Chapter 1

ECONOMIC MANAGEMENT AND GOVERNANCE IN THE DRIVE FOR ECONOMIC TRANSFORMATION IN SIERRA LEONE: SELECTED ISSUES

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1.1 Introduction

Sierra Leoneans would like to attain middle-income status by 2035 or soon thereafter. Hence, they need rapid economic growth. To do so, in turn, requires tremendous improvement in economic governance and economic management. Sierra Leone has been weak in coherent policy formulation and policy implementation. That record must change.

In this context, an important question is what do economists know about the factors that affect economic growth in a country like Sierra Leone? The good news for Sierra Leone is that it can greatly improve its economic growth by designing and implementing policies over which it has adequate control. What is basically required, then, is for Sierra Leoneans to understand what kinds of policies need to be implemented and then put in place management and governance arrangements that create the capacity to design and fully implement those policies. This volume covers several of the important policy areas. In addition to introducing the papers in the book, this chapter aims to provide an overview of fundamental economic management and governance issues to which Sierra Leoneans need to pay urgent attention if they want to achieve the required economic growth. Hence, the chapter will cover at some length some topics of importance to policymaking at this time that are not addressed by the papers in the rest of the book. Perhaps the most important of these latter issues is decentralization of governance.

1.2 Economic Growth: Basic Determinants

The growth rate of real per capita gross domestic product (GDP) over some extended period of time is typically thought to be a function of the following:[1]

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[1] For a good introduction to the subject matter, see Barro (1997), Devarajan *et al.* (2003), Glaeser *et al.* (2004) and Sachs and Werner (1997).

(i) initial level of GDP;
(ii) initial level of human capital;
(iii) population growth rate;
(iv) investment level (investment in physical and human capital relative to GDP);
(v) efficiency of investment (given the state of technology);[2]
(vi) technological change and innovation;
(vii) a number of 'policy' variables;
(viii) a number of 'political and institutional' choice variables;
(ix) several structural and environmental economic and socio-political variables;
(x) external variables.

The *policy variables* above typically include: inflation, government consumption ratio (e.g. ratio of government consumption, excluding defence and education, to GDP), black market premium of the currency exchange rate, taxation level(s), certain government regulations and controls, and infrastructure and public services. The *political and institutional choice variables* typically include: democracy (political rights); risk of appropriation by government; government effectiveness/efficiency, including corruption; constraints on the executive; property rights; and the rule of law. The *structural and environmental economic and socio-political variables* typically include: labour markets; financial markets and financial depth; ethnolinguistic diversity; urbanization rate; and political stability and instability. The *external variables* include especially terms of trade.[3]

1.2.1 The Basic Variables

In this listing, the basic variables are the first six. The last four set of variables tend to work mainly by influencing the fourth, fifth and sixth variables, namely, investment level, efficiency of investment, and technological progress and innovation. As regards the first six, most theoretical and empirical work in economics indicate that the growth rate during any period normally tends to vary inversely with the *initial level of per capita GDP*, because of so-called

[2] The efficiency of investment depends on the productivity of investment in producing capital and the productivity of capital in producing final goods and services. More precisely, one can think of the marginal efficiency of investment as the product of the marginal productivity of investment in producing capital and the marginal productivity of capital in producing final goods.

[3] Here terms of trade is typically taken to be the price of exports relative to the price of imports.

‘catch up’ effect; positively with the *initial level of education*; inversely with the *population growth rate*; positively with the *investment ratio*; positively with the *marginal efficiency of investment*; and positively with *technological progress and innovation*.

As regards the initial level of GDP, a country like Sierra Leone supposedly has some gap between its potential output per worker (the steady state output per worker) and the actual level; so there will be catch-up forces that tend to jerk up the country’s rate of growth. This is the so-called *convergence* property at work: the lower the starting level of real per capita GDP, the higher is the predicted growth rate, other things being equal, during some specified period of time. Normally, the convergence force applies only in a conditional sense, because economies differ in various respects. The growth rate, in other words, tends to be ‘high’ if the starting per capita GDP is low in relation to the country’s long-run or steady-state position – that is, if an economy begins far below its own feasible target position.

There is theoretical and empirical support for an *interaction effect* between *human capital and the pace of convergence*, namely, that a country’s growth rate is more sensitive to its starting level of per capita output the greater is its initial stock of human capital. The initial level of education is therefore very important; the higher the level and the better the quality composition, the faster a country can jerk-up its growth rate, via the catch-up effect.

Population growth is typically shown to be inversely related to growth. The explanation is that if the population is growing ‘fast’ the fertility rate tends to be ‘high’. In that case, a significant portion of the economy’s investment is used to provide capital for new workers rather than to raise capital per worker. In addition, a higher fertility rate means that increased resources must be devoted to child rearing rather than to production of goods. Third, the saving rate is adversely affected, and hence investment; in other words, increased fertility raises the dependency ratio and hence consumption relative to output.

A problem is that, in an absolute sense, sub-Saharan African (SSA) countries are not, for the most part, suffering from overpopulation – it can be argued that quite the reverse seems the case for most of the countries. In addition, empirically, countries with large populations benefit from having large internal markets and greater ability to lead in technological development and innovation. Urbanization, which comes with population growth, also has positive effects on growth (via innovation, for example).

Still, from an optimal equilibrium perspective, the conclusion would seem to be that the countries of sub-Saharan Africa (SSA) should reduce their fertility rates and let their populations grow mainly via declining mortality rates, at least for the foreseeable future.

The *investment–GDP ratio* correlates positively with growth. In other words, *investment* is good for growth: investment in equipment, in research and development (R&D), and in education and training of workers (human capital). The investment–GDP ratio is rather low in Sierra Leone, even with respect to SSA countries as a group, the average of which is already lower than other regions of the world. Sierra Leone's investment in *physical* capital in relation to GDP has in the 2007–10 period, for example, been hovering in the 13–16.5% range and is expected at best to stay around 17–18% in the next few years unless something is purposely done to change that. As a minimum, Sierra Leone's investment should rise to 23–25% in the next few years and move a little higher after that, to at least 25–28%, or so, for some time.

The *efficiency of investment* in sub-Saharan African (SSA) countries tends to be low by world standards. The low efficiency appears to be a symptom of underlying factors, such as government inefficiency, low education and training, suboptimal operation of markets, weak institutions (rules), general corruption, and political instability, all of which keep returns on capital in producing GDP relatively low and productivity of investment in producing capital relatively low as well.

1.3 Economic Management

Policymaking often involves decision-making at two important levels, namely, addressing what may be called *neutral fundamentals* and designing policies of *selective intervention* that tend to alter incentives through deliberate action of the authorities as opposed to what would operate if markets were left to themselves after benefiting from the neutral fundamentals.

Whether in the form of neutral fundamentals or selective intervention, much policy making is often described as *policy reforms*. These occur when policymakers take steps to correct certain policies, whether intended to be neutral or selective intervention, because the policies are considered mistaken in some important welfare sense; alternatively, policy reforms can result from the authorities choosing to design policies to address problem(s) which they had neglected before or simply had failed to recognize as important enough to demand their positive action.

1.3.1 Neutral Fundamentals

An important element among the fundamentals in economic management to transform the economy of Sierra Leone is putting in place a *strategy to build the capacity of firms in the economy to perform their tasks well.* The relevant capacity building will be facilitated by: (1) the quality of the enabling environment for innovation (or what is sometimes called the 'national innovation system'), (2) the human capital in the economy, (3) the physical infrastructure, and (4) steps taken to improve effectiveness and efficiency of cooperation among firms.

Apart from policies that help build firms' capacity, *incentives also need to be structured to ensure promotion of strong firms.* Such incentives include not only policies on human capital in general, but also policies to: (i) improve the quality of life in the country and hence attract talent; (ii) enhance openness of the environment, that is, markets, institutions, immigration laws, information flows, ideology, and access to the authorities; (iii) make the country's taxation (corporate taxation, taxation of wages, salaries, interest, and dividends, taxation on capital gains, etc.) competitive in the international arena; (iv) reduce administrative obstacles to doing business in the country; and (v) clean up the legal system, that is, the law, the courts, and the police, in light of the requirements to make the country a good place to do business.

The chapter by Varvaloucas *et al.* addresses the very important need for reform of the whole of the justice system in Sierra Leone, from the perspective of improving the functioning of the institutional framework, and hence the business environment, and thereby bolster economic growth. The reason, of course, is that improving the justice sector can lead not only to enhanced safety and less crime but also to more efficient regulation of business activity, an environment more conducive to entrepreneurship, and therefore to increased overall growth. The chapter focuses on both the formal and customary legal systems. The authors argue that justice sector reform would be most effective if reforms are implemented in both systems, rather than prioritizing the formal over the customary. They highlight issues specific to each system, and argue that policies to promote growth and development should target those specific issues, the most prominent of which are delays, corruption, and poor implementation in the formal system; and capture, corruption, and inconsistency in the customary. They identify policy measures to tackle each issue: training of officials, development of monitoring systems, amendments to inappropriate laws and procedures, and broad-based civic education programmes that communicate legal information to the public.

Macroeconomic policies are also important in creating incentives to attract and keep strong firms. The ultimate goal is the maintenance of macroeconomic stability. Market participants benefit from low inflation, stable exchange rates, capital mobility, and convertibility of the domestic currency, or at least an absence of exchange controls.

Coordination between monetary and fiscal policies helps in the achievement of macroeconomic stability, particularly in a small open economy like Sierra Leone with a very rudimentary financial sector, a central bank that does not have a wide range of effective monetary instruments, and where government debt instruments are extremely important in the financial market as a whole. In such a setting, fiscal policy can greatly influence macroeconomic stability. The paper by Robert Korsu and Lansana Daboh explores this topic. They investigate the role of fiscal and monetary policies in determining inflation, economic growth and the trade balance, and highlight some implications for the conduct of monetary and fiscal policies in Sierra Leone. Given its importance, they also study the relationship between bank lending and inflation, economic growth and the balance of payments, in these conditions. The results of their simulation experiments show that increased bank lending to the private sector increases private investment, real GDP and the trade balance, though this is associated with costs in the form of increased prices.

1.3.2 Selective Intervention in Markets

The fundamentals discussed above are *neutral* in the sense that, by themselves, they do not bias incentives towards any particular area of activity. A country could remain purely agricultural, for example, or depend mainly on tourism, even with the 'right fundamentals'. So, the question becomes: are there some special policies that a country could use to bias incentives in order to achieve certain objectives, such as enhanced industrialization or export promotion and diversification, because *the market* and *the neutral fundamentals* left to themselves do not result in the kind of industrial development or export volume and composition that is 'optimal' for the country over the long run? This is the kind of question that all well-managed countries will find themselves having to answer. Sierra Leone's economic managers must be prepared technically and organizationally to answer such a question, particularly in the two areas mentioned.

I would argue that, in Sierra Leone, the objectives of intervention, the extent of the intervention and the instruments chosen in the intervention should all be calibrated taking into account three interrelated principles, in order to ensure good value for money. These principles are: making sure that the objectives of a particular intervention policy make economic sense; that the policy supports strong firms, which by definition can be competitive in open markets; and that normally the focus in assessing value should be on production and output. All of this requires careful technical analysis by the policymakers.

First, *the policy objectives must be economically rational and make economic sense*. In this context, the framework must be medium- to long-term (that is, dynamic). There is always much uncertainty for the decision makers, of course. What this means is that, to the extent possible, the authorities should work with some notion of a minimum expected social rate of return on the resources expended on any intervention.

Second, *the policies must promote strong firms*. In other words, the policies must ensure that the benefits of intervention accrue to those firms that will produce the best results (in terms of social rate of return). One way to achieve this is by ensuring that there is openness to all firms to compete for the 'rights' and privileges under the intervention regime and that the selection process which decides the winners meets generally acceptable criteria of objectivity. 'Bidding' is one such process. Satisfaction of clear and fair criteria for receiving rights and privileges is another.

Third, *the authorities must focus on production and output* in assessing their policies. A small country like Sierra Leone should put production and output that contribute directly and indirectly to raising GDP over and above all other objectives. This in a sense helps the calculation of the social rate of return. In practice, it also means that selective interventions that, for example, use subsidies or protection to further certain values, norms and traditions should, when there is a loss to GDP, in comparison with some alternative policy, normally be avoided. For example, subsidizing domestic producers of some commodity merely to reduce dependence on imports of that commodity, or blocking the export of certain commodities to ensure that there is ‘sufficient’ supply of it in the local market should be avoided under normal circumstances. The paper by Chikezie points out that misguided selective intervention can actually be counterproductive in a country like Sierra Leone which explicitly attempts to promote entrepreneurship as part of a programme to push private sector development.

Two important areas where discussion of the selective intervention strategy is currently actively underway in the context of Sierra Leone economic transformation are: export promotion and industrialization. In the area of *export promotion*, Sierra Leone and most other African countries are concerned about two things. First, they do not accept that it is optimal for them to continue to dig up their minerals, harvest their agricultural products, and fish their waters and simply export all the products raw without further processing. Second, they do not accept that for many simple manufactured commodities they cannot beat foreign (non-African) producers in the African markets and make handsome profits while providing much-needed employment. These are the underlying motivations driving export diversification in the vast majority of African countries today.

Export promotion programmes in the bulk of SSA aim, on the whole, at: (1) export diversification, (2) increasing market share in traditional exports, and (3) fostering private sector development and regional economic integration. In order to achieve *diversification of their exports*, SSA countries right now want to (i) move away from only their ‘traditional’ exports by adding new commodities and services and (ii) move up the value chain (upgrading), especially for old traditional exports. Four types of upgrading have been identified in the literature (see, for example, Oyelaran-Oyeyinka and McCormick 2007). Listed in the order they fall in the usual upgrading path, they are:

- *process upgrading*, which involves increasing the efficiency of internal processes and making the firm more competitive in making existing products;
- *product upgrading*, which involves introducing new products or improving old products faster than rivals;
- *functional upgrading*, which involves changing the mix of activities conducted within the firm/industry/country, or moving from low-return activities to high-return activities;
- *chain upgrading*, which means moving to a new and more profitable chain.

The objective of *increasing market share* in traditional exports is particularly important when the country authorities strongly believe that the country’s market share is unnecessarily small, given the obvious potential of the country. As regards the objectives of *private sector development and regional economic integration*, which increasingly go hand-in-hand, these have entailed concerted efforts to push firms to try to export, as a way not only to foster innovation and productivity increases but also to promote economic integration in the various regional economic communities of the African continent.

In varying degrees of enthusiasm and thoroughness, the export promotion strategies in Sierra Leone as in many other SSA countries have contained measures to: (1) address economic policy fundamentals; (2) pick potential 'winners'; (3) directly address relevant selective intervention/incentive issues; and (4) to address other market access problems and challenges faced by exporters of the country concerned.

Picking potential/likely 'winners' has basically meant a search for commodities and services where the country's comparative advantage is emerging, or could emerge with appropriate assistance, based on some identified 'potential', and then to specify what needs to be done to speed up the 'process of emergence'. It is all about creating 'competitive advantage' of some sort. There are many difficult issues here as to how potential comparative advantage can be decided outside of a pure market framework or process. But these countries try to pick winners on the basis of criteria that they consider 'reasonable' and realistic. Sierra Leone, for example, in its 2010–15 national export strategy, decided to focus on certain agricultural commodities (such as cashew, cassava, chili pepper, cocoa, coffee, ginger, oil palm, rice, and sugar) which the country was already producing in substantial quantities and sometimes exporting, fisheries, tourism and mining. In all of these there was significant comparative advantage (see Sierra Leone 2010; Belloc and Di Maio 2012).

Selective intervention by the public sector, directed at entrepreneurs can include tax relief, subsidies, entrepreneurial and other types of training, market research, assistance with raising standards, access to finance, market penetration, and fostering of joint ventures and clusters. Apart from these, Sierra Leone is also trying to promote export processing zones. A major difficulty right now is developing objective criteria to assess the relative efficiency (and hence economic rationality) of the different interventions. The paper by Marianna Belloc and Michele Di Maio in this volume discusses some of the issues in this very complex subject matter.

The experience in Sierra Leone, so far since its strategy was put in effect, indicates that certain aspects of export promotion and diversification could require heightened attention by policymakers when there were serious deficiencies at the starting point, namely, quality management, export packaging, cooperation between government and business, and cooperation among the producers themselves. Developing export competence fast enough can also be very challenging. Similarly, adequately addressing problems of access to finance and cost of finance for the producers and exporters can be very slow. Progress can usually be made fast, at least at a formal level, in the area of trade facilitation where the government and the relevant state bodies can quickly put in place legislation, rules, and various technologically related systems that should greatly help in genuinely facilitating trade, all elements of which are sometimes called 'invisible' infrastructure (see Staples 2002); unfortunately, even here, actual implementation of the formal legislation and rules can fall far short of being resolute.

African countries, including Sierra Leone, also try to address *other market access problems and challenges* in seeking to promote their exports. Among these is the removal, or sizeable reduction, of certain domestic subsidies in industrial countries, particularly in agriculture, and the lowering of certain tariff and non-tariff barriers to trade, again especially by the industrial countries. Such actions are expected to have enormous beneficial effects on the typical African country. These demands for subsidy reductions and increased market access are expressed in international fora and in direct negotiations with the countries or with regional groups such as the European Union.

Africans also try to benefit from special (preferential) access policies, when possible, such as the Africa Growth Opportunity Act (AGOA) passed by the United States in 2000, to give producers in the vast majority of African countries certain preferential access rights to the US market.

Although no paper in this book really addresses the issue of selective intervention for promoting *industrialization*, the subject is raised in policy discussions in Sierra Leone. To many, it is an unavoidable strategy if the country wants to achieve high middle income within the next 25–30 years. But here, again, just as in the case of export promotion, it seems obvious that, first of all, at this point in its economic development, Sierra Leone should emphasize the neutral fundamentals in its economic policymaking. Second, apart from that, there is a strong economic theoretical case for tailoring any selective intervention policies to push industrialization in such a way as to promote firms that can be competitive in open markets. In general, such selective intervention policies should be neutral between exports and import-substitution and encourage open competition and foreign direct investment in the domestic economy. Thus, for example, if tax holidays are to be given as incentives, they should be given on an open and equitable basis to all firms.

1.3.3 Policy Reforms

The majority of the papers in this volume are about policy reform issues in specific areas. In fact, the papers address areas where Sierra Leone policymakers are themselves seriously thinking of ways to improve policies, in the attempt to rapidly increase economic growth, namely: financial sector reform, export promotion, technical and vocational education and training, agriculture and food security, customary land tenure reform, reforming the justice system as a whole, and better educating women and improving their employment prospects.

The paper by Omotunde Johnson on the *financial sector* is an attempt at guiding policy actions for the development of the financial sector as a whole, especially at this stage when the Sierra Leone financial sector is at a fairly low level of development. The paper sets the stage by listing the structural factors that make for a world-class financial centre, among which are included open and fair financial markets, free flow of capital and a convertible currency, and a skilled workforce. It then discusses the main fundamentals of the environment that the authorities need to get right, namely, capacity building of the firms and service providers to do the job well, creating appropriate microeconomic incentives for enterprises and improving general socio-political and economic governance of the country, including compliance with appropriate international standards and codes. The paper follows this up with discussion of the importance of a well-formulated and appropriate regulatory strategy. It finally discusses the key policy areas that must be addressed as the first steps in the financial development process, namely, aspects of money-market development, payment system development and capital market development. Also addressed in the paper are certain longstanding access to finance questions, whether in credit, saving facilities, or insurance.

Whether one is concerned about financial sector development broadly or more narrowly about issues of finance as a constraint on local entrepreneurship, several aspects of *bank performance or competition in the banking sector* are important, especially in a country like Sierra Leone where banks dominate the supply side of the outside finance for business. Olufemi Sallyanne Decker’s empirical paper on structural change and competition in the Sierra Leone banking sector in Sierra Leone is, therefore, of major importance to policy-makers in that country. First, the paper examines how the banking system in Sierra Leone has evolved in terms of market structure in the period 2001–10 and considers the implications of these changes for competition. Second, the paper applies a widely used test, the Panzar–Rosse methodology, to a panel data set to evaluate empirically the nature of competitive conditions in Sierra Leone. Specifically, the paper addresses the question of whether there has been a change in competitive conditions, following rapid foreign bank entry. It is well known that competition in the financial sector can greatly influence financial development, innovation and economic growth. As banks dominate Sierra Leone’s financial system, there is a need for reliable analytical tools for measuring and monitoring competition in banking markets to inform financial reform, financial regulation and government policy.

Using industry-wide data, the paper examines trends in key structural variables as identified in the industrial organization literature. These include changes in the number of banks, the number and distribution of bank branches, the ownership of banks, deposit and lending activity, market shares and industry concentration. Trends in interest spreads and bank margins as well as profitability were also analysed to gain insights into intermediation efficiency and profitability, both of which are expected to be affected by competitive conditions. Using bank-specific data, the Panzar–Rosse methodology is used to test competitive conditions. It is based on the premise that banks will employ different pricing strategies in response to changes in factor inputs depending on the competitive behaviour of market participants. The results of the trend analyses indicate that there have been marked structural changes which could suggest a turbulent competitive environment. The most significant change has been in the number and ownership of banks. In particular, the number of banks almost trebled since 2001, with foreign bank entry increasing rapidly between 2007 and 2009. The number of bank branches has increased greatly over the decade, with foreign banks now controlling almost two-thirds of the branch network. In spite of the intense lending activity, domestic banks clearly dominate lending but market share of deposits is almost equal for domestic and foreign banks suggesting that competitive pressures may be different in lending and deposit markets. The concern here is that domestic banks may become deprived of cheap funding from deposits. In spite of the decrease in concentration and profitability that have accompanied new entry, changes in the interest spreads and margins indicate inefficiencies in intermediation that may be due to the nature of competitive conditions and other factors that keep the lending rate elevated as deposit rates decline.

Unlike previous sub-Saharan African studies that have compared competitive conditions over time and after financial reforms and found an improvement in the level of competition, it appears, from the findings of Decker, that banks in Sierra Leone are taking steps to increase their market power. A conclusion from these findings is that an increase in the number of banks alone may increase rivalry but would not necessarily lead to a more competitive market structure. Decker argues that policies to foster effective competition need to have several dimensions and she discusses some of what would be entailed in a comprehensive competition policy.

Microfinance is an important area of study as a possible factor in poverty reduction. In that context, many policymakers are convinced that it can be a factor in promoting entrepreneurship among the low-income and, hence, economic growth. The paper by Hugh Kweku Fraser is about access to financial services in Sierra Leone, mainly via microfinance. The thrust of the paper is that microfinance has played a key role in the increase in access to finance in Sierra Leone over the last several years. The paper begins by first differentiating microfinance from other access to finance tools such as mobile telephone banking and gives an overview of microfinance and the other tools that facilitate increased access to finance. The paper examines the various current and planned types of microfinance providers and products in Sierra Leone. It examines their current performance and their potential to reach more people (especially the unbanked and under-banked) in a sustainable way. It also attempts to quantify the credit and saving needs and the numbers reached by microfinance providers. At the macro level, it examines the appropriateness of the current and planned policy and regulatory frameworks for microfinance. The paper concludes by summarizing the identified problems affecting microfinance development in Sierra Leone.

A very different subject is *customary land tenure*, a topic that is overwhelmed with all sorts of romantic idealization of what really happens with respect to access to land. In the chapter on reforming the customary land tenure system in Sierra Leone, Omotunde Johnson argues that reform is necessary and that it will need to address issues related to customary law itself as well as the question of statutory strangers introduced in the *Protectorate Land Ordinance* of 1927. Johnson argues that discussions of reforms of customary land tenure in Africa ignore the reality of disorderly privatization when the state imposes statutes to obstruct voluntary and orderly privatization by the landowners, as well as inequities in land rights and in access to land among the purported landowners under communal management. The paper argues for an institutional environment which enables ownership rights to land to evolve in an orderly manner in a regime of freedom of contract among the owners of the land, and with government policy designed to minimize transaction (including contract) costs, ensure competition, and develop markets as well as to provide appropriate oversight, *inter alia*, to guard against inequities in any strictly spontaneous evolutionary process.

To start the process, Johnson argues for immediate reforms to the current traditional system, while still leaving ownership of land at the level of the extended families, namely: (1) repeal of the Protectorate Land Ordinances; (2) establishment of explicit legal right of all Sierra Leoneans to live anywhere without permission of some local authority and being individually responsible for their own actions under national and local laws; (3) clearly defining and allocating property rights in land to extended families and to individual members of such families; and (4) granting the right to rent and lease to all comers, under terms that are freely negotiated between the contracting parties.

We have indicated that the Sierra Leone authorities are serious about *export promotion* along lines we discussed earlier and hence it is important to get the policies right. This is exactly the concern of the paper by Marianna Belloc and Michele Di Maio who survey the literature on strategies and practices for export promotion by developing countries. The paper starts by illustrating theoretical justifications for export promotion policies (EPPs) and continues by exploring in further detail the diverse forms export promotion policies may take. Then it briefly discusses the issue of how to evaluate the performance of EPPs and describes the current WTO rules concerning EPPs. This is followed by illustration of the different measures taken by governments around the world to increase exports and by a review of the existing empirical evidence on the effects of the different EPPs in both developed and developing countries. The paper notes that successful export promotion strategies have clearly defined priorities, goals, and objectives, and in particular they have been able to: (1) create a favourable domestic enabling environment for potential exporters (in terms of infrastructures, regulation, access to finance, insurance, and fiscal policies); (2) foster strategic collaboration between private and public actors and cooperation among producers, exporters and the policymakers; (3) improve productivity and technological content of domestic goods, and provide incentives to nurturing innovation; (4) enhance access to credit; (5) stimulate appropriate institutional development; (6) negotiate for a favourable international environment (multilateral relation, international trade forum, regional agreements); (7) work to build the country's image in foreign markets (through marketing, information provision, advocacy); (8) offer targeted and tailored assistance, and rely on continuous evaluation; and (9) institute monetary and fiscal policies designed to improve the enabling environment. The authors also underscore that cooperation between the government and the private sector is crucial in order to identify distortions, bottlenecks and weaknesses to be addressed on a case-by-case basis.

Skills development needs to be strengthened in Sierra Leone, not only via reform of the general education system but perhaps even more so via reform of technical and vocational education and training (TVET). The issues to be addressed would include: an examination of the current state of skills training in the country, including the institutional and organizational environment for training; analysis of the role of the government in TVET and the role of the non-government sector; ways to improve skills development for the informal economy; and tackling the many issues in the financing of skills development (such as resource mobilization, allocation mechanisms, and financing enterprise-based training). Indeed, there is general agreement that TVET in Sierra Leone needs a new focus and a new direction to make a contribution to rapid development in the country and help address the serious problem of youth unemployment and underemployment.

The review paper on *TVET experiences* in various regions around the world by Christian Kingcombe should, *inter alia*, contribute to informing the Sierra Leone authorities as they seek to develop a comprehensive design and implementation of strategies for TVET in Sierra Leone. Among other topics, the paper reports findings which indicate that the majority of TVET interventions appear to have positive labour market impacts for participants in terms of post-programme employment and earnings. The paper then proceeds to address many of the important questions that the Sierra Leone authorities are facing as they try to develop a comprehensive TVET programme, namely: (1) the organization for the development and implementation of a national TVET policy; (2) the major elements of a national TVET policy; (3) the linkage between general education and TVET (4) the role of formal schools versus enterprises in TVET; (5) policies for ensuring good quality in TVET; (6) strategies and structures for non-formal TVET; (7) linking TVET with the requirements of the labour market; (8) the training of TVET teachers and instructors; (9) ways of addressing socio-economic factors such as public perception problems and inequities in access to TVET; and (10) aspects of the numerous policy issues associated with the financing of TVET.

Technical and vocational education and training is not the only area of human capital development where Sierra Leone is lagging. The *literacy rate* in Sierra Leone is low; achievement in science and mathematics is poor, mainly because of lack of teachers and facilities; there is enormous overcrowding in classrooms; and last but not least *women’s education and skills training* (and hence formal employment) seriously falls below that of men. This last subject matter is the concern of Agnes Pessima in her contribution in this volume. Agnes Pessima’s paper argues that girls and women’s low level of education and training is responsible for women’s low representation in formal sector employment in general and their clustering in the margins of business organizations and government departments. Pessima discusses Sierra Leone government’s policies and intervention strategies to raise the educational status in the country of girls and women, and the outcomes of the interventions. Government, for example, has made efforts to reduce school fees and the cost of books, and not let pregnancies permanently prevent girls from completing their schooling mainly by allowing them to return after delivery to complete their schooling. But other problems that are influenced by culture and by attitudes of teachers and parents are much harder to address. These include early marriage of girls, heavy domestic workloads for girls that affect their concentration on schoolwork, and deliberately pushing girls into certain subjects in general education and certain skills in TVET both of which can give them a disadvantage in employment and income opportunities in the market place. Pessima makes suggestions to help reinforce the various initiatives and interventions which have so far been successful to become even more so. In that context, *inter alia*, she suggests actions such as training and sensitization of teachers, parents and others to enable them to counter the cultural and other obstacles which still dampen girls’ enrolment and attendance in schools and make them hesitant to enrol in certain subjects and skills training courses.

The paper by Amara Sheriff and Ben Massaquoi tackles the important area of *agriculture*. As is well known, agriculture in many African countries has stayed underdeveloped, with low productivity per acre and per worker, partly due to poor macroeconomic environment and partly due to structural problems that have not been adequately addressed. The authors discuss both aspects in their paper. The authors begin by stating that, in Sierra Leone, the focus of agricultural development is mapped out in a National Sustainable Agricultural Development Plan (NSADP) which is a comprehensive framework to promote agricultural development in Sierra Leone. The primary goal of the NSADP is to address on a sustainable basis the reoccurring problem of food insecurity and hunger and ensure food self-sufficiency and food security. The major thrust of the plan rests on the crop subsector. The chapter reviews the interventions and initiatives of the past several decades, indicates what was learnt from the successes and failures of those interventions, the current initiatives in the so-called ‘development phase’ and the challenges ahead.

Sierra Leone agriculture is characterized by food production involving mostly smallholder farming for subsistence. Several official initiatives and interventions have been pursued over the years. These began with swamp clearance and its partial development and cultivation during the colonial era. The government of Sierra Leone and its partners have pursued a large number of programmes between independence (1961) and the present day. The theme running through all these policies, strategies, and plans/programmes has been the attempt to achieve food self-sufficiency and food security, with emphasis on rice, the staple.

During the current planning period in this sector (2007–12), the vision for the agriculture sector in general and food security in particular is ‘to make agriculture the engine for socio-economic growth and development through commercial agriculture and private sector participation'. The policy development objectives to achieving this vision and the guiding principles are to: (1) increase agricultural productivity (intensification); (2) promote diversified commercial agriculture through private sector participation; (3) improve agricultural research and extension delivery services using technology, development, dissemination, and adoption and feedback systems; (4) promote efficient and effective resource management systems; and (5) bring, into the mainstream of policy, themes such as gender and youth promotion in agriculture, concern for farmers health (including HIV/AIDS and malaria), sustainable development and the environment.

The authors discuss elements in the Smallholder Commercialization Programme whose overall goal is to reduce rural poverty and household food insecurity on a sustainable basis, and to strengthen the national economy. In particular, the programme's aims comprise the following key objectives, to be attained by 2015: (1) increasing agriculture sector growth from its current estimate of 4% to 7.7% per annum by 2015; (2) increasing incomes of farming households by 10%; and (3) increasing household food security by 25%.

1.3.4 The Natural Resource Management Challenge

Sierra Leone is expecting greatly enhanced production from minerals, especially iron ore, and also to begin soon exploiting some petroleum resources. Hence, in the next couple of years, GDP is expected to experience a huge jump, government revenue will greatly increase, and the country will be faced with the challenge of how to prevent or dampen Dutch disease. Herbert M'cleod, in his chapter, discusses the particular case of iron ore, which is going to start the boom.

In this light, as an important element of its economic management, Sierra Leone should design a coherent framework for managing its mineral and oil resources so that they produce maximum benefits to the country's long-term development and the welfare of present and future citizens. The elements of that framework, I would suggest, should include: (1) putting in place procedures in reaching agreements with extracting companies which ensure that the royalties, taxes and other economic benefits to the country make rational economic sense for the country (that is, the benefits are maximized subject to certain real world constraints); (2) having a framework for monitoring implementation of agreements that ensure that the country's expectations are actually realized; and (3) introducing clear guidelines for the management of any government revenue from the natural resources to ensure that such revenues are utilized in ways that make the maximum possible contribution to the long-run growth and welfare of the economy of Sierra Leone.

As regards the *budgetary revenue management* with enhanced receipts from natural resources, once the expected sizeable revenues begin to flow to the government budget as a result of minerals and petroleum, there will no doubt be some challenge to the government to spend some of that money wisely in Sierra Leone, or to simply save some of it in foreign assets of various kinds. Hence, to begin with, there are three directions in which the additional budgetary revenue could be distributed: government consumption, government domestic investment, and government savings. In consequence, there would be a multifaceted technical problem to be solved: deciding the distribution of the money among the three major categories mentioned, and deciding the allocations within each of these categories.

From a practical policy perspective, the Sierra Leoneans need to decide on two basic approaches which I will distinguish as *rules* versus *bounded discretion*. In addition, Sierra Leoneans have to decide the extent to which they want to take an approach that encompasses the interest of future generations.

Even though the state of poverty makes for a bias for consumption 'today' relative to consumption 'tomorrow', – in other words, a time preference for disposable income today relative to disposable income tomorrow – it seems reasonable to assume that Sierra Leoneans as a minimum want to do all they can to raise substantially the rate of economic growth of their country by appropriate domestic investment. These two considerations would, in principle, tend to bias the shares among the three major categories in the order of domestic investment first, domestic consumption second, and saving/investment (in foreign assets) third. Whatever the case, from the point of view of the collective decision-making involved, the citizens must agree on either a simple rules approach or a bounded discretion approach.

The most obvious content of a *rules approach* will comprise two rules. *Rule 1* would state that, given a certain amount of '*enhanced mineral and oil revenue*', no more than x% should be used for government consumption and the rest should be used either for domestic investment or for investment in foreign assets. *Rule 2* would specify the minimum expected rate of return to justify any domestic investment made from those revenues. This *rate of return constraint* could be specified either in absolute terms or in relation to what the funds could earn in foreign assets (the *opportunity cost* of the domestic investment). The calculation of the rate of return on some government investment could be a really complex exercise. This is particularly unavoidable because the *rate of return on government domestic investment* should be the *social rate of return to the investment*. Such a social rate of return would take into account all the benefits of the investment to the development (GDP) of the country.

Calculating the social rate of return to investments in things like infrastructure, education and training, and subsidies to research and innovation activities can be very complex indeed. Still they should be attempted. When the government is not investing domestically it will need to ensure that the funds are well invested abroad, whether via the Bank of Sierra Leone or some foreign agent.

Given the need for growth in Sierra Leone, the enhanced mineral and oil revenue will have to be truly enormous and spread over several decades and even generations to make a case for any of that money not ultimately finding a 'profitable' investment outlet domestically. In any event, my suspicion is that the ultimate challenge for a number of decades would be making sure that the domestic investment occurs at a rate that is optimal in the sense that it meets some minimum rate of return requirement, and avoids waste, due, for example, to investing at too rapid a pace or with poor sequencing of projects.

We should note that the reasons why one would want to have Rule 1 are so that the government does not spend all the money on consumption activities, especially via inflated government wages and salaries, and also because one does not want the government to reduce its tax effort with respect to current generations, which could be an alternative way in which consumption is encouraged. Of course, the whole question of the optimal tax rate, especially to encourage private investment, as well as the appropriate level of government wages and salaries, will be taken into account in a discussion of Rule 1.

Now, if a rules approach is to be taken, there would need to be clear definitions of a couple of terms and concepts. First and foremost, the revenue subject to the rule (the *enhanced mineral and oil revenue*) must be defined. For instance, the rule may decide that certain historical level (average or maximum) of mineral revenue is not part of the 'enhanced mineral and oil revenue', and hence the government can handle that 'normal' revenue as it has historically. Second, *government consumption* or *government investment* may need to be defined, at least for some categories of government expenditure. For example, certain kinds of education and training expenditures may be considered investment, even if traditionally the government has classified them as part of current expenditure.

A rules approach also would require a dedicated governance arrangement. In particular, the rules themselves as well as the process of changing the rules must be legitimated in some way. A simple way would be to have the rules entered into a law, passed by parliament, which may specify, clearly, a procedure for changing them.

The rules approach has the disadvantage of inflexibility. Although its simplicity can turn that inflexibility into strength, there would still remain the problem that, for a small, poor, developing country, in a very uncertain global environment, there is always need for some room for maneuver. In any event, it would be interesting to discuss, although there is the suspicion that its inflexibility may hinder its support in many circles, especially if the process for changing the rules is cumbersome or too strict. This could happen if, for instance, the proposal is that the rules be written into the constitution, as countries or regions have done with rules designed to keep inflation low or requiring a balanced budget.

A less inflexible approach may, in such a situation, seem more attractive. Such an approach – *bounded discretion* – could involve giving the government broad powers to 'do the right thing' with some bounds on the nature of 'the right thing' and on the decision-making processes for determining 'the right thing'.

In the new situation of enhanced mineral and oil revenue, a bounded discretion approach would *tighten decision-making procedures to be followed by* *government* in expanding government employment, raising government wages and salaries, and in making domestic investments. For example, the government could be required to do proper cost–benefit analysis, in its allocation of funds among departments and units, and rates of return calculations in making investment decisions. Then the government would be asked to rationalize its domestic investments as opposed to saving in foreign assets, given the rates of return calculations. The government could also be required to restrict the ratio of government wages and salaries to some maximum relative to gross domestic product.

An *oversight and validation framework* would need to be established, under this approach, to verify that government is following appropriate procedures, both technically and operationally. An independent body with rotating membership could be established by parliament and civil society, working jointly, to carry on this oversight-cum-validation work. The independent body should have status in law and should report routinely (a term to be defined after discussion) and directly (the forms to be agreed after discussion) to parliament, society at large, and to the parliamentary–civil society group that appoints its members. The oversight-cum-validation body should be given adequate resources to do its work.

The disadvantages of the bounded-discretion approach are that it could be administratively cumbersome and expensive. Those who like the flexibility of the approach can explore alternative ways of formulating the approach to make it not too cumbersome administratively and not too expensive to implement.

As regards the issue of *Dutch disease*, the problem, of course, is that with the expected large inflow of foreign exchange from the enhanced mineral and oil exports, the real exchange rate of the leone could appreciate so seriously that other exports and certain import substitutes are discouraged. This real exchange rate appreciation could occur via a rise in the domestic price level and/or a rise in the nominal value of the leone vis-à-vis other currencies. The natural resource exports and the production of purely domestic goods (non-traded goods) would essentially crowd out other potential exports and certain import substitutes, the discouraged goods not being profitable to domestic firms, because of high domestic wages and 'cheap' imports. An attempt to diversify exports would therefore fail. Indeed, labour and capital would shift from commodities like coffee or ginger to the natural resource and non-traded goods sectors.

The country could, in brief, easily find it optimal to simply use the foreign exchange earnings from the natural resources to finance imports for consumption and for production of goods destined for domestic use (the non-traded goods). Real wages could, in this situation, also end up being suboptimally high, during the natural resource boom years, when taken in the context of the long-run optimal situation for the country.

There is a problem, in this sort of scenario, for a country like Sierra Leone because the natural resource boom years should sensibly be used as an opportunity to transform the country into a developed country and in the process build the capacity to diversify exports and to substitute for certain imports. For instance, if foreign exchange is used to import technology and personnel that help transform the country's productive capacity in general, giving it the ability to produce 'sophisticated' commodities and services, then it is possible for both imports for investment and exports of non-natural resources goods and services to rise together, without serious exchange rate appreciation. In that context, boosting the productivity of the non-traded goods sectors via modernization, human capital development and innovation can also be good for the long-term development of the country.

An important factor at play for Sierra Leone is that a good part of the foreign exchange that flows in would accrue to the government. The government, in cooperation with the central bank, can simply build up foreign reserves and government surpluses to be used up partly in economic transformation of the country (infrastructure, skill development, innovation), and partly to be saved (say, in some trust or wealth fund) for future generations, in a manner that does not lead to real exchange changes that damage export diversification. The conclusion is that this topic and the management of revenue topic discussed above are very much related and should be addressed together.

As regards the normal *growth effect of minerals on the Sierra Leonean economy*, in his paper, Joseph Kargbo argues that the policymakers need to identify and exploit the intersectoral linkages between mining, agriculture and other sectors of the economy. He estimates growth multipliers that show the magnitude and strength of the production and consumption linkages between various economic sectors in Sierra Leone. Growth in mineral exports can trigger the initial income shock to generate the growth multipliers. Thus, in the past, an additional Le 1.00 of income pumped into the mining sector generated an additional Le 7.69 of income in the economy. This growth effect can be greater in the oncoming years if policymakers can find ways to increase the backward and forward linkages emanating from the mineral and oil sectors, which is of great concern to Herbert M'cleod in his paper. In managing the natural resources, both authors stress the need to curtail corruption and improve transparency. They suggest policy actions that would achieve those objectives.

1.4 Economic Governance to Improve Policymaking and Implementation Environment

Good economic management benefits immensely from good governance (especially economic and political governance). Without some minimum quality of good governance: (1) appropriate economic policies (especially when it comes to the details) will not have a tendency to be selected, except by pure chance; (2) when appropriate policies are put in place, whether by design or by chance, implementation of those policies will tend to be poor; and (3) if good policies are introduced and are fully implemented, they will not yield close to the desired results, because the environment to absorb and make effective the good policies will not tend to be there.

The whole idea in the drive for good governance is to put in place processes, rules, and organizational arrangements to ensure that optimal policies are put in place and implementation is as full and complete as possible. This requires appropriate: (1) leadership, (2) cooperation, (3) institutions, and (4) organizational structure and capacity.

1.4.1 Leadership

As regards leadership, Sierra Leone needs transforming leadership at all levels: political, civil society, and business. In the language of leadership experts (see, for example, Burns 1978; Gardner 1990), a transforming leader is able to unite the separate interests of followers in the pursuit of 'higher goals', the realization of which is tested by the achievement of significant change that represents the collective or pooled interests of the leaders and the followers. Transforming leaders are power holders but they are not power wielders. Rather than manipulating followers to act solely in the interest of the leaders, the latter induce followers to act for certain goals that represent the values and the motivations of both leaders and followers. The genius of leadership, then, lies in the manner in which leaders see and act on their and their followers' values and motivations.

Transforming leadership from civil society is important, in this case, to help put pressure from below for good economic policies. Such civil society leadership will engage in mobilization activities to build agency on the demand side for good economic policies.

Transforming leadership in business is also valuable – in spotting and exploiting profit opportunities, applying the relevant business model, building the appropriate business organization, motivating workers, and mobilizing the capital, while also putting pressure on the political leadership to improve economic policies and ensure the appropriate enabling environment.

In a country like Sierra Leone trying to grow fast (9–12% GDP growth per year), political leadership is key in the network of leadership. *Political leadership* is a very important factor in the economic performance of nation states (see, for example, Arndt 1984; Johnson 1986, 2007). A political leader (or the political leadership in power) with certain qualities could make a substantial contribution to the economic development process.

In practical terms, it is always interesting to try to list the attributes that make for good leadership – transforming leadership, that is. I would argue in favour of four attributes (see Johnson 2007), namely: (1) general *moral character* – i.e., honesty, integrity, and discipline; (2) basic *societal understanding*; (3) persuasive communicative skills; and (4) innovative ability.

Societal understanding, for instance, would include deep knowledge of the people's basic aspirations and how to motivate them to act in a particular way as well as understanding of the nature of the political and resource constraints faced by the country both in its domestic policy and in its international relations. *Persuasive communicative skills* have to do with capacity to communicate effectively with others in the society to persuade them about the merits of adopting certain ideas and practices.

The extremely important skill of *innovative ability* would tend to be greater the deeper the general conceptual understanding of institutions (rules) and their possibilities in the particular social setting of the country concerned; the less the aversion toward risk-taking; and the greater the willingness to bear uncertainty. Lack of innovative ability will show up particularly as dearth of imaginative ideas. A leader without innovative skills but with societal understanding would invariably know what doesn't work but can hardly devise policies and techniques that work in his or her society. He or she copies and fumbles without serious analysis. By trial and error he or she might succeed but could fail too.

The institutions of the modern state are the outcome of political and social forces within a country. Therefore, it is difficult to avoid the conclusion that to explain the failure of political leadership in a country like Sierra Leone one must look beyond the state itself to the whole national community at large that instituted (by default or design) the state and its institutions. How to change the system to ensure that good leaders almost always emerge is a major challenge in a country like Sierra Leone. In other words, there are structural weaknesses in the socio-political system such that there is no logical tendency for those with the greatest ability for leadership to also be given the opportunity for leadership. Namely, in the existing political systems it would be only a matter of chance that persons among the most capable in the societies become leaders, as the methods and systemic processes by which leaders get chosen do not have a natural tendency to produce good leaders. In short, in order to address a problem of poor political leadership in a country like Sierra Leone one must look closely at the socio-political system that produces the leaders.

Many in the Western countries believe that instituting democracy (in the Western sense of course) will take care of the problem of how generally to produce good leadership. Well, democracy is good in its own right. But, from the standpoint of producing transforming political leadership to speed up the development process, the evidence is not clear. From an economic theoretical perspective, it would appear that democracy is good for growth, partly through the finding that political stability is good for growth and partly through the positive effect of democracy on several aspects of governance. Democracy has been correlated with per capita income, the degree of ethnic and religious tolerance that a country has achieved, the degree to which there exists a market economy, the existence of a large middle class, and the international influences that a country has had.

Nevertheless, the line of causation between the political regime and economic growth, and hence between democracy and economic growth, is not clear (see, for example, the discussion in Barro 1997). In fact, the evidence appears to be that the line of causation running from income and growth to democracy is much stronger than the line of causation running from democracy to growth and income. Legitimate and good leadership is what matters for growth in the end, irrespective of the degree of democracy. Focusing on political leadership helps bring one closer to how politics matters for economic growth. Good political leadership, *inter alia*: (a) reduces business risks and uncertainty felt by entrepreneurs; and (b) puts in place appropriate signals for inducing efficient allocation of resources in the economy. Good political leadership has arisen in undemocratic as well as in democratic regimes.

Realizing that democracy per se does not help in demonstrating how politics matters, and since political leadership is empirically difficult to measure, social scientists have come up with some rather subjective measures that economists use sometimes as indices for *socio-political governance*. Sierra Leoneans should pay attention to these indices. After all, one of the problems that policymakers in Sierra Leone have to worry about is the possibility of having to pay a premium to attract strong firms and highly talented people, because of uncertainties related to political instability and governance in the country. Investors worry about corruption, government efficiency, maintenance of rule of law, and sustainability of policies. Strategies must therefore be developed to build credibility for political stability, low levels of corruption and other elements of good governance.

As elaborated in Omotunde Johnson's paper on financial sector reform, when assessing countries on corruption and socio-political governance on the whole, many analysts will resort to surveys and indices purported to measure, for instance, *risk of expropriation*, *general governance indicators*, and *constraints on the executive*. Analysts will also look at the global corruption reports of Transparency International. It would seem sensible for the authorities in Sierra Leone to treat such surveys, indices and reports very seriously. In other words, the Sierra Leone authorities should try and understand how these indices are constructed and what they can do to improve their ratings. Such understanding will help them to design an appropriate plan to improve the country's rating.

1.4.2 Cooperation

The role of institutions in the development process has come to be greatly appreciated over several decades now. Institutions are *rules* governing behaviour in human interaction. Institutions coordinate expectations and constrain behaviour in interactions of individuals. Hence, institutions are at the core of the incentive structure that motivates behaviour of the kind that creates wealth. But institutions are themselves outcomes of cooperation. In other words, they are elements of the order that cooperation brings about. Hence, countries succeed in the development process especially when they are able to cooperate to bring about appropriate political, legal, and social institutions that are favourable to economic development and growth.

In this context, *cooperation* is the willingness to communicate, negotiate, and reach agreement on the design and maintenance of institutional and organizational arrangements, procedures, and mechanisms, including how to share the ensuing benefits and costs, without fighting, coercion, or total domination by one party. A body of intellectual work has emerged, which seeks to explain how institutions and modes of economic organization in a country or society can emerge and change over time, via cooperation, even without central governmental direction, that is, via *spontaneous order*. In that discussion, both trust and self-interest play important roles, as do evolutionary processes.

The state can also contribute to augmenting cooperation in ways that speed up the economic development process. For the state to be effective in doing so, its behaviour and structure must meet certain standards. For instance, a corrupt and dictatorial state is unlikely to be successful in fostering the appropriate cooperation.

Sierra Leoneans can benefit from increased cooperation. Cooperation can, in turn, be increased via processes used in creating and enforcing institutions and organizations. Such attempts at change can work through spontaneous order as well as through the state (that is, via *authoritarian order*).

To elaborate, cooperation for spontaneous order is adversely affected by low generalized trust, ethnicity, and collectivism. Low generalized trust is the feeling that one can't really trust anyone, outside of a few close friends and relatives, to be honest and to put in adequate effort, in business relationships for example; in other words, there is an expectation of rampant corruption and free-riding. This could be aggravated by difficulties in constructing effective monitoring and sanctioning devices to use against dishonest persons and free riders, as when, for example, the legal system is inefficient and corrupt and socio-cultural enforcement mechanisms don't work effectively. The consequence is that agents find it optimal to assume that everyone else outside of some small circle of friends and relatives would be one type of agent (or partner) in a cooperative effort, namely, untrustworthy, and that dishonesty and free-riding will be costly to monitor and punish. In such a context, business ideas will remain small-scale with heavy emphasis on supervision, by the owner, of any employed staff.

One implication supported by academic research is that there could be a vicious circle involving the level of generalized trust, trusting behaviour, and the expectation of untrustworthiness, so that in fact generalized trust diminishes over time (see, for example, Barr 2003). To counter this, in order to foster economic development, a community must find exogenous ways to increase trusting behaviour to promote the expectation of trustworthiness and hence generalized trust. Getting the community to understand the link(s) from trusting behaviour to generalized trust to cooperation and finally to economic development would help; so also would the existence of feasible ways to begin the process and get onto the virtuous circle involved.

Thus, Sierra Leoneans cannot help but address, head-on, ways to reduce *corruption* and free-riding at all levels and in all relationships. At least in the early stages of such an evolution, this would involve, among other things, creating effective monitoring and sanctioning devices, especially via raising the efficiency and honesty of the legal system. Prevention should be stressed over punishment in addressing corruption and free-riding.

Not surprisingly, *spontaneous order* benefits from the enabling role of the state, particularly in enforcing laws and contracts. The order that the state tends to create is sometimes called *authoritarian order*, which itself tends to benefit from an enabling role of civil society and business leadership. In brief, the study of cooperation in the development process is to a great extent a study of government–business–civil society cooperation that promotes economic development.

When we turn to the state and *authoritarian order*, there is a great need in Sierra Leone for cooperation there as well. For the state to be effective in the development process, Sierra Leoneans must cooperate in fashioning institutions and organizations of the state that are also effective in reducing ethnicity (see Johnson 2005) and controlling corruption within the state itself.

Such a state can also take the leadership in encouraging greater cooperation among private sector firms in the production of goods and services. Indeed, with such leadership, the private sector firms can become even more productive through enhanced cooperation via well-functioning formal associations and clusters. Business leaders and the state can work together to educate private firms about the resulting gains from collective efficiency, which can accrue to them, via *external economies* and *joint action*, as firms become embedded in networks of users, suppliers, consumers and knowledge producers. At least four well-known types of external economies could be pointed out to the private sector firms: market access, labour market pooling, intermediate input effects, and technological (or, simply, knowledge) spillovers.

Experience shows, though, that the authorities must be cautious in their approach to building appropriate cooperation among firms. In particular, the government must not attempt to impose an agenda on firms; there must be a trust-building process; the authorities must not be so concerned with national priorities that they neglect localized common concerns of firms; and a strategy to boost cooperation among firms must be designed and implemented so that firms have evidence of ‘quick wins’. Using a governance model that reflects real partnership between firms on the one hand and the government on the other could help prevent problems. Moreover, the government facilitators must be knowledgeable and have credibility with the firms (see, for example, Morris and Robbins 2007).

To cap it all, in countries that have been able to grow fast in the last century and a half, the *political leadership* has played a leading role in galvanizing and mobilizing the population. Such leadership has used the elements of collective self-interest and trust very effectively in combination with what we call *focal points* embedded in the cultures to bring people together. *Collective self-interest* typically arises in the face of exogenous constraints, that is, forces emanating from outside the community or from nature that make it the self-interest of the leaders and the followers of the community to pursue certain objectives. These constraints could be factors which threaten the political or economic survival of the community or they could arise from international competition that endangers the self-esteem of the community vis-à-vis some other community with which it competes. Such constraints provide the incentive (make it in the self-interest of the community) to seek rapid economic development or progress. In a country like Sierra Leone, the fact that the country is so poor and underdeveloped, which makes others disrespect its citizens in the global community, can be used as an effective galvanizing force/focal point, appealing to the people's pride, to elicit cooperation for rapid development.

1.4.3 Institutions

When one talks about institutions as *rules* governing behaviour, one of the operational requirements is *legitimacy*. Institutions that are not legitimated by the populace at large will not be willingly obeyed and promoted by the people; in short, there will be no sense of loyalty to the institutions. There will be, in such a situation, '*legitimation deficit*'. Hence, Sierra Leoneans always need to find ways to make sure that rules are legitimated. In all such situations, legitimation involves citizens' consent (or approval) without coercion. Such consent comes via several procedures, namely, open discussion and deliberation, voting, and overwhelming demonstration of support in parliament, in the newspapers, and in civil society voluntary organizations.

Another major problem in institution building is *implementation*. Laws and conventions need to be resolutely implemented to achieve their objectives. Take, for example, the problem of *controlling corruption*, which remains a major problem in Sierra Leone. Despite all the formal institutional and organizational actions taken by Sierra Leone, corruption has been very difficult to control and indicators of the perception of corruption are not really making much of a dent. There are well-known implementation and other problems that account for this difficulty in reducing corruption.

First, there is inadequate appreciation by ordinary Sierra Leoneans of the economic costs of corruption, because of a focus on the distributional aspects of corruption and a neglect of its effect on economic growth. Many times, for instance, when Sierra Leonean voters want to get rid of certain politicians they consider very corrupt, the complaint would be that those persons have eaten enough so it is the turn of others to eat. At best, the ordinary citizen will appreciate that a good fraction of the money stolen gets siphoned off into foreign countries rather than being invested in the country. This growth effect they can understand. What the ordinary citizens do not fully understand is that the attempts of the governing team of politicians, and their allies in the government bureaucracy, civil society and the business community, to capture corruption revenue magnify distortions and misallocation of resources in the economy as well as discourage investment, with serious adverse growth effects. The general point is that in a country where public sector officials and employees can get away with corruption, because of weak institutions or weak enforcement of rules, there is substantial expected and realizable corruption revenue from holding office. This has behavioural consequences that cause aggregate output loss to the rest of the society to be of greater magnitude than the real revenue realized by those who share in this corruption revenue (see Johnson 1975). The effect of the corruption is not simply distributional; otherwise, a simple approach to mitigating and possibly even eliminating any adverse growth effect would be to encourage people to invest at home any money they steal or bribes they receive from being in office.

Let me elaborate a little. To start with, in the typical African country like Sierra Leone, one effect of the attractions of capturing the state and reaping corruption revenue is that there is excessive flow of human and other resources into political activity designed to take control of the state. This obviously induces a fall in output in activities from which the excess resources flow into politics. In the typical African country, rural activities, including agriculture, especially suffer from these distortions. For, among other things, the thugs, militia, and political advisers and activists tend to base themselves disproportionately in urban areas. Moreover, even when they reside in the rural areas, these political activists neglect other activities for the reward they know they can get from their political 'duties'.

Private firms typically assist the government personnel to collect the corruption tax by obtaining monopoly rights and special privileges and concessions from the government and would share in the corruption tax proceeds by not handing over (as bribes, gifts, etc.) all the monopoly rents they realize. The most efficient producers and service providers do not usually end up with these special favours. In fact, high-quality business firms stay away from corrupt countries, except, sometimes, in the mineral and petroleum sectors.

Putting pressure on foreign governments to pass laws prohibiting companies originating in their countries from engaging in corrupt practices, when doing or bidding to do business in an African country, will not necessarily improve growth and efficiency in the African countries that have corrupt governments. Such laws will help only if they are adopted in all countries of the world and are resolutely enforced by all countries. Otherwise, we run the risk that only the most efficient companies obey the laws or follow norms to that effect. The first line of attack on the problem should be addressing directly the corruption in the African countries.

Another set of persons, in a corrupt African country, with incentive and ability to aid the corrupt politicians in the collection of the corruption revenue in return for a share of the proceeds, is the state bureaucracy, i.e. the civil servants. A fairly effective way in which this government–civil service cooperation works is this: the political leadership ignores, and even signals approval of, 'gifts' to the civil servants in return for the civil servants helping to hide corrupt practices of top politicians. The bureaucracy (especially the senior members of this bureaucracy) uses its implicit bargaining power to augment its wealth in corrupt ways. An implication is that the existence of a corrupt government will encourage corruption within the bureaucracy of the state. Indeed, in deciding whom to employ and whom to promote in the state bureaucracy, expected and past efficiency in helping to collect the corruption revenue will become an important criterion of the politicians and the top bureaucrats.

The adverse implications for economic growth are clear: the most efficient persons for the state may not be employed, and the allocation of positions may not be socially efficient. Moreover, the incentive system has been altered. The state's employees will find it advantageous to divert some of their energies to improving their efficiency in corruption-revenue collection and less on traditional (and socially valuable) activities. Corruption at the highest political levels of the state reduces efficiency of the state bureaucracy.

Government corruption also leads to exit of labour and capital from the economy, as well as discouragement of capital inflow, even when in many cases these factors of production are far more productive in the country with corrupt government than in the alternative country to which they go. The exit is to avoid the corruption tax, by going to places where such a tax either does not exist or at worst is substantially lower. The obverse of this consideration is that a country with corrupt government would tend to attract labour and capital which are efficient at corruption activities and not so efficient at production; they flow in to participate in the corrupt government–civil service–business coalition. Corruption at the highest political levels of the state thus reduces the average level of efficiency of the factors of production that remain in the country or that get attracted to the country from abroad.

These are only some of the ways in which the attraction of corruption revenue induces behaviour that adversely affects economic growth. The general point, once again, is that the vast majority of the African population does not understand these adverse growth effects. As a result their enthusiasm for strict enforcement of anti-corruption measures is seriously abated.

A second factor adversely affecting implementation of policies to control corruption is unenthusiastic public support of many anti-corruption efforts, because of the belief among ordinary Sierra Leonean citizens that corruption cannot be avoided in view of low salaries. In fact, too often the typical citizen retorts that corruption is everywhere, so why is the rest of the world picking on Africans? This sort of attitude is widespread in Sierra Leone.

Third, adversely affecting implementation is the fact that ethnicity is rife. Ethnicity creates an incentive for redistribution of state resources to one's ethnic group. Indeed, fundamentally, in many African states, including Sierra Leone, loyalty to ethnic group is often far stronger than loyalty to the state. Apart from any sociobiological causal factor, such as group solidarity and selection, this feeling has been aggravated by an absence of a feeling of ownership of the state by too many of the citizens. This, in turn, is related to the fact that, at the dawn of independence, the processes employed in holding together the national states and in writing constitutions did not involve the sort of cooperation that would have produced institutional and organizational structures legitimated by the citizens at large (see Johnson 2004). This unfortunate mistake has been perpetuated by the fact that subsequent political reforms (including constitutional reforms) did nothing to remedy the damage done at independence.

Compounding the problem of ethnicity and less than desirable loyalty to the state is also an absence of legitimated anti-corruption norms.

Fourth, affecting implementation of formal anti-corruption prescriptions in many African countries is the fact that corruption persists at the highest political levels. The consequence is inadequate political support for anti-corruption agencies and unequal enforcement of laws. The greatest dilemma in the attack on corruption in the African continent today is how to create effective institutions (that is, rules) to control government corruption when those who wield the greatest power in fashioning those institutions, namely, the political leadership in these countries, also happen to be the ones who benefit the most from corruption. Regarding unequal enforcement of laws, every African leader today will say that in their anti-corruption drives there is no sacred cow. But in fact it is difficult to find citizens from any African country plagued by serious corruption at the top where the citizens believe that the anti-corruption rules are enforced equally. Rather, what is obvious to many is that the tools of anti-corruption agencies are used mainly against political opponents and hardly against political allies.

Fifth, implementation is made difficult because sometimes the relevant legal framework is not sound and/or the organization for enforcement is confused, typically with unclear and overlapping functions and authority of several agencies involved.

Sixth, the capacity (both human and material) of anti-corruption agencies is, too often, inadequate. This is aggravated by poor lines of communications with government departments and lack of contact with, and transparency to, ordinary citizens and civil society groups that can be of value in getting information and evidence.

The last three noteworthy factors adversely affecting implementation of anti-corruption measures are straightforward. The seventh is that proving crimes beyond reasonable doubt is often difficult. Eighth, whistle-blowing is not looked kindly upon in many quarters. Again, the feeling among ordinary persons that corruption cannot be avoided because of low salaries makes whistle-blowing accepted only for enemies or those considered too greedy. Finally, stolen assets, including money, are often placed in the names of relatives, trusted acquaintances and friends.

1.4.4 Organization

In governance, in a country like Sierra Leone, special attention needs to be paid to four particular organizational issues, namely: (1) the organizational structure best suited to achieve the task at hand; (2) capacity building to ensure that the tasks assigned to the organization can be accomplished; (3) political and fiscal decentralization, especially the optimal degree and nature of such decentralization; and (4) the role of government versus non-government operators (private sector, non-governmental organizations, and self-help community organizations or so-called people's organizations). The third issue, decentralization, is extremely important in the political and economic governance discussions at this time, in Sierra Leone, and warrants discussion here.

Now what does decentralization entail? One type of *typology* differentiates political, administrative, and fiscal decentralization. *Political decentralization* typically gives a lot of autonomy to local governments which in turn are accountable to their local populations, especially via electoral processes. In a sense, political decentralization is about territorial governance. The effectiveness of political decentralization is greatly constrained by the degree of revenue decentralization and the extent of discretion (earmarking, conditionality) over use of budgetary resources even where they are transfers from the centre. *Administrative decentralization* involves decentralization of management and administrative responsibilities such as human resource management, financial resource allocation and administration, and enforcement of rules, regulations and codes. *Fiscal decentralization* involves decentralization of authority over budgetary revenue and expenditure decisions, management, and administration.

Another type of typology differentiates deconcentration, devolution, delegation, and privatization. *Deconcentration* is the transfer of decision-making power from the central government offices in the centre to regional or other local offices of the central government. This gives the local offices autonomy over a wide range of functions in the implementation of policy in the relevant area, say education or road maintenance, e.g. personnel management, budget management. *Devolution* involves the transfer of decision-making from the central government to regional or local governments. *Delegation* is the assignment by government (central or local as relevant) to particular entities – e.g. in education to public school principals and/or local school councils – to perform certain functions, at the discretion of the government, and as long as it so wishes.

Decentralization of governance of greatest interest in SSA countries is that involving political and fiscal decentralization in the first typology and devolution in the second typology. It is about shifting authority, resources and information away from the central government toward local governments. In addition, there is interest in the commitment to decentralization, and hence the institutionalization of the governance structure, including the mechanisms in place to prevent erosion and reversal of the decentralization mentioned above.

The *case for decentralization* is well studied in economics. Decentralization is partly a reaction to the failures of the centralized state. It is seen as a way to introduce intergovernmental competition, and make government more responsive and efficient. Decentralization is also seen as an element of a democratization programme and hence a signal of the commitment to move away from centralization and authoritarianism and towards genuine participation at the grassroots level. In general, the conventional wisdom is that decentralization should be preferred when tastes are heterogeneous and there are no spillovers across jurisdictions. The central government solution is preferable with spillovers and no heterogeneity.

Important for decentralization is the economic efficiency of intergovernmental competition (that is, competition among local governments). In this context, governments offer public tax and expenditure bundles, and mobile individuals are expected to allocate themselves according to their preferences, vis-à-vis packages of services, taxes, and regulations. This is the so-called Tiebout thesis of people voting with their feet (see, for example, Tiebout 1956). When there are significant intercommunity interdependencies, competition among local governments can result in economically inefficient public policies. Examples sometimes cited are low income assistance, local income and business taxes, and regulation. Economic federalism, in principle, will assign these tasks to the central government in addition to services which approach pure public goods (e.g. national defence).

Decentralization encourages efficient allocation of resources, when public services can be efficiently provided on a relatively small scale, so one does not need big government on technological grounds anymore. Small governments can handle certain tasks better, including certain information problems, making governance at the local level more responsive to the ‘needs’ of the vast majority of the population, and thereby more capable of ensuring well-matched service provision.

Political accountability may be greater at the local than at the central government level. Many have noted that the local government may have better local information and accountability pressure (see, for example, Bardhan 2002); in a democracy, the local politicians may therefore have greater incentive to use the local information than national or provincial politicians, because they are answerable to the local electorate more than the central government politicians. In other words, centralization has costs in terms of reduced accountability: the probability that the welfare of a given locality will determine the re-election of the government declines.

The mechanism of accountability may also be strengthened by what economists call ‘yardstick competition’, that is, jurisdictions being compared to each other. The combination of decentralization and yardstick competition encourages experimentation in the way a given public service is provided as well as learning from other jurisdictions.

Decentralization facilitates political participation and helps promote and protect basic liberties and freedoms. Peace can be better secured in ethnolinguistically diversified environments with decentralized management that grants local cultural and political autonomy to the various significant ethnic groups, giving voice to those groups (see, for example, Brennan and Hamlin 2000; Johnson 2005). Decentralization can be also sometimes used as a way to obtain legitimation of a new regime or a comprehensive government programme involving a major break with the past.

Decentralization can improve government policies towards markets and thus promote investment as well as business efficiency. Competition among local governments will tend to limit governments' predatory behaviour, as businesses will leave jurisdictions with behaviour considered unfriendly to business (see, for example, Qian and Weigast 1997). Decentralization can also lead to the emergence of hard budget constraints in much government activity. With substantial fiscal decentralization, local governments without access to central bank resources, directly, or indirectly via the central government, will be faced with much harder budget constraints than the central government. For example, local governments that waste resources in bailing out inefficient enterprises will tend to have high taxes, poor public services and insufficient funds to spend attracting efficient enterprises. This promotes efficiency and economic growth.

Sometimes economists discuss the issue of how to *structure* decentralization. Structure can refer to *geography* as well as to *functional jurisdiction* (see, for example, Frey and Eichenberger 1999). In Sierra Leone, discussions on decentralization clearly assume that decentralization (political and devolution) will be structured mainly according to geography, but decentralization along functional lines is not ruled out, especially where the non-government sector is to be brought in (e.g., via privatisation of certain functions).

There is a big discussion among students of the subject about the relevance to an African country like Sierra Leone of the above case for decentralization, and hence how strong this case is in that context. The point is, to put it differently, that there are many caveats which should be taken into account in trying to apply the above analysis to an African country like Sierra Leone. I will mention some here. First, the assumption of population mobility (people voting with their feet) among jurisdictions often fails in poor countries. Second, it is usually assumed that allocated funds automatically reach their intended beneficiaries – their targets. This ignores corruption. Third, the institutions of local democracy and the mechanisms of political accountability are often weak. Thus one often finds a problem of local capture of governments by elite groups at different levels.

Fourth, the traditional literature is concerned with efficiency. Often, in developing countries, like Sierra Leone, the burning issue is redistribution – reaching out to the poor, certain neglected communities, etc. In this regard, some have argued that decentralization could worsen inequality across regions unless redistribution objectives are somehow taken care of by central government policy intervention. But others, in contrast, believe that jurisdictional competition will in fact promote a tendency to equality as the less well-off localities can offer attractive terms and conditions to induce capital inflow.

Fifth, the fiscal federalism literature typically assumes that lower levels of government both collect taxes and spend funds. In many of the African countries, including Sierra Leone, the decentralization issues are really about providing centrally collected tax revenue to lower levels of government, rather than seeking to empower lower levels of government to collect taxes. The focus is mainly on public expenditure assignments, unaccompanied by any significant financial devolution.

Sixth, one must take into account different levels of technical and administrative capacity of local governments. The problem is more serious for some services than for others.

Seventh, there are issues related to the financing of local government expenditure. In particular, it has been argued by a number of economists that the methods of financing local government expenditure do matter. The three basic ways of financing are: local taxes, user fees, and central government transfers. The risk of capture and corruption are greatest for local taxes and central government transfers. Central government transfers also run the risk of more politically favoured communities ending up with more than an equitable share of revenue. Moreover, flexible central government transfers can lead to soft budget constraints: the local governments' expectation that the centre, *ex post*, will help to cover any excess spending on their part, because the resource constraints are not credibly rigidly fixed *ex ante* (see, for example, Rodden *et al.* 2003).

User charges may be a compromise between the need for matching provision to local needs and avoiding an unduly heavy burden on the local poor. But user charges cannot be used for anti-poverty programmes. In addition, they may not be practical where exclusion is politically or otherwise difficult to enforce. In such cases compulsory taxation may be unavoidable.

The above scepticism should be taken seriously in designing and implementing policy. In general, the two biggest risks to accountability in a country like Sierra Leone are *corruption* and *capture* by local interest groups and elites. Attitudes toward hierarchy and weak institutions to control corruption at the top can make capture and corruption difficult to prevent or control in practice. Local governments can be even less democratic than the central government in many areas. Local chiefs, headmen and councillors, district commissioners, etc., often act as big persons rather than as servants of the people and the people often find it more difficult to protest against them than against similar officials of the central government. For meaningful accountability, decision makers must be appropriately rewarded or punished for performance. The question, in general, then, is: how can Sierra Leone continue to improve on accountability in public sector governance at the local level?

In addition to the above, there are always dangers in Sierra Leone for *ethnicity* and *unhealthy regional rivalries* and hence corruption, for example in budgetary relations between the centre and the local areas. Sierra Leoneans need to put rules and procedures in place and to have them fully implemented to guard against such dangers.

The *capacity of local governments* to govern or manage programmes efficiently can be limited. Of course, it is easy to exaggerate this for political or bureaucratic reasons. For example, the African bureaucrats of the centre are often accused of having an elitist attitude towards the 'petty bureaucrats' of the local governments, especially where local governments are dominated by so-called traditional rulers. In this context, the decentralization experience of certain African countries seems to lend credence to an alternative view that central government bureaucrats underestimate the capacity of local communities to identify and manage community development projects and the funds associated with those projects. Still, to be on the safe side, Sierra Leoneans need to pay attention to capacity building, whether in the form of equipment or library facilities, or training of the personnel in the offices concerned.

As regards information on local needs and delivery costs, for many important services the central governments in African countries often have greater capacity to obtain the necessary information than even the local governments. Hence, in Sierra Leone, the centre does often need to give information on aspects of the local environment to the local authority concerned. A systematic way of doing so may not simply be a technical issue which regular staff can handle. There may be diplomatic and sensitive considerations in formalizing the procedures, particularly so that all local governments are treated equally.

As to the gap between commitment of resources at the central level and delivery at the local level, the situation is perhaps more complex. Leakage could be easily overcome by transparency – for example, by making public, in the local community, the funds that have been committed and the targets, as well as when funds are delivered. Sierra Leone is making progress in this kind of transparency, but no doubt improvement is still possible.

As in many other African countries, Sierra Leone is already taking steps to enhance the efficiency of decentralization. There should be concerted efforts to ensure that the steps yield the desired results. A few of these steps can be listed. First, the authorities are encouraging participatory local planning by communities to discuss local development priorities and agreeing on lists of projects to send to the centre for funding. Typically these projects have to deal with roads, education, health, water supply, and police. There is a need to find out if the local populations find the process so far in place satisfactory. Second, the authorities need to continue to increase the attempts at capacity building at the local government level. In that regard, there is a benefit to looking at the appropriateness of the capacity building processes that are in place. Third, the central government has procedures to audit and oversee the local government jurisdictions. There should be continuous review of whether this process is working efficiently enough both in terms of speed and meeting the needs of all concerned.

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