

average of 15% in 2008 and has worsened the primary fiscal deficit as well as the current account balance. Significant revenue shortfalls, exacerbated by delayed external assistance had complicated budget execution, already weakened in the context of national elections. Since end 2007, efforts are being made to restore fiscal discipline and pursue structural reform to maintain macroeconomic stability.

The world food crisis presents a significant challenge to poverty reduction in Sierra Leone. The international price of rice, a staple of the Sierra Leonean diet, has doubled from \$375 to \$775/ton over the first six months of 2008, although it roughly went back to previous levels by 12/2008. As rice represents one third of household expenditure on food, recent estimates suggest that a 20% increase in price of rice alone would put an additional 100,000 to 150,000 people into poverty. Standards of living have further been reduced by the high price of fuel which forms a relatively high proportion of the final cost of goods due to weak transport infrastructure.

2.1.2. National Development/ Cooperation Policy and Strategy

National policy and strategy: The Government of Sierra Leone (GoSL) has adopted a Poverty Reduction Strategy Paper (2005-2007) which has been extended until the adoption of a new PRSP (II) covering 2009-2013. The draft PRSP II indicates the GoSL's intention to redirect its development strategy towards a strengthening of the productive sector and ensuring an environment conducive of economic growth as a way to reduce poverty.

In response to the rise in food and fuel prices GoSL undertook a number of measures to reduce the burden on the population. Import tariff rates on petroleum, rice, wheat, flour and sugar were reduced and the government fixed the reference price for rice tariffs at \$375/ton, well below world prices. This ensured that while rice inflation on international markets reached 138% in June 2008, domestic prices only rose by 49%³. The GoSL has also developed the National Agriculture Response Plan in direct response to the food price crisis. The NARP suggest major investments in 1) the development of safety nets, 2) agricultural production and 3) rehabilitation of feeder roads. Component 2) agricultural production is well covered by an allocation of 16,200,000 euros under the EU funded Food Facility programme. In contrary, there is currently still a significant funding gap on component 1) and 3) of the NARP. GoSL further acted to improve food security in the future by distributing an additional 71,000 bushels of seed rice to farmers. Additionally the government imposed a ban on the export of rice and palm oil. The forgone revenue from the tariff reductions has resulted in a budget shortfall.

National Budget and medium term financial perspectives: Estimated GoSL budget for the year 2009 amounts to 312,400,000 euros including grants. National budget remains highly dependent on external aid (45%). Although the objective of the GoSL remains to restore budget credibility and ensure a macroeconomic framework and the PFM capacity of the GoSL this objective has been put under pressure by the food and fuel crisis.

Due to the reduction of import tariffs, GoSL has estimated a shortfall of approximately 500,000 euros on food products and 4,300,000 euros on petroleum from its budget for 2008. Furthermore, GoSL faces rising costs in the provision of basic services. It provides free meals for children in Government boarding schools and schools for the handicapped; it provides food for patients in Government hospitals; provides the meals of prisoners, the police and the armed forces; and faces rising costs at the local authority level where responsibility for health and education has been decentralised. GoSL estimated the extra costs for 2008 to be 2,000,000 euros for food and 1,000,000 euros for fuel. The funding gap as a result of the food crisis alone rests at 2,500,000 euros, totalling around 8,000,000 euros if the funding gap due to fuel is included. In its last PRGF review, the IMF Board has granted an upward revision of the primary fiscal balance target by 0,4% of GDP to accommodate the budget impact of the rise in fuel and food prices.

In January 2009, the Ministry of Finance reported a 32% increase in value in food imports over 2008, thus affecting the country's current account balance and the stock of foreign reserves held in the Central Bank.

³ Statistics Sierra Leone

Performance Measurement: Performance measurement for GBS is conducted through close dialogue with the IMF for the macroeconomic situation, and the IMF-WB for the PRSP review (Annual Progress Report process). The MDBS partners have agreed to assess jointly a Performance Assessment Framework (PAF). The selected indicators for the draft PAF 2009 are coherent with the Millennium Development Goals (service delivery: education, health) and EC priorities in terms of fostering transparency in budget management (PFM reform) and good governance (civil service reform, economic reforms, accountability, etc.). They are also in line with the Government's PRSP priorities.

2.2. Eligibility for budget support

2.2.1. *National Development or Cooperation Policy and Strategy*

The GoSL changed some institutional arrangements within MoFED to strengthen the PRSP preparation process and the aid coordination. The Development Aid Coordinating Office (DACO) core functions have been integrated into the Ministry of Finance and Economic Development, although the PRS monitoring function will probably move to Statistics Sierra Leone (SSL) and general aid policy may go back to the President's office.

2.2.2. *Macroeconomic situation*

GDP growth in Sierra Leone has remained around 7-8% in the post-war years. However, as resettlement following the war is completed the country must rely on productivity increases to drive economic growth. This has not occurred and so real GDP growth slowed to 6.4% in 2007 and is projected to fall to 5.5% for 2008 and 2009, barely sufficient to maintain per capita incomes. Inflation has increased dramatically in 2007 and 2008 due to the effects of higher food and fuel prices. Deviating from its recent average of 10%, inflation reached a peak of 17% by September 2008 before falling to 13% by the end of the year as commodity prices have fallen. The fiscal situation excluding grants has deteriorated in 2008 partly due to GoSL's change in fiscal stance in response to the fuel and food crisis. The deficit before grants is projected to rise from 6.8% of GDP in 2007 to 9.4% in 2008. Support from donors and the Multilateral Debt Relief Initiative has limited the actual deficit for 2008 to a projected 2.8% of GDP. The inflationary shock of higher world commodity prices has led to an appreciation of the real exchange rate of 2.9% in the year from September 2007. As a consequence the current account deficit is estimated to have widened to 10.6% of GDP in 2008. This evidence points to increasing internal and external imbalances that, if left uncontrolled, could prompt a macroeconomic crisis.

2.2.3. *Public Financial Management*

A PFM-PEFA Performance Assessment Report was carried out in December 2007 and published in May 2008. This report emphasises the improvement in aggregate financial discipline. The report also points at some fiscal management failures but also at weaknesses as regards donor practices (predictability of budget support, etc.).

Sierra Leone has made progress in PFM reforms in the last few years monitored in the wider context of the MDBS. A PFM National Action Plan (NAP) was implemented in 2006-2007, and delivered reforms in a number of areas. The PFM legal framework is in place and the new financial regulations (FMR) were adopted in 2007. There is strong political commitment on the side of the Ministry of Finance though further prioritisation and sequencing of the programme is needed.

In order to consolidate the improvements made and coordinate donor interventions the GoSL has prepared an Integrated PFM Reform Programme (IPFMRP) supported by donors which is addressing persisting weaknesses in Sierra Leone's PFM system. It comprises a comprehensive set of activities and indicators aiming at promoting efficiency and accountability in the use of public resources. It should be entering into force in 2009.

2.3. Sector Policies

Budget support operations and PFM are closely linked to other ongoing and planned sector policies such as the civil service reform, the fight against corruption and the new private sector/productive approach and interventions in agriculture. In the specific case at hand, one should also take into consideration sector policies in the context of the NARP.

2.4. Lessons learnt

The 9th EDF budget support has been focused on poverty reduction but recent macroeconomic slippages lead MDBS donors to focus on macro-economic stability and monitoring of the framework PFM reform as it is essential to give the State the means to deliver results in the fight against poverty.

This is indeed the approach developed by the SL 10th EDF budget support programme (2009/2011), amounting 46,400,000 euros (39,000,000 euros (GBS) + 7,400,000 euros (complementary support PFM).

Performance assessment (PAF 2009) has been adapted to this new approach. The MDBS annual review in July 2008 decided to modify some aspects of the joint system to ensure better predictability (timing of disbursement) and ease budget execution that will improve quality of poverty expenditure. MDBS partners have agreed to align their strategies and support the new IPFMRP. The idea is to increase the effectiveness, coherence and ownership of PFM reform activities and to reduce transaction costs in line with the Paris Declaration and the Aid Effectiveness Agenda. The EC will ensure complementarity with actions from other MDBS partners.

2.5. Complementary actions

Other donors are providing budget support (WB, DfID) and are currently involved in PFM interventions. A substantial project to support the NRA is being implemented by DfID (£16 million for 3-5 years). Donors' support to social sectors is mainly provided through a project approach.

Following the food crisis the World Bank has disbursed approximately 2,100,000 euros in direct budget support to the government to cover both the fuel and food funding gap. In combination with the Commission's additional budget support of 6,420,000 euros this will cancel out all of the approx. 8,000,000 euros 2008 budget shortfall caused by the food and fuel crisis.

As outlined earlier, the Commission allocated a further 16,200,000 euros in direct response to the food price crisis under the Food Facility Programme as well as 2,700,000 euros for the development of safety nets in urban and sub-urban areas of Freetown under the Food Security Thematic Programme.

In addition the release of the remaining Variable tranche of the 9th EDF budget support programme is still to be requested and evaluation. Afterwards, the 10th EDF general budget support intervention will assure the continuity of the EC support in this framework.

2.6. Donor coordination

Donor coordination is organized within the MDBS framework. MDBS do have regular and ad-hoc meetings to address budget support, macroeconomic and PFM issues. A stronger coordination with the IMF is needed to monitor the macro-economic situation, budget execution and structural reforms (PFM, economic governance, financial sector). This is in line with the EC communication for fragile states, the Conclusion of the Council (16 Nov 2007) and Paris Declaration. On the GoSL side, MoFED is expected to play a significant role in improving donor coordination.

3. DESCRIPTION

3.1. Objectives

The supplementary budget support will help reduce the unexpected increase in GoSL's budget deficit due to the rise in world food and fuel prices. This will maintain macroeconomic stability and allow GoSL the fiscal space to phase-out the fiscal measures undertaken in 2008 to cushion the impact of the hike in food and fuel prices. It will also allow GoSL to address some funding gaps of the NARP (see above) as well as to resume or step-up some of its poverty-reducing expenditures in the coming months.

3.2. Expected results and main activities

In the short term, this intervention is expected to ease budget execution, strengthen Sierra Leone's macroeconomic framework (decreasing fiscal deficit, improving current account balance, improving foreign reserves position) and resume suspended poverty-related programmes. GoSL has committed to

maintaining expenditure on food for schools and hospitals, as well as providing local councils with sufficient funding to do the same. Therefore the additional budget support will indirectly contribute to basic service delivery and will further macroeconomic stability. As indicated above, this intervention will also allow filling the financing gaps identified the NARP.

3.3. Stakeholders

The main stakeholders of this additional budget support will be the GoSL. Provision of financial resources is expected to be allocated to various ministries, in accordance with the GoSL's policy agenda. Ultimately, the population of Sierra Leone will benefit from this budget support operation, thanks to a stable macro-economic environment and continued provision of essential public services. Other DPs (and IMF) are also stakeholders.

3.4. Risks and assumptions

The global economic environment has remained volatile since the peak of the food and fuel crises. Due to the normal harvests across the world and investment in greater productive capacity, food prices have tailed off since their peak in the first half of 2008 and are unlikely to rise to those levels in the medium term. Likewise, the price of petroleum has fallen as global economic prospects have worsened. Falling prices eases the pressure on standards of living in Sierra Leone, however the same price drop could worsen the fiscal deficit unless the reduction in import tariffs is reversed. GoSL has described the tariff cuts as temporary and therefore falling prices is not a significant threat to macroeconomic stability. A greater threat comes from the global economic downturn which has already damaged the terms of trade and could widen the current account deficit further. The additional budget support would only serve to appreciate the real exchange rate and therefore exacerbate this problem. Finally, economic governance issues or corruption remains a risk, especially due to the unanticipated nature of this financial support. The Ministry of Finance and Economic development has created a special fund to deal with commodity crisis-related funds to mitigate this risk.

3.5. Crosscutting issues

The EC additional budget support should generate positive results at political, economic, social and environmental levels.

4. IMPLEMENTATION ISSUES

4.1. Budget and calendar

The budget is fixed at 6,420,000 euros to be taken from Envelope B of the 10th EDF. The budget will be allocated as an additional fixed tranche to the ongoing Sierra Leone 9th EDF general BS programme (9 EDF SL 17 - CRIS 2004/017-043)

The release of the tranche should take place before 31/12/2009 (end of the operational implementation phase of the programme). The rider will increase the overall amount of the Financial Agreement from 62,000,000 euros to 68,420,000 euros.

4.2 Budget support modalities

General, direct and non-targeted budget support. Additional fixed tranche (5th) to the SL 9th EDF BS programme.

4.3 Performance monitoring and criteria for disbursement

Description of performance monitoring arrangements

The performance monitoring arrangements and the criteria for disbursement of funds will be the same as for the SL 9th EDF BS programme. The same as the original FA.

4.4 Evaluation and audit

The dispersal of additional funds related to the food crisis will be evaluated within the ongoing 9th EDF General Budget Support process. Evaluation reports will be presented to the GoSL and to the MDDBS. The same as the original FA.

