TOWARDS WALKING OUT OF FRAGILITY IN SIERRA LEONE

Highlights from the Sierra Leone

Development Finance Assessment (DFA) and Integrated National Financing Framework (INFF)

Ministry of Planning and Economic Development

2020

Background

Sierra Leone's Medium-Term National Development Plan (MTNDP) 2019-2023 sets an ambitious vision for the country's sustainable development. It targets various development parameters, including stable economic growth, enhanced public finances and service delivery, alongside progress in poverty reduction, education, health, and peace and cohesiveness. Achieving the targets in the MTNDP will be an important step in Sierra Leone's journey out of fragility towards its vision of becoming an inclusive, green, middle-income country by 2035.

A development finance assessment (DFA)[1] was commissioned to inform how to finance the plan. The DFA report summarises the findings from DFA dialogues about the landscape, trends, and opportunities for financing the MTNDP. It revealed several opportunities to grow public resources, mobilise new private investments, deepen the engagement of the diaspora and enhance collaboration with new and emerging development partners.

Mobilizing the required resources entails implementing diverse policies and partnerships in collaboration with other actors. To support this, the Government prepared an integrated national financing framework (INFF) to oversee and drive forward financing and means of implementation across the national plan. This abridged version presents key elements of the INFF and DFA, including a table of recommended actions.

The DFA and INFF were prepared in 2018/2019, often drawing on 2017 data. While specific circumstances may have shifted since that time, the overall elements and recommendations are still considered applicable to the current situation.

The Financing Landscape

Understanding the financing landscape is vital for identifying the most pertinent opportunities and priorities for financing the national plan. It is important to build as comprehensive an understanding as possible of current trends and trajectories across public and private flows, and the contributions that these diverse types of financing are making toward sustainable development in Sierra Leone.

Figure 1 depicts contributions from four types of development finance that are standard across countries. While Sierra Leone has experienced growth in overall financing since 2008, this is dominated by domestic and international public finance, shown in the blue and grey areas. The contribution of private sector finance (orange and yellows areas) remains nascent, although there have been significant fluctuations year-on-year. Figure 2 shows a snapshot of just the year 2017, revealing that International public finance alone accounted for about a quarter of total financing, in the form of official development assistance (ODA). This as compared to 18% for government revenues and 14% for other forms of Government finance.

[1] The DFA is a UNDP tool built on development finance principles articulated in the Addis Ababa Action Agenda from the third international conference on Financing for Development.

Figure 1: Multi-year Trends in the Four Types of Development Finance

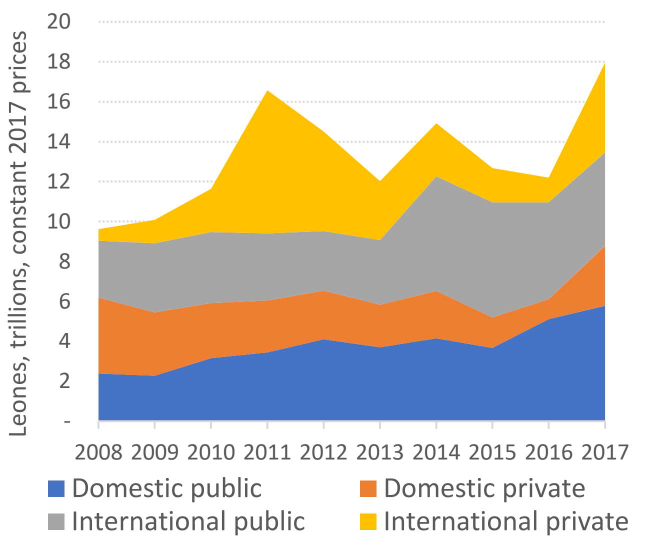
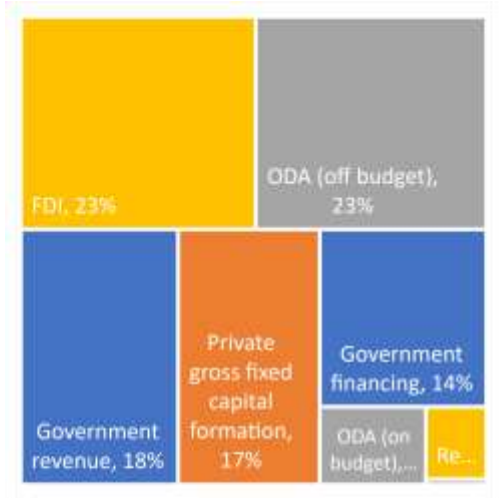


Figure 2: Contributions to Development Finance in 2017

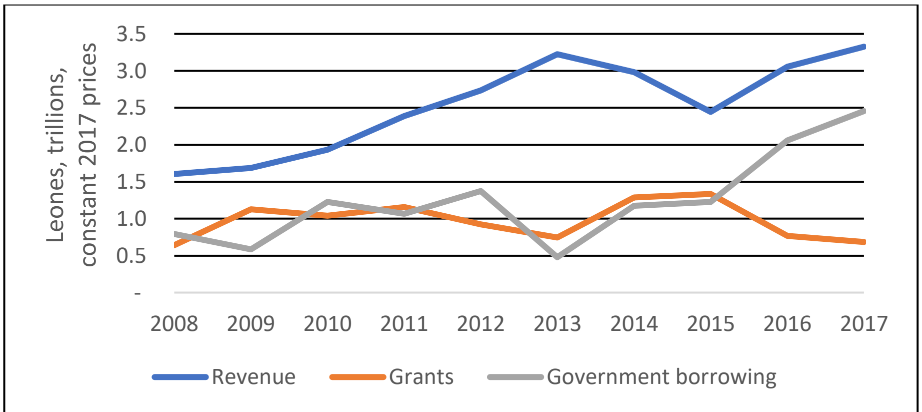


Sources: based on data compiled from a range of sources – see full INFF data notes annex for details. Data in Figure 2 is for 2017, except for data on state-owned enterprises which is for 2016. Re = remittances.

Looking more closely at Government finance, Figure 3 shows that total government revenues (blue line) has grown an average of 10% a year over the last decade. Despite this, revenue has not kept pace with increased government spending and public debt levels have steadily risen, including new foreign loans that almost doubled between 2016 and 2017. Consequently, government interest payments have risen sharply and were equivalent to 18% of total government revenue in 2017.

Income tax accounts for the largest portion of revenue, followed by customs and excise taxes, all of which can fluctuate significantly from year to year. Revenues remain very low both in absolute terms and compared to neighbouring countries. Raising domestic revenues is a high priority for the government and it has shown strong commitment to reforms, including steps to strengthen tax administration, revise tax policy, and remove costly tax exemptions. State-owned enterprises will continue to play a critical role for financing in key areas such as energy, transport, and other infrastructure.

Figure 3: Government Source of Funds, 2008-2017



Private Sector

Credit to the private sector, a proxy for domestic investment, accounted for just 4 per cent of domestic lending in 2017. Addressing constraints to private sector borrowing and longer-term borrowing is critical. Reducing public dominance in domestic debt markets that crowds-out private borrowers is key, as well as issuing longer maturity debt to help stimulate longer-term lending more widely. The underdevelopment of capital and financial markets limits access to commercial funding and this must be addressed to achieve outcomes of the national plan, as stimulating private sector investment can help drive growth in key commercial sectors. Investment from abroad, in the form of foreign direct investment, can also be further developed, as it is presently characterized by low underlying volumes, punctuated by larger, infrequent one-off investments.

Development Cooperation

ODA plays a significant role in Sierra Leone's financing landscape, accounting for over a quarter of total financing. The majority of ODA is provided in the form of grants, although loans have increased within total ODA. The health sector is the largest recipient of ODA, and ODA to other social development sectors has also grown rapidly.

Part of the health funding that Sierra Leone receives comes from thematic funds such as GAVI or the Global Fund. Sierra Leone has been quite successful in accessing finance from international thematic funds focused on health and there is similar potential to access more international climate funds to scale up funding for climate and the environment.

Diaspora and Remittances

Remittances are a vital source of financing for many communities as well as a key source of foreign exchange for the country. Most are thought to come from Sierra Leoneans in three countries, Guinea, USA and UK, which together accounted for an estimated 77 percent of remittances in 2017 according to the World Bank migration and remittance database.

Formal remittances totalled nearly US$50 million in 2017, but the true value of remittances may be significantly higher. As Sierra Leone is one of the few countries in the world to tax the receipt of remittances, many do not go through formal channels. Transfers to the country are subject to the 20% goods and services tax (GST), making remittance transfer costs to Sierra Leone higher than in several neighbouring countries.

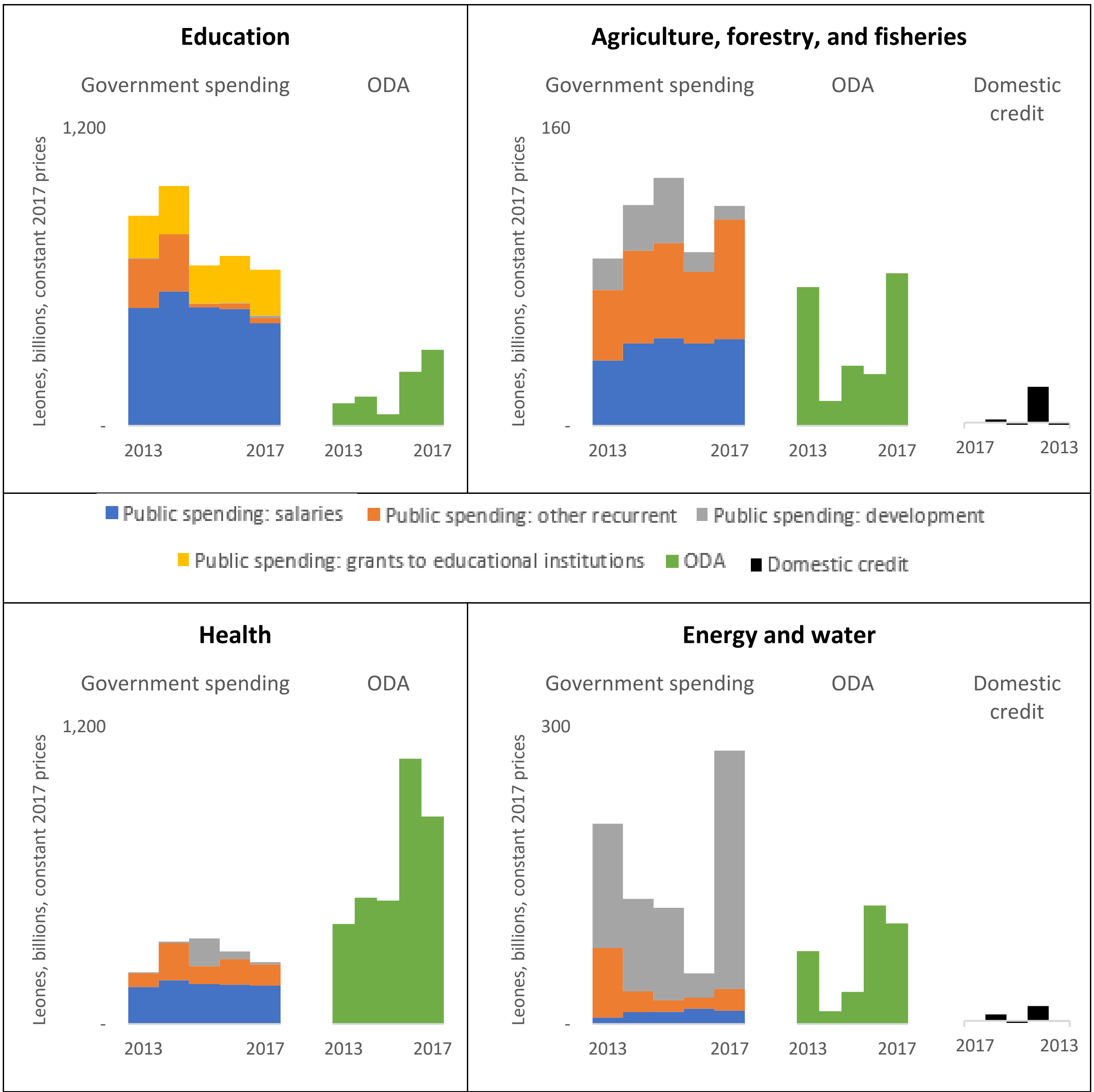
There are opportunities to deepen finance engagements with the diaspora through mechanisms such as diaspora bonds. These have been used by a growing number of countries as a mechanism to access longer-term, lower-cost financing for development projects. Government can explore and lay the groundwork for of a diaspora bond programme, as well as increased remittance flows, to enhance financing for national plan investments.

Integrated Planning and Finance

Sierra Leone uses decentralised structures to implement national plans and programmes (see back cover). The Ministry of Planning and Economic Development plays a coordinating role, working at the national level as well as with regional administrations and districts at the subnational levels. Ministry of Finance oversees the annual budget process. Infrastructure projects are often led at the national level, largely due to lack of capacity at subnational levels within the decentralized system.

The national plan identifies strategic sectors for achieving objectives and understanding the mix of resources being invested in each sector is important. Figure 4 shows there is often significant variation in public spending, which comes in the form of salaries (blue) and other recurrent spending (orange), among others. ODA spending is shown in green.

Figure 4: Breakdown of Finance in Key Sectors, 2013-2017



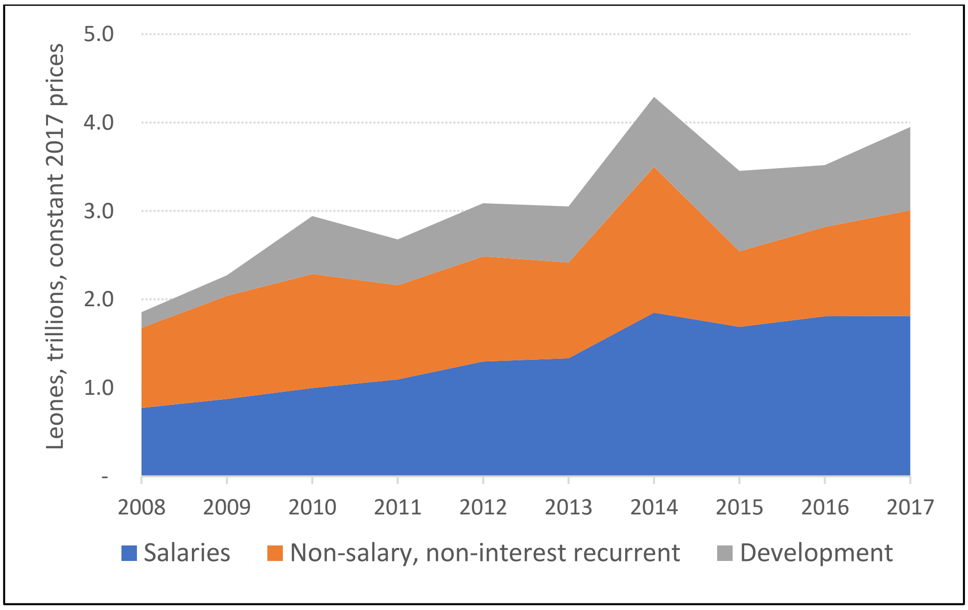
Sources: Ministry of Finance, OECD DAC, and Bank of Sierra Leone. See full INFF report for additional notes.

Aligning the National Budget with the MTNDP

Government spending is the largest resource within Sierra Leone's financing landscape invested explicitly for the purpose of advancing national development priorities. The effectiveness of government spending therefore is a key determinant of progress toward MTNDP objectives. Yet, there are often fluctuations between planned, budgeted, and actual spending, presenting challenges for delivering on the MTNDP. Achieving the government's revenue targets would mobilise significant additional resources for public investment in the national plan.

While increasing overall fiscal space will be critical for investing in the MTNDP, the quality of public spending is just as important as the overall level. Three-quarters of budget spending is recurrent, including on salaries, which accounted for 46% of public spending in 2017 (see Figure 5). There is room for enhanced systems to manage public spending in prominent cross-cutting areas, such as gender equality and addressing climate change challenges.

Figure 5: Trends in public salary, non-salary, and development spending, 2008-2017



Source: Author's calculations based on Ministry of Finance. Note that 2013 figures are budgeted, not actual.

Private Investment

Private actors such as businesses, investors, and the diaspora, have important roles to play in the realization of the national plan, as many MTNDP objectives are impacted by the extent and nature of private sector investment. The scale and nature of commercial investments are a key determinant of economic growth and contribute toward job creation and other areas of sustainable development articulated in the national plan. Working with the banking community to develop suitable domestic lending products is important to promote private sector growth, especially in sectors key to MTNDP objectives.

Reducing public borrowing levels is also important to promote more favourable lending terms being offered to the private sector. The dominance of public borrowing is driven by the high demand for credit from the government and by the high interest rates that it is willing to pay.

Stock exchanges can play an important role in growth and development by helping businesses to mobilize resources to fund growth. Sierra Leone has a stock exchange established in 2009, however it is largely inactive and not fulfilling its role in facilitating investment. A functioning stock exchange could unlock and channel resources into productive investments.

Public-private partnerships are a mechanism for leveraging financial, human, and technical resources to deliver public investments and services. For example, Government-held pension assets can be used for infrastructure investments involving private sector partners, and public funds can help attract private capital through instruments such as *development impact bonds*. These bonds are an innovative mechanism for attracting private capital and are designed to generate specified, pre-agreed sustainable development outcomes at affordable cost.

Similarly, *diaspora bonds* are instruments that allow a government to borrow from members of the overseas diaspora to fund public investments. They can be attractive as they provide a mechanism for borrowing in hard currency, often at lower cost and with longer maturities than is possible through other mechanisms. The Government can also consider promoting Islamic finance bonds and banking practices to expand financing options.

Systems Strengthening Needed for Successful INFF Implementation

Enhance Integrated Development Planning and Reporting: adopt an integrated approach to implementing and reporting on international commitments, decentralized to local levels for efficient financial management; increase alignment with non-state actors' plans.

Automate Financial Systems: use innovation and technology in revenue generation and expenditure management, and in key other sectors, such as health, energy, and education.

Establish Public-Private Collaboration Platforms: support public-private dialogue to build mutual understanding between government and private actors to promote investment in critical sectors and catalyze production to induce needed revenue flows.

Promote Economic Diversification and value-added Production: spread investment attention across sectors such as agriculture, fisheries and tourism, alongside mining and other sectors with private sector participation; support the human capital development project.

Monitoring and Review*:* assess the efficacy of existing mechanisms to monitor, track and report on each financing initiative and build necessary capacity.

Governance and Coordination*:* use local and national governance structures for dialogue on revenue generation; develop recommendations for strengthening institutional structures.

Monitoring and Accountability

The ability to monitor the impact of different types of finance on sustainable development outcomes is key for maximizing realization of the national plan. While finance tracking systems capture information on resources invested, by whom, and how, it is important to complement this with monitoring systems that capture information on development results for a full picture of the impacts investment are having on sustainable development outcomes.

Mutual accountability and transparency in public finance resource allocation are important for mobilising and effectively investing resources in the national plan and building partnerships among actors. Stronger monitoring will enable greater impact on sustainable development outcomes. Beyond the central government, budget transparency among state-owned enterprises seems weak. The DFA failed to access basic information on the financial performance, spending and investment of key state-owned enterprises.

Key Recommendations

Enhance Domestic Revenue Mobilization:
introduce a GST lottery using customer receipts as entries, to encourage greater compliance; boost large taxpayer auditing capacity, publish tax expenditure reporting information (including for exemptions), and revise levies and departmental charges.

Align Public Spending more with MTNDP:
build MTNDP outcome information into the budget process of Ministries, Departments, and Agencies to be more results-focussed; track public spending on cross-cutting priorities, such as gender and climate.

Boost Private Participation in Public Investments:
leverage diaspora financing for issuing diaspora bonds; invest a portion of pension assets held by Government into strategic long-term infrastructure projects; pursue public-private partnerships to leverage financial, human, and technical resource from the private sector.

Maximize Benefit from Development Cooperation:
access untapped and innovative models of development cooperation, including with emerging development partners through South-South Cooperation, encourage piloting of new models such as development impact bonds; access support from untapped global thematic funds, especially for climate projects; work to qualify for a US Millennium Challenge Corporation Compact (realized by Sierra Leone in 2020).

Encourage Private Sector Investment and Growth:
adjust the scale and profile of public debt to reduce crowding-out private borrowing; promote long-term lending to business with financial sector reforms; encourage public sector banks to increase private sector lending; reboot the stock exchange; promote diaspora investment; lower cost of sending remittances to Sierra Leone; and reduce illicit financial flows.

Financing Options from the INFF

The following tables include 18 recommended Financing Options for the Government and other actors to pursue, organized into three categories. Details are provided here for select options only, to illustrate details contained in the full INFF document for all Options.

Maximizing public sector revenue

1. Introduce a GST lottery using customer receipts as entries to encourage compliance
2. Boost large taxpayer auditing capacity of National Revenue Authority
3. Revise levies and departmental charges to ensure costs are covered
4. Build outcome information into the budget process to align more with MTNDP
5. Create systems to track public spending on gender and climate
6. Publish tax expenditure reports, including revenue foregone through tax exemptions
7. Establish a diaspora bond to fund strategic development investments
8. Promote the investment of a portion of pension assets in infrastructure

FINANCING OPTION	ACTIONS
7. Establish a diaspora bond 8. Promote investment of pension assets in infrastructure	**Ongoing Actions in Pursuit of these Options** •The World Bank conducted diaspora mapping in Europe and the USA to gauge investment interest •Investing in debt securities **Additional Actions Needed to Mobilize Resources under these Options** •Create the regulatory landscape by the central bank •Conduct Scoping research to gauge the scale of an offering including interest rate, term length and frequency of issuance •Determine the target diaspora •Decide on the structure of the bond - project-based or earmarked funding •Collaborate with international institutions to designing and manage bonds •Re-establish the stock exchange •Explore new investment types for pension assets
Key Stakeholders Identified for Pursuing these Options: Ministry of Finance, Debt Directorate; Central Bank; Office of Diaspora Affairs; Ministry of Planning and Economic Development; Association of Commercial Banks; CSOs; UNDP; World Bank; NASSIT **Existing Coordination Structures to Follow up on these Options**: Ministry of Finance, Cash Management; Presidential Economic Briefings **Timeline Needed for the Delivery of these Options**: These actions could take up to 24 months to actualize from the time of initiation	

Private sector investment and financial services

9.	Promote longer-term lending to businesses with financial sector reforms
10.	Encourage public sector banks to lend more to private sector and limit purchases of public sector debt
11.	Promote diaspora investment through one-stop shop, diaspora bank accounts, and relaxed capital controls to promote business investment
12.	Conduct public-private dialogues on how to mobilize inclusive, sustainable private investment and design positive business-related reforms
13.	Reduce tax on remittances and promote digital services to lower transaction costs
14.	Reduce illicit financial flows through anti-corruption, auditing, and customs detection

FINANCING OPTION	ACTIONS
9. Promote long term lending to businesses with financial sector reforms 10. Encourage public sector banks to lend more to the private sector and limit purchases of public sector debt	**On-going Actions in Pursuit of these Options** •Introduce know your customer strategy by the Central Bank •Operationalise the single lending limit of 25% of capital by banks •Operationalise collateral register by the Central Bank •Banks investing heavily in gilts (fixed-interest securities) **Additional Actions Needed to Mobilise Resources under these Options** • Update the current prudential guidelines to reflect international reporting standards in addressing classification of delinquent loans •Establish a quota system for banks in relation to the amount of government debts (bonds) that they can buy annually •Strengthen the current regulatory framework to enable banks to undertake long term financing/investment in relation to the amount of regulatory capital required to support such plans •Encourage state banks to skew their investment portfolios towards private sector lending •Facilitate responsible lending to the private sector

Key Stakeholders Identified for Pursuing these Options: The Ministry of Finance; The Central Bank; Association of Commercial Banks; IFC; Civil society organisation; Ministry of Trade and industry; SMEDA; European Union; African Development Bank; FCDO, Chamber of commerce; Apex Bank

Existing Coordination Structures to Follow-up on these Options: Ministry of Finance Cash Management and Presidential Economic Briefings

Timeline Needed for the Delivery of these Options: These actions could take up to 18 months to actualise from the time of initiation

Maximizing Strategic Development Cooperation

15. Engage South-South Cooperation partners and establish a secretariat for such
16. Access US Millennium Challenge Corporation Compact funding
17. Introduce development impact bonds to support investments in key MTNDP sectors
18. Access support from untapped global thematic funds, especially for climate finance

<table>
<tr><th>FINANCING OPTION</th><th>ACTIONS</th></tr>
<tr><td>15. Engage South-South Cooperation partners

16. Access US Millennium Challenge Corporation Compact funds

17. Introduce development impact bonds</td><td>On-going Actions in Pursuit of these Options
•Establish new diplomatic relations with South-South Cooperation partners to build mutually beneficial partnerships
•Conduct a ‘constraints analysis’ to inform Millennium Challenge Corporation Compact development

Additional Actions Needed to Mobilise Resources Under these Options
•Cultivate direct engagement between potential South-South Cooperation partners and the recommended secretariat
•Conduct ongoing dialogue to build relationships with South-South Cooperation partners, especially in key MTNDP sectors
• Continue to engage a range of stakeholders for the ‘constraints analysis’ and future steps required for Millennium Challenge Corporation Compact development
• Actively engage with development partners who have experience with issuing of development impact bonds in other countries, including the UK and USA, to explore potential application to Sierra Leone</td></tr>
<tr><td colspan="2">Key Stakeholders Identified for Pursuing these Options: The Ministry of Foreign Affairs and Development Cooperation; Ministry of finance; Ministry of Planning and Economic Development; Chinese embassy; NaCSA; USAID; Anti-corruption commission; Ministry of Water Resources; Ministry of Energy and Civil society organisations
Existing Coordination Structures to Follow-up on these Options: Ministry of Finance Cash Management and Presidential Economic Briefings
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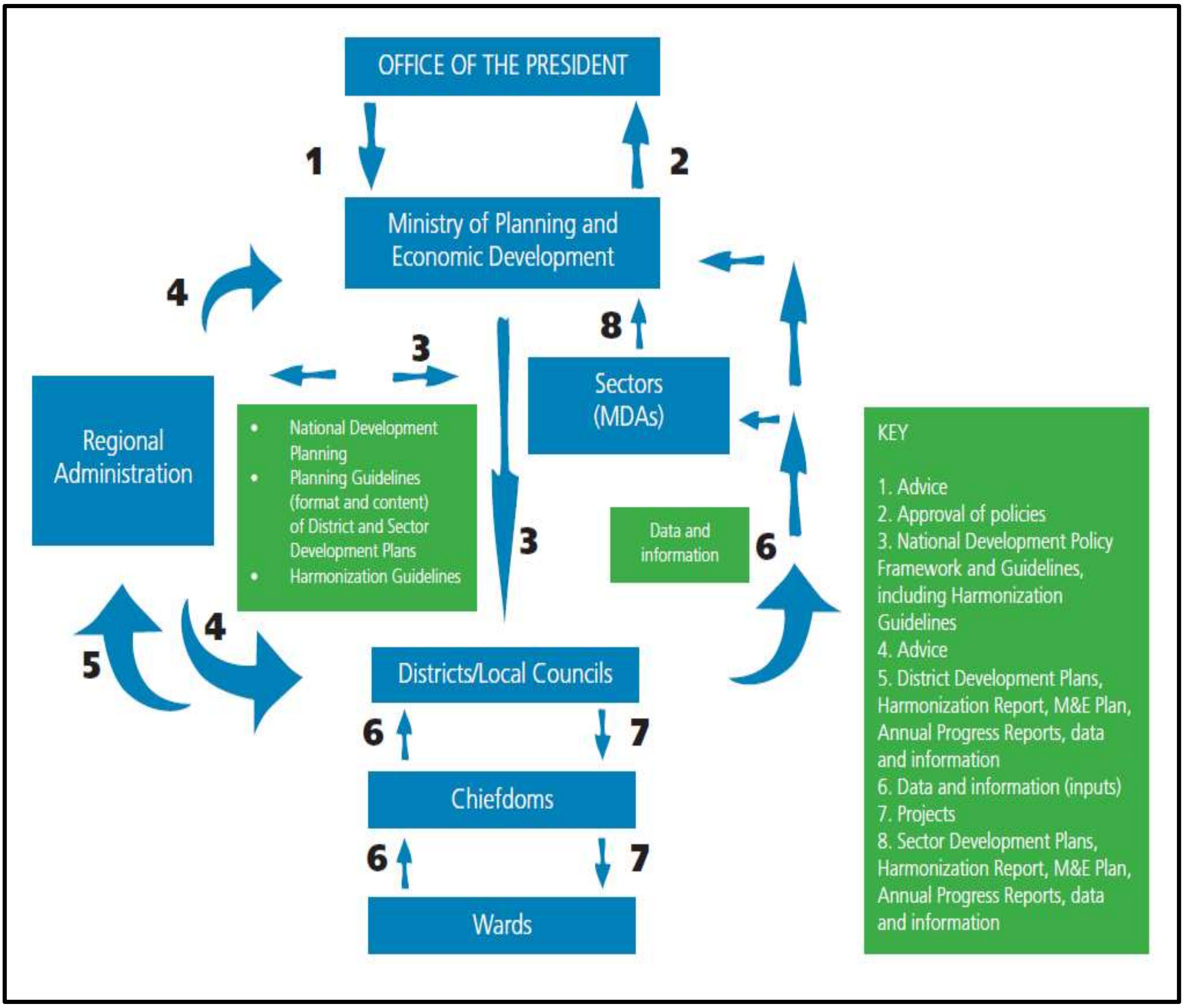
The National Planning System



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