. It requires the involvement of parliament through the Public Accounts Committee in negotiations, ratification and tracking the utilization and management of loans including debt repayment. However, the study showed their participation in most instances is limited to the ratification of the loan after contract has been signed between the GoSL and the Creditors. Over the last ten years, only two instances were reported involving parliamentary representatives in delegations for loan negotiation or consultations for donor support to the country's development agenda – during the first term of the current government and Poverty Reduction Strategy Paper Consultative Group meeting held in London in 2005. Had it not been for donor requirement which demands a "Certificate of Passage" before any disbursement, issued by parliament after ratification of contract, it is believed parliamentarians would only know about grants or loans only during implementation. *A recent breach of this constitutional mandate which captured the attention of parliamentarians was the new buses given to the people of Sierra Leone by the Libya. The Act requires parliament to be involved in any negotiation or signing of documents. However, they only knew about the details of*

the buses at the launch of the vehicle for public use. When the line Minister was queried by parliamentarians, he cunningly said they were awaiting the arrival of remaining 20 out of the 60 buses donated in the country before presenting to the House of Parliament.

Several factors limit the participation of Parliament in loan or grants negotiations and its handling:

- The Executive Arm of the government frequently marginalizes parliament in times of overseas trips. Because of their meagre salaries, government officials compete for overseas trips as means of augmenting their weak economic status. For instance, a two-week overseas trip could earn an official a whopping sum of US\$ 4,000 equivalent to between 10 to 12 Million Leones compared to an average monthly salary of Le 300,000. Therefore, influential officers within the executive arm of government are the most favoured for overseas trips restricting the participation of crucial stakeholders like parliamentarians.
- Parliamentarians receive an equivalent of between US\$350 – 400 as monthly salary which is comparatively better in a country where average monthly take home is less than US\$100. However, the amount is grossly insufficient to give the necessary personality to command respect within government and the populace. For instance, most of them cannot afford the cost of decent living place let alone afford the cost of a car. As a result, the executive arm tends to ignore their input into strategic national decisions. In fact, most of them had to scout around ministers and civil servants for contracts to enable them break even. Their role of monitoring and tracking the expense of public funds is compromised.
- Apart from a few of them with strong professional background or experience in financial management like the chairman of the Public Accounts Committee, the majority have very little knowledge about fiscal and budgetary issues. It would therefore be difficult for them to understand issues around public accounts including debts, its design and contracting. In this circumstance their input might not add value to any negotiation relating to debts. Like the executive and civil servants, parliamentarians need capacity building in fiscal and budgetary matters for them to make any meaningful contribution.
- In some countries, the Public Account Committee is chaired by an opposition representative for it to be objective and thorough. In Sierra Leone, this committee is chaired by the majority party which also constitutes the executive branch of government. Because of party loyalty, some of the contracts are hastily approved by parliament for the common reason of not to stifle government programmes. It was revealed from the audit some of approvals are made with some form of executive pressure. In spite of this, it was indicated parliament through its Public Accounts committee has been effective in monitoring some donor funds. In fact, a parliamentary audit of the utilization of public funds had just been concluded, taking members of the committee to different project sites across the country. Donors like UK DFID have expressed their interest in report of parliament on public accounts.
- Work overload of especially the parliamentary staff is another factor that restricts effective parliamentary participation in loans and debt and other relevant public account issues. For instance, a clerk could be assigned to six different parliamentary committees in addition to other sub and ad hoc committees. This kind of circumstance would certainly not allow for any effective participation and efficiency.
- What obtains in some countries is the establishment of a Parliamentary Service Commission exclusively responsible for determining the conditions of service of parliamentarians and parliamentary staff. In the Sierra Leone situation, condition of service of parliamentarians is determined by the Public Service Commission, a department of the executive arm of government. The executive determines packages for parliamentarians and responsible for payment of salaries and other parliamentary costs including travel expenses in and out of the country. The arrangement creates space for compromise on many issues including loans and grants as parliamentarians would not want to be at logger heads with their master. A Parliamentary Service Commission could be a better option for independence, respect and objectivity.

5.4 Reckless Borrowing and Debt Management Systems

The issue of reckless borrowing mostly emanates from the utilization of the proceeds of the credit to achieve the desired goal. A concrete example was a loan agreement signed October 2001 between the Islamic Development Bank (IDB) and the Government of Sierra Leone. The loan was signed on behalf of the Sierra Leone Road Transport Corporation (SLRTC) for the acquisition of 17 buses, 10 trucks and provision of fast moving spare parts for the maintenance of the vehicles amounting to 10% of the stock value of the fleet, freight and insurance at US \$ 3 million.

During the procurement process, six companies from five countries bided and a four-man Sierra Leonean delegation went to the five countries to inspect the buses that were quoted. The selected bidder was an Iranian company called Iran-Khodro. The buses were scheduled to land at the Freetown port in March 2003 but arrived seven months later. This was because the buses shipped from Iran were initially discharged at Doha Port, in Qatar, where they remain unprotected for seven months. The buses arrived in Freetown with a number of parts missing, with signs of degradation caused by corrosion and a number damaged parts like missing tapes, damaged doors, weak bellows, corroded shock absorbers, dead batteries, defective gammets, and missing jacks. Coupled with these problems, it was later learnt that the buses were not according to the specifications demanded and that they were not suitable for the road conditions in the country as the ground clearance was extremely low for use as inter-city buses. In less than two years after arrival before August 2005, seven of the buses were permanently grounded, and one year later, only three were road worthy.⁴

It could be concluded the management of this debt was of disservice to the nation because the expected financial returns from the commercialization of the buses to service the debt never materialized. Notwithstanding the collapse of the buses, Government is still servicing the debt. Similar issues were identified with two ADB funded projects, one at NaCSA and the other at the Artisan Fisheries Project with the National Cooperative Development Bank where government has to pay back funds to the creditor for mis-procurement.

5.5 Evidence of Loan pushing or Forced Borrowing

The study found it difficult to identify loans that were forced on the Government of Sierra Leone. What came out as an issue was some of the conditions or implementation issues (modus operandi) of the loan proceeds. Government may for instance want one donor to fund all the components of a development project. These requests are most times rebuffed by the creditor, and instead either fragment the entire programme into phases or force the government to source other donors to fund the other components of the programme. In these instances, government in its desire to meet the planned activities would have no choice but to accept the small amount that a particular creditor makes available. Sometimes government is unable to find another donor that would fund the subsequent components of the programme. As time goes on, the entire programme comes to a halt because other donors are not interested in funding the programme. In certain cases, initial studies on the project funded by one donor become obsolete after years because additional funds were not available to continue with the implementation of the outcomes of the study. Through this process, some programmes have undergone more than two feasibility studies. Some examples include the Rolakkoh Rice Development Project and the Bumbuna Hydro-Power Project.

Other instances are the "arms twisting" of government to undertake stringent budgetary measures before loans are granted. This situation was notorious during the IMF Structural Adjustment Programmes, wherein stringent conditionality undertaken by governments make them unpopular among its citizens.

⁴ A review report on the acquisition of buses and trucks projects dated August 2005

6.0 Current Information on Debt

The current debt issue in Sierra Leone is directly linked with the Enhanced HIPC⁵ Initiatives, the G8 and the Paris Club as detailed in the subsequent subsections.

6.1 The Enhanced HIPC Initiatives and the Sierra Leone External Debt Profile⁶

In addition to sound public debt management, Government's short-term objective in debt management is to reach the enhanced HIPC initiative completion point in 2006. This would enable Government to secure incremental resources to finance the poverty reduction strategy. In the medium term, Government aims to achieve debt sustainability and put in place mechanisms that would ensure lasting exit from the existing huge debt overhangs.

⁵ These are Group of 41 developing countries that have been classified by multilateral agencies as being heavily indebted poor countries. These 41 HIPCs are those that are eligible for highly concessional assistance from the World Bank – *International Development Association* (IDA), and from the IMF's *Poverty Reduction and Growth Facility* (PRGF, previously the Enhanced Structural Adjustment Facility, ESAF). In addition, these countries face an unsustainable debt situation even after the full application of traditional *debt-relief* mechanisms.

⁶ The HIPC Initiative was launched by the IMF and the World Bank in 1996 as the first comprehensive effort to eliminate unsustainable debt in the world's poorest, most heavily indebted countries. In October 1999, the international community agreed to make the Initiative broader, deeper and faster by increasing the number of eligible countries, raising the amount of debt relief each eligible country will receive, and speeding up its delivery. The enhanced Initiative aims at reducing the net present value (NPV) of debt at the decision point to a maximum of 150 percent of exports and 250 percent of government revenue, and will be provided on top of traditional debt relief mechanisms (Paris Club debt rescheduling on Naples terms, involving 67 percent debt reduction in NPV terms and at least comparable action by other bilateral creditors).

Table 11 : World Bank Loan Agreements (2000 - 2005)

Project Title & Year of Loan Contracting	Amount	Signing Date	Interest Rate	Grace Period (Yrs.)	Maturity Period (Yrs)	Implementing Agency	Duration (Yrs)	Closing
Loan 2000								
Community Rein. & Rehabilitation	SDR25,000,000.00	3-Mar-00	1% - 2%	10	40	NaCSA	3	30-Jun-03
Loan 2001								
Second Public Sector Management Support	SDR2,700,000.00	14-Mar-01	1% - 2%	10	40	Ministry of Presidential Affairs	3	30-Jun-04
Econ. Rehab & Rec. Credit II	SDR29,400,000.00	14-Dec-01	1%-2%	10	40	Ministry of Finance	2	3-Mar-03
Loan 2002								
HIV/AIDS Response	SDR12,100,000.00	26-Mar-02	1% - 2%	10	40	President's Office	4	31-Dec-06
Loan 2003								
National Social Action	SDR25,400,000.00	2-Jun-03	1% - 2%	10	40	NaCSA	5	31-Dec-08
Econ. Rehab. & Rec. Credit III	SDR22,000,000.00	9-Jun-03	1% - 2%	10	40	Min. of Finance	1	31-Dec-04
Loan 2004								
Power and Water (PPF)	US\$800,000.00	10-Feb-04				Min. of Energy & Power	0.5	30-Nov-04
Power and Water	SDR24,200,000.00	6-Jul-04	1%-2%	10	40	Min. of Energy & Power	10	31-Mar-10
Loan 2005								
Infrastructural Development (PPF)	US\$1,700,000.00	19-Apr-05	0.75%			Ministry of Transport & Comm.	0.5	31-Dec-05
Urban Water Supply (Supplementary)	SDR2,200,000.00	28-Jun-05	1%-2%	10	40	Guma Valley Water Co.	0.5	31-Dec-05

The assistance from the IMF and IDA would be delivered to Sierra Leone after satisfying the following conditions:

- Continued commitment by Sierra Leone to the financial and economic programs supported by IDA and the IMF's Poverty Reduction and Growth Facility (PRGF).
- Completion of a fully participatory poverty reduction strategy paper, with broad endorsement by the Executive Boards of the IMF and the World Bank. Toward this end, the government has established a detailed plan for participatory PRSP preparation. Preparatory activities for the household expenditure survey conducted in 2002. The survey results informed the definition of poverty line, as well as detailed analysis of the incidence, depth, and severity of poverty. Implementation of the full PRSP for at least one year is expected before the assistance from the IMF and IDA is granted.
- Implementation of an agreed set of measures in the context of the government's poverty reduction strategy, in the areas of governance and decentralization of government functions, structural measures, education and health.
- Confirmation of the participation of other creditors in the debt relief operation.

Sierra Leone is a heavily indebted poor country, which is eligible to benefit from the new G8 Initiative upon reaching completion point by mid 2006. To reach the completion point, Sierra Leone has taken significant milestones since reaching the decision point in March 2002. These are as follows:

- Sierra Leone has continued to maintain good track record under the Poverty Reduction and Growth Facility (PRGF) Arrangement with the IMF. In early June 2005, the Executive Board of the IMF successfully concluded the sixth and final review of Sierra Leone's performance under the PRGF programme. Government is in the process of discussing and negotiating a successor PRGF programme which will take the country to the enhanced HIPC completion point. A new PRGF programme was discussed and is slated for IMF Board discussions following a country review team visit in August 2006.
- Sierra Leone has prepared a broad based participatory PRSP, which has also been approved by the Bretton Woods institutions.
- Sierra Leone has started implementation of the PRSP in the context of the 2005 Budget.
- Sierra Leone held a successful Consultative Group Meeting (CGM) in London on the 28 – 29 November, 2005, where it secured pledges amounting to US\$800 million in support for the PRSP.

In March 2002, Sierra Leone reached "decision point" under the enhanced HIPC Initiative, following the preparation and implementation of the Interim Poverty Reduction Paper and the satisfactory implementation of the IMF Poverty Reduction and Growth Facility (PRGF) arrangement. As a result, total debt relief approved by the Executive Boards of the Bretton Woods Institutions worth nearly US\$950 million (about US \$ 600 million in Net Present Values – NPV - terms). Between March 2002 and March 2005, multilateral creditors including the IMF, the World Bank, ADB and the European Investment Bank delivered interim debt relief totalling US \$ 119.5 million (equivalent to Le291.4 billion). Table 12 shows interim debt relief delivered by these creditors covering 2002 to 2005. As observed from the table, the relief significantly increased from US \$ 35.8 million in 2002 to US \$ 44.8 in 2003 but then declined to about US \$ 35.5 million and US \$ 20.8 million in 2004 and 2005 respectively. It is projected to increase in 2006 as Sierra Leone reaches the completion point under the enhanced HIPC Initiative, through the stock of debt relief as well as the new G8 debt relief initiative.

There are two main reasons for the shortfall in 2004 and 2005:

- a) It was envisaged that following the decision point in March 2002, Sierra Leone would reach completion point in December 2004 and thus benefit from an irrevocable and total debt relief from all external creditors. Due to the delay in the preparation of the PRSP, the completion point date was shifted to mid 2006. As a result, interim debt relief from some creditors was exhausted in Quarter 1, 2005.
- b) There was a slight shift in completing the sixth and final review of Sierra Leone's performance under the PRGF arrangement. Since IMF debt relief is approved on an annual basis consistent with the completion of annual performance reviews, the delay in the sixth review resulted in the

loss of some amounts of interim relief, which is however re-imburseable as Sierra Leone reaches completion point in 2006. On an annual basis, interim debt relief amounted to US \$ 20.8 million in 2005 compared to US \$ 44.8 million in 2003 and US \$ 35.5 million in 2004. A decline is projected for 2006 at US \$ 15.9 million, but would increase as the completion point is reached.

6.2 Projected Debt Relief under the Multilateral Debt Relief Initiative (MDRI)

As Sierra Leone reaches the completion point of the HIPC initiative, multilateral creditors are expected to deliver irrevocable stock of debt relief schemes, together with an additional relief under the G8 MDRI. Indicative schedules show debt relief savings under the MDRI comprising IDA, IMF, ADB to rise from US \$ 2.9 million in 2007 to US \$ 30.2 million in 2008; US \$ 34.3 million in 2009; US \$ 40.6 million in 2010; and US \$ 41.1 million in 2011 as repayment of principal sums that fall due.

Table 12 – Delivery of HIPC Interim Debt Relief: 2002-March 2005 in Thousand US\$

	2002	2003	2004	2005	Grand Total
IMF	30,446	33,074	22,032	5,777	91,329
IDA	4,080	7,000	8,504	9,221	28,805
AfDB/F	1,232	2,552	2,718	2,637	9,139
EIB	0	2,138	2,270	2,031	6,439
IFAD	0	0	0	1,180	1,180
Total	35,758	44,764	35,524	20,846	136,892
Total (Le in Million)	79,323	106,864	95,408	60,689	342,284

Source: Ministry of Finance

6.2.1 Impact of Debt Relief on External Debt Service

HIPC debt relief has had positive impact on both the foreign exchange and fiscal budget through debt service savings. Prior to the application of HIPC relief, total debt service due in 2002 including IMF principal repayments stood at US\$57.9 million. However, after the application of HIPC relief of US\$35.8 million on the 2002 debt service obligations, net debt service paid amounted to US\$ 21.7 million. When compared to actual debt service paid by Government in 2001 of US\$87.9, there was a 75.3% drop of US\$66.1 million. There was increase in debt service due including IMF repayments in 2003 and 2004 from the total in 2002 by 2% and 7% respectively. However, net debt service paid of US\$13.9 million in 2003 was the lowest between the periods resulting from substantial inflow of HIPC savings totalling US\$44.8 million in 2003.

Table 13: Impact of HIPC Debt Relief on External Debt Service (in million US\$)

	2002	2003	2004	Q1 2005
Debt Service Due (incl. IMF repayments)	57,489	58,644	61,518	11,145
Debt Service Due (excl. IMF Repayments)	42,100	23,106	38,246	11,145
HIPC Inflow (Debt Service Savings)	35,758	44,764	35,524	3,404
Net Debt Service Paid	21,731	13,880	25,995	7,741

There was also a sharp increase in actual net debt service paid in 2004 by 87% relative to 2003. This was due to reduction in HIPC inflows and slight increase in debt service due before HIPC relief, in 2004. Reasons for the sharp fluctuations in HIPC inflows have already been examined in the preceding section. Actual debt service paid in the first quarter of 2005 amounted to US\$7.7 million. Actual debt service in 2005 is projected to increase as a result of substantial fall in projected HIPC inflows. Table 4.2 shows net debt service paid between 2002 and Q1, 2005.

6.2.2 Impact of HIPC Debt Relief on Government Budget

Following the approval of HIPC debt relief in March 2002, Government prepared a supplementary Contingent Poverty Budget based on inflows of HIPC resources amounting to Le75.3 billion. The resources were directed primarily at enhancing expenditures on health, education, security and rural development. Some of the activities included the rehabilitation and reconstruction of 13 district peripheral health units, 19 secondary health care services, increased tertiary health care services and purchase of essential drugs, the construction of over 30 primary and secondary schools, police barracks as well as several other poverty related projects including support to the new National Commission for War Affected Children.

However, since 2003, HIPC resources are subsumed into the consolidated budget meaning the HIPC relief is captured in the national budget framework as a grant contributing to the overall expenditure outlay, with special focus on poverty. These activities funded in the budget are not specifically linked to HIPC resources but the budget clearly shows expenditures that are pro-poor.

Table 14: Use of Interim Debt relief in Millions Leones 2002-2004

	2001	2002	2003	2004	2005(Est.)
Interim Relief		75,326	106,617	93,650	58,699
Poverty Reducing Budgetary Allocation		160,459	140,566	174,435	
Actual Expenditure	72,832	120,555	140,158	134,691	

Source: Budget Bureau, Ministry of Finance

In Table 14, it is observed that HIPC resources have gradually reduced from their peak in 2003. Actual expenditures on poverty, that is, HIPC and other sources, were also lower than budgetary allocations from 2002 to 2004. Since the Contingent Poverty Budget was prepared in the second half of 2002, and largely targeting rehabilitation and reconstruction works, much of the expenditure estimated at around Le35 billion in 2002 were rollover to 2003 because of the length of time that was required to prepare and actualise projects. Also, Government had asked MDA's to prepare strategic plans before accessing HIPC resources. Consequently, actual poverty related expenditure in 2002 was lower than programmed. However, it picked up in 2003. In 2004, actual expenditure declined by about 4 percent relative to the level in 2003. This was due largely to the shortfall in projected external budgetary support and higher than expected domestic interest payments although domestic revenue over performed. The loss in external support in 2003 was estimated at about Le133.5 billion while interest payment was higher than programmed by about Le38 billion. This shortfall coupled with weak capacity to utilise resources, particularly in infrastructure projects, and wage pressures explain the lower than programmed expenditure in poverty reduction.

6.3 Proposed G8 100% Cancellation of Multilateral Debt: Implications for Sierra Leone

On June 11, 2005, G8 Finance Ministers agreed to cancel up to US\$40 billion, which is 100 per cent of HIPC's debt owed to multilateral creditor institutions including the IMF and the World Bank.

To benefit from the G8 initiative, a HIPC country must have reached "completion point" under the enhanced HIPC Initiative. Under the Agreement, 38 countries are eligible to benefit from the debt relief. Initially, 18 countries inclusive of 14 from Africa that are post-HIPC completion point countries, are immediately eligible to benefit from the relief; while 9 others, including Sierra Leone that are in the interim period and currently receiving interim debt relief, would benefit from the Agreement upon reaching HIPC Completion Point. Eleven other countries that are all trapped in conflict, Governance and human right issues are yet to be eligible for any debt relief.

6.3.1 Implications for Sierra Leone

Sierra Leone's total external debt stock as at end March 2005 stood at about US\$1.7 billion. Of this, debt owed to the IMF, World Bank, African Development Bank and other multilateral creditor institutions amounted to US\$1.052 billion, about 60% of the total debt. The implication is that almost the entire debt of Sierra Leone inclusive of the Paris Club bilateral debt, which stands at US\$377.3 millions, would be cancelled. The current annual official debt service payment excluding external commercial debt is estimated at US\$40 million. Once Sierra Leone reaches completion point under the enhanced HIPC Initiative and benefit from the New G8 Initiative, these payments will be translated into debt relief savings and will increase resources to the social sector.

While the G8 Initiative addresses multilateral debt, HIPC countries remain to be strangled with commercial debt. In the case of Sierra Leone, Government has requested the World Bank to support a second IDA-Debt Reduction Programme to reduce external commercial debt amounting to about US\$270 million. It is expected that the Programme would be implemented as Sierra Leone reaches completion point in 2006.

6.4 Instituted Checks and balances to avoid reckless borrowing and irresponsible lending to the country

The GoSL has developed a detailed plan for the use of funds made available through debt relief under the enhanced HIPC Initiative, and for their transparent and accountable expenditure. The government has adapted its existing accounting framework to identify budget expenditures which are poverty-related, and that sub-component financed by HIPC relief. Projections indicate that HIPC relief will be directed primarily at increased expenditures on education, health, and rural development. The poverty spending plan will be guided by Sierra Leone's Interim Poverty Reduction Strategy Paper (I-PRSP).

Sierra Leone has made substantial progress in implementing economic reforms in recent years despite recurrent disruptions caused by the civil war that lasted till 2000. Following a peace agreement reached in mid 1999, the government, with support from multilateral donors, adopted a strong economic rehabilitation and recovery program aimed at sustaining the peace through disarmament, demobilization, and reintegration programs, promoting macroeconomic stability, and implementing key structural reforms.

Sierra Leone has also made strong structural reforms in recent years, including tax policy and administration reforms that support private sector redevelopment and fiscal stability, improved public expenditure management and control, exchange and trade liberalization to strengthen competitiveness, financial sector modernization and regulatory reforms, improvements in governance, and more effective delivery of social services.

The country's debt information including key debt indicators is attached as appendix 1.

7.0 Recommendations and Conclusion

7.1 Recommendations

The audit identified crucial issues associated with sourcing of external debt and subsequent utilization of the proceeds to implement programmes. Some of these originate from the creditors and the bulk emanating from the debtor nation. They include:

- 1) Loan negotiation should not be viewed as an occasion of political patronage. The technical elements in loan contraction are crucial to the successful implementation of the programme. Involving the wrong members in the delegation compromises the ability of the delegation to detect certain technical flaws in the loan agreement. Therefore, technically qualified personnel should be involved in loan negotiations.
- 2) Government has experienced repayment of mis-procured sums of money as a result of implementing agencies not following creditor procedures. Examples cited include the Artisanal Fisheries Project involving a micro-credit component of 549M Leones mismanaged by the National Cooperative Development Bank and the NaCSA Social Action Support Project under the African Development Bank funds amounting 249 Billion Leones, equivalent to 600 ADB's Units of Accounts. Mis-procurements represent injudicious utilization of creditor fund that could lead to loan suspension and cancellation.
- 3) Delays on the part of the creditors (sometimes emanating from the borrower or implementing agency) in disbursing portions of the proceeds of the loan that fall due and are applied for, lead to longer term project implementation with cost overruns. While beneficiaries are sensitized on a programme completion date that abnormally takes longer to come to fruition, the government comes under pressure from its citizens and sometimes from the international community. To ameliorate this, due consideration should be given to the recruitment of competent personnel to implement donor funded programmes. In carrying out their responsibilities, creditor procedures and regulations should be strictly adhered to.
- 4) The inability of government to pay the counterpart funds for programme implementation causes delays in programme completion. In some cases, creditors suspend disbursement of loans due to government's negligence in honouring its commitment to fully contribute to the programme. It results to doubts about government's ability to adequately budget for such expenditures. In some cases, certain commitments are undertaken that are not budgeted for by government. When it comes to implementation, availability of resources to finance the expenditure becomes a daunting task to the Ministry of Finance and Accountant General's Department. Therefore, Government should be critical on white elephant commitments, by not undertaking uncommitted expenditure or rather deferring them.
- 5) It was observed that co-funding and component funding of development projects in Sierra Leone run into protracted negotiation and implementation huddles. There are also co-funding problems with some of the development programmes. Since the activities to be funded by the different creditors sometimes go simultaneously or one contingent upon the other, delays in one creditor to disburse the loan would significantly hamper programme implementation even though the other creditor has provided the funds needed for its component. The problem is compounded by the multiplicity of the differences in disbursement or procurement procedures across creditors. The Sababu Education project, co-funded by World Bank and the African Development Bank is a suitable example in which one donor preferred construction varies. The variation in plans and facilities could lead to conflicts among communities and between communities and executing agencies.

Another example is the Bumbuna Hydroelectric Project where different donors are financing different components of the entire work. While one donor funds the construction of the dam and generation of

power, a second donor funds the transportation of the power from the dam site to the Kingdom power station, and another funds the distribution networks to consumers. While this is a cumbersome process in resource generation to fund the project, there is difficulty in having a smooth project implementation to attain the final goal. It could be understood that creditors have ceilings on loans they grant and therefore government is faced with the option of splitting one project into series of phases that end up in funding and implementation complications.

Therefore, Government should embark on donor engagement to highlight and negotiate challenges in such situations like the Bumbuna Hydropower project and encourage creditor support in 100% funding of projects of that kind.

- 6) The absorptive capacity of government to manage huge sums of money also came to light. This was expressed in the very slow rate of disbursement of funds to government because of its inability to fast track implementation.
- 7) The timeframe between programme identification and real start-up of utilization of the proceeds of the loan sometimes takes up to three years. Some project implementation personnel contacted reported the numerous and protracted studies carried out on a specific programme. Sometimes bureaucratic procedures in loan contract cause the delays between identification and start-up. Government should be upfront with fulfilling conditions precedent to granting the first disbursement under the loan.
- 8) Government has increased its capacity to track public debt statistics following the low premium that was given to debt management over the years and the staff turnover during the civil war. Support in this area are coming from Government, the ADB, the West African Institute for Financial and Economic Management, African Capacity building foundation (ACBF), Debt Relief International (DRI), Department for international development (DFID), IMF/World Bank and Commonwealth Secretariat (COMSEC). Series of trainings and work-programmes have been conducted and or supported by these institutions for personnel involved in public debt management. These trainings have covered External Debt Statistics; Debt Recording and Statistical Analysis, Training of Trainers on Debt Strategy Analysis; Debt Sustainability for Low Income Countries; Debt Reporting and the IMF/World Bank Debt Compilers Guide. Notwithstanding this, statistics on general macroeconomic indicators remain varied from different sources. As a capacity building drive, Government should embark on the harmonization of all macroeconomic data and develop standard reporting formats in consonance with international standards.
- 9) Recently, Parliamentarians were concern about the amount of grants or loans that actually go towards project implementation. Sources within parliament give an estimate as high as 70 per cent of the fund going back to the donor institution in the form of consultancies and other administrative costs. Civil Society and other stakeholders including parliament should lobby donor institutions and countries to utilize indigenous human and material resources except where such expertise is not available in country.

7.2 Next Steps

- i) Users of this study should understand public debt issues in order to challenge the strategic stakeholders on these issues;
- ii) There should be constant liaison with the debt compilation institutions like the Ministry of Finance, the Bank of Sierra Leone, Statistics Sierra Leone, the Parliamentary Committee on Public Accounts;
- iii) Users of this study should collaborate with the major creditor institutions for accessing their reports, websites and participation in debt programmes in the country;
- iv) Advocate for the involvement of the civil society groups in programme identification, design and implementation;
- v) Build constituency around and consult with the membership about critical issues

- vi) Identify the relevant power holders and constructively engage them for common understanding and remedy

Appendix 1 – Current Information on Sierra Leone's Debt Indicators

Table 1 - Social Indicators

No.	Key Indicators	2000	2001	2002	2003	2004	2005
1	Total population		3,515,812		4,971,000	4,976,871	
2	Health Expenditure as total % of Government Expenditure	na	8.7	10.6	11.3	12.1	8.8
3	Health Expenditure as total % of GDP	1.6	1.5	2.0	1.7	1.7	1.4
4	Education Expenditure as total % of Government Expenditure	na	21.1	23.4	24.2	23.6	20.1
5	Education Expenditure as total % of GDP	3.8	3.9	4.2	4.4	3.9	3.8
6	HIV Prevalence Rate %			0.9			1.5
7	Life Expectancy at Birth (Yrs)	na	na	na	37	na	na
8	% of Population Living under US \$ 1 a Day	na	na	81.6	na	na	Na

Sources: Statistics Sierra Leone; Ministry of Finance; National AIDS Secretariat

- Statistics Sierra Leone. **NOTE:** Since independence, four censuses have been conducted - 1963, 1974, 1985 (3,515,812) and 2004 respectively. Other figures are estimates.
- National Population-Based HIV Seroprevalence Survey Sierra Leone - 2005. The 2002 figure was survey conducted by Centre of Disease Control (CDC)

Table 2 - Basic Indicators of External Debt (US \$ million, unless otherwise indicated)

No.	Key Indicators	2000	2001	2002	2003	2004	2005
1	External Debt Stock	1,221.36	1,427.60	1,536.04	1,630.40	1,712.80	1,698.30
2	Domestic Debt Stock*	67.75	105.26	130.00	147.34	161.38	179.59
3	Total Debt Stock	1,289.11	1,532.86	1,666.04	1,777.74	1,874.18	1,877.89
4	Domestic Debt/Total Debt (in %)	5.3	6.9	7.8	8.3	8.6	9.6

Domestic Debt Stock (Million Le)*	142,180	208,968	272,899	345,574	435,935	512,962
Average Official Exchange Rate (Le = 1US\$) (Mid-Rate)**	2098.71	1985.19	2099.16	2345.42	2701.3	2856.3

* Domestic Debt Stock (in million Leones) converted to US\$ using average mid-rate exchange rate figures

** Source: Bank of Sierra Leone Bulletin (Jan-June 2005)

Sources: External & Domestic Debt Figures - Ministry of Finance and Bank of Sierra Leone

Table 3 - Debt Indicators (US \$ million, unless otherwise indicated)

No.	Key Indicators	2000	2001	2002	2003	2004	2005
1	Bilateral Debt Stock	346.00	371.30	406.70	434.70	415.70	403.30
2	Multilateral Debt Stock	759.00	784.10	878.64	945.90	1,043.50	1,050.00
3	Commercial External Debt	116.36	272.20	250.70	249.80	253.60	245.00
4	Total External Debt Stock	1,221.36	1,427.60	1,536.04	1,630.40	1,712.80	1,698.30
5	Total Domestic Debt	67.75	105.26	130.00	147.34	161.38	179.59
6	Total Debt Stock (Ext. & Dom.)	1,289.11	1,532.86	1,666.04	1,777.74	1,874.18	1,877.89
7	Total External Debt Service Paid	na	na	na	na	61.50	47.39
8	Export (fob)	12.94	29.09	48.70	92.40	139.70	152.60
9	Total Debt as % of Exports (fob)	9962.2	5269.4	3421.0	1924.0	1341.6	1230.6
10	External Debt as % of Exports (fob)	9438.6	4907.5	3154.1	1764.5	1226.1	1112.9
11	Nominal GDP	633.88	806.05	935.91	985.23	1,071.43	1,234.26
12	External Debt as % of GDP (nominal)	192.7	177.1	164.1	165.5	159.9	137.6
13	Interim Debt Relief (HIPC)	na	na	35.76	44.76	35.52	20.85

Nominal GDP (billion Leones) 1330.32 1600.17 1964.63 2310.77 2894.26 3525.42

Sources: Bank of Sierra Leone; Ministry of Finance; WAIFEM