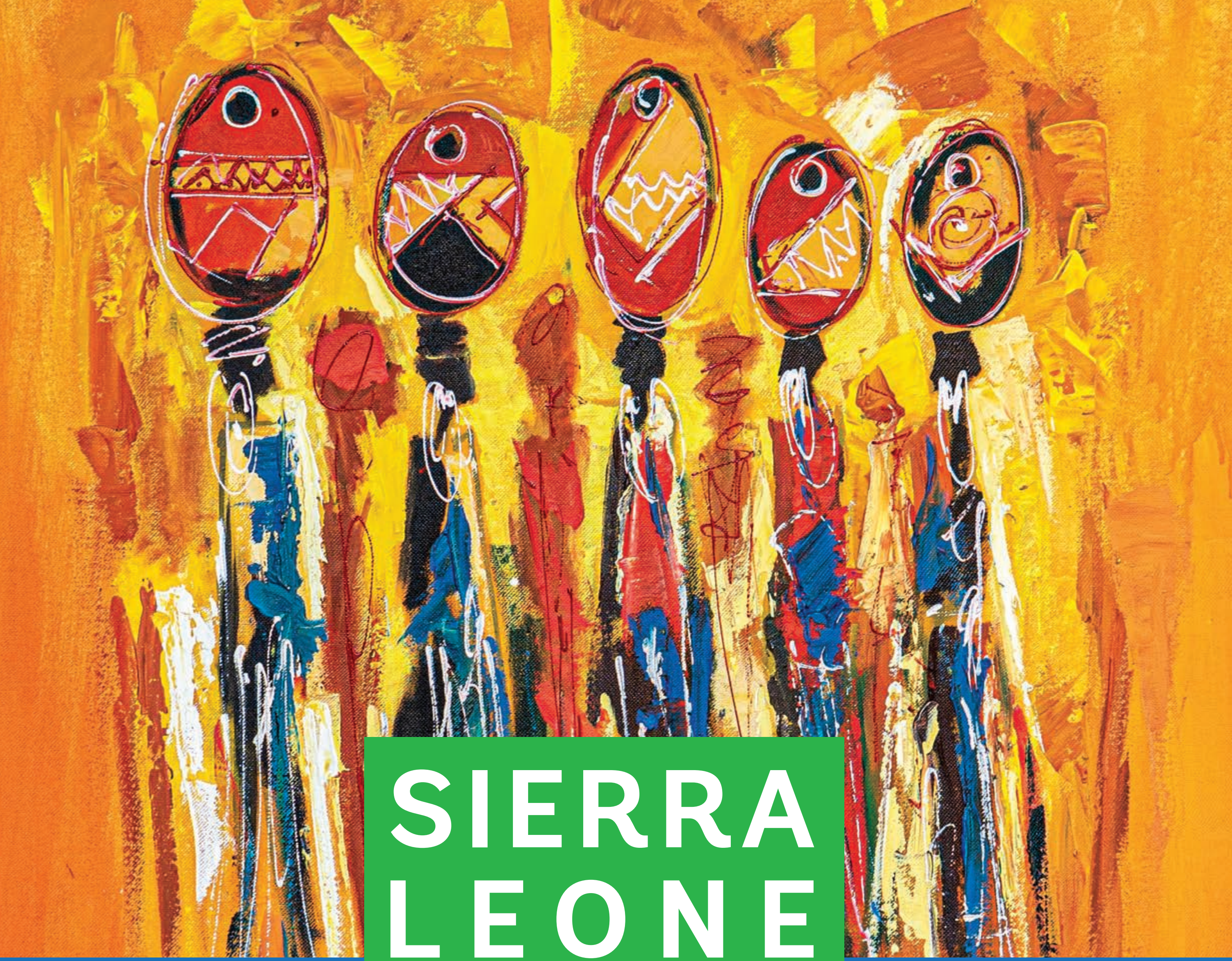

SIERRA LEONE ECONOMIC UPDATE

Leveraging SME Financing and Digitization for Inclusive Growth

WORLD BANK GROUP

June 2022

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ACRONYMS

ACF	Agriculture Credit Fund
ACH	Automated Clearinghouse
B2G	Business-to-government
BSL	Bank of Sierra Leone
BPS	World Bank Group's Business Pulse Survey
CAC	Corporate Affairs Commission
CRB	Credit Reference Bureau
DSA	Debt Sustainability Analysis
ECOWAS	Economic Community of West African States
EMDEs	Emerging Markets and Developing Economies
FDI	Foreign Direct Investment
Forex	Foreign Exchange
FSA	Financial Service Association
FSP	Financial Service Provider
G2B	Government-to-business
G2P	Government-to-person
GDP	Gross Domestic Product
GoSL	Government of Sierra Leone
ICT	Information and Communication Technology
MFI	Microfinance Institution
MPR	Monetary Policy Rate
MSE	Micro-and-small enterprises
MSME	Micro, small-and-medium enterprises
MTI	Ministry of Trade and Industry
NCRA	National Civil Registry Agency
NDA	Net Domestic Asset
NFA	Net Foreign Asset
NGO	Non-governmental organization
NPL	Nonperforming Loans
NSFI	National Strategy for Financial Inclusion
NIDS	National Innovation and Digital Strategy
OARG	Office of Administrator & Register General
PFM	Public Financial Management
PP	Percentage points
PPG	Public and Publicly Guaranteed

PV	Present Value
P2P	Peer-to-peer
P2P	Person-to-person
POS	Point-of-sale
RTGS	Real time gross settlement
SERP	UN Socio-economic Response Plan for Sierra Leone
SLL	Sierra Leone Leones
SME	Small-and-medium enterprises
SMEDA	Small and Medium Enterprises Development Agency
SMS	Short Message Service
SSA	Sub Saharan Africa
UADF	Universal Access Development Fund
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Program
US$	US dollars
WAEMU	West African Economic and Monetary Union

EXECUTIVE SUMMARY

Recent Macroeconomic Developments and Outlook

The economy had begun to recover from the COVID shock, but it is now faced with renewed uncertainty. Following economic contraction in 2020, growth had resumed, driven in part by iron ore mining. However, the growth outlook now faces renewed uncertainty, against the backdrop of the Russia-Ukraine war, global inflationary pressures, and the continued threat of COVID outbreaks. After expanding by 5.7 percent in 2021 (the strongest post-recession recovery in about 80 years), global economic growth is now expected to moderate to 3.2 percent in 2022, and 3.1 percent in 2023 reflecting hikes in critical food and fuel prices caused by Russia-Ukraine war, adding to existing inflationary pressures stemming from lingering supply bottlenecks and over-heating economies.

Sierra Leone's gross domestic product (GDP) grew by 3.1 percent in 2021, after shrinking by 2.0 percent in 2020. Agriculture, with its dominant share of the economy, contributed over half of total growth. Manufacturing was the fastest growing sector, expanding by 12.3 percent in 2021 after contracting by 6.7 percent in the previous year. The sector benefited from government support to small and medium-sized enterprises (SMEs) through the MUNAFA Fund and Bank of Sierra Leone's (BSL) SLL500 billion special credit facility, as well as from increased agribusiness investments, due to the recovery in agriculture. However, SMEs continue to bear the brunt of the economic shock from COVID-19. The World Bank's Business Pulse Survey (BPS) reported that around 88 percent of SMEs reported a decline in sales during the pandemic, often closing operations and laying off staff – which aggravated their pre-existing constraints of access to finance, land, and infrastructure. Overall economic growth is expected to strengthen further but remain moderate, averaging 4.4 percent over 2022–24.

Public finances have deteriorated since the onset of COVID-19. Reflecting a combination of higher expenditure, revenue shortfalls and tax-deferring policies. After steadfast macroeconomic management had reduced the fiscal deficit to 3.1 percent of GDP in 2019, the deficit jumped to 5.9 percent in 2021, reflecting a combination of higher expenditure, revenue shortfalls and tax-deferring policies. This was appropriate under the circumstances and in line with similar responses around the world. However, given the lack of fiscal space at the start of the pandemic, and the very high cost of borrowing, corrective action is now urgently needed.

Public debt has risen steadily in recent years to reach 76.9 percent of GDP in 2021, one of the highest levels of indebtedness in sub-Saharan Africa and the highest level in Sierra Leone since HIPC debt relief was obtained in 2008. The increase in debt reflects persistent fiscal deficits, currency depreciation, and limited access to concessional sources of financing. Increasing reliance on high-cost domestic borrowing has increased the debt servicing burden and crowded-out credit to the private sector. Interest payments have been the fastest growing component of the budget and now surpass domestic spending on health. According to preliminary Debt Sustainability Analysis by the IMF/WB the country is at high risk of debt distress. Public debt is believed to be sustainable provided that the authorities remain committed concessional financing and fiscal.

Revenue collection improved, in part thanks to tax administration reforms and one-off mining revenues. Total domestic revenues, including both tax and non-tax receipts, increased to 16.1 percent of GDP during 2021, from 14.7 percent of GDP in the previous year. The resolution of a tax-dispute between SL Mining Company (Marampa mines) and the government resulted in a US$20 million (0.5 percent of GDP) one-time settlement in mining royalties. Other sources of tax revenue also improved due to: (i) overall economic recovery; (ii) stricter enforcement of tax laws, and (iii) the automation of taxation processes, including roll-out of Electronic Cash Registers (ECRs) for the administration of goods and services tax (GST), and the Integrated Tax Administration System (ITAS) for the electronic registration, filing and payment of taxes.

Expenditures are rigid and increased further during 2021, driven in part by inflationary overruns. Total expenditures stood at an estimated 26.6 percent of GDP. Recurrent spending, which makes up almost two-thirds of total spending, increased by 0.6 percentage points to 18.3 percent of GDP due to higher wages and current transfers. Of total recurrent spending, nearly two-thirds are committed in the form of wages and salaries and interest payments. Overall, a combination high inflation and the need to preserve essential health and education services constrained expenditure consolidation. Capital expenditure fell marginally to 7.5 percent of GDP in 2021 but remained higher than its pre-COVID-19 level (5.7 percent of GDP) reflecting the government's drive to improve rural connectivity as part of its pandemic response program.

External accounts have been cushioned thanks to international aid. The current account runs a chronic deficit, which widened to 13.7 percent of GDP in 2021 (from a 14-year low of 7.0 percent of GDP in the previous year), as the recovery in import demand outpaced the resumption of iron ore exports. However, gross external reserves have increased to 5.8 months of imports from 4.7 months of imports, reflecting increased grants, and an additional Special Drawing Rights allocation (US$281 million) by the IMF during the pandemic. However, the current account runs a chronic deficit, which widened in 2021 to 13.7 percent of GDP in 2020 from a 14-year low of 7.0 percent of GDP in the previous year, as the recovery in import demand outpaced the resumption of iron ore exports

Domestic inflation is vulnerable to global food and fuel prices. Inflationary pressures have accelerated since mid-2021, driven first by the post-pandemic rebound in consumption, and subsequently by global supply chain disruptions since the onset of the Ukraine war, and depreciation pressures on the Leone. Recent inflationary pressures have eroded the purchasing power of Sierra Leonians, leading to concerns about deteriorating welfare. According to simulations, doubling food inflation from 5 to 10 percent results in a 3.6 percent loss of purchasing power for Sierra Leonians, and a 2.6 percentage point increase in the poverty rate. Monetary policy effectiveness is limited in supply-driven inflationary episodes. In response to accelerating inflation, the central bank began tightening monetary policy in late 2021, but monetary policy effectiveness is limited in supply-driven inflationary episodes.

Economic growth is expected to strengthen over the medium term (2022–24). Real GDP growth is projected to average 4.4 percent with contributions from investments (especially in mining and agriculture) on the demand side, and from agriculture, tourism, construction, and mining and manufacturing on the supply side. The outlook assumes that iron ore production will improve, coupled with continued large-scale investments in new mines (for gold and diamonds) as well as agriculture, supported by the government's policy shift to promote private sector participation. However, the growth outlook is subject to significant downside risks and uncertainties related to the war in Ukraine, the 2023 general elections, and the path of the pandemic. Headline inflation is expected to remain elevated in 2022 due to global supply chain disruptions caused by the war in Ukraine but will decline gradually to single digits as domestic food production increases by 2024 and offsets the effect of high international prices. The current account deficit is expected to remain large, narrowing marginally to 13.1 percent of GDP by 2024 as strong import demand offsets the recovery of mining sector exports. The fiscal deficit is expected to exceed the budgeted target in 2022 due to higher than anticipated inflation and a rise in subsidies but projected to narrow to 2.9 percent of GDP by 2024, driven by gains in domestic revenue mobilization, expenditure rationalization, and public financial management reforms.

Policy responses should focus on cushioning the impact of recent shocks and implementing reforms to safeguard and strengthen economic recovery over the medium-term.

- Providing well-targeted crisis support to vulnerable households and firms affected by higher food and fuel prices remains a priority. Expanding social safety nets and increasing cash transfers to cover more households affected by recent shocks could provide a significant buffer to vulnerable households.
- COVID-19 era support to small and medium-sized enterprises through small grants for working capital and production must be sustained to protect jobs and safeguard the recovery. Paying-off domestic arrears is another efficient way to support the private sector.
- Prudent fiscal management will be crucial to strike a balance between the emerging expenditure needs and limited fiscal space. In the near term, well-targeted crisis supports, and transfers can contain the expenditure bill. Simultaneously, the government should access only concessional sources of borrowing and financing to address its debt vulnerabilities and manage its risk of debt distress. Exchanging high interest domestic debt for highly concessional external loans could reduce the costs associated expensive domestic borrowing. In the medium-term, sustained fiscal adjustment and active debt management can support debt sustainability and reduce vulnerabilities. Reduction in domestic borrowing needs will also free up more credit for the private sector. Expenditures will need to be reprioritized with a greater focus on improving efficiency. The recent WB Public Expenditure Review also provided a range of recommendations in the areas of health, education, social protection and agriculture.
- Monetary policy should maintain balance between lowering inflationary pressure and strengthening the recovery. With inflation driven mainly by supply side shocks, tightening the policy stance too quickly could halt the recovery.

Leveraging SMEs for Inclusive Growth: The Role of Finance and Digitization

SMEs can be engines of economic growth and job creation, under the right circumstances. Currently, in Sierra Leone, SMEs (along with micro-enterprises) provide livelihoods to approximately 70 percent of the population and represent over 90 percent of the domestic private sector. However, most operate in the informal sector, only ten percent are registered-and they struggle to grow. The main business environment constraints they face are access to finance and land, unreliable electricity, high tax rates, and customs and trade regulations. Access to finance consistently features as one of the top constraints for SMEs across various surveys and diagnostics conducted by the World Bank and other development agencies.

Access to finance for SMEs and digital finance are priorities for the government. The National MSME Development Strategy was developed in 2013, with support from IFC. The National Innovation and Digital Strategy (NIDS) was launched in 2019. The Government supported SMEs through the operationalization of the MUNAFA Fund in 2021. The sum of SLL100 billion was allocated in the national budget for a period of four years (2020 to 2023) to address the lack of access to capital by SMEs. In March 2021, the BSL created a SLL100 billion[1] (US$8.5 million) Agriculture Credit Facility to support the importation of agriculture inputs and reduce food insecurity by incentivizing private sector participation in agriculture.

The main constraints for SMEs to access finance include:

- *Low availability of financing instruments and external capital:* Most SMEs are either self-financed or financed through informal loans from friends and

[1] Exchange rates as of March 2022: US$1 = SLL11719.83.

family. Financing instruments available to SMEs are limited, short-term, and expensive. Commercial banks and MFIs offer a limited range of products and high interest rates. Other Financial Institutions (OFIs) are constrained by their small capital bases. There are few equity investors willing to provide the required capital for start-ups and growth

- *Lack of collateral:* Most financial institutions have high collateral requirements, accepted typically in the form of immovable assets, particularly land. This puts SMEs, and notably women-led ones, at relative disadvantage, as they often lack such collateral.
- *Informality, poor financial and digital literacy, and business readiness:* Informal firms tend to have inadequate recordkeeping, governance and accounting – which make it difficult to prove eligibility for financing through formal channels. In addition, limited financial and digital literacy is a barrier to the uptake of digital finance.
- *Constrained access to infrastructure:* Lack of access to Information and Communication Technology (ICT) and electricity poses a significant barrier to access digital finance. While mobile phone usage has expanded, there are issues of coverage and affordable access to mobile networks. Internet connectivity is expensive.

The provision of financial products and services through digital channels, is widely considered an essential enabler to reduce the SME financing gap. For starters, digitization of financial services can provide an impetus for SMEs working in the informal sector to join the formal economy. Further, technology innovations can serve as the foundation for the development of new business models and digital financial products, which include digital loans and other credit products, as well as equity capital.

However, the state of digitization of financial services – both in terms of infrastructure and adoption – is still at its nascent stages. Sierra Leone lags its counterparts in Sub Saharan Africa in overall ICT performance. Access to electricity also remains a challenge both in terms of reliability and affordability.

Digital financial services (DFS) are not diversified, and mobile money remains the main driver. DFSs have grown during the COVID-19 crisis. Financial service providers (FSPs) actively encouraged the use of digital channels, resulting in increased usage of digital finance. However, the overall policy and regulatory environment for DFS is fragmented, outdated, insufficient in scope and lacks resources. The development of financial infrastructure (payments and credit) is essential to facilitate growth and uptake of sophisticated DFS products that enhance SME access to finance. In addition, a robust identification system and enabling legal and regulatory environment will be essential.

The payments infrastructure – including the RTGS, ACH and securities settlement system – needs to be upgraded. Though a few banks are connected to each other through bilateral agreements, FSPs are not connected to each other. This means most consumers cannot transfer money between a bank account and their mobile wallet or send money from a Microfinance Institution (MFI) savings account to a family member whose only form of financial access is a mobile phone. A retail payment switch is expected to be operational – with World Bank support – by the end of 2022. Digitization of government payments and services could increase uptake of DFS, and encourage informal entrepreneurs to join the formal economy, paving the way for their access to formal finance.

Sierra Leone lacks a modern credit reporting system. The BSL operates the Credit Reference Bureau (CRB) manually via an Excel spreadsheet. The establishment of a digital credit registry would help with the digitization of the underwriting process by credit providers, leverage data and algorithms to develop credit scores that will increase reach and improve risk management, and thus improve the effectiveness of the financial intermediation process and boost access to finance. An upgraded, online collateral registry was launched in December 2021. However, inconsistent enforceability of credit agreements constrains credit provision. In practice, collateral is mostly employed as a symbolic pledge since it does not provide sufficient protection against credit risk. Financial institutions consistently report constraints to repossession and realization of collateralized assets.

Sierra Leone lacks a modern insolvency framework. Without effective debt recovery and or strong mechanisms for business exit, the losses that result from non-performing loans (NPLs) can drive a higher cost of capital and generate a heightened perception of risk among financial institutions and investors.

Key recommendations for greater SME access to finance are presented below. These recommendations may be read in conjunction with the recommendations in the Sierra Leone Digital Economy Diagnostic exercise conducted in 2020.[2]

- Develop a coordinated national approach to expanding access to finance for SMEs, develop and implement a uniform national definition of MSMEs, and systematically expand data collection on SMEs and SME finance from government agencies and financial institutions.
- SME support needs to be focused on growth-oriented firms, and less on subsistence micro enterprise.
- The National Financial Inclusion Strategy for 2022–2026 is an opportunity to prioritize public and private sector actions towards expanded SME finance that are targeted, additional, and coordinated.
- Institute robust performance reviews and ongoing monitoring and evaluation for government MSME programs to ensure public spending is having the intended impact on Sierra Leone growth priorities.
- Support improved credit information by establishing a modern digital credit registry and corresponding legislation to expand data collection.
- Support the rollout of the new modern online collateral registry through a strengthened secured transactions framework and a review of court processes to facilitate recovery of collateral.
- Structural barriers to adoption of digital finance must be addressed. Various digital finance products could facilitate SME access to finance in Sierra Leone: (i) Digital Loans, (ii) Crowdfunding (reward-based), (iii) Equity crowdfunding, (iv) Person-to-Persons (P2P) and marketplace lending, and (v) Others including factoring, reverse factoring, secured revolving lines of credit and electronic invoicing.

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2 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

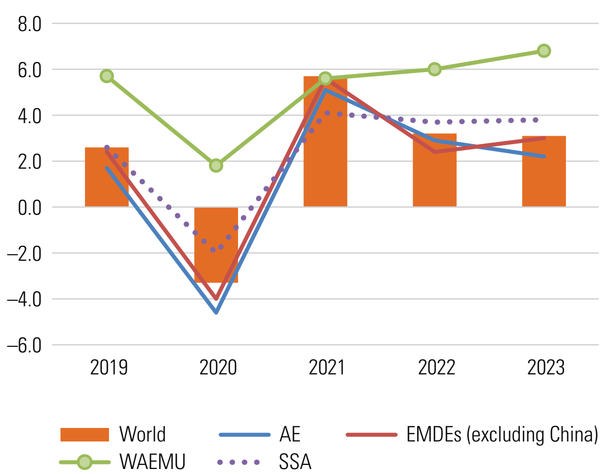
PART 1

Global and Regional Trends

The global economy rebounded in 2021, recovering all the losses of the previous year. After contracting by 3.4 percent in 2020 due to the COVID-19 pandemic, the global economy expanded by 5.7 percent in 2021. This was the strongest post-recession recovery in about 80 years, driven by substantial fiscal support and strong vaccination programs in advanced economies. Growth in advanced economies reached 5.1 percent in 2021, while emerging markets and developing economies (EMDEs, excluding China) grew by 6.6 percent. The latter group normally grows significantly faster than advanced economies but was held back by the slow pace of vaccinations, higher commodity prices, and the premature withdrawal of macroeconomic support. Chinese economy was resilient and growth accelerated to 8.0 percent from 2.0 percent in 2020.

In sub-Saharan Africa (SSA), economic growth also recovered to 4.1 percent in 2021 after a 2.3 percent contraction in 2020. The recovery was driven by better containment of COVID-19 as well as strong external demand from the region's partners (mainly US, Europe and China), and higher commodity prices. SSA's top-three economies (Angola, Nigeria and South Africa) grew by 2.9 percent in 2021 (after contracting by 4.1 percent in 2020) thanks largely to higher oil prices and reforms in the oil sector (Angola and Nigeria) and strong metal prices (South Africa). After contracting by 0.8 percent in 2020, the West and Central Africa sub-region grew by 3.2 percent in 2021, led by solid growth in the West African Economic and Monetary Union (WAEMU, 5.6 percent).

FIGURE 1 Global and Regional Growth, 2019–2023f



Sources: January 2022 Global Economic Prospects database. AE: advanced economies, EMDE: emerging markets and developing economies, SSA: Sub-Saharan Africa. e = estimates, f = forecast. Growth rates for country groups are calculated as weighted averages using GDP shares consistent with purchasing power parity as weights.

However, global economic growth is now facing a renewed setback, driven by the war in Ukraine, while policy tools to prop up the economy have been eroded. The war has resulted in spikes in critical food and fuel prices, adding to existing inflationary pressures stemming from lingering supply bottlenecks and over-heating economies. Given elevated inflation, advanced economies are reducing fiscal support and raising interest rates. Global growth is expected to moderate to 3.2 percent in 2022, and 3.1 percent in 2023. In advanced economies, growth is forecast to decelerate to 2.9 percent in 2022 and further to 2.2 percent in 2023, which is consistent with their pre-pandemic trend. Emerging markets and Developing Economies' (EMDE) growth (excluding China) is projected to drop by half to 3.5 percent in 2022, partly due to the impact of the war in Ukraine, before recovering to 4.4 percent in 2023/24. China's exceptional growth is expected to ease to an average of 5.1 percent 2024, reflecting the resurgence of the pandemic and additional regulatory tightening to strengthen financial stability. Among EMDEs, small states and fragile and conflict-afflicted countries will generally experience slower growth owing to lower vaccination rates, tighter fiscal and monetary policies, and more persistent scarring from the pandemic.

In SSA, growth is projected to soften to 3.7 percent in 2022, before improving to 4.3 percent in 2023. The decline in 2020 reflects dampened growth expectations in the region's main trading partners and adverse effects of rising inflation on domestic demand. The region's top-three economies are only expected to grow by an average of 3.0 percent in 2022/24. Growth forecasts for these three countries remain below average pre-COVID levels, but the rest of SSA is expected to reach or exceed its 2011–19 average GDP growth rate by 2023. However, there are various risks which could lead to lower growth, related to low COVID-19 vaccination rates and threats of renewed outbreaks, the slow pace of the global recovery, prospects of further unrest and conflict, rising poverty and food insecurity, and delays to investments in infrastructure as well as a slow implementation of structural reforms. Higher food and fuel prices could also worsen the negative impact of increased poverty on economic growth.

RECENT DEVELOPMENTS IN SIERRA LEONE

The COVID-19 pandemic has set back the economy and fiscal balances, which are now further impacted by the war in Ukraine. Real GDP growth turned negative in 2020, while the government's efforts to reduce the fiscal deficit were undermined by the need for emergency spending. Just when the economy began to recover, the war in Ukraine caused new disruption through sharply higher food and fuel prices. Thus, the authorities face both the short-term challenge of coping with these price shocks while recovering from the pandemic, and the medium-term challenge of renewing fiscal consolidation and promoting higher economic growth.

The Economy had Begun to Recover from the COVID Shock, But It is Now Faced with Renewed Uncertainty

Although economic recovery began in 2021, real GDP growth remains below its pre-COVID-19 level. Despite the recovery, real GDP growth, at 3.1 percent, was below its pre-COVID level (5.3 percent) and the average for SSA (3.5 percent). Per capita GDP grew by only 1 percent in 2021, after contracting by 4 percent in the previous year. The economy continued to function below potential during 2021, reflecting output losses in key productive sectors, mainly services, mining and manufacturing (see Table 1). Rapid population growth (at 2.1 percent per annum) has meant growth only translated in modest per capita gains. While real GDP is expected to exceed its pre-pandemic level this year, real GDP per capita will not do so until 2023.

On the demand side, growth was driven by the realization of pent-up consumer demand, and a moderate recovery in investments. Private consumption grew by 4.2 percent and contributed about 4.0 percentage points to real GDP growth thanks mainly to the relaxation of COVID-19 restrictions (such as curfews, a ban on night clubs and restaurants, and land border closures) which boosted consumer confidence and increased demand for both food and nonfood items. Further, a strong performance of the agricultural sector, which employs more than 50 percent of the workforce, also supported household incomes and private consumption. Public investments grew by 3.8 percent and contributed 0.2 percentage points to overall growth, with the resumption of several capital projects (especially, roads) which were suspended during the pandemic. Private investments contributed 0.4 percentage points to overall growth, particularly foreign direct investments (FDI) in mining and agriculture.

FIGURE 2A Real GDP by Contributions to Growth, 2019–2024

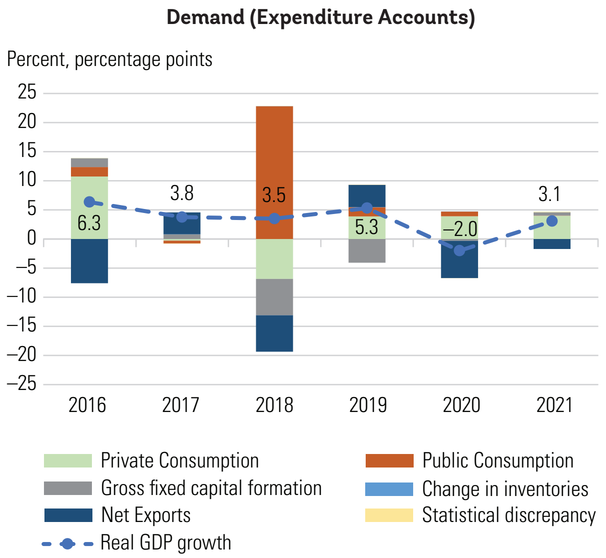
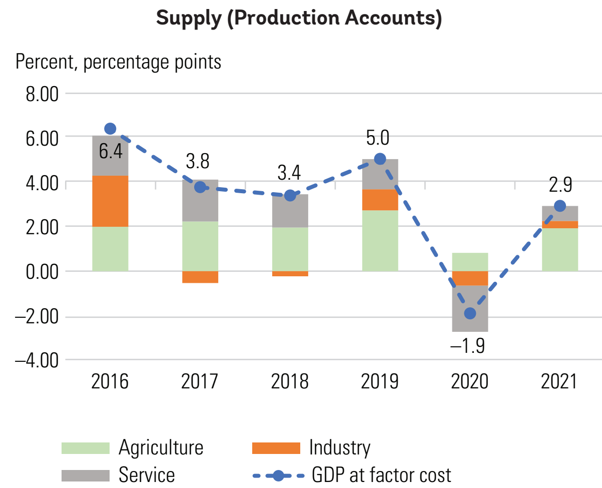


FIGURE 2B Real GDP by Contributions to Growth, 2019–2024



Source: StatsSL and World Bank Staff Estimates

BOX 1 Impact of the COVID-19 Pandemic on the Private Sector

The pandemic affected business through five main channels discussed below.

Cash flow. More than 90% of firms in Sierra Leone reported to face a decrease in cash inflow resulting from the impact of lockdown measures and the demand slowdown. There is a concentration of firms in the construction and utilities sector that appears to have better weathered the impacts of the pandemic: approximately one-fifth of firms in the construction and utilities sector experienced an increase in demand and cash flow during September 2020 as compared to the previous year.

Cash horizon. The average firm in Sierra Leone had only 86 days of available cash to maintain existing cash flow obligations (payroll, suppliers, taxes, loan repayment, etc) at the time of the survey. Firms in manufacturing, ICT, and transport and storage sectors tend to have more cash on hand, as compared to the firms in construction or utilities, entertainment and recreation, or food processing.

Arrears. The liquidity crunch has impacted firms' ability to stay current on their loan or credit payments. While only 26 percent of all firms in Sierra Leone had already fallen in arrears on outstanding liabilities at the time of the survey, an additional 23 percent were expected to soon fall in arrears. Large firms were much less prone to falling in arrears as compared with small to mid-size firms, while construction and utilities firms were much less prone to arrears as compared with firms in other sectors.

Availability of financing. 35 percent of firms reporting reduced availability of finance since the onset of the pandemic. Among the difficulties reported in access to finance, firms reported high interest rates as the main difficulty, while high repayment risk and low level of guarantees and/or collateral also reported.

Supply chain disruptions. Supply chain disruptions made it more difficult for firms to access inputs and raw materials for their operation. In Sierra Leone this has been especially prominent among firms in manufacturing and accommodation sectors. 59% of firms in manufacturing sectors and 57% of firms in accommodation and food service sectors reported a decrease in the availability of raw materials. Cost increases appear to be the major driver, while travel restrictions and border closures are also commonly reported reasons for difficulties in procuring raw materials.

Source: World Bank Business Pulse Surveys (2021)

The contribution of net exports was negative (–1.7 percentage points) despite a strong recovery in iron-ore exports, due to the relatively stronger growth in consumer demand and imports.

On the supply-side, agriculture was the leading contributor to real GDP growth. Agriculture grew by 3.7 percent in 2021 (contributing more than half or 1.9 percentage points to overall growth) compared to 1.6 percent in the previous year. Strong outturns for crops (an increase of 3.9 percent – mainly rice and tubers) were supported by favorable weather and increased private sector participation in input markets. The fisheries and livestock sub-sectors also recorded impressive recoveries – (see Table 1 below). Forestry returned to a more normal growth rate, 3.3 percent during 2021, as the 2020 ban on timber exports was lifted.

TABLE 1 Real GDP growth by sub-sector (%)

	2017	2018	2019	2020	2021
AGRICULTURE	**4.5**	**3.9**	**5.4**	**1.6**	**3.7**
Crops	5.3	4.1	6.6	2.1	3.9
Livestock	3.5	2.6	2.0	0.2	5.4
Forestry	3.5	4.7	3.7	0.8	3.3
Fishing	1.3	2.8	1.2	0.2	2.5
INDUSTRY	**–5.3**	**–2.5**	**10.9**	**–7.1**	**3.8**
Mining & quarrying	–13.6	–4.0	17.1	–12.7	4.6
Manufacturing	4.9	3.2	4.5	–6.7	12.3
Electricity	6.6	5.8	4.7	3.9	5.1
Water	3.7	1.3	5.0	2.4	2.6
Construction	5.1	–6.5	4.7	4.6	4.2
SERVICES	**5.3**	**4.1**	**3.7**	**–5.6**	**2.0**
Trade & Tourism	4.9	1.9	0.1	–29.6	6.8
Transport, storage & communication	5.2	4.0	6.7	2.6	3.9
Finance, insurance and real estate	4.6	4.0	3.0	2.2	3.9
Public administration	7.1	5.4	6.0	–0.5	6.4
Education	5.7	6.1	–1.0	0.7	2.6
Health	4.8	4.8	5.0	2.4	2.8
Other service activities	4.8	4.7	4.7	–4.0	3.3
NPISH	4.3	4.3	5.9	3.6	4.0
FISIM	1.5	3.4	3.6	1.8	4.1
Total Value Added	**3.8**	**3.4**	**5.3**	**–2.0**	**3.1**
Taxes on products	**3.6**	**5.5**	**5.0**	**–1.8**	**5.0**
GDP AT MARKET PRICES	**3.8**	**3.5**	**5.3**	**–2.0**	**3.1**

Source: StatsSL and World Bank Staff Estimates

Industrial activity expanded by 3.8 percent in 2021, with improvement in both mining and manufacturing. Mining activities contracted by 12.7 percent in 2020 largely on account of the impact of COVID-19 restrictions, and a tax dispute between SL Mining and the government. During 2021, that dispute was resolved with a one-time tax settlement, which allowed an immediate resumption in the stockpile of iron ore exports, and a restart of production from 2022. Overall, mining activities grew by 4.6 percent during 2021, including gold, bauxite, and diamonds. Manufacturing also rebounded from a 6.7 percent contraction in 2020 to grow by 12.3 percent, in part thanks to relaxation of COVID-19 restrictions and increased agribusiness investments helped by the recovery in agriculture. Increased government support to small and medium-sized enterprises (SMEs) through the MUNAFA Fund and Bank of Sierra Leone's SLL500 billion special credit facility also supported manufacturing activity which is dominated by SMEs.[3] However, during COVID approximately one-third (32 percent) of businesses were either temporarily closed or only partially open, 74 percent of those fully open reported a reduction in working hours, and almost 90 percent reported a decrease in sales.[4] These government programs aimed to boost local production of essential commodities, particularly food stuffs, and cushion the impact of the pandemic on businesses. Over 5,300 SMEs received loans from the MUNAFA Fund in 2021 with 75.8 percent of the beneficiaries being female-owned businesses. Manufacturing was also supported by the relaxation of COVID-19 restrictions and increased agribusiness investments helped by the recovery in agriculture.

After a 5.6 percent contraction in 2020, services made the second largest contribution to real GDP growth (0.7 percentage points) in 2021. Driven by a broad-based recovery in key sub-sectors as COVID-related restrictions eased, services registered an overall growth of 2.0 percent during 2021. The removal of night-time curfews, including restrictions on

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3 According to the World Bank Business Pulse Surveys 2020-21, https://www.worldbank.org/en/data/interactive/2021/01/19/covid-19-business-pulse-survey-dashboard (visited 15 March 2021).

4 The Office of Administrator and Registrar General (OARG) report 6,000 registered companies, but databases across various Ministries, Department and Agencies (MDAs) as well as private sector industry associations point to a much larger number of mainly MSMES of 1–5 employees in the informal sector.

congregational worship and nightclubs, supported the recovery of recreation, entertainment and food services (restaurants). Trade and financial services also improved with the gradual removal of international restrictions on cross-border movement as the number of COVID-19 infections declined globally. Tourism grew but only modestly by 3.4 percent, compared to a 27.1 percent contraction in 2020. The communication sub-sector grew by 5.7 percent in 2021, maintaining its performance of 2020, as more households and businesses switched to online solutions to either work from home or ensure business continuity.

During the first quarter of 2022, economic activity has been affected by a terms-of-trade shock due to the rise in global fuel and food prices. The onset of the Ukraine war in early 2022 has disrupted global markets and supply chains, resulting in a sharp rise in commodity prices. Despite limited direct exposure to the conflicting countries, fluctuations in global commodity prices exposes several economic vulnerabilities through three predominant and interconnected channels: (i) inflation: sharp rise in global food and fuel prices, which account for more than half of all goods imports, poses a risk of higher inflation and potentially food insecurity within the country; (ii) public finances: higher domestic inflation has contributed to expenditure overruns; and higher fuel prices have resulted in an increase in subsidy obligations to power producers; (iii) growth: through the first two channels, higher inflation, global supply chain disruptions and fluctuations in power supply on account of unpaid subsidies has had a detrimental effect on economic activity. Favorable fluctuations in iron ore, gold, or diamond prices, can also boost mining production and exports but will be limited by the country's ability and logistics to ramp up production.

Public Finances have Deteriorated Since the Onset of COVID-19

Pre-COVID fiscal gains have been since reversed with emerging expenditure needs and revenue shortfalls. Prior to the COVID-19 pandemic, the fiscal deficit declined for two consecutive years and stood at 3.1 percent of GDP in 2019 thanks to steadfast fiscal consolidation efforts by the government. However, the COVID-19 shock disrupted this momentum, and prompted the authorities to provide support through fiscal stimulus, including social transfers. The fiscal deficit has since increased by 2.6 percentage points of GDP (to 5.8 percent) in 2020 and 5.9 percent in 2021, reflecting a combination of higher expenditure and revenue shortfall.[5] The initial increase in the deficit was driven by immediate COVID-19 related expenditures, and a simultaneous fall in revenue collections reflective of slower economic activity, and tax-deferring policies.

Total expenditure increased further during 2021, driven by inflationary overruns, to an estimated 26.6 percent of GDP. Recurrent spending, which makes up almost two-thirds of total spending, increased by 0.6 percentage points to 18.3 percent of GDP due to higher wages and current transfers. Of total recurrent spending, nearly two-thirds is committed in the form of wages and salaries and interest payments. Wages and salaries rose by 0.4 percentage points to 8.6 percent of GDP on account of (i) an unbudgeted increase in emoluments to tertiary education institutions; (ii) increments in the security sector (military and police); and (iii) new recruitment of teachers, to support implementation of the education-for-all policy, and health workers. Subsidies and transfers increased, mainly due to higher energy subsidies to Karpower (the main power producer) which are indexed to global fuel prices. Interest payments on public debt increased marginally to 3.1 percent of GDP. Expenditure on goods and services exceeded the budget target by 0.7 percentage points of GDP but declined compared to the 2020 level to 3.2 percent of GDP. However, a combination of high inflation and the need to preserve essential health and education services constrained expenditure consolidation. Capital expenditure fell marginally to 7.5 percent of GDP in 2021 but remained higher than its pre-COVID-19 level (5.7 percent of GDP) reflecting the government's drive to improve rural connectivity as part of its pandemic response program. One thousand two hundred kilometers (1200km) of trunk and feeder roads were rehabilitated across the country, creating jobs for young men and women and linking farmers to markets.

5 The authorities' policy response to COVID-19 has been influenced by the need to save lives while supporting livelihoods. The main pillars of the government's response included containment measures, health sector responses and the social and economic actions as defined in the Quick Action Economic Response Program (QAERP)[4]. Spending on the social and economic response pillar in the QAERP has been the largest amounting to 2.2 percent of GDP, followed by the health sector response (1.0 percent of GDP) and containment measures (0.4 percent of GDP).

BOX 2 Arrears and Power Outages

Sierra Leone witnessed widespread power outages intermittently since the start of December 2021, as the country struggled to pay its biggest supplier of electricity on time. Karpowership (KP), a Turkish subsidiary which accounts for more than half of the electricity supply in Sierra Leone, has been rationing power supply in response to accumulating arrears from the government. Freetown has witnessed the most extensive load shedding as electricity demand peaked at nearly 78MW, while supply from alternate sources (hydro and solar) amounted to 35–40MW. According to KP, the government owed US$36 million in unpaid arrears at the time of shutdown and was in violation of a previously agreed payment schedule. The current Power Purchase Agreement, or PPA, was signed in 2020 for 5 years, between the Electricity Distribution and Supply Authority or EDSA (on behalf of the federal government) and KP. Under the current contract, the agreed price is dependent on the variable global cost of fuel.

These power outages reflect three noteworthy facts. First, the unreliable power supply is driven in part by a significant capacity gap as energy demand exceeds installed capacity. The gap between projected energy demand and existing supply is expected to rise in the coming years to nearly 50MW by 2025. While this has made room for independent power producers (IPPs) to enter the market, it has also resulted in expensive PPAs due to lack of competition and the government's limited negotiating power. Unreliable power supply and frequent outages represent a major constraint to growth and poverty reduction in the country. Second, weak public finances have contributed to, and been affected by, the troubles of the power sector. Overall, poor cash management has resulted in recurrent accrual of arrears. Since Q4 of 2021 the government has reportedly accrued new arrears, including those to the power sector. Further, high technical and commercial losses at EDSA have resulted in low recovery of revenues. All EDSA obligations are guaranteed by the government of Sierra Leone (GoSL), including the arrears owed to KP, and will most likely have a direct impact on the federal budget. Third, the indexation of fuel prices, embedded in the PPA, results in an increase in overall costs when global crude oil prices increase. During 2021, as crude oil prices have risen to above US$70 per barrel (compared to US$50 per barrel predicted under the contract) the average cost has increased from 14 USc/kWh to about 18 USc/kWh.

Interest obligations have risen with increased reliance on relatively expensive domestic borrowing. Interest payments increased by 0.1 percentage points to 3.1 percent of GDP in 2021 driven mainly by domestic interest cost (Figure 3). Total interest on domestic debt stood at 2.7 percent of GDP, while interest payment on external debt amounted to only 0.4 percentage points of GDP. Interest payments have increased due mainly to increased domestic borrowing to finance mounting fiscal deficits and compensate for the declining levels of budget support from donors. This relatively high level of non-discretionary interest expenditure has limited the fiscal space for critical social spending on health and education. Interest payments have been the fastest growing component of the national budget since 2015, and now exceed the value of domestic health spending, and are equivalent to the level of domestic education expenditure.[6]

[6] See PER.

Domestic revenue collection improved during 2021, in part thanks to tax administration reforms and one-off mining revenues. Total domestic revenues, including both tax and non-tax receipts, increased to 16.1 percent of GDP during 2021, from 14.7 percent of GDP in the previous year. The resolution of a tax-dispute between SL Mining Company (Marampa mines) and the government resulted in a US$20 million (0.5 percent of GDP) one-time settlement in mining royalties. Other sources of tax revenue also improved due to: (i) overall economic recovery; (ii) stricter enforcement of tax laws, and (iii) the automation of taxation processes, including roll-out of Electronic Cash Registers (ECRs) for the administration of goods and services tax (GST), and the Integrated Tax Administration System (ITAS) for the electronic registration, filing and payment of taxes. Total tax revenues increased by 0.9 percentage points to 12.5 percent of GDP in 2021; of which personal income tax increased by 0.4 percentage points. On the flip side, corporate tax collections remained flat at 1.5 percent of GDP reflecting historic

TABLE 2 Fiscal Operations of Central Government (Percent of GDP)

	2018	2019	2020	2021	2022f
Total Revenue and Grants	**15.8**	**18.6**	**20.0**	**20.8**	**20.9**
Domestic Revenue	**13.7**	**15.2**	**14.7**	**16.1**	**15.8**
Tax Revenue	11.8	12.5	11.6	12.5	12.4
Nontax Revenue	1.9	2.7	3.1	3.6	3.4
Grants	**2.1**	**3.4**	**5.3**	**4.7**	**5.1**
Total Expenditure	**21.3**	**21.7**	**25.7**	**26.6**	**25.9**
Goods and Services and Wages	10.9	11.2	11.7	12.2	11.5
Interest Payments	2.8	2.7	3.0	3.1	3.0
External	*0.3*	*0.3*	*0.3*	*0.4*	*0.3*
Domestic	*2.5*	*2.4*	*2.7*	*2.7*	*2.7*
Capital Expenditures	6.4	5.6	7.6	7.5	8.2
Other Expenditures	1.2	2.2	3.4	3.8	3.3
Overall Balance	**–5.5**	**–3.1**	**–5.8**	**–5.9**	**–5.0**

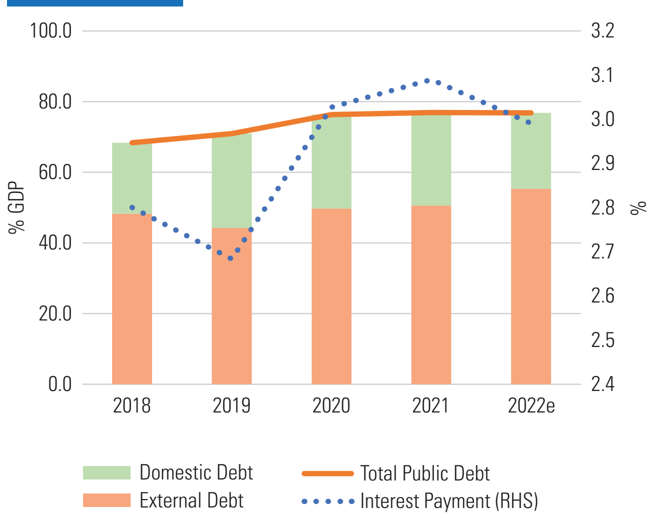
f: forecast
Source: Sierra Leonean Authorities and WB staff estimates

collection challenges, and excise duties declined by 0.3 percentage points due to duty reductions on petroleum products to mitigate the impact of rising global crude prices. Non-tax revenue (including capital transfers from the Central Bank in lieu of IMF support) increased by 0.5 percentage points to 3.6 percent of GDP, primarily on account of IMF resources and royalties from fisheries and timber. Total foreign grants declined by 0.6 percentage points compared to 2020, as development partners scaled back emergency COVID-19 support, to 4.7 percent of GDP. Both project and budget support grants declined.

Reliance on domestic financing of the deficit has increased in recent years, as financing needs remain elevated, and sources of external concessional financing are limited. Net domestic financing climbed by 1.1 percentage points to 5.0 percent of GDP driven mainly by borrowing from the banking system including the Central Bank's on-lending of IMF's resources – Rapid Credit Facility (RCF) and Extended Credit Facility (ECF). External borrowing which consists mainly of project loans declined to 0.6 percent of GDP (from 1.7 percent of GDP in the previous year) reflecting challenges in accessing concessional financing. The authorities remain committed to zero non-concessional external borrowing.

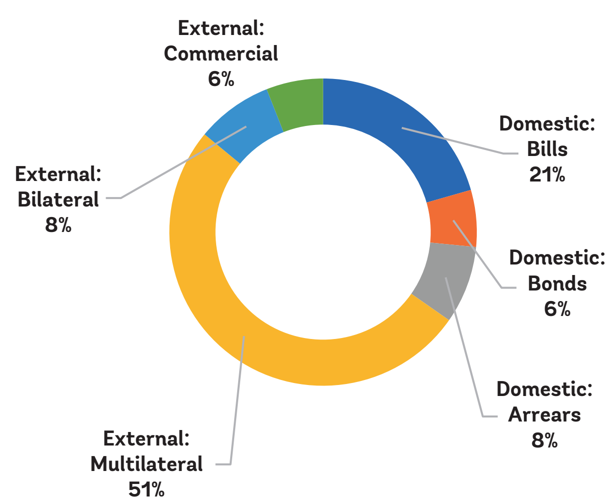
The 2022 budget is underpinned by expenditures reprioritization and ambitious revenue mobilization targets. The 2022 budget was presented to the Parliament in November 2021. The overall fiscal deficit, including grants, was budgeted to decline to 3.7 percent of GDP thanks mainly to ambitious domestic revenues which were projected to increase by 2.5 percentage points of GDP in 2022.

FIGURE 3 Public Debt Indicators (% GDP)



Source: Sierra Leone Authorities and World Bank Staff estimates

FIGURE 4 Composition of Public Debt, end-2021



Meanwhile, total expenditure was budgeted to increase by 1.7 percentage of GDP in line with the Budget's objectives to promote human capital development, expand social protection systems, improve infrastructure, and implement programs to mitigate climate change. Since the presentation of the budget, the economy has been hit by unanticipated shocks to global commodity prices and a rise in domestic inflation, resulting in higher expenditure needs, particularly in the form of subsidies and social transfers. The overall deficit is therefore projected to reach 5.0 percent of GDP over 2022, reflecting a combination of spending overruns and revenue shortfalls precipitated by the war between Russia and Ukraine.

Public Debt Burden has Risen and is Assessed to be at High Risk of Distress

Public debt has risen steadily in recent years, reflecting consistent fiscal deficits, a depreciating currency, and limited access to concessional sources of financing. Total public debt reached 70.9 percent of GDP in 2019 and rose sharply to 76.3 percent of GDP in 2020 as primary deficits increased due to expenditure pressures to respond to the COVID-19 pandemic while GDP fell. During 2021, public debt is estimated to have increased further to 76.9 percent of GDP (US$3.14 billion) driven by additional borrowing mainly from multilateral sources to finance growing expenditure needs. This is one of the highest levels of indebtedness in sub-Saharan Africa and the highest level in Sierra Leone since HIPC debt relief was obtained. 67 percent (US$2.10 billion) of the total debt stock at end-2021 is external and denominated in US dollars, while 33 percent (US$ 1.04 billion) is domestic.

Public and publicly guaranteed (PPG) external debt accounts for about 67 percent of total public debt and has increased since the onset of COVID-19. During 2020, external debt to GDP increased nearly 5 percentage points to 49.5 percent of GDP on account of increased financing from development partners during the pandemic, and further to 50.5 percent by end-2021. Nearly 80 percent of the PPG external debt is from multilateral creditors, while official bilateral creditors account for around 12 percent. External commercial creditors (which comprise mainly pre-HIPC arrears) account for about 9 percent of PPG total external debt. Domestic debt increased significantly in 2019, resulting in a jump in interest payments in 2020 (see Figure 3). However, it then declined from about 27 percent of GDP at end-2020 to 26.3 percent of GDP at end 2021. A projected further decline in 2022 should help prevent a further rise in interest payments. About 75 percent of domestic debt is owed to commercial banks mainly in the form of 364-day treasury bills. The Bank of Sierra Leone holds about 10 percent of domestic debt, while the nonbank public holds about 15 percent.

The public debt portfolio is still dominated by external borrowing, but domestic debt has been growing. The share of external to total debt has declined slightly to 67 percent in 2021, but the debt portfolio continues to face foreign exchange (FX) risk. The large share of external-to-total public debt is driven by low availability and high cost of domestic sources of funding, compared to concessional and long-term borrowing terms of external debt. Nonetheless, the share of domestic to total debt has increased to 33 percent of total debt in 2021, partly driven by the buildup of domestic arrears and new issuance, and the domestic debt portfolio remains of short duration and high cost. The share of domestic debt maturing within 1 year is currently estimated at 73.7 percent while the weighted interest rate is 13.8 percent. However, the average time to maturity (ATM) of the external debt portfolio is 11.4 years, leading to a total debt ATM of 9.3 years.

The domestic debt stock includes unpaid domestic suppliers' arrears. The total stock of verified arrears stood at SLL3.3 trillion (8.7 percent of GDP) in 2019. Subsequently, the authorities developed an arrears clearance strategy to guide and inform the process of clearing the existing stock of arrears and prevent future accumulation.[7] During the pandemic, clearance of arrears was prioritized to support the liquidity position of domestic suppliers. Since then, nearly SLL1.1 trillion (2.6 percent of GDP) was repaid in 2020, with increased support from development partners. In 2021, the stock of existing arrears was further paid down by 1.6 percent of GDP. The clearance of domestic arrears has

[7] The Government's arrears clearance strategy is based on the combination of: (i) significant grant resources; (ii) increased revenue mobilization; (iii) deep discounts or haircuts and (iv) an extended payment plan.

helped cushion the effects of the pandemic on businesses. However, accumulated new arrears in 2021 amounted to 0.8 percent of GDP, raising the outstanding stock of domestic payment arrears to 5.3 percent of GDP. This represents a substantial fiscal risk to the budget, a significant tax on the private sector, and one of the biggest constraints to public service delivery.

A preliminary Debt Sustainability Analysis (DSA) suggests that the risk of debt distress remains high, but public debt is assessed to be sustainable. This, however, is predicated on the authorities' ambitious fiscal adjustment program including its continued reliance on concessional financing and grants. High debt service needs, and exposure to growth, export and exchange rate shocks present the most pressing risks to debt sustainability. According to the last full WB/IMF DSA in July 2021, Sierra Leone was assessed to be at high risk of debt distress.

External Accounts, though in Chronic Trade Deficit, were Better Cushioned Thanks to International Aid

Sierra Leone runs a chronic current account deficit, which widened in 2021 as the recovery in import demand outpaced the resumption of iron ore exports. The current account deficit increased to 13.7 percent of GDP in 2020 from a 14-year low of 7.0 percent of GDP in the previous year, but closer to its pre-covid levels. The deficit was driven largely by a worsening of the trade balance and a slowdown of official transfers. Official transfers moderated to 3.1 percent of GDP (US$128.8 million) in 2021 as development partners scaled back COVID-19 support. The trade deficit increased to 15.1 percent of GDP from 14.0 percent in the previous year. Payments for services (including transport, communication, finance, business, etc.) exceeded receipts by 7.2 percent of GDP in 2021 compared to 3.2 percent of GDP in 2020, reflecting the increase in service-related imports underpinned by the recovery of aggregate demand. Despite the reduction of debt service payments on account of the debt service suspension initiative (DSSI), income payments exceeded receipts by 1.8 percent of GDP compared to 0.7 percent of GDP in 2020 reflecting increased compensation of expatriates and investment earnings of nonresidents.

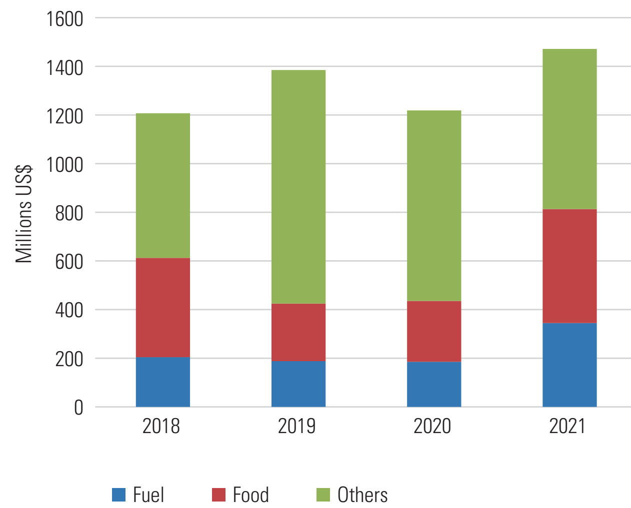
Merchandise exports increased to 20.6 percent of GDP (US$845 million) in 2021 from 16.4 percent of GDP (US$648 million) in the previous year, supported by iron ore shipments and a recovery of external demand. Iron ore exports rose from zero to US$145 million (3.5 percent of GDP) in 2021 as both the Tonkolili and Marampa mines resumed operations (see Figure 5). Total mineral exports consequently increased by 3.3 percentage points to 13.6 percent of GDP (US$561 million), accounting for 66.4 percent of total exports in 2021. Non-mineral exports increased by 1 percentage point to 6.9 percent of GDP (US$284 million) driven mainly by agricultural products (palm oil, cocoa, coffee) and timber. The Euro Area and China are the country's biggest trading partners, accounting for 25.6 and 19.3 percent of exports respectively between 2016 and 2020.

However, merchandise imports also increased to 35.9 percent of GDP (US$1.48 billion) from 30.9 percent of GDP (US$1.2 billion) partly because of the sharp increase in the global prices of food and fuel. Food and fuel together accounted for 55 percent of total merchandise imports compared to 40 percent in the previous year (see Figure 6). Fuel imports almost doubled in 2021, increasing by 3.7 percentage points to 8.4 percent of GDP (US$345 million) reflecting the sharp rise in global crude oil prices (by 65 percent between January and December 2021). Food imports increased by 5.1 percentage points to 11.4 percent of GDP (US$469 million) as a result of both higher international food prices and freight charges. Other imports, comprising mainly manufactured goods and transportation equipment, declined by 3.8 percentage points to 16.1 percent of GDP (US$660 million) as real sector activities recovery was relatively weak.

The current account deficit was financed by net inflows into the capital and financial accounts, resulting in an accumulation of reserves (Figure 7). Capital account inflows increased by 0.6 percentage points to 3.0 percent of GDP (US$124 million) in 2021, mainly thanks to the increase in project support grants from development partners (from US$60.6 million to US$89.8 million), offsetting the slowdown

FIGURE 5 Selected Merchandise Exports, 2018–21

FIGURE 6 Selected Merchandise Imports, 2018–21



Source: Sierra Leone authorities, IMF and World Bank staff estimates

in official transfers (such as budget support and program grants). Net financial account inflows recovered, as foreign direct investment (FDI) increased by 5.1 percentage points to 8.5 percent of GDP (US$596 million). FDI more than doubled, increasing from US$135 million to US$350 million in 2021 with inflows in the mining, agriculture and telecoms sectors. Other investment however declined slightly by 1 percentage points to 5.9 percent of GDP (US$246 million). Gross external reserves increased to US$932 million (5.8 months of imports) from US$677 million (4.7 months of imports), thanks mainly to an additional Special Drawing Rights allocation (US$281 million) by the International Monetary Fund, strengthening the buffer against external shocks (Figure 8).

FIGURE 7 Current Account and Sources of Financing, 2018–21

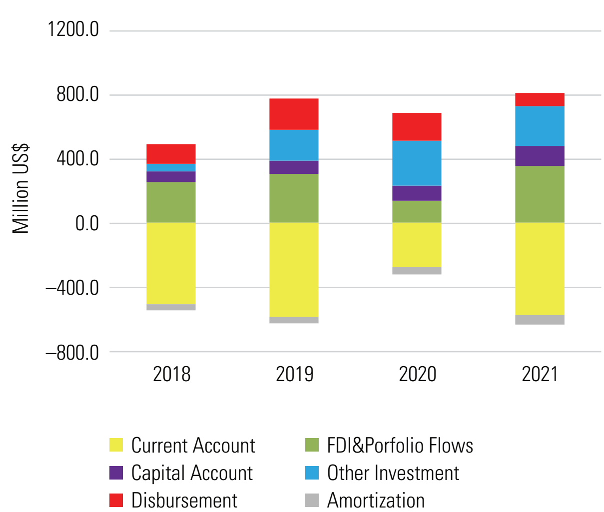
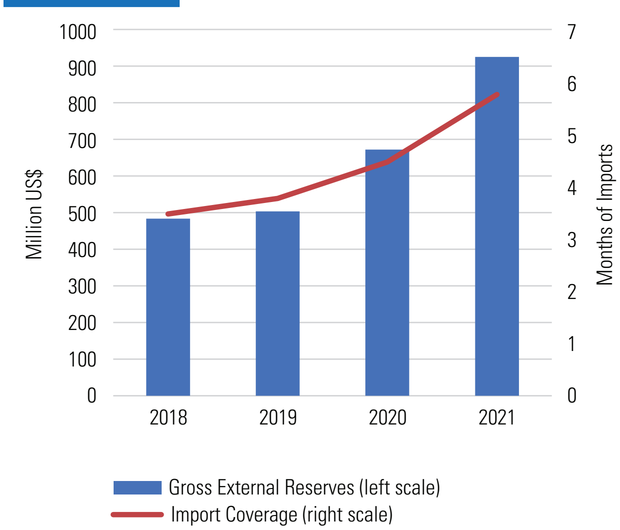


FIGURE 8 Reserve Coverage, 2016–20



Source: Sierra Leone authorities, IMF and World Bank staff estimates

Inflation has Accelerated with Rising Global Food and Fuel Prices, and a Depreciating Currency

Inflationary pressures have accelerated, with a broad-based increase in food, fuel, and core inflation. After declining to 8.9 percent in March 2021 year-on-year (YoY), headline inflation (End-period consumer price inflation (CPI)) rose sharply to 17.9 percent by end-December 2021, registering the ninth consecutive month of accelerating inflation (see Figure 9). Domestic prices are vulnerable to global fluctuations due to the country's high import dependence. Global food inflation as estimated by FAO rose to a 10-year high of 28 percent, and average global crude prices rose by 67 percent during 2021. The increased global crude oil price has been passed through to consumers resulting in a 50 percent upward adjustment in retail fuel prices, as per the fuel price liberalization policy adopted by the government in 2018. This trend of rising global inflation has aggravated the impact of domestic supply chain and pandemic related disruptions, resulting in high domestic inflationary pressures. Meanwhile, depreciation of the Leone has further contributed to rising domestic inflation by raising the domestic currency price of imported items. However, the 12-month moving average CPI for the whole year (2021) stood at 11.9 percent, the lowest in five years, due to subdued economic activity and relatively lower nonfood prices early in 2021. Average inflation has since accelerated to 17.1 percent in 2022Q1 reflecting rising global food and crude oil price increases, supply-chain disruptions caused by the war in Ukraine, and continued depreciation of the Leone.

Food inflation was the primary driver of rising inflation in 2021, but fuel and core inflation have gained in relative importance in 2022. Food is a major component of the consumption basket, and food inflation increased from 15.1 percent as of end-December 2020 to 19.8 percent at end-December 2021 (the highest level recorded in 3 years), driven largely by higher international food prices (see Figure 10). After declining to single digits by end-December 2020, core inflation (which excludes highly volatile food and energy prices) started rising in the second half of 2021 and climbed above food and headline inflation by 2022Q1 (see Figure 10). This reflects in part the gradual recovery of consumption demand post-pandemic and renewed global supply disruptions induced by the ongoing Ukraine war. The persistent double-digit food inflation, along with the economic impacts of the pandemic, have negatively affected households and raised concerns of food insecurity within the country. Also, the continued rise in prices for essentials like food and fuel could present risks to social and political stability in the country, ahead of planned general elections in 2023.

FIGURE 9 Consumer Price Inflation, 2018–22

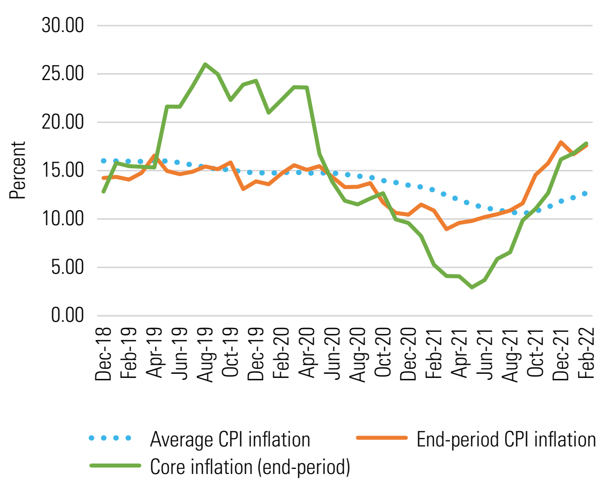
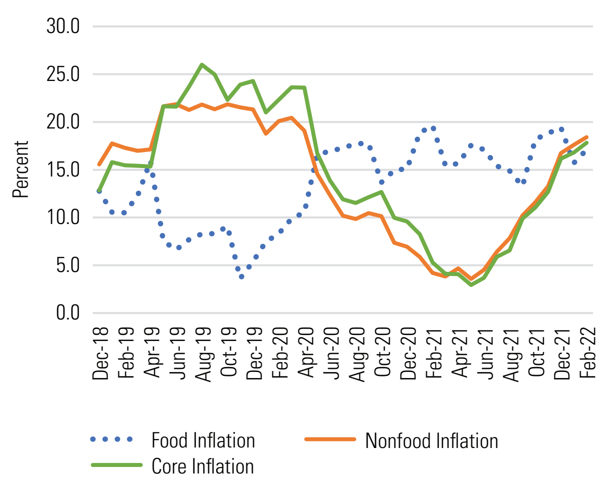


FIGURE 10 Core, Food and Nonfood Inflation, 2018–22



Source: StatsSL and WB staff estimates.

BOX 3 CPI Base Revision

Sierra Leone launched a revised Consumer Price Index (CPI) series in March 2022. The new series included several changes: (i) the base period was updated from the year 2008 to the month of December 2021, (ii) the underlying consumer basket was updated to reflect latest consumer preferences and coverage was marginally expanded, and (iii) geographical coverage was expanded to include the new North-West region. According to the latest estimates, year-on-year inflation has accelerated and averaged 17 percent in the three months since December 2021.

The CPI series is routinely updated in line with international best practice to revise the base period against which changes in all subsequent periods are measured, and to update the underlying consumer basket to reflect the latest consumer preferences. Usually, the base period is a whole year to average out any in-year fluctuations and seasonality. However, this revised series has updated the base to the month of December 2021, during which inflation was 17.9 percent year-on-year, the highest rate in 40 months. Using a base period with unusually high inflation, not reflective of underlying trends, can lead to underestimating inflation in subsequent periods.

CPI Basket Comparison (Old vs New)

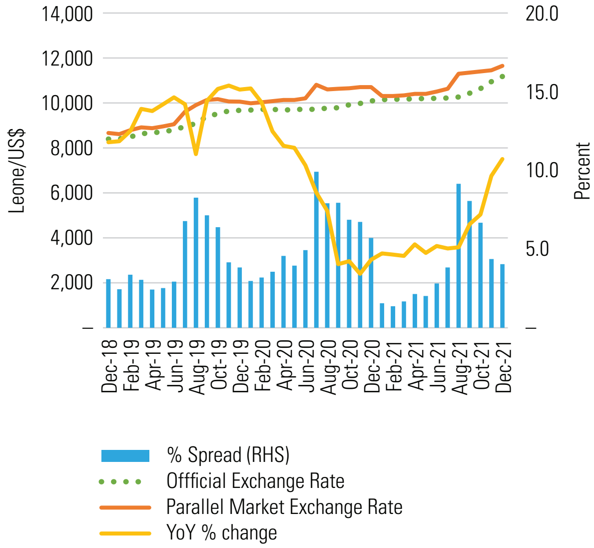
Weights in CPI (%)	Previous	New	Difference
Food and non-alcoholic beverages	41.9	40.3	–1.6
Alcoholic beverages, tobacco and narcotics	1.7	1.0	–0.7
Clothing and footwear	7.3	7.7	0.4
Housing, water, electricity, gas and other fuels	13.7	8.9	–4.8
Furnishings, household equipment, etc	5.9	5.6	–0.3
Health	11.4	7.6	–3.8
Transport	7.8	8.6	0.8
Communication	2.0	4.7	2.7
Recreation and culture	1.5	2.6	1.1
Education	2.9	3.1	0.2
Restaurants and hotels	0.9	6.1	5.2
Miscellaneous goods and services	3.1	3.9	0.8
Total	**100.0**	**100.0**	**0.0**

Source: Statistics Sierra Leone and World Bank Staff estimates

The Leone depreciated during the second half of 2021, after stabilizing temporarily in earlier months. The currency depreciated by 11 percent (YoY) against the US dollar in 2021 at the official window (9 percent at the parallel market) against the backdrop of a widening of the current account deficit and rising inflation (Figure 11). However, the spread between the official exchange rate and the parallel market rate narrowed to 4.1 percent from 5.7 percent in 2020 as the BSL rolled back its earlier directives that restricted foreign exchange transactions at the official market. The increase in global food and crude oil prices (Figure 12) and supply chain disruptions caused by the COVID-19 pandemic increased the cost of importing essential commodities, driving up demand for foreign exchange. The real effective exchange rate is estimated to have risen marginally during 2021 by 0.5 percent, marking the third consecutive year of increase and a continued erosion of its export competitiveness.[8] This reflects the fact that domestic prices continue to

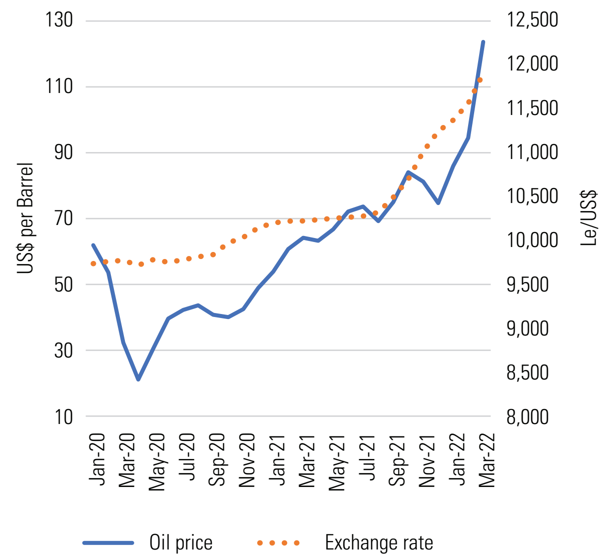
8 REER is the real effective exchange rate (a measure of the value of a currency against a weighted average of several foreign currencies) divided by a price deflator or index of costs. An increase in REER implies that exports become more expensive, and imports become cheaper; therefore, an increase indicates a loss in trade competitiveness.

FIGURE 11 Exchange Rate Developments



Source: BSL and World Bank staff estimates.

FIGURE 12 Global Crude Versus Exchange Rate



rise faster than those in the country's main trading partners and implies that further depreciation may be inevitable.

Pressure on the exchange rate has intensified in 2022 as global food and crude oil prices increased further due to the Ukraine war. To respond to the increased demand for foreign exchange, the BSL has setup two facilities: Special Facility for Food (SFF) and Fuel Reserve Facility (FRF). The SFF is expected to provide foreign exchange (through commercial banks) to facilitate the import of food items (mainly rice, flour and sugar) while FRF will provide forex to aid fuel imports. Both SFF and FRF are expected to prevent shortages of essential commodities while easing FX demand pressures to stabilize the exchange rate and dampen inflation. While the creation of FRF and SFF can be helpful, they should be timebound, well-governed, and administered competitively through the banking system with clear objective criteria for selecting recipients in order to avoid the creation of dual markets.

In response to rising inflationary risks, the central bank began tightening monetary policy in late 2021. The Monetary Policy Committee (MPC) of the BSL raised the monetary policy rate (MPR) by 25 basis points to 14.25 percent in December 2021, for the first time in over a year, after inflation accelerated and returned to double digits. As inflation averaged 17 percent in 2022Q1, the MPC tightened monetary policy further, sharply raising rates by 75 basis points to 15 percent on 5 April 2022. Key money market interest rates, that had fallen during 2020, also rose during 2021, signaling constrained liquidity. For example, between December 2020 and 2021, the 1-year T-bill rate rose from 10.5 to 21.4 percent (see Figure 20), as government borrowed increasingly from the banking system. With commercial banks preferring to hold safe treasury assets, liquidity became tight, and the interbank rate rose from 10.4 percent to 15.1 percent, slightly above the MPR. The maximum lending rate (MLR) declined by nearly 4 percentage point during this period to 20.5 percent (helped by the low interest rates on the BSL's $50 million special credit facility), but it still exceeds return on savings by over two times. Overall, the tightening of monetary policy could help contain demand-driven core inflation, but simultaneously aggravate supply constraints in the near-term by affecting credit to the private sector and slowing the pace of overall economic recovery. Supply side measures to address the inflationary pressure, such as the recent creation of SFF and FRF can help businesses access vital foreign exchange to cope with the rising import bill for food and fuel but need to be complemented with programs to boost local food production.

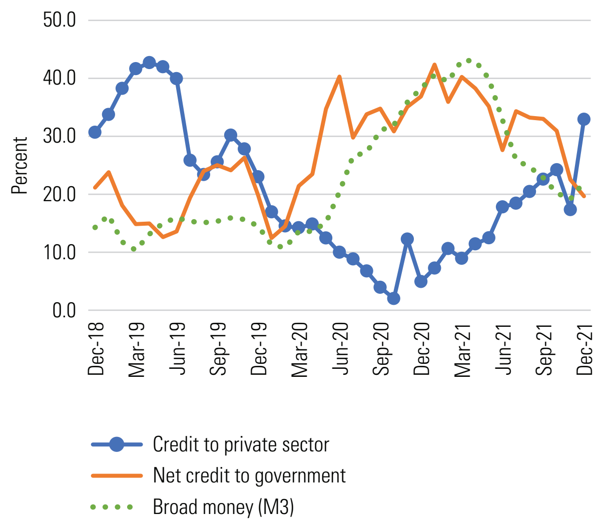
Financial Sector was Relatively Stable Despite an Increase in Nonperforming Loans, Due to Its Interdependence with the Public Sector

The tightening of the monetary policy stance has caused monetary aggregates to slowdown, reflecting the overall economic momentum. Broad money (M3) growth decelerated to 22.1 percent at end-December 2021 (yoy) from 38.1 percent in the previous year reflecting the slowdown in both net domestic assets (NDA) and net foreign assets (NFA). Credit to the private sector rose by 19.5 percent, funded by increased deposit mobilization and BSL's SLL500 billion special credit facility. Credit to agriculture, which has the lowest share in total credit, grew by over 400 percent during the year and accounted for 5.3 percent of total credit (SLL149 billion) compared to just 1.2 percent in the previous year (see Figure 15). The service sector including commerce, finance and other services (transport, communication, etc.) continues to account for the largest share of credit followed by construction and manufacturing. On the liabilities side, reserve money grew by only 8.7 percent at end-December 2021 (yoy) (down from 55 percent in 2020) driven mainly by a slowdown in the growth ofcurrency in circulation (to 24 percent yoy from 46 percent in 2020).

The sovereign debt-banking nexus continues to pose significant risks. Net government borrowing grew by 19.6 percent compared to 36.8 percent at end-December 2020 as the authorities sought to limit borrowing from the Central Bank to improve compliance with 2019 BSL Act. However, net government credit was driven mainly by new borrowing from commercial banks to help finance the fiscal deficit. Government borrowing needs have remained large (reflecting spending pressures from the pandemic) and continue to influence monetary policy considerations. While private sector credit growth exceeded the growth rate of net government credit from banks, the latter remains large, potentially crowding out productive investments.

The banking system remained relatively stable in 2021 despite an increase in nonperforming loans. During 2021, total banking system assets and customer deposits increased by 20.8 percent and 23.2 percent, respectively, as banks sought to expand financial intermediation and support any recovery in real activities. The ratio of nonperforming loans (NPLs) to gross loans increased by 2.5 percentage points to 15.2 percent with NPLs in the services, construction and manufacturing sectors (see Figure 16). However, the capital adequacy ratio (CAR – regulatory capital-to-risk-weighted assets), increased by 1.2 percentage points (yoy) to 41.3 percent in 2021, far above the 15.0 percent statutory minimum (see Table 3). Banks remain profitable as both return on assets (5.4 percent) and return on equity (23.9 percent) were above the averages for SSA. The ratio of liquid to total assets remained high and relatively unchanged at 73.7 percent as commercial banks continue to prefer short-term government paper, such as T-bills, over long-term investments which have higher lending risks. The net loans (total loans less provisions for NPLs) to deposits ratio went down 1.0 percentage points to 20.8 percent as bank deposits increased, a sign of general improvement in banking system liquidity. The ratio of NPLs (net of provisions) to capital has improved substantially in the last five years (Table 3).

FIGURE 13 Key Monetary Aggregate (YoY % Change), 2018–22



Source: BSL data, World Bank staff estimates

FIGURE 14 Key Money Market Interest Rate, 2019–22, Percent

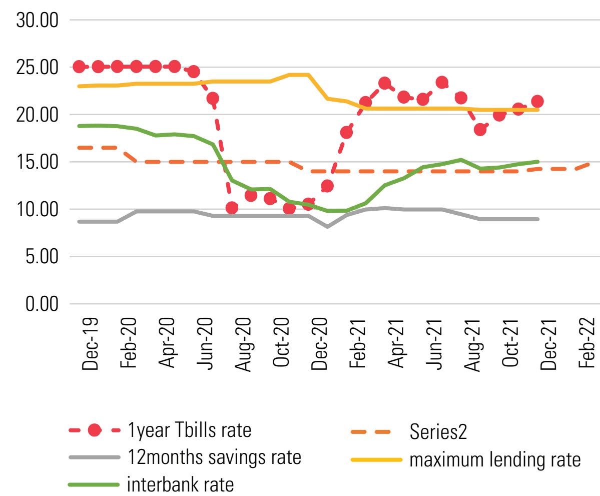
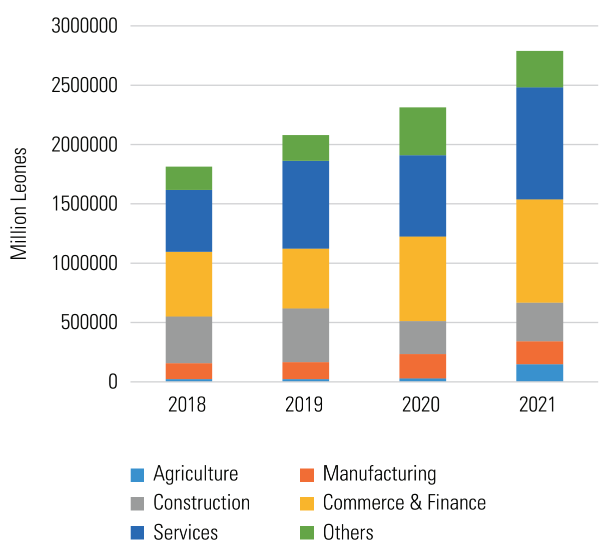


FIGURE 15 Composition of Private Credit, 2018–21, SLL



Source: BSL data, World Bank staff estimates

FIGURE 16 Sectoral Distribution of NPLs, 2018–21, Percent

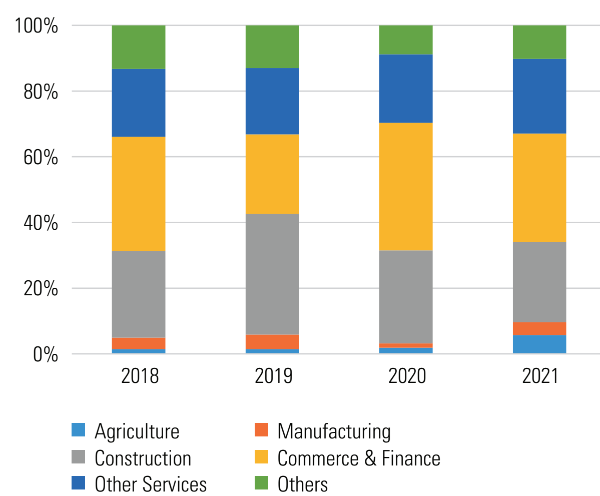


TABLE 3 Selected Financial Soundness Indicators, 2017–20, Percent unless Otherwise Stated

	2017	2018	2019	2020	2021
Capital adequacy/1	34.2	38.4	41.7	40.1	41.3
Asset quality					
Nonperforming loans to total gross loans	14.6	12.7	16.8	12.7	15.2
Nonperforming loans (net of provisions) to capital	12.1	9.9	7.2	4.3	4.7
Earnings and profitability					
Return on assets	5.3	6.1	6.1	6.1	5.4
Return on equity	25.6	27.3	26.1	25.7	23.9
Liquidity					
Ratio of net loans to total deposits	19.2	27.2	25.0	21.8	20.8
Liquid assets to total assets	66.9	67.9	68.4	73.4	73.7
Share of foreign currency in total deposits	37.1	38.3	37.0	37.5	38.1
Net open position in foreign exchange to capital	–14.4	–12.8	–1.8	–12.2	–10.6
Memo: Le billion					
Total Assets	7433	8549	9498	13076	15805
Cash	408	482	433	433	686
Total Deposit	5275	6111	6759	9407	11592
Gross Loans	1497	1773	2055	2267	2713

Source: Bank of Sierra Leone data, World Bank staff estimates.
Note 1: Capital requirement over risk-weighted assets (solvency ratio)

POVERTY AND INFLATION

The recent acceleration in inflation has been driven by food prices. Notably, by the end of 2021 -i.e., as COVID restrictions were lifted, the growth rate of prices across all components of CPI basket have slowed, *except* for food items. Indeed, the growth rates of food prices increased steadily from 8.7 percent in 2019 to 13.6 percent in 2020 and 17.0 percent by the end of 2021. While domestic agricultural production increased in 2020, disruptions in markets and in the supply chain of food production and trade had offsetting effects on prices.

Food is a key driver of costs of living for Sierra Leonians. Food items comprise the largest share of CPI basket—43 percent, thus the contribution of higher food prices to the growing cost of living is significant. For example, in 2021 out of total inflation of 11.9 percent, more than half, 7.3 percentage points (or 62 percent) was attributable to food (see Figure 17 and 18).

The costs of healthcare and education services have also risen sharply, while other expense categories have seen lower rates of growth. During the pandemic year, the highest growth of prices was observed for education and health services. Though schooling was disrupted for a large part of 2020, the prices for education-related services rose by more than 51 percent. Health-care cost started growing at a high rate in 2019 and this continued well into 2020, as the composite price index for medicine and healthcare-related goods and services increased by 24 percent in 2020. Over the same period, i.e., in 2020, the lowest growth of prices was observed in utility sector. The consumer price index for housing, electricity, and fuel increased by just 3.6 percent.

Sierra Leone is highly dependent on food imports and exposed to changes in international food prices. Around one-third of Sierra Leone's merchandise imports are food items. Global food and cereal price have been increasing since the summer 2020[9]. Growth of international prices for food and cereal reached a peak in March/April of 2021 of 40 percent and 36 percent (year on year), respectively. After that, though global food inflation decelerated, it remained higher than in previous years. The domestic food price index for Sierra Leone has

9 https://www.fao.org/worldfoodsituation/foodpricesindex/en/

FIGURE 17 Average CPI Inflation by Component

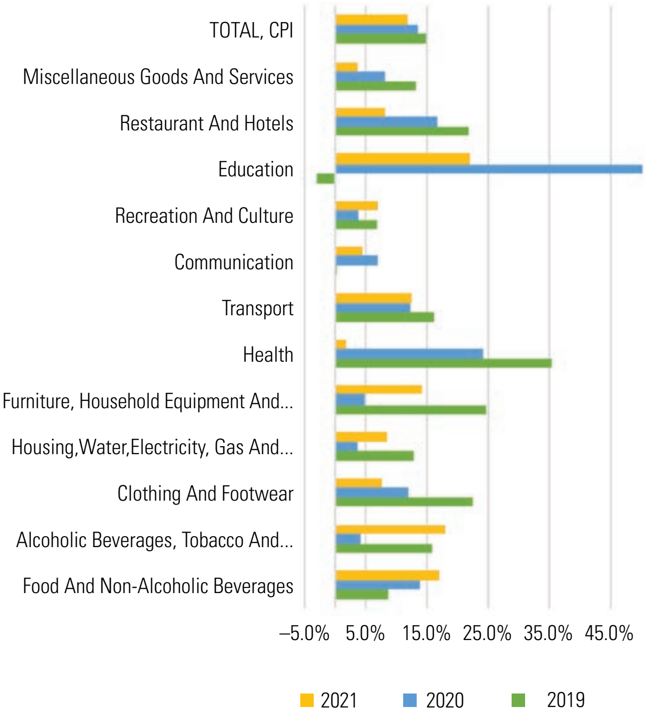
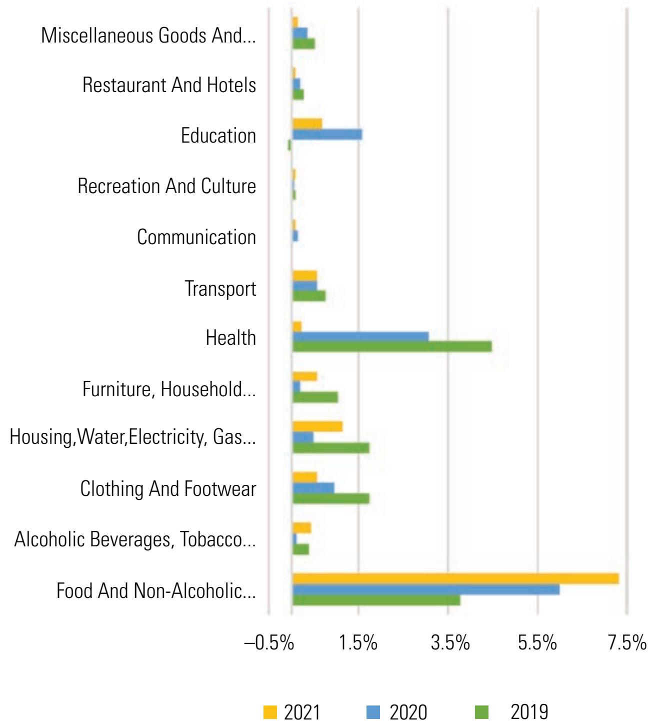


FIGURE 18 Contribution to CPI Inflation



Source: WB Staff estimates based on StatsSL CPI data

loosely followed the global trend, but with a lag. The global food spike of late spring 2021 had a muted impact on domestic food prices, likely only putting some pressure toward the end of 2021.

Inflation, When Caused by Food Prices, has a Larger Impact on Poverty

Recent inflationary trends have generated policy concerns regarding the extent to which growing prices erode the purchasing power of households. Volatility and sudden upward movements especially in food prices – for example due to domestic (e.g., disruption in supply of agricultural inputs or disruption in markets and trade) or external (e.g., global food price hikes or sudden changes in the exchange rate) reasons – have been known to cause significant surges in the vulnerability levels of households (Ivanic et al., 2012). With the significant budget share spent on food across households, unexpected, even small food price hikes could lead to significant loss of purchasing power in the short run. This section conducts a sensitivity analysis of how changes in prices in the aggregate or at the level of specific items impact the welfare of households.

The impact of inflation is assessed by disaggregating the impact on various goods and services categories present in the household budget. As we have seen, food accounts for the largest share of household spending and the impact of food inflation therefore is the most prominent. We find that a food price shock of 5 percent leads to an average loss of purchasing power of 1.8 percent and a 1.4 percentage point increase in the national incidence of poverty (see Figure 20 and 21). Doubling food inflation from 5 to 10 percent result in the proportional loss of purchasing power (3.6 percent), but less proportional increase in poverty rates (2.6 percentage points from the

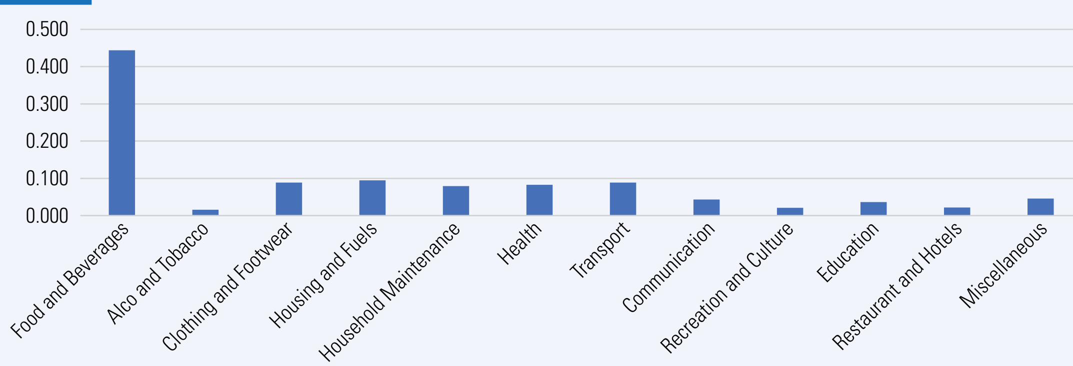
BOX 4 Simulating the Impact of Inflation – Methodology and Assumptions

It is important to isolate the impact of inflation on welfare. We simulate changes in expenditures with price shocks and compare them to the baseline level of expenditures.[10] The welfare loss in the short run is defined as the difference between the expenditures obtained with new/higher prices and baseline expenditures (Laderchi et al., 2013). The total impact is then obtained by summing up the changes in expenditures across all items or consumption categories. The exact magnitude of the direct negative welfare impact of inflation depends on: (i) household consumption pattern, i.e., the shares of expenditures of the specific items in the total household budget; (ii) the magnitude of the price increase (i.e., inflation); and (iii) the estimated value of price elasticity of demand for the item. This approach follows the measurement of the equivalent variation of the consumer demand function resulting from changes in relative prices.

The analysis assumes no substitution of consumption items and no income growth, thereby identifying only the short-run impact of inflation. It utilizes data from the Sierra Leone Integrated Household Survey (2018). It classifies household consumption in twelve groups following the UN's "classification of individual consumption by purpose" (COICOP) categories. As a first step, the simulation applies different inflation rates (from 5 to 50 percent) to each COICOP category to allow for heterogeneity in the patterns of household consumption. Second, the simulations assume no income/earning adjustment. This is based on recent literature that finds that income growth tends to be slow and generally lower when compared to consumer price inflation in the short run (Ha et al., 2019). The third important aspect of the methodology is that the income distribution was shifted based on the real growth of per capita GDP between 2018 and 2020. The projected distribution serves as a baseline for changes in the purchasing power and poverty due to inflation by COICOP categories.

The simulations do not reflect projections of poverty going forward. World Bank poverty projections are based on actual and forecasted growth in real per capita GDP. In the absence of current data on consumption expenditures by households across welfare quintiles, growth of GDP serves as a good single proxy for changes in real incomes and productivity. However, basing the projection on the aggregate number would not allow isolating the impact of consumer prices, which is the gap that this note seeks to fulfill.

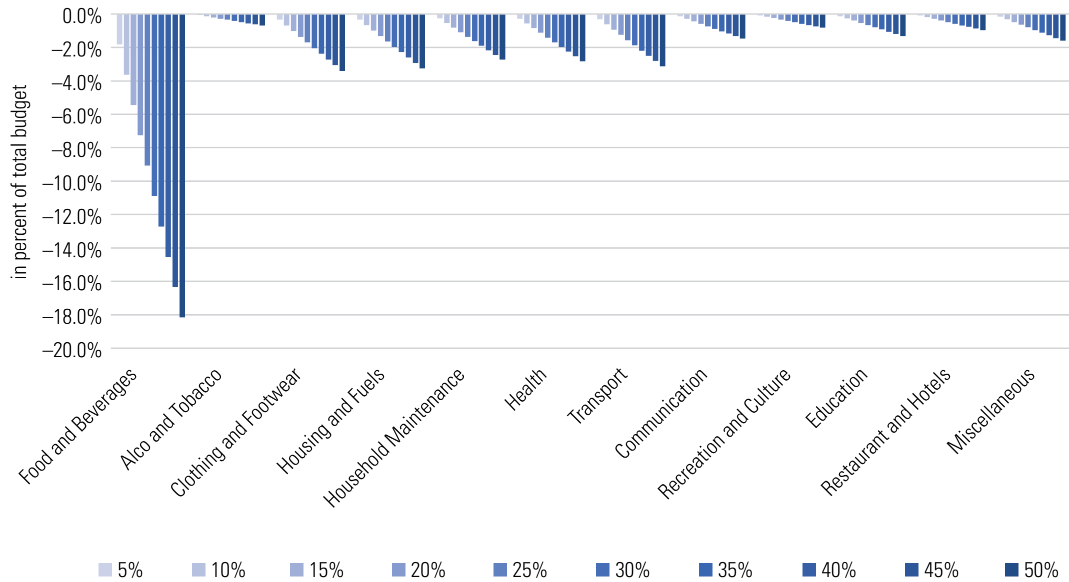
FIGURE 19 Inflation Elasticity of Poverty



Source: Staff estimates based on SLIHS 2018

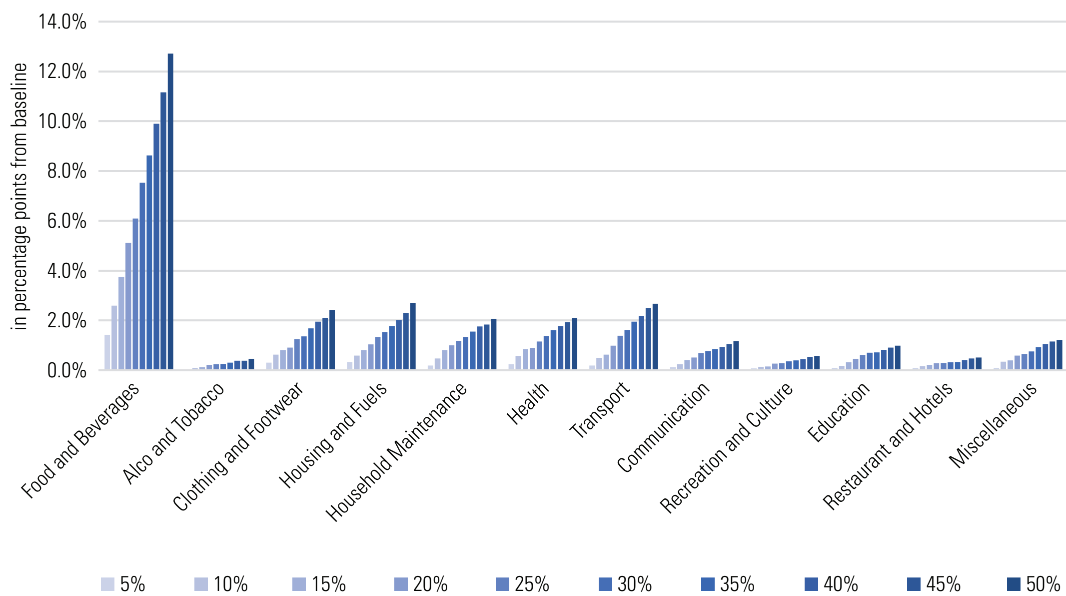
10 It is also possible to nowcast the welfare distribution to current period, but as long as the shape of the distribution is kept unchanged along with consumption patterns the impact measured in terms of loss of purchasing power will be similar.

FIGURE 20 Loss of Purchasing Power Due to Inflation by COICOP Category



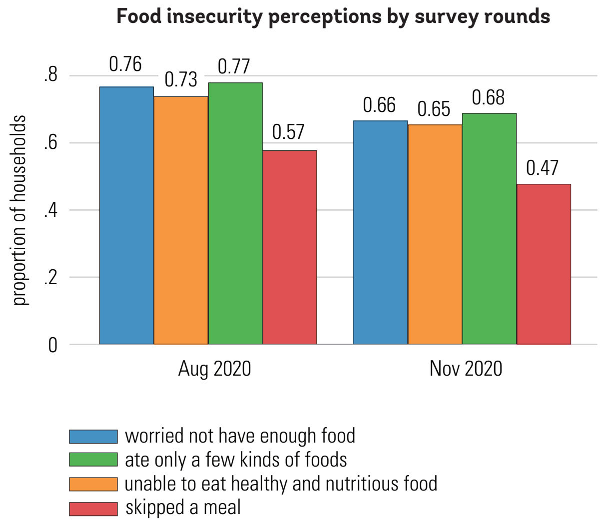
Source: Staff estimates based on SLIHS 2018

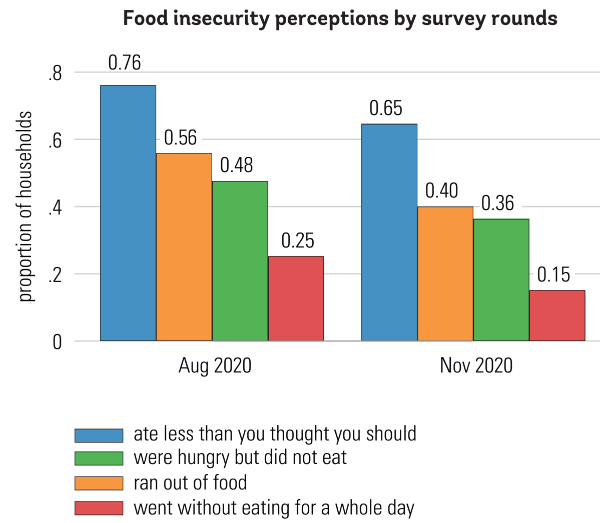
FIGURE 21 Change in Poverty Due to Inflation by COICOP Category, Assuming No Income Growth



Source: Staff estimates based on SLIHS 2018

FIGURE 22 Perception of Food Insecurity (August and November 2020)





Source: Staff estimates based on CIMS 1 and CIMS 2

baseline), which makes sense because of the shape of the expenditure distribution, as the distance between the poverty line and consumption expenditures varies across different households, resulting in non-linear change in poverty rates.

Other consumption categories, which could lead to high price vulnerability include clothing, housing and fuel, health and transport. For example, a 15 percent price shock in the housing and fuel category could lead to a 1 percent reduction in real income and 0.8 percentage point increase in poverty. Based on the simulated poverty changes and price shocks it is possible to calculate the "inflation elasticity of poverty", which models the percentage increase in poverty incidence associated with percentage change in prices of specific consumer category. As expected, this elasticity is highest for food, followed by clothing, housing and fuel and lowest for alcoholic beverages and tobacco and restaurant and hotels. The estimates of elasticity values can help to focus the price monitoring efforts and prioritize the policy measure to target items most important for household welfare. For example, while in 2020 highest growth in prices was observed in education, the inflation elasticity of poverty for this category is not high. In contrast, in 2021 the food index hiked up by 17 percent and likely significantly impacted household welfare. Similar to estimates of loss in purchasing power the values of elasticities represent the upper bounds of the inflation impact.

Concerns of Food Insecurity have Risen Since COVID-19

Food inflation is a major concern of the population according to phone surveys.[11] During 2020, food prices were high though food inflation decelerated towards the end of the year which may explain why food insecurity indicators improved. Fear of lack of access to food was pervasive (76 percent of survey respondents) in Sierra Leone during the early months of the pandemic when there were lockdowns and market closures, especially in urban areas. This share declined to 66 percent in November 2020 as life began to return to normal. Another and more concerning indicator of food insecurity is when a family runs out of food. This indicator also showed improvement between June and November 2020—it fell from 56 percent of households to 40 percent (see Figure 22). Finally, despite improvements in food insecurity, levels remain high in Sierra Leone. In two thirds of households, people consume less food than they consider sufficient, and in more than a third of households, individuals stayed hungry and did not consume enough food.

[11] In 2020, the World Bank and UNICEF partnered with Statistics Sierra Leone to undertake a multi-round phone survey to assess the socio-economic impact of Covid-19 pandemic on households across the country. The first two rounds were conducted in August and November of 2020.

NEAR AND MEDIUM-TERM ECONOMIC OUTLOOK

Growth is expected to accelerate going forward, but slower than previously forecast. Over 2022, it is expected to reach 3.9 percent, up from an estimated 3.1 percent in 2021, but below the previous forecast of 5 percent. It will be supported by (i) resumption of iron-ore mining operations at both Marampa and Tonkolili mines, for the first time since the Ebola crisis; and (ii) overall gradual recovery in domestic and global consumption demand. Commodity prices have been disrupted by the Ukraine-Russia war and will present both positives and negatives, with marginal net-negative terms-of-trade effects. On one hand, higher food and fuel prices have raised import costs, presented fiscal risks, and resulted in accumulation of arrears to Karpower, causing power outages. On the other hand, higher mineral prices could present gains for the economy. Iron ore prices have trended upwards along with those of other commodities, on account of disruptions to supply from Ukraine and Russia (which together account for nearly 5 percent of world exports of iron ore) and increased demand from alternative sources. A sharp increase in iron ore prices can present terms of trade gains, and further bolster exports. However, domestic mineral production may remain constrained in the near-term by the country's logistical capacity to trade and transport.

Growth is expected to gradually recover over the medium-term, driven by agriculture and mining. Real GDP growth is projected to average 4.4 percent over the medium term (2022–24), with contributions from investments (especially in mining and agriculture) on the demand side, and from agriculture, tourism, and mining on the supply side. The outlook assumes that iron ore production will improve, coupled with continued large-scale investments in new mines (for gold and diamonds) as well as agriculture, supported by the government's policy shift to promote private sector participation. Agriculture is expected to contribute 1.9 percentage points to medium-term growth (45 percent of the total), reflecting bumper crop production on account of increased private sector participation in the sector and investments in cash crops. Recent reforms in the fisheries sector, including increased surveillance, are expected to boost fish catch while ensuring sustainability. Industry is expected to contribute 0.8 percentage points (14 percent) to medium-term growth driven mainly by buoyant mining activities especially for iron ore, gold and diamonds. The expected implementation of new capital projects including several rural bridges and roads to connect communities and a new airport terminal are expected to boost construction activities. The service sector is expected to contribute about 1.7 percentage points (41 percent) to growth driven mainly by continued recovery in tourism,

TABLE 4 Selected Macroeconomic Indicators (annual percent change unless indicated otherwise)

	2019	2020	2021 e	2022 f	2023 f	2024 f
Real GDP growth, at constant market prices	5.3	–2.0	3.1	3.9	4.4	4.8
Private Consumption	4.3	4.3	4.2	6.2	4.9	5.9
Government Consumption	5.1	2.7	0.1	0.0	15.7	0.9
Gross Fixed Capital Investment	–34.2	–4.1	7.6	9.8	13.5	12.1
Exports, Goods and Services	–1.6	–9.8	40.5	18.0	9.5	10.1
Imports, Goods and Services	–7.0	7.5	18.4	12.4	13.1	7.8
Real GDP growth, at constant factor prices	5.3	–2.0	3.1	3.9	4.4	4.8
Agriculture	5.4	1.6	3.7	3.5	3.6	3.6
Industry	10.9	–7.1	3.8	9.4	4.7	4.7
Services	3.8	–5.9	2.0	2.9	5.7	6.7
Inflation (Consumer Price Index)	14.8	13.5	11.9	14.2	12.1	10.9
Current Account Balance (% of GDP)	–15.3	–7.0	–13.7	–15.9	–14.2	–13.1
Net Foreign Direct Investment (% of GDP)	12.2	5.1	14.4	10.1	7.4	6.7
Fiscal Balance (% of GDP)	–3.1	–5.8	–5.9	–5.0	–4.2	–2.9
Debt (% of GDP)	70.9	76.3	76.9	76.8	76.7	75.1
Primary Balance (% of GDP)	–0.4	–2.7	–2.8	–2.0	–1.4	–0.1
GHG emissions growth (mtCO2e)	3.1	1.4	3.0	3.0	2.7	2.8
Energy related GHG emissions (% of total)	3816	3957	4106	4467	4919	5397

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Note: e = estimate, f = forecast.

transport, communication, and trade from the COVID-19 pandemic. Public services including health and education are expected to increase on account of government's post-pandemic recovery measures.

Inflationary pressures are expected to be elevated in 2022 but moderate to about 10.9 percent by 2024. High global food and fuel prices are expected to aggravate domestic inflation during 2022. However, strong agricultural output is expected to boost domestic food production and, coupled with prudent monetary policy to stabilize the exchange rate, should stabilize inflationary pressures in the medium-term.

The overall fiscal deficit is projected to narrow to 2.9 percent of GDP by 2024, driven by gains in domestic revenue mobilization, expenditure rationalization, and public financial management reforms. However, the deficit including grants is projected to be elevated in 2022, declining by only 0.9 percentage points to 5.0 percent of GDP owing to spending pressures[12] from the fallout of Russia-Ukraine war. Over the medium-term, deficit reduction will be helped by the slowdown in COVID-related spending, some gains in domestic revenue mobilization, and continued public financial management reforms. Domestic revenue mobilization is expected to increase reflecting among others the modernization and automation of taxation processes (ITAS, ECR and Customs Electronic Single Window), adoption and implementation of a duty and tax waiver policy, strengthened compliance audits, implementation of transfer pricing regulations, and roll-out of a Block Management Registration System (BMRS) to small and medium taxpayers to bring them into the tax net. Stringent control over spending will be anchored by the IMF ECF program while safeguarding

12 Total expenditure is projected to be elevated in 2022 on account of inflation-driven overruns on goods and services, and high subsidy payments and social transfer payments to support access to energy and food supplies within the country.

social expenditures to support human capital development. Public financial management reforms aimed at strengthening public procurement and improved compliance with audit recommendations will generate fiscal savings over the medium-term. Reprioritization of recurrent spending will be supported by payroll reforms to reduce the wage bill.[13]

Public debt will remain high, but it is expected to decline gradually over the medium term as economic growth and fiscal consolidation efforts progress. During 2022, public debt is expected to remain essentially constant at 76.7 percent of GDP. Although the present value of public debt-to-GDP ratio tracks downwards over the medium to long term, it remains relatively high. Both the external and public debt service-to-revenue ratios rise over the medium term, indicating a tight liquidity situation, before steadily declining in the long-term. The DSA stress tests indicate the debt indicators are sensitive to growth and exports shocks. Improvement in domestic revenue mobilization could lower government's borrowing needs and free up credit to the private sector. The continued implementation of policy and performance actions (PPAs) under the World Bank's Sustainable Development Financing Policy (SDFP) is expected to strengthen debt management and enhance debt transparency, lowering the risk of debt distress. To improve debt sustainability and lower the risk of debt distress Sierra Leone needs sustained fiscal adjustment supported by strengthened public financial management, effective expenditure prioritization, and redoubling structural and revenue mobilization reforms. Spending on social sectors (education, health and social protection) must be safeguarded to support the recovery and strengthen resilience. But with limited fiscal space to allow for increased spending, the focus will need to be on improving efficiency, as explained in the recent Public Expenditure Review.

The current account deficit is expected to narrow to 13.1 percent of GDP by 2024 as the recovery in the mining sector boosts export growth. Exports are expected to remain strong, driven mainly by mining which will be helped by favourable commodity prices. However, import growth is expected to remain large as aggregate demand rebounds, keeping the trade and current accounts in deficit. The deficit is expected to be financed over the medium-term by inflows on the financial account, especially FDI in mining and agriculture, which could cushion the exchange rate and keep external reserve coverage above 3 months of imports.

[13] The plans to continues to strengthen the integrity of the payroll including, automation of the payroll of Sub-vented Agencies and reconciling mismatches of names and dates of birth of public servants in the National Social Security and Insurance Trust (NASSIT) and National Civil Registration Authority (NCRA) databases with the Government payroll. This is ensuring that only employees with valid NASSIT, BBAN and National Identification (NI) numbers are included in the payroll.

RISKS TO THE OUTLOOK

The medium-term growth outlook faces significant downside risks and uncertainties related to the war in Ukraine, the 2023 general elections, and the path of the pandemic. As such, the downside risks are both external and domestic.

The main external risks relate to the ongoing war in Ukraine that has led to global supply disruptions and high inflation. New variants of COVID-19, along with the slow pace of domestic vaccinations, could cause more waves of infections, prompting mobility restrictions and dampening the medium-term economic outlook. A prolonged war between Russia and Ukraine could intensify fluctuations in global commodity prices. Despite limited direct exposure to the countries in conflict, fluctuations in global commodity prices expose several vulnerabilities of Sierra Leone's economy through three predominant and interconnected channels: (i) inflation: a sharp rise in global food and fuel prices, which account for more than half of all goods imports, poses a risk of higher inflation and potentially food insecurity within the country; (ii) growth: fluctuations in iron ore, gold, or diamond prices, can affect domestic mining production and exports, while pervasive power outages due to rising fuel prices could dampen business performance and investment decisions; and (iii) public finances: higher domestic inflation can cause expenditure overruns and higher fuel prices, if not passed through, can put pressure on the government's subsidy bill.

On the domestic front, the key downside risks are related to the 2023 general elections, high consumer price inflation, potential fiscal slippages due to expenditure pressures and high public debt burden especially the high domestic interest costs. First, local council, parliamentary and presidential elections are all scheduled within the year 2023. Businesses may postpone investment decisions ahead of elections to observe the outcome and gauge the government's commitment to continued reform. Further, post-election violence, as occurred during 2018, could pose significant risks to the economic outlook. Second, a sustained increase in inflation, especially food, could intensify food insecurity and threaten social stability in the country. Third, execution of the national budget could be challenged by increased spending (mainly subsidies, goods and services and domestic interest payments) to mitigate the impact of domestic inflation, or as part of the pre-election campaign. If the authorities fail to adhere to medium-term fiscal targets, the consequent widening fiscal deficits could worsen macroeconomic imbalances and hinder economic recovery. The cost of debt servicing could go up further with fiscal slippages.

POLICY PRIORITIES

Sierra Leone's economy has been adversely impacted by two recent shocks: the COVID-19 pandemic; and the war between Russia and Ukraine. Policy priorities should therefore focus on cushioning the impact of these shocks and implementing reforms to safeguard and strengthen economic recovery over the medium-term.

Providing well-targeted crisis support to vulnerable households, affected by higher food and fuel prices, has emerged as a priority. Expanding social safety nets and increasing cash transfers to cover more households affected by recent shocks could provide a significant buffer to vulnerable households. The social safety nets program should be strengthened through better targeting of beneficiaries and linkage to productive activities (farming and fishing) and social programs (school feeding and maternal health).

COVID-19 vaccination remains low (at 20 percent of population) and expanded coverage to at least half of the country's population will help safeguard the economic recovery. The country has over a million doses of COVID-19 vaccines in store but needs to scale up public awareness about the safety and efficacy of vaccines to reduce hesitancy and increase inoculations. Health spending should continue to focus on implementing a strong rollout of vaccines and investments to strengthen the resilience of the health sector. Spending on education should focus on improving the learning environment to prevent COVID-19 transmission in schools, increase pupil enrollment especially for vulnerable groups, and undertake investments to improvement teacher management.

The authorities should cushion the impact of the war and the pandemic on small businesses with the help of well targeted cash transfers and credit facilities. COVID-19 era support to small and medium-sized enterprises through small grants for working capital and production may be sustained to protect jobs and safeguard the recovery. Modernizing digital payment systems and investing in digital architecture will be critical for reskilling workers and expanding financial inclusion through seamless interoperability between pay platforms, including mobile money.

Sustained fiscal adjustment and active debt management can support debt sustainability and reduce vulnerabilities. In the near term, government should focus on concessional sources of borrowing and financing. Exchanging high interest domestic debt for highly concessional external loans could reduce the costs associated with expensive domestic borrowings. A balanced mix of domestic and external borrowing can mitigate the risks related to interest cost and exchange rate volatility. To improve debt management and strengthen fiscal sustainability the authorities should discourage non-concessional borrowing by implementing the WB PPAs to maintain a zero ceiling on non-concessional borrowing over the medium-term. The capacity of debt management staff should be strengthened to improve debt recording and reporting. In the medium to long-term, efforts to deepen domestic debt markets by introducing medium to long-term bonds to extend the yield curve can help lower domestic costs of borrowing, while containing the exposure of public debt to currency fluctuations.

Adherence to the arrears clearance strategy, along with strict compliance with PFM regulations, can help avoid future accumulation of arrears, **support the private sector and improve service delivery**. Strengthening cash management by linking quarterly budget allocations to revenue performance and improving fiduciary management in ministries, departments and agencies (MDAs) by deploying budget officers and internal audit staff can help prevent accumulation of new arrears. The recently upgraded Integrated Financial Management Information System (IFMIS) can be used to improve commitment controls, strengthen cash and debt management, and enhance oversight of local councils to minimize fiscal risks.

Monetary policy should maintain balance between lowering inflationary pressure and strengthening the recovery. With inflation driven mainly by supply side shocks, tightening the policy stance too quickly could halt the recovery. Targeting a stable growth of money will be critical for anchoring prices while increasing private investment. Supply-side measures will be crucial in addressing the current inflationary pressures. The creation of FRF and SFF can be helpful but should be timebound, well-governed, and administered competitively to avoid the creation of dual markets. During the pandemic the authorities established a Special Credit Facility (SCF) of SLL500 billion to support the imports of essential commodities. It is important to align the SCF and two new facilities (FRF and SFF) to ensure simplicity and avoid duplication.

PART 2

Leveraging SME Financing and Digitization for Inclusive Growth

INTRODUCTION

Small-and-medium enterprises (SMEs) dominate the domestic private sector in Sierra Leone as they constitute 90 percent of all activity and provide livelihoods to approximately 70 percent of the population.[14] However, most SMEs operate in the informal sector and only ten percent are registered. SMEs in Sierra Leone face significant barriers to growth, such as limited access to finance, unreliable electricity, high tax rates, and cumbersome customs and trade regulations. Access to finance consistently features as one of the top constraints for SMEs across various surveys and diagnostics conducted by the World Bank and other development agencies. Digitization and use of Digital Financial Services (DFS) can provide a pathway for improved access to finance and inclusive growth among SMEs. This section discusses the main constraints faced by SMEs, particularly in accessing finance, the role of digital finance and some key recommendations that can allow SMEs to unlock their potential and contribute to more resilient and inclusive growth in Sierra Leone. While this part primarily focuses on SMEs, micro, small-and-medium enterprises (MSMEs) have been referenced in some places: frequently this reflects the lack of disaggregated data for SMEs and microenterprises.

14 Promoting A Resilient And Inclusive Private Sector In Fragile Contexts - Sierra Leone, Intellecap (May 2021) https://www.intellecap.com/wp-content/uploads/2021/05/Promoting-a-resilient-private-sector-Sierra-Leone-May21-1.pdf.

OVERVIEW OF SMEs IN SIERRA LEONE

Defining SMEs

While no standardized definition of SME exists in Sierra Leone, they represent significant economic activity and are a priority for growth. A few definitions for SMEs exist in parallel in Sierra Leone. The Small and Medium Enterprises Development Agency Act (SMEDA) of 2016, which created a dedicated agency to support micro, small and medium enterprises (MSMEs) in Sierra Leone, defined small enterprise as having annual turnover less than SLL100 million (US$8,500) and medium enterprise as having turnover larger than this but less than SLL500 million (US$42,680). The Small and Micro Taxpayer Regime as established in The Finance Act of 2021 in turn defines SME as having a turnover between SLL10 million (US$850) and SLL350 million (US$29,876) for the purposes of taxation. Another definition is provided for the purposes of incentivizing business registration for SMEs registering between 2021–2023. The SME definitions employed by SMEDA are generally not applied in the financial sector, where there is no unified common measure. Data on finance provided to SMEs by financial institutions is not collected by the Bank of Sierra Leone (BSL), and SME economic activity is not tracked by regular economic surveys.

A. SME Contribution to the Economy

SMEs are an engine of economic growth and key contributors to job creation. In Sierra Leone, MSMEs provide livelihoods to approximately 70 percent of the population[15] and constitute over 90 percent of the domestic private sector. Accordingly, SMEs have been prioritized within Sierra Leone's National Development Plan (NDP) 2019–2023 as critical to achieve goals of economic diversification, including by expanding Sierra Leone's agriculture-based economy into sectors such as tourism and fisheries. Figure 1. provides an overall profile of SMEs in Sierra Leone based on responses to the 2017 Enterprise Surveys.[16]

Most SMEs in Sierra Leone operate within the informal sector. SMEDA estimates a total of 50,000 MSMEs operate in Sierra Leone, of which SMEDA estimates roughly ten percent are registered with any entity (Office of Administrator and General (OARG), Corporate

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[15] Promoting A Resilient And Inclusive Private Sector In Fragile Contexts - Sierra Leone, Intellecap (May 2021) https://www.intellecap.com/wp-content/uploads/2021/05/Promoting-a-resilient-private-sector-Sierra-Leone-May21-1.pdf.

[16] World Bank. 2017. Enterprise Surveys: Sierra Leone Country Profile 2017. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/30299.

FIGURE 1 SMEs in Sierra Leone: A Country Profile from the 2017 Enterprise Surveys[17]

	Sierra Leone2017	Small firms	Medium firms	Large firms	Sub-Saharan Africa	Low Income
Firm Characteristics						
Age of the establishment (years)	17.2	17.3	14.5	23.8	14.7	14.0
Gender						
Percent of firms with female participation in ownership	18.8	19.4	14.6	16.7	31.8	27.6
Percent of firms with a female top manager	15.9	16.8	12.1	4.0	15.9	14.2
Proportion of permanent full-time workers that are female (%)	23.3	23.7	20.0	20.8	28.2	25.3
Percentage of permanent full-time non-production workers that are female.	33.4	34.2	27.8	8.5	30.4	28.2
Percentage of permanent full-time production workers that are female.	23.6	24.4	16.8	8.8	19.4	16.7
Workforce						
Percent of firms offering formal training	21.6	20.0	28.5	41.3	29.7	27.1
Proportion of workers offered formal training (%)*	43.0	43.5	37.3	46.9	44.8	40.2
Years of the top manager's experience working in the firm's sector	12.2	12.2	13.3	8.6	14.9	14.5
Number of permanent full-time workers	14.5	8.6	34.1	111.1	30.1	28.1
Number of temporary workers	3.2	2.0	8.4	19.4	6.9	7.6
Number of permanent production workers*	9.8	7.0	24.1	95.5	43.1	34.3
Number of permanent non-production workers*	2.7	1.8	10.8	22.4	11.1	10.5
Number of permanent skilled production workers*	6.7	5.0	19.7	61.0	28.0	24.2
Number of permanent unskilled production workers*	2.4	1.9	4.5	28.7	12.7	9.5
Proportion of unskilled workers (out of all production workers) (%)*	26.6	27.0	21.2	27.3	25.0	23.6

Source: World Bank Enterprise Surveys (2017)

Affairs Commission (CAC), city councils, district councils or any other authority). SMEs in Sierra Leone tend to exist in low value-added activity areas, such as food and agricultural processing, light manufacturing, tourism, and trade.[18]

Top business environment constraints faced by SMEs in Sierra Leone are access to finance, access to land, electricity, tax rates, and customs and trade regulations (see Figure 2). A survey conducted by the Ministry of Trade and Industry (MTI) of the GoSL in 2016, which targeted 945 firms, highlighted some of the key barriers to SME growth.[19] Access to finance was clearly the biggest barrier to growth, with 81 percent of the SMEs confirming this constraint.[20] Small firms are particularly affected, with 44 percent indicating it to be their most significant constraint. For medium-sized firms, tax rates were the most problematic. However, considering

17 The Country Profiles produced by the Enterprise Analysis Unit of the World Bank Group provide an overview of key business environment indicators in each economy, comparing them to their respective geographic region and group of countries with similar income levels. The same topics are covered for all countries with slight variations of indicators. All indicators are based on the responses of firms.

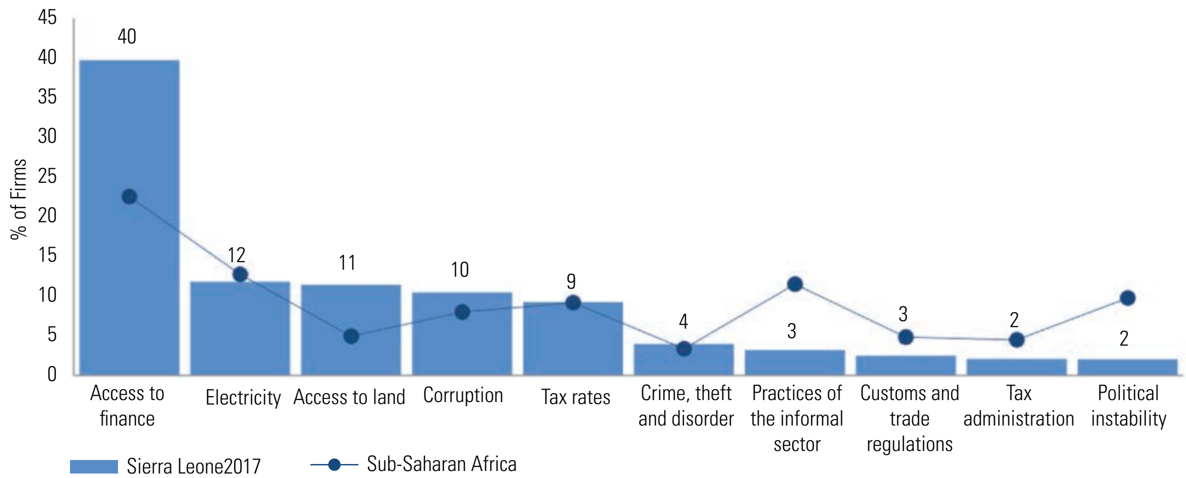
18 Enabling Environment for Sustainable Enterprises in Sierra Leone. International Labour Office (2019) https://www.ilo.org/wcmsp5/groups/public/---ed_emp/documents/publication/wcms_682137.pdf.

19 "Ebola don go, leh we make Salone grow!", President's Recovery Prioirities. Government of Sierra Leone (2016) https://www.presidents-recoverypriorities.gov.sl/single-post/2016/11/07/mti-conducted-a-survey-of-945-smes.

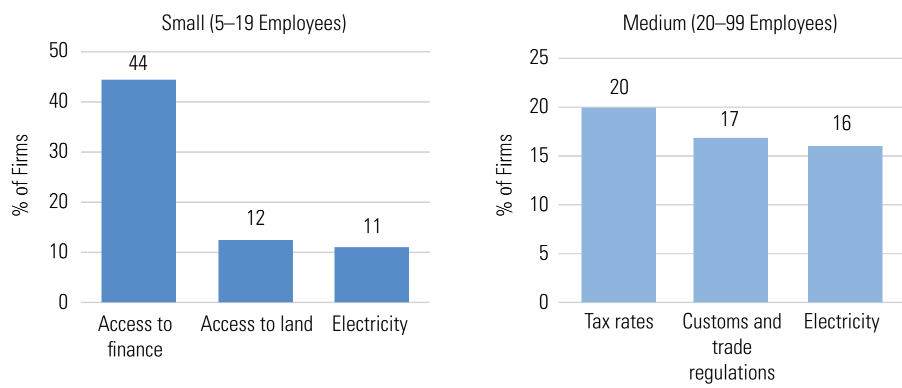
20 African Economic Outlook 2017. African Development Bank, OECD and United Nations Development Program (2017). https://www.oecd-ilibrary.org/docserver/aeo-2017-55-en.pdf?expires=1645602227&id=id&accname=ocid195787&checksum=5EAB082F89ACF17720CAF443E08B27F1.

FIGURE 2 Top Business Environment Constraints in Sierra Leone

A: Top ten business environment constraints (overall, 2017)



B: Top three business environment constraints (by firm size, 2017)



Source: World Bank Enterprise Surveys (2017)

that only 10 percent of the medium-sized firms with bank accounts also had bank loans (Figure 3) in 2017, access to finance appears to be a significant constraint for medium sized enterprises as well.

B. Impact of COVID-19 on SMEs

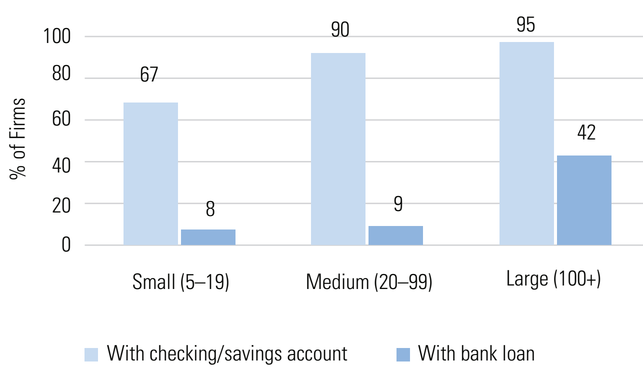
Businesses continue to bear the brunt of the economic shock from COVID-19, including in Sierra Leone. The World Bank's Business Pulse Surveys 2020–21 (BPS) provide a comprehensive assessment of the short-term impact of the COVID-19 pandemic on businesses during the first and second waves of the pandemic in 2020–21. Around 88 percent of the SMEs in Sierra Leone reported a decline in sales, with an average decline of 40 to 47 percent in monthly sales at the time of interviews in October 2020 and March 2021, respectively. This has had a direct impact on employment and wages. Many SMEs reacted by closing operations and laying off staff, leaving the barest minimum headcount onboard. The BPS further found that almost 35 percent of the SMEs in Sierra Leone had reduced worker wages, and 25 percent of SMEs had laid off their workers in the past thirty days preceding the interview in October 2020. SMEs reported a lack of support during this period, with only one percent of the firms having received credit support, tax reductions or exemptions, or wage subsidies. In comparison, a slightly higher percentage of SMEs reported receiving cash transfers (3.6 percent).

SMEs operating in sectors that were locked down were severely impacted by COVID-19. Halting trading during lockdowns severely handicapped SMEs' capacity to repay their loans, which now affects their ability to access additional loans to revive their businesses. The shift to digital commerce was slow or non-existent mostly due to SMEs' unfamiliarity with online commerce platforms and the high cost of setting up a presence on these platforms.[21]

C. Access to Finance: Challenges Faced by SMEs

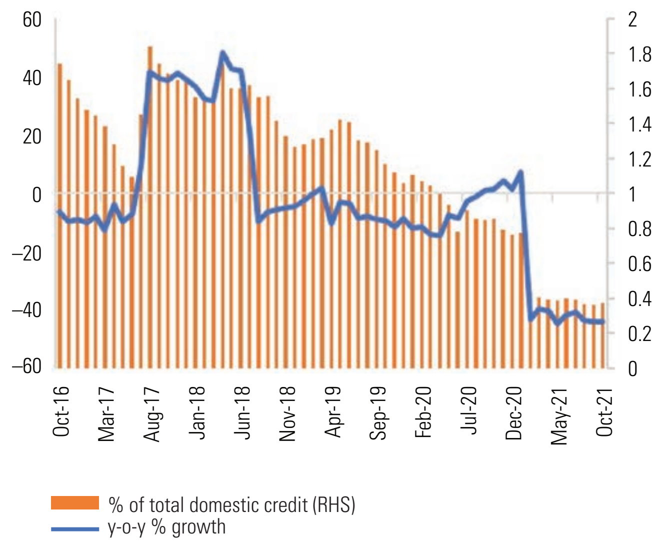
SMEs in Sierra Leone are characterized by low levels of access to finance and scarce credit options. According to the latest available data from the Enterprise Surveys,[22] only 17 percent of the SMEs in Sierra Leone have an outstanding loan or line of credit. In 2017, about 70 percent of SMEs had an account at a formal financial institution, but this did not translate to access to credit (Figure 3). For instance, according to the 2017 Enterprise Surveys only 2.8 percent of the firms used banks for working capital financing, while 1.3 percent

FIGURE 3 Use of Financial Services by Firms – by Size



Source: World Bank Enterprise Surveys (2017)

FIGURE 4 Private Sector Credit in Sierra Leone



Source: BSL

used banks to finance their investments. Further, BSL data shows that the proportion of private sector credit to total outstanding credit in Sierra Leone has been declining since 2018 (See Figure 4). On the supply side, financial intermediation is very low and has been decreasing in recent years due to the increasing reliance on government borrowing from the banking sector, which is also crowding out loans to private sector. The marked decline in lending to the private sector began in 2016, when commercial banks were observed to shift asset holdings from their loan portfolio to government securities. This shift may have been in reaction to stricter BSL requirements on new lending in response to high non-performing loans (NPLs) and insufficient provisioning. Additionally, unpaid government arrears discussed in part 1 exacerbates hardships faced by SMEs.

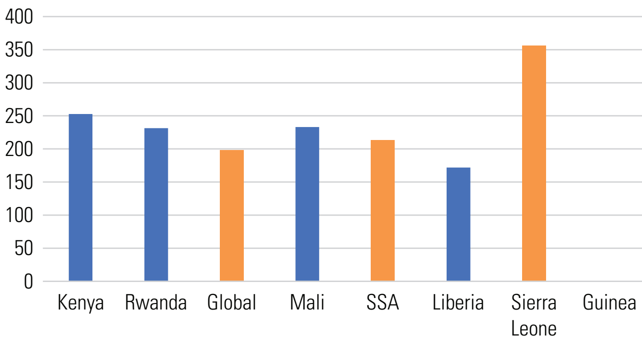
Most financial institutions have high collateral requirements, accepted typically in the form of immovable assets such as land. Fixed asset ownership, particularly land ownership, is often used as the basis for judging creditworthiness. This puts SMEs, and particularly women-led ones, at relative disadvantage as they often cannot put up such collateral for loan.[23] On average, 78 percent of capital stock of SMEs

21 Resilient and Inclusive Financial Services Delivery During COVID-19. Toronto Center (2021) https://res.torontocentre.org/guidedocs/Resilient%20and%20Inclusive%20Financial%20Services%20Delivery%20During%20COVID-19.pdf.

22 World Bank. 2017. Enterprise Surveys: Sierra Leone Country Profile 2017. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/30299.

23 "Request For Expressions Of Interest (Consulting Services – Firm Selection)". Government of Sierra Leone (10 February 2021) https://mof.gov.sl/wp-content/uploads/2021/02/express_of_interest-Market-Study-Main.pdf.

FIGURE 5 Value of Collateral Needed for a Loan, Percent of Loan Amount



Source: World Bank Enterprise Surveys (2017)

in emerging markets and developing economies is held in movable assets, against only 22 percent in immovable property.[24] The customary land tenure system in several parts of the country, that regulates ownership, possession, access, and the use and transfer of land rights, also presents a major constraint to entrepreneurs' ability to leverage their immovable assets as collateral. Women entrepreneurs, whose customary land rights are often considered subordinate to those of men, face an additional disadvantage due to this system.[25] The Enterprise Surveys[26] found that collateral rates were upwards of 355 percent, against a regional sub-Saharan Africa (SSA) average of 213 percent (see Figure 5). In addition, financial institutions frequently require letters of support from reputable sponsors. In some cases, financial institutions report using post-dated checks from existing clients as collateral. This is despite the relatively low loan sizes and short repayment periods that are required for clients that typically have very established histories with the financial institutions. Otherwise, movable collateral, such as vehicles, equipment, or inventory, is rarely accepted by commercial banks, though microfinance institutions (MFIs) report some usage.

SMEs face several barriers to growth and access to finance in general, and DFS specifically. A mapping of Sierra Leone's digital and entrepreneur ecosystem revealed that 70 percent of the entrepreneurs were doing business only for survival; very few businesses cited business growth as part of their plans. Reasons for this included lack of business development skill training, lack of financial and digital literacy, and limited access to finance.[27] Early-stage SMEs in Sierra Leone face additional constraints in access to finance. Most of the businesses in Sierra Leone are initially financed through personal funds and informal loans from friends and family. Lack of access to early-stage finance is likely to eventually impact a firm's overall profitability and therefore its ability to grow.[28] Policy initiatives that are targeted at improving access to finance for mature SMEs (such as business formalization or collateral registries), might be insufficient for younger SMEs that are already more vulnerable due to their age.

Some of the key reasons for lack of access to finance and DFS by SMEs are discussed in detail the subsequent paragraphs.

i. Informality, Lack of Financial and Digital Literacy, and Business Readiness

Informal business practices have made it challenging for SME to access finance through formal channels. As noted previously, despite their economic importance, only ten percent of the SMEs in Sierra Leone are registered. Although required to register at the Corporate Affairs Commission (CAC) (if as a company) or the OARG (sole proprietorship and partnerships) and submit annual reports, only 14,000 business are registered with the CAC and it is unclear how many of these are activeData on the number of companies submitting annual reports is not available. Demand side data on SMEs is scarce, but financial institutions indicate

24 Alejandro Alvarez De la Campa, et al. 2010. Increasing Access to Credit through Reforming Secured Transactions in the MENA Region, World Bank Group. Washington, DC.

25 "Enhancing Women and Girls' Land Rights in Rural Sierra Leone by Sarah Maguire and Alice Lahai", DAI (2 March 2017) https://dai-global-developments.com/articles/enhancing-women-and-girls-land-rights-in-rural-sierra-leone.

26 World Bank. 2017. Enterprise Surveys: Sierra Leone Country Profile 2017. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/30299.

27 "Sierra Leone - Boosting Entrepreneurs Skills with Financial and Digital Literacy Trainings", UNCDF (17 December 2021) https://www.uncdf.org/article/7372/sierra-leone-boosting-entrepreneurs-skills-with-financial-and-digital-literacy-trainings.

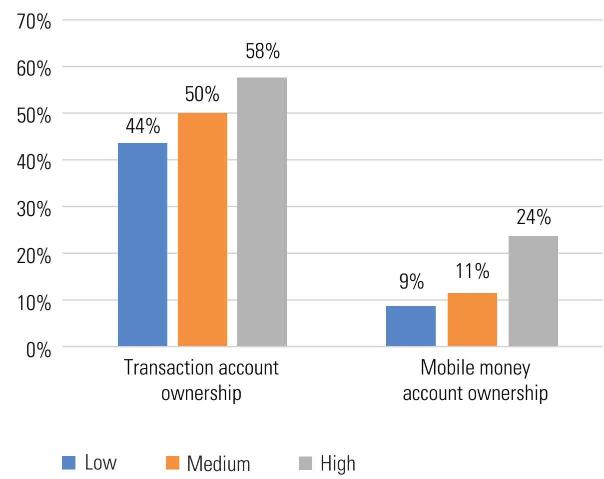
28 SMEs, financial constraints and growth (Working Paper), Bank for International Settlements (2014) https://www.bis.org/publ/work475.pdf.

that assessing creditworthiness of SMEs in Sierra Leone is challenged by gaps in recordkeeping, governance, and business skills. In addition to structural macroeconomic issues, these information asymmetries help drive high collateral requirements.

Various factors help explain this lack of formalization. Tax rates for SMEs are perceived as being too high, business formalization processes appear lengthy and tedious, and there is a negative perception or low awareness of business laws. For example, the Electronic Transactions Act of 2019 provides legal recognition of electronic transactions and the legal enforceability of contracts executed electronically. But there continues to be low awareness of this law among SMEs.[29] Inconsistent tax policy has made it challenging for SMEs to file and pay their taxes and stay in compliance with existing regulation. In recent years, training under the Tax Preparer Scheme and the Block Registration of taxpayers has been initiated to help boost property taxation and compliance among SME taxpayers.[30]

Additionally, lack of financial and digital literacy is a barrier to access and uptake of digital finance. Financial literacy is found to be a clear enabler for greater uptake of DFS.[31] Higher ratios of financially literate populations have demonstrated positive and strong relationships with higher percentages of the population owning an account as well as making or receiving digital payments (see Figure 6). As of 2014, only 21 percent of the adults in Sierra Leone were found to be financially literate, compared to 70 percent in more advanced countries.[32] Cost and digital literacy constraints prevent more than a third of the Sierra Leonean population

FIGURE 6 DFS uptake and Usage Metrics (%, 2017) at Various Levels of Financial and Digital Literacy



Note: Percentages show averages for each level of implementation
Source: World Bank staff estimates based on Global Findex data (2017)

from accessing the internet and therefore all the resources and opportunities for development.[33]

The Ebola crisis and the ongoing COVID-19 pandemic have both demonstrated the importance of financial literacy and financial consumer protection in increasing the uptake of digital channels. At the height of the Ebola crisis, Sierra Leone turned to mobile wallets to make fast, accurate, and secure payments to response workers. Studies have found that improving financial literacy can reduce resistance to digital payment products and channels. During the Ebola crisis, though there was an increased uptake of mobile money among response workers, often they did not use their electronic accounts either to save or to access other financial services. In a few other cases, financial service providers (FSPs) did not treat response workers with low levels of literacy fairly, which led to lack of trust in DFS.[34] During the

29 Digital and Entrepreneurship Ecosystem Mapping in Sierra Leone. UNCDF (2021).

30 Sierra Leone: Third and Fourth Reviews Under the Extended Credit Facility Arrangement, Requests for Extension and Rephasing of the Arrangement, Waivers of Nonobservance of Performance Criteria, and Financing Assurances Review-Press Release; Staff Report; and Statement by the Executive Director for Sierra Leone, International Monetary Fund (African Department), (August 2021) https://www.elibrary.imf.org/view/journals/002/2021/183/article-A001-en.xml.

31 Enablers of Digital Financial Services, World Bank Group *(forthcoming in 2022)*.

32 Financial Literacy Around the World, Standard & Poor and World Bank Group (2016) https://gflec.org/wp-content/uploads/2015/11/3313-Finlit_Report_FINAL-5.11.16.pdf.

33 "Sierra Leone Giga Towards Digitization for All", Department of Science, Technology and Innovation. Government of Sierra Leone (10 February 2021) https://www.dsti.gov.sl/sierra-leone-joins-giga-toward-digitization-for-all/.

34 Saving Money, Saving Lives: A Case Study on the Benefits of Digitizing Payments to Ebola Response Workers in Sierra Leone, Better Than Cash Alliance (2016) https://reliefweb.int/sites/reliefweb.int/files/resources/Better_Than_Cash_Alliance_Ebola_Case_Study_May_2016.pdf.

COVID-19 pandemic, faced with a similar situation, FSPs in Sierra Leone embarked on financial literacy campaigns using short videos, radio, and field ambassadors to fill in the knowledge gaps of customers that had so far hindered the uptake of DFS.[35] There was a discernable increase in DFS uptake during the COVID-19 pandemic.

ii. Low Entrepreneurial Skills and Lack of Business Development Support

Low business skills among entrepreneurs have made it challenging for SMEs to grow into creditworthy or investment-eligible enterprises. Providers of both risk capital and bank financing find it difficult to find 'investible' companies because entrepreneurs and SMEs in general lack basic business skills (management, sales, distribution networks, marketing and forecasting demand) to build resilient ventures that can respond to market challenges.[36] Start-up skills are low in the region, but Sierra Leone scores particularly low in this regard, scoring 1 percent.[37] Sierra Leone ranks 134 out of 140 countries in the World Economic Forum (WEF) Global Competitiveness rankings of 2018 including in ICT adoption and Innovation capacity. Results from the Global Entrepreneurship Index point to significantly poor start-up skills in Sierra Leone – which ranks at 132 out of 137 countries surveyed.[38] Sierra Leone also fares poorly in the Entrepreneurship Attitudes sub-index alongside countries like Chad, Mali, Pakistan, Bangladesh, Ethiopia, Eswatini and Burundi.

SMEs also lack the capacity-building and mentorship support to grow their business skills to build their eligibility for access to finance. While there have been several business capacity-building initiatives in the country, the number of entrepreneurs and companies supported remains low.[39] A large share of entrepreneurship support is provided through government, development partners, and NGO-supported initiatives.[40] In recent years, fintech players like InvestED are trying to cover this gap by providing a training platform to low-income entrepreneurs using a mobile app on topics such as entrepreneurship, business skills and financial literacy.

Despite a growing number of business development service providers in Sierra Leone, most of the entities are perceived as expensive and low value for money. An Enterprise Survey conducted by the Sierra Leone Opportunities for Business Action (SOBA) project in 2017 found that 94 percent of entrepreneurs in Sierra Leone cannot afford to pay for the business support services they need, and 51 percent of entrepreneurs sought business advice from family and friends or rely strictly on themselves.[41] Further, business development services in Sierra Leone are centralized in Freetown and inaccessible to firms operating outside of the capital. This has created a gap in access to longer-term business coaching and mentorship for SMEs in the country.

Thus far, business development service providers and other wide-ranging entrepreneurship support programs have not focused on building e-business skills among entrepreneurs. Often, they themselves lack an understanding of digital technologies. Yet, global trends would suggest that firm competitiveness now and, in the future, would largely depend on entrepreneurs' ability to harness e-business skills. For digital entrepreneurs, business development service providers themselves have a low rate of technology adoption and usage in business diagnostic and advice, lacking relevant experience in digital strategies. The skills of business development service

[35] Resilient and Inclusive Financial Services Delivery During COVID-19. Toronto Center (2021) https://res.torontocentre.org/guidedocs/Resilient%20and%20Inclusive%20Financial%20Services%20Delivery%20During%20COVID-19.pdf.

[36] Sierra Leone Economic Diversification Project (project documents), World Bank (2020).

[37] World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

[38] Global Entrepreneurship Index, The Global Entrepreneurship and Development Institute - GEDI (2018) https://thegedi.org/wp-content/uploads/dlm_uploads/2017/11/GEI-2018-1.pdf.

[39] Sierra Leone Economic Diversification Project (project documents), World Bank (2020).

[40] This includes Sierra Leone Opportunities for Business Action (SOBA), Sierra Leone 'Agcelerator', Resilience Business Development Support, and Aurora Impact.

[41] The State of Entrepreneurship in Sierra Leone, Sierra Opportunities for Business Action (SOBA) (2017) https://investsalone.com/wp-content/uploads/2020/07/SOBA-The-State-of-Entrepreneurship-in-Sierra-Leone-Snapshot.pdf.

providers themselves need upgrading to develop relevant content and adopt more innovative support approaches.[42]

Women-owned SMEs face additional constraints to growth and access to finance. A 2015 study by the IFC found that about 70 percent of economically active women in the country worked in or for micro or small businesses. Yet most struggled to access the training and financing products they needed to grow, including saving, credit, leasing, and pension facilities. Evidence pointed to the difficulties faced by women in accessing even the most basic financial services. Further, high family and household expenses restricted the ability of women entrepreneurs to run and grow their businesses. Other exacerbating factors included inherent institutional gender biases, lack of government policy and intervention focused on gender, and a discriminatory cultural environment towards women.[43]

iii. Limited Availability of Financing Instruments and External Capital

Financing instruments reportedly available to SMEs are limited, short-term, and expensive. Entrepreneurs and business owners in Sierra Leone who need external formal financing are more likely to seek loans rather than equity and other forms of financing.[44] Few offerings exist for factoring, supply chain financing, leasing, private equity, long term funds, or other instruments needed by SMEs to support growth and the business lifecycle. Although financial institutions report low rejection rates of SME loan applicants, this tends to be because they frequently accept applications only from pre-existing customers with at least a six-month track record, which also disproportionately disadvantages early-stage SMEs. While some government-funded instruments, such as credit facilities, have been channelled towards SME finance through private sector financial institutions, in general firms mainly rely on friends and family and self-finance their businesses.

SMEs cite challenges of high interest rates offered by commercial banks and MFIs. Typical loans to SMEs are offered for six-month terms at interest rates ranging from 22 to 30 percent per annum, requiring repayment to begin after a 30-day grace period. SMEs in practice are competing with government for the limited credit commercial banks have on offer. Government securities offer higher returns and a stable income source to banks, therefore driving up interest rates and crowding out private sector borrowing. SMEs are disproportionately affected by this, given their existing vulnerabilities. In addition to their relatively higher credit risk, the risk aversion from banks towards serving the SME segment could be related to high default rates and high non-performing loans (NPLs) in their portfolios (estimated at 24 percent in 2020), though analysis of whether these NPLs have been related to SME activity has not been undertaken: it is not currently possible to do so based on lack of segmented portfolio data by enterprise size.[45]

While other financial institutions (OFIs) tend to have a greater mission orientation towards financing to SMEs, they are restricted in their ability to fund SMEs based on their more limited capital bases and corresponding regulatory constraints. BSL Guidelines for Other Deposit Taking Institutions cap the maximum loan size to individual borrowers at 0.1 percent of the institution's capital base, and to group loans at a limit of 0.5 percent, constraining the potential loan size to SMEs. For those OFIs serving SME clients, many report difficulty in retaining clients as they graduate to larger ticket sizes and have more sophisticated banking needs.

The entrepreneurial ecosystem in Sierra Leone is characterized by a lack of investors who are willing to provide the required capital for start-up and growth. For an estimated 65 percent of the businesses in Sierra Leone, the major source

42 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

43 "IFC Study Finds Women in Sierra Leone can Succeed in Business with Increased Support", IFC Press Release (13 March 2015) https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=24527#:~:text=The%20National%20Study%20on%20Women's,launching%20or%20growing%20a%20business.

44 Sierra Leone Agro Processing Competitiveness Project (project documents), World Bank (as of March 2022).

45 Sierra Leone Agro Processing Competitiveness Project (project documents), World Bank (as of March 2022).

of start-up capital is personal savings (UNCDF 2021).[46] For growth of SMEs, early-stage or risk financing should be an important source of capital for expansion.[47] Business promoters and investors do not offer suitable financial instruments to SMEs which most times need patient capital over longer periods compared to the short-tenured funds on offer in the market.[48] While recent years have seen improvements in the availability of this type of capital, more can be done to attract more investors and to better connect entrepreneurs with sources of financing.

iv. Lack of Access to Infrastructure

Lack of access to reliable infrastructure – both ICT and electricity – continues to pose a significant barrier for access to digital finance. Information and Communication Technology (ICT) infrastructure along with supporting digital infrastructure provides the way for people, businesses, and governments to get online and link with local and global digital services, and in turn increases opportunities for growth and access to finance. The total number of mobile connections in Sierra Leone in March 2022 was equivalent to 113 percent of the total population, but many subscribers have multiple connections. Market penetration of unique mobile subscribers was 49.9 percent and market penetration of unique mobile internet subscribers was 22.7 percent.[49] Despite recent advancements in ICT infrastructure and internet connectivity, it remains expensive and at times inconsistent.[50] Businesses also face challenges in accessing reliable and affordable electricity supply. The challenges are twofold: (a) the time and cost it takes for a business in new premises to get connected to electricity and (b) consistent supply during the dry season. The next section discusses the state of infrastructure and its role in supporting SMEs in greater detail.

46 "Sierra Leone - Boosting Entrepreneurs Skills with Financial and Digital Literacy Trainings", UNCDF (17 December 2021) https://www.uncdf.org/article/7372/sierra-leone-boosting-entrepreneurs-skills-with-financial-and-digital-literacy-trainings.

47 Early-stage finance refers to a wide range of instruments including venture capital finance (equity and debt), crowdfunding, angel investment, grants, capital from friends and family, and bootstrapping (personal savings).

48 Sierra Leone Agro Processing Competitiveness Project (project documents), World Bank (as of March 2022).

49 GSMA intelligence database, GSMA (2022).

50 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

DIGITIZATION OF FINANCIAL SERVICES AS AN ENABLER TO SUPPORT SMEs

The provision of financial products and services through digital channels is widely considered an essential enabler to close the SME financing gap. For starters, digitization of financial services can provide an impetus for SMEs working in the informal sector to join the formal economy. Further, technology innovations can serve as the foundation for the development of new business models and digital financial products, which include digital loans and other credit products, as well as equity capital. New financial sector players and traditional financial institutions alike can use technology to transform the traditional lending process by automating the underwriting and loan-servicing tasks making it significantly cheaper, faster, and easier to provide financing to SMEs. But most importantly for SMEs, digitization facilitates improved access to information—both within the firm, to increase efficiency and profit maximization, and to create data for external partners such as equity investors and lenders. Digitizing payments generates significant amounts of detailed transactional data which can be used as a basis to estimate income, evaluate risk, and extend financial services. Accelerating the development of digital payments for SMEs also strengthens the ecosystem for financial inclusion for consumers, allowing them to pay electronically.[51]

Some of the foundational components to realize the benefits of digitization of financial services include having trustworthy proof of official identity, reliable digital infrastructure along with supporting financial and credit infrastructure, and affordable (digital) financial services that can reach informal businesses.[52] Each of these foundational elements are discussed in the following sub-sections.

A. ICT and Digital Infrastructure as a Foundation for Digitization

Overall ICT sector performance in Sierra Leone lags other SSA countries due to the country's economic and social challenges. Sierra Leone was ranked 161 out of a total of 214 economies for mobile penetration in 2020[53] and 146 out of a total of 152 economies for

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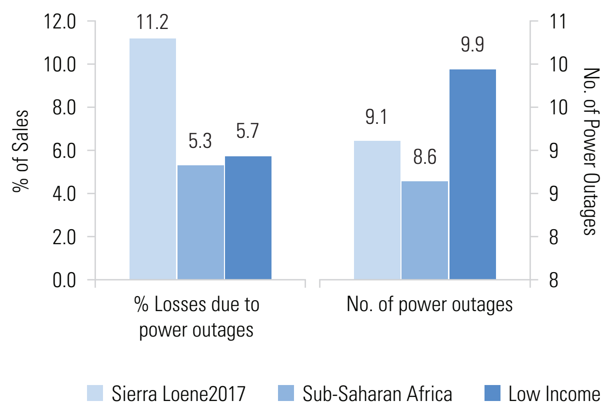
[51] "How can digital financial services help a world coping with COVID-19?" by Margaret Miller, Leora Klapper, Ghada Teima and Matthew Gamser, World Bank Blogs (3 August 2020) https://blogs.worldbank.org/psd/how-can-digital-financial-services-help-world-coping-covid-19.

[52] Promoting Digital and Innovative SME Financing, Global Partnership for Financial Inclusion, SME Finance Forum and World Bank Group (2020) https://www.gpfi.org/publications/promoting-digital-and-innovative-sme-financing.

[53] Mobile-cellular subscriptions per 100 inhabitants by the ITU, 2020 (Sierra Leone's value was 86.30).

FIGURE 7 Reliability of Electricity Supply and Related Losses: Comparison with Low Income and SSA Countries



Source: World Bank Enterprise Surveys (2017)

internet usage in 2020.[54] Mobile broadband subscription has been increasing, but remains low at 35 percent in 2021.[55] Due to the prolonged civil war, the country's fixed line infrastructure was poorly managed and much of it destroyed.

Access to electricity is still a challenge, both in terms of reliability and affordability. There is limited availability of the electricity grid outside of Freetown and a few other major cities – this problem being compounded by high fuel prices. The price of electricity is high due to key gaps in the country's electricity transmission infrastructure.[56] As a result, only 23 percent of Sierra Leoneans have access to electricity, which is below the SSA average of 30 percent. The gap in infrastructure not only impacts people's welfare and ability to access services, but also impedes competitiveness, job creation and poverty reduction.[57] Efficiency in the operation of the private sector requires a reliable supply of electricity. Figure 7 shows the extent to which firms in Sierra Leone faced failures in the provision of electricity measured by average number of power outages (right hand side), and their effect on sales as measured by the percentage losses they generated (left hand side), according to the firms that responded to the Enterprise Surveys[58] (as of 2017). Losses generated due to power outages in Sierra Leone were higher than the averages for both low-income countries and SSA, though the average number of outages across the three categories were comparable (between 8.5 and 10 outages). Inadequate electricity provision supply can increase costs, disrupt production, and reduce profitability.

Mobile phone usage has expanded with effective competition among operators. Mobile communication is the main service for both voice and data communications in the country. The mobile market has experienced steady growth driven by strong competition. As of December 2021, there were four mobile operators (Africell, Orange, Sierratel, and Qcell). Africell has been the market leader since 2009 with over 55 percent of market share. Orange increased its market share to 46 percent in 2019. The new market entrant, Gambian-owned Qcell, launched its mobile services in January 2019, and had almost a 10 percent market share in 2021. Sierratel's share has been declining over the years, and it was approximately 2 percent in 2021.[59] All four mobile operators offer 3G services. In January 2018, Sierratel and Africell launched 4G/LTE networks in Freetown and other major locations. Orange launched 4G services in April 2019.

There are issues of coverage and affordable access to mobile networks. In 2021, it was estimated that approximately 93 percent of the total population is covered by 2G mobile signals, however mobile broadband network coverage was still low at 72 percent (3G) and 68 percent (4G).[60] Mobile operators do not see these uncovered areas as commercially viable, with compounded challenges such as no power supply, no main access roads, and so on. The Universal Access

[54] Percentage of individuals using the internet by the ITU, 2020 (Sierra Leone's value was 18.00).

[55] DE4A scorecard database. "Unique" mobile-broadband subscriptions per 100 inhabitants. World Bank.

[56] World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

[57] "More than 270,000 Sierra Leoneans to Get Better Access to Electricity", *Press Release*, World Bank Group (28 January 2021) https://www.worldbank.org/en/news/press-release/2021/01/28/more-than-270000-sierra-leoneans-to-get-better-access-to-electricity#:~:text=Only%2023%25%20of%20Sierra%20Leonean,job%20creation%20and%20poverty%20reduction.

[58] World Bank. 2017. Enterprise Surveys: Sierra Leone Country Profile 2017. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/30299.

[59] GSMA Intelligence database https://data.gsmaintelligence.com (visited 15 March 2022).

[60] Rural Access Study, GSMA/World Bank (2021).

Development Fund (UADF) is operational but has very limited financial and human resources.

Internet connectivity has been expanding, but prices remain high. According to the 2021 Affordability Index developed by the Alliance for Affordable Internet (A4AI), Sierra Leone was ranked 67 out of a total of 72 countries.[61] Affordability of broadband internet is measured and compared by broadband service price as a percentage of GNI per capita.

The operating environment in Sierra Leone is very expensive for the operators. This is due to broken or lacking infrastructure (power supply, backbone infrastructure, etc.), high fuel costs for diesel generators, and high tax rates set by the government. The cost of a personal computer and broadband internet subscription at home is beyond the budget of most people in Sierra Leone. Most people access the internet at work or at public access points. Those who have access to the internet are generally in Freetown and other major cities.

The GoSL has demonstrated a high commitment to digital transformation. Box 1 below details an emerging digital development engagement between the GoSL and the World Bank.

B. Infrastructure and Technology for Adoption of DFS

In Sierra Leone, cash is the main payment instrument for small-value payments, while checks are predominately used for larger-value transactions and among businesses. According to Global Findex, in 2017, only 1.5 percent of adults had received payments from self-employment through a mobile phone, compared to 8.1 percent in Kenya and 5 percent in Ghana. Similarly, only 2.1 percent of adults in Sierra Leone had received payment for agricultural products by mobile phones, compared to 9.4 percent in Ghana and 12.7 percent in Kenya. Sierra Leone has historically lagged its counterparts in West Africa in adoption of DFS. Compared to an average mobile money uptake of 36 percent across West Africa in 2018, less than five percent of the Sierra Leonean population had mobile money accounts.

[61] The A4AI Affordability Index is calculated from Sub-indexes (Communications Infrastructure, and Access) https://a4ai.org/affordability-report/data/?_year=2021&indicator=INDEX (visited 15 March 2022).

Digital finance is not diversified in Sierra Leone, and mobile money remains the main driver of DFS. DFS in Sierra Leone are very much at the first of 4 stages in DFS development using the trajectory of the World Bank's 2020 DFS report, as the economy is predominantly cash-based. Two mobile money providers, Orange Money and Africell money, represent a substantial portion of the DFS sector. The two providers together have over 5.5 million customers as of September 2019, of whom 18.1 percent are active users of their services.[62] Further, given the low penetration of advanced smartphones, most users of DFS continue to rely heavily on USSD technology, as opposed to sophisticated banking applications. Mobile phones with the highest use are basic smartphones that do provide access to more sophisticated financial apps such as mobile banking applications. Advanced smartphones and tablets are still expensive and out of reach of the masses.[63] However, change is happening. As of early 2019, there were 10,378 registered mobile money agents, compared to 4,559 agents in early 2018.[64]

The use of mobile money grew during the Ebola crisis and through the COVID-19 pandemic. During the Ebola outbreak of 2014–16, mobile money adoption was encouraged among response workers (see Box 2), and it has grown over the next half decade. In 2020, during the first wave of the COVID-19 pandemic, the country saw 59 percent growth in the number of active customer accounts. The increased activity was evident in the number of transactions as well as in the amounts transacted through DFS accounts: in December 2020, 14.3 million DFS transactions worth SLL 1.7 billion (US$164 million) were conducted, which corresponds respectively to a 32 percent and a 69 percent yearly growth in transaction volume and value.[65] Merchant payments

[62] World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

[63] Digital and Entrepreneurship Ecosystem Mapping in Sierra Leone. UNCDF (2021).

[64] Financial Stability Report 2018. Bank of Sierra Leone https://www.bsl.gov.sl/FSR_2018.pdf.

[65] State of Digital Financial Services Market in Sierra Leone. UNCDF (2021) https://www.uncdf.org/article/7147/state-of-the-digital-financial-services-market-in-sierra-leone.

BOX 1 Emerging Digital Development Engagement Between GoSL and the World Bank

The Government of Sierra Leone (GoSL) has demonstrated a high level of political will for digital transformation and is keen on stepping up efforts to mainstream digital technologies and innovation in the day-to-day work of the Government as well as to enhance the quality of public service delivery to the citizens and businesses. However, the constraints to fostering digital transformation still remain significant in Sierra Leone to unleash digital transformation. The World Bank Digital Development team has built a strong relationship with the Ministry of Information and Communications (MIC), the Directorate of Science, Technology, and Innovation (DSTI) of the State House, National Telecommunication Authority (NATCOM) and other Ministry, Departments, and Agencies (MDAs) which are active in digital initiatives in alignment with the National Digital Development Policy and Strategy.

The proposed Sierra Leone Digital Transformation project (a total of US$50 million, going to the Board in June 2022) will expand access to broadband internet, increase digital skills and improve government capacity to deliver public services digitally. To achieve a scaled impact, it is critical to address holistically the major constraints to more productive usage of the broadband internet (i.e. digital access/ connectivity, digital skills, as well as building capacity for improved service delivery) whilst promoting a more enabling environment for private sector involvement.

Digital Access and Digital Skills

Despite the significant progress made in the supply of digital infrastructure and broadband connectivity, the demand and usage of digital technologies remains low. Low demand for broadband, in turn, could serve as a major constraint for attracting further investment in digital infrastructure. Therefore, the project aims to increase broadband access and usage by improving last-mile access to digital connectivity, increasing digital literacy and skills, and exploring approaches towards device affordability issues. The improvement in digital skills will yield increased employment opportunities in Sierra Leone, particularly for the growing youth population, women, and persons with disabilities. Also, even a basic level of digital literacy can help unleash new job opportunities that leverage digital platforms, such as microwork and freelancing, in both the informal and formal sectors of the economy.

Digital as Enabler for Improved Service Delivery

The project will support digital transformation of the public sector and government systems with the clear objective of enhancing public service delivery. The government will benefit from digital platforms and digital infrastructure to provide services digitally to more citizens and businesses with the increased ease of access, thereby making the public service delivery more inclusive and available. The public sector modernization through digitalization will help reduce fragmentation and transaction costs within the government, therefore increasing efficiencies and reducing avenues for rent-seeking.

Creating an Enabling Environment for Private Sector Involvement and Mainstreaming Digital Solutions

Given the important role that the private sector plays in the digital economy, it is key to create a policy and regulatory environment that can promote market competitiveness and increase the private sector involvement in the digital realm. Currently, there is insufficient market competition in the broadband value chain that keeps internet prices high and unaffordable to many individuals and businesses. Strengthening policy and regulatory frameworks—invisible mile of the digital value chain—thus will be an important pillar to be supported by the project. Additionally, the project will also contribute to creating a safe digital environment where digitally enabled solutions and innovation can be further advanced. The project will support enhancement of Cybersecurity, Data Governance, and Open Data and support the institutional development of the new government agencies created to implement and manage digital development initiatives in Sierra Leone, such as National Digital Development Agency (NDDA), National Communications Authority (NCA), and National Cybersecurity Coordination Center (NCCC). Also, the project will include interventions that leverage digital infrastructure and technologies to build capacity for climate adaptation; for example, the development of digital communication infrastructure for an early warning system will be supported by the project.

BOX 2 Mobile Cash Transfers to Frontline Workers in Sierra Leone during the Ebola Crisis

Sierra Leone was one of the hardest hit countries by the Ebola outbreak of 2014–16. More than 60,000 frontline response workers played a critical role in stemming the epidemic. However, cash-based payments to these workers posed a significant problem, as missed, reduced, or delayed payments became a major cause of strikes. In December 2014, the GoSL and donors turned to mobile money to make payments to frontline response workers. The BSL issued mobile money guidelines during the Ebola crisis.

A crucial factor that aided in the adoption of mobile cash transfer approach was the relatively high level of connectivity. Sierra Leone entered the crisis with a high level of mobile phone penetration, and a national network of more than 5,000 mobile payment agents, which could convert mobile payments to cash. Although nearly all response workers owned mobile phones, at the outset of the mobile cash transfer program only 15 percent of them were registered for mobile money. Authorities worked to fast-track minimum know-your-customer (KYC) requirements so that response workers could be quickly registered and start receiving digital payments.

Mobile transfers also effectively ended unauthorized deductions by managers, which often ran up to 50 percent of workers' hazard payments when payments were made in cash. As a result, strikes subsided. Overall, it is estimated that mobile transfers led to cost savings of US$10.7 million for the GoSL, development partners, and response workers.

Source: Itai Agur, Soledad Martinez Peria, and Celine Rochon, Digital Financial Services and the Pandemic: Opportunities and Risks for Emerging and Developing Economies, IMF (2020).

have remained low. Providers attribute the low uptake to: (i) merchants not using the channel because the option is more expensive than accepting cash or simple peer-to-peer transfers; and (ii) lack of trust and a low level of consumer awareness of the use and benefits of the channel.[66] While usage of DFS services is growing, there are uncertainties around the extent to which specific population segments, such as SMEs, women and rural population, use the services. One of the primary reasons for this is the lack of sector and population disaggregated data on the use of DFS.[67]

The growth in DFS is evident in the increased investments in digital infrastructure and support services by financial institutions and government. Almost all commercial banks operating in the country have rolled out digital financial products to ease banking transactions for customers during the COVID-19 crisis. FSPs actively encouraged the use of digital channels in response to COVID-19 restrictions, resulting in increased usage of digital finance (Figure 8).

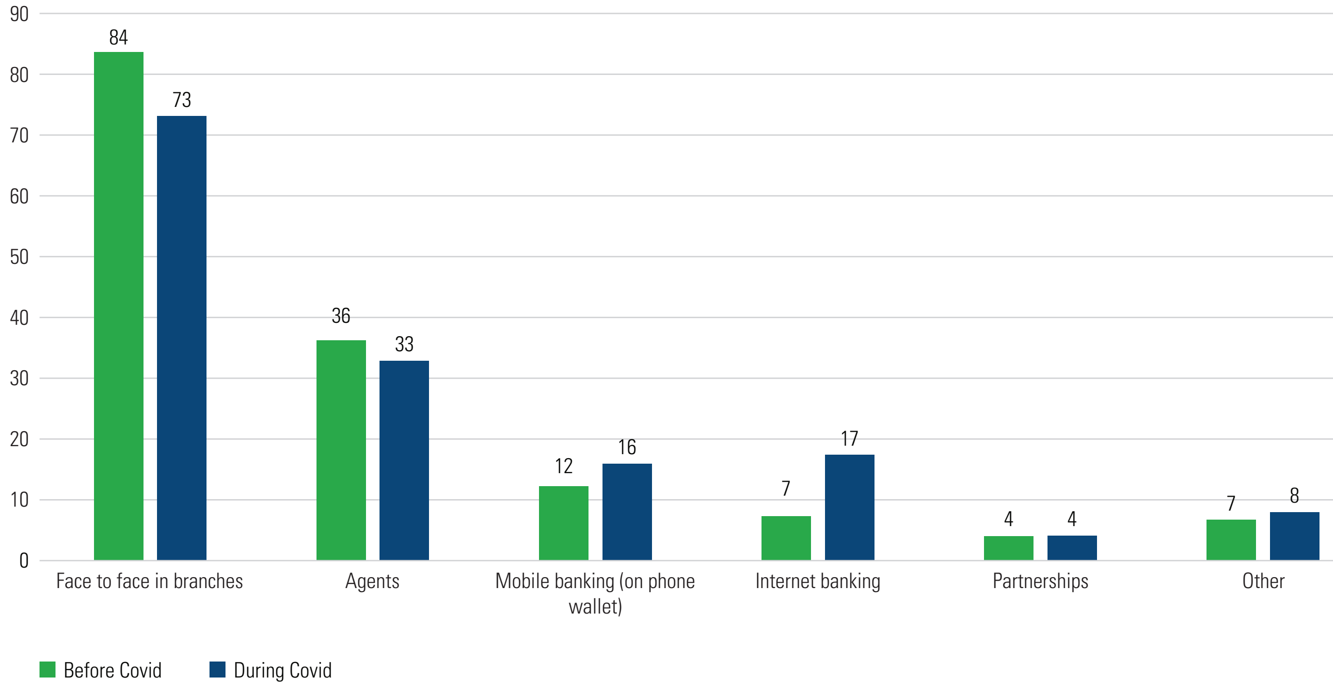
Social media is a major technology used by both FSPs and SMEs in Sierra Leone. An estimated 70 percent of businesses use social media for business activities, with WhatsApp and Facebook being the most dominant platforms. Access to social media is through mobile phones for a majority of businesses, with a few of them also using mobile Wi-Fi. The basic smartphones in greatest use provide access to basic social media applications.[68] FSPs have been leveraging social media and other innovative communication tools to reach their customers. In response to COVID-19 restrictions, FSPs used social media platforms such as WhatsApp, Short Message Service (SMS), and Facebook to reach their customers. In a survey conducted by the Toronto Center, over one third of FSP respondents reported using these social media platforms to reach out to their clients. In a few cases, FSPs also provided mentoring and coaching

66 State of Digital Financial Services Market in Sierra Leone. UNCDF (2021) https://www.uncdf.org/article/7147/state-of-the-digital-financial-services-market-in-sierra-leone.

67 "What's the state of digital finance in Sierra Leone in 2021?", UNCDF Blog (11 October 2021) https://www.uncdf.org/article/7220/whats-the-state-of-digital-finance-in-sierra-leone-in-2021.

68 Digital and Entrepreneurship Ecosystem Mapping in Sierra Leone. UNCDF (2021).

FIGURE 8 Delivery Mechanisms by FSPs Before and During COVID-19 (% Represents Number of FSPs that Responded)



Source: Toronto Center (2021))

services to some SMEs to enable them to shift into profitable segments or adopt online shopping.[69]

Bank and mobile network operator integration, and application programming interface (API) sharing, are increasing among industry players. Most financial institutions in the country now offer bank-to-wallet and wallet-to-bank services, and a lot of providers now share their APIs with other players in the sector. Fintech firms have started to innovate in this area. Noory, a Sierra Leone-based fintech, is an open payments API aggregator which allows third-party developers to connect to banks and mobile money networks, therefore improving interoperability between platforms. These improvements are expected to further improve as the country fully implements the national switch project which is expected to make digital financial transactions easy and cheaper.

While the legal and regulatory framework for advancing DFS has been strengthened over the past years, additional regulatory and policy reforms are required. The recently gazetted NPS Act covers the spectrum of important payment system issues, including recent innovations in the market such as fintech, payment systems oversight, and remittances among others. BSL has also recently adopted new guidelines on e-money services, the digital termination of remittances into accounts and the use of agents. Despite these improvements, most which have been supported by the ongoing Financial Inclusion Phase 1 Project, additional regulatory and policy reforms are required, including on e-KYC, financial consumer protection, cybersecurity, among others.

Additionally, significant improvements need to be made to the country's financial infrastructure to facilitate greater

[69] Resilient and Inclusive Financial Services Delivery During COVID-19. Toronto Center (2021) https://res.torontocentre.org/guidedocs/Resilient%20and%20Inclusive%20Financial%20Services%20Delivery%20During%20COVID-19.pdf.

uptake of DFS products among SMEs. The next sub-section discusses gaps and areas for improvement in Sierra Leone's financial infrastructure to facilitate better access to finance for SMEs.

C. Financial Infrastructure as an Enabler of Access to Finance for SMEs

Development of financial infrastructure is essential to facilitate growth and uptake of sophisticated DFS products that enhance SME access to finance. A recent analysis shows that lack of infrastructure could be an impediment to expanding to underserved segments and to more sophisticated, integrated DFS products and services beyond basic mobile money uses.[70] While mobile money is considered a useful tool for expanding transaction account ownership among underserved individuals, more sophisticated DFS products that are tailored to the needs of small businesses are required to enhance SME access to finance. The infrastructure elements considered in this analysis included both ICT infrastructure and financial infrastructure (payments and credit infrastructure). The next sections discuss the state of financial infrastructure in Sierra Leone, along with the role they play in uptake of DFS.

i. Payments Infrastructure[71]

The main payment systems in Sierra Leone are the real-time gross settlement (RTGS) and automated clearing house (ACH) systems, both of which were introduced less than a decade ago in 2013. Both include participation by all 14 commercial banks operating in the country. The RTGS system is responsible for processing large-value transactions above SLL50 million or approximately US$4,266. According to payment system statistics published by BSL, 118,247 RTGS transactions valued at SLL59.2 trillion (US$5.05 billion) were processed through the RTGS in 2019. Meanwhile, the ACH system is an interbank system for retail payments (of less than SLL50 million or US$4,266). However, the usage of the ACH system has been very low. In 2019, there were only 21,972 direct credit transactions worth SLL100.2 billion (US$8.5 million) compared to 15,317 transactions in 2015. While the ACH can facilitate direct debit, as of 2020, direct debit payments were yet to go live in Sierra Leone. Sierra Leone is also working on developing an interoperable national instant payments system.[72] The World Bank's financial inclusion technical assistance in Sierra Leone has revealed a need for the country's payments infrastructure – including the RTGS, ACH and securities settlement system – to be upgraded.

A retail payment switch to facilitate interoperability is a critical and missing element of the payments system. Though a few banks are connected to each other through bilateral agreements, FSPs are not connected to each other. Concretely, this means most consumers cannot transfer money between a bank account and their mobile wallet or send money from an MFI savings account to a family member whose only form of financial access is a mobile phone. For example, SMEs that would like to transfer funds from their mobile money account to their bank account can only do so if both institutions have integrated with each other to facilitate such a transaction. This is especially important in areas that are not serviced by banks. Employees in rural areas who have electronic deposits into accounts would benefit from interoperability between these accounts and mobile money, to facilitate transfers to the latter and thus avoid walking long distances or paying for transport to collect their salaries.

A retail payment switch is expected to be operational – with World Bank support – by the end of 2022. A retail payment switch would provide a common platform through which all service providers can have access to the payments system. This would allow for interoperability and ultimately

70 Enablers of Digital Financial Inclusion, World Bank Group *(forthcoming, 2022).*

71 This subsection is primarily based on the Sierra Leone Digital Economy Diagnostic conducted in 2020 (see World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805).

72 "The State Of Instant Payments In Africa: Progress And Prospects", Africa Nenda (October 2021) https://www.africanenda.org/uploads/files/211005_AfricaNenda-Instant-Payments-in-Africa-Report_vF.pdf.

contribute to financial inclusion and deepening, as individuals will need an account to make or receive digital payments. This would also help establish digital payment guidelines that could be eventually used for credit scoring and credit decision-making, including for SMEs. However, corresponding improvements in ICT infrastructure will be needed, so that the switch and other payment systems payments are not interrupted.

The overall number of financial service access points is low and concentrated in the urban areas. As of 2020, Sierra Leone had a total of 105 ATMs across 8 of its 14 banks, of which 3 banks had 5 or fewer ATMs in total. There were 2.2 million ATM transactions worth SLL384.9 billion (US$32.8 million) compared to 60,996 transactions in 2015. In part, the number and value of transactions are driven by the limit of SLL400,000 (approximately US$34) per withdrawal. There were 79,318 ATM cardholders in 2019. The low usage of point-of-sale (POS) terminals is likely due to lack of restrictions on the value. In 2019, there were only 301 POS terminals, largely at high-end restaurants and hotels, with 40,815 POS transactions valued at SLL72 billion (US$6.1 million), a significant jump from 130 POS terminals and 11,509 transactions in 2015. Only 1.5 percent of adults had credit cards in 2017, compared 1.7 percent of adults who had debit cards. Most of these financial access points are concentrated in the capital city of Freetown and other urban centers. A lack of access to financial services throughout the country appears to be a significant barrier to converting the demand for financial services – especially in rural areas – into actual usage.

Digitization of government payments and services could serve as instrument to increase uptake of DFS. As was evident for government-to-person (G2P) payments to response workers during the Ebola crisis, digitization of payments can reduce leakages, and result in time and cost savings for the government.[73] Digitization of relief payments – both G2P and government-to-business (G2B) payments to MSMEs – has proven to be a critical tool at the height of the COVID-19 pandemic.[74] Additionally, digitization also has the purpose of bringing informal entrepreneurs and SMEs into the formal economy, therefore paving the way for their formal access to finance. Government collections (both P2G and B2G payments) can also be leveraged to help payment service providers achieve stronger commercial viability of their low-cost payment solutions due to higher levels of activity. Broadening the acceptance of electronic payment instruments for a wide variety of government collections can be a natural and meaningful means of making the accounts and other products issued in connection with government transfer programs – and, in general, all transaction accounts – more useful to account holders.[75]

ii. Credit Infrastructure

Credit Reporting

Sierra Leone lacks a modern credit reporting system. Established in 2011 as a unit within the Banking Supervision Department following the enactment of the Credit Reference Act 2011, the BSL operates a credit registry (denominated the Credit Reference Bureau, or CRB) manually via an Excel spreadsheet. The registry records information on both individuals and firms: in total, approximately 26,000 unique entries. Banks are required to report both positive and negative information to the credit registry and are provided credit reports on individuals for a nominal fee. MFIs have also recently been required to report data to the BSL CRB. However, due to limited BSL capacity, MFIs are not permitted to reciprocally request credit reports. While commercial banks and MFIs provide their information to the credit registry, community banks, financial sector associations (FSAs), and mobile money companies do not report data. Other sources

[73] Saving Money, Saving Lives: A Case Study on the Benefits of Digitizing Payments to Ebola Response Workers in Sierra Leone. Better Than Cash Alliance (2016) https://reliefweb.int/sites/reliefweb.int/files/resources/Better_Than_Cash_Alliance_Ebola_Case_Study_May_2016.pdf.

[74] "Responding to crisis with digital payments for social protection: Short-term measures with long-term benefits" by Michal Rutkowski, Alfonso Garcia Mora, Greta Bull, Boutheinia Guermazi and Caren Grown, World Bank Blog (2020) https://blogs.worldbank.org/voices/responding-crisis-digital-payments-social-protection-short-term-measures-long-term-benefits.

[75] Payment Aspects of Financial Inclusion, Committee on Payment Market Infrastructures and World Bank Group (2016).

of alternative data, such as retailers, utilities, or other public agencies, are also not utilized by the CRB. The BSL CRB is actively utilized by the financial sector, reportedly receiving on average over 100 requests per day from banks – and provided over 40,000 reports on firms and individuals since inception. Producing a single credit report is time-intensive because of the nature of manually pulling data from the Excel spreadsheet, which is complicated by identical names and the absence of unique identifiers. Because of this, the BSL is constrained in its ability to provide rapid responses to credit checks. It is also limited in its coverage of creditworthy individuals and legal entities.

The establishment of a digital credit registry in Sierra Leone could improve credit information and boost access to finance. It could help with the digitization of the credit underwriting process by credit providers, leveraging data and algorithms to develop credit scores that will increase reach and improve risk management and thus improve the effectiveness of the financial intermediation process and boost access to finance.

Secured Transactions and Collateral Registry

An upgraded, online collateral registry was launched in December 2021. The launch of this collateral registry is intended to further encourage transparent credit information, allowing a financial institution or other creditors to check online to see whether a pledged asset has been used to secure another debt obligation. The registry has several enhancements, including allowing for 24-hour, 7-day-a-week access and allowing for interested third party searches. In terms of legal reforms, the Borrowers and Lenders Act was amended in 2019 to strengthen the legal framework for moveable asset financing and to cover individuals and businesses not licensed or supervised by BSL within the purview of the law. The Borrowers and Lenders (Collateral Registry) Regulation detailing key provisions of the law is also being drafted. There has been some indication of increased utilization of the collateral registry since its launch in December 2021.

Although progress has been made with the establishment of this registry, the inconsistent enforceability of credit agreements, especially with regards to collateral, further constrains credit provision to SMEs. Whether immovable or movable, in practice collateral is mostly employed by financial institutions as a symbolic pledge since neither provide sufficient protection against credit risk: financial institutions consistently report constraints to repossession and realization of collateralized assets. Rather than attempt to enforce contracts through legal action, financial institutions appear to utilize protracted restructuring and apply social pressures in instances of delinquency. This is because seizure of collateral in Sierra Leone requires a court order, which can be costly and inefficient. Despite the existence of a commercial fast-track court that is meant to resolve creditor disputes efficiently, anecdotally, financial institutions view it as a mechanism of last resort because of the lengthy time to resolution, with some reporting cases taking up to seven years. This renders asset recovery, as well as the resultant value of any collateral given the protracted delays to enforcement, highly unpredictable. Currently there are no formalized out of court enforcement options available to secured creditors.

Debtor and Creditor Rights

Sierra Leone lacks a modern insolvency framework. Lower credit availability to the private sector can often be exacerbated by creditor's experienced difficulty of loan recovery. Without effective debt recovery and strong mechanisms for business exit, the losses that result from NPLs can drive a higher cost of capital and generate a heightened perception of risk among financial institutions and other investors. Effective legal, regulatory, and institutional frameworks allow for the resolution of NPLs, thereby facilitating business exit and reorganization, settling of commercial disputes, and collecting of debts. Noted gaps in the Companies Act of 2009 include the lack of: restructuring provisions to allow viable firms to negotiate a plan with creditors; a framework for qualifying and monitoring insolvency administrators; procedures aimed at maintaining the value of a company in insolvency (such as continuation of contracts and post-commencement); involvement of creditors at key decision points; any kind of informal out-of-court framework for restructurings.

Digital ID system

The lack of a reliable digital identification system has posed a challenge for adoption of digital finance. During the Ebola crisis of 2014, the lack of reliable paper identification and documentation made it challenging for mobile money operators to perform their required KYC.[76] To combat these challenges, the GoSL took steps in 2019 to establish the national digital ID system (e-ID). The e-ID is expected to mitigate the low level of trust in digital economy. In 2019, the NCRA piloted the e-ID system using both biometric and blockchain technology. This pilot is being conducted by the BSL, with support from the United Nations Development Program (UNDP) and multinational lender Kiva.[77] The success of this newly launched digital ID system will ultimately depend on a high level of trust in the issuing authority and reliability of the underlying technology used for this ID system.

76 Saving Money, Saving Lives: A Case Study on the Benefits of Digitizing Payments to Ebola Response Workers in Sierra Leone. Better Than Cash Alliance (2016) https://reliefweb.int/sites/reliefweb.int/files/resources/Better_Than_Cash_Alliance_Ebola_Case_Study_May_2016.pdf.

77 "In Sierra Leone, new Kiva Protocol uses blockchain to benefit unbanked" by Catherine Cheney, Devex (21 August 2019) https://www.devex.com/news/in-sierra-leone-new-kiva-protocol-uses-blockchain-to-benefit-unbanked-95490.

DIGITAL FINANCIAL PRODUCTS TO FACILITATE SME ACCESS TO FINANCE

A. Supply Side Overview

Sierra Leone's financial sector is small and underdeveloped. In 2020, financial sector assets as a percentage of its gross domestic product (GDP) were only 23.5 percent, compared to the global average of 70 percent.[78] Most financial institutions are concentrated in the capital, Freetown, and secondary urban areas like Kenema and Bo, leaving most people in other parts of the country cut off from the financial system. Concentration is driven by the high operating cost for institutions going into the rural and under-served areas of the country.[79]

The financial sector is dominated by commercial banks. The sector includes 14 commercial banks, 17 community banks (credit unions), 59 financial services associations (FSAs) and 18 microfinance institutions (MFIs) (3 deposit taking and 15 credit only) and 4 mobile money providers (two of them covering the lion's share of the market). The commercial banking sector accounts for 99 percent of all financial sector assets. Foreign banks account for more than 60 percent of the industry's total assets. Commercial banks account for 85 percent of the financial sector assets; two state-owned banks hold about 30 percent of the total.[80] Additionally, the financial sector comprises a stock exchange, and 62 money exchanges.

i. Credit Financing

Sierra Leone's financial system is characterized by low levels of credit penetration. Private credit by deposit money banks[81] as a percentage of deposits was only 26 percent in 2020, down from 35 percent in 2019. Credit to the private sector is merely six percent of the country's GDP,[82] substantially lower than the SSA regional average of 24 percent[83] and the low-income country average of 16 percent.

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78 Sierra Leone: Financial system deposits, percent of GDP. The Global Economy database https://www.theglobaleconomy.com/Sierra-Leone/financial_system_deposits_GDP/ (visited 15 March 2022).

79 https://www.uncdf.org/article/7231/sierra-leones-journey-towards-digital-financial-inclusion-part-2

80 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

81 Deposit money banks are financial institutions that have liabilities in the form of deposits payable on demand, transferable by check or otherwise usable for making payments.

82 IMF International Financial Statistics. International Monetary Fund (2022).

The microfinance sector has grown rapidly since 2018 to become an important provider of financing to SMEs.[84] This sector comprises primarily MFIs (both deposit-taking and non-deposit-taking) and FSAs which generally serve SMEs, rural, low-income and otherwise underserved segments of the country. The combined resources of community banks and MFIs by the beginning of 2019 amounted to almost SLL402 billion (US$34.3 million), while their total loan portfolio at the same date stood at US$24.9 million.[85] These institutions account for about 1 percent of financial sector assets but have a wide geographic reach.[86] Women make up a significant portion of loan recipients—44.1 percent in the case of FSAs.[87]

Meanwhile, some interventions to enhance financing of SMEs through commercial banks are underway. For example, Union Trust Bank SL Ltd, aided by the African Development Bank (AfDB), has the second largest loan portfolio and is the most active lender to MSMEs, and particularly, to agribusiness, manufacturing, trade, and services sectors.

Additionally, there is a nascent but growing crop of digital credit providers. For instance, mobile money providers are starting to explore opportunities to expand beyond pure mobile money to related services such as digital credit and other financial products.[88] Partnerships have emerged between MFIs and mobile network operators to offer loans to MSMEs – one such example being the partnership between Empire Solutions, an MFI authorized to provide digital micro-loans, and Orange money.[89]

ii. Equity Financing

Venture capital investors are few and far between, and there are no formal angel investor networks creating a gap in the supply of early-stage financing in Sierra Leone. Angel investors can fill an important gap between personal savings or capital from friends and families and venture capital or commercial bank financing. While some digital entrepreneurs have been able to raise capital from angel investors, there are no formalized networks and limited platforms that allow entrepreneurs and angel investors to meet. Access to such investments largely relies on individual entrepreneurs' ability to navigate this informal network. Regional formal angel investor networks for digital entrepreneurs exist, but entrepreneurs in Sierra Leone show limited knowledge regarding those opportunities. On the investors side, limited knowledge of financing opportunities and mechanisms also limit the number of individuals who are willing to participate and invest in new ventures.[90] Providers of early-stage finance also cite lack of quality deal flow as a major constraint in the supply of finance to entrepreneurs. Additionally, there is a limited appetite for equity finance among entrepreneurs, leading to limited uptake of the already scare equity investment options.

B. SME Finance Products

SMEs require a range of financial products as a function of their stage of growth. At start-up or seed phase, when firms tend to be most risky, financing tends to be sourced from personal savings, family, and friends, as well as potential second mortgages on personal property. During the second phase of development, external sources are necessary, but firms are typically still too risky to be attractive to venture capitalists or other financing. Rather, government grants or other seed funding, such as through angel investors, frequently bridges

83 "Financing Small Businesses in Sierra Leone", Triple Jump (29 August 2018) https://triplejump.eu/2018/08/29/financing-small-businesses-in-sierra-leone/.

84 Financial Stability Report 2018. Bank of Sierra Leone (2018) https://www.bsl.gov.sl/FSR_2018.pdf.

85 Sierra Leone Financial Sector Overview. Making Finance Work for Africa (2022) https://www.mfw4a.org/country/sierra-leone (visited 15 March 2022).

86 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

87 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

88 Digital and Entrepreneurship Ecosystem Mapping in Sierra Leone. UNCDF (2021).

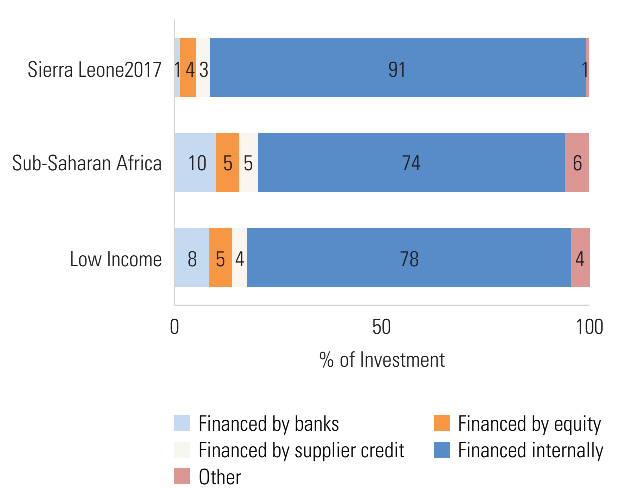
89 "Sierra Leone - A new private sector consortium in digital finance for underserved markets", UNCDF (20 December 2021) https://www.uncdf.org/article/7377/sierra-leone-a-new-private-sector-consortium-in-digital-finance-for-underserved-markets.

90 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

the gap between personal funds and institutional financing. Once in growth stages, SMEs need funds to finance their expansion. At this stage, an SME may still have difficulty securing traditional financing due to its reliance on intangible assets, low profitability, short track record, and resultant inability for investors to assess its future growth prospects. Alternative lending products such as leasing, warehouse receipt system and factoring, invoice discounting platforms, marketplace finance platforms, and integrated on-line merchant platforms, are useful to bridge this gap. Once a firm has a more established and transparent performance history, firms may become eligible for longer term lending. Sierra Leonean SMEs depend on internal financing significantly more than the average for SSA or low income countries, and substantially less on bank loans (Figure 9).

Digital Loans. In Sierra Leone, demand for digital loans accelerated during the peak of the pandemic as providers looked for ways to meet the needs of their customers. Data shows an uptake in the number of unique customers using digital loans. The marginal uptake of digital loans is visible in market share, given as the volume and value of transactions recorded. From barely 0.1 percent in December 2019, the number of digital loans reached 0.2 percent of transaction volumes and 0.3 percent of transaction values by December 2020. The service is, however, quite recent and provided by only three providers.[91]

FIGURE 9 Sources of Financing for Purchase of Fixed Assets in Sierra Leone versus SSA and Low Income Countries



Source: World Bank Enterprise Surveys (2017)

Crowdfunding (reward-based). Though relatively nascent, the donation or reward-based crowdfunding sector in Sierra Leone is growing steadily. According to Statista, the transaction value for reward-based crowdfunding[92] in Sierra Leone is expected to reach US$0.3 million in 2022, up from US$0.2 million in 2021. Between 2020 and 2022, average transaction values recorded a growth of almost 33 percent (See Figure 10). The average funding per crowdfunding campaign increased from US$650 in 2020 to US$780 in 2021 and is expected to average at US$893 in 2022.[93]

Equity crowdfunding. Equity crowdfunding refers to raising capital for an SME or startup by using an online platform and asking investors to each invest a relatively small amount in it. The benefit of equity-based crowdfunding for SMEs is the ability to raise capital through an alternative channel—which may be easier and cheaper than using venture capital and private equity firms. However, investment-based crowdfunding is practically non-existent in Sierra Leone at present. According to Statista, the average funding per campaign in the equity crowdfunding segment would amount to only US$10,994 in 2022.[94]

P2P and marketplace lending (Alternative lending). Marketplace lending refers to platforms that serve as a matching

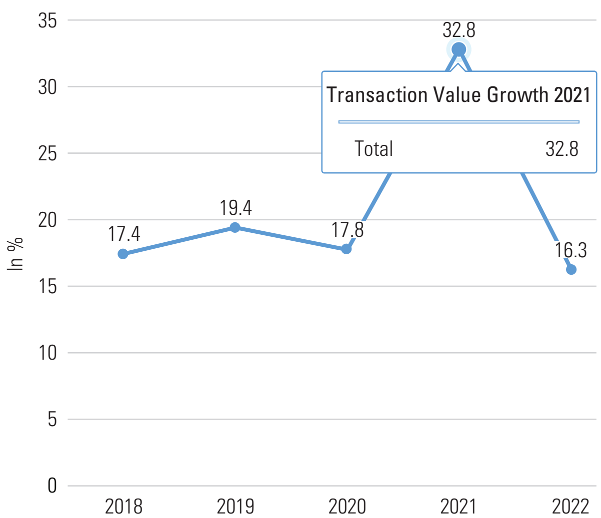
91 State of the Digital Financial Market in Sierra Leone 2021. UNCDF (2021) https://www.uncdf.org/article/7147/state-of-the-digital-financial-services-market-in-sierra-leone.

92 Reward-based Crowdfunding campaigns can be initiated for a wide range of different purposes such as product launches, art-, music- and film-financing, software development, scientific research etc. Usually there is a financing goal defined by funding volume and time to reach this goal for every campaign. The campaign creator publishes engaging content (e.g. photos, videos, text) that explain the goal and motivation of the fundraising. Almost everyone can participate in reward-based Crowdfunding campaigns as an investor. The only prerequisite is a valid payment account. Well-known platforms for these reward-based Crowdfunding campaigns are Kickstarter and Indiegogo.

93 Statista data on fintech alternative financing - crowdfunding (2020) https://www.statista.com/outlook/dmo/fintech/alternative-financing/crowdfunding/sierra-leone (visited 15 March 2022).

94 Statista data on fintech alternative financing - crowdinvesting (2022) https://www.statista.com/outlook/dmo/fintech/alternative-financing/crowdinvesting/sierra-leone (visited 15 March 2022).

FIGURE 10 Transaction Value Growth for Crowdfunding in Sierra Leone



Source: Statista (2022)

service connecting borrowers (consumers, SMEs) who need capital with investors who have capital available to invest. Peer-to-peer (P2P) lending enables individuals to obtain loans directly from other individuals, cutting out the financial institution as the middleman. Collectively these may be referred to as 'alternative lending'. According to Statista, the total transaction value in the alternative lending segment in Sierra Leone is projected to reach US$7.6 million in 2022. Globally, the appeal of alternative lending to SMEs is determined by the ease of access to traditional finance, which varies greatly from region to region. The alternative lending industry is moving towards consolidation, and traditional lenders and fintech firms are coming together.[95]

Boxes 3 and 4 below detail digital finance products and examples of innovative business models respectively that have helped facilitate SME access to finance.

BOX 3 Products to Facilitate Access to Finance for SMEs and Digital Applications

- **Factoring** is a financing product that allows a financial institution to provide financing to an SME supplier through the purchase of its accounts receivable or invoices ("receivables"). In factoring transactions, the SME supplier is the client of the financial institution. Key barriers/ frictions addressed: Lack of collateral, information asymmetry, high cost to serve relative to revenue.
- **Reverse factoring** is a financing product by which a financial institution provides immediate liquidity to SMEs through the discounting of accounts payable of a large buyer. In reverse factoring transactions, the large buyer is the client of the financial institution. Key barriers/ frictions addressed: Lack of collateral, information asymmetry.
- **Secured revolving lines of credit** (known as asset-based lending or ABL) is a lending product used to provide working capital to mature or sophisticated SMEs, using their account receivables and inventory as collateral. Key barriers/frictions addressed: Lack of collateral, high cost to serve relative to revenue.
- **Electronic invoicing** refers to the digital evolution of tax invoices, which have the same legal validity as their paper-based counterparts, but are originated, validated, remitted, received, rejected or accepted, and/or archived or registered electronically for tax, accounting, billing, and commercial or financing/ discounting purposes. Key barriers/ frictions addressed: Lack of collateral, information asymmetry, high cost to serve relative to revenue.

Source: Fintech and SME Finance: Expanding Responsible Access by Ghada Teima, Ivor Istuk, Luis Maldonado, Miguel Soriano, and John Wilson, World Bank Group Fintech and the Future of Finance Technical Note (2022)

95 Statista data on fintech alternative lending (2022) https://www.statista.com/outlook/dmo/fintech/alternative-lending/sierra-leone#transaction-value (visited 15 March 2022).

BOX 4 Fintech Firms and Business Models that are Enhancing SME access to Finance Across the World

- **InvestED** is a fintech company based in Sierra Leone that provides a platform for training low-income entrepreneurs using a mobile app. Topics covered include entrepreneurship, business skills, and financial literacy. In addition, users can qualify for credit products offered by lending partners. Loan repayments are managed via mobile money.
- **Funding Circle** specializes in peer-to-peer lending. Over the past 8 years, they've matched investors to 62,000 small businesses around the world and approved US$8.6 billion in loans. Businesses can complete an application online in 10 minutes with minimal documentation and will typically get a decision in 24 hours. Yet, despite approving a new loan every five minutes, Chief Risk Officer Jerome Le Luel has said average risk on Funding Circle's whole book is about 2 percent.
- **Kabbage** specializes in financing of SMEs that have trouble getting funding from big banks, either because they're too small or because their credit history is less than perfect. As an automated lending platform, they can process applications and make decisions in as little as 10 minutes. While credit score is considered, Kabbage's algorithm—developed in conjunction with credit-scoring giant FICO—considers 30 data points. These include cash flow and business performance. The algorithm can also learn from historical data, which means it becomes more effective at predicting risk over time.
- **Inbonis** is the first credit rating agency authorized by the European Securities and Market Authority (ESMA) specialized in rating SMEs with a unique methodology to assess SMEs. They have developed a scoring model with predictive power that can evaluate the quality and features of companies so they can be automatically assessed, which is smoothly integrated into the client's ecosystems. With no geographic limitations, Inbonis is an independent and supervised organization working in Europe, South America, and West Africa and focuses on understanding SMEs' needs and context.
- **Lnndo** digital lending has obtained a "category two" banking license for "providing and arranging credit" in Abu Dhabi and the MENA Region, allowing them to lend funds directly from their balance sheet against credit for others. Lnndo's credit model is different as they verify the SMEs' digital business identity and online transactions through POS payment, gateway receipts, customer reviews, and government registrations. The verifications occur with the digital ecosystem of e-commerce platforms, acquiring banks, and payment providers. Their digital identity and data-driven credit transactions are changing the game by providing SMEs with loans through a 10-minute digital journey and wiring the funds within seven days.
- **Ysys** is specialized in fintech and SMART Humanitarian Solutions supporting MSMEs, humanitarian actors, and development agencies in managing their businesses and projects interventions. They have been established and licensed in Egypt, focusing on markets across the Gulf countries. Their innovations include open banking, which enables MSMEs to apply and even access different financial services at any time. In addition, they use social media platforms, connecting SMEs with finance opportunities using service providers like WhatsApp, Facebook, Instagram, and Telegram.
- **Marco** is the first tech-enabled trade finance platform designed to provide working capital to SME exporters across Latin America. They also provide factoring supply chain finance, asset-based lending, and purchase order finance, among other services. Marco focuses on providing finance solutions to SMEs in Latin American emerging markets such as invoice factoring, purchase order, or inventory financing. In addition, they help SMEs get access to working capital to bid on new contracts, ultimately grow their cross-border business, and reach to the United States, Canada, the EU, and UK markets.
- **Fundbox,** a US-based fintech firm can make lending decisions in under three minutes. The system works because Fundbox lends money against unpaid invoices. But unlike traditional invoice factoring, Fundbox doesn't take over the relationship with the debtor. The borrower simply pays back the loan once the invoice payment clears into their bank account or is recorded on their accounting software.

Source: SME Finance Forum (2022) https://www.smefinanceforum.org/post/fintech-platforms-disrupting-sme-finance; Provenir (2019) https://www.provenir.com/resources/blog/7-fintechs-that-are-transforming-sme-lending/

PROGRAMS IN SUPPORT OF SME FINANCE

A. Government Policies and Programs Supporting SMEs and SME Access to Finance

Access to finance for SMEs and development of digital finance are priorities for the government. Both objectives were priority areas under the country's National Strategy on Financial Inclusion 2017–2020, as well as the planned National Financial Inclusion Strategy for 2022–2026.

i. Small and Medium Enterprises Development Agency

The National MSME Development Strategy was developed in 2013 by the MTI with support from IFC. The MTI also developed a National MSME Policy that complements the Strategy and an implementation plan that will guide the implementation of activities to ensure the development of MSMEs. In 2016, the Small and Medium Enterprises Development Agency Act 2015 was passed establishing the SMEDA. SMEDA is a government agency responsible for coordinating SMEs activities in Sierra Leone Some of SMEDA's functions include the design and implementation of development support programs and schemes for SMEs. The agency also aims to facilitate, assist, and provide market access and business linkage opportunities to SMEs to enable them to compete successfully in national and international markets.[96]

ii. National Innovation and Digital Strategy (2019–2029)

The National Innovation and Digital Strategy (NIDS) was launched in 2019. Under the NIDS, "*a unified digital identity to be used by governments and businesses will enhance service delivery and ensure the dignity of citizens who often are challenged to prove who they are.*" The NIDS also states that across *"universities, government spaces, and private institutions, a series of initiatives that promote youth innovation, small and medium enterprise support and product/solution translation will be enhanced."* As of 2019, nearly 75 percent of the Sierra Leonean

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[96] Progress report: Enabling Environment for Sustainable Enterprises and promotion of business linkages between MNEs and local enterprises in Sierra Leone. International Labour Office (2020) https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/documents/publication/wcms_771892.pdf.

population had a verified digital and biometric record with the NCRA. This data is to be linked to other datasets within government for integrated and effective service delivery across property and business management, tax and revenue generation, access to social services and benefits, public transportation, immigration and more.[97]

iii. Other Initiatives

The GoSL's 2014 Statement of Economic and Financial Policies established an SME Fund to support business entrepreneurial skills, innovation, expansion, and development, and to improve access to credit for women and youth. The 2015 Statement of Economic and Financial Policies adopted a policy that 30 percent of all government-funded procurement transactions should go to women to promote empowering women, especially women-owned businesses. Further, to overcome the difficulty of accessing credit for SMEs, the National Strategy for Financial Inclusion (NSFI) 2017–2020 was launched in late 2016.[98] A follow up NSFI was launched in April 2022 that highlights the MSMEs as a focal group for expanding client-centric products and services.[99] Those not engaged with the formal financial sector are especially targeted for a significant impact on financial inclusion.

B. SME Credit Enhancement Instruments

i. Sierra Leone Microcredit Scheme (MUNAFA FUND) and Agriculture Credit Facility

The GoSL supported SMEs through the operationalization of the MUNAFA Fund and launched the Agriculture Credit Facility (ACF).[100] Launched in 2021 as part of the COVID-19 Quick Action Economic Recovery Program prepared by the MoF, BSL, and the National Revenue Authority (NRA), which prioritized "providing support to hardest-hit businesses to enable them to continue operations and avert lay-offs of employees."[101] Government allocated SLL100 billion for a period of four years (2020 to 2023) to address the lack of access to capital by SMEs. Currently, 11 FSPs met the minimum eligibility criteria and ten FSP loan agreements have been signed by SMEDA and the FSPs. SLL26 billion was disbursed targeting 4,100 MSMEs. In March 2021, the BSL created a SLL100 billion (US$8.5 million) ACF to support the importation of agriculture inputs and reduce food insecurity by incentivizing private sector participation in agriculture.[102] This low-interest medium-term lending facility (similarly structured as the structured credit facility) helps finance the production, procurement, and distribution of agricultural inputs.[103]

As part of the COVID response, a BSL Special Loan Repayments Forborne Facility was launched in June 2020. Intended to soften the negative impact of the pandemic on Sierra Leone, the facility provided interest-free loans to eligible participating MFIs to support loan forbearance in May, June, and July 2020. The program is part of a wider government response to COVID. However, none of the facilities noted provide any risk sharing, and all credit risk continues to be borne by the participating financial institutions.

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97 National Innovation and Digital Strategy of Sierra Leone 2019-29.

98 African Economic Outlook 2017. African Development Bank, OECD and United Nations Development Program (2017). https://www.oecd-ilibrary.org/docserver/aeo-2017-55-en.pdf?expires=1645602227&id=id&accname=ocid195787&checksum=5EAB082F89ACF17720CAF443E08B27F1.

99 Sierra Leone National Strategy for Financial Inclusion 2022-2026.

100 Website of the Small and Medium Enterprises Development Agency of Sierra Leone.

101 Government of Sierra Leone's COVID-19 Quick Action Economic Recovery Program, MoF, BSL, NRA

102 "Central Bank launches SLL100bn agricultural credit facility", Awoko Newspaper (3 December 2021) https://awokonewspaper.sl/central-bank-launches-le100bn-agricultural-credit-facility/.

103 Sierra Leone: Third and Fourth Reviews Under the Extended Credit Facility Arrangement, Requests for Extension and Rephasing of the Arrangement, Waivers of Nonobservance of Performance Criteria, and Financing Assurances Review-Press Release; Staff Report; and Statement by the Executive Director for Sierra Leone, International Monetary Fund (African Department), (August 2021) https://www.elibrary.imf.org/view/journals/002/2021/183/article-A001-en.xml.

KEY RECOMMENDATIONS

To achieve economic growth and improved livelihoods, adequate financial services that address the specific needs and financing requirements of SMEs urgently need to be developed.[104] However, it is imperative to note that critical structural reforms are needed in the financial sector that go beyond the scope of reforms specific to SME and digital finance. As noted above, limited intermediation by banks reflects significant crowding out of private sector borrowing. Because government securities provide significant yield (and a stable income source), this can drive interest rates higher. At the same time, Sierra Leone has experienced high NPLs, with state owned banks possessing questionable asset qualities (outside of their significant government security holdings). These circumstances in a high-inflation environment require larger scale intervention across the financial sector and fiscal financing space. With these constraints in mind, the following are recommendations to encourage the enabling environment for SMEs to access finance, especially during the recovery stages of the global COVID-19 pandemic.

As a first step to developing a coordinated national approach to expanding access to finance for SMEs, develop and implement a uniform national definition of MSMEs and systematically expand data collection on SMEs and SME finance from government agencies and financial institutions. Although a national definition of SME was issued with the institution of the SMEDA act, this definition is not employed by the government or the financial sector as part of data collection efforts. Without this data it is unclear whether public or private sector initiatives are reaching SMEs. For example, SME lending across supervised financial institutions is not uniformly tracked by the BSL, preventing a determination of the share of business lending that is devoted to SMEs on a segmented basis. Financial institutions should be required to adopt a harmonized definition of MSMEs for reporting purposes, and report periodically on their SME loan portfolios, including on terms, so that supply side offerings can be monitored, and corresponding risk appropriately assessed.

The National Financial Inclusion Strategy for 2022–2026 is an opportunity to prioritize public and private sector actions towards expanded finance in a way that is targeted, additional, and coordinated. As a part of its NFIS monitoring and evaluation strategy,

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[104] These recommendations are in line with the Aide Memoire from a recent Financial Sector Assessment Program (FSAP) on access to finance for SMEs in Sierra Leone. These should be read in conjunction with the recommendations in the Sierra Leone Digital Economy Diagnostic 2020 (see World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805).

authorities may collect firm level data that is disaggregated by firm size (as per a uniform definition of SME and MSME), sex (both ownership and employment), firm location (urban or rural), and firm age (early-stage or mature) to better understand the specific constraints faced by entrepreneurs in vulnerable groups. This is essential to help prescribe targeted policy measures for each of these vulnerable groups.

Policies (including the NFIS) should have specific actions targeted at growth-oriented, job-creating SMEs. Despite the stated emphasis in the strategy and policy priorities of the NFIS on SMEs offering job growth and innovation, current support programs are splintered and appear to emphasize subsistence microentrepreneurs. Policies and programs aimed at SME development and expanding SME finance should be allocated in line with priorities. That is, since many SMEs may operate in low value add sectors of the economy with limited capacity to scale up to become larger enterprises, to the degree that public programs aim to increase productivity and support jobs, allocations of public funds to SMEs should prioritize those that are most likely to do so. Current public sector initiatives, including those that leverage the private sector, may instead primarily serve enterprises in the subsistence microenterprise segment that are unlikely to have growth potential or their stated impacts. Prioritizing support services to job-creating SMEs is especially salient to help boost the recovery phase of the pandemic. In addition, several government agencies, such as CAC, OARG, and Sierra Leone Investment and Export Promotion Agency (SLIEPA) overlap on issues in SME finance but do not appear to coordinate on actions, such as business skills trainings for entrepreneurs. The planned SME Working Group is an opportunity to increase efficient allocation of resources for shared priorities.

Institute robust performance reviews and ongoing monitoring and evaluation for government MSME programs to ensure public spending is having the intended impact for SL growth priorities. While SME finance has been recognized as a priority for the government of Sierra Leone through demonstrable efforts such as the creation of SMEDA, the SME Policy, and the more recent deployment of the MUNAFA fund, the effectiveness of these efforts has been challenged by the lack of targeting and splintering of efforts. For example, SMEDA had a budget of SLL1.6 billion (US$0.1.3 million) approved for 2022, against a budget of SLL100 billion (US$8.5 million) deployed for the MUNAFA fund. As part of this review, the MUNAFA fund, along with the BSL Microcredit facility, should be closely reviewed for effectiveness to ensure that the current loan sizes and cap on on-lending pricing are having the intended reach and market impact on SMEs. The MUNAFA fund should also be reviewed for governance, as it is currently managed internally by SMEDA. Periodic data on performance against objectives should be made public at regular intervals for all government programs.

Support improved credit information by establishing a modern credit registry and corresponding legislation to expand data collection. Without transparent and reliable credit information, financial institutions inevitably fall back on established lending relationships and additional measures to buffer their credit risk. A modern, automated registry would facilitate the use of the registry by additional financial sector actors and, along with the reform of the Credit Reference Act, support the incorporation of additional alternative data to provide enhanced assessments of borrower creditworthiness. With the development of a modern credit registry, the BSL would also be able to expand the application of registry data towards use for financial sector supervision. Currently, the registry is used only as a public credit bureau; a modern registry should be utilized by the BSL as a tool to measure banks' credit risk exposure or to optimize prudential regulation to ensure that provisioning and capital requirements adequately cover expected and unexpected losses.

Support the rollout of the new modern online collateral registry through a strengthened secured transactions framework. The latest data from the new collateral registry indicates an uptick of usage. However, without an integrated legal framework for secured transactions to ensure that contracts are enforceable, and corresponding judicial timeliness, it is unlikely that the collateral registry will have its desired benefits of encouraging financial institutions to structure and price loans to SMEs on more favorable terms. Regulations to the Borrowers and Lenders Act of 2019, currently under development, should be designed to provide more legal certainty. Once these are established, further opportunities to encourage usage of the collateral registry should be explored as part of requirements to financial institutions participating in the public sector concessionary funding schemes.

A review of the commercial court enforcement process should be conducted to determine how case efficiency can be improved. Opportunities to include formalized out of court processes to protect the rights of secured creditors could also be explored. This will increase predictability of asset recovery and enforcement actions available to secured creditors.

Promote knowledge and create awareness among entrepreneurs on laws and business practices. For example, the Electronic Transactions Act of 2019 provides legal recognition of electronic transactions and the legal enforceability of contracts executed electronically. But there continues to be low awareness of this law among SMEs. Further, an increased awareness of the use of movable assets as collateral by SMEs – especially those led by women and youth – and expansion of its use for access to credit is particularly salient for these underserved groups.

And finally, the recommendations in this section should be read in conjunction with the recommendations from the Sierra Leone Digital Economy Diagnostic[105] exercise conducted in 2020. Existing structural barriers must be addressed for DFS to be delivered to entrepreneurs, including to rural farmers and agri-businesses. Please see Annex 1 for a list of the 'High Priority' recommendations in the diagnostic, covering digital infrastructure, digital platforms, digital financial services, digital entrepreneurship, and digital skills.

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105 World Bank. 2020. Sierra Leone Digital Economy Diagnostic. World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/35805.

ANNEX

List of High Priority Recommendations and Next Steps from the Digital Economy Diagnostic

Action	Responsible Agency	Time Frame	Priority
Digital Infrastructure			
Ensuring that the digital economy is more inclusive.			
R5. Improvement in the management of the UADF	UADF	Medium to long	High
Supporting more agile and enabling regulation and policy			
R3. Revision of the licensing regime	NATCOM	Short	High
R6. Streamlining of the cybersecurity environment and development of dedicated law or legislative framework on cybersecurity/cybercrime	MIC	Medium to long	High
Streamlining institutional framework and coordination for the GoSL's digital transformation agenda			
R2. Further strengthening of the regulatory institution (NATCOM) to foster market competition	NATCOM	Medium to long	High
R4. Liberalization of the international gateway	NATCOM	Short	High
Increasing competition			
R1. Coordination of Policy and Strategy Documents for development of Digital Economy	MIC/DSTI	Short to medium	High
Digital Platforms			
Ensuring that the digital economy is more inclusive			
R8. Initiate a comprehensive plan to modernize government services to citizens and businesses.	MIC	Medium	High
Streamlining institutional framework and coordination for the GoSL's digital transformation agenda			
R1-1. Strengthen leadership and promote institutional and donor's coordination for digital transformation	MIC/DSTI	Short to medium	High
R2. Design and implement a WoG ICT enterprise architecture to provide the foundation for digital transformation	MIC/GoSL	Short to medium	High
R4. Establish and apply a shared platforms/services for government approach	MIC	Short	High
R5. Expedite the implementation of a national data center as a base for establishment of a hybrid government cloud to create a common virtual infrastructure for the public sector	MIC	Short	High
R6. Implement the interoperability framework (technological and regulatory)	MIC	Short	High
R7. Develop new or modernize existing core systems (back-office) in line with WoG ICT architecture and international good practices	MIC	Medium	High

(continued)

Action	Responsible Agency	Time Frame	Priority
Creating a trust environment			
R3. Create a trust environment for digital government	MIC	Long	High
Strengthening collaboration among the key stakeholders (GoSL, private sector, academia, civil society, and development partners)			
R1-2. Strengthen donor's coordination for digital transformation	MIC	Short to medium	High
Digital Financial Services			
Ensuring that the digital economy is more inclusive			
R12. Implement national retail payment switch	BSL	Short	High
R19. Undertake a mapping of government payments	BSL	Short	High
R21. Activate the ACH debit system	BSL	Short	High
R22. Digitize cash transfer programs with the aim of digitizing all government payments	BSL and NaCSA	Medium	High
Supporting more agile and enabling regulation and policy			
R7. Adopt the amended National Payment Systems Act	BSL	Short	High
R23. Amend the legal and regulatory framework to facilitate the digital termination of remittances	BSL	Short	High
Streamlining institutional framework and coordination for the GoSL's digital transformation agenda			
R13. Establish and operationalize national retail payment switch implementation committee	BSL	Short	High
R20. Establish connection between MoF IFMIS and BSL EFT	BSL and MoF	Short	High
Creating a trust environment			
R6. Conduct an in-depth diagnostic on cybersecurity needs related to DFS	BSL	Medium	High
Enhancing human capital			
R11. Bolster BSL licensing capacity on DFS and with respect to DFS-related legal, regulatory, and oversight framework responsibilities	BSL	Short to medium	High
Digital Entrepreneurship			
Ensuring that the digital economy is more inclusive			
R4. Prioritize investment readiness for entrepreneurs to lower transaction cost for investors and establish a viable pipeline	MTI	Short to medium	High
R12. Promote uptake of digital goods and services	GoSL	Short to medium	High
Supporting more agile and enabling regulation and policy			
R1. Close gap in the existing legislative framework to support the expansion of digital goods and services and manage emerging risk of expansion to consumers and entrepreneurs	MIC, MTI	Short to medium	High
Creating a trust environment			
R6. Safeguard assets of digital entrepreneurs	BSL/GoSL	—	High
R10. Establish physical spaces to support innovation	MTI and DSTI (Ecosystem Unit)	—	High
Digital Skills			
Ensuring that the digital economy is more inclusive			
R1. Enhance connectivity for education institutions, prioritizing secondary schools, TVET institutions, and universities	MTHE and MIC	Medium	High

(continued)

Action	Responsible Agency	Time Frame	Priority
Supporting more agile and enabling regulation and policy			
R4. Integrate the use of digital technologies in the delivery of education across all sectors and implement existing policies to include the computer skills program in the curriculum	MBSSE and MTHE	Short- Medium	High
Enhancing human capital			
R2. Ensure the curricula, teaching methods, and assessment are linked to digital skills	MBSSE and MTHE	Medium	High
R3. Provide capacity building for Ministries of Education, Skills Development, and Higher Education	DSTI	Medium to long	High

DSTI = Directorate of Science, Technology, and Innovation
MBSSE = Ministry of Basic Senior Secondary Education
MIC = Ministry of Information and Communications
MTHE = Ministry of Technical and Higher Education
NaCSA = National Commission for Social Action
NATCOM = National Telecommunications Commission
UADF = Universal Access Development Fund