Making Government More Effective: Some Economic Policy Priorities in Sierra Leone

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International Growth Centre,

December 2011

Introduction

States have five economic roles: taxation, expenditure, regulation of private economic activity, macroeconomic management, and norm setting. The Government of Sierra Leone has inherited an ineffective state and a divided society, but a valuable natural endowment. These distinctive features suggest some policy priorities for each of these roles.

1. Taxation

For the first decade post-conflict taxation was inevitably light. The private economy had retreated into informality so there were few tax handles, and the tax administration was weak. It is now time to raise the tax effort.

Taxation helps to build an effective state in two political-economy ways. First, the larger the share of economic growth that the state captures through taxation, the stronger is its incentive to adopt and maintain growth-enhancing policies. Second, the more tax that citizens pay the stronger is their incentive to scrutinize how revenues are spent.

A good current example of this process at work is the State Government of Lagos. Since 2006 Governor Fashola has increased taxes and spent the revenues on visible improvements in infrastructure. This has proved to be politically popular and is now being taken as a model by other Nigerian states.

The task of raising tax revenues is partly a matter of good design of taxes, and partly of good administration. A crucial distinction in tax policy for Sierra Leone is between general taxation and the taxation of the rents on natural resources.

In respect of general taxation, the Government has already taken the key steps in tax design by introducing a VAT. The core task now is probably to strengthen tax administration through the National Revenue Authority. However, unlike in other African countries, revenues fell in real terms following the setting up of the NRA. Corruption and politicization of the NRA appear to be the underlying explanation. The attempt to introduce accountability and transparency in governance should therefore focus on the revenue collection institutions in particular. Also, the NRA was not allowed to collect non-tax revenues with line ministries still clinging on to this function. This function should be assigned (or re-assigned) to the NRA to promote accountability and transparency. Care would need to be taken so as not to kill the goose that lays the golden egg by excessive taxation of the small formal sector. The way forward is to broaden the tax base, for instance, by taxing self-employed professionals and urban commercial housing.

The design of a tax system for natural resources is complex and needs to reflect country specificities of geology and risk. While the potential returns from the taxation of natural resources in Sierra Leone are very large, over the past decade, natural resource revenues as a share of total government revenue were lower than all but one other country of 47 countries recently compared by the IMF.

Possible Action Point: The government should determine whether its current tax design is satisfactory, and if not commission an independent expert review. The IGC has recently provided such a Review for the Government of Zambia.

2. Public Expenditure

The economy faces many acute needs, but it is important to be realistic about the administrative and managerial capacity of the government to meet these needs even if finance is available. Sierra Leone has never managed to build an effective public sector even prior to the civil war. The legacy of war has not made this task any easier, on the contrary it will be harder than it was. It is thus sensible not to attempt to rebuild something that did not work in easier circumstances. One implication is that the need for a conventional public sector should be minimized. There is a wide borderland of activities that are sometimes placed in the public sector and sometimes placed in the private sector. It is appropriate for Sierra Leone to draw the line between public and private activities so as to minimize the requirements placed on the public sector. Management contracts are a useful half-way-house between public and private ownership. For example, ports can be run for the government by organizations such as the Crown Agents, and portable power stations can now be rented commercially until public supplies are adequate.

A second implication is that the old model of public spending undertaken by line ministries that take monopoly responsibility for the services in a sector should be set aside. Even in developed countries where this model has worked reasonably well governments are now moving away from it. In Sierra Leone, where the old model has never worked, it may be better to leapfrog to the new style of more decentralized and competitive delivery of public services. The key ingredients of this new model would be the separation of the function of setting policy from the function of implementing service delivery. Policy is inevitably the direct responsibility of ministers and ministries, but implementation could be decentralized to quasi-independent public agencies, operating under clear rules and public scrutiny, which in turn contract with multiple types of suppliers of services: local governments, churches, NGOs, and private firms. Analogous to the creation of the National Revenue Authority to raise revenue instead of keeping the function within the Ministry of Finance, there may be scope for public organizations outside the regular line ministries which manage parts of the public spending process.

Possible Action Point: consider allocating some revenues and aid through dedicated public agencies that contract with non-state providers of services and monitor their performance. The IGC, in collaboration with the World Bank and DFID, is conducting a program of work on such non-traditional approaches to public service delivery.

3. Regulation of Private Activity

Reforming the institutional environment for doing business should be a major preoccupation of government. While some progress has been realized in recent years, Sierra Leone is still only 143 out of 183 countries in 2011on the World Bank Doing Business Index so there is still a long way to go as reflected in its ranking in areas like transfer of property (169), obtaining a building permit (166) and payment of taxes and duties (149).

Sierra Leone needs private commercial investment. The major opportunities are natural resource extraction, large-scale agriculture, and a wide variety of urban commercial activities. Each of these requires appropriate regulation.

Natural Resource Extraction

Investment in resource extraction needs a considerable amount of regulation since the underlying natural assets belong to the state. Central to socially advantageous investment is a transparent and competitive process by which contracts are awarded, such as auctions. To attract investors while ensuring that the state captures the rents from resource extraction, the tax code needs to be well-designed. In particular, the code should incorporate fiscal responses to changing world prices, so that it does not need frequent renegotiation. The Natural Resource Charter, which is a flagship program of NEPAD, sets out useful guidelines on the decisions for successful management of resource extraction.

Possible Action Point: the Government of Sierra Leone could invite NEPAD to help benchmark how Sierra Leone currently compares with best practice along this decision chain.

Commercial Agriculture

Investment in commercial agriculture also needs specific regulation. Although there is currently plenty of investor interest in land acquisition, it is important to distinguish between pioneer investors, and speculators (Collier and Venables, 2011). Pioneer investors take a considerable risk by attempting to grow crops and market them in new locations. If successful not only will their enterprises generate jobs and tax revenues, they will be copied by other investors. This copying effect is a beneficial externality for Sierra Leone, and so such investors are socially valuable beyond the private returns they may make. Speculators, in contrast, wish to acquire large tracts of land on long leases that will be left idle unless future changes in world prices make cultivation valuable. In economic terms, acquiring a long lease on land which is then left idle has an 'option value'. However, the circumstances in which the option becomes valuable to the speculator are those in which the government loses out because it has parted with the land at a low price. Hence, speculators who acquire idle land at a negligible price are gaining a valuable asset (the option value of land) at the expense of the country. The temporary price spikes of 2008 in food and fuel triggered a wave of such speculative land acquisition in Africa. The implication is that the Government should regulate commercial land acquisitions, to encourage pioneer investors while discouraging speculators.

Possible Action Point: The Government could establish a code for investment in commercial agriculture, requiring investors to invest in and cultivate a reasonable proportion of their land area within three years of acquisition. For regulation to be credible the government would need to build a capacity to monitor investor behaviour.

Urban Commercial Investment

Urban commercial investment needs to be able to acquire secure rights to urban land. Currently, urban land rights are confused, with no clear register and multiple claimants and hence no proper market. This may explain why there has been relatively little reconstruction in Freetown, despite the evident need.

Possible Action Point: Establish a legal process for swift resolution of urban land rights.

4. Macroeconomic Management

The Government is facing economically troubled circumstances both externally and internally.

Inflation

Externally, many African governments are finding that the price level is very exposed to surges in the world price of fuel and food which are large components of the overall price index. Faced with such shocks, central bank policy is not straightforward. Simple adherence to a pre-set price stability rule risks imposing deflation, but conversely monetary accommodation risks that the external shock triggers more persistent, internally driven inflation. The IGC has done extensive recent work on these issues for central banks in other African economies and could do so for Sierra Leone.

Possible Action Point: Central bank to review policy rules for inflation targeting in the presence of external shocks.

Managing Revenues from Natural Resources

As revenues from natural resource extraction become more important, the inherent volatility of these revenues will become an increasing problem. To cope with unanticipated shocks to resource revenues it is important to build policy rules and institutions that smooth spending. Smoothing can be done both by insurance, in the form of hedging, and the accumulation of liquidity through saving when revenues are judged to be atypically high. These strategies can potentially be combined in a single institution tasked with achieving the resilience of spending in the face of revenue shocks: a Sovereign Resilience Fund. Chile and Nigeria have been legislated for Funds along these lines.

Not only are natural resource revenues volatile, they are unsustainable because natural assets are being depleted. It is therefore important to offset resource depletion with the accumulation of public investments, for example in infrastructure. This requires policy rules that determine the rate of investment out of revenues, and also rules that police the process by which investment is undertaken so as to ensure its integrity and efficiency. It is useful to embed these rules in an institution tasked with implementing them: a Sovereign Development Fund into which savings are placed and which manages the investment process. Ghana and Nigeria have recently created Funds along these lines.

Possible Policy Action: Investigate whether Sovereign Resilience and Development Funds would be appropriate for Sierra Leone. The IGC could assist with this work.

Generating Jobs

Especially after the events in North Africa, all African governments are rightly concerned to accelerate jobs creation. In Sierra Leone this is challenging because the economy is likely to be many years away from being competitive in manufacturing. Two possible areas for jobs creation are agriculture and construction.

In agriculture, both smallholder and commercial, a likely obstacle to employment growth is the high cost of transport. Both road networks and rail networks have the potential to reduce transport costs but they are expensive investments. The IGC, through the work of J-PAL, can advise on road investment. Rail investment will be financed as a by-product of resource extraction. Here, the policy issue is the extent to which such a rail network can be adapted to being multi-user. Typically, resource extraction companies have preferred to own and operate their own lines, using them only for dedicated traffic. However, this preference against multi-user operation may reflect the fact that much of the benefits that would accrue from agricultural co-use of railways would not be captured by the resource extraction companies. Where externalities are important they create a public interest in ensuring that railways are multi-user.

Possible Policy Action: review potential rail investments to explore the scope for requiring multi-user operation.

In respect of construction a striking need is for decent mass housing in the vicinity of Freetown. Such construction would have the potential to generate large-scale employment as well as through the accumulation of an improved housing stock. There are currently multiple impediments to mass housing, ranging from affordable finance; legal rights that could function as collateral; affordable construction processes; and complementary infrastructure services. In respect of each of these there is scope for policy action.

Possible Policy Action: develop a strategy for mass urban housing. The IGC has a research program on mass housing which could provide assistance.

5. **Norm-Setting**

Economists now recognize that both the degree of inter-personal trust and people’s sense of identity have significant economic consequences. The degree of trust affects the cost of transactions. The identities that people adopt can matter at various levels. In respect of attitudes to work, Nobel laureate George Akerlof argues that effective organizations encourage their workforce to self-identify with functional role models that induce correspondingly more useful behaviour. In respect of social cooperation, research has clearly established that strong and differentiated sub-national identities weak the capacity to cooperate at the national level.

The Government can influence both trust and identities by the norms which it sets, both by its rhetoric by its actions.

In respect of trust the Government can more actively target corruption which, as reflected in the Corruption Perception Index, remains a major problem. Specific measures include widespread dissemination of information on all aspects of governance, and further privatization of service delivery (as already discussed). Also, government procurement should be centralized. The present arrangement wherein individual ministries independently (to a large extent) undertake their own procurement is economically inefficient and also more susceptible to corruption than a centralized arrangement. Lastly, it is also important to de-personalize processes. For instance in the Ministry of Lands, land registration is often held up by a single signature, offering considerable scope for bribery.

In respect of identity, an example of how over time rhetoric and decisions shape identities is the contrast between Kenya and Tanzania. Both societies have a similar number of ethnic groups, but whereas in Kenya politics has exacerbated ethnic divisions, in Tanzania there has been a sustained attempt to reduce the salience of ethnic differences. (This work was done by IGC researcher Edward Miguel, who is currently working on Sierra Leone).

Unfortunately, after periods of internal conflict people tend to have little trust in each other and to have fractured and dysfunctional identities. In Sierra Leone regional and ethnic sentiments tend to be strong in politics and the risk of ethnic unrest (especially before, during and after elections) cannot be discounted (witness the disturbance in Bo in September 2011). Many scholars argue that the elitist chieftaincy system has profound implications for the way politics and the state works in Sierra Leone, and that, in particular, it undermines the scope for creating an inclusive political state and building a national identity. Eligibility to the chieftaincy is by aristocracy – membership of a "ruling house" while the chiefs are not popularly elected. Chiefs largely determine access to land, dispense justice and determine local citizenship (who is a "native" or a "stranger"). Being a native of a chieftaincy, as opposed to a stranger, confers many benefits. This institution, it has been argued, has clearly influenced the extent to which a national identity can emerge and can help explain why voting patterns in elections are still rooted in region and ethnicity (Chaves and Robinson 2011). Furthermore, many rebel combatants cited grievances against abuses by chiefs as a reason for enlisting in the rebellion (Peters 2006, Richard 2005). At the same time, recent survey results suggests that chiefs retain legitimacy at the local level, with local people looking up to them for protection against perceived corrupt politicians in Freetown. Moreover, sometimes local people have tended to be suspicious of reforms that might lead to "natives" losing control of the chieftaincy and local institutions. Thus, there is no obvious answer to the question of whether and how to reform the chieftaincy system to foster political inclusion and build a national identity.

Possible Action Point: develop a government strategy for building trust through rhetoric and decisions which emphasize a common national identity.

References

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