ECONOMIC CHALLENGES AND POLICY ISSUES IN EARLY TWENTY-FIRST-CENTURY SIERRA LEONE

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I hope that the book will turn out to be of lasting value to Sierra Leoneans as they wrestle with the economic development challenges in the next two to four decades of the century.

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Part I

Introduction

Chapter 1

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

By Omotunde E. G. Johnson

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]

The author would like to thank Kareen el-Beyrouty for comments on an earlier draft, while remaining solely responsible for the contents of the paper.

[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 policymakers 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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Part II

Macroeconomics and Financial Sector Issues

Chapter 2

A MACROECONOMIC MODEL OF THE SIERRA LEONE ECONOMY: THE ROLE OF FISCAL AND MONETARY POLICIES IN STABILIZATION

By Robert Dauda Korsu and Lansana Daboh

2.1 Introduction

Every economy uses both monetary and fiscal policies for stabilization and the Central Bank is the institution that manages the monetary policy of an economy while the Treasury or the Ministry of Finance manages fiscal policy and the two institutions coordinate to achieve optimal desired results. In Sierra Leone, the Ministry of Finance and the Bank of Sierra Leone are the authorities that manage fiscal and monetary policies, respectively.

Fiscal management has resulted in persistent budget deficit in Sierra Leone since the early 1970s and monetary policy has been more expansionary than contractionary. Despite the fact that monetary policy has price stability as the ultimate objective of the monetary policy framework while economic growth is the main macroeconomic objective of fiscal policy, the performance of the economy on these indicators has been unsatisfactory. As in the case of most sub-Saharan African economies, Sierra Leone experienced moderate growth in the 1970s and the growth performance of the 1980s was poor. Real gross domestic product (GDP) grew by 2.4% in the 1970s, which slowed to 2.2% in the 1980s and to −5.29% in the 1990s. Thus, growth performance was worse in the 1990s (the war period) while the 2000s, which is the postwar period, experienced a higher growth rate than the 1970s, 1980s and 1990s, with an average growth of 6.0%.

Net foreign asset, which was positive in the early 1970s, has consistently been negative since the mid 1970s and the size of the deficit on the trade balance and the current account has been growing since the 1990s. The end of the war could not divert this trend, though there was a large flow of foreign aid (mostly

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for postwar reconstruction), which increased foreign reserve in the early to mid 2000s. However, Sierra Leone still experiences deterioration in the external sector. The rate of inflation was low in the early 1970s while the mid 1970s to the end of the 1990s experienced double digit inflation rate (triple-digit inflation was the case in some years). Single-digit inflation was observed in the early 2000s and double digit inflation re-emerged in the mid 2000s.

Important empirical questions from the macroeconomic performance of Sierra Leone are the following.

(i) What is the role of fiscal policy in the macroeconomic stabilization process of Sierra Leone?

(ii) What is the role of monetary policy in the macroeconomic stabilization process of Sierra Leone?

(iii) What are the channels of transmission of fiscal and monetary impulses to key macroeconomic variables of interest to the Ministry of Finance and the Bank of Sierra Leone?

While much has been done on the role of fiscal and monetary policies in other developing countries, taking into consideration both the final effect and the macroeconomic adjustment process, we are not aware of any published study on this issue in the case of Sierra Leone. The objective of this study is therefore to investigate the role of fiscal and monetary policies in attaining low inflation, economic growth and favourable external balance as well as the channels of transmission of these policies in the Sierra Leonean economy. An investigation into these issues helps in providing guidelines in the macroeconomic stabilization efforts of the fiscal and monetary authorities of the economy.

The rest of the chapter is organized as follows. In Section 2.2 we discuss the macroeconomic performance of Sierra Leone in brevity. Section 2.3 is the discussion on the methodology, Section 2.4 is empirical results and Section 2.5 includes conclusions and recommendations.

2.2 A Review of Sierra Leone's Macroeconomic Performance

The economic performance of most of the sub-Saharan African countries was relatively stable in the 1970s but the performance of these economies was not satisfactory in the 1980s and 1990s. This scenario was the case also for Sierra Leone. In Sierra Leone, real GDP grew by 2.4% in the 1970s, which slowed to 2.2% in the 1980s and to −5.29% in the 1990s. The 2000s has been a mixed outcome depending on the macroeconomic variable under consideration. For example, the rate of inflation reduced to an average of 8.4% over the period 2000 to 2009, from an average of 36% in the 1990s while the trade balance worsens to −14.7% of GDP from an average of −9.0% in the 1990s.

Sierra Leone recorded positive growth of real GDP in the early 1970s to mid 1970s, with an average real GDP growth of 3.24% (see Table 2.1). The rate of inflation was relatively low in the early 1970s but became double digit for the first time in the mid 1970s. Average inflation rate from 1970 to 1975 was 8.44. This average was higher than 5% as a result of the high inflation rates of 1974 and 1975.

The second half of the 1970s was not favourable for Sierra Leone though real GDP growth was positive. The growth of GDP fell from the average of 3.24% in the period 1970 to 1975 to 1.57% between 1976 and 1979. The rate of inflation increased from the average of 8.44% in the period 1970 to 1975 to an average of 14.41% between 1976 and 1979 while trade balance, as a ratio of GDP, worsened from −6.38% in the period 1970 to 1975 to −10.54% in the period 1976 to 1979.

The economy deteriorated in the 1980s in terms of both internal balance (economic growth and inflation) and external balance. During this period monetary policy was accommodating fiscal policy. Moreover, the exchange rate was fixed while fiscal and monetary policies were inconsistent in the sense that fiscal deficit was high, with an average of 10.0% of GDP (deficit excluding grant) and money growth was very high, with broad money growth and narrow money growth being 53.0% and 58.0% respectively and real interests rates being an average of −52.0%.

Fiscal deficit (excluding grant) as a percentage of GDP increased from the value of 3.47% over the period 1970–75 to 8.51% over the period 1976–9 and increased further to 11.46% over the period 1980–85. Growth of narrow money increased from 11.77% over the period 1970–75 to 20.66% over the period 1976–9 and increased further to 41.37% over the period 1980–85. Growth of broad money increased from 12.7% over the period 1970–75 to 23.79% over the period 1976–9 and increased to 35.34% over the period 1980–85.

The rate of inflation rose from the average of 8.41% over the period 1970–75 to 14.41% over the period 1976–9 and increased further to an average of 45.81% over the period 1980–85. Growth of real GDP fell from an average of 3.24 over the period 1970–75 to 1.57% over the period 1976–9 to an average of 1.36% over the period 1980–85. Net foreign assets declined from an average of 30.2 million leones over the period 1970–75 to −21.36 million leones over the period 1976–9 and further declined to an average of −676.62 million leones over the period 1980–85. Though export growth was higher than import growth between 1976 and 1985 export value was lower than import value. Hence, the trade balance was in deficit as in the period 1970–75.[1] Trade balance as a percentage of GDP deteriorated from an average of −6.38% over the period 1970–75 to an average of −10.54% over the period 1976–9 and slightly improved to only −9.82% over the period 1980–85.

Poor export performance and low levels of capital inflow were behind the low levels of foreign reserves in the 1980s. Foreign reserves excluding gold which reduced from an average of US$43.17 million in the period 1970 to 1975

[1] The analysis focuses on the trade balance because the services element of the current account has been negligible in Sierra Leone, as is the case in many sub-Saharan African countries.

TABLE 2.1. Basic macroeconomic indicators for Sierra Leone, 1970–2009.

Indicator	1970–75	1976–9	1980–85	1986–90	1991–5	1996–2000	2001–5	2006–9
Real GDP growth (%)*	3.24	1.57	1.36	0.86	−6.1	−4.48	6.31	6.0
Inflation rate (%)	8.43	14.41	45.81	93.12	48.12	21.37	6.53	10.2
Trade balance (% of GDP)	−6.38	−10.5	−9.82	−2.24	−3.72	−14.33	−18.69	−10.4
Foreign reserves excluding gold (million US$)	43.17	35.02	14.96	7.31	26.56	39.52	99.65	202.5
Net foreign assets (million Le)	30.2	−21.4	−676.62	−23,083	−254,382	−239,994	−186,511.4	−19,965.4
Investment (% of GDP)	12.83	11.66	13.39	8.55	7.52	6.08	9.86	10.5
Real interest rate (%)	−11.17	−6.81	−36.77	−68.91	−11.15	3.16	−6.21	−7.3
Budget deficit excluding grant (% of GDP)	3.47	8.51	11.46	7.66	6.14	9.74	13.44	9.1
M1 growth (%)	11.77	20.66	41.37	74.74	30.45	24.98	25.02	22.1
M2 growth (%)	12.7	23.79	35.34	71.5	31.96	27.89	27.3	24.0

Source: calculated by authors from International Financial Statistics and World Development Indicators. *World Development Indicators.

to US$35.02 million in the period 1976 to 1979 was only US$14.96 million in the period 1980 to 1985, and between 1986 and 1990 it was as low as US$7.31 million.

In order to rebuild the economy, the government introduced the National Economic Emergency Programme (NEEP) in November 1987. This comprised rigid currency holdings and control of cross-border trade and prices of staple products. These measures which proved to be futile were abolished in December 1989 for the Economic Recovery Programme (ERP). The ERP came from the series of meetings with the IMF and the World Bank in relation to the adoption of an adjustment programme. Though the programme had elements in common with the conventional IMF programme it did not have direct financial support from the IMF. The prime objective of the programme was to restore economic growth through structural reforms, including fiscal and monetary restraints.

In 1992, the relationship with the IMF was deepened and the Structural Adjustment Programme was adopted. Fiscal and monetary restraints were the thrust of the programme, including reduction of the role of the government, improvement of service delivery and promotion of the private sector. The Adjustment Programme that started in 1992 was supported by the IMF under the Rights Accumulation Programme (RAP) from 1992 to 1994 and later under the Enhanced Structural Adjustment Facility (ESAF) from 1994 to 1996. The World Bank also supported the programme through the reconstruction imports credit (RIC) and later by the structural adjustment credit (SAC). The rate of inflation therefore fell from 102.69% in 1991 to 65.5% in 1992 and ranged between 22% and 26% from 1993 to 1995, which were lower than the values in the previous decade. However, GDP growth was negative in 1992 (a value of −23.47%), 1994 (a value of −1.99%) and 1995 (a value of −9.17%) while it was 1.36% in 1993. Trade balance as a ratio of GDP deteriorated from an average of −2.24% over the period 1986–90 to −3.72% over the period 1991–5 and −14.33% over the period 1996–2000. Table 2.2 shows the year-on-year inflation rate, real GDP growth and trade balance as a percentage of GDP from 1970 to 2010.

The rate of inflation reduced from 21.37% over the period 1996–2000 to 6.53% over the period 2001–5 and increased to 10.2% over the period 2006 to 2009. Real GDP growth increased from −4.48% over the period 1996–2000 to 6.31% over the period 2001–5 and decreased to 5.2 over the period 2006 to 2009. However, trade balance as a ratio of GDP worsened to −18.69% over the period 2001–5 and to −10.2% from a value of −14.33% over the period 1996–2000.

The performance of the economy of Sierra Leone in the period 2001–9 (the postwar period) was better than the 1980s and 1990s, in terms of inflation rate and output performance. This is not surprising as this is a period of structural adjustment and stable political environment, reflected in increased investment–GDP ratio from 8.55% over the period 1986–90 to 9.86% in the postwar period. However, the performance on the side of the external sector (the trade account) was worse than before the mid 1990s.

TABLE 2.2. Annual inflation rate, GDP growth and trade balance for Sierra Leone from 1970 to 2010.

Year	Inflation rate	Real GDP growth	Trade balance (% of GDP)	Year	Inflation rate	Real GDP growth	Trade balance (% of GDP)
1970	6.4	7.9	−3.6	1991	102.7	2.3	−0.7
1971	−1.3	3.4	−3.7	1992	65.5	−23.5	0.6
1972	5.5	0.9	−1.1	1993	22.2	1.4	−3.8
1973	5.6	2.2	−5.0	1994	24.2	−2.0	−3.8
1974	14.4	3.4	−14.0	1995	26.0	−8.7	−11.0
1975	20.0	1.6	−11.0	1996	23.1	5.7	−17.4
1976	17.1	−0.5	−10.1	1997	15.0	−21.4	−7.7
1977	8.4	0.1	−6.9	1998	35.5	−0.9	−13.1
1978	10.9	2.4	−13.3	1999	34.1	−9.2	−11.8
1979	21.2	4.3	−11.9	2000	−0.8	3.3	−21.6
1980	12.9	4.6	−18.5	2001	2.1	4.4	−19.4
1981	23.4	2.8	−15.9	2002	−3.3	5.9	−23.1
1982	26.9	4.6	−14.4	2003	7.6	6.2	−21.1
1983	68.5	−2.2	−4.7	2004	14.2	7.5	−13.9
1984	66.6	3.9	−2.2	2005	12.1	7.5	−16.0
1985	76.6	−5.6	−3.2	2006	7.3	7.2	−10.5
1986	80.9	1.2	−0.6	2007	13.8	6.4	−10.3
1987	178.7	6.7	1.2	2008	13.2	4.4	−10.6
1988	34.3	−7.6	−5.5	2009	12.5	4.5	−11.0
1989	60.8	0.7	−4.8	2010	16.8	5.2	−14.5
1990	111.0	3.2	−1.6				

Source: calculated by authors from IFS CD-ROM, WAMA database and World Development Indicators.

2.3 Methodology

2.3.1 Description of the Macroeconomic Model

The methodology used to determine the effects of fiscal adjustment and a monetary policy rule on inflation, income and the external sector of Sierra Leone is the estimation of a small macroeconomic model that links the price level to the fiscal, monetary, real sector and external sectors of the economy.

The Fiscal Sector

The fiscal sector considers fiscal deficit to be the difference between government expenditure and government revenue. That is,

$$\mathrm{FDEF} = G - R, \tag{2.1}$$

where FDEF is fiscal deficit, G is government expenditure and R is government revenue.

The Monetary Sector

The monetary sector is characterized by the credit counterpart model as it recognizes the role of fiscal deficit in money supply determination. The model posits that the growth of money supply depends on fiscal deficit, net external transactions of the government, domestic debt management policy and bank lending to the private sector. This is an identity. In order to determine the relative importance of the response of each of the variables of this identity, it is important to model the process. Hence, by considering the fact that the monetary authorities in Sierra Leone have a limited array of financial instruments and the weak nature of the financial system, domestic debt management is not considered among the explanatory variables. The money supply model is therefore given as in equation (2.2):

$$\left.\begin{array}{c}\ln \mathrm{MS} = \alpha_0 + \alpha_1 \ln \mathrm{FDEF} + \alpha_2 \ln \mathrm{FR} + \alpha_3 \ln \mathrm{LOANP} + U_2, \\ \alpha_1, \alpha_3 > 0,\ \alpha_2 < 0,\end{array}\right\} \tag{2.2}$$

where MS is money supply, broadly defined. FR is foreign reserve,[2] a proxy for net external transactions, LOANP is loan to the private sector and U_2 is a disturbance term that is assumed to be identically and independently normally distributed.

The Price Level

The price level (P) of the economy of Sierra Leone is modelled as a weighted average of the prices of tradable goods (P^{T}) and non-tradable goods (P^{NT}). That is,

$$\ln P_t = \alpha(\ln P^{\mathrm{T}} t) + (1 - \alpha)(\ln P_t^{\mathrm{NT}}), \quad 0 < \alpha < 1. \tag{2.3}$$

The price of tradable goods is determined in the world market and depends on foreign price (P^{f}) and the nominal exchange rate (e). Hence, under the purchasing power parity (PPP), the following holds:

$$\ln P_t^{\mathrm{T}} = \ln e_t + \ln P_t^{\mathrm{f}} \tag{2.4}$$

The price of non-tradable goods depends on conditions in the money market. That is, the degree of disequilibrium in the money market. Increase in excess money supply increases the general price level. Hence,

$$\ln P_t^{\mathrm{NT}} = k(\ln M_t^{\mathrm{s}} - \ln M_t^{\mathrm{d}}), \tag{2.5}$$

where k is a scale factor representing the relationship between economy-wide demand and the demand for non-tradable goods.

[2] Foreign reserve, instead of net foreign assets which is equivalent to foreign assets minus foreign liabilities and can be negative, is used as a proxy for net external assets of the country enabling the equation to be estimated in logarithmic form. Moreover, the elasticity of foreign reserve with respect to the stock of money supply can be determined in this respect.

In line with the theories of money demand (for example, the Keynes demand for money, the Baoumol–Tobin model and Friedman's asset choice theory), the demand for money is an increasing function of real income (y) and a decreasing function of interest rate (i).

In linear form, the demand for money function is given as

$$\ln M_t^{\mathrm{d}} = \gamma_0 + \gamma_1 \ln Y_t + \gamma_2 \ln i_t, \quad \gamma_1 > 0,\ \gamma_1 < 0. \tag{2.6}$$

Substituting equation (2.6) in equation (2.5) implies that the price of non-tradable goods is given as

$$\ln P_t^{\mathrm{NT}} = \beta(\ln M_t^{\mathrm{s}} - \gamma_0 - \gamma_1 \ln Y_t - \gamma_2 \ln i_t) \tag{2.7}$$

By holding foreign price level constant on the basis that it is out of the control of the domestic economy, equation (2.3) therefore reveals that the price equation is a function of domestic money supply, output, nominal exchange rate and interest rate. We account for the role of the rebel war in the price formation process by introducing a war dummy (DWAR) in to the model. Thus, the price model is given as in equation (2.8). That is,

$$\left.\begin{aligned} \ln P_t = \lambda_0 + \lambda_1 \ln \mathrm{MS}_t + \lambda_2 \ln \mathrm{RGDP}_t + \lambda_3 \ln \mathrm{EXR}_t + \lambda_4 \ln i_t + U_2, \\ \gamma_1, \gamma_3, \gamma_4 > 0,\ \gamma_2 < 0, \end{aligned}\right\} \tag{2.8}$$

where MS is money supply, P is price level, RGDP is real GDP, EXR is nominal exchange rate and i is interest rate.

The Real Sector

The real sector consists of the primary sector, the secondary sector and the tertiary sector. The primary sector basically deals with the agricultural activities, the secondary sector deals with mining and quarrying as well as manufacturing while the tertiary sector deals with services. Modelling the real sector would therefore require setting up models for these subsectors over the estimation period. However, to the extent that the gross domestic product of the economy, measured from the output approach is identical to the measurement from the expenditure approach, the real sector of the economy is captured through the activities on the expenditure side of the economy. Moreover, along this line, there would not be need to estimate a big macroeconomic model but focus can be on a small macroeconomic model which is our interest here, unlike the use of the output approach. Hence, the output of the economy of Sierra Leone is given as in equation (2.9):

$$\mathrm{GDP} = \mathrm{CP} + \mathrm{CG} + I + X - M, \tag{2.9}$$

where Y is GDP, CP is private consumption, CG is government consumption, X is export and M is import. Equation (2.9) has aggregate investment, which is therefore disaggregated into private and public investment, and public consumption and public investment are aggregated to obtained government expenditure (G). Hence, equation (2.9) becomes:

$$\mathrm{GDP} = \mathrm{CP} + \mathrm{IP} + G + X - M. \tag{2.10}$$

Investment is a major driver towards economic expansion of an economy and every economy often pursues policies to get this gain. It is therefore expected that increase in investment increases the output of an economy through increase in the stock of capital. Hence, a private investment model and an output model are specified for the real sector of the economy.[3]

The private investment model is specified based on the Accelerator Principle, on the grounds that in the absence of a strong stock exchange market as in the case of Sierra Leone, the expected profitability of investment which is the driver of investment is determined by output changes. The model is augmented by accounting for the role of prices and interest rate as well as bank loan to the private sector to account for the effect of price level and various aspects of monetary policy (the financial market). The aspects of financial market captured here are the effect of interest rate on private investment and the effect of bank lending to the private sector on private investment. Interest rate captures the role of the rental price of capital while bank lending captures the role of credit availability.

The private investment model is therefore specified as in equation (2.11):[4]

$$\left.\begin{aligned} \left(\frac{\mathrm{IP}}{\mathrm{GDP}}\right)_t &= \beta_0 + \beta_1 \ln \mathrm{RGDP}_t + \beta_2 \ln \mathrm{LOANP}_t \\ &\qquad + \beta_3 \ln i_t + \beta_4 \ln P + \beta_5 \mathrm{trend} + U_3, \\ &\beta_1, \beta_2 > 0,\ \beta_3 \beta_4 < 0, \beta_5 > 0 \text{ or } \beta_5 < 0, \end{aligned}\right\} \tag{2.11}$$

where IP is private investment, RGDP is real GDP, LOANP is bank lending to the private sector, i is interest rate and P is the price level.

In spite of the fact that investment is an important variable under the real sector of an economy, the growth of real GDP is a more common measure of the performance or prospect of an economy. Hence, a model of real GDP is also developed under the real sector model. Real GDP is considered to depend on

[3] It would be interesting to estimate an aggregate investment equation but aggregate investment constitutes private and public investment. To the extent that the macroeconomic effects of fiscal deficit is part of the interest of the paper and increase in government investment increases government expenditure, which increases fiscal deficit, we considered the government's investment being part of its expenditure (G) and estimated only a private investment equation.

[4] Interest rate being the price of credit (loan) is expected to affect loan size, which may in turn affect private investment. However, it may be the size of credit (availability problem), the cost of credit (the use cost of capital), or both affect private investment. An empirical investigation matters here.

private investment, openness of the economy to trade and the terms of trade, which is used as an indicator of the effect of external factors on the output of Sierra Leone. A trend variable is included in the output model to capture the role of technology. Equation (2.12) shows the output model:

$$\left.\begin{aligned} \ln \mathrm{RGDP}_t = \delta_0 + \delta_1 \left(\frac{\mathrm{Ip}}{\mathrm{GDP}}\right)_t \delta_2 \ln \mathrm{OPEN}_t + \delta_3 \ln \mathrm{TOT}_t + \delta_4 \mathrm{trend} + U_4, \\ \delta_1, \delta_2, \delta_3 > 0,\ \delta_4 < 0 \text{ or } \delta_4 > 0. \end{aligned}\right\} \tag{2.12}$$

The External Sector

The external sector of Sierra Leone is captured through the trade balance. This is a simplistic way of capturing the external sector. But for a developing country like Sierra Leone, the capital account as well as trade in services does not provide much net inflow, compared to the trade in goods. This is why periods of huge trade deficits are often characterized by huge overall balance of payments deficit, except in cases where the capital and financial accounts increase through increased external debt or SDR allocation as in the case of the IMF SDR allocation of 2009.

The trade balance is modelled along traditional grounds, where the trade balance is a function of income and the exchange rate. The independent effect of increased domestic prices on the trade balance, through changes in import and export, is accounted for by incorporating the price level into the model of trade balance. The openness of the economy to international trade is also accounted for in the trade balance model of Sierra Leone. Equation (2.13) shows the trade balance model:

$$\left.\begin{aligned} \left(\frac{\mathrm{TB}}{\mathrm{GDP}}\right)_t = \xi_0 + \xi_1 \ln \mathrm{RGDP}_t + \xi_2 \ln \mathrm{EXR}_t + \xi_3 \ln P_t + \xi_4 \ln \mathrm{OPEN}_t + U_5, \\ \xi_1, \xi_3 < 0,\ \xi_2 > 0 \text{ and } \xi_4 > 0 \text{ or } \xi_4 < 0, \end{aligned}\right\} \tag{2.13}$$

where $(\mathrm{TB} / \mathrm{GDP})$ is trade balance as percentage of GDP, and the other variables are defined as earlier.

2.3.2 Estimation Technique

To the extent that, when variables are not stationary, regression using them leads to spurious regression we obtained the estimated stochastic equations by first of all testing the variables for stationarity. That is because a situation where the variables are related as a result of the existence of common trend but not a reality leads to misleading inferences. The Dickey–Fuller class of tests and the Phillips–Perron test were used in the stationarity (unit root) tests. While the former assumes that the disturbance term from the auxiliary regression are identically and independently distributed, the latter makes no assumption about this. Following the tests for stationarity were tests for cointegration, which was necessary given the results of the stationarity tests. Variables are cointegrated when they are individually non-stationary and a linear combination of them is stationary. The existence of cointegration among variables means that the variables are related in the long run. The cointegration tests were carried out using the Johansen Maximum Likelihood Procedure, as this method does not make any assumption about which variable is endogenous and it also reveals the relevant long-run relationship, through a cointegrating vector. Moreover, we are interested in the long-term relationships among the variables in each stochastic equation. The relevant coefficient are given by this test.

The estimation of the long-run coefficient in the Johansen context starts with the estimation of vector autoregression (VAR). Since our interest is to obtain the long-run dynamics of the endogenous variables, a war dummy which captures the impact of the decade old war, is not introduced in the model specifications for the endogenous variables. However, we introduced this dummy in each of the systems of equations in the VAR underlying the Johansen tests. But because of the numerous equations a VAR result comes out with we did not report the VAR results in the empirical section of this paper. Tests for the optimal lag length of a VAR can be done, however, to save the degrees of freedom a lag length of one was adopted for the VAR.

In a macroeconomic model, the effect of a policy variable on a target has both direct and indirect effects. Hence the ultimate or total effect of a change in an exogenous variable, on endogenous variables in a system of equation is not determined by the signs and significance of the estimated parameters. Thus, policy simulation following the estimation of the underlying macroeconomic model is more appropriate in determining the impact of exogenous variables on endogenous variables in a system. This captures both direct and indirect effects and also gives the dynamic impact of a variable on endogenous variables. We therefore applied the technique of policy simulation following the estimation of the equations from the various sectors of the economy and this was preceded by a validation of the estimated model. The simulation experiments were done by solving the estimated model under different scenarios.

2.3.3 Data Description and Sources

The data for the study is annual and was from International Financial Statistics, African Development Indicators and Statistics Sierra Leone, over the period 1971 to 2009. Table 2.3 presents the data description and sources.

2.4 Empirical Results

In this section we discuss the time series properties of the variables (unit root and cointegration), results of the estimated model, validation of the model and policy simulations.

TABLE 2.3. Data sources and description.

Variable	Symbol	Description	Source
Budget deficit	FDEF	Total government expenditure minus total government revenue	International Financial Statistics CD-ROM
Money supply	MS	Broad money supply, that is, narrow money supply plus quasi money	International Financial Statistics CD-ROM
Foreign reserve	FR	Foreign Reserve, excluding gold	International Financial Statistics CD-ROM
Bank lending to the private sector	LOANP	Net claims on the private sector by the banking system	Financial Statistics CD-ROM
Price level	P	Consumer Price Index with 2000 as the base year	International Financial Statistics CD-ROM
Nominal GDP	GDP	Domestic product at current price	International Financial Statistics CD-ROM
Real GDP	RGDP	Gross domestic product at constant prices	African Development Indicators
Nominal exchange rate	EXR	Average of the price of one US dollar in leones	International Financial Statistics CD-ROM

Results of the Unit Root Tests

Table 2.4 and Table 2.5 present the results of the unit root tests. The results of the test show that all but one of the variables are not stationary in level but are stationary after first differencing. Terms of trade is stationary according to both the Dickey–Fuller test and the Phillips–Perron tests statistics.

Tests for Cointegration

Tests for cointegration were carried out following the tests for unit root. The tests for cointegration were necessary given the fact that the variables were found to have unit root and are stationary only after first differencing. Cointegration test is carried out in order to determine whether variables have a long-run relationship. Table 2.6 shows the result of the cointegration tests. The results show that there is cointegration among the right-hand-side variable in each of the specified equation and the left-hand side variables. At the 1% level, with the

TABLE 2.3. Continued.

Variable	Symbol	Description	Source
Interest rate	i	Treasury bill rate	International Financial Statistics CD-ROM
Private investment	IP	Calculated as the difference between gross domestic investment and public investment	Statistics Sierra Leone
Openness	OPEN	Calculated as the sum of export and import, scaled by GDP	Calculated by author from International Financial Statistics CD-ROM
Terms of trade	TOT	Calculated as the ratio price of export to price of import (with $2000 = 100$)	Calculated by author from African Development Indicators
Trade balance	TB	Aggregate export minus aggregate import	International Financial Statistics CD-ROM

exception of the trade balance model for which there is a multiple cointegrating vector (three cointegrating vectors), there is a single cointegrating vector in each the sectors. However, to the extent that our interest is to obtain the parameters of the long-run equations of the variables whose equations have been specified, we consider only the first cointegrating vector from the trade balance model as our interest is in the first vectors given the ordering of the variables in the VAR models.

Results of the Long-Run Models

The long-run models were obtained from the cointegrating vectors. Tables 2.7–2.11 show the long-run results of the specified equations of the small macroeconomic model.

The money supply equation. The money supply equation shows that budget deficit and loan to the private sector by the banking system have positive effects on money supply in Sierra Leone while foreign reserve, which is the proxy for net external transactions, has a negative effect on money supply. All the variables are significant at the 1% level. The elasticities show that money supply in Sierra Leone is more responsive to loan to the private sector than budget deficit and foreign reserves. The money supply elasticities for loan to the private

TABLE 2.4. Results of the tests for stationarity: using Dickey–Fuller and augmented Dickey–Fuller tests.

Variable		Dickey–Fuller test statistic		Augmented Dickey–Fuller test statistic				
				One-lag model		Two-lag model		
		With drift	Drift and trend	With drift	Drift and trend	With drift	Drift and trend	Conclusion
ln BDEF	Level	0.549	−2.807	−1.343	−1.685	−1.278	−1.561	$I(1)$
	Δ level	−7.911***	−9.051***	−5.049***	−5.168***	−4.966***	−5.199***	
ln EXR	Level	−0.406	−1.622	−1.003	−1.439	−0.970	−1.238	$I(1)$
	Δ level	−2.765***	−2.939*	−3.856**	−3.358*	−3.856**	−3.295*	
ln FR	Level	−0.429	−1.145	−0.178	−1.199	−0.467	−1.486	$I(1)$
	Δ level	−6.093***	−6.637***	−3.629***	−4.252***	−2.972**	−3.772**	
ln I	Level	−1.669	−1.761	−2.322	−2.262	−2.118	−2.037	$I(1)$
	Δ level	−4.834***	−4.840***	−4.165***	−4.133**	−3.585**	−3.575**	
ln IPGDP	Level	−1.244	−1.126	−1.229	−0.660	−1.228	−0.554	$I(1)$
	Δ level	−9.381***	−9.618***	−4.848***	−5.058***	−3.401**	−3.247*	
ln LOANP	Level	0.256	−1.847	0.059	−1.982	−0.070	−2.601	$I(1)$
	Δ level	−4.241***	−4.428***	−3.231**	−3.219*	−3.268**	−3.258*	

TABLE 2.4. Continued.

Variable		Dickey–Fuller test statistic: With drift	Dickey–Fuller test statistic: Drift and trend	Augmented Dickey–Fuller test statistic, One-lag model: With drift	Augmented Dickey–Fuller test statistic, One-lag model: Drift and trend	Augmented Dickey–Fuller test statistic, Two-lag model: With drift	Augmented Dickey–Fuller test statistic, Two-lag model: Drift and trend	Conclusion
ln MS	Level	−0.318	−1.609	−0.653	−1.503	−0.754	−2.082	$I(1)$
	Δ level	−3.044***	−3.184*	−3.141**	−2.128	−3.002**	−1.999	
ln OPEN	Level	−2.681	−2.887	−2.162	−2.169	−2.464	−2.408	$I(1)$
	Δ level	−7.949***	−7.967***	−4.467***	−4.441***	−4.802***	−4.878***	
ln TOT	Level	−3.438***	−5.142***	−4.402***	−4.994***	−2.919*	−3.577**	$I(0)$
ln P	Level	−0.435	−5.519	−1.201	−1.204	−1.434	−1.496	$I(1)$
	Δ level	−2.368**	−2.555	−2.991**	−2.155	−2.922**	−2.735	
ln RGDP	Level	−0.069	−0.819	−0.819	−1.019	−1.503	−1.629	$I(1)$
	Δ level	−4.534***	−4.649***	−2.702*	−2.799	−2.748*	−2.357	
TBG	Level	−2.169	−2.433	−2.133	−2.053	−2.272	−2.294	$I(1)$
	Δ level	−6.912***	−7.206***	−4.074***	−4.025**	−4.069***	−3.949**	

Critical values are as follows. Auxiliary regression with drift: 1%, −3.6394; 2%, −2.9511. Auxiliary regression with drift and trend: 1%, −4.2436; 2%, −3.5443. Note: ***, ** and * indicate that the variable is stationary at the 1%, 5% and 10% levels of significance, respectively.

TABLE 2.5. Results of the tests for stationarity using the Phillips–Perron test.

Variable		Phillips–Perron test statistic: With drift	Phillips–Perron test statistic: Drift and trend	Conclusion
ln BDEF	Level	−2.395	−2.659	$I(1)$
	Δ level	−9.922***	−15.944***	
ln EXR	Level	−0.604	−1.414	$I(1)$
	Δ level	−2.890**	−2.822*	
ln FR	Level	−0.303	−1.130	$I(1)$
	Δ level	−6.144***	−6.732***	
ln I	Level	−2.000	−1.937	$I(1)$
	Δ level	−4.629***	−4.549***	
ln IPGDP	Level	−2.017	−1.853	$I(1)$
	Δ level	−9.198***	−9.458***	
ln LOANP	Level	0.183	−2.061	$I(1)$
	Δ level	−4.489***	−4.464***	
ln MS	Level	−0.339	−1.554	$I(1)$
	Δ level	−3.087**	−3.051	
ln OPEN	Level	−2.691	−2.829	$I(1)$
	Δ level	−10.147***	−11.193***	
ln TOT	Level	−3.169**	−3.416*	$I(0)$
ln P	Level	−0.757	−1.061	$I(1)$
	Δ level	−2.939*	−2.645	
ln RGDP	Level	−0.963	−1.096	$I(1)$
	Δ level	−4.591***	−4.646***	
TBG	Level	−2.342	−2.373	$I(1)$
	Δ level	−7.240***	−7.179***	

Note: ***, ** and * indicate that the variable is stationary at the 1%, 5% and 10% levels of significance, respectively.

sector, budget deficit and foreign reserves are 0.88, 0.32 and −0.64, respectively. Table 2.7 shows the result of the money supply model.

The price equation. The price equation shows that money supply and nominal exchange rate have positive and significant effects on the price level in Sierra Leone. Interest rate has a negative but insignificant effect while real income has a negative significant effect. All significant variables are at the 1% level. Moreover, the output elasticity of price is higher than the money supply, interest and exchange rate elasticities. The positive effect of money supply implies that changes in the price level of Sierra Leone are not unconnected to expansion of monetary supply. The positive effect of exchange rate implies that exchange rate pass through effect to domestic prices prevails in Sierra Leone. However, the monetary phenomenon and exchange rate pass through effects observed

TABLE 2.6. Results of the cointegration tests.

Eigenvalue	Likelihood ratio	5% critical value	1% critical value	Hypothesized no. of CE(s)
Money supply model				
0.632975	64.50746	47.21	54.46	None**
0.394840	28.42373	29.68	35.65	At most 1
0.226581	10.34230	15.41	20.04	At most 2
0.029895	1.092644	3.76	6.65	At most 3
Inflation model				
0.680583	95.22010	68.52	76.07	None**
0.495535	52.99351	47.21	54.46	At most 1*
0.358683	27.67597	29.68	35.65	At most 2
0.258197	11.23940	15.41	20.04	At most 3
0.005083	0.188532	3.76	6.65	At most 4
Private investment model				
0.715448	115.9761	87.31	96.58	None**
0.577987	69.47310	62.99	70.05	At most 1*
0.426945	37.55253	42.44	48.45	At most 2
0.307420	16.95191	25.32	30.45	At most 3
0.086825	3.360630	12.25	16.26	At most 4
Output model (lags interval: 1 to 1)				
0.646979	63.89377	47.21	54.46	None**
0.346617	25.36833	29.68	35.65	At most 1
0.207467	9.621439	15.41	20.04	At most 2
0.027143	1.018155	3.76	6.65	At most 3
Trade balance model				
0.616440	101.4158	68.52	76.07	None**
0.541822	65.96019	47.21	54.46	At most 1**
0.460568	37.08179	29.68	35.65	At most 2 **
0.317628	14.24398	15.41	20.04	At most 3
0.002788	0.103284	3.76	6.65	At most 4

TABLE 2.7. Results of the long-run money supply model.

ln MS	ln BDEF	ln FR	ln LOANP	C
	0.3188	−0.6354	0.8850	1.8151
—	(2.9541)	(−2.6026)	(5.3934)	

Values in parentheses are t-values.

from the Sierra Leonean data are not one-for-one. The elasticities for monetary phenomenon and exchange rate pass through are 0.47 and 0.65, respectively. The elasticity for output is 0.84. The price equation shows that structural factors have the largest effect on domestic price level in Sierra Leone. This is reflected

TABLE 2.8. Result of the long-run inflation model.

$\ln P$	$\ln$ RGDP	$\ln$ MS	$\ln$ EXR	$\ln i$	Constant
—	−0.8373 (−3.3510)	0.4666 (5.8116)	0.6519 (7.9416)	−0.0396 (−0.5357)	11.3078

Values in parentheses are t-values.

TABLE 2.9. Result of the long-run private investment model.

(I/GDP)	$\ln$ RGDP	$\ln$ LOANP	$\ln i$	$\ln P$	Trend	Constant
—	5.3898 (2.4736)	4.5501 (4.4068)	−2.2360 (−3.0303)	−2.4793 (−3.4769)	−0.5871 (−2.7497)	−121.1154

Values in parentheses are t-values.

in the magnitude of the elasticity of output, relative to those of the other explanatory variables. Table 2.8 shows the results of the price equation.

The private investment equation. The private investment equation shows that output and loan to the private sector have positive effects on private investment in Sierra Leone while price level has a negative effect. The positive effect of loan to the private sector on private investment suggests the importance of credit in building private investment in Sierra Leone. The negative effect of price level on private investment in Sierra Leone suggests that inflationary conditions are inimical to private investment in Sierra Leone and the significance of output in the private investment model reveals that the accelerator principle does hold in Sierra Leone. We estimated private investment as a percentage of nominal GDP, without log. Hence, the coefficients cannot be interpreted as elasticities. The response of private investment to real GDP is the highest in the model and this is followed by loan to the private sector.

The lowest response, though negative, is from interest rate. All the variables are significant at the 1% level. Table 2.9 presents the results of the private investment model.

The output equation. Table 2.10 shows the result of the output model. The output model shows that the determinants of income are private investment and terms of trade since openness to trade is insignificant though it had the right sign. These two variables may seem to be small in number as determinants of output. However, our interest here is a macroeconomic model. Hence, we focus on macroeconomic determinants and these determinants themselves are interrelated. All the variables that are significant are at the 1% level. The trend variable is also significant at the 1% level. All the variables have positive effects on real income. These results suggests that trade liberalization measures are not significant in the income determination process of Sierra Leone though they have positive effects on output. This does not however suggest that it has

TABLE 2.10. Result of the long-run output model.

ln RGDP	(I/GDP)	ln OPEN	ln TOT	Trend	C
—	0.1316 (5.4656)	0.0559 (0.5628)	0.9592 (4.2021)	0.0083 (2.7471)	14.9968

Values in parentheses are t-values.

TABLE 2.11. Result of the long-run trade balance model.

(TB/GDP)	ln RGDP	ln EXR	lnP	ln OPEN	C
—	15.75469 (2.1073)	23.07852 (5.9558)	−21.66430 (−6.0042)	−6.723256 (−1.0745)	−390.2393

Values in parentheses are t-values.

no impact on the external sector. The positive and significant effect of terms of trade implies that favourable external sector in terms of price of export relative to import is important to increasing output in Sierra Leone. The coefficient of the trend variable shows that over the estimation period, GDP growth was positive but was less than 1% on average (about 0.8%). This slow growth is not in contrast with the reality in Sierra Leone, over the period 1971 to 2009 given the history of poor macroeconomic performance, especially in the 1980s and the 1990s (the war period). With this slow growth, which the coefficient implies, suggests also that catching up with the developed economies is not taking place in Sierra Leone, which could be due to low level of education and low level of innovative activity.

The trade balance equation. The model of trade balance shows that income and exchange rate have positive effects on the trade balance while the price level and openness of the economy to international trade have negative effects on the trade balance. Apart from openness to trade, all the variables are significant at the 1% level. Openness to trade is not significant in the trade balance model. The negative effect of openness on the trade balance implies that as the economy opens to trade, import increases more than export does and this deteriorates the trade balance though it may have a positive implication for revenue from international trade taxes. The negative effect of prices on the trade balance implies that as the price level increases, the real exchange rate appreciates and the trade balance deteriorates. The positive effect of the nominal exchange rate implies that as the nominal exchange rate depreciates its depreciating effect on the real exchange rate improves the trade balance. The positive effect of income on the trade balance of Sierra Leone implies that development in the real sector of Sierra Leone has a virtuous effect on the external sector of the economy. Table 2.11 shows the result of the trade balance model.

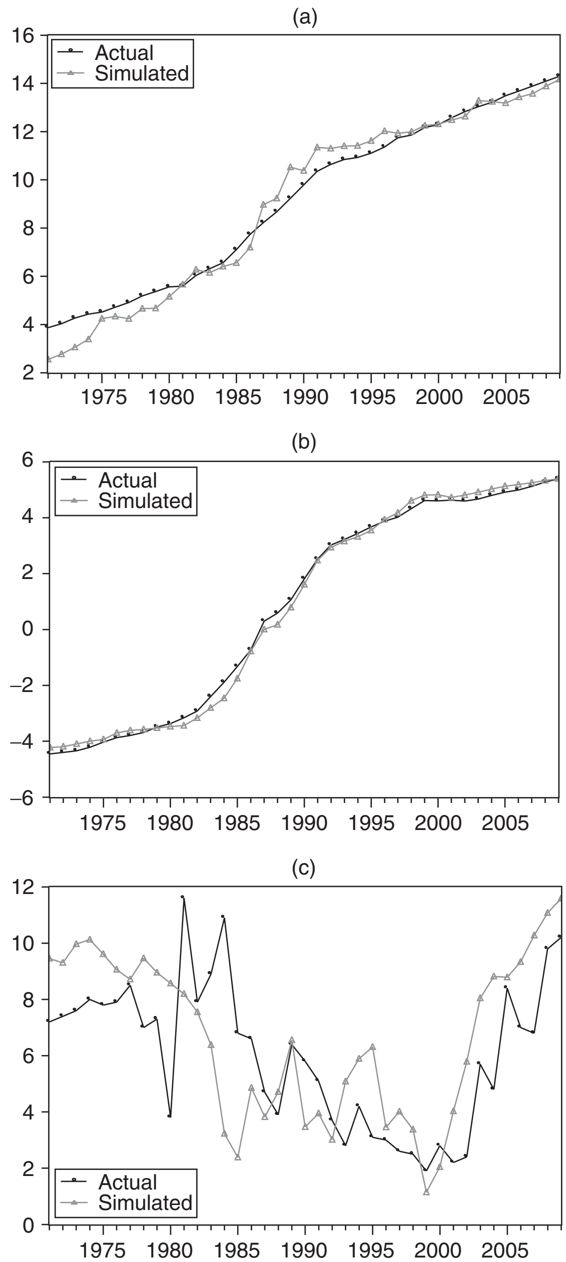


FIGURE 2.1. Graphs of actual and simulated values of some endogenous variables. (a) Money supply. (b) Price level. (c) Private investment.

2.4.1 Validation of the Macroeconomic Model

The R^2 values of are important in measuring the robustness of a model where the model is estimated using the ordinary least squares but when the ordinary

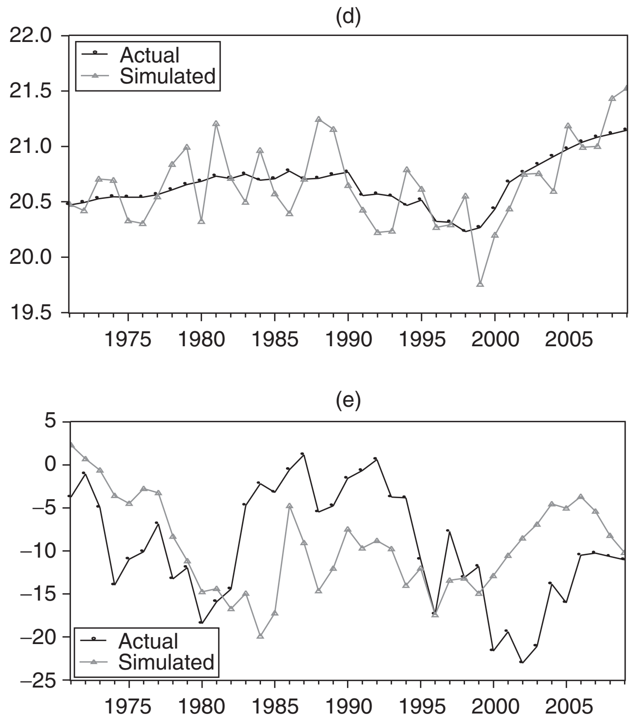


FIGURE 2.1. Continued. (d) Real GDP. (e) Trade balance.

least squares is not used, as in this case where we have used the long-run coefficients from the Johansen Maximum Likelihood procedure, the R^2 ceases to serve this function. For one thing, the cointegrating vectors do not come with R^2 values. Moreover for a macroeconomic model, the value is not in the R^2 but in the ability of the model to forecast values that are close to the historical values of the individual series and the tracking of turning points of the historical series. We therefore carried out historical simulation for this purpose. This approach involves an examination of the graphs of actual and in-sample simulated series of each variable. Figure 2.1 shows the graphs of actual and simulated series. It shows that the paths of the actual and simulated series are close and the turning points of the actual series are often tracked by the simulated series.

It is important to note however that interest rate is not significant in the price equation and openness to trade is not significant in the output and trade balance models. However, since our emphasis is on building and solving a macroeconomic model under various policy scenarios but not a mere reliance on the coefficients of the variables in the model, maintaining these variables in the macroeconomic model does not detract from the relevant conclusion. We therefore maintained these variables, as in the case of some other macroeconomic models (see, for example, Olofin 1986; Iyoha 2004).

2.4.2 Policy Simulations

Counterfactual policy simulations were carried out in order to determine the effects of various macroeconomic policies (monetary and fiscal) on the price level, income and the trade balance of Sierra Leone. Counterfactual policy simulations deal with the question of what would have happened to a macroeconomic variable if a particular policy had been implemented earlier. The period 2002 to 2009 is taken as the simulation period on the grounds that this was the year when the rebel war officially ended and the authorities might have found it difficult to follow a particular stabilization policy in the war period. Moreover, we want the simulation period not to be very far from the period for which the authorities still have to plan for, in terms of policy making. The simulation experiments were carried out for budget deficit, loans to the private sector and money supply. We have referred to them here as simulation experiments I, II and III, respectively.

Simulation experiment I. In this experiment, budget deficit as a ratio of GDP was set at 4% from 2002 to 2009. The basis of this quantitative value is the ECOWAS Monetary Cooperation Programme, which requires member countries to carry fiscal operations such that the budget deficit (excluding grant) as a ratio of GDP is 4%. We asked the question what would have happened to money supply, price level, private investment, real GDP and the trade balance if this policy had been achieved and maintained since 2002. The result of this simulation experiment is shown in Table 2.12 and Figure 2.2. A negative value in Table 2.12 implies a decrease in the endogenous variable and a positive value implies an increase in the endogenous variable. The result shows that money supply and the price level would have reduced while private investment, real GDP and the trade balance would have increased. In terms of its relative impact over the period 2002 to 2009, the price level would have had the highest impact (a reduction of about 7.6% of the baseline), followed by trade balance and private investment (an increase of about 6.5% and 6.2%, respectively, of the baseline) while money supply and real GDP would have had the least impact, with 2.4% and 4.2% of the baseline, respectively.

Simulation experiment II. The second simulation experiment was for loaning to the private sector. The conventional reason for encouraging lending to the private sector is to boost private investment and economic growth. The historical series shows that the highest value of a loan to the private sector in terms of GDP was in 1981 with a value of 7.4% of GDP, and in that year private investment (as a percentage of GDP) had the highest value in the historical series from 1971 to 2009, a value of 11.6% of GDP. We therefore asked the question: what would have happened to key macroeconomic variables if bank lending to the private sector had been 7.4% of GDP from 2002 to 2009? The result of the simulation experiments are shown in Table 2.13 and Figure 2.3.

The result shows that maintaining bank lending to the private sector to 7.4% of GDP from 2002 to 2009 would have increased money supply by 3.5%, price

TABLE 2.12. The macroeconomic effects of maintaining fiscal deficit at 4% of GDP from 2002 to 2009.

Year	Money supply	Price level	Private investment	Real GDP	Trade balance
2002	−3.58	−9.38	7.94	5.50	8.20
2003	−2.89	−12.98	10.07	6.11	10.58
2004	−2.52	−9.76	7.76	4.93	8.11
2005	−2.27	−7.16	5.88	3.95	6.11
2006	−2.29	−7.56	6.15	4.11	6.41
2007	−1.48	−4.04	3.36	2.37	3.50
2008	−1.99	−4.83	4.07	2.97	4.24
2009	−2.36	−5.23	4.44	3.34	4.63
2002–9	−2.42	−7.62	6.21	4.16	6.47

Note: the figures are in percentage deviations from the baseline. A positive figure indicates an increase and a negative figure indicates a decrease.

TABLE 2.13. The macroeconomic effects of maintaining loan to the private sector at 7.4% of GDP from 2002 to 2009.

Year	Money supply	Price level	Private investment	Real GDP	Trade balance
2002	7.40	19.38	56.51	39.14	55.67
2003	4.21	18.89	50.47	30.61	50.62
2004	3.17	12.27	33.58	21.33	33.51
2005	3.21	10.14	28.64	19.24	28.43
2006	4.37	14.42	40.39	26.99	40.14
2007	3.28	8.97	25.70	18.13	25.53
2008	1.80	4.38	12.68	9.27	12.60
2009	0.39	0.86	2.52	1.89	2.50
2002–9	3.48	11.16	31.31	20.82	31.12

level by 11.2%, private investment by 31.3%, real GDP by 20.8% compared to their baseline scenarios while the trade balance would have worsened by 31.1%, compared to the baseline scenario. Hence, this policy option almost has the same impact on private investment and trade balance and these are where it has the strongest impact, followed by real GDP. Its impact on money supply is the least significant.

Simulation experiment III. The third simulation experiment is for money supply growth. The growth of money supply over the period 1971 to 1973 is used here for the quantitative test. The basis of this is that during this period, Sierra Leone recorded single-digit inflation, with the highest being 5.62% (in 1973), single digit for the trade deficit as a percentage of GDP (the trade balance ranging from −1.1% to −5.0%) and positive annual GDP growth (ranging from 2.3% to 3.5%). Broad money grew by an average of 18.2% over this period.

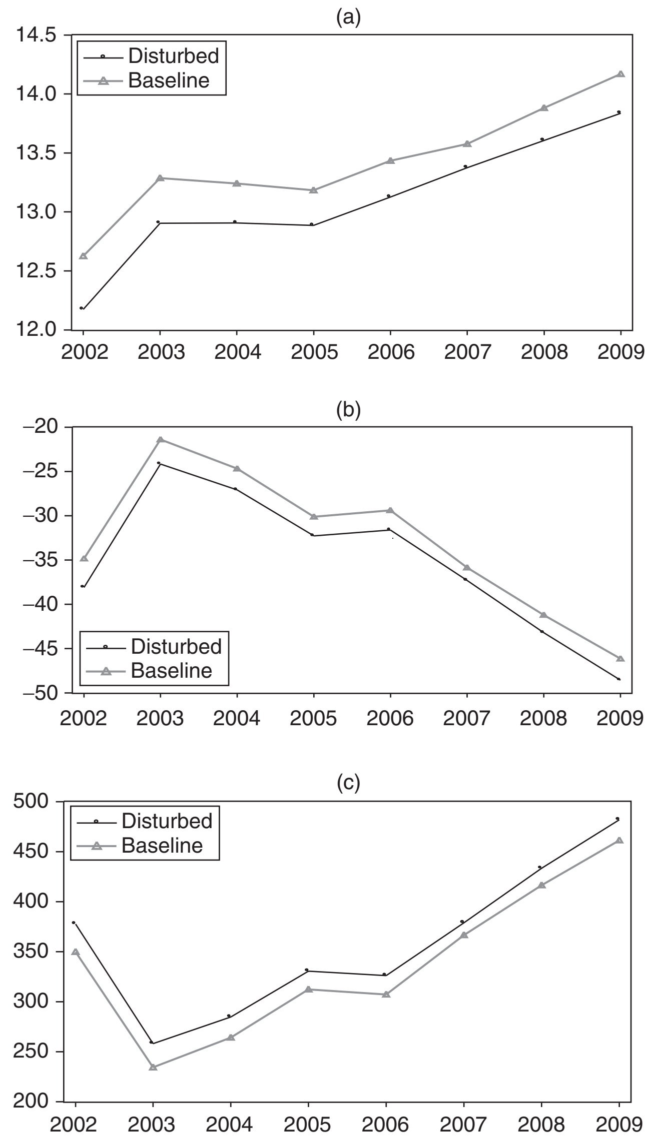
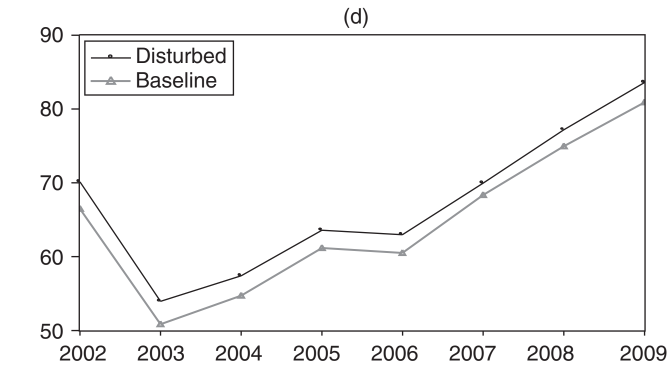


FIGURE 2.2. The macroeconomic effects of maintaining fiscal deficit at 4% of GDP from 2002 to 2009. (a) Money supply. (b) Price level. (c) Private investment.

Comparing this to what actually happened over the period 2002 to 2009, money supply growth, inflation rate and trade deficit were lower than in the period 2002 to 2009 and GDP growth in the latter period was higher than the former. In the period 2002 to 2009, average money supply growth was 24.2% (with a minimum of 21.5%, in 2006), inflation rate was 10.18%, trade balance as a percentage of GDP was −14.56% and real GDP growth was 6.5%. We therefore asked the question: what would have happened if money supply growth over



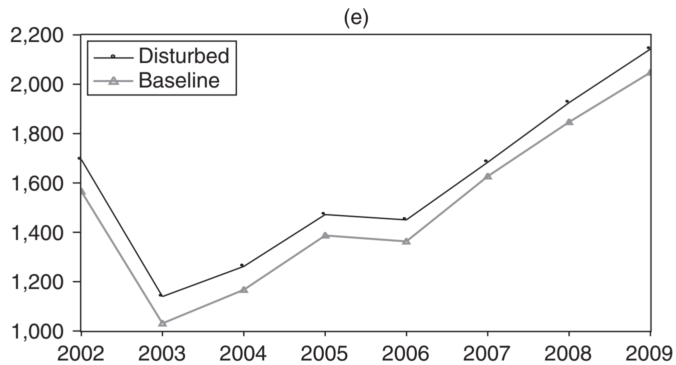


FIGURE 2.2. Continued. (d) Real GDP. (e) Trade balance.

the period 2002 to 2009 had been the same as its average growth over the period 1971 to 1973? Such a policy can be likened to a monetary policy rule that targets monetary aggregate such that there is a ceiling on the growth of money supply to the size of 18.2%. The conduct of open market operations is then done within this framework. The effect of this is traced on the price level, income and the trade balance of the economy. In this scenario, the model is solved without the money supply equation as money supply growth is given explicitly. Table 2.14 and Figure 2.4 give the results of this experiment.

The results show that if money supply growth had been kept at 18.2% from 2002 to 2009, the price level would have reduced by −1.3% of the baseline, private investment would have increased by 1.00% of the baseline, real GDP would have increased by 0.62% of the baseline and the trade balance would have improved by 1.06% of the baseline.

Comparing the policy simulation results. A comparison of the simulation results reveals that in terms of price stability, the quantitative impact of a fiscal policy rule with deficit being 4% of GDP is stronger than a monetary policy rule with growth of broad money supply being 18.2%. While both policies reduce the price level, the price impact of the former is about 6.5 percentage points

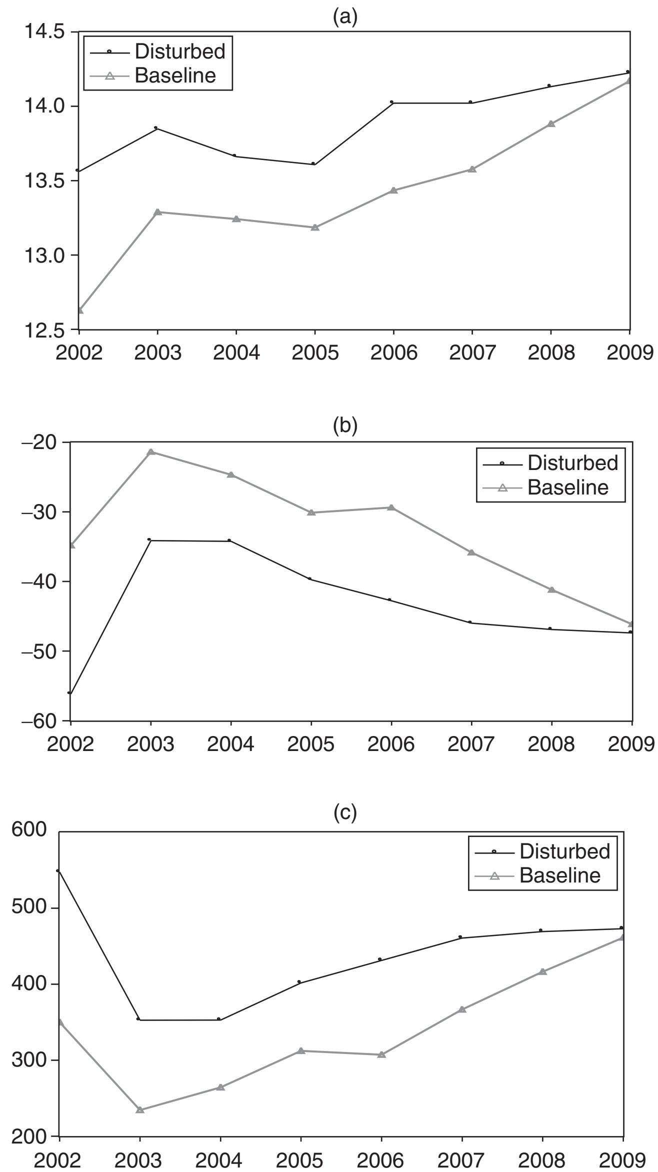


FIGURE 2.3. The macroeconomic effects of maintaining loan to the private sector at 7.4% of GDP from 2002 to 2009. (a) Money supply. (b) Price level. (c) Private investment.

stronger than the latter. While these two policies have disinflationary effects, the policy with increased loan to the private sector has an inflationary effect.

In terms of impact on the real and external sectors, all of the three policies in the simulation experiments have the same qualitative impact, in the sense that they increase private investment, real GDP and the trade balance. However,

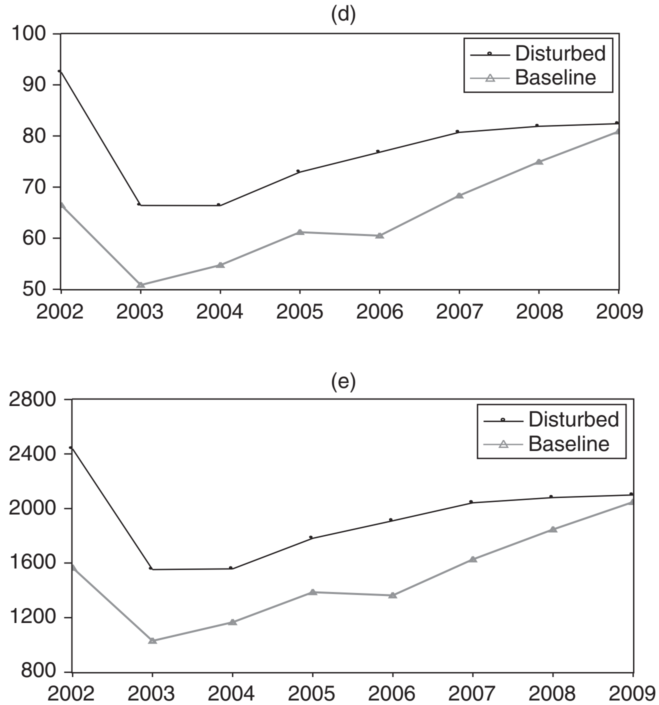


FIGURE 2.3. Continued. (d) Real GDP. (e) Trade balance.

TABLE 2.14. The macroeconomic effects of maintaining money supply growth at 18.2% from 2002 to 2009.

Year	Price level	Private investment	Real GDP	Trade balance
2002	0.54	−0.45	−0.31	−0.47
2003	−16.71	12.96	7.86	13.63
2004	6.26	−4.97	−3.16	−5.20
2005	5.37	−4.40	−2.96	−4.58
2006	−2.02	1.64	1.10	1.71
2007	0.50	−0.42	−0.29	−0.43
2008	−2.42	2.04	1.49	2.12
2009	−1.90	1.61	1.21	1.68
2002–9	−1.30	1.00	0.62	1.06

Note: figures are in percentage deviations from the baseline. A positive figure indicates an increase and a negative figure indicates a decrease.

the impact of loan to the private sector (kept at 7.4% of GDP) on all the three variables (private investment, real GDP and the trade balance) is the strongest. The simulation with a monetary policy rule has the least impact on private investment, real GDP and the trade balance.

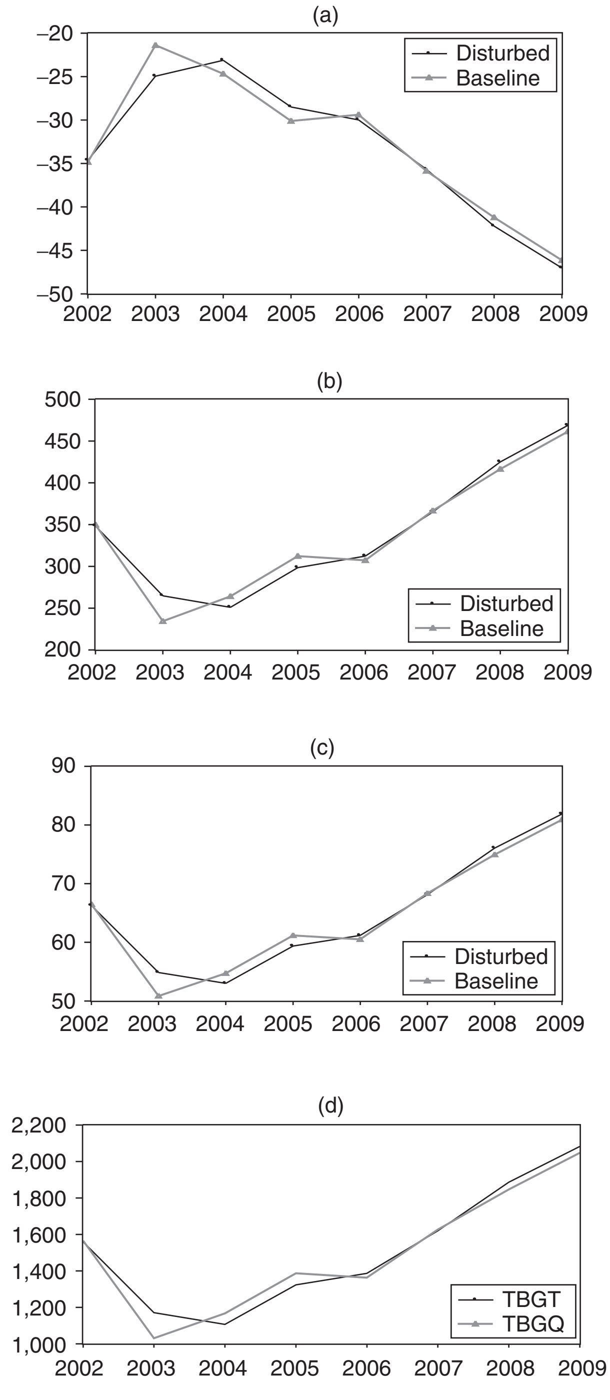


FIGURE 2.4. The macroeconomic effects of maintaining the growth of money supply at 18.2% from 2002 to 2009. (a) Price level. (b) Private investment. (c) Real GDP. (d) Trade balance.

2.5 Conclusion and Recommendations

2.5.1 Conclusion

The conduct of fiscal and monetary policies has not been without challenges in Sierra Leone. The fiscal profile has been characterized by budget deficits and the coordination of the fiscal authority and the monetary authorities whereby monetary accommodation of the deficit has been more of the norm than the exception. While the early to mid 1970s was relatively stable, the 1980s and 1990s were very challenging. The economy experienced high inflation rates and low growth of GDP, which was negative in some periods. The external sector did not also escape this abysmal scenario. In the early 2000s, the country's performance on inflation was relatively satisfactory as single digit was the case but double digit is the common case in recent times. While real GDP growth has been better since the 2000s than the 1980s through the 1990s, external sector performance, measured in terms of the trade balance, in the 2000s compares unfavourably with the 1980s and the 1990s. The objective of this chapter has therefore been to investigate the role of fiscal and monetary policies in attaining low inflation, economic growth and favourable external sector. This is done with a view to providing guiding principles in the conduct of fiscal and monetary policies in Sierra Leone.

The methodology involved the estimation of a small macroeconomic model with aggregate annual data from 1971 to 2009, which comprises equations for money supply, price, private investment, real GDP and the trade balance. In the spirit of policy simulations, the estimated model was solved under different policy scenarios related to fiscal and monetary policies in the counterfactual sense from 2002 to 2009. The results of the simulation experiments show that increased bank lending to the private sector increases private investment, real GDP and the trade balance. It is associated with costs in terms of increased prices through its expansionary impact on money supply.

The result also reveals that maintaining budget deficit (excluding grant) at 4% of GDP reduces money supply and the price level, increases private investment and real GDP and improves the trade balance. Another outcome of the simulation exercise is that maintaining the growth of broad money at 18.2% has the same qualitative impact on the price level, output and trade balance of Sierra Leone with a policy of having budget deficit maintained at 4%. However, in quantitative terms, maintaining budget deficit at 4% of GDP has a stronger impact on the price level, output and trade balance of Sierra Leone than maintaining broad money growth at 18.2%, implying that the monetary growth associated with this fiscal rule is lower than a money growth of 18.2%.

2.5.2 Recommendations

Based on the results of the study, the following recommendations are useful.

To the extent that the underlying broad money supply growth consistent with a fiscal rule with budget deficit excluding grant (percentage of GDP) being 4%

is lower than 18.2% and the fiscal policy rule has a stronger impact on the price level it is important that the monetary authorities consider an option of having a monetary policy rule which would have broad money supply growth below 18.2% when price stability becomes the key interest to the development agenda of policymakers.

To the extent that bank lending to the private sector being 7.4% of GDP enhances private investment, real GDP and the external sector, though it has monetary expansion and rising price implications, it is important for policymakers to consider policies which can prioritize banking lending to the private sector where boosting the real sector and the external sector are the priorities of policymakers. This therefore requires improving the financial environment for bank lending to be encouraged given that information asymmetry problems discourages bank lending. It is therefore important that the operation of the Credit Reference Bureau and the Commercial Court, which has recently been set up to mitigate credit risk, be expedited.

The development of the financial environment whereby bank lending is increased should be accompanied by strong fiscal consolidation as bank lending to the private sector has strong implications for rising prices, through its expansionary impact on money supply while low fiscal deficit thwarts monetary expansion and rising price level.

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Chapter 3

FINANCIAL SECTOR REFORM AND DEVELOPMENT IN SIERRA LEONE

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3.1 Introduction

Financial instruments, firms, and markets influence saving rates, investment decisions, technological innovations, and long-run economic growth rates. From a functional perspective, financial systems perform five basic functions which have been highlighted in the finance and growth literature (see, for example, Levine 1997). Namely, they

1. facilitate the trading, hedging, diversifying, and pooling of risk,
2. allocate financial resources among competing users,
3. monitor managers and exert corporate control,
4. mobilize savings in all the geographical areas they serve,
5. facilitate the exchange of goods and services.

The performance of these functions then affects economic growth by increasing the incentives for capital accumulation and technological innovation. In their day-to-day activities the firms and individuals in financial systems can be observed advising clients, structuring and arranging deals, providing finance to borrowers and equity issuers, and managing funds and investments of individuals and so-called institutional clients.

The available evidence indicates that countries with larger banks and more active stock markets grow faster over subsequent decades even after controlling for many other factors underlying economic growth. Industries and firms that rely heavily on external financing grow disproportionately faster in countries

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with well-developed banks and securities markets than in countries with poorly developed financial systems (see Levine 1997; Demirgüç-Kunt and Levine 2008). There is some element of reverse causation as well. In other words, economic activity and technological innovation affect the structure and quality of financial systems. Financial development will also be affected by innovations in telecommunications and computing, and by legal and political institutions of countries (see Levine 1997; Demirgüç-Kunt and Levine 2008).

The most developed financial systems are generally international in their scope, so-called *international financial centres*. At its most dense a financial centre will actually be a form of cluster containing a substantial number of fair-sized financial services firms, major international accounting firms, as well as legal services and telecommunications and computer engineering firms (including consultancies). The financial services firms in such a centre will be highly diversified with some of them engaged in activities covering the whole spectrum of activities in major areas like banking, securities, foreign exchange trading, insurance, derivatives, fund management, and various specialized professional financial services. Such a financial centre will often be an exporter of financial services as well, in addition to responding to local demand for such services (see Johnson 2009a).

As with so many institutional and organizational developments, financial systems emerge and develop via a mixture of spontaneous order and central direction or official policies. Many writers have raised the question of what the structural factors that make for a reputable world-class financial centre are, apart from simply being a developed financial system. One publication (Securities Industry Association 2007) lists the factors as follows:

- open and fair financial markets;
- free flow of capital and a convertible currency;
- skilled workforce/flexible labour laws;
- prevalent use of a globally familiar language;
- fair, transparent, efficient legal and regulatory regime;
- sound and fair tax regime;
- implementation of international standards and best practices;
- low cost of doing business;
- high-quality, reliable and appropriate physical infrastructure;
- stable political and economic environment.

This implies that countries that want to foster the emergence of highly developed world class financial systems must find ways to create environments which have these characteristics.

In this paper, we outline a strategy for financial sector reform and development, starting from a very rudimentary financial system as that currently existing in Sierra Leone, which builds on the stock of international knowledge and experience. We focus, especially, on getting the fundamentals right, the need for a well formulated and appropriate regulatory strategy, and key policy areas in the first steps in the financial market development process.

3.2 Social Efficiency

An overarching goal of financial sector reform and development is to create an environment that would permit the emergence and sustainability of a socially efficient financial sector, in both a static and dynamic sense. Static efficiency means that, given the institutional framework, the tastes and preferences of the individuals in the society, as well as the distribution of wealth, the resources employed in the financial sector cannot be reallocated in such a way as to improve someone's welfare without making someone else worse off; in other words, there is intra-sectoral efficiency in resource allocation. Static efficiency also implies intersectoral efficiency. That is, given the same underlying structural factors (institutions, tastes and preferences, and wealth distribution) the resources employed in the financial sector should not be more productive elsewhere in the economy nor should there be resources that are employed in other sectors that are more productive in the financial sector.

Dynamic efficiency means first of all that institutional changes affecting the financial system are made when the changes yield greater benefits than they cost (in the sense of opportunity cost). Institutional changes involve changes in the rights and obligations which control/regulate economic relations among persons, namely,

(i) property rights,

(ii) norms, rules and conventions of behaviour,

(iii) types of contracts.

Dynamic efficiency not only implies institutional changes, in a formal sense, being made when they are beneficial to make, but also that the degree of enforcement of institutional arrangements will be increased up to the point where the marginal cost of additional enforcement becomes equal to the marginal benefit.

Institutional changes are not the only modifications that are required from time to time. Starting from some equilibrium, the returns to resources allocated among sectors can change over time because of changes in the environment including changes in relative prices. Dynamic efficiency requires that resources be mobile among sectors and thus are able to respond to changes in opportunities. Indeed, dynamic efficiency requires equality in risk-weighted rates of return to investment in firms and activities within the financial sector and among sectors of the economy.

In assessing whether or not a financial system is efficient or facilitates efficiency, one can use certain direct and indirect indicators. One can group these indicators into those that relate to

(i) the institutional environment,

(ii) market structure and size,

(iii) the nature, level and evolution of transaction costs.

3.2.1 Institutional Environment

The institutional environment is the most important of these factors because institutions both enable and constrain crucial actions. Hence they are major determinants of the incentive structure. The institutional structure specifies the conventions and codes of conduct, the freedom to contract, and the property rights structure (ownership rights, rights of transfer, appropriability of earnings from one's assets, the internalization of costs and benefits from one's activities). This is one reason why the legal and the regulatory framework are extremely important. So also are clubs and associations (e.g. forex clubs, bankers' associations, accounting associations, etc.). Hence either by law, by negotiated agreement, or 'tradition', institutional arrangements evolve or are designed to enhance the efficiency of the financial system by facilitating certain transactions, reducing transaction costs, and integrating otherwise segmented markets. Such institutional arrangements specify, for example:

(i) rules, codes of conduct including fiduciary obligations, and procedures in interactions;

(ii) uniform guidelines in formulating different types of contracts;

(iii) uniform standards and measurements for commodities and services;

(iv) assessment and evaluation standards (credit ratings, etc.);

(v) common technical language in communications, common value dates for money, exchange, and securities transactions, and uniform computer codes and languages for financial transactions;

(vi) chart of accounts for use by banks.

These factors, in turn, promote well-functioning and orderly competition, exchange, intermediation, and arbitrage.

3.2.2 Market Size and Structure

The social efficiency of financial markets tends to be enhanced

(i) the more competitive markets are,

(ii) the higher the level of expertise of market participants,

(iii) the more internalized costs and benefits are so that market participants capture a high fraction of the flow of wealth (net of externalities) created by their actions,

(iv) the more quickly market participants respond to price signals using efficiently all the information at their disposal.

Market size and structure affect each of these characteristics of the market (competitiveness, participants’ expertise, internalization of costs and benefits, and response elasticities). There are also often economies of scale which accrue as the unit size of financial transactions increases or as the absolute size of a total market increases.

In investigating the contribution of market size and structure to the social efficiency of the financial system, one would tend to look at a number of indicators. These would include

(i) barriers to entry (hence openness of the market),

(ii) the degree of segmentation of the market for a particular asset (e.g. government securities, foreign exchange) across regions or across groups of firms of the same country,

(iii) the number of firms in a particular market,

(iv) the stock of financial assets held relative to GDP,

(v) the variety of financial instruments in the market,

(vi) the diversity of participants (brokers, dealers, market makers) and the degree of specialization by functions and by assets,

(vii) the extent to which a market is privatized or at least the degree to which organizations are profit-seeking and have autonomy and accountability in decision-making.

3.2.3 Transaction Costs

Transaction costs in financial markets show up as buying and selling spreads, commissions and brokerage fees, various kinds of service charges, insurance costs, and risk premiums. These represent the costs of making computations and of record-keeping (e.g. labour time used in paperwork and accounting), acquiring and processing information, assessing risks (including the credit standing of counterparties in transactions), measures taken to deal with residual risks (including insurance), enforcing contracts and agreements (e.g. monitoring and policing agents and counterparties), and policing property rights in general. They also reflect basic marketing and other costs involved in the business of intermediation – the essence of much normal activity in private financial markets.

Transaction costs reflect genuine opportunity costs of resources used in transacting and such costs can be reduced by institutional reforms or modifications of market structure. In other words, the level of transaction costs in relation to the total value of the commodity being transacted partly reflects the state of development of financial markets and of the supporting infrastructure in the economy at large (communications facilities, computer facilities, adequately trained personnel, etc.).

3.3 Developing the Financial Sector in Sierra Leone

Sierra Leone is at a very low level of financial development. A country of about 6 million people, with a per capita income of around US$315, Sierra Leone currently has 13 commercial banks, 9 community banks, 9 insurance companies, 3 housing finance companies which are non-deposit taking, 2 savings and loans, the Finance and Trust Corporation, 2 discount houses, some 42 foreign exchange bureaus, and 6 microfinance institutions, also non-deposit taking. Total bank assets at end-2010 were equivalent to US$582 million. The Bank of Sierra Leone further lists the National Social Security and Insurance Trust and the Sierra Leone State Lottery as non-bank financial institutions. A stock market was launched on 18 July 2009.

Sierra Leone has a fairly liberalized financial system. Interest rates and exchange rates are market-determined, there are no selective credit controls, and despite the fact that the largest commercial bank is state-owned, the banking system is not government-dominated in its activities. But there are cash and liquidity requirements, which banks have to follow, constraining somewhat the structure of banks' asset portfolios.

3.3.1 The Challenges

Banks in Sierra Leone are small (assets averaging about US$45 million); efficiency is low (non-interest expense averaging about 10.1% of total assets, and interest rate spreads some 10.8 percentage points); there is high concentration in the banking sector, despite recent improvement (the three largest banks hold about 54% of total assets); and the skill and experience level of bankers are deemed low on average. The new stock exchange will take some time to get a significant number of listings.

Soundness of the financial system is in some question, although it is not in any danger of crisis. The capital–asset ratio of the banks, for example, is good (about 17%), but non-performing loans are a problem – tending to hover around 16% in recent years.

The state of banking supervision is still rudimentary. Certainly one does not see any attempt to explicitly organize the approach to assessing the soundness of a financial firm and its management around risks and risk management, which in turn would stress the importance of clear understanding of financial risks and optimal assignment of the responsibility for managing the risks, namely liquidity, credit, interest rate, market, foreign exchange, operational, sovereign, legal, and fraud risks. All in all, the regulatory strategy is in need of a focused, coherent, modern approach.

The payment system is very rudimentary, with no interoperable ATM system, no widespread credit card use in domestic payment transactions, no significant use of checks or internet banking, and of course no electronic large value payment system. There is also no credit rating agency.[1] Although there is no generally available empirical evidence on the matter, it is also very doubtful that the commercial banks have the data and the sophistication to have developed internal processes that go beyond so-called traditional approaches in credit risk management, in general, and for most of them so-called ‘expert systems’ among these traditional systems.[2] Furthermore, the normal financial markets (short-term credit, medium and long-term credit, foreign exchange, etc.) are very rudimentary and not well functioning.

There is a lot of work to be done on what we shall call ‘the fundamentals’ in Sierra Leone. We shall mean here, in particular, the innovation system, human capital, financial capability of the populace, infrastructure and public

[1] The 2011 *Credit Reference Act* provides a framework for the establishment of credit reference bureaus. Until such bureaus come into existence, the Bank of Sierra Leone is authorized by the Act to create a credit reference division at the Bank to perform the functions of a credit reference bureau.

[2] Saunders (1999) classifies the traditional approaches into *expert systems*, *rating systems*, and *credit scoring systems*. In the first, *expert systems*, the credit decision is made by the local lending officer who typically makes recommendations to some loan committee. The officer in making a recommendation takes into account the so-called five Cs, namely, character, capacity, capital, collateral, and cyclical or economic conditions (see Saunders 1999, pp. 7–9). This approach is criticized for not ensuring consistency and objectivity across clients, offices and types of borrower. *Rating systems* could vary enormously. Banks’ internal rating systems differ in sophistication, depending on the data available (quantity and quality), the training and skills of the staff of the firm, and other resources (computers, libraries, and research budgets) devoted to the effort (see, for example, Stephen and Fischer 2002). Their models seek to foster consistency, transparency, and objectivity in credit ratings. The effort involves building databases, benchmarking, constant review, and backtesting. The models use financial and market data, sector-specific information (data and variables), and qualitative information. In decision-making on rating grades, they estimate probability of default and loss given default (and hence expected loss from a loan to a counterparty), as well as migration potential, which is the probability that the credit rating of the counterparty will change to some other rating grade (AAA, Aa, A, Baa, Ba, B, Caa–C, for example) from one period to another. The objective of *credit scoring systems* is to identify important variables affecting the probability of default and weighting them into a score. Thus, the credit scoring system can be used as an element in the rating system. Another way to look at it is that one can fit a model for default probability as a function of several variables and then use the coefficients as weights in determining credit scores. A simple well-known example of a scoring model (the Z-score model) is that of Altman (1968) for commercial loans, where Z is a function of the ratio of working capital to total assets, the ratio of retained earnings to total assets, the ratio of earnings before interest and taxes to total assets, the ratio of market value of equity to book value of total liabilities, and the ratio of sales to total assets.

services, various factors affecting microeconomic incentives to enterprises (openness, taxation, administrative barriers, legal environment), and general governance (macroeconomic policies, socio-political governance, compliance with international standards and codes).

Moreover, in Sierra Leone, all the financial markets are rudimentary in their development and operations. This reflects especially the weak fundamentals. In addition, the financial sector associations, including the bankers' association, are not well functioning.

3.3.2 The Authorities' Financial Sector Development Plan

The financial sector development plan (FSDP) of Sierra Leone emphasizes eight major areas:

(i) building commercial banking sector capacity;

(ii) increasing access to finance;

(iii) improving mobilization and investment of long-term funds;

(iv) strengthening banking supervision and regulation;

(v) improving the macroeconomic environment, *inter alia* to bolster financial system stability;

(vi) modernizing the payment system;

(vii) strengthening short-term financial markets and monetary policy;

(viii) strengthening the central bank infrastructure.

The action plan of the FSDP does not include any form of sequencing of policies. Such an approach would be useful, based on forward-looking effective demand calculations, budget constraints, and other elements of implementation capacity. The role of the actors responsible for the implementation – the government, the central bank, private financial firms, other supporting firms, and the non-financial sector users of financial services – would also be specified in such a plan. The Sierra Leone FSDP is, otherwise, a reasonably comprehensive plan. It is a development plan, starting from a very low base of financial development.

We proceed now to present a coherent analytical approach to guide policy actions for the development of the financial sector in Sierra Leone. This could assist any attempt by the authorities to refine the FSDP and to construct an action plan for its resolute implementation.

3.4 Getting the Fundamentals Right: Capacity Building

As in so many other activities, reputation is important in the financial services business. Credibility of promises and a belief that the authorities are serious and committed to building a world class financial sector will flow from good reputation. Capacity to do the job well, as revealed by competence and integrity of the firms and service providers that operate in the financial sector, enhances reputation. As is recognized in the FSDP, a strategy must therefore be put in place to build capacity of the people and organizations in the financial system to perform their tasks well. We would argue that the relevant capacity building will be facilitated by the quality of the national innovation system, the human capital of the financial system, the financial capability of potential demanders of the financial services, the supporting infrastructure, and the steps taken to improve effectiveness and efficiency of cooperation among the firms concerned.

3.4.1 Innovation System

Innovation is important in the financial services industry and it is a continuous process, which of course poses great challenges for regulators. In trying to develop the financial system, the Sierra Leonean authorities will be advised to examine closely their innovation system to ensure that it supports their plans.

The concept of a national innovation system is useful in ordering one’s thinking in this regard (see, for example, Nelson 1993; several papers in Oyelaran-Oyeyinka and McCormick 2007). A national innovation system is the set of institutions, organizations, and mechanisms supporting technical innovation in a country. Here, one would be interested in the processes by which firms in the financial system master, use and supply products that are new to them.

The innovation system will comprise the whole set of institutions and organizations whose interactions determine the innovative performance of the markets and firms in the financial system. Innovation will involve copying and catching up with products and practices of others; appropriate adaptation of existing products to the specific clients and/or environment of the system; investment in new equipment; organizational reforms; learning new skills, including technical and analytical knowledge (mathematics and statistics, finance, economics, etc.); and adopting new approaches in marketing and cooperation with financial centres around the world. An objective of a policy on the national innovation system is, in short, to enable domestic firms to develop sufficient technological, organizational, and scientific sophistication and adaptability to function effectively when compared with some other financial systems in the global environment.

Strengthening the national innovation system and making it supportive of the financial services sector would involve looking at the quality of secondary schools; programmes at universities, research centres and institutes; technical and vocational training in the country; and training and research programmes within firms in the financial sector. Apart from training and research facilities, there are other important factors which will influence the innovation system and which the authorities must influence. Among these, habits and practices of major actors in the financial system are important. Firms must be motivated to inculcate habits and practices which encourage innovation. In that regard, the incentive structures within the financial firms matter.

The competitive environment is also important. National policy fostering open markets and safeguarding their integrity will be good for innovation. Appropriate incentives will also encourage innovation and survival of only strong firms which tend to be more innovative. Labour-management relations matter, *inter alia*, because they can influence employees' attitudes and commitments towards technical change and innovation. Moreover, availability of finance to support innovation (especially acquisition of equipment and training) is extremely important. Government policies can influence all of these elements that affect innovation, as can cooperative arrangements among firms and organizations in the system.

3.4.2 Human Capital

The quality of the human capital in the financial system will be crucial to financial development. The technical capability, innovative ability and integrity of the human beings operating in the system and overseeing its markets and organizations are important dimensions of this quality. Indeed, many of the policies being implemented to boost the development of the financial system will be designed with an eye to attracting high-quality personnel. The indispensability of high-quality people to achieving a high degree of competitiveness has forced all financial centres seeking to compete at the international stage, for example, to be open in their recruitment policies, acquiring people from wherever they can be found. Sierra Leone can, no doubt, benefit from adopting such an attitude.

Given sound government policy, including support for education and training of Sierra Leoneans in top universities around the world, within a relatively short period of time Sierra Leoneans will have no problem having a substantial share of the top positions in the leading financial firms in the country, without sacrificing quality. Thus, given the benefit of rapid financial development the country should be open to firms – especially banks, insurance companies, rating organizations, and accounting firms – from all over the world. International firms and conglomerates thrive on their diversity and their ability to rotate their employees worldwide. The authorities in Sierra Leone should not only welcome such international firms to the country but should also refrain from restricting their flexibility in personnel management. Similarly, fund managers, advisors and consultants of foreign origin should be encouraged to open offices in Sierra Leone if they so wish. A high-quality labour pool should enrich the country, with appropriate efficiency gains.

Two areas with thorny issues that all financial sectors around the world have had to address are labour policies and personal income taxation. In the case of labour polices, the main issue is the degree of freedom and flexibility that the top management will have with respect to hiring and firing, overtime pay, minimum wage, leave, treatment of unions, and hiring of foreigners at all levels of the firm. A cautious approach would be to take a survey of what countries with leading financial centres are doing at the moment and adopt a mix of policies, in light of normal practices in those leading centres, which are sufficiently flexible and also would be fair to the workers in Sierra Leone. If necessary, legal changes should be made in the Sierra Leone institutional environment.

The same can be said for personal income taxes. First and foremost, a country like Sierra Leone should negotiate double taxation treaties with at least those countries where the risk of double taxation exists. As to the level of taxation when relevant, the advice again would be to do a survey of the leading financial centres and get a good idea of their personal taxation, both of nationals and of foreign nationals who are residents in the country. Then an attempt should be made to modify domestic taxation laws to become competitive.

3.4.3 Financial Capability of the Populace

Other things being equal, it seems reasonable to expect that persons with enormous financial capability, namely, 'the knowledge, skills and motivation to manage their finances' (HM Treasury 2007, p. 3), will tend to use financial systems more than persons with low capability. Indeed those with high financial capability will have greater ability to reap returns from their savings and will be willing to explore alternative ways of investing their assets and managing financial risks. Having a large proportion of the population with a high level of financial capability should motivate more business for a national financial system than otherwise. This will help build a solid demand base that is useful for sustaining a national financial system and hence giving its financial services personnel good practice. In addition, the population of young persons from which future financial services experts could emerge would become greater.

The United Kingdom has introduced a useful initiative, elements of which I believe are worth copying in Sierra Leone. The idea is to put together a coherent programme to enhance the financial capability of the population. The overall strategy will include supply-side policies to improve general access to financial services markets as well as to good but affordable financial advice. The expected outcome of the strategy is 'better informed, educated and more confident citizens, able to take responsibility for their financial affairs and play a more active role in the market for financial services' (HM Treasury 2007, p. 7). One obvious indication of the relevance of this approach for Sierra Leone is that when one looks at Sierra Leone, planning for retirement and old age has always been a challenge, abated only by the willingness and ability of the younger generation to voluntarily care for their old citizens. The introduction of the National Social Security and Insurance Trust (NASSIT) will go some way towards remedying this problem. But NASSIT, by its nature, covers mostly the formal sector, which still remains smaller than the informal sector of the economy. One can argue, of course, that the relationship between participation and/or the form of participation in the financial system on the one hand and financial capability on the other is worth empirical investigation. This is an exercise that the policymakers can attempt in due course.

Taking a cue from the British approach, key elements in an action plan for Sierra Leone would be: appropriate education (mathematics, finance, etc.); improved avenues for information and advice; availability of opportunities to practice and develop appropriate skills; and outreach programmes. The Bank of Sierra Leone could lead the effort, in partnership with the government, the financial services industry and civil society organizations of interest. Other countries have programmes that achieve some of the same objectives as the UK one and apply some of the same tactics, most notably introduction to personal finance education in schools. Businesses and voluntary associations and organizations offer free programmes to young people and economically disadvantaged persons in other countries as well. Moreover, it is possible to obtain much of the training and the advice in the open market. The idea in the Sierra Leone case, as is the intention in the UK one, would be to have a high degree of planning and overall coherence and to offer much of the programme without significant monetary outlays from the beneficiaries. Indeed, in Sierra Leone, formal finance education, advice and outreach programmes are not widely available from schools, charitable organizations, or the financial services industry. Hence, a publicly organized financial capability programme would seem to be of much social value.

As in other programmes, with this sort of planning, it is always useful to organize some sort of a survey so as to fully understand the nature and dimensions of the problem to be tackled and the seriousness of the different aspects of the problem. Hence, it would be useful for the Sierra Leonean authorities if they want to mimic this effort to organize such a benchmark survey.

3.4.4 Infrastructure and Public Services

The physical and technological infrastructure in place will be important elements of the capacity available to perform financial services tasks, including the ability to innovate. This infrastructure will comprise

1. transport and communications networks,
2. basic utilities such as electricity, water, sanitation, and postal system,
3. financial system related infrastructure (trading facilities, clearing and settlement systems for money and securities, other electronic linkages among participants).

Some of the infrastructure decisions and investments will, of course, be left to the financial services markets and firms themselves. As regards public sector organization, the central government and the local governments will have clear functions specified in law regarding the provision of infrastructure and other public services. It would seem that the effectiveness and efficiency of the public sector organization could be enhanced if some explicit coordination is arranged within the public sector to focus on the requirements of the financial system. In the Sierra Leone situation, this could be one of the tasks of the Financial Sector Steering Committee which has been proposed to oversee the implementation of the FSDP.

3.5 Getting the Fundamentals Right: Microeconomic Incentives

The policy environment will affect the economic returns to the people and firms that operate in the financial sector. If these returns are low, people and firms that can earn higher returns elsewhere will leave, until an appropriate stock is left, such that the marginal returns to those who stay equals the returns they would earn elsewhere. To make matters worse, if the policy environment is unfavourable, even the highly productive human capital developed within Sierra Leone could actually flow out of the country. In short, the incentives to attract and retain high-quality people and firms in the financial sector are extremely important.

Some of the incentive issues have already been addressed when discussing human capital. We can mention here that the quality of life also matters in attracting talent. Hence, making the country attractive to live in will be a positive incentive to enterprises. Later, we will briefly discuss governance issues, which also can affect the structure and hence the behaviour of enterprises vis-à-vis the financial sector. We now briefly discuss issues of openness, taxation, administrative obstacles, and the legal environment.

3.5.1 Openness

The financial sector will benefit from the presence of strong firms – by definition, firms that can survive in open competitive markets and can build the capability to export their services. In order to attract such firms and keep them, an overarching requirement is the maintenance of an economic environment (markets, institutions, immigration laws, information flows, ideology, and access to the authorities) that is open.

An open environment will exhibit several obvious characteristics. First, there will be fair and open access rights to all to locate in and/or do business with the Sierra Leone financial sector, irrespective of national ownership of a firm. Hence, firms with 100% foreign ownership will be welcomed. Especially in the early stages of financial development, such firms have the potential, when properly screened using objective standards, of bringing badly needed expertise and business connections to the local financial sector. Second, 'firewalls' limiting the types of business to be engaged in by the same firm/organization will not be too restrictive, that is, not out of line with the leading financial centres of the world.[3] Third, innovation will be encouraged, that is without regulatory and other obstacles that are more stringent than those found in the leading financial centres, taking due account of the capability of a financial firm. Fourth, institutionalized procedures will exist through which policymakers and regulatory and supervisory authorities consult and elicit the opinions of financial services providers before implementing new or revised rules, taxes and other costly obligations on the financial sector markets, firms and people. The authorities must also demonstrate that they seriously consider the views and analyses of the financial sector organizations before finalizing their decisions. Fifth, there must be a high degree of freedom and flexibility allowed firms in their day-to-day operations, again taking due account of the capabilities of the financial firms. Hence, such firms must be allowed capital mobility,[4] currency convertibility in an open exchange market and, as stated before, implementation of human resource management policies that enable them to accumulate the human capital they find optimal.

3.5.2 Taxation

The various kinds of taxation to be considered include corporate taxation; taxation of wages, salaries, interest, and dividends; taxation on capital gains; and taxation of specific transactions. Then, of course, there can be all kinds of taxes in the form of fees which are not labelled as 'taxes'. Rather, they may be called registration fees, stamp duties, transfer fees (such as when shares are transferred).

[3] In its argument urging the Japanese authorities to remove certain firewall restrictions, the International Business Association (IBA) Japan (2007, p. 15) argued as follows:

> IBA financial conglomerate members currently encounter the following problems due to the firewall restrictions in Japan; (1) inefficiencies due to the overlapping of human resources, organizational structures, and systems; (2) constraints on effective and efficient business management practices, including the formulation and implementation of business strategies and risk management at the group level; and (3) constraints on providing comprehensive financial services that would maximize customer convenience.

Note that a financial conglomerate could, for example, conduct banking, securities as well as other financial services business.

[4] Capital mobility has a positive impact on financial market development: among other things, it improves the menu of investment outlets available to suppliers of funds while users of funds have access to cheaper and more sophisticated financing, and so it expands the opportunities for portfolio diversification. At the same time, capital mobility complicates risk management for individual financial firms, makes macroeconomic management more challenging, and fosters financial integration, which increases the risk of cross-border contagion (see Sundararajan *et al.* 2002). In order to address the complications, two fundamental policy responses have been found useful. First, the macroeconomic policy framework (most notably monetary and exchange policies) must be appropriately designed and tailored to meet the circumstances. Second, a strong prudential framework should be developed to help ensure a sound financial sector with a high standard of risk management (see Sundararajan *et al.* 2002).

Governments in their tax policies are usually concerned with revenue, fairness, income distribution, protection, and efficiency. In the context of a financial sector, it is useful for the Sierra Leone authorities to see the problem as one in which they are trying to promote production (of financial services), enable the financial sector to attract and keep talent, and to attract foreign direct investment to the financial sector. Hence, the taxation of the financial services must not do damage to the competitiveness of the financial sector in all these dimensions. It should be particularly obvious that the bargaining power (that is, the special non-pecuniary attractions and indirect pecuniary benefits) of operating in the Sierra Leone financial sector is not likely to be great for some decades to come. So there will be no 'rents' to be partially captured. This means that the solution to the tax problem is straightforward. The taxes mentioned above cannot, in their total burden on the firms and the highly talented employees, be higher than appropriate competitor financial sectors in the international financial world. In fact, it would seem that the general burden of the different taxes should be at least as favourable (that is, as light) as the most favourable of the top 50 financial centres in the world.

Similarly, if special incentives are granted to investors of any kind, there is no reason why investors in financial services should not be extended similar benefits, as appropriate.[5] A general advice would be to look carefully at what others are doing and be as competitive as possible with respect to the types and levels of taxation. Double taxation treaties, for instance, as mentioned before, should be signed where useful. Many countries have also been directly addressing certain specific taxes that are relevant in this area. One could benefit from what those countries are doing and at worst match the most favourable ones, in order to be competitive.

In its attempt to examine the tax code to remove elements that would be discouraging to the development of a sound financial sector, Sierra Leone may use the opportunity to reform the whole tax system. A compelling reason may be that some taxes may not be easy to remove or lower for the financial system without doing so for the whole economy. A way around this may be to make the financial sector an enclave which will allow it to enjoy special tax privileges not enjoyed by firms, organizations and individuals outside the enclave. But we would not recommend this approach in Sierra Leone.

3.5.3 Administrative Barriers

Although on the face of it the administrative barriers to doing business in Sierra Leone are not as great for the financial sector as for many other sectors in the economy, there should be some effort made to reduce whatever administrative barriers exist to smooth operations in the financial sector, especially for foreign firms and individuals. In brief, the barrage of licenses, approvals, permits, and other requirements should not unduly raise the costs of setting up and doing

[5] A similar point has been made by Sanyal (2007) in the context of Mumbai.

business in the financial sector. For example, any lingering recurring problems with utility companies, the tax and port authorities, and the immigration office could be greatly alleviated. Of course, improvements should benefit all the firms and organizations in the financial sector, not only those with foreign ownership.

3.5.4 Legal Environment

The law, the courts, and the police all need to be reviewed in light of the requirements to make the financial sector in Sierra Leone grow, be efficient and competitive. It would be advisable to do a formal review of the legal system in light of the experience of the top international financial centres in the world to ensure that the legal framework is adequate. Even casual observation reveals that the regular courts in Sierra Leone in their operations are way below the normal level of efficiency required to support the financial system rather than be an obstacle to the system's development. The evidence on this score must be clear, since the courts have been handling cases in which the financial services sector has been involved. Indeed, since the hard evidence indicates that the court system is not up to the task, especially in terms of speed and decisiveness, Sierra Leone commissioned a Fast Track Commercial Court in December 2010 to expedite commercial cases. This process needs to continue, in addition to instituting reforms of the regular courts and the legal system as a whole.

For instance, the FSDP suggests setting up 'an effective court system', *inter alia* to strengthen debt collection. There would seem to be a need for a special court system to handle most if not all financial sector matters, including disputes and contracts among the financial firms themselves, basically to speed up the legal processes involved. Hopefully, the Financial Sector Steering Committee will address this broad issue.

The ability to use land and other real estate as collateral is a major problem for financial sector development in Sierra Leone. The FSDP also raises this as an area worth addressing. Inadequate land titling and registration and the traditional land tenure system (see chapter 6 of this volume) all impose constraints on use of real estate as collateral. A further aspect that is ignored in general is the absence of an orderly and well-functioning real estate market, even in that part of the country where there is fee simple ownership of land. This greatly reduces the liquidity of real estate and hence its utility as collateral in the credit market.

3.6 Getting the Fundamentals Right: General Governance

The overarching policy environment of a country greatly affects the rating of its financial system among peers and among regulatory authorities in other countries of the world. Hence, given the abundance of alternatives, strong financial firms or highly talented people may not find it good for their reputation to operate or work, respectively, in a country that is considered poorly governed, or even to having close business relations with financial firms located in that country. In addition, the governance of a country has immediate wealth effects on the owners and employees of firms and organizations that are located in that country. Of particular importance are three components of the national governance environment, namely, macroeconomic policies, socio-political governance, and the degree of compliance with relevant international standards and codes.

3.6.1 Macroeconomic Policies

Macroeconomic policies are important for obvious reasons. The financial system's participants will expect these policies to affect the real rate of return on their efforts; the expected real value of their investments in the system, over time; and the ability to transfer their assets and earnings in the system from the domestic economy to another country. Thus a financial system benefits from low inflation, stable exchange rates, capital mobility, and convertibility of the domestic currency or at least an absence of exchange controls.

The manner in which the central bank uses its instruments to achieve its objectives of low inflation and financial system stability will affect competitiveness and efficiency of the system. Among the instruments are reserve and liquidity requirements; these should not be used in ways that seriously tax banks or reduce their flexibility in using their reserves. Central bank fees and other regulations for use of payment systems facilities it controls should also be no more onerous than those in leading financial centres. As we argued earlier, capital mobility will also pose challenges. A country cannot really be a big player in the financial system business if it has stringent capital controls – inwards and outwards. At the same time, capital mobility complicates risk management for individual financial firms and could make macroeconomic management more demanding. Assuming that other governance aspects (to be discussed below) are consistently well taken care of, the basic strategy to address these complications and challenges is twofold. First is to put in a place a macroeconomic policy framework that ensures low inflation and exchange rate stability. The second is to ensure that the financial system is sound, most importantly by establishing a prudential framework appropriately designed and tailored to meet the challenge. Important elements in the quality of such a prudential system will be that

1. there should be clear understanding of risks by those who are the bearers of the risks,

2. the responsibility for managing risks in financial transactions should be clearly assigned,

3. there should be appropriate incentives to those responsible for managing risks to do so in a socially efficient way (see Johnson 2002b).

No matter how sound the underlying macroeconomic policy and prudential frameworks, it is doubtful that the probability of a financial crisis can be reduced to zero. Hence, as part of the public policy framework, the authorities will be well advised to have measures in place to address crises when they do arise. Since the size of the financial system relative to GDP is bound to increase with its development, financial crises can become particularly disruptive. Hence, having a policy response fairly well thought out in advance is important. Liquidity support (typically from the central bank) and fiscal support from the government are the overarching elements of such a strategy, coordinated with emergency measures by the regulatory and supervisory authorities.[6]

3.6.2 Socio-political Governance

One of the problems that policymakers in Sierra Leone have to address is the need to effectively 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 level of corruption and other elements of good governance.

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*.[7] 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 with the same seriousness as they would a credit rating report. In other words, the Sierra Leone authorities should try and understand what go into these reports and what they can do to improve their ratings. This will help them design an appropriate plan.

Another part of the response strategy is, of course, to design a plan to improve general governance – with clear objectives and instruments – make it transparent, and then implement it resolutely. In designing the plan, the

[6] See Välilä (2002) for a discussion of the basic analytical issues involved in considering fiscal support.

[7] *Risk of expropriation* comprises survey indicators of institutional quality from the *International Country Risk Guide*. The data include subjective assessments of risk for international investors along such dimensions as law and order, bureaucratic quality, political corruption, risk of expropriation by the government, risk of government contract repudiation, and overall maintenance of the rule of law. The *governance indicators* of the World Bank currently comprise six dimensions: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. The *constraints on the executive* measures come from Polity IV data set (*Polity IV Project*). The aim is to measure directly the limits of executive power. Constraints on the executive refer to the extent of institutionalized constraints on the decision-making powers of chief executives. The concern is with the checks and balances between and among the various parties in the decision-making process.

authorities should remember that they will need to worry about sustainability during implementation. For this reason, especially, particular attention should be paid to the deliberative process in putting the programme together and the legal and organizational framework involved (see, for example, the discussion in Johnson (2007, pp. 155–161)).

3.6.3 Compliance with Appropriate International Standards and Codes

One of the costs of globalization is that countries are affected, through trade and financial flows, by what other countries are doing. Hence, developments that adversely affect financial sector stability and efficiency in one country can easily spill over into other countries. In addition, countries are genuinely interested in adopting practices that have improved risk management, efficiency and governance in other countries.[8] For these reasons, countries have been cooperating in various venues and organizational settings to agree on standards and codes in a number of areas, which would be institutionalized in countries worldwide, thereby reducing the cost of enhanced cooperation in financial services, among other economic activities.

The standards and codes are broad norms legitimated by the international community of market economies. They have evolved from experience and widely accepted theory; arrived at by agreement (via open discussion); and are expected to be implemented by national authorities, without a central world authority, because such implementation is in the self-interest of the countries. The self-interest of countries emanates from two basic forces: the quest for domestic financial stability and development, and the desire to participate in the increasingly global and integrated system of trade and financial markets.[9]

In trying to develop its financial system, Sierra Leone, then, must clearly demonstrate that it is resolutely implementing relevant norms – the standards and codes. Otherwise, as stated above, the rating of the country's financial firms, among peers and by regulators in other countries, will tend to suffer. In that case, the financial firms in the country will not be able to participate in important financial cooperative arrangements with other financial firms abroad and the country will not be attractive to some major international financial firms and centres. Important standards and codes that would need to be implemented to achieve credibility are listed in Table 3.1.

It will first and foremost be useful to develop domestic expertise to implement the full compliance processes, starting with self-assessments of the state of compliance. Even with such expertise, a developing country like Sierra Leone will still find that, for credibility, it will have to arrange peer review by experts

[8] In Ghana, for example, Asembri (1996) was proud of the high standards for listing and trading that the young Stock Exchange of Ghana had set as confirmed by a visiting team from the Commonwealth Secretariat in October 1992.

[9] See Johnson (2002a), who makes these points in the case of the compliance with the *Core Principles for Systemically Important Payment Systems*.

TABLE 3.1. International standards and codes: useful for financial services supervision and the enabling environment.

Banking Supervision	Basel Committee's *Core Principles for Effective Banking Supervision*
Banking Supervision	Basel Committee on Banking Supervision, *Principles for Sound Liquidity Risk Management and Supervision* (September 2008)
Financial Stability Forum	*FSF Principles for Sound Compensation Practices* (April 2009)
Securities	International Organization of Securities Commissions' (IOSCO) *Objectives and Principles for Securities Regulation*
Insurance	International Association of Insurance Supervisors' (IAIS) *Insurance Supervisory Principles*
Payment Systems	Committee on Payments and Settlement Systems (CPSS) *Core Principles for Systemically Important Payment Systems*
CPSS–IOSCO	Joint Task Force's *Recommendations for Securities Settlement Systems*
Anti-Money Laundering and Combating the Financing of Terrorism	Financial Action Task Force's (FATF's) *40+8 Recommendations*
Corporate Governance	OECD's *Principles of Corporate Governance* and Basel Committee on Banking Supervision's *Enhancing Corporate Governance for Banking Organisations*
Accounting	International Accounting Standards Board's *International Accounting Standards (IAS)*, and *International Financial Reporting Standards (IFRS)*
Auditing	International Federation of Accountants' *International Standards on Auditing*

from the leading financial centre countries of the world and/or from appropriate international organizations – in essence, to validate the country's own self-assessment and implementation of compliance.

Table 3.1. Continued.

Data Transparency	The International Monetary Fund’s (IMF’s) *Special Data Dissemination Standard/General Data Dissemination System* (SDDS/GDDS)
Fiscal Transparency	IMF *Code of Good Practices on Fiscal Transparency*
Monetary and Financial Policy Transparency	IMF *Code of Good Practices on Transparency in Monetary and Financial Policies*

3.7 Regulatory Strategy

Sierra Leone, like other African countries, needs a high-quality regulatory environment, not only to avoid financial crises but also for financial development. There are at least three major consequences for financial sector development. First, a high-quality regulatory environment will have a positive effect on cooperation among the firms in the financial sector since all the firms will trust each other more than if the regulatory standards were suspect. Second, financial firms outside the country will look favourably on building relationships with the financial firms and markets in the country. Third, authorities in other countries will be less prone to imposing tight regulatory standards on dealings of their local financial firms and markets with financial firms and markets in Sierra Leone (see Johnson 2009b).

The regulatory strategy in a high-quality regulatory environment must achieve two overriding objectives. First, it must ensure clear understanding by regulators and financial firms of risks faced by the financial firms and how those risks could be managed. Second, the regulatory strategy must be clear about the role of regulation versus the market in ensuring that the financial risks are efficiently managed and controlled. We should note that, in this discussion, oversight agencies are part of the regulatory authorities.

3.7.1 Financial Risks and Their Management

Not too long ago, banking supervisors would talk about ‘CAMEL’. That acronym stands for capital adequacy, asset quality, management capability, earnings level and quality, and liquidity. There is nothing wrong with assessing a financial firm using those headings to organize one’s approach. But nowadays there is increasing feeling that explicitly organizing one’s approach to assessing the soundness of a financial firm and its management around risks and risk management is extremely important. The CAMEL is taken care of in this approach while bringing risks and their management more sharply into focus. In fact, it is interesting to note that supervisory authorities in a number of countries, while still using the CAMEL approach, had transformed the CAMEL into CAMELS or CAMELOT. But then they were not unanimous about what the S, O, and T stood for. Sometimes the S (in CAMELS) was for 'systems and control', but typically it was for 'sensitivity to market risk'. Similarly, the O and T in CAMELOT were sometimes for quality of 'operations' and 'treasury management'; otherwise they were for 'operating environment' and 'transparency'.

Returning to risk management, the regulatory agency or agencies of the country must ensure that the human and non-human capacity is there – within the regulatory community and the financial firms – to understand and manage the financial risks in the markets in which the financial firms in the country operate. An important component of the human capacity is knowledge of the analytics of risk management. Complementary resources include computers, data, libraries, and research budgets. Firms will have their internal processes. The regulatory agencies must set standards, sometimes in great detail, and must also oversee internal processes of firms to make sure that they are appropriate and sound.

Many different types of risks are identified in the literature. The most important ones are liquidity, credit, interest rate, market, foreign exchange, operational, technological, sovereign, legal, and fraud (see, for example, Penza and Basal 2001; Saunders and Cornett 2008).

3.7.2 Regulation versus the Market

Since financial firms have an incentive to survive, it would seem that market discipline should do a satisfactory job in forcing internal processes of banks to develop and maintain sound models and processes to address risks. Indeed, financial firms should take primary responsibility for their risk management.

While accepting this perspective, a traditional response has been threefold. First is that market discipline can be effective if there is full and accurate information disclosure and transparency. Given that precondition, the more sophisticated the pool of those who could monitor the management of financial firms – such as owners, depositors, customers, and rating agencies – the more effective one would expect the forces of market discipline to be.

Second, even with substantial market discipline, from a micro point of view the actions of financial firms could have certain adverse effects on third parties for which it is very difficult to structure property rights and enforcement sufficiently to ensure complete internalization of costs and benefits. Indeed, this is one motivation for the great concern with consumer protection as an element of regulation.

Third, from a macro point of view, the argument is that the soundness of the financial system is essential for systemic stability and economic growth. Hence regulators must also have important responsibilities for risk management within financial firms.

One sore point about regulation, though, is the issue of *standardization*. Indeed, dissatisfaction with some of the regulatory initiatives has been an additional motivating force for financial firms to develop techniques and approaches that would be superior (from the perspective of firms' risk-return profiles) to the regulatory standardized approaches (see, for example, Crouhy *et al.* 1998). The intention is to convince the authorities to permit the firms to implement their own internal processes, with only oversight by the authorities. Perhaps no other regulatory move was more energizing to the financial firms than the Bank for International Settlements (BIS) accord on risk-weighted capital requirements. The 'one size fits all' policy, as the firms saw it, was damaging to their optimal portfolio management and hence profits. Banks, for example, believe that the credit risk associated with a portfolio would be affected by the degree of portfolio diversification and the credit quality of the counterparties. Thus, for them, it is difficult to come up with capital requirements without detailed analysis of a bank's particular situation. There is, therefore, continuous debate on when and how to use internal models as opposed to some standardized approach; on when the market is a more socially optimal regulator of governance behaviour than public authorities; and on how one goes about deciding an optimal regulatory regime and strategy.

An *optimal regulatory regime and strategy*, among other things, will balance regulatory rules, supervisory review, and market discipline. Llewellyn (2002), for instance, argues that several problems emerge with a highly prescriptive approach to *regulation*. For example, the risks under consideration may be too complex for simple rules; prescriptive rules may prove inflexible and not sufficiently responsive to market conditions; and the rules may have perverse effects in that they are regarded as actual rather than minimum standards. He stresses that a central issue is the extent to which regulation differentiates between different banks according to their risk characteristics and their risk analysis, management, and control systems. An important theme in this framework is that regulation can never be an alternative to market discipline. On the contrary, regulation needs to reinforce, not replace, market discipline within the regime.

How one determines, in practice, the balance between regulation, on the one hand, and market discipline, on the other, is bound to remain of major concern among experts. Sometimes the determination in practice gets influenced by balance of power of those with interests in the outcome of the game. Calomiris (2006), for example, discusses the influence of three constraints to the regulatory stance of the US Federal Reserve (Fed) during the Greenspan era: opposition by politicians, opposition by big banks, and effect on the erosion of Fed regulatory power. In this general context, it is interesting that in the final decades of the twentieth century, at the same time that the public authorities around the world were emphasizing an important role for market discipline in eliciting good governance in financial firms, those same authorities – as well as the international organizations in their standard-setting activities – were refining regulatory rules, standards, and codes. In the end, the one thing on which the experts seemed to agree was that the relative weights should indeed vary from one country to another and perhaps among types and sizes of financial firms as well, depending on the particular circumstances. Some of the determining factors, for a country, would be the available expertise within financial firms and within regulatory agencies, the nature of the risks faced by the financial firms, and the relative sophistication and efficiency of the pool of others who could monitor the management of financial firms.

Despite the publicity accorded the recent *communiqué of the G-20* meeting in London (G-20 (April 2009)), and numerous high-level discussions among policymakers in the major countries since then, our suspicion is that the nature of this market versus regulation debate will change little. Indeed, the basic principles guiding regulatory frameworks for some time now are likely to remain the same. The vigilance in the application of those principles might intensify and, perhaps, certain markets and organizations which have been spared close supervision will now be subjected to scrutiny. For example, the G-20 members in the communiqué agree 'to extend regulatory oversight and registration to Credit Rating Agencies to ensure they meet the international code of good practice, particularly to prevent unacceptable conflicts of interest'. Certain systemically important hedge funds may also be subjected to regulation and oversight. Moreover, capital requirements of financial organizations will most likely be re-examined and perhaps tightened, which means raising minimum capital in absolute terms or, at least, in relation to (risk-weighted) assets.

The financial firms that are considered too big to fail might, for example, be required to hold more capital in relation to risk-weighted assets than they have had to before, after adjusting for their individual circumstances. But we do not believe that banks considered too big to fail will be broken up or prevented from engaging in certain market activities they were allowed to before the recent financial crisis, as some well-known persons have suggested. But at least these banks will most likely end up losing some of the trust, which they enjoyed in the past, notably in the quality of risk assessments of their activities and in setting appropriate capital requirements. Their risk management practices in particular will be more tightly overseen.

3.7.3 Corporate Governance

If one starts with the realization that the financial organizations under consideration will be operating in a developing country like Sierra Leone and that failures in a financial system have systemic economic effects, it is difficult to be concerned with only shareholder interests when looking at corporate governance of financial firms and markets in general. Indeed, even extending the concern to workers and other participants in the financial system is not enough.

These days, most experts in the field of corporate governance start from the view that a corporation is 'a complex web or "nexus" of contractual relationships among the various claimants to the cash flow of the enterprise' (Macey and O'Hara 2003). In the context of a developing country, the fiduciary duties of managers and directors of financial services firms should be broader than maximizing the value of the firm for shareholders. Loyalty of the organization's officers to shareholders should not have external harmful effects on the larger community for which those shareholders do not pay. The beneficiaries of directors' fiduciary duties (in particular, of care and loyalty) in the case of banks and other financial organizations should extend beyond shareholders.[10]

The requirement of fiduciary duties of senior officers of financial services firms, organizations and markets should then hold the officers liable not so much for mistakes of judgement or wrong decisions but rather for actions and inactions that manifest fraud, illegality, gross negligence, and conflicts of interests or wrong decisions not made in good faith. It is not only shareholders that should take action to enforce the fiduciary rules but also the supervisory authorities. In that regard, the internal supervision of financial services firms, the information reporting systems of the firms, and the decision-making processes, research facilities and standards of the organizations, will all be matters of supervision/oversight by the authorities.

A clear approach is thus necessary to ensure that, in exercising their fiduciary duties to shareholders, the financial services firms and markets in the financial system do not act in ways that threaten the stability of the economy or reduce confidence in the financial system as a whole. In fact such an approach is implicit in the best supervisory regimes around the world. Such regimes contain rules, procedures and processes designed to ensure the soundness of financial firms, including their ability to withstand shocks of reasonable probabilities. The fiduciary duties to shareholders are conditional on meeting these supervisory standards.

3.7.4 The Compensation System and Risk-Taking

If the incentives in regulatory agencies are sufficient to make the personnel in those agencies perform their work well in making sure that risk assessments and capital provisions in the systemically important financial firms are optimal, there will be no need for additional micro-supervision such as implementing pay limitations for executives of the financial firms. Still, it is easy to endorse an increased focus on the relationship between compensation systems and risk taking within financial firms. It is very tempting to say that this is not a big issue in an African country like Sierra Leone, partly because compensation packages are not as explicitly structured in ways that encourage high risk deals for quick profit, and partly because the kinds of bubbles that provide an environment for such deals tend to be really rare and not as bloated in the African economies as compared with more developed economies. Yet it

[10] Macey and O'Hara (2003) also take a view that is along this line when discussing the corporate governance of banks. They call for 'bank directors to expand the scope of their fiduciary duties beyond shareholders to include creditors'. Hence they 'call on bank directors to take solvency risk explicitly and systematically into account when making decisions, or else face personal liability for failure to do so'.

would be surprising to see, occasionally, bank personnel systematically permit dangerously high concentration of exposure to a few sectors, as was the case for the recent banking problems in Nigeria (see Sanusi 2009), without some initial motivation to exploit what was perceived as possibilities for quick and/or certain substantial profit in the hope of being rewarded with salary hikes and other compensations (bonuses, promotion, etc.).

The Financial Stability Forum (re-established as the Financial Stability Board in April 2009), in April 2010, issued nine *principles for sound compensation practices* designed to ensure effective governance of compensation, effective alignment of compensation with prudent risk taking, and effective supervisory oversight and engagement by stakeholders (FSF 2009). The three principles dealing with effective governance are especially important. Principle 1 states that 'the firm's board of directors must actively oversee the compensation system's design and operation.' The idea is that the compensation system 'should not be primarily controlled by the chief executive officer and management team. Relevant board members and employees must have independence and expertise in risk management and compensation'. Principle 2 states that 'the firm's board of directors must monitor and review the compensation system to ensure the system operates as intended.' Principle 3 states that 'staff engaged in financial and risk control must be independent, have appropriate authority, and be compensated in a manner that is independent of the business areas they oversee and commensurate with their key role in the firm.'

3.7.5 Early Warning Signals

Public policy towards crisis prevention and resolution has included concerted efforts to improve early warning signals and the promptness of response to crises. Policy in the area of warning signals has at least two interrelated aspects. One is developing the ability to recognize and comprehend signals from financial firms that they are experiencing serious problems, especially liquidity and credit problems. The second involves putting in place a forward-looking risk-based supervision framework that could alert the authorities to problems arising with respect to both individual firms and a financial subsector or market.

A *risk-focused bank supervision framework that is forward-looking* can be an important component of an early warning system (see, for example, Baldwin 2002). Risk-focused supervision requires the supervisor to make qualitative assessments and develop a thorough understanding of a bank's risk profile and risk management capabilities. Forward-looking and proactive, risk-focused supervision also requires flexibility in supervisory programme design. The approach, in brief, involves identifying different categories of banks and then developing supervisory programmes tailored to the specific needs of each category. Statutory supervisory requirements must be sufficiently flexible to accommodate such an approach.

3.7.6 Organizational Structure: Unified or Not?

It is obvious that, from an organizational perspective, a regulatory/supervisory agency must have clear objectives, autonomy, and expertise to do its job, as well as be accountable to government, parliament, financial sector/industry, and the populace at large. Autonomy includes budgetary and instrument autonomy. Instrument autonomy includes authority and power to enforce its rules and to sanction for non-compliance, as well as immunity from prosecution of its officials for official actions taken in the line of duty.

Most experts believe that a supervisory/regulatory agency outside the central bank or the government must be funded by levy on the regulated firms and markets, rather than by government. South Africa, for instance, has a Financial Services Board (FSB) that supervises non-bank financial services; the FSB is financed by the financial services industry itself, with no contribution from government. The FSA in the United Kingdom also does not receive any funding from government; it charges fees (which it classifies as *periodic*, *application*, and *special project* fees) to firms they regulate and to other bodies (such as 'recognized investment exchanges', according to the FSA). Having said that, there is nothing, in principle, to prevent a country from deciding to wholly or partially finance an independent supervisory agency from general government revenue if, in light of the rudimentary state of the financial sector, levies from that sector are insufficient to maintain a supervisory agency of a sufficiently high standard.

Whatever the case, Sierra Leone is likely to continue to have the Bank of Sierra Leone as the bank supervision authority for the foreseeable future. There is nothing wrong with that, especially since the bank appears committed to continue its efforts at strengthening its capacity to perform the relevant tasks. Still, for reasons stated in the next three paragraphs, Sierra Leone may need to re-examine this question sometime in the not-too-distant future as the financial system develops.

An important issue is whether there should be a unified supervisory agency as in Australia, Canada, Denmark, Iceland, Japan, Norway, Korea, Singapore, Sweden, and the United Kingdom, for example, or instead one should adopt various models of splintered agency arrangements as in the majority of countries (see, for example, Abrams and Taylor (2000) for a discussion). A disaggregated approach to supervision could work well, even for a country trying to develop its financial system from a low base. In addition, the country, for historical reasons, may feel comfortable with a non-unified approach. Moreover, the financing of a unified agency outside the central bank may prove difficult for the country.

In the case of Sierra Leone, it would seem reasonable that, despite its history, a single, unified agency would have several advantages which are important for an accelerated development of its financial system. First, there would be efficiency gains – economies of scale in regulatory activity – in the form of savings on administration, infrastructure, data collection and management;[11] absence of a need for modalities to share information and establish cooperative committees and the like with other agencies; efficient use of highly trained and experienced experts in short supply coupled with the ability to pay them well and hence to retain them in the public sector; ability to finance continuous training of staff in-house or externally; and externalities in knowledge and information sharing among staff of varied expertise in close proximity to each other (clustering effect). Second, it makes sense to encourage financial conglomerates[12] and, for these, unified supervision is advantageous; overall risk-assessment for the whole enterprise is important, because problems in one area will spill over to other areas. Third, products across subsectors are becoming more and more similar and hence directly competitive; regulatory neutrality can be better attained with unified supervision. Fourth, there will be little or no risk of financial services falling between the cracks due to lack of clarity of supervision authority in a dynamic financial services environment, foreign regulators will have to deal with only one supervisory agency, and the accountability problem is simplified as everyone will know the agency that is responsible for the supervision of the financial services industry and hence for any lapse or mistake. Finally, the gains from clustering and accessing global value chains will be better appreciated, and hence facilitated, by a single unified regulator.

There are, of course, certain risks and challenges that will confront a unified agency. But the experience of those agencies, particularly in the case of the UK Financial Services Authority which deals with a global financial centre, demonstrates that the challenges can be comfortably met. First of all, there will be a challenge to balance the multiple objectives of a unified supervisory agency. But surely, these objectives would all revolve around risk management, efficiency, consumer protection, and corporate governance issues. Second, possible diseconomies may arise. One frequently mentioned is that politicians and policymakers may be tempted to assign the unified agency functions that are outside its core domain. Another is that the unified agency may become somewhat inefficient due to its monopoly status. But clearly the direct solutions to these problems are not difficult to find. Third, it may be challenging to create a single agency culture, since the mindset of supervisors of different types of specialized financial firms and markets often appear to differ. Still, countries with unified agencies in place have been well aware of this problem and have found solutions for it.

[11] Michael Foot, for example, notes that before the FSA in the United Kingdom, there were eight different 'principal' regulators. They 'all had support services for Information Services and Human Resources that were seriously suboptimal in size. It proved also much easier and more effective for the FSA to represent UK interests in Brussels and at the huge range of international regulatory meetings than it had been for the individual regulators'.

[12] Fear of conflict of interest, insider trading and domination and abuse are, of course, risks that should be addressed in this regard. Conglomerates are also more complex to supervise than financial firms operating in only one subsector, because the risks, consumer protection, creditor protection, and corporate governance issues differ in significant details across subsectors.

3.7.7 The Role of the Central Bank under a Unified Structure

Even where there is unified supervision of financial services, by an agency separate from the central bank, the central bank must ensure that it has up-to-date prudential information on the banks. The central bank needs the prudential information on the banks in connection with its conduct of monetary policy, its foreign exchange rate policy and management, and its lender-of-last-resort function and other elements of its role in the payment system. In each of these areas of activity, banks will be the primary, and sometimes the only, set of financial services firms with which the central bank will be directly dealing. The central bank will need to have adequate information on the state of banks and the authority to request information (including via regular reporting) from individual banks.

Apart from direct contacts with banks, in the unified structure the central bank should in any event maintain close contact with the financial services supervisor. That way, the central bank can obtain additional insight from the financial services supervisor on the state of particular banks, as necessary. Indeed, as in Ireland, the financial sector supervisor can reside within the central bank while being independent (see O'Sullivan and Kennedy 2008).

3.8 First Steps in the Financial Market Development Process: Key Policy Areas

A developed financial system will have certain architectural and organizational structures that are well functioning. Indeed, it is these structures and their functioning that make a financial system developed, as opposed to being underdeveloped or rudimentary. This means that, from a policy point of view, financial market development can be seen as finding a socially optimal way to put such structures in place and have them well functioning. The important questions include: where should the focus be over the next decade or so in a country like Sierra Leone with a highly underdeveloped financial system and what are the appropriate roles of the public sector and the private sector? In addition, what should be the nature of cooperation between the private and the public sectors? In this context, selective intervention policies should be carefully thought through: financial markets should generally be given freedom and space to evolve and expand. Clearly, in the early stages of a major effort in financial market development, attention needs to be paid to certain important elements and aspects of the money market, the payment system, and capital markets.

3.8.1 Money Market Development

An active money market benefits monetary policy, the government as well as portfolio managers, banks, and securities markets. Hence, serious attention needs to be paid to its evolution from a very early stage of implementing a financial system development plan.

As regards *monetary policy*, problems and shocks relevant to monetary policy formulation are revealed more quickly the more developed are money markets, as they show up in market variables such as interest rates; the monetary transmission process is also smoother, and with shorter lags, the more integrated and efficient are money markets. An active, liquid, integrated and efficient national money market facilitates open market and other central bank operations to influence interest rates, base money, bank free reserves or any other targets of monetary policy.

Government instruments to finance deficits will also see increased demand and hence lower interest rates, other things being equal, the more developed are money markets. Moreover, with well-developed money markets, low risk instruments become available to portfolio managers and banks, and hence diversification and intermediation are made easier, with ultimate benefit to saving and investment as the gains are passed on to savers and investors.

For money market development, the building blocks and enabling environment are well known. To facilitate the evolution of well-functioning and active markets in financial products, the authorities need to take resolute steps to ensure certain desirable qualities of the environment. These relate to the legal framework, the clearing and settlement systems, the efficiency of the banking system, and macroeconomic stability, which are discussed elsewhere in this paper, as well as credit rating systems.

Ideally, well-functioning and efficient credit rating organizations would be desirable. But these are not likely to emerge in Sierra Leone for some time to come. Banks should therefore be encouraged to further develop their own internal credit rating systems. These, no doubt, will vary in sophistication from one bank to another, as mentioned earlier. The Bank of Sierra Leone should improve its database to help provide some of the information that the banks would need.

Ultimately, the financial system would benefit from specialized credit rating organizations. The authorities could promote the emergence of such organizations, including helping to identify sources of technical assistance. The authorities should also ensure that the credit rating organizations maintain an appropriate balance between confidentiality and accessibility to lenders and investors of the raw data and information collected and the credit ratings themselves.

The money market in Sierra Leone will evolve along several different lines depending on the preferences of the participants. The products of a developed well-functioning money market could be standardized (typically by maturities) or non-standardized. Non-standardized products have irregular maturities and in some countries irregular settlement procedures as well. They can also have specific securities as collaterals, e.g. repos with liquidity provided against specific bonds. The organization of the market differs in detail among countries, even with well-functioning money markets. The relative importance of market makers (who take positions, quote two-way interest rates) and of brokers (who do not take up positions and charge commissions for their services) also differ widely from place to place. Generally in well-functioning markets trading via brokers is small (around 10–20%); the rest is done on a bilateral basis. The nature of the trading also differs (role of electronic screens, bilateral direct contacts via telephones, use of correspondent accounts with major banks, etc.). Foreign exchange swaps tend to be quoted in terms of an exchange-rate premium/deduction, and not directly as an interest rate. The premium, of course, will tend to reflect interest rate parity calculations. In general, there are deposit and short-term funds, bond repos, securities with short remaining maturities, private sector money market assets, and swaps.

Deposits are the cornerstone of the interbank market. This is normally a market for unsecured overnight funds. The associated credit risks could be enormous. A secondary market in prime assets (an asset-based market), in contrast, facilitates interbank transactions across the maturity spectrum and avoids the credit risk problem, whether by outright sales of paper, collateralized deposits, or repurchase agreements.

As part of its role in the market, the central bank may help determine the standards that banks need to satisfy to be allowed to participate; it may help in developing an electronic trading system to use; and it could insist on specifying the maturities and the limits (e.g. in relation to deposits or capital) to prevent excessive borrowing or short-term borrowing becoming long-term.

The interbank market itself can be important for monetary operations and policy. The interbank rates can serve as benchmarks for fixing interest rates for other financial products and could be the major operating targets of monetary policy.

Private sector money market assets, such as bankers' acceptances (BAs),[13] certificates of deposits (CDs),[14] or commercial paper[15] could be useful in the development of the money market. But they could differ greatly in credit risks and the authorities may have little or no control over their supply. Discounting them can be a challenge for the central bank. For BAs, there are typically two names at least, the endorsing bank and the accepting bank; hence the credit risk is typically lower. The CD is a 'one name' paper, the name of the issuer, as is the commercial paper.

The Bank of Sierra Leone, as the central bank, can have substantial leverage over the money market, because it could decide standards to participate in any open market operations, to come to its discount window, and to settle in its books. The central bank can take several direct steps to assist in the development of the money market. Perhaps the most important role the central bank could play is the provision of settlement services for the banks. That way, they do not have to use correspondent banking arrangements and will

[13] Banker's acceptance is a bill of exchange or time draft drawn on and accepted by a bank. The bill of exchange itself is a two-name paper, the drawer and the drawee.

[14] A negotiable claim issued by a bank in return for a term deposit.

[15] An unsecured note issued by companies for borrowing (typically on a short-term basis).

settle using balances with zero credit risk and achieve settlement finality with payment, once their accounts have been credited and debited in the books of the central bank.

The central bank can be also important in information, practices and architecture. In other words it can encourage certain practices and procedures, and its persuasive powers are enhanced by the fact that it could intermediate and foster cooperation among market participants, at the early stages of market development. The central bank could encourage the emergence of market makers and market maker agreements, for instance by having special financing facilities for market makers and requiring signing of market-maker agreement(s) in the various products for access to the financing facilities. The central bank could also encourage up-to-date computerization. Moreover, the central bank could collect, collate, and disseminate information (mainly aggregated and with short time lag of a week to a month) to market participants on things like positions, transactions volume, financing, bids and offers. The central bank should also see that the market participants set standards on matters like delivery and payment, no doubt with the purpose of early achievement – that is, as soon as possible – of delivery versus payment on the books of the central bank.

Important issues arise with respect to *discount window policy* and *reserve requirement policy*. There is a delicate balance to be struck with respect to access of banks to borrowing from the central bank at the discount window. The central bank cannot encourage use of its discount window as a first resort; the banks should be encouraged to go to the market. The central bank could even help by having a 'discount window' that is effectively selling one bank's excess to another bank with a demand for reserves, e.g. for settlement purposes in the books of the central bank. In other words, the central bank could be operating an interbank market for, say, overnight funds. At the moment, in Sierra Leone, the discount houses do not appear to be doing a satisfactory job in this area, and the level of activity in the interbank market is low.

To encourage banks to continue to first look to the interbank market, as that market develops, the Bank of Sierra Leone could lend at only penalty rates, sometimes even backed by securities (so-called Lombard facility). The central bank could, alternatively, lend at non-penalty rates with rules of access that discourage overuse. With minimum reserve requirements, allowing the averaging of reserve holdings would facilitate active reserve management by banks, increasing their liquidity.

The central bank could influence the composition of the products in the money market, e.g. via the instruments selected for open market operations or discounting. For instance, if over time there comes to be only limited stocks of government treasury bills for public debt purposes, a decision would need to be made regarding whether the central bank would issue its own bills, whether the government would agree to have a special issue of bills to be employed for monetary policy purposes only, or whether the central bank would agree to using short-term private debt instruments (including interbank products) in its monetary operations. In the case of private debt instruments, the central bank selects among the market papers available, taking into account especially credit risk, and this has an unavoidable impact on the product structure of the interbank market.

All things considered, Sierra Leone already has substantial ability, which with some appropriate technical assistance, could enable it to rapidly develop its money markets, particularly by aiding in the evolution of bonds, bankers' acceptances, commercial paper, and bond repos. Banks could issue certificates of deposits (CDs), and large non-financial firms could issue commercial paper and bankers' acceptances (BAs). These instruments could soon begin to be regularly traded in financial markets. The Bank of Sierra Leone should set capital requirements for accepting banks in the case of BAs. The right to issue CDs and accept bills of exchange/time draft could be restricted to sound banks – banks declared safe and well run – by the banking supervision department of the BSL. Given the limited trust for banks by potential depositors, the credit risk fears of some market participants, and the expected initial absence of a sizeable and active market for CDs, banks may, for some time, be able to attract participation only in CDs of short duration – say three, six, and nine months. After some experience with those maturities, additional and longer maturities could be successfully issued.

Banks could also be permitted to sell bonds. Bonds would normally be of longer duration than CDs – say, three to five years to start. In the current Sierra Leone environment, banks may need to take measures to increase the attractiveness of the bonds. Until an active secondary market for them emerges, the issuing banks could stand ready to repurchase the bonds on demand, with discount rates closely tied to some indicator rate. The discount factor would differ with the term to maturity of a bond. A disadvantage of the policy of commitment to repurchase the bond is that banks may lose the assurance of the medium-to-long-term nature of the loan involved in a bond issue; they may, therefore, feel constrained from using the funds to make medium-to-long-term loans. While this is understandable, the enhanced liquidity of the bond due to the policy may encourage the development of a secondary market in the bonds, so that the issuing banks in fact are never called upon to repurchase the bonds before maturity.

In addition to standing ready to repurchase outright their own bonds, banks could also be willing to arrange repo agreements involving their own or other banks' bonds. In this way, a bond repo market involving commercial bank bonds could emerge.

3.8.2 Payment System Development

Sierra Leone has a very rudimentary payment system. Desirable for efficient and well-functioning financial markets would be at least one large value payment system that satisfies the ten core principles for systemically important payment systems (see CPSS 2001). The Bank of Sierra Leone would no doubt own and manage this system. Settlement among domestic banks for all financial market transactions would also take place in the books of BSL. The BSL must unavoidably address a number of organizational issues as it strives to lead the modernization process and develop the payment system. Typically, countries find it useful to set up a National Payments Council (NPC), comprising at least the central bank and a number of commercial banks, and probably also other financial organizations that actively participate in the payment system. Within such a coordination body, ideas can be openly discussed, information on demand for payment services obtained, and a consensus reached on important public policy issues related to institutions (including the legal framework), competition policy, and the role of the central bank, as well as technological and other choices for major (especially large-value) systems (e.g. types of payment instruments, queuing mechanisms, availability and pricing of intraday liquidity, overnight credit, availability of information to participants, and time of settlement finality) and risk control measures such as use of collateral and backup and contingency plans (see Johnson *et al.* 1998). Support from the NPC can indeed greatly enhance cooperation, at the implementation stage of major initiatives, thereby lowering implementation cost. It is hoped that the National Payments Council/Committee proposed in the FSDP of Sierra Leone will be sufficiently well designed and well functioning to achieve the desirable objectives of such a coordinating body.

A major challenge the authorities will face is deciding how the payment system should evolve with the demand (basically user requirements) of the financial system, given limited resources on the one hand and the desire to foster economic growth and development on the other (see, for example, Johnson *et al.* 1998; CPSS 2006). This is made more complicated by the fact that, despite the slow pace of realizing the objective, a monetary union is proposed among The Gambia, Ghana, Guinea, Liberia, Nigeria and Sierra Leone, which will ultimately form a monetary union with the Banque des Etats de L'Afrique de L'Ouest (BCEAO) countries, in order to achieve monetary union of the countries of the Economic Community of West African States (ECOWAS). This means that Sierra Leone, in its payment system development policies, will face pressures to develop its desired real time gross settlement (RTGS) system in order to facilitate cross-country transfers within such a union, an RTGS system that will, no doubt, be more sophisticated than what would be optimal for purely domestic payments purposes for some time to come. The likely fruition of the monetary union being uncertain in its timing will leave the Sierra Leone authorities with major uncertainties in their decision-making process. Nevertheless, the challenge must be met and with careful analysis the country should be able to avoid unnecessary waste of funds.

A well-developed depository system for securities should complement the development of the clearing and settlement system. Moving quickly to dematerialized securities and making sure that the speed of settlement of stock transactions meets international standards would also help the development of the capital market (discussed below).

3.8.3 Capital Market Development

From the perspective of financial market development and benefiting from the growth effect of such development, Sierra Leone should not in principle be anxious to push stock market development at this stage, rather than simply pressing on with development of the banking system. Overall, financial structure per se does not seem to matter a lot for economic growth as compared to financial development pure and simple (see, for example, Demirgüç-Kunt and Levine 2001). Still, introducing a stock market as an important element in the development of the market-based segment of the financial system can contribute not only to accelerating financial development but also to raising the efficiency with which the banking system operates in the performance of its intermediation function. In addition, the banks will be able to raise equity in the stock market and the stock market will benefit from the screening capabilities and securitization activities of the banks. Hence, there could be an effective co-evolution of two important branches of the financial system (see, for example, the model of Song and Thakor 2010). All of this should have a positive effect on economic growth.

A stock market was inaugurated in Sierra Leone in 2009 and a Securities and Exchange Commission (SEC) is expected to be established in the near future. Before it comes into being, the Bank of Sierra Leone will perform the SEC functions. Apart from trying to get the stock market functioning in a regular way and putting in place the rules (particularly relating to capital adequacy of brokers and ensuring disclosure and investor protection) and the machinery to make the SEC perform its functions effectively, the Sierra Leone authorities want to take some initial steps to develop and deepen the capital market. According to the plan, these steps should include creating a long-term debt market depending initially on government debt instruments, and introducing law and regulations to facilitate collective investment schemes 'to allow the formation of investment companies and unit trusts'. The authorities, as reflected in the FSDP, also see the two discount houses as potentially 'the dominant players' in the capital market in the foreseeable future.

Unfortunately, stock market capitalization and liquidity[16] in Sierra Leone are unlikely to be significant for the foreseeable future. Many obstacles lie in the way. Development of the stock market will be challenging for the Sierra Leone authorities and the financial sector participants themselves, given the small size of the Sierra Leonean economy. Such development will require policies

[16] Two measures of liquidity found useful are the *value traded ratio*, that is, the total value of shares traded on a country's stock exchanges divided by GDP, and the *turnover ratio*, that is, the total value of shares traded on a country's stock exchanges divided by stock market capitalization (the value of listed shares on the country's exchanges). The turnover ratio measures trading relative to the size of the market. Levine (1997), in addition, notes that trading costs and the degree of uncertainty associated with trading and settling transactions are also important in assessing liquidity. He further explains that the objective of the liquidity indicators is 'to measure the degree to which agents can cheaply, quickly, and confidently trade ownership claims of a large percentage of the economy's productive technologies'.

and investment, particularly for automation of trading and setting up a central depository system. The Sierra Leone stock exchange should nevertheless benefit from attempts within ECOWAS countries to promote regional integration of such exchanges, as evidenced by the example of the Bourse Regional Des Valeurs Mobilière (BRVM), a regional exchange involving eight French-speaking West African countries of the West African Economic and Monetary Union (see, for example, Yartey and Adjasi 2009).[17]

To ensure that the stock market contributes effectively to financial development and economic growth of Sierra Leone, the authorities will need to take steps to ensure substantial growth in listing on the market, including the organizational and institutional changes mentioned above to promote development of the market. Otherwise, as the evidence shows, the stock market will help large firms raise capital but the direct contribution of the stock market to economic growth will be very small and probably even insignificant; in addition, the stock market will remain underdeveloped (see Yartey and Adjasi 2009).[18] Indeed, despite the strong case for co-evolution, one would suspect that, particularly at this early stage of stock market development, the banking system evolution is likely to be of greater help to development of the stock market than the reverse.

As regards relying on the government bond market to be the backbone of development of the capital market in general, a problem is that it can encourage undesirable government budget deficits not financed by foreign grants. Government bonds also typically are a more expensive source of finance than treasury bills. Rather than pushing public debt to form the backbone of the development process of the capital market, the authorities should work on the enabling environment to stimulate private equities and private debt (bonds and long-term bank loans and deposits) to play this role.

This does not mean, of course, that government bond issuance should be discouraged, only that it should not be expanded aggressively as a means to help develop the capital market. The government can, for instance, develop a modest programme of issuing bonds via regular auctions, which can serve purposes of market development as well as assisting in monetary policy of the central bank. The government can also lead the way in issuing different types of bonds, e.g. indexed bonds, floating rate bonds, retail bonds (for small investors), which the private sector can mimic, thereby promoting the development of the market.

Still, in general, as potential major investors in long-term debt instruments – such as the National Social Security and Insurance Trust (NASSIT) – increase

[17] The eight countries are: Benin, Burkina Faso, Côte d’Ivoire, Guinea-Bissau, Mali, Niger, Senegal and Togo.

[18] The evidence is that the contribution of the stock market to economic growth becomes significant after some threshold of the ratio of value of shares traded to GDP is crossed. In other words, stock market liquidity matters greatly for the contribution of stock markets to economic growth in general.

their demand for bonds and long-term bank deposits, ways should be found to enable private sector firms as well as public enterprises to build the appropriate capacity (such as proper accounting and good governance) to enter such a market, in addition, of course, to the normal equity market (the stock exchange). A 'corporate bond market' can thereby emerge. Venture capital could be a great source of funds in such a market. Of course, venture capital firms could also emerge to acquire equity in well-run public commercial firms, if such firms exist.

Credit ratings matter greatly for the development of capital markets. Banks and ordinary savers are not likely to hold the equity or liabilities of commercial firms without some concrete knowledge of the risks they face and the appropriateness of the pricing of those risks. This, understandably, leads to an anxiety to create credit rating organizations. But such bodies even if planned can take some time to emerge and become effective in performing their role in the financial system. Hence, Sierra Leone's banks and other financial firms need to depend heavily on their own internal rating systems more heavily than in fully developed financial systems. Since, in any event, such internal rating systems will always have value, no matter how developed the financial system, it makes sense to stress, as part of the first steps in financial market development, capacity building of financial firms, particularly banks, to accelerate development of their own internal credit rating systems and processes.

This also means that, as part of the first step in capital market development, serious technical assistance would be useful to potential entrepreneurs, to modernize their operations, particularly those firms and enterprises in tourism, agriculture and exports in general. Such firms could then provide the incentives for venture capitalists to enter the budding Sierra Leone capital market and for banks to increase seriously their portfolio of long-term loans. The modernized enterprises would also be able to issue equity and bonds for which there would be effective demand from savers and regular investors. Various aid agencies and non-governmental organizations could assist commercial enterprises in Sierra Leone in their undertaking to modernize. Seeking such assistance makes sense because, if there is a sound economic policy environment in Sierra Leone (see Johnson 2004) and hence good prospect for sustainable growth in the 7–10% range for a couple of decades, modern companies will undoubtedly be the drivers of this growth process. They will become important channels via which foreign investors come to Sierra Leone, to invest outside of the minerals sector, including investing in the county's bond and equity markets, and financing enterprises in tourism as well as in agriculture and industry, particularly export-orientated enterprises.

The development of the secondary bond market may also need early attention in the financial development programme implementation. Promotion of some kind of bond market association, as found useful in some countries (e.g. Republic of South Africa), is a logical way to begin. This may evolve into a bond exchange, as in South Africa (see Mboweni 2006); or some other arrangement may be equally satisfactory in the Sierra Leone context.

3.9 The Longstanding Access to Finance Questions

Since independence, policymakers in Sierra Leone, as in most other sub-Saharan African countries, have worried about access to credit for low-income and rural persons (individuals and enterprises); for certain types of activities, especially agriculture; and for medium- and long-term investments, as opposed to short-term particularly self-liquidating demands of commerce. In economic terms, the view is that the way the credit markets work in these low-income countries has resulted in a deviation of private and social profitability in the allocation of credit; adverse effects on small-scale entrepreneurship; and overall suboptimal financial intermediation that has deterred saving mobilization for development. As stated in the Sierra Leone Financial Sector Development Plan (FSDP), 'increasing access to finance for the 73% of the population who live in rural areas, the 70% who live in poverty, and the 50% of the economy that is represented by agriculture, are at the heart of the FSDP.'

If the available funds for lending are suboptimally allocated, it seemed logical to many policymakers, for a long time, that part of the solution or remedy should lie in selective credit controls. Unfortunately, such controls were seen to have serious adverse welfare and economic growth effects and considered rather indirect attempts to solve the underlying problems (see Johnson 1974, 1975). Johnson (1974) argued that to address the underlying problems the direct solutions involved an explicit tax-cum-subsidy or the creation of financial firms with actual or potential comparative advantage in assessing the creditworthiness of, and in administering and servicing loans to, what we can call here the 'neglected borrowers'. This second approach has gained much currency because high administrative cost and the fear of high default rates, in light of adverse selection and/or moral hazard, are seen as important reasons why certain borrowers are neglected by the regular financial firms. Credit rating agencies certainly do not exist in Sierra Leone to help banks in the client screening process, for instance, and internal rating systems of the banks are not designed – in light of profitability considerations – to help solve the screening and monitoring problems related to lending to micro-borrowers, for example.

The informal financial sector in Sierra Leone is regarded as also not functioning well, having been adversely affected by the decade long socio-political instability (1991–2001). Hence, apart from whatever innovations the regular commercial banks are able to make to adapt and improve their ability to increase credit to the neglected individuals and enterprises, the FSDP is placing its hopes on microfinance institutions (MFIs) and on community banks which also accept deposits unlike the MFIs.

3.9.1 Community Banks

It is not clear why the Sierra Leone authorities want to actively promote community banking in a small underdeveloped country like Sierra Leone with an underdeveloped commercial banking system, as opposed to simply focusing on encouraging greater commercial bank branching and increasing the ability of those banks to lend to certain 'neglected' groups. In big countries like the United States, the idea of community banks is to give greater attention to the demand ('needs') of local communities – individuals and businesses. Community banks are expected to channel deposits, obtained mainly from the local community, into loans in the communities involved. The bank officers are also supposedly highly accessible to the community depositors and borrowers and are immersed in the local affairs of their communities. In making decisions on loans, for example, personal characteristics of the borrowers are likely to be taken into account, including family history. One advantage often cited for such banks is that they understand the needs and constraints of small businesses, being small businesses themselves.

But community banks in a country like the United States are big relative to some of the commercial banks in a country like Sierra Leone. Moreover, the commercial banks in Sierra Leone are likely to behave like community banks in extending loans and in their relationships with their communities. It is little wonder that even in the FSDP there is the thought that it may be a good idea to encourage commercial banks (among others) to acquire major shareholding in the community banks. In this author's view, in the Sierra Leone context, promoting branch banking by the commercial banks is a more direct way to achieve whatever benefits are seen to ensue from promoting so-called community banks.

3.9.2 Microcredit Organizations

The place of microcredit firms and organizations in a country like Sierra Leone is still open to discussion. The issues are how they should be financed and operated and what the measurement of their 'success' should be. The promise is, of course, that by increasing access to credit for neglected groups and activities, microcredit organizations can substantially alleviate poverty, promote entrepreneurship among the low-income population, facilitate improved intertemporal consumption patterns among the very poor and hence welfare of those borrowers and, in some cases, will augment the saving rates of the poor communities. An important general recommendation that can be made is for the authorities to arrange for a comprehensive study of the way forward in microcredit design, organization, monitoring and supervision, building on the recent Sierra Leone experience as well as the worldwide experience with microcredit. The result of the study should not only be used to guide government intervention but also to inform financial firms, civil society and aid organizations that are supportive of special initiatives in microcredit.

For instance, the enormous research that has been going on in the microcredit area has provided evidence that group lending, which has seemed like the preferable way to lend to the poor, to enable group enforcement of obligations, may not be as essential as once thought. Collateral-free individual liability lending has worked under several schemes. Also, experience has revealed ways to address problems with group lending – most notably strategic default leaving others to bear the repayment obligation – where such lending continues to be found essential. The structuring of incentives – e.g. gradual increase in lending ceilings, threats to cut off credit for repayment failures, varying interest charged with repayment record – have been experimented with in several locations around the developing world (see, for example, Karlan and Morduch (2010) for a review and some references). Diversity in the structuring of repayment schedules has also been experimented with, demonstrating that flexibility is feasible in this area and that a one-size-fits-all approach is not necessarily optimal even within the same organization and country. Ways to improve screening of potential borrowers and perform risk analysis with the data set available from the information obtainable are important areas of work to which public policy can also provide some input and incentives.

At the same time that all of this is going on, there is also a case for addressing the general question of the role of microcredit in poverty alleviation. No doubt an important issue in these investigations would be if it is possible to ensure viability of microcredit programmes without subsidies and financial aid. On the face of it, this possibility seems realistic with appropriate design and management, especially given the high return to capital found among microcredit enterprises in several contexts around the world and the high interest rates the very poor are willing and able to pay for consumption and emergency loans obtained from traditional lenders, even in Sierra Leone. Related to this is the question of whether finance is the main constraint on entrepreneurship among the poor.

The fundamental question is whether there are better ways for public policymakers to use public funds (including money obtained from aid) to help the poor – for instance, via general education and technical and vocational education and training, or provision of certain health services – than subsidization of microfinance activities. Studies can be easily designed and conducted to help answer these questions. The ideal would be to get a better sense of how much additional credit should be aimed at the very poor as opposed to being allocated to someone else – a sort of marginal decision-making regarding the optimal allocation of any given amount of credit in the economy – since, for example, poor people do vary widely in their ability to benefit from additional credit via microcredit programmes (for discussions of some of the issues involved, see Armendáriz de Aghion and Morduch (2005), Banerjee and Duflo (2010), Khandker (1998) and Yunus (1999)).

3.9.3 Long-Term Finance for Small and Medium Non-micro Enterprises

The measures to improve the enabling environment for financial firms, by getting the fundamentals right, as well as to develop the capital markets, discussed earlier, would all help to increase the access to long-term investment funds, including bank long-term loans. As mentioned in the FSDP, there is also a need to look at specific problem areas that many have highlighted, namely, the system of land rights, several collateral issues, as well as transparency in pricing and in the procedures of the banks. Beyond that, in order to improve policymaking in this general area of long-term investment funds for the medium- and small-scale enterprises in the private sector in Sierra Leone, there is great need for serious research and analysis in order to clarify several major issues. These would include the following topics:

- the available evidence that finance is a significant constraint on local entrepreneurship among small and medium enterprises (SMEs) in Sierra Leone;
- the nature and potential sources of funds available to Sierra Leone enterprises;
- the type of actions that local entrepreneurs can, and should, take to gain increased access to potential funds, given their capacity to use the funds;
- the ways local entrepreneurs can enhance their capacity to use available funds profitably.

Answers to such questions would help in designing appropriate public policy (especially via the government, the central bank, and the legal system) not only to further improve the enabling environment so as to attract suppliers of funds to lend to the long-term investors but also to enhance the capacity of the Sierra Leone entrepreneurs to attract and use the funds.

3.9.4 Saving Facilities for the Lowest Income Individuals and Groups

Although discussions of access to finance for the so-called underserved in most African countries, including Sierra Leone, have emphasized credit, it is useful to keep in mind that the supply of instruments, mechanisms and products for financial saving as well as the supply of insurance services are also elements of access to finance that are important to financial development and to economic growth in general, which it can be argued are not optimally available in most African countries and certainly not in Sierra Leone. Here, again, the low-income and rural populations are the most underserved.

Policymakers in Sierra Leone know that low-income individuals, despite their low incomes, are capable of saving and do save. In Sierra Leone they save via cash held in their homes, including in foreign exchange, especially US dollars; deposits made with trusted, typically more well-to-do, relatives and friends; investments in non-financial assets like cattle, land, residential buildings and jewellery; and miscellaneous business assets, which they use in commerce as well as in other businesses they operate, such as tailoring or taxi service. When these are the only saving outlets, the savers can typically benefit from greater flexibility, liquidity and diversity in their savings portfolios. More importantly, and related, financial intermediation in the system as a whole is most likely suboptimal. Indeed, from a national point of view this also means that national investment may not be as efficient as it can possibly be. The return to national savings may not be as high as is feasible and the saving rate may not be as high as it possibly can.

Hence, countries like Sierra Leone want to design and effectively market financial sector products that can attract savings of the poor into the financial system (see, for example, CGAP 2010; WSBI 2004, 2008). In the formal sector, an effective tool recently introduced in Sierra Leone is the National Social Security and Insurance Trust (NASSIT). It seems surprising that no serious initiative has been put in place to enable and attract the informal sector to participate in this system. It seems highly desirable and possible to get informal sector employees to participate in NASSIT on a voluntary basis. Hence, NASSIT should be encouraged by the authorities to look into ways to make this a reality.

A successful initiative of years past was the Post Office Savings Bank (POSB). The objective stated in the FSDP of separating the POSB from the Post Office and rejuvenating it, including increasing its access in the rural areas, is an excellent one. But the management of the POSB would have to improve drastically for it to fully attain its potential effect on financial saving, especially among the poor. As with the Tanzania Postal Bank (see WSBI 2004, 2008), the POSB of Sierra Leone can also profitably enter the microcredit business, with the saving and credit components complementing each other. In this light, some minimal saving requirement could be a qualification for obtaining a loan, whether individually or as a member of a microcredit group. In order to boost the ability of the POSB to garner savings, following concerted efforts to improve the POSB management and putting in place an appropriate supervisory framework for it, the Bank of Sierra Leone can examine the possibility of increasing the safety of the saving deposits by providing some kind of guarantee to the depositors.

With literacy rates increasing and general educational levels rising among the poor, it should become easier even for commercial banks to design and build up flexible saving accounts in the population as a whole. These accounts could earn interest, and hence superior to traditional passbook accounts, while not as inflexible as term deposits. Such accounts, as with certain saving accounts already in existence, could allow withdrawals after minimal notice. In order to market such accounts, apart from finding ways to spread the information, innovations like using deposit collectors, mimicking what informal saving arrangements do, can be efficient, especially in the larger towns. In Sierra Leone, following tradition, to attract the savers from smaller towns and villages, the deposit collectors can arrange periodic meetings with depositors (say once a month) in public places such as community centres. The challenge would be to find inexpensive ways for savers to withdraw funds to meet urgent unexpected needs; indeed, accessibility to savings accounts at all times is an important incentive contributing to success in saving drives directed at low-income individuals and groups. The availability and increasing use of cell phones could play a part in such drives in the foreseeable future. For instance, a saver could call a deposit collector who would agree to meet the saver who wants to withdraw money before the next regular meeting of depositors.

The government and banks, but not other private firms, in the nearer future could also be allowed to issue bearer (coupon) bonds. The bonds maintain anonymity with respect to the holder to whom interest and principal will be paid upon tendering a bond certificate; hence they do run the risk of loss due to theft, misplacement or destruction. But unlike cash they earn an interest. In the early stages, an innovative bank could offer safe deposit facilities especially for low-income persons residing in certain neighbourhoods.

The government could also, or instead, consider issuing a small savers security to be purchased on tap. The security could be of various maturities, cashable before maturity but not transferable, and hence avoiding the risk of forgery which can be quite substantial for a bearer instrument. The interest rate on this security should at least match that of regular government securities of similar or close maturities.

3.9.5 Insurance

The FSDP has some sensible plans for strengthening the insurance industry (Republic of Sierra Leone 2009, pp. 40–47). The plans include amending the current Insurance Act (2000), *inter alia*, incorporating microinsurance and crop insurance, and creating the conditions for its speedy implementation, including by putting in place the necessary institutional and organizational framework. The supervisory authority (the Sierra Leone Insurance Commission – SLICOM) will be strengthened. To meet the challenge, the Sierra Leone authorities propose to work closely with the Sierra Leone Insurance Association (SLIA), which they will try to make more effective as an organization through various devices to enhance its capacity to support the industry as a whole, as well as with the individual firms/companies themselves. Ways will also be found to make the industry better serve the public including via requiring companies to maintain a complaints register and formalizing an insurer redress mechanism that works in the public interest. Finally, the FSDP indicates that the authorities will encourage the insurance companies to come up with more socially optimal ways to use their investment resources, diversifying away from the current tendency to concentrate in the real estate area.

All these are steps in the right direction. But no doubt more needs to be done. We would add that the FSDP should, in addition, put some plans into effect to increase the demand for insurance, particularly for health, housing, and life. There is clear suboptimal insurance in these areas. Hence, the SLIA should be encouraged, perhaps in cooperation with the Bank of Sierra Leone, the Ministry of Finance and Development, and SLICOM, to study ways in which the insurance market could be expanded in Sierra Leone, including the appropriate insurance product designs for various types of potential clients/demanders.

Insurance facilities and products for the lowest income individuals and groups, which are no doubt very hard to design and manage and for which the effective demand, prima facie, is especially low, should be given special attention in such a study. Poor households in poor countries like Sierra Leone do face a variety of risks from shocks, which can have serious adverse long-term consequences for their well-being. There are traditional devices which the poor use to address these risks. In farming, for example, multi-crop farming is one. Generally, mutual and communal assistance arrangements, especially to deal with adversities like illnesses, bereavement, and crop failures are also forms of insurance. Still, there is a potential effective demand from the formal insurance market, which should not be neglected *ex ante*.

3.10 Keeping Track of Progress and Programme Evaluation

We have indicated above that an action plan would be an essential element of the reform and development plan. No doubt, this would be a rolling plan. Now, in conclusion, we highlight the important issues of tracking progress in implementation and of programme evaluation. In order to ensure that the relevant authorities and the financial sector keep track of the progress being made in the reform and development processes and to enable continuous programme evaluation as well valuable research projects, we would highly recommend that systematic data collection and storage begin as early as possible. In particular, we would recommend data on:

1. evidence of actual implementation of official programme initiatives;
2. the detailed evolution of important aspects of the financial system;
3. panel data on important outcomes, that is, effects on 'final' financial system variables of policy interest.

The goal of the reform and development, in a sense, is to effect changes in 'final' financial system variables such as:

1. credit (aggregate and to various sectors, subsectors and categories of borrowers);
2. real interest rates on loans;
3. spreads between lending and borrowing rates;
4. saving rates;
5. aggregate value of insurance premiums per capita or relative to GDP;
6. the total value of shares traded on the country's stock exchange divided by GDP;
7. the total value of shares traded on the country's stock exchange divided by the value of listed shares on the country's exchange.

The data collected would allow policymakers to test, for example, whether credit to a particular group increased between two or more dates because of human capital improvements in the banks, particular innovations in the banks, increased financial capability of the populace (as measured by some index), or because of some specified changes in the taxation system, the legal system, or the regulatory system?[19] The individual bank data should be collected and used for such estimation.

It is also important to keep track of the evolution of aspects of the financial system, because in a sense, these are the intermediate targets of the programme; they are the evidence of the success of implementation of the programme. Continuing with the above example, these 'intermediate' target variables are the independent variables used in explaining the 'final' system variables (the final outcomes) of the reform process. The more the intermediate target variables change over time, the more meaningful the econometric evaluation can be. Of course, the hope is that the changes will be in the direction that reflects success in financial system reform and development.

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[19] For an introduction to the econometric evaluation of programmes, see Imbens and Wooldridge (2009).

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Chapter 4

STRUCTURAL CHANGE AND COMPETITION IN THE SIERRA LEONE BANKING SECTOR: AN EMPIRICAL INVESTIGATION

By Olufemi Sallyanne Decker

4.1 Introduction

Sierra Leone's 2009 Financial Sector Development Plan explicitly states that there is a need to develop a competitive and efficient financial sector to promote private sector development, accelerate economic growth and reduce poverty.[1] The importance of financial development in achieving economic development goals is well researched in the academic literature and forms the cornerstone of policy prescriptions for financial sector reforms (see, for example, Levine 1997; Levine *et al.* 2000; Honohan and Beck 2009; Beck *et al.* 2011).[2] In the context of the IMF's financial sector assessment efforts and national poverty reduction strategies, increased attention is being paid to the role of banking structure and competition in financial sector development. Beck *et al.* (2011, p. 5) see competition as 'the most important driver of financial innovation that will help African financial systems deepen and broaden'. There is a concern that uncompetitive banking markets cause banks to provide inadequate services and realize excessive profits.

The World Bank (2005, p. 18) defines competition in the financial system as 'the extent to which financial markets are contestable and the extent to which consumers can choose a wide range of financial services from a variety of providers'. A contestable market is one in which real or perceived entry and

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[1] This builds on the recommendations of the 2006 Financial Sector Assessment Programme report. The four priority areas of the 2009 Financial Sector Development Plan are the strength and competitiveness of the banking sector, access to finance, mobilization and investment of funds and regulatory and legislative reforms for development, stability and capacity building.

[2] Kargbo and Adamu (2009) recently found a positive link between financial sector development and economic growth in the case of Sierra Leone.

exit barriers do not exist and the threat of entry is sufficient to force firms in an industry to behave as if it were competitive.[3] Llewellyn and Weyman Jones (2010) distinguish between traditional notions of competition and effective competition. Whereas traditional views and measures of competition focus largely on the numbers of competitors, effective competition occurs in an environment that is open and transparent and in which consumers have access to information needed to make rational choices at low transactions costs.

Competition in banking is considered beneficial for a number of reasons. Sinclair (2000) states that competition in banking should accelerate long-run growth by narrowing the spread between lending and borrowing interest rates and by limiting collusive and restrictive practices. As in any other market, increased banking competition can promote economic growth through improved cost efficiency, welfare gains from lower prices and better services for consumers, innovation and a greater variety of products (Cetorelli 2001a; Northcott 2004; Claessens 2009; Pruteanu-Podpiera *et al.* 2008; Schaek and Cihak 2008; Bikker and Spierdijk 2009). Increasing competition among banks can also widen access to all potential clients and so promote financial inclusion and social equality (Demirgüc-Kunt *et al.* 2008).

Bank credit plays an essential role in financing the production of goods and services. Competition in the banking sector can impact on private sector development because of how it affects industrial firms' access to external financing. Petersen and Rajan (1995), Vives (2001), Cetorelli (2001b) and Mitchener and Wheelock (2010) have found that where industries depend on external financing, concentration in the banking sector can enhance the growth of the industrial sector. One explanation for this is that concentration and market power increase availability of bank credit to firms by providing incentives for banks to establish relationships with their customers. Alternatively, Beck *et al.* (2004) found that concentration is associated with financing obstacles for small, medium and large firms. Similarly, Claessens and Laeven (2005) concluded that greater competition allows financially dependent industries to grow faster.

Like most African economies, Sierra Leone's rudimentary financial system is dominated by banks. However, there has been no study of competitive conditions in the Sierra Leone banking sector. Indeed, few studies have directly estimated the level of competition in African banking markets. Kasekende *et al.* (2009) have noted that reliable measurement and monitoring of competitive conditions pose significant challenges for African policymakers and that these shortcomings must be addressed to reform banking and capital markets effectively. A sound understanding of the impact of changes in banking market structure on competition and reliable and transparent measurement of competition in banking is needed to inform both microprudential and

[3] The characteristics of a contestable market lead to a market in which potential competition becomes as powerful as actual competition. Competitive behaviour and pricing can be observed even if there may be only one firm serving the market. Inefficient firms whose production costs are higher than those of potential entrants are forced to leave the industry.

macroprudential regulation, banking supervision, banking competition policy and monetary policy.

Sierra Leone's banking sector presents a unique opportunity to study banking competition in the context of postwar financial reconstruction. This is because conflict exacerbates many of the informational limitations of developing countries' banking systems that can act as impediments to banking competition. The damage and destruction that accompany war worsen information asymmetry and can distort financial intermediation because of loss of capital, personnel, property, records and uncertainties in collateral (Addison *et al.* 2001a,b; Bikker and Spierdijk 2009).

Postwar structural changes, such as rapid foreign bank entry, provide an added impetus to explore competitive conditions in Sierra Leone banking. The Bank of Sierra Leone and the International Monetary Fund have both commented on these changes. In spite of concerns that there are too many banks relative to the size of the market, the level of intermediation remains low, which may indicate limited competition.[4] Excessive competition can create instability in the banking sector and have a negative impact on some customers, especially those at risk of being financially excluded. Limited competition leads to inefficiency and the exercise of market power.

This study adopts an industrial economics approach and a unique bank-level panel data set on the Sierra Leone banking system to study structural change and competitive conditions over the period 2001–10.[5] The notion of structural change embraces alterations to the conventional elements of market structure, such as size distribution, numbers and comparative significance of banks within the financial system and in the mechanisms by which financial intermediation takes place within the financial system (Llewellyn 1990; Gardener 1992). Ultimately, changes in industry structure alter the competitive environment within which firms operate and their strategies for profit maximization. Competition studies are undertaken to determine whether players in a market are able to exercise market power and raise prices above marginal costs.

The contribution of the chapter is threefold. First, trends and patterns in key structural developments are examined to highlight drivers of change and the implications of these for competition and effective financial intermediation. Second, by evaluating competitive conditions in Sierra Leone using both structural competition measures and the Panzar–Rosse approach, the study

[4] The Bank of Sierra Leone (2009) has expressed concern that, given the relatively small size of the market, there may be too many banks operating the sector. On the other hand, the IMF has suggested that the low level of intermediation in Sierra Leone may be indicative of limited competition in the sector (IMF 2010).

[5] Industrial economics is concerned primarily with the relationship between market structure, firm conduct and performance as well as the nature of the competitive process in markets. Revell (1987, p. 1) clearly states the case for studying banking sectors within an industrial economics framework. 'Banking is like any other industry in having an economic structure … and … there is a branch of applied economics that can be called the industrial economics of banking.'

adds to the small but growing body of literature on the industrial organization of banking in African economies. Third, lessons and policy considerations for policymakers are outlined.

This chapter is organized as follows. Section 4.2 analyses key structural changes in the sector since 2001. Section 4.3 outlines the Panzar–Rosse methodology used in the econometric analysis of competitive conditions in Sierra Leone banking for the period 2001–10 and summarizes previous African studies that have used the methodology. The empirical results are presented in Section 4.4. Section 4.5 considers the policy implications of the findings and Section 4.6 concludes.

4.2 Structural Change in Sierra Leone Banking 2001–10

Sierra Leone's protracted civil war disrupted the banking sector in a fundamental way, leaving widespread damage to the branch network and banking infrastructure as well as financial loss and loss of customer goodwill and confidence.[6] To provide the foundations for developing and strengthening the financial system, new regulations and legislation were introduced in the immediate aftermath of the war. The Bank of Sierra Leone Act 2000 updated and clarified the functions of the Bank of Sierra Leone, including matters relating to developing and promoting an efficient banking and financial system in Sierra Leone. It also brought the legislation in line with other central bank legislations in West Africa and emphasized the Bank of Sierra Leone's price stability objective. The Other Financial Institutions Act (2001) widened the supervisory remit of the Bank of Sierra Leone to include any institution engaged in financial activity.

The Banking Act and the Banking Regulations of 2001 and 2003 saw the introduction and implementation of prudential standards and measures relating to capital adequacy, provisioning and a move towards embracing international norms. In line with the Basel Accord, the regulations adopted a minimum risk weighted capital requirement which was set at 15%. Other areas covered included bank licensing, minimum paid-up capital, local assets ratio, connected lending and foreign exchange exposure. In an additional bid to strengthen prudential regulation, steps were also taken to comply with the Basel Principles for Effective Supervision.[7] Kargbo (2010) suggests that one of the reasons why the legislation was reviewed was to facilitate adequate licensing of new banks entering the Sierra Leone banking sector. Since 2001, there have been several increases in the minimum paid-up capital. The Banking Act 2000 set the minimum capital requirement at Le 800 million for domestic banks and at Le 1.6 billion for foreign banks. In 2005, the minimum capital requirement

[6] A notable casualty was Barclays Bank SL Limited Barclays had operated in Sierra Leone since 1917 but ceased operations in 1999 by selling its share to the government of Sierra Leone.

[7] See the Bank of Sierra Leone Annual Report for 2001.

Table 4.1. Banks operating in Sierra Leone as at 31 December 2010.

Bank	Date of establishment	Ownership
Standard Chartered Bank SL Ltd	18 March 1971*	Foreign private
Sierra Leone Commercial Bank	15 February 1973	Local public
Union Trust Bank	26 April 1995	Local private
Rokel Commercial Bank	20 September 1999	Local joint public/private
Guaranty Trust Bank	1 February 2002	Foreign private
First International Bank	31 May 2002	Foreign private
International Commercial Bank	1 November 2004	Foreign private
Ecobank**	22 November 2006	Foreign private
Access Bank	8 November 2007	Foreign private
Skye Bank	19 August 2008	Foreign private
United Bank for Africa	21 July 2008	Foreign private
Zenith Bank	11 September 2008	Foreign private
Bank PHB	18 June 2009	Foreign private

Source: IMF country reports, Bank of Sierra Leone annual reports, bank websites.
*Established operations in Sierra Leone in 1898. **Procredit Bank, which set up operations on 1 August 2007, was taken over by Ecobank in 2010. 'Ownership' based on a controlling interest of more than 50%.

was increased to Le 15 billion for all commercial banks by 2009. At the end of 2010, the minimum capital was doubled to Le 30 billion for all commercial banks to cover a five year period effective 2014. The Bank of Sierra Leone has also adopted the CAMELS rating system in its supervision activities, as it builds up a risk based approach to supervision.[8] These regulatory changes set the backdrop for a new era in Sierra Leone banking.

The postwar period has seen growth in the banking system and an influx of foreign banks. Table 4.1 presents incorporation and ownership details of the 13 banks operating in Sierra Leone at the end of 2010. At the end of 2010, the Sierra Leone banking sector comprised 13 banks with mixed ownership. 10 banks are foreign owned. Of the 3 local banks, the government has 100% ownership of the Sierra Leone Commercial Bank and majority ownership of Rokel Commercial Bank. United Trust Bank is the only indigenous privately owned bank.

4.2.1 Number of Banks and Branching

Figure 4.1 highlights the sector's rapid transformation in terms of the number of institutions as well as the size of the branch network. The number of banks

[8] The CAMELS rating system is used by regulators and bank supervisors to determine a bank's overall condition, identify its strengths and weaknesses and provide a summary measure of a bank's overall financial condition. The six elements of the system which denote the acronym CAMELS are capital adequacy, asset quality, management, earnings, liquidity and sensitivity to market risk.

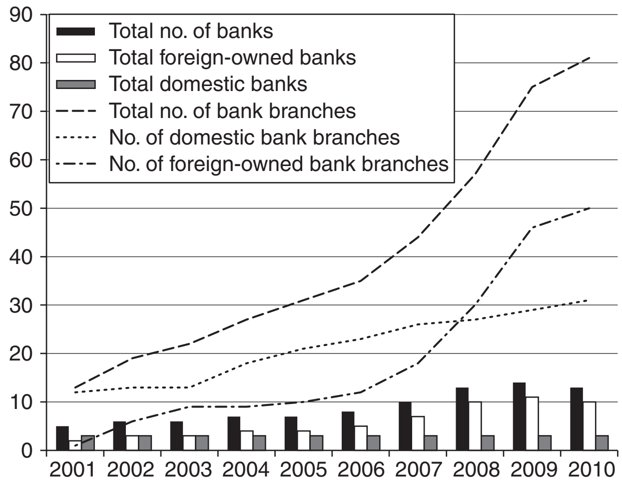

FIGURE 4.1. Numbers of banks and bank branches 2001–10.
Source: author's calculations.

almost trebled between 2001 and 2010 rising from 5 to 13, with 11 foreign banks granted licenses in the period. The influx of foreign banks was gradual between 1999 and 2004 but accelerated between 2007 and 2009, when 6 out of the 11 made their entry. The regional dimension of the new entrants' origin is a distinctive feature as 9 of them are subsidiaries of leading Nigerian banks.[9] Accompanying the influx of new banks has been growth in and a wider distribution of the branch network. Figure 4.1 shows a sixfold increase in the number of bank branches from 13 in 2001 to 81 in 2010. Of the 13 bank branches operating in 2001, 9 were located in the capital city, Freetown. By 2010, the branch network had become more dispersed with approximately 50% located in Freetown. Foreign bank entry has played a role in the rapidly expanding branch network. In 2001, 92% of the network was domestically owned. By 2010, 50 of the 81 bank branches belonged to foreign banks, with local banks accounting for only 31 branches (38%).

This finding suggests that foreign banks may be using branching to differentiate themselves and gain competitive advantage. It also emphasizes the importance of the location of the banking firm, particularly in more rudimentary circumstances where technological adaptation is low and informational problems are more severe. These make a physical presence necessary for banks to supply their services to customers in ways that are appropriate and suitable for them. Proximity to customers can help banks to collect information on their customers, develop relationships and facilitate more efficient relationship lending, especially as foreign banks may not have the trust capital, image and reputation that local banks enjoy. Extensive branching can also be perceived as

[9] The two exceptions are International Commercial Bank (a Malaysian Bank) and Procredit Bank (a German microfinance bank).

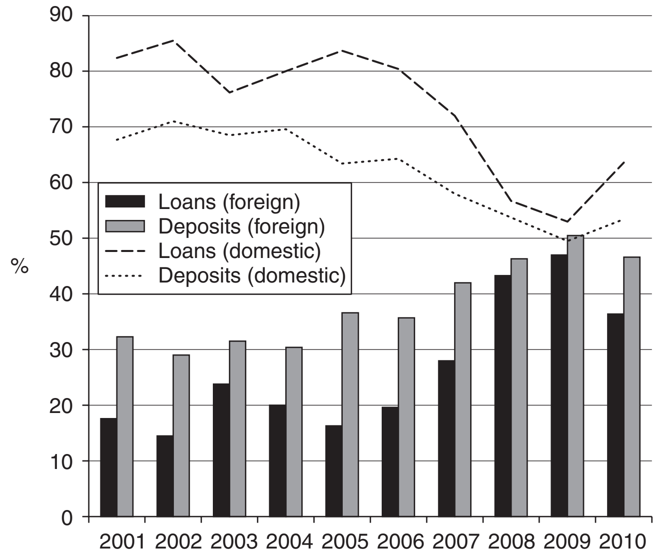

FIGURE 4.2. Market shares of domestic and foreign banks, 2001–10.

a symbol of high-quality banking services and can be used as a unique selling point in marketing campaigns.

4.2.2 Banking Activity and Market Shares

Table 4.2 provides a summary of changes in key indicators of banking activity over the period. Total assets increased from Le 255 billion to Le 2.441 trillion. Between 2001 and 2010, assets grew at an average annual rate of 57.79%. The amount of loans outstanding in 2010 stood at Le 874.70 billion. The average annual growth rate for loans over the period studied was 36.92%. Total deposits in 2010 were Le 1.62 trillion. Over the period 2001–10, deposits grew at an average annual rate of 24.87%. The higher loan growth rate suggests that lending activity may have started at a much lower base than deposit collection. Also, banks may have been more aggressive and successful in making credit available, over the period, than in mobilizing deposits.

The breakdown of the market shares shown in Figure 4.2 reinforces the impact of foreign bank entry as a key dimension of structural change. At the end of 2010, local banks accounted for less than half of all banking assets, 44.6% compared to 65.2% in 2001. Government-owned local banks accounted for 37.7% of assets of the banking system. Between 2001 and 2010, foreign banks' market share of loans increased from 17.6% to 36.4%. Within the same period, foreign banks' share of deposits increased by almost 15% from 32.3% to 47%. The continuous decline, since 2005, in the domestic banks' market shares stemmed in 2010. This upturn may signal a turning point in developments in the industry.

TABLE 4.2. Summary of the Sierra Leone banking sector, 2001–10.

	2001			2005			2010		
Classification	Total	Domestic	Foreign	Total	Domestic	Foreign	Total	Domestic	Foreign
Number of banks	5	3	2	7	3	4	13	3	10
Number of branches	13	12	1	31	21	10	81	31	50
Total assets (Le billion)	255.2	166.2	89.0	670.8	427.4	243.4	2,441.6	1,088.9	1,352.7
Total deposits (Le billion)	176.4	119.3	57.1	506.8	321.3	185.5	1,625.6	868.3	757.3
Total loans (Le billion)	37.7	31	6.7	167.5	140.4	27.1	874.7	556.4	318.3
Loan/deposit ratio (%)	21	26	11.7	33	43.73	14.6	54	64	42
Loan/asset ratio (%)	14.8	18.6	7.5	25	32.8	11.1	36	51	23.5
Market share									
Assets (%)	100	65.2	34.8	100	63.7	36.3	100	44.6	55.4
Deposits (%)	100	67.7	32.3	100	63.4	36.6	100	53	47
Loans (%)	100	82.4	17.6	100	83.7	16.3	100	63.6	36.4
Revenues (Le billion)	52.1	30.9	21.2	126.1	79.8	46.3	379.6	165.7	213.9
of which: interest revenue (Le billion)	22.1	13.39	8.76	75.5	51.83	23.7	219.7	107.05	112.65
Interest revenue/total revenue (%)	42.4	4.5	41.3	59.8	65	51.2	57.8	64.6	52.7
Net income (Le billion)	26.2	12.76	13.44	48.1	27.3	20.8	84.4	53.8 (64%)	30.6 (36%)
Net interest margin (%)	7.5	7.77	7.0	9.69	10.18	8.84	7.04	8.02	6.25
Return on assets (%)	11.9	11.49	7.86	8.1	5.37	6.22	3.40	5.01	−0.98
Non-performing loans (Le billion)	12.3	11.22	1.1	50.2	40.3	9.9	153.4	99.2	54.20
Non-performing loans/gross loans (%)	32	36	16	30	29	37	18	18	17

The analysis shows that foreign banks operating in Sierra Leone have always accounted for a much greater share of deposits than of loans, controlling almost half of the deposit base in 2010. Foreign banks generally have lower market shares of loans due to informational disadvantages that they tend to face in the lending markets (Cihak and Podpiera 2005; Kablan 2010; Rashid 2011). Another reason for foreign banks' higher market shares of deposits could be that due to a perception that they offer better quality services and have a reputation for deposit safety, foreign banks can attract deposits away from local banks and so gain market share. They can also use innovative products to mobilize new deposits.[10] Faced with informational disadvantages that can make lending in the host country riskier, they may be more inclined to collect and transfer much of the finite resource base of their host countries away from the domestic banks to lend abroad. Rashid (2011) points out that such practices can reduce local banks' access to cheaper deposit funds and force them to resort to more expensive interbank funding. The main concern about the impact of foreign bank entry on lending is the possibility of cream-skimming where foreign banks lend only to the best credit risks, forcing domestic banks to make riskier loans.

The analysis presented here shows that foreign banks more than doubled their share of lending over the period. This suggests a more vigorous competition on the lending side and could also be indicative of the general growth in lending levels. Lending levels had been quite low during the war and in its immediate aftermath, due to sluggish economic activity. Analysis of the loan-to-deposit ratio shows that lending was indeed sluggish in 2001, representing only 21% of deposits. By 2010, this had more than doubled to 54%. In the 10-year period, the ratio of loans to deposits increased by 38 percentage points for domestic banks (from 26% to 64%) and by 30 percentage points for foreign banks. The quality of the lending portfolios, while still a cause for concern, has improved over the period with the ratio of non-performing loans to total loans falling from 32% to 18%.

Figure 4.3 shows that the pattern of growth in deposits and loans has been quite volatile over the years with growth of loans displaying considerable variability. After 2006, the deposit growth rate was fairly consistent at around 33%. There was very strong loan growth in 2002 and 2003 and again between 2007 and 2009. The marked increase in lending in the 2002–3 period and after 2006 corresponds with episodes of foreign bank entry. Volatility in lending does not only increase costs and undermine risk management but it also means fluctuation in the funds available for consumption and investment purposes, impacting on growth. Domestic banks are expected to be more stable in their lending because they are less likely to be affected by developments in international markets. Foreign banks, on the other hand, can transmit problems in their home markets and from their international operations to developing and emerging economies through the lending channels, resulting in more

[10] However, in some banking markets, high switching costs can act as barriers to entry on the deposit side and local banks that have developed established relationships with depositors can have a competitive advantage.

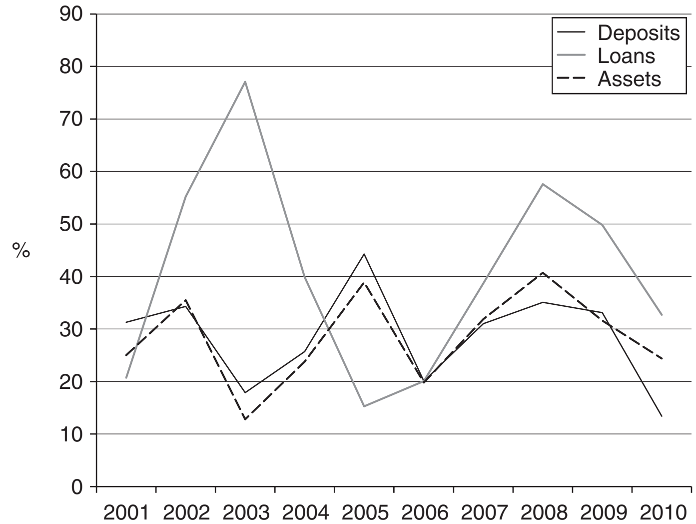

FIGURE 4.3. Year-on-year growth in assets, loans and deposits, 2001–10.
Source: author's calculations.

volatile lending patterns. While further investigation is required to determine the extent to which these fluctuations are attributable to foreign bank lending, it is perhaps not coincidental that the foreign banks' share of loans more than doubled from 17.6% to 36.4%. In 2010, although the level of deposits and loans rose overall, there was a clear slowdown in the growth rates, which may be a result of the impact of the global financial crisis.

What is emerging is a picture of intermittent periods of considerable activity, especially on the lending side. According to BSL (2009), there are observable differences between the behaviour of the incumbents, which are mainly domestic banks and the new entrants. The more established banks have not been as active as the new entrants in developing their business and enhancing their services. Furthermore, in many respects, domestic banks are at a disadvantage because of factors such as a lack of marketing expertise, bad loans, lack of institutional and financial capacity, poor financial strength and poor commitment to developing the market. These circumstances have even given rise to operational problems at, and stability concerns about, the two largest banks, Sierra Leone Commercial Bank and Rokel Commercial Bank (BSL 2009).

4.2.3 Intermediation Efficiency, Concentration and Competition

In 2007, there were only 160,000 accounts for a population of more than 5 million inhabitants (IMF 2009). Credit to the private sector was about 6% of GDP compared to the sub-Saharan average of 17% (IMF 2009). Demirgüç-Kunt *et al.* (2008) estimate that only 13% of the adult population in Sierra Leone has an account with a financial intermediary. One of the reasons why intermediation

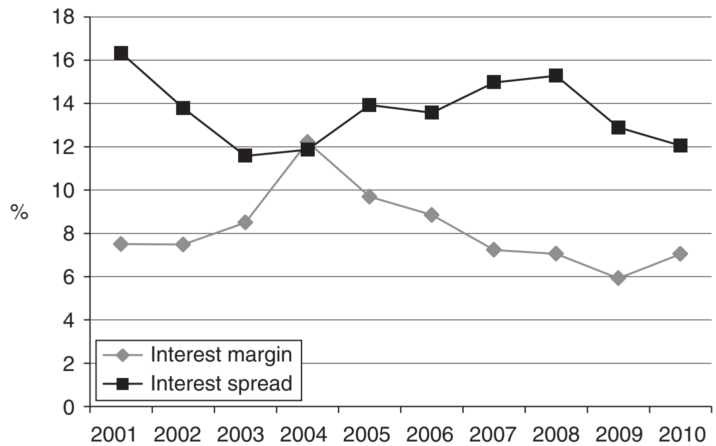

FIGURE 4.4. Interest rate spreads and interest margins 2001–10.
Source: author's calculations.

could be low is the presence of a non-competitive market structure. The high barriers to access which exist in Sierra Leone could also lead to low levels of intermediation.[11] More competitive banking systems are expected to exhibit lower interest spreads and margins because firms are faced with an ongoing incentive to improve their operations continuously, resulting in lower costs, lower prices and efficiencies in financial intermediation (Brock and Rojas Suarez 2000; Belaisch 2003; Beck and Hesse 2009; Rashid 2011). Interest spreads and margins serve as a useful proxy for intermediation efficiency in a financial system.[12] A lack of competition in banking markets weakens incentives for banks to improve efficiency leading to large interest rate spreads.

There are different definitions of interest spreads due to the fact that banks have different lending and deposit rates and follow different practices in setting rates. Following Folawewo and Tennant (2008), the interest rate spreads for the banking sector as a whole are shown in Figure 4.4 to give an indication of the broad state of financial intermediation efficiency in Sierra Leone. For interest margins, a wide measure is adopted here and is calculated as interest received minus interest paid divided by total assets (Brock and Rojas Suarez 2000).

[11] Sierra Leone has been shown to have a higher level of barriers to services such as consumer loans, commercial loans and deposits when it comes to physical access, affordability and eligibility. For these three services, Sierra Leone has worse statistics for physical access compared to Ghana and Nigeria. Furthermore, in terms of minimum amounts required for opening saving and current accounts and minimum sums for consumer and mortgage loans, Sierra Leone has more stringent requirements than these countries when measured as a percentage of GDP per capita, only faring slightly better in terms of the conditions for loans to businesses (Demirgüç-Kunt *et al.* 2008).

[12] Interest rate spreads (*ex ante* spreads) are calculated from the contractual rates charged on loans and paid on deposits. Interest margins (*ex post* spreads) measure differences between banks' interest revenues and actual interest expenses.

Interest rate spreads decreased sharply from a high of 16.33% in 2001 to 11.58% in 2003 and then started to rise in 2004. Spreads widened from 11.58% at the beginning of 2004 to 15.28% in 2008 and then dropped by 3.9% to 12.89% in 2009. There was also a small dip in 2006. Further investigation revealed that the widening spreads are due to low and declining deposit rates and high lending rates. The deposit rate ranged from a low of 7.67% in 2001 to a peak of 11.07% in 2005 before dropping gradually to 8.95% in 2010. In 2005, the minimum lending rate rose considerably from 22% to 25% and stayed at that level up to 2008 before falling to its pre-2005 level. These wide spreads could also reflect risk premiums embedded in the lending rate and low deposit rates paid by banks because of high switching costs, which keep depositors captive, or because the banks are trying to cover other operating costs. Encouragingly, the interest spreads started to fall in 2009, although margins are on the increase.

Over the period, interest margins increased in the first half of the period peaking in 2004 at 12.21% before declining quite sharply in 2005 and more gradually up to 2009. The margin started to widen again in 2010 – an increase of 1.1% over 2009. While interest margins for domestic banks have been slightly higher than the industry average, the reverse is observed for foreign banks with lower margins than the sector. These figures do not indicate how much of this is due to interest from loans or to interest from investments in government securities which form a significant part of the banks' portfolios.

The determinants of interest rate spreads and interest margins are varied and apart from market structure can include transaction costs due to market frictions, information asymmetry and bank characteristics. The next section considers trends in two structural measures that are used as crude indicators of competitiveness, the concentration ratio and the Herfindahl–Hirschman index.

4.2.4 Concentration

Market concentration data is often used in initial assessments of competition even though it is now widely accepted that concentration does not measure competitiveness. Recent investigations however do concede that, *ceteris paribus*, there is a tendency for more concentrated markets to be less competitive (IBC 2011; House of Commons 2011). The concentration ratio CR_n measures the proportion of output that is attributable to the top n firms in an industry, ranked by market shares. By stressing the position of the top firms, the measure reflects inequality in the market but does not identify the distribution of output among the largest firms. An alternative measure, the Herfindahl–Hirschman index (HHI) is calculated as the sum of squared market shares (Rhoades 1993). This index takes into account both the numbers of firms and their relative sizes, capturing those firms that are not included in the n firm concentration ratios. The HHI is often used by competition authorities in initial assessments of the likely impact of mergers and acquisitions on market

Table 4.3. Concentration ratios and HHI by total assets, 2001–10.

Year	Asset concentration CR3 (%)	Asset concentration CR5 (%)	Asset concentration HHI	Deposit concentration CR3(5) (%)	Deposit concentration CR5 (%)	Loan concentration CR3 (%)	Loan concentration CR5
2001	90.8	100	2,839	93	100	83	100
2002	89	97	2,733	91	99	82	98
2003	85	97	2,508	87	97	80	98
2004	85.8	96.6	2,549	89	99	81	96
2005	82.7	95.7	2,387	84	97	84	96
2006	79.2	92.8	2,251	83	96	81	95
2007	69.1	85.6	1,832	75	92	72	86
2008	56.1	77.5	1,394	63	84	57	77
2009	53.9	73.6	1,282	60	78	55	73
2010	53.5	73.9	1,290	65	82	64	79

Source: author's calculations.

concentration.[13] To grasp the implications of the different HHI values over time, the HHI can be translated into a number equivalent index to indicate the number of banks of equal size that would give the value of the index.[14] However, like the concentration ratio, the HHI gives no indication about the behaviour of firms in the market.

Table 4.3 reports asset, deposit and loan concentration indicators for the period 2001–10. In 2001, the Sierra Leone banking system displayed a high degree of concentration. Asset concentration decreased significantly over the period with the three-firm concentration ratio falling by 37.7% and the five-firm concentration by 26.1%. The HHI also fell until 2009. There was a slight increase in 2010, reflecting Ecobank's takeover of the operation of Procredit Bank.[15] For example, the asset HHI of 2,839, in 2001, is broadly equivalent to a system with approximately four banks of equal size, while the asset HHI of 1,290 for 2010 is broadly equivalent to a system with approximately eight banks of equal size.

In 2001, 93% of deposits and 83% of loans were held by the three largest banks. The lower concentration levels for deposits would suggest more competition in the market for deposits than in the loan market. With new entry,

[13] In the US Merger Guidelines, an HHI index below 1,000 points indicates low concentration, between 1,000 and 1,800 points moderate concentration and above 1,800 points high concentration. Transactions that increase by more than 100 points in concentrated markets raise concern. Regulators generally consider an industry with an HHI of less than 2,000 points competitive, one with an HHI of between 2,000 and 6,000 points as oligopolistic and one with an HHI above 6,000 points as monopolistic.

[14] The number equivalent is calculated as the reciprocal of the HHI.

[15] In early 2010, Procredit Bank's management decided to discontinue operations on the grounds that new minimum capital requirements introduced by the Bank of Sierra Leone were not compatible with the bank's microfinance business model.

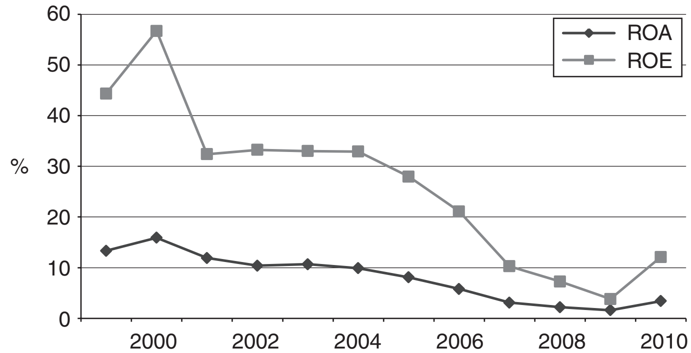

FIGURE 4.5. Banking sector profitability (ROA and ROE).

the concentration ratios dropped considerably and the data reveals a clear difference in the pattern of change over time. Decreases in concentration were significantly higher in the period between 2005 and 2010, than for the first half of the period. The three-firm deposit concentration ratio had dropped by 28% from 93% in 2001 to 65% in 2010. The decrease in the five-firm deposit concentration ratio was smaller, 18% with 15% of that decrease occurring at the time of significant foreign bank, between 2005 and 2010. In the case of loans, the three-firm concentration ratio fell by slightly less than the five-firm concentration ratio. The greater declines observed in the three-firm concentration ratios indicate that some of the new entrants are of a significant enough size to challenge the dominance of the large incumbent players.

Bank profitability in Sierra Leone at the beginning of the period studied was high. Return on assets was 11.9% in 2001 and return on equity 32.4%. The very high ROE figures recorded in the first half of the study period reflect the banks' very low level of capitalization. Subsequent increases in the minimum paid-up capital have seen the ROE figure fall quite dramatically.

These high levels of profitability may have been due to protected or uncontested markets. The very high profitability indicates that the domestic banks would struggle to meet the challenge of liberalization. With the influx of new entrants, there has been a marked decline in overall bank profitability as shown by both return on assets and return on equity, in Figure 4.5. By 2009, return on assets has declined to 1.6%, the lowest level in the period studied. This increased to 3.4% in 2010 largely as a result of the performance of the more established banks. Domestic banks have performed better than the foreign banks with new entrants recording significant losses in the period following entry. In 2010, half of the foreign banks recorded a loss, which is a concern. This could lead to the adoption of aggressive strategies to cover losses. The much reduced profitability can threaten the viability of some players and increase the risks of bank failure and its potentially contagious effects.

A comparison of profitability figures for Sierra Leone and Nigeria in the period just preceding the influx of Nigerian banks highlights the attractiveness of Sierra

Leone to Nigerian banks. Return on assets in the Nigerian banking sector was 8.37% in 2004, 3.01% in 2005 and 2.07% in 2006.[16] On the other hand, return on assets in Sierra Leone was 10.67%, 8.1% and 5.8%, respectively, for the three years.

The drop in profitability over the period, combined with the decline in concentration, provides support for an argument that competitive conditions intensified over the period when foreign bank entry was the defining feature of structural change in Sierra Leone banking. However, concentration levels started to increase again in 2010, which may indicate the beginnings of an increase in market power, in spite of the large number of banks. Structural measures such as the degree of concentration need to be supplemented with further analysis to determine to what extent limited competition may be a contributory factor to the low level of intermediation in the country and to determine whether banking markets in Sierra Leone can be characterized as contestable. Using the Panzar–Rosse framework and a unique bank-level data set, the next section provides a non-structural assessment of competitive conditions.

4.3 Measuring Competitive Conditions in Sierra Leone Banking Using the Panzar–Rosse Framework

The different metrics that have been used to evaluate and track competitive conditions in the banking sector can be traced to two major streams in the industrial economics literature on competition: the traditional structural approach and the alternative, non-structural approach which is adopted by proponents of the new empirical industrial organization (NEIO) methodology. The traditional approach infers competitive conditions from market structure variables and is underpinned by the structure–conduct–performance (SCP) framework and the efficient structure hypothesis.[17] The SCP framework proposes that markets characterized by few firms and high barriers to entry (high concentration) will facilitate pricing conduct aimed at achieving joint profit maximization via collusion, price leadership or other tacit pricing arrangements, yielding profits and prices that are greater than the competitive norm. Studies adopting this approach focus on concentration as a determinant of competition and use structural measures such as concentration ratios and the Herfindahl–Hirschman index as primary measures of competition.

The efficient structure hypothesis suggests a reverse view of market concentration, arguing that concentration within an industry is the result of competition which has the effect of producing efficiency differences between firms. It is the superior efficiency of large firms that leads them to increase in size which results in higher market concentration (Demsetz 1973; Peltzman 1977; Brozen

[16] See Central Bank of Nigeria Annual Reports for 2004, 2005 and 2006.

[17] The SCP framework was developed by Bain (1951, 1956) out of the seminal work of Chamberlain (1933) and Robinson (1933) on imperfect competition.

1982). Starting with the work of Berger and Hannan (1993) and Berger (1995) the collusion/efficiency question has been explored in several competition studies using regressions that include proxies for market concentration and efficiency as variables to explain changes in banks' profitability.

Alternative non-structural measures proposed by NEIO models do not rely on observations of the competitive environment but focus on actual bank behaviour as a determinant of competition and also take contestability into account. New empirical industrial organization models commonly assess competitive conditions by estimating deviations from competitive pricing. Techniques that follow a non-structural approach include those developed by Breshanan (1921), Lau (1982), Iwata (1974), Hall (1988), Roeger (1995), Rosse and Panzar (1977) and Panzar and Rosse (1982).

We now present the Panzar–Rosse framework before testing the hypotheses derived from the framework against the data. The Panzar–Rosse model provides a market power test that uses the relationship between bank revenues and input prices as a means of determining the nature of competitive conditions in an industry. Rosse and Panzar (1977) and Panzar and Rosse (1982, 1987) developed a competition measure, the H-statistic, which can reflect the structure and conduct of the market to which a firm belongs by measuring the extent to which equilibrium revenues respond to changes in input prices. The H-statistic is derived by summing the elasticities of a particular firm's (bank's) revenues with respect to input prices.

Table 4.4 summarizes how the H-statistic, which ranges from $-\infty$ to 1, is commonly interpreted to distinguish between different competitive environments. Negative values indicate imperfect competition. A negative H-statistic indicates that an increase in factor prices, increases marginal costs and reduces output and revenues. Values between 0 and 1 indicate monopolistic competition. If H is positive but less than 1, increases in input prices lead to revenues increasing less than proportionately to the changes in input prices. $H = 1$ is widely interpreted as perfect competition.[18] When $H = 1$, increases in input prices raise costs without affecting the optimum level of output produced by individual banks. Industry revenues rise due to exit of some firms and an increase in price as demand increases for the output of remaining firms.

The following reduced-form equation is estimated to calculate the H-statistic:

$$\log R_{it} = \alpha + \sum_{j=1}^{j} u_j \log P_{it}^{j} + \sum_{k=1}^{k} \beta_n \log \mathrm{CF}_{it}^{k} + \varepsilon_{it},$$

where R_{it} denotes firm revenue, P_{it}^{j} denotes the vector of the price of factors with $j = 3$ inputs, CF_{it}^{k} denotes the vector of bank-specific and other control

[18] This interpretation has been challenged by Llewellyn and Weyman Jones (2010, p. 14) who have pointed out that it is based on a misreading of the original work of Panzar and Rosse. In the alternative interpretation, all values of the statistic that are less than or equal to 1 are compatible with monopolistic competition, while some values are also compatible with either monopoly or perfect competition.

TABLE 4.4. Interpretation of the PR H-statistic.

Estimated value of H	Competitive environment
$H = 1$	Perfect competition in long-run equilibrium Natural monopoly in a perfectly contestable market Sales maximization subject to a break-even constraint
$0 < H < 1$	Monopolistic competition
$H \leqslant 0$	Conjectural variation oligopoly Neoclassical monopoly Collusive oligopoly Short-run competition

variables for each bank that may shift the revenue schedule, and ε_{it} denotes the error term.

The Panzar–Rosse test is based on a static analytical model and relies on a market equilibrium condition that the data observations must be in long-run equilibrium at each point the data is observed. This is to avoid ambiguity in interpreting the H-statistic in cases where the value of H is negative. When a market is in equilibrium, $H < 0$ reflects imperfect competition but if a market is in structural disequilibrium, competitive firms can also exhibit $H < 0$. In equilibrium, the sum of ROA elasticities with respect to factor input prices should be zero as return on assets should be uncorrelated with input prices.[19] Shaffer (1982) suggests a test for equilibrium. In the empirical test for market equilibrium, profits, usually measured by return on assets or return on equity, replaces revenues as the dependent variable in the same reduced-form equation that is used to calculate the H-statistic. This is shown below:

$$\log \mathrm{ROA}_{it} = \alpha + \sum_{j=1}^{j} u_j \log P_{it}^{j} + \sum_{k=1}^{k} \beta_n \log \mathrm{CF}_{it}^{k} + \varepsilon_{it}.$$

Taking the sum of ROA elasticities to be E, $E = 0$ indicates equilibrium, while $E < 0$ indicates disequilibrium. The definition of what constitutes equilibrium in the banking sector is unclear as highlighted by Shaffer (1982). When used in banking studies, long-run market equilibrium has been taken to imply that the banking system has attained a reasonable level of stability, that it is readily able to absorb shocks and that market conditions do not induce entry or exit (Molyneux 1996; Claessens and Laeven 2004; Buchs and Mathisen 2005; Musonda 2008; Bikker *et al.* 2009).

Although the PR model has been used widely to assess market conditions in large cross-country studies as well as for single countries, there have

[19] The reasoning is that long-run competitive equilibrium implies that $P = \mathrm{MC} = \mathrm{AC}$ with zero economic profits for any set of input prices. In the same vein, in disequilibrium, increases in factor prices result in subnormal profits until the market adjusts.

been few studies of this type for African countries.[20] A summary of relevant country-specific African studies and cross-country studies that include African countries is presented in Table 4.5. The results of these studies generally provide evidence of monopolistic competition with the H-statistic ranging from 0.39 to 0.89. Also competitive conditions have been found to improve following a period of liberalization or financial sector reform (Mugume 2007; Hauner and Peiris 2006; Biekpe 2011).

These studies have generally used the ratio of revenues to total assets as the dependent variable. Some have also included log of total assets as an independent variable. Bikker *et al.* (2009) have challenged these approaches, pointing out that they depart from the Panzar and Rosse theoretical framework and argue that such scale corrections constitute a misspecification that will bias the H-statistic upwards.[21] Furthermore, this misspecification makes it impossible to distinguish between perfect competition and imperfect competition in cases where the H-statistic is negative. By using the ratio of revenues to total assets for the PR test, studies estimate a price equation, rather than a revenue equation and so the H-statistic that is obtained does not reflect how output and ultimately, revenues are affected by changes in input prices. Buchs and Mathisen (2005) estimated price equations with and without log of assets to assess the effect of scale and found that the specifications which did not include log of assets provided more stable results.

This study departs from previous African studies and evaluates competitive conditions in Sierra Leone during 2001–10 by using unscaled revenue equations in which revenues are not divided by total assets. Very few studies have used unscaled revenue equations. These include Goddard and Wilson (2009) in a cross-sectional study of European banking, Bikker *et al.* (2009) in a cross-sectional study of 101 countries from developed and developing economies, Olivero *et al.* (2010) in a study of Latin American and Asian countries and Pawlowska (2011) in a study of Polish banking. Daley and Matthews (2009) use a scaled revenue equation in which revenues are not divided by total assets for the independent variable but the log of total assets is included as an independent variable.

4.3.1 Model Formulation, Variables and Data

Concurring with Bikker *et al.* (2009), Goddard and Wilson (2009), Olivero *et al.* (2010), Pawlowska (2010) and Daley and Matthews (2011), the Panzar–Rosse model for obtaining empirical measures of the H-statistic and evaluating

[20] See, for example, Shaffer (1993), Molyneux *et al.* (1996), Prasad and Ghosh (2007) and Rezitis (2010) for single-country studies, and Claessens and Laeven (2004), Molyneux *et al.* (1994), Casu and Girardone (2006), Bikker *et al.* (2009) and Goddard and Wilson (2009) for cross-country studies.

[21] Scale correction has been introduced in empirical PR models to account for the intuition that bigger banks are more likely to earn larger revenues in ways that are not related to changes in input prices.

competitive conditions in Sierra Leone banking is given by the following reduced-form revenue equation:

$$\begin{aligned}\ln \mathrm{REV}_{it} = a + b\ln(\mathrm{PF}) + c\ln(\mathrm{PL}) + d\ln(\mathrm{PK}) + e\ln(\mathrm{CAR}) \\ + f\ln(\mathrm{LOTA}) + g\ln(\mathrm{RTBR}) + h\ln(\mathrm{INF}) + \varepsilon_{it}.\end{aligned}$$

The model for obtaining the equilibrium conditions is:

$$\begin{aligned}\ln(1 + \mathrm{ROA})_{it} = a + b_1\ln(\mathrm{PF}) + c_1\ln(\mathrm{PL}) + d_1(\mathrm{PK}) + e\ln(\mathrm{CAR}) \\ + f\ln(\mathrm{LOTA}) + g\ln(\mathrm{RTBR}) + h\ln(\mathrm{INF}) + \varepsilon_{it},\end{aligned}$$

where i indexes banks and t indexes time. REV_{it} is revenue using either total revenue or interest revenue. PF, PL and PK define the unit prices of the three factor inputs, where PF equals the price of funds, PL the price of labour and PK the price of capital (other expenses/fixed assets).[22] The unit prices of the inputs are proxied by ratios of expenses to volumes, where the data for volumes is available. The unit cost of labour is measured by the ratio of personnel expenses to total assets. The ratio of personnel expenses to the number of employees is considered a better measure of the unit of labour, but where employee data is not available consistently for some banks, total assets is used as a denominator. The ratio of interest expenses to total funding is used as a proxy for the unit cost of funds and the ratio of other expenses to fixed assets, is used to proxy for the unit cost of physical capital. The H-statistic is $b + c + d$.

Bank-specific control variables are introduced to account for unique bank policies and circumstances that may be reflected in the revenues of individual banks such as portfolio composition, size, earnings potential, risk profile, growth orientation, liability structure and financial problems. The bank-specific control variables used in this study are the ratio of loans to assets (LOTA) as a proxy for the relative composition of bank assets and the capital adequacy ratio, CAR to account for the impact of regulatory capital requirements. Like the ratio of loans to assets, CAR is also an indirect measure of risk. Coccorese (2004) acknowledges the significance of the macroeconomic environment for banking competition. Consistent with Buchs and Mathisen (2005), Hauner and Peiris (2005) and Musonda (2008) who conducted studies for sub-Saharan African banking, two time series macroeconomic control variables are included. These are the 91-day Treasury bill rate (RTBR) and the inflation rate (INF).

Since the PR test is only valid if the market is in equilibrium, it is necessary to also estimate the model, using return on assets as the dependent variable.

[22] In this study, the definition of inputs follows the intermediation approach proposed by Sealy and Lindley (1977) in which labour, capital and purchased funds are usually specified as inputs while loans and deposits are specified as outputs. As funds borrowed from depositors are used in the production of earning assets, deposits are, therefore, intermediate outputs used in the final economic output of the bank.

TABLE 4.5. Panzar–Rosse model studies and results in African countries.

Authors	Countries	Sample period and number of banks	Results
Mlambo, K., and Mthuli, N. (2011)	South Africa	1999–2008 26 banks	0.57 Monopolistic
Biekpe, N. (2011)	Ghana	2000–2007: 17 banks	0.66 Monopolistic competition
Hamza, R. A. (2011)	Tunisia	1999–2008: 12 banks	0.67–0.71 Monopolistic competition
Mensi, S. (2010)	Tunisia	1990–2007: 10 banks	0.88–0.89 Monopolistic competition
Kasekende, L., Mlambo, K., Murinde, V., and Zhao, T. (2009)	SANE countries (South Africa, Algeria, Nigeria and Egypt)	1992–2007: Cross-sectional	Monopolistic
Greenberg, J. B., and Simbanegavi (2009)	South Africa	1998–2007: 14 banks	0.74 Could not reject perfect competition

TABLE 4.5. Continued.

Authors	Countries	Sample period and number of banks	Results
Musonda, A. (2008)	Zambia	1998–2006 Quarterly data: 13 banks	0.65 Monopolistic
Mugume, A. (2007)	Uganda	1995–2005	0.28 Monopolistic
Hauner, D., and Peiris, S. J. (2006)	Uganda	March 1999–June 2004: 15 banks, quarterly panel data	0.39 average Monopolistic competition
Buchs, T., and Mathisen, J. (2005)	Ghana	1998–2003: 20 banks	0.56 average Monopolistic competition
Claessens and Laeven (2004)	Kenya, Nigeria and South Africa (in a study of 50 countries)	1994–2001	Monopolistic competition 0.58, 0.67 and 0.85, respectively

To deal with cases where ROA may have a small negative value, 1 is added to ROA and $\ln(1 + \mathrm{ROA})$ is used as the dependent variable. The equilibrium E-statistic is $b_1 + c_1 + d_1$. Consistent with Shaffer (1982), Moylneux *et al.* (1996) and Claessens and Laeven (2004), the F-test is used to determine whether $E = 0$.

As one of the goals of the study is to analyse the evolution of competition over the period, the sample is split into two subperiods (2001–5 and 2006–10) to assess the impact of time on competitive conditions. 2006 marks a halfway point in the full sample and, furthermore, significant foreign bank entry and a marked increase in the number of banks started in 2006.

4.3.2 Bank Data Sample

The relevant market under consideration consists of all commercial banks as suppliers of retail banking products. The data set covers all banks operating the Sierra Leone in the period 2001–10. The data set comprises 2 state-owned banks, 1 domestic private bank and 11 foreign banks. Quarterly data on the bank-specific variables was extracted from a data set made available by the Bank of Sierra Leone. The information on Treasury bill interest rates and inflation rates was compiled from the Bank of Sierra Leone’s Annual Reports and Economic Reviews. As the data was obtained from central bank returns, data was available on a consistent basis for all banks in the data set. The sample used in the study is an unbalanced panel data set. All observations where banks reported missing values were excluded. For each factor input price, observations lying outside the 1–99th percentile range were removed from the sample.

4.4 Empirical Results

This section presents the results of the estimations using both interest revenue and total revenue as dependent variables. Casu and Girardone (2006) have argued that increased diversification of banks’ activities and the importance of fee income justifies considering both interest revenue and total revenue as dependent variables. In Sierra Leone however, interest revenue accounted for close to 60% of the banking sector’s revenues in 2010, an increase of almost 20% when compared to 2001. For domestic banks, the proportion of interest revenue was 64.6% while it was only 52.7% for foreign banks. Furthermore, the proportion of interest revenue to total revenue increased from 42.4% in 2001 to 57.8% in 2010.

Consistent with the empirical literature on competition in banking markets, the study employs fixed-effects panel data estimators. Goddard and Wilson (2009) have challenged this approach, arguing that the PR test should be based on a dynamic adjustment model since adjustments for firms may be partial and not instantaneous, thus violating the equilibrium assumption of the PR model. The dynamic panel estimator was not considered appropriate

TABLE 4.6. Value of the Wald test to determine a long-run equilibrium in the Sierra Leone banking sector between 2001 and 2010 (E_0: $E = 0$. E_1: $E < 0$).

Year	ROA E-statistic value	Wald test value for $E = 0$ and probable p-value	
2001–10	0.004	0.382	
		0.2262	Equilibrium
2001–5	0.033	*0.0000*	
		0.0000	Disequilibrium
2006–10	-0.01	0.0726	
		0.2358	Equilibrium

p-values obtained when ROE is the dependent variable are in italics.

for this study as the cross-sectional dimension of the data (number of banks) is much smaller than the times series dimension. The Breusch–Pagan Lagrange multiplier statistic was used to test whether the panel estimation approach was more appropriate than the pooled approach and the Hausman test was used to determine whether the fixed-effects estimator was preferable to the random effects estimator. The fixed-effects estimator uses different aspects of the panel data and allows for a greater heterogeneity among the parameters with respect to banks and/or time. In fixed-effects models, a varying intercept term is assumed to capture the differences in behaviour over groups (banks) and where the slope coefficients are assumed to be constant. The one way model allows the intercepts to vary across banks only, by introducing a set of $N - 1$ dummy variables to account for the effects that are specific to each bank but are constant across all time periods. The LM test supported the panel regression approach and the Hausman statistic supported fixed-effects panel regression approach.

All the regression models are analysed using the fixed-effects estimation approach based on the results of the Hausman test. The regressions were estimated with robust standard errors in order to correct for heteroscedasticity and cross-sectional correlation. Regressions were run first to test for equilibrium conditions in the full and subsamples. The results reported in Table 4.6 show the E-statistic value and the p-values for the long-run equilibrium tests when ROA is the dependent variable. p-values are also shown for when the equation was estimated using ROE as the dependent variable. The null hypothesis of long-run equilibrium is accepted if the p-values are larger than 0.05.

Using both ROA and ROE, the tests confirmed that the data is in long-run equilibrium for the full sample period, 2001–10. This was also the case for the second subsample period (2006–10). For the earlier period (2001–5), the test results indicate that the market was not in equilibrium. Given the level of entry that has taken place in the Sierra Leone banking sector, it is not surprising to find some evidence of disequilibrium over the period studied. This finding is similar to that of a number of other studies where the banking sector had experienced dynamic changes in the period studied.[23]

The results obtained for the tests of competitive conditions, using interest revenue and total revenue are shown in Table 4.7. Focusing first on the results which describe the estimates for interest revenue as the dependent variable, the estimated value of the H-statistic in all cases (full sample period and both subsample periods) is significant and positive. Following Bikker *et al.* (2009), we interpret the results as follows: a positive value is inconsistent with any form of imperfect competition. The Wald test (F-statistic) for testing the hypothesis that the H-statistic for the period is equal to zero can be rejected at the 5% level of significance, allowing us to reject monopoly. For the entire period, where the H-statistic is 0.87, the null hypothesis that the H-statistic is equal to 1 for the full sample period cannot be rejected at the 5% level of significance. This does not provide a clear indication of the competitive structure of the banking market. The results at best indicate perfect competition or a high degree of contestability and at worst borderline monopolistic competition.

Similarly, for the H-statistic estimate of 1.08 for the first subperiod 2001–5 shown in column II, while it is possible to firmly reject monopoly, $H = 1$ or a perfectly competitive banking market cannot be rejected. Furthermore, for the first subsample, the equilibrium test $E = 0$ was rejected in favour of $E < 0$. This finding suggests that competitive conditions prevailed generally but there was also some structural disequilibrium. The results reported in column III for the second subsample showed a decrease in the H-statistic to 0.66. The H-statistic in this case is statistically different from both 0 and 1, rejecting monopoly and perfect competition and indicating the revenues were earned under conditions of monopolistic competition. Following Bikker and Haaf (2002), the predominant practice in the literature has been to interpret the H-statistic cardinally with lower values representing less competition and higher values as representing more competitive or contestable markets.[24]

These results indicate that while there has been a rapid increase in the number of banks, competitive conditions appear to have worsened after 2005. As foreign bank entry increased, a more turbulent and fierce competitive environment may have led banks to mimic each other's strategic approach resulting in them targeting the same markets and becoming more homogeneous in terms of their core offering. Consequently, their distinctive features became less discernible. As profitability declined, in a bid to regain market power, it appears that banks have sought to reverse the situation and reorientate themselves through differentiation strategies. The danger of such situations where banks

[23] See, for example, Matthews *et al.* (2007) for a study of the British banking industry; Mugume (2007) for Uganda; Daley and Matthews (2009) for Jamaica; and Stavarek and Repkova (2011) for Czech Republic.

[24] The interpretation of the H-statistic as a cardinal measure is a contentious issue in the recent literature. Shaffer (1982) and Bikker *et al.* (2009) caution against interpreting the H as cardinal. They emphasize that the PR test is a one tail test in which a negative value may arise under various conditions but a positive value is inconsistent with imperfect competition.

focus on specific strategies or niches and mimic each other's strategies is that the heightened competition risk can give rise to financial stability concerns.

Another possible factor could be that as the number of banks increases and the environment becomes more turbulent, structural impediments such as a lack of transparency and difficulty in acquiring reliable information could prevent banks from operating competitively. On the deposit side, for example, increased opaqueness could deter customers from switching to the new banks, thereby leading to a worsening of competitive conditions. Information limitations can also inhibit competition in lending markets as foreign banks may not be able to acquire information as easily as domestic banks even though, as argued by Claeys and Hainz (2006), they may be better at screening borrowers. As pointed out earlier, in the case of Sierra Leone, informational problems would have been exacerbated because of the effect of the war.

The findings differ from those of Buchs and Mathisen (2005) and Biekpe (2011) for Ghana and Mugume (2007) for Uganda. They had found that competition increased over time. Apart from the fact that the financial sectors of these countries were more stable and developed than that of Sierra Leone, a key difference between these countries and Sierra Leone is that they had introduced comprehensive packages of financial reforms, in addition to liberalizing entry to foster competitiveness. Ghana's reforms included restructuring of distressed banks, strengthening of the regulatory and supervisory framework, privatization of state-owned banks and promotion of non-bank financial institutions (Bawumia 2010).

The regression coefficients for the unit prices of labour, capital and funds had mixed signs. Among the different input prices, the price of capital and the price of funds contribute predominantly to the explanation of the interest revenues of the banks. The price of capital is particularly emphasized in the period between 2001 and 2005. This is reversed in the latter half of the study period when price of funds becomes slightly more important. In Sierra Leone's postwar reconstruction context, even though re-establishing physical infrastructure and the costs of new entrants setting up a branch network are significant sources of expenditure, the benefits from capital expenditure appear to outweigh the costs. In studies for developed countries, the coefficient on the unit cost of capital is usually very small, reflecting the stability of the capital element after a period of time. It is therefore not surprising to see the significance of the cost of capital declining between 2006 and 2010. The price of labour is significant and positively related to revenues for the first sample period but not in the second sample period. This indicates that personnel costs accounted for a higher proportion of the overheads of banking firms between 2001 and 2005. New entrants do not have a high staff component in the period immediately after entry but would recruit more staff as their businesses grow.

The negative sign on the capital adequacy ratio, CAR, suggests that banks may be holding higher levels of capital which attract funding costs. Schaek and Cihak (2007) have found that in a more competitive environment, banks are likely to hold more capital than the levels required by prudential regulations,

TABLE 4.7. Regression results I: unscaled revenue equations.

	ln (interest revenue) as dependent variable			ln (total revenue) as dependent variable		
Coefficient/ t-statistic	I 2001–10	II 2001–5	III 2006–10	IV 2001–10	V 2001–5	VI 2006–10
ln PL	−0.0293	0.265	0.0547	−0.03765	0.3212	−0.0168
	−0.31	2.51**	0.66	−0.48	3.46**	−0.25
ln PK	0.4669	0.7867	0.2836	0.494972	0.6842	0.3753
	4.35**	6.51**	2.49**	5.36**	6.67**	3.63**
ln PF	0.4342	0.0486	0.3345	0.419512	0.0387	0.3473
	3.33**	0.42	3.00**	3.75**	0.42	3.4**
ln LOTA	0.1924	0.411	0.0735	0.1692	0.3049	0.0934
	1.67*	2.28**	0.75	1.71*	2.18**	1.08
ln CAR	−0.2488	0.0611	−0.3262	−0.2617	0.0386	−0.3335
	−2.17**	0.54	−2.83**	−2.6	0.43**	−3.13**
ln RTBR	1.9788	1.535	6.6487	1.2701	0.9145	6.4654
	3.01**	3.50**	4.95**	2.26**	2.70**	5.27**
ln INF	7.1834	5.0157	10.7146	5.2493	3.23	10.5901
	4.71**	4.10**	4.49**	4**	3.06**	4.91**
Cons	17.8803	16.4575	17.6206	18.50811	17.3561	18.002
	22.47	22.04	24.14	27.1	28.49*	27.43
No. of obs.	303	108	195	303	108	195
Adj. R-squared	0.73	0.93	0.83	0.79	0.94	0.87
H-statistic	0.87	1.08	0.66	0.87	1.03	0.7
H_0: $H = 0$ F-statistic	96.57	327.52	63.87	134.22	381.46	89.06
H_0: $H = 0$ p-value	0	0	0	0	0	0
H_0: $H = 1$ F-statistic	2.09	2.73	15.01	2.65	0.69	15.48
H_0: $H = 1$ p-value	0.1496	0.1018	0.0001	0.1048	0.4098	0

* and ** denote significance at the 5% and 10% levels, respectively. t-statistics are shown below their respective coefficient entry.

even though this may be more expensive to fund than deposits. Capital supports the long-term viability of a bank and its ability to generate profits in the future. It may also be that, with increased competition, banks are not able to find good lending opportunities and so maintain high equity capital.

The ratio of loans to assets, LOTA is positive and significant for the full sample period and the period between 2001 and 2005. As loans carry credit risk, this indicates that banks may be charging a risk premium to compensate for this risk, leading to increases in both interest and total income. Both the macroeconomic variables RTBR and INF, are signed as expected and significant. The positive finding for the treasury bill rate is similar to that of Buchs and

TABLE 4.8. Regression results II: price equations.

Coefficient/ t-statistic	ln (interest revenue/total assets) as dependent variable			ln (total revenue/total assets) as dependent variable		
	I 2001–10	II 2001–5	III 2006–10	IV 2001–10	V 2001–5	VI 2006–10
ln PL	0.7026	0.5114	0.7272	0.6943	0.5676	0.6556
	4.08^{**}	5.86^{**}	4.16^{**}	4.50^{**}	5.98^{**}	4.18^{**}
ln PK	0.1489	0.4321	0.0469	0.1769	0.3297	0.1386
	1.42	5.81^{**}	0.44	1.90^{*}	4.40^{**}	1.48
ln PF	−0.0630	−0.0361	−0.0871	−0.0777	−0.0460	−0.0743
	−0.62	−0.67	−0.78	−0.89	−1.14	−0.74
ln LOTA	0.2205	0.1155	0.3571	0.1973	0.0093	0.3771
	1.56	1.80^{*}	2.20^{**}	1.59	0.27	2.59^{**}
ln CAR	0.0032	−0.0494	−0.0270	−0.0096	−0.0720	−0.0343
	0.05	−0.76	−0.30	−0.15	−1.16	−0.41
ln RTBR	0.3433	0.2553	1.3262	−0.3653	−0.3651	1.1429
	1.13	1.35	1.16	−1.45	-2.92^{**}	1.13
ln INF	0.1466	1.532	1.0457	−1.7874	−0.2536	0.9212
	0.17	2.31^{**}	0.50	-2.49^{**}	−0.46	0.49
Cons	−0.2378	−0.6679	−0.0724	0.3899	0.2307	0.3091
	−0.46	−1.47	−0.11	0.87	0.52	0.53
No. of obs.	303	108	195	303	108	195
Adj. R-squared	0.65	0.89	0.67	0.69	0.91	0.72
H-statistic	0.78	0.91	0.69	0.79	0.85	0.72
H_0: $H = 0$ F-statistic	206.18	548.99	65.73	251.00	552.99	91.32
H_0: $H = 0$ p-value	0	0	0	0	0	0
H_0: $H = 1$ F-statistic	14.84	5.70	13.64	17	116.86	13.81
H_0: $H = 1$ p-value	0.0001	0.0189	0.0003	0	0	0.0003

* and ** denote significance at the 5% and 10% levels, respectively. t-statistics are shown below their respective coefficient entry.

Mathisen (2005) and Biekpe (2011) for the Ghanaian banking sector, indicating the significant impact of the government financing element on banks' revenues. Government securities are a less risky form of investment for banks and, given the attractive interest rates, can reduce bank lending to the private sector. The results for the alternative specification in which total revenue is the dependent variable mirror the findings obtained with the interest revenue specification (reported in columns IV, V and VI).

The model was also estimated using the ratio of revenue to total assets as the dependent variable.[25] As noted earlier, this approach is widely adopted in

[25] Bikker *et al.* (2009) refer to these specifications as price equations.

African studies that apply the PR test. The findings are reported in Table 4.8. Unlike the results for the unscaled revenue specification, the price equations' results indicated that revenues were earned under conditions of monopolistic competition for the entire period as well as for the two subsamples when interest revenue was used as the independent variable. However, similar to the unscaled revenue estimations, the results indicated that competitive conditions seemed to worsen in the second subsample period. The H-statistic fell from 0.91 for the first period to 0.69 for the second period when interest revenue divided by total assets was the dependent variable and from 0.85 to 0.72 when total revenue divided by total assets was the dependent variable.

To check robustness and explore the role of size of banks further, a scaled revenue specification was also estimated by including log of total assets as an independent variable and using log of interest revenues and log of total revenues as dependent variables. Again in all the estimated results, the F test rejected both monopoly and perfect competition indicating that both interest and total revenues appear to have been earned under conditions of monopolistic competition throughout. Consistent with the other two specifications, the results indicated that there seemed to be a marked deterioration in competitive conditions in the second half of the period. These results show that the size of banks is an influential factor in determining the level of interest and total revenues generated.

Given the key structural changes in the sector over the period, these results are to be interpreted with some caution as the Panzar–Rosse test can give misleading results in cases where banks have not completely adjusted to market conditions and markets are not in equilibrium. In such cases, the bias is towards a conclusion of monopoly power. In addition, the PR test is unable to distinguish between cost plus pricing and competitive pricing as cost plus pricing is not associated with a particular level of market power. It is also doubtful whether stable cost and revenue functions existed during the period analysed. Gutierrez de Rozas (2007) points out that when using unbalanced data sets in such studies that cover a period of rapid entry, the data would include new entrants that would behave differently, perhaps more aggressively, as compared to cases where market equilibrium may have prevailed throughout with no entry or exit. Figures for newly established banks may distort the data set for the rest of the banking sector.

4.5 Policy Implications

Sierra Leone's Financial Sector Development Plan recognizes that several factors could determine the low level of intermediation in Sierra Leone apart from a non-competitive market structure. Although creating a competitive financial sector is one of the Plan's broad goals, an explicit competition policy for banking has not yet been outlined. The findings of this study provide an opportunity to reflect on competition related aspects of Sierra Leone's financial sector development, especially as they suggest that competitive conditions may not be ideal in spite of the large number of banks in operation. The aim of a competition policy is to develop a market in which there are a sufficient number of suppliers that offer a range of services and choice to consumers. Furthermore, competition is more likely where conditions that are conducive to innovation are maintained.

4.5.1 Foreign Bank Entry

Opening up markets to foreign banks is a feature of structural competition policy which can have many benefits. The challenge for policymakers is to gauge how best to open domestic banking markets to foreign bank entry so that the benefits will outweigh the costs. The dimensions of entry that need consideration include the speed of entry, mode of entry and origin of entrants. What is deemed reasonable would depend on the size of the market and the state of the domestic banks' balance sheets. The smaller the size of the market, the greater the likelihood for overcrowding to occur before the full benefits of foreign bank entry can be harnessed. A small market cannot accommodate too many players without stability concerns. An incremental rate of entry could allow domestic banks to make cost and efficiency adjustments and be in a better position to compete in a manner that is not destructive. The speed of entry may create perverse incentives for local banks with weak balance sheets to take more risk. In terms of scheduling the process, it may even be better first to privatize government-owned institutions, before opening a banking sector to rapid foreign bank entry so that sound corporate governance arrangements are in place.

The origin of entrants and mode of entry are other significant considerations. Recent work has shown that the country of origin of foreign banks may be important in determining their impact on competition. Pohl (2011) finds that regional south–south banks in particular seem to enhance domestic banks' efficiency through spillover and competition effects.[26] South–south banks may be more prepared to serve less transparent customers because of their experience of doing business in more challenging environments and are more likely to specialize in the same target markets as domestic banks. The large number of Nigerian banks in Sierra Leone does not foster much diversity in the banking system. Diversity in the origin of foreign entrants is needed to limit the potentially damaging effects of shocks that can be easily transmitted from the foreign banks' home country to the Sierra Leonean economy through lending channels.

[26] Foreign banks from developing countries entering other developing countries are referred to as south–south banks and foreign banks from industrialized countries entering developing countries are referred to as north–south banks.

Furthermore, all foreign bank entry has been by greenfield investment.[27] The mode of entry can have different effects on the incentives of domestic banks. A mixture of greenfield entry, entry by mergers with local banks or through strategic investments in local banks can lead to more effective competition. The general consensus is that greenfield investment leads to greater competition than entry by acquisition (Claeys and Hainz 2006; Schmidt 2008). Foreign bank entry typically results in lower profitability for domestic banks. A downside is that the credit quality of the domestic banks' loan portfolios could tend to deteriorate more as they strive to make up for falling profitability. In particular, large government-owned domestic banks are more likely to be susceptible to moral hazard by virtue of the fact that they are too big or too systematically important to fail and also government ownership may not have created the incentives for sound management. An approach worth considering is to require new entrants to make equity investments in domestic banks either by way of transfer of shares or by existing shares or by issuing new shares. Entry through strategic investments in domestic banks has been widely used in China, for example, with some success. Such a strategy is expected to have a positive effect on management and corporate governance in the domestic banks. While such investment is expected to be long term, measures will have to be put in place to facilitate orderly exit of investment.

4.5.2 Diversification of Financial Services Providers

Diversity and heterogeneity in the spectrum of financial service providers is more likely to enhance competition, fuel innovation and widen access as various institutions would have different cost structures, attitudes towards and capacity for innovation, strategies and orientation to serve financial needs. Where competition is between institutions that are very similar, it can intensify to the point where it becomes destructive rather than productive. Sierra Leone's banking system is very limited, comprised only of commercial banks. Lessons can be drawn from the banking systems of other West African countries that have merchant and development banks as well as thriving mutual and cooperative sectors in which cooperative banks, credit cooperatives and credit unions play a significant role. Sierra Leone's community banks have a very narrow remit and risk losing their relevance to the changing financial needs of the Sierra Leonean economy in terms of promoting financial inclusion and competition.[28]

Developing financial cooperatives provides a valuable contribution to competition and financial sector development. The key institutional characteristics of financial cooperatives that differentiate them from banks are their

[27] The term 'greenfield investment' refers to an entry strategy where the entrant sets up an entirely new operation, for example, by creating a new subsidiary.

[28] According to the Poverty Reduction Strategy Paper, these banks were established to empower communities 'to own and manage the development process' as well as to 'provide an institutional anchor to the government's microfinancing programme' (GSL 2005, p. 58).

governance structure and their dual economic and social goals. The aim of these member-owned institutions is to promote their members' economic interest and welfare, rather than to maximize profits. Typically, they emerge to fill gaps in financial services provision and as argued by Cuevas and Fisher (2006) offer a 'natural solution' to the problem of adverse selection in financial intermediation which leads to the exclusion of some economic agents from financial services.[29] They can bring competitive pressures to bear on private sector banks because they often have lower operating costs and do not seek to maximize profits. The cooperative form has advantages in addressing informational market failures, combating the effects of excessive market power and engendering trust. The members are also customers and it is expected that the governance structure limits the exploitation of vulnerabilities in the members' position such as those that may arise from their poor bargaining power or level of financial capability.

Cooperatives can fulfil the role of community banks but are more flexible and have a greater potential for adaptation with the changing needs of the financial system. This is because they exhibit significant heterogeneity. As Fonteyne (2007) points out cooperatives can range from small-scale self-help community-based institutions to large-scale retail banking institutions and diversified financial conglomerates. They can also form networks which would allow them to take advantage of economies of scale and scope. They can, in addition, be the heart of financial education initiatives. By pursuing a mixed outreach strategy, the membership of community-based cooperatives and credit unions can draw from a cross-section of society fostering wider participation. The activities would focus on creating a critical strategic fit between the needs of the specific community and the provision of the cooperative, rather than a 'one size fits all' offering.

In terms of their operations, cooperatives focus on traditional financial intermediation but do so in innovative ways. Decker (2010) found evidence of product and process innovation by British credit unions to address financial exclusion in sustainable ways. Credit unions in particular have enjoyed much success in Ghana and the Gambia particularly in providing services to those below the poverty line, first time users of formal financial services and for providing funds and cash management services to petty traders and small businesses. In this way they can play a positive role in creating a pathway to financial inclusion for the unbanked population. Sierra Leone's postwar experience with NGOs showed that there is scope for institutions that do not have a profit maximization objective to widen access and innovate. Non-governmenttal organizations like cooperatives are cause and values driven which provides an ideological and ethical basis for their work. In Sierra Leone, they took the lead in providing appropriate lending products and introducing innovative financial methodologies and delivery processes to address the

[29] For example, credit unions emerged in the United Kingdom in the 1960s to meet the needs of immigrants from the Caribbean who were excluded from mainstream financial services.

particular challenges that arise in a postwar environment such as working with displaced fluid populations with no assets (Decker 2009). Over time, to enable cooperatives to play a deeper role in financial development, measures should be taken to widen their services from traditional savings and loans to include banking services and enable them to lend to meet the financing needs of small businesses.

4.5.3 Improving Information

An integral part of effective competition relates to the ability of consumers to make informed and rational choices. Therefore, the importance of reducing information asymmetries to enhance effective competition and financial intermediation cannot be overemphasized. The information problems inherent in banking are exacerbated in the postwar environment that characterizes Sierra Leone's financial sector. On the side of consumers, high levels of illiteracy and poor understanding of financial products and the formal financial system feed misconceptions and mistrust and precludes many citizens from using formal banking. On the lending side, opportunistic borrowers can exploit situations where banks have no information or poor access to information on potential borrowers' creditworthiness or on the extent of their indebtedness. Implementation of plans to establish a credit reference bureau is a welcome step in addressing the information asymmetries that act as obstacles to effective financial intermediation.

Banks should be required to provide key information in a form that makes their products easy to understand and charges and charging structures transparent and easily comparable. Apart from the requirements placed on banks, a measure that is used by the UK regulatory body the Financial Services Authority is to publish basic information booklets for consumers that provide impartial information to raise understanding of the financial system, the role of different types of financial institutions and financial products. This could be considered in Sierra Leone. Given the high levels of illiteracy in Sierra Leone, a complementary approach would be to disseminate financial information and education to the public through impartial advisers working from independent information centres. Their activities can extend to price comparisons to enhance transparency. These centres can be funded in part by banks, as part of their social responsibility agenda, and in part by the government as a public–private initiative. Other outlets that can be used to improve financial literacy include the workplace, schools and other educational and community-based organizations including faith groups. Financial education can be incorporated into the school curriculum and as part of basic literacy education. In Sierra Leone, many people fund their children's education with the expectation that these children will play a key role in providing an educated input in family decision-making and to provide a better informed platform for future generations. The budding Sierra Leone Bankers' Association can take an active role in coordinating such a venture.

4.5.4 Measuring and Regulating Competition

For any policy to be effective, monitoring, measurement and reporting are essential. Informed analysis helps regulators and policymakers to design appropriate frameworks for and make continuous improvements to policy. It is therefore important for the Bank of Sierra Leone, which currently assumes the responsibility for all aspects of financial sector policy to engage in formal competition analysis as part of its regulatory overview. An added benefit of monitoring and reporting on competition is that it will help to improve transparency. Timely identification of changes in competitive conditions will promote early corrective action and minimize the negative consequences that can arise from ineffective competition. This study provides an initial basis for exploring which competition measures may be appropriate for Sierra Leone, given the dynamics of the industry, its level of development and the institutional capacity and resources of the regulatory body, currently the Bank of Sierra Leone.

Demirgüç-Kunt and Peira (2010) have argued that multiple measures and factors should be used to measure competition. The findings of this study also support that view, as declines in concentration or lower barriers to entry do not necessarily mean that competitive conditions would improve. Structural measures have the advantage of being easy and straightforward to calculate. In addition, the required data is readily available at the Bank. While the limitations of these measures are recognized, it remains a fact that empirically, there is a tendency for high concentration to be found where there are competition problems.[30] The Panzar–Rosse H-statistic also has potential as a measure, because of its theoretical underpinnings and its ability to indicate changes in competitive conditions and bank-level data requirements. Ultimately, it is the way in which competitive pressures change the behaviour of incumbent firms that indicates the impact of competition in a market. Therefore, measurement of competition should have structural and behavioural dimensions. In this regard, monitoring price setting behaviour of individual banks, their target markets and strategies could throw light on how competition affects banking.

Banking is a multiproduct industry and competition would be different in individual submarkets. Therefore, competition should be measured in each submarket so that polices could be developed appropriately. This study has shown differences between the way in which the deposit and loan markets operate; these need to be taken into account. Loan rates could vary across locations, with interest rate spreads being higher where bank presence is low. Furthermore, government-owned banks may compete differently from other banks and charge lower rates. More reputable banks can charge higher fees,

[30] Several factors can limit the use of concentration ratios and the Herfindahl–Hirschman Index as indicators of competitiveness. As they are based only on the number and size of existing firms, the effect of the potential competition caused by threat of entry is not captured. Also competition can be softened by product differentiation or intensified by other strategic factors.

and where customers are willing to pay more for 'quality' services or a bank's reputation, competition can be less effective. Analysis of the loan and deposit rates for individual commercial banks can shed light on the strength and speed with which policy changes affect interest spreads and direct future policy making.

The 2007–9 global financial crisis highlighted the impact of increased competition on stability and the social cost of bank failure that may arise because of too much competition.[31] Failure is a feature of all competitive markets, but the extent of the social costs in banking call for a balance between competition and stability. In recognition of this, the Sierra Leone authorities have tightened prudential regulation, largely by increasing capital requirements as entry barriers were lowered. The existence of cooperative financial institutions in the system can also help foster stability. The performance of cooperatives in the recent global financial crisis suggests that they may be more resilient than private sector banks. Birchall and Ketilson (2009) found that cooperatives increased assets, deposit and membership levels during the crisis. Hesse and Cihak (2007) also found that cooperatives are more stable than commercial banks.

Sierra Leone does not have a deposit insurance scheme in place to protect small depositors and create a safety net in terms of crisis. The feasibility of introducing such a scheme in Sierra Leone in the short-term needs to be considered carefully because of the moral hazard problems, their funding and management and the need for speed and unambiguity in their deployment. In terms of stability, there is a growing consensus that it is in the area of exit and crisis resolution policies that African countries are weakest. Banks and the regulator could prepare explicit recovery and resolution plans to ensure orderly exit. The aim is to minimize collateral damage to the wider financial system especially where banks are considered as 'too big to fail'. Resolution and wind-up plans need to be outlined by the regulator. These can be put in place when a troubled bank does not meet all threshold conditions even though they may not be insolvent. In the case of Sierra Leone there will be a need for clear allocation of responsibilities between home and host country regulators in addition to outlining resolution options such as mergers with private banks or nationalization. Where banks outline their plans for recovery and resolution, these plans are known as 'living wills'. Writing of living wills would be advisable for large and complex banks that are of systemic importance. Bank regulation and supervision, generally, is a highly resource intensive activity and given that the Bank of Sierra Leone's current capacity is rather limited, there is a need for continued investment in capacity building.

[31] In the literature, the competition–fragility view posits that too much competition can be destructive, detrimental to stability and lead to financial crises (Allen and Gale 2004; OECD 2010; Vives 2010). On the other hand, the competition–stability argument argues that competition drives down loan rates which in turn induces borrowers to undertake less risky investments (Boyd and De Nicolo 2005).

4.6 Conclusions

This study has discussed structural changes in the Sierra Leone banking sector, evaluated competitive conditions in Sierra Leone banking using structural measures and the Panzar–Rosse test and outlined policy considerations in the area of banking competition. The key findings are that competitive conditions are evolving and that an increase in the number of competitors alone cannot result in effective competition. The balance of evidence leads to the conclusion that banks in Sierra Leone banks appear to earn profits under conditions of monopolistic competition. Furthermore, it appears that some of the competitive pressures arising from new entry may have dissipated, after the foreign banks had gained a reasonable amount of market share and established a basis for strengthening market power.

This study has provided a platform for studying a hitherto unexplored aspect of Sierra Leone banking. While it has provided a basis for future studies it has not been without limitations and many important issues remain to be addressed. Directions for future study include the impact of increased competition on lending practices and credit allocation, especially on credit access to SMEs. It would also be worthwhile to investigate whether foreign banks practise cream-skimming in Sierra Leone. The impact, if any, of changes in competition on bank efficiency is another important direction for future research. Further work needs to be done to explore the application of a dynamic estimation technique to the Panzar–Rosse test and also evaluate other measures such as the Lerner Index, persistence of profits and the Bresnahan–Lau approach to measuring competitive conditions in Sierra Leone.

Policy recommendations arising from the study are that there is a need for an explicit and holistic competition policy that incorporates structural as well as behavioural dimensions.

More effective competition requires a more nuanced consideration of the characteristics of new entrants and their entry strategies, encouraging new types of financial services providers, improving education to consumers and information for both consumers and banks and undertaking competition analysis for supervision and regulatory purposes. The challenge is to find a fine balance between competition, concentration, stability, profitability and efficient intermediation.

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Chapter 5

ACCESS TO FINANCE: THE ROLE OF MICROFINANCE

By Hugh Kweku Fraser

5.1 Statement of the Problem

Sierra Leone, a land of 71,740 km^2, is home to a population of 6.3 million, which grows at a rate of 3.6% per year and a population density of 76 inhabitants/km^2. The gross domestic product (GDP) per capita (2009) is among the lowest in Africa at US$322 (see Allen *et al.* 2010).

With three democratic elections behind it since the 1991–2001 rebel war, Sierra Leone has exited a post-conflict situation and now faces development challenges. Sierra Leone remains at the bottom of United Nations Development Programme's (UNDP) Human Development Index, with 70% of the population living below the national poverty line of US$1.25 per day, a life expectancy of 42 years of age and literacy levels of 35%. It ranks 153 out of 156 on the Gender Development Index, with women's literacy rates at just over half that of men. Under the Global Hunger Index, Sierra Leone is classified as 'extremely alarming' (Government of Sierra Leone *et al.* 2010).

One way to help redress these rather dire statistics may be through increased access to finance for improved economic growth.

The importance of financial access was also strongly underlined at the review of the Millennium Development Goals, as a key accelerator to meet the UN human development objectives and particularly the alleviation of poverty.

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Here, there was a general agreement that bringing relevant financial services to people in need in emerging and developing countries can be a highly effective tool to lift people out of poverty, financially empower them and offer them genuine opportunities for personal development and education.

Odell (2010) refers to other studies by, among others, Karlan and Zinman (2010) and Banerjee *et al.*[1] which found little evidence to support microfinance having a significant impact on poverty reduction. However, she also reports that recent empirical evidence using household data indicates that access to basic financial services such as saving, money transfers and credit can make a substantial positive difference in poor people's lives and refers to World Bank researchers Bruhn and Love (2009),[2] as well as Kaboski and Townsend (2005).[3] and Dupas and Robinson (2009). For firms, especially small and medium enterprises (SMEs), lack of access to finance is often the main obstacle to *growth* (Schiffer and Weder 2001).

Access to finance (A2F) is therefore essential for economic development and individual social empowerment. Alexandre *et al.* (2010) report that there is growing interest in the financial access agenda and that one driver has been the mounting empirical evidence that increasing financial access is both pro-growth and pro-poor, that is, it promotes growth with less inequality.[4]

5.2 Research Objectives

What therefore is the level of financial services access in Sierra Leone, what are the major tools that have contributed to whatever level Sierra Leone has achieved in financial access and how effective have tools been in facilitating access to finance? For a long time microfinance has been considered *the* major tool for achieving substantial levels of financial access primarily because the majority of the population who are financially excluded are the low-income group for whom microfinance is the most suitable form of financial access.

[1] At the macro-level, Beck *et al.* (2007) find that 30% of the cross-country variation in poverty rates can be attributed to variations in financial depth (private credit/GDP), while Levine (2005) finds a strong link between financial depth and economic growth. These findings are offset somewhat by Banerjee *et al.* (2009) and Karlan and Zinman (2009) which find little to no short-term impact from providing households access to micro-credit in India and the Philippines, respectively.

[2] Their research found that opening of branches in Banco Azteca across neighbourhoods led to an increase in informal business ownership and incomes for residents of municipalities where a branch was opened.

[3] Their research in Thailand found that MFIs, especially those targeted at women promoted asset growth, consumption smoothing and occupational mobility and reduced dependence on moneylenders

[4] Dupas and Robinson (2009) find that after six months, access to a savings account led to a 39% increase in productive investment and a 13% increase in food expenditure among women micro-entrepreneurs in Kenya.

While there are now other new tools for increased A2F such as mobile money payments, microfinance remains the most tried and tested tool.

However, even though microfinance is an acknowledged effective tool for mitigating several social and economical problems of the rural mass, there is still a huge gap to bridge between the targeted objectives and reality. What role, therefore, has microfinance played in increasing financial access in Sierra Leone? What have been its successes and failures in this role? Indeed, should microfinance continue to play the pre-eminent role in advancing access to finance in Sierra Leone? This study will attempt to highlight the role of microfinance in financial access. This will include how providers of microfinance services are functioning in Sierra Leone especially towards alleviation of poverty and enhancing business development. It is hoped that these findings will be helpful to policymakers in better decision-making.

It should be noted that this paper is about access to *financial services* which, we argue, is different from *access to finance*. Generally, 'finance' includes debt, equity and guarantees i.e. where the term 'finance' is limited to liabilities. This is different from 'financial services' which is much broader and encompasses both liabilities and assets such as savings, deposits and insurance. For the purposes of this paper however, access to finance means access to financial services, as described above.

5.3 Access to Financial Services: An Overview

5.3.1 Definitions of Access to Finance

The UK Department for International Development (DFID) is one of the several development partners for whom access to finance is high on the agenda and it gives as one of the headline results of its private sector approach: help more than *50 million people* to access savings, credit and insurance (DFID 2011). Access to finance is synonymous with what is now popularly referred to as financial inclusion and has gained particular prominence in recent years and includes but is not limited to microfinance alone. Full financial inclusion as described by Accion's Centre for financial inclusion is (see Rhyne 2010):

> a state in which all people have access to a full suite of quality financial services, provided at affordable prices in a convenient manner and with dignity for the clients. Services are delivered by a range of providers, most of them private and reach everyone who can use them, including the disabled, poor, rural and other excluded populations.[5]

Financial inclusion is achieved when consumers can *access* and *sustainably use* financial services that are affordable and appropriate to their needs. The

[5] One would also add to the ACCION definition above, the word 'available' to read: *access to a full suite of available quality financial services*. This is added here because not all types of financial services are available in all countries. In Sierra Leone for example even the most financially included person is not as financially included as someone in the UK or USA.

level of inclusion is determined largely by factors affecting the demand side i.e. the consumer and the supply side i.e. the institutions providing the required services.

Factors affecting the demand side may specifically *exclude* the consumer from using the service i.e. an *access* barrier or, while the consumer may not be specifically or explicitly excluded, may be *discouraged* from using the services.

Similarly, on the supply side, factors (e.g. regulatory, shareholder pressures etc.) may explicitly exclude or discourage financial institutions from providing a particular financial service to certain economic groups.

With the emergence of A2F tools such as mobile money payments (MMPs) it is arguable that the regulatory aspect may also be a factor which can influence financial inclusion. In Kenya, the central bank of Kenya (CBK) allowed the facility to start up on its own and gave it a free rein to evolve before coming in with regulation while in Nigeria the Central Bank of Nigeria (CBN) is orchestrating and regulating the whole process from the very beginning.

The group of consumers most seriously affected by financial exclusion are those at the low end of the economic spectrum or as is now more frequently described, those 'at the bottom of the pyramid'[6] (Cohen *et al.* 2008).

Access to finance indicators can be very many in number.[7] However, this study measures access to finance by the following yardsticks:

(a) number of clients reached/served;

(b) types of services available;

(c) areas penetrated with financial services, especially rural or previously excluded areas;

(d) general spread of provision of financial services.

This paper will attempt to give some statistics on various measures of access to finance in Sierra Leone, such as percentage of those banked, percentage of those with access to savings, private sector credit, etc., even though this should form a comprehensive study all of its own.

A DFID/World Bank/FINMARK Trust survey (Chidzero *et al.* 2006) gives the dimensions of financial access as follows.

- Institutional dimension (across providers), e.g.
  - formal/informal,
  - public/private,
  - domestic/foreign.

[6] The 'bottom of the pyramid' comprises the 4 billion people in the world living on less than US$2 per day (Prahalad 2005).

[7] For example, Columbia has over 20 indicators.

- Functional dimension (across services), e.g.
  - transactions (check cashing to cross-border remittances),
  - savings (from safekeeping to investment),
  - loans and credits (infrequent to readily available),
  - insurance/risk transformation.
- Product dimension (across devices/interfaces), e.g.
  - types of bank accounts, types of loans, credit cards, etc.

The indicators of financial services access can be split into institutional and functional, again as given by the 2006 survey.

Institutional core indicators.

Banks and bank-like providers. Broad-spectrum intermediaries (including some credit unions and niche banks). Criteria: deposit taking, access to national payments network, supervision and oversight, standard terms.

Other formal financial institutions. More specialized, e.g. insurance, money transfer agents, finance/credit companies. Also regulated, vary by country and by service, trade-off of comparability/comprehensiveness.

Informal financial service providers. No financial regulation, but organized ROSCAs, tontines, moneylenders, pawn shops, esusu,[8] stokvels, etc.

Functional core indicators.

Payments. Receive money regularly through formal financial instruments: income, remittances.

Saving. Keep money in formal financial instruments which allow them to safeguard and accumulate money, transactions accounts, savings accounts, time deposits/bonds, stocks, voluntary pension plans, etc.

Loans and credits. Have obtained/have outstanding a loan or credit facility from a formal financial institution, now or over the past 12 months.

These cover the whole spectrum of financial access from full formal access to limited unregulated but organized access to finance. In some way or other, therefore, one could argue that everyone has some level of access to finance. Perhaps the argument regarding access to finance is that, at the level of the bottom of the pyramid and largely due its lack of any type of regulation, the available access is unreliable, unsecure and limited.

[8] An esusu group is a group of friends/colleagues who save regularly and each member takes a turn to collect the amount saved. It is a form of rotating savings and credit associations (ROSCAs).

For someone to be considered financially included to the minimum level, he/she must have formal (even if not central bank-regulated) access to at least one of the following facilities:

- access to saving facilities;
- access to credit facilities;
- access to money transfer facilities;
- access to insurance facilities.

The products and services developed from these facilities are the major tools for increasing access to finance and are described in the next section.

5.4 Microfinance and Other Tools for Increasing Access to Finance

Microfinance is of course one of the major tools for increased A2F and it includes microcredit, (micro) savings and microinsurance. Microfinance can provide very small loans – for example, from US$5 to US$50 – and accept saving deposits of less than US$1, which, despite the small size, can be essential for creating income-generating activities and sustainable livelihoods (Helmore 2009).

We shall describe the role and importance of these in this section as well as the other major tool, mobile money payments.

First, though, it is useful to have a working definition of microfinance. Microfinance in its original form was mainly credit-based and was the granting of small loans to very poor people mainly in rural areas to carry on microbusinesses. It was developed to provide low-income households with a way to build and expand their financial resources.

Two major aspects stand out here. First, microfinance was mainly about credit while saving (or other financial services) rarely featured. This was no doubt due to the fact that almost all microfinance activity was undertaken by non-bank institutions which were not regulated by central banks and therefore could not take deposits. Second, microfinance was only or mainly for business purposes. Again this was because microfinance was seen as an economic development tool to lift poor people out of poverty through increased economic activity. Poverty, however, is not only about income or economic poverty but also social poverty such as inadequate health, housing and education.

As the microfinance space has broadened it has become a pillar of economic development policies. In recent years, there has been a concerted effort to expand such programmes with the goal of alleviating poverty and promoting development (Buera *et al.* 2011).

Saving

Even though microfinance began with mainly credit it was hardly going to be self-sustainable without the saving element (Kristof 2009). Similar views about the importance of saving are also echoed by Dupas and Robinson (2009). Access to a formal saving facility is therefore perhaps the most basic financial service that can be offered to anyone who is economically active (i.e. with a source of income, even if intermittent). In 2001, Stuart Rutherford, an acknowledged expert in savings for the poor had this to say:

> Although their incomes may be tiny and irregular, the poor need more money than they often have at their disposal. The need for 'useful lump sums' arises from life-cycle events such as birth, education, marriage and death, from emergencies, including ill health, and from opportunities to invest in assets or commercial activities. The most reliable and sustainable way the poor can obtain 'useful lump sum' resources is to build them, somehow or other, from their own savings; savings-led financial services for the poor exist to help them do just that.

Almost everyone with some income does make some savings even if irregularly or with very small amounts of money or for short periods of time. Because they are financially excluded, however, most low income people at the bottom of the pyramid save in informal ways. These include:

- keeping money in a box at home;
- giving money to a relative (or even employer) for safe-keeping;
- joining a business association or savings club, e.g. esusu.

Most importantly, well-designed deposit services can enable poor people to take charge of their financial lives. Savings can provide a cushion against economic shocks, enabling poor households to reduce financial vulnerability.

Credit

Access to, and usage of, formal credit facilities usually follow a period of successful saving history. The period varies by different types of credit providers.

Formal sources of credit come in many forms and some do not even involve a bank or financial institution such as supplier credit where one buys goods on credit from a supplier of those goods.

Credit, in its various forms, is perhaps the most important activity of formal financial institutions and it is usually where they make or lose money. For that reason they are very cautious about lending money and more so to someone without an acceptable banking and saving history. The most common types of credit facilities in least developed countries such as Sierra Leone are:

- working capital/overdrafts, mainly for businesses;
- term loans for businesses such as for asset purchase;

- wholesale lending e.g. a commercial bank lending to a community bank or microfinance institution (MFI);
- consumer loans;
- specialist loans, such as for housing/property.

People, and especially the financially excluded, save so that they do not have to rely wholly or even partly (where possible) on credit, but in the end most of us have to rely to some extent on some form of formal or informal sources of credit either for personal and/or business purposes.

Microfinance has been the major tool used to increase access to finance and make the 'poor' more financially included. The Financial Inclusion Centre's website states that:

> Financial services tailored to the needs of poor people contribute to poverty alleviation, social justice, quality of life and human dignity. At a societal level, these services also contribute to the economic growth and stability of emerging markets. For these reasons, microfinance has emerged as a leading strategy in sustainable economic development.

In recent times therefore, the term 'microfinance' has become a buzzword in most of the developing world as well as in the formulation of welfare programmes by governments. Following success stories in microfinance across developing countries, particularly Bangladesh, third world nations started to give more importance to it. It is seen as *the* tool for eradicating poverty and has developed into the donors' favourite means of doing so (Augsburg and Fouillet 2006).

But is microfinance all it is cracked up to be? Until very recently, scarcely a voice was raised against it. It was regarded by governments, academics and increasingly by the wider public as an unalloyed public good (Centre for the Study of Financial Innovation 2011). The Centre for the Study of Financial Innovation (CSFI) survey goes on to ask: how can the bottom-up approach of microfinance be replicated widely enough to make a significant dent in the global problem of poverty? The report makes clear that a lot of people who are in or close to the microfinance sector are now worried that microfinance has taken a wrong turn and is suffering from 'mission drift'. It is clear that the sector as a whole is coming under much harsher scrutiny. There have recently been concerns in India and Bangladesh about the apparent adverse effects of microfinance to the extent that the celebrated Professor Yunus was relieved of his position as Chairman of Grameen Bank.

It appears therefore that the jury is still out on the impact of microfinance on economic development and therefore poverty eradication or alleviation. Several recent studies on the impact of microfinance have questioned whether microfinance has made a quantitative improvement in the lives of borrowers, or has had any effect on poverty alleviation on a systemic basis. Odell (2010) says a more comprehensive survey and additional studies of the macroeconomic effects of microcredit and microsavings are badly needed. This is despite a

2010 survey by the Poverty Reduction and Equity group of the World Bank (Kotikula *et al.* 2010) suggesting a definite correlation between microfinance and poverty alleviation in Bangladesh.[9] Several microfinance practitioners have countered the doubts about the poverty alleviation impact of microfinance and have witnessed the positive impact of microfinance (ACCION *et al.* 2010). They point to the following from the experiences of their programmes:

(a) business loans from microfinance institutions open a world of opportunity previously closed to them by the formal financial sector;

(a) savings accounts – equally critical financial tools – facilitate the safe accumulation of assets, while microinsurance reduces their vulnerability to risk;

(c) microfinance is particularly able to empower women.

Further, Buera *et al.* (2011) report that the Microcredit Summit Campaign Report (2009) documents 3,552 institutions with reported loans to over 154 million clients throughout the world as of 2007. For comparison, the numbers in 1997 were 618 institutions and 13 million clients. This is a sixfold increase in the number of institutions and 12-fold increase in the number of borrowers over 10 years.[10]

So far the few published randomized controlled trial (RCT) studies of microfinance have been able to track short-term results only (Odell 2010). Two that looked at standard microcredit clients over a short period (12–18 months) found no evidence of improvements in household income or consumption, although they did find some other possible benefits (Banerjee *et al.* 2009; Karlan and Zinman 2009). Interestingly, the only RCT study of microfinance so far that found short-term welfare improvements looked at microsavings, not microcredit (Dupas and Robinson 2009). A South Africa RCT found income improvements from small, high-interest consumer loans, but such loans are not usually thought of as microfinance (Karlan and Zinman 2008).

Many more of these studies, including especially longer-term ones, will be needed before general conclusions can be drawn. For now, it seems an honest summary of the evidence is to say that we simply do not know yet the extent to which microcredit and other forms of microfinance are helping to lift millions out of poverty.

What microfinance does, however, is to provide access to financial services for several million people who were previously excluded. The benefits of that access to the recipients however still appear to remain an open question.

[9] An interesting result of this study is that the decline in poverty is greater where microfinance access increased more sharply. For example, in areas where microfinance members increased by less than 20% the poverty rate fell by 3.9%. In areas where the number of microfinance members increased by more than 40% the poverty rate fell by 13.3%.

[10] Buera *et al.* concede that these increases overstate average growth – because of an increase in survey participation – but the actual growth is still dramatic. For example, a single programme, the National Bank for Agriculture and Rural Development (NABARD) in India grew from 146,000 to 49 million clients over this period.

5.4.1 Other Access to Finance Tools

Mobile Money Transfer

Formalization of money transfer services has seen a significant development over the past decade or so and new ways of money transfers especially using mobile telephony are taking hold especially in developing countries.

This rise has come about because despite microfinance's growing success many low-income households still lack access to financial services mainly due to low population densities, poor infrastructure, weak financial product design, etc. However, branchless banking, particularly mobile banking, has been met with much enthusiasm because of its potential to deliver financial services to a much greater number of people at the bottom of the pyramid (Cohen *et al.* 2008).

Informal money transfer services among people have existed for decades especially the use of long distance drivers taking money for example, for person A in Freetown to a relative B in a rural village deep in, say, the Northern province. Banks too have always been involved in money transfers but often of relatively large amounts for businesses and personal banking customers. Then came the advent of services such as Western Union and MoneyGram in Africa including Sierra Leone.

The last few years have seen the dramatic rise of mobile money payments in Latin America and Africa with Kenya's M-PESA leading the pack in Africa with over 9 million subscribers and 14 million registered SIMs (Sadana *et al.* 2011). In Sierra Leone there is ZAP provided by Airtel and Splash mobile money service.

The attraction of these transfers is that unlike most of the other facilities, it allows transfers of small amounts and an almost 'at-your-doorstep' service with little formality.

As a means of financial inclusion, mobile money transfer can potentially overtake saving as the easiest and most basic way to financially include the financially excluded into the formal financial system. The uniqueness of mobile money transfers arises because it is available without having to utilize, or be a customer of, a formal financial services provider.[11]

Insurance

Microinsurance is a scheme that uses an insurance mechanism whose beneficiaries are (at least in part) people excluded from formal social protection schemes, in particular informal economy workers and their families.

Below are the critical features of microinsurance:[12]

1. transactions are low-cost (and reflect members' willingness and ability to pay);
2. clients are essentially low-net-worth (but not necessarily uniformly poor);

[11] This is used to mean an institution that is legally registered to provide financial services.
[12] See various publications from the Microinsurance Innovation Facility website.

3. communities are involved in the important phases of the process (such as package design and rationing of benefits);
4. the essential role of the network of microinsurance units is to enhance risk management of the members of the entire pool of microinsurance units over and above what each can do when operating as a stand-alone entity.

5.5 Demand for Financial Services in Sierra Leone

Access to finance cannot be meaningfully discussed without some indication of the level of demand for financial services. There have been very few definitive studies (such as a Finscope survey) on access to finance in Sierra Leone.[13] However, in early 2008 an EU BizClim-funded study[14] offered the first insights into microfinance demand[15] in urban and rural areas of Sierra Leone. The findings from that study have been compared to available national population data in order to quantify demand for various financial products and services.[16] It should also be noted that this study centred more on microfinancial services as opposed to overall, general access. However, given that the overwhelming majority of access to finance issues involves those at the 'bottom of the pyramid', the study remains very relevant as a measurement of overall access to finance.

The findings, as reported in Miamidian (2008) for funding agency Kreditanstalt für Wiederaufbau (KfW) are given below.

5.5.1 Size of Desire for Loans

According to the study, desire for microcredit is substantial and on the rise throughout the country. While only 10% of households currently have bank loans outstanding, 58% are interested in obtaining a loan within the next year. This need or desire, was double the previous year.

While Sierra Leone remains a primarily rural country, with 63% of the population residing in rural households, much of the country's economic

[13] Finscope is a widely recognized access to finance methodology developed by Finmark Trust of South Africa and used in most parts of East and Southern Africa as well as in some parts of West Africa (e.g. Nigeria).

[14] The Field Survey on the Microfinance Demand in Sierra Leone. In early 2008 an EU BizClim-funded study offered the first insights into microfinance demand in urban and rural areas. The findings from this study have been compared to available national population data in order to quantify demand for various financial products and services. It should be noted that these calculations are imperfect, and while useful for the initial strategy design, should be strengthened further by a Finscope survey as part of the FSDP.

[15] While the BizClim study uses the term 'demand', this paper was unable to establish that the term, as used in the BizClim study is in fact 'effective demand'. We will use the term 'desire' as opposed to the term 'demand' used in the BizClim study.

[16] It should be noted that these calculations are imperfect, and while useful for initial discussion, should be strengthened further by a Finscope-type survey as part of the Financial Sector Development Programme.

TABLE 5.1. Estimated desire for credit.

	Number of households	Percentage of households desiring loans	Value of average desire for loans (leones)	Value of total desire loans 2008 (leones)
Urban	268,250	63	2.2 million	371.8 billion
Rural	456,750	45	1.65 million	339.1 billion
Total	952,947			710.9 billion

Number of households is calculated according to the following formula:

- population of 5.8 million (according to 2007 World Bank data) divided by average household size of 8 (according to 2004 UE/BizClim survey) equals 953,974 households;
- urban population is 37% (according to 2007 World Bank data) equals 352,961 households;
- rural population is 63% (according to 2007 World Bank data) equals 600,987 households.

Source: table data calculated from Field Survey on the Microfinance Demand in Sierra Leone.

activity can be found in the capital city of Freetown, and other urban centres. The desire for loans reflects this reality. Table 5.1 presents an estimate of desire for loans in rural and urban areas.

5.5.2 Size of Need for Saving

The mix market found that the median MFI in Africa mobilizes more savings compared to its loan portfolio than MFIs in any other region. Microfinance institutions have learned over the years that reaching poorer, rural areas often requires savings-led initiatives, since savings are generally in higher demand than loans.

As such, the finding that savings needs in Sierra Leone are relatively low is surprising. Even more unusual is that saving needs are higher in the urbanized Western Area (30% of households) compared to the rural areas (between 6 and 13%). Miamidian finds this unusual because 'MFIs have learned over the years that reaching poorer, rural areas often requires savings-led initiatives, since savings are generally in higher demand than loans.' She believes this is likely reflective of the high levels of poverty in the country, as well as the loss of assets suffered by many families during the war. The study found that poverty was clearly a factor in ability or willingness to save.

The following table presents an estimate of the actual need for savings based on reported savings from 2007.

While these numbers are very low, it should be noted that the survey found that one-third of Sierra Leonean households would be interested in opening a bank account.

TABLE 5.2. Estimated desire for saving.

	Number of households	Percentage of households desiring savings	Average savings capacity (leones)	Total desire for saving 2007 (leones)
Urban	268,250	24	562,000	36.2 billion
Rural	456,750	8	168,600	6.2 billion
Total	952,947	—	—	42.3 billion

Source: data calculated from Field Survey on the Microfinance Demand in Sierra Leone.

TABLE 5.3. Money transferred annually (US$).

	Amount received annually	Amount sent annually
Urban	139,986,620	114,663,485
Rural	106,916,708	87,542,122
Total	246,903,328	202,205,607

Source: data calculated from Field Survey on the Microfinance Demand in Sierra Leone.

5.5.3 Use of Payment Services and Transaction Accounts

According to the study, 31% of Sierra Leonean households use money transfer services; making it the most frequently used financial service. Usage is similar in urban and rural areas, though gender distinctions vary dramatically, as the large majority of those willing to use formal money transfer services are women (86%).

It is interesting to note that only 8% of households transferring funds use formal channels including banks (3%) and Western Union (5%). Informal channels are much more frequently used in rural areas.

Extrapolating the available data, it appears that large amounts of money are sent within the country each year, primarily through informal channels.

Using the conservative assumption that all money sent is within Sierra Leone, a total of US$246.9 million in funds is moved through formal and informal channels around the country on an annual basis.

5.5.4 Size and Purpose of Demand for Leasing Products

There is limited information on the size of the demand for microleasing, however it appears that there is room for microleasing, potentially in conjunction with training and other business support services in developing microenterprises in productive sectors.

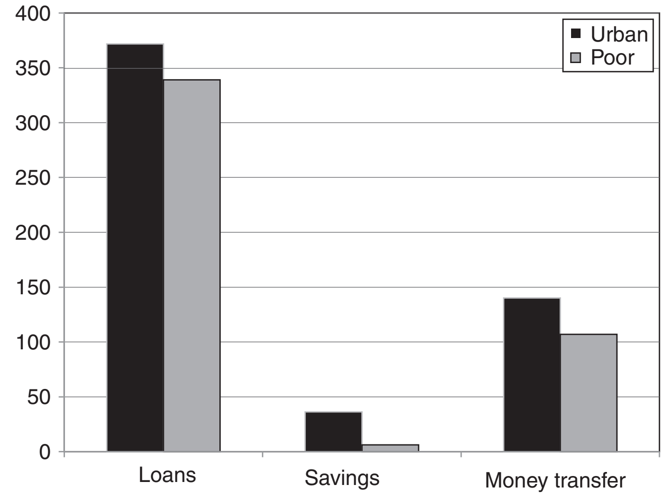

FIGURE 5.1. Desire for financial services. *Source*: EU BizClim study 2008.

5.5.5 Size and Purpose of Demand for Insurance Products

Microinsurance has proven to be an important service in the international microfinance landscape. As with many countries in which this service is new or limited, the largest impediment to determining demand is awareness. In Sierra Leone, only 2.2% of households are insured. Not surprisingly, therefore, most of the population has never heard of insurance, with a greater awareness in urban areas (51%) than rural areas (28%). Given this limited information, no estimate of demand for insurance is available.

Lack of information, however, does not imply lack of demand. Insurance companies have identified microinsurance as their primary growth market.

Figure 5.1 gives a diagrammatic presentation of the financial services demand in Sierra Leone and illustrates the extremely poor demand for savings services, which should be the basic and most sought after financial service. It suggests a worrying lack of appropriate financial intermediation in the banking industry and the financial sector specifically. This apparently dysfunctional situation may be largely due to the poor state of financial product development in Sierra Leone where the development of appropriate financial services products is not given sufficient attention. This shall be discussed in more detail in Section 5.12.

Finally, the KfW document summarizes demand for finance as follows.

5.6 Types of Microfinance and Other Access to Finance Providers in Sierra Leone

According to the MITAF II project document, in 2003 it was estimated that, of the 90,000 to 160,000 potential microfinance clients in Sierra Leone, fewer than 15,000 had access to financial services. In 2009 the number of clients of the microfinance sector increased from 13,000 in 2004 to 123,000. This strongly suggests that microfinance in Sierra Leone has done tremendously well over the past five years or so.

Although Sierra Leone's financial sector is dominated by the banking and microfinance sectors, and from the perspective of 'access to finance/financial services' these two are the most important, mobile money payment providers are fast catching up. The discussion in this section will also include NASSIT, which as mentioned earlier is a social security fund but arguably has the largest number of savers, most of whom would qualify as micro or small. Providers of microfinance in Sierra Leone are varied, and can be grouped as follows below.

- Formal (regulated/supervised by the central bank or other regulatory body):
  - commercial banks;
  - community banks.
- Semi-formal (legally and formally registered but not by the Central Bank):
  - microfinance institutions;
  - cooperatives;
  - financial services associations;
  - village savings and loans associations;
  - government and donor funded projects/programmes.
- Informal:
  - savings clubs such as esusu groups;
  - other informal groups such as business associations, farmers and other sectoral groupings.

We shall now examine each type in some detail.

5.6.1 Commercial Banks

One common feature of the banking system in Africa is that a large number of them invest in government securities, primarily treasury bills. Although Allen *et al.* (2010) believe this is reflective of a highly dysfunctional banking intermediation that ignores provision of private credit in favour of safer government securities, it is in fact a deliberate and rational choice by the banks, in their circumstances, designed to reduce risk and maximize profits. Be that as it may, it does not help in increasing financial access. A review of the Sierra Leone banking industry 2010 results (Fraser 2011) shows that, on average, banks in Sierra Leone invest 55% of their earning assets in government and other securities (including the statutory cash ratio) and only 34% in loans and advances.

The number of commercial banks has increased to 13 with the entry of a number of new banks in the last few years, particularly Nigerian-owned banks and banks remain the dominant player in the financial sector. A few of the commercial banks (such as Ecobank, First International Bank, Union Trust Bank) have piloted microfinance schemes in the past year in direct competition with microfinance institutions. However, most banks in Sierra Leone remain deeply conservative and are mainly concentrated in the capital city, Freetown. Before the war, the economy had less than half that number of commercial banks almost all of which had reasonable coverage in major parts of the country, especially provincial headquarter towns. However, during the war, the network of bank branches across the country was substantially affected. Many branches were victims of lootings, vandalism and abductions of staff.

With the formal end of the war, and declaration of peace in the country in 2002, economic activities have been returning to prewar levels, thus ushering in the establishment of several new commercial banks in addition to the ones that existed before the war.

Consequently, the level of competition among commercial banks has intensified. Competition will become even fiercer when these 'mainstream' banks begin (as, for example, have Union Trust and FI banks) to venture into rural areas to compete not only among themselves but also with rural financial providers such as community banks and financial services associations. These latter two types have several challenges but on paper may be better suited to provide more appropriate financial products and services to local communities than do the commercial banks.

Diagnostic studies of the financial sector (see, for example, Kargbo and Adamu (2010, pp. 33–35)) identified both systemic and institutional inefficiencies in the financial sector that have contributed to the high cost of financial intermediation and limited the availability of financing for productive investment, especially for small and medium-sized enterprises. Legislative and other structural inadequacies also handicapped (and still do to a certain extent) the financial sector resulting in the following consequences: weak judicial procedures for loan recovery; weak credit risk evaluation mechanisms for bank clients; and high intermediation costs.

To address these problems, the Bank of Sierra Leone (BSL) and Banking Acts were revised in 2000 to provide a sound legal framework for the banking system consistent with a more independent central bank and effective banking supervision. New banking regulations were issued requiring increased capital and reporting comparable with international standards, to make the banks more stable and less prone to failure. The BSL is now better placed to pick up early warning signals of weaknesses in financial institutions. The regulatory and supervisory role was extended to other financial institutions, which led to the enactment of the Other Financial Services Act in 2001.

Therefore, while struggling to rectify their problems, commercial banks in Sierra Leone have been relatively slow to embrace microfinance, unlike countries in East and Southern Africa and even to an extent in West Africa, especially Francophone West Africa.

About five years ago, Sierra Leone had its first microfinance bank when the foreign-owned pro-credit bank began operations in Freetown. Its experiences however were not positive and in 2010 it sold its operations to Ecobank which has maintained the microfinance arm as part of its operations.

The other bank with a major microfinance focus is Union Trust Bank (UTB) which runs its microfinance operations largely through Finance Salone as its microfinance subsidiary.

FI Bank[17] is also making significant strides in microfinance provision in Sierra Leone, especially in the area of agriculture.

5.6.2 Rural Financial Services Providers

Community Banks

In terms of being closest to the real targets of microfinance services, community banks are designed to be just that. In 2009, there were six community banks (CBs) operating in Sierra Leone.[18] These community banks were established between 2003 and 2008 by the BSL through a capital injection programme as a catalyst for financial services extension into the rural sector of the economy. The banks were geographically distributed across the four provisional headquarters of the country so as to stimulate rural communities to rebuild their lives through access to financial services. In 2010, the Rural Finance and Community Improvement Programme (RFCIP), a rural finance project in the Ministry of Agriculture, Forestry and Food Security (MAFFS) helped establish three other[19] community banks and aims to establish another four by the end of 2011 which will bring the total of community banks to 13.

Rural banks were first established in the 1980s across the country. They were meant to provide financial services to rural populations, where the traditional commercial banks were averse to operate and penetrate due to high transaction costs, poor infrastructure, etc. They were created with substantial financial support provided by the BSL, including participating in the equity capitalization. The banks provided simple deposit services and loan products, as a downscaled version of commercial banking operations. However, they became defunct and non-operational at the height of the war.

[17] It used to be known as First International bank but is now FI Bank.

[18] They included Segbwema Community bank (Kailahun district), Mattru (Bonthe district), Marampa community bank (Lunsar, Port Loko district), Yoni (Tonkolili District), Zimmi community bank (Pujehun district) and Kabala community bank in Kabala (Koinadugu District).

[19] Pendembu (Kailahun district), Jiama Suafe (Kono district) and Kayima (Sandor Chiefdom, Kono district).

Capital injection in the form of term loans to each community bank ranged from Le 700–900 million, used for construction of buildings, purchase of vehicles (one car and one motorcycle), computers, generators and other equipment. Only Le 100 million (about US$25,000) each was allocated as working capital including for on-lending operations. The CBs were imposed on the communities instead of simply being facilitated to evolve where the community would feel stronger ownership. The BSL, in establishing them, had felt the banks would be able to accumulate capital through savings mobilization and earnings from fees and interests on the loans they would extend to their clients, and that, given the assumed high demand for financial services, in the selected areas, their capital positions would have improved in the succeeding years, to allow them to repay the long-term credit provided by BSL. The Bank of Sierra Leone also provided technical advice and support to the CBs, through its representatives on the boards of directors of these banks. This also provided the banks with on-site inspections twice a year. The BSL, however, since 2008, ceased having representatives on the boards of CBs, to avoid the conflict of interest by being both supervisor and implementing agent.

The unsatisfactory situation of low liquidity, poor deposit mobilization and weak operating structures such as poor internal controls, led all the CBs to change their legal status by transforming into companies limited by shares. They began selling shares in 2008, with the objective of attracting more capital and liquidity, to improve both their client outreach.

Community banks' performance. At establishment these banks had high operational costs (such as a high staff to client ratio because of too many staff), disproportionate to volume of business, and commenced lending activities with limited capital only six months after inception and poor loan repayment performance. As a consequence, all CBs incurred losses during their early years of operations. These problems plus inability to raise more capital led to liquidity constraints which did not allow them to increase the loan portfolio and expand their operations. Savings mobilization did not reach the expected high levels. They all had high administrative cost and the relatively low interest rates charged on loans[20] that did not enable them to earn sufficient incomes to cover the costs. Furthermore, for some of the banks, loan appraisals were not effectively done in the initial years of operations, which led to further losses as a result of delinquent loans. Such was the case, for example with the Segbwema CB which too quickly rushed and gave out over 500 loans in the early months of operations in 2005, because it wanted to meet the requirements of MITAF to benefit from a grant of US$30,000. The consequence was that there were bad loan appraisals (some of which were not even referred to the board for

[20] An option would be to raise their interest rates but this would make their loan products unattractive to the target group.

approval), which led to a portfolio at risk[21] (PaR) of close to 90%.[22] The bank was therefore obliged to effect loan write-offs in 2008 that enabled it to lower the PaR to the current rate of 30%.

Generally, it can be said that the inadequacy of on-lending capital made it difficult for the banks to record successful performances. Their operational revenues are however gradually improving. Four of them have reached operational self-sufficiency (OSS), while three of those four have achieved financial self-sufficiency (FSS). They have all received, at some point, capacity building from MITAF I, and this has helped them operate in a more efficient way. All the CBs are planning to introduce computerized management information systems in their operations, and some also plan to hire new credit officers so as to lower the ratio of clients per credit officer, which is currently around an average of 600–800. Despite the constraints and relatively weak overall performance, the CBs in over 5 years of operations were able to mobilize a reasonable combined deposit of Le 8,299.9 million as at September 2008. The banks also attracted 9,459 account holders during the period. These deposits were only mobilized in 32 chiefdoms in 6 districts, out of 149 chiefdoms in the 12 districts of the country. They have therefore been able to spread banking habits, mobilize deposits and provide finance to promote income generating activities to a growing number level of low income entrepreneurs.

Main challenges and constraints of community banks. The main challenges and constraints of CBs are the following:

- inadequate liquidity;
- high operating costs;
- inadequate computerization;
- untrained and inexperienced staff;
- inexperienced directors and management;
- lack of shared resources and services;
- inadequate supervision.

The challenges faced by community banks have been significantly reduced with the support of the Rural Finance and Community Improvement Programme (RFCIP). The project has so far facilitated the establishment of three more community banks (to add to the original six), provided capacity building and technical backstopping as well as capitalizing some of the banks. Some

[21] With PaR, the full outstanding balance of a loan is deemed to be risk as soon as one repayment is missed. This is a stricter measurement of portfolio quality than the more simple repayment rate ratio where the portfolio risk is simply measured against the number of repayments missed as opposed to being measured against the full remaining outstanding balance.

[22] Any portfolio at risk of more than about 5–10% is a sign of poor loan portfolio management.

problems with technical capacity and capital however remain. These issues have been recognized by the BSL and strengthening of community banks is specifically mentioned in the Financial Sector Development Plan (FSDP).

Financial Services Associations

Financial services associations (FSAs) are rural grass-roots financial institutions registered as community-based organizations that provide a range of financial services to poor rural communities and are owned and operated/managed by rural communities via associations. The main available products offered are credit facilities for income generating activities and small businesses. The establishment and ongoing development of FSAs is also a major focus of the RFCIP.

As organizations, FSAs are built up from[23] locally available financial resources mobilized from the local residents and transformed into loan capital from which credit is provided to qualified shareholders who require it. Only shareholders can be customers of an FSA. As a result, a major element of an FSA loan appraisal is the FSA's knowledge of the borrower who is not only an FSA shareholder but also almost always a local resident. Loan sizes are up to a maximum of four times the held shares.

The FSAs, based on an idea borrowed from eastern Africa – Kenya, to be precise – operate informally, with villagers or people living in very informal settings without access to, and the capacity to meet the 'prudential' demands and requirements of, formal commercial banks. The FSA model also takes advantage of existing local customs, knowledge, relationships, and group solidarity.

FSA products. A well-established and fully operational FSA may have a wide range of products and services. However, it should be noted that since the model is still new in Sierra Leone, group and individual loans, voluntary saving from shareholders and money transfers are the only services offered presently. Services planned to be offered are as follows.

Money transfer facility (MTF). Money transfer from and to FSA and other financial institutions (including overseas).[24]

Third party cheque clearance. The FSA will offer services of clearing legitimate bank cheques on behalf of its shareholders.

Sale of cheque leaf. The FSA shall avail cheque leaves for sale to those clients who wish to transfer money in form of cheque system.

[23] While all the FSAs in Sierra Leone as well as in some other parts of Africa (e.g. Kenya) have been assisted in the establishment and development by development partners (such as IFAD in Sierra Leone) the local population invests by buying shares and the donors exit eventually.

[24] Although none of the FSAs is carrying out money transfer services at the moment, some expect to begin providing this important service very soon in order to better serve the rural communities by linking them with remittances from their relatives abroad.

Pay point to all interested parties. The FSA will act as a pay point to the willing shareholders who are on current payrolls and receiving retirement pensions.

FSA experience in Sierra Leone. There are currently some 26 FSAs operational in Sierra Leone under the RFCIP, which is funded by the International Fund for Agricultural Development (IFAD). The FSAs are located in the interior of the country across Kono, Koinadugu, Kenema, and Kailahun districts – the operational area of RFCIP. The objective is for there to be at least one FSA for every two Chiefdoms in Sierra Leone. This means that by the time the project ends there should be at least 75 FSAs.

Village Savings and Loans Associations

The Village Savings and Loan (VS&L) model is a savings-based approach that has proven on a very large scale that it can substantially fill the financial services gap (Helmore *et al.* 2009). By intermediating small local pools of capital to satisfy household cash-management needs it facilitates immediately sustainable and profitable savings, insurance and credit services to people who live in places where banks and MFIs do not have a presence.

The model was originally developed in Maradi, Niger, by CARE International in 1991 and has spread to 33 countries in Africa, 3 in Latin America and 7 in Asia, with now almost 3 million active participants worldwide.

The methodology, in various forms, is now used by international NGOs to provide entry-level financial services to people who are either too poor or living in places that are too remote to be availed of financial services by microfinance institutions.

A village savings and loans association (VSLA) is a self-selected group of people who pool their money into a fund from which members can borrow.[25] The money is paid back with interest, causing the fund to grow. The regular savings contributions to the group are deposited with an end date in mind for distribution of all or part of the total funds (including interest earned mainly from loans given out and from bank savings accounts) to the individual members, usually on the basis of a formula that links payout to the amount saved. This lump sum distribution provides an amount of money that each member can then apply to his/her own needs.

CARE's VSLA programme in Sierra Leone is Expanding Microfinance Opportunities to Poor People (EMOP), which aims at improving household livelihood security of 46,200 people (6,600 direct beneficiaries) in four chiefdoms of Koinadugu district. The project will increase access by 6,600 rural low income farmers, youths and women to financial services through the establishment of village savings and loan schemes and linkage with microfinance institutions

[25] In CARE's VSLAs, each member contributes to a savings fund with small, regular and mandatory deposits. The comprehensive training programme by CARE supports the group for up to one year, and includes skills to succeed in saving as well as establishing new businesses.

TABLE 5.4. Key statistics for Finance Salone.

	2008	2009	2010 (to June)
No. of active savers and borrowers	15,704	17,831	18,578
Amount loaned out (billion leones)	19.4	19.7	9.6
Amount of savings (billion leones)	1.8	1.5	1.6
No. of branches	10	10	11
Gender split among borrowers: male	7,017	8,688	8,887
Gender split among borrowers: female	8,687	9,144	9,691

Source: Finance Salone.

and community banks. By 2009, just three years after introducing it, CARE had established over 350 VSLAs with close to 11,000 members.

CARE has found that VSLAs meet the need for savings and credit at the very bottom rung of the world's economic ladder.

5.6.3 NGO–MFIs

There are about nine[26] active microfinance institutions (MFIs) in Sierra Leone. Unlike community banks and commercial banks, MFIs are not allowed to accept deposits. They are however a major avenue of financial access to the informal and rural sectors of the country.

Little introduction in needed for NGOs and MFIs, being the pioneers of microfinance provision in most African countries. Most began as donor-funded projects (for example, the Kenya Rural Enterprise Programme – KREP – which is now a bank) and to varying degrees copied the Grameen Bank model. Four NGO/MFIs which are considered the most successful are discussed briefly below.

Finance Salone

Finance Salone was established in 2005 and is arguably the leading microfinance institution in Sierra Leone. In 2010 Union Trust Bank bought a majority shareholding in it. Even with its affiliation to UTB, it is not allowed to accept deposits in its own name and so only have loan products. This affiliation however has enabled it to obtain additional equity and concessional loans from the bank.

Table 5.4 shows some salient statistics as at June 2010.

The table shows consistent increases in all the areas measured.

Finance Salone offers three main products, all loans (group and individual loans for business purposes and consumer loans). These products are offered mainly in Freetown localities and commercially busy provincial towns outside

[26] ARD, BRAC, CEDA, Finance Salone, GGEM, Hope Micro, LAPO SL, Luma and SMT.

Freetown. Loans finance mainly petty trading (75%), services such as auto repairs, beauty salons, restaurants, etc. (10%), and handicrafts (15%).

Finance Salone has 11 branches operating throughout the country and 6 sub-offices and serves over 18,000 clients. Its 2009–13 plan envisages further extension. Finance Salone had (as at September 2010) a repayment rate of 98% and an acceptable portfolio at risk below 30 days at 5%.

Lift above Poverty Organization

The Lift above Poverty Organization (LAPO) originated from Nigeria. It provides small individual loans (ranging from Le 300,000 to Le 1.5 million i.e. US$70–350) for a period of repayment ranging from five to eight months, at 3% interest rate per month. As collateral, a 10% deposit is required. A follow-up service to the clients is usually immediately made to avoid defaults, which are currently recorded at only 2%. The portfolio at risk (PaR) is an excellent 1.16%.

By mid March 2009,[27] LAPO had reached over 8,000 clients through two branches in Freetown and Kenema. It plans to further extend its services to urban and semi-urban areas.

Hope Microfinance Institution

Hope Micro's mission is to provide financial services for the poor in a manner that is sustainable, readily accessible, and responsive to their needs. Hope Micro provides commercial loans for trade through a group lending solidarity method, with a 3% flat interest rate per month. The loan size ranges from Le 50,000 up to Le 500,000. It had tested some agricultural loans, which didn't succeed because of the failure of the crops financed (weather, disease, etc.).

Early in 2011 Hope Micro established a partnership with KopoKopo and Splash Mobile Money to bring mobile financial services to their 16,000 microfinance customers. Hope Micro plans to scale the service in order to offer both loan disbursement and repayment through Splash Mobile Money to all of its 16,000 customers. Hope Micro is the first MFI in Sierra Leone and one of the first in West Africa to offer mobile financial services.

Its customers may now be able to repay their loans using Splash Mobile Money, a service allowing users of the top three mobile networks to load cash to their phones, send money, pay bills, withdraw cash, and buy goods. This initiative should serve to bring thousands more people into the financial access fold.

BRAC (Sierra Leone)

BRAC Sierra Leone's microfinance programme was set up in 2007 and has been designed to provide reliable access to cost-effective financial services to

[27] See www.mixmarket.org/mfi/country/sierraleone.

poor and marginalized women. The nature and content of the programme is described below.

Women's groups. These groups deliver the microfinance and other programmes through organizing groups of poor women who come together to improve their socioeconomic position. The BRAC microfinance branch offices conduct area surveys and consult with community leaders and local elders to select the 30–40 members of each group. The group is then subdivided into smaller groups of five, each with their own elected leader.

The members of each small group take joint responsibility to solve peer repayment problems. New borrower groups meet four times before any loan disbursement takes place. After that, they meet weekly to discuss credit decisions with their dedicated BRAC credit officer and make their loan repayments. Also, BRAC provides training and technical assistance to its members and others in the community, empowering them to earn more income from existing activities and start new ones.

Microloans. At the core of the programme are microloans, which are exclusively for the women participating in the group process. Borrowers range in age from 18–50 with little or no education and to women who are not served by other microfinance institutions.

Key features of a microloan. The key features of a microloan are

- loan repayments in small weekly installments,
- no physical collateral needed,
- loan range of US$100–300,
- competitive interest rates, that is, rates that are more attractive than their competitors' rates,
- death benefits provided in the form of an insurance payout,
- financial services delivered to member's village,
- available in rural and urban areas.

Small enterprise loans. BRAC offers small loans to individual entrepreneurs seeking to expand their small businesses. Typically, loans are given for trading, agriculture, poultry and livestock, fruit production and other types of small enterprises. These small entrepreneurs would otherwise have limited access to the formal financial system – they are too large for microloans but with insufficient/inadequate collateral for commercial banks. Some members of the microloan scheme become eligible for a small enterprise loan as their businesses grow and expand and their investment needs change.

Key features of a small enterprise loan. The key features of a small enterprise loan are

- availability to both male and female entrepreneurs,
- loan range US$1,000–3,000,
- lower interest rates relative to its competitors,
- repayment mode of equal monthly installments.

5.6.4 Cooperatives

Sierra Leone has had a long experience with the cooperative movement, but the long exposure to the tenets of the movement has not left it in good stead. Some studies (see, for example, Ferguson *et al.* 2005; Fraser *et al.* 2011) have shown that the existing cooperative movement in Sierra Leone is weak with only few active cooperative societies.

Several benefits accrue from adherence to cooperative principles (Reynolds 1998). Today, governments expect cooperatives to inform policymaking and engage in advocacy while the cooperatives themselves seek a more pronounced, active and permanent role in decision-making (Mercoiret 1999). Cooperative societies can (as seen, for example, in East Africa[28]) be a major source of income and investment for low-income people (Wanyama 2009). The shared spirit of cooperation and empowerment leads to engagement in larger projects such as reconstruction of schools or health facilities.

Given their successes elsewhere in Africa, cooperative societies therefore could also, and indeed had have a very important role to play in Sierra Leone's socio-economic development. However, over the past 10–15 years a number of problems have dogged the cooperative movement in Sierra Leone (Fraser *et al.* 2011):

- weak capacity in the cooperative department;
- lack of an apex cooperative body or congress;
- other problems, such as an old and unrevised cooperative law and lack of a national cooperative policy.

What appears to be the most recent and only definitive study of the cooperative movement in Sierra Leone is a 2006 study Ferguson *et al.* (2006) prepared for

[28] Cooperatives are recognized by the government of Kenya to be a major contributor to national development, as cooperatives are found in almost all sectors of the economy. With the total population of Kenya at approximately 37.2 million (Republic of Kenya 2008a, p. 13), it is estimated that 63% of Kenya's population participate directly or indirectly in cooperative-based enterprises (Ministry of Cooperative Development and Marketing 2008, p. 4). Indeed, the Ministry of Cooperative Development and Marketing estimates that 80% of Kenya's population derives their income either directly or indirectly through cooperative activities (see Wanyama 2009).

the Commonwealth Secretariat that made the following observations which remain largely valid today:

> In the early 1980s cracks began to show in the movement as excessive reliance on government support led to government interference in some cases and to weak internal capacity in others. As the Cooperative Department began to downsize and withdraw services, the movement shrank and experienced failures.[29]
>
> Inclusive Growth Strategies 2011

With the end of the rebel war, a programme of cooperative revitalization has been undertaken by MTI and the Cooperative Department. This is an initiative to provide credit primarily, but not exclusively, to the fishing industry by the African Development Bank (AfDB) and, to a lesser extent, by the government of Sierra Leone (GoSL). Attracted by the promise of credit access, almost 800 cooperatives were established or revitalized, more than three-quarters of which were new (Fraser *et al.* 2011).[30] Unfortunately however, this has not worked out very well as the scheme was abused and most of the cooperatives are now defunct.

In addition, international NGOs and even other government departments are establishing cooperatives that are not being registered with the Department of Cooperatives, thus the true size of the cooperative movement is not known.

The revitalization efforts continue and, currently, there are over 1,000 officially registered, but unviable, cooperatives in Sierra Leone. The Ministry of Trade and Industry has also recently commissioned a consultancy firm to undertake a study of the movement in Sierra Leone with the objective of developing a policy and legal framework.

There is much to do to develop the cooperative movement in Sierra Leone and it should not be counted on any time soon to provide any meaningful contribution to A2F.

5.6.5 Other Access to Finance Providers

Mobile Money Payment Providers

Mobile money providers are becoming a major access to finance tool in Sierra Leone and in the past two years the major ones are SPLASH and Airtel.

SPLASH. SPLASH operates on three of the mobile telephone networks in Sierra Leone (Airtel, Comium and Africell) and was launched in September 2009 as a pilot and was rolled out in February 2010. By October 2010 it had 9 branches, 40 sub-agents and subsidiaries with up to 150 outlets countrywide and had 50,000 users. Currently (May 2011) SPLASH covers all major towns

[29] Even these are still few and fledgling. Some of the previously stronger ones such as the dockworkers cooperative are now floundering.

[30] Most of these appear to have been established only to take advantage of the AfDB microcredit.

in Sierra Leone and has now reached 70,000 users. In October 2010, SPLASH teamed up with Union Trust bank as an agent in the SPLASH network using its network of bank branches. It also has a similar arrangement with Guaranty Trust Bank.

Airtel. Airtel started their service in 2010 and claim to cover 90% of the country with this service. In barely one year of mobile money transfer operations, it states that it has reached 254,643 active users with over 400 agents. Like SPLASH, Airtel also collaborates with two banks, Zenith bank and Guaranty Trust Bank.

5.6.6 Microinsurance in Sierra Leone

Microinsurance is virtually non-existent in Sierra Leone. Very few of the eight insurance companies in Sierra Leone have developed microinsurance products. Aureol insurance company has developed a microinsurance product but is finding it difficult to interest the target groups (MFIs, small business associations and banks). They report that the target groups, especially the banks, seem more interested in insuring the *loans* made to their micro and small business clients.

The very experience of microinsurance was that the few small business traders who did take out insurance did not renew their policies after the first year. The industry believes that, apart from cost of premiums, some businesses also had bad experiences regarding claims and so lost faith in insurance. Another complaint from the industry is that even the NGO/MFIs themselves do not seem to understand and therefore do not value microinsurance.

5.7 Access to Finance: Outreach in Sierra Leone

5.7.1 Commercial Banks' Outreach

According to the Financial Sector Development Project document, there were only 160,000 bank accounts in the country in 2006. The document goes on to state that Sierra Leone has one of the lowest bank branch penetrations in Africa with one branch per 200,000 people, although more branches are opening. Credit to the private sector amounts to 5% of GDP, far below the sub-Saharan African average of 17%. Agricultural loans account for only 2% of gross loans, although agriculture provides 75% of employment and 50% of GDP.

Table 5.5 gives Sierra Leone's banking outreach from 2007 to 2009 and a comparison with Ghana in 2009.

The table above shows significant increases in availability of banks and their services from 2007–9 in Sierra Leone. Even the number of ATMs is no longer 'N/A' with Rokel bank, Ecobank, UBA and a few others having introduced ATMs, some of which accept international visa debit cards. This shows that the other aspect of A2F i.e. access to a wider variety of services even for the already banked, is on the increase.

TABLE 5.5. Sierra Leone banking outreach 2007–9.

	2007	2008	2009	Ghana 2009
Number of borrowers from commercial banks per 1,000 adults	4.7	8.1	9.0	34.0
Outstanding loans from commercial banks (% of GDP)	5.6	7.5	9.4	31.4
Number of depositors with commercial banks per 1,000 adults	63.9	92.4	113.1	332.3
Outstanding deposits with commercial banks (% of GDP)	16.1	18.5	20.4	40.8
Number of commercial bank branches per 1,000 km^2	0.8	1.0	1.2	3.2
Number of commercial bank branches per 100,000 adults	1.8	2.2	2.8	5.1
Number of ATMs per 1,000 km^2	N/A	N/A	N/A	N/A
Number of ATMs per 100,000 adults	N/A	N/A	N/A	N/A

Source: IMF 2009 Financial Access Survey.

Comparison with Ghana (Table 5.5), however, shows Sierra Leone's banking outreach still trailing way behind.

There are few specific reports/statistics from commercial banks in Sierra Leone but an annual report (Johnson 2009) showed the number of branches of commercial banks increased to 73 in 2009 from 57 in 2008. As of August 2010 there were 80 (Bank of Sierra Leone 2011).

Credit to the private sector by the commercial banks continued to grow, reaching a high of 46.17% of total credits in 2009 (Bank of Sierra Leone annual report 2009) (which is in line with the Africa average of about 46%) from only 29% in 2008 (Miamidian and Khalaf 2009). There is no indication what percentage of this went towards microfinance.

The commercial banks' net loan-to-deposit ratio was only 33% in 2008 and rose to 53% in 2009 which suggests increased lending generally but, again, no breakdown to microfinance lending.

At the end of 2010, the commercial banks' outreach statistics were as shown in Table 5.6.

5.7.2 Outreach of NGO/MFIs and Other Microfinance Providers

In terms of the NGO/MFI types, the preceding sections have shown that there has been, and continues to be, increased outreach by MFIs. Finance Salone for example, has, in its 5 years of existence, reached 11 towns.

Tables 5.7–5.10 give some details of the outreach and performance indicators of other access to finance providers.

TABLE 5.6. Commercial banks' outreach (December 2010).

	Number of loans	Total value of deposits	Total clients	Number of branches
2008	19,287	1,077,078,079	17,858	57
2009	24,624	1,310,551,912	24,731	75
2010	—	1,825,702,820	27,750	80

Source: Bank of Sierra Leone.

TABLE 5.7. NGO/MFI outreach (September 2010).

	Number of savers	Total active clients	Number of MFI outlets
2008	N/A	75,746	—
2009	N/A	93,590	—
2010	N/A	101,250	—

Since non-bank MFIs are not allowed to take deposits the number of savers would be more or less the same as the number of active clients.

TABLE 5.8. Community banks (September 2010).

	Number of loan clients	Number of depositors (US$)	Total clients	Number of banks
2008	—	—	—	6
2009	—	—	—	6
2010	9,261	12,156	21,870	9

Figures for 2008 and 2009 were not available except for number of community banks.

A major concern for NGO/MFIs is bad debts which lead to write-offs. Between 2007 and 2009, four NGO/MFIs alone had to write off Le 6.7 billion (approximately US$1.5 million) (National Commission for Social Action 2010).[31] This represents only 4% of the whole NGO/MFI industry's outstanding loan portfolio. However, since the largest single write-off was Le 3.6 billion (US$840,000) and the highest single amount of portfolio outstanding among the MFIs over the period was US$12 million, it means that, at best, there was a single write-off of 7%[32] of one MFI's portfolio or, maybe at worst, over 56%.[33]

Increased activity (more loans, increased savings, etc.) by banks does not necessarily mean increased access to financial services. What this attempt to

[31] *Credit Lines* is NaCSA's microfinance programme's biannual newsletter.
[32] US$840,000 as a percentage of US$12 million.
[33] That is, if the largest write-off of US$840,000 was among the four MFIs whose write-offs totalled US$1.5 million.

TABLE 5.9. FSAs.

	Number of loan clients	Number of depositors (US$)	Total shareholders	Number of FSAs
2008	623	N/A	2,819	6
2009	1,547	N/A	6,256	11
2010	3,514	N/A	12,446	17

As at June 2011 there were 26 FSAs and over 19,000 shareholders.

TABLE 5.10. Mobile money transfers.

Number of clients	Total clients	Number of outlets
$>$ 320,000	—	—

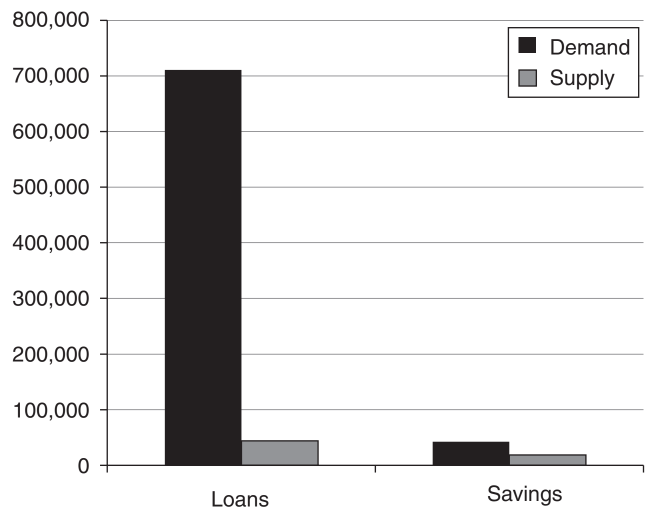

FIGURE 5.2. Access to finance: supply and demand. Note that 'demand' here has been taken to represent 'desire' as opposed to 'effective demand'. *Source*: MITAF Presentation 2010.

quantify access shows is that Sierra Leone still needs to definitively quantify its level of financial access.

5.7.3 Summary of Outreach and Access to Finance

As can be seen from Tables 5.7–5.10, there have been increases in all the various types of providers of microfinance and other A2F providers. Despite the significant increases, however, Figure 5.2 shows that desire still far outstrips supply, especially for loan products. Whether desire will turn into effective demand if supply does increase is another, perhaps even more important consideration.

A limitation of Figure 5.2 is that it only gives a picture for loans and savings products and none for the other types of access to finance tools.

Another limitation of the figures from Tables 5.7–5.10 is that they may almost certainly include a significant amount of double counting as client figures and transaction (savings, etc.) values may include customers with multiple accounts, borrowings, etc. That would certainly be the case for commercial banks as well as for NGO/MFIs where belonging to multiple MFIs occurs regularly. Further, while commercial banks' increasing numbers could conceivably mean increased access to financial services, microfinance clients would make up a negligible percentage.

What comes out clearly from the patchwork of microfinance outreach in Sierra Leone is the scarcity of credible and definitive information on actual outreach or access. A definitive baseline study will be useful.

5.8 Sustainability of Financial Access

Increasing numbers in geographical spread and client intake is all well and good and on the surface gives a picture of increased access. A2F however should also be measured against the sustainability of such access. Sustainability will depend largely (but not exclusively) on the continuing sustainable existence of the financial access provider e.g. an MFI such as Finance Salone and their continued ability to meet the needs of their target groups.

The part failure of FI Bank's esusu product in Freetown is a lesson, as are the original failures of the community banks. Similarly, the major write-offs of some microfinance institutions in 2009 (see footnote 33 and the Table 5.8 notes) and sustainability ratios[34] for MFIs in Sierra Leone do not make for very optimistic reading. Though the high-performing MFIs have strong sustainability ratios,[35] Table 5.11 shows that the sustainability of MFIs generally remains a concern.

Average PaR is increasing and by September 2010 was way over 10% while operational self sustainability (OSS) was still under 100% and financial self sustainability (FSS) was way off 100%. Financial services associations seem to have fared much better even though they are a much newer type of financial services provider while the community banks seem to be still floundering. According to

[34] The three main sustainability ratios in microfinance are portfolio at risk (PaR), operational self sustainability (OSS) and financial self-sustainability (FSS) with FSS being the ultimate. Operational self-sufficiency is attained when the MFI can cover all its operating (e.g. administrative, personnel, etc.) costs fully but still relies on grants and in-kind donations especially for its loan capital. Financial self-sustainability is attained when the MFI does not rely on any grants or donations and can source commercial funding.

[35] Such as LAPO's 1.16% PaR or Finance Salone's 107% and 96.5% operational self-sustainability and financial self sustainability, respectively.

Table 5.11. Average sustainability ratios of MFIs in Sierra Leone.

	December 2007 (%)	December 2008 (%)	December 2009 (%)	September 2010 (%)
Weighted average PaR < 30	6.96	5.83	10.06	13.70
Weighted average OSS	89.96	99.94	104.32	95.14
Weighted average FSS	73.67	79.93	78.75	76.00

Source: MITAF presentation 2010.

Table 5.12. Average sustainability ratios of CBs and FSAs in Sierra Leone.

	December 2008	December 2009	December 2010
Average PaR			
Community banks	Not available[a]	Not available	22%
FSAs	2.5%	1.3%	4%
Average OSS/net profit/(loss)			
Community banks[b]	Not available	Not available	83.5%[c]
FSAs (net P/L)[d]	US$5,000	US$14,500	US$39,450[e]

[a]The RFCIP only took over responsibility for the CBs in 2010 and the statistics prior to that are not reliable. [b]This average does not include the three new community banks since they are less than a year old. [c]Each of the FSAs in each of the three years made a net profit. This 'profit' may however be misleading as it is 'profits' before factoring in adjustments for substantial RFCIP grants. [d]Of the six, four were over 100% while the other two were, disappointingly, below 40% which is the reason for the average of 83.5%. [e]The average net profits for the FSAs each year were US$828, US$1,320 and US$2,320.

the RFCIP records, as at June 2011, similar performance/sustainability ratios for CBs and FSAs were as given in Table 5.12.

A note on the national social security and insurance trust. For a significant number of employed people in Sierra Leone, their mandatory contributions to NASSIT are the only, or at least the most significant and secure, savings they have. It is therefore arguable that NASSIT figures should form part of any discussion on access to financial services.

However, NASSIT is not included in this discussion as an access to financial services enabler, because this paper focuses on access to financial services that enable someone to make use of those services voluntarily and access is not constrained by statutory or other restrictions that make it practically impossible. NASSIT is mandatory and can only be accessed under the following conditions:

- retirement at 60 years of age;
- death;
- invalidity.

Some disadvantages of NASSIT as a true financial services provider are that

- in most cases NASSIT pays out contributions as pensions as opposed to a lump sum payout,
- contributions cannot be used as security for loans or type of facility,
- effectively one only enjoys the full NASSIT benefits[36] if one joins up before age 45.

For the record, as at March 2011 NASSIT had 167,000 contributors. Contributions have been increasing annually and for 2010[37] was Le 97 billion.[38] This amount is only approximately 6% of the total deposits of commercial banks. The over 167,000 NASSIT contributors however far outstrip the total in commercial banks of 27,700.[39]

In terms of number of depositors, NASSIT contributors would substantially add to the financial inclusion numbers.

5.9 Legal and Regulatory Environment in Access to Finance in Sierra Leone

5.9.1 Microfinance Policy

The government of Sierra Leone published the National Microfinance Policy in December 2010. The policy framework is based largely on the National Recovery Strategy in the short term and the *Agenda for Change*, in the medium term *'both of which emphasize the crucial role of microfinance in our endeavour to reduce poverty'*.[40] It expands the financial infrastructure of the country to meet the financial requirements of the micro, small and medium enterprises (MSMEs). Further, the policy advocates for viable and sustainable microfinance institutions that can be adequately integrated into the mainstream of the national financial system and provide the stimulus for growth and development. The policy emphasizes the importance of credit, saving, payments and

[36] To enjoy the full 30% NASSIT pension.

[37] The contributions for 2010 were an 18% increase over 2009 which in turn had seen a 24% increase over 2008.

[38] This is approximately US$22 million. Extrapolation of these figures give average monthly contributions of approximately US$133 (Le 580,000) per contributor. In reality, however, the employee contributes on 5 of the 15% contribution which would make contributions or savings from the employee's own salary US$6.5 or leones 30,000 per month.

[39] One should also bear in mind that this figure would include several depositors with multiple accounts.

[40] National Microfinance Policy – Government of Sierra Leone: The Poor are Bankable.

microinsurance as the critical aspects of the microfinance sector which must be promoted.

The Vision of the Microfinance Policy

The microfinance policy is guided by a vision of achieving widespread access to microfinance throughout the country, made possible by institutions operating on commercial principles. A wide range of institutions are expected to be involved in the provision of services, including community banks, non-bank financial institutions, and NGOs. Microfinance will be integrated with the mainstream financial system with a flexibility that ensures that their special features are not compromised.

Policy Targets

The main targets of the policy are:

- to provide financial services to the majority of the poor but economically active population thereby enhancing their productivity and reducing poverty;
- to provide sustainable livelihoods to unemployed citizens, especially women and youth, by improving their access to financial services.

The BSL will have primary responsibility for implementation of the policy and will apply the same fundamental principles it applies to other parts of the financial system in regulation and supervision to the operations of deposit-taking MFIs. However, it will modify regulations in order to accommodate the special characteristics of MFIs.

There are roles for all the different types of microfinance stakeholders both in the public (including central government, BSL and NaCSA) and private sectors (from commercial banks to community-based organizations) as well as the meso-level microfinance apex organization SLAMFI.

Implementation may be some way off as first the BSL needs its microfinance capacity adequately strengthened and the apex SLAMFI needs a complete overhaul and rejuvenation.

Legislation Proposed by the Policy

The microfinance policy includes certain specifics for the framework for regulation and supervision of the microfinance sector. They include the following.

- Only MFIs that are licensed to accept deposits from the public or from other financial institutions will be subject to regulation and supervision.
- For organizations such as cooperative societies where many of the risks that regulation protects against do not arise central bank supervision will

not be applied. However, where such organizations grow beyond a certain size, supervision will be applied.

- Minimum capital or other entry requirements for the successful operation of microfinance institutions may differ from those required for full service commercial institutions.
- Existing financial institutions will be encouraged to offer microfinance services.

5.9.2 The Financial Sector Development Plan 2009

The Financial Sector Development Plan aims to radically reinvent the micro and rural finance sectors. One of the four priority areas of the FSDP is to increase access to finance by broadening its outreach, governance and supervision, and community banks.

The priorities for outreach include increased focus on agricultural finance, setting up a credit guarantee scheme and institutional strengthening and product development within microfinance providers.

Governance and supervision priorities include amending the Other Financial Services Act (OFSA), finalizing prudential and non-prudential regulation and supervision for deposit-taking and non-deposit-taking MFIs, determining the legal structure and framework for financial services associations (FSAs) and updating the Cooperative Societies Act of 1977.

The strategy for restructuring the community banking system includes:

- only licensing new CBs whose structures address weaknesses of existing CBs;
- drafting a timetable for BSL exit from CBs and improving governance to ensure long-term sustainability;
- strengthening the existing CB/MFI supervision wing in the BSL;
- encouraging communities to participate in CB/MFI capitalization and management;
- ensuring that CBs/MFIs have agricultural lending skills by setting up a formal CB/MFI training programme including training on agricultural lending.

The foregoing is a clear indication that the BSL realizes that the major issues affecting micro and rural finance are

- inadequate capital,
- limited outreach,
- poor governance and oversight,
- weak community banks.

5.10 The Role of Meso Level Service Providers

5.10.1 MITAF

Microfinance Investment and Technical Facility II (MITAF II) is the continuation of MITAF I which was a US$13 million project mainly financed by United Nations Capital Development Fund (UNCDF), UNDP and KfW. The MITAF is a multi-donor facility created in mid 2004, which seeks to develop a competitive, sustainable and inclusive financial sector that provides access to financial services to low income people throughout Sierra Leone.

MITAF supports eligible banks, non-bank financial institutions, and NGOs through funding operations, loan portfolio growth and granting technical assistance packages for institutional and capacity building purposes.

The recently started MITAF II will undertake the following to increase access to finance.

Loans up to four years: to reach new markets, such as SMEs and agriculture at commercial rates.

Partial guarantee facilities: to commercial banks for lending to microfinance intermediaries.

Quasi-equity: microfinance intermediaries, requiring quasi-equity to improve capital base.

Technical assistance grants: cost share support for banks seeking to down-scale, MFIs seeking to merge or transform, and any institutions seeking to gain best practice knowledge.

Innovation grants: cost-share support to institutions developing and testing new product, linkages or distribution channels.

Support to existing community banks.

The following results were achieved by MITAF I, which ran from 2004–9:

- savings by supported MFIs, from under US$1 million in 2004 to just under US$6 million in 2009 with active saving clients from 5000 to over 35,000;
- overall outreach from less than 10,000 to 90,000.

Among the key MITAF evaluation findings (Duval and Bendu 2009) was that 'MITAF has been instrumental in building an inclusive financial sector in Sierra Leone.'

Overall, the evaluation concluded that MITAF I had met several of its objectives but still had a lot to do to further strengthen the microfinance sector in Sierra Leone, and MITAF II is designed to do just that.

5.10.2 NaCSA

There are few other non-financial service providers such as trained and experienced auditors and capacity building providers. One of the few is the National Commission for Social Action (NaCSA). NaCSA was established as a 'social fund' in November 2001 by an act of parliament.

Given that its main brief is that of postwar reconstruction, NaCSA funds projects, builds physical and social capital,[41] helps reduce poverty and promotes sustainable development, thereby helping to reduce the risk of renewed conflict.

NaCSA's interventions in microfinance[42] are currently limited to building the capacity of microfinance institutions in best practices of the industry, coordinating microfinance policies and sharing information on developments in the sector. Information sharing was also achieved through the continued publication of the microfinance newsletter, *Credit Lines*, and opening of the 'Micro-Finance Information Centre'.

5.11 Conclusion: Remaining Barriers to Access to Finance in Sierra Leone

From the foregoing sections of this chapter, it is evident that much progress has been made in improving access to finance in Sierra Leone, especially through microfinance. The progress achieved has involved a wide variety of institutions, products and services. However there are still huge gaps to fill for the Country to truly and substantially improve financial access. There are a number of factors which are impediments to increased financial access in Sierra Leone.

The MITAF project reported in its September 2009 evaluation that the two major gaps in financial access in Sierra Leone are as follows.

The operating environment. This remains a challenge to the continued growth and sustainability of microfinance institutions as well as mobile money payment providers. Financial institutions in Sierra Leone face significant challenges in providing services to micro-entrepreneurs. These include continued pervasive poverty, further exacerbated by the recent economic downturn, which severely constrains the effective market for clients' goods and services; limited infrastructure throughout the country, particularly the lack of adequate roads, electricity and communication systems, which further limits client market opportunities and the ability of institutions to offer sustainable, quality services, particularly in rural areas; lack of a credit culture that would foster client willingness to repay loans; and a high degree of corruption resulting in lending fraud.

[41] Refers to connections within and between social networks. It highlights the value of social relations and the role of cooperation and confidence to get collective or economic results.

[42] Taken from the NacSA Annual Report 2009.

Weak capacities. Despite clear improvement in institutional capacity at the micro, meso and macro levels, internal weaknesses continue to jeopardize sustainability. Microfinance institutions continue to demonstrate significant internal weaknesses in governance, management, staffing, systems and internal controls.

Institutional weaknesses in meso- and macro-level institutions, such as the Sierra Leone Association of Microfinance Institutions (SLAMFI) and the Banking Supervision Department of the BSL, also raise questions about the ability of these institutions to continue to fulfil their key roles effectively.

We shall discuss these impediments under the macro, meso and micro categories.

5.11.1 Macro Level

There is no microfinance act or specialized regulations for MFIs or community banks. This is one of the stark deficiencies that emerge from this study. What this means is that the sector is not effectively regulated or supervised by a competent financial sector regulatory authority and so make failures more likely. Even with regulations in place there will remain the need to build the capacity of the officers who would need to implement any microfinance act or regulation.

There are a number of issues to be considered when developing a microfinance legal and regulatory framework. These include having clear definition and scope of microfinance, and a supervisory agency with adequate legal authority, institutional and organizational capacity to perform the tasks.

5.11.2 Meso (Non-financial Service Providers) Level

As a minimum at this level, a strong and effective apex microfinance association is required. By all accounts, SLAMFI is very ineffective and one of the objectives of MITAF and the FSDP is to strengthen the organization. The Association of Microfinance Institutions of Uganda (AMFIU) and the Association of Microfinance Institutions (AMFI), in Uganda and Kenya, respectively, for example, are strong and very effective apex organizations which have been very instrumental in the development of the microfinance sector in those countries.

Support service providers are also at a premium and with the exception of MITAF, which is a project (and therefore not a permanent fixture), there is virtually no other capacity building provider to speak of, except perhaps NacSA.

This level of support is essential to help overcome the problems that beset the sector at the micro-level, such as (among many others):

- low financial literacy;
- weak capacities among meso level providers;
- inappropriate product offerings.

TABLE 5.13. MFIs' capital inadequacy (micro).

	NGO/MFI (%)	LLC (%)	Bank (%)
Savings (compulsory)	23	13	0
Savings (voluntary)	0	0	95
Loans (commercial)	0	25	31
Loan (subsidized)	28	24	0
Shareholders' equity	0	7	49
Donated equity	25	9	0
Retained earnings	24	22	(75)
Total	100	100	100

Source: MITAF.

5.11.3 Micro Level

Arguably most crucial is the micro-level, i.e. the microfinance providers themselves.

The major weaknesses at this level are:

- weak microfinance (expertise and experience) capacity at all levels of MFIs[43] from the boards to the staff;
- poor product design;
- lack of capital;
- poor ICT facilities.

Another major failing with almost all the non-bank MFIs is that of inadequate capital and the table below gives the funding sources for the different types of MFIs.

Table 5.13 clearly shows that non-bank MFIs are at a major disadvantage because, unlike banks and deposit-taking institutions, they cannot access the cheapest sources of funds i.e. savings and equity.

These failings at the micro-level are also, to varying degrees, results of weak macro and meso level support to the financial sector. Examples include:

- FI Bank's disappointing experience with its esusu product in Freetown which suggests strongly that even though well meaning, some aspects of the product were poorly designed (a failure which an effective meso-level provider may well have prevented).[44]
- The early failures of the community banks because of, among other factors, poor design by the central bank which led to ineffective boards, management and products.

[43] The term 'MFI' also includes cooperative societies, FSAs and VSLAs.
[44] For example, Microsave, an organization specializing in product development.

While therefore the micro-level is the most crucial link, the other levels are what facilitate it and ensure that it works effectively.

Another level and one that is very important in the whole discourse, is the current or potential clients themselves. Apart from (or maybe because of) the infrastructural difficulties of accessing financial services in Sierra Leone a huge majority of the population is ignorant of financial services and how to access them.

5.12 Summary: What Can Be Done

While microfinance appears to have made significant strides in outreach and the situation in the financial sector shows that all is not lost, the sector does need substantial strengthening. So what can or should be done?

The FSDP is a step in the right direction if effectively implemented. Another first step is for the BSL or another credible entity (e.g. MITAF II) to start regularly collecting sets of standardized indicators for all microfinance providers (including other access to finance enablers such as insurance companies) in Sierra Leone. There is a need to start with a comprehensive and definitive baseline so as to know what the true picture is and hence to be better prepared to address the issues effectively. These indicators would include number of deposits, numbers and types of loans and other financial services, borrowers and savers, number of branches and other financial access points (even where those are branchless, such as ATMs and non-bank agents), value of loans and deposits.

Second, the overriding objective of any changes at the macro level should be that the financial sector should work for the private sector, i.e. it should ensure that the bulk of its earning assets are in the form of loans and advances to the private sector. To help achieve this, incentives should be provided to motivate financial institutions to be innovative in offering credit, savings and other services on a large scale.

At all levels (macro, meso and micro) innovation should be encouraged, especially in the area of product design. The development of M-PESA by Safaricom in Kenya is a good example of such innovation.

Third, rural areas should be the main focus of the financial sector working for the private sector and this means specifically agricultural lending and provision of other rural-based financial services.

Fourth, there is a need to reduce the cost of financial services. Reducing inefficiencies in providing the services will help reduce the cost of the services. This can be achieved through (among other things) improved product designs and better trained and more experienced management and staff.

Fifth, confidence in the formal and semi-formal financial sectors needs to be built. This may be brought about by increased financial literacy initiatives so that those in the informal sector, especially in rural areas, begin to learn more about and so develop more trust in and use the financial instruments designed for them.

Notwithstanding these areas that need attention, there is no doubt that access to finance is increasing as evidenced by the annually increasing client numbers of the MFIs, and it is clear that in the uptake of mobile money payments (in which MFIs such as Hope and banks such as UTB, have become involved), for example, microfinance has contributed substantially to this growth. Perhaps most encouraging are the early successes of the FSAs.

5.13 Definition of Terms

Access to finance. This refers to the ease with which individuals or enterprises can obtain and make use financial services.

Bottom of the pyramid. This is the largest, but poorest socio-economic group. In global terms, this is the 2.5 billion people who live on less than US$2.50 per day. The phrase 'bottom of the pyramid' is used in particular by people developing new models of doing business that deliberately target that demographic, often using new technology. This field is also often referred to as the 'base of the pyramid' or just the 'BoP'.

Financial services. The provision of services directly related to loans and advances, savings, insurance and money transfers by any type of provider for any legal purpose and which, crucially, is not forced or mandatory (such as mandatory pension fund contributions) and allows the client voluntary access to and use of that service with minimal restrictions.

Macro, meso and micro. Macro involves the structure, behaviour and decision-making of the entire financial sector at the national, regulatory level. Meso is a prefix meaning middle or intermediate. Micro means 'small' or at the individual level. These have been grouped together because in this paper they are used to delineate the three main levels that the paper argues affect A2F i.e. the regulatory authorities (macro level), the providers of non-financial or support services to the sector (meso) and of course the main players in the sector, the financial institutions (micro-level).

Microfinance. The provision of financial services to the low income population especially for, but not limited to, business purposes. Microfinance therefore includes, but is not limited to, microcredit, microsavings and microinsurance. The key characteristics are: the value (usually very low) of and methodologies used, for financial services transactions.

Microinsurance. A term increasingly used to refer to insurance characterized by low premiums and low caps or low coverage limits, sold as part of a typical risk-pooling and marketing arrangements, and designed to service low-income people and businesses not served by typical social or commercial insurance schemes.

Mobile money payments. This is an alternative financial transactions method. Instead of paying with cash, cheque or credit cards, a consumer can use a mobile phone to pay for a wide range of goods and services. While it is possible to be used by segments of the population which do not fall under the BoP, it is used currently largely by the under-banked and unbanked in most African countries. Technically therefore, while it is a tool for increased financial access, it is not exclusive to 'microfinance'.

Appendix A: Abbreviations

AfDB	African Development Bank
AMFI	Association of MFIs (Kenya)
AMFIU	Association of MFIs of Uganda
ATM	Automated Teller Machine
A2F	Access to Finance
BSL	Bank of Sierra Leone
CSFI	Centre for the Study of Financial Innovation
CB	Community Bank
DFID	Department for International Development
FSDP	Financial Sector Development Plan
FSA	Financial Services Association
FSS	Financial Self-Sufficiency
FIB	First International Bank
GoSL	Government of Sierra Leone
GDP	Gross Domestic Product
IFAD	International Fund for Agricultural Development
INGO	International NGO
KREP	Kenya Rural Enterprise Programme
KfW	Kreditanstalt für Wiederaufbau (German)
LAPO	Lift Above Poverty Organisation
MIS	Management Information System
MFI	Microfinance Institution
MITAF	Microfinance Investment and Technical Assistance Facility
MSME	Micro Small and Medium Enterprises
MAFFS	Ministry of Agriculture, Forestry and Food Security
MTI	Ministry of Trade and Industry
MMP	Mobile Money Payments
NCDB	National Co-operative Development Bank
NaCSA	National Commission for Social Action National
NDB	National Development Bank
NGO	Non-Governmental Organisation
OSS	Operational Self Sufficiency
OFSA	Other Financial Services Act
PaR	Portfolio at Risk

RCT	Randomized Controlled Trials
RFCIP	Rural Finance and Community Improvement Programme
SLAMFI	Sierra Leone Association of MFIs
UTB	Union Trust Bank
UN	United Nations
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
USD	United States Dollars
VSLA	Village Savings and Loans Association

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Part III

Private Sector Development and Export Promotion

Chapter 6

REFORMING THE CUSTOMARY LAND TENURE SYSTEM IN SIERRA LEONE: A PROPOSAL

By Omotunde E. G. Johnson

6.1 Introduction

A major institutional reform that would help unleash the vast economic growth potential of Sierra Leone in tourism, agriculture, and industry is reform of the customary land tenure system. Such a reform 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. I shall deal with the latter first, because, in spite of the enormous attention given to this question, in the popular discussion of the land tenure question in Sierra Leone, it is to me the easiest one to resolve. Namely, the 1927 Ordinance could simply be repealed and other laws related to it amended as appropriate. The policymakers would then be left with the fundamental question of what to do about customary law related to land rights in Sierra Leone, which, at the end of the day, raises more difficult challenges. In this paper, I offer my views on this extremely important area which is overdue for institutional and organizational reform. It is one of the unfortunate realities in the Sierra Leone policymaking environment that government after government has been afraid to confront this issue head-on, because of the powerful vested interests that would be affected. The proposal in this paper does not ignore this reality. But in the process it does not compromise good economics and economic policymaking.

Discussions of reforms of customary land tenure in Africa are often plagued by romantic idealization of what transpires under communal ownership (see, for example, Barrows 1974; many of the papers in Downs and Reyna 1988). Such a romantic perspective ends up favouring what it considers the status quo. In the process, it ignores the reality of disorderly privatization when the state imposes statutes to obstruct voluntary privatization by the landowners, as well as inequities in land rights and in access to land among the purported landowners under communal management. This romanticism is typically coupled with a view that individualization must necessarily emerge only via coercive authoritarian order of the state, which *inter alia* would impose on the individuals, of the once communal community, costly titling, registration and policing of private property rights. In this paper, I will argue for an institutional environment which enables individualization to be achieved via orderly evolution of land rights under 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, improve markets and to provide appropriate oversight, *inter alia*, to guard against inequities in any strictly spontaneous evolutionary process.

6.2 The Protectorate Land Ordinances

First, let us deal with the question of statutory strangers introduced in the Protectorate Land Ordinance of 1927. According to this basic law, all land in the Provinces – formerly the Protectorate – of Sierra Leone 'is vested in the Tribal Authorities who hold such land for and on behalf of the native communities concerned'. The Tribal Authorities are there defined as comprising the 'paramount chiefs and their councillors and men of note, or sub-chiefs and their councillors and men of note'. The important provisions of the Ordinance, for our immediate purposes, here, include the following.

- A non-Provincial must first obtain the consent of the Tribal Authority in order to occupy any land in the Provinces.
- A non-Provincial may not acquire a greater interest in land in the Provinces than a lease for 50 years, but renewal is allowed for up to 21 years.
- A non-Provincial residing in a given chiefdom and who is other than a leaseholder of land within the chiefdom shall pay a settler's fee. This is in lieu of the customary tributes or labour services, due from all strangers, to the Chief. This fee may be wholly or partly waived in the case of a non-Provincial, who by his profession or trade 'is in the opinion of the Paramount Chief, conferring a benefit on the chiefdom', or who 'is employed by a person engaged in an industrial undertaking'. By the Protectorate Land Amendment Ordinance of 1935, this waiver privilege is extended to all those engaged in any industrial enterprise.

In retrospect, it is difficult to discern the British rationale for some of the stranger provisions in these Land Ordinances. It was against customary law to sell land to strangers of any origin, but land could be leased, rented, or pledged. Perhaps the British wanted to impose a ceiling on the duration of leases and to ban pledging to non-Provincial strangers. As a practical matter, though, the stranger provisions did have an economic effect, at least in those days, via the distribution of rents from leases. When land was leased to non-Provincials, part of the rent was normally distributed to the Chief and Tribal Authority and to District Councils. There was no such distribution of the incomes yielded by the land when allocated to other uses. This was tantamount to imposing a tax on income from one source while not taxingor taxing at a lower rate the income from other sources. Other things being equal, the landowner's return from leasing to non-Provincials was thereby reduced relative to other uses. The economic impact is quite obvious.

One can understand, of course, why the British made explicit the obligation of settler fees, namely, so that non-Provincial strangers would not be subjected to traditional tribute obligations. In any event, it would seem that the simplest way to start land tenure reform in Sierra Leone is to repeal these ordinances. In that case, until reforms are instituted, regular customary law would apply.

A related advantage of repealing the Ordinances would be that, apart from communal/state lands, the law would now be clear that land belongs to the extended families. There would be no question of land being held in trust by the Tribal Authorities. The issue would then become what rights do the landowners (the extended families) have to use and transfer their family lands. It is my view that this is one of the biggest hurdles slowing down customary law reform in Sierra Leone. Without any effort on their part, the 'big men' of the communities captured a valuable asset: power over all land in their communities. Thus, for example, they have no interest in changing that part of the law which vests all land in the Tribal Authorities who then hold such land for and on behalf of the native communities concerned; the big men will in fact vehemently oppose any proposal to change the law in that area. The political leadership supported by civil society will have to wrestle it from them.

6.3 Land Tenure Systems and Wealth Creation

The ultimate motivation of land tenure reform is to put in place institutional arrangements that enable, as best as one can, each parcel of land to be put to its most economically valued use at any time. The objective is to ensure that the most productive users of land have access to land, and that all users of land use it efficiently. In this light, a tenure system facilitates wealth creation if the institutional framework meets three basic criteria; see Johnson (1972) for a fuller discussion of these criteria and Alchian (1977) for some useful perspectives on the economics of property rights.

First, there must be clear definition and allocation of property rights in land. This means that property rights must be established and allocated to specific owners whether they are individuals or groups. These rights must be easy to identify and verify. In addition, they must have legal and tenure certainty. Legal certainty means that the rights will be protected against the unlawful acts of others and that the results of legal actions are easy to forecast. Vague definitions and unsecure allocations of property rights militate against wealth production mainly because they increase transaction costs and inhibit exchange. The private return on investments in and attached to land will be lower the less certain and/or clearly defined are property rights in land. This will adversely affect the aggregate value of such investments being undertaken. In addition, the discount rate (time preference) in decision-making will be higher when tenure certainty is low. Hence, the duration of investments in and attached to land when made will be shorter the more uncertain are property rights; for the higher the discount rate, the higher the present value of short-lived income streams relative to long-lived income streams.

The second condition fostering wealth creation in land is that the method of distributing wealth resulting from using land must be such as to create an incentive for economic agents to use land in its most-valued uses net of transaction costs. We are here talking of the cost–reward structure of land use. This important criterion means that the cost–reward structure from using land in production must manifest a high degree of what economists call 'internalization' of costs and benefits. With perfect internalization, the value created by any particular activity on the land will accrue to those who bore the cost of undertaking the activity. If within the land tenure system the cost–reward structure fully internalizes benefits and costs, each user of land is motivated to use land in space and time so as to yield the maximum wealth from the land. Any reduction in wealth as a result of a user's misallocation implies an equivalent reduction in his or her wealth.

The third criterion for a land tenure system to facilitate general economic efficiency is that the system must ensure freedom and legal enforcement of contracts which do not impose damages on third parties for which the contracting parties are not made to compensate. Restrictions on transfer via sale, renting, or leasing, according to this criterion, can seriously reduce economic efficiency. Restrictions on sale, for example, raise the cost of transferring landownership for certain uses and users. The result is to effectively reduce the number of ways of capturing wealth from one's land. There are three noteworthy effects of placing major restrictions on sales compared with placing few or no restrictions. First, the value of the land (in a utility sense) to an individual is lowered. Second, the supply price of funds to an individual who wants to use land as collateral is bound to increase; the landowner's access to credit in regular credit markets is adversely affected, *other things being equal*. The supply of credit to a particular borrower is, of course, affected by factors other than the quality of collateral. In addition, the utility of land as collateral in credit markets is affected by the quality of the land market and by the working of the legal system as it operates in this area. Hence, despite the correctness of the proposition, the effect of having land (which could be used as collateral) on an individual's access to credit (formal and informal), should not be exaggerated.

Third, when there are major restrictions on sale of land, the profitability of investments in and attached to land is lowered. Once again, such investments will be discouraged since the individual investor is restricted in his or her ability to alter, within any given period, the composition of his or her wealth in response to changing tastes and opportunities. In equilibrium, the total amount of these investments undertaken would be a smaller proportion of aggregate investment the greater the level of restrictions on transfer through sale. Moreover, in equilibrium, the last dollar invested in and on land would yield a higher net present value than the last dollar invested in other assets for which such restrictions do not exist, implying a deadweight loss in wealth to society.

6.4 Evolution of Land Rights

Looking at the history of the evolution of land rights in those areas of Sierra Leone where customary land law prevails, there are four justified statements that can be made. First, there was a time when communal ownership made neoclassical economic sense. Second, over time the systems were evolving towards individual ownership. Third, the British colonial regime instituted a statute which in effect not only stopped the orderly evolution of the system but placed the land under the guardianship of so-called tribal authorities and subjected the customary systems to legal principles which imposed unclear standards to the natives of 'natural justice, equity, and good conscience' (see Johnson 1972). Fourth, the systems, following this colonial interference, in the face of economic and demographic pressures, are now experiencing disorderly evolution towards individualized rights, with the latter unclear both in their nature and their status in law, coupled with the additional problem that they are leading to major transfers of wealth towards the elites in the various communities.

To elaborate, there are economic situations under which a communal system of land rights is efficient and there is no case for enforcing strict private ownership of land. Under a regime of freedom of contract allowing rights to evolve spontaneously, the community members in such circumstances will not have an incentive to privatize. Such situations arise when land is not a scarce commodity. If land is not scarce, there is no positive value to society of creating clearly defined property rights in the land. Moreover, given that we start with a system of communal rights, the creation and enforcement of private property rights entail costs to society. Therefore the scarcity value of land must rise to some minimum before it becomes efficient for society to create such rights (see Johnson 1972). Indeed, one device to ensure that property rights creation and enforcement are efficient is precisely to allow individuals or groups the freedom to contract to establish private rights over land and to introduce a legal framework for enforcement of these contracts, with the cost of enforcement being borne by the contracting parties themselves.

A tendency for land tenure systems to move along evolutionary paths towards individual ownership has been noticed for a long time (see, for example, Lugard 1926, chapter XIV). Using *a priori* economic principles, I advanced the following thesis many years ago on the evolution of communal systems of land tenure (Johnson 1972, 1976b): as the scarcity value of land increases, private ownership of land will increase and/or there will be a movement towards private ownership of land. Briefly, the argument is as follows (Johnson 1972, 1976b). As the scarcity value of land increases, it becomes profitable to invest in land and to economize on use of land. But the cost of policing one's investments to ensure that one reaps a 'satisfactory' fraction of the returns is much higher under communal ownership than under private ownership. *Inter alia*, under communal ownership an individual must contribute to the policing of all the other members' use of all land to ensure proper use, whereas under individual ownership he or she has to police the use only of his or her parcel(s). High policing costs reduce the incentive of individuals to engage in investments that improve or conserve land as well as in certain activities that economize on land use; in equilibrium, actual policing costs incurred to achieve any given objective tend to be rather high. Thus, individuals find that for any given amount of investment their wealth under communal ownership is lower than it would be under private ownership. But, as we stated earlier, the positive cost of privatizing ownership reduces the profitability of privatizing when the scarcity value of land is 'low'.

The cost of privatizing comprises mainly the sum of the opportunity cost of all the resources – labour, etc. – used in intra-group contracting to create individual ownership to specific plots of land, and the costs involved in implementing (including policing) the agreed terms of the contract. As the scarcity value of land increases, the increasing return on investments that improve or conserve the land and indeed that economize on land use, cause the potential wealth of the individual, if his land is privatized, compared with his actual wealth under communal ownership of the same land, to diverge more and more. This difference may be considered the benefit of private ownership. As the scarcity of land increases, this benefit becomes greater relative to the cost of privatizing, and more and more individuals in the community will seek individual ownership.

Empirically, the hypothesis implies that increases in the prices of goods in whose production land is an important factor, increases in the intensity of use of land and increasing population density will be positively correlated historically with increasing privacy of ownership and with reductions in the size of groups having communal ownership to land in any given area. Empirically, the hypothesis also implies that, if we compare different areas within a region of Sierra Leone where customary land tenure prevails, the incidence of private 'ownership', despite its unclear status at the moment, will be most significant in areas of greatest population density and/or with comparative advantage in the production of commodities and services whose prices have risen most sharply. Indeed, for the last half-century, in Sierra Leone, the evidence is that the incidence of individual 'ownership' has been greatest where cultivation of tree crops, swamp farming, modern buildings and population growth have been most intense (see, for example, Greene 1969; Hussain 1964).

6.5 The Major Drawbacks of the System

The underlying source of the problems with the customary land tenure system is that the 1927 statutory law froze the evolution of the system, without seeking the general consent of the population of owners of the land. As the economic situation has been changing in the country, and given the accompanying failure of public policy to address certain issues, a set of problems have resulted, from the perspective of economic efficiency (static and dynamic). One problem is what can be called creeping, disorderly, and non-transparent privatization, which is aggravating inequalities in access to land among family members with equal rights in principle. In other words, certain individuals with power and influence in the families and communities are able to obtain large stretches of land, which they treat and use as if they have individual ownership, subject only to the constraint on sale to strangers and some residual uncertainty as explained below.

There are serious legal uncertainties of property rights (see also Renner-Thomas 2010) as well as 'high' enforcement costs of contracts, in the customary law environments. There are, in turn, mainly three interrelated sources of these, namely:

1. the nature of statutory law and the approach of law-enforcement agencies vis-à-vis individual ownership under customary law;
2. uncertainty as to the nature of one's rights under the customary law(s);
3. the unwritten nature of customary law and most 'contracts' (see Johnson 1976b).

The prevailing idea in the statutory law is that the landholding group is no smaller than the 'family', that is, the extended family. Moreover, the Tribal Authorities, as the guardians of the system for and on behalf of the native communities, effectively have ownership rights over all the land. This all means that if, for example, an individual to whom a block of 'family land' has been allocated in the past maintains it by large investments, and the central government or some stranger wants it for some purpose – say for large-scale farming or to build a road – the distribution of the rent or other compensation is not easily predictable and *ex ante* transparent. Indeed, the individual's investment could be ignored in that distribution. Also, some other member of the family who had long departed the area can still claim rights to the parcel of land later on and the investment of an individual in and on that land could be ignored in the settlement of the claims. It has been known for some time that when people establish plantations and make a success of them, others who have some semblance of claim to the land through ancestry, for example, come forward with their claims (see, for example, Hussain 1964). The resolution of such disputes can be very uncertain.

Furthermore, there is often uncertainty regarding the nature of rights under the law. This uncertainty arises at two levels. First, the limits to the powers of Tribal Authorities and elders in the family vis-à-vis ordinary family individuals and strangers are often not as clear as is desirable. Strangers, for example, have lost tenancy and all their investments for vague 'crimes' such as 'disloyalty and misconduct' to the Tribal Authority. This leaves open the door to simple exploitation and harassment. Second, the application of native law, say, on appeal to a higher statutory court, has always been subjected to 'natural justice, equity and good conscience', which leaves wide discretionary powers to the law-enforcement agencies.[1]

Perhaps the most serious source of uncertainty and high enforcement cost is the unwritten nature of customary law, property rights and contracts. For example, the 'ownership' of most parcels of land are not clearly prescribed and known, and boundaries are often unclear, consequently leading to much bush dispute. With regard to contracts, it is true that, even with privatized land in an environment with an elaborate and developed legal system, the details of an agreement (including how to handle contingencies) do not all need to be written in a contract. This is one way in which trust, and most of all generalized trust, reduces transaction costs in relationships (see Johnson 2007, chapter 3; Macauley 1963). But that is a far cry from having only verbal contracts or having written contracts that are very general in their content and have very few details or references to the handling of major contingencies. Moreover, as in other parts of Africa with customary land tenure (common property rights), certain types of land 'sales' have been taking place and apparently approved by the families. This can be applauded as evidence of dynamism in the traditional systems (see, for example, Platteau 1995). But the status of such 'sales' is rather unclear. In fact, it is not clear whether these transactions are considered sales by the family members or simply some form of pledge or informal long-term lease. At any rate, in strict customary law outright sales of land are forbidden.

When land is permanently allocated to a family member, or when it is pledged or transferred in any other way, written contracts are very seldom made. Instead, the contracts are made verbally in front of witnesses. This gives too much scope to double-dealing. Also witnesses may die or give different interpretations to the same agreement.

The Chief and the elders of the community play an important role as registrar with regard to boundaries between families and villages. This is why bush disputes between individuals of two different families soon become interfamily disputes and those between individuals of two different villages become intervillage disputes.

Disputes often arise as to who first cultivated an area, and/or as to who are the direct descendants of the original cultivator. The original cultivator of a bush and his descendants own the bush. If no written records exist as to the original developer or his legitimate descendants, disputes over ownership rights are bound to occur as land becomes more scarce.

6.6 The Reform Sceptics

There are many persons both within and outside Sierra Leone – some scholars, others just interested observers, with or without a stake in the system – who

[1] See, for example, Native Court Ordinance, Laws of Sierra Leone 1960, Chapter 8, Section 5.

do not see the value of, or the 'need' for, a coherent official approach to land tenure reform. I will call these persons 'sceptics' of reform. Unfortunately, these sceptics have diverse perspectives on what is exactly going on within these systems. All they seem to agree on is that changes are taking place in the nature of the system; that is, there is an evolutionary process occurring.

First, there are those who argue that the current system works well and there is no need to change the customary form of landownership and organization for determining land use. One strand of this argument in Sierra Leone is that the possibility of leasing is sufficient to ensure that efficient users who are strangers have access to land. Leasing, in other words, can ensure the efficiency in use of land. These particular sceptics ignore the fact that leases do end and renewal is uncertain. Hence, the nature of investment in and on land will be affected. In particular, certain forms of long-term investment will be disadvantaged by leasing, unless a system of fair compensation is formalized, made transparent and enforced with certainty. In addition, a leased property cannot typically be used as collateral for credit. Moreover, the leasing 'market' is not anywhere near efficient. Indeed the process of getting a lease is an administrative process and there is no open organized market.

The second type of scepticism is the argument that those who favour facilitating privatization are trying to impose privatization, and indeed individualization, of communally owned land. The sceptics believe that this will have no beneficial effects on efficiency of land use, while at the same time having adverse social effects: in particular, it is believed that privatization will lead to the emergence of a poor landless class and undesirable concentration of landownership. The main problem with this argument is that it misrepresents the analytics of persons like this author who want to see privatization allowed to *evolve* rather than being imposed. In other words, the idea would be to permit freedom of contract, including the right to privatize. The proposition is that this evolution was historically taking place in Sierra Leone. It was the British colonial regime that froze the evolutionary process, without pressure or demand of the native populations. The current sceptics are also in denial of the fact that the evolution now taking place is disorderly, *inter alia*, because it lacks status in law and because it does not ensure that the rights of all the joint owners of land are fairly treated, especially given the hierarchical structures in decision-making within certain families and groups. As such, among other things, it is resulting in grave inequalities in land use and ownership rights.

The third sceptical view is that if the state takes an active role in facilitating privatization it is likely to overreach by, for example, pushing too hard and fast for land registration and titling. Both titling and registration will raise the value of a property, because of their effects on security of property rights (see, for example, Lanjouw and Levy (2002) for an empirical study on the effects of titling on property values). It is rightly argued that such registration and titling are costly, which is consistent with the analysis in this paper. But the argument as put by the sceptics is unhelpful to policymaking. Rather more rational is the argument that titling and registration should be subjected to social cost–benefit calculation, some elements of which will be determined by the individuals of the landowning groups given the principle of internalization of costs and benefits. Such an approach would be automatic under a regime of freedom of contract. In addition, the argument in this paper emphasizes that the government should have clear oversight responsibility; in that capacity, the authorities would develop a coherent strategy to address the sort of problems that are likely to show up if the evolutionary process is left only to unmitigated spontaneous order. To underscore the point, the reform process being proposed would proceed in light of cost–benefit analysis, with internalization of costs and benefits to the private agents who 'own' the land, and with well-structured oversight by the central authorities. Moreover, as part of the oversight strategy in monitoring the evolutionary process, the authorities would ensure that titling and registration do not lead to unfair transfer of land wealth to the elites of the traditional societies involved. In fact, one of the advantages of titling programmes, properly and economically implemented, would be that they benefit the weaker and poorer members of the communities concerned. It would be important to incorporate this distributional aspect, which has value to social and political stability, into the social cost–benefit analysis and into the distribution of the public cost of managing and overseeing the evolutionary process. One possible means of achieving this would be through the cost structure (the schedule of charges for different types of services, which may vary according to the location of the land and the income and wealth of the persons involved) for registration and titling per acre, town lot, or square foot, or whatever the unit of measurement for land size.

It is useful to state clearly the aspects of the sceptics' warnings that I believe to be justified (see also Platteau 1995) and that should not be ignored in an approach that argues in favour of freedom of contract, facilitating the evolution of the customary land tenure system towards privatization – which this author believes is where the system will end up under a regime of orderly freedom of contract – with appropriate official oversight. One justified warning is that private property rights may be costly to establish and enforce. Another is that, left unregulated, privatization may result in adverse welfare externalities, especially because the relevant markets, even when they exist, may not be competitive and are unlikely to be perfect. In addition, privatization without appropriate public policy may hamper the emergence of trust and certain forms of cooperation, which worked well at some historic time period under the regime of common property – certainly before the British interfered with the system. Under private ownership, in today's world, the absence of trust and cooperation of certain forms may be harmful to efficiency of use of the land, including cooperation that keeps the land well conserved (see, for example, Seabright 1993).[2] Despite this, the possibility of private owners overexploiting

[2] Indeed cooperation is important in the development process as a whole and any policy which brings about or aggravates a cooperation deficit must be dangerous to the development process in a country (see Johnson (2007) for a general discussion of the importance of cooperation and the sources of cooperation deficit in the African setting).

the land is no grounds for opposing privatization as long as internalization of costs and benefits prevails. This way, the landowner who does not take care of his or her land fully suffers the resulting wealth loss.

Finally, it is useful to emphasize that the approach taken here is consistent with those who emphasize that self-governance under common property can be socially efficient in both a static and dynamic sense. Freedom of contract in determining the pace and type of evolution in property rights is an aspect of self-governance. Indeed, the argument here is that the statutory interference with the evolutionary process of customary land tenure has contributed to its dynamic inefficiency. It is, of course, quite possible that without such interference the state may still have found good reason to interfere in the interest of intra-group equity in the evolutionary process. But that would have been a different matter altogether.

6.7 Possible Short-Term to Medium-Term Reforms

I shall now turn directly to further elaboration of the details of the proposed reform plan, involving freedom of contract of landowners and oversight by the country authorities. I would like to differentiate the short-to-medium-term period from the long term. In our present context, the former period in my view should last at least five years and could (via consensus) last up to ten years or even longer. In this section I discuss reforms during the short-to-medium term. Long-term reforms are addressed in the following section.

It is possible to make immediate reforms to the current traditional system in Sierra Leone, in a fashion that goes a long way towards satisfying the criteria required for a land tenure system to facilitate wealth creation mentioned earlier, while still leaving ownership of land at the level of the extended families. The four most important immediate reforms would be:

- repeal of the Protectorate Land Ordinances;
- establishment of an explicit legal right for all Sierra Leoneans to live anywhere without permission of some local authority and the right for them to be individually responsible for their own actions under national and local laws;
- clearly defining and allocating property rights in land to extended families and to individual members of such families;
- granting the right to rent and lease to all comers, under terms that are freely negotiated between the contracting parties.

Among these reforms, establishing clear definition and allocation of property rights in land to extended families and to individual members of such families is, in my view, the most difficult element in the above reform agenda. Clarity and certainty of rights are among the ultimate objectives here. The issues that will need to be addressed include the following.

- What is meant by family ownership?
- What are the rights of individuals within the family?
- Who are the members of a family that have rights to some particular parcel of land?
- Do the extended family members have the right to sell land and, if so, how is the family to decide?
- How should the family make decisions in contracting to lease or rent family land?
- Should all the rules concerning ownership and individual rights be uniform throughout the country?
- If diversity of rules is permitted, what rules will be uniform and what are the limits on local autonomy?

These are some of the issues that will need to be addressed. Factors such as traditional intra-family power structure, existing decision-making procedures within families, public interest in equity and equal worth of all persons, and diversity in existing traditions across the country must all come into play as the experts and stakeholders deliberate over the answers. The rules must then be codified and made statutory.

There are other reforms that would be needed as well, following diligent investigation and analysis of current customary law and practices in the country. Among these, two are noteworthy.

First, the application of customary law has, since the days of the British, been subjected to 'natural justice, equity, and good conscience' (see, for example, Johnson 1972). This leaves wide discretionary powers to the law-enforcement agencies, as mentioned above. This issue will need to be addressed so that the status and scope of this statutory authority of the judiciary and/or oversight agencies can be clarified.

Second, the authorities should promote a culture of written contracts. As also mentioned above, many bush disputes and other problems have arisen because many (if not most) agreements (pledges, loans, gifts, exchanges) are unwritten. When the reform authorities investigate the details, they will discover that, because of the unwritten nature of property rights and contracts over several generations, the ownership of many parcels of land is not clearly prescribed or known, and boundaries are also often unclear. Indeed, when one reads transcripts of many Native Court cases and reports in central government administrators' files, going as far back as necessary, it is striking how many bush disputes are a consequence of unwritten agreements. Many of these cases, which start with disputes between individuals of two different families, *inter alia*, result in serious inter-family and inter-village disputes.

In the modern world, many types of profitable agreements for all sides are discouraged if there is a fear that word-of-mouth agreements are too risky or that the rights of a person claiming 'ownership' of a parcel of land are uncertain.

This also means that contracts must be resolutely enforced by the legal system. The reforms will therefore need to clearly specify and publicize the nature and scope of enforceable contracts. The oversight agency mentioned below could no doubt play a leading role in this reform and development process.

6.8 The Long-Term Evolution of the System

If, as part of the short-term to medium-term reforms, extended families are allowed to sell land, then the decision makers would, in effect, have decided that they want the system to move towards individual ownership. For I do not believe it would make sense to restrict sales of family land only to other extended families.

If, after due consultation with the other stakeholders of the system, the Sierra Leone authorities decide that they want to permit the evolution of customary land tenure towards individual (fee simple) ownership, they must then decide whether they want the evolution to take place under conditions of freedom of contract (with appropriate oversight from the authorities) or under authoritarian centralized control. I have argued above that if the tenure system is allowed to evolve under conditions of freedom of contract – that is, if individuals and groups are not prevented by some central authority (the state) from making institutional changes that they deem fit – as the real values of long-term investments in and on land increase, the system of ownership rights will evolve towards individual ownership. Decentralized decision-making and internalization of costs and benefits would be two advantages of the freedom-of-contract approach over the centralized authoritarian approach, making efficiency and hence optimal pace of privatization attainable without complex and continuous cost–benefit analysis. The social efficiency of the process would be further promoted by appropriate enabling public policy environment and oversight.

If sales of family land are barred in the immediate future, as discussed earlier, then an important question would become whether, over time, restricting sales will make sense if the system is allowed to evolve towards individual ownership (that is, away from extended family ownership). One would think not. As an aspect of individual property rights, the right to transfer via sale, in addition to leasing, renting and pledging, will no doubt evolve with privatization.

What would be entailed is straightforward: families would be given the right to make permanent allocation of land to individual family members, who will then regard their individual allocations as their own private property. The agreements would be written, and supported by surveys and registration at a reasonable cost. The costs would be borne by the families, who would decide on the distribution of such costs among the family members. Families would decide on individualization moves at their own discretion. In this context registration, for example, which is costly, would occur in accordance with the equilibrium pace of individualization and would thus commence with the most economically valuable areas, like swamp lands and heavily populated areas.

I would suggest that the right to transfer by lease, rent, pledge or sale of land be granted immediately upon individualization. Whether this freedom of the individual should be unconstrained immediately the reforms are instituted is a legitimate issue for debate. I see no reason why this freedom should be constrained outside of some minimal oversight requirement, as mentioned below.

With regard to the imposition of some minimal constraint on the freedom of the individual to transfer land, the authorities, for instance, could require that, for a specified period after an individual obtains sole ownership from the family, all agreements to lease, rent, pledge, or sell by that individual must go through some review by the oversight agency in order to ensure that the individual receives a 'fair' price.

Whatever the case, one should not be opposed to major land redistribution over time, as do some opponents of individualization of landownership (see, for example, Barrows 1974). The relevant issue is whether any long-run inequality of landownership is socially efficient. If the land markets function efficiently (something that I have argued in this paper should be part of government policy to ensure), transfers of land by sale do not by themselves alter wealth distribution, only the forms in which wealth is held by different individuals.

6.9 Communal Land

Where there is still land that is not family land or designated state land, but rather community or communal land, the governance of such land may need clarification in today's Sierra Leone. This, no doubt, will be done taking into account traditional practices and the current Local Government Act in place. Again, the conclusions of such a review and clarification must be written into law.

Whatever the case, there are economic efficiency considerations that should inform and guide the governance arrangements for communal land. In particular, those persons allocated communally owned land at any point in time should be allowed to sublet and to sell their *investments* in and on land. The freedom to sublet increases the probability that the most productive users of the communal land will ultimately gain access to the land, irrespective of the original allocation of the communal land. It 'increases the probability' rather than ensures because the wealth effect of the original allocation plus the existence of transaction costs in the secondary allocation process will affect the equilibrium (final) allocation. The freedom to sell one's investments in and on land also increases the probability that all socially profitable investments in and on land will be made. Here, again, it does not 'ensure' this because of the additional risk for the individual who is making the investments of not being able to fully capture the net return of the investments, as compared to a situation in which he or she privately owns the land.

It is clear, then, that the governance arrangements pertaining to communal land will affect the efficiency of allocation and use of land and of investments in and on land, under communal ownership, by affecting

1. the efficiency of the primary allocations,
2. the transaction costs and efficiency of private secondary allocations,
3. the certainty with which individuals expect to capture through sale (or any other method) their investments in and on land.

In this regard, the governance arrangements must find ways to address

(i) possible corruption and inefficiency in the primary allocations of land,

(ii) the adverse effects of risks of insecure property rights related to investments in and on land under communal, as opposed to private, ownership.

6.10 Oversight

Oversight has value in the areas of land rights, land transfers and land use. But, as regards the reform process under discussion in this paper, it is useful to stress the importance of heightened and vigilant oversight during some transition period, until it is rational to leave matters to the market with relatively minimal oversight. For many years, the land market that will be needed to support the new system will remain underdeveloped and inefficient. There will be asymmetries in bargaining power and in information that, without vigilant oversight, will be grave enough to lead to undesirable exploitation. Buyers, for example, may be duped if owners are able to sell the same plot of land to multiple buyers and then disappear.

Pricing would be a difficult issue for a long time as the market develops. One way to alleviate this problem without strict price control and regulation is by mimicking an auction process. All offers could be made public, with counter-offers made acceptable over some limited period of time before a deal is closed. This should work for both buyers and sellers. For example, if someone wants to buy land they could advertise on some bulletin board monitored by the oversight agency. Similarly, a seller could advertise on the board and any offers would be good for a certain number of days while the seller waits for a counter-offer. The oversight agency could also collate information and act as a real estate agent would act in a pure market situation. The agency could be authorized to charge commission for such services. It would be important, though, to separate (that is, put a Chinese wall between) the pure overseeing branch of the agency and the real estate agency branch. This latter branch should have a sunset period. The nature of oversight would, of course, change over time as the land market develops.

There would be a great opportunity to get the records straight from the beginning. Proper recording of surveys, titles and sales, these records being computerized and with proper backup facilities, would give these areas of Sierra Leone a blessing that even the Western Area does not have at the present time. I would reiterate that the timing of surveys and formal titling procedures should preferably be decided by the families themselves, which would be the norm in a regime of freedom of contract in the evolutionary process proposed in this paper.

The reform process under discussion could thus give Sierra Leone the opportunity to develop an orderly and well-functioning real estate market, with proper codes of conduct and qualifications for real estate agents and brokers, underpinned by sound information systems and proper records.

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Chapter 7

SURVEY OF THE LITERATURE ON SUCCESSFUL STRATEGIES AND PRACTICES FOR EXPORT PROMOTION BY DEVELOPING COUNTRIES

By Marianna Belloc and Michele Di Maio

7.1 Introduction

Increasing exports ranks among the highest priorities of any government in both developed and developing countries. The reason is that favouring domestic export performance is predicted to be conducive to economic growth (for reviews of the empirical literature on the relation between export and growth see Giles and Williams (2000) and Harrison and Rodríguez-Clare (2009); see also UNCTAD (2008b)). Export promotion policies (EPPs) are the set of policies and practices aimed at directly or indirectly supporting export in a given country.

Export promotion policies have been widely used by most countries around the world for a long time. Reviewing the past and present international experiences with EPPs and assessing the effectiveness of the different policies is hence crucial to provide governments in developing countries with some guidelines to help identify the best practices so far. This is the objective of the present paper.

The term EPP may encompass a large set of policy interventions, ranging from exchange rate policies (Bhagwati 1988) to any 'specific measures that generally amount to the government bearing a portion of the private cost of production of export' (OECD 1984). In general EPPs involve all the measures and programmes aimed at assisting current and potential exporters. These measures may be addressed to either national exporters or multinational enterprises producing locally (or both). Yet, in the last decades the set of policies and measures available to governments to influence exporting has been gradually restricted by the WTO. For instance, the use of selective export subsidies is now severely

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limited for most countries. Nonetheless, WTO rules do not prohibit all types of EPPs. Policies are still allowed when they promote

(a) domestic investment in research and development,

(b) regional development,

(c) environment friendly activities.

Notably, these may be useful instruments to increase export quality and export diversification. As we will argue below, it is crucial to consider the present and future constraints when discussing the available options for developing countries in designing their own EPPs.

This paper proceeds as follows. In the next section, we present the content and characteristics of the export promotion measures (Section 7.2). Then we briefly discuss the importance of evaluating EPPs and how this has been done in different countries (Section 7.3). In Section 7.4 we describe the current WTO rules concerning EPPs and how they determine which alternatives are available to developing countries. In Section 7.5 we illustrate the distinct sets of EPPs implemented by governments in both developed and developing economies and review the existing empirical evidence on their effects. Section 7.6 summarizes the main results of the paper and draws concluding remarks.

7.2 Export Promotion Policies

7.2.1 Export Subsidies

The WTO (2006) defines an export subsidy as a benefit – conferred by the government to a firm – that is contingent on exports. It may take different forms. For instance, an export subsidy can be

- a government transfer to selected entities (cash subsidy, tax exemption or deferment, preferential tax treatment, duty drawbacks on imported intermediate inputs or duty suspension, temporary admission, etc.),
- a regulatory policy (such as regulatory protection at the border, a border tax adjustment, preferential rules of origin, etc.) that entails a direct or indirect transfer,
- the provision of a public good at no cost or below market price for exporting firms.

Export subsidies may also be distinguished on the basis of the category of beneficiaries, i.e. producers versus consumers, or on the basis of the nationality of the beneficiary, i.e. domestic entities versus foreign entities.

Finally, subsidies may be general, if they are addressed to a wide category, or specific, if the category is narrow.

For policy purposes, a useful definition of export subsidy is: 'a transfer from the government to a private entity that is "un-requited", that is, no equivalent contribution is received in turn' (WTO 2006, p. xxiii). This definition (as National Account Statistics do) focuses on direct payments and does not consider duty drawbacks; whereas the definition adopted by the WTO under the Agreement on Subsidies and Countervailing Measures (ASCM) refers to 'a financial contribution by the government or any public body' (ASCM Article 1.1(a)) that may consist in

(i) direct transfers of funds, including potential transfers, such as loan guarantees,

(ii) foregone revenues that are otherwise due,

(iii) goods and services provided by the government other than general infrastructure,

and, in addition, 'any form of income or price support in the sense of Article XVI of GATT 1994' (i.e. support which operates directly or indirectly to increase exports of any product from, or reduce imports into, a Member's territory) (WTO 2006, p. 53).

According to this definition, regulatory policies are not considered subsidies within the WTO ASCM. Of course, a strict interpretation of the definition of a subsidy is not particularly compelling for evaluating its effects (a subsidy must give a benefit to the recipient), but is crucial for WTO disputes.

Subsidies to the export sector can be either direct export subsidies or production subsidies on the export side. The former are granted to producers only on the part of their output that is in fact exported, so they are subsidies working across borders. The latter are given on the whole production of the exported good. Production subsidies to exporters are superior to export subsidies (that can be seen as negative tariffs) in the fact that they are less distortionary. Indeed, while export subsidies, as well as tariffs, create two types of distortions, on both the production and the consumption side, production subsidies generate distortions only on the production side (see, for example, Gandolfo 2006). Yet production subsidies are more costly for governments than export ones (because all production must be subsidized). Quotas may have some advantages vis-à-vis tariffs and subsidies since they reduce uncertainty in the sought outcome and automatically reduce the level of protection as domestic costs fall (Melitz 2005). However, like tariffs quotas have undesirable distortionary effects on consumption, but generate less revenue than equivalent tariffs.

Thus, in the presence of perfect markets, subsidies (as well as tariffs, quotas, and any form of protection) imply welfare costs in terms of distortion on the production side, or both on the production and the consumption side, causing a misalignment between the optimal world price and the domestic price. However, in the presence of market failures such as economies of scale or externalities, subsidies may be used to correct existing distortions in the good and factor markets and align optimal and actual prices; hence they may turn out to be welfare improving (detailed theoretical treatment can be found in WTO (2006, pp. 58–62)). Promoting exports rather than protecting the domestic production

1. induces firms to increase productivity to be competitive in the international market,
2. gives incentives only to high productivity firms,[1]
3. leads to market expansion allowing the exploitation of the Marshallian externalities and makes domestic firms aware of the foreign demand.

There are a number of possible arguments against the use of export subsidies. First, the subsidy may be used by the firm for objectives other than increasing exports. In developing countries, where control mechanisms are less efficient, this case may be frequent. Second, the export subsidy schemes are often complex and usually require specific government capabilities in allocating them.

Of course, even in situations where a subsidy can be theoretically justified, there is an array of implementation issues. The evaluation of the actual situations in which in practice a government subsidizing intervention is recommended is far from being straightforward from theoretical models' consideration. Implementation issues also arise in the presence of government failures that can be responsible for results different from the desired ones. These important concerns lead to the consideration that trade (as any) policy decisions take place in a complex institutional environment, are often dictated by special interests (Grossman and Helpman 1994) and their actual effects strongly depend on how they interact with the political power of the elites (Acemoglu and Robinson 2006; Robinson 2009).

There are a number of other measures that, while not being direct export subsidies, may have the same effect and for this reason are strictly regulated by the WTO. Among these, one can find the duty drawback scheme, which is a system to refund duties paid on the imported inputs incorporated in the finished exported good. Clearly this is a particularly advantageous scheme when tariffs for intermediate products are high, as is usually the case for developed countries. Members of the WTO may establish duty drawback schemes providing that they do not configure an implicit export subsidy.[2] The management of duty drawback schemes can be cumbersome, especially for developing countries. This is why one of the issues debated in the Doha Round

[1] Nonetheless, as noted by Harrison and Rodríguez-Clare (2009), this is welfare increasing only if there are barriers that prevent resources to flow from low productivity to high productivity firms. In any case, the optimal policy would be to remove these barriers.

[2] The duty drawback scheme can be used if: (1) duties have been actually paid on the inputs; (2) the amount of duty reimbursed is not larger than duties paid; (3) there is a verification system of the whole scheme. Nonetheless, under the Substitution Drawback System (Annex III ASCM), WTO members may refund duties on (other) inputs if domestically produced inputs are used to produce the export goods.

(started in 2001) was about providing technical assistance to countries willing to use them.

Another measure that may result in an export subsidy without being explicitly so is a tax system that favours a specific enterprise or industry. These benefits may take different forms, the most common being condoning or not collecting tax revenues. The (usually temporary) income tax exemptions and reductions also belong to this category and are a measure largely used in developing countries to attract foreign firms. They are also known as 'tax holidays' for newly established firms. Other tax incentives may include double deduction of business expenses and insurance premiums, sales tax exemptions, reinvestment allowances, and so on.

7.2.2 Export Processing Zones

Farole (2010a) defines export processing zones (EPZs), free trade zones (FTZs) and other forms of special economic zones (SEZs) as[3] demarcated geographical areas within a country's national boundaries where the regulation of firms' activity and the dedicated policies are differentiated from those applied to firms outside the zone, and addressed to creating a policy environment and associated infrastructures that are exporter friendly, for both domestic and foreign producers.[4] All the measures already mentioned in Section 7.2.1, subsidies broadly defined, domestic taxes and custom duties exemption, regulatory policies and public good provision, can be used in EPZs as well, but limited to a given geographic location. Interventions of this kind may be aimed at (English and de Wulf 2002):

(a) fostering production and employment in (potentially) exporting industries,

(b) increasing foreign exchange profitability of (non-traditional) exporting producers,

(c) stimulating FDI in the given area when exporting by local producers is heavily constrained.

The reason for promoting EPZs is that it is a viable (second-best) policy in the presence of strong economy-wide weaknesses and impediments to other national policies. It is always recommended the EPZ not be insulated from the rest of the economy and efforts be made to generate positive spillovers at an economy-wide level. Examples of EPZs that are usually considered

[3] For a detailed discussion about the difference across the various measures see FIAS (2008).

[4] The conceptualization of EPZs has evolved over time. Until recently the World Bank considered the creation of an EPZ (see, for instance, Madani 1999; Watson 2001) a second-best option to resort to only in the case that the first-best option of free trade is not achievable. Among the others, Stein (2008) finds fault with this view, arguing that EPZs should instead be considered a viable policy instrument in the more general industrial policy framework.

successful are those provided by Mauritius in the mid 1990s and Mexico in the 1990s (the well-known 'maquiladoras'); while a negative example is offered by Senegal. Key factors determining the success of EPZs are economic and political stability, profitability of local production (and related exchange rate policies), skill-content of local employment. Of primary importance are also policies addressed to remove bottlenecks and weaknesses regarding availability of and access to infrastructures, regulatory constraints and services. Interventions in the form of pure economic incentives, such as credit liabilities and preferential tax treatments, are of second-order importance. Export processing zones are not explicitly mentioned in the WTO agreements and are potentially in conflict with the WTO rules only to the extent that they provide firms subsidies conditional on exports. These cases, as seen in Section 7.2.1, are included in the WTO ASCM.

7.2.3 Trade Finance

One of the most important obstacles to industrial development is a weak financial market, in which producers may face credit constraints and experience difficulties in finding the necessary resources to finance investments. Such constraints may depend on either inefficiencies of the financial sectors or lack of creditworthiness by private firms (English and de Wulf 2002). Sometimes, however, the problem can be purely informational, and the misalignment between credit supply and demand may be due to imperfect risk evaluation by firms or creditworthiness evaluation by banks and financial institutions. Governments may intervene in several ways to enhance credit access. Traditional measures are subsidizing credit for small firms, spurring competition in the credit markets, facilitating information transmission and providing credit insurance, export credit and export guarantees. By definition, export credit is needed in situations where (whatever the reason) the buyer of the goods defers the payment for a certain period of time. Export credits may be in the form of supplier credits (i.e. credit granted by an exporter to a foreign buyer) or buyer credits (i.e. the exporter gets in contract with a buyer, which is financed by a loan agreement between a bank in the exporter's country and a bank in the buyer's country). Export guarantees are instead instruments that cover the risks of export credits (political or commercial) in the case of default by the borrower. In most countries, the government assumes the credit risk through specialized institutions. It is clear that these two measures may both result in an indirect form of export subsidy and, for this reason, their provision is regulated by the WTO.[5]

[5] Permitted export credits are only those included in Annex I of the ASCM. An exception to prohibited export credits is the OECD Arrangement on Guidelines for Officially Supported Export Credits which regulates the provision of export credit conditional to a number of rules. The Annex also prohibits export guarantees that are granted at premium rates inadequate to cover long-term operating costs and losses.

In addition the government may provide

(a) foreign currency revolving funds, which is granting credit by the exporters' banks to pay the imports of intermediate inputs;

(b) pre-shipment export finance guarantee schemes, which are targeted at exporters or potential exporters that have no sufficient proof of creditworthiness by collateral but have export letters of credit;

(c) matching grant schemes, which are targeted at potentially successful exporters that overestimate the risk of the exporting project and so underinvest in it.

As in the case of export and promotion subsidies, considerations regarding pressure lobbies, interest groups involvements and government failures are of primary importance for the implementation issues of these measures as well.

7.2.4 Trade Promotion Organizations

Trade promotion organizations (TPOs) are aimed, on the one side, at supplying local exporters and potential exporters the necessary information to identify the foreign markets where to sell their products and, on the other side, at improving the knowledge by potential foreign customers about domestic products and firms. Market failures that justify TPOs' activities are mainly due to information dissemination and coordination failures, such as imperfect information on the part of the domestic producers about foreign sales prospects, asymmetric information problems between domestic producers and foreign consumers, difficulties in cost and risk evaluation by exporters, barriers to entry in foreign markets because of lack of knowledge or of coordination (among suppliers, or between suppliers and buyers).

More specifically activities of the TPOs involve:

(i) image building, advertising, advocacy;

(ii) advertising and marketing of domestic products, through trade missions, trade fairs, trade shows and information dissemination;

(iii) providing support services to local exporters, in order to assist enterprises in the planning and preparation for international involvement, stimulate interest for export in the business community, acquire expertise and know-how necessary to enter export markets, provide organizational help and cost-sharing programmes;

(iv) conducting market research to develop awareness of export opportunities, identify targets and potential business partners.

Trade promotion organizations are now widespread in both developed and developing countries, with diversified experiences. The reason for a significant increase in the number of TPOs (they have about tripled in the last twenty years, as documented by Lederman *et al.* (2008)) is twofold. First, changes in the regulatory environment (especially in the WTO rules) have led, in the last decades, to substantial restrictions in the export promotion activities (subsidies and similar trade policies) and have, as a consequence, induced the governments to look for new measures to circumvent such restrictions. Second, other dramatic changes in the international trade environment are occurring, such as increasing liberalization of goods, services and factor markets, redesign of regional agreements and rebalance of power, advances in information, communication and transportation technologies. These changes, on the one side, have created new profitable opportunities for exporters and investors worldwide. But, on the other hand, they have also increased uncertainty in the globalized international arena. From this it follows that potentially successful opportunities could remain unexploited because of limited information and lack of proper evaluation of the associated risks. The aim of the TPOs is to help domestic and foreign entities internationally involved to match potential opportunities with profitable experiences.

7.3 The Importance of Evaluating Export Promotion Policies

There are two levels at which one may want to evaluate the effects of EPPs: the country and the firm level. At the country level, the EPPs may be evaluated in terms of economic growth performance (export-led growth argument, see Section 7.2), increase in income and in foreign exchange reserves. At the firm level, the evaluation would instead consider changes in the firms' export flows, in the entrepreneurial attitudes and in the firms' market and product diversification.

Evaluating EPPs is crucial for both assessing their effects and improve their functioning. Evaluation programmes are already in place, for instance, in Denmark, the United Kingdom, the United States and Australia. In most of the cases, the evaluation is based on the direct measurement of the impact of EPPs on the export volumes conducted by external entities.

Assessing the effectiveness of the EPPs is also important to increase awareness by local producers. Empirical evidence shows that not all exporting firms apply to export support programmes, even when they are available. One reason is that firms may not be aware of the programmes' existence and effectiveness. Moreover, since applying for programmes is costly to the firm, the uncertainly related with their success may discourage applications. These aspects have been the focus of a line of research investigating firms' awareness, usage and perceptions of export promotion programmes (see, for example, Vanderleest (1996) for the United States, Crick (1997) for the United Kingdom, Haunschild *et al.* (2007) for Germany, and Ali (2006) for Australia). Even if not conclusive on the impact of EPPs on export performance, these studies can be useful when the planning, the assessment and the decision-making are done (Francis and Collins-Dodd 2004).

The evaluation of EPPs faces enormous difficulties. A large number of studies (Seringhaus 1986; Seringhaus and Botschen 1991; Diamantopoulos *et al*. 1993; Czinkota 1994; Crick 1995; Crick and Czinkota 1995; Czinkota and Wongtada 1997; Crick and Chaudhry 1997; Seringhaus and Rosson 1998; Crick and Chaudhry 2000; Francis and Collins-Dodd 2004; Gillespie and Riddle 2004; Yin and Yin 2005; Shamsuddoha and Ali 2006) all agree that there is no sufficient empirical evidence to support the view that export promotion (whether public, private or mixed) is, in general, effective. In addition, there is no agreement on which form the intervention should take. Since most of the studies have been conducted in developed countries and have considered mainly medium-large firms, the available information cannot be trivially used to infer conclusions in the context of small and medium enterprises (SMEs) and in developing countries.

Carazo (2007) emphasizes that the fact that the empirical evidence does not always support the positive effects of export promotion programmes is not surprising if one considers: (a) the cross-country heterogeneity (both in terms of country characteristics and of export support programmes), (b) the strong variability in firms and entrepreneurs' characteristics and needs, (c) the different obstacles to exporting that different firms in different sectors face, and (d) the stage of development and international involvement of the different firms. Finally, differences in the evaluation criteria and in the empirical methodologies implemented to assess EPPs' effects tend not to lead to conclusive results.

Singer and Czinkota (1994) identify the reasons why export promotion programmes may have a positive impact on export performance as follows:

(a) they increase the firm informational and experiential knowledge (see also Kotabe and Czinkota 1992);

(b) they stimulate managers' positive attitudes and perception towards exporting;

(c) they increase export commitment by the firm (see also Marandu 1995).

Surprisingly, export promotion programmes as determinants of export growth have not received much attention in the management literature. For instance, a very comprehensive review by Sousa *et al.* (2008) shows that among 54 articles published in the management/business/marketing literature between 1998 and 2005, only 4 articles include export assistance as an explanatory variable. Yet, relying on the limited existing empirical evidence, management research seems to support the view that the existence of programmes (sponsored by either government or non-government agencies) designed to assist firms' export activities contributes positively to the export performance of the firms (Gençtürk and Kotabe 2001; Alvarez 2004; Lages and Montgomery 2005).

Additional elements further complicate the assessment of the effectiveness of export promotion programmes. The first is the presence of numerous confounding factors in the relationship between export performance and export promotion programmes provided by TPOs. Volpe Martincus *et al.* (2010) argue that whether or not export promotion activities result in increased trade is likely to depend on:

(a) the kinds of promotion activities and the specific instruments used;

(b) the institutional features (e.g. networks of offices, reporting schemes, rules for the selection and promotion of the personnel, relationships with other public and private organization within the country) and the associated incentives structure;

(c) the country-level macroeconomic and sectoral policies that affect the export sector.

The second reason relates to how one wants to measure the effectiveness of TPOs. This problem is obviously related to the shortage of information about the activities and the results of the TPOs, especially in developing countries.

The third reason concerns TPOs' heterogeneity. For instance, as discussed by Volpe Martincus *et al.* (2010), TPOs in the various Latin American countries remarkably differ in the amount of resources spent and in the number of employees employed in their activities.

Lederman *et al.* (2008), using survey data from 88 developed and developing countries, find that the activity of export promotion agencies have a strong and statistically significant impact on the countries' total export volumes. The authors use an instrumental variables approach to deal with endogeneity issues: the causal relation suggests that an additional dollar spent on export promotion increases exports by about US$40. They also find that the magnitude of this positive effect changes across regions, and that the marginal impact is decreasing with GDP and with the amount of expenditure. On the contrary, Görg *et al.* (2008), considering Ireland, find little evidence that export promotion increases the number of exporters. Few other studies examine the direct relationship between the use of export promotion programmes and export performance (see Francis and Collins-Dodd 2004; Gencturk and Kotabe 2001; Katsikeas *et al.* 1996; Kedia and Chhokar 1986; Lesch *et al.* 1990; Marandu 1995; Singer and Czinkota 1994) and reach mixed conclusions.[6]

Finally, notice that, for a long time, exporting has been considered a primary concern only for large firms. Nowadays, given the increasing internationalization of the markets, SMEs are also involved in export and very much interested in the export promotion services (Bloodgood *et al.* 1996; Crick *et al.* 2001; Wilkinson and Brouthers 2000). Availability of firm-level and plant-level data sets encourages empirical assessments also at this level of aggregation.

[6] Williamson *et al.* (2009) list several contributions that appeared in the *International Trade Journal* in the last 25 years discussing the effectiveness of TPOs (and of governmentally sponsored export promotion strategies in general) in both developed and developing countries.

7.4 Export Promotion Polices and the WTO

The institutional environment EPPs face has changed remarkably in the last 20 years. The WTO has shown a more restrained attitude towards EPPs and introduced forms of intervention that permits the countervailing of prohibited export promotion practices.

Subsidies are regulated by the ASCM signed during the Uruguay Round negotiations.[7] The ASCM describes both substantive (types of subsidies and their elements) and procedural provisions (investigations and actions to counter illegal subsidies). Specific rules regarding subsidies for agricultural products are found in the Agreement on Agriculture (AoA).

Article I of the ASCM describes the defining characteristics of a subsidy. Article II lists the elements which make a subsidy specific and thus prohibited even if not listed under Article III, which describes the prohibited subsidies. A subsidy is specific if it is granted to

(a) an enterprise,

(b) a group of enterprises,

(c) an industry,

(d) a group of industries,

(e) a group of enterprises in a designated geographical region.

It is important to note that specificity may be *de jure* or *de facto*. A subsidy is not specific if granted on the basis of objective criteria or conditions (e.g. number of employees). All subsidies under Article III are regarded as specific.

The agreement defines two categories of subsidies:

(a) prohibited subsidies (listed in Article III);

(b) actionable subsidies (those not falling under Article III and that meet the requirements of Article V).

Prohibited subsidies are of two types:

1. all the subsidies that, *de jure* or *de facto*, are contingent upon export performance;[8]
2. all the subsidies that are contingent upon the use of domestic rather than imported inputs/goods.[9]

[7] The General Agreement on Tariffs and Trade (GATT) disciplines subsidies and countervailing measures in Articles III (8(b): internal taxes), VI (countervailing measures) and XVI (domestic and export subsidies).

[8] Article 3.1(a) of ASCM. Annex I of ASCM provides for an Illustrative list of 12 prohibited export subsidies.

[9] Article 3.1(b) of ASCM.

Actionable subsidies are instead subsidies that are not prohibited under Article III but may cause adverse effects.[10] Adverse effect means harm caused to

(i) the domestic industry in the importing country,

(ii) foreign exporters competing with domestic exporters in a third market, or

(iii) foreign exporters competing with domestic exporters in the domestic market.

The WTO regulates the actions countries can take to countervail the effects of subsidies. A country may seek the withdrawal of the subsidy implemented by a rival nation or the removal of its adverse effects. There are two possible ways to counter such subsidies. At the multilateral level, any affected WTO member may request WTO dispute settlement proceedings. At the national level, the affected WTO member may impose countervailing duties (extra duties) after an investigation which testifies that imports are subsidized and this negatively affects categories under (i), (ii) or (iii) above.

As with many other WTO agreements, the ASCM also allows for special and differential treatment. The prohibition of export subsidies may be exempted for the LDCs and for countries with GDP per capita below US$1,000 per year.[11] Import substitution subsidies (i.e. subsidies designed to help domestic production and avoid importing) are instead by now forbidden to all countries. Notice, moreover, that sometimes ASCM prohibits specific subsidies and financial assistance that distorts trade in non-primary products even if Article 27 of ASCM has special rules for LDCs (for a discussion of this point see Czinkota (2002)).

The issue of export subsidies is particularly relevant for agriculture. Agriculture is one of the thorniest issues in trade negotiations between developed and developing countries. The rules concerning export subsidies and domestic support in agriculture are treated in the AoA. The Agreement states that WTO members can only grant export subsidies[12] to the products and in the amounts listed in the Members' Schedule of Concessions reported in the AoA. The special and differential treatment (SDT) also applies to export subsidies in agriculture. This implies that flexibility regarding reduction commitments for a period of up to 10 years is granted to developing countries. Moreover, there is an obligation on developed countries to undertake the 'Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries'.

[10] Adverse effects are defined by V of ASCM. It is the complaining country that has to show that the subsidy has an adverse effect on its interests. Otherwise the subsidy is permitted.

[11] Article 27 of ASCM.

[12] Export subsidies in the agricultural sector are in Article 9 of the AoA.

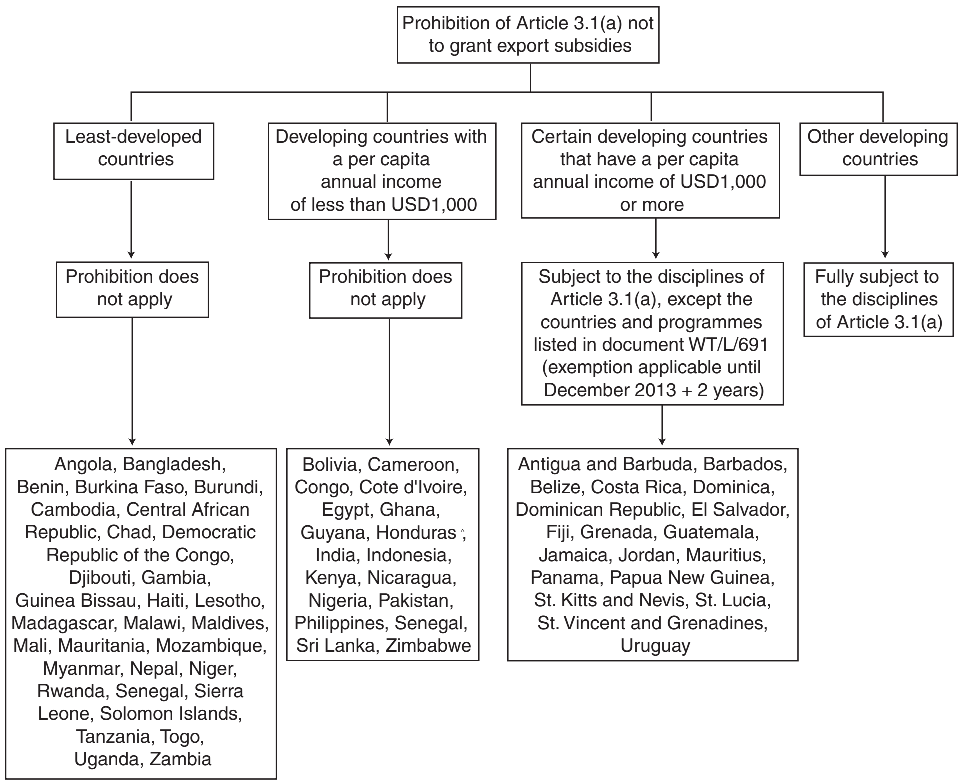

FIGURE 7.1. Applicability of export subsidies in developing countries.
Source: International Trade Centre 2009.

7.5 Export Promotion in Action: Policies, Instruments and Results

Export promotion is pervasive in developed as well as in developing countries and covers a vast array of policy interventions ranging from public goods provision to exchange rate policies, from financial assistance to marketing and advertising services. Tables 7.1 and 7.2 (from Melo 2001) for Latin American countries and Table 7.3 (from UNECA 2010) for African ones provide an overview of the considerable heterogeneity in this policy area.

In what follows we provide a review (with no claim to be complete) of the existing empirical literature on export promotion policies implemented in different countries with an attempt, when possible, to provide an evaluation of the different policies' effectiveness, also emphasizing the differences between developed and developing countries. Indeed, national systems of export promotion in developed economies, even if addressed to similar goals and designed to play similar roles, tend to be characterized by an organizational setup and strategic approaches that differ remarkably from those of industrializing and developing economies (Seringhaus and Botschen 1991; Seringhaus and Rosson 1990).

TABLE 7.1. Export promotion policies:
comparative table, selected Latin American countries.

	Tax refund scheme	Drawback schemes	Temporary admission schemes	EPZ
Argentina	✓	✓	✓	✓
Bolivia	✓	✓	✓	✓
Brazil	✓	✓	✓	✓
Chile	✓	✓		
Colombia	✓	✓	✓	✓
Costa Rica		✓	✓	✓
Ecuador		✓	✓	✓
Mexico	✓	✓	✓	✓
Peru	✓	✓		
Uruguay	✓	✓	✓	✓
Venezuela	✓	✓	✓	✓

Source: Melo 2001.

TABLE 7.2. Financial incentives to support export:
comparative table, selected Latin American countries.

	Credit export agency	Export credit line in the development bank	Export credit insurance	Loan working capital	Finance for entire investment	Finance for marketing	Buyer's credit
Argentina	✓		✓	✓	✓	✓	✓
Bolivia							
Brazil		✓	✓	✓			✓
Chile		✓		✓		✓	✓
Colombia	✓		✓	✓		✓	✓
Costa Rica				✓			
Ecuador			✓	✓			
Mexico	✓	✓	✓	✓	✓	✓	✓
Peru		✓		✓			
Uruguay		✓	✓	✓			
Venezuela	✓		✓	✓			✓

Source: Melo 2001.

In the following subsections we focus on some of the most important policies aimed to support export growth, namely: (1) direct export subsidies, (2) export processing zones (EPZs), (3) measures to attract FDI, (4) establishment of a trade promotion organization, (5) trade finance policies, (6) removal of trade barriers and standard compliance, (7) enhancement of the investment climate and complementary policies.

TABLE 7.3. Export promotion policies: comparative table, selected African countries.

	Botswana	Cameroon	Côte d'Ivoire	Ghana	Kenya	Mauritius	Morocco	Nigeria	Rwanda	Senegal	Uganda	Zimbabwe
Incentives for export activities	✓	✓	✓	✓	✓	✓	✓		✓	✓	✓	✓
Export processing zones		✓	✓	✓	✓	✓		✓	✓	✓	✓	✓
Export promotion (manufacturing)	✓			✓	✓	✓	✓		✓			
Standardization/ quality improvement for exports	✓	✓	✓		✓				✓		✓	
Measures to attract FDI for export activities	✓	✓	✓	✓	✓	✓		✓	✓		✓	✓
Facilitated credit for non-traditional manufacturing	✓		✓			✓	✓			✓		
Selective tariff protection (peak/high tariffs)	✓	✓		✓	✓	✓	✓		✓			
Utilization of other trade instruments	✓						✓					
Export duties to favour local manufacturing		✓		✓	✓		✓		✓			

Source: UNECA 2010.

7.5.1 Export Subsidies

Among export subsidies one may distinguish between direct export subsidy, duty drawback and tax exemption schemes. This section will consider them in turn. The effect of export subsidies (see Section 7.2.1) on export performance is mediated by a number of elements such as the political environment, the administrative capabilities to distribute and monitor the use of subsidies. This implies that it is often difficult to clearly assess their effectiveness: the implementation of subsidy programmes is, most of the time, complex and the resource allocation is under the control of the national and international groups endowed with power (see Robinson 2009).

Direct Export Subsidies: Developed Countries

A rigorous empirical study on the effects of export subsidies in a developed country is provided by Görg *et al.* (2008) for the case of Ireland. The authors consider all types of firm-specific subsidies (not tailored to favour exporting explicitly but to promote investment in technology, training or physical capital, and, in turn, exporting) ranging from capital grants to training and R&D grants, from rent subsidies to employment grants and grants to technology acquisition and investments in R&D to loan guarantees and interest subsidies. Results conducted on a sample of plants with at least 20 employees for the 1986–2002 period show that, while sufficiently large subsidies granted to already exporting firms are effective in promoting export flows, they have no statistically significant impact on the decision to start to export. Furthermore, as it turns out, the elimination of the grants does not lead the firm to stop exporting.

Australia also has a remarkable tradition of export promotion. The most important public institution charged with export assistance is the Department of Foreign Affairs and Trade. Its portfolio includes a number of agencies that are responsible for the various export assistance measures, and in particular: (a) tax incentives, (b) financial assistance, (c) information transmission and marketing services (Molnar 2003). The first of these measures is described in the present subsection, the second in Section 7.5.5 and the third in Section 7.5.6. The Australian government’s expenditure for export promotion is among the largest in the group of developed countries, in particular larger than in Canada, the United Kingdom and the United States, and much larger than in Belgium, Sweden and Germany (Molnar 2003). Nevertheless, Australian programmes have always abided by the WTO rules. The Australian Trade Commission (Austrade) is responsible for export facilitating policies and support to SMEs. The report published in 2002 by Austrade gives an account of such an activity that comes to operate in a continuously changing environment. Since the 1980s, the Australian economy has opened up to the international trading system, progressively removed trade barriers, liberalized international investment and implemented various microeconomic reforms. At the same time, however, the international environment has changed as well, creating stimulus and challenges to Australian firms, which are particularly disadvantaged by their distance from the most important world markets. Government effort has been primarily devoted to trade negotiations and international diplomacy to create a favourable business environment for Australian exporters (Australian Trade Commission 2002) and, in particular, for SMEs (Mahmood 2004). Secondly, the government has tried to develop an appropriate policy framework, finding and mobilizing resources for trade promotion organizations and aligning targets and actions of community, business and government. In particular, five goals have been set:

(a) spurring firms' intention to export by identifying proper companies and encouraging them to get ready for exporting and planning their international involvement;

(b) increasing opportunities of accidental exporters;

(c) increasing the success rate of intenders by means of properly tailored government programmes;

(d) encouraging new firms with global potential to export, by trade promotion at national, state and local levels;

(e) increasing the number of regular exporters through continuous support and consolidation of overseas networks.

One of the most important programmes conducted by Austrade is the Export Market Development Grant Scheme that provides financial assistance in the form of taxable grants especially to SMEs to promote sales of their products overseas (see Molnar 2003). The grants concern a series of export facilitating initiatives such as overseas representation, marketing visits, communications and advertising, trade missions and fairs. Since the end of the 1980s, resources addressing these aims have not been increased and, yet, the related effects have not been significant. The export promotion activity by Austrade is supported by Ausindustry, which is a government agency belonging to the Department of Industry, Tourism, and Resources. Ausindustry provides complementary tax-related services, the Tradex scheme that consists in the duty drawbacks on imported goods that are used as intermediary inputs in exported goods' production or exported subsequently by domestic firms. The number of users of the Tradex schemes has substantially increased starting from 2000 (Molnar 2003).

Direct Export Subsidies: Developing Countries

Since the 1970s, a number of papers have studied the effects of export subsidies in developing countries adopting a country-level perspective (Frank *et al.* 1975; Low 1982; Jung and Lee 1986; Nogués 1989; Hoffmaister 1992; Arslan and van Wijnbergen 1993; Faini 1994; Moreira and Figueiredo 2002; WTO 2006). The conclusions of these studies are mixed, with a slight prevalence of negative evaluations on the effects of export subsidies. For instance, Low (1982) documents the failure of the subsidy scheme in Kenya showing that it is related to the poor implementation and the discretionary choices made by the bureaucrats in the allocation of government grants. Similarly, subsidy schemes have been shown to be ineffective in Turkey (Arslan and van Wijnbergen 1993). In general, however, qualitative and quantitative conclusions on the effects of such programmes depend on the country and on the period considered. Nogués (1989) studies the cases of Argentina, Mexico and Brazil to conclude that only in the case of Brazil export subsidies had, as also confirmed by Moreira and Figueiredo (2002), a positive impact on export performance, but only because they had been associated to macro stabilization policies and import liberalization. The comparison of the Brazilian case with the experiences of the other two countries testifies that export subsidies schemes are neither necessary nor sufficient for export flows to increase. Indeed, Mexico has registered export growth similar to the Brazilian one but without using export subsidies. Argentina, on the contrary, has implemented export subsidy programmes and experienced negative results: the allocative inefficiency has increased, oligopolistic market structures were reinforced, and incentives were captured in rent seeking activities. Even when successful, export subsidies usually do not pass the cost–benefit analysis. Hoffmaister (1992) finds a positive effect of the tax credit scheme in Costa Rica on exports, but he gauges its cost to be very high considering the export growth.

More recently, firm-level analyses on the effects of export subsidies have become available. Helmers and Trofimenko (2009), using data on Colombia, provide micro-evidence on the fact that in most of the cases the amount of subsidies received by the firm was highly discretional. In the sample of countries considered, it turns out that the actual allocation of resources was not fully determined by the compliance with the officially stated criteria for access to the subsidy scheme. Nonetheless, the authors find that, in general, subsidies exhibit positive impact on Colombian export volumes. The impact is decreasing in the size of the subsidy and in the degree of the firm's connectedness to government officials.

Duty Drawback Schemes

Duty drawback schemes consist in refunding duties paid on the imported inputs incorporated in the finished exported good. Duty drawback schemes are quite cumbersome in terms of administrative management. Nonetheless, they are largely used by developing countries (see also Tables 7.1–7.3). Temporary admission schemes are similar measures that allow exporting firms to import inputs, raw materials, intermediate and capital goods employed in producing the exported good with total or partial exemption from import duties.

In Malaysia, the Industrial Development Authority oversees duty exemptions on raw materials, components, machinery and equipment. In Thailand, the exemption of import duties on machinery is an integral part of the Investment

Promotion Act. One of the main pillars in the export promotion strategy of the Nepal government is the provision of a duty drawback scheme and the exemption for strategic sectors from paying customs duties.

African countries also make significant use of duty drawback schemes. However, in most cases they have not worked efficiently and their effects have been negligible (Hinkle *et al.* 2003). But there are exceptions. Among these one can find Malawi where the import of raw materials used in the production of transport vehicles is exempted from customs duties. The horticultural sector enjoys exemption from customs duty for all imported inputs. This measure is expected to contribute to the increase in exports of a sector that is considered strategic for the national economy. In Senegal, new firms are given exemption from customs duties (for three years) and all firms are exempted from duties on imported raw materials. Also Kenya employs a duty drawback scheme that is part of the country's set of measures for export promotion. In particular, the scheme allows the remissions of customs duties on capital goods and raw materials if used in exported products.

Melo (2001) reports that 16 out of 26 Latin American countries have implemented some type of drawback scheme. Dominican Republic has used a simplified drawback scheme for non-traditional exports: the refund is made immediately, and no documentation of the use of imported inputs is required.[13] The Colombian government provides a full set of exemptions related to duties. These are contained in the 'Special Imports/Export Program' (which enables producers to ask for duty exemption on inputs used into production of exported goods) and in the 'Temporary Imports for Re-Exporting Unaltered Products' scheme (which allows firms to import products duty-free provided that they are re-exported in the country of origin of the imported goods). Interestingly, there is also a subset of incentives conditioned on the fulfilment of some requirements related to export performance. For instance, the 'Permanent Customs Users' is a programme that allows business providers to obtain duty drawbacks if their operations exceed US$6 million during the previous year.

While duty drawback schemes are quite widespread, empirical analyses about users' evaluation and their effects are very few. An exception is the survey study on the use of these schemes in Latin American countries presented by Macario (2000a). According to the results, the Colombian drawback mechanism, so-called 'Plan Vallejo', has been judged important for export growth by Colombian exporters. Yet the programme was abandoned because it did not comply with WTO rules (Macario 2000c). Agosin (2001) describes the effects of the duty drawback schemes implemented in Chile starting from the 1980s. For a long period, Chile has used two different programmes. The first was a standard scheme under which duties were rebated *ex post*. The second, in place since 1985, was dedicated to small non-traditional exporters: it was a simplified drawback system under which exporters received a cash subsidy on the export values instead of one on the value of the imported inputs.

[13] Also Chile had a similar simplified drawback scheme. However, this country had to abandon it because it did not comply with the WTO rules.

While there are no empirical studies on the causal effects of such measures on domestic economic performance, the volume of export and the number of exporters after its introduction grew rapidly. One of the reasons why the simplified scheme is considered more effective is that it did not require costly bureaucratic procedures to be implemented: this is a clear advantage for small new exporters.

Finally, the analysis of Ten Kate *et al.* (2000) shows that Mexican firms have been largely using both temporary admission and duty drawback schemes. Particularly effective has been the ALTEX programme, which facilitates export and import formalities for firms whose exports over total sales ratio is above 40%. One important feature of this scheme is that instead of refunding the paid duties *ex post*, firms are exempted from paying duties in the first place. In this way, the mechanism has the additional advantage of reducing firms' working capital needs. This is considered one of the reasons for Mexican export success in the 1990s.

Tax Exemption/Deductions

Several developing countries implement tax exemptions and deductions schemes to favour exporting firms (see also Tables 7.1–7.3).

According to Hinkle *et al.* (2003), at the end of the 1990s Senegal implemented an effective programme for reimbursing VAT on domestic and imported inputs used as inputs in exports. But this is the only African country in which such a measure is documented to have had positive effects, with the remaining cases testifying negative or nil results.

In Kenya and Malawi governments provide firms with incentives for manufacturing under bond (exemption from customs duties on imports of capital equipment, tax benefits and investment allowances on plants, machinery and building, etc.). In addition, Malawian firms can rely on an indefinite loss carry-forward. In Malawi and Colombia, VAT exemption is granted for imported industrial machinery. In Colombia, tax exemptions are conditioned on export performance. A number of tax incentives are given only to the so-called 'highly exporting users', i.e. companies that export at least 30% of total sales. These schemes have been designed following the pioneering Mexican tax refund system that is part of the ALTEX programme (see the previous subsection): the programme allows exporting firms to benefit from a quick recovery of the ad valorem tax on domestic inputs.

7.5.2 Export Processing Zones

Export processing zones (EPZs), providing benefits and exemptions to domestic and foreign firms locally producing, have proliferated in the last decade. They became popular thanks to the successful experience of the NICs at the beginning of their development process (Stein 2008).

Since the beginning of the 1990s, EPZs have been one of the most widely used strategies for increasing exports in Latin American countries (ECLAC 2004).

Almost all Latin American countries have indeed created EPZs with the only large country exception of Chile (Melo 2001). In Colombia, Special Customs Zones offer tax benefits to companies that set up operations in designated locations. In El Salvador firms located in FTZs are given a 20-year income tax holiday and duty-free schemes for imported materials needed for production. Countries in Central America seem to have benefited from EPZs, especially at the early stages of export growth in apparel, although the boom in some cases proved to be short-lived (e.g. El Salvador), and results are still under fierce debate (on Dominican Republic's experience see Kaplinsky (1993) and Willmore (1995)).

A comprehensive empirical analysis on the effects of EPZs is missing in the literature. Existing research indicates partial success in some countries, but only limited to exports and employment outcomes. Yet, very few cases passed a cost–benefit assessment (Jayanthakumaran 2003). Anecdotal evidence and some country studies confirm that results are generally disappointing: EPZs have generally been unable to generate the significant positive externalities they are theoretically predicted to yield.[14] There are however exceptions. For instance, Hinkle *et al.* (2003) argue that the EPZs created in Mauritius have achieved successful results as well as in Morocco, Philippines, Honduras and the Dominican Republic.

As documented by Ramachandran and Cleetus (1999), starting from the 1980s, the Chinese government extensively relied on EPZs and open coastal cities (OCCs). The open door policy was inaugurated in 1978 and consisted in favouring: (a) import of foreign capital, (b) import of advanced technology, (c) import of Western management know-how, (d) export promotion and import substitution and (e) investment in human capital. The locations of the first four SEZs were identified on the basis of their proximity to the regional world trading markets of Hong Kong, Macao and Taiwan, and were: Shenzhen, Zhuhai, Shantou and Xiamen. The objective was to create a policy environment and associated infrastructures that were exporter friendly, for both domestic and foreign producers, in geographically isolated and controlled areas with favourable characteristics thanks to their location. Firms locating in a SEZ were given preferential treatments in terms of taxation, import licensing and tariffs. Furthermore, while in the rest of China investments were under control of the central planning, in the SEZs they could be made by autonomous decisions. Over time, the scope of the SEZs has progressively been extended to cover more and more issues, also including: (a) free foreign exchange by foreign-owned enterprises, (b) insurance by foreign companies, (c) foreign trade restriction exceptions for approved enterprises, (d) port facilities for foreign enterprises, (e) new securities markets access for foreign firms, (f) reduction of tariffs and quotas, (g) infrastructure and reorganization of bureaucratic systems, (h) exemption from state subsidies paid to employees, (i) tax exemption on profits remitted abroad, (j) duty drawbacks, and others. The effects of Chinese

[14] For a thoughtful discussion of the characteristics and results of one such programme, namely the industrial specialization regime (ISR) in Argentina, see Sirlin (1999).

SEZs have been positive in terms of output growth, exports, employment and attraction of FDI, but they have not been evenly distributed among the geographic areas or among firms. The firms that benefited the most are private firms located in coastal regions, which are closer to the most important regional world markets. Moreover, not all sectors were supported. Targeted sectors were only the textiles, machinery and electronic goods, which are those where China enjoys comparative advantage. This strategy has been accompanied, starting from the 1990s, by a process of privatization of state-owned enterprises, and, starting from the WTO accession of China (2001), by a progressive (but very problematic) process of trade liberalization.

FIAS (2008) reports that in 2006 there were 91 EPZs in 20 sub-Saharan African (SSA) countries. The 51% of the total EPZ employment in SSA is concentrated in South Africa; however, a significant share of workers employed in EPZs also characterizes Mauritius, Lesotho, Kenya, Nigeria and Madagascar (ILO 2007). A systematic assessment of the African experience with EPZs is provided by Farole (2010a), who measures their effects on a number of economic indicators, and namely: investments, exports, employment and structural economic change. Results show that the African zones were unable to create a favourable climate for foreign investors and, in general (with the exception of Ghana and Lesotho), performed very poorly. None of the African EPZs played an effective role in triggering the expected structural transformation in the export sector. Mauritius is one of the few African successful cases. In this country the creation of EPZs stimulated the boom in sugar production and export earnings in the 1970s, and caused an increase in the investment in joint ventures between domestic and foreign investors in the special zones. Of course an important role was played by tax holidays and duty-free imports. However, the reason for the success of the Mauritius is due to the fact that the government of this country was able to create a business environment (UNECA 2010), by fostering demand and supply of better educated workers, spurring innovation by domestic firms, improving information dissemination, and several supporting institutions (see also Section 7.5.7).

In most of the other countries experiencing EPZs, attraction of foreign firms is primarily committed to advantageous tax treatments (Di Maio 2009) and consequently positive effects have not materialized at a national economy-wide level. Rodrik (2004, p. 8) argues that, in these cases, it would be fair to say that subsidizing foreign investors with the objective of increasing exports is a 'silly policy' because such a policy may result in transfers from poor country taxpayers to rich country shareholders.

7.5.3 Policies to Attract Foreign Direct Investment

Developed Countries

Different measures can be used to attract foreign direct investment (FDI), such as income tax holidays, tariff exemptions, and subsidies for the creation of infrastructures. For instance, as documented by Harrison and Rodrìguez-Clare (2009), in the 1990s the British government offered between US$30,000 and 50,000 per employee to attract Samsung and Siemens, whereas Ireland has attracted FDI through a corporate tax rate of (only) 10% to all foreign manufacturers who moved part of their production in Ireland (Görg and Strobl 2008). Strategies for attracting FDI in specific sectors have also been widely used. Alfaro and Charlton (2007) show that, considering a sample of 29 countries, the most targeted sectors worldwide include machinery, computers, telecommunications, and transport equipment.

Developing Countries

Several instruments can be used to attract FDI in developing countries despite the difficulties that characterize those economies.[15] In its report Economic Development in Africa, UNCTAD (2008a) critically reviews African countries' polices and strategies related to FDI in extractive industries. The government of Senegal provides a number of incentives to firms operating under the Free Export Company regime. These are the *zero tax* on salaries for foreign employers and dividends for foreign shareholders and no restrictions on the transfers of funds or recruitment of foreign staff. In addition, incentives for new foreign enterprises include: (a) the cancellation of VAT (for three years), (b) the provision of tax credits, (c) lower tax on profits, (d) the exemption from patent fee, property tax and license fee, (e) zero income taxes for stocks and shares.

Kenya adopts a more sector-orientated strategy. The Kenyan Investment Authority[16] provides a 60% allowance on investment in manufacturing and hotels and the offsetting of losses by future payable taxes. Some other countries have designed measures to attract FDI selecting only firms that are expected to contribute the more to the development process of the country.

The government of Malawi grants lower taxes on remittance and payments to foreign firms that provide training programmes or that invest in disadvantaged areas. One of the missions of the Malaysian Industrial Development Agency (MIDA) is to promote foreign investment in the manufacturing and service sectors. To this end, MIDA provides a number of incentives and different schemes. For instance, firms that have the 'pioneer status' pay 30% of statutory income for a period of 5 years; firms that operate locally for at least 12 months and incur qualifying capital expenditure to expand production capacity are granted with the 'reinvestment allowance'; foreign firms that invest in qualifying capital

[15] For instance, one crucial limitation to productive investments in Africa is the lack of adequate infrastructures (land, air and maritime transportation, electricity, water, and telecommunications). A good infrastructure system is an important precondition for export growth. Poor transportation and communication systems and the high cost of electricity and the unreliability of its provision increase transaction and production costs and are large obstacles to international trade. To have an idea of their importance, that generators represent the bulk of investment for small manufacturing firms (UNECA 2010).

[16] See www.investmentkenya.com/.

expenditure within 5 years are given 60% allowance under the 'investment tax allowance' scheme. Finally, the MIDA provides a set of incentives for SMEs consisting of tax exemptions. As part of the strategy to attract FDI, the MIDA also oversees the granting of manufacturing licenses and tax incentives.

The Thailand Investment Promotion Act established the Board of Investments (BoI) to attract foreign investment, with the objectives: (a) to support export and the demand for domestically produced inputs, (b) to promote the quality and the production standards of domestic producers, (c) to favour the growth of less-developed regions, (d) to support and stimulate SMEs by applying a minimum level of investment capital. To this end, it offers a number of incentives (e.g. *easy entry* to the country for foreigners interested in studying local investment projects, possibility of repatriation of money in foreign currency). In addition, all the tax incentives that are available for domestic exporting firms also apply to foreign firms.

Since the beginning of the 1990s, Latin American policies to support export growth have mainly relied on FDI attraction (ECLAC 2004; Mortimore and Peres 1998). For instance, the government of El Salvador provides unlimited remittance of net profits for most types of business and manufacturing, and up to 50% for commercial or service companies. It also provides no foreign exchange restrictions for foreign firms. While these policies have been largely used by Latin American countries in the last two decades, a systematic evaluation of their effects is still missing in the literature.

7.5.4 Trade Promotion Organizations

Governments have established trade promotion organizations (TPOs)[17] to facilitate and encourage exports (ITC 1994). The mission of the TPOs is to reduce the problems of imperfect information with the aim of increasing and diversify exports. The TPOs usually rely on a network of offices abroad in order to facilitate the information gathering on foreign markets and sales opportunities. Furthermore, TPOs provide a number of services, including (a) dissemination of information on export markets, (b) assistance in export marketing, (c) packaging and labelling, (d) quality standards management, (e) general training about export activity, (f) legal assistance, (g) assistance in obtaining export financing, (h) trade missions and trade fairs. They can be government-funded or operate through the private sector.

Developed Countries

In the United States the TPOs are mainly sponsored by individual states. Wilkinson and Brouthers (2000) conduct a survey on the effects of the activity of state government export promotion organizations (EPOs) on the international

[17] Sometimes the literature refers to them also as trade promotion agencies (TPAs), export promotion agencies (EPAs) and export promotion organizations (EPOs).

marketing efforts of 764 SMEs in the United States between 1992 and 1999. Two types of intervention are considered: trade shows and trade missions. Trade shows are an important promotional tool because they allow enterprises to gain customers, disseminate relevant information, acquire knowledge on the foreign markets and identify prospects and targets (Bonoma 1983; Seringhaus and Rosson 1991). Trade missions consist in meetings between buyers and sellers to promote sales in the overseas locations (Jaramillo 1992), advertise goods and identify business targets (Seringhaus and Rosson 1990), establish long-term relations with potential business partners (Seringhaus 1989; Spence 2003). Wilkinson and Brouthers (2000) evaluate the success of the activity of the EPOs by considering four measures of firm performance in foreign markets: sales growth in foreign markets, overseas market share, number of countries exporting to and overall export performance. The study hence evaluates the impact on these four measures yielded by trade shows and trade missions, controlling for number of employees, total company sales, export intensity and export barriers. The authors find that government sponsored trade shows have a positive and statistically significant effect, while export missions have no statistically significant impact on exports. Decisive conclusions on the effectiveness of the US export promotion strategy are, however, difficult to draw. Coughlin and Cartwright (1987), using cross-state data for 1980, find that the relation between state export promotion and export flows is positive even if there is significant diversity across states for the estimated elasticity. However, they are unable to detect causality since using cross-sectional data they cannot control for unobserved heterogeneity. Bernard and Jensen (2004), using plant-level data for the period 1984–92, find that, when controlling for possible determinants of export decisions, the effects of state expenditures for export promotion are negligible.[18] Gençtürk and Kotabe (2001) undertake a study on the effects of the export assistance programme implemented by the Midwestern states' governments. The results suggest that, using the authors' words, 'these programmes are neither a panacea nor a complete waste of resources' (p. 66). They find that export promotion increases profitability of exporting firms but not the volume of their sales abroad. The reason for the limited success of these interventions by the government can be ascribed to low firms' awareness of, and often reluctance to participate in, such programmes. This reveals once again the crucial role played by information dissemination. At the same time, the goals achieved (in the case of the Midwestern states' export assistance programme, the success in increasing firms' profitability and many other results documented in the present survey) show that these policies may be, and indeed often are, effective. Yet, given the resource constraints usually faced, such programmes should be targeted to specific needs, tailored to remove specific bottlenecks and weaknesses, geared to enhance key aspects of the national environment and of the international relationships, strongly

[18] However, their data is on relatively larger firms. Since most EPOs tend to target small and medium-sized firms, their sample may be excluding those firms for which such programmes are most effective.

based on performance-orientated goals, and continuously monitored by means of reliable evaluation systems.

Spence (2003) studies, using questionnaires, the effects of the activity of the TPOs on a sample of 190 UK companies in the period 1996–7. In particular, the author considers the effects of trade mission participation on export performance and relation building with foreign partners. According to the author, the key factors for the success of the programmes are: (a) improving market diversification in the international context, (b) maximizing the knowledge about specific targets and fostering the communication with potential partners prior to the mission, (c) enhancing the use of ICT, and (d) developing a close contact with customers through regular meetings.

Seringhaus and Botschen (1991) carry out a comparative study of the Canadian and Austrian export promotion systems. In Canada the export promotion services are provided by the Canadian Trade Commissioner Service. It is government-based and characterized by loose coordination, cooperation between federal and secondary levels of government and consultation with the private sector. There is however also a large number of other government-owned or government-controlled agencies that supply support to exporters, and a non-negligible number of private export promotion agencies, export clubs and associations with similar goals. The Austrian system is instead primarily managed at the private or quasi-private level and is characterized by an integrated organization structure that is responsible for strategic planning and training of the internationally involved firms. The organization operates at the national level but with special concern for regional needs. Services to exporters are mainly provided by the *Bundeswirtschaftskammer* (that is, a national chamber of commerce with broad structure and mandate), industry associations, banks and management institutes. The government provides financial support to export transactions, export guarantees and insurance. The empirical study by Seringhaus and Botschen (1991) is conducted on 271 Canadian enterprises and 312 Austrian enterprises. Overall, the survey-based research suggests that in both countries support and assistance to exporting private enterprises has not been enough. Interviewed companies, both in Austria and in Canada, would welcome further help to plan and organize their international involvement, more tailored programmes and greater involvement of private sector institutions, although Austrian companies turn out to be more willing to use the export support and training programmes. Yet, Van Biesebroeck *et al.* (2010) document that the programmes implemented by the Canadian Trade Commissioner Service have exerted positive effects on Canadian exporter performance, product and market diversification, and that exporters that make use of the programme export about 18% more than the non-programme users. These encouraging results are confirmed by the 'Canada's State of Trade' report (2010). Francis and Collins-Dodd (2004) have also conducted a study of programme impact evaluation on 183 Canadian SMEs in high-tech sectors segmenting firms by level of export involvement, distinguishing the different needs and obstacles they face, and found that sporadic and active exporters benefit the most from export promotion interventions, whereas permanent exporting firms receive little or no help from such programmes.

In Australia export promotion is implemented by Austrade (for the organization of the EPPs in Australia see Section 7.5.1). Among the various policy measures, Austrade also provides marketing services, through various programmes such as the Trade Start and the Export Access, and information services, through, for instance, the Market Information Service, the Trade Watch and other programmes and campaigns. Such programmes exploit the advances in the information and communication technologies and, consequently, make use of Internet-based marketing tools, free online trade information, websites, besides seminars, workshops, trade fairs, missions, presentations, marketing campaigns, etc. The Australian Trade Commission (2002) indicates that there is a positive correlation between participation in government programmes and number of successful intenders (that is, firms that plan to become exporters): the success rate of non-users of government programmes was 16%, while that of the programme users was 74%. Australian export performance has registered a significant increase in the period between 1994–5 and 2002–3, but, notwithstanding the clear objectives stated by the Australian government of doubling exports, the positive economic conditions, and the free trade agreements signed by Australia in such a period, export flows remained stable between 2002–3 and 2006–7 (Brewer 2009). Among the explanations for this outcome, one can mention the fact that some of the problems faced by firms in general and Australian firms in particular are beyond the control of the firm managers and cannot be dealt with at the firm level, such as exchange rate dynamics and international competition patterns (Mahmood 2004). However, the low effectiveness of the export promotion programmes also strongly depends on the low awareness about them by Australian entrepreneurs (Ali 2006). As Mahmood (2004) emphasizes, Australian firms (especially the small ones) face many difficulties associated to the internationalization process that affects the intention to export. Most of these difficulties are related to information, market identification, target and strategy planning, and risk evaluation. Yet, besides this, even when markets are identified, there are strong constraints related to the lack of proper equipments for marketing and promotion purposes. Awareness about export promotion programmes could be enhanced by interventions on the educational side (seminars, workshops, training programmes), the operational side (information about technical standards, customer lists, commercial legislation) and the promotional side (export subsidies, financial assistance, consultation, and advocacy).

As testified by the empirical inquiry conducted by Piñho and Martins (2010), exporting decisions by Portuguese firms are strongly constrained by problems of lack of knowledge about overseas markets and opportunities, lack of skilled personnel and suitable human resources and financial assistance. To deal with these problems, export promotion programmes have been implemented by the government, various trade associations and the European Union. Lages and

Montgomery (2005) carry out a survey on a sample of 519 firms to gauge the direct effects of export promotion on short-term export performance and the indirect effects through pricing strategy adaptation. The survey indicates that the final effect of export assistance on export performance is not statistically significant. Export assistance turns out to have a direct positive impact on short-term performance, but it has a negative indirect effect through the pricing strategy adaptation.

As stated in the Boston Consulting Group (2004) report, Denmark is implementing a vast array of initiatives to improve exporting performance mainly directed by the export promotion body, the Danish Trade Council (DTC) created in 2000. These involve (a) administration, (b) trade policy, (c) customer services, (d) marketing and advertising, (e) promotion of foreign investments in Denmark, (f) negotiation within the WTO arena, (g) export promotion programmes for SMEs, (h) export analysis, and (i) advisory services. These activities are integrated in a broader project that is aimed at creating a favourable environment for local exporters and foreign investors (see Section 7.5.7). The DTC, whose activity is assisted by a number of other trade promotion agencies such as the Danish Energy Authority, the Danish Export Credit Office and the Danish Chamber of Commerce, has actively operated in the recent years but the evaluation of the results obtained is not available yet. Nevertheless, the Growth and Innovation Framework (2004) reports that in 2001 the DTC participated in the export activity with a contribution amounting to the 6% of the current exports. The surveyed companies ascribed to this intervention a direct increase in exports of 0.6%. The report also found that, on average, every dollar spent on the DTC's services increased firm turnover by US$217.

Since 1999 the UK government's export promotion strategy relies on a series of export promotion measures provided by the UK Trade and Investment (UKTI) (Boston Consulting Group 2004). The UKTI is involved in a series of regional and national export promotion initiatives that are targeted to new, rather than existing, exporters and to onshore activities enhancing local enterprises exporting abilities, rather than offshore activities promoting national exports. The underlying mission of the UKTI is improving the supply-side to enhance the business performance of potential exporters. This has mainly implied coordination of government support for exporters and tying export promotion to economic policies to foster entrepreneurship, competitiveness and international involvement with a focus on initiatives that favour entire sectors rather than individual firms.

The New Zealand trade promotion strategy has also strongly relied on trade promotion organizations but with a stronger emphasis on information dissemination and consulting, rather than on market visits, meetings, trade fairs and trade missions (Boston Consulting Group 2004). The implemented initiatives have promoted an easier access to information for local producers and their partners, and guaranteed an improved matching between local exporters and potential buyers in the past three decades. Notwithstanding this effort and considering that without a counterfactual and rigorous analysis assessing the effective impact of the export promotion activities is difficult, the New Zealand export performance is still not satisfying.

The Spanish export promotion system has been growing in the last twenty years. It is government-based and implemented at the regional level; 6 out of the 17 regional governments (Andalusia, Aragon, Basque Country, Catalonia, Murcia and Valencia) have developed an extensive network of offices around the world over the last decade. Gil *et al.* (2008) find that EPAs have positive and statistically significant effects on exports flows and that these effects are greater for regional agencies than for national embassies and consulates.

Hauser and Werner (2010) describe and evaluate the impact of the German foreign trade promotion system. The system consists of three large institutions (the so-called 'three pillars for the promotion of foreign trade and investment') and a number (about 300) of other smaller institutions that operate at different levels and carry out foreign trade and investment promotion programmes. Hauser (2006) indicates that there are about 140 and more different export support measures. In spite of this huge mobilization of resources, the German system has failed to achieve positive and significant results in terms of exporting performance of SMEs that were its main target. In particular, Hauser and Werner (2010) conduct a quantitative-empirical survey with 615 German enterprises in 2005. The package of interventions considered include: (a) business seminars, (b) company pools, (c) cooperation symposia abroad, (d) export and FDI finance credits, (e) foreign trade consultancy programmes, (f) German centres, (g) Hermes export credit guarantees (see Section 7.5.5), (h) how-to-do-business-abroad publications and information offers, (i) investment guarantees, (j) participation in trade fairs abroad, (k) marketing assistance programmes, (l) matchmaking events abroad, (m) political support for projects abroad, (n) promotion of joint ventures, FDI and cooperation, (o) trade missions and entrepreneur trips, (p) training of foreign executives and staff, (q) services provided by Federal Government embassies and/or by representative offices of the state governments in foreign countries (Hauser and Werner 2010). The authors find that SMEs access trade promotion programmes less than large firms and the reason is that the system has been unable to plan and implement size-specific interventions to compensate for the lack of in-house resources available to small firms.

The success of South Korea in terms of export flows has been largely attributed to government EPPs. The Korean Trade and Investment Promotion Agency (KOTRA) was founded in 1962 and now counts about 97 offices abroad. In order to facilitate South Korean exports, the KOTRA provides information regarding foreign business practices, cultural and market conditions and it directly supports firms through its overseas investment support centres. Kang (2011) uses data on the budgets of the KOTRA's overseas offices in 78 destinations for the period 1994–2004. The analysis shows that an increase of 10% in the budget of the overseas offices has increased exports by 2.45–6.34%. This testifies that the network of the KOTRA offices located abroad has been a critical factor in the success of South Korea's exports.

Developing Countries

Trade promotion organizations are widespread in developing countries as well, and their characteristics are quite heterogeneous across countries. For instance, as for the ownership structure, they may be state-owned, private or characterized by mixed ownership structure. Even if different in the ownership structure, TPOs implement very similar activities. For instance, ProChile (Chile) and ProExport (Columbia) both carry out market research and, in conjunction with business associations and regional public/private consultative committees, contribute to the identification of priorities for exporters. Usually TPOs activities are sided by other institutions supporting exports. For instance, in Colombia a number of institutions operate in addition to ProExport such as Banco de Comercio Exterior de Colombia SA (BANCOLDEX), Centro de Información y Servicios de Comercio Exterior (ZEIKY) and Compañía Nacional de Seguros para las Exportaciones (SEGUREXPO). Yet, their effectiveness in supporting SMEs in their export activity turns out to be poor (Carazo 2007).

Some early studies have taken a negative assessment of TPOs in developing countries (Hogan 1991; Keesing and Singer 1991a,b; de Wulf 2001). In particular, Keesing and Singer (1991a,b) have argued that TPOs in developing countries are inefficient because of weak leadership, inadequate funding and inefficient bureaucratic executives.

In South Africa, the Department of Trade and Industry (DTI) implements selective interventions to promote specific sectors and their export activity. The Trade and Investment South Africa (TISA) is the institutional body that implements the policies of the DTI. The DTI has 48 diplomatic missions worldwide. Rather than providing generic export support, the TISA selects strategic industries and high growth potential sectors. One of the TISA's objectives is to identify new products and new markets and to facilitate exports by matching potential exporters with foreign buyers. Finally, it provides financial assistance to implement the export marketing and investment assistance (EMIA) scheme, which supports export activities by domestic producers and encourages FDI in the country (Department of Trade and Industry 2006). Van Aarde and Viviers (2007) argue that the DTI, in order to make its activity more effective, should expand the set of areas of information collection to cover the whole set of activities included in the EIMA scheme.

There are two different ways to try to assess the working of TPOs. One possibility is to look at TPOs' programmes users' opinions about the ability of the different instruments to increase exporting. For instance, Ten Kate *et al.* (2000) indicate the key services, in the opinion of Mexican exporters, provided by the national TPO to improve information gathering on foreign market access and financial assistance to SMEs for international involvement. The authors also find that Mexican exporters consider the activity of the TPO to be particularly important at the initial stages of the export activity: similarly, from their survey on the Chilean entrepreneurs, Macario (2000b) documents that TPOs' services are particularly effective for firms that are about to start exporting. Hashim and Hassan (2008) report the result of a survey of Malaysian SMEs, according to which the set of incentives provided by the Malaysian External Trade Development Corporation (such as special incentives to increase export, export credit insurance schemes, TPOs activities, duties and sales tax exemptions, and technology acquisition funds) positively contributed to their success in exporting.

There are few empirical evaluations of TPOs activities in developing countries. One exception is offered by Van Aarde and Viviers (2007) who describe the South African DTI's efforts in evaluating the effects of export incentives. Results show that the sectoral return on investment (ROI) for national pavilions produced 100% positive results, whereas the ROI for trade missions yielded 56% positive results.

Using firm-level data from Chile, Alvarez (2004) shows that the utilization of export promotion programmes (in particular the participation in government-supported export committees) is positively correlated to export performance of SMEs. However, trade shows and trade missions do not increase the probability of export success.

Recently, Volpe Martincus and co-authors have provided a number of studies on the characteristics of TPOs and on their effects in terms of intensive and/or extensive margins of export. In their analysis on Latin American countries, Volpe Martincus *et al.* (2010) find that in Costa Rica and Peru, the TPOs helped local firms to increase their export through diversification. In the case of Uruguay, this implied also entering new markets of destination. As for Chile and Argentina, TPOs led firms to increase both the number of markets served and the number of products exported. Interestingly, the effects are the larger the smaller and the less experienced in exporting the firms are. Finally, the Colombian case shows that the combination of different measures and activities makes the intervention more effective. According to the authors' findings, it turns out that the effects of TPOs are predictably larger:

(a) on the extensive margin of firms' exports (increase of the number of destinations or of the number of goods exported);

(b) on more differentiated products;

(c) on relatively smaller firms with limited past involvement in international markets;

(d) when services are bundled (rather than being provided by independent suppliers) and thus able to provide support throughout the entire export process.

Comparing TPOs and Embassies

It is important to compare the activity of TPOs and other public institutions that perform similar activities. Rose (2007) notes that embassies and consulates usually provide market information and identify sales opportunities for exporters.

These activities are shown to have a significant effect on countries' total exports with export increasing by 6–10% for each additional consulate in a sample of 22 exporting countries. Comparing Spanish regional agencies and embassies and consulates, Gil *et al.* (2008) show that the estimated impact is larger for the former than for the latter. Volpe Martincus *et al.* (2010) show that embassies and consulates contribute to the increase in the export of homogenous goods but are less effective than TPOs in increasing diversification of exports of differentiated goods.

Trade Fairs, Trade Shows and Others

There are a number of empirical analyses attempting to evaluate the impact of trade fairs on export performance. A report produced by KPMG (1994) computed the ROI of the Trade Fairs Support Scheme (TFSS) operated by the UK Department of Trade and Industry showing that the programme generated positive results. The report also found that sales of firms that attended overseas trade fairs increased on average by 19%, while 17% of participating firms increased employment as a result of the TFSS provision.

The different instruments used by TPOs may indeed have very different effects. Alvarez (2004), in his empirical investigation on Chile for the period 1990–96, finds no significant effect of trade shows and trade missions on export performance. On the contrary, access to market studies, frequent meetings with clients, authorities and experts and participation in exporter committees turn out to exert a positive and statistically significant impact on export.

Wilkinson and Brouthers (2000) use US state-level data and distinguish between the effects of trade missions, trade shows and foreign offices on export. They find that only trade shows are positively correlated with export. It is thus important to carefully consider the optimal combination of the different actions that a TPO may undertake and the optimal mix of actions for the different categories of domestic firms.

Volpe Martincus *et al.* (2010) conclude that the evidence on TPOs' performance and effectiveness is too scanty to draw definite conclusions.[19] There is some evidence that export success is correlated with the presence of this type of organizations, but very few studies have taken into consideration the issue of endogeneity and reverse causality. Further research effort is hence needed in this area.

7.5.5 Trade Finance Provision

Developed Countries

Credit access constraints still represent an important barrier to export even in developed countries because imperfections in the credit markets increase

[19] Note that this did not prevent the number of TPOs to increase around the world.

the transaction costs faced by firms that intend to export. To deal with these market failures, government may provide trade credit and trade insurance. For instance, trade credit provision is a widely used intervention both in the United States (Elliehausen and Wolken 1993) and in Europe (Egger and Url 2006) where it is handled by the national export credit agencies (ECAs). Since the 1980s, public trade insurance provision and export credit policies have however been more strictly controlled and their scope has been restricted by international authorities. In particular, the WTO ASCM's rules impose that premiums for export credit guarantees should be adequate to cover non-performing trade credit and operating costs. An attempt at harmonizing and coordinating rules and practices for trade credit and trade insurance among industrialized countries has been conducted by the OECD. Currently these measures, which require the premiums to reflect the underlying risk, are restricted to extra-OECD trade or to export credits of long duration.

Egger and Url (2006) provide an empirical study of the effects of the public export credit guarantees provided by the Austrian Public Export Credit Agency (Oesterreichische Kontrollbank) using export data for the period 1996–2002. The authors find that the impact of export credit guarantees is relatively small in the long run and requires a very long period to materialize.

Moser *et al.* (2006) illustrate the instrument of public export credit guarantees available to German firms (called Hermes guarantees) to mitigate the negative effects of political risk; their empirical inquiry covers German exports to 130 countries for the period from 1991 to 2003. The main justification for public intervention here is that private credit markets are unable to provide proper risk coverage to exporters and this may lead to underinvestment. There are two ways of providing export guarantees: (a) the ECA grants a supplier credit, meaning that the insurance is sold directly to the exporter, or (b) the ECA gives the insurance indirectly to the exporter by covering the default risk to the bank that finances the exporter. As emphasized by the authors, the interventions implemented by the public ECA are governed at the international level by various institutions, namely: the WTO ASCM, regarding the use of export subsidies; the Knaepen Package, regarding minimum risk-based premium fees for country and sovereign risks; the European Union, regarding the restriction of the public export credit activities to non-marketable risk. The authors find that the political risk is an important determinant of exports and that public export guarantees have a positive and statistically significant impact on exports.

As a part of the Australian Department of Foreign Affairs and Trade, the Export Finance Insurance Corporation (the 'financial arm of Austrade' – see Sections 7.5.1 and 7.5.4) is the agency that provides insurance and finance services to SMEs in order to increase export profitability and reduce the related risk (Molnar 2003). Financial measures include: (a) export credit insurance, (b) political risk insurance, (c) fixed interest rate finance scheme for foreign buyers of Australian products, and (d) direct or indirect (through banks using Export Finance Insurance Corporation's Export Finance Guarantee) credit provision to buyers. Molnar (2003) documents that between 1992 and 2002 the export volumes of firms participating in Export Finance Insurance Corporation's programmes have gradually and substantially increased.

Finally, in New Zealand, firms frequently cite lack of finance – particularly to meet working capital requirements – as a key barrier to export growth (Bell *et al.* 2000). Nonetheless, the University of Auckland Icehouse's experience with start-ups suggests that knowledge about access to finance is often a more crucial issue than its actual supply.

Developing Countries

Melo (2001) reports that 14 out of 26 countries in Latin America have some institutional scheme to provide credit to exporters. Credit to exporters comes from ECAs in 5 countries in the sample, and from special credit lines for exporters in national development bank in 6 countries. As expected, smaller countries (particularly in the Caribbean) do not provide credit facilities but they rely on grants from the Caribbean Export Development Agency to finance their exporters' activities. Export credit agencies usually provide exporters with two types of loans: (a) loans to finance working capital, and (b) loans to finance fixed investment costs. The authors report that 14 out of 26 countries provide only credit to finance working capital, while 10 have programmes that in addition finance also fixed investment costs. Only 7 countries provide buyers' credit (i.e. loans to foreign buyers of domestic exports) and provide credit insurance services to their exporters. In Argentina and Brazil, the national development bank offer, in addition to the activity of the national ECAs, dedicated credit lines for the export of capital goods.

Besides standard credit schemes, there are also other financial services that are increasingly used to promote exports. One of these is the factoring service that allows firms with foreign creditworthy buyers to sell their accounts for immediate cash. This financial tool entails: (a) credit protection, (b) accounts receivable bookkeeping and (c) collection services and financing (Klapper 2006). It has been extensively used by both developed and developing countries, and, in particular, by China, Mexico, Turkey and Brazil, providing profitable opportunities for exporters and SMEs.

Evaluating the effects of export credit and financial programmes in developing countries is particularly difficult because of data limitations. One possibility is to look at the users' opinions about these programmes. According to Macario (2000c), Colombian exporters positively evaluate the activity of export credit provision offered by Bancoldex. Exporters extensively use these services because of two main advantages they provide: (a) interest rates that are lower than the market ones, and (b) credit availability for longer periods with respect to commercial banks. In their survey on Malaysian SMEs, Hashim and Hassan (2008) show that entrepreneurs agree that most of the 10 different types of incentives offered by the Export Import Bank of Malaysia (such as bank letter of credit and policy, buyer and supplier credit facility, overseas project financing facilities) played a positive role in increasing export.

7.5.6 Removal of Trade Barriers and Standard Compliance

Some authors have argued that an effective way to increase exports from LDCs is removing trade barriers and domestic supports in developed countries to agricultural commodities such as cotton, sugar and groundnuts.[20] It is well known that these protectionist measures have several negative effects for LDCs, including the reduction in their terms of trade. While developed countries have committed themselves to reduce these trade restrictions for agricultural products in the Doha Round, such agreements have not been implemented yet.

However, one should not expect too much from further trade restrictions removal to foster LDCs' export growth for three reasons. First, given the current state of the Doha Round negotiations, one cannot be too confident about the fact that these impediments will in fact be removed. Second, a number of case studies have shown that the most critical constraints on developing countries' export growth are domestic. Finally, one may also note that most agricultural primary commodities and minerals, in which developing countries have comparative advantage, are not produced in developed countries, and market access is already relatively open for unprocessed exports of these commodities.

A related issue is that concerning sanitary and quality standards. A major challenge for developing countries' exporters is that of complying with increasingly demanding developed countries' health and safety norms and requirements (see UNECA 2010). One effective way to contribute to increasing export is to provide firms producing in LDCs with the necessary support to obtain the certifications required for the access to the global value chains, especially in the agro-industry.

One additional obstacle to export growth in LDCs is the use of export taxation, although this is nowadays not a very common practice (see the discussion by Henkle *et al.* 2003).

With regard to developed countries, Smeets *et al.* (2010) document that Dutch exporting firms may benefit from the removal of trade barriers: the amount of the potential benefit varies depending on the importance of the destination country, and the impact may be different depending on whether one considers the export volumes (intensive margin) or the decisions to start exporting (extensive margins). For large countries, export volume decisions are much more responsive to trade costs and trade barriers (two or three times more) than export decisions, whereas for small countries trade barrier removal has similar effects on export decisions and export volumes.

The Boston Consulting Group (2004) highlights that the multilateral trade liberalization has been a key determinant of the increase in the world trade flows in the last two decades. Then a further reduction of the remaining trade barriers would be desirable. Yet, this is not an obvious outcome of the current

[20] Also, Latin American countries have tried since the beginning of the 1990s to increase export mainly through international trade negotiations to obtain access to new markets (ECLAC 2004).

negotiations, especially because of the actions of interest groups in both the United States and the EU (for the theoretical background, see Grossman and Helpman (1994), and for empirical evidence on the EU see Belloc and Guerrieri (2008)).

7.5.7 Improving the Investment Climate and Other Complementary Policies

A complementary strategy to foster the domestic export performance consists in improving the investment climate. A good example about the way this can be done is offered by Denmark (Boston Consulting Group 2004). Rather than investing public resources to furnish direct support to exporters or potential exporters, the Danish government's efforts have been addressed to create a favourable economic and administrative environment for domestic enterprises and to provide them with the conditions for a successful international involvement. Such targeted policies entail (a) the removal of financial constraints, (b) education and training programmes, (c) a flexible and entrepreneurial workforce (a well-functioning university system, specialized training facilities, regional entrepreneur parks, tax breaks for foreign workers with skills shortages), (d) investment in R&D and advanced technologies, (e) incentives for collaboration between public and private entities, (f) improved access to venture capital (Danish Investment Fund, state-owned financial companies, loans provided on commercial terms, incentives to pension companies to invest in small and innovative businesses), (g) market liberalization (such as those implemented in the electricity market (2003), or in the gas market (2004)), (h) the removal of bureaucracy or administrative constraints to business activities (such as simplification of processes with online forms and of tax payment procedures for SMEs).

A similar strategy has also been implemented by New Zealand as documented by the Boston Consulting Group (2004). The underlying idea is fostering a positive business environment through unilateral trade liberalization, privatization and deregulation. These policies in the most recent years have led to a change in the product portfolio of New Zealand manufacturing away from the domestic market towards export markets. However, structural bottlenecks still present in the national economic system seriously hamper international competitiveness.

To create a favourable domestic investment climate, complementarity between EPPs and additional policies is crucial. Among the other factors, the following are important (Clarke 2005).

Enhancing the financial system. In many developing countries, the financial system is unable to provide long-term credit to the local private sector.

Simplifying the tax system. In most developing countries, the tax system is complex and its burden is borne only by the formal sector that is typically only a small part of the economic system.

Improving the customs procedures. Administrative procedures are typically very complex and cumbersome. Ineffective trade procedures, mainly customs, are in many cases more costly than import and export taxes.

7.6 Concluding Remarks

Exporting Matters

Increasing export is among the highest priorities of any government in both developing and developed countries. The reason is that increasing export is expected to lead to higher growth (see Giles and Williams 2000; Harrison and Rodríguez-Clare 2009). In the last three decades, the proper strategy to increase export was argued to be trade liberalization and the reduction of government intervention in the economy. This view has recently changed. It is nowadays more recognized that free trade and no government intervention are not always optimal strategies given the weak economic structure of most developing countries and the presence of numerous market failures. Yet, there is still strong disagreement on the way (and the measure) in which governments should intervene to increase domestic export.

(Almost) All Countries Use EPPs

In this paper we have reviewed the empirical literature on the EPPs that have been implemented in both developing and developed countries in the last few decades. The purpose was to identify which practices were successful considering the different countries’ experiences.

As we have seen, almost all countries in the world have implemented some form of EPPs. Yet, while some of these polices have been used for decades, the way in which they combined and implemented have been changing dramatically. Our analysis has also shown that, besides few common characteristics across nations, each country has its own peculiarities concerning the strategy to promote export. It follows that the other countries’ past and current experience can only provide a clue from which each country should find its own way. This interpretation is in line with the view expressed by Rodrik (2010) that the optimal policy is not a set of instruments, but rather a process through which each government (in collaboration with the private entities) learns which policy mix is optimal given the domestic demand and production structures and the external circumstances affecting them.

What Does the Evidence Say about the Effects Of EPPs?

In this paper we have reviewed the empirical evidence concerning several policies and measures to promote exporting, namely: export subsidies, EPZ, TPO, FDI attraction, trade and finance provision.

Empirical evidence from both developed and developing countries suggests that the effects of export subsidies (in the form of direct subsidies, duty drawbacks and tax exemptions) are country specific. In general, export subsidies have not been very effective in increasing exports and, in any case, they usually do not pass the cost–benefit analysis. Regarding the use of duty drawback and tax exemption schemes the evidence is mixed, but somehow more in favour of their positive effects. This is especially true for the duty drawback schemes that turn out to be particularly useful for SMEs, which mostly suffer from the external tariffs on imported inputs used into production.

Export processing zones are a hotly debated measure for export promotion. They do not appear to have been as beneficial as many policymakers expected them to be. While there have been successful cases (see, for instance, China and Mauritius), the existing literature is not conclusive about the optimal conditions for the success of EPZs in terms of export increase and economic growth. In particular, EPZs have not brought about the expected results in terms of technology transfer or knowledge spillovers. In most of the cases, export has increased, but this was not sufficient to bring positive effects at the nation's economy-wide level, since the spillovers from EPZs to the other regions in the country have in general been negligible. Since the number of countries using EPZs is rapidly increasing and their creation and management are resource consuming, a rethinking of their role and a careful evaluation of their effectiveness are necessary. For instance, Sierra Leone, where starting to export is currently a lengthy and complicated process for domestic firms (World Bank 2011),[21] has recently resorted to this measure in the attempt to increase export. One may therefore ask: are there any guidelines that a government should follow to make EPZs most effective?

While there is not a unique model for zone design and development, Farole (2010b) describes some elements that characterize the successful EPZs. A number of preliminary conditions have to be met. First, EPZs cannot be thought to be the engine of economic growth of a given country, but they should only be used as a part of a broader package of industrial, trade and economic development policies. Second, both the government and the private sector should be involved in the managements of the EPZs. Also important is that the government's commitment in the EPZ development turns out to be credible and that incentive schemes maintain stability over time. Finally, a monitoring mechanism of the activities in the EPZ and the establishment of clear standards regarding environmental, labour and social compliance are required.

The choice of the location for the EPZ is a strategic matter. First, the chosen location should be either close to large final markets or easily accessible to them. Second, it should be an attractive place due to the presence of both backward linkages (demand effects generated by the linkages from the final good producers to the producers of the intermediate goods) and forward linkages (cost effects generated by linkages from the suppliers of the intermediate goods to the producers of the final goods). Third, the location should

[21] For instance, as of 2008, there was no duty drawback scheme in place (UNCTAD 2010).

enjoy a good investment climate and access to good infrastructure and trade facilitation. The practice (in the past much more common than today) of creating EPZs in remote or depressed zones should be avoided. Interestingly, according to Farole (2010b), trade preferences and fiscal incentives are not correlated in a significant way to the EPZs' economic outcomes. This indicates that, rather than focusing on cost incentives, the government should work to provide an improved investment climate, effective legal, regulatory and institutional framework and efficient physical infrastructures. Finally, FIAS (2008) reports that there is some evidence that privately managed EPZs outperform government organized ones.

Farole (2011) suggests that the activities to be located in the EPZs are those related to sectors in which the country enjoys a comparative advantage. In several developing countries these are agriculture, minerals, oil and gas, and tourism. It follows that future zones should not be designed to replicate the traditional EPZ model of assembly of imported components.[22] Another important (and somewhat provocative) conclusion is that, given the available evidence, attracting existing domestic SMEs into EPZs seems not to be an objective to pursue. A better strategy could be trying to create and strengthen linkages between local SMEs outside the zone and the firms producing in the zone. As we said, it is crucial for the success of EPZs that the government provides the economy with a set of complementary measures, such as an automatic duty drawback scheme and a VAT system with an efficient reimbursement mechanism. It could also be recommended to allow direct duty-free import of selected inputs used in the production of exported goods. One important issue concerning EPZs relates to WTO prescriptions. At present the WTO makes no clear-cut restrictions on EPZs; however, this will probably be done in the near future. As a consequence, countries could widen the scope of EPZs to reduce possibility of a clash with the WTO rules.

The TPO is another important instrument for export promotion. Recently the evaluation of their effect has attracted the attention of researchers and policymakers. The evidence shows that in several cases TPOs have had a positive impact in terms of increasing both export volumes and export products' diversification. They have also proved to be more effective when focused on solving the specific needs of firms. Still, in most of the cases, survey-based research suggests that support and assistance currently provided to exporting firms is not considered enough by domestic entrepreneurs. Most LDCs are nowadays creating their own TPOs. Hence, one may ask: given the collected experience worldwide, which are the characteristics that a government in an LDC that has decided to set up a TPO should focus on? Consider again Sierra Leone. The Sierra Leone Investment and Export Promotion Agency (SLIEPA) was created by the government in 2007 to promote investment and export development through personalized services and information to investors and

[22] The expiration of the Multifibre Agreement and the end of the African Growth and Opportunity Act (AGOA) have largely contributed to reduce the potential of such EPZs.

exporters. How can the government improve SLIEPA's intervention?[23] While to answer such a question requires a detailed look at the particular circumstances of the considered country, the empirical literature here reviewed may give some clues. For instance, the empirical findings by Volpe Martincus *et al.* (2010) suggest that one crucial feature for a successful TPO is that it provides multiple bundled services, i.e. provides support throughout the entire export process, rather than support on selected services.

Attracting FDI has long been one of the most used strategies by developing countries to increase exports. Nowadays this idea is losing appeal because of the disappointing results achieved in the past. In most of the developing countries, FDI has been directed mainly to (extractive) natural-resource sectors that usually have few linkages with other sectors of the economy. Since these sectors are usually highly capital-intensive, they generate low labour demand. There are still very few cost–benefit analyses on this issue to draw final conclusions; however, the available evidence suggests caution is necessary. Governments should not push too much with this instrument unless there is a clear development strategy behind it, as in the case of the Chinese strategy to promote joint ventures in high-tech sectors (Harrison and Rodriguez-Clare 2009).

Studies on the effects of EPPs generally point out that credit and export guarantees are important to increase the probability of exporting, especially for SMEs.

Finally, increasing access to the world markets through the removal of tariff protection is another possible strategy to increase exports. Actually, this is one of the fiercest requests advanced by the developing countries during the negotiations of the Doha Round. However, the removal of trade barriers by developed countries alone is unlikely to increase the exports of developing countries significantly. Preferential treatments and the regional trade arrangements may also be helpful, but eliminating domestic supply constraints is usually more effective (UNCTAD 2008).

Best Practices in EPPs

This survey has shown that there are a number of instruments expected to be effective in supporting exports. Among the traditional measures, the duty drawback scheme is, as the existing surveys of entrepreneurs' opinions seem to suggest, one of the most effective. Macario (2000a) suggests two ways to improve the duty drawback mechanism: (a) making it accessible to indirect exporters[24] and granting domestic companies to pay lower tariffs on imported

[23] The SIEPA (2010) has also prepared a National Export Strategy Paper, which outlines plans to improve productivity standards and exports for a number of products. This is another confirmation of the commitment of the government to reach important results in terms of export growth.

[24] An indirect exporter is defined as a firm that sells its product to a trade intermediary in its own country, who then goes on to export the good.

goods used into production; (b) eliminating any form of duty payment for exporters. This would considerably reduce the funds needed for working capital of exporting firms.

A second crucial aspect is the availability of credit for exporters. This is a particularly relevant topic for SMEs for which the credit constraints are more binding than for large firms. Since SMEs are the large majority of firms in developing countries, if export growth has to be achieved governments have to take some actions in this domain.

Third, the government should simplify regulation related to export: long bureaucracy procedures negatively affect the new exporters especially. At the same time, governments should improve information collection and dissemination about foreign markets and requirements for exporting. Actions in this category should also be addressed to the crucial issue of making export products and services comply with the requirements and rules of developed countries markets.

Besides traditional forms of intervention, a number of other possible measures can be implemented by developing countries to support export growth. Improving cooperation among exporters and between government and business actors has been one of the strategies suggested by UNIDO since the mid 1990s. For instance, there is nowadays an increasing awareness about the possibility of using export consortia[25] to help SMEs overcome the obstacles to the international markets access. This may be seen as a complement to other forms of government intervention.

Finally, policies for long-run export growth must also be considered. In this context, it is important to exploit the complementarity between EPPs and the set of policies aimed at improving local firms' productivity and technological content of domestic produced goods.

Evaluating EPPs

Evaluation of EPPs is obviously a very complicated matter. There is large cross-country heterogeneity in terms of evaluation practices, and the quality is in general quite low. For instance, TPOs are usually evaluated using input measures (i.e. number of missions organized) rather than output measures. Moreover, to evaluate any EPPs, one should also look at some other performance measures such as the return on investment (ROI) of these activities.[26]

Programme evaluation is crucial for two reasons. First, a well-designed evaluation programme is likely to provide useful information to enhance the export promotion strategies. Second, knowledge about the benefits of such policies may be able to increase firms' willingness to apply for them. In fact, one of the main weaknesses of several export promotion strategies is that firms

[25] An export consortium is a formal voluntary alliance of firms with the objective of promoting exports of goods and services of its members through joint actions.

[26] The latter is the ratio between the total cost of export assistance and the actual export sales.

do not take full advantage of the EPPs, either because they are not aware of them or because they believe the policies are ineffective. Indeed, many studies have emphasized that the lack of awareness by the local entrepreneurs contributes to explaining the partial failure of export promotion initiatives. Awareness about export promotion programmes can be enhanced by interventions on three distinct but complementary aspects: (a) educational (seminars, workshops, training programmes), (b) operational (information about technical standards, customer lists, commercial legislation), and (c) promotional (consultation, advocacy, and marketing).

The availability of ICT has been shown to be particularly useful in enhancing awareness about and use of EPPs; but also close interaction between private and public entities through regular meetings is crucial (e.g. Spence 2003). Widespread use of improved ICT, therefore, cannot replace direct contact for relationship building and cooperation at different levels. It is interesting to note that the direct contact between exporters and high government officials was one of the characterizing features of the Developmental State in South Korea in the 1970s (Amsden 2001).

The Role of SMEs

There is an ongoing debate among economists and policymakers about the role that SMEs should play in the development process and the actions the government should direct towards them. Some authors have expressed scepticism concerning policies aimed at training and advising SMEs for international involvement. There are two main reasons for this. First, it is argued, these policies require special government capabilities that at present cannot be (in general) found in LDCs. Second, SMEs do not export because they are not productive enough; so governments should not be committed to help them in exporting but rather to identify the reasons why they are incapable of achieving the productivity threshold to become exporters (see, for example, Melitz 2005). However, there are some constraints to exporting, for instance informational problems, that are not necessarily due to the smaller size of the firm. These information problems may, in particular, be related to the quality standards imposed by foreign buyers and the rules established by the international trade agreements. In these cases, export-favouring measures directed towards SMEs should be considered.

Government Capabilities and the Domestic Institutional Environment

Export promotion strategies have historically been characterized by the participation of both the government and the private sector, at different degrees in different countries. Identifying a unique and optimal model is not possible, given that either one depends on the institutional environment where it operates. However, the strategic collaboration between different levels of the government (regional and national level for instance) and the private sector should be favoured and considered as a key element for the policy success (see also Hausmann *et al.* 2008). For this to be possible and effective, however, certain government capabilities are required.

According to Ten Kate *et al.* (2000), one successful example to look at is Mexico. The Mexican government has designed effective programmes, provided a number of different services to exporters and reduced to the minimum the bureaucratic export formalities, fully abiding by WTO rules. The key factors for the effectiveness of these programmes is increasing government efficiency and strengthening government capabilities (training and motivating human capital, for instance). Indeed, a prerequisite of any successful EPP has to do with the given government's ability to design, apply, enforce and monitor the implemented policies. It follows that the policy mix suggested for a given country must be tailored on the bases of specific national government and national agencies' capabilities. These considerations could lead to very practical criteria of policy design that may suggest which policy to implement depending on which governmental institution is more efficient (less corrupted). Adopting such criteria could minimize resource waste and reduce rent-seeking by domestic powerful groups. In particular, this argument suggests not applying a certain policy mix only because it was successful in another country. The same policy implemented in two different countries may yield completely different outcomes. The country-specific institutional environment is indeed crucial for policy results (see, for example, North 1990). and policy complementarities make these arguments even more compelling.

What Can Be Done to Improve EPPs?

Successful export promotion strategies have clearly defined priorities, goals, and objectives, and in particular aim to

1. create a favourable domestic enabling environment for potential exporters (in terms of infrastructures, regulation, access to finance, insurance, 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. negotiate for a favourable international environment (multilateral relations, international trade forum, regional agreements),
6. work to build the country image in foreign markets (through marketing, information provision, advocacy),
7. offer targeted and tailored assistance, and rely on continuous evaluation,

8. be supported by monetary and fiscal policies designed to improve the enabling environment,

9. stimulate institutional development, also considering institutional complementarities.

Cooperation between the government and the private sector is crucial in order to identify distortions, bottlenecks and weaknesses to be addressed case by case. It is important that the policymakers understand the requirements of the exporting firms in order to create a favourable environment and design effective instruments to increase export. Tailored assistance is needed in an increasingly complex environment where the challenges to face are context-specific, country-specific and even firm-specific. Export promotion policies need to be designed in order to satisfy the requirements of different types of firms depending on the size, the age and the export experience. For instance, firms at different stages of export involvement have different needs. Here, identifying the target is particularly important.

(a) In the first stage firms need to get ready and be motivated to export. This implies that they need assistance to get informed about export opportunities, degree of international competition, risks and potential benefits (besides resource availability when imperfect credit markets are present), and thus organizational and managerial capabilities/competencies should be consequently enhanced (Czinkota 1996; Seringhaus and Rosson 1990).

(b) In the second stage, firms need support in export planning and international involvement strategy design.

(c) In the third and final stage, firms need support in selling their goods and services abroad.

Finally, one should consider that EPPs may affect export performance either directly, through the set of policies with direct influence on foreign trade, or indirectly, through the set of policies that have their direct influence in other aspects of the economic systems (e.g. monetary and fiscal policies, production and price controls, investment policy, exchange rate policy) but, in turn, are able to indirectly influence foreign trade performance. All these policy measures cannot be considered in isolation: important complementarity in policy processes must be always taken into account. Not only it is the case that which policy is implemented matters, but also which policy, in which situation, and in the context of which policy mix. We hope that this paper – identifying the best practices and, at the same time, emphasizing the policy, institutional and economic complementarities that make successful stories context-specific – might provide some contribution to guide governments and the private sector in the thorny matter of export promotion.

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Chapter 8

LESSONS FOR DEVELOPING COUNTRIES FROM EXPERIENCE WITH TECHNICAL AND VOCATIONAL EDUCATION AND TRAINING

By Christian Kingombe

8.1 Introduction

This literature review paper examines the lessons learned from the experience in developing countries, particularly in Africa, in the design and implementation of strategies and policies for technical and vocational education and training (TVET) with the aim to inform national policies in Sierra Leone.

There are several dimensions that can be used to describe TVET, for example, its venue (company-based, apprenticeship, school-base), character (initial, continuing), etc. It has been agreed by UNESCO and ILO to jointly use the term TVET. There has also been discussion to add TVET to the UNESCO 'Education for All' (EFA) and 'Education for Sustainable Development' (ESD) initiatives (Maclean *et al.* 2009; see King and Palmer 2006). *The definition of TVET* adopted by them is:[1]

> Those aspects of the educational process involving, in addition to the general education, the study of technologies and related sciences, and the acquisition of practical skills, attitudes, understanding and knowledge relating to occupations in various sectors of economic and social life.
>
> UNESCO 1999

King and Palmer (2006) find in their review that *skills development* is increasingly used by donors as the preferred term for what used to be called TVET or VET; but in the field and at the country level, policymakers and employers

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[1] TVET, VET and career and technical education (CTE) are almost identical in meaning. What is most prominently used depends on what part of the world you are talking about. Source: TVETipedia.

continue to use the older terminology of vocational, technical and agricultural education and training (see DFID 2007; Palmer 2007a).

This chapter follows a related but different definition by the Association for the Development of Education in Africa (ADEA). The ADEA defines 'post primary education' as being all-inclusive, and including the following dimensions:

- all forms of learning, e.g. non-formal and informal;
- all modes of delivery, e.g. distance learning, apprenticeship;
- all types of settings/venues, e.g. community schools, work sites.

It also sees 'post primary education' as holistic, including:

- traditional 'general' secondary education;
- development of life skills and key competencies;
- technical and vocational education and training (ADEA 2007).

The 2008 Biennale in Maputo validated the paradigm shift consisting of the integration of formal, non-formal and informal pathways to knowledge and skill acquisition into an integrated, coherent education and training system. The 2012 ADEA Triennale in Ouagadougou continues the work begun at Maputo and underscores the importance of the further changes to be made to the design and build education and training systems that can face the current and future challenges of sustainable development (ADEA 2011b). In fact, the key concepts of ADEA's 2012 Triennale connect the various *definitions of skill to that of sustainable development* through the notions of efficiency and effectiveness. They are summed up as follows.

The concept of skill. Skills is defined as 'combinatory knowledge that uses and integrates theoretical, procedural and environmental knowledge, know-how and life skills to resolve problems, make decisions, carry out plans, etc'.

The concept of sustainable development. This gives added richness to the various meanings of the concept of skill, in that it orientates them toward a multidimensional development process.

The concept of lifelong learning. The theme of the Triennale redefines the concept of basic education by broadening it to include the opportunity, for any young or adult, to acquire the key skills constituting the theoretical and practical foundation that is essential for lifelong learning (ADEA 2011b).

Along the same lines, Radwan *et al.* (2010) argue that in order to achieve the African Continent's development aspirations, young people need to have access to an education that will enable them to enhance their standard of living, become aware of health issues, achieve their desired family sizes and gain *competitive (lifelong technical and vocational) skills (for sustainable socio-economic growth)* that will be in high demand in the labour market(s). De Largentaye

(2009) recalls that vocational training is only one of several instruments for employment generation. Whereas vocational training can develop appropriate skills and thereby improve labour supply and the *'employability'* of the workforce, the demand for labour depends on incentives for investment, including prices, the exchange rate and generally, the business climate in the country.

The African Union's (AU's) Plan of Action for the Second Decade of Education (2006–2015) recognizes the importance of TVET as a means of empowering individuals to take control of their lives and suggests the integration of vocational training into the general education system. However, the integration of TVET strategies into comprehensive employment policies remains a challenge in most African countries. Many interventions in the (formal) labour market are clustered under the title *'active labour market programmes' (ALMPs)*. Such ALMPs may lead to direct job creation (through demand-side interventions such as *a new public works programme (PWP)*), help the unemployed fill existing vacancies (through supply-side interventions such as *retraining* to meet the new job requirements), or improve the functioning of the labour market (through labour market intermediations, e.g. *employment information and labour offices*) (Dar and Tzannatos 1999).

When planning for TVET, policymakers and decision makers should be able to make informed decisions about whether the intended ALMP objective ('benefit') is met, and at what cost, supported by evidence-based information. There is, unfortunately, a paucity of evidence-based information about TVET, particularly in sub-Saharan Africa (SSA). This chapter aims to contribute to filling that critical information gap by re-examining the world of TVET and its diverse aspects and documenting them in order to provide the best answers and best practices to *improve TVET in Sierra Leone*. This is done by recent trends in TVET with regards to the restructuring of formal and non-formal education systems to ensure relevance of education and training in response to the changing patterns of employment, the needs of the labour market, and the rapid pace of change in technology and communications. The chapter particularly focuses on identifying challenges and opportunities for low income, fragile and post-conflict countries to help the government of Sierra Leone in its *search for an appropriate demand-driven* (i.e. programmes meet the needs of the economy, society and communities) *and good-quality TVET system*, which will equip more young women and men particularly in the informal economy with skills that will improve their employability in more productive and decent work.

The chapter builds on previous work undertaken for the 2008 edition of the African Economic Outlook (AEO), which provides a snapshot of TVET in 34 African countries. It also draws on the seminal UNESCO–UNEVOC International Handbook of Education for the Changing World of Work (Maclean *et al.* 2009), which is the first reference tool of its kind providing a comprehensive coverage of all the twelve important areas we discuss in this chapter. The review also uses official TVET documents, the French Development Agency's (AFD's) survey in seven African countries on experiences of support to TVET in the informal sector, World Bank, IADB and ILO studies, successful case studies as well as the academic literature using statistical approaches and a few socio-anthropological studies.

The chapter is structured as follows. Section 8.2 provides a brief stocktaking of statistical enrolment data from UNESCO as well as of the available quantitative evidence on the impact of TVET. Section 8.3 presents and discusses different institutional and strategic TVET frameworks. Section 8.4 discusses the importance of a demand-orientated TVET system. Section 8.5 discusses the various existing and potential sources for the financing of the costs of different forms of TVET. Finally, Section 8.6 concludes and presents a number of policy options pertaining to each of the preceding sections of the chapter.

8.2 Stocktaking of Statistical Evidence

Skills development and TVET have recently returned to the international policy agenda. A TVET and skills strategy has been launched by UNESCO reflecting a growing interest in the skills agenda (King 2009).[2] The forthcoming 2012 *Education for All Global Monitoring Report (GMR)* will focus on skills development, emphasizing strategies that increase employment opportunities for marginalized groups. Most of the UNESCO data presented in this section refers to the school year ending in 2007, and are based on survey results reported to and processed by the UNESCO Institute for Statistics (UIS) before the end of May 2009. The weakness of the UIS data set is that it does not capture all aspects of the holistic ADEA Post-Primary Education definition. This is a challenge that the forthcoming GMR should attempt to address.

Globally, the number of secondary students at the age group from 10 to 18 years enrolled in TVET increased from 46.6 million in 1999 to around 54 million in 2007 with the percentage of females remaining around 45%. The 16% increase in TVET was slightly lower than the 19% increase in total secondary enrolment (including both lower and upper secondary enrolment). During the same period the world's youth unemployment fell slightly from 73.5 million in 1999 to 72.5 million in 2007, after which it rebounded due to the global crisis. This fall is equivalent to a fall in the world's youth unemployment rate from 12.6% in 1999 to 11.8% in 2007 (ILO 2010, 2011). The increase in TVET enrolment was driven by both the economies in transition (EiT) and the developing countries which recorded an increase of 26% and 28%, respectively, whereas the OECD experienced a fall of 10%. However, the enrolment rates and TVET's percentage share of total secondary enrolment vary widely among regions (Table 8.1).

In both 1999 and 2007 TVET programmes accounted for 36% and 32% respectively of total secondary enrolment in the Pacific, far above the other regions. At the other end of the spectrum TVET is far less common in South and West Asia (2%) and the Caribbean (4%) in 2007. Although the share in Central Asia and SSA is lower than in Central and Eastern Europe (16%) and East Asia

[2] Source: www.britishcouncil.org/goingglobal-gg4-skills-development.htm.

TABLE 8.1. Enrolment in secondary education, 1999 and 2007.

Country or territory	School-age population 2006 (total)	Total enrolment: School year ending 1999		Total enrolment: School year ending 2007			Enrolment in private schools as % of total enrolment: School year ending		Enrolment in technical and vocational education: School year ending 1999			Enrolment in technical and vocational education: School year ending 2007			
		Total	% F	Total	% F	Δ (%)	1999 (med.)	2007 (med.)	Total	Share	% F	Total	Share	% F	Δ (%)
World	782,790	436,797	47	518,721	47	19	11	11	46,649	11	45	54,024	10	46	16
Transition countries	29,135	31,719	49	26,261	48	−17	0.1	0.7	2,713	9	40	3,428	13	40	26
Developed countries	82,951	84,564	49	83,335	49	−1	6	7	15,023	18	45	13,553	16	43	−10
Developing countries	670,705	320,514	46	409,125	47	28	16	15	28,913	9	46	37,044	9	47	28
Arab states	42,556	22,682	46	27,453	47	21	9	10	3,297	15	43	3,157	11	43	−4
Central and Eastern Europe	36,792	39,582	49	32,375	48	−18	0.6	1	7,286	18	41	6,385	20	39	−12
Central Asia	11,470	9,356	49	10,891	48	16	0.1	1	556	6	41	1,271	12	46	129

TABLE 8.1. Continued.

Country or territory	School-age population 2006 (total)	Total enrolment, School year ending 1999: Total	Total enrolment, 1999: % F	Total enrolment, 2007: Total	Total enrolment, 2007: % F	Total enrolment: Δ (%)	Enrolment in private schools as % of total enrolment, School year ending 1999 (med.)	Enrolment in private schools, 2007 (med.)	Enrolment in TVET, School year ending 1999: Total	TVET 1999: Share	TVET 1999: % F	TVET 2007: Total	TVET 2007: Share	TVET 2007: % F	TVET: Δ (%)
East Asia and the Pacific	213,360	133,579	47	165,769	48	24	13	19	18,974	14	47	23,658	14	49	25
East Asia	210,090	130,307	47	162,324	48	25	11	12	17,797	14	47	22,550	14	49	27
Pacific	3,270	3,272	49	3,445	48	5	—	—	1,176	36	47	1,109	32	44	−6
Latin America and the Caribbean	66,153	52,575	51	58,547	51	11	20	20	5,004	10	54	6,275	11	54	25
Caribbean	2,233	1,151	50	1,294	50	12	—	19	39	3	45	51	4	49	30
Latin America	63,919	51,424	51	57,253	51	11	24	22	4,965	10	54	6,225	11	54	25
North America and western Europe	62,328	60,661	49	62,401	49	3	9	9	8,849	15	45	8,645	14	43	−2
South and west Asia	243,954	97,783	41	125,705	44	29	—	13	1,531	2	30	2,412	2	27	57
Sub-Saharan Africa	106,177	20,578	45	35,580	44	73	23	14	1,152	6	36	2,221	6	39	93

Note: data for 2006 except for countries with a calendar school year, which are for 2007. *Source*: UNESCO Institute for Statistics database (UIS 2009).

(17%), these two subregions, on the other hand, experienced the highest growth rates between 1999 and 2007 of 129% and 93%, respectively (Table 8.1).

This worldwide growth in TVET enrolment has fuelled economic growth in some countries and fallen short of expectations in others. Globalization is prompting governments to take renewed interest in this multisectoral approach of education and training for sustainable development according to Maclean *et al.* (2009), which is considered an indispensable means to tackle the many challenges that the rapidly increasing number of unemployed youth (see ILO 2011) are confronted with when it comes to their integration in the labour markets.

According to the Paris Declaration on Mutual Accountability, ‘a major priority for partner countries and donors is to enhance mutual accountability and transparency in the use of development resources.’ Accountability has become a hallmark of educational reform initiatives in the United States. Federal legislation requires that states develop evaluation systems to assess student performance, including vocational achievement, and successful transition from school to post-secondary education/or employment (Rojewski 2009). The mandated programme evaluation in terms of collecting data to respond to these US federal mandates has led to a disproportionate number of evaluation studies based on US data.

8.2.1 Evaluations of TVET and Other Active Labour Market Programs

Cunningham *et al.* (2010) recently proposed a four-step framework to guide youth interventions (see Figure 8.1). A *Youth Employment Inventory (YEI)* has been compiled to improve the evidence base for making decisions about how to address the problem of youth employment. As policymakers consider measures to help young people make the transition into the labour market and obtain decent work, they are hampered by a lack of information on what their options are, what works in different situations, and what has been tried and failed. To respond to this situation, the World Bank has compiled a worldwide inventory of the interventions that are designed to integrate young people into the labour market. This YEI is based on available documentation of current and past programmes and in 2007 included *evidence from 289 studies of interventions from 84 countries in all regions of the world.* The interventions included in the YEI have been analysed in order to (i) document the types of programmes that have been implemented to support young workers to find work; and (ii) to identify what appears to work in terms of improving employment outcomes for youth (Betcherman *et al.* 2007).

The YEI does not include new project information but, rather, is based exclusively on existing documentation gathered from a wide range of published and electronic sources. For practical reasons, the inventory is largely limited to *post-formal schooling interventions.* It covers ongoing and completed interventions specifically targeted at young people or that had young people as primary participants.

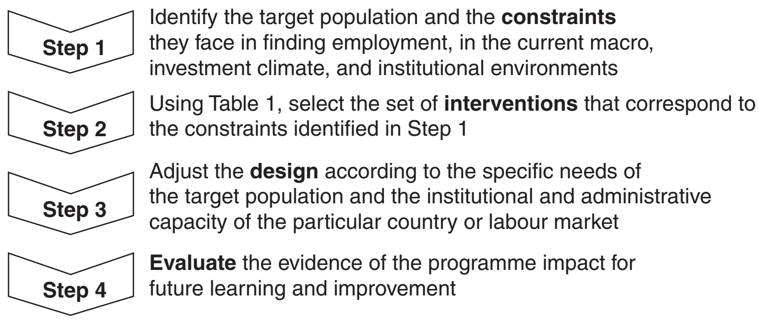

FIGURE 8.1. A framework to guide youth employment interventions.
Source: Cunningham *et al.* 2010.

The most common type of intervention for youth is *skills training*. This category accounts for 39% of all the YEI covered interventions and is significant in all regions, but is especially popular in Latin America and the Caribbean where it represents 56% of the programmes included in the inventory. *Comprehensive multiple-service interventions* – for instance, combining vocational and on-the-job training with wage subsidies and public works, or classroom and on-the-job training with paid work experience and job search assistance – account for 32% of the total. One-half of these multiple-service programmes are in OECD countries. Making the labour market work better for young people (especially through wage subsidies), and improving chances for young entrepreneurs each account for 12% of the total. The largest number of interventions is in the OECD area but Latin America and the Caribbean also has good coverage (Betcherman *et al.* 2007).

The methodology for assembling the inventory emphasized the search for programmes in developing countries. However, 42% of the interventions in the inventory are from OECD countries; this reflects both the level of activity as well as the availability of documentation in industrialized countries. Among developing regions, youth programmes have been most widely implemented in Latin America, which accounts for 24% of the interventions included in the inventory. The shares in the other regions are 14% in Eastern Europe and Central Asia, 10% in sub-Saharan Africa, 7% in South and East Asia and the Pacific, and 3% in the Middle East and North Africa (Betcherman *et al.* 2007).

Only about one-quarter of all programmes included have evidence on the net labour market impact. Overall, *only 1 in 10* programmes designed to integrate young people into the labour market, included in the YEI, has an evaluation which measures both net impact in terms of improving employment outcomes for the youth and cost. Moreover, these figures are likely to overestimate the true incidence of scientific evaluations of youth programmes. This is because the interventions subject to extensive analysis and documentation were more likely to be captured for the inventory compared to those without. Based on evidence from the ALMP interventions as captured by the YEI, it is possible,

Table 8.2. The menu of constraints and interventions.

Constraints	Possible ALMP interventions: Evidence-based interventions	Possible ALMP interventions: Mixed evidence, theoretically sound
Job-relevant skills constraints		
Insufficient basic skills	Information about the value of education	Second chance programmes
Technical skills mismatch	– Training 'plus'/ comprehensive programmes – Information on returns to technical specialities	On-the-job training
Behavioural skills mismatch		Behavioural skills training
Insufficient entrepreneurial skills		Entrepreneurial training
Lack of labour demand		
Slow job-growth economy	Wage or training subsidies	– Public service programmes – Labour-intensive public works
Employer discrimination	Affirmative action programmes	– Subsidies to employers hiring target groups – Employee mentoring

as Cunningham *et al.* (2010) has done, to generate a menu of constraints and possible ALMP interventions (see Table 8.2).

Outside the OECD area (especially the Anglo-Saxon countries) and other than studies sponsored by international organizations, rigorous evaluations are quite rare.

Sub-Saharan Africa

Quantitative analysis of *formal TVET systems in Africa* has been hampered by the lack of quantitative data on TVET participation, graduation and labour-market outcomes. National statistics on access to TVET are often not available as can be seen from Table 8.3; even when they are their quality is variable, due to methodological difficulties in defining relevant indicators. Furthermore,

TABLE 8.2. Continued.

	Possible ALMP interventions	
Constraints	Evidence-based interventions	Mixed evidence, theoretically sound
Job search constraints		
Job matching	Employment services	Technology-based information sharing
Signalling competencies		– Skills certification – Training centre accreditation
Firm start-up constraints		
Lack of access to financial or social capital	Comprehensive entrepreneurship programmes	Microfinance
Social constraints on the supply side		
Excluded-group constraints (ethnicity, gender, etc.)	– Target excluded group's participation in programmes – Non-traditional skills training – Safe training/employment spaces for specific groups	Adjusted programme content/design to account for excluded-group specific needs

Source: Cunningham *et al.* 2010.

while the data that does exist may meet some national information needs, it can rarely be used for cross-country comparisons.

Latin America and the Caribbean

Youth unemployment in Latin America is exceptionally high (15.7% in 2009 (ILO 2011)), as much as 50% among the poor (Attanasio *et al.* 2008). Consequently, among ALMP, *job training* is popular in Latin America as an attempt to help the labour market insertion of disadvantaged youth, and also as a way of providing skills to low-income groups to enable them to deal with the challenges of globalization (Ibarrarán and Shady 2008).

Ibarrarán and Shady (2008) summarize the findings from the first rigorous set of evaluations of *job training programmes* in Latin America that were made in the context of a project undertaken by the Office of Evaluation and Oversight

TABLE 8.3. GDP per capita, aid, poverty and TVET enrolment share (sub-Saharan Africa).

Country or territory	GNP per capita: Current US$ 1998	GNP per capita: Current US$ 2007	GNP per capita: PPP US$ 1998	GNP per capita: PPP US$ 2007	Net aid per capita (US$) 2005	% population living on less than US$1 per day 1990–2005	% population living on less than US$2 per day 1990–2005	Enrolment in technical and vocational education, School year ending in 1999: Total	1999: Share	1999: % F	2007: Total	2007: Share	2007: % F	Δ
Angola	460	2,540	1,800	4,270	28	—	—	58	19	27	—	—	—	—
Benin	340	570	960	1,310	41	31	74	25	12	38	58	13	43	127
Botswana	3,350	6,120	7,620	12,880	40	28	56	10	6	36	11	7	38	17
Burkina Faso	240	430	740	1120	50	27	72	13	8	53	26	6	49	95
Burundi	140	*110*	300	330	48	55	88	—	—	—	13	6	44	—
Cameroon	630	1,050	1,430	2,120	25	17	51	165	26	40	124	17	39	−25
Cape Verde	1,240	2,430	1,790	2,940	317	—	—	—	—	—	2	3	43	—
Chad	220	540	820	1,280	39	—	—	3	2	31	4	1	46	26
Comoros	420	680	940	1,150	42	—	—	*0.2*	1	25	0.2	*0*	*7*	6
Côte d'Ivoire	730	920	1,510	1,620	*7*	15	49	26	4	50	—	—	—	—
Democratic Republic of the Congo	*110*	140	*240*	290	32	—	—	**372**	**30**	31	**562**	**20**	—	51
Equatorial Guinea	1,120	**12,860**	5,090	**21,220**	78	—	—	1	6	45	—	—	—	—
Eritrea	210	270	720	620	81	—	—	0.8	1	16	1	1	46	77
Ethiopia	130	220	420	780	27	23	78	3	*0*	21	191	6	44	**5,565**
Gabon	4,070	7,020	**12,210**	13,410	39	—	—	6	7	34	—	—	—	—
Ghana	370	590	820	1,320	51	45	79	23	2	22	67	4	46	194
Guinea	470	400	810	1,120	19	—	—	—	—	—	5	1	14	

TABLE 8.3. Continued.

Country or territory	GNP per capita: Current US$ 1998	GNP per capita: Current US$ 2007	GNP per capita: PPP US$ 1998	GNP per capita: PPP US$ 2007	Net aid per capita (US$) 2005	% population living on less than US$1 per day 1990–2005	% population living on less than US$2 per day 1990–2005	Enrolment in TVET, school year ending in 1999: Total	1999: Share	1999: % F	2007: Total	2007: Share	2007: % F	Δ
Kenya	440	640	1,110	1,550	22	23	58	10	1	39	25	1	**62**	161
Lesotho	680	1,030	1,340	1,940	38	36	56	1	2	**57**	2	2	53	29
Liberia	130	140	250	*280*	—	—	—	20	17	30	—	—	—	—
Madagascar	250	320	690	930	50	61	85	30	4	35	—			
Mali	280	500	690	1,040	51	36	72	27	12	40	55	10	51	104
Mauritius	3,760	5,580	6,720	11,410	26	—	—	9	9	22	18	14	31	98
Mozambique	220	330	390	730	65	36	74	21	20	26	28	6	31	35
Niger	200	280	530	630	37	61	86	7	6	40	3	1	17	−*62*
Nigeria	270	920	1,120	1,760	49	**71**	**92**	—	—	—	166	3	35	—
Rwanda	260	320	550	860	64	60	88	28	26	54	—	—	—	—
São Tomé and Príncipe	—	870	1,630	204	—	—	—	—	—	*0.1*	2	43	—	
Senegal	510	830	1,140	1,650	59	17	56	7	3	35	—	—	—	—
Sierra Leone	160	260	340	660	62	57	75	—	—	—	12	5	60	—
South Africa	3,290	5,720	6,140	9,450	16	*11*	*34*	160	4	44	—	—	—	—
Togo	300	360	680	770	14	—	—	15	*7*	25	32	8	38	106
Uganda	280	370	610	1,040	42	—	—	40	13	30	—	—	—	—
United Republic of Tanzania	230	410	700	1,200	39	58	90	24	9	31	—	—	—	—
Zambia	310	770	810	1,190	81	64	87	6	2	7	51	8	39	765

Source: UNESCO Institute for Statistics database (UIS 2009).

at the Inter-American Development Bank. These programmes increase the employment rate of participants by about 0–10% and the impact in terms of quality of jobs (measured by wages, social security and/or formality) is slightly higher (see Table 8.4). This research was complemented by two independent impact evaluations of similar training programmes in Chile and Colombia. They report the results of two evaluations with an experimental design (the Dominican Republic and Colombia), one with a natural experiment (Panama) and four non-experimental evaluations (Argentina, Chile, Peru and Mexico). Overall, the results in Table 8.4 suggest that *employment effects* range from modest to meaningful – increasing the employment rate by about 0 to 5 percentage points – although higher and significant for some groups such as *women* in Colombia and Panama – with impact of 6 to 12 percentage points in the employment rate.

8.2.2 Survey of Quantitative Evaluations Studies

TVET links skill development policies to employment needs and labour market requirement, especially because the majority of new work opportunities are increasingly found in productive self-employment and work in the informal economy rather than in formal employment (UNICEF–WBI 2008).

The amount and type of TVET varies widely across countries, and this is not necessarily linked to a country's state of economic development. For example, Martínez *et al.* (2010) argue that the impact of such training does vary according to the level of economic development. It appears to have greatest effect on *early-stage entrepreneurial activity* in countries with favourable institutional contexts (see Section 8.3). Training appears to be particularly effective in *western European countries* with low rates of early-stage entrepreneurial activity, such as Belgium, France, Germany and the United Kingdom.[3] This finding fits the so-called global entrepreneurship monitor (GEM) model,[4] which predicts that training in starting a business is most effective and relevant in *innovation-driven countries*. According to Martínez *et al.* (2010) it supports the argument that *factor-driven countries* in particular should not invest large-scale resources in training programmes if basic levels of entrepreneurial framework conditions are not adequate.[5] An alternative explanation for the findings is that the *quality*

[3] General measure of the environment for entrepreneurship from a National Expert Survey (NES) shows a higher average score for Western Europe (3.0 on a scale of 1 to 5), compared with 2.7 for Latin American and Caribbean. In Republic of Korea and Japan, institutional barriers, as well as cultural perceptions, may prevent the gains in awareness and attitudes from translating into intention and action (Martínez 2010).

[4] The GEM model of Entrepreneurship and National Economic Growth was designed specifically to facilitate understanding and analysis of why entrepreneurship is critical to economic growth.

[5] The NES process includes the selection of at least 36 experts, covering *9 framework conditions* that influence a nation's entrepreneurial environment, including financial support, education and training, etc. Interviews are conducted with at least 4 experts in each of the 9 areas (Martínez 2010).

TABLE 8.4. Summary of findings: labour market impacts of job training programmes.

	Employment rate	Formality	Wages
Dominican Republic	None, higher (5–6%) but not significant in the east and Santo Domingo	Health insurance 9% higher for men (43% versus 34%)	17% (marginally significant), larger for males under 19
Colombia	5% for women, none for men	6–7% for women; 5–9% for men	22% for women, 10% for men
Panama	Overall not significant; 10–12% for women and in Panama City	Overall not significant, probably higher outside Panama City	Overall negligible, large for women (38%) and in Panama
Peru	Large, 13% (much higher for women – 20% – than for men, for which negligible)	Large: overall 11%, 14% women, 5% men	12–30%
Argentina	0–11%, 10–30% for youngest (under 21)	0–3%, 6–9% for youngest in one cohort	No significant pattern
Mexico	Overall, no clear pattern; on-the-job training robust positive effects (12–30%)	Positive effects (10–20%) since 2002	No consistent patterns, at best small and mostly not significant
Chile	18–22% larger for youngest groups	15–23% larger for youngest groups	22–25%, imprecisely estimated

Notes: Employment figures show differences in percentage points vis-à-vis the comparison group, while *the wages* refer to percentage differences. *Formality* means finding a job in the formal sector. Significance refers to statistical significance, with 'significant' denoting 5% and 'marginally significant' denoting 10%. In most cases there is a larger and significant impact on *job quality* (measured by getting a formal job (i.e. *formality*), having a contract and/or receiving health insurance as a benefit, social security or formality). *Source*: Ibarrarán and Rosa-Shady 2008, p. 27.

of training may vary by country context, and that less-developed economies have lower quality forms of training. Martínez *et al.* (2010) find that there is some support for this view from the collective opinions of experts in these countries.

In Section 8.2.2 we proceed by summarizing the findings from a rigorous set of *evaluations of job training programmes* in the OECD, Latin America, Asia and

Africa. Section 8.2.2 also reviews the econometric studies on the determinants and effects of training in the developing countries as well as in the OECD countries.

Review of Evaluations of Job Training Programmes

Renaud (2009) asks 'how do we know when an educational institution is doing well compared either with other institutions, or against external standards?' He provides a clear survey of the topic of the use of *performance indicators* to measure the quality of institutional provision, both the pros and the cons, and provides details of indicators such as selectivity, expenditure and quality of teachers. He concludes, however, that these sorts of indicators, so often employed, do not get to the central question of *learners' outcomes*. He argues that future research ought to focus less on institutional characteristics and more on learner outcomes.

There is a very large literature, which seeks to evaluate the outcomes of individual programmes. Martin (2000) divides these evaluations into two main types.

The first type seeks to measure *the impact of programme participation* on individuals' employment and earnings after they have left the programme, judging the outcomes against the experiences of a benchmark or control group of similar individuals who did not participate in the programme. This type of evaluation makes sense for those active programmes which attempt to make participants more productive and competitive in the open labour market, e.g. training and job-search assistance.

The second type of evaluation attempts to measure *the net effects of programmes* on aggregate employment and unemployment by estimating what, in economists' jargon, are called 'dead-weight', 'substitution' and 'displacement' effects. These evaluations are mostly relevant for employment programmes, i.e. programmes that attempt to stimulate job creation in the private sector (including self-employment), as well as direct job creation in the public sector (Martin 2000).

Based on *micro-evaluations* involving comparing labour market outcomes for individuals who have gone through a particular programme with those of a control group of their peers, Dar and Tzannatos (1999) suggest that the programmes should be tightly targeted at those for whom they are found to be *the most cost-effective*,[6] or, if the evaluations point towards these programmes being ineffective, they should be amended or discarded.

As mentioned above, much of the evaluation literature relates to the United States and Canada where there is a long-standing tradition of evaluating labour market programmes. Few European countries have carried out rigorous evaluations until recently. As a result, some European countries (e.g. Norway, Sweden,

[6] A better understanding of cost levels and structures is a prerequisite to increasing *cost-effectiveness*. In recent years, much progress has been made to better record and assess educational expenditures. In the field of TVET, information on costs and expenditures is generally still limited (see Peano *et al.* 2008).

United Kingdom; Germany and France (AfD)) and Australia are undertaking rigorous evaluations of their labour market programmes.

For example, the GTZ Evaluation Unit[7] contracts independent research bodies each year to conduct these evaluations. Final evaluations take place shortly before or after the completion date of projects. *Ex post evaluations* focus in particular on the sustainability of results. They are conducted two to five years after completion of the project (Castañer 2007). However, in other countries, the most common method of *'evaluation'* consists of simply monitoring the labour market status and earnings of participants for a brief period following their spell on a programme. While this sort of exercise provides useful information, Martin (2000) warns that it cannot answer the vital question of *whether the programme in question 'worked' or not for participants.*

The OECD has reviewed the available evaluation literature in OECD (1993) and this review was updated in Fay (1996) and the OECD review by Martin (2000) of the evaluation literature, which tells us about what works and what does not. Martin (2010) cautions that the bottom line from this OECD research on the effectiveness of ALMPs is not terribly encouraging. The track record of many active measures is mixed in terms of raising the future employment and earnings prospects of job seekers and producing benefits to society. As the OECD Jobs Study (1994) stressed, more *effective active policies are only one element in a comprehensive strategy of macroeconomic and micro-economic measures* required to cut unemployment significantly. Nonetheless, they remain a potentially important weapon in the fight against unemployment (Martin 2000).

Martin (2000) characterizes the evaluation literature in the following way. The 'outcomes' are invariably expressed in terms of programme impacts on *future earnings and/or re-employment prospects* of participants. There is an issue about *the scale of programmes*, even those which appear to work. Many programmes, which have been evaluated rigorously, tend to be *small-scale programmes* – sometimes called 'demonstration' programmes. While the evaluation literature tells a lot about what works, Martin (2000) underlines that it is not very instructive in answering other equally important and related questions, such as why do certain programmes work for some groups and not for others, and in what circumstances? For example, do skill-enhancing activities e.g. via classroom training and/or on-the-job training, work best or must they be combined with personal counselling, job-search assistance and mentoring services in order to work? Policymakers want to know the answers to such questions (Martin 2000), which is why we want to take a closer look at these issues in what follows in Sections 8.3–8.5.

In summary, Martin's (2000) review of the evaluation research highlights *five principles* which could guide the selection of ALMPs in order to maximize their effectiveness. One principle of relevance to the research objective of our chapter is the importance of *keeping public training programmes small in scale and*

[7] DED, GTZ and InWEnt were the predecessor organizations of Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH.

well targeted to the specific needs of both job seekers and local employers, which is aligned with the view of Martínez *et al.* (2010). Another is that if, in the spirit of the G20 Seoul Summit 2010 knowledge-sharing pillar, we are to expand the range of international knowledge on 'what works' and 'why' among ALMPs, it is vital that more countries and donors begin to evaluate their ALMPs systematically as, for example, DFID has started to do. Indeed, Martin (2000) suggests that *evaluation be built into the design of programmes* at the beginning rather than being viewed as an *ex post* exercise. Evaluations should also be undertaken in a rigorous way that allows one to draw useful inferences about the effectiveness of the interventions in terms of their *impacts on the employment and earnings prospects* of the programme participants and that cover *a sufficiently long period* so that one can assess whether the programme yields any long-term private or social benefits.

Reviews of Econometric Studies on the Effects of Training

Carnoy (1994) suggests that in order to make effective use of TVET to equalize economic outcomes among different groups, policymakers first have to estimate the impact of various types of TVET on employment and incomes. These estimates do not necessarily assume that employability and income differences reflect productivity differences (i.e. that market prices – wages, in this case – are good estimates of the real economic value of education and training). Employability and incomes are assumed merely to reflect the value that society places on certain education and training certificates – whatever the social or economic reason (Carnoy 1994).

The model generally used to make such estimates relates employment (including self-employment) and individual income or wages to education, training, experience (age) and, if data is available, ability and socio-economic background. Because labour markets are usually different in the rural and urban areas of developing countries and because women and men are differentially treated by employers in both labour markets, separate estimates are generally made for urban and rural workers and for men and women according to Carnoy (1994).

The situation has also been analysed from other perspectives. An extensive literature has been developed on the segmentation of formal and informal labour markets in developing countries. Incomes in informal labour markets can be in the form of wages or of returns to entrepreneurial ability combined with occupational skills. In order to calculate the latter, Carnoy (1994) argues that we need to know skills, income, and the value of physical capital invested in the informal entrepreneurs' business. Yet, in most developing countries, the *estimation of income returns to TVET in informal labour markets* is crucial to developing a TVET investment strategy.

Carnoy (1994) further argues that we should for example be able to compare the payoffs to academic education with those to vocational education, and that we should obtain a good approximation for the impact of completion of a given level of vocational education or a training programme versus its non-completion (the 'certificate effect'). If we run the estimates of the equations in stages – that is, first with formal schooling and training as independent variables, then with ability, then on-the-job training – Carnoy shows that we can separate out the impact on income of schooling, ability and later training. If the third-stage education and training coefficients are much smaller than those in the second stage, this he suggests is associated with *much of the return to formal training* being linked to the access it provides to further training in workplaces.

The international empirical literature on whether labour market training has a positive impact on employment is extensive. Most of the studies are based on non-experimental methods.

A study by Zweimuller and Winter-Ebmer (1991) found an insignificant effect when using a single-equation model of employment effect of manpower training schemes. After correction for selection into training by simultaneous estimation of a two-equation model, the employment effect of training emerges as positive and significant (Torp 1994).[8]

In Denmark, Jensen *et al.* (1993) analysed the impact of labour market training within a fixed-effect model with panel data for almost 40,000 workers (1976–86). They found *no wage effects* for participants with unemployment experience prior to training, neither for men nor for women.[9] Concerning *employment effects of training*, previously unemployed participants experienced a significant *decrease* in post-training unemployment (Torp 1994).

In Ireland, Breen (1991) evaluated (subsidized) temporary employment schemes[10] and training programmes for *young people*. Both were found to have positive short-term employment effects. The long-run effects were significantly positive for the temporary employment schemes only. Tests for *selectivity bias* show no evidence of such bias for training.[11] The short-term effect of the

[8] One approach to assessing the employment impact of training is to take differences in both individual and local labour market characteristics into account. The dependent variable is duration of employment within a limited response period. As this variable is censored, a Tobit estimation model is required. Using non-experimental data, the problems of unobserved heterogeniteity and selection bias arise (Torp 1994).

[9] Westergaard-Nielsen (2001) finds that the youth programme in Denmark was the only part of the labour market reforms in the late 1990s, which clearly lowered the reservation wage. The lower benefits mean that those with higher alternative wages will choose jobs and that those with relatively low alternative wages would choose training.

[10] Termed a 'variant of conventional public works programmes'. While direct employment schemes may indeed lead to the provision of public goods/services, their overriding purpose is that of employment generation. In Ireland, Community Employment is the largest direct employment scheme. Community Employment, which replaced the Social Employment Scheme in 1994, is targeted at the long-term unemployed (Halpin and Hill 2008).

[11] Based on the general lessons learned from over 30 years of experience in evaluating government training programmes and a survey of the main methodological lessons learned from 30 years of evaluation activity conducted mainly in the United States, Heckman *et al.* (1999) identified eight lessons from the evaluation literature that they believe should guide practice in the future (for details see Heckman *et al.* 1999).

employment schemes increased, however, after correcting for selectivity bias. Torp (1994) argues that this indicates a negative selection into these labour market programmes.

A common concern for impact evaluations of ALMPs is the *self-selection process* of participants into the programme. Unobservable characteristics, such as motivation or other factors determining a person's participation, may also determine their ability and make them different from non-participants. Unless the existence of unobservables can justifiably be ruled out, it cannot be concluded that the programme had an impact. The simplest way to establish this is to assign treatment randomly to some part of the study population and to withhold treatment from the others (see Adda *et al.* 2007). However, others resort to quasi-experimental methods where the control group is formed by matching non-participants with participants based on observable characteristics that are thought to determine programme participation and/or eligibility (Cunningham *et al.* 2010).[12]

From his review of the empirical literature Torp (1994) concludes that it is not surprising that the results of the analyses diverge. He argues that most of the programmes evaluated seem to have positive employment or wage effects. Some of the analyses illustrate general problems, indicated by several authors in this area of the evaluation literature: different non-experimental methods that proclaim to take into account *the selection to training* have proved to produce estimates that are sensitive to model specification and assumptions made by the estimator (see Lalonde 1986; Heckman and Hotz 1989).

Other studies summarized by Dar and Tzannatos (1999) have also taken advantage of *the advances made in model development and econometric analysis*. However, a number of issues affecting the reliability of the findings of these studies for guiding public policy remain open. First, there are unresolved technical issues, such as handling *selection bias* and assessing *deadweight and displacement/substitution effects* likewise mentioned in Torp (1994). Second, there are a variety of data problems in the specific surveys. These include benchmarking pre-intervention profiles (employment history, human capital attributes, etc.) and the tracking of participants and non-participants for no more than one or at most two years while, in many cases, *the full impact of policies* is unlikely to play out in this short period of time (such as in *the case of training and self-employment*) (Martin 2000). Third, *administrative data* which may be called upon to provide supplementary information, tends to be surprisingly poor, so that the nature or the intensity of the intervention received by the participant is often uncertain (Dar and Tzannatos 1999).

Concerning *the macroeconomic evaluations of the active policies* in terms of what works and what does not, Martin (2000) concludes that the jury is still out on the matter. The results of the various *econometric analyses* are inconclusive, some studies appearing to show robust effects of active policies in terms of lowering the natural or equilibrium rate of unemployment or real

[12] For more detail on evaluating Active Labour Market Programmes see Heckman *et al.* (1999).

wage pressures, others appearing to show zero or insignificant correlations. This literature is bedevilled by a number of data and technical difficulties, notably *simultaneity bias* since cross-country comparisons reveal that the amount of spending on active programmes is positively related to the unemployment rate.

Betcherman *et al.* (2004) agree with this caution by stressing that it is increasingly *difficult to isolate impacts of particular types of programmes* because of a trend towards integrated service provision. Nevertheless, their review leads to a number of general conclusions.

Training for the unemployed. Participants often benefit from these programmes in terms of higher employment rates but not in terms of higher earnings.[13] Programmes seem to work best with on-the-job training and active employer involvement. Results are more positive for women than men.

Retraining for workers in mass layoffs. These programmes most often have no positive impacts, although there are exceptions. The few successful cases typically include a comprehensive package of employment services to accompany the retraining.[14] However, these are generally expensive.

Training for youth. These programmes are almost always unsuccessful in improving labour market outcomes, at least in developed countries. It makes much more sense to invest earlier in the education system to reduce drop-outs and other schooling problems. While there are few studies in developing countries, evaluations in Latin America do find positive impacts for programmes that integrate training with remedial education, job search assistance, and social services.

Public works. This can be an effective short-term safety net but public works do not improve future labour market prospects for participants.

Micro-enterprise development/self-employment assistance. There is some evidence of positive impacts for older and better-educated workers. However, take-up is low.

[13] They examined 49 evaluations of training programmes primarily aimed at the unemployed. These programmes are quite diverse but most have the objective of skills development through classroom and/or on-the-job training, which can include gaining work experience. The dominant methodological design for the training evaluations is quasi-experimental, with most applying matching techniques to analyse employment-related outcomes. The new wave of evaluations reinforces the view that the record for training unemployed workers is mixed. There are many programmes with positive results, especially in terms of increasing employment probabilities (as opposed to wage rates), but others appear to offer little benefit to participants. The evidence suggests that the design of the programme is critical for ensuring favourable outcomes.

[14] The common approach involves a combination of services where training is provided in a comprehensive package that also includes basic education where needed, employment services, and relevant social services. However, it is important to acknowledge that these comprehensive services approaches involve trade-offs: they are costly and cannot easily reach large numbers (Betcherman *et al.* 2004).

Betcherman *et al.* (2004) suggest that many findings from industrialized countries do seem to apply broadly to transition countries but – on the basis of what is still a small sample of studies – this is not always true in the case of developing countries. The much larger *informal labour markets* and weaker capacity to implement programmes may limit what some programmes can achieve in terms of creating formal employment or increasing wages. The few evaluations in these countries for *employment services and training programmes* for the unemployed are less positive than the (much larger) body of evidence in the OECD and transition countries. On the other hand, some *youth training programmes* in developing countries have much more positive impacts than are seen in OECD countries. It may be that such programmes in these low-income labour markets have more potential because abundant supplies of skilled workers are not available according to Betcherman *et al.* (2004).

For example, the World Bank (2008) finds that rising levels of education are producing higher earnings in the informal sector. In Ghana, using *household data* from the 2005 Ghana Living Standards Survey, the comparison of earning gains *estimated with multiple regression analysis* showed returns by level of schooling for self-employed workers in the urban non-agriculture sector that approach or match those of wage workers in the urban non-agriculture sector (Adams 2008, 2009).

Betcherman *et al.* (2007) seek to identify the determinants of positive programme impacts systematically. This is done by carrying out *a meta-analysis of the interventions* in the YEI and using *econometric methods* to combine and synthesize results from the individual studies to get an overall picture.[15] Their results suggest that there are no major differences across categories of interventions in terms of *impact or cost-effectiveness*. Three categories of interventions – making the labour market work better for young people (primarily wage subsidies, public works, and job search assistance), skills training, and comprehensive programmes – each had similar percentages of programmes with positive impacts. Although *entrepreneurship programmes* had the highest positive impact rating, the number of these interventions in the inventory is too small to draw firm conclusions. The meta-analysis found no statistically significant differences in the impact of the different programme types (Betcherman *et al.* 2007).

[15] To identify the determinants of programme outcomes more systematically, they carried out a meta-analysis based on the interventions collected by the inventory. A meta-analysis uses econometric methods to quantitatively combine and synthesize results from individual studies in a common field in order to get an overall picture. They chose this approach in order to analyse what types of youth interventions work best and what are the key features in implementation design and targeting that explain variations in employment and earnings outcomes under different economic and institutional conditions.

8.2.3 Rate of Return Calculations

As a routine task accompanying processes, evaluation is still not widespread in the TVET sector. When evaluations are carried out, this is often done to evaluate *effectiveness and efficiency of specific TVET programmes*, often driven by reasons of accountability. The broad panorama of evaluation methods and their possible mix described by Deitmer and Heinemann (2009) aimed at showing that there are areas of TVET where evaluation can have a suitable impact too. Focusing on the underlying learning processes and using also formative, processes-orientated methods is not a task that is easily integrated into TVET. They describe some of the most important preconditions and implications to expand the field of evaluation to TVET. Deitmer and Heinemann (2009) propose that when *evaluating learning processes*, we have to be sure to sufficiently involve the most relevant stakeholders: teachers/trainers and learners.

Betcherman *et al.* (2007) warn that the absence of rigorous evaluations almost certainly leads to an overestimation of programme impacts by policy-makers. Properly evaluated programmes are less likely to lead to positive assessments of impact and effectiveness than judgements based on 'non-scientific' methodologies. In the absence of such evaluations, policymakers are likely to overestimate the benefit of their interventions and, as a result, allocate resources inefficiently.[16] This is a particular concern in developing countries where resources are scarce and evaluations are uncommon (Betcherman *et al.* 2007).

The majority of interventions included in the YEI appear to have positive labour market impacts for participants. Two specific *performance indicators* post-programme – employment and earnings – are considered in assessing programme 'impact'. *An assessment of impact* was possible for 172 interventions, where an assessment could be made regarding employment and/or earning outcomes; these included both programmes where only gross outcomes were available and those where net impact evaluation were carried out.[17] Of these 172 programmes, 132 (78%) were rated as having had *a positive impact* in terms of the employment and/or earnings of participants. When only programmes with

[16] Policymakers who tend to focus on *gross outcome measures* are generally overestimating how useful their interventions are in helping young people find employment or increasing their earnings. Ideally, programmes should be evaluated within a cost/outcome framework involving a comparison of the cost of a course of action (e.g. the cost to the individual of taking the course is the fee that has to be paid plus the value of whatever the individual has had to give up in order to participate in the training, e.g. after-tax earnings) with its outcome (Betcherman *et al.* 2007).

[17] The impact of such a programme on employment should be measured not by the proportion of trainees who get jobs (the gross outcome) but the difference the programme makes to that proportion (the net impact). Thus, a comparison has to be made with a control group, i.e. a group of people with the same characteristics as the trainees (age, sex, education, social class, etc.) save that they did not participate in the programme (Betcherman *et al.* 2007).

net impact evaluations were considered, *the share with demonstrably positive labour market impacts* for participants was 60% (44 of 73 programmes). In the case of many of these programmes, the assessment was made on the basis of gross-outcome data alone. But once *cost-effectiveness* is taken into account along with labour market impacts,[18] less than half of the programmes in the inventory could be judged as successful. However, of the 134 programmes assessed to have positive employment impact, only 25 had done *a cost–benefit analysis*.[19] Of these, 14 were cost-effective (56%), while 11 (44%) were not (ibid).[20]

Assuming that this observed *ratio of cost-effectiveness* applies to programmes without cost information, Betcherman *et al.* (2007) estimate the overall success rate of interventions, where 'success' is defined as having a positive labour market impact and cost-effectiveness. The authors' estimate, using all programmes with outcome indicators that about 44% of interventions were successful according to this definition. When they restrict their calculations to programmes with net impact evaluations, the estimated success rate is 33%.

EML Consultants (2009) carried out a study on the quantification of the economic and social benefits of vocational education in Sri Lanka. The results of their analysis show that the rate of return (ERR) of the entire TVET sector trainees is high, with an ERR of over 42%. All categories of institutes showed high economic benefits with the lowest being in other government institutes and the highest being in private sector institutes. The economic benefit–cost ratio ranged from 2.5 to 13.9 and the economic internal rate of return (EIRR) ranged from 19% to 124%. The private sector, National Apprentice and Industrial Training Authority (NAITA), Vocational Training Authority (VTA), and village level institutes showed high rates of economic return of over 50%, as well as high benefit–cost ratios.

Carnoy (1994) addresses the question of how to determine *the overall effect of the TVET system on efficiency and equity*. The aim is to suggest criteria to guide the allocation of public resources for education and training, to meet both efficiency and equity goals. Carnoy (1994) argues that the value of additional vocational education and training in (a) equalizing opportunity and (b) equalizing outcomes in a particular society needs to be measured. The first

[18] A relevant cost-effectiveness measure would be the extent of improvement in employability per unit of spending (Betcherman *et al.* 2007).

[19] Cost–benefit calculation consists of comparing the stream of costs attributable to the training with the stream of benefits resulting from it. The benefit–cost ratio is the discounted present value of the stream of benefits from the training (measured by its impact on the before-tax earnings of a trainee) divided by the discounted present value of the stream of costs (direct and indirect) attributable to the training (Betcherman *et al.* 2007). See, for example, GTZ (2009, Chapter 2) or EML Consultants (2009) for details and concrete examples.

[20] A programme is considered *cost-effective* if the evaluation results indicate that *the benefits* (e.g. reduced use of social assistance, increased tax gains through participants who found a job, increased earnings, etc.) exceed *programme costs* (income support, training material, cost of training, etc.). Since we are relying on available project documentation, specific methodologies used for the cost–benefit analysis can vary.

of the roles can be assessed by the amount spent by the public sector on TVET for various groups; the second by the 'employability' and the income gain to various groups associated with TVET (and various types of TVET).

Individuals and governments *incur costs in taking and providing TVET. The total cost of different types of TVET* is one measure of 'value', at least to the entity incurring the expense. If the economic value as measured by additional expected earnings (which incorporate the probability of employment), even in the short term, from a particular investment in TVET, is negative or low, *individuals* will not continue to incur the cost of that investment. Yet, Carnoy (1994) proposes that *governments* often will, for two reasons:

1. the public sector may consider that there is a high payoff to society in the longer term of developing certain skills in the younger labour force;

2. the public bureaucracy may consider that public spending on vocational education and training legitimizes the bureaucracy.

One of the most common methods of evaluating TVET programmes is to assess whether the programme *improves the probability of finding work*. Some studies have used the probability of employment to adjust the earnings of different groups. Other studies compare the occupation levels and employment patterns of graduates from different streams of education. Thus, in Colombia, vocational stream graduates tend to get semi-skilled jobs when they graduates from secondary schools, whereas academic streams graduates, even when they do not go on to university obtain access to jobs that provide more training and entrance to higher-skilled jobs. A third index of success is the percentage of graduates from a specific field of education employed in a related field of work. Carnoy (1994) argues that this matching is often better for *vocational secondary school graduates* than for those who take only academic preparation, and when vocational students are 'matched' to labour market demands their wages are significantly higher than those of academic graduates.

An analysis of data from eleven countries in Latin America by Psacharopoulos in 1994 showed that half of these countries (six) 'show that *the rate of return for vocational secondary education* is higher than that for secondary general education'. It was also reported from this study that, 'in seven out of eleven countries, *the private return* to secondary education does not differ between general and vocational education' (Yamada 2002).

Earnings differentials are the most common measure of the economic value of education and training. Even though a lot of years have passed since Mincer (1962) used income curves and some assumptions about *the payoff to education to estimate the value of training* associated with different levels of schooling, his analysis is still useful. In effect, Mincer measured the 'extra' income earned over and above a fixed return to education to measure the value of post-schooling training of workers in the labour force with different levels of formal education. He concluded that the steeper income curve of workers with secondary education, for example (as compared with those with primary schooling), was due to the greater investment in training made once

TABLE 8.5. Private rate of return to investment in education (+1 year), by level of education.

	Primary	Secondary	Higher
Asia	20	15.8	18.1
Europe/Middle East/North Africa	13.8	13.6	18.8
Latin America/Caribbean	26.6	16.0	19.5
OECD	13.4	11.3	11.6
Sub-Saharan Africa	26.6	17.0	19.0

Source: Psacharopoulos and Patrinos 2002.

they began working. Carnoy (1994) further argues that Mincer's method is useful because it *addresses the difficulty of separating education and training*; it measures the value of training as the discounted additional income workers get because of the learning opportunities that follow from their educational and occupational choices; and it provides *an overall methodology for valuing TVET as the discounted earnings stream realized by those who take it* (see EML Consultants, 2009).

Psacharopoulos and Patrinos (2002) provide a comprehensive review of four decades of estimating Mincerian equation across 98 countries. They find that:

- the rates of return are generally falling by level of education and level of economic development (Table 8.5);
- *the average private rate of return* to a year of schooling is 19%;
- the average returns are highest in Latin America and sub-Saharan Africa;
- while average years of schooling have increased, the rate of return is declining.

The basic finding is that more education raises wages and thus likely also economic performance. Other findings summarized in Te Velde (2005) include:

- Barro (1997) finds that one year of additional education raises growth by 1.2% per annum;
- Benhabib and Spiegel (1994) find low to negligible rates of returns to investment in education;
- Krueger and Lindahl (1999) find a statistically significant relationship between education and growth for countries with low-income levels;
- Wolff and Gittleman (1993) find that primary education is statistically significant for output per person in poorer countries.

Thus, while it is clear that higher educated workers earn more, it is less clear whether all types of education raise growth in all type of countries. The effect of education appears larger for low-income countries, and this might be consistent with the hypothesis that education is important for catch-up. Generally it is important to distinguish between education that contributes to scientific advance and education that aims to create an absorptive capacity to foster the adoption and benefits from best practice technology. For example, Borensztein *et al.* (1998) suggest that education is important to benefit from inward FDI (Te Velde 2005).

Mincer's method can be extended to a much more detailed breakdown. Average age–income profiles can be measured for groups with different combinations of formal general schooling, vocational education, training and apprenticeships. Furthermore, VET can be categorized by occupational skills. Carnoy (1994) suggests that this would permit assessing the cost and value of each education/training 'path' to be assessed and even the implicit value of on-the-job training associated with that path to be estimated.

More recent studies have used a more flexible specification than the standard Mincer model. However, in part due to data limitations, the fiction that educational attainments can be ordered into an ascending sequence has been maintained.[21] But Year 12 completion and vocational qualifications are overlapping rather than sequential attainments. The failure to recognize this has led researchers to view that the return to completing Year 12 is quite high compared to the return to vocational qualifications. A related limitation is the almost exclusive focus on the average effect of education for the population as a whole. As a consequence, existing results on the return to Year 12 completion and VET qualifications present a confusing picture. Ryan (2002) interprets his results to imply that the return to a Level II VET qualification for those who have completed Year 12 is zero. The same result is obtained in a more explicit form in Leigh (2008). Given that the most common path to a Level III qualification is via an apprenticeship, the results imply that four years of post-school vocational education and training is a waste of time (Stromback 2009).

In contrast to the aggregate measures used by economists, research into the school to work transition has employed much finer measures of education and training choices. Because of this finer detail, this research is more attuned to the policy issues and has been very helpful in tracking the relationships between these choices and early labour market outcomes. This research agenda according to Stromback (2009) clearly recognizes the diversity and has contributed much to our knowledge of how well a particular alternative works for young persons who choose that alternative. However, describing these relationships does not uncover the causal effect of the choices. Stromback (2009) observes that this research does not explicitly address the 'what if' question that is of most interest for policy purposes. We know that those who complete Year 12 do fairly well, and better than those that do not, but not whether the early school leavers would have done better had they completed Year 12?

[21] For example, most statistical collection by the Australian Bureau of Statistics only records people's highest level of qualification. According to that scheme, any post-school qualification is ranked higher than a school qualification (Stromback 2009).

In contrast to previous studies Stromback (2009) uses the *treatment-effect approach* that is commonly applied in the field of policy evaluation. Thus, young persons are viewed as obtaining one or both of two treatments – completing Year 12 and obtaining a vocational qualification – or no treatment, leaving school before completion. To estimate the effect of these treatments Stromback (2009) used *the method of matching* rather than parametric models that allows for heterogeneous effects in a more natural way. Whether schooling and TVET is treated as single independent treatments[22] or combinations of multiple (i.e. Year 12 completion and TVET qualifications) treatments Stromback (2009) finds no significant effect on early career earnings from completing Year 12 or a TVET qualification while being largely independent of ability and socio-economic factors.[23] Stromback (2009) concludes that the main implication is that the return/effect to completing Year 12 takes a long time in coming and the benefits can be obtained in more than one way.

8.2.4 Rate of Return to Active Labour Market Policies

Carnoy (1994) discusses models of *estimating TVET equity effects*, which involve comparing what individuals from certain groups gain from their investment in TVET, corrected for the additional taxes they pay to the public sector, and the value to society of public spending on TVET. By comparing these two returns, he argues that it is possible to understand, in yet another and more comprehensive way, *the equity impact of investment in TVET*.

The most common form of measuring the net payoff to investment in TVET by both individuals or private enterprises and the public sector (i.e. ALMP) is *the rate of return*:

- the private rate of return (PRR) estimates the future income payoff to resources spent by individuals on various kinds of TVET;
- the social rate of return (SRR) estimates the future income payoff to the totality of resources (private plus public) spent on these same kinds of TVET (Carnoy 1994).

The coefficient estimated in the income equation represents PRR for the given age group, including income forgone as a private cost only. These coefficients are called *'Mincer (1974) rates of return'*. We can estimate PRR to TVET including

[22] Early studies, following the standard Mincer model, *forced educational attainments into a 'years of education' variable* by translating vocational qualifications into a year of education equivalent. More recent studies have used *a more flexible specification*. However, in part due to data limitations, the fiction that educational attainments can be ordered into an ascending sequence has been maintained (Stromback 2009).

[23] Ryan (2002) interprets his results to imply that the return to a Level III VET qualification for those who have completed Year 12 is zero. The same result is obtained in a more explicit form in Leigh (2008). Given that the most common path to a Level III qualification is via an apprenticeship, the results imply that four years of post-school vocational education and training is a waste of time (Stromback 2009).

all private costs (income forgone plus direct private costs, such as books, uniforms, school supplies and tuition) from a series of income equations, one for each age group, which yield age–income profiles by level and type of vocational education and training and by level of academic schooling. Once private direct costs are added to income forgone during the school years, these age–income profiles form the basis of the benefit and cost stream, in accordance with standard measurements of present value (ibid.).

The PRR provides a good starting point for analysing which groups in a particular country received high or low payoffs from TVET. *To estimate the SRR* on the same TVET and academic education, we simply add public spending per pupil on each type of TVET and on academic education to the private costs so as to estimate social costs, and use private income streams not corrected for taxes paid on additional income to estimate social benefits attached to each type and level of TVET and to academic education (Carnoy 1994).

We can estimate TVET equity between different groups using rates of return in two stages.

Stage 1. Using the PRR (corrected for taxes paid) and applying it to various levels and types of TVET, and assuming we know who obtains these various levels and types of TVET, we can see that the PRR shows who is receiving higher and lower payoffs to their investment.

Stage 2. Those groups with higher PRR may also pay higher taxes – sometimes even more in taxes than the public costs of the TVET. The difference between SRR and PRR (corrected for taxes paid) to various levels and types of TVET captures this concept of evaluating the impact on equity of public spending (Carnoy 1994).

In Latin America, payroll taxes have tended to be used to train workers and young people from lower social classes for production jobs. They are thus probably more redistributive than general TVET spending financed by value-added taxes or excise taxes which are predominantly allocated to higher vocational education. But payroll taxes may also have a negative distributive effect in reducing the demand for production labour. If we believe that this negative effect is offset by the positive equity impact of payroll tax-financed TVET, then payroll taxes also have a second positive feature – they can be seen as a form of 'earmarked' tax in the sense that they are destined for worker training which then also benefits the firms and the workers who pay the payroll taxes for the training (ibid.).

The OECD database covers five main categories of (ALMPs) as follows.

- Public employment services and administration.
- Labour market training is divided into two categories:
  - spending on vocational and remedial training for the unemployed;
  - training for employed adults for labour market reasons.

- Youth measures include:
  - training and employment programmes targeted to the young unemployed;
  - apprenticeship training, which is mainly for school leavers, not the unemployed.
- Subsidized employment is divided into three categories including:
  - assistance to unemployed persons who wish to start their own business;
  - direct job creation for the unemployed in the public or non-profit sectors.
- Measures for the disabled include
  - vocational rehabilitation – training and related measures to make the disabled more employable (Martin 2000).

Dar and Tzannatos (1999) have examined about 100 evaluations. Many of these studies have already been summarized by others (such as the OECD and the ILO), but they have also included a significant number of individual studies. However, *most studies apply to OECD countries* – mainly the United States, Canada, UK, Sweden and Germany (Dar and Tzannatos 1999).

Dar and Tzannatos (1999) suggest that the evidence points to some *generalizations about ALMPs*, which they summarize programmatically.

- *Public works* can help the more disadvantaged groups (older workers, the long-term unemployed, those in distressed regions) as a poverty/safety net programme. However, they are instruments as an escape route from permanent unemployment.
- *Training for the long-term unemployed* can help when the economy is improving.
- *Small-scale, tightly targeted on-the-job training programmes*, often aimed at women and older groups, offer the best returns. However, cost-effectiveness of these programmes is generally disappointing. The real rate of return is rarely positive, and they are no more successful than job search assistance programmes in terms of post-programme placement and wages.
- *Retraining for those laid off en masse* usually has little positive impact and, as is the case for the long-term unemployed, it is more expensive and no more effective than job-search assistance.
- *Training for youth* generally has a positive impact on employment prospects or post-training earnings – it clearly cannot make up for the failures of the education system. Taking costs into account, the rate of return of these programmes in both the short and long run is usually negative.

A very broad generalization on the effectiveness of these ALMPs leads Dar and Tzannatos (1999) to conclude the following.

- Some of these programmes – such as *wage subsidies or training for youth* – are unlikely to be cost-effective instruments in reducing unemployment.
- Some programmes – such *as job search assistance* – are likely to have positive impacts on the probability of finding employment if they are well designed and implemented. However, the impact and cost-effectiveness of most of the ALMPs depends not only on their design, but also on the overall macro and labour market framework in which they are designed (Dar and Tzannatos 1999).

The review by Betcherman *et al.* (2004) does not change the overall findings from the 1999 study on the impacts of ALMPs in any fundamental way. A wide range of results can still be found with some programmes demonstrating positive labour market effects for participants and others showing either no impact or even negative effects. Obviously, programme design and the context in which the programme operates matter a great deal as concluded by Dar and Tzannatos.

While it can be argued that the lessons from the OECD countries on the effectiveness of these programmes may not be directly applicable to developing countries, it is unlikely that these programmes will be more successful in developing countries given the scarcity of administrative capacity to implement these programmes and the paucity of monitoring and evaluation (M&E) experience to study their effectiveness according to Dar and Tzannatos (1999).

Moreover, the few existing rigorous studies of vocational training in developing countries evaluate Latin American programmes, and such studies neglect entirely programmes in Africa. To begin to address this gap in the literature an ongoing IGC project conducted by Hjort *et al.* (2011) aims to evaluate the impacts of a vocational education voucher programme among Kenyan youth, using *a randomized controlled evaluation design* together with an innovative panel data set. The study will explore whether subsidized vocational schooling can enable the unemployed and those with little formal schooling to move into new and higher-paying occupations, which are often found in cities. In particular, the project will examine the effect of vocational training on formal sector employment, labour market earnings, migration decisions, remittances, fertility decisions and other major life outcomes.

The results of the Hjort *et al.* (2011) study should help inform governments, policymakers, and donors of the economic returns to vocational education, allowing them to improve the effectiveness of such programmes in Africa. Moreover, their research design will provide an assessment of vocational education's potential to reduce or exacerbate interregional economic inequalities through migration and remittances. This IGC project is also designed to examine the different returns of private sector vocational training relative to public sector training.

The remaining sections of our chapter cover the remaining issues. In so doing, this improves our understanding of the institutional and implementation features that seem to be systematically correlated with better results, but which are not easily captured by using the econometric evaluation literature approach reviewed so far.

8.3 Institutional/Strategic Framework

Technical and vocational education and training is back on the international agenda. In the mid 2000s, the Commission for Africa, the Millennium Project and Summit, new World Bank policies on secondary, higher and general education, and on skills development, as well as the *World Development Report of 2007* on youth all argued that holistic, integrated, intersectoral approach education is crucial, including TVET. Increasingly, the Poverty Reduction Strategy Papers (PRSPs) will need to reflect this same comprehensive approach. While general absence of skills development in PRSPs has been recognized (Caillods 2003; ILO 2005), the World Bank notes that many governments in SSA have put policies in place that emphasize *training for the informal sector* (World Bank 2004), although it has been suggested that these policies tend to ignore the 'holistic' ones that, in fact, are related to the education.

Johanson and Adams (2004) argue that getting the macroeconomic context right remains the essential first step in focusing on skills development programmes, which in turn can have an incentive effect on investment. Training does not create jobs. Skills are a derived demand and that demand depends on policies for growth and employment creation, although these at times can be short-sighted. These points are emphasized in this section. Section 8.3.1 shows the importance of general education. Section 8.3.2 discusses the role of formal TVET schooling and vocational training in enterprises. Section 8.3.3 explains how to ensure good-quality TVET. Section 8.3.4 presents a few strategies for TVET in the informal sector, which starts by looking at the organization and for the development and implementation of a national TVET policy. Section 8.3.5 derives the implications for policy and practice in the informal sector. Section 8.3.6 briefly presents the organization for the development and implementation of a national TVET policy in various SSA countries. Section 8.3.7 looks at some of the major elements of such a national TVET policy by highlighting some recent cases of good practice in Ethiopia, Niger and Zambia.

8.3.1 The Importance of General Education for TVET

A long-standing debate within Western countries, but also evident in practice elsewhere (e.g. Brazil and China), is the degree to which education should be focused on developing specific vocational knowledge and skills, or be comprised of a form of education that generally serves as a foundation for paid vocations. In other words, whether workplace competencies or general education should be the primary goal of education. Billet (2009) suggests that the emphases on specific occupational outcomes will probably fluctuate over time as economic circumstances change. As global economic competition has increased, many Western-style countries have intensified the focus on workplace competencies within vocational education supply rather than on more general educational outcomes. Where they exist, these *more general purposes* are sometimes manifested as more generic workplace competencies suitable for several occupations.

In many Asian countries, the provision of vocational education is that of *technology education* undertaken within schools by schoolteachers with limited experience outside the school classroom. Here, the educational processes and goals are developed through and enacted within the educational sector that is primarily concerned with general education. Yet, in a different way, in Russia and China there are levels of vocational education that are masked by activities across educational sectors more institutionally distinct than in other countries (e.g. colleges, polytechnics, universities). All this leads to provisions of TVET and professional practices that are in some ways distinct and hybrid in each country (Billet 2009).

During the 1990s, the international policy debate on education was mainly focused on *basic education*. Although skills training, apprenticeships and formal TVET programmes were seen as components of *the expanded vision of basic education* at the World Conference on Education for All (WCEFA) in Jomtien in 1990, where 155 countries joined together to adopt the World Declaration on Education for All (Hughes 2009), they have not featured substantially as a core element of the global agenda of education since that time. This could be associated with the donors' result-based management approaches which have a tendency to focus on quick and measurable results away from interventions with more long-term outcomes. Engberg-Pedersen and Fejerskov (2011) argue that result-based development aid has failed, for example because the MDG approach has led to significant construction of schools instead of addressing the more longer-term needs of training competent teachers or supporting educational reforms to ensure that the curriculum is up-to-date.

The World Conference Forum, held in Dakar, Senegal in 2000 noted that more than 100 million children were still not attending any school and that one-third of the world's population lived in countries where the achievement of the EFA goals was unlikely. Six areas were adopted to achieve EFA, specifying targets for achievement by 2015:

- in early childhood education;
- in UPE, including recognizing the needs of the most disadvantaged;
- *in access to learning and life-skills programmes for youth and adults*;
- in improving adult literacy levels;
- eliminating gender disparities;
- in improving the quality of education, especially in literacy, numeracy and essential skills (UNESCO 2000 quoted in Hughes 2009, p. 2039).

Although most countries are making substantial progress towards *attaining basic education for all*, the point remains that for countries to compete in the world economy their young people must be trained beyond basic education and that TVET needs to play an important role in this process (Hawley 2009). Responding to that position, Hughes (2005), in a paper titled 'Why access to TVET for all is essential if education for all is to be achieved', elaborated that the link between UPE and TVET is highly relevant, given the failure of so much formal education in addressing the needs of all students, particularly those for whom some forms of exclusion have reduced their life chances. Hence TVET provides low achievers with learning and life opportunities so that they are not kept out of school (UNICEF–WBI 2008).

The Jomtien Declaration went beyond the idea of UPE to use the term *'basic education'* defined by UNESCO in 2000 as 'the minimum skills and knowledge needed in order to be able to make a full contribution to one's local environment and to be in control of one's life,' by noting that problems with literacy and low school attendance are related to other social indicators: high birth-rates, high infant mortality; low agricultural productivity; lower life-expectancy; poor housing quality; limited access to clean water; restricted employment opportunities; and a lack of political participation. There is a strong correlation between all these figures and education: where there is deterioration in one indicator there tends to be deterioration in all of them. Basic education was seen as the essential tool for breaking this cycle of disadvantage (Hughes 2009).

The fact that the UPE goal remains unachieved after such a long and persistent effort points to the need for some *new initiative* to complement the continuing approach through primary and secondary education. *A partnership of EFA with TVET* can make major strides towards meeting the goal. Support for such a partnership now can provide a major boost to the achievement of EFA by 2015. This extension from literacy to multiple literacies was recognized at the General Conference of UNESCO in 2003 (Hughes 2009).

If the formal system is incomplete and the achievement of UPE is inadequate, this will still leave a substantial proportion of people excluded from opportunity. Nepal, for example, has a population of 23 million people, mostly in rural areas, with 2 million children working in agriculture. It is estimated that 54% of children never complete primary school. *A radical change of approach* is necessary to deal with this reality. Hughes (2009) proposes an approach that provides skills for work and that can help transform attitudes. The priority in Nepal and other developing countries is to meet the current needs for primary education while also providing help to the most vulnerable groups, including skills development.

Technical and vocational education and training is specifically designed to provide access to productive work and competency-based curriculum because of its focus on technologies and related sciences as well as the acquisition of practical skills relating to occupations in various sectors of economic life and social life. Access to productive work is one need, but so are the creative attitudes relevant to seeking and finding work. Recognizing that UPE entails the need for coherent pathways to further education and to skills for employment and self-employment, an international consensus was reached on the need for a holistic, integrated, intersectoral approach to education, including TVET.

Many African countries are seeking new approaches. The lead YES agency of Burundi teamed up with the Dutch YES team. The purpose was to fund a micro-credit scheme for Burundian families. 'About 37 families received €100 each to begin micro-enterprises activities in late 2002. Other activities included *technical training* provided by the lead agency for youth to set up small businesses in different villages. Additional school materials were provided to assist' (Holmes and Tschanz 2004, quoted in Hughes 2009, p. 2047).

Mali provides an interesting example of a country that has made great advances, but that still faces severe problems. The gross enrolment rate (GER)[24] for the primary education level (ISCED1)[25] was 7% in 1962 increasing to 62% in 2002. An effort on this scale has its costs. *The total education sector* currently accounts for around 30% of the overall central government budget. The priority accorded to TVET expressed in capital expenditure terms is evidenced by the fact that in 2008 TVET drew nearly 15.6% of investment expenditure in Mali, against 12.7% in 2005 (OECD and AfDB 2008; see Table 8.6). The gains in primary education are striking, but it is a heavy strain on limited resources. Also, this success leaves a difficult problem untouched. The socio-economic development of the country has been substantial, but there is an extra challenge because *disadvantaged groups still have limited access to vocational skills*. The government is using non-formal education programmes to provide literacy and basic education, as well as vocational and rural skills training. These are combined with microfinance schemes at the village level to provide extra opportunities (Holmes and Tschanze 2004, quoted in Hughes 2009).

In Uganda the Education Sector Plan envisages that Business TVET will become an alternative to academic education in the last two years of the secondary level, rather than an alternative to the early years of secondary education (OECD 2008; see Lauglo and Maclean 2004).

Moreover, there is an obvious difference in the way TVET is organized in French-speaking African countries such as Mali and English-speaking countries such as Uganda. This is attributable to the colonial influences that have largely been retained to date with minimal modifications. In Algeria, Morocco, Senegal and Tunisia, which are all Francophone, TVET retains a fairly large amount of *general content* as has been the case with TVET in France. However, lack of specificity towards vocational contents has the disadvantage of delinking the TVET courses from the mostly informal labour-market skills. Atchoarena and

[24] Total enrolment in a specific level of enrolment, regardless of age, expressed as a percentage of the eligible official school-age population corresponding to the same level of education in a given school year. It indicates the capacity of the education system to enrol students of a particular age group. *Source*: http://glossary.uis.unesco.org/glossary/en/home.

[25] ISCED stands for 'International Standard Classification of Education' (ISCED 1: Primary education (ISCED97)).

Delluc (2001) found this to be the case in their study of TVET in Côte d'Ivoire, Madagascar, Mali and Senegal, where the informal sector, especially micro-enterprises, is totally ignored by the programmes and patterns of TVET delivery. Originally modelled on the French school system, TVET in these countries has often not fully taken into account the possibilities of traditional apprenticeship for meeting the needs of the artisanal sector (Oketch 2009).

In contrast, Anglophone countries display a much stronger experience, both in dual forms of public-sector training and in the provision of training for the artisanal sector (Atchoarena and Delluc 2001). In the case of these English-speaking countries, the vocational content is generally high and the academic content is extremely limited. While this has the advantage of reflecting specificity in terms of the skills needed in the informal sector, where more jobs continue to be created, Oketch (2009) argues that it has the disadvantage of limiting progression to higher levels of education or movement between vocational and general institutions (see De Moura Castro 1988). This high level of specificity leads to narrowness, an issue that often makes TVET less appealing, relegating it to a type of education only capable of leading to what many refer to as 'dead-end' jobs (Oketch 2009) (see Section 8.4.3).

There are some emerging trends in countries such as Botswana, Ghana and South Africa,[26] where TVET has been 'modernized' from the traditional apprenticeship schemes to programmes that *permit movement into the national training system*. The aim of this approach is to include a balanced proportion of *general and vocational content* that would enable participants to move both laterally within the TVET programmes and vertically to general or advanced education institutions. This progression within and between TVET and general education, when fully implemented, can create a breathing space whereby the education system responds to the types of skills demanded for the labour force at different periods (Oketch 2009). Moreover, it has been argued that adding vocational elements to primary school curricula or ensuring that basic education school-leavers are literate and numerate is the best way of preparing them for further training and also making them ready for the world of work (Ahadzie 2009; see Herrington *et al.* 2010).[27]

So why is Africa's youth unemployed? One of the main explanations is the low literacy and numeracy rates. Africa has the worst education outcomes of any continent. Although wage rates are low they do not compensate for low productivity and investors have shied away from starting labour-intensive

[26] In 2003 the International Mathematics and Science Study (TIMSS) surveyed 50 countries including South Africa, Botswana and Ghana. Not only did these African countries perform better than South Africa, but there was evidence that other African countries would also have performed better than South Africa had they been included (Herrington *et al.* 2010).

[27] The *Global Competitiveness Report 2009–10* cites South Africa's inadequately educated workforce as the second most problematic factor for doing business in the country. South Africa is ranked 45th out of 133 countries overall by the GCR. However, this ranking plummets to 107th in terms of the quality of primary education (down from 104th the previous year), 119th for quality of higher (secondary and tertiary level) education and training (down from 110th last year), and a dismal last in terms of the quality of maths and science education.

businesses in Africa (World Bank 2011). Creating productive employment opportunities for Africa's youth has proved challenging for Africa's policymakers and those that have attempted to support them. Part of the reason that this problem has proved so intractable is that an effective approach must draw on a myriad of disparate solutions. To be successful, African leaders will, for example, have to overhaul flawed education systems and ensure access for the most disadvantaged children; and improve skills starting with basic literacy and numeracy and including cognitive skills, problem solving and developing managerial talent (World Bank 2011), which we will take a closer look at in the rest of this chapter.

8.3.2 The Role of Formal Schools versus Enterprises and Other Forms of Productive Activities in TVET

For many years, state provision dominated the field of education in many African countries. However, over the past 20 years, private provision has been steadily growing. This has happened as state provision has either found it increasingly difficult to expand and cope with increased demand for education or simply because the state's capacity to monopolize provision of education has generally deteriorated and become unattainable. This can also be said of the TVET sector. Moreover, the MDG quest to achieve UPE has incrementally absorbed a larger share of the public sector's educational resources often at the expense of both TVET and higher education (see UIS).

Atchoarena and Esquieu (2001) conducted research on this phenomenon and documented patterns of provision and policy issues with reference to private technical and vocational education in SSA. They conclude the following.

- Private provision of TVET is growing rapidly and even dominates in some countries.
- There is heterogeneity in private provision with key aspects, such as legal status, ownership, objectives and financing, most difficult to establish clearly.
- The majority of private TVET institutions enrol students from low socio-economic backgrounds.
- A sizeable number of private institutions cannot be properly traced in government registrations records, implying that they operate illegally.
- Many of the private providers offer courses with a high concentration in commercial trades, although there are also a few cases such as Mali, where 21% of the offering are in technical areas (such as light industrial skills).
- Given the private nature, tuition fees are the main source of operational resources for these institutions.

- The private sector has the benefit of tailoring the courses to the labour-market demands and seems to be flexible in adapting to demand (Oketch 2009) as well as to the social demand for 'modern' skills such as computing, administration, management where the demand is low.
- There is little evidence to indicate a close working relationship between enterprises and the private institutions. In most cases, it is up to the students to choose what they would like to specialize in by themselves. The degree to which they respond to the actual needs of the enterprises is thus less known (Oketch 2009) as is the trainers' skill level.

In Ghana, there are 160 TVET institutions run by the government agencies and 250 registered private institutions. It is thought, however, that there could be approximately another 700 unregistered private providers. Private technical and vocational institutions run a variety of courses in Ghana which last an average of three years. Their students take the City and Guilds of London Institute or the Ghana Education Service Craft examination, or the National Vocational Training Institute (NVIT) Craftsman or Trademan Grade examination (Oketch 2009).

Thus, competencies can be acquired either through structured training in public or private TVET schools and centres, or through practical experience on the job in enterprises (workplace training in the formal sector and informal apprenticeship), or both (the so-called *'dual' training*, involving a combination of workplace and institution-based training) (OECD 2008; De Largentaye 2009).

In Mali, the effort to address the needs of the real economy has led to support a 'dual' training system. Formally introduced in Mali in 1997, *dual training* is a training system which combines work supervised by a trained artisan (80% of the training time) and formal courses in training centres (20%). Evaluations confirm that the dual system improves skills significantly and contributes to social inclusion and to improved employment (De Largentaye 2009). The seven country studies surveyed by Walther (2007) showed that traditional forms of youth training in workshops are in fact the point of departure for the slow (cf. the issue of short-term efficiency versus long-term impact) but far-reaching transformation of crafts apprenticeship into *dual systems* that combine on-the-job and theoretical training. The changes taking place vary from country to country, but everywhere they entail the structuring of established practices through the progressive introduction of interaction between practice and theory. The AFD field survey showed that schemes to structure and progressively improve apprenticeship practices that involve all of the partners concerned are the best way to help young people vitalize their professional trajectories (Walther 2007). Additionally, there is also the key issue of the long process of setting up professional organizations as the interlocutors of the relevant public authorities.

The private sector is now routinely involved with the Ministry of Employment in the design of programmes and in the quantification of training needs for *the dual system*. However, the scope of the dual training system in Mali remains small, with about 1,000 apprentices graduating every year, as compared to the 300,000 or so entering the labour market.[28] Scaling-up requires: the extension of the system to a variety of activities; a better control of costs, which currently vary between 60 and 1,000 euros per trainee *per annum*; and a proper training certification system (De Largentaye 2009).

8.3.3 Policies for Ensuring Good Quality in TVET, Including Monitoring and Evaluation Mechanisms

Aside from the early criticisms by Foster (1965), numerous concerns have been voiced over the past decade. Atchoarena and Delluc (2001) summarize them in Africa in terms of

- poor quality,
- very high costs,
- training not suited to actual socio-economic conditions,
- disregard of the informal sector's needs,
- disregard of the labour market and of the high unemployment rate among graduates (quoted in Oketch 2009, p. 541).

Indeed, in the bulk of the African countries, the lack of funding of formal TVET has led to the obsolescence of equipment and weak managerial capacity, which in turn *affect the quality of training programmes*. Moreover, the oversight responsibility for TVET is in general shared between the ministries responsible for education or technical education and labour or employment, although some specialized vocational training programmes (in agriculture, health, transport, etc.) fall under the supervision of the sector ministries (OECD 2008).

Most programmes emphasize the improvement of skills of the youth labour force or support the creation of youth entrepreneurs, and the emphasis is placed on improvement of quality in the supply of employable labour. As for demand, emphasis is placed on creation of an environment conducive to the growth of the private sector – a measure that has indirect, but nevertheless important, implications in the creation of employment for youth. However, UNIDO, African Union *et al.* (2007) argue that the two aspects should not be isolated from one

[28] According to the latest UIS data (table 3F) available in 2010 in Mali the total enrolment in secondary all grades was 654,619 up from 597,039 in 2009 (table 1). The total enrolment in lower secondary, public and private all programmes in 2009 was 510,651 (table 3B). The entrance age of lower secondary is 13 and the duration of lower secondary is 3 years, whereas the entrance age at upper-secondary is 16 years and the duration of upper secondary is 3 years (table 1). The total enrolment in upper secondary, public and private, all programmes in 2010 was 247,634 (224,732 in 2009) of which enrolment in upper secondary, public and private, TVET programmes was 104,666 in 2010 up from 89,032 in 2009 (table 3B). Hence, the total secondary, public and private, all programmes enrolment was 758,285 in 2010 up from 686,071 in 2009, with total, public and private, TVET programme enrolment equal to that of the upper secondary level (table 3B in UIS database).

another, but be undertaken in a linked and complementary manner. There is need, therefore, for concerted efforts to seek a more direct role for the private sector in programmes that generate jobs for youth.

In order to improve the participation of young and disadvantaged groups in the labour market, the Latin American governments have been implementing several policies. Some policies deal with the structural causes, such as the coverage, access and *quality of basic and secondary education*. Two influential demand-driven training programmes, the Mexican Probecat (1984) and Chilean Joven, have laid groundwork for this type of programmes.

The Chile 'Joven' vocational training programme, which started in 1992 with the support of the IDB, was based on youth training experiences in the United Kingdom and the United States. Building upon the existing training system in which the state had *a regulatory and supervisory role*, and in which private training firms had to be accredited by the state agency to be entitled to tax-deductible training costs, the government created a new programme that was *under the supervision of the national agency* that oversees the private vocational training, which is named the National Training and Employment System (SENCE). The mechanism innovated in Chile was internalized by the IDB and (with the participation from the International Labour Organization (ILO), which also supported governments in preparing proposals for this type of operations) it was later replicated throughout Latin America: in Venezuela (1993), Argentina (1994), Paraguay (1994) and Peru (1996) in the early-to-mid 1990s, and later in the Dominican Republic (1999), Colombia (2000), Panama (2002) and Haiti (2005) (Ibarrarán and Shady 2008).

In Argentina growth stalled again in 1995 and unemployment never stopped growing, reaching 30% for youth aged 15 to 24 in 1999. As a result of these uncomfortable statistics, the Argentinean government took several initiatives both to reduce unemployment and to avoid its worst consequences. The Programa de Apoyo a la Reconversión Productiva funded by the IDB was one amongst others and the Proyecto Joven was part of this loan. Claudio de Moura Castro (1999) examines this Proyecto Joven Argentine programme for the purpose of training unemployed youth in semi-skilled occupations. The programme was found to be innovative in many respects, successful in unexpected ways but in need of revisions. The project contains important innovations at the management level. It is noteworthy that all the training is outsourced from ministries of labour and/or local government to private and public providers through the purchase of training by competitive bidding in the private and public market, instead of trying to create a training system or rely on the regular training institutions. The same is happening with some control, evaluation and auditing processes. This avoids the chronic problems of civil service operation and creates checks and balances between execution and funding decisions. The quality and dedication of the management was considered to be one of the reasons for the success of the programme, which seems professionally run and well monitored. Internships are beneficial to students and reduce the mismatch between training and demand.

However, de Moura Castro (1999) warns that the immediate impact is probably less convincing than it appears at first sight. Evaluations indicate that about 30% of the graduates get a job after the internships and that up to 70% are working after six months. These he argues are internationally respectable results. But the same international experience shows that while in most programmes the tracer studies show very encouraging results, when stricter methods are used to establish control groups the benefits drop precipitously. Given the methodological weaknesses in the creation of the control groups, the programme cannot convincingly avoid the scathing criticism levied at other similar programmes, claiming that they help little to alleviate unemployment.

8.3.4 Strategies and Structures for Non-formal TVET

There are three main schools of thought regarding the relationship between the formal and informal economies.

The dualists: the informal economy is a separate marginal economy not directly linked to the formal economy, providing income or a safety net for the poor (ILO 1972).

The structuralists: the informal economy is subordinated to the formal economy. In order to reduce costs, privileged capitalists seek to subordinate petty producers and traders (Castells and Portes 1989).

The legalists: informal work arrangements are a rational response by micro-entrepreneurs to over-regulation by government bureaucracies (de Soto).

In fact, it has increasingly become clear that there are many interdependencies between the informal and the formal economies. Market links exist through the trade of goods, raw materials, tools and equipment and acquisitions of skills and know-how. Informal actors provide services to formal actors on a subcontracting basis. In addition, individuals can participate both in the formal and the informal economies (Flodman Becker 2004).

The informal sector of SSA has become a growing source of employment for large numbers of youth, but also for older workers pursuing entrepreneurial goals and others adjusting to structural changes in the region's employment (Johanson and Adams 2004). Initially viewed as *a safety net* for those unable to find employment in the modern sector, the image of the informal sector has begun to change with time and the education of those entering it. More workers have begun to view it not as a temporary stop while searching for employment in the formal wage economy, but as a preferred destination offering opportunities to those wanting to become entrepreneurs (Adams 2009).

Informal employment has been persistent and has been rising in many regions of the world. During the 1990s, informal work in the non-agricultural sector represented 43% of employment in North Africa, 57% in Latin America, 63% in Asia and 75% in SSA. Including *traditional agriculture*, the percentages were even higher. In SSA percentages stood at 95% in Benin and 90% in

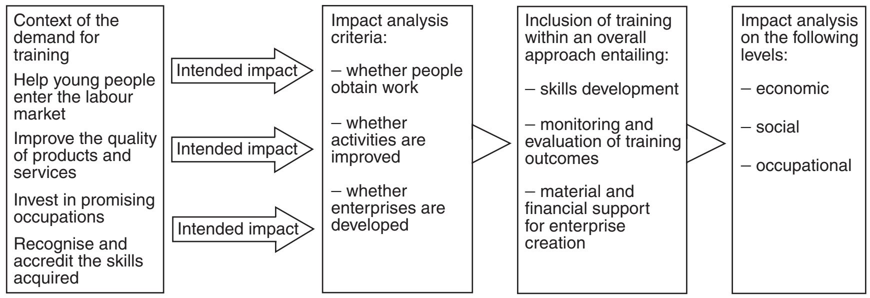

FIGURE 8.2. Training as one element in the overall informal sector development process. *Source*: Walther and Filipiak 2007.

Cameroon, Ethiopia and Senegal. Two-thirds of the people of SSA are less than 25 years old, compared to 30% in Europe. Field studies by AFD such as some recent field studies carried out by Walther and Filipiak (2007) in seven African countries (Angola, Benin, Cameroon, Ethiopia, Morocco, Senegal and South Africa) show large youth cohorts entering the labour market. In South Africa, every year there are 826,000 school leavers and in Benin 200,000. Whereas equivalent figures for annual labour demand are not readily available, the formal economy is clearly unable to cater for this employment demand. Most school leavers, especially early school leavers, make *a living as self-employed in the informal economy*. With little access to formal vocational training, the vast majority resorts to makeshift mechanisms in the informal economy (e.g. on-the-job training or traditional apprenticeships) (Adams 2008, 2009; de Largentaye 2009).

The analysis by Walther and Filipiak (2007) of the situation in the seven countries surveyed makes it possible to identify a number of key factors for stimulating the informal sector in Africa (Figure 8.2).

Walther and Filipiak (2007) suggest that these factors offer some useful guidelines for further reflection and sequential action. Firstly, they determine the conditions required if appropriate context specific intervention in the informal sector is to help it thrive and progress from being a subsistence economy to one of growth and development. Secondly, they provide the basis for a range of recommendations on how to refocus local, national and international policies on objectives and modes of action that are truly adapted to the specific circumstances of this economy, whose main benefits are that it gives work and income to those who would not otherwise have any, and is a potential source of growth and development.

The AFD field surveys carried out by Walther and Filipiak (2007) clearly showed that *training schemes in the informal sector are only truly effective* when their promoters tailor them to the social and economic situations they are supposed to improve or develop. The surveys also clearly revealed that the effectiveness of such schemes depends on their being part of a larger process of means to implement the expected outcomes.

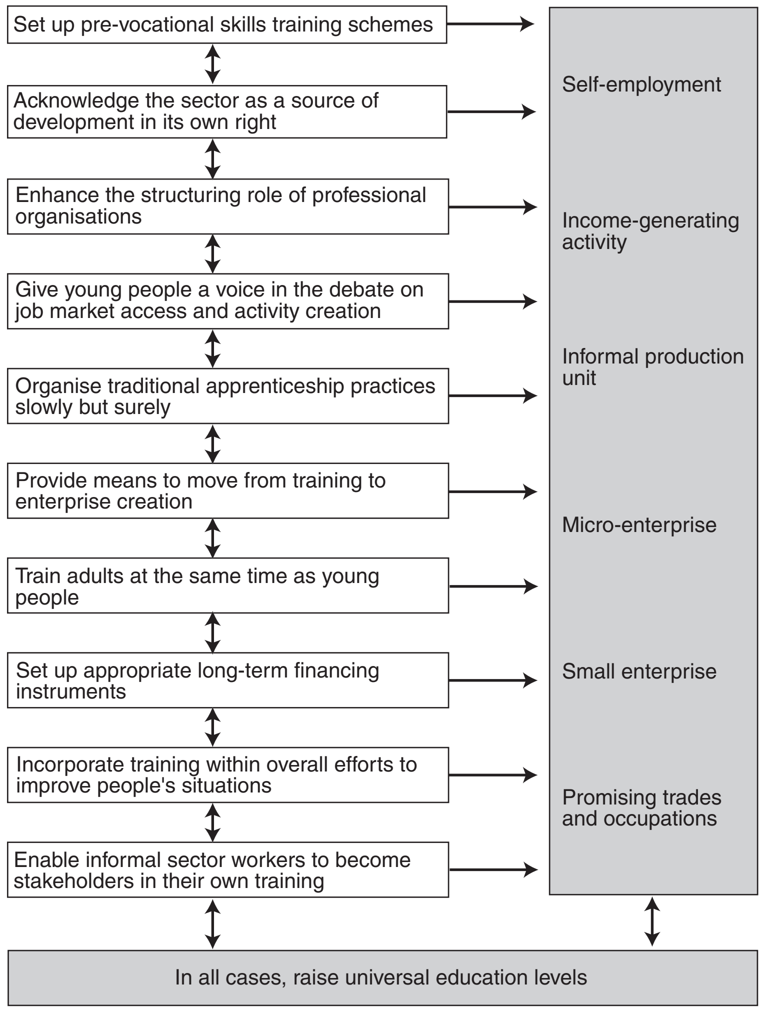

FIGURE 8.3. The process for developing a thriving informal sector through TVET. *Source*: Walther and Filipiak (2007, p. 18 and p. 184).

The comparison by Walther and Filipiak (2007) of the seven countries' respective situations helped to identify *10 major factors or guidelines* to ensure that vocational training in the informal sector has the means to increase the skills and qualification levels of employees and micro-entrepreneurs, and make a positive contribution to their working conditions and the profitability of their activities. Figure 8.3 gives a coordinated, interactive overview of the means and conditions for effective intervention in the informal sector.

These 10 key factors are interconnected elements of an overall process to ensure *effective delivery of training in the informal sector*. Ultimately, they constitute some useful guideposts for further reflection and action. First, they determine the conditions required for intervention in the informal sector to help it thrive and progress from being a mere subsistence economy to one of sustainable growth and equitable development. Second, they provide the basis for a range of recommendations on how to refocus local, national and international policies on objectives and modes of action that truly suit the specific circumstances of this economy, whose main usefulness is that it gives work and incomes to those who would not otherwise have any, and is a potential source of future growth and development (Walther and Filipiak 2007).

Many governments in developing countries have begun to respond to the training deficit with strategies and policies based on a 'demand-driven' approach to VET that stimulates the 'production' of trainees with competencies, defined explicitly by the employment sector. In some countries, this has included greater attention to training that occurs in the informal production, service and commercial sectors. Emphasis is being put on raising the quality of training and performance in order to strengthen simultaneously the economic welfare of individual artisans and their families and of the society. Singh (2009) proposes that an implicit goal of such a process is the eventual *'formalization' of the informal sector*, in order to raise the economic and social benefits of the 'sector'.

Muskin (2009) examines the potential of the informal sector to contribute to the readjustment of national TVET strategies and policies, drawing on research conducted in Chad in the mid 1990s. Following other researchers, Muskin has tried to reveal the 'quality' of skills required to operate productively in the informal sector. The training needs include: fundamental theory; elements of basic design; techniques and basic knowledge; specific products and services; basic business skills, attitudes and habits, organization of operations; fundamental cognitive skills and basic school-related technical skills. The basic challenge of training for informal sector participation is to prepare both future and current owner-operators with satisfactory competence equally as technicians and entrepreneurs, covering each of these eight categories. Training has to take into consideration the diverging training needs in terms of content, as well as delivery of the 'low' and 'high' end of the informal micro-enterprise (IME) sector (Singh 2009).

In close association with the pervasive informal sector is the increasing interest in the so-called '*system of traditional apprenticeship*'. This is not surprising, given that this 'system' has proved to be an enduring and an effective source of skills for many developing countries. But its resilience is also attributable to its positive association with the equally pervasive informal sector of West African economies. Perhaps a more engaging argument for the resurgence of interest in traditional apprenticeship is the inability of formal systems to deliver the types of skills that are required to ensure employability of the ever-increasing new labour market entrants and to contribute to overall poverty reduction (Fluitman 2005, referred to in Ahadzie 2009).

In addition to traditional apprenticeship models, there are attempts to provide *pre-employment skills training* through short-term training programmes. These aim to transfer skills for self-employment quickly. Palmer (2009) argues that in order for skills acquisition to be more effectively translated into skills utilization, programmes need to be accredited only and when they meet the required standards of good delivery and quality learning and training (Singh 2009).[29]

The problem facing most youth as they graduate from self-employment-orientated TVET programmes is that, while they have acquired skills during their training, most find it very hard to utilize these skills productively in the labour market. Indeed, Palmer (2009) finds that the environment in which most graduates trained find themselves is quite disabling. Most quantitative studies fail to account for the transformative context, or the different types of environment into which school, TVET or apprenticeship graduates emerge. Usually, the generic returns for different levels of education or different types of occupation are simply stated. But research would suggest that the returns to education and skill acquisition are markedly higher where there are other supportive measures in place as shown in Palmer (2007b).[30]

8.3.5 Implications for Policy and Practice in the Informal Sector

The major message from the Muskin (2009) study is that apprenticeship training may represent a major approach for creating future producers and service providers in what was, and likely remains, the most important economic sector in the majority of SSA countries. More particularly, the analysis yields four recommendations for improving training in Chad's informal sector.

- *An institutional capacity* (public, private, or more likely, mixed) should exist to assist the informal sector's members, individually and collectively to asses and articulate their specific training needs.
- *Policies should be adopted and strategies designed* to improve the quality of apprenticeship training.
- Any improvements to apprenticeship training should be matched with effort to provide *professional skills up-grading to the entrepreneurs.*
- These three recommendations imply *greater coordination and cooperation* across the informal sector and within the individual vocational areas.

[29] A good example is Edexcel, a Pearson company, which is the United Kingdom's largest awarding body offering academic and vocational qualifications and testing to schools, colleges, employers and other places of learning in the United Kingdom and internationally. Accreditation from Edexcel service can recognize and accredit professional bodies' in-house training programmes against international quality standards.

[30] Much can be learnt from how the formal enterprise environment is measured in developing countries, for example in the World Bank's 'Doing Business' surveys, its Regional Programme on Enterprise Development data on investment climates, or its enterprise surveys. However, the formal enterprise environment is very different from the informal micro-enterprise contexts (Palmer 2007b).

> One measure of improved performance is the achievement of greater efficiency. As such, Muskin (2009) proposes that the members of the informal sector and each vocation should move to greater coherence in the definition of the skills, as well as the methods by which to attain, transfer, maintain, expand and certify them.

The preceding recommendations also suggest the value of further developments in the participation by governmental and non-governmental agencies, as well as the private sector, in supporting the informal sector. This approach may arguably represent the best chance for the informal sector to emerge from its present 'inertia' according to Muskin (2009).

Furthermore, Ahadzia (2009) proposes that expanding the traditional apprenticeship system depends on pursuing policies that reduce the costs of training and improve access to credit, raw materials, technology and markets for the craftsmen. These are beyond the immediate control of the craftsmen themselves. The responsibility to formulate such policies falls essentially on state and non-state actors outside the apprenticeship system. Collaboration among all partners will arguably according to Ahadzia (2009) create the appropriate policy intervention for expanding the training system.

Finally, from the review of *the criteria for training policy in the informal sector* in Latin America, Pieck (2009) draws the conclusion that *an integral approach is indispensable*. Clearly, what is needed today is a strategy capable of reconciling policy in the fields of education, occupational training and employment. Today's problems suggest the need for *professional and occupational training councils* that would include the following among their key functions:[31]

- orientating and coordinating the initiatives of the various institutions that relate to this field;
- setting up links between institutions of various sectors (NGOs, the private sector, public organizations);
- helping to design methodologies and strategies capable of meeting the training needs of the informal sector.

According to Pieck (2009) this strategy would seek to quantify the conception and practice of occupational training on the basis of the confluence of actions and actors who at present neither identify themselves with this activity nor are part of it.

[31] They could for example promote and coordinate various local activities in relation to professional training and, particularly, the practical training of students at local authority schools, at the same time encouraging industrial placements in companies and involving students in the most detailed, motivating and responsible learning process to complement that given in the classroom, by placing the student in the world of work.

8.3.6 Organization for the Development and Implementation of a National TVET Policy

Human-resource development strategies in African countries aim to pursue the development of skills at all levels of the spectrum (low, intermediate, and high levels), but each country needs to emphasize *the mix of skills* that best corresponds to its stage of economic development and the needs of the local labour market. In 2007 the OECD Development Centre and the AfDB within the African Economic Outlook (AEO) project carried out a review of TVET systems in 34 African countries, which revealed that *the current status of TVET systems in Africa* differs from country to country and TVET systems are delivered at different levels in different types of institutions, including technical and vocational schools, polytechnics, enterprises, and apprenticeship training centres (Abdul-Wahab and Afeti 2009). Moreover, technical and vocational skills are delivered through a wide range of modalities and actors (OECD 2008). The findings in the AEO 2008 Report illustrate how these countries have managed to put the development of skills at the centre of their development strategy.

According to OECD (2008) most countries in the sample have a primarily school-based model, where education is provided in specific schools or colleges with workshops for the practical training. In general, students enter the vocational education tract at the end of primary school, corresponding to 6–7 years of education as in countries like Sierra Leone, Burkina Faso and Kenya or at the end of lower secondary school (ISCED2), which corresponds to 7–9 years of what is called basic education in e.g. Ghana, Mali, Nigeria and Swaziland. The duration of school-based TVE is between 3 and 6 years, depending on the country and the model. Some countries, e.g. Ghana, Senegal, and Swaziland, in an attempt to expose young people to pre-employment skills, have incorporated basic vocational skills into the lower secondary school curricula (OECD 2008).

Evidence shows that success in getting more children into primary school leads to increased demand for secondary education. More attention is being given to diversified approaches to education which includes vocational and skills development (Levesque 2007). Some countries adopt an enterprise-based model through apprenticeships. Education and training alternate between theoretical education in a school context and practical training in an enterprise (which account for about 50–70% of the pupils’ time). In other countries, the delivery systems combine school-based vocational education and apprenticeship. This model attempts to combine advantages of the school-based model and of the enterprise-based model (OECD 2008).

Seventeen countries in SSA have presented draft *comprehensive sector-wide education plans for 2015*. Main regional grouping country examples of the expansion of vocational education and skills include the following.

Common Market for Eastern and Southern Africa (COMESA).

- Ethiopia: increase in admissions to TVET from 94,592 (2005) to 312,826 (2010) and 624,095 by 2015. New standards and programmes for TVET.

- Kenya: improving TVET, tertiary education and adult literacy.
- Rwanda: 50% increase in the number of TVET institutions.
- Uganda: New technical/vocational qualifications framework.

Economic Community of West African States (ECOWAS).

- Sierra Leone: more private investment in education at all levels and more direct links between education and employment.
- Gambia: 50% increase in the number of TVET institutions. Revised standards and programmes for TVET.
- Ghana: 50% increase in the number of TVET institutions.
- Senegal: Second priority is TVET in order to have a qualified and skilled labour force.

Southern African Development Community (SADC).

- Malawi: optimizing private sector participation in basic education and in TVET.
- Mozambique: increasing participation in secondary education and TVET.
- Namibia: doubling of enrolments in TVET by 2011.
- Tanzania: 30,000 full time and 35,000 part time and distance learning students in technical and higher education, by 2008.

8.3.7 The Major Elements of a National TVET Policy

The joint OECD–AfDB AEO review of the successful African countries' experiences suggested eight necessary conditions for formulating and implementing successful TVET strategies:

1. adopting a clear vision and leadership at the highest political level;
2. improving forecasting and planning for skill needs;
3. improving the quality of TVET;
4. addressing the skill needs of the informal sector;
5. facilitating the growth of the productive sector through technological learning and innovation;
6. fostering partnership with all stakeholders (i.e. the government, social partners, business associations, and various stakeholder groups in the formal and informal sectors of the economy);
7. involving the local communities;
8. strengthening local management of TVET through the delegation of responsibilities to regional authorities.

TVET systems, under the assumption that they do exist, in a growing number of African countries are undergoing or have undergone promising reforms that are designed to build on the inherent strengths of the system. In the ECOWAS countries this is no exception. The major reforms concern the following.

- Adopting national strategies and derived policies for TVET – Burkina Faso, Senegal, Mali, Ghana, Gambia, Niger, and Nigeria.
- Have or are in the process of setting up of national TVET bodies: Gambia, Ghana, and Nigeria.
- Have or are in the process of developing National Qualification Frameworks (NQFs) (National Vocational Qualification Frameworks (NVQFs) in Nigeria; National Skills Qualifications Framework (NSQFs) in Gambia).[32]
- Adopting updated competency based curricula more aligned with the labour market needs: Nigeria, Gambia, Senegal, and Burkina Faso.
- Linking training to employment (either self or paid employment) (Abdul-Wahab and Afeti 2009).

World Bank (2006) argues that, for reforms to succeed, close involvement of the private sector (both formal and non-formal/informal) at all levels – from policymaking to being involved in running institutions and investing in skills development, is critical and the government is working closely with the private sector to move forward in transforming this vision into reality. In the ensuing subsections we will highlight two recent examples of TVET strategies considered successful by many TVET experts, namely that of Ethiopia and Niger both undertaken in 2007 as well as Zambia, which had seen the growth of the total TVET enrolment increase the most.

Ethiopia's TVET Strategy

The significant increase in TVET enrolment in Ethiopia has been managed by a combination of government funding, intensive short-term teacher training and building of TVET centres. However, the rationale was still that of a supply-driven system. Hence, the future stages of the TVET reform require a paradigm shift towards a demand- and outcome-driven system (cf. ADEA 2011). This holds not only for the training itself, but for the management of the TVET system and its

[32] The National Skills Qualification Framework (NSQF) or Gambia Skills Qualification Framework (GSQF) was developed in 2006 and implementation began in 2007. The NSQF emphasizes qualifications and standards to be delivered by registered and accredited training providers to enhance quality improvement in the TVET system. In 2007 some training institutions were closed for failure to meet standards and so far 53 training institutions have been registered and accredited. A lead body established in 2007 is responsible for the registration and accreditation of training providers, trainers and assessors based on set standards and benchmarks. A training levy which forms the main financial base of the National Training Authority is being collected.

institutions as well. The deciding factor for success is not input or supply, but performance according to GTZ (2006).

At an International Symposium on Implementation Issues of Diversified Financing Strategies for TVET organized by the Ethio-German Engineering Capacity Building Program (ECBP) on November 20–21, 2006 in Addis Ababa it was agreed that the Ethiopian approach to TVET reform and financing are very much in line with international best practice in terms of performance. All stakeholders seem to agree that public–private and civil society partnerships will be key to making any TVET reform process succeed (GTZ 2006).

Ethiopia has made considerable progress towards UPE and continues to work hard to ensure relevance and quality at each educational level. As an increasing number of young people graduate from general education, the government of Ethiopia has recognized that it is of utmost importance to provide them with options for further education and training in order to increase their employability. In this context it is important to build a demand-driven, flexible, integrated and high-quality TVET system. The government of Ethiopia (GoE) therefore has involved all stakeholders in the planning, policy making, training delivery and monitoring and evaluation (M&E) of the TVET system, although TVET development is hampered by a serious lack of relevant data and information. The ongoing reform seeks to increase the engagement of the private sector – both of private TVET providers and enterprises as future employers of TVET graduates – and to provide students and trainees with knowledge, skills and abilities relevant for the world of work (GTZ 2006; Walther 2007).

The recent growth in TVET enrolment and provision has been achieved by a considerable expansion of public spending and increased TVET provision by private institutions. Government sources estimate that private TVET providers currently provide approximately 30% of all TVET in Ethiopia. Private TVET providers estimate their share of the market to be closer to 50%. Also, NGOs provide a significant share of TVET in Ethiopia (GTZ 2006).

Niger

In Niger the percentage of women enrolled in TVET has fallen from 40% in 1999 to only 17% in 2007. Moreover, during the same period the share of secondary students enrolled in TVET programmes declined from 6% to only 1%. Nevertheless, in 1998, the government of Niger launched a process to reform the TVET sector. This was the year in which the National Office of Vocational Training (ONAFOP) was started in Niger, which offers opportunities in finance training for and by the informal sector and building capacity in the TVET sector (Johanson and Adams 2004).

It is against this background that the government of Niger's sectoral TVET policy has been elaborated and whose strategic policies and measures correspond with the government's own development plan (Government of Niger 2006). Niger received support from the EU, the French Cooperation and the

Luxembourg Aid Agency to carry out TVET reform. This process amounted to *a sectoral policy document* issued on 16 March 2006, whose basic principles govern and guide the TVET system in Niger. The TVET funding came from *a TVET tax on the enterprises*, which goes directly to the TVET fund circumventing the Treasury in the Ministry of Finance (Agune 2010).

Technical and vocational education and training is a priority by the government of Niger because it is considered to constitute an effective means to include and maintain the youth in the labour market. The sectoral TVET policy in Niger permits first of all to better address the issues and the objectives of the TVET systems. Secondly it also enables concrete development of a better synergy between the vocational training systems and the world of work in order to adapt the training to the evolving needs of the labour market. The implementation of this sectoral policy demands a new type of relationship between the government and all the partners operating in the sector with the aim of reforming the TVET sector and establishing a real partnership (Government of Niger 2006).

Zambia

The government of the Republic of Zambia (GRZ) through the Ministry of Science and Technical Vocational Training (MSTVT) instituted the Technical Education, Vocational and Entrepreneurship Training (TEVET) Reforms in 1994 that saw the formulation of the TEVET Policy (1996), the Strategy Paper (1997), the TEVET Act No. 13 of 1998 and the revised act No. 11 of 2005. Government established the Technical Education, Vocational and Entrepreneurship Training Authority (TEVETA) to regulate all forms of technical education and vocational training. As a result of this, all training providers, regardless of ownership, are required by law to register with TEVETA.

The MSTVT has been implementing the TEVET Development Programme (TDP) since 2001 with the objective to ‘develop a TEVET system that will improve the skills of both the formal and informal sectors of the economy through creating a high-quality, sustainable, demand-driven, and equitable training system’. The broad development objectives of the TDP are as follows.

Demand responsiveness: establishment of a training system that was responsive to the demands of both the formal and informal sectors of the economy.

Quality: improvement in the quality of training.

Equity: assurance of equity (gender, disability and vulnerability) in the delivery of training.

Sustainability: development of mechanisms for assurance of financial sustainability of the training system (Mwanza 2008).

Zambia as a consequence of its TVET reform had the second highest growth rate (+765%) in the total number of secondary students enrolled in TVET programme between 1999 and 2007.

8.4 Demand Side and Supply Side for Skills

8.4.1 Ways of Addressing Socio-economic Factors Such as Public Perception Problems and Inequities in Access to TVET

The teaching profession *per se*, but particularly the field of TVET, often suffers from low standing. The poor prestige of vocational education has implications for both pre-service and in-service teacher training throughout their professional life. Billet (2009) argues that it is as though we are dealing with a sector whose contributions are not fully appreciated or understood, and whose status is shaped by societal views and sentiments about the learning of vocational knowledge.

Promoting African entrepreneurship is a long-term process, involving overcoming negative cultural perceptions regarding entrepreneurship, which is often seen as something to be engaged in only by those who have failed in other ventures. Flagship national entrepreneurship programmes, supported by strong communications efforts, have been found to help increase entrepreneurship opportunities and skills, as well as tackling these negative perceptions according to Radwan *et al.* (2010).

A lot of research has been carried out looking at the linkages between national culture and entrepreneurship. Studies have, for example, looked at components of entrepreneurial activity captured by national rates of innovation, regional rates of new firm formation, power distance, individualism, etc. However, Mungain and Ogot (2006) controversially argue that *national culture*, is largely absent in most African countries that are still dominated by the cultures of their individual ethnic communities, at least in the rural areas.[33]

Mungai and Ogot (2006), therefore, present the differences amongst four ethnic communities in Kenya on their perceptions on entrepreneurship based on the proposition that culture is one of the key reasons which may hinder or encourage entrepreneurship amongst the four different ethnic communities represented by samples selected from Nairobi. Two factors known to be closely linked to the propensity for entrepreneurship are risk aversion[34] and locus of control.[35] The study finds significant differences among communities, suggesting that certain cultures may foster an entrepreneurial spirit within its members more than others.

Nevertheless, for many parents and students TVET still remains a 'second-class' education. In 2007, in the Republic of Korea, about 13% of secondary students were enrolled in TVET. So the government is trying to open a pathway

[33] In 1950 14.7% of Africa's inhabitants were urban, in 2000 had it risen to 37.2% and the UN expects it to rise to 45.3% in 2015.

[34] Risk taking refers to the willingness to commit significant resources to some uncertain opportunities. A high risk-taking propensity is often attributed to entrepreneurs.

[35] This concept refers to the belief held by individuals that they can largely determine their fate through their own behaviour. In addition, internal locus of control has proven to be more useful than need for achievement in differentiating entrepreneurs from non-entrepreneurs.

to higher education. First, TVET students are now getting academic subjects so that they can apply for a place in university. In some schools, academic and vocational students share as much as 75% of a common curriculum. The government is also channelling public and private investment into new post-secondary training institutes to kill the myth that TVET is an academic 'dead-end' (Maclean *et al.* 2009).

The Czech Republic is one of the few countries where vocational education enjoys a good reputation. In 2007 about 38% of secondary students were enrolled in TVET (UIS 2009). Instead of abandoning the system to market forces, the government has given greater freedom to principals and teachers to update curricula and introduce new occupational fields, as opposed to the specific skills associated with a particular job. Another major selling point is the 'open-door' policy to higher education. Some of the new post-secondary training institutes (set up over the past 10 years) allow students to transfer directly into universities (Maclean *et al.* 2009), all of which contribute to improving the perception of TVET.

Moreover, TVET in general can motivate student learning. Students who do not succeed in school, both in developed and developing countries, are almost without exception those who lack the motivation to learn – those who see no value for themselves in the learning. A key finding of research on 'disengaged students' has identified the power of the perceived usefulness of learning in motivating the learner. There are few motivators to match the value of an education that provides an avenue for varied work opportunities, as well as the capacity to use those opportunities well. Hughes (2005) argues that TVET has a role not just in preparing students for work but also in increasing their motivation to learn more generally.

Technical and vocational education and training has suffered from being considered as the fall-back position for those who did not succeed in the more academic streams. It is only in recent decades that this perception has been challenged. A major reason for this modification has been the changing role of work and its impact on national and international economies. With work becoming more technologically based and more diverse, thus reducing the opportunities for unskilled work, technical and vocational education has assumed a key educational role. The enhanced role of TVET as an entry point to the 'knowledge society' is reflected in the role it has been accorded by UNESCO (Hughes 2009).

8.4.2 Linkage of TVET with Labour Market and the Evolution of the Economy

There is a rich literature on the supply side of youth employment as we have seen in the previous sections. However, there is almost no youth-focused literature that starts off from *the demand side of the labour market*; that is, *job creation*. Radwan *et al.* (2010) argue that the strand of economic thought that highlights the particular needs of youth as secondary workers comes closest to looking at these issues but it is focused on broad macroeconomic issues such as labour market regulations, minimum wages and information asymmetries (see Borjas 2010), which is only part of the job creation story.

Exacerbating the poor quality of formal education is the tendency of the African private sector to underinvest in training. The formal sector is likely to consider that it does not need to attract employees through the quality of their career development and training programmes, as *demand for jobs* is so high. Furthermore, many large formal sector jobs are in sectors (including the public sector) that are protected from competition, and so a dynamic skill development programme is less critical. Radwan *et al.* (2010) believes that the informal sector is unlikely to offer training given the instability within which the sector operates, which can make any long-term investment unviable despite the fact that it employs thousands of youth as 'traditional' apprentices. *Changing the incentives for African firms* and multinational companies operating in Africa is key to a long-term approach to skill development.

In order to overcome these various *market failures* – namely, mismatching of skills with training provision and underinvestment in training – Radwan *et al.* (2010) argue that the private sector must partner institutions of higher learning to support the curriculum development process. Public providers of education and training must also better consider how to deliver those skills which are crucial to all private enterprise, such as those relating to management and entrepreneurialism.

A number of studies at the World Bank are moving toward a more comprehensive approach to skill gaps and market needs. One such effort is 'MILES' (which stands for macroeconomic framework, investment climate and institutions, labour market regulations, education and skills, and social protection). Currently being implemented in several countries, MILES uses comprehensive analysis of *education–labour market linkages* to develop policies that foster job creation and poverty reduction (Fasih 2008). *The framework* within which educational supply and demand are analysed is thus broadened to include a country's macroeconomic situation, investment climate, and labour market policies. A more comprehensive framework will not only strengthen the diagnostic capacity of education supply and demand analysis, it will make the policy approach to education issues more efficient. However, the paper by Radwan *et al.* (2010) argues that the MILES framework misses out on a crucial component of the youth employment jigsaw, in terms of identifying and supporting *youth intensive sectors* (Radwan *et al.* 2010).

Most recently, *a new approach to skills development* has been published by the Human Development Network (World Bank 2010). The 'STEP' framework ('skills towards employment and productivity') has five steps:

- getting children off to the right start;
- ensuring that all students learn;
- building job-relevant skills;

- encouraging entrepreneurship and innovation;
- facilitating labour mobility and job matching.

This combination of steps enables policymakers to focus on concrete steps involved in creating *a coherent skills-building system*. As the steps imply, it includes the crucial linkages to private sector demand, as well as often overlooked element of *entrepreneurial skills building* (Radwan *et al.* 2010). Chapter 2 of Martínez *et al.* (2010) reviews the literature and reveals that entrepreneurship education and training has grown rapidly in recent decades. However, little comparative data exists on how many people receive training in business start-up activity, whether some people are more likely to receive training than others and whether the training makes any difference in their subsequent entrepreneurial behaviour.

According to the AfDB High Level Panel Recommendation on Skills Development, priority should be given to *links to the private sector*. Public/private partnerships (PPPs) and the involvement of the corporate sector in TVET-related programme activities mounted by UNESCO are becoming increasingly important. For example, in December 2008, UNESCO signed a four-year partnership agreement with the UK-based StratREAL Foundation to cooperate in the field of *entrepreneurship education* in the Arab states region. The objective of this partnership is to support decision makers in the development of educational policies and programmes that *integrate entrepreneurship education in the education systems* of the Middle East and North Africa (MENA). The activity represents a significant and sustainable contribution to skills development for youth across the Arab states region (Maclean *et al.* 2009).

While the public sector has been slow to respond to the changes in demand for skills brought about by growth of the informal sector, Brewer (2004) argues that the private institutions have been more responsive to this demand. Largely dependent on fees, for-profit institutions are concentrated in urban markets and less frequently found in rural areas. They are *responsive to demands for skills*, adjusting quickly to changing needs. The programmes offered often require limited investment in equipment and facilities and provide easy market entry and exit for the providers. Commercial courses are popular, including IT programmes. Although, Johanson and Adams (2004) warn that quality varies widely where standards are left to the provider, they do propose that private for-profit providers could play a larger role in the provision of training to those in the informal sector. Adams (2008) suggests that sometimes modular short courses are well suited to a more flexible delivery of skills training for those who cannot afford long spells away from their work.

8.4.3 Training of TVET Teachers and Instructors

Billet (2009) finds that the teaching profession within the broader sector of TVET is differentiated by the way in which this educational provision is manifested in a particular country, the institutions within that country, and what purposes it seeks to serve at a particular moment in that country's social and economic development. As a sector of education that is often *seen as needing to be highly responsive to changes* in the kinds of skills and knowledge that countries require to be developed, Billet (2009) argues that TVET has particular cultural impetus[36] and forms. Not least of these is the degree to which its purposes are aligned with *directly training the skills required for work* by the community, or some other educational goal, such as more general competencies associated with the quality of working life.

Billet (2009) further suggests that the kinds of roles that *TVET professionals* will undertake are likely to be quite varied given that the different educational purposes, institutions and sectors in which they practice are likely to shape the way in which their professional roles and activities will be transformed. These shape not only the conduct of professional practice, but also the training programmes that prepare individuals for the profession and in-service professional development. Yet, within all of this difference and across these distinct provisions there are likely to be at least *two elements of commonality*: constant change and relatively modest prestige. Billet (2009) argues that these also affect the professional preparation and career development of teaching staff.

Billet (2009) suggests that it is important to understand the bases for initial preparation for professional practices and the processes by which TVET professionals are able to *maintain the currency of their practice* through a career characterized by changing demands and goals.

Billet (2009) divides the examination of the preparation and ongoing development of those who practice as teachers within TVET into two areas:

- those dealing with the profession and its preparation;
- those focusing on professional development, particularly changing roles and further development for TVET professionals.

With regards to the first area, it largely concerns *the current and emerging societal requirements for TVET teachers* and their pre-service preparation. These requirements are often premised on particular imperatives that the contributors clearly identify according to Billet (2009).

Zhao and Lu (2009) note that, in China, there are barriers that inhibit elevating the prestige of vocational education and educators, including the sector's traditional modest standing, a lack of stability in policymaking and the failure of vocational educators to organize themselves politically (Billet 2009).

One contentious issue is who *the curriculum-makers* are, e.g. in terms of their social origins, visions of TVET, etc., and to what degree TVET professionals are empowered not only to enact what others have decided should be taught, but also to design and develop further the goals of students' learning and the means by which that learning is supported. Beven (2009) argues for TVET professionals

[36] That is, something which encourages a particular activity or makes that activity more energetic or effective.

to have a key role in applying their pedagogic and curriculum knowledge in designing learning experiences for students that are based not only on government and industry directives, but also upon the situational factors that shape the enactment of any curriculum. Therefore, Beven (2009) proposes that the curriculum process needs to take into account the importance of the student, who ultimately experiences the curriculum (Billet 2009). Leite *et al.* (2009) similarly propose that *the role of the TVET professional needs to go beyond that of just being a teacher* of vocational practice (Billet 2009).

Kerre (2009) offers *an approach to the preparation of TVET educators* that is suitable to African countries. Kerre (2009) holds that the educational provision of TVET is most likely to be effectively *delivered through the schooling system*, given the strengths of the existing educational institutions. Therefore, it is necessary to *prepare specialist teachers to deliver quality TVET through the schooling system*. The in-service development of the TVET professional becomes an imperative following the kinds of demands described above. Clearly, pre-service teacher education will not be sufficient to meet the evolving demands placed upon TVET professionals throughout their teaching careers (Billet 2009).

Harteis (2009) argues that *a combination of practice-based and academic-institution-based experiences* are the ones most required to develop expert capacities in TVET teachers. It is through these two contributions that the integration of both of these kinds of experiences can provide the kinds of teacher-training processes that Harteis promotes as being essential for effective professional development (Billet 2009).

Gerds (2009) talks about the *implementation of technical and vocational teacher qualification standards* in developing countries. Gerds (2009) mentions that in the last two decades, a process of *developing standards* for occupation-directed education, training and development has come from the Anglo-American countries. It can now be seen in many countries all over the world. It is not an understatement to say that *the establishment and acceptance of national teacher qualification standards (NTQS)*, not only for the education and training of the workforce, but also for vocational and technical teaching staff, has set in motion radical changes and improvements.

Nevertheless, Gerds (2009) warns that some undesirable consequences are possible. Notwithstanding his concerns, other authors suggest that the development of *rigorous national teacher qualification standards* and their certification may 'increase the professional standing of the teaching profession'; create a consistent, unified vision of accomplished teaching; and establish for the general public *a positive image of public education*. Furthermore, 'the extensive nature of the standards development process is seen as an innovative model for developing the codified knowledge of teaching excellence, designed to remove misconceptions of what constitutes good teaching' (Billet 2009).

According to an ILO survey, some 70 countries are in the process of developing or implementing some kind of qualifications framework (Allais *et al.* 2009a). The ILO and ETF are in the process of carrying a number of qualifications framework (QF) case studies, which includes:

- 5 early starters (England/Wales, Scotland, Australia, New Zealand and South Africa);
- 11 recent starters (Botswana, Mauritius, Tunisia, Lithuania, Russia, Turkey Bangladesh, Malaysia, Sri Lanka, Chile, and Mexico).

Some of the *lessons learnt* based on the analysis of these NQF case studies are the following.

- QFs are not static – early starters changed considerably over time.
- A loose comprehensive framework can help create pathways to higher learning.
- No evidence that QF improved relationships between education and labour markets.
- Where new qualifications and competences have been designed, there has been lack of uptake, with many not being used at all.
- There is little indication that employers find qualifications easier to use than prior to NQF in terms of making qualifications relate more closely to their needs.
- Allais *et al.* (2009a) comment that introducing a qualifications framework is a far more ambitious and radical project than most policymakers and designers have realized. In some ways, qualifications frameworks are best seen as utopias, and like all utopias, they are more attractive in theory than in reality.
- Limited formal roles for Ministries of Labour.
- Many countries are not tracking labour market results – no data on whether NQF improves supply and demand of training.

The development of a NQF requires legislation to set up a National Qualification or Training Authority to construct and administer the NQF, including the development of unit standards. Abdul-Wahab and Afeti (2009) argue that a *Regional Qualification Framework* for the ECOWAS region can facilitate the portability of qualifications, skills and labour within the region, such that TVET can become an instrument of regional integration.

8.5 Cost Analysis and Financing Issues

Lack of resources is seen as a hindrance to pursuing the objectives of training the workforce for self-employment, and raising the productivity of the informal sector as well as in the public sector. This is all the more so given that TVET is an expensive form of education and expanding it without necessary and adequate facilities and equipment does not lead to increasing productivity in the long run. Yet, at the same time, criticisms of TVET have led to cuts in the volume of training provided in the public institutions and a call for the mostly family-run informal enterprises to take on more responsibility for providing TVET. Oketch (2009) suggests that *a look at the funding of TVET* can shed light on the contradiction between the emphasis for skills and the limited funding that the governments are willing to commit to it. Moreover, the international pressure on countries to meet their EFA goals for 2015 has meant that more resources have been shifted, both within national budgets and by international aid assistance, to realizing UPE and yet the rhetoric over skills and the value of TVET continues unabated according to Oketch (2009).

The analysis of financing patterns used to focus on collection and allocation mechanisms. Increasingly, these concerns are being linked to the wider question of organizing training systems and particularly with *the sharing of responsibilities* between the key stakeholders according to Atchoarena (2009a).

Atchoarena (2009a) argues that *financing strategies for TVET* are part of a broader effort to engage all concerned parties, particularly companies and learners, in a dynamic process of skills acquisition. Atchoarena (2009a) proposes that achieving such a goal requires maintaining a careful balance between incentives and constraints according to national circumstances.

Atchoarena (2009a) suggests that *the debate on TVET financing* typically turns around the following two key questions.

- Who pays for skills development?
- What mechanisms can be put in place to finance skills development, and what works best, in particular as far as spending public money is concerned?

While economic and financial issues present constraints for financing policies, Atchoarena (2009a) suggests that a third element opens new opportunities. The *wide body of knowledge on different funding mechanisms* that have developed internationally is indeed a valuable asset for policy decisions. According to the economic rationale, *those who benefit from training should pay for it*. In many countries, pre-employment training, initial training and institution-based training are still considered to be a responsibility of the government, while financing continuing training and education is left to social partners (Atchoarena 2009a).

Little data is available on the sharing pattern in individual countries, even regarding initial training. In the current economic context it has become more and more common for governments to *promote co-financed mechanisms for TVET*. This frequently includes creating incentives for employers and individuals to invest more in skills development. Atchoarena (2009a) writes that the current trend emphasizes *the role of enterprises and learners in contributing to the costs* of skills development.

Section 8.5.1 takes a look at the role of the domestic government and Section 8.5.2 presents various financing mechanisms and instruments.

8.5.1 Public Finance for TVET

Despite the importance given to TVET by many governments, the training system in Africa is largely *underfinanced*. Generally, the provision of technical and vocational skills and especially formal TVET is expensive, since facilities, material, equipment and maintenance costs are high. The *financing of TVET* percentages of public expenditures varies considerably from country to country. It ranges from a low of 0.9% a decade ago in Ethiopia to 12.7% in Gabon in the same period (ILO 1998, cited in Atchoarena and Delluc 2001). Getting the financial breakdown for TVET in Africa is difficult because in many countries allocation is done at ISCED level rather than by programme. Many countries are therefore unable to provide the UNESCO UIS accurate expenditure data. Difficulties in specifying spending on TVET are compounded by the fact that provision in the private sector and other ministries with TVET responsibilities is hardly captured in the data.

According to the latest public expenditure figures Mali allocated the highest share of its total public expenditure on education to TVET (Table 8.6). Investment expenditure recorded strong progression at every level. The priority accorded to TVET education by the Malian government is expressed in the figures: it drew nearly 15.6% of public expenditure on education in 2008, against 12.7% in 2005 (OECD 2008) and 9.1% in 1995.

Gabon is ranked second in Africa when it comes to public expenditure on TVET as a percentage of total public expenditure on education (Table 8.6). In Gabon TVET financing methods are quite varied. For many years, the national budget allocated to education has oscillated between 10% and 15%. The scheduled TVET investment budget for 2008 was 13.9% of the government's investment budget: this was an increase of 40.7% compared to 2007. Financing of TVET is executed according to the priorities of the ministry's strategic plan and the priority action plan approved by the finance ministries (OECD 2008).

Difficulties in specifying spending on TVET are compounded by the fact that provision in the private sector is hardly covered by the data. Oketch (20009) carried out interviews with respondents in seven African countries, which revealed that many of the private providers due to their mistrust towards civil servants and researchers do not want to cooperate in providing their financial information, and, in cases where they do, the figures are often inaccurate.

The Ugandan government's priority in the education sector continues to be directed towards the UPE programme. The education ministry allocates approximately only 4% of its total budget to the business, technical and vocational education and training (BTVET) subsector (Table 8.6), while two-thirds of the budget goes to primary education. Since 2002, however, vocational training has increasingly gained importance particularly at the post primary education levels. The proportion of BTVET within the education budget is set to increase from the current level to 12% by 2015. Funding for TVET at post-primary levels is also inadequate. In 2005 Ministry of Education expenditure on TVET was only 1.2% of the total resource envelope for education; similarly in

TABLE 8.6. Public expenditure on TVET as a share of total public expenditure on education.

Country or territory	1990s Period	1990s % expenditure	After 2000 Period	After 2000 % expenditure	Rank
Algeria	—	—	2005–9[a]	13	3
Cameroon	—	—	2007	2.34	10
Cape Verde	1991	2.9	2008	5.47	6
Eritrea	1994	1.6	2004–5	8.60	5
Gabon	1992	12.7	2008	13.9[b]	2
Kenya	1993	—	2006–7	2.70	9
Mali	1995	9.1	2008	15.6[b]	1
Nigeria	—	—	2005	13	3
Senegal	1990	2.7	1992–2005	<4.5	7
Uganda	—	—	2006–7	3.60	8

Notes: 1990s data from ILO World Employment Report 1998–9, Statistical Annex Table 8. [a]World Bank Public Expenditure Review (PER) 2007. [b]Share of overall public capital expenditures. *Source*: author based on the ILO and UNESCO databases.

2002 the Ministry of Manpower allocated 12% of its budget to the TVET sector under that ministry (Palmer 2007).

8.5.2 Financing Mechanisms and Instruments

Table 8.7 summarizes some of the benefits and limits of the use of *payroll taxes to finance TVET*. Traditionally governments directly financed training providers and training delivery. In order to improve the effectiveness of public spending, *new forms of management* are, however, being developed (Atchoarena 2009a).

Financing mechanisms and instruments are generally seen as a way to mobilize additional resources. Payroll taxes and training funds constitute the most significant attempt to involve industry in the financing and regulation of a training market. Financial arrangements can also contribute to improving the efficiency of public spending. They are often part of a broader body of reform inspired by *the new public management principles*. An extended analysis of this topic is offered by Ziderman (2009), whereas Walther (2009) provides *a comprehensive review of financing criteria and models* illustrated by examples from eight countries in Europe and Africa.

Government policies to encourage enterprises to invest in skills subsidize the cost of this investment through various measures. *The incentives* may vary in their impact on the actual amount of training done. Twenty-one countries in SSA have introduced *training funds* financed by *payroll taxes*. These funds *reimburse enterprises for the cost* of qualified training undertaken. *Training vouchers* are also an instrument used by governments and training funds to subsidize the cost of training by enterprises and individuals (Patrinos 2002,

TABLE 8.7. Advantages and limitations of using payroll taxes to finance TVET.

Advantages
– Training funds are powerful tool to expand training provision.
– Training funds can stimulate employers' investments in training and skills development.
– Training funds contribute to the establishment of a market for training when resources can also be allocated to private providers, which lead to a competition between public and private providers.
Limitations
– Fund management, including the accumulation of surpluses and the diversion of funds, sometimes causes problems.
– The system cannot operate on a sustained basis without sufficient support from the business community.
– Formal sector employers are often resistant to supporting skills development in the informal sector, i.e. to cross-subsidize skills development in the informal sector.
– The long-term sustainability of training funds in LICs remains open to question.

Source: Atchorarena (2009a, p. 1032).

referred to in Adams 2008). Offered to master craftspersons and workers in the informal sector, vouchers can help pay for training selected by the worker. The cost of training is also subsidized by *governments by allowing enterprises to deduct eligible training costs from their income* for tax purposes or that provide *tax credits* for qualified training expenses.

The introduction of training levies on payrolls is used globally to mobilize additional resources for skills development (Ziderman 2003, referred to in Adams 2008). The fairness of the levy is judged on the taxation principle that those who benefit from the resources spent on training should be those who pay as mentioned above. *Payroll levies* have been used to finance the provision of training by national training organizations, as found in Latin America in countries like Brazil, Columbia, and Venezuela, but also training directly by enterprises where *a levy grant system* is adopted and administered through a training fund. Enterprises are reimbursed in a levy grant system for the cost of qualified training expenditures by these funds. This is the dominant model found in SSA (Adams 2008, 2009).

The impact of these funds on training by the informal sector, however, is limited according to Adams (2008). *Most funds exempt smaller enterprises* (below 50 employees) from the payment of a levy because of the higher administrative cost of enforcing compliance by these enterprises. Dar *et al.* (2003), in a review of *international experience with training funds,* find that small employers do not benefit substantially from these schemes. *The financial* *incentives offered are insufficient* to offset the other factors that deter training by small enterprises. As a result, *training funds with levy grant schemes* tend to favour larger enterprises and the training of more highly educated and skilled workers in these enterprises (Adams 2008).

Limited evidence is available in SSA on *the initiatives of national training funds to reach small enterprises in the informal sector*. Other voucher programmes have been introduced to encourage training in the informal sector (see Johanson and Adams 2004). *The Kenya Jua Kali voucher programme* was successful in its pilot stage in expanding the supply of training to workers in the informal sector and lowering cost. There was evidence of its positive impact on the earnings of participants and strengthening of the capacity of local Jua Kali Associations responsible for distribution of the vouchers, but problems were encountered with corruption in scaling up that led to high administration costs (Adams 2001; Riley and Steel 2000, referred to in Adams 2008).

A similar voucher programme targeted on informal sector enterprises was offered in Ghana in the early 1990s that largely failed due to lack of attention in the design of the marketing and distribution of the vouchers (Johanson and Adams 2004). Worldwide, countries allow enterprises to *deduct the cost of training from their income* as a cost of business before taxes, but for the informal sector where small enterprises may not earn sufficient income to pay taxes or may avoid taxes altogether by not being registered, these deductions provide limited incentive for training. The same result may apply to *tax credits* that are targeted to selected enterprises in return for agreed training and employment actions. Where the credit can be refunded to the enterprise in the absence of a tax liability, this may serve as an added incentive for training and even registration of the enterprise, but once again that may not be sufficient to prompt small enterprises in the informal sector to train (Adams 2008, 2009).

Atchoarena (2009a) also proposes that financing of TVET cannot rest solely on the government budget. He calls upon businesses, local governments, NGOs and individuals to contribute to this investment. Yet he warns that the temptation to rely increasingly on private-sector funding may face *structural limits* due to the already high, and sometimes increasing, cost of training in many fields. The new skills requirements linked to globalization, the constant search for competitiveness and the preservation of social cohesion clearly require *new funding formulae* according to Atchoarena (2009a).

8.5.3 The Relations between Costs, Efficiency-Impact and Financing

Costs

Principals and teachers point to the heavy expenses required to develop curricula, train staff and equip classrooms for specialized TVET subjects, which generally cost three times more than academic courses (Maclean *et al.* 2009). Lauglo (2006) argues that part of TVET policy preparation is *cost analysis*. Annual costs of established TVET institutions are usually available, but surprisingly often cost analysis of different training specialties within the same institution are lacking, and surprisingly often cost estimates do not seek to produce combined costs of recurrent expenses and annualized capital expenses. Lauglo (2006) therefore raises the following questions: how should the accuracy of cost information be improved, and how should the use of cost information be ensured?

Efficiency

A series of 'internal efficiency' questions relates to the flow of students or trainees 'internal' to courses. Applied to TVET, this would especially be for longer courses which are 'pre-employment' rather than to short 'training events' and training within industry itself. Lauglo (2006) raises the following question: what are course completion rates and drop-out rates in different types courses? Other indicators (regrettably rarely available) are capacity utilization of facilities and of available human resources. *Benefit–cost analysis* is sometimes attempted on TVET (usually internal rate of return estimates) in order to estimate what may be termed *external efficiency*. It is a method which has been both widely espoused and – especially as a means of estimating benefit–cost to society rather than merely to private persons – widely criticized. Lauglo (2006) suggests that research has a role in both critically assessing its potential and limitations, and in applying such analysis.

8.6 Conclusions and Policy Implications

Education and skills are important for growth and productivity but are also at the centre of *a fair and inclusive globalization*, which according to the ILO (2004) is understood as being about harnessing the benefits of globalization while promoting sustainable economic and social development, and broad access to opportunities is vital. The World Commission on the Social Dimension of Globalization noted that all countries that have benefited from globalization have invested significantly in their education and training systems (Poschen 2009; ILO 2004). Viewed from the perspective of an ever-changing fast-paced global economy, change in workplaces and labour markets is being driven by powerful and interconnected forces: rapid technological advances (particularly ICTs) and their global diffusion, increased trade and FDI, intensified competition in international markets, etc. (ILO 2008a; Greene 2009).

To quote the definition of the term *employability* in the ILO's Human Resources Development Recommendation no. 195, paragraph 2(d) (2004), it is an 'individual's capacity to … secure and retain decent work, to progress within the enterprise and between jobs, and to *cope with changing technology and labour market conditions*'. In other words, this means that the field of vocational training has never been as important as it is today (Greene 2009).

Based on lessons learned distilled from our review of evaluation studies and past TVET experiences in various regions around the world, a number of suggestions and policy options is provided in this concluding section, which could serve as inspiration for how Sierra Leone's schools, teachers and education system as well as all economic and social stakeholders could respond to the needs of the current economy. This also includes providing some guidance to the TVET reform process that is currently underway in Sierra Leone through the revision of the National TVET Policy 2010 prepared in collaboration with UNESCO.

8.6.1 Quantitative Evidence on the Effects of TVET Interventions

Several quantitative studies, which predominantly focus on OECD countries because of the much higher availability of data sources, find that the majority of TVET interventions appear to have positive labour market impacts for participants in terms of post-programme employment and earnings. But Betcherman *et al.* (2007) conclude from their statistical analysis of the patterns of programme success from 84 countries in all regions of the world that interventions in the OECD targeting disadvantaged youth are as good, if not better, than programmes with no particular orientation.

From our own review of the statistical impact evaluation studies, e.g. using methodologies such as a non-experimental procedure for evaluating a prototypical job training programme, evaluations of the impact of a randomized training programme, scientific (i.e., control-group) evaluations, etc., we conclude the following.

- *The development of relevant skills* is an important instrument for improving productivity and working conditions and the promotion of decent work in the informal economy.
- *Education and skills* can open doors to economically and socially rewarding jobs and can help the development of small informal-sector and formal-sector (growth-orientated) enterprises (Kingombe 2010), facilitate the reinclusion of displaced workers and migrants into the labour force, and support the transition from school to work for school drop-outs and graduates.

More specifically, we conclude the following.

- The statistical analysis of the Youth Employment Inventory (YEI) based on documentation of current and past programmes that have been implemented to support young workers find work, with a focus on disadvantaged young people, and *evidence from 289 studies of interventions from the 84 countries* shows the following.
  - The most common type of intervention for youth is *skills training.*
  - Only 10% of the interventions in the YEI are in SSA countries.

  - There is great need for improvements in the quality of evidence available as regards the effects of youth employment interventions.
  - The absence of rigorous evaluations outside the OECD area almost certainly leads to an overestimation of programme impacts with possible inefficient allocation of resources.
  - 78% of the evaluated programmes have been rated by Betcherman *et al.* (2007) as having had an impact in terms of the two specific performance indicators post-programme employment and/or earnings of participants.

- Quantitative analysis of formal TVET systems in Africa has been hampered by the lack of comparable quantitative data on TVET participation and outcomes.

- Among active labour market programmes (ALMPs) in Latin America:

  - *Job training for young people*, 16 to 29 years of age, particularly the following categories of interventions: vocational training including apprenticeship systems and to a much lesser extent second chance and equivalency programmes, is popular as an attempt to help the labour market inclusion of disadvantaged youth.
  - Overall results suggest that *employment effects* range from modest to meaningful – increasing the employment rate by about 0 to 5 percentage points.
  - Educational benefits in terms of *the rate of return*, e.g. higher entry wages, higher wages throughout working life, increased job opportunities and a reduced risk of becoming unemployed, for vocational secondary education is higher than that for secondary general education.[37]

It should be added that in general almost no research exists on the contribution to economic and social development of vocational training versus general education (Descy and Tessaring 2005, referred to in GTZ 2009). By far most of the economic studies refer to secondary and tertiary education without distinguishing between general and vocational secondary education. Furthermore, most of them are limited by methodological issues, particularly the control for

[37] While some scientists have demonstrated the great importance of general education for economic growth, it seems that no thorough investigation of the impact of TVET on economic growth has been carried out thus far. While the human capital theory is coherent, the results of empirical studies concerning TVET are very limited and, in fact, largely incomparable, due to the different structures and roles of TVET in different countries. Furthermore, with regard to individual benefits, important differences between people enrolling in academic educational institutions and those enrolling in vocational educational programmes are often not taken into account (Dohmen 2007 referred to in GTZ 2009).

selection bias is missing.[38] The studies provide very divergent results, using different methods.

Whereas some studies estimate lower returns to general education compared to vocational education, others find that the income effects of vocational qualifications lag behind. Taking into account the length of time of studying and the earnings forgone, the returns to vocational training approximate the returns to academic qualifications (Machin and Vignoles 2001 cited in Dohmen 2007, referred to in GTZ 2009).

Some generalizations about ALMPs suggest the following.

- *Training for the long-term unemployed* can help when the economy is improving.
- *Small-scale, tightly targeted on-the-job training programmes*, often aimed at women and older groups, show the best returns. However, the cost-effectiveness of these programmes is generally disappointing.
- Concerning *the evaluations of the macroeconomic effects of the active policies*, such as making the labour market work better for young people (e.g. counselling, job search skills; wage subsidies; public works programmes); improving chances for young entrepreneurs; skills training for young people (e.g. vocational training; literacy and numeracy – young adult literacy programmes), the results of the various econometric analyses are inconclusive.
- The OECD Jobs Study stressed that more *effective active policies are only one element in a comprehensive strategy of macroeconomic and microeconomic measures* required to cut unemployment significantly.
- Many findings from OECD countries do not always seem to apply broadly in the case of developing countries. The much larger *informal labour markets* combined with much weaker capacity to implement programmes may limit the ability of some programmes in developing countries to accomplish much, in terms of creating formal employment or increasing wages.
- In terms of financing and impact, it is important to *keep public training programmes small in scale and well targeted* to meet the specific needs of both job seekers and local employers.
- *The evaluation of programmes and interventions* should be built into the design of TVET programmes at the beginning.

[38] That is, the target group for TVET, and particularly for vocational training, is different from the target group for general education, for example the fact that TVET is seen as being for dropouts it therefore attracts less motivated pupils/students/apprentices. Thus, a comparison between the rates of return to general education and TVET is necessarily biased towards general education (GTZ 2009).

Indices of TVET value as probability of employment, of attaining entrance to some particular occupation and employment, and good job matching to education and training are useful indicators for policymakers. Yet, these indices should be seen as complements to the equally feasible estimates of the material consumption payoff to TVET certificate holders, specifically, *the additional earnings* (adjusted for employment probability) that TVET yields to those who obtain it (Carnoy 1994).

- In general, the social rate of return (SRR) to spending on vocational schooling or specialized private vocational training in establishments outside the workplace is likely to be lower than to spending on general education, mainly because the unit costs (per trade area) of vocational schooling is much higher,[39] and also because, even if academic education does not provide occupational skills, it does attract better prepared individuals from higher socio-economic groups. However, there are exceptions (cf. the case of Germany's famous 'dual system').
- To be effective, *TVET has to be flexible* and tied to current future labour market conditions, for two main reasons:
  - TVET is geared to developing skills in young people for application to work, and without employment of those skills the training has little meaning or value;
  - TVET skills tend to depreciate rapidly if not used at once.
- The closer TVET is tied to existing employment opportunities, the higher both the private rate of return (PRR) and the SRR.
  - In a number of Latin American countries relatively short-course vocational education outside the firm has yielded reasonable rates of return because it is provided to workers who already have jobs and who return to them.
  - In-plant training is not only generally cheaper than TVET in schools, but it may also have a greater effect on productivity, implying a doubly powerful impact on the private rate of return PRR and SRR (Carnoy 1994).

Cost–benefit analyses as well as *estimates of the rates of return* are important instruments for evaluating the outcome of TVET. The analysis of rates of return is just one useful instrument for assessing the impact of training, but it cannot be the only criterion as it does not detect externalities and long-term effects (Lipsmeier *et al.* 2003; referred to in GTZ 2009). However, these aspects should

[39] By definition, *the unit cost of a programme* is the total cost divided by the number of units of training output: participants, batches or hours. This ratio measures the average amounts of resources required to generate one unit of output. Unit costs analysis provides information on the efficiency of training programmes. It is important to check the number of trainees to get an idea of the reliability of the unit costs (Peano *et al.* 2008).

be taken into account in order to arrive at a more profound conclusion on participation in TVET (op. cit., p. 16).

8.6.2 Institutional and Strategic Framework

It is claimed that *strategic considerations* are important in profiling vocational skills in developing countries. Although only a few PRSPs contain skills and education development chapters, most have only devoted a subsection to TVET (cf. Gambia's 2007 PRSP Chapter 5.2 '*Delivery of Social Services – Education*'[40]; Mozambique's 2011 PRSP 2011–2014, Chapter 5.c *'General Objectives 3: Human and Social Development'*[41] or Tanzania's 2010 PRSP II Chapter 4.2 *'Goal 2: 'Ensuring Expansion of Quality Technical and Vocational Education and Training, Higher Education, and Adult, Non-formal and Continuing Education'*[42]), these chapters are often not linked to other chapters. These *strategy papers*

[40] According to Section 4.4.2 on *'PRSP II Priorities and Strategies for the Industrial Sector'*, 'Department of State for Education in consultation with the National Council for Technical and Vocational Training develop a policy to integrate technical and applied science training in primary and secondary schools based on a market analysis of the types of skills the Gambian labour force will need, particularly those required for industrial development.' According to Section 5.2.5 on *'Intervention Priority Areas'* only a small section/paragraph is devoted to *the purpose of the TVET programme*, namely, it is to improve access to, and quality of, TVET in The Gambia. Targets of PRSP II for TVET Gambia are as follows: (i) TVET institutions increased by 50%; (ii) number of skills development centres in rural areas increased (target of more than two centres); (iii) System of Prior Learning accreditation approved; (iv) labour market information system (LMIS) established; (v) mechanical and engineering laboratories established; (vi) approved syllabi established; (vii) TVET affordable to 90% of all eligible trainees; (viii) 50% increase in the number of differently abled people in TVET; (ix) 75% retention rate in TVET system; (x) gender parity achieved in TVET; (xi) at least 75% of the total expected levy is collected; and (xii) Functional Gambia National Vocational Qualification framework established.

[41] According to Annex 1: *'Government Program to Achieve the Objectives of the PRSP 2011–2014'* on TVET recommends to 'consolidate the reform underway and expand the formal and informal system at the various levels, with a special focus on learning opportunities for young people not in school.' On 'employment and vocational training', it recommends to 'improve the quantity and quality of vocational training, in order to make citizens more employable and to promote work and employment opportunities in rural areas, with special attention to young people, women, persons with disabilities and those affected by HIV/AIDS.' On 'secondary education', it recommends to 'expand secondary vocational education on a sustainable basis, through the formal system and distance education, with due regard to quality.'

[42] Cluster strategies to achieve two broad outcomes under Cluster II (that is, improvement of quality of life and reduction of inequities) are structured under six goals including goal 2: 'ensuring expansion of vocational, technical, polytechnics, and higher education, and improving non-formal and continuing education.' The required TVET cluster strategies, according to Tanzania's PRSP II, are: '(i) expanding and improving infrastructure in order to expand enrolment, especially of girls; (ii) reviewing curricula and updating the range of courses offered in order to provide knowledge and skills relevant to the job market and the national growth and development agenda; (iii) strengthening PPPs for the delivery of technical and vocational education and training; (iv) improving quality of teaching and

do not methodologically and strategically link TVET to economic development objectives.

Concerning the Organization for the Development and Implementation of a National TVET Policy

Human-resource development strategies in African countries aim to pursue the development of skills at all levels of the spectrum (low, intermediate, and high levels), but each country *needs to emphasize the mix of skills* that best corresponds to its own stage of economic development and the needs of the local labour market.

In its organization for the development and implementation of its national TVET policy the government of Sierra Leone's Ministry of Education, Youth and Sports needs to bear in mind that:

- there are diversified approaches to education which includes TVET;
- TVET is delivered through a wide range of modalities and actors,[43] as revealed by our review of TVET systems.

Education and training systems in LDCs have many weaknesses and are not yet, in general, assets in terms of achieving development goals. Educational output is often distorted, favouring academic non-technical qualifications, while vocational, technical and employability skills training that could open up labour market opportunities are in short supply (ILO 2008a).

Illiteracy puts formal training out of reach for many people in the informal economy, including for apprentices and master craftspersons. The success of combining literacy training with livelihood training has been demonstrated by many programmes, such as the Society for the Development of Textile Fibres in Senegal, the Tangail Infrastructure Development Project in Bangladesh and the Somaliland Education Initiative for Girls and Young Men (Oxenham 2002, referred to in ILO 2008a).

- In the United Republic of Tanzania, the Vocational Education and Training Authority has designed and tested *an integrated training programme* comprising literacy, technical and managerial training.
- *Informal apprenticeships* can improve training and productivity outcomes.

learning environment; (v) strengthening quality assurance; (vi) promoting adaptation of science and technology to Tanzania's conditions; (vii) promoting use of ICT in teaching and learning; and (viii) mainstreaming HIV and AIDS into curricula, implementing HIV and AIDS intervention for students. Increased emphasis on vocational and technical training needs to be supported with strengthening of M&E in order to monitor, in particular, acquisition of the desired competencies'.

[43] *Formal TVET* in public vocational training centres and schools; non-governmental institutions; the informal/unregistered sector (i.e. traditional apprenticeship); and enterprise-based training.

- In Benin, the Artisans' Support Office *(Bureau d'appui aux artisans)* seeks to complete the training of apprentices by working with various trade associations.

- Making informal apprenticeships more effective requires an integrated strategy (for details of the key elements see ILO 2008a, p 51).

Formal public training systems in LDCs face problems of relevance, quality and equity.

- *Formal TVET systems* fail to deliver skills for existing jobs.

- *The quality of training* has deteriorated as budget cuts have curtailed investments in facilities, equipment and staff salaries.

- *Equity in access to education and training* is a critical problem in LDCs. Women and girls are under-represented in vocational education and training (ILO 2008a).

Concerning the Major Elements of a National TVET Policy

New policies and delivery systems have been introduced by many LDCs to address these problems, many of which centre on *coordination and partnerships with the private sector*. For example, Malawi, United Republic of Tanzania and Zambia have established national consultative or coordinating bodies (national training authorities) that advocate partnership as a means of improving efficiency in the use of public money by making vocational education and training more responsive to the job market. Structuring the relationship between the training system, employers and trade unions is a major feature of national training authorities (Johanson and Adams 2004).

The government of Sierra Leone might consider:

- adopting a clear vision, strategy and leadership at the highest political level;

- improving forecasting and planning for skill needs;

- improving the quality of TVET;

- addressing the skill needs of the informal sector;

- facilitating the growth of the productive sectors;

- fostering partnership with all stakeholders;

- involving the local communities;

- strengthening local management of TVET.

Concerning the Linkage between General Education and TVET

In the mid 2000s, recognizing that universal primary education entails the need for coherent pathways to further education and to skills for employment and self-employment, *an international consensus* was reached on the need for a holistic, integrated, intersectoral approach to education, including TVET. *The Bonn Declaration* states clearly that *TVET should be a central part of EFA*:

> Recognizing that the vast majority of the worldwide labour force, including knowledge workers, require technical and vocational knowledge and skills throughout life, we affirm that skills development leading to age-appropriate TVET should be *integral to education at all levels*, and can no longer be regarded as optional or marginal. It is especially important to integrate skills development in Education for All (EFA) programmes and to satisfy TVET demand created by learners completing basic education.
>
> UNESCO–UNEVOC 2004 quoted in Hughes 2009, p. 2051

Concerning the Role of Formal Schools versus Enterprises in TVET

Competencies can be acquired either through structured training in public or private TVET schools and centres, or through practical experience on the job in enterprises (workplace training in the formal sector and informal apprenticeship), or both (the so-called 'dual' training, involving a combination of workplace and institution-based training) (OECD–AfDB 2008).

In recent years, there has been much policy and programme development activity to *encourage enterprises to expand workplace learning*, while improving the quality of training. In a number of French-speaking African countries (for example, Benin, Burkina Faso, Chad, Côte d'Ivoire, Guinea, Mali, Niger, Senegal and Togo) training funds have been established. The funds are primarily fed by money collected in enterprises (a certain percentage of their payroll). The funds finance employee training within or outside the enterprise and constitute the embryo of these countries' emerging systems of lifelong learning (ILO 2008a).

The government of Sierra Leone should take into consideration that:

- the private provision of TVET is growing rapidly and even dominates in some countries;
- many of the private providers offer courses with a high concentration in commercial trades;
- the private sector has the benefit of tailoring the courses to the labour-market demands;
- there is little evidence to indicate a close working relationship between enterprises and the private institutions.

Concerning Policies for Ensuring Good Quality in TVET

Formal TVET is seriously under-funded, and in turn the obsolescence of the equipment and weak managerial capacity affect the quality of training programmes. Moreover, the oversight responsibility for TVET is in general shared between the ministries responsible for education or technical education and labour or employment, although some specialized vocational training programmes (in agriculture, health, transport, etc.) fall under the supervision of the sector ministries (OECD–AfDB 2008).

The government of Sierra Leone should bear in mind that in order to meet the skills demand in terms of *relevance and quality* it must:

- *increase the capacity* of schools, training institutes and enterprises to deliver relevant and high-quality skills, and to respond to rapidly changing skills needs;
- *expand the availability of good-quality basic education* as an essential right and as a foundation for vocational training, lifelong learning and employability;
- *upgrade informal apprenticeship systems* to deliver skills and knowledge as a basis for higher value added activities and more advanced technologies;
- *facilitate recognition of skills* for the effective and efficient matching of workers' skills with skills required in enterprises (irrespective of where the skills were gained);
- *promote equal opportunities for women and men* in access to relevant and quality education, vocational training and workplace learning, and to productive and decent work (ILO 2008a).

Moreover, the government of Sierra Leone should also consider the following.

- If the effort to collect skills programme/project data on a regular basis is successful, it will be of considerable assistance in monitoring the impact of TVET programmes.
- The important challenge ahead will be monitoring the quality of TVET, the internal efficiency of providers, and the relevance of programmes.
- It is recommended that, in order to *achieve a standardization of training* across the country, occupational standards should be developed for crafts in the traditional apprenticeship system:[44]
  - a programme of training in pedagogy could be introduced to improve the instructional abilities of craftsmen in the informal sector;

[44] *Occupational standards and competency-based training* are intended to improve the relevance of training and thus of the employability of trainees. Competency-based training shifts the emphasis from time spent in training courses to what trainees can actually do as a result of the training. Occupational standards provide the essential link between workplace requirements and education and training institutions and programmes (ILO 2008a).

  - for example, over 100 occupational standards have been adopted by CARICOM as a basis for a regional qualifications framework (ILO 2008a);
  - as part of the TVET reform process, the Ethiopian Ministry of Education has established an outcome-based TVET system, including occupational standards-based assessment and certification (GTZ 2006).

- Government regulations on apprentice training could be made available to all craftsmen (Ahadzie 2009), however, the success of promoting apprenticeship programmes depends on specific capacities, e.g. know-how in business and financial management, marketing and advocacy, which are very scarce in low-income countries. Therefore, development assistance for capacity building could be part of any policy towards TVET development in Sierra Leone.

Concerning Strategies and Structures for Non-formal TVET

The government of Sierra Leone could pursue a strategy based on the state-of-the art of what is known about the informal sector for improving skills as a means of promoting its growth and productivity and improving the incomes of those employed in the sector. According to van Adams (2008, 2009) such an approach needs to include the following elements:

- both the role and the place of the informal sector has to be recognized for policy purposes;
- the education levels and literacy of those employed in the formal sector needs to be raised;
- the complementarity of training with other small business services, such as entrepreneurship, business development services and microfinance needs to be recognized;
- sustainable financing for skills development needs to be promoted;
- using the informal training systems should be carefully assessed when reforming TVET by strengthening traditional apprenticeships;
- a role for public providers of skills needs to be defined;
- the capacity of industry associations needs to be strengthened;
- monitoring and evaluating outcomes for skills development needs to be taken into account in the continuous reform/redesign of the TVET system;
- effective training schemes in the informal sector needs to be tailored to the social and economic situations they are supposed to improve or develop;
- an *active labour market policy needs to be formulated with a TVET component.*

8.6.3 Demand Side and Supply Side for Skills

Concerning the Linkage between TVET and Labour Market

Public/private partnership (PPP) and the involvement of the corporate sector in TVET-related programme activities mounted by UNESCO are becoming increasingly important. According to the AfDB High Level Panel Recommendation on Skills Development, priority should be given to links to the private sector. Hence, the government of Sierra Leone may consider the following.

- *Changing the incentives for African firms* and multinational companies operating in Africa, which are key to a long-term approach to skill development.
- Involving the private sector as partner with institutions of higher learning to support the curriculum development process.
- Ensuring that public providers of education and training better consider how to deliver those skills which are crucial to all private enterprise.
- Improving entrepreneurship education and training, for example,
  - by using the ILO's Start Your Business (SYB), Improve Your Business (IYB) and Expand Your Business (EYB) training modules,
  - by using *UNCTAD's Empretec programme* through a national centre (i.e. one-stop-shop) to help found or expand businesses.
- *The Institute of Technical Education (ITE)*, Singapore, is an example of best practice as a post-secondary technical education institution, but it is perhaps too far away from Sierra Leone's context to be of relevance in the short-to-medium term. The important role that the reform of the TVET system plays in achieving Ethiopia's targets to overcome poverty could be considered instead.

Concerning the Training of TVET Teachers and Instructors

Promoting demand-driven TVET is not a sufficient condition to ensure the quality and relevance of training. *Complementary policies* are needed to improve the qualifications and dedication of teachers. In general, *teachers in formal TVET programmes* have relatively low formal qualifications, they are poorly remunerated, lack motivation, and suffer from low social status and poor career prospects. In many cases, vocational teachers lack practical skills in the trades that they teach and have difficulties to impart skills that meet the occupational standards (OECD and AfDB 2008).

The government of Sierra Leone therefore might consider the following propositions.

- Grollman (2009) proposes that the key to *enhancing the status of the profession* is through a process of professionalization that needs to be introduced by individuals themselves and supported by TVET institutions which provide the training, as well as those partners in the community whose interests are served well by TVET trainers and trainees.

- A great deal of scientific research suggests improvements resulting from the development of standards. For example, in the United States teachers who have been certified against National Board for Professional Teaching Standards (NBPTS) have been shown to be more effective classroom teachers. A major precondition of these achievements is that standards are developed by teachers, as in any other of the more recognized professions. This has consequences on development of cornerstones and concepts for pre- and in-service teacher training and on delivery – and not only for TVET teachers (Gerds 2009).

These concepts correspond to general international trends of curriculum developments, such as the following.

- *Raising the degree of teachers' freedom* in decision-making and choices.
- *Providing flexible and reversible relations between learning and working for teachers* based on modular curricula for pre- and in-service teacher training, usually based on standards.
- *Generalization of TVET teacher-training curricula* by 'regrouping vocational specializations' and by stressing cross-field qualifications.
- *Combining and linking different pathways of recruiting TVET personnel* within a coherent system of teacher training, according to the different functions of teachers:
  - practitioners from industries without formal technical and pedagogical qualifications;
  - teachers with or without vocational, technical but with pedagogical qualifications;
  - practitioners from industries with formal technical/vocational qualifications (ibid.).

8.6.4 Ways of Addressing Socio-economic Factors such as Public Perception Problems and Inequities in Access to TVET

For many parents and students TVET remains a 'second-class' education. To address this issue, governments such as those of the Republic of Korea, the Czech Republic, etc., are trying to open pathways to higher education. However, all the potential risk of reverse effects on the quality of higher education as well as the costs should be borne in mind.

The government of Sierra Leone could also take the following recommendations into account.

- Mungai and Ogot (2006) recommend that the SSA governments need to take concerted efforts to make *entrepreneurship part of the national culture*. For example, in 2002, the ILO and vocational training institutions in some Central Asian countries started the Know About Business (KAB) programme to promote *positive attitudes among young people towards enterprise and self-employment*. The KAB programme gives vocational education students knowledge and practical skills to start, operate and work productively in a small enterprise, and accustoms them to an environment where full-time wage jobs are scarce. The curriculum has been adopted as the official business education curriculum for secondary and vocational training schools (ILO 2008a).
- Institutional reforms should address the stigmatization of vocational training as being reserved for the academically weak through a sustained civic education campaign.

8.6.5 Financing TVET

Ways are being discussed to enable TVET students to pursue higher education or training. The problem lies in finding the money. The government of Sierra Leone might consider the following.

- *Taking a look at the funding of TVET* can shed light on the contradiction between the emphasis for skills and the limited funding that the governments are willing to commit to it.
- *The analysis of financing patterns* is increasingly being linked to the wider question of organizing training systems and particularly *the sharing of responsibilities* between the key stakeholders.
- Atchoarena (2009a) suggests that *the debate on TVET financing* typically turns around three key questions:
  - who pays for skills development?
  - what mechanisms can be put in place to finance skills development?
  - what works best, in particular as far as spending public money is concerned?
- In the current economic context it has become more and more common for governments to *promote co-financed mechanisms for TVET*. Based on the core principles for financing laid out in the national TVET Strategy, a Financing Framework for TVET in Ethiopia has been drafted. The main principles of the new TVET Financing Framework are diversification of funding sources, increased involvement of the private sector, and increased efficiency. These principles are not intended to reduce public spending, but to share the burden and readjust the roles that the public sector, the private sector and households play in TVET financing (GTZ 2006).

Public Finance for TVET

The public sector must still actively finance TVET because it needs to address issues of equity, market failures, strategic development, etc. (GTZ 2006).

- Despite the importance given to TVET by many governments, the training system in Africa is largely *underfinanced.*
- *Financing of TVET* as percentages of public expenditures varies considerably from country to country. It ranges from a low of 0.9% a decade ago in Ethiopia to 12.7% in Gabon in the same period.
- Getting the financial breakdown for TVET in Africa is difficult because in many countries allocation is done at ISCED level rather than by programme.
  - According to the latest public expenditure figures Mali allocated the highest share of its total public expenditure on education to TVET.
  - Gabon is ranked second in Africa when it comes to public expenditure on TVET as a percentage of total public expenditure on education.

Financing Mechanisms and Instruments

Traditionally governments directly financed training providers and training delivery. In order to improve the effectiveness of public spending, *new forms of management* are, however, being developed.

- Payroll taxes and training funds constitute the most significant attempt to involve industry in the financing and regulation of a training market.
- *Government policies to encourage enterprises to invest in skills* subsidize the cost of this investment through various measures.
  - Twenty-one countries in SSA have introduced *training funds* financed by *payroll taxes.*
  - *Training vouchers* are also an instrument used by governments and training funds to subsidize the cost of training by enterprises and individuals.
  - *The introduction of training levies on payrolls* is used globally to mobilize additional resources for skills development.
- *The impact of these funds on training* by the informal sector, however, is limited.
- Atchoarena (2009a) proposes that financing of TVET cannot rest solely on the government budget. He calls upon businesses, local governments, NGOs and individuals to contribute to this investment.

8.6.6 Policy Implications

Reforming TVET is a long-term process. Accelerating the pace of change can jeopardize quality. Any TVET reform requires good monitoring and evaluation (M&E) mechanisms and willingness to learn from experience (GTZ 2006). Constant innovation is a key ingredient in the reform process of the education and training systems so that they provide the skills and competencies that will be needed to boost the growth. If done properly, the results can be spectacular. The Republic of Korea is an example of how TVET can fuel stellar economic growth. While no model should be emulated, the Korean experience offers key lessons (see Maclean *et al.* 2009; GTZ 2006), which the government of Sierra Leone could take a closer look at.

- A TVET reform consists of a broad range of programme of TVET activities that focus on:
  - development of new national TVET strategy and policy;[45]
  - implementation of competency based training;
  - new teacher training arrangements;
  - a greater role for the private sector;
  - more decentralized management of the formal TVET institutions.
- Although the Republic of Korea, China and Singapore are examples of good TVET reform practice in Asia, given the socio-economic context of Sierra Leone their experience probably cannot be transferred to Sierra Leone, since no one size fits all.
- The government of Sierra Leone may also want to take a closer look at some of the recommendations coming out of the EC/ILO TVET reform project in Bangladesh.[46]
- On the other hand, a number of examples of good TVET reform practice in Africa are more relevant for replication by the government of Sierra Leone. These include the following.
  - Benin, Togo, Senegal and Mali, which are restructuring their TVET systems to incorporate traditional apprenticeships.

[45] *National development frameworks* may provide an opportunity for countries to integrate skills development into broad national development processes. Skills development plays an important role in national development strategies, five- or ten-year national development plans, national employment policies, Poverty Reduction Strategies (PRSs) and Decent Work Country Programmes (DWCPs). These are the principal vehicles for articulating and implementing national development goals in general (ILO 2008a).

[46] The National Skills Development policy 2010–2015 for Bangladesh represents a ground-breaking attempt to improve coordination and delivery of skills in Bangladesh for the betterment of the nation as a whole. This policy also extends and builds on other major government policies such as the Education Policy of 2009, the Non-formal Education Policy of 2006 and the Youth Policy of 2003.

- The experience in South Africa and experiments in Morocco, Benin and Cameroon underscore the need to associate social partners in TVET systems in the restructuring of apprenticeship.[47] For example, they offer skills assessment for graduate apprentices so that their skills are recognized in the labour market.[48]
- The support for the establishment of an integrated TVET system in Rwanda to assist their national level institutions in addressing the acute shortage of middle-level skilled labour in the country, also known as the missing middle.
- The TVET reform process in Ethiopia is of considerable size and complexity. As part of this TVET reform process, the Ethiopian Ministry of Education is establishing an outcome-based TVET system, including occupational standards-based assessment and certification. *Learning from international best practice*, it is currently in the process of developing the most appropriate mechanisms, procedures and instruments for standard setting, assessment and certification (GTZ 2006).

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[47] Various studies have noted that the Egyptian vocational and education training system does not provide skills that are in demand by employers and young people. To understand the reasons see ILO (2008a).

[48] The South African Qualifications Authority (SAQA) has developed common procedures and guidelines for the implementation of recognition of prior learning (RPL) within the National Qualifications Framework. The comprehensive guidelines encompass assessment, feedback and quality management systems and procedures. Industry 'Sector Education and Training Authorities' (SETAs) develop industry-specific plans (for example in the tourism, hospitality and sport, health and welfare, construction, insurance, and engineering sectors) to advise on RPL procedures, set skills verifications procedures and organize provision of upgrading training. Some of these industries particularly target workers in the informal economy (ILO 2008a).

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Chapter 9

WILL THE LION EVER ROAR? BRIDGING THE GAP BETWEEN POLICY REFORMS, POLITICAL PRACTICE AND ENTREPRENEUR-LED GROWTH IN SIERRA LEONE

By Chukwu-Emeka Chikezie

9.1 Introduction

The government of Sierra Leone has set out to tackle entrenched poverty, marginalization, dependency and helplessness through a strategy that proposes to foster growth that is diversified (especially into job-creating sectors with good linkages with the wider economy), inclusive and accelerated. Indeed, the *Agenda for Change* enshrines this position as formal policy for poverty reduction. To this end, the government asserts that an energized, innovative private sector lies at the heart of this urgent need for more decent, productive jobs for the broad mass of Sierra Leoneans.

This chapter makes the following points.

1. Sierra Leone has set its hopes in reducing poverty in a programme of accelerated, diversified, and inclusive growth.
2. A revitalized, energized private sector is expected to drive and underpin this growth agenda.
3. There appear to be a number of problems with this approach:
   (a) there are incoherent approaches to what private sector development in practice actually means and probably a philosophical resistance to creating an environment in which markets can work for the poor in Sierra Leone;
   (b) in spite of the commendable government-led efforts to strengthen and support the private sector, rent-seeking by public officials remains the bane of entrepreneurs' lives;
   (c) focused implementation/follow-through seems to be lacking;

The author acknowledges, with gratitude, helpful comments by Omotunde Johnson and Rebecca Simson. All errors and omissions are, however, the sole responsibility of the author.

(d) there are non-existent or inadequate mechanisms in place for monitoring or evaluating progress;

(e) the impact on the private sector so far is not encouraging or is hard to discern.

4. Taking account of the capacity-constrained state and private sector in a still-fragile Sierra Leone, for the private sector to drive growth in Sierra Leone the focus has to be not on supporting entrepreneurs/entrepreneurship or strengthening institutions but on both; the two are intertwined, which makes the life of the policymaker all the more difficult.

5. Success in this endeavour is unlikely without strong leadership combined with an improved level of cooperation among the state, private sector, and development partners.

This chapter argues that there is a disconnect between the apparent policy consensus surrounding the centrality of a revived private sector in Sierra Leone to the country's overall growth and poverty reduction strategy and practice/implementation. This disconnect requires greater commitment to addressing the underlying government, market, and information failures in the system. Even with better policy formulation, the problem of capacity to implement, which is weak across the public and private spheres, must also be tackled. The chapter explores remedies fashioning new instruments and levers to better connect private sector needs – that ultimately result in increments of the quality and quantity of investment – to public sector supply. Recognizing the urgency surrounding job creation and the improvement of incomes in Sierra Leone, this chapter seeks to understand why the results – to the extent that they are discernible – have been disappointing, even allowing for the inevitable lags between interventions and impact. In so doing, the chapter does not aim to produce a shopping list of things for the government to do. Institutional reform is complicated and often politically unpalatable. But the status quo is undesirable. Thus, the chapter aims to map out practical, realistic options for a range of actors who may have both the will and ability to change things for the better.

The next section reviews the literature on the link between entrepreneurship and economic growth in a country such as Sierra Leone. Even if links between entrepreneurship and growth are well established in the literature, is entrepreneurship a binding constraint to growth in a post-conflict state like Sierra Leone? Crucially, the insight we emerge with is that focusing on a supposed dichotomy between support for entrepreneurs/entrepreneurship and getting the institutions right is unhelpful. What matters more is the interaction between entrepreneurship and institutions.

The paper then briefly examines the gulf between policy and practice in Sierra Leone. First drawing upon previous work, it presents a breakdown of the binding constraints hampering economic subsectors. This serves to reinforce the message that the question of entrepreneurship and its contribution to growth is inextricably bound up with the question of institutions.[1] In recognition of the fact that underpinning the overall private sector development strategy in Sierra Leone is a system-wide approach called Making Markets Work for the Poor, the section poses the question as to whether there is either a commitment to such a philosophical pro-poor market orientation or even to a systems approach to reform in general. Beyond whatever philosophical doubts or resistance to change there may be, there are also straightforward implementation problems. For it to take effect, the change process has to go beyond policy pronouncements and legal changes. Wholesale institutional reforms are necessary but lacking. Finally, this section also looks for monitoring and evaluation mechanisms that would provide feedback and learning about what is working and why or why not. Such mechanisms are found lacking.

Following this, the chapter offers some recommendations on the way forward. It makes a case for strategically placed private sector actors to take the lead in driving change in order to help bridge the gap between the intention of policy reform and the actual reality as it impacts entrepreneurs. Moreover, while state reforms are undoubtedly needed, it is all too easy to overstate what the state must or indeed can do, with the downside being a de facto disempowerment of non-state actors who have critical roles to play. In addition to a focus on what the government could do, the section also considers the role of civil society – which could bring much more critical reflection, perhaps through think tanks, to bear on the current quest for private sector-led growth – and development partners, who enjoy considerable influence over both policymaking and implementation in Sierra Leone and who must necessarily coordinate their efforts for greater impact.

Finally, the chapter concludes on a note of hope. True, in structural terms, the omens do not look good. But structure is not destiny and there is scope for considered and concerted leadership – not just (or even) from within government but from the private sector, among entrepreneurs themselves, as well as other sectors of society – to turn things around.

9.2 Growth through Private Sector Development?

The brief review that follows starts with a consideration of the definition of entrepreneurship. It then addresses whether entrepreneurship is a binding constraint on growth. Next is an examination of some of the debates surrounding the growth diagnostics methodology. After this comes a consideration of the question of destructive entrepreneurship and institutions. Finally, the section wraps up with a summary.

[1] Institutions are understood in the following terms: 'institutions are the rules of the game of a society or more formally are the humanly devised constraints that structure human interaction' (North 1990).

9.2.1 Entrepreneurs and Entrepreneurship

It seems appropriate to commence the brief review of relevant literature with a consideration of the definition of entrepreneurs and entrepreneurship. As Parker (2009, p. 6) points out, there is no general agreement among scholars as to the meaning of entrepreneurs or entrepreneurship. While some associate the term with the self-employed and small business owners, others restrict the use of the term to business owners who employ other workers, and yet others prefer 'a Schumpeterian standpoint and argue that entrepreneurship entails the introduction of new paradigm shifting innovations rather than a particular occupation' (Parker 2009, p. 6).

In constructing his theory of economic development, Schumpeter takes a particular view of development, or the 'carrying out of new combinations', which he sees as covering five cases as mentioned below.

- The introduction of a new good – that is one with which consumers are not yet familiar – or of a new quality of a good;
- the introduction of a new method of production, that is one not yet tested by experience in the branch of manufacture concerned, which need by no means be founded upon a discovery scientifically new, and can also be a new way of handling a commodity commercially;
- the opening of a new market, that is a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before;
- the conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists or whether it has first to be created;
- the carrying out of the new organization of any industry, like the creation of a monopoly position (for example through trustification) or the breaking up of a monopoly position.

Schumpeter 2008, p. 66

Schumpeter called the carrying out of these new combinations 'enterprise' and the individuals whose function it is to carry them out 'entrepreneurs'. In later work, Schumpeter (1942) went on to argue that capitalism itself consists of an incessant process of 'creative destruction' – a constant revolution of the economic structure from within; out with the old, in with the new. 'The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers, goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates.' In other words, it is the enterprise and the entrepreneur that create this 'perennial gale of creative destruction' (Schumpeter 1975, pp. 82–85) and indeed who face its full force, as other entrepreneurs engage in the innovative and entrepreneurial processes and generate competition for incumbents.

Schumpeter's thinking about entrepreneurs has been hugely influential and his original intervention proved to be quite pivotal in scholarly understanding of entrepreneurship (Ahmad and Seymour 2008, p. 8). However, scholars have also criticized Schumpeter on a number of fronts – the vagueness of his definition of innovation (Hagedoorn 1996); his assertion that entrepreneurs do not bear risk (Parker 2009, p. 35); and predictions about the impending demise of the entrepreneur that have proven wide of the mark (Parker 2009, p. 35).

However, these criticisms notwithstanding, when we consider the likely reasons for interest in entrepreneurship – not as an end in itself, but as a means toward growth, job creation, wealth creation, productivity and competitiveness improvements, etc. – we cannot dismiss Schumpeter out of hand.

The challenge, nonetheless, is in translating such a definition into objective measurements (especially if cross-border comparisons are intended). The appeal of statistics and indicators, such as the number of new business ventures or businesses with employees, lies in the relative ease with which they can be measured.

Indeed, as Ahmad and Seymour (2008) point out, there is a tension between 'top-down' definitions of entrepreneurship, i.e. those that relate to the goals of policymakers driving the agenda and the 'bottom-up' approaches often used by researchers somewhat based upon the pragmatism of available data sets and the realities as they emanate in the field of operations.

The Organization for Economic Cooperation and Development (OECD) has invested considerable effort in devising not only a workable definition of entrepreneurship but also a framework that takes account of the determinants, performance, and impact of entrepreneurship and a set of indicators to measure (sometimes by proxy) these entities (Ahmad and Hoffman 2008). Obviously, the data-gathering capacities of Sierra Leone, a least developed country, and OECD member countries are hardly comparable, but the conceptual concerns and challenges facing policymakers are arguably similar.

The OECD uses the following definitions.

- *Entrepreneurs* are those persons (business owners) who seek to generate value, through the creation or expansion of economic activity, by identifying and exploiting new products, processes or markets.
- *Entrepreneurial activity* is the enterprising human action in pursuit of the generation of value, through the creation or expansion of economic activity, by identifying and exploiting new products, processes or markets.
- *Entrepreneurship* is the phenomenon associated with entrepreneurial activity.

Ahmad and Hoffman 2008, p. 8

The authors make explicit their focus on economic entrepreneurship rather than, say, social entrepreneurship, without diminishing the importance of the latter. In Section 9.3.4 we shall consider other less productive or even destructive dimensions of entrepreneurship that are important to also consider.

Ahmad and Hoffman (2008) make a distinction between entrepreneurship and entrepreneurial activity to emphasize the point that an entrepreneur is not a prerequisite to observable entrepreneurial behaviour in a company – the managers and employees may simulate the behaviour of an entrepreneur.

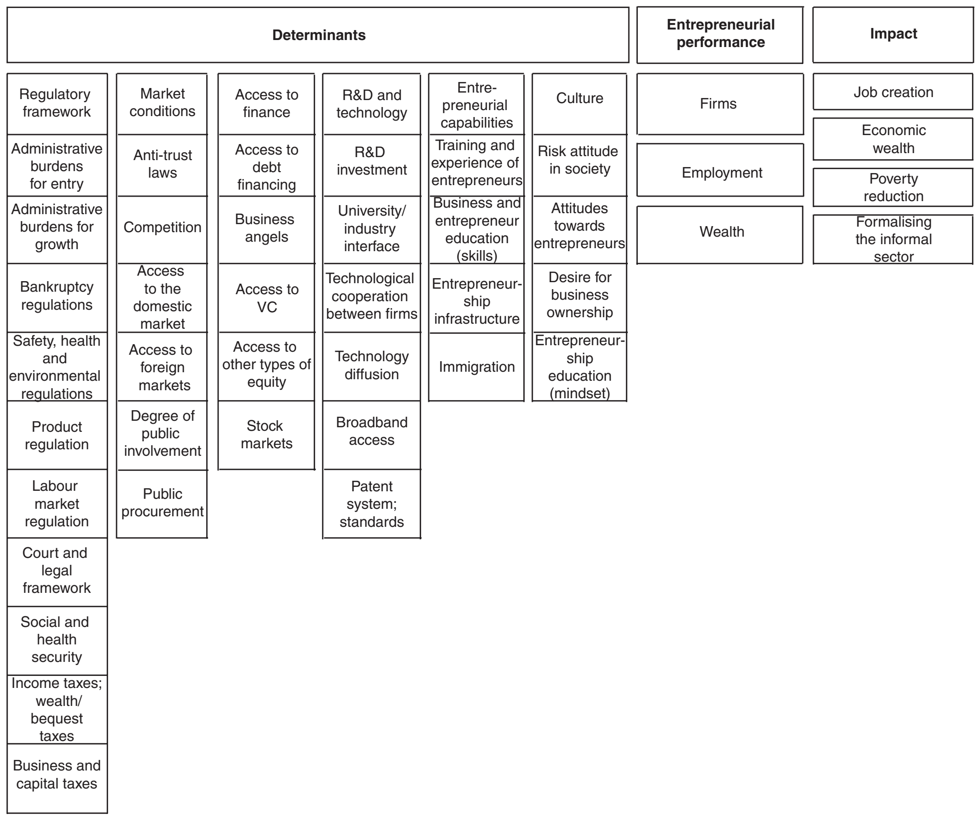

FIGURE 9.1. The OECD/EUROSTAT framework for entrepreneurship indicators: adding policy areas for entrepreneurial determinants. *Source*: Ahmad and Hoffman 2008, p. 20.

These definitions do not only associate entrepreneurship or entrepreneurial activity with new, small startups,[2] the self-employed, or even SMEs only; larger or older firms are also capable of entrepreneurial activity.[3] The definition of entrepreneurs does not assume that in seeking to generate value they necessarily succeed; some fail but are still entrepreneurs. The concept of *new* products, processes or markets presents some challenges from the viewpoint of measurement and indicators but is leaning more towards what some have called innovative rather than replicative entrepreneurship.

Figure 9.1 presents the OECD framework of desired impacts of interest to policymakers – job creation, economic growth, poverty reduction, and formalizing

[2] 'The typical startup isn't innovative, has no plans to grow, has one employee, and generates less than US$100,000 in revenue' (Shane 2008, p. 7).

[3] However, some researchers contest this point. For instance, Spencer and Kirchhoff (undated) argue that entrepreneurship should be reserved 'for the creation of new independent ventures to commercialize an innovation'.

Entrepreneurial performance		
Firms	**Employment**	**Wealth**
Employer enterprise birth rates	**High growth firm rates by employment**	**High growth rates by turnover**
Employer enterprise death rates	**Gazelle rates by employment**	**Gazelle rates by turnover**
Business churn	Business ownership start-up rates	Value added by young or small firms
Net business population growth	Business ownership rates	Productivity contribution, young or small firms
Survival rates at 3 and 5 years	Employment in 3- and 5-year-old firms	Innovation performance, young or small firms
Population of 3- and 5-year-old firms	Average firm size after 3 and 5 years	Export performance, young or small firms

Figure 9.2. OECD/EUROSTAT framework for entrepreneurship indicators: adding indicators to categories for entrepreneurial performance. *Source*: Ahmad and Hoffman 2008, p. 17. Business churn is the level of attrition of businesses.

the informal sector – all of which are equally of interest and relevance to policymakers in Sierra Leone; the units of analysis for entrepreneurial performance; and the determinants of performance. In most cases, these determinants combine to influence entrepreneurial performance, which in turn has an impact. For instance, high administrative barriers to doing business, combined with rigid market regulation can dissuade entrepreneurs from registering their business. This in turn can limit access to debt finance or indeed any form of finance as well as ability to bid for public procurement contracts. Such a firm is likely to experience stunted growth and contribute little to employment growth. Figure 9.2 presents the OECD's chosen indicators for entrepreneurial performance. We shall revisit this framework later when we examine in greater depth the suggested binding constraints on entrepreneurship and investment in Sierra Leone. For now, suffice it to say that developing such a framework that is adapted to Sierra Leone's realities will assist policymakers to formulate policy on the basis of evidence. In the OECD context, employer enterprise birth rates, rates of high-growth firms based on employment growth, rates of high-growth firms based on turnover growth, Gazelle[4] rates based on employment, Gazelle rates based on turnover, and employer enterprise death rates are deemed to be the core indicators of interest to policymakers.

9.2.2 Is Entrepreneurship a Binding Constraint on Growth?

While there may be strong arguments to suggest that entrepreneurship is not a binding constraint to growth especially for the poorest countries, there

[4] 'Gazelle' refers to young, high-growth companies (Ahmad and Hoffman 2008, p. 12).

is also evidence to suggest that entrepreneurship does play important roles in all stages of countries' developments. Therefore, a key contention of this chapter is that policymakers should pay close attention to development of entrepreneurship in Sierra Leone now, even as they address other, arguably more pressing, binding growth constraints.

Naudé (2009) has argued that entrepreneurship is not a binding constraint on growth and development in the poorest countries, among which Sierra Leone would surely be counted. This makes his work useful precisely because he sets out to question a growing trend in a strand of literature to posit the importance or even centrality of entrepreneurship to development (for example, see Baumol *et al.* 2007). He reviews two bodies of literature – that dealing with management/entrepreneurship and that dealing with development economics – to conclude that the entrepreneurship literature has not provided sufficiently convincing empirical evidence to support the general claim of the centrality of entrepreneurship for growth and development.[5] He seems to come down more on the side of development economists who argue that institutional weakness, not entrepreneurship, is the binding constraint.

First of all, terminologies and conceptual constructs matter a great deal. As Naudé points out, 'within development economics "development" involves both an increase in real output per capita, as well as in a structural transformation of the economy, from rural, agriculturally-based to being mainly urban- and industrial-based. In addition, many development economists are concerned that such development should be inclusive and sustainable, that is, it should be shared (inequality should not increase) and not be environmentally destructive' (Naudé 2009, p. 6). Entrepreneurship scholars, by contrast, typically narrow their focus to GDP per capita or employment/productivity growth. Poverty, welfare and inequality are not the concern of entrepreneurship studies.

Implicit or explicit in the entrepreneurship literature is a 'simple taxonomy of different "stages" of development, wherein each stage has by implication a different structure'. Naudé sees two problematic implications flowing from a reliance on an approach such as the three-stage factor-driven, efficiency-driven and innovation-driven taxonomy proposed by Porter (1990). First, moving from one stage to the next requires the strong hand of the guiding state to address market failures, coordination, etc. In other words, entrepreneurship is not *the* binding constraint.[6]

Second, the Schumpeterian association of entrepreneurship with innovation as driver of growth in the final stage of development suggests that entrepreneurship is not the main driver in earlier stages.

[5] Naudé (2007, p. 2) also points out that entrepreneurship in developing countries is a relatively under-researched phenomenon.

[6] However, some entrepreneurship scholars do explicitly ascribe the transformational role to entrepreneurs. For instance, 'business entrepreneurs drive and shape innovation, they speed up structural changes in the economy, and they introduce new competition, thereby contributing to productivity' (Bosma and Levie 2010, p. 8).

Indeed, in his review of the literature, Naudé shows how most entrepreneurship scholars themselves see the significance of entrepreneurship coming to the fore at later stages of development, beyond least developed stage. Because ‘radical innovations are not essential in poor economies to move the production and technological frontier outwards as in developed economies, the implication is, as in development economics, that entrepreneurship is not the binding constraint on economic growth and development’ (Naudé 2009, p. 16).

Furthermore, beyond the conceptual links between entrepreneurship and development, Naudé finds the empirical foundations for entrepreneurship scholars’ claims to be shaky. He concludes that very little is known about whether and how entrepreneurship does or does not contribute to economic growth in developing countries.

While there is undoubtedly some ground for agreement with Naudé, there are also some grounds to object to his argument. Areas of agreement would include the weak empirical basis for the contribution of entrepreneurship to economic development leading to our incomplete understanding, and a general view that entrepreneurship is more important in more advanced developing countries.

For objections, first, entrepreneurship scholars’ approach to the topic seems more nuanced than Naudé indicates. For instance, there is less a focus of state versus plucky individual entrepreneur and more a consideration of how the state and entrepreneurs interact and indeed how the former enables (or, in some cases, disables) the latter. Second, there may be sound pragmatic reasons for focusing on a narrow subset of development enablers but that need not imply a total disregard for development per se. Third, a focus on entrepreneurship as the binding constraint may not do justice to the growth diagnostics methodology. We explore these objections in further detail below.

We can agree with Naudé that the literature on entrepreneurship and development tends to make a clear distinction between so-called necessity entrepreneurs – who abound in poor, developing countries and who may reduce poverty (by taking up self-employment in the absence of any other options) but who do not contribute to growth (because they do not establish innovative firms that create jobs, improve productivity, etc.) – and opportunity entrepreneurs who are scarcer in developing countries but contribute to growth in developed economies. The Global Entrepreneurship Monitor, for instance, has helped to draw this distinction.

However, as Habiby and Coyle (2010) note, GEM 2009 reports that while the incidence of necessity entrepreneurship is predictably higher in developing countries than developed, there are also more opportunity entrepreneurs in the developing world as well. For instance, 10 out of 100 people GEM interviewed in developing countries were launching businesses, 40% of whom were necessity driven and 60% opportunity. By contrast, only 5 out of 100 people interviewed in the developed world were launching a business, 20% of whom were necessity driven and 80% opportunity driven. Of course, this says nothing about the opportunity entrepreneurs' contribution to growth of developing countries (or developed, for that matter), but it does debunk the myth that there is a dearth of opportunity entrepreneurs in developing countries (we do not know from the GEM data what the distribution of necessity/opportunity entrepreneurs across developing countries is).

In line with Naudé's observations, GEM argues 'it is the entrepreneurial mechanism that turns innovation into economic output. A lack of entrepreneurship can therefore be seen as a bottleneck for innovation-driven countries in achieving their growth ambitions' (Bosma and Levie 2010, p. 11).

But the GEM perspective on stages of development differs from that presented by Naudé in a significant way:

> It is important to recognize that all three principal types of economic activity: factor-driven, efficiency-driven, and innovation-driven, are present in all national economies. But their relative prevalence – and their contribution to economic development – varies.
>
> Bosma and Levie 2010, p. 11

Moreover, Bosma and Levie (2010) argue that entrepreneurship is a key mechanism for development in every phase but entrepreneurship's impact is likely to differ. Seen from this perspective, the challenge for policymakers will be to strike the right balance between creating the optimal conditions to enable entrepreneurs to contribute to growth while being attentive to the more basic (e.g. primary education) or other requirements depending on the precise conditions prevalent in the country in question.

In other words, there may be less of the dichotomy between, say, entrepreneurship and institution-building that Naudé presents and more of a creative balance to be struck between the two.

While Naudé's interest in the topic may have been primarily to incorporate the study of entrepreneurship into development economics to contribute to a better understanding of the way in which institutions affect economic development, policymakers have the unenviable task of making tough decisions with limited information (though hopefully incorporating the best and most accessible insights that rigorous and empirically grounded theory has to offer) and allocating scarce resources to achieve desired outcomes. There is general consensus that 'our understanding of the relationship between entrepreneurship and development remains incomplete' (Bosma and Levie 2010, p. 8); policymakers must still make critical choices in their quest for development.

9.2.3 Growth Diagnostics

The growth diagnostics framework that Hausmann *et al.* (2005) propose is intended as a strategy for figuring out policy priorities. They make three key points to justify their proposed approach. First, reform strategies should primarily be aimed at increasing rates of growth, i.e. they should be growth strategies. Second, although some general, abstract principles apply across the board, considerable knowledge of local specificities is required to translate them into operational policies. Third, growth strategies require a sense of priorities so that governments deploy their limited policymaking capital to alleviate binding constraints rather than in pursuing too many targets at once (Hausmann *et al.* 2005).

Even though Hausmann *et al.* (2005) are development economists, it is interesting to note their focus on growth as a key enabler of development stems not from a lack of concern for the wider development issues but from a pragmatic appreciation of the challenges policymakers face. There is clearly a fault line among academics of different leanings on this question of a focus on growth.[7] Development practitioners argue that this focus on growth is not pro-poor as it overlooks and fails to tackle inequality head-on (Sabates-Wheeler 2009). Nonetheless, as Sabates-Wheeler (2009) points out, growth theorists argue that poverty and inequality can be addressed in growth frameworks by ensuring that the poor participate in the growth. In other words, what is required is inclusive growth that focuses on creating jobs and raising poor people's incomes.[8]

The growth diagnostics decision tree at the heart of the methodology takes as its starting point that the problem of low growth stems from 'low levels of private investment and entrepreneurship' (Hausmann *et al.* 2005). This low level of investment in turn stems from low returns to economic activity or the high cost of finance. Low economic activity may result from low social returns, which in turn stem from poor geography, low human capital, or bad infrastructure. Low economic activity may also be the result of low appropriability, which stems from government or market failures. Government failures emanate from micro-risks: property rights, corruption, and taxes; and macro-risks include financial, monetary, and fiscal instability. Low appropriability may also stem from market failures – information asymmetries: 'self-discovery',[9] or from coordination failures.

Some have argued that this particular decision tree is best suited to situations where there is a need to ignite growth (e.g. as may apply in many sub-Saharan African countries) rather than to sustain growth, as may apply in many Asian economies (Felipe and Usui 2008).

[7] The debate is hardly new: Samuel Brittan (2011) quotes nineteenth-century English philosopher John Stuart Mill as advising that growth, like happiness, is best pursued by focusing on more specific goals.

[8] 'The challenge for policy is to combine growth-promoting policies with the right policies for assuring that the poor can participate fully in the opportunities unleashed and so contribute to that growth. If a country gets the combination of policies right, then both growth and poverty reduction will be rapid. Get it wrong, and both will be stalled' (Ravallion 2007, p. 4).

[9] This refers to the notion that entrepreneurship in a developing country consists of discovering the underlying cost structure – what can and cannot be produced profitably. The social value of such discovery, which can be imitated if successful, outweigh the private costs (borne by the entrepreneur alone, if their project fails) (Hausmann and Rodrik 2002).

Critically, however, from our viewpoint, the growth diagnostics methodology integrates entrepreneurship, investment, productivity, innovation, and institutions into one framework. Hausmann *et al.* (2005) stress that they do not mean innovation and R&D in the way they are often used in reference to advanced economies but the ability to identify and generate higher productivity activities in the context of the specific country in question (in our case Sierra Leone).

As Sabates-Wheeler (2009) points out, the growth diagnostics approach has captured the attention of important and influential bilateral and multilateral aid institutions and this, by extension, makes it an influential body of work. This is certainly true in Sierra Leone, where, as we shall see below, the growth diagnostics methodology helped inform both the *Agenda for Change* PRSP II and the formulation of the Private Sector Development Strategy.

It is worth remembering that the originators of the growth diagnostics approach saw the pursuit of growth as a dynamic process. Thus the methodology entails identifying the binding constraints; designing appropriate policy interventions best suited to alleviating the constraints identified; and institutionalizing the diagnostic and policy design processes, taking account of the dynamic way in which binding constraints will likely change over time (Sabates-Wheeler 2009).

9.2.4 Destructive Entrepreneurship and Institutional Arrangements

Baumol (1990, p. 897) offers an alternative definition of entrepreneurs, namely, as 'simply, persons who are ingenious and creative in finding ways that add to their own wealth, power, and prestige'. He posits that the amount of entrepreneurial talent in an environment may be given but that the talent can allocate across a spectrum of activities – from those that are beneficial to a society (e.g. innovative and job-producing) to those that are harmful (e.g. rent-seeking or organized crime) – depending, among other things, on the institutional arrangements, or rules of the game at play and the payoffs or incentives on offer. He surveys the historical record to identify broad correlations between periods of productive, or unproductive, or destructive entrepreneurship and the incentives/rules of the game.

The relevance, as Baumol (1990, p. 916) sees it, of these insights, is to guide the policymaker's attention to, for instance, the preponderance of rent-seeking behaviour among entrepreneurs as a promising area for changes to the rules of the game to tilt them more in favour of productive endeavour.

A society's institutions are probably the product of complex interactions that evolve over time and may not lend themselves to quick fixes, even assuming there is the political will to do so. However, it may be possible to change incentive structures in a shorter space of time, assuming, of course, that the political will to do so exists.

Although we are primarily interested in matters economic in this chapter, we can hardly ignore politics. Although Robinson (2008) discusses Sierra Leone's political economy with a view to offering some guidance to the World Bank's

Country Assistance Strategy, his prognosis – sobering and pessimistic though it is – is immensely insightful. Writing in the year after the ruling All People's Congress Party swept to power in the August 2007 elections, Robinson's 'preliminary conclusion is that while there are some obvious changes, much appeal probably remains in the political strategies which immiserized the nation' (2008, p. 3). Furthermore, although terms of trade may be more favourable for enduring economic growth, 'without political change such growth will likely be oligarchic and lead to large increases in inequality' (Robinson 2008, p. 3). Starkly put, Sierra Leone is poor because it has had 'terrible governance' (Robinson 2008, p. 4).

In Robinson's view, a patrimonial state is one in which patrons typically focus on supplying private rather than public goods to their clients in return for support. This patrimonial state is characterized by insecure property rights, selective application of laws, market distortions that enable rent-seeking, and a co-opted bureaucracy – a far cry from the rational-legal meritocratic system identified by Max Weber. Robinson goes on to consider the causes of such a patrimonial system usefully thinking not just about supply-side factors but also the demand pull side. Supply-side factors include the absence of a national identity, no social contract or legitimate structure of authority, heterogeneous identities creating a fissiparous polity, and a path dependency from weak colonial institutions (such as reliance on indirect rule via chiefs as in Sierra Leone's case).

On the demand side, 'in a very heterogeneous society there may be much less demand for public goods, which reduces the opportunity cost of the massive under-supply of public goods which is the natural by-product of patrimonialism. Another facilitating factor on the demand side may stem from the fact that in a society divided by ascriptive differences it is easy to conceive of a polarization between different groups which may lead people to be disposed to reject the application of universal rules, so undermining principles which would impede the creation of patrimonialism' (Robinson 2008, pp. 10–11).

Historically (up to the prewar period), Robinson argues that Sierra Leone fitted this picture pretty well. Taking stock of postwar contemporary Sierra Leone, he notes that on the plus side, democratic institutions have taken root – the role of the Electoral Commission in overseeing the peaceful transition from SLPP to APC rule in 2007 is a particular highlight. Less positive, in that author's view, is the emergence of the Freetown electorate as swing voters upon which the results of an election might turn, potentially creating an urban bias in policy focus (and thus reinforcing historical patterns of rural marginalization and centralization). Polarized ethnic identities continue to shape voting patterns and political competition can intensify pressures to deliver private (rather than public) goods, both characteristics of which are of course negative.

In surveying the first few months of the APC regime, Robinson notes that the president is not part of the APC old guard and thus marks a genuine break with the past. Most notably positive has been a more determined push against corruption through a strengthened legal regime for the Anti-

Corruption Commission. On the other hand, Robinson observes the clientelism in appointments from ministries to parastatals to other public sector agencies and a degree of authoritarianism.

With a few more years of APC rule since Robinson's piece in 2008, it is possible to confirm most of the trends he observed in the regime's early days. Perhaps what has emerged more clearly is a determination to deliver public goods – power in Freetown, roads across the country, free healthcare to pregnant women and mothers of children under five, and arguably the Smallholder Commercialization Programme (SCP) all spring to mind in this regard. However, Chaves and Robinson (2011) document a resilient patrimonialism, suggesting that the drive to deliver public goods may be compatible with forms of patronage and rent-seeking.

Many informed observers believe that rent-seeking is all too alive and virulent across society. Indeed, a core thesis of this chapter is that rent-seeking and corruption more generally continue to be the bane of legitimate business endeavour in Sierra Leone and raise fundamental questions about the efficacy of private sector development efforts to date, disconnected as they seem to be from the day-to-day reality of business owners and their ventures in the country.

Returning to Robinson's broad thesis, we can say at the very least that there is a great deal of continuity between the old and new APC regimes mixed in with some few positive signs of change and it is too early to tell whether Sierra Leone can make a clean break with its past or whether a fundamental and permanent break with the past is possible.

9.3 Sierra Leone's Growth Strategy

The purpose of this section is to examine the extent to which we can say that Sierra Leone has a growth strategy in place and if so what its core elements are, how progress is monitored, what remedial steps are taken, and so on.

Before proceeding, however, it is worth stressing that, on paper at least, Sierra Leone displays a strong policy commitment and cross-party consensus on the primacy of the private sector in the drive for accelerated, diversified, and inclusive growth. Evidence for this assertion can be found in various policy and strategy documents, including *An Agenda for Change, Sierra Leone's Second Poverty Reduction Strategy Paper, 2008–2012*, the government of Sierra Leone's (GoSL) preeminent document setting out its pro-poor growth strategy. The *Agenda for Change* identifies the private sector as a critical underpinning for the strategy as a whole. The Smallholder Commercialization Programme (SCP) – GoSL's flagship agricultural programme – the Private Sector Development Strategy, the Financial Sector Development Plan (FSDP), the Doing Business Reforms programme, and the export strategy are all further and more detailed programmatic manifestations of the *Agenda for Change*. They all assert the importance and centrality of the private sector to the growth agenda.

9.3.1 Binding Constraints to Investment and Entrepreneurship

In tackling its task of assisting the government of Sierra Leone to devise and implement a private sector development strategy, the Private Sector Development Strategy Programme (PSDSP) undertook a thoroughgoing analysis of Sierra Leone's growth agenda and the role of the private sector within it. A diagnostic report (PSDSP 2008) was the main analytical underpinning for the ensuing strategy. The study takes as its starting point the need for Sierra Leone to accelerate and diversify its growth to ensure that the poor participate more fully in the economy. In other words, the goal is broad-based, inclusive growth. Moreover, it sets out a case for increasing investment and entrepreneurship as the initial priority in this regard.

> [I]ncreasing and diversifying investment appears to be a pre-condition for bringing about the other conditions for broad based growth:
>
> - Increasing productivity and competitiveness depends upon investment in productivity enhancing technology. The technology used in Sierra Leone in many industries is old and outdated as a result of decades of under investment. It also requires innovative entrepreneurs who can introduce better business models that are likely to improve productivity and competitiveness.
> - Market access [of products and services in which poor providers/producers are active] and functioning [of these markets] will only improve if there is private investment to overcome key bottlenecks in ... value chain[s].
> - The country is likely to only benefit fully from the international linkages of trade and investment if it can develop its own capacity to export and domestic businesses can harness the technology transferred by FDI. Attempting greater trade integration without building the productive capacity of the economy will simply result in higher levels of imports.
>
> PSDSP 2008, pp. 10–11

Thus the Diagnostic Report sees investment and entrepreneurship as the building blocks of the economy, without which scope for broader, more inclusive growth is limited.

The report points to the need to increase and diversify domestic and foreign investment. Domestic investment is important because foreign direct investment (FDI) tends to follow local investment patterns rather than lead them. Moreover, FDI has typically constituted no more than 30% of gross capital formation in recent years in Sierra Leone (and even major FDI destination countries like China usually do not exceed this sort of figure).

On entrepreneurship, the report points out:

> If private investment is to increase and diversify, then the incentive for entrepreneurs to engage in productive rather than predatory activities must be improved. And there must be ways to recognize and encourage the more

> able entrepreneur. The critical process of discovering new economic activities in which the economy can compete rests on improving the quality of entrepreneurship.
>
> PSDSP 2008, p. 15

Prior to the PSDSP Diagnostic Report, two earlier growth diagnostic studies had been undertaken in Sierra Leone (Hornberger *et al.* 2007; Phillipson 2008). All three assessments laboured under similar constraints of paucity of reliable, current data. They arrived at broadly similar conclusions but while the PSDSP Diagnostic Report agreed with the other two studies that the availability of an educated workforce does not constrain investment and entrepreneurship, human capital is a constraint precisely because the quality of entrepreneurship is low.

In essence, the key binding constraints hampering entrepreneurship and investment in Sierra Leone's economy are as follows.

Domestic lending. Micro, small, and medium-sized enterprises are particularly constrained as they primarily rely upon domestic financial institutions for loan capital.

Market failures. The resource sectors in which economically active but poor citizens are engaged are heavily constrained by information and coordination failures that manifest in the value chains of economic sectors and clusters that are characterized by low competitiveness, missed opportunities, etc.

Micro risks caused by government failures. 'Rights to property, poor stewardship of natural resources, corruption and poor policies and institutions affect all industries' (PSDSP 2008, p. 35).

Infrastructure. Inevitably, the high cost, or poor quality, or unavailability of infrastructure hampers business (especially manufacturing) and simply rules out some ventures as completely uneconomic or infeasible.

Human capital. The poor quality of entrepreneurship affects most sectors, although skills more broadly are not considered to be a binding constraint.

As already noted, the Diagnostic Report heavily influenced the PSDS in the sense that the five pillars identified in the strategy are indeed the same five key binding constraints identified by the Diagnostic Report (GoSL 2009b).

The PSDS itself is best understood as an organizing framework to guide interventions of various actors – across GoSL, development partners, private sector development support agencies, and the private sector itself – rather than as a unitary strategy to be implemented by one accountable body. Nonetheless, under the PSDSP a few catalytic interventions were implemented that intended to serve as demonstration projects within select pillars of the strategy (an example was the launch of the country's first national business plan competition, Business Bomba).

The Ministry of Trade and Industry is currently establishing a Private Sector Development Directorate to, among other things, effectively coordinate the implementation of the PSDS.

9.3.2 Philosophical Underpinnings of Growth in Practice in Sierra Leone

However, although implementation undoubtedly leaves much to be desired as far as programmes in Sierra Leone in general and PSD initiatives in particular are concerned, the contention of this section of the chapter is that there is fundamental, though unexpressed, resistance in Sierra Leone to the philosophy that underpins the PSDS and many related initiatives.

Underpinning the Diagnostic Report, the PSDS, and the project as a whole has been the 'Making Markets Work for the Poor', or M4P approach, championed by bilateral aid agencies such as the UK Department for International Development (DFID). In particular, 'achieving institutional and systemic change in the operation of markets important to the poor is at the core of the M4P approach' (DFID 2005, p. 15); arguably this presents considerable challenge in a context such as Sierra Leone's. While it is outside the scope of this chapter to analyse in depth specific GoSL programmes, Table 9.1 presents a snapshot of a few recent GoSL initiatives and compares them with how they might have been approached using an M4P framework.

The GoSL initiatives are of course more eye-catching (i.e, with popular appeal) than the M4P alternatives. They are precisely the sorts of things a government wants to be seen announcing to an expectant public in the run-up to an election. They resonate with the public. For example, every entrepreneur complains about the grotesquely high interest rates banks charge for their loans (compared to their below-inflation rates on deposits). Here, at last, is the government doing something about that. Here is modern day democratic politics at play, with a populist twist and albeit with the urban bias that Robinson (2008) and others before him have cautioned about. But a US$2 million loan fund parcelled out at 5% is clearly unsustainable given the real costs of capital and the high demand at that low interest rate. And yet such a sum represents barely 1.12% of total loans disbursed in 2009 and is thus a mere drop in the ocean.

The imposition of a temporary ban on the export of locally produced rice and palm oil may also generate a number of unintended consequences. The bans were reimposed (previous governments have imposed similar bans) as a price stabilization measure[11] allegedly because these commodities are illegally smuggled across borders and sold in neighbouring countries. It is unclear what makes cross-border trading among ECOWAS and Mano River Union countries illegal in the absence of such a ban (and the legality of the ban under Sierra Leone law is itself subject to doubt). A government-owned company, the Sierra

[11] 'Government bans rice and palm oil' (www.freetowndailynews.com/africa.html, accessed 5 March 2011).

TABLE 9.1. Selective GoSL interventions versus M4P alternative approaches.

GoSL initiative	M4P alternative
Subsidized loans for SMEs (5% interest rate compared to market rates that typically exceed 25%) in order to improve access to affordable finance[10]	Loan guarantee scheme combined with establishing a market for business development support services and incentives to banks to overcome high costs of capital for borrowers
Export bans on rice and palm oil to reduce shortages and price rises in urban markets	Ongoing efforts to incentivize increased production of rice and palm oil; better coordination of infrastructure development (roads especially) to improve producers' access to markets (Freetown especially); better coordination of support mechanisms to improve varieties and production techniques in order to increase farmers' productivity.
Establishment of numerous rural community banks and village-level financial savings clubs to widen access to rural finance	More calibrated approach to work with existing commercial financial institutions to advance the access frontier of financial services in rural areas, in other words to widen access to financial services in commercially viable and sustainable ways.

Leone Produce Marketing Company has taken up buying of local produce in remote market areas with better access to Liberia and/or Guinea than Freetown. Calling on 'all security personnel, custom officials, trade monitors, district councils, and other relevant government functionaries to enforce this ban and take appropriate action to bring to justice any defaulters',[12] as the Minister of Trade has done, sets the scene for continued harassment of traders and paves the way for further entrenchment of rent-seeking behaviour among such personnel. GoSL's actions also serve to reinforce the popular narrative that difficult trading conditions are somehow the result of exploitative traders, thus exposing them to the 'grabbing hand' of the state. This is hardly an encouragement for would-be entrepreneurs.

Given how central cross-border trade is to the local economies, livelihood strategies, and food security in the border areas of Sierra Leone, Liberia, and

[12] 'Government bans export of locally produced rice and palm oil' (www.awoko.org/2011/02/16/government-bans-export-of-locally-produced-rice-and-palm-oil/, accessed 5 March 2011).

Guinea (WFP 2010), the government's action is probably evidence of the urban bias in policymaking as Robinson (2008) had suggested.

All of the problems that GoSL has sought to solve with subsidized loans and export bans are the result of a complex mix of systemic failures – market, government, coordination, and information. While the political pressure to present solutions is perhaps a sign of a healthy democracy in action demanding accountability of elected leaders, failure or unwillingness to put in the long hours to address existing market and government failures but rather opting for more direct government interventions runs the risk of fuelling a vicious downward cycle in which failures beget government interventions which in turn beget further failures justifying even more intrusive government interference.

9.3.3 Implementation Problems

M4P is presented as a development objective; an analytical framework; and a practical framework for action (DFID 2005, p. 1). As an analytical tool, M4P can help inform growth strategies but it can also be used on a stand-alone basis to change markets to be more pro-poor (DFID 2005, p. 3). However, there is a fundamental contradiction in trying to implement what essentially is a whole systemic framework using a piecemeal project-by-project approach.

But if there are philosophical differences between the way GoSL chooses to address PSD and a conventional M4P approach, there are also problems with the way even sound initiatives are implemented, further hampering growth prospects.

For instance, the flagship of GoSL's recent World Bank Doing Business Reforms has been the simplification of business registration. This initiative was informed by a survey of informal businesses in Sierra Leone that suggested that informal businesses were not unwilling to formalize but both the cost and complexity of the process were obstacles (FIAS 2006). Both the General Law (Business Start-Up Amendment) Act (2007) and The Registration of Business Act (2007) were enacted and given their Presidential Assent in 2007. They greatly simplified the business registration process and in theory paved the way for businesses to be registered at much lower cost.[13]

However, in spite of the fact that the Office of the Administrator and Registrar General (OARG) – the body responsible for business registration – published the costs of registering a business and the time it should take as part of these reforms, businesses' experience with the service has been quite mixed. In reporting on the experience of supporting various winners of the 2010 business

[13] Specific reforms included: Elimination of the Exchange Control requirement for business registration; elimination of the obligatory involvement of a solicitor in the preparation of Memorandum and Articles of Association during the business registration process; elimination of the annual renewal of Business Registration License; elimination of the Advance Tax Payment system for newly registered businesses; combining the Work and Residence permits into a single permit and extending the validity of this permit beyond one year (Coffey International Development 2009).

plan competition, Business Bomba, AFFORD Sierra Leone (2010) noted the following:

> [T]he registration of a sole business by two winners at the Office of the Administrator and Registrar General (OARG) produced huge variances of up to Le 300,000. What we observed was that personalities within the OARG system collect monies in the guise of aiding the registration process of businesses. In these cases, the amount spent in the registration of the businesses far exceeds the official rate of OARG.

Many business registrants report the same experience, suggesting this is far from a one-off aberration but rather is the norm. Indeed, across a whole raft of reforms, implementation is turning out to be the weakest link.

9.3.4 Oversight Mechanisms

An absence of an agreed overarching analytical framework, let alone buy-in to M4P, and weak implementation of reform initiatives are not the only obstacles hampering the pursuit of growth in Sierra Leone. In addition, GoSL lacks effective mechanisms to monitor the progress of its de facto growth strategy (i.e. the *Agenda for Change* (GoSL 2009a)). Even if there is some oversight at ministerial level, there needs to be overarching strategic oversight if any strategy is to achieve its desired objectives.

The only overarching review mechanism that assesses the performance of the goals set out in the *Agenda for Change* is a document called the *Joint Progress Report on the Agenda for Change*, January 2009–June 2010 (GoSL 2010b). However, this report appears to be addressed to an essentially external audience, given that it has been produced as a result of a recommendation of a 2009 Peacebuilding Commission High-level Special Session on Sierra Leone (GoSL 2010b, p. 9). Although the report 'has been structured in such a way to reflect the government's achievements and constraints with respect to the *Agenda for Change*', it lacks the analytical depth or rigour to penetrate the sorts of issues pertaining to, for instance, entrepreneurship and growth.

Moreover, although the report points to the drop in the growth rate to 4% in 2009 and a projected rate of 5% in 2010 and the possibility of 6% by 2012, it does not analyse the implications of this much lower growth rate in relation to previous targets or the prospects for achieving medium-term goals. Indeed, the report itself implicitly acknowledges the absence of an effective monitoring mechanism: 'in order to make future reporting even more effective, there is a need to develop a Results Framework for the *Agenda for Change* – this should set out priority policy and institutional actions and output and outcome indicators' (GoSL 2010b, p. 18).

The list of recommendations that emerge from consultations (as opposed to a more sustained process of analytical reflection, including input from stakeholders) produce an anodyne shopping list of suggestions. Take for example the following: 'there is a need for more periodic meetings with the top management of each Ministry to discuss the constraints on implementation, and suggestions for effective implementation. The information gleaned from these meetings should be incorporated into future activity plans and strategies' (GoSL 2010b, p. 42). Such suggestions are of limited use to policymakers or practitioners in enhancing the country's growth prospects.

9.4 *Agenda for Change* versus Change the Agenda

What will change things for the better? More determined implementation of the existing policies outlined in the *Agenda for Change* or a fundamental rethink of priorities and a change to the agenda? This section makes the case for a bit of both. As a framework for action, the *Agenda for Change* is good enough and surely focused, and disciplined implementation is more important at this stage than constantly revisiting plans and frameworks. Yet the need for more coherence and clarity around the role of the private sector in particular and creation of the closest-to-ideal conditions for productive entrepreneurship to flourish demand a rethink of the approaches adopted, the role of GoSL, and the quest for a more judicious mix of institutions to drive the private sector-led growth agenda.

This subsection maps out a suggested action agenda for various actors – the private sector, GoSL, civil society, and development partners.

9.4.1 Private Sector's Role in Driving Private Sector Development

Sierra Leone's private sector is relatively weak, reflecting wider institutional and organizational capacity constraints in the country. It is also highly fragmented, with a profusion of largely donor-dependent business membership organizations, none of which has the legitimacy, or capacity, to speak for the private sector as a whole. Nor are the divisions along reasonably rational lines such as a confederation of Sierra Leonean large-scale industry versus an association of small business owners, for instance. Rather, there are sectoral groupings (market women, petty traders, agriculture, etc.), ethnic groupings (Lebanese, Fula, even 'indigenous', etc.), jostling with the Sierra Leone Chamber of Commerce, Industry, and Agriculture that is probably still regarded as the premier business membership organization. However, even the Chamber of Commerce boasts only some 300 members, barely half of whom are current in the payment of their dues.[14] The Chamber itself has recently seen the formation of a breakaway association, initially dubbed the Chamber for Agriculture but now called the Sierra Leone Centre for Agribusiness Development.

Sensible but unfortunately donor-driven attempts to congregate all the business membership organizations under the umbrella of a well-funded, structured Sierra Leone Business Forum for the purpose of engaging in a public–private dialogue between GoSL and the private sector have had only partial

[14] Personal communication with the Executive Secretary, Friday 25 March 2011.

success. And, in any case, the long-term sustainability of such an arrangement after the eclipse of donor funding remains in doubt.

Yet, as has been argued in this chapter, there is a disconnect between the apparent policy consensus surrounding the centrality of a revived private sector in Sierra Leone to the country's overall growth and poverty reduction strategy and actual practice/implementation. Realistically, without the private sector taking the lead to drive the agenda, albeit interfacing closely with GoSL where appropriate, this state of affairs is likely to continue.

We contend here that leading lights within Sierra Leone's private sector need to come together to establish a structure, such as a trust and implementation fund, to drive this country's private sector development agenda. The trust would be established as an autonomous body with a mandate to drive forward a private sector development agenda that result in job creation and a widening of opportunities for wealth creation in the economy.

The trust would have as its board members a small number of eminent and successful business leaders of proven integrity, vision, and track records of sound managerial capability.

At the risk of being branded elitist, while being thoroughly grounded in the realities and possibilities of private enterprise, such leaders need to be enlightened enough to see the bigger picture and operate beyond narrow self-interest to set and advance a broad agenda for inclusive private sector-led growth in Sierra Leone. In addition to being influential, respected, well-established, accomplished entrepreneurs and managers in their own right, these leaders must be able to operate well above the fray of political patronage and intrigue.

Today, cooperation and joint action among Sierra Leone's private sector suffers from a 'collective action problem' (Olsen 1965), not least because divide and rule has been an effective mode of political control used by successive governments intent on disbursing selective private goods rather than collective public goods. Nonetheless, this situation is not necessarily hopeless as Ostrom (2000) counters that cooperation is widespread, although not inevitable.

This board would oversee a small secretariat of professionals to manage the day-to-day implementation of the trust's programmes. Such implementation would include raising resources for an implementation fund that would be used to design and implement demonstration projects and other initiatives to advance the private sector development agenda.

The credibility of such an initiative will be greatly enhanced if some of the required resources for trust management and implementation are mobilized from domestic private sector sources rather than relying entirely on external funds to finance trust programmes. The trust would also need to engage closely with existing business membership organizations and ensure they were part of the wider stakeholder group to which it was accountable (without being held hostage to the demands of any single group).

The trust would need to be savvy enough to initially pick areas of intervention well away from the crowded field of GoSL market interference to demonstrate by doing and with visible, quick results what is possible in terms of a growth agenda when the talent of real productive, innovative entrepreneurs is unleashed. For instance, rice production and distribution are highly sensitive areas subject to much political interference and are best avoided in the first instance. Perhaps creative approaches to business development support and SME capacity building offer more promise in the first instance. With time and success, it should be feasible to take on more ambitious and touchy areas. Through the PSDSP, much of the analytical work has been done, some pilots have been tested (such as the business plan competition, some value chain interventions, etc.) so such an initiative has a strong foundation upon which to build.

At present, no comprehensive, effective monitoring and evaluation or performance management framework exists to track progress in private sector development or private sector-led growth in Sierra Leone. Given the evident desirability of tackling widespread unemployment, for instance, it is surprising that at present no one collects accurate, comprehensive data on unemployment or number of jobs created. An M&E framework would draw clear links between inputs and outcomes and impacts (and not just outputs) and assess the extent to which different policy measures generate scalable solutions or offer better value for money. It would make sense for the trust to take this on as one of its core tasks. Statistics Sierra Leone and various government ministries already produce useful data (see, for instance, GoSL 2009c) but the challenge is pulling the required data into a useful framework to inform on progress and help identify the necessary course corrections. Figures 9.1 and Figures 9.2 above highlighted the OECD's approach to determinants, performance indicators, and impacts pertaining to entrepreneurship and arguably they form an excellent start for Sierra Leone. The framework could be adapted to reflect, for instance, the absence of other forms of infrastructure such as power, roads, and water in the Sierra Leone context, in contrast to OECD countries (where the focus is on high-speed broadband access to the internet). Undeniably, it is a major undertaking but one that is absolutely essential if in future years Sierra Leone is to be able to assess what progress has been made toward achieving sustained, diversified, inclusive, private sector-led growth year on year.

Another group of private sector actors with a critical role to play in strengthening the private sector are the business support providers – the firms that offer business planning, advisory, consulting, and training services to other firms. At present, the market for such business services hardly exists or is at best ill-developed. Well-managed business support firms with a commitment to their clients' growth and development demonstrate a vested interest in the evolution of a fully fledged market for their services. Much of the responsibility for the evolution of this market lies with the service providers themselves. The more professionally minded among them with a commitment to delivery of high-quality services could, for instance, form themselves into an association of business support providers with the aim of setting some minimum self-regulated performance and quality assurance standards. This would send a strong signal to buyers of their services – business owners as well as various support agencies or other businesses who purchase such services (i.e. embedded services) on behalf of their own client groups.

9.4.2 GoSL's Role

When we consider GoSL's role in driving the growth agenda, particularly considering the role of the private sector, the good news is that there is broad consensus across the political spectrum on the need for the sort of reforms upon which successive governments have embarked in recent years. Indeed, so apparent is this continuity that the opposition has in the past accused the current government of being nothing more than a 'pull nar doe' government (in other words, a government that arranges naming ceremonies for babies it did not conceive).

It is probably futile to expect a wholesale shift of GoSL policy vis-à-vis private sector development before an election. What may be more realistic is an effort to encourage the government to affirm its own growth targets set out in the *Agenda for Change* and to commit more effort to monitoring results and taking necessary corrective action when evidence emerges that results are adrift from planned targets. Indeed, GoSL may borrow a leaf from the British government that has established the Office for Budgetary Responsibility to provide *independent* assessments of the economy's growth prospects. Framing evidence that the Sierra Leonean economy is off its growth targets as a problem requiring investigation and solutions along the lines of course corrections may help to avoid the risk that below-par performance is immediately seen as a failure and thus politicized. If the latter ensues, there will be less willingness to discuss growth performance openly and as a result, it may be harder to mount the rational responses required to keep growth on track.

Within GoSL itself, until there is some organizational unit (which could be within a ministry) directly responsible for delivering the overall growth strategy, it is likely to continue to fall between the cracks. Rather than creating another special position, it might be that this is something that the office of the Chief of Staff to the President or the Strategy and Policy Unit inside the Presidency should take direct responsibility for, assuming that they can bring on-board the requisite skills. Already, these bodies monitor the performance of the individual delivery units, but no one seems to take a strategic view at the aggregate level.

One area where it might be possible to persuade GoSL to develop a clear strand of policy is on entrepreneurship itself. Such a policy might have a number of components. First would be a clear definition of entrepreneurs, entrepreneurial activity, and entrepreneurship and a strong statement of commitment to allow productive, innovative entrepreneurs as much free reign as possible while seeking to minimize the incentives for destructive entrepreneurship.

Second, would be to give this quest for an improvement to the incentive structure for entrepreneurship more teeth by tasking the Anti-Corruption Commission with a special role to designate areas, such as the Special Economic

Zone set up by the company First Steps, as areas of special interest as far as preventing and prosecuting all forms of corruption is concerned, thus discouraging destructive entrepreneurs and limiting the 'gabbing hand' (Naudé 2007, p. 14, quoting Frye and Shleifer 1997) of the state.

Third, Sierra Leone's President recently called for 2012 to be declared the Year of the Productive Entrepreneur[15] and this potentially forms the basis for a concerted public–private partnership between GoSL and the private sector to bring a focus to bear on the constraints hampering entrepreneur-led growth in Sierra Leone and the critical role that entrepreneurship necessarily must play in the country's growth and development. This would draw in a comprehensive range of stakeholders and actors to look at near-term, medium-term, and long-term issues, such as educating tomorrow's entrepreneurs. Such a year could culminate in a national 'jobs summit' (in reality a jobs and incomes summit) to focus on how the private sector is creating the jobs and incomes so desperately needed in Sierra Leone. GoSL could take the lead at regional – Mano River Union, and ECOWAS – levels as well as across the continent to address and advance this jobs agenda and engender the needed fresh thinking and sense of urgency.

9.4.3 Role of Civil Society

A striking feature of civic life in Sierra Leone is the absence of a space or culture of public discourse around policy matters of import to the general populace. There is a vibrant press of sorts and a lively FM radio scene but there are no visible think tanks contributing to policy debates. Furthermore, NGOs tend to come across as single issue focused and often appear overly confrontational rather than bringing solutions and plausible alternatives to the table. There are few meetings open to the general public where public policy is discussed or subjected to critical scrutiny. Worse, there is a general reluctance among well-informed citizens to speak out, for fear of being branded as troublemakers or anti one thing or another.

Often, when a government official has committed to a particular line of action, regardless of its merits, it can be difficult to then advocate for a change of course that might risk some loss of face for the official. Rather, it may be preferable to engage in more of an agenda-setting exercise through high-quality think tank-type policy research, seminars, discussions, briefs, and 'quiet diplomacy', etc.

Given the economic contractions during the war years and political turbulence, it is perhaps not surprising that Sierra Leone does not have the well-populated think tank scene that one or two African countries can boast of. However, with the war hopefully behind it and the economy gradually picking up and sustaining at least respectable growth, prospects may look

[15] Speech at the Grand Finale of the 2011 Business Bomba business plan competition, 23 April 2011, Miatta Conference Centre, Freetown.

more promising for a market for at least one or two think tanks to emerge, especially focusing on a broad range of economic matters. The advent of the internet, social media, etc., suggests that the barriers to entry to publishing good-quality material should now be lower alongside operating costs. Arguably, this could be the most useful contribution from civil society at this stage, namely, complementing existing roles already played by others (for instance, NGOs implementing livelihood programmes).

9.4.4 Development Partners

GoSL's development partners display a healthy appetite to support the development of the country's private sector. Both the UK Department for International Development (DFID) and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH (German International Cooperation) subscribe to the M4P paradigm through their private sector development support programmes. Historically, DFID Sierra Leone's Private Sector Development Advisor played a leading role among development partners in private sector development prior to its decision to end its support for that strand of work. Other development partners frequently expressed appreciation for this lead from DFIDSL. With an intended DFIDSL re-engagement on the private sector development front, the prospects for a resumed leadership role to fill the vacuum created by its earlier departure look promising.

A critical role will be to try to forge a common agenda among development partners supporting private sector development in Sierra Leone. The omens look good – partners have generally shown willingness to align their efforts around GoSL's private sector development strategy. In addition to this, efforts to align initiatives behind the M4P approach will greatly strengthen the coherence of private sector-led growth efforts in Sierra Leone.

Development partners will need to be both pragmatic and creative in supporting initiatives in spaces where government interference is minimal and where dramatic results can be demonstrated, hopefully creating momentum behind approaches that can garner increased buy-in over time.

Finally, development partners could play a pivotal role in supporting the Sierra Leonean-led private sector development trust mentioned earlier provided they can satisfy themselves as to its credibility, seriousness, dedication, and commitment to stay the course for the long duration.

9.5 Conclusion

This chapter has focused on matters both economic and political in nature relating to private sector development and the prospects for growth of the economy. The policies that the authorities are trying to implement are arguably good enough, although the deep commitment to reforms that would truly reign in corruption and ensure full implementation and monitoring of the policies may be lacking. However, we argue that the answer is not to call on the government to enact more policies to promote private sector development.

While more effort from GoSL is desirable and essential, there is much that non-state actors can and must do too. Even with the best will, implementation capacity across government is weak and will likely remain so for some time to come. Combining this systemic weak capacity with the evidence of entrenched interests wishing to maintain the status quo would lead to an overly pessimistic prognosis of the likelihood of positive change anytime soon.

But opportunities for positive change do exist, though non-state actors will need to engage in concerted, collective, collaborative action to advance their own interests, which are consistent with private sector development and inclusive and enhanced economic growth in Sierra Leone.

Policymakers have assigned to the private sector a lead role in the effort to drive growth, create jobs and improve incomes in the economy. But organized sections of the private sector have yet to bring real leadership to bear to catalyse and drive change.

'Structure is not destiny' (Leftwich 2009, p. 8). In other words, in taking a sober look at institutional constraints, let us not forget the importance of human agency in shaping affairs. Growth is certainly too important to be left to politicians alone. The private sector must be entrepreneurial not just in building successful business ventures but also in fostering the right environment for those ventures to succeed.

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Part IV

The Real Sectors

Chapter 10

THE FOOD SECURITY SITUATION IN SIERRA LEONE: POLICIES, STRATEGIES, ACHIEVEMENTS AND CHALLENGES

By Amara Idara Sheriff and Ben A. Massaquoi

10.1 Introduction

Agriculture is the most significant sector in the economy of Sierra Leone. Contributing as it does about 45% of the gross domestic product (GDP) and employing about 65–70% of the population, agricultural development is important in its own right as well as having positive implications for the development of other sectors of the economy. This chapter will discuss policies adopted by the government of Sierra Leone (GoSL) and its partners to achieve the central goal of food security for the nation.

The focus of agricultural development in Sierra Leone is mapped out in a National Sustainable Agricultural Development Plan (NSADP) which is a comprehensive framework to promote agricultural development in Sierra Leone based on the principles of the Comprehensive Africa Agricultural Development Programme (CAADP). The National Sustainable Agricultural Development Plan's primary goal is to address on a sustainable basis the recurring problem of food insecurity and hunger including disasters and emergencies. It is to ensure food self-sufficiency, food security and stable economic growth (NSADP 2009).

The major thrust of the plan rests on the crop subsector due to its magnitude, diversity, actual and potential contribution. There is evidence that Sierra Leone was self-sufficient in rice, the national staple, during certain periods. However, this was not sustained. Physical, biological, socio-economic, technical, cultural and institutional factors are all challenges combined to make rice self-sufficiency unstable (NSADP 2009).

Against these challenges, there are opportunities such as adequate arable land, abundant water resources, favourable climate, hard-working farmers and encouraging government and donor partner support. The many challenges and opportunities give rise to several policy recommendations and strategies, discussed below. However, the success of the NSADP is contingent upon

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unfettered political commitment and favourable macroeconomic and climatic conditions. The objectives of this chapter are to review the interventions and initiatives of the past, what was learnt from the successes and failures of those interventions, the current initiatives in the so-called 'development phase' and the challenges ahead. The chapter will also conduct a comprehensive review of the different agricultural subsectors and key sector issues with a view to ascertaining their status, assessing their development potential and studying the main factors that could hamper the realization of the potential. Finally, the chapter will propose appropriate strategies and policy measures for the development of the agriculture sector, flushing out, in particular, those with particular relevance for food security and poverty reduction.

Sierra Leonean agriculture is characterized by food production involving mostly smallholder farming for subsistence. The greatest challenge throughout history is for the country to feed its ever-increasing population on a permanent basis. To this end, several initiatives and interventions have been pursued over the years. This began with swamp clearance, partial development, and cultivation during the colonial era. The period between independence and the present day saw a large number of programmes by the government of Sierra Leone and its partners. These included

(i) Freedom from Hunger (FFH) campaign (late 1960s to early 1970s),

(ii) integrated agricultural development projects (IADPs) of the early 1970s and 1980s,

(iii) Crash Rice Programme (late 1980s),

(iv) Agricultural Sector Support Project (ASSP) (late 1980s to late 1990s),

(v) Agricultural Master Plan (early 1990s),

(vi) Vision 2025 (developed early 2000),

(vii) Medium Term Agricultural Strategic Plan (MTASP) and Agricultural Development Strategy (2003–7),

(viii) Agricultural Sector Review – FAO/MAFFS (2003),

(ix) Interim Poverty Reduction Strategy Paper (IPRSP) (2001–3),

(x) Poverty Reduction Strategy Paper (PRSP1) (2005–7),

(xi) The National Food and Nutrition Policy (2004–8),

(xii) Agenda for Change (PRSP II) (2008–10).

The theme running through all these policies, strategies, and plans/programmes is to achieve food self-sufficiency and food security, with emphasis on rice, the staple. This is due to Sierra Leone's comparative advantage for domestic production of rice as against import to meet its needs. In this regard, the crop subsector offers the greatest hope and best opportunity, and its promotion is vital.

Sierra Leone covers a geographic area of 72,000 km of which 5.4 million ha are potentially cultivable. The upland agro-ecology represents approximately 80% or 4.3 million ha, and the rest are lowlands with potential for high crop yields under sound management practices. The lowlands comprise 690,000 ha inland valley swamps, 145,000 ha of naturally grassy drainage depressions (Bolilands), 130,000 ha of riverine grassland and 200,000 ha of mangrove swamps (ASR 2003).

It has four main physiographic regions. The coastline plain, much of it swampy, covers 15% of the country and averages 50 km in width and does not rise above 50 m. The interior plains cover 43% of the country, vary in altitude from 50–200 m and have a topography occasionally broken by large isolated inselbergs. The Guinea Highlands to the north-east cover 20% of the land area with an elevation in excess of 500 m and culminate in the country's highest point at 1948 m. Finally, the Plateau Region is immediately south of the Guinea Highlands (see WAAPP 2010).

Sierra Leone's economy is largely based on two sectors: agriculture and mining. Both sectors have been declining over the last two decades. Presently, in spite of a vast resource endowment, the country is considered as one of the poorest with a GDP per capita income estimated at about US$365 in 2009.

The crop subsector, with rice dominating, contributes about 75% of agricultural GDP. Annual per capita consumption of rice is amongst the highest in sub-Saharan Africa, estimated at 104 kg. It is estimated that domestic production of rice currently accounts for about 75% of the total annual national requirement for rice of 557,297 metric tonnes, as indicated in Table 10.1 and Figure 10.1. The fisheries subsector contributes 21% of agricultural production and livestock represents 4%. Fisheries are dominated by artisanal marine capture systems, and by small-scale fishing in inland waters. Industrial fishing is mainly done by foreign fleets. Aquaculture is not yet of significance. Total catch is currently estimated at 65,000 metric tonnes with artisanal production accounting for up to 70%.

The contribution of forestry to the agricultural sector's GDP has varied between 9% and 13% since 1984–5 (FAO 2002). Over 90% of the domestic energy needs for heating and cooking are provided by fuel wood. Tree crops plantations, which are found mostly in the eastern part of the country, constitute the bulk of agricultural exports and of the domestic palm oil supply. The main export crops are coffee, cocoa, kola nut and oil palm. Present yields are low for lack of maintenance (NSADP 2009). Fuel (wood and charcoal) production is the most important forestry activity and provides a supplementary source of income for most farmers. The uncontrolled logging practice has a negative impact on the remaining forest reserves.

The livestock population was very severely depleted during the 1991–2001 conflict but with the restocking programme undertaken by government, development partners and the private sector, the stock numbers have been restored to the prewar levels.

TABLE 10.1. Rice self-sufficiency level 2002–8 and projections 2009–15.

Year	National paddy production (MT)	National milled production (MT)	National requirement: milled (MT)	Self-sufficiency (%)
2002	422,033	221,584	543,979	41.7
2003	445,033	233,642	561,600	41.60
2004	542,000	325,200	516,880	62.9
2005	552,000	331,200	526,701	62.9
2006	579,000	374,400	536,708	69.8
2007	638,000	382,800	546,905	70.0
2008	702,000	421,200	557,297	75.6
2009	966,000	579,600	567,885	102.0
2010	1,062,000	637,560	578,675	110.0
2011	1,168,860	701,316	589,670	118.9
2012	1,714,328	1,028,597	600,874	171.0
2013	1,800,044	1,080,026	612,290	176.4
2014	1,890,046	1,134,028	623,924	181.8
2015	1,984,548	1,190,729	635,778	187.3

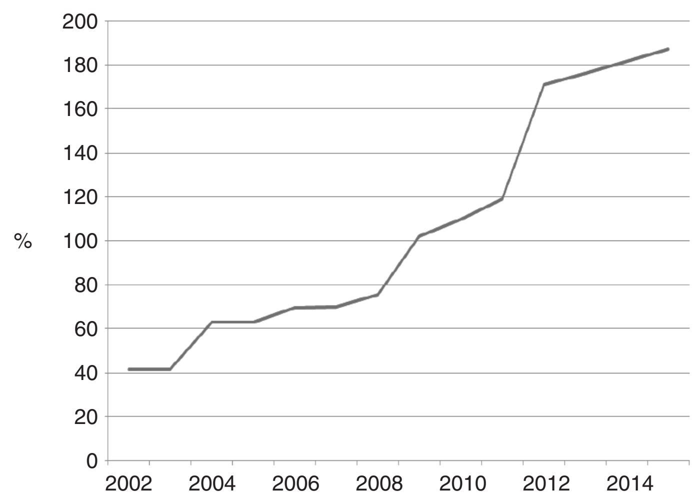


FIGURE 10.1. Rice self-sufficiency.

In Sierra Leone, however, food is synonymous with rice, and its self-sufficiency is the centrepiece of food policy. The importance of rice is reflected in the huge expenditure on its annual import, which currently stands at about US$47 million for 144,000 MT (2009 import) commercial imports in addition to 20,000 MT humanitarian imports (MAFFS 2010). There are indications that Sierra Leone achieved rice self-sufficiency in the 1960s. This positive development continued well into the 1970s primarily due to the high level of government and donor support, including heavy subsidies on farm inputs and services. However, production declined seriously in the 1980s and the late 1990s as a result of the oil crisis, changes in fiscal policies, structural adjustment and the rebel war. Rice production slowly picked up again in early 2000 and it currently fulfills over 91% of national requirements (Sierra Leone Agricultural Bulletin 2010).

The rest of the chapter is organized as follows. The next section examines agriculture and the macroeconomy followed by the potential for stable food production and rice self-sufficiency; and the agricultural development policies and strategies that have been pursued for the achievement of food security in Sierra Leone. Immediately following are the current policies and programmes 2007–12, production outlook and the major challenges to improving food security in Sierra Leone.

10.2 The Agriculture Sector and the Macroeconomy

Agriculture is the dominant sector in the economy. Therefore, macroeconomic policies pursued must target agricultural development for overall growth of the economy. An adverse macroeconomic situation for agriculture is a recipe for poor economic performance. The interplay between agriculture and the macroeconomic forces are pertinent to the discussion that follows in the next sections.

10.2.1 The Pre-War and Rebel War Years

The economy, after growing at 4% per annum immediately after independence in the 1960s, deteriorated sharply in the following two decades as a result of (i) poor governance, (ii) overall poor economic policies and (iii) heavily taxed agriculture (ASR 1992). The rate of growth of GDP in real terms fell from 4.0% in 1972–3 to 2.8% in 1973–4; by 1975–6 it recorded a negative growth of 2.0%, reflecting the debilitating effect of the 1974 oil price hike. By the turn of the decade the situation improved, as the economy recovered from the oil price shock and the massive government expenditures on infrastructure for the 1980 Organisation of African Unity (OAU) conference in Freetown. The GDP grew at 3.6% in real terms (see ASR 1992).

In the 1980s, the growth of GDP declined – from an average of about 1.5% from 1973–80 to just under 1.0% in the 1980s. Coupled with constant population increase, this led to a considerable decline in per capita income from over US$350 in 1981 to only US$200 in 1989. The kind of fiscal and monetary policy that government pursued during the 1980s could only have been described as wayward. To finance its deficits on current account, government resorted to bank borrowing which led to inflationary increases in base money. By the middle years of the decade, inflation, which was 23.9% in 1980–81, was running at a rate of 70.4%. Similarly money supply growth ballooned from 3.0% in 1980–81 to 75.8% in 1985–6 (Agricultural Master Plan 1996).

The State of the Agricultural Sector Before the War

'The general deterioration of the macro-economy has caused serious problems for the agricultural sector. Major problems, *inter alia*, include high inflation, shortages of foreign exchange and strongly negative real interest rates which have contributed to adverse conditions in the terms of trade for agricultural products, low investment – both public and private – in the sector, a serious shortage of imported inputs, reduced consumer purchasing power, unattractive producer prices, and low farm incomes. The development of small-scale, agriculture-based industries to provide the backward and forward linkages needed to foster and sustain the growth of agricultural output has been stifled, with undesirable consequences for the growth of the entire rural economy. The result is a vicious circle in which the unfavourable macro-economic environment has depressed agricultural sector growth, which has in turn led to a further worsening of the macro-economic situation.'

MAFF/FAO 1992

Towards the end of the 1980s, it became increasingly evident that government policies were serving the Sierra Leonean economy poorly. All post-independence advances made in either economic growth or income equity had disappeared. Consequently, employment generation was disproportionately slow, unable to match the annual increases in the country's labour force – a recipe for civil strife. In reaction to the gloomy economic situation and on advice from the IMF and World Bank, the government of Sierra Leone in 1989 began to implement a Structural Adjustment Programme (SAP), which sought to establish fiscal and monetary discipline, to liberalize and open the economy and to create an enabling environment in which the private sector could thrive. But the situation did not improve. Donor support was low; the budget deficit and inflation rate remained high, and foreign reserves low.

It is evident that the war of the 1990s cannot be blamed for the fundamental weaknesses that have hindered the development of a vibrant agricultural sector. It is worth recalling the findings of the 1992 agricultural sector review for Sierra Leone whose focus was on the period of the 1980s, before the war (see the box at the top of this page).

10.2.2 The Post-Rebel War Years

Overall, during the 1990s, the war-ravaged economy of Sierra Leone was volatile but on average contracted at a rate of 4.6% per annum (Government of Sierra

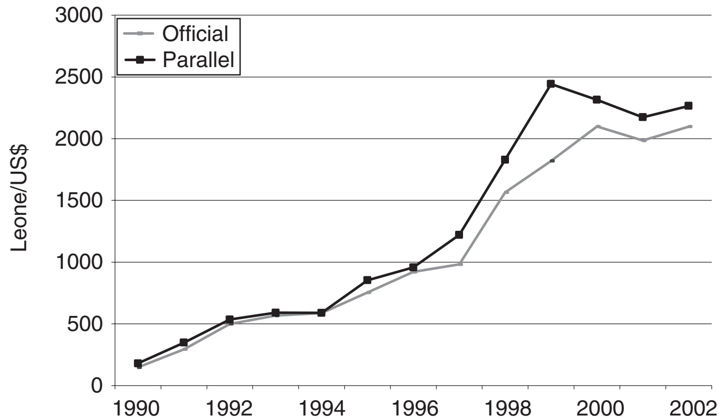


FIGURE 10.2. Official and parallel market exchange rates, 1990–2002. *Source:* Based on data from Bank of Sierra Leone, Ministry of Finance and Central Statistical Office.

Leone 2001). Consistent with this, agricultural and non-agricultural incomes plummeted during the period. Per capita income dropped by 47% during the 1990s, leading to an exacerbation of poverty, especially in the rural areas.

The cessation of hostilities in 2002 has brought about an improvement in Sierra Leone's security situation, and enabled the re-establishment of government's control over all areas of the country, paving the way for the resumption of economic growth. This stability has provided a framework within which relief and humanitarian assistance have been provided in an orderly manner, while laying the foundation for economic reconstruction. Output growth rose from 3.8% in 2000, 5.4% in 2001, and 6.3% in 2002, reflecting the continuing recovery in agriculture and expansion of activities in the manufacturing, construction and services sectors (ASR 2003).

Tax policy has focused largely on the streamlining of indirect taxes and gradual reduction in import taxes, which reduced the average tax burden on commodities consumed by the poor. The relative stability of the exchange rate (see Figure 10.2) has helped to sharply reduce inflation, thereby relieving the poor of the harsh 'inflation tax' experienced in the 1990s. The pace of fiscal adjustment has been appropriately flexible and tailored to the availability of external budgetary support, subject to the need to limit domestic bank financing of the overall budget deficit to levels that would avoid reigniting inflation (see EPRU 2003).

The main macroeconomic objectives of the current medium-term programme are to promote higher economic growth, further stabilize the economy and to create an economic environment conducive to labour-intensive growth and poverty reduction. Specifically, the aim is to raise real GDP growth to 6–7% during 2007–12. Growth is expected to come mainly from putting into production under-utilized capacity in the agricultural and mining sectors and reconstruction and rehabilitation activities (Agenda for Change 2008–12).

TABLE 10.2. Percentage contribution to real gross domestic product by sector.

Contribution to GDP by sector	2006	2007	2008	2009	2010 provisional
1. Agriculture	47.33	46.33	46.25	45.92	45.55
Crops	32.05	31.46	31.75	31.89	32.05
Livestock	2.90	2.91	2.82	2.73	2.62
Forestry	3.77	3.60	2.55	3.44	3.31
Fishery	8.61	8.37	8.13	7.87	7.59
2. Industry	9.23	9.71	7.87	6.56	6.74
Mining and quarrying	4.70	5.34	3.45	2.43	2.73
Manufacturing and handicrafts	2.25	2.16	2.09	1.97	1.91
Electricity and water supply	0.17	0.15	0.31	0.28	0.28
Construction	2.11	2.06	2.03	1.89	1.82
3. Services	39.26	39.27	41.47	42.14	42.34
Trade and tourism	5.30	5.94	6.46	5.84	6.64
Wholesale and retail	5.27	5.59	5.00	5.00	4.76
Hotels and restaurants	0.45	0.44	0.41	0.4	0.38
Transport, storage and communication	7.55	8.41	8.41	10.8	10.45
Finance, insurance and real estate	6.19	5.38	6.14	5.6	5.17
Administration of public services	3.97	3.37	2.66	2.5	3.11
Other services	4.03	3.87	3.8	3.8	3.71
Education	2.85	3.34	4.95	4.4	4.12
Health	3.14	2.49	3.18	3.3	3.35
NPISH	0.51	0.44	0.46	0.5	0.65
4. FISIM	−1.94	−1.83	−2.45	−2.72	−3.06
5. GDP at basic price (1 + 2 + 3 − 4)	93.87	93.48	93.14	91.90	91.56
6. Indirect taxes	6.13	6.52	6.86	8.10	8.44
7. GDP at market price (5 + 6)	100.00	100.00	100.00	100.00	100.00

Source: National Accounts Section, SSL. 'NPISH' stands for non-profit institutions serving households. 'FISIM' stands for financial intermediation services indirectly measured.

10.2.3 Public Expenditure on the Agricultural Sector

Public spending on agriculture has increased 1,150% in real terms over the last seven years, rising from Le 6 billion in 2000 to Le 75 billion in 2007 and to 76 billion in 2010 (see Table 10.3). This increase is consistent with the importance attached by government to the rapid revitalization of the agriculture sector. Increased spending to agriculture over these years has coincided with strong growth in the sector. It is likely, however, that this growth is attributed as much to the restoration of peace and stability as to government's rehabilitation efforts and the government commitment to the Maputo declaration in 2003, where heads of states and governments of the African continent agreed to allocate at least 10% of the total national budget to agriculture.

TABLE 10.3. Actual expenditure, 2000–2010 (constant 2000 Le million).

	Actual	Planned									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total MAFFS	6,026	9,089	9,750	15,026	34,386	37,649	44,635	75,206	66,188	51,129	76,072
Recurrent	5,094	8,296	8,504	12,922	17,070	20,543	22,411	24,589	29,091	33,144	31,614
Salaries	3,868	4,616	4,808	5,320	5,035	5,255	5,522	10,711	12,436	13,657	8,438
Others	1,226	3,680	3,696	7,602	12,035	15,288	16,889	13,880	16,656	19,487	23,176
Development	932	793	1,245	2,103	17,316	17,106	22,224	50,617	37,096	17,985	44,458
Domestic	0	793	1,245	2,103	2,245	2,928	3,433	7,340	2,400	2,800	7,822
Donor	932	0	0	0	15,071	14,178	18,790	43,278	34,696	15,185	36,636
MAFF spending as % of total GoSL	N/A	2.6	2.4	3.2	4	N/A	N/A				
% GDP	0.5	0.6	0.7	0.9	2	2.1	2.3				
Other spending											
Marine resource			1,170	1,340	13,300	9,243	5,075				
NaCSA		3,679	3,540	3,319							
GDP deflater (IMF)	1	1.061	1.103	1.176	1.225	1.257	1.282				

Sources: Ministry of Finance and Office of the Accountant General.

Over the same period, the National Commission for Social Action has spent around Le 3.5 billion per year on small-scale agricultural rehabilitation projects under its ERSF and IRDP programmes. In total, NaCSA has funded almost 200 agricultural rehabilitation projects through these two programmes. Spending through the Ministry of Marine Resources, which was part of MAFFS up until May 2002, has remained relatively constant in real terms at Le 1.2 billion in 2002 and Le 1.3 billion in 2003.

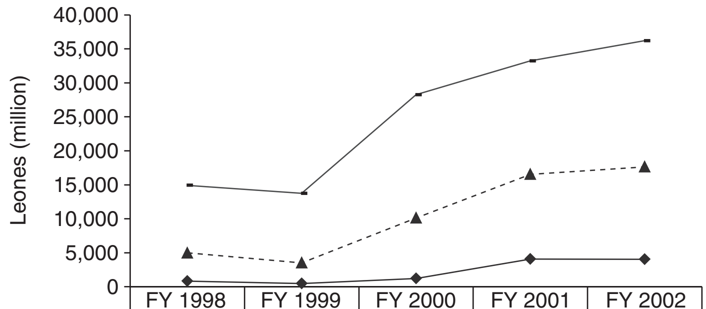
As a proportion of total public spending, the Ministry of Agriculture, Forestry and Food Security's share has increased modestly from 2.5% of total public spending in 2001–2 to just over 3% of spending in 2003, 6.7% in 2007 and almost 10% in 2010, thereby meeting the Maputo agreement.

Future expenditure on agriculture is planned to increase as well. The budget allocation to MAFFS for 2011 is Le 140 billion in real terms (Le 150 billion in nominal terms). This is over twice the level of actual sector spending in 2008. The budget allocation for agriculture is planned to increase further in 2012 and 2013. The proposed increase in spending comes from two sources: a rise in the non-wage recurrent budget, largely for the purchase of planting materials, agricultural machinery and other farm inputs; and a number of large donor-funded projects that are now being implemented.[1] A large increase in spending is also proposed for the Ministry of Marine Resources in 2011–13, as a result of donor support to the Artisanal Fisheries Development Project.

If these levels of spending are achieved, agriculture's share will increase to 10% or more of total public spending. This is broadly consistent with the Maputo Declaration of 2003 by the African heads of states and governments. It is also important to note that international experience indicates that growth in agriculture requires a framework of effective support services, and that public funding is required for at least some of these. Also, in Sierra Leone it will take some time for effective private sector delivery of agriculture services to emerge, and government faces a situation where public funds will continue to be required for some years for rehabilitation activities, including improvement of basic rural infrastructure. It is important, however, that decisions over future levels of public funding to agriculture are made on the basis of farmers' needs and the quality of expenditure provided. Continued growth in the sector also depends as much upon improvements in the wider policy and institutional environment as upon the provision of publicly funded services.

On the expenditure side, spending on wages and salaries together with goods and services comprised almost 70% of government expenditure, with the wage bill accounting for about 60% of the total expenditure. Data from the Budget Bureau of the Ministry of Finance show a quantum leap in public expenditure on the agricultural sector.

[1] These include IFAD's Rehabilitation and Community-Based Poverty Reduction Project; AfDB's Agricultural Sector Rehabilitation Project; and AfDB's Nerica Project, World Bank Rural and Private Sector Development Project, IFAD's Rural Finance and Community Improvement Project.



	FY 1998	FY 1999	FY 2000	FY 2001	FY 2002
Agriculture	832	478	1,226	4,086	4,042
Education	14,921	13,740	28,256	33,242	36,203
Health	4,983	3,515	10,126	16,550	17,647

FIGURE 10.3. Trends in public expenditure on major sectors.
Source: ASR Mission based on data from the Budget Bureau, Ministry of Finance.

Analysis of available data (see Figure 10.3) shows that although the public expenditure on educational and health sectors are higher in magnitude, agriculture records much higher percentage change in actual government expenditures, between 2006 and 2007. The greatest percentage increase occurred between 2010 and 2011, representing a very positive correlation between the President's Agenda for Change vision of making agriculture the engine for socio-economic growth and development through increased agricultural production and the government's provision of the wherewithal to make the vision a reality. This expenditure analysis did not take into consideration the data from the UNDP supported programmes, the EU support for food security through NGOs, USAID support, NGOs operating in the sector and NaCSA. Suffice to say, though, that levels of agricultural spending under these programmes could only increase total public expenditure on agriculture in Sierra Leone which may have a positive impact on the sector and the economy as a whole.

10.2.4 Foreign Trade

Sierra Leone's export base is narrow, and is dominated by a few mineral and agricultural products. Minerals (mostly diamonds with small quantities of rutile, bauxite, and gold) provide the bulk of export earnings (86% in 2002). Agricultural commodities (mostly cocoa and coffee with small quantities of fish products and tobacco) account for about 14% of the GDP (Bank of Sierra Leone Bulletin 2002). The war had a devastating effect on Sierra Leone's export base. Exports declined from a value of US$140 million in 1990 to a mere US$4.5 million in 1999, as indicated in Figure 10.4. Since then, increased diamond exports have spurred on a recovery. The value of merchandise exports rose to US$49 million in 2002. Among agricultural exports, cocoa has exhibited the best recovery to date and comprised 80% of the value of agricultural exports in 2002. Although export taxes have all been removed on agricultural

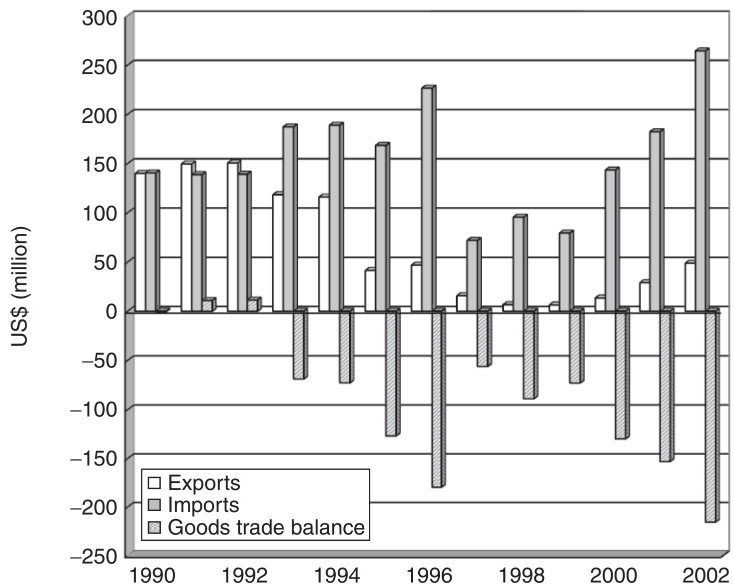


FIGURE 10.4. Exports, imports and goods trade balance, 1990–2002.
Source: ASR Mission based on data from Statistics Sierra Leone.

goods, there are still quota restrictions on the exportation of some agricultural products such as palm oil, rice and fish. These led to major smuggling activities along the porous borders with Liberia and Guinea.

Total exports picked up in 2009, ending the year at US$230.7 million, up 7% on the previous year's performance. A key area of export performance was cash crops, such as coffee and cocoa, and fish and shrimps. Aided by an improvement in Sierra Leone's terms of trade and higher prices for these commodities, export values increased, with cocoa exports rising by 37%, and coffee and fish and shrimp rising 780% and 620%, respectively, albeit from a lower base. As a result, in 2009, cash crops made up 21% of total exports, up from 8.5% the year before which has a positive impact on the sector, the farmers and the economy.

Alongside the virtual collapse of exports during the 1990s, imports also fell, the decline being particularly sharp after the 1997 UN Security Council sanctioned trade embargo against Sierra Leone, a reaction against the AFRC coup. Imports fell from a value of US$181 million in 1990 to a low of US$79 million in 1999. However, with the return of relative peace and calm in 2000, imports swiftly increased to US$146 million in 2000, rising in the following year to levels exceeding those before the war, in nominal terms (Bank of Sierra Leone 2002; MOF 2003).

In 2002, food imports represented the largest share of total imports at 27%, followed by mineral fuel and lubricant; and machinery and transport equipment which each accounted for about 20% of imports, while manufactured goods comprised 13% of imports. The dominance of food imports suggests the need to consider closely the possibility of import substitution, through enhanced domestic production (especially of rice), as a strategy for reducing the import bill. This is even more justified given that analysis carried out in recent studies confirms results of an earlier analysis which showed that the country has relatively high comparative advantage in the production of rice in at least three of the agro-ecologies, using improved varieties (ASR 2003).

The total value of imports in 2009 was estimated at US$520.3 million, about 2.6% below the 2008 level. This decline was driven by the decline in the prices of oil and food commodities, which together made up close to half of Sierra Leone's import bill in 2009, as well as a depreciation of the leone against major international currencies, which made imports less affordable in Sierra Leone. The fall in the import bill was moderated by a strong rise in the value of imports of manufactured goods, machinery and transport equipment (EPRU Economic Bulletin 2009).

10.3 Potential for Stable Food Production and Self-Sufficiency in Rice

Stable food production with particular focus on crops and rice self-sufficiency has occupied the mind of the Sierra Leone government for decades. This is amply reflected in the policies, strategies, and plans implemented over the years. The primary reason is that food is a fundamental human right embodied in United Nations Charter of 1948, and lately (2000), articulated in the Millennium Development Goals (MDGs). Food is life, and no person, community or country should be allowed to go hungry. However, for such a noble goal to be attained, factors that combine to enhance the development and growth of the agriculture sector must be sufficiently addressed, and appropriate mechanisms put in place to promote it (Sheriff *et al.* 2009). Rice will be discussed first, followed by other crops.

Rice is by far the most important crop not just as staple, but in terms of huge expenditure on its import and value in trade. The current estimated total production stands at 888,000 MT or a little over 91% of national requirement (Agricultural Statistical Bulletin 2010). In order to offset the shortfall, and to ensure export on a sustained basis, production has to significantly increase. Providing appropriate and timely input supply, and promoting effective research – extension delivery through farmer training in improved cultural practices including integrated production and pest management (IPPM) will bring about significant yield increases and total production (Sheriff *et al.* 2009). Due to economies of scale, and characteristic labour shortage in the vast low lands, farm mechanization using tractors, power tillers, harvesters, threshers, winnowers, and hullers is imperative. This will also significantly reduce the labour drudgery especially on women who produce over 60% of the food.

It is acknowledged, however, that farm mechanization and large-scale irrigation schemes the world over are capital-intensive undertakings, and must

TABLE 10.4. Production of major food crops 1990–2008 and production target 2009–15.

	Rice			Maize		
Year	Area cultivated (ha)	Yield (MT/ha)	Production (MT)	Area cultivated (ha)	Yield (MT/ha)	Production (MT)
1990	362,467	1.50	543,700	8,200	1.50	12,300
1991	274,067	1.50	411,100	7,333	1.50	11,000
1992	280,000	1.50	420,000	6,667	1.50	10,000
1993	324,000	1.50	486,000	8,000	1.20	9,600
1994	296,867	1.50	445,300	7,167	1.20	8,600
1995	248,370	1.35	335,500	8,469	0.98	8,200
1996	290,248	1.35	391,700	9,082	0.98	8,900
1997	304,667	1.35	411,300	9,592	0.98	9,400
1998	275,407	1.35	371,800	8,776	0.98	8,600
1999	183,852	1.35	248,200	9,355	0.93	8,700
2000	146,667	1.35	198,000	11,125	0.80	8,900
2001	230,089	1.35	310,620	12,540	0.80	10,032
2002	312,640	1.35	422,065	14,870	1.08	16,060
2003	329,678	1.35	445,633	14,870	1.08	16,060
2004	361,333	1.50	542,000	15,865	2.02	32,125
2005	368,000	1.50	552,000	19,332	2.02	39,051
2006	482,500	1.20	579,000	24,165	2.02	48,813
2007	531,666	1.20	638,000	27,200	2.02	54,944
2008	585,000	1.20	702,000	28,550	2.00	57,120
2009	644,000	1.50	966,000	29,978	2.00	59,956
2010	708,400	1.50	1,062,600	31,477	2.50	78,693
2011	779,240	1.50	1,168,860	33,051	2.50	82,628
2012	857,164	2.00	1,714,328	34,704	2.50	86,760
2013	900,022	2.00	1,800,044	36,439	2.50	91,098
2014	945,023	2.00	1,890,046	38,261	2.50	95,653
2015	992,274	2.00	1,984,548	40,174	2.50	100,435

be planned and managed in such a way as to ensure technical and economic feasibility. Both call for major private sector investment.

The strategy for increasing rice production is two pronged: (a) increase in the area cultivated, mainly in the lowlands where there is much underutilized capacity, and (b) increases in productivity per unit area in all ecosystems. Area expansion will mainly be in the Bolilands and riverine grassland areas while inland valley and mangrove swamps offer opportunities for yield increases. The government's goal is to achieve rice self-sufficiency and this strategy targets a land area of 830,000 ha and an increase in the average rice yield to 2 MT/ha to realize the government's goal of rice self-sufficiency. Increasing the productivity of rice and expanding the area under the crop will require considerable improvement in the existing infrastructure, agricultural services and appropriate coordination and management.

TABLE 10.4. Continued.

	Cassava			Sweet potato		
Year	Area cultivated (ha)	Yield (MT/ha)	Production (MT)	Area cultivated (ha)	Yield (MT/ha)	Production (MT)
1990	18,240	10.00	182,400	7,462	5.20	38,800
1991	16,340	10.00	163,400	5,923	5.20	30,800
1992	23,227	8.80	204,400	6,692	5.20	34,800
1993	27,330	8.80	240,500	7,696	5.20	39,500
1994	27,898	8.80	245,500	8,442	5.20	43,900
1995	29,739	8.80	261,700	8,692	5.20	45,200
1996	31,977	8.80	281,400	9,320	5.00	46,600
1997	30,048	10.30	309,500	10,060	5.00	50,300
1998	35,275	8.00	282,200	3,460	5.00	17,300
1999	30,000	8.00	240,000	4,000	5.00	20,000
2000	45,506	10.30	268,711	5,620	5.00	28,100
2001	61,768	12.00	741,216	7,640	5.00	38,200
2002	68,909	13.00	895,817	9,090	5.00	45,450
2003	83,936	13.00	1,091,168	16,379	5.40	84,446
2004	134,404	13.08	1,758,004	28,240	5.40	153,196
2005	175,923	13.00	2,287,000	29,652	5.40	160,121
2006	228,700	13.00	2,973,100	31,135	5.40	168,129
2007	297,310	13.00	3,865,030	32,692	5.40	176,537
2008	312,176	13.00	4,058,288	33,346	5.40	180,068
2009	327,785	13.00	4,261,205	34,013	5.40	183,670
2010	344,175	13.00	4,697,992	34,693	5.40	187,344
2011	361,384	13.00	4,474,275	35,387	5.40	191,090
2012	379,453	13.00	4,932,892	36,095	5.40	194,913
2013	398,426	13.00	5,179,538	36,817	5.40	198,812
2014	418,347	13.00	5,438,515	37,553	5.40	202,788
2015	439,264	13.00	5,710,436	38,304	5.40	206,842

10.4 Other Crops

Other cereals cultivated include sorghum, millet and maize. Maize is frequently intercropped with rice, while millet – as a short duration crop – is seen as a useful 'hunger crop' in the rainy season. The total production of maize and millet is shown in Table 10.4 as well as being indicated in Figures 10.5 and 10.6.

10.4.1 Roots and Tubers

Turning to roots and tubers, cassava and sweet potato are the most important staple foods after rice. Their roots, tubers, and leaves are consumed fresh, and their products like chips, flour, and gari are in high demand for both local consumption and export. Their production level is shown in Table 10.4 and Figures 10.5 and 10.6.

TABLE 10.4. Continued.

	Groundnut			Millet		
Year	Area cultivated (ha)	Yield (MT/ha)	Production (MT)	Area cultivated (ha)	Yield (MT/ha)	Production (MT)
1990	20,000	1.50	30,000	5,000	0.80	4,000
1991	22,667	1.50	34,000	5,000	0.80	4,000
1992	20,667	1.50	31,000	5,500	0.80	4,400
1993	25,200	1.50	37,800	5,500	0.80	4,400
1994	26,333	1.50	39,800	4,000	0.80	3,200
1995	24,800	1.50	37,200	4,000	0.80	3,200
1996	23,867	1.50	35,800	4,000	0.80	3,200
1997	25,267	1.50	37,900	3,000	0.80	2,400
1998	23,600	1.20	35,400	3,000	0.80	2,400
1999	24,167	1.00	29,000	3,000	0.80	2,400
2000	14,700	1.20	14,700	5,000	1.00	5,000
2001	40,750	1.20	48,900	5,000	1.00	5,000
2002	48,667	1.20	58,400	5,500	1.00	5,500
2003	58,750	1.40	70,500	5,500	1.00	5,500
2004	63,473	1.50	91,128	6,000	1.00	6,000
2005	69,820	1.50	104,730	6,000	1.00	6,000
2006	76,802	1.50	115,203	6,500	1.00	6,500
2007	84,482	1.50	126,723	6,500	1.00	6,500
2008	88,706	1.50	133,059	6,500	1.00	6,500
2009	93,141	1.50	139,712	7,000	1.00	7,000
2010	97,798	1.50	146,697	7,000	1.00	7,000
2011	102,688	1.50	154,032	7,500	1.00	7,500
2012	107,822	2.00	215,644	8,500	1.00	8,500
2013	113,213	2.00	226,426	9,000	1.00	9,000
2014	118,874	2.00	237,748	9,500	1.00	9,500
2015	124,817	2.00	249,634	10,000	1.00	10,000

Considerable progress has been made by the National Agricultural Research Institute, MAFFS, and development partners including NGOs in the development and dissemination of improved cassava and sweet potato cultivars to farmers. Data from MAFFS of 2010 indicates that the country is now self-sufficient in these two crops. It is noted, however, that this achievement has more to do with expansion of area under cultivation than increases in yields. The gap between farmers yields of 10 MT/ha for cassava and 5MT/ha for sweet potato and that of the Njala Agricultural Research Center recording 17 MT/ha, for cassava and 10 MT/ha for sweet potato, is quite significant, and needs to be closed. In this regard, due consideration must be given to improved husbandry and production practices in the face of increasing demand.

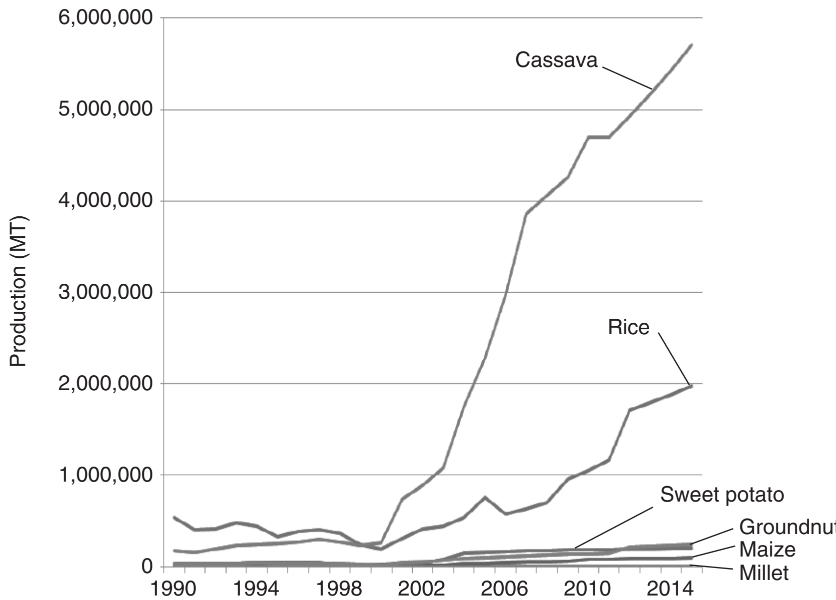


FIGURE 10.5. Crop production trends.

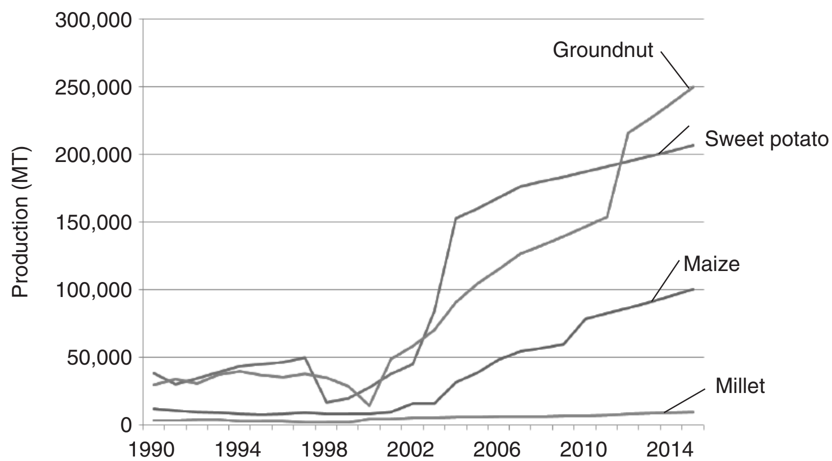


FIGURE 10.6. Crop production trends: minor crops.

10.4.2 Pulses

Apart from some energy, pulses in general and grain legumes in particular provide essential protein, vitamins, and minerals the body needs. They play a critical role in sustainable land use and sound environmental management. Conscious and focused incorporation of these crops into the cropping systems and patterns will go a long way to ensure stable food production and food security. Common pulses grown in Sierra Leone are groundnuts, beans, peas, and melon seeds. These are high value crops and are mostly used in daily diets.

Groundnut is the most popular grain legume grown on the uplands, and in swamps, after rice. Due to its high nutritional and cash value, production is on the increase. It is mostly cultivated by women in small plots due to labour constraints. Most of the crop is grown in the Northern Region. It is used directly as food, and for oil extraction, while the residue is used as animal feed. Despite the small holdings, and low yields, groundnut is a promising crop in terms of food, cash and feed value. It is also important in the cropping system, especially when groundnut follows rice as a second crop, or maize in rotation. Groundnut yield and total production will markedly increase through appropriate mechanization, good husbandry, and effective post-harvest operations. Table 10.4 and Figures 10.5 and 10.6 show the production of groundnut during the period under review and projections from 2009–15.

Beniseed or sesame is among the many crops cultivated alongside upland rice in mixtures. Reliable estimates of yields and total production are difficult to get. Yet, it is a dominant feature of upland rice farming system. Used mainly as a condiment in sauce, soup, and stew, beniseed is an important part of family meals. At industrial level, it has gained increasing importance in the manufacture of baby food, and other food products. The Benimix Factory located in Bo, southern Sierra Leone which produces the Benimix baby food is on a serious drive to promote beniseed production, and there is every reason to support such private sector initiative.

10.5 Agricultural Development Strategies and Policies of the Recent Past

The remaining sections will review the agricultural development policies and strategies of the past and lessons learned from the successes and failures of those interventions, the current policies and strategies being pursued, and the challenges ahead.

Even before the end of the 1991–2001 war, the government initiated a number of development policies and strategies with the object of attaining food self-sufficiency and food security. As a direct result, obligations regarding the right to adequate food at the international and national level were undertaken with a strong political commitment for its realization for all. However, the modalities to coordinate the necessary efforts, to ensure accountability, transparency, non-discrimination and empowerment, and to monitor progress were not effective.

The primary objectives of the government's postwar agricultural strategy are to promote sustained growth of agricultural output, food security and the reduction of poverty. The strategy comprises development programmes, respectively, for rice, other food crops, export crops, livestock and fisheries. The objective is to expand and diversify national food production, generate employment and export revenues. In support of these programmes, actions are needed in six thematic areas: (i) maximizing food production to assure food security for the population and to exploit the country's comparative advantage in producing food for import substitution and for export in the region; (ii) institutional reforms and technology development; (iii) availability of adequate and sustainable infrastructure; (iv) diversification of crop production, expanding exports of traditional products to the extent that they can be competitive in the world market, while improving quality and diversifying the export base; (v) effective natural resource management; and (vi) creating opportunities for rural employment to reduce the income gap between urban and rural areas and to stem the rural exodus.

10.5.1 Food Security Issues

A state of food security is achieved when 'all the people at all times, have physical, social and economic access to sufficient, safe and nutritious food to meet their dietary needs and food preferences for an active and healthy life' (World Food Summit 1996). Four basic conditions need to be fulfilled: accessibility to food; availability of sufficient food; reliability and stability of access and availability; and effective utilization of food consumed.

With respect to food demand and nutritional needs, between 1979–81 and 1992–4, daily per capita energy availability declined from about 2,200 calories to 1,800 calories, and per capita protein availability from 47.3 g to less than 41 g (ASR 2003). This shows that Sierra Leoneans were getting only about 75–80% of the average daily dietary requirement. Cereals contributed 61% of the energy supplies (rice 54%). Rice is the base of the diet. It is also the main staple food and is grown by virtually all rural families (ASR 2003).

As regards food supplies, domestic paddy production fell from 504,000 to 405,000 MT between the period 1979–81 and the period 1992–4. However, by 2002 domestic production of paddy has reached the prewar level (Table 10.4). Over the last five years, imported rice dropped from 40% to 20% of total rice consumption. Fish productions declined by 60%. The effects of the war on the livestock population have probably been the most devastating as compared to any other subsector of the agricultural economy. Livestock that was not slaughtered, by the warring factions, was led out of the country into Guinea by Fula herders. It is estimated that 40% of the national cattle herd was transferred to Guinea. Food supply in Sierra Leone became a very critical issue.

On the subject of food insecurity and poverty, the decline in real incomes together with deteriorating health, education and other social services resulted in worsening standards of living during the 1980s. The war only aggravated the economic malaise, by the displacement of almost half the population and the exile of over 200,000 people into the neighbouring countries. In consequence, the production of food and export crops declined, revenues plummeted, unemployment and underemployment increased and food supply became critical. The vulnerable groups most affected by food insecurity are low-income urban families, poor smallholder farmers, livestock and poultry and fish producers and, within these groups, women and children in particular.

For these groups, which comprise 68% of the population, subsistence remains extremely precarious. Infant mortality rate is 147 per 1,000, life expectancy is 42 years, only 42% of the population has access to safe drinking water, and adult illiteracy is 79%, with women registering over 90% illiteracy (MICs 2005).

In 2003, FAO approved the Special Programme for Food Security (SPFS) for Sierra Leone. The programme seeks to improve food security and livelihoods among rural poor through farmer participation and use of improved production technologies that will remove the bottlenecks to increased production. During the implementation of the programme, greater importance was assigned to small-scale/rural families as beneficiaries of the programme.

The implementation strategies included organizing the farmers into small groups at chiefdom, section, or village levels for the establishment of their own mechanism for the reception and provision of resources, training of participating farmers (men, women and youths), and generation of appropriate technologies.

10.5.2 Food Security Strategies

The target groups to be addressed by the food security strategy of the Sierra Leone authorities would be, principally, small farmers, landless rural dwellers, and impoverished urban families. The objective is to raise in the medium term the daily per capita energy intake from the current 1,800 cal to 2,200 cal and to 2,400 cal by 2010. This strategy includes food distribution as payment for work in infrastructural rehabilitation, and promoting the increase of subsistence production. The food to be distributed would be constituted of internally purchased surpluses, imported food and international grants (ASR 2003).

Initially, there would be need for further study to refine the general understanding of the characteristics of each of the vulnerable groups and the numbers involved. If the goal of eradicating hunger by 2015 is to be attained, decisive action on a very large scale is required. The one way of addressing the hunger/poverty trap in the short run is to empower communities (and especially enterprising groups among them) to develop a better understanding of the specific nature and causes of their food insecurity and to jointly define solutions, which lay largely within their capacity to implement. Solutions should be necessarily community-specific, reflecting local needs and opportunities, such as the deliberate setting aside of community food reserves at harvest time, adjusting cropping systems to result in more food becoming available during the hungry season, introducing labour-saving cultivation methods, collective measures to reduce the incidence of malaria, making additional land available to strangers, group saving systems to reduce future borrowing, locally sourced school feeding programmes to increase aggregate food availability within the family. The overall goal should, from a food security perspective, be to have very large numbers of the most food-insecure people achieve modest production/food availability gains (ASR 2003).

In the long run, a growth strategy emphasizing agricultural intensification offers the best opportunity to meet the combined objective of achieving food security and reducing poverty. The focus on intensification is necessary because of land pressure in areas with high agricultural potential and the need for protecting soil fertility and the remaining natural resources to assure that long-term growth can be sustained. Intensive agriculture requires higher investments in factors of production, reliable input supply, relevant extension service, accessible and reliable marketing service, and attractive financial rewards to farmers. It is important to recognize that a focus on the economies of scale through modernization and intensification purposes should not ignore the focus on the smallholders, because of their relative efficiency in using resources.

Programmes to address long-term, chronic food insecurity would also focus on broadening the opportunities for producers to attain sustainable livelihoods. The immediate focus would be on enhancing the livelihoods of small-scale resource-poor farmers, through a combination of agricultural technologies and support services, access to markets and credit, along with rural enterprises and agro-processing. All farmers should be encouraged to diversify their sources of income, for example by producing high value vegetables and tropical fruits for the export market, rearing more short-cycle livestock, taking advantage of non-timber forest products (honey, traditional medicine) and, in some places, developing ecotourism.

10.5.3 Institutional Reforms and Technology Development

A number of institutions involved in Sierra Leone agriculture include government ministries, non-governmental organizations (NGOs), parastatals, local government and community-based organizations (CBOs). Two technical ministries – the Ministry of Agriculture, Forestry and Food Security (MAFFS) and the Ministry of Fisheries and Marine Resources (MFMR) – are primarily responsible for agricultural development. Their mandate is wide, covering most aspects of crop, livestock and fisheries development, supervision of project planning and project implementation. Agricultural pricing and marketing is centred in the Ministry of Trade and Industry (MTI), while the Ministry of Education, Science and Technology (MEST) is responsible for some basic agricultural research at the university level. The main vetting ministry is the Ministry of Finance and Economic Development (MOFED). In addition, since colonial times, several public enterprises have been created to perform various development and marketing functions of relevance to agriculture.

Coordination between ministries and agencies has been a major issue in policy making. There is no central focus for discussing policies, and the existing administrative systems provide little room for interministerial and interagency cooperation. Better coordination is required to avoid sharp policy differences. A case in point is where the Ministry of Trade and Industry and the police are enforcing a ban on exporting domestic rice and palm oil to neighbouring countries, in order to keep domestic prices of these commodities low, while MAFFS holds the view that free trade encourages increased production.

The implementation of development policies, programmes and projects in the agricultural sector has fallen short of expectations over the years. The proliferation of development institutions, while retaining parallel administrative structures, has resulted in overlapping institutional functions, competence, and efforts, and hence in waste of resources. The best example of overlapping institutional functions is in the domain of agricultural extension, where individual donor projects, NGOs and other agencies carry out some of the same functions through different delivery mechanisms, with the result that farmers have received different and sometimes conflicting technical advice.

Ongoing and anticipated reforms in agricultural institutions are predicated upon current government policy on decentralization. The government has chosen a route of decentralization to open up the political space and improve inclusiveness. With the decentralization, local government would become a major player in the agricultural sector by way of increased availability of access to services to people, grassroots participation in decision-making and community ownership of programmes and projects.

Several studies have confirmed earlier claims relating to the general weakness in terms of infrastructure and manpower. In relation to agriculture, the following areas are particularly relevant (ASR 2003): (i) research, (ii) extension, (iii) agricultural statistics and (iv) land tenure.

10.5.4 Research

Before 2007, the research system in Sierra Leone consisted of the National Agriculture Research and Coordinating Council (NARCC) and its constituent institutes, the Institute of Agricultural Research (IAR) and the Rokuprr Rice Research Station (RRRS), Departments of the University of Sierra Leone (the Institute of Marine Biology and Oceanography (IMBO)), Fourah Bay College (FBC) and Njala University College (NUC), with some very minor activities by a few NGOs and one private sector firm. The GOSL established NARCC in April 1985 to formulate agricultural policy and set research priorities in light of farmers' needs, researchers' recommendations and GOSL policy objectives.

Although some progress in research has been achieved, the low yields in Sierra Leone reflect the limited progress. The lack of supporting services for inputs, credit and marketing did not help the situation.

The GOSL has reformed and reorganized NARCC, by creating the Sierra Leone Agricultural Research Institute (SLARI) through an act of parliament in 2007 to bring under a unified management structure the Rice Research Station (RRS), the Institute of Agricultural Research (IAR), and other tertiary research centres. In addition to the two research centres, SLARI is on the verge of adding four additional centres addressing issues in the other subsectors such as the Teko Livestock Research Centre (TLRC), Kenema Tree Crop Research Centre, the Magbosi Water Management and Research Centre and the Freetown Fisheries

Research Centre. Socio-economic research is cross-cutting and it is embedded in each of these centres.

The principal stakeholders (researchers, extension agents and farmers) should be involved in the process of technology generation, diffusion and adoption. Appropriate linkage and communication mechanisms between these actors are of paramount importance in the development of any sustainable agricultural system.

Three types of research should proceed concurrently. Firstly, adaptive research should be undertaken in the context of agro-ecological zones and should focus on solving immediate problems holding back production increase in these areas. Close links with the extension service, by way of participation in the same project, would ensure quick feedback from farmers and an indication of what needs further research.

Secondly, long-term research, centred at the agro-ecological research stations, should bring together the results of the adaptive efforts and provide a backup support for these efforts as national research capacity expands. Restructuring research on the basis of agro-ecological lines is part of the decentralization agenda, which makes research more participatory and client-orientated. As its capacity develops, the research system should be directed to the development of agricultural technology. Priorities include:

- developing an overall structure for agricultural research, including the university and the SLARI;
- strengthening links with international research institutions, and improving the testing and screening capabilities of new technologies available internationally, especially of minor crops;
- establishing a central soil–plant–water-orientated laboratory to improve water management (trials on consumptive water use, salinity, drainage, water logging, etc.);
- upgrading research facilities and laboratories.

Thirdly, socio-economic research which focuses on specific elements of government policy, particularly with regard to the distributional impact of policy reforms on the welfare of different groups, notably the poor and the vulnerable, should be undertaken. The socio-economic research will help to update information on food production, people's livelihoods and their access to food in the different districts of Sierra Leone so as to guide government and other actors focusing on food insecurity on how best to programme food security support in general.

10.5.5 Extension

The extension delivery system in Sierra Leone has had various problems, mainly because there has never been any policy on which to base the decisions. The various methods, and the variants tried, have been determined by the donors, leading to sometimes conflicting messages. The low level of government funding and the lack of human capacity in the government extension delivery system have also gravely contributed to the poor performance of the sector. A major defect with the systems already tried out is the fact that the extension personnel are not accountable to the people they serve.

There is little justification, therefore, for seeking to rebuild an extension service around the models which have been tried unsuccessfully in the past and found to be both ineffective and unaffordable. The fact that the service is now virtually inoperative and that most of its facilities and equipment have been destroyed during the war provides an opportunity to test and apply radically different approaches. A new paradigm shift in the national thinking on extension should focus on the role of the private sector, which includes the grassroots, community-based organizations.

In order to improve extension services, a strategy is to create a semi-autonomous National Agricultural Advisory Service (NAAS), which will gradually take over the agricultural extension delivery and management from MAFFS. Primary responsibility at grassroots will be vested in the farmer groups that will be the prime clients of the advisory services. Various stakeholders will also be intimately involved in the programme as partners at all levels. Key among the partners shall be private sector organizations, professional bodies, research and training institutions, NGOs, community-based organizations, local and central government development agencies, and development partners and donors.

This strategy is predicated on the strengthening of the farmer-based and community-based organizations, so that they would be in the advantageous position to partake in the service delivery opportunities. The benefit to the farmers and the communities generally is not difficult to discern, given that they will be serving themselves, and would be easily accountable to the other members. This means that any extension programmes developed must have a component that aims at strengthening these grassroots organizations.

Research and extension need to work closely together. Research should be farmer-focused, problem-solving and demand driven. Simultaneously, extension workers should have access to practical know-how and inputs resulting from research.

10.5.6 Agricultural Statistics

Policymakers and planners including private sector participants and donor agencies need reliable and timely agricultural statistical information for the formulation, monitoring and evaluation of developmental strategies and programmes, especially those in support of increased food security and agricultural production.

Prior to the outbreak of the rebel war in Sierra Leone, agricultural statistical data collection went on annually, interspersed with periodic agricultural census activities. The main institution involved is the Statistics Unit of the Planning, Evaluation, Monitoring and Statistics Division (PEMSD) of MAFFS. Currently PEMSD compiles some basic but limited agriculture statistics obtained under a biannual food security and vulnerability assessment survey conducted by the Ministry of Agriculture, Forestry and Food Security in collaboration with the World Food Programme and other agencies.

In order to improve the current situation a development strategy is necessary. This can be conceptualized into short-term and long-term programmes. The short-term strategy focuses on the immediate improvement of the scope and coverage of current data collection activities via the following:

- training of more staff to collect data at field level and ultimately increasing the number of households from whom information is collected;
- improving data collection at the field level with the introduction of better designed questionnaires;
- adequate preparation for undertaking an agricultural census;
- establishing an embryo data processing unit with the necessary equipment;

The longer-term strategy should focus on building the capacity of an agricultural statistics unit by:

- improving the capacity and capability of PEMSD to properly collect, process, analyse and disseminate agricultural statistical data;
- developing a scientific statistical survey design for collecting agricultural data;
- establishing an improved data processing unit capable of processing agriculture survey results using state-of-the art computer software packages;
- implementing an agricultural census.

Such a development programme can be implemented by PEMSD. Significant investments in training, equipment and statistical software would be needed. It is important that agricultural statistical data contains information that adequately reflects gender characteristics and concerns. Consequently gender differentiated data, essential for planning for the improvement of the status of women and vulnerable groups, should be given special attention in all agricultural data collection exercises.

Adopting a computerized general data acquisition and dissemination system as well as satellite imagery should be considered part of any strategy to improve agricultural statistics.

10.5.7 Land Tenure Issues and Strategies

The agricultural sector review (ASR 2003) found that there is no crisis of land tenure as far as agricultural development is concerned. The evidence suggests that, without any legislative intervention, the land tenure system in the Provinces has begun accommodating freehold interests in the urban areas. For farmlands, most Paramount Chiefs agree that the leasehold interest is acceptable to them as it allows them to continue to retain some interest in the land for the benefit of future generations. The Protectorate Land Ordinance, 1927 (cap. 122) provides for 'non-natives' to acquire leasehold interests of up to 50 years' duration with the option to renew for further periods. This should be adequate to accommodate demands for farmland for investment. However, there is need for a transparent and legally enforceable land tenancy arrangements, with rent replacing customary dues. A key reform is, therefore, not the law itself, but rather supervision of local justice. This can be done through sensitization of all stakeholders about land tenure issues (ASR 2003).

Given that the mere registration of deeds does not provide adequate security for investments in land, there is a need to provide state guarantee of titles. This can be done in a land title registration regime and it is recommended that, as a long-term measure, government should give serious consideration to the implementation of land title registration in the country.

Meanwhile, to improve the security of interests in deeds, which are registered, it is recommended that a closer relationship be established between the Deeds Registry and the Charting Room of the Surveys and Lands Division. This should lead to a situation where land transactions could be tracked from the Charting Room to the Deeds Registry. Thus, searches should be done in the Charting Room with the information fed to the registrar. To make this possible the record-keeping machinery in the Surveys and Lands Division should be overhauled to improve the retrieval of information. It is recommended that a study be conducted into this to ensure that the right relationship is created.

All the records of the Deeds Registry are located in the Administrator and Registrar-General's Department. This is risky because in times of fire or other calamity, those records could be lost. It is recommended that copies of the documents be kept in a safe place some distance away from the registry. In the long term, it is recommended that these documents should be put on microfilm to enhance storage and easy retrieval.

10.5.8 Rural Finance

The financial service needs of smallholder producers are simple but their satisfaction can be life enhancing. They need access to convenient, liquid and safe deposit services which are protected against inflation by positive real rates of interest. Savings provide a shield against emergencies. Similarly, poor households that depend on a myriad of activities in the informal sectors of the economy need access to credit to free them from exploitative financial relationships. In spite of these needs and the importance of agriculture, only 1% of loans and advances of the commercial banks goes to the agricultural sector. The only reliable sources of small loans for farmers and others involved in agriculture are those that originate from the informal saving and credit systems.

The main constraints with those sources of rural finance are that the loans are normally inadequate and have very high interest rates.

However, over the past five years, with the advent of the Nigerian banks, the implementation of the IFAD-funded Rural Finance and Community Improvement Project, which establishes community banks and financial services associations (FSAs) or village banks, and the proliferation of microfinance institutions, the total number of intermediaries providing service have exceeded 10, with an estimated coverage of over 25% of the country. Commercial banking remains largely underdeveloped and very urban-orientated. Out of a total of 13 commercial banks operating in the country, less than 5 have branches; while another 5 have branches in the provincial urban towns. Thus, some 30% of the licensed commercial banks in the country do not have a branch network of any consequence. Moreover, all of these banks operate only in Freetown and the main provincial towns, giving priority to big clients with acceptable collateral.

Over the years, several rural credit programmes have been implemented, with varying impacts on the communities they served. In terms of spatial distribution, only the National Commission for Social Action's (NaCSA) microcredit operation can claim to have national coverage, but does not provide financial services to smallholder producers in agricultural production activities. All the other programmes operate in a few localities.

One thing that has plagued all rural finance efforts is the perpetual inability of the farmers and women groups to save on a sustainable basis. Efforts by various donor-funded projects saw the emergence of a saving culture among rural clients, but in every case, at the end of the project the clients have been unable to sustain the saving habit.

The main focus in improving the situation should be on funding a programme with the mandate of identifying the ways of encouraging rural savings. There will be a need to look at successful cases of rural financial institutions in developing countries. We believe that the programme should not just identify instances of best practice from other countries, but should provide seed money, on a cost recovery basis, that would create such institutions. Again, like the case of the extension strategy, this should be anchored on the existence of sound grassroots organizations, so that they can participate in the provision of such services.

10.5.9 Infrastructure

In the ASR and other sources, the lack of the required infrastructure is identified as the foremost constraint to agricultural development in Sierra Leone. The absence of basic rural infrastructure, including roads, markets, small-scale irrigation, and post-harvest equipment, contributes to the poor showing of the sector. If Sierra Leone is to meet its objective of making agriculture the engine of socio-economic growth, it has got to design implementable strategies to enable it to increase output of produce from the farms to marketing and processing outlets. The overall objective should be to set in place essential support infrastructure to accelerate the pace of agricultural sector development, to reduce poverty and improve the welfare of rural communities. A more specific objective should be to fully rehabilitate and increase the coverage and effectiveness of the agricultural support services and provide a critical mass of basic economic infrastructure at the community level.

There are three main areas of infrastructural development that would have the greatest influence on the agricultural sector in Sierra Leone, namely: (i) rural roads, (ii) small-scale equipment and (iii) irrigation.

Roads

The importance of rural roads in moving goods and people from the production areas to areas where effective demand for the goods exists has never been more evident than in the Sierra Leonean case. The opposite of moving inputs to the farms are just as important. The current state of the road network is deplorable.

The government of Sierra Leone (GOSL), we believe, should refocus attention on the improvement of the rural road networks in the country. Already, the GOSL is aware of this important factor of production and national development. This commitment is reflected in the assistance government has sought from donors to address this constraint. On the local front, government has put together a feeder road policy and has increased the road user tax, from Le 700 to Le 1,000 per gallon of diesel and petrol, which now provides a hefty sum to the Roads Development Fund, on an annual basis. There is also some amount of funds that goes toward roads development from vehicle licensing fees and other services provided by the Sierra Leone Road Transport Authority. Some of these funds should be spent on rural roads rehabilitation and development. The government's strategy should be not to lose sight of the importance of this sector to the overall national economic development.

Small-Scale Irrigation

The dependence on rain-fed agriculture as the main source of water for agricultural production is a contributing factor to the low state of food crop production. This dependence also inhibits any possible diversification into the year-round production of vegetable and horticultural products. Sierra Leonean farmers are not strangers to irrigation schemes. Farmers in the Koinadugu District and Western Area have experience in using the gravity method, one of the simplest forms of irrigation. Another method is to lift water from shallow wells (1.5 m diameter and 1.5 m deep) using simple water pumping devices including treadle pumps. These irrigation methods are available and have a good potential for raising production of vegetables, undertaken by women in urban and peri-urban areas. In the absence of these schemes, studies show that women spend over 60% of their time fetching water for their crops.

A possible strategy would thus be to undertake the development of low-cost irrigation technologies that farmers could easily afford. Once the technology is developed, training of local manufacturers for the fabrication and installation of such equipment will be the next prong in the strategy. When these manufacturers become proficient, to the extent of building high-quality products, and are able to maintain viable businesses, farmers (including women), would be in a position to access the equipment and services.

These irrigation schemes could be used to grow not only rice but also high-valued vegetables and horticultural products, for the local market as well as for the regional West African and European export markets.

A successful small-scale irrigation scheme depends on seven conditions:

- access to adequate irrigable land;
- existence of sufficient water of suitable quality;
- availability of ample labour supply;
- availability of non-irrigation inputs to production (e.g. seeds, fertilizer, and pesticide);
- existence of profitable markets for the production surplus;
- access to sufficient resources to make expansion feasible;
- availability of improved water lifting technologies.

The focus on these areas, into which a key technology input is inserted, allows for immediate and high economic impacts amongst beneficiaries. Women and the youth would now be able to increase their non-farm income activities, as the technology would reduce farm labour demands.

10.6 Natural Resource Management

Several studies have indicated that natural resource management is under severe pressure in Sierra Leone. There is serious deforestation and excessive poaching in the marine waters. In an effort to get a clearer picture, it is imperative to support a comprehensive and dynamic land use study and mapping, which in turn would also constitute the basis for the establishment of a participatory M&E system for the natural resource base.

Development efforts in the subsector over the last two decades have been characterized by a strong emphasis on modernization of the artisanal fleet and fish processing methods, with the expectation that introducing more advanced technologies would increase fish supplies to domestic and export market. The existing state of affairs indicates a failure of these interventions. Apart from this, the fisheries subsector in Sierra Leone has been plagued with its own fair share of problems, among which are

- lack of proper records to determine the state of the major fisheries,
- the lack of knowledge relating to high-priced, but unexploited species,
- the inability to monitor the exclusive economic zone of the Sierra Leonean waters,
- lack of access to appropriate fishing gear,
- ban on Sierra Leonean fish exports to the EU.

A combination of all these factors have led to the low level of catch landed by artisanal fisherfolk – the main source of fish for the local consumers.

Environmental degradation is also a cause for concern in highly populated areas, like the Western Area, and in the mining areas of the Eastern, Northern and Southern Provinces. While migration to less populated areas (even if feasible) can help alleviate problems in the immediate term, measures will have to be taken to prevent further environmental degradation in the longer term. The reduction in the fallow periods and the subsequent decline in soil fertility and soil erosion call for increasing attention to micro-level problems associated with crop and livestock management.

10.6.1 Forestry

The growth strategy in the forestry area should, we believe, be accompanied by a rational development of Sierra Leone's rich resources. Policy changes in favour of long-term timber concessions and the association of the private sector in the regeneration and protection of forests are needed to ensure the existence of renewable resources for future growth. While incentives are needed for establishing forest industries to increase export revenues and value added for the country, the government should ensure that the private sector in the wood processing industry also contribute through conservation and reforestation. There is also the need for integration of cropping, livestock and forestry systems. To this end, land tenure security is important for promoting land improvements.

10.6.2 Fisheries

In the area of fisheries, the government, through a well-defined programme, could firstly carry out a comprehensive assessment of all the fisheries (marine, freshwater, inland, fish ponds, etc.), as well as a detailed stock assessment exercise. The effective protection of the Sierra Leone EEZ should be taken seriously, given that poaching is on the upsurge from countries that have exhausted their stock.

A new strategy could then be based on:

- developing the capacities of the artisanal fisherfolk to harvest stocks through pilot activities centred on the transfer of appropriate fishing technologies from other countries in the sub-region;
- training of fisherfolk, fish processors and fishmongers in improving their abilities to add value to artisanal catches, while stimulating increased private sector participation in fish exports by sensitizing potential business investors;
- local emphasis on linking fisherfolk with local demand for fish (for which a selective assessment of fisheries would be required);
- possible exploitation of artisanal fisherfolk of offshore fishing for potential export.

Government policy should be that private undertakings are encouraged, with priority given to developing the artisanal fisheries (based on coastal communities and stimulated by the establishment of local markets offering competitive prices to fisherfolk) and provision of viable fish landing sites and marketing services.

10.6.3 Environment

Any strategy would depend on results of natural resource inventory, mapping of degraded environment, and participatory rural appraisal findings. It is assumed that this will promote the adoption of proper land husbandry and other resource management techniques. In principle, programmes should support on-farm and off-farm activities that improve soil and water conservation, land husbandry, forestry and water conservation techniques. Other support shall be directed at addressing the management inadequacies, and loss of soil fertility.

A number of strategies have been enumerated that government had pursued or should pursue in order to achieve food security, and key amongst these are better infrastructure, research, extension, better statistics, mechanization, and irrigation. Government however cannot undertake all of these activities at the same time because resources are limited and choices have to be made so that priority is given to activities that will have the biggest impact on food security. Therefore, from our analysis and experience in the sector we believe government should give topmost priority to the following strategies, in order of importance: (i) infrastructure, especially feeder roads; (ii) extension services; and (iii) irrigation.

10.7 Current Policies and Programmes: 2007–12

A state near to food security has been achieved due to the ongoing policies and programmes. 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:

- enhance increased agricultural productivity (intensification);
- promote diversified commercial agriculture through private sector participation;
- improve agricultural research and extension delivery services using technology, development, dissemination, and adoption and feedback systems;
- promote efficient and effective resource management systems;
- mainstream cross-cutting themes, namely, gender and youth promotion in agriculture and address farmer health (including HIV/AIDS, malaria, and IVS related diseases) and sustainable development and the environment.

To achieve these development objectives and to address the food security challenges the following programmes and plans are put in focus.

10.7.1 The Agenda for Change (PRSP11)

Agriculture is the number one priority in the Agenda for Change. The Agenda identifies food security as one of its fundamental pillars and that poverty is the main cause for food insecurity, which particularly affects people's ability to access food with its attendant implications for other consequences of food security as discussed earlier in this paper. Indeed, there are very close linkages between the poverty alleviation objectives of the Agenda for Change and food security objectives.

10.7.2 The CAADP Process and the National Agricultural Investment Plan

A national agricultural investment plan based on the CAADP framework has been produced in conformity with the implementation of the 2003 Maputo Declaration by the African heads of states and governments. This declaration states that the agriculture sector should grow by at least 6% and that at least 10% of the national budget be allocated to the sector.

The national investment plan commonly called NSADP provides direction for investment in the agriculture sector. The smallholder commercialization programme is the first step in operationalizing this plan with the aim of promoting smallholder farmers to access inputs, equipment and other services along the value chain for increase production and market access.

The overall goal of the Smallholder Commercialization Programme 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:

- increasing agriculture sector growth from its current estimate of 4% to 7.7% per annum by 2015 (SAM Analysis 2009);
- increasing incomes of farming households by 10%;
- increasing household food security by 25%.

In this light, the SCP seeks to do the following.

- Promote commercialization of smallholder agriculture through increasing productivity, intensification, value addition especially via processing, developing post-harvest infrastructure and appropriate marketing facilities, and institutional strengthening to build self-reliance of farmer-based organizations (FBOs).
- Develop appropriate small-scale irrigation infrastructure in order to boost rice production.
- Improve access to markets through the rehabilitation and effective maintenance of priority feeder roads.
- Broaden smallholders' access to rural financial services tailored to the specific needs of clients expected to be individuals and groups, in particular FBOs/ABCs.
- Promote national growth and development with equity by reducing households' vulnerability to shocks and disaster and increasing food security and nutrition of vulnerable households through providing a package of social protection safety nets with focus on children, promoting human capital potential and employment, improving livelihoods and contributing to creation of productive assets.
- Ensure effective strategic and well-coordinated operational planning and implementation of SCP, with efficient coordination of resources and implementing partners, and adequate monitoring and evaluation of progress and impacts (SCP-IP 2010).

Appendix A: Smallholder Commercialization Programme: Programme Components

Component 1: Smallholder Commercialization: Production Intensification, Diversification, Value Addition and Marketing (US$69.472 million)

The objective of this component is to promote commercialization of smallholder agriculture through increasing productivity, value addition, and marketing with emphasis on commodity chain development and institutional strengthening of farmer-based organizations (FBOs).

The component is implemented through MAFFS, who is the lead actor in strengthening and facilitating the creation of FBOs, formed on the basis of farmer field schools (FFSs). The ministry would contribute to the establishment of agricultural business centres (ABCs), created by 3–5 FBOs who would come together and function as the primary gateway to commercialization of smallholders. The ABCs would provide a range of technical, operational and marketing services to smallholders and be a main entry point for MAFFS extension support. The ABC commodity focus will depend on the predominant cropping system and economic activity of the membership with early emphasis on rice and other food crops but also including livestock, non-timber forest products and fish processing.

Expected results of the component include the formation of 2,750 FBOs trained in FFS including organizational and business management skills, and organized into about 650 ABCs with adequate capacity, infrastructure and equipment to render services to clients. Thirteen district ABC networks will be formed with the view to promoting commodity chains, platforms of exchange and eventual apex bodies at national level. A MAFFS extension service will better support smallholder commercialization through improved technical performance and operational capacity – supported through over 200 capacity building events and rehabilitation of two extension training centres, Makali Training centre at Makali, Tonkolili District and Lambayama Training centre at Kenema, Kenema District and provision of equipment to improve mobility in reaching farmers. The ABC growth and commodity chain development and market access will be facilitated and actively promoted by district and ward councils reflected in enhanced decentralized planning and development activities (SCP-IP 2010).

Component 2: Small-Scale Irrigation Development (US$48.61 million)

The aim of this component is to develop appropriate small-scale irrigation infrastructure in order to boost rice production, a major staple in the country. Results expected from small-scale irrigation development would substantially contribute to increased food security, the generation of marketable surplus for lowland smallholders and their insertion in national agricultural trade, as well as creation of wealth and employment for youth.

Emphasis will be put on two main objectives: development of small-scale gravity irrigation systems, particularly inland valley swamps (IVS), which can be developed by communities themselves at a relatively low cost so that large number of smallholders can benefit; and provision of support to farmers to maintain and manage the schemes toward assuming full responsibility with no external support. Technical options and implementation modalities for the development of IVS will draw on the long experience in the country and lessons learned. Social conflicts, inappropriate land tenure and technical issues (design) have been major causes of failure of IVS in the past. Thus particular attention will be given to social survey and land tenure analysis during the identification and selection phases of IVS; community engagement and acceptance of clear land tenure agreements before embarking on works; appropriate design of IVS to avoid misconception and eliminate IVS which necessitate too complicated or too costly works; building the capacity of FBOs/user groups to ensure proper maintenance of developed IVS (SCP-IP 2010).

Component 3: Market Access Expansion through Feeder Road Rehabilitation (US$95 million)

The objective of this component is to improve the ability of smallholders, market-orientated farmers and agri-businesses (including ABCs) to have physical access to markets and to operate in a profitable way through the rehabilitation and effective maintenance of priority feeder roads.

The implementation strategy encompasses the following general considerations.

(i) Priority would be given to full rehabilitation and spot improvement of existing feeder roads instead of new construction.

(ii) Favouring labour-based methods (LBMs) combining use of labour and light machinery – wherever it is technically and economically feasible. Such methods have been extensively tested and proven successful with assistance of ILO in the 1990s and implemented country-wide since then.

(iii) Rehabilitation and improvement of feeder roads should reach the standard of all-weather road.

(iv) Attention would be given to capacity building of specialized contractors using LBMs – both through refresher technical training for existing ones and training of new contractors – as well as facilitating their financial access (lease or loans) to the needed machinery to perform works. This would increase their outreach and yearly implementation capacity, enhance quality of works and hopefully foster competition between contractors at district/regional levels in order to reduce rehabilitation costs.

(v) Rehabilitation works would be subject to agreements reached with district councils and concerned ward/communities with regard to the organization and financing of yearly routine maintenance works (mainly labour-based using small tools).

(vi) Provision will be made to finance regular mechanized maintenance works (spot improvement) two to three years after rehabilitation works are carried out (SCP-IP 2010).

Component 4: Smallholder Access to Rural Financial Services (US$26.52 million)

The objective of this component is the access of smallholders and the rural poor and their organizations to rural financial services geared to their needs.

The first pillar of the strategy is to assist the establishment of a large number of rural MFIs at chiefdom or section level, as proximity to members/clients is key to ensure outreach (maximum 5–10 km, less than one day of walking distance from customers). Proximity of rural MFIs will serve a limited local financial market however, and will still not generate substantial income. Thus the operational model should allow for limited fixed running costs: no or limited permanent staff; payment according to performance; power and computerization only when financially justified; assistance for monitoring and supervision and to ensure reporting to BSL through a shared technical services agency. Such MFIs should rely on active community and members involvement in overall management, strategic decision-making (e.g. adaptation of financial products to local needs, interest rate policy, etc.) and capital raising in the form of shares (initial capital to start operations and compulsory increases linking credit amount to share value). Such a model corresponds to the Financial Services Association (FSA) strategy, one which has been widely tested in several countries in Africa and elsewhere since 1987, and in Sierra Leone from 2008 through the Rural Finance and Community Improvement Project (RFCIP). It can effectively and efficiently respond to most of the needs of the rural poor, including access to a secured savings facility, very short-term and small loans (for social emergencies and petty trade) at easier conditions than those offered by moneylenders, short-term loans of limited amount for economic activities (agriculture, small ruminants, storage, etc.), and to some extent to bigger loans and longer-term loans, depending on the amount of capital and reserves raised and the eventual access to a refinancing facility. It is estimated that a minimum of 130 FSAs can be created and made sustainable country-wide (SCP-IP 2010).

Component 5: Strengthening Social Protection, Food Security, Productive Social Safety Nets (US$135.7 million)

The objective of this component is to promote national growth and development with equity by reducing households' vulnerability to shocks and disaster, increasing food security and nutrition levels of vulnerable households, with a focus on children, promoting human capital potential, and improving livelihoods. Increasing incomes and food security of the vulnerable poor will be achieved through a triangle of interventions focused on: providing safety nets and employment opportunities for food-insecure households, while contributing to productive asset creation; protecting the health and nutrition of pregnant and lactating women and children of food-insecure vulnerable households while promoting early education; and strengthening national capacity in early warning disaster response and risk management, mainly through ensuring adequate buffer stocks stored at district/ABC levels.

This component will be implemented through close partnerships and collaboration with MAFFS and WFP in particular, as well as district councils and other related ministries, notably Health and Education, and NaCSA. Alignment will be essential with other SCP components, particularly SCP Component 2 (irrigation), 3 (market access) and also 1 (training, tree plantations, construction of ABCs, etc.) to maximize benefits from the productive safety nets intervention, which focuses on employment creation through food for work and food for training while building assets. Targeted food security and nutritional support to vulnerable groups will be implemented in close collaboration with Ministry of Health and in accordance with national data (on poverty, vulnerability, food security, child malnutrition, etc.). Universal school feeding will scale up existing programmes, working closely with Ministry of Education. Strengthening of national early warning systems will be implemented through PEMSD of MAFFS, specifically involving the Statistics Department, while district councils jointly with ABCs will be responsible for establishing storage infrastructure with emergency buffer stocks at decentralized levels (SCP-IP 2010).

Component 6: Smallholder Commercialization Programme (SCP) Planning, Coordination, Monitoring and Evaluation (US$3.9 million)

The objective of this component is to ensure: (i) effective, strategic and operational planning of the SCP programme; (ii) efficient coordination between and amongst the components of the programme on one hand and the various sources of funding and implementation partners within and outside MAFFS on the other hand; and (iii) overall monitoring of SCP implementation, progress and evaluation of final results and impacts on smallholders, etc.

The coordination and management of the SCP will be anchored within the ongoing priorities of the government and work through existing government structures, planning and steering committees at national and district levels.The programme will enhance coordination, alignment and synergy between donor-funded activities/operations. M&E will be based on result-based monitoring and be conducted through participatory processes that ensure lesson learning and information sharing. Gender mainstreaming will be promoted throughout SCP including management and operations and M&E, where indicators will be developed to track gender mainstreaming.

In order to avoid the establishment of parallel structures, the programme will be coordinated by a small secretariat headed by a coordinator and assisted by finance and procurement specialists. The other components will be implemented by the various divisions of the MAFFS, SLRA, WFP, Bank of Sierra Leone, local councils, NGOs and the private sector (SCP-IP 2010).

This approach is in line with ministry's policy of using a programme approach as opposed to project intervention approach. Therefore, specialists that will be recruited by the programme will be placed within the technical divisions of the

MAFFS. The programme will then build the capacity of the ministry and will thus ensure sustainability. This approach will also smoothen the transitional period of merging the PIUs of current donor projects into the ministry's setup.

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Chapter 11

THE MINING SECTOR AND GROWTH: LESSONS FOR THE FUTURE

By Joseph M. Kargbo

11.1 Introduction

Mining has been a significant component of the Sierra Leonean economy since the 1930s, and the country is endowed with a wide range of minerals, including diamonds, iron ore, gold, and rutile. The nation's established diamond fields cover over 18,000 square kilometers (km^2) and are found mainly in the south-eastern and eastern parts of the country. The mining sector employed about 14% of Sierra Leone's labour force, accounted for over 60% of export earnings and up to 20% of the country's GDP during the prewar period (see Government of Sierra Leone (GoSL) 2003, 2008, 2009a,b; World Bank 2008).

The large-scale mining of diamonds, iron ore, rutile and gold is done by foreign-owned companies, while individuals and small groups focus mainly on artisanal and small-scale production of diamonds and gold. Sierra Leone's vast mineral wealth conveyed the mistaken notion that the country was destined for a bright future at the achievement of political independence from Britain in 1961. Control of the nation's diamond fields was a major reason for destabilizing the country and outbreak of the 11-year rebel war that was started by the Revolutionary United Front (RUF). Moreover, the evidence seems to indicate that Sierra Leonean politicians have created a decision-making environment that enables rogue operators in the minerals area to capture mineral extraction rights at the expense of the national economic development of the country (see, for example, Keen 2005; Reno 1995; Smillie *et al.* 2000; Gberie 2005, 2010; Gbenda 2011; *Standard Times Press* 2011a,b,c; and Kargbo 2010).

In view of the country's performance in the mining sector, one may ask whether Sierra Leone has experienced the natural resource curse or whether it has been a victim of other forces that may be more insidious and difficult to

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manage. What should be expected of the mining sector and how can the gains be optimized for general economic growth? Answering these questions is the main focus of this research. This chapter examines the performance of the mining sector in Sierra Leone to glean lessons from the successes and failures of the sector, and of specific minerals. Questions relating to the structure, governance and operations of the sector are examined as well as issues relating to the integration of the sector into the rest of the economy.

The rest of the chapter is organized as follows. Section 11.2 examines the performance of the mining sector in Sierra Leone within a historical and contemporary context. Section 11.3 deals with the management of government revenues for economic growth. It contains macroeconomic growth multipliers for various sectors of the Sierra Leonean economy. Section 11.4 presents the model for diamond production followed by the empirical results. The final section has the conclusions with recommendations for policy and practice destined to yield optimum gains from the sector.

11.2 Mining in Historical Perspective

Mining has a fairly long history in Sierra Leone as organized mining was started shortly after the enactment of the Minerals Act of 1927 and diamonds were discovered in Kono district in 1930 (see, for example, Saylor 1967; Smillie *et al.* 2000; Kargbo 2010).

The mining sector in Sierra Leone has been organized in three broad categories over the years. Large-scale production of precious and non-precious minerals, such as diamonds, bauxite and rutile is carried out by foreign-owned companies. Large-scale annual mineral production is expected to reach at least US$500 million within the next decade. It is estimated that up to 38,000 people could be employed by the large-scale mines, with an additional 300,000 people including dependents and extended family members deriving their livelihoods directly from these mines (see World Bank 2008; M'cleod 2010). Mechanized small-scale mines mostly for diamonds are done by both foreign-owned and Sierra Leonean firms.

Artisanal production of precious minerals, such as diamonds and gold involves about 200,000–300,000 artisanal miners. This makes artisanal mining the second biggest employer in the country after agriculture. Government statistics show that artisanal and small-scale miners account for 80–90% of the diamond exports. However, artisanal mining is currently unregulated and surrounded by informality and human insecurity as there is no set minimum wage rate and health and safety standards, as well as lack of access to capital and reliable pricing information, coupled with frequent disruptions and deception that generally keep miners and their families in appalling conditions (see IRIN News 2009; Diamond Development Initiative 2008, 2009a,b; Kargbo 2010; Hund and Hart 2008). Mining without rehabilitation ruins arable farmland, pollutes streams and rivers, and damages the natural habitat of flora, fish and fauna. The Sierra Leone Environmental Protection Agency (SLEPA) has been reviewing various large-scale mining operations in order to limit the environmental costs of mining in the country. Furthermore, SLEPA has plans to extend environmental regulations to the artisanal mining sector.

Mr Patrick Tongu, head of the Network Movement for Justice and Development, an NGO that works on mining issues in Sierra Leone, argues that:

> Efforts to overhaul mining legislation and to make the industry more transparent focus only on foreign-owned, large-scale, industrial mining but ignore the artisanal mining sector.... Unless that is addressed these changes will not lead to real sustainable growth.
>
> IRIN News Report 2009

In order to facilitate a better understanding of the contributions of the mining sector to the Sierra Leonean economy over the years, we divide the analysis in this section into two subperiods covering the colonial era to 1990, and 1991 to the present period.

11.2.1 Colonial Era to 1990

A wide variety of companies have participated in mining activities in Sierra Leone over the years, particularly following the significant discovery of minerals during the 1930s and 1940s. For example, the Sierra Leone Development Company (DELCO) mined iron ore at Marampa, near Lunsar, during the 1930–76 period. The Sierra Leone Selection Trust (SLST) started mining diamonds in Kono district in the 1930s, while the Sierra Leone Chrome Mines Company exploited chromite near Hangha (for further details see, for example, Kargbo 2010; Smillie *et al.* 2000; Gberie 2005, 2010). The discovery of minerals triggered a huge influx of foreigners, in particular the Lebanese and citizens of other West African states that somehow acquired Sierra Leonean passports. Partnership Africa Canada (PAC) (2004) reported that as much as 55% of the diamonds produced in Sierra Leone were smuggled out of the country during the 1950s and 1960s.

Figures 11.1 and 11.2 present the evolution of official diamond exports and their importance in the Sierra Leonean economy during the past eight decades. Cumulative diamond production exceeded 26.0 million carats over the 1930–64 period. Almost all of these were from the alluvial diamond fields. The average SLST annual diamond production was approximately 750,000 carats over the 1956–75 period. The SLST, which was a wholly owned subsidiary of the Consolidated African Selection Trust (CAST) Limited received an exclusive prospecting and mining license from the colonial government that covered the whole country for 99 years. In return, SLST was to provide all the necessary capital to develop the diamond fields, and 27.5% of the profits were to be paid to the government. Moreover, SLST paid an annual rental fee of £7,000 to the government. At the same time, a Protectorate Mining Benefit Trust Fund was set up in 1932 for the benefit of all inhabitants of the Protectorate, and all proceeds

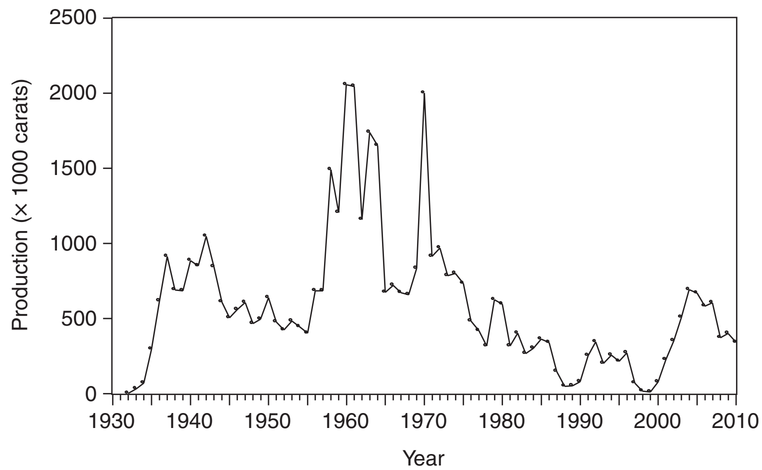

FIGURE 11.1. Diamond production in Sierra Leone, 1932–2010. *Source*: based on data from government of Sierra Leone and Levi *et al.* 1976. *Note*: the figure for 2010 includes only the first eight months of the year.

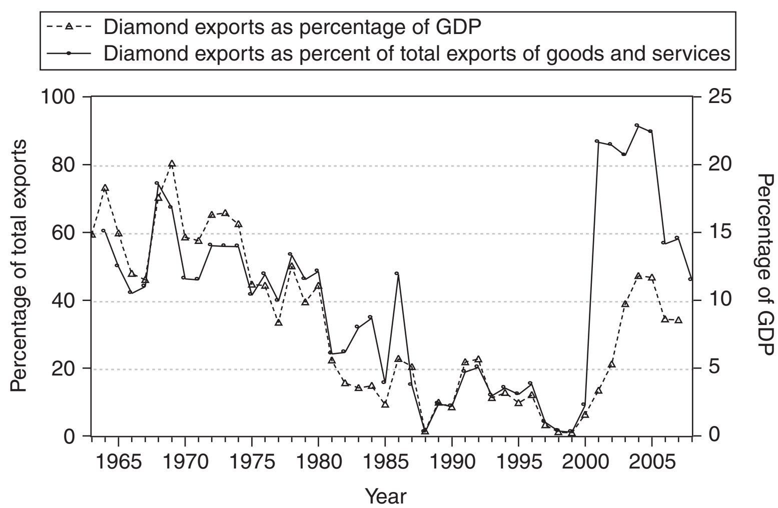

FIGURE 11.2. Diamond exports in Sierra Leone, 1963–2008.
Source: based on data from the government of Sierra Leone and IMF.

from the mining rental fees were deposited into this fund (see Kargbo 2010; Williams *et al.* 2002; Gberie 2002, 2005).

The huge influx of individual miners in Kono district increased illegal diamond mining during the 1950s. The number of diggers increased up to 75,000 in 1955, with significant negative impacts on other economic activities in the country. In particular, the agriculture sector experienced significant production declines as the farmers abandoned rice fields for the diamond fields of Kono, and iron ore mines in Marampa, near Lunsar (see Levi *et al.* 1976). The farmers who remained on their farms were not able to produce enough food to meet domestic demand. Moreover, the rice shortages were exacerbated by alleged hoarding and smuggling by Lebanese merchants in order to artificially increase food prices in the country (see, for example, Van der Laan 1975; Williams *et al.* 2002). The significant shortages of rice and other food items led to price hikes and the outbreak of riots in Freetown and other parts of the country during the 1955–6 period. About 18 people died and there was widespread destruction of property during the riots. Gberie (2002) reported that riots in 1919 in Freetown were also triggered by rice shortages, and those riots were directed mainly at the Lebanese merchants who dominated the retail trade in Sierra Leone at the time. The colonial administration investigated the causes of the 1955–6 riots and hoarding allegations; in the end, they deported two Lebanese rice dealers for their role in creating the rice shortages.

The influx of illegal miners led to their encroachment into the SLST concession areas as more and more Sierra Leoneans demanded mining access rights to some of those concessions. These were demands that the government could not ignore without serious clampdown and bloodshed, which neither the government nor SLST could stomach. This situation prompted the colonial government and SLST to review their existing agreement, resulting in a reduction of SLST's concession to 590 km^2 in the Yengema/Koidu area and 210 km^2 in the Tongo area. The revised lease was for 30 years and SLST received a compensation of £1.57 million for giving up mining rights in Bo District (see Kargbo 2010; Williams *et al.* 2002).

The Alluvial Diamond Mining Scheme (ADMS) was introduced in February 1956 to facilitate the provision of licenses and legal mining activities by artisanal and small-scale miners in Kono district and other parts of the country. The ADMS awarded 2,000–3,000 licenses per year covering 40 chiefdoms during the 1956–76 period. There were 25,000–40,000 tributors working in the licensed areas during this period. The ADMS regulated diamond sales and exporting through the then sole exporter – the Diamond Corporation of West Africa (DICORWAF), which was a subsidiary of De Beers. To some extent, the ADMS was successful in curtailing illegal diamond mining activities in the ADMS areas until the outbreak of the rebel war in the 1990s. However, SLST continued to experience illegal diamond mining activities in its leased areas throughout their stay in Sierra Leone (see Reno 1995; Williams *et al.* 2002).

The government of Sierra Leone became a direct participant in formal mining activities when it acquired a 51% stake in SLST through the National Diamond Mining Company (NDMC) in September 1970, thereby effectively nationalizing SLST. Prime Minister Siaka Stevens allowed Jamil Said Mohammed – a businessman of mixed Sierra Leonean–Lebanese heritage and Siaka Stevens' close business associate – to buy 12% of the government's shares without any open bidding process. In effect, Jamil controlled 6.12% (i.e. $0.12 \times 0.51 = 0.0612$) of the entire mining company's shares. British Petroleum International Limited ('BP Minerals') acquired SLST's 49% stake in 1980 and sold its shares to the

Precious Minerals Mining Company (PMMC) four years later for US$8.5 million (see Williams *et al.* 2002; Kargbo 2010).

The government gave the PMMC full control of NDMC management and the company's shares were distributed as follows: government of Sierra Leone had 35%, Jamil Said Mohammed and Tony Yazbeck (a Lebanese businessman with close ties to Siaka Stevens and Jamil) each had 15%, and the remaining 35% was distributed amongst 46 people and companies with close ties to Siaka Stevens, Jamil, Yazbeck or senior politicians of the All People's Congress (APC), the ruling party, and their associates (see Kargbo 2010; Smillie *et al.* 2000; Williams *et al.* 2002). The attempts of Siaka Steven's successor, Joseph Momoh to reform the mining sector, in particular, the diamond trade, were not successful.

11.2.2 1991 to Present

The mining sector in Sierra Leone has been dysfunctional and riddled with corruption, poor government policy and lack of technical staff and resources to effectively manage the country's mineral wealth over the years. These problems are most pronounced in the diamond industry, which is largely alluvial in nature. One can argue that government mismanagement, corruption and greed contributed to the political instability and rebel war that started in 1991, which led to the death of up to 200,000 people, with thousands maimed and having their limbs cut off, and sending nearly 500,000 people as refugees to various other countries.

The struggle to control the diamond mining areas perpetuated the war. Both the Revolutionary United Front and government forces were intricately involved in diamond mining and smuggling. The Government Gold and Diamond Department (GGDD) which values and levies export taxes on all diamonds that are officially exported from Sierra Leone was eventually closed in the 1990s after the National Provisional Ruling Council (NPRC) looted the gold and diamonds that were kept in the GGDD headquarters in Freetown. According to the *Cocorioko Newspaper* (2010a,b), John Benjamin, NPRC's Chief Secretary of State and currently Chairman of the SLPP, made all the arrangements for the sale of diamonds in Antwerp valued at US$45 million (see also Kargbo 2010; Abraham 2004; Kpundeh 2004).

Despite Sierra Leone's well-known vast mineral wealth, the country has not been able to attract any of the large global mining companies like Rio Tinto operating in Guinea, and ArcelorMittal working in Liberia. The more recent entrants into the nation's mining sector, especially during the war period, include African Minerals Limited (AML), Koidu Holdings and London Mining Company (LMC). These companies are generally known in the global mining industry as *'juniors'* or *'bottom feeders'* that scour the earth in search of new mineral deposits that they may partially develop, advertise and sell to bigger and more developed mining companies (see, for example, Gbenda 2011; Smillie *et al.* 2000; Gberie 2005, 2010; Kargbo 2010). These companies generally lack the reputation of global giants.

Let us briefly look at each of these companies to have a better understanding of the role they play in the economic performance of Sierra Leone.

Koidu Holdings Limited

Koidu Holdings Limited, a former South African-owned company whose ownership has transferred to the Geneva-based Benny Steinmetz Group is involved in Kimberlite diamond mining, and shortly after the war it signed an exclusive 25-year lease to mine all known Kimberlite deposits in the country. Gberie (2010) reported that the Kimberlite mines are expected to yield for the company diamonds worth approximately US$1.5 billion during the lease period. Koidu Holdings Limited claims it spent US$18 million during 1995–7 on trial mining activities but had to halt operations because of the war (see Smillie *et al.* 2000; Partnership Africa Canada 2004, 2006).

African Minerals Limited

African Minerals Limited (AML) which is controlled by the controversial Romanian-born businessman, Frank Timis, was started in 1996 as African Diamond Holdings Limited, and later changed its name to Sierra Leone Diamond Company. The company is now registered in Bermuda and started operations in Sierra Leone during the war. Through its incarnations over the years, African Minerals has a number of subsidiaries that acquired prospecting and exploration licenses for diamonds, bauxite and other minerals in Sierra Leone. Partnership Africa Canada (2006, 2009a,b) reported that these subsidiaries include Fatkad Mining Company Limited, Kangaroo Mining Company Limited, and Molans Mining Company. Sierra Leone Diamond Company had beneficial interests in North West Diamond and Gold, Limited. The tangled web of corporate names and interests creates confusion and raises concerns amongst serious observers about the legitimacy or truth about some of the claims African Minerals is making in Sierra Leone.

According to Partnership Africa Canada (2009a,b), African Minerals claims (without providing any evidence publicly) that it holds mining and exploration licenses that cover more than 40,000 km^2, which is an area covering over 50% of the country. The mineral rights were granted by the government of Sierra Leone sometime between 2004 and 2005. These claims have prompted civil society groups to accuse the company of 'land grabbing' (see also Gberie 2010). Milestone Trading Company and African Minerals were recently suspected of fraudulently passing leaflets to scare off artisanal miners from their leased property in Sando Chiefdom, Kono district (see Kargbo 2010). African Minerals has made a series of attention-grabbing announcements about its Tonkolili iron ore project during the past two years. It claims that, based on its detailed surveys, Sierra Leone has nearly 10 billion tons of iron ore deposits at an average grade of 29.9%, mostly in the Northern Province, in particular Tonkolili district. This claim makes this discovery the largest iron ore find in the world within the past 20 years and largest deposit in Africa (see Gbla 2009; Gberie

2010; Kargbo 2010). Shortly after these announcements, Frank Timis made over US$500 million in 2010, thereby making African Minerals the largest company listed on London's Alternative Investment Market (AIM). The earlier attempts by African Minerals to sell a 12.5% stake of its company to China Railway Materials Commercial Corporation for US$245 million did not materialize. However, there are arrangements underway for China's Shandong Iron and Steel to invest over US$1 billion in the company's mining operations in Africa (see, for example, McNamara 2010; Gberie 2010; Kargbo 2010).

For his part, Mr Tony Sage of Cape Lambert Resources, which fully acquired Marampa mines from African Minerals within the past year, announced that the company was putting up the mines for sale in 2011 (see Evans 2010). During the discussions for the purchase of the mines, Cape Lambert had agreed to spend at least US$25 million on the development of the mines. However, within a year, they were seeking at least US$500 million plus an ongoing equity interest in the project. According to Cape Lambert, the Marampa mines contains 197 million tons of a 28.5% grade iron ore with further exploration expected to expand this resource base.

In view of Frank Timis's chequered past, the political leadership in Sierra Leone should be very careful in dealing with him, in particular, when there is enough evidence available for them to make the right decisions. For example, African Minerals claimed in 2005 that it had invested US$12 million the previous year in a series of high-resolution airborne magnetic surveys over its license areas, and that nearly 40% of the area had been surveyed. As Gberie (2010) has reported, this turned out to be false.

Frank Timis founded Regal Petroleum in 1996 and, while Timis was serving as head of the company, Regal produced a series of false and misleading reports concerning the production potential of Greek oil wells that the company was developing (see Holmes 2009; *Wall Street Journal* 2009a,b; Kargbo 2010). The deception led to the sharp rise in Regal's share price by more than 500% between June 2003 and March 2005. The three fundraisings held by Regal during this period produced more than £100 million. After admitting that the Greek wells were in fact dry, Regal's share price dropped by more than 60% in a single day in May 2005. The matter was investigated by the UK Alternative Investment Market (AIM) disciplinary committee since Regal violated AIM's rules. After almost five years of investigation, Regal Petroleum was found guilty, fined £600,000 and was publicly censured. This was the largest fine ever handed down by the Alternative Investment Market.

The current political leadership in Sierra Leone should benefit from the advice of knowledgeable persons and organizations if Sierra Leone is to benefit from its mineral wealth far more than in the past. Such advice would no doubt include the importance of collecting information on the quantity and value of the minerals and of using auctioning processes in allocating extraction rights to the minerals. As *The Economist* (2010) has noted, Sierra Leone seems to be repeating the mistakes of the past, only that now the stakes are higher. In particular:

> The kind of resource predation that led to violence breaking out in the first place may be returning, this time with iron ore rather than diamonds as the catalyst. With notable haste, the government in Freetown has given two big extraction leases to British companies. The first, London Mining, will redevelop an abandoned mine at Marampa. The second, much larger, deal with African Minerals concerns a find at Tonkolili that the company says is the world's largest deposit of magnitite – used, among other things, for coating industrial boilers.
>
> *The Economist* 2010

Obviously the Sierra Leonean authorities should ensure that all deals conform to the Mines and Minerals Act 2009 that was passed by parliament in November 2009 (see GoSL 2009c). In this regard, various observers have identified serious breaches of the law. For example:

> On 31 December 2009, the government signed a 25-year agreement with London Mining which bluntly violated key provisions of the recently passed 2009 Mines and Minerals Act. The Agreement included an 80% reduction in income taxes for 10 years for the company, as well as 80% reduction in other major revenue streams from it for 25 years. London Mining is to pay a corporation tax of 6% – instead of 30% set by the 2009 Act – on its investment; duty on its mining materials was pegged to 1% instead of the official rate of 5% which all other companies pay, and royalties were reduced for it to 3% instead of the official 4%. Worse yet, the agreement should remain in force for 25 years, and can only be changed if London Mining wishes to do so.
>
> Gberie 2010, p. 13

This controversial deal drew angry protests from a wide range of quarters, including civil society organizations such as the Network Movement for Justice and Development, the media and other sections of the society (see Gberie 2010; Kargbo 2010). It is rather ironic that during the same month President Koroma's administration signed documents that gave huge tax concessions to foreign-owned mining companies, the government imposed the Goods and Services Tax which has severe consequences on vulnerable members of the population in the country (see, for example, GoSL 2009d; Gbenda 2011; Kargbo 2011). The country's Minister of Trade and Industry, Dr Richard Konteh, announced on 1 May 2011 that the government was cutting by 50% (effective immediately) the annual fuel subsidy to save money and help repay the country's foreign debt (see Akam 2011; Bah 2011). As a result, fuel prices increased by nearly 30% overnight at the gas stations. This policy has been adopted during a time of rising street tensions and riots due to sharp increases in commodity prices that exacerbate food and fuel price inflation across countries around the world (see also Kargbo 2009).

Frank Timis formed African Petroleum so that he could bid for the offshore oil fields of Sierra Leone's newly discovered oil reserves. Gbenda (2011) reported that parliament is in the process of ratifying an offshore lease agreement for African Petroleum despite the evidence that is available in the public domain about the deceptive business practices of Frank Timis and his companies. Both the London Stock Exchange and the Australian Stock Exchange have blocked the listing of African Petroleum on their markets (Bennet 2010; Kargbo 2010). Frank Timis accused the exchanges of a 'witch-hunt', but others will call it due diligence to prevent the ripping-off of an unsuspecting public.

Already, there are disputes between the exploration companies concerning the demarcations of the various areas covered by each company's exploration license. For example, the dispute between the Nigerian-owned Oronto Petroleum of Chief Arthur Eze and Anadarko Group, an American company working with Repsol and Woodside, could be referred to the US State Department and Justice Department in Washington, DC, for violation of the Foreign Corrupt Practices Act of 1977. Fugleberg (2011) reported that Oronto Petroleum Corporation has filed a complaint against Anardako in the US District Court in Wyoming on 14 April 2011, claiming that Anardako and Repsol conspired with the government of Sierra Leone to take away part of the exploratory block (off-shore area) that was initially leased to Oronto, thereby hindering Oronto's ability to market and develop the block. Meanwhile, both the government of Sierra Leone and Oronto are in arbitration proceedings at the International Chamber of Commerce Court of Arbitration in London to settle Oronto's claims that the government took part of its block and gave it to Anardako and Repsol. The evidentiary hearing is set for 5 December 2011. Gberie (2010) reported that Repsol allegedly bribed Sierra Leonean government officials to win their portion of the contract. At the same time, it is not entirely clear whether Oronto Petroleum was doing any serious oil exploration in Sierra Leone since it was granted the first lease shortly after the end of the war (see Gberie 2010).

President Koroma told parliament on 8 October 2010 that:

> All of us grew up knowing that our country is rich in mineral resources. However, these riches have not been translated into tangible benefits for our people. The country's mineral sector also lacked proper regulatory regimes, leading to non-transparent transactions, decrease in investor confidence and failure to attract large-scale investments. My government is determined to change this.

President Koroma should put in place a proper management framework to facilitate the implementation of his *Agenda For Change*. The problems highlighted by the President are clearly tied to the endemic corruption that has permeated the Sierra Leonean society for decades (see, for example, Kargbo 2010; Adolfo 2010; GoSL 2010; Thomas 2011). President Koroma ran his election campaign leading up to the 2007 elections on a promise to vigorously fight corruption in Sierra Leone. Among other things, he should endeavour to keep this promise.

11.3 Management of Revenues for Economic Growth

The efficient management of the nation's wealth, for economic growth and reduction of income inequality and poverty, is urgently needed if Sierra Leone

TABLE 11.1. Estimates of Sierra Leone government revenues, 2011–15 (US$ million).

Company, ministry, department or agency	Year 2011	2012	2013	2014	2015
Mining companies	27.68	200.9	534.57	718.28	743.53
Projected tax receipts, excluding mining taxes	160.6	169.53	178.34	183.23	184.87
Ministry of Fisheries and Marine Resources	3.75	4.25	4.75	5.25	5.75
Ministry of Agriculture, Forestry and Food Security	0.26	0.3	0.31	0.33	0.34
Petroleum Resources Unit	5.73	5.73	5.73	5.73	5.73
Projected aid flow	200.95	219.57	197.07	205.86	204.86
Grand total	398.97	600.28	920.77	1,118.68	1,145.08

Source: based on M'cleod (2010). *Notes*: mining companies figures are projections by selected mining companies.

is to prevent another round of political instability, increased social tensions and outbreak of war. Nearly 70% of the population is below the national poverty line. Sierra Leone's current Poverty Reduction Programmes are being implemented within the *Agenda for Change* framework announced by President Koroma in December 2008. The Poverty Reduction Strategy requires significant investments in infrastructure, improvement in the delivery of social services, and private sector development.

Sierra Leone is expecting a very significant increase in government revenues within the next five years (see Table 11.1). The mining sector is expected to account for 48–81% of those revenues. Government analysts argue that these are very conservative estimates as they do not include taxes from some newly registered enterprises that will be generating tax revenues within the next 1–2 years. Furthermore, the estimates do not include the discovery of other minerals, such as heavy sands, gold and oil (see M'cleod 2010). Managing this unprecedented boom in national wealth for sustained economic growth and poverty reduction need to be the primary objective of government policymakers in Sierra Leone. They cannot adopt a business-as-usual approach as this could spell trouble for this post-conflict nation with a fledgling economy. Growth in real GDP was expected to be 4.5% in 2010, up from 3.2% in 2009, and may increase to 5% or higher in 2011.

The government's fiscal policy in recent years has largely focused on the mobilization of domestic revenues and improving the management of government expenditures to maintain macroeconomic stability and promote sustainable economic development. The government has increased enforcement of existing tax laws to eliminate tax evasion and avoidance. For instance, the National Revenue Authority is implementing measures in accordance with the provisions of the Finance Act of 2009, in particular with regards to the issue of transferring off-budget revenues to the Consolidated Revenue Fund (see Kargbo 2011). Moreover, the government has designed the Integrated Public Financial Management Programme in efforts to achieve sustainable improvement in the credibility, predictability, transparency and control of fiscal and budget management in the country.

It is expected that the enactment of the Public Debt Management Act of 2011 which was signed by President Ernest Koroma on 14 March 2011 will boost the development of a comprehensive legal and regulatory framework for sustainable public debt management in the country. This bill will consolidate all existing laws that relate to public debt management in Sierra Leone (see GoSL 2011). The country's external debt in 2010 was equivalent to 39% of GDP, while domestic public debt was equal to 16.5% of GDP. The savings provided by the Highly Indebted Poor Countries (HIPC) initiative increased by approximately 41.0% during the 2008–9 period (see Kargbo 2011). Thus, the reduction of the public debt will free up funds for economic development. At the same time, the proper management of the mining sector can help to reduce or pay off the country's remaining debt, thereby freeing up funds for economic development because the debt burden will either be light or non-existent in the future.

The International Council on Mining and Metals (ICMM) reported in December 2008 that nearly 3.5 billion people worldwide live in economies that significantly depend on mining and related activities. Approximately 43% of these people live in low-income and emerging market countries and earn less than US$2.00 per day. The research findings of the ICMM's Resource Endowment Initiative that was launched in 2004 in partnership with the World Bank and the United Nations Conference on Trade and Development showed that contrary to the frequently cited 'resource-curse' arguments, mining can make significant contributions to economic growth and poverty reduction in Sierra Leone and other mineral-rich countries. However, such contributions depend upon the availability of the right management, building of institutional capacity that improves legislative and regulatory frameworks, improved governance, investor- and environment-friendly conditions, coupled with genuine collaboration between the host governments, civil society organizations, international aid agencies and foreign donor countries (see Commonwealth Secretariat and ICMM 2009; Dumas 2010).

Despite being amongst the top 10 diamond producing countries in the world, Sierra Leone consistently has ranked at the bottom of the UN Human Development Index during the past few decades. Table 11.2 shows Sierra Leone's ranking as a major diamond producer in recent years. Although countries such as Botswana, Mozambique, Uganda and Ghana are success stories in relation to management of their huge mineral wealth, the level of poverty remains high in several countries (see, for example, Partnership Africa Canada 2005, 2008, 2009a; Collier 2007, 2010; Dumas 2010).

Increasingly, there is an awareness across African countries that mineral resources are both economically and strategically important assets that must

TABLE 11.2. Major African diamond producers in 2007.

Country	US$ (million)	% of world production
Botswana	2,960.14	24.50
South Africa	1,417.33	11.70
Angola	1,271.96	10.50
Namibia	748.05	6.20
Democratic Republic of Congo	609.83	5.00
Lesotho	164.07	1.40
Sierra Leone	141.57	1.20
Central African Republic	59.86	0.50
Guinea	50.20	0.41
Tanzania	28.50	0.24
Ghana	27.86	0.23
Zimbabwe	23.38	0.20
Liberia	2.70	0.02
Togo	1.24	0.01
Total	7,506.65	62.08

Source: based on data from Partnership Africa Canada (2008).

be handled judiciously for the benefit of Africans. The catalysts for realizing better benefits from the vast mineral wealth in Sierra Leone and other African countries include: a sustained boom in commodity markets and prices, rapid global economic growth, especially in emerging markets such as China and India that fuel demand for resources, and improvement in governance and spread of democracy (see Pedro 2008; M'cleod 2010). As Ferguson (2007) has argued, for far too long, the most vigorous debates about Africa's economic development future have largely been directed and dominated by outsiders, in particular, citizens of industrialized countries and international institutions located outside the continent. Sierra Leone and the other African countries will find it very difficult to achieve their development potential if they continue to do things as usual. There must be a reawakening for the Africans to chart their own development trajectory and hold their political leaders accountable for their actions. Part of this process includes understanding the intersectoral linkages between mining, agriculture and other sectors of the economy.

11.4 Intersectoral Linkages

As Sierra Leone implements a wide range of postwar development policies and programmes to revamp the economy and reduce poverty, the policymakers need to identify and exploit the intersectoral linkages between mining, agriculture and other sectors of the economy. Using data covering the post-independence period, Kargbo (2010) estimated the macroeconomic growth

TABLE 11.3. Simulation results for sectoral income shocks of Le 1.00 in Sierra Leone.

Simulation experiment: shock to sector	Growth multiplier	Changes in sector			
		Agriculture	Manufacturing	Services	Mining
Agriculture	7.96	1.450	1.690	1.050	3.770
Manufacturing	8.68	1.590	1.860	1.150	4.080
Services	8.74	1.600	1.870	1.160	4.110
Mining	8.69	1.590	1.860	1.150	4.090

Source: author's calculations. *Notes*: see Chapter 9 of Kargbo (2010) for details of the econometric model used in providing the estimates for this table.

multipliers for agriculture, mining and other sectors of the Sierra Leonean economy that reflect the spin-off effects on local activities that are triggered by spending of increased incomes in the farm and non-farm sectors.

Table 11.3 presents the growth multipliers that estimate the magnitude and strength of the production and consumption linkages between various economic sectors in Sierra Leone.[1] The growth in mineral exports can trigger the initial income shock to generate the growth multipliers. Both forward and backward linkages are very important for sustaining economic growth in the country. Backward linkages deal with the demand for derived inputs from a new activity, such as the demand for logs/timber that is triggered by the establishment of sawmills in a rural area due to the boom in mining activities. Forward linkages involve production activities that grow from the introduction of a new intermediate product in the market. For example, the increased output of boards by the new sawmills or falling prices for boards could stimulate the construction industry, thereby requiring more labour, food supplies and services from other sectors of the economy. Thus, as shown in Table 11.3, an additional Le 1.00 of income pumped into the mining sector generates an additional Le 7.69 of income in the economy (i.e. growth multiplier (Le 8.69) − initial Le 1.00 = Le 7.69). The mining sector has the potential to generate higher additional income to the economy net of the initial Le 1.00 increase compared to any other sector. For example, an initial Le 1.00 increase in the mining sector will generate an additional Le 1.59 in agriculture, Le 1.86 in manufacturing, and Le 1.15 in the services sector. Furthermore, the initial Le 1.00 shock to mining feeds back into the mining sector through the various growth linkages in the economy, and generates an additional Le 3.09 of income within the economy.

Haggblade *et al.* (1991) argued that consumption linkages are more important than production linkages in the low-income countries. For example,

[1] The agriculture sector includes forestry, hunting and fishing. Mining sector includes quarrying and construction. Manufacturing includes handicrafts. Services sector includes wholesale and retail trade, hotels and restaurants, transport, storage and communication, finance, insurance, real estate and business services, producers of government services, etc. (see GoSL 1992).

consumption linkages accounted for 80–90% of the total growth multipliers in Sierra Leone and Malaysia, compared to 60% in Oklahoma. Two interrelated sets of consumption linkages are important in understanding the impacts of income distribution on sectoral growth and employment in Sierra Leone. The first set of consumption linkages deals with factor intensities of the consumption pattern – that is, the amount of labour, capital and foreign exchange resources used to produce the goods and services that shape that consumption pattern. The second set of linkages is referred to as locational linkages because they show us where the impacts of rural consumption expenditures are felt (see, for example, King and Byerlee 1977; Byerlee *et al.* 1983; Kargbo 2010). The extent to which the effects of locational linkages are felt in the economy depends on income and distribution – whether the commodities are produced at home by the family or purchased in rural or urban areas, and domestically produced or imported. Furthermore, consumption patterns are highly labour-intensive in Sierra Leone. Approximately, 84% of all increases in consumer expenditures were on goods produced in the small-scale agricultural, fishing, industrial and services sectors. Thus, increases in rural incomes are an effective way of creating employment activities in the country, in particular in rural areas.

According to the report on the *Census of Business Establishments 2005* produced by Statistics Sierra Leone, imported materials accounted for 75% of the raw materials used by business establishments in Sierra Leone (see GoSL 2006). Nearly 68.3% of the businesses (all in retail trade) in Sierra Leone imported 52.2% of the raw materials and goods, compared to using only 12.2% of the raw materials that are locally produced. Large-scale enterprises required Le 25.00 worth of imported inputs to produce Le 100.00 of output, compared to Le 4.50 of imported inputs for Le 100.00 of output in the agriculture and small-scale industry (see Byerlee *et al.* 1983). The small-scale sector imported only 20% of their capital goods requirement compared to more than 50% imported by large-scale enterprises.

The analysis in Table 11.3 is further supported by the intersectoral spending patterns during the postwar period as reported in the government's *2003/04 Sierra Leone Integrated Household Survey (SLIHS) Statistical Report*. For instance, non-farm enterprises spent a total of nearly Le 10.0 billion on inputs to operate their businesses. Nearly 33% of the input expenditures were on hired labour. Retail trade enterprises accounted for 48% of the total input expenditures, while enterprises involved with manufacture of wearing apparel and mining activities accounted for 27% and 22%, respectively (see GoSL 2007). Other non-farm enterprises accounted for the remaining 3%. About 7% of retail trade activities used hired labour of between 1 and 25 people. More than 50% of the mining activities used between 1 and 6 people as hired labour. Approximately 45% of retail trade expenditures were on vehicle rentals, while 28% of the expenditures in the mining sector were on fuel and lubricants.

It was estimated that 1.61 million households had access to 7.52 million pieces of farm equipment, such as hand hoes, cutlasses and winnowers. Furthermore, the *2003/04 SLIHS Statistical Report* showed that nearly 3.20 million pieces of farm equipment were sold in Sierra Leone during the survey period. The total value of the various farm implements was Le 591 billion for hand hoes, Le 306 billion for winnowers and Le 365 billion for cutlasses (GoSL 2007).

The foregoing analysis shows that increased household incomes derived from, say, increased mineral and/or agricultural exports, better infrastructure or technology are spent on farm and non-farm items whose production was previously constrained by lack of adequate local demand. Such spending has spin-off effects that subsequently generate new additional income in the economy. The extent to which additional net income growth can stimulate rural development in Sierra Leone or any country depends on how the rural households spend the extra income. Is the incremental income spent on items imported or those produced locally? Does the extra income stimulate new local production or simply lead to higher prices?

As governments of the major mining countries debate the environmental, social and economic impacts of mining, a key question that features in these debates is whether the benefits exceed the cost of mining. Issues dealing with corporate and social responsibility, environmental stewardship and community development are increasingly being included in mining contracts. Taxation of mining companies is one way of increasing the benefits. Whilst mining companies (or most companies for that matter) are always in the habit of vigorously resisting higher levels of taxation, Otto (2008) argued that the prevailing total effective tax rate is generally not the dominant factor reputable mining companies use in deciding where to invest. His research shows that mining companies are more interested in the overall stability of the tax regime, including the predictability of tax changes within the next 10–20 years, say. Political risks and environmental laws are other major factors that are generally considered in the decision-making process. In effect, reputable mining companies do not necessarily invest in the country with the lowest level of taxation.

A team of consultants that were closely involved in the development of the ICMM's Resource Endowment Initiative made a number of observations on the issue of taxation in the mining sector (see ICMM 2008; Commonwealth Secretariat and ICMM 2009). First, the government should try to maximize its tax revenues over the long term instead of the short term, thereby allowing appropriate adjustments to the tax regimes as conditions change. When and where appropriate, the adjustments can be made in collaboration with the mining companies and disclosed to the public to ensure that the tax system continues to receive popular and political support. Second, special tax regimes for mining (e.g. project-specific arrangements) are inherently risky despite the fact that they seem to offer stability. It is better to adopt the longer-term goal and economy-wide perspective by subjecting mining into the general tax system, and if necessary including features in the tax code that are unique to the mining sector, such as extremely high up-front capital costs and the revenue stream from royalties provided by mining investments. Third, increased transparency is in the best interest of the companies and governments. There is a growing body of evidence which shows that good governance and public accountability enhances political legitimacy while creating a viable and stable operating environment for the mining companies.

The above discussion on taxation means policymakers in Sierra Leone and other developing countries should consider the factors discussed above in designing their tax policies for the mining sector. For example, Sierra Leone could start off with simpler tax regimes rather than more complex regimes that may be hard to administer effectively. This allows for the development of competent local administrative capacity to handle more complex tasks in the future. Finally, as the ICMM (2009) has observed, the fiscal decentralization or revenue sharing arrangement with sub-national governments (e.g. Local District Councils and Chiefdoms in the case of Sierra Leone) do not necessarily achieve the desired benefits from mining, especially when the local governments are riddled with corrupt officials and the funds are not invested for the benefit of the people.

The next section presents the modelling exercise to illustrate its usefulness in quantitative policy making.

11.5 A Model For Diamond Production

The implementation of policy reforms requires decisions that are based on reliable information. We illustrate in this section how available data in the diamond industry and wider economy can be used to predict the impact of changes in prices, income, exchange rate and trade policies on diamond production in Sierra Leone. It is widely known that diamond smuggling is a very serious problem in Sierra Leone and neighbouring countries. Thus, based on our discussion in the previous sections, we hypothesize that officially recorded diamond production (DIAPD) in Sierra Leone could be represented by the following econometric relationship:

$$\mathrm{DIAPD}_t = f(\mathrm{PRDIA}_t, \mathrm{PRCOMM}_t, \mathrm{OPEN}_t, \mathrm{WINC}_t, \mathrm{RER}_t, \dots, Z_t), \quad (11.1)$$

where DIAPD_t represents the quantity of officially recorded diamonds that are produced and exported per year in Sierra Leone. Note that Sierra Leone generally exports all the diamonds that are officially recorded as produced in a given year. PRDIA_t is the real price of diamonds exported through official channels, and it is calculated as the unit value deflated by Sierra Leone's CPI. Sierra Leone is a price-taker in the world diamond market, thus, it only reacts to movements of world diamond prices in terms of the quantity of diamonds it exports. De Beers and other members of the diamond cartel use various strategies, including withholding or reducing supply to control diamond prices around the world. In effect, diamond exports in the current period are likely to be influenced by exports in the previous periods. OPEN_t refers to openness of the Sierra Leonean economy, and it is calculated as the ratio of the sum of total imports and exports over GDP. This variable is used as a proxy for the country's trade policies over the past decades (see Kargbo 2010).

PRCOMM_t is the world market price of commodities, such as coffee and cocoa. Artisanal diamond mining is a low tech and labour-intensive process that is done mostly during the dry season, which happens to be the time for harvesting of coffee, cocoa and other cash crops in Sierra Leone. Agricultural activities compete for the farmer-miner's labour hours. In effect, coffee or cocoa production is a substitute for alluvial diamond mining in the diamond mining areas of Sierra Leone (see Kallon 2004; Kargbo 2010). An increase in coffee (or any other cash crop) prices would increase the opportunity cost of diamond mining, thereby causing a rational farmer to embark on harvesting and processing of the season's coffee, cocoa or other cash crop. On the other hand, a fall in coffee prices will cause the farmer-miner to concentrate on diamond production for that year.

RER_t is the bilateral real exchange rate expressed in leones per US dollar adjusted by the respective countries' price indices (CPIs). Miners are paid in leones, but the diamonds are sold in foreign currency. In this case, a depreciation of the leone against the US dollar would likely raise the value of diamonds denominated in leones. Assuming all other things are held constant, this would likely create incentives to produce and export more diamonds. However, an appreciation of the leone could have the opposite effects because miners may have fewer incentives to offer diamonds through official channels, thereby increasing diamond smuggling to Liberia and other neighbouring countries. WINC_t is an index of real incomes (GDP) of industrialized countries. Z_t refers to other factors that affect diamond production in Sierra Leone, and $t = 1, 2, \ldots, n$ refers to annual time periods.

Because of data availability for all the variables required in our investigation, we limit the modelling exercise to reflect developments within the past five decades. This period encompasses different civilian and military regimes and the rebel war. We include dummy variables to capture the impacts of regimes and other changes in the economy. These dummy variables are defined below. $\mathrm{POLINST}$ is a dummy variable for war period/political instability in Sierra Leone, with $1 =$ occurrence of event, and 0 otherwise. APCREG is the dummy variable for APC-led government, with 1968–91 and 2007–9 $= 1$, and 0 otherwise. $\mathrm{SLPPREG}$ is the dummy variable for SLPP-led government/regimes in the country, so 1962–7 and 1996–2007 $= 1$, and 0 otherwise. $\mathrm{NPRCREG}$ is the NPRC regime dummy variable, with 1992–6 $= 1$, and 0 otherwise.

There are time lags involved in the interaction of miners, dealers and other participants in the diamond production and marketing chains in Sierra Leone and international market. We use the Johansen (1988, 2000) method in conducting our exercise within the cointegration framework. The model is estimated with the method of full information maximum likelihood, and the procedure has the advantage of permitting the joint determination of variables in the system. Furthermore, the method takes into account the short-run dynamics of the variables while allowing the system of variables to return to long-run equilibrium. This makes the technique very useful for policy analysis (see also Johansen and Juselius 1990). The variables to be tested are specified in vector error correction form as:

$$\Delta P_t = \sum_{i=1}^{k-1} \Gamma_i \Delta P_{t-i} + \prod P_{t-k} + DZ_t + \nu_t, \tag{11.2}$$

where P_t is an m-dimensional vector of endogenous (non-stationary) variables (e.g. $\mathrm{DIAPD}_t, \mathrm{PRDIA}_t, \mathrm{OPEN}_t, \ldots, \mathrm{WINC}_t$) in the system. Simply put, endogenous variables have their values determined and interact with each other within the model, while exogenous or predetermined variables have their values determined outside the model. Endogenous variables are regarded as random or stochastic because their values are obtained from the measurement of some random process, while exogenous variables are treated as non-stochastic (see, for example, QMS 1998; Greene 2008). Z_t refers to the vector of stationary exogenous variables, including the dummy variables, D represents the matrix of parameters associated with the exogenous variables, Γ_i is a matrix of parameters for the lag process, k is the number of lags, and ν_t is the error vector, which is multivariate normal and independent across observations. Based on the Granger representation theorem, if the coefficient matrix, $\boldsymbol{\Pi}$ has reduced rank $r < m$, then there exists $m \times r$ matrices $\boldsymbol{\alpha}$ and $\boldsymbol{\Phi}$, each with rank such that $\boldsymbol{\Pi} = \boldsymbol{\alpha}\boldsymbol{\Phi}'$ and $\boldsymbol{\Phi}'\boldsymbol{P}$ is stationary (Engle and Granger 1987). The elements of α are called the adjustment parameters in the vector error correction model, and r is the cointegrating rank. Each column of $\boldsymbol{\Phi}$ is the cointegrating vector. Bear in mind that our series may have non-zero means and deterministic trends as well as stochastic trends. Likewise, the cointegrating equation(s) may have intercepts and deterministic trends. We used the *likelihood ratio (trace) test statistic* for testing the hypothesis of at most r cointegrating vectors in each model. An alternative test statistic is the *maximum eigenvalue statistic* (see, for example, Johansen 2000; Johansen and Juselius 1992; QMS 1998 for details).

11.5.1 Data Sources

The data for official nominal exchange rates, the index of gross domestic product (GDP) for industrialized countries, the total exports and imports of goods and services, the CPI, and the world market prices for coffee and cocoa was obtained from various issues of the *International Financial Statistics (IFS) Yearbook*, published by the International Monetary Fund. The data for diamond production and exports was from various Sierra Leone government publications and websites, such as Statistics Sierra Leone, which is available at www.statistics.sl/ and the Bank of Sierra Leone, available at www.bankofsierra leone-centralbank.org/. Supplementary data was obtained from Saylor (1967), Levi *et al.* (1976) and the World Bank Africa Database CD-ROM.

11.5.2 Empirical Results and Policy Implications

This modelling exercise has been done to demonstrate the importance of using quantitative techniques in designing effective policies for economic growth in Sierra Leone. This aspect of policymaking provides us information about the magnitudes of potential changes brought about by the implementation of various policies in the economy. In effect, this technique shows the linkages between various sectors of the economy, and thus, can serve as an effective planning tool in the practitioner's kit. Any serious attempts at effective policy formulation should include the use of quantitative methods whenever and wherever possible. The professionals that guide the country's politicians and leaders should be encouraged to use these quantitative techniques. Furthermore, where necessary, training should be provided to the policy advisers in the use of these quantitative techniques.

Prior to conducting the cointegration tests, we used the augmented Dickey–Fuller (ADF) and Phillips–Perron unit root tests to determine the stationarity of the individual variables used in our analysis. Having a stationary time series is very important for economic modelling and forecasting, coupled with the prevention of spurious regressions that are often found in the economics literature (see Engle and Granger 1987; Greene 2008; Kargbo 2010). Research has shown that a time series that is weakly stationary has its mean, variance and autocorrelation basically constant through time. However, non-stationary time series do not have valid error-correction representations, thereby making their use in policy analysis rather suspect as they could lead to misleading conclusions. Because a large number of economic time series variables are non-stationary, we difference them to achieve stationarity. Our unit root test results showed that all the variables are $I(1)$, which means stationarity was achieved after differencing the variables once.

The cointegration test results are presented in Table 11.4, and they show that there is only one cointegration relation amongst the variables in the system. The long-run parameter estimates for the impacts of changes on diamond production in Sierra Leone are presented in Table 11.5. The normalization centres on the variable (in this case, DIAPD) with the coefficient 1.000. These results suggest that reductions in world income (proxied by the incomes of industrialized countries (WINC)) brought about by, for example, a recession, have negative impacts on diamond production in Sierra Leone as it leads to reductions in demand for diamonds worldwide. Whilst emerging market economies, such as China, Israel and India are major diamond importers (see Table 11.6), we do not have sufficient data or a single income variable that captures all of these countries. But it is clear that since we live in an integrated global environment, a recession in or reduction in the incomes of industrialized countries is bound to affect demand for products from Sierra Leone and other countries. For instance, as shown in Table 11.5, a 1.0% reduction in world income (WINC) would lead to a 6.0% decline in Sierra Leonean diamond exports, assuming all other factors are held constant.

TABLE 11.4. Johansen cointegration tests and results for diamond production in Sierra Leone, 1962–2007.

Number of lags and DT	Hypothesized number of CE(s)	Eigenvalue	Trace (LR) test statistic	5% critical value	1% critical value	Rank (r)
1, CT	$r = 0$	0.541	92.950**	87.31	96.58	1
	$r \leqslant 1$	0.499	57.069	62.99	70.05	
	$r \leqslant 2$	0.223	25.246	42.44	48.45	
	$r \leqslant 3$	0.163	13.666	25.32	30.45	
	$r \leqslant 4$	0.112	5.466	12.25	16.26	

Notes: DT refers to the type of deterministic trends that are present in the data. For example, C indicates that a constant was included in the cointegrating equation (CE), and CT indicates that a constant and trend was included in the CE. r tests for the number of cointegrating relations against the alternative hypothesis of full rank, i.e. all series in the model are stationary. ** indicates rejection of the hypothesis at the 5.0% significance level. The number of lags was determined by minimizing the Akaike information criterion and Schwarz criterion. See QMS (1998) for further details.

TABLE 11.5. VEC estimates for diamond production in Sierra Leone, 1962–2007.

DIAPD	WINC	PRDIA	RER	PRCOF	Constant	Trend
1.000	−6.081	0.485	−0.438	1.058	3.305	0.124
	(2.114)	(2.063)	(2.151)	(2.874)		(1.754)
Adjustment coefficients						
−0.228	0.030	−0.115	0.071	0.068	—	—
(2.361)	(5.784)	(1.191)	(0.431)	(1.317)		

Notes: numbers in parentheses are absolute t-values. '—' indicates that data is not available. 'PRCOF' is the real price of coffee. All the variables are expressed in logarithms.

Increases in the real prices of diamonds (PRDIA) elicited a positive response from miners and dealers, thereby leading to increases in diamond production. The complexities of household economics and labour linkages may affect the level of competition for the farmer's or miner's labour hours devoted to farming or mining. Thus, the increase in real coffee prices may have led to reduction in diamond production, assuming the higher coffee prices were more attractive than diamond mining during the period. Officially recorded diamond production declined with the appreciation of the real exchange rate (RER) during the period under investigation. The adjustment to long-run equilibrium is borne by changes in diamond production (DIAPD) and world income (WINC).

Table 11.7 presents the short-run estimates for the impacts of changes in diamond production during the past five decades. The coefficients for variables that represent the various regimes seem to contradict the narrative laid out in the earlier sections of the paper. For instance, the coefficients show that the

Table 11.6. The world's top diamond importers, 2007–8.

Country	2007 US$ (million)	2007 % of world total	2008 US$ (million)	2008 % of world total
European Community	14,426.510	36.0	14,507.531	37.5
India	9,664.344	24.0	9,591.556	24.8
Israel	5,858.193	15.0	5,357.613	13.9
People's Republic of China	2,230.128	6.0	2,331.180	6.0
South Africa	2,113.895	5.0	—	—
Switzerland	—	—	1,560.438	4.0
United Arab Emirates	—	—	2,155.663	5.6
Other	5,779.210	14.0	3,171.797	8.2
Total	40,072.281	100.0	38,675.779	100.0

Source: based on data from Partnership Africa Canada (2008, 2009).

various regimes (e.g. APC, SLPP and NPRC) that have ruled the country during the post-independence period have positive impacts on diamond production. Indeed, while the impacts of the regimes may seem to contradict the negative image described earlier about the lack of widespread benefits from diamond production, a close analysis of the evidence in this chapter shows that only a few elites have benefited immensely from the nation's mineral wealth. Thus, it could explain why the regime coefficients are positive since a selected number of senior government officials have colluded with rogue operators over the years to maximize their benefits from diamond mining and access to other mineral rights at the expense of national development. In effect, the very senior policymakers or members of the regimes embarked on corrupt activities that sabotaged the government policies for personal gain (see, for example, Abraham 2004; *Cocorioko Newspaper* 2010a,b; Kargbo 2010).

Recently, there have been allegations surrounding Mr Usman Boie Kamara, the former Director of Mines and Mineral Resources who has been implicated in the smuggling in 2002 of the largest diamond ever found in Sierra Leone. The diamond weighed 1,444 carats. After the diamond dealers had gone carried out some elaborate plans and substituted the large diamond for a smaller one, President Ahmad Tejan Kabba and the nation were shown on national television a diamond that only weighed 110 carats, which was eventually sold for US$1.0 million. The *Standard Times Press* (2011a,b,c) has reported in a series of articles how Mr Usman Boie Kamara used his government position to conspire with the group of diamond dealers to smuggle the 1,444 carat diamond out of the country, thereby causing the nation to lose significant tax revenues that could have been used for development programmes. Despite repeated requests from the Parliamentary Sub-Committee on Mines and Mineral Resources,

Table 11.7. Short-run estimates for the determinants of diamond production in Sierra Leone, 1966–2008.

$$\begin{aligned}\Delta \log \mathrm{DIAPD} = &- \underset{(0.108)}{10.315} + \underset{(7.447)^*}{3.230}\ \mathrm{ACC} + \underset{(2.176)^{**}}{0.326}\ \mathrm{SLPPREG} \\ &- \underset{(3.100)^*}{5.806}\ \Delta \log \mathrm{WINC}_{t-1} - \underset{(6.129)^*}{0.519}\ \Delta \log \mathrm{DIAPD}_{t-2} + \underset{(2.564)^{**}}{0.391}\ \mathrm{APCREG} \\ &+ \underset{(0.079)}{0.017}\ \mathrm{POLINST} + \underset{(4.813)^*}{1.427}\ \mathrm{NPRCREG} - \underset{(1.366)}{0.360}\,\Delta \log \mathrm{PRCOF}_{t-1} \\ &+ \underset{(2.313)^{**}}{0.112}\ \Delta \log \mathrm{RER}_{t-1} + \underset{(0.956)}{0.094}\,\Delta \log \mathrm{PRDIA}_{t-1} + \underset{(0.932)}{0.309}\,\Delta \log \mathrm{PRCOA}_{t-1} \\ &- \underset{(1.143)}{0.468}\,\Delta \log \mathrm{OPEN}_{t-1} - \underset{(5.657)^*}{0.482}\ \mathrm{EC}_{t-1}\end{aligned}$$

R^2	0.551	ARCH: χ^2 (1)	1.404
Adj. R^2	0.326	WHET: χ^2 (21)	14.694
SER	0.531	JB statistic: χ^2	0.190
D–W statistic	2.245	RESET	$F(1, 28) = 0.053$
F-statistic	2.453**	No. of observations	43
LM: χ^2 (1)	2.924***		
LB Q-statistic: χ^2 (22)	28.257		

Notes: Numbers in parentheses refer to the absolute t-value. *, ** and *** denote significance at the 1% 5% and 10% levels, respectively. 'PRCOA' denotes the real price of cocoa. The regressions were corrected for heteroscedasticity and serial correlation. The auto-correlation coefficient is 0.992. 'LM' is the Lagrange multiplier test of residual serial correlation. 'ARCH' and 'WHET' are tests for heteroscedasticity based on Engle (1982) and White (1980), respectively. The LB Q-statistic is used to test whether the residuals are white noise. The number of lags is in parentheses. The Jarque–Bera (JB) statistic tests for normality in the residuals, and it is distributed χ^2 with two degrees of freedom. 'RESET' is a test for specification error. The degrees of freedom for the other tests are in parentheses adjacent to the distributions. The error-correction term (EC) is the lagged residual from the cointegration regression, and its coefficient measures the speed of adjustment. Δ is the first difference operator.

Mr Kamara has refused to appear in front of the committee and answer questions under oath. Other people who have been called by the committee have appeared and testified. Yet, Mr Usman Boie Kamara is one of the leading candidates for flag bearer to contest the presidential elections in 2012 under the Sierra Leone People's Party. Repeated calls by the press for the Anti-Corruption Commission (ACC) to investigate this diamond case have so far not yielded any response from the nation's crime 'watch dog'.

Moreover, while officially recorded diamond production and export figures may have shown a dramatic decline since the early 1970s due to smuggling, trade figures in Belgium and neighbouring countries show an entirely different picture. For example, between 1986 and 1996, The Gambia, which has no known diamond deposits, exported US$420 million worth of diamonds to Belgium. Some of the owners of the companies in Belgium that imported diamonds from

The Gambia had family members in Sierra Leone that operated similar lines of business and are deeply involved in smuggling. Gberie (2002) argued that some of these prominent Lebanese families are alleged to have used some of the proceeds from the diamond business in West Africa to fund fighting militias in Lebanon, support global terror and other Jihad networks (see also Reno 1995; PAC 2009a,b; Kargbo 2010; Smillie *et al.* 2000).

The establishment of the Kimberley Certification Process Scheme (KPCS) has positive impacts on officially recorded diamond production due to the reduction in smuggling. Recent government statistics showed that the value of diamond exports that passed through Sierra Leone's official channels increased from US$25.9 million to US$142 million over the 2001–9 period. Movement of diamonds in the international markets now requires detailed documentation as to the origin of the diamonds and other pertinent information on the exporter as required by the KPCS. The Kimberley Process Certification Scheme was initially designed to remove 'blood diamonds' or 'conflict diamonds' from the legitimate multi-billion global diamond market. Despite the fact that corruption and smuggling continues to plague the diamond industry, smugglers are now at a greater risk of having their diamonds confiscated at international borders if they are caught without a valid Kimberley Certificate. For example, the US Customs and Border Protection Agency seized 28 rough diamonds that weighed almost 1,200 carats from two US jewellers at JFK Airport in April 2009 because the jewellers did not have a Kimberley Certificate (see Cavaliere 2009; Kargbo 2010). The diamonds which were smuggled from Sierra Leone had a declared value of US$800,000. Furthermore, because of intense scrutiny by non-governmental organizations, the press and other agencies, some European countries have recently stepped up enforcement of the Kimberley Process (see Partnership Africa Canada 2008; Kargbo 2010). The Government Gold and Diamond Office (GGDO) estimates that at least 20% of the diamonds produced in Sierra Leone are not exported through official channels. Some estimates put the value of smuggled diamonds at between US$30 and US$70 million per year (see Partnership Africa Canada 2004, 2005; Gberie 2010; Kargbo 2010).

There have been discussions among the Mano River Union (MRU) countries to harmonize their fiscal regimes and mining codes as they strive to craft a coherent mineral development strategy that protects the interests of their countries and the MRU community during negotiations with mining companies (GoSL 2008). The harmonization will reduce the price differential of diamonds and other minerals in regional markets and thereby help to reduce smuggling. However, officials at the Government Gold and Diamond Office confirmed to Partnership Africa Canada that diamonds smuggled from Zimbabwe have been presented to them for certification under the Kimberley Process. The smuggled diamonds were simply returned to the would-be exporter because the GGDO has no authority to seize the diamonds. There is increasing fear that foreign criminal elements and terrorist organizations are using smuggled diamonds for money laundering and terrorist financing (see Kargbo 2010).

Table 11.7 also shows that diamond production (DIAPD), which has also been affected by the global financial crisis within the past two years, has negative impacts on current production. Diamond production increases with the depreciation of the real exchange rate (RER) in the short run in Sierra Leone. The coefficient for EC shows a fairly rapid adjustment to shocks in the diamond industry. About 48% of the deviation from long-run equilibrium levels is corrected within any given year. The diagnostic tests support the robustness of our model, thereby making it useful for policy formulation and analysis.

11.5.3 Impulse Response Functions

Figure 11.3 presents the impulse response functions (IRFs) which provide us with another perspective in analysing changes in diamond production in Sierra Leone. The estimates are derived from the vector-error correction model (VEC) used in Tables 11.4 and 11.5. Shocks to real diamond prices (PRDIA) and international coffee prices (PRCOF) have negative impacts on diamond production throughout the forecast horizon, while shocks to world income (WINC) elicit negative responses from diamond production during the first three years; thereafter, diamond production becomes positive for the rest of the forecast horizon.

11.5.4 Variance Decompositions

The VEC model that generated the results reported in Tables 11.4 and 11.5 also provided the variance decompositions (VCs) for shocks that influence diamond production in Sierra Leone. As shown in Table 11.8, the VCs show very strong feedback amongst the variables used in the model. These results reinforce the linkages revealed by the growth multipliers in Table 11.3. Note that the impacts of changes in commodity prices and exchange rates cut across various sectors of the economy. For example, shocks to real exchange rates (RERs) account for up to 18% of the forecast error variance (FEV) in diamond production, and 5–13% of the FEV in real diamond prices (PRDIA). Shocks to world income (WINC) account for up to 5% of the FEV in diamond production, while shocks to real diamond prices account for up to 10% of the forecast error variance in diamond production (DIAPD). Own-shocks account for the largest proportion of forecast error variance for all variables in the system. The forecast error (SE) displays a pattern that confirms the presence of stationary processes in the model.

11.6 Concluding Comments

We have presented a detailed analysis of the mining sector in Sierra Leone. Although the mining sector has made fairly significant contributions to the national economy over the years, corruption, greed and the war almost completely destroyed the economy during the 1990s. It is widely believed that

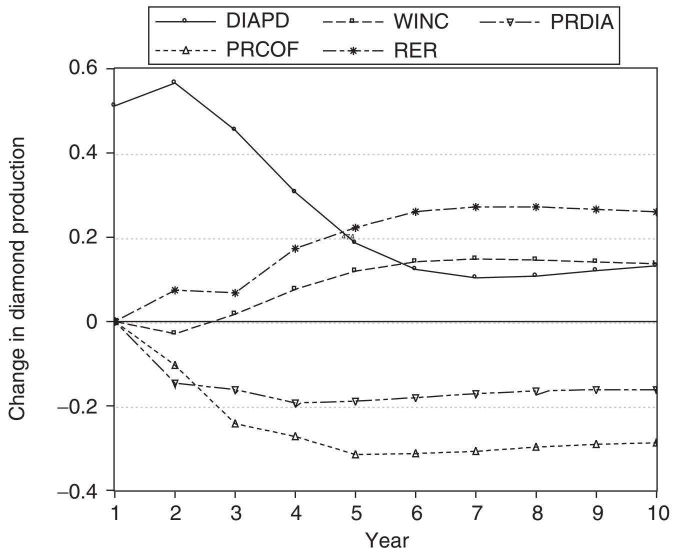

FIGURE 11.3. Response of diamond production to shocks in Sierra Leone.
Source: author's calculations.

TABLE 11.8. Decomposition of forecast error variance for diamond production in Sierra Leone.

Forecast error in	k years	SE	Shocks to DIAPD	PRCOF	WINC	RER	PRDIA
DIAPD	1	0.511	100.000	0.000	0.000	0.000	0.000
	3	0.957	85.977	7.618	0.124	1.104	5.175
	7	1.363	50.766	23.545	3.408	12.461	9.818
	10	1.584	39.318	27.655	4.908	17.680	10.437
PRCOF	1	0.274	1.318	98.681	0.000	0.000	0.000
	3	0.468	4.223	92.397	0.330	3.003	0.045
	7	0.804	13.123	78.357	1.409	7.091	0.019
	10	0.982	14.996	75.341	1.625	8.016	0.021
WINC	1	0.028	0.738	0.314	98.947	0.000	0.000
	3	0.043	14.284	2.439	66.751	14.539	1.985
	7	0.100	54.567	6.931	14.205	23.874	0.421
	10	0.127	58.585	6.324	9.443	25.376	0.271
RER	1	0.874	3.697	1.002	3.869	91.432	0.000
	3	1.585	4.733	0.448	3.718	90.389	0.710
	7	2.466	4.071	0.356	3.464	91.143	0.966
	10	2.956	3.878	0.332	3.399	91.379	1.011
PRDIA	1	0.512	18.852	0.756	0.296	4.895	75.202
	3	0.995	25.920	7.706	1.045	12.593	52.736
	7	1.586	27.234	8.053	1.078	13.226	50.408
	10	1.894	26.579	8.439	1.005	13.105	50.871

the people of Sierra Leone have not realized the full benefits to be derived from the mining sector. Rather, the minerals sector has been plagued by, and associated with, smuggling, corruption, security problems, environmental degradation and social upheaval in the country. Lack of fair prices paid to artisanal miners has contributed to smuggling of diamonds to neighbouring countries. Our empirical results show that commodity prices, the growth of incomes in industrialized countries, government regimes and government policies, including exchange rate and trade policies, had important impacts on diamond production in Sierra Leone.

To curtail corruption and improve revenue collection, transparency and other standards in the mining sector, the government should consider the following actions.

- The government must restructure the institutions that are responsible for managing the country's mineral resources and finances. It must set up an Extractive Industries Commission (EIC) that is independent and be responsible for the smooth operation of all aspects of the diamond, gold and other minerals produced in Sierra Leone. The EIC should also include the new oil, gas and any other minerals that are discovered in Sierra Leone. Activities of the Petroleum Resources Unit should be transferred to the EIC. This entity must establish a ring fence around the revenues derived from the mineral sector (i.e. establish a special fund) for specific development programmes widely accepted by the country, maintain an open-door policy to receive complaints from the general public and industry participants, collect and analyse data pertinent to the mining industry, publish periodic reports, including an annual report, and should have the necessary powers to launch investigations and resolve issues.

- A non-partisan and independent think tank or policy group should be established to help the policy formulation, discussion and implementation process in Sierra Leone. The politicization of almost every national issue, combined with patronage in appointments rather than qualifications and experience, make it difficult to adopt best practices in mining and other sectors of the economy. The think tank or policy group will help in educating the general public and holding the political leaders accountable for their actions.

- The EIC must work closely with the ACC and other law enforcement agencies to root out corruption and smuggling in the country. The current regulatory authorities (e.g. Ministry of Mineral Resources, and Government Gold and Diamond Office (GGDO)) should have no control over the new EIC. In fact, the GGDO should be transferred to the newly created entity. The creation of the new entity is imperative, in view of the fact that the vast majority of Sierra Leoneans have not benefited much from the diamond industry and other minerals after nearly 80 years of mining.

- The government must implement a fair market price policy, such as one that requires diamond dealers pay miners prices that are close to the world market prices, coupled with strict enforcement of the Kimberley Certification Process, border control, licensing and tax laws to minimize smuggling in the country.
- Strengthen law enforcement in relation to the Kimberley Certification Process. There should be strict controls over the granting and holding of mining and exporting licenses in the country. Any license owner that engages in activities that are detrimental to the development of the country, including violation of the rules and regulations of the mining industry should be tried, and if found guilty, be fined, sent to prison and/or stripped of his/her licenses. Also, government officials and others that exercise control over the mining industry must be prevented from participating in the industry's activities, e.g. being a miner, dealer and/or exporter. This is similar to the regulatory techniques employed worldwide in other corruption-prone industries, such as gambling, and the financial services industry, where individuals with certain sensitive information are limited to the type of activities they participate in, and ownership of shares in certain businesses is limited to a specific percentage.

We hope the issues discussed in this paper will serve as discussion points in the wider policy debates both within and outside Sierra Leone concerning the country's development trajectory.

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Chapter 12

SUSTAINABLE DEVELOPMENT AND IRON ORE PRODUCTION IN SIERRA LEONE: THE NEXT FIFTY YEARS

By Herbert P. M'cleod

12.1 Introduction

The current commodities boom opens up tremendous opportunities for Sierra Leone to break out of the cycle of poverty and underdevelopment, through the judicious use of the extensive natural resource endowments of the country. The experience of the post-independence era, when diamonds, rutile, iron ore and bauxite offered similar prospects for a natural-resource-led growth, has been dismal. For various reasons, but principally because of the policy choices adopted in the past and the economic development path followed, the country eventually descended into conflict. Fifty years later, the country now faces a similar future, and this time around only a different route charted carefully after drawing from the experience of the past, and learning from the pitfalls of others, can enable the country to avoid the same trajectory that led to a total collapse of the state.

Recently, mining companies with exploration or exploitation licenses have confirmed large deposits of iron ore, gold, rutile, bauxite, extensive deposits of rare earths, as well as good prospects for petroleum.

At this time in the country's history the transformation of the economy requires large inflows of resources, beyond what is available domestically and what is received as normal aid flows. Prudent use of those resources can lead to exploitation of these mineral deposits in a way that can transform Sierra Leone's economy within 10–15 years. The exploitation of these iron ore deposits have the potential to generate a significant part of the financial resources required to transform the economy, and more importantly, to stimulate directly and indirectly other sectors. However, these prospects and opportunities also present risks similar to what the country faced in the past, but this time around

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TABLE 12.1. Estimated reserves for selected minerals, 2010.

Iron ore	Gold	Rutile	Bauxite
13 billion tons	4.5 million ounces	600 million tons	2 billion tons

Source: company websites and estimates from the Ministry of Mines.

the effects could be worse.[1] By all indicators, Sierra Leone's best period ended in the early 1980s. Hence, the country must modify its strategy for exploiting its natural resources, if it is to obtain results different from those experienced in the past 50 years.

This chapter argues that, for Sierra Leone, the strategy that focuses on maximizing government revenues from mineral extraction has not provided optimal benefits to the country in the past, and therefore advocates a more comprehensive approach that will maximize the benefits of mining to the entire development process. In the past, government policy on minerals extraction, influenced by external advice that in turn was based on the prevailing theories, revolved around the proportion of revenues accruing to the country as compared to the foreign investor's share.[2] This largely ignored the country's capacity to even determine what the true values of gains from the extraction are, and the reality of how revenues that do flow in are then managed.[3] The orientation adopted in this paper places emphasis on the overall contribution to the development process, and reviews some of the links in the iron ore value chain in order to identify opportunities that can be harnessed by the local economy, with a special accent on how to maximize the non-revenue benefits of mining the ore.[4]

Section 12.2 presents a picture of the current need for massive injections of resources required for the development activities envisaged, and the potential offered by mineral revenues. Section 12.3 outlines briefly the history and background of iron ore mining in Sierra Leone. Section 12.4 argues for a dissection of the value and supply chain for iron ore in order to determine the potential for local participation at each link of the chain, and measures that

[1] By the early 1980s all the elements of the natural resource curse were evident in the country: growing inflation, increasing unemployment, expanding income inequalities, plus the erosion of political and economic governance manifested by the one-party system, the dominance of a few businessmen in the economic affairs of the state, etc. This time around and less than 10 years after the conflict, there are signs from the minerals sector that some of these are already emerging.

[2] See Otto *et al.* (2006). Thus, in the past, for example, negotiations over mineral agreements revolved around royalty and tax payments by the investor with passing references to local employment and business stimulation opportunities.

[3] In short, how to convert the wealth in the ground to investment opportunities rather than merely expanding consumption opportunities, the institutional and other weaknesses in financial management, etc. – the realities of a post-conflict and fragile economy.

[4] This orientation eschews the usual enclave nature of the extraction process to one that fully integrates it into the rest of the national economy.

could augment such levels. Section 12.5 analyses the country's experience in negotiating agreements and the outcomes obtained. Section 12.6 juxtaposes the socio-political dynamics of the fragile state and the behaviour of the investor prepared to take the high risks, in order to explain the current nature of iron ore operations. It further argues that where the government's objective goes beyond revenues to include obtaining maximum benefits for overall development, better outcomes may be obtained. Section 12.7 evaluates the current montoring arrangements in place for mining agreements and discusses measures for improving them. Section 12.8 examines the complex challenges related to the management of revenues from mineral taxes. Section 12.9 warns against the possible negative socio-political effects of poor management of the industry. Section 12.10 concludes the chapter with recommendations for action to be taken now in order to avoid errors of the past, and to take maximum advantage of all the opportunities for value addition locally, as a contribution to sustainable development.

12.2 Background

The current government's *Agenda for Change* (Republic of Sierra Leone 2008) – its plans for the transformation of the country – calls for public sector investment in the order of US$1.92 billion over the five-year period. Similarly, estimates for achieving the Millennium Development Goals (MDGs) call for a flow of resources in both the private and public sector amounting to US$12–15 billion in the next five years. *Vision 2025*, a document outlining the country's aspirations for the coming decade, when translated into plans and programmes, calls for even greater investment funds from all sources.

Yet, notwithstanding the surge in foreign direct investment (FDI) to sub-Saharan Africa between 2004 and 2009, when inflows jumped from under US$20 billion to almost US$59 billion,[5] post-conflict Sierra Leone has been receiving relatively less than its neighbours (Guinea received US$141 million and Liberia received US$378 million compared to Sierra Leone's US$33 million in 2009).[6] The last donor conference on Sierra Leone held in London at the end of 2009 did not mobilize additional aid funds over and above the level of previous years – an average of US$350 million per annum.

West Africa is now being described as iron ore's new frontier (Reuters 2010) with all four countries of the Mano River Union possessing large deposits that, when added to the Mauritanian exports, could account for just under 10% of the world's supply, compared to 1% exported in 2009.

Indeed, if current plans materialize, the region will be exporting at least 500 million tons per annum in the next five years, yielding considerable revenues to governments for development. The multiplier effects will go well

[5] UNCTAD database (see www.unctad.org/fdistatistics); African Economic Outlook 2011.

[6] The figures for 2010 and 2011 are significantly higher thanks largely to investments by two iron ore mining companies.

beyond the US$1.5 billion from royalties plus other fiscal gains that such exports will yield.[7]

In these circumstances, the announcements of iron ore deposits and the projected government revenues to be derived from its extraction will have the potential to provide a substantial part of the revenues required to meet the urgent development needs, particularly in infrastructure. Additionally, the nature of the process of iron ore extraction has the potential to influence positively the development fortunes of the country over the next 10 years.[8] Two reasons justify this optimism: firstly, iron ore indexed prices are expected to hover around US$125 (65% Fe FOB) per metric ton over the next 5–10 years – up from an average of US$50 per ton in 2009.[9] Secondly, the industry's activities, if managed and organized well, will have potentially direct and indirect effects[10] on other sectors of the economy.

The government's stated objective[11] is to obtain optimal benefits from the mining industry. Until recently, such benefits were conceived primarily in terms of maximizing tax revenues, expanding direct employment, and minimizing damage to the environment. Although there is no universally accepted definition of what is optimal, various assessments and long-term vision of stakeholders[12] claim to be maximizing the direct and indirect benefits to the economy both in the short and long term, while minimizing the negative environmental costs in both the short and long term (Otto *et al.* 2006). The results have not reached expectations, as evidenced by the decline in the economy leading to its eventual collapse and rebel war. The strategy proposed in this chapter goes a step further than the usual concentration on revenues to be earned, and increasing the stage of processing within the country.

[7] Assuming similar growth multipliers as in Kargbo (2011), an investment of US$10 billion per annum in the mining sector can be expected to generate US$70 billion of economic activities.

[8] Although it is now known that there are exploitable reserves of petroleum, these will take up to 6–8 years to come fully on-stream.

[9] Currently (first quarter 2011), it ranges from US$150–US$210 pmt (China 62.5% Fe).

[10] This goes beyond the 'backward and forward' linkages, first advanced by Hirschman, and which refers to the inputs purchased from the economy (backward linkages) by the company and the inputs sold (forward linkages) to the economy, as outlined in subsequent sections of this paper.

[11] Presidential Task Force for the Review of Mineral Rights; Strategy and Policy Unit, Office of the President (2008), Terms of Reference.

[12] For example, the National Mining Association of the United States defines it in terms of maximizing sustainable development from the social, environmental, and economic perspectives. (The iron mines directly contribute US$1.8 billion to the economy of Minnesota every year in the form of purchases, wages and benefits, taxes, and royalties. Subsequent business impact induced as the result of iron mining is responsible for more than an additional US$1.6 billion – making the total economic impact US$3.1 billion on the state and region's economy. Currently the mines directly employ approximately 3,000 men and women, with an additional 1,210,000 employed in vendor jobs (Iron Mining Associates of Minnesota, mission statement and vision).)

TABLE 12.2. Iron ore exports 1947–53.

Year	Tonnage exported	Total export value (pound sterling)
1947	642,300	—
1948	926,370	4,249,167
1949	974,050	5,340,915
1950	1,142,621	6,661,232
1951	1,184,735	10,068,449
1952	1,378,959	9,924,799
1953	1,200,240	11,738,769

Source: Jarrett 1956.

The alternative methodology takes as its point of departure the goal of long-term contribution of the industry to sustainable development of the economy rather than maximizing revenues, or the government's 'take' (see Otto *et al*. 2006) only. By unbundling the value chain of iron ore to ascertain the links or sublinks that can be provided within the country,[13] the economy's 'participation' and potential gain in the process of value addition for the mineral can be maximized.[14] This is not to suggest that maximizing revenues should be abandoned.

12.3 History and Evolution of Iron Ore Mining

In Sierra Leone, iron ore was mined in the Port Loko district where a very high-grade ore was extracted by a British company incorporated locally as Sierra Leone Development Company (Delco), and with little processing exported primarily to the United Kingdom, United States and Germany from 1933 to 1975. At its height in 1952, annual production amounted to 1.5 million tons per annum (mtpa), and in terms of value, exports exceeded that of diamonds. Values quoted amounted to £9.92 million pounds.

There were two types of deposits mined in Marampa: hematite and hard laterite. The mined ore contained about 50% metallic iron but the ore was then concentrated to about 67% (95% iron oxide, Fe_2O_3). The concentrated product was conveyed to the port, Pepel, by a railway completed in 1933. The railway was used primarily by Delco during its years of operations and handed over to

[13] The intention is not to impose high cost production inputs but rather to seek local solutions for goods and services used in the supply chain. To illustrate, it is cheaper in the long run to train a local engineer who can perform and replace the services of a more expensive expatriate after five years. However, unless the government intervenes, an individual company will not invest in such training with the risk that the trained personnel will go to another company.

[14] See African Union (2009) for a presentation that describes the goals to be achieved here.

government for commercial purposes when the company stopped operation in 1975. By 1952, the company had a labour force of 2,834 Sierra Leoneans. All production stopped in 1975, due to the exhaustion of higher-grade ores and the inability of the firm to secure the investment required to continue its operations. Since then there has been no mining activity in the area until after the war, when some operators succeeded in obtaining exploration licenses that have now been converted into full mining companies.

The estimates of reserves in known iron ore deposits are as follows:

African Minerals:	11.2 billion tons
London Mining:	900 million tons
Marampa Mines (Cape Lambert):	850 million tons

In addition, the Chinese King Ho group is examining locations close to the Gola Forest that is speculated to contain about 30 billion tons. In the next 18 months the results of exploration in that area will confirm the extent and nature of these deposits.

Currently, there are two operators with industrial mining licenses; London Mining operating the area mined earlier by Delco, with estimated reserves of almost 900 million, and African Minerals, with reserves of 11.2 billion. Neither company has operated a large iron ore mine before, nor is either quoted on the major stock exchanges so far.[15] although African Minerals has plans to seek listing. Two other mining companies with experience in iron ore mining, Cape Lambert and Kingho, have exploration licenses only.

The four countries constituting the Mano River Union (MRU) – Guinea, Sierra Leone, Liberia and Côte d'Ivoire – would secure greater benefits from the ore if they were to coordinate their strategies and adopt a regional approach to exploiting the deposits. Indeed, the Nimba belt containing deposits of the ore stretches from Liberia through Sierra Leone to Guinea.[16] A subregional initiative, when undertaken in collaboration with investors, would yield maximum benefits to all parties. There are additional opportunities for extracting further gains by carefully exploiting all components of the value chain in a larger West African market; benefits include a more efficient (lower cost) access to the sea that is not restricted by national boundaries, economies of scale for staff training, logistics, research, and even processing. Plus, there would be clear advantages from information sharing, coordinating the development of, and sharing the benefits from, shipping and port facilities, etc. Arcelo Mittal and BHP Billiton failed recently to combine their operations into a single joint venture in Guinea and Liberia that could have reaped the benefits of scale and joint action. However, because such gains exceed the narrow commercial interests of each company, the joint intervention of both host governments, or the regional subgroup, the Mano River Union, could have provided guarantees

[15] Both are listed in AIM, the stock exchange for smaller companies.

[16] For a more detailed description of the geological formations within which iron ore deposits are found, see Obafemi (2010).

or deal-breaking incentives.[17] The case of Mittal importing 32,000 tons of crushed rocks for its railway in Liberia could also have been resolved by sourcing the extensive quarries in Sierra Leone at costs that would have likely been lower.[18] In short, the joint interventions of the host governments, through guarantees and incentives, could promote joint extraction and offer greater opportunities for the economies of the countries.

12.4 Securing the Optimal Contribution of Iron Ore to Sierra Leone's Development

As pointed out earlier, the most evident and immediate effects of iron ore production are the revenue windfalls it will generate for the government's budget. The full potential effect, however, would be realized if it were possible to locate the entire value chain, from mining the ore to processing and marketing the final product within the country. This, of course, is clearly not feasible. However, it could be used as target to be aimed at; provided efficiency and effectiveness are not sacrificed, and recognizing that the foreign investor must also obtain a fair share for her investment. Put differently, there should be a deliberate effort made to identify possibilities for the country's maximum participation in the links of the value chain. Once this is done, government should use guarantees, incentives and support to ensure the exploitation of these opportunities, resulting in a win–win situation for both the country and the company. To do so requires unbundling the package of activities from ore extraction to final product, and pinpointing all the services supporting the process. This will show up the various services or processes that could potentially be located within the country or for involvement of the nationals. Such mutually agreed measures should be part of the agreements with mining companies.

Two types of activities can be identified in the value chain, and classified as 'visible' and 'invisible'.[19] Visible refers to the services directly related to the extraction process (drilling/upgrading the ore content/health services/catering services/construction/protective wear and preventive maintenance); the processes and measures for refinement before export (sinter feed/pellets, etc.); the provision of energy; the supply of water, transportation of the product to the coast for export (road and rail construction/dredging of waterways/ports development); and shipping to the world markets.

[17] The failure was announced on 8 September 2010.

[18] The Minister of Lands, Mines and Energy, Dr Shannon, justified the importation of 32,000 tons of ballast (crushed rocks) by Mittal for building the railway, with the explanation that local supplies were insufficient (24 September 2010).

[19] This is slightly different from the usual forward and backward linkages and includes activities that are not directly and only part of the production process, e.g. banking.

Invisible activities are back-room-type services that support the extraction and refinement process and include research (e.g. testing of soil samples, application of new technologies, resolving operational technical problems, use of specialists consultants); logistics (including vehicle maintenance, personnel services, office supplies, and administrative support); food supply (such as catering and basic shopping), internet technology support (namely, service providers, database and website support); and entertainment services, banking and insurance services, and travel services.

In addition to unbundling the value chain to identify potential nationally produced goods and services, there should be coherence between the public sector's development strategy, plans and programmes on the one hand and the programmes and activities that form part of the mining enterprise on the other. Thus, national employment programmes, infrastructure plans, revenue flows and environmental management programmes must all, in one form or the other, take account of the activities of the iron ore extraction industry.

What is envisaged is not merely expanding the government's 'take', a tactic that pits the company's interests against that of the country. Rather, the intention is to identify, with the company, longer-term options that would lower long-term costs by making use of low-cost local options. A simple everyday example is illustrative. The driver of a piece of complex earth-moving equipment may not be available locally. Hence, the company will bring in an expatriate at considerable cost in the short run. However, local drivers could be trained to operate such machinery and in time will take over. A carefully crafted training programme for the industry will lower long-run costs, while the country's employment levels will increase. What is advocated here is for both government and the company to plan for increased local participation, with respective responsibilities clearly defined. For the government this would be through training, common support services, accreditation, etc., and companies will more proactively seek local solutions, but without compromising quality or efficiency.

In the past such considerations hardly featured in the agreements signed with the mining company. This time around the agreements should contain provisions to cover such activities. Hence, negotiations of the agreement with the company must be done only after careful planning and reflection over how best the extraction process will fit with the country's overall development strategy, and how it will stimulate the local private sector and improve the competitiveness of local firms. Equally important will be the steps government will take in close collaboration with the private sector to make use of the opportunities offered.[20]

The provisions in the agreements that relate to five areas would require greater precision, namely,

[20] The past and new mining legislation have a standard provision for local procurement contained in all agreements, but this has hardly ever been enforced in the past. Government will now have to improve enforcement in combination with incentives to mining companies, support to potential local private sector, and aggressively organizing for greater local content.

1. employment,
2. infrastructure,
3. environment,
4. community participation,
5. revenue flows.

These cannot be left to current laws, as in the past, which were not designed to regulate long-term issues involved in 25-year investments.

Employment. Here, the objective is to maximize the recruitment of Sierra Leoneans, rather than expatriates, throughout the life of the mine, not only in the visible activities, but also equally in the invisible support services. The provisions in the mining agreement relating to the use of locally available expertise and local participation in subcontracts need to be carefully crafted for this purpose and, at the same time, to develop an integrated (national and expatriate) workforce. This would be one way to avoid sowing the seeds of discontent. An important dimension is the long-term provision of national experts. Here, one option could be to encourage the mine operators, as part of corporate social responsibility, to engage in a *public/private partnership* for supporting a mining engineering faculty within the university. The option of using revenues for such targeted goals has not worked in the past because of shortcomings in the budget system, leakages, and institutional rigidities. These shortcomings will take some time to correct and hence this interim approach could be justified.

Closely linked to employment is technology transfer. Companies should be encouraged to use the new facilities being set up within the country for tests and, in collaboration with the university, to undertake basic research for mine operations. A well-established system of internship for graduates will ensure a good supply of relevant skills throughout the life of the mine – over 50 years by current estimates. In terms of direct activities, opportunities should be given to local companies for partnering with international firms introducing new techniques and technologies in providing one or more of the links in the supply chain.

Infrastructure. Iron ore extraction, like mining of other base metals, involves major infrastructure for refining, transporting, and even the development of the mine itself: rail, roads, shipping, and energy including electricity, dredging, and the general administration of ports. Again, adequate preparations by the relevant government authorities are needed to determine the ideal configuration for all infrastructure development before the commencement of negotiations with companies on location of transport routes, phasing of power supplies, and use of waterways. Currently, the company negotiates separately with each authority generally outside the mining agreement. As a result, the government misses the opportunity of securing better outcomes that could be derived from a more unified national approach, one that would take into account the long-term plans, synergies and interlinkages among all entities.

Environmental considerations. The Environmental Protection Act of 2008 does not contain detailed provisions to cover the mining sector and primarily relies on the Environmental and Social Impact Assessment reports for control and management of the effects of the mining operations on the environment.[21] This has led to the anomaly of environmental issues being treated in three separate sections of an agreement:

1. fiscal, for performance bonds required for mine closure;
2. mining operations, for issues related to mining technology;
3. environment issues, for the economic and social impact analysis (ESIA).

Here is another case of segmented approaches resulting in suboptimal benefits to the country.[22] The way out is to deal with environment issues comprehensively integrating all dimensions into one regime.

Community participation. One of the first actions to be undertaken even at the time of exploration is the dialogue between the company and the local communities. A system should be put in place for continuous dialogue, not only regarding any corporate socially responsible actions envisaged, but also for the use of community funds. Government must restrict itself to the role of honest broker and remain aloof in negotiations at this level. This stance could later be vital in times of tensions between the two parties.

Revenue flows. The complexity of accounting methods and techniques used by transnational firms make it difficult for the typical government accountant to monitor financial flows within the multinational company, and deal with transfer pricing in its various forms. At a minimum, therefore, in order to ensure that the appropriate share of revenues accrues to the country, an international audit firm should routinely be employed to review the accounts and financial operations of the company.

12.5 Contract Negotiations: Terms and Conditions for Extracting the Ore

The process of extracting the ore and its export from the host country are undertaken in partnership with a foreign investor. The terms and conditions of the partnership are usually defined in a minerals agreement that is negotiated between the two parties. The agreement therefore defines in large measure the gains that the country secures from the extraction of its natural asset.

[21] Detailed regulations to complement the Act are now under preparation.

[22] Since ESIAs take some time to prepare, evaluate and approve, companies commence operations on the basis of approvals by the other entities, but the Sierra Leone Environment Protection Agency (SLEPA) awards a temporary permit only.

This section examines Sierra Leone's experience so far, and proposes how the country can obtain more favourable provisions in the agreements signed with investors.

There are five factors that largely explain the unfavourable agreements that the country has signed in the past and that have diluted the country's gains from mineral exploitation: poor preparations preceding the negotiation of an agreement; improper representation at the negotiating table; dysfunctional systems combined with poor coordination among institutions dealing with different aspects of the mining operations; corruption; and weak legislation.

Successive governments have been saddled with poor contracts, partly because of the practice of reacting to proposals from mining companies rather than presenting government's proposals, and partly also because most of the companies operating in the country had little or no experience with full scale mining operations and care little about reputational risks. Not surprisingly, in the past there was little done in terms of due diligence of the companies, study of the market, and technology for the ore to be mined, etc. Nor is a negotiating strategy agreed upon before meeting the companies. In any event negotiations often have concentrated on revenue flows, with environmental issues receiving marginal attention. This is consistent with the prevailing school of thought that calls for maximizing the net present value of income streams from the company.[23] It is also similar to the approach that focuses on the total take by the government as compared to that of the company (see Otto *et al.* 2006). The general mantra of international finance institutions until recently emphasized the creation of a 'friendly' business environment, rather than stable development conditions for sustained growth of the entire economy. 'Friendly' generally referred to the conditions for the foreign rather than for the local investor. Hence the agreements spell out tax breaks, the general conditions for the operation of the foreign investment, the regime of fiscal concessions, the stabilization clauses that protect the investor from changes in the law, and protection against nationalization, etc. Sustainable development hardly features, even as a phrase, in the agreements.[24] The weaknesses in the state's capacity to negotiate, monitor, and take the initiative, inevitably leave the country with relatively few benefits. The abuse of transfer pricing abounds. For example, in the recent renegotiation of an agreement, a company that 'sold' the product of the mine to its parent company was found to be charging over US$2 million annually as marketing fees!

After poor preparation, in the past, Sierra Leone left negotiations to the Ministries of Mines and Finance, and the Legal office. Yet disposing of the

[23] Tilton (2004) prefers maximizing net present value of social benefits but doubts that using the tax rates will be helpful.

[24] There are no known cases where IFIs have recommended postponing the extraction of a mineral on the grounds that the conditions are not ripe for the country to obtain optimal benefits from it. Not that this approach is necessarily the best, but if sustainable development is the overall goal of the country then the exploitation of a strategic natural resource must be designed with more than revenue maximization in view.

country's patrimony concerns all and sundry, and at the least should command the direct attention of the highest office. And the normal situation is for the government's delegation to consist of the political heads of these ministries supported by one technical member of staff and a foreign consultant. With laws and regulations not designed for managing natural resources effectively, agreements governing their extraction need to be comprehensive and detailed. However, the voluminous documentation involved cannot be handled by the usual few officials representing the government, half of whom are political heads, acting in isolation. A team supported by professionals should be set up solely for negotiations.[25]

Although the country formulated a number of development plans, structural adjustment programmes, and more recently PRSPs, it is striking that, despite the potential importance of natural resources in the country's development, no development strategy has been woven around the opportunities and challenges of depleting a natural resource; and negotiations with companies for mining concessions have not incorporated the country's overall development programme in determining the minimum expectations from the agreements. Indeed, preparations for negotiations hardly occurred, as the practice consisted primarily of getting reactions to a company's submissions for fiscal concessions.

Nor has there been a home for the process; i.e. no single entity has the responsibility for agreement. The fiscal discussions take place in the Ministry of Finance, outside the reviews of technical operations done by the Ministry of Mineral Resources. The latter pilots the agreement through parliament, even though the most controversial provisions relate to finance, environment, and local communities. The mining company normally negotiates terms for other aspects of its operations, such as for water use, port facilities, etc., outside the mining agreements. Furthermore, once agreements have been signed there is no mechanism for monitoring the implementation of the agreement's provisions. Consequently the companies are under no pressure to meet all their obligations. In short, coordination and consultation are inadequate; the package finally adopted is therefore hardly coherent with the rest of the country's development strategy.

Juxtaposing all of the above to the dysfunctional nature of the country's institutions partly explains why the agreements were so lopsided and in turn limited the country's gains from the extraction of the minerals.

We now turn to the fourth area of loss: legislation. Until 2009 the legal framework was outdated and granted extensive discretionary powers to the Director of Mining. The new act is more modern and a major improvement. However, changes introduced at the parliamentary level reintroduced the discretionary authority, this time to the minister, and set up a potentially convoluted system of controls through a Minerals Advisory Board with executive authority in addition to its advisory role; as well as a few ambiguous provisions. To make matters

[25] The government has now set up a core team that is supported by local and foreign specialists. If this team is allowed to operate freely, this will reduce significantly the likelihood of poorly negotiated agreements.

worse, the board is not independent of the ministry. These anomalies must be corrected in amendments to the act as soon as possible.

12.6 Dealing with the Non-technical Obstacles: A Post-Conflict Challenge?

The mining sector in Sierra Leone's post-conflict history is characterized by large numbers of small companies that acquire prospecting and exploration licenses that are typically sold to others within three years. For all the five industrial mining companies, ownership has changed hands at least twice within five years of operations. With such instability and frequent changes in leadership, it is no wonder that performance of the companies has been poor; since the 1980s, not one of them registered profits before 2009.[26]

As a post-conflict country riddled with weak institutions and beset with rumours of widespread corruption, Sierra Leone's mining industry attracts high-risk investors and bottom feeders.[27] However, neighbouring Liberia is a post-conflict country but does have more reputable and well-established mining companies. One explanation put forward by some observers is that after the departure of De Beers and SIEROMCO in the 1980s, the leading investors have been controversial figures, and that this in turn attracts similar operators. Such operators set up companies with relatively short-term horizons. Some of these investors are prepared to do whatever it takes, including using unorthodox methods to obtain unusually generous contracts, begin preliminary operations then sell out to more established companies. Occasionally such companies may advance through to mining operations. Not having established any credibility as sources for reliable supplies, such companies tend to sell to the spot market rather than through long-term contracts or are unable to secure good prices for long-term buyers, when they do undertake full mining activity. Being new, they usually lack the experience to proceed without the participation of a major miner. In addition, even when they attempt full production, they do not find it easy to mobilize funds.[28] They frequently encounter all forms of operational problems during production.[29] Negotiating agreements with such companies poses special challenges. In Sierra Leone all such companies obtain overgenerous agreements, all of which are also approved by parliament, an indicator of the type and level of support they can muster.

[26] A few months after the operations of the task force commenced, questions were being posed on the nature of the finances of large companies.

[27] Small mining operators who search for feasible mining opportunities partially develop them then sell to established firms.

[28] Having swallowed the bait, the government may well find itself providing letters of guarantees for the companies to get loans!

[29] The two mining companies have already had strikes, arson, litigation, etc., in their plants even before commencement of mining for export.

At the other end of the spectrum are larger, better established, and often integrated mining companies. These[30] are more concerned with stability, reputational risks, and a long-term relationship coinciding with that of the life of the mine – normally exceeding 25 years (Butler 2004). Companies like Vale or BHP Bilton are more equipped to deal with the challenges of new mines and the vagaries of the business cycles.

Governments are therefore faced with a choice between two types of investors: the large investor, or the bottom feeder (Gberie 2010). Under pressure for quick money, weak governments tend to favour the high risk takers and investors/speculators. They are nimble, spend seed money to establish the reserves, pay whomever and whatever it takes to get the license, etc., but do not go the long haul. It is therefore not surprising that they end up with overgenerous fiscal concessions. In short, their behaviour, conditioned by their shorter-term horizons, lack of concern with reputation, and weaker oversight from their home countries, produces outcomes that coincide with government officials' private need for immediate action and money. It is therefore not surprising that government officials find themselves defending these companies, pointing to the commencement of mining operations and the revenues accruing to government as justification. By so doing they inadvertently give up the neutrality and objectivity necessary to promote the public interests.

An equally worrying concern is that the country may suffer even further from their lack of experience through technical difficulties, plants shutdowns, staffing problems, etc. Unfortunately, because the government does not have the resources to obtain the basic information on the quantity and quality of ore deposits, it must depend on mining operators to do so on a first-come, first-served principle. This has limited the government's ability to award mining licenses to the best potential operator. As a result successive governments avoid taking the hard decision to refuse operators who would normally not pass the test of credibility and ability to mobilize the financing and technology to operate the mines.

The two companies now licensed to mine the iron ore deposits are unknowns in the iron ore industry, but succeeded in obtaining very generous provisions in their initial agreements.[31] After initial faltering steps they now seem likely to mobilize the resources needed to commence operations.

This history and background do not augur well for the country to obtain optimal benefits from its iron ore deposits. Accepting that benefits are to be gleaned not only from direct revenues in the form of taxes but also from employment, technology transfer, modern management skills, stimulation of the private sector, possibilities for joint ventures, etc., will all require the adoption of a different approach if different results are to be expected.

[30] None of the majors operate in Sierra Leone, although almost all of them are found in neighbouring Guinea and Liberia.

[31] The President, Dr Ernest Bai Koroma, has since ordered that both agreements be renegotiated, to bring them in line with international practice, and the new Mining Act.

To assess how this can best be done we must return to the value chain of iron ore. Usually the chain is considered primarily in terms of the 'visible' activities: mining the ore, washing plants, sinter plants, pig iron or pellets for blast furnaces, shipping and dredging, steel plants (both integrated and mini mills) and trading/marketing (see, for example, Laurens 2007 (available at www.onemine.org)). In addition, there are sublinks attached to the chain that today's globalized market offers for entry by any *applicant* (sublinks refer to all services that feed into the value addition process). An example is haulage. This is usually subcontracted to a foreign company with a track record or that has done business with the mining company earlier. Government, through the chamber of commerce or the Sierra Leone Investment and Export Promotion Agency (SLIEPA), could put in place measures and incentives for setting up of cooperatives by local transport companies to bid for such contracts. Other cases include IT services, drilling and construction, supply of equipment, maintenance of machinery, etc. The internet now opens up possibilities for even recruitment services to be provided locally or in association with foreign companies.

The same methods should be applied to the 'invisible' activities, or backroom operations, such as support services that otherwise would be provided by foreign contractors. An example is international travel of mine operators. It is now estimated that over half of the air passenger traffic consists of personnel of one or more of the over 100 mining companies operating in the country. Travel arrangements tend to be done by the head office of the parent companies. However, a network of local travel agents could bid for and provide a one-stop travel facility to the companies. Similarly, in the case of banking services, currently the practice is to confine local banks to providing services involving transactions in leones. However all local banks have foreign accounts and there is no reason why companies cannot use the local bank for foreign transactions. Thus, the services provided by the parent company and for which management fees are charged, should be carefully scrutinized for elements that can be performed by local agents. In sum, this author believes that the provisions in mining agreements covering procurement must be carefully drafted with the objective of ensuring that as large a proportion of services are provided locally by Sierra Leone-based firms. The exact content will have to be influenced by what options exist and could be developed in the private sector as well as with other minerals. As a matter of principle, the author believes that each third party contract should be analysed for possibilities of increasing local content, either immediately, or, as a minimum, plans should be set in motion for longer-term local supply.[32] Such provisions are only meaningful if national authorities prepare and organize well.[33] Admittedly, not all services or inputs can be provided by local companies now. Nevertheless identification of

[32] This need not be at the expense of efficiency, and can be conceived in terms of partnerships with international suppliers.

[33] It is useless to insert provisions relating to national procurement if services and good cannot be supplied in the quantity and of the quality expected by the mining company.

such opportunities can stimulate local collaboration and support measures for transforming an opportunity to an operational success.[34]

12.7 Monitoring and Implementation

As stated earlier, there is no institutional home for the agreements signed between the government and the mining investors. As a result no single institution monitors the implementation of the full agreement. The first Extractive Industry Transparency International (EITI) report (Adam Smith International 2010) on Sierra Leone noted that reconciling differences on reported tax payments between the records at the National Revenue Authority and the Ministry of Mineral Resources was difficult. Iron ore being the most important resource in the country, this author believes that the monitoring of the implementation of agreements related to its extraction should be assigned to a unit within the President's or Vice President's office. Such a unit would deal with cross-sector and cross-ministerial issues. It could also draw attention to the changing landscape of national and international activities related to the mineral.[35]

The operations of iron ore companies should not be considered merely a matter for the mineral resources ministry, as happened in the past. The repercussions of improperly implemented provisions affect several sectors. Adding to this the imposition of discipline and the need to go beyond narrow mandates of each ministry all points to such a unit being located at the highest level of the leadership rather than at ministerial levels.

The fiscal provisions in agreements deserve special mention. The mining sector employs complex systems of financial management, many of which disguise transfer pricing. Adding the manipulation of debt-to-equity ratios, shareholding, discounted sales, intricate accounting, and interlocking directorates makes ascertaining the full value of financial gains for the country difficult. Notwithstanding the above, there are still those who continue to believe that government must grant overgenerous tax concessions to entice companies to invest. The recent successful renegotiation of a large-scale mining operation confirm that significantly more can be secured for the country, leaving the miner with a normal return on the investment.[36] The National Revenue Authority should set up a dedicated desk for iron ore related payments in order to monitor closely the implementation of the revenue provisions of the agreements.

In general, it is imperative that an iron ore bureau/desk be set up within the Ministry of Mineral Resources, because of the importance of the mineral

[34] For examples, see Battat *et al.* 1996.

[35] Tanzania set up the Tanzanian Mineral Audit Agency in 2007 while Liberia is in the process of establishing one.

[36] It is sad that while the country is labouring under the yoke of higher oil prices some of these 'investors' are already raking in hundreds of millions of dollars in the stock market even before a single ton of ore has been exported.

and its widespread occurrence in the country. The planned National Minerals Agency will take up this task among others, but in the meantime setting up some of the critical units that are needed and that could be incorporated into the agency would be a good start. Desks or bureaus would be manned by local and international personnel and mandated to monitor both performance of the mining companies and the evolution of the industry in order to advise government on issues that are likely to affect either negatively or positively the current and future benefits to the economy. This is a responsibility that would naturally go to the unit that is also responsible for negotiating agreements.

12.8 Revenue Management

Unfortunately, abnormally large inflows of funds into an economy can be accompanied by major challenges. There is a growing body of literature showing the potential negative consequences when such flows are inappropriately managed, as well as some possible ways out for developing countries.[37] Avoiding them requires careful management. Failure to do so results in increased income inequalities, distortions in production patterns, dramatic changes in wage and exchange rates, significant displacement of population, dilution and erosion of democratic values and practices, corruption, and increased vulnerability of the economy to global price shocks.

The important contribution of iron ore exploitation to the development of the country is in the form of the increased revenues that are likely to flow into the budget of the government. The experiences of other countries point to the affliction of what is known as the Dutch disease.[38] There will be strong pressure and temptation to spend the windfall revenues on recurrent items such as wages, or to undertake grandiose projects that are politically attractive; or even to engage in procurement that encourages leakages through corrupt practices. In Sierra Leone such consequences will be disastrous. With weak institutions and poor systems of checks and balances, the results will include enrichment of a few decision makers and their allies, heightened income inequalities, inflation (if the exchange rate appreciates, inflation is unlikely), distortion to the patterns of production, high cost production structures, and the general loss of the country's natural assets. The political and economic consequences have

[37] For a theoretical analysisn see Corden and Neary (1982). A more recent study shows that where there is a dynamic and knowledge intensive natural resource sector the effects of the Dutch disease may be mitigated (see Cavalcanti *et al.* 2011).

[38] When the Dutch discovered large gas deposits in the 1950s, windfall revenues emanated from their exploitation, triggering an appreciation of the currency. In turn this raised the costs of manufacturing and other tradables, adversely affecting that sector of production in the country. For a discussion of the Dutch disease see Corden and Neary (1982).

played out in the cases of the Democratic Republic of the Congo, Central African Republic and others. Sierra Leone must avoid this at all costs. Transparency and information sharing are useful parts of the solution. In addition, a national non-partisan debate on how the resources are to be used, informed by a rigorous analysis of the various options, will be a first step.

There are a variety of approaches to manage the sudden and large inflow of funds into an economy. The creation of sovereign wealth funds with special rules is the most widely used, and has had mixed success (see Heuty and Juan Aristi 2010). No such strategy existed in Sierra Leone in the past. Rather the flows of revenues from iron ore, diamonds and other minerals were paid into the consolidated funds and got 'lost' in the state coffers to be (mis) used as other funds were.

In Sierra Leone, where infrastructure needs are critical and have been shown to be an important 'binding' constraint to development, there is considerable pressure to reconstruct roads, hospitals, offices, etc. At this time, or in the next 2–3 years, the option of ring-fencing the windfall revenues may not be feasible or economically practical. Yet it should not be dismissed outright, particularly as infrastructure development is susceptible to corruption through inappropriate contracting, rent seeking, politically inspired choices all contributing to erosion of the country's fledgling democratic institutions and traditions (see Anne-Claire Poirson 2005; Frankel 2010).

Another option involves setting up an investment fund (sovereign wealth fund) outside the country that would release a steady flow of cash consistent with the level that can be absorbed without major distortions, through exchange rate effects on resource allocations and on production. There are many examples of successful and failed cases of wealth funds. While the Norwegian fund is often cited as a success story, the circumstances of its creation and the environment in which it operates do not make it readily applicable to Sierra Leone. At the same time the Chad fund set up by the World Bank failed to meet expectations, and the reasons can equally be found in present-day Sierra Leone. The Trinidad Heritage and Stabilisation fund could provide some useful lessons. Sierra Leone should attempt this option with caution.

It is argued (Dunning 2008) that one way to avoid some of the negative outcomes associated with the resource curse is to transfer cash directly to citizens (Deverajan and Le 2010). In this case the grants will be treated as income and therefore subject to taxation. Advantages include improved income distribution, direct increase in household incomes, and of course political gains for the ruling government. The downside is the loss of (lump sum payments by mining companies) revenues for infrastructural development. Although direct cash transfers is practiced in some developing countries including post-conflict countries (e.g. Timor Leste), the political and economic environment in a country determines the success or failure of this approach.

Whatever option(s) are selected, Sierra Leoneans must be given an opportunity to discuss and understand the various implications.

12.9 Socio-political Effects

As was the case for the Marampa mines, which transformed an area populated by a few villages to a bustling mining town in the 1930s, so will the current mining operations transform Tonkolili, Port Loko and Bombali areas within the next few years. Migration of unskilled labour to these areas in search of jobs will lead to urbanization and possible loss of agricultural labour in other parts of the north.[39] Food shortages and poorly supplied social services in the opened up areas could turn them to politically tense and socially explosive areas. There is already some evidence of this happening in the recent upheavals in Lunsar (London Mining), and the mining operations of the African Minerals company. It would not be far-fetched to imagine the area becoming the new Kono[40] of the country, within the next five years. Although the country is small and minerals are widely distributed in various parts of the country – petroleum in the south, iron ore in the north and south, rutile in the south, gold in the north-east and south, diamonds in the east – regional tensions due to distribution of wealth from minerals should not be ruled out.

Even more importantly, inappropriate management of the windfalls from the iron ore operations in Sierra Leone will produce negative effects that could alter the country's socio-political landscape. As revenues flow in, there will be big winners, but the majority of the population will gain nothing in the initial phases. Income inequalities will rise, and there will be a rapid increase in income levels in Tonkolili, Port Loko and Bombali – the districts surrounding the mines. The net effect would be positive if the migration is really a movement of the unemployed urban youths to the new areas where jobs are available.

In the long run and depending on the market for iron ore, unless there is accompanying infrastructure development in the form of roads, schools, clinics, water supply, markets, energy supply, etc., combined with alternative livelihoods, the area will be littered with ghost towns 50 years on, as was the case for Pepel and Marampa.

An alarming threat is the possibility of state capture. When only one or two companies dominate the economic landscape of the country, the owners very quickly begin to control and dictate the affairs of state using the power of the purse to secure even more concessions, influence key appointments, manipulate the justice system, compromise the role of the legislature, and finally control the political process. The experience of the past 18 months when the agreements of the two companies with major stakes were adopted by parliament (and, in one case, unanimously after parliament was recalled

[39] This is part of the Dutch disease syndrome, involving movement of labour from certain sectors to others leaving acute shortages and decline in production. In Sierra Leone labour shortages are already taking their toll in the new large farms with absentee owners. Even in the services sector, semi-skilled labour is now moving towards these new areas where higher salaries are available.

[40] Kono is the area where alluvial diamond mining flourished accompanied by a high level of crime. Skirmishes among rival diggers were rampant in the early years.

from recess), is a reminder of the remark of former President Siaka Stevens after a failed coup: 'eternal vigilance is the price we have to pay for our liberty.'[41] Fortunately, both agreements are being revisited upon the instruction of the current President Ernest Bai Koroma. A renegotiation of course never produces outcomes as good as new negotiations. In these cases as the companies make progress in developing the mines; the phenomenon of state capture makes it even more difficult to alter the bad provisions in the initial agreements. Very strong resistance can be expected using 'insiders'. The implementation of the government's policy in this regard will be the first real test of the commitment of the leadership to maintain control of the economy and take a radical departure from the past.

This phenomenon of state capture should not be underestimated. The country must be watchful of coup d'états in different forms. The leadership must indeed be vigilant and empowered to confront these dangers, and civil society must remain objective and continue to alert the citizenry of the lurking menace.

Government participation in the equity of a company is increasingly debated in official circles. It is sometimes argued that the state must 'own' part or all of the company that exploits one of its natural assets, not only to obtain some of the profits generated, but also to ensure that its interests are preserved when decisions with potentially significant repercussions for the economy are taken. Botswana is often cited as a case where the state participates in the decisions of the diamond mining company Debswana, and thus enjoys part of the profits generated by the company, without the former abdicating its regulatory role.

Sierra Leone's experience in this area so far has been disastrous.[42] The acquisition of 51% stake in the diamond mining company in 1970 benefited a private businessman and contributed to the disintegration of the sector (Kargbo 2011). Similarly the ownership of shares in Sierra Rutile has not been of any benefit to the country; on the contrary, this has meant the loss of much needed taxes for the treasury. Inevitably, equity participation gives rise to political interference and clever manipulation of share volumes diluting the government's share. This practice is therefore strongly discouraged, particularly at this time in the country's evolution where weak institutions and capacities prevail against a background of widely reported corruption nurtured by informal networks. The benefits of ownership can be better obtained by inserting specific provisions in the mining agreement targeting the gains sought by free equity participation.

The lessons of Kono (diamonds) and Marampa/Pepel (iron ore) are the most obvious evidence of the consequences of no, or poor, planning before and during the boom years. Proper planning for alternative livelihoods that will be independent of, and complementary to, the mining sector would have produced different results. In the past, alternative livelihoods were conceived

[41] The original quote is attributed to Andrew Jackson's farewell address in 1837.

[42] The picture outside the mining sector is the same; almost all state-owned entities operate at a loss.

as jobs linked to, or supporting, the mining sector rather than being quasi-independent of the mining sector. When the mines close, such jobs inevitably end as well. However less mining-dependent alternative livelihoods would continue even after the closure of the mines. The north of the country is an area with potential for agricultural activities. It is essential, therefore, that alternative livelihoods be designed around agro-industrial production.[43]

12.10 Conclusions

The extraction of iron ore has the potential to transform the country in the next two decades, only if the right policy choices are made now, the right balance is struck between short-term needs and longer-term goals, and if the difficult decisions are taken on the newly assigned licenses. The iron ore industry in Sierra Leone will have to be developed as an integral part of the development of the economy, and not be allowed to become an enclave, as was the case in the past. To achieve this, the mining operations surrounding the exploitation by various investors must be the result of a comprehensive plan, including carefully negotiated agreements, structured organization of local small businesses in order that the country participates as much as possible in the supply and value addition process both now and in the long term.

Accepting the government's objective to secure optimal benefits from the exploitation of iron ore deposits, the preceding sections have revealed some of the shortcomings of past policies in Sierra Leone. In turn these have provided useful pointers to what should be addressed early on, now, as well as what should be avoided.

A clear lesson that emerges is the importance of careful planning and preparation by the national authorities in order to glean the maximum contribution from the mineral resource to long-term sustainable development of the country.

The current desperate economic conditions of the country have been used to justify the dominance of short-term considerations in decision-making, chief of which is the need for immediate revenues.[44] This is shortsighted and puts at risk the greater longer-term goal of optimal gains from the sector. Although the boost to national revenues is important, the optimum gains from iron ore production are to be realized by carefully managing the totality of its contributions to the overall development of the country.

The government has recently launched a major reform of the mining sector. Its success would require correct choices on policy, institutions, and mechanisms – in particular for human resources development – being adopted as part of the development planning process.

[43] The government may also consider allocating a small percentage of revenues from mining to be used specifically for encouraging alternate agro-industrial activities. The diversification of the economy is critical for sustainability but often only receives lip service.

[44] Paradoxically, there is an unexplained readiness to grant overgenerous concessions.

Finally, there should a concerted attempt to avoid doing business as usual. The current systems in place for negotiating agreements and managing revenues are now being revisited for greater efficiency and effectiveness. Public disclosure can be an important instrument for this purpose and for reducing corruption. All agreements, licenses and payments by mining companies should be put in the public domain. Ultimately success requires all stakeholders, particularly those in charge of the minerals sector, to approach their tasks differently, be prepared for bold new measures and not be compromised by grandiose promises by mine operators. The mining sector cannot be left on autopilot; instead it must be driven by, put at the forefront of, and be integrated with, the government's transformation agenda. A start has been made at the level of contract negotiations. Now attention must turn to the management of the contracts, and of the finances flowing from it into the economy.

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Part V

Governance and Social Services

Chapter 13

IMPROVING THE JUSTICE SECTOR: LAW AND INSTITUTION-BUILDING IN SIERRA LEONE

By Alaina Varvaloucas, Simeon Koroma, Momo Turay and Bilal Siddiqi

13.1 Introduction

Efficient, fair and low-cost legal systems can have a variety of positive effects. The legal system regulates personal actions and economic transactions, with the aim of resolving disputes, enforcing rules of conduct, providing certainty to economic actors and 'justice' to citizens. In providing quick and cheap resolution of welfare- and productivity-reducing disputes, an effective legal system can have direct economic impacts. Any private sector or public sector initiative is ultimately subject to the rules and procedures specified by the legal system. Improving the justice sector in this way can lead not only to enhanced safety and less crime, but to efficient regulation of business activity, an environment more conducive to entrepreneurship, and overall growth.

13.1.1 Legal Institutions and Economic Development

In the macro picture, the impact of strong legal institutions on economic growth and development has been widely explored in the cross-country literature, under the popular label of 'institutions' (North 1981, 1990; La Porta *et al.* 1997, 1998, 1999; Acemoglu *et al.* 2001; Rodrik *et al.* 2004; Acemoglu and

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Johnson 2005; La Porta *et al.* 2008) or 'governance' (Kaufmann and Kraay 2002). North (1981, 1990) famously posited that the enforcement of contract law and property rights made nineteenth-century growth in England possible, spawning a range of literature. An influential paper by Acemoglu *et al.* (2001) argued that cross-country variance in growth can be explained by such property rights institutions, and showed that one standard deviation increase in protection against expropriation risk triples gross domestic product (GDP) per worker. There has been some debate about the IV techniques used in Acemoglu *et al.* (2001), however, and thus the usefulness of the results. Glaeser *et al.* (2004), for instance, argue that human capital is more crucial to growth than institutions are, and that poor countries often grow through policies implemented by dictators, only improving their institutions after periods of economic development.

Recent micro research has also explored various kinds of regulatory or institutional reform (see Pande and Udry 2006) and found positive impacts on a host of economic variables such as credit use (Castelar Pinheiro *et al.* 2001; Japelli *et al.* 2005), debt recovery (Visaria 2006), and entrepreneurship and investment (Chemin 2007). For example, Chemin (2007) uses a difference-in-difference analysis to prove that a new legal reform in Pakistan reduced the time a case spent in court, which in turn triggered an increase in entrepreneurship and influenced people to take out loans. Similarly, Visaria (2006) exploits variation in the spread of debt tribunals in India to show that tribunal establishment reduced loan repayment delinquency by 3–10%. Besley and Burgess (2004) and Field (2003) find similar impacts of labour regulations in India and land titling in Peru, respectively.

Weak legal institutions and lack of 'access to justice' disproportionately affects the poorest and most vulnerable members of society (UNCLEP 2008), who tend to have little bargaining power in the customary justice system (Kane *et al.* 2005; Sandefur and Siddiqi 2011), little knowledge of their legal rights (e.g. McLaughlin and Perdana 2010), and few resources with which to meet the high financial and social costs of accessing the formal system (e.g. Manning 2009a). For example, Deininger and Castagnini (2004) show in the case of Uganda that land conflict most severely affected female-headed households and widows. Interventions to strengthen legal institutions and improve 'access to justice' are therefore likely to have a pro-poor impact.

Finally, legal institutions also play a key role in strengthening the state structures, improving accountability, and, in a fragile state context, preventing localized grievances from evolving into mass conflict. Few examples are better than the civil war in Sierra Leone, which according to the country's Truth and Reconciliation Commission (TRC) had its roots in decades of sustained bad governance that eroded the tenets of justice and made the populace lose confidence in the justice sector's ability to resolve disputes – pushing many to take the law into their own hands. In most instances, both the formal and customary systems meted out heavy-handed and arbitrary justice (Kane *et al.* 2005; TRC 2007).

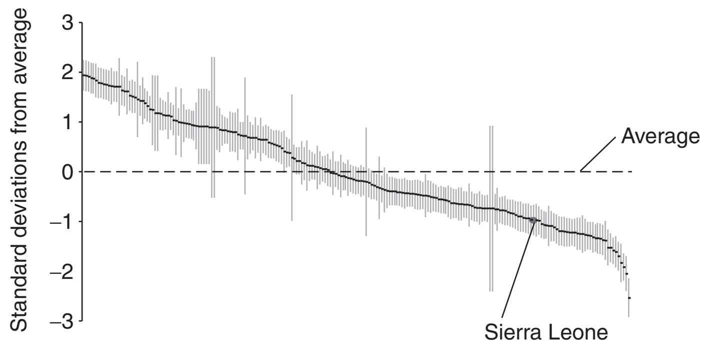

FIGURE 13.1. Global governance indicators: rule of law. *Source*: authors, using Kaufmann and Kraay (2010) Aggregate Governance Indicators data set.

13.1.2 Governance and Growth

A useful overall picture of the relationship between economic growth and governance has been provided by Kaufmann *et al.* (2002, 2004, 2010a,b), who find robust positive relationships between good governance and per capita income for a sample of 175 countries. They develop perceptions-based indices for each of six governance 'clusters': voice and accountability, political stability, government effectiveness, regulatory quality, rule of law, and control of corruption. The last two are most relevant to the discussion here. The rule of law cluster includes indicators for predictability of the judiciary, the enforceability of contracts, and perceptions of the rate of violent and non-violent crime, all of which can measure success in providing a fair and just environment for economic interactions to occur. The control of corruption cluster includes indicators for political or elite corruption, having to pay bribes to complete tasks, and the ease of conducting above-board business. Kaufmann and Kraay focus on presenting correlations, but stop short of making causal inferences. However, others have since used their measures to establish the causal relationship between governance and growth. For example, Rodrik *et al.* (2004) use the 2000/01 rule of law index developed by Kaufmann *et al.* (2002) to show that a one standard deviation increase in rule of law doubles per-capita GDP, controlling for distance from the equator.

The data from Kaufmann *et al.* has important implications for a country like Sierra Leone. Sierra Leone falls nearly one standard deviation below the average in both rule of law and control of corruption (Figures 13.1 and 13.2), ranking 17th from the bottom in rule of law (at 176) and 16th from the bottom in control of corruption (at 177). Ghana and Uganda, two countries whose justice sectors are commonly compared to Sierra Leone, both rank well ahead in the rule of law cluster at 103 and 130, with Liberia a few ranks behind Sierra Leone at 183. In the corruption cluster, Sierra Leone ranks last of the four at 177, behind Uganda at 166, Liberia at 139 and Ghana at 86 (Kaufmann and Kraay 2010).

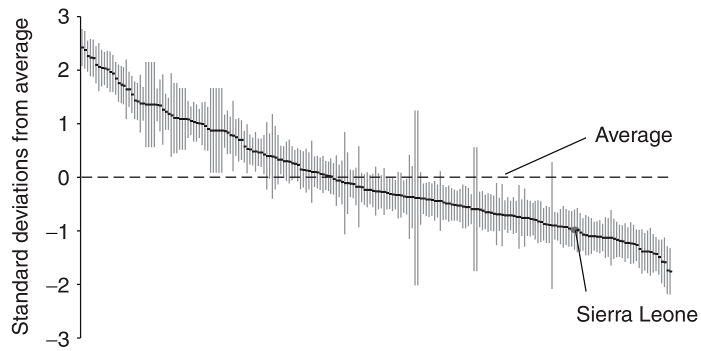

FIGURE 13.2. Global governance indicators: control of corruption. *Source*: authors, using Kaufmann and Kraay (2010) Aggregate Governance Indicators data set.

Weak legal institutions contributed to Sierra Leone's war (TRC 2007). Conversely, while conflict had a profound impact on all sectors in Sierra Leone, the justice sector was particularly affected. Crime incidence rose dramatically as courthouses and police stations were destroyed. In a 2005 national household survey conducted by the Institutional Reform and Capacity Building Project (IRCBP) and Statistics Sierra Leone (SSL), 68% of respondents said that someone in their community had died during the war, and 47% that community members had been injured (Bellows and Miguel 2006). Sierra Leone is now far safer and more stable than it was before, but the country still suffers from crushing poverty, with US$367 GDP per capita in 2010 and a 2010 ranking of 158 on the Human Development Index (IMF 2010; UNDP 2010). Still a post-conflict nation only a decade out of civil war and one of the poorest countries in the world, Sierra Leone's justice sector is grossly under-resourced and operates on a limited capacity.

Sierra Leone has a dualistic legal structure, incorporating both a formal system rooted in British common law and a customary system based on traditional or customary law into its justice sector. In practice, the formal system remains difficult to access, slow to respond and alien to most Sierra Leoneans, while the customary system is autocratic, somewhat arbitrary, and generally biased towards males, elders and local elites (Kane *et al.* 2005; Dale 2007; Manning 2009a,b).

This chapter will focus on both the formal and customary legal systems. We argue that justice sector reform is most effective if reforms are implemented in both systems, rather than prioritizing the formal over the customary as is the case today. We do not imply that either the formal or the customary system is 'better', 'more efficient', or 'more just' than the other, but rather that the two systems together serve the populace and require equal attention so that they form an effective complement to each other. Further, we argue that development initiatives – projects in any sector, such as health, education, or infrastructure – which respect the customary system will receive more buy-in from local leaders, whose influence would curry favour for such projects amongst their communities. This makes the projects' ultimate goals easier to achieve.

We also highlight issues specific to each system, and argue that policies to promote growth and development should target these 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. We 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.

Section 13.2 begins with a history of Sierra Leone's dualistic legal sector and the present state of the formal and customary systems. Section 13.3 then goes into further detail about the structural and situational inefficiencies in each system and how they inhibit social and economic development. Finally, we discuss policy recommendations and how to achieve complementarity between the two systems, arguing in Section 13.4 that complementarity will help maximize the justice sector's positive effect on Sierra Leone's growth and social progress. Section 13.5 concludes.

13.2 Context: Justice in Sierra Leone

13.2.1 Overview

Sierra Leone is divided into 13 districts. The Western Area, one of the 13, includes the capital, Freetown, and the rural areas around Freetown. The other 12 are predominantly rural. The 13 districts are subdivided into 149 chiefdoms administered by local government. Paramount Chiefs are in charge of each chiefdom, while town or village chiefs are in charge of individual towns and villages. Section chiefs sometimes preside over small groups of villages.

Sierra Leone's dualistic legal structure is split between a formal legal system overseen by the judiciary arm of government and a customary system supervised by the Ministry of Local Government under the executive branch. The formal system has sole jurisdiction in Freetown and, in the Provinces, must be used for serious crimes punishable by lengthy jail terms or monetary disputes involving large sums of money. As a result, most business disputes – such as conflicts over large pieces of land, labour cases, adjudications involving diamond and other natural resource companies – are generally handled in the formal system as civil cases. This system is overseen by magistrates and judges, and cases are argued by lawyers trained in regular law schools. Criminal cases are governed by the Criminal Procedures Act of 1965.

The customary system is split into two types of general forums. The first, local courts, are a mix between the formal and customary; while they follow customary laws, their setup and process mimics a magistrate's court in many ways. Local courts are run by local court chairmen, clerks, and chiefdom police. They are responsible for minor disputes such as marriages, divorces, hostile verbal exchanges, land, debt, and minor altercations. They can handle criminal disputes whose punishments are less than 6 months in jail or Le 250,000 (approximately US$50) in fines (now Le 50,000 after the passing of a new bill). Lawyers do not participate in the local court process, only court chairmen who hear cases and render judgements using customary law. Dissatisfied disputants can appeal their cases to a District Appeals Court or the Customary Law Officer, whose job it is to oversee local courts and act as a forum for judicial review. After a recent amendment to the Local Courts Act of 1963, the legislation which originally legalized local courts as a forum for dispute resolution, the Chief Justice will now appoint the chairmen.

The second type of forum in the customary system comprises a large range of actors who mediate and adjudicate cases. These include village chiefs, section chiefs and respected elders. Under the Local Courts Act (LCA) of 1963, they cannot advertise themselves as a court, and their decisions are not legally binding, but they can hear cases if the disputants voluntarily present them for intercession (GoSL 1963). Such cases might include family matters, domestic violence, debts, neighbourly disputes, or the minor thefts of crops or small animals. Dissatisfied disputants might then approach the local courts. Chiefs and elders come into their roles in a variety of ways – either by influence through secret societies, election, lineage, or respect for certain knowledge about tradition.

13.2.2 Origins

The foundation of Sierra Leone's current dual legal system was laid in 1896, when the colonial British government signed the Protectorate Declaration with local chiefs in what is now known as the Provinces. The 1896 Proclamation was the first attempt to unify the territory that is now Sierra Leone. Legal dualism had existed informally before 1896, but the Proclamation formalized the structure, leading to the official division of the justice system into two parts: a formal system instituting mostly British common law and statutes, and a customary system based on traditional law and courts run by paramount chiefs. The former was effective in the 'colony' – covering present-day Freetown and its rural environs, called the Western Area. The latter was used outside the 'colony', among locals in the Protectorate (now Sierra Leone's Provinces). As they traditionally had, chiefs continued to wield political, judicial, and legislative authority over their people. However, chiefs were no longer held accountable by their subjects, but rather by the British, who would increase or reduce a chief's territory 'in a bid to reward loyal chiefs and punish recalcitrant ones' (Koroma 2011). Chiefs were able to become more authoritarian and even rule for life (Abraham 1978).

13.2.3 Independence

After independence, the new government of Sierra Leone continued using British common law and statutory law, as the colonial government had. In 1963, two years after independence, the Local Courts Act of 1963 was passed, governing customary law in the Provinces. The LCA repealed the paramount chiefs' courts, now mandating that a paramount chief nominate a local court chairman to oversee the local courts. While the authority of village and section chiefs were not recognized by the government as legally binding, chiefs continued to adjudicate cases in their communities, as they had before colonialism and as they continue to do today. Similar systems exist in other African countries formerly ruled by the British, such as Ghana, Uganda, Kenya, and Zimbabwe.

13.2.4 Civil War

During the nation's civil war from 1991 to 2002, the rule of law in Sierra Leone crumbled, with the formal system almost ceasing to function (TRC 2007). Law enforcement personnel were targeted by rebel groups; over 900 members of the Sierra Leone police (SLP) were murdered during the war, 300 in the invasion of Freetown alone (Baker 2005). Though rural Sierra Leoneans had never relied on the formal system, now the customary system became even more important in dispensing with disputes. As a large percentage of the rural population became displaced or uprooted due to fighting, traditional justice in the Provinces also fell apart, leaving Sierra Leone without any kind of coherent justice system.

13.2.5 International Justice and the Special Court

Following the cessation of hostilities and the advent of peace, Sierra Leone, with the help of the international community, created two judicial bodies designed to process acts of atrocity committed during the conflict. The Truth and Reconciliation Commission (TRC), which had no authority to prosecute perpetrators, travelled to 12 districts in Sierra Leone hearing the testimonials of both victims and perpetrators and encouraging fractured communities to come together once more as a way of understanding the causes of the conflict, consolidating peace, and fostering democratic governance. The Special Court, a hybrid international court jointly set up by Sierra Leone and the United Nations (UN), indicted 13 men it deemed most responsible for the prolonged violence, including former Liberian President Charles Taylor, spending millions of dollars in the process. Both bodies were important in fighting impunity, symbolically restoring the rule of law to Sierra Leone, and bestowing a sense of closure to many citizens. However, it is beyond the capacity of both institutions to have any significant impact on the domestic justice sector. Yet, over US$22 million, not including defence attorneys, translators, investigations, or detention halls, was budgeted for the first operational year of the Special Court (Scharf 2000). By 2012, it had spent US$175 million on the trials in Freetown and US$250 million on Charles Taylor's trial (Waugh 2012; Special Court 2012), while the Ministry of Finance only spends US$8–10 million each year on the police, prisons, and courts combined (MoFED 2011). While the TRC and Special Court has featured prominently in international media and policy discourse, the domestic justice sector, far more relevant to the life of the average Sierra Leonean, is rarely discussed, although some effort has been made by organizations such as the UK Department for International Development (DFID), the United Nations Development Programme (UNDP), and the Open Society Justice Initiative (OSJI) to support justice sector reform.

13.2.6 The TRC Report

One important legacy of the TRC was a report that highlighted deficiencies such as bad governance, an unfair justice system, and gross human rights violations in the prewar government, grievances commonly cited as the reason for the anger and disillusionment that drove Sierra Leoneans to violence. As part of the report, the TRC also listed key policy concerns for the now post-conflict nation. The TRC suggested drastic improvements in the justice sector, as corruption and injustice were cited as underlying causes for the war (TRC 2007). Since the advent of peace, the democratically elected government in Sierra Leone, with strong support from international donors, has strived to strengthen the rule of law by expanding the reach of the formal legal system and promulgating progressive new legislation. Partly as a result of the TRC's recommendations, vast resources were poured into the formal system by DFID, the UNDP, the World Bank, the International Rescue Committee (IRC), and other international organizations in an effort to create a more efficient, just, accessible, and accountable judicial system.

13.2.7 Recent Developments

In recent years, policymakers in the justice sector have been experimenting with a range of policy interventions designed to improve service delivery. The police service has been revamped – trained in crowd control, human rights, arrest procedure, and largely stripped of any weapons. Courthouses destroyed during the war were rebuilt. To increase access to the formal system for rural Sierra Leoneans, many up-country magistrates were made mobile, travelling to multiple towns to hear cases rather than sitting permanently in only one central location. In some areas, witness support funds facilitate witness appearances at trials. Special procedural rules were created for vulnerable groups, including juveniles. To disperse power, the World Bank pushed a decentralization initiative which gave authority to district and chiefdom governments. The country's first Anti-Corruption Commission was created in 2000, and in 2008, was granted the power to prosecute without prior approval from the Attorney General.

But still, the pace of reform since the end of the war has been slow, especially for areas of the justice sector not directly related to security. This can be attributed to the ollowing.

Urgency

After the war, the government, the international community, and Sierra Leoneans themselves largely focused on urgent issues of security and resettlement. People's primary concerns were for their personal safety and food security, and justice reform was a secondary, if not tertiary, goal. Now that Sierra Leone has enjoyed peace and stability for a number of years, there is a greater push for justice sector reform, especially given how institutional failure in the past had helped lead to war.

But though the pace of reform is faster now and the country's priority has reorientated more toward development rather than immediate conflict recovery and prevention, there is still a greater focus on topics such as roads, schools, health, and drug trafficking. While some reforms receive international support and other proposed laws are dealt with in a timely manner because they have economic implications, swift legal reform is generally not considered imperative to the immediate needs of the nation. The Ministry of Finance awards the justice sector – including police, prisons, and courts – well below 1% of its annual budget, with one employee stating that justice was far from one of the ministry's top priorities (MoFED 2011). In comparison, the world average from 1988 to 2000 for policing alone was almost 1%, with Malawi spending about 1.1% and South Africa 1.9% (Shaw *et al.* 2003). Sierra Leone's former colonial power, the United Kingdom, allocates about 5% of public spending to its justice sector each year (NGRF 2010).

Pressure

Without domestic or international political pressure, bills can take years to pass into law. Of bills that have been pushed into law relatively quickly in recent years, most, if not all, of them have been pushed through parliament by an outside influence. The creation of the Anti-Corruption Commission was aided by DFID and supported heavily by the then-president; an anti-trafficking bill was strongly supported by the United States; the creation of the Special Court and a child rights bill was supported by the United Nations; and after cocaine consignments were discovered in 2009 there was huge international interest in the passing of a drug bill. Other laws such as gender bills and the registration of customary marriage also had a great amount of international support.

While justice sector reform is certainly supported by international organizations – the Justice Sector Development Programme (JSDP), the UNDP – as well as domestic organizations such as Timap for Justice, the same political pressure does not exist as it does for human trafficking or drugs. While the active participation of these organizations likely abets the speed at which reforms are passed, more international pressure and domestic interest, especially from parliamentarians, would probably achieve faster results.

Capacity

Sierra Leone is still a post-conflict state. Given that most institutions were destroyed during the war, Sierra Leone has had to build capacity and recreate structures that allow processes to move smoothly. This means allowing for missteps and time to work out the most efficient ways of doing things. There are a series of steps involved in passing a law through parliament. The bill needs to be drafted, made into a cabinet paper, and then passed through a parliamentary committee. This requires manpower. Currently there is a shortage of draftsmen in the Ministry of Justice, and a slew of people are required to create the cabinet paper. Once the law is passed, it requires further manpower to broadcast the changes in law around the country, to train officials, and to ensure the law is being followed.

Moreover, many of those in government do not have the desire to focus on the justice sector either because they have no background in it, they consider it of secondary importance, they have not been briefed on its importance, or they have political or economic interests in not passing reforms. For instance, the Ministry of Local Government stood to lose a lot in the recent passing of a new Local Courts Bill, which considerably reduced its authority over the local courts.

13.3 Structural Deficiencies in Formal and Customary Justice

13.3.1 The Formal System

Figure 13.3 is a simple representation of the causes, outcomes, and effects of problems in the formal justice sector. The middle column, 'Outcomes', lists the main types of issues found in the formal system: delays, corruption, and poor implementation of laws, procedures, and public services. The column on the right, 'Effects', lists the social, political and economic effects of these problems. The column on the left, 'Causes', lists the causes of the outcomes in the middle column. Policies targeted at the issues listed in the 'Causes' column would have a domino effect, reducing the negative effects listed in the 'Effects' column by improving 'Outcomes'. For instance, a new policy addressing inadequate monitoring of officials, a 'Cause', could reduce corruption, an 'Outcome', and therefore reduce money wasted by individuals utilizing the formal system, an 'Effect'.

The flowchart is broadly representative of negative aspects of the formal system, namely, that it is slow, rigid, expensive, at times outdated, and difficult to access for most citizens, especially the rural poor – all concerns the customary system purports to address. At the same time the formal sector provides a set

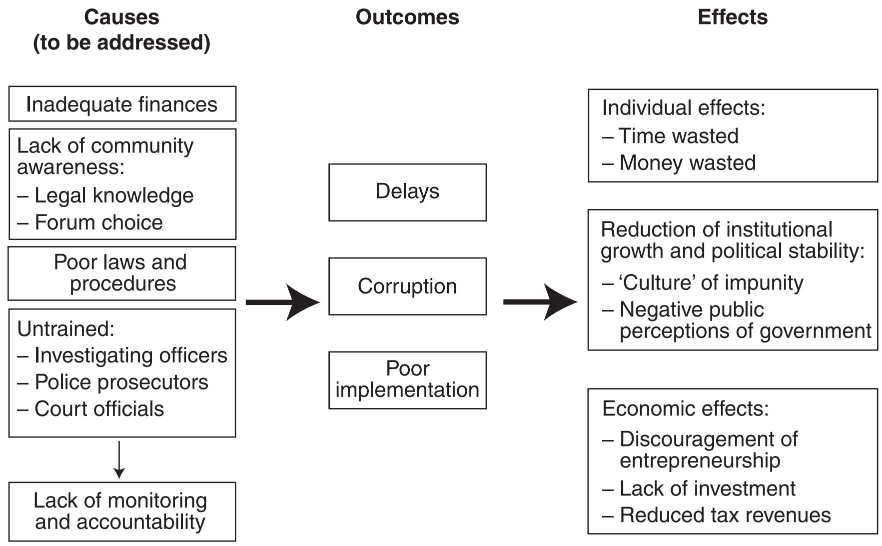

FIGURE 13.3. Causes, outcomes and effects of problems in the formal justice sector. *Source*: authors.

of written procedures to follow which, if they were created and implemented properly, could form the base for a justice system that equalizes each individual regardless of gender, age, or status. The following section illustrates how to ameliorate the problems in the formal justice system by describing in detail the middle and right columns of the flowchart and then suggesting policy changes based on the left column.

Delays

One of the principal problems facing the formal justice system is the excessive delays that occur in case processing. Delays in case processing occur both at police stations and in courts, but court delays tend to be more extensive and ubiquitous. They also have larger ramifications for involved parties and the efficiency of the system as a whole.

Delays in the police. When a person is arrested, by law he or she can only be held for 3 days for minor crimes and 10 days for major crimes before being officially charged and sent to court. In the police, this '3–10 day rule' is often ignored for a variety of reasons:

1. court delays or weekends, during which the courts do not sit;
2. cautionary reasons such as a concern for public safety, evidentiary integrity, or to wait for the completion of a police investigation;
3. petty extortion.

TABLE 13.1. Detention times.

	Non-felonious		Felonious	
Days	Number	%	Number	%
0–3	2,728	77	—	—
3–10	814	23	1,130	99
+10	20	1	16	1
Total	3,562	—	1,146	—

Source: CSAE 2010b. The first column presents detention times, while the remaining columns present the number of interview respondents falling into each category of crime.

Twenty-four percent of people arrested for non-felonious crimes are kept longer than the 3-day rule, as shown in Table 13.1, taken from a Centre for the Study of African Economies (CSAE) 2010 survey (CSAE 2010b). The survey involved a two-month daily roll call in 18 up-country police stations, during which researchers tracked the time each detainee spent in police detention.

Case overload in courts. Due to a lack of finances for building new courthouses and for salaries for new magistrates and judges, magistrates' courts only sit permanently in some major towns. In the rest of Sierra Leone's 12 districts, the magistrates' courts are circuit courts, meaning they are mobile and travel from a central town – usually a provincial or district headquarter – to smaller surrounding towns which do not have their own courts. The High Court is also a circuit court. These trips rarely go according to a schedule due to logistical constraints.

Because civil matters, business disputes, minor criminal matters and High Court referrals for major crimes are heard in magistrate's courts, there is an overload of cases in both sitting and circuit courts. Even one day's delay can create a backlog of cases that continues for months. The High Court, which hears major crimes, is also overburdened, as it is a circuit court. When logistical problems with circuit courts are combined with already busy case schedules, the case overload problem is exacerbated. Any delay in one town visited by a circuit court can cause delays in the next town, which in turn causes a delay in the next.

Adjournments. Another key reason for case delay is the high frequency of adjournments due to the unavailability of witnesses, lawyers or prosecutors being absent, the accused or the complainant failing to appear, magistrates arbitrarily refusing to hear a case, or incorrect charges levied by the police.

More often than not, magistrates adjourn such incomplete cases rather than dismiss them. In a CSAE court survey conducted from August to October 2010 in 10 up-country magistrates' courts, 89% of criminal cases were adjourned for the reasons listed in Table 13.2. Importantly, these statistics are only for criminal cases – a number of civil cases were heard or adjourned as well, for which survey data is not available.

TABLE 13.2. Reasons for court cases being adjourned, August–October 2012.

Primary reason	Adjournments: Number	Adjournments: %
Accused absent	506	11
Complainant absent	632	14
Complainant dropped	2	0
Insufficient evidence	307	7
Judgement given	19	0
Magistrate refuses case	315	7
Prosecution absent	23	1
Representation absent	52	1
Too many previous adjournments	10	0
Witness absent, exhibit absent	1,512	33
Other	1,174	26
Total	4,553	

Source: CSAE 2010a; Sandefur *et al.* 2011b.

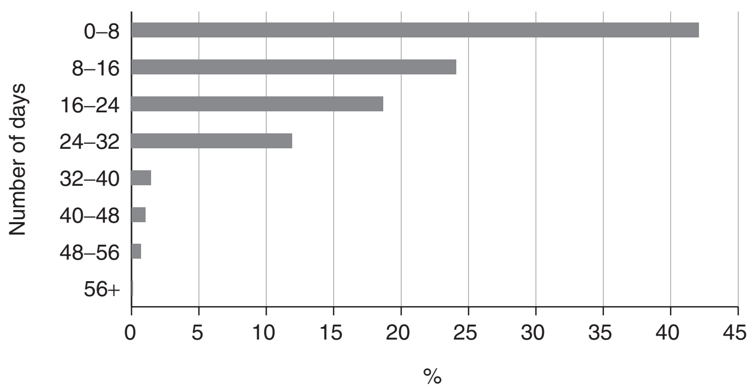

FIGURE 13.4. Days between adjournments.
Source: CSAE 2010a; Sandefur *et al.* 2011b.

While many cases are heard again within a week, Figure 13.4 indicates that, for the majority of cases, more than eight days go by before a case is called again.

A CSAE survey of prisoners in six up-country prisons showed that 6.7% of the total sample of 890 inmates on remand had had more than eleven adjournments (Figure 13.5). Given the average number of days between adjournments of 13.5, taken from Figure 13.4, such remand inmates can be in prison for months awaiting a decision for even minor crimes such as petty theft or loitering. Civil cases can also take months to be resolved, although the rate of adjournment is likely lower due to a more lenient burden of proof.

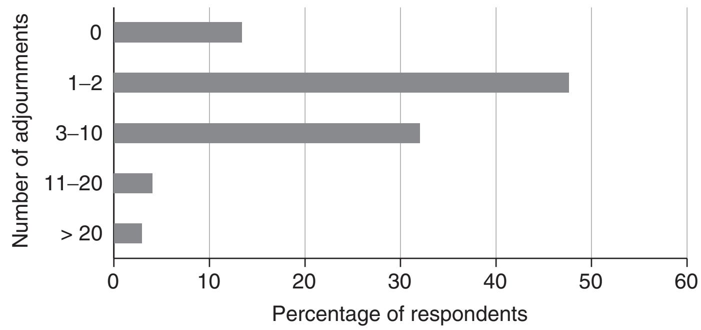

FIGURE 13.5. Court adjournments. *Source*: CSAE 2010a; Sandefur *et al.* 2011b.

TABLE 13.3. Bribes paid to police.

	Percentage who paid a bribe	Amount range	Average	Observations
Complainant	36	10,000–85,000	21,736	957
Detainee (in cells)	62	2,000–6,000,000	28,667	3,349

Source: CSAE 2010b,d. *Note*: Le 4,000 = US$1.

Corruption

Police. Corruption is rampant within the formal system, especially simple bribe-seeking by police and court officials. As shown in Table 13.3, CSAE surveys indicate that 62% of those in police detention in 18 sampled sites across Sierra Leone had to pay a bribe to the police, ranging from Le 2,000 (US$0.50) to Le 6,000,000 (US$1,500). Moreover, these figures are likely an underestimate due to fears of reporting corruption. The bribes were for many reasons: favourable statement-taking, food, contacting family members or sureties, bail, or even release. The CSAE survey evidence suggests that complainants, too, must pay money to the police when they report a case, with 36% of respondents reporting bribes paid in the range of Le 10,000 (US$2.50) to Le 85,000 (US$21.25).

Researchers at CSAE also note several instances where a person has been arrested and threatened with detention or being charged to court regardless of whether that person has committed a crime. In these cases, the written reason for arrest is most often 'loitering' or some sort of traffic offence. While there is no clear evidence that such charges are fabricated, the low burden of proof required for arrest and detention for such 'minor' crimes allows for an arbitrary and selective application of the law, with bribe-seeking as an obvious objective.

Courts. CSAE qualitative interviews of police, prison, and court officials revealed that court clerks often accept bribes to move a person's case to the top of a magistrate's daily case list, and can even prevent a case from being heard until a kind of ransom has been paid. The Anti-Corruption Commission has recently prosecuted a magistrate on charges of corruption, and a small number of judges have been suspended pending an investigation into alleged corrupt activities.

Poor Implementation

Capacity. Many investigating officers do not fully understand evidentiary burdens or how to assign an official charge to a case. Cases are sometimes charged to court with little evidence to back them up. In other examples, cases are charged to court with the wrong charge attached to them, which makes them difficult to prosecute. Both instances take up valuable time in a magistrate's court. Police prosecutors, who are generally not lawyers but who prosecute cases for the state in court, also end up delaying cases by being unprepared, not ensuring the appearance of witnesses or complainants, or by not understanding which cases should be pressed for prosecution and which should just be dropped. These misunderstandings are exacerbated by poor communication between police prosecutors and the Director of Public Prosecutions Office (DPP), which oversees prosecutions around the country.

Lost in the system. Few Sierra Leoneans know their basic rights under the Constitution or the Criminal Procedures Act (CPA) of 1965, much less the intricacies of sureties, bail, and pre-trial detention. Sixty-five percent of detainees from a 2009 CSAE Detainee Survey said they did not know how long they could be held before being charged to court, while 40% did not know if their charge was bailable (CSAE 2009a). In a 2010 Public Perception Survey on Bail, 75% of respondents either did not know what bail was or could not correctly describe nor understand it (JSCO 2010a).

Only 10.2% of detainees surveyed by CSAE from August–December 2009 stated that they even spoke and understood English – vital to those without lawyers since most proceedings in the formal system are conducted in English, from witness statements to court hearings (CSAE 2009a). This leaves the proper and just implementation of the law to officials, making it easy for such officials to take advantage of arrestees, or simply to ignore their rights if they are not explicitly demanded.

13.3.2 Effects

Individual

These delays in case processing have several ramifications on the time and personal resources wasted by individual parties involved in a criminal or civil dispute. Because of excessive court adjournments, detainees accused of minor crimes can be held on remand for several months, in some instances longer than their sentence would have been if they had been tried immediately. Detainees tend to be poor, so withstanding the opportunity cost of lost income due to excessive jail time is difficult.

Complainants and witnesses also face an opportunity cost of lost income for repeatedly coming to court without resolving a case, as well as the transport costs associated with travel. Complainants are often asked to pay to have their cases investigated. The overall cost of taking a case to the formal system is thus often prohibitively high, causing some victims not to report crimes.

Finally, the formal system is stacked against poor defendants. Although a police prosecutor is assigned to almost every case, defendants are not entitled to lawyers unless they can pay for one themselves, which most cannot. Without adequate representation to build and fight a case for them, most defendants end up being convicted, although most cases that come before a magistrate are adjourned. Out of 4,625 cases in the CSAE court survey, 4,188 were adjourned for another court date. Of those that were not adjourned, 137 cases were dismissed and 3 defendants were acquitted. In total, 297 defendants, or 68% of the total, were convicted. Of cases that were not dismissed and were ultimately adjudicated, the conviction rate was between 98–100% for all 6 sites (CSAE 2010a; Sandefur *et al.* 2011b).

Institutional Growth and Political Stability

Corruption and impunity. Petty corruption affects people on a personal economic level, but there are larger ramifications. When people know interacting with the police costs money, they are less likely to report crimes, even serious ones, to the police, and more likely to report them to local authorities, or not at all. Tankebe (2010) finds that vicarious experiences of police corruption in Ghana affect a person's assessment of procedural effectiveness and trustworthiness.

Constant bribery tilts the system toward those with money, or at least toward those willing to pay, further eroding public confidence in the police and formal courts. Perhaps more seriously, it also creates a 'culture of impunity' (Azfar 2006), where corruption can become an accepted, even desired, alternative to adhering to the law. Countless interactions between the citizenry and the police that an outsider may see as corruption are to an insider normal or even welcome as opposed to harsh legal fines for minor violations such as traffic offences. A 2010 National Public Perception on Corruption Survey found that though 70.8% of people found corruption and bribery to be a 'serious offence', 10.3% found it to be only a 'minor offence', 6.4% to be 'no offence', and 10.5% that bribery was an 'acceptable way of life' (JSCO 2010b). If a significant portion of the public do not see petty bribery as a serious problem, then it is unlikely corrupt officials will ever be punished.

Trust. As displayed in Table 13.4 (taken from the 2007 IRCBP National Public Services (NPS) survey data set), the percentage of people who said they 'trusted' chiefdom officials, central government officials, police, local court officials, or magistrate court officials was all below 50% (IRCBP 2007). But respondents

TABLE 13.4. Trust in various groups over time.

Group	Percentage of respondents trusting 2007	Percentage of respondents trusting 2008
Justice sector officials		
Police	36	38
Local court officials	41	***45***
Magistrate court officials	34	***37***
Other groups		
People from own community	75	74
People from outside community	36	38
Chiefdom officials	47	***51***
Local councillors	33	***49***
Central government officials	42	45
NGOs/donor projects	57	59

Source: IRCBP 2008. *Note*: figures in italics indicate significant changes since 2007.

tended to trust customary bodies more than formal bodies, specifically chiefdom officials more than central government officials ($t = 8.04$), and local court officials more than magistrate court officials ($t = 13.1$).

By the 2008 NPS survey, the numbers had somewhat changed. Figures for the police, central government officials, and NGOs increased, but only increases for local court officials, magistrate court officials, local councillors, and chiefdom officials were statistically significant.

In a country still rebuilding from a war brought about by a failure of central government, trust in formal government officials and systems is important for maintaining stability, increasing citizen involvement, collecting taxes, and delivering public services effectively. Subpar justice provision can erode trust in the government's ability to deliver in any sector, including health, education, and finance.

Business, Investment, and Tax Revenue

Negative public perceptions of the formal system also have consequences for business. With judicial slowness, the security of property rights is threatened, loan possibilities are reduced, and law and order situations threaten productivity. Chemin (2007) found that 875 civil and criminal judges in Pakistan were able to adjudicate 25% more cases due to a new reform, resulting in legal conditions conducive to business. The reform led people to uphold their contracts more often, eased access to finance, expanded rental markets, and fostered incentives for investment. When entrepreneurs believe legal issues with their businesses will be resolved quickly and fairly, they are more likely

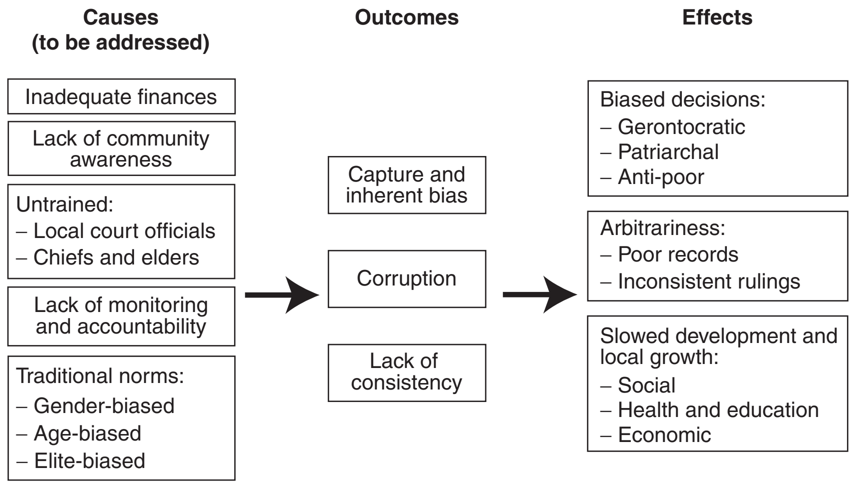

FIGURE 13.6. Causes, outcomes and effects of problems in the customary system. *Source*: authors.

to take the risk of launching a business. Chemin found that the proportion of people attempting to buy land, machinery, or other capital and applying for business permits almost tripled due to the reform. This led to a one-third increase in the number of people who went from unemployed to self-employed or employed to self-employed.

Such findings have implications for Sierra Leone, where civil and business matters can last for months with no results, or are resolved through corrupt means. Bayley (2006) finds that a legal institution's ability to control corruption can trigger higher confidence in the police or the courts. Higher confidence means a greater willingness to interact with those institutions on a daily basis, and, by extension, a greater willingness to take on the legal risks of business.

An inefficient formal legal system also has consequences for tax revenue. Business owners who know they can avoid paying hefty taxes through corrupt means without being held accountable in court have the incentive to do so, affecting the central government's ability to deliver public services. For that reason, many businesses resisted the introduction of the 2010 Goods and Services Tax, which makes it easier to pursue businesses that evade tax.

13.3.3 The Customary System

The flowchart on the customary system (see Figure 13.6) is similar in structure to the flowchart based on the formal system. The middle column displays the three main problems, or 'outcomes', in the customary system: capture, corruption, and lack of consistency. The right column represents the negative impact of the problems, while the left lists the causes and policy targets.

The flowchart is only illustrative of problems, and does not list the positive aspects of the customary system, such as that it is cheaper because of a lack of lawyers and other expenses, easier to access because it is local, less intimidating, and everything is conducted in the the language of the immediate area (Kane *et al.* 2005; Zombo 2006). Despite being based in tradition, customary law can actually be more modern and flexible, since its interpretation tends to evolve with the community's norms and beliefs as well as current economic circumstances, while statutory laws tend to evolve slowly and to be rigidly applied. For instance, some colonial laws created in 1677 are still in effect today in Sierra Leone (Kane *et al.* 2005).

But this ability to adapt and evolve is also one of the customary system's greatest weaknesses, as it leads to uncertainty, elite capture, and a certain arbitrariness when it comes to case decisions. The following section describes the flowchart on the customary system in detail in much the same way as the previous section on the formal system.

Capture and Inherent Bias

Elitism. Due to traditional customs, chiefs and elders are seen as the most respected individuals in small communities. The orders and edicts of chiefs are rarely questioned, and in this hierarchical atmosphere nepotism and favouritism are common. Maru (2006) describes a case in which a man was fined an exorbitant amount of money for trivial reasons such as 'speaking out of turn' and his case thrown out because he was bringing his case against relatives of the paramount chief. Local court chairmen are also subject to direct political pressure by the Paramount Chief, who has the power to recommend them for appointment.

Neither customary officials nor local court chairmen can be held legally responsible for decisions rendered during their tenure. Moreover, local courts hear local cases, so it is likely that the chairman, elder, or other staff have close ties to the community, which can bias them in cases where friends, family, or influential persons are involved. Without connections, money, or both, it can be difficult to win a case if the adjudicating chief, elder, or local court chairman is not fair. Since most people do not have knowledge of avenues for appeal, the word of a local court official, elder, or chief is often final.

Women and youth. Customary law in Sierra Leone is often interpreted through the lens of traditions characterized by ageism and patriarchy (Kane *et al.* 2005; Manning 2009a,b). People become more respected the older they become, and men are more respected than women. In many areas it is accepted that men beat their wives, that women can only inherit property if they marry a relative of their deceased husband, or that special favour should be given to the party who is older (Kane *et al.* 2005). Manning (2009a,b) writes that the power balance is shifting, albeit slowly.

Corruption

Local court officials (chairmen, clerks, chiefdom police, and bailiffs) are currently being paid from the chiefdom administration coffers, not on a monthly basis but upon availability of funds, leaving them either to work as volunteers or raise their own funds. The local courts thus often rely on revenue generation from fines or informal taxation to survive. Likewise, village and section chiefs who take on cases receive nothing from the government since they are not officially recognized, leaving them to work as volunteers or raise their own funds through donations. Since both groups have complete power over the cases they adjudicate, they often end up illegally levying fines for purposes of revenue generation or personal enrichment.

Local court clerks are also involved in corrupt activities. Since clerks in the local courts are in charge of case intake the same way clerks in the formal system are, this can incentivize them to solicit bribes from accusers or defendants. Their added advantage is that most clerks can read and write, while many chairmen cannot, giving them complete control of record-keeping.

Lack of Consistency

Law. Part of what enables customary law to be more flexible and to evolve is because it is unwritten, varies from locality to locality, and is open to interpretation by the adjudicating official. But this flexibility has negative aspects to it. Customary officials have generally only been trained in formal law on an irregular basis, and they have no obligation to set down their own laws in writing or even their own interpretations of existing laws. Thus their opinions can change from case to case, leaving community members uncertain about various issues. Unless the chairman makes a concerted effort to be consistent, any known legal precedent is not necessarily followed and often not recorded. Village and section chiefs, especially since they are not recognized as official adjudicators, are likewise not bound to previous decisions.

Consistency. The tenure of a local court chairman is three years, so he or she is always new and rarely receives training. With no training in mediation and adjudication and no explanation of the Local Courts Act, the chairman rarely knows how to sentence effectively, consistently, and fairly. Village and section chiefs, not recognized by the government, receive no training unless it is through an NGO programme.

Poor record-keeping adds to the inconsistency. Since records are not properly kept – a 2007 Local Courts Records Analysis Survey called them 'incomplete, untidy, illegible, disorderly and above all not dated' – a chairman cannot be held to previous decisions made on similar matters (Koroma 2007).

13.3.4 Effects

Biased Decisions

Because of elite capture, gerontocracy, and patriarchy, decisions rendered in the customary system are often biased toward the rich, the old, and men (Kane *et al.* 2005). Since most people in Sierra Leone use the customary system and do not have easy access to formal courts, this means that effectively the only outlet for women, youth, and the very poor to access just judgements is fundamentally biased against them. Such decisions alienate youth, fail to narrow the opportunity gap between rich and poor, and reinforce gender imbalances.

The effect of such biased decisions is perhaps the greatest on gender relations. While men are generally favoured, Kane *et al.* (2005) write that this is especially the case with marital disputes – disputes over property, beatings, or other domestic problems – in an attempt to save a man from 'losing face'. Since the authority of customary leaders is generally undisputed, constant public reinforcement of the dominance of men over women hinders social development initiatives seeking to empower women.

Arbitrariness

Since customary law is unwritten and legal precedent is rare, the law that is applied to each individual case can be borderline arbitrary. Since each case is at the discretion of the court chairman or other traditional leader, law can technically change day to day, week to week, or month to month, making it difficult to abide by. Without published records, it is difficult to keep chairmen accountable for their decisions, which helps reinforce their power and their ability to play favourites during mediations and adjudications.

Moreover, since there is no written law there are also no set fines for each offence, which is again left up to the court chairman or to the adjudicating leader, who can fine accusers and defendants at will. As described in Maru (2006), this can be used as a weapon against a disfavoured disputant, or as a method of personal enrichment. This erodes a community's trust in its leaders as people lose confidence in their leaders' ability to deliver a judgement fairly. It is also an easy way for policymakers who prefer the formal system to discredit the customary system as arbitrary and inconsistent.

Impact on Development Initiatives

Because customary leaders and chiefs exert a great deal of influence over their communities, they can greatly aid or diminish the impact of local development initiatives. As described at the beginning of this chapter, no local project will be successful without buy-in from local and Paramount Chiefs. Their actions can harm social initiatives by reinforcing gender stereotypes. Their biased decisions can reinforce individuals' perceptions of the elite as special or privileged, or leadership as corrupt and unfair. Allowing such bias and inconsistency creates a culture of impunity and favouritism, two characteristics post-conflict countries seek to avoid. Such an atmosphere makes potential entrepreneurs and investors hesitant to work closely with customary officials, to the economic detriment of labourers from the community. Development projects are often hindered by 'gift-giving' to traditional leaders, or hampered by leaders who do not seek to punish those guilty of corruption, who may feel their power threatened by certain projects, or who view some programmes as going against traditional norms. To maintain good relations with local elites, chiefs can allocate jobs or resources based on convenience rather than merit, similar to the way in which cases are often adjudicated.

13.3.5 System-Specific Policy Recommendations

This section outlines several 'micro-policies' that, if implemented, would aid in reforming Sierra Leone's justice sector and might lead to further growth and social development. While these policies suggest important reforms for both the formal and customary systems, they are also by no means comprehensive or exhaustive. Additionally, because few of the interventions below have been rigorously evaluated in Sierra Leone, we do not prioritize the recommendations. Rather we suggest that the recommendations be considered by policymakers and civil society in their entirety, and further evidence-based research be conducted to establish the efficacy of each intervention on Sierra Leonean social and economic development.

While the policies below are meant to be Sierra Leone-specific, some are informed by reforms implemented in other countries. Many of the policies below also have applications in other countries with similar problems; for instance, Uganda's customary system is also typified by geographically divergent traditions and norms (Kane *et al.* 2005). However, we caution against extrapolating policy changes for other African countries from the section below without careful historical and political analysis of that country. For instance, Sierra Leone is not characterized by instances of extrajudicial killings the way that Zimbabwe or Kenya are; political repression the way Malawi and Uganda are; or widespread violent crime the way South Africa and Nigeria are.

Decongesting the Formal System

Financial resources. Inadequate resources greatly hinder case processing in Sierra Leone, beginning with police investigations. The police are often unable to travel anywhere to investigate crimes or to call sureties or witnesses, and have no ability to conduct forensic analysis. Once a case gets to court, it is only heard if an unlikely confluence of events occurs, i.e. the magistrate, police prosecutor, all witnesses, and the defendant are present. If one is missing the case is most likely adjourned. Providing reimbursement for witnesses, hiring more magistrates to work outside of Freetown, and providing sufficient incentives for those magistrates to live in rural areas away from Freetown would help to grease the wheel of the magistrates' court system and quicken case processing.

A separate court for commercial disputes. Movements have been made toward separating out commercial disputes by establishing a 'fast track commercial court', supported by DFID and officially opened in December 2010.

Such a court would hear only economic claims, so that business and investment cases are not subject to delays due to case backlog in the overburdened magistrates' courts. It has received generally positive feedback thus far.

Changes to procedures. Establishing a limit on the number of adjournments a case can collect would reduce time on remand and the time taken to complete a case, helping to rid the courts of frivolous cases. Eliminating the requirement that a felonious case be referred to High Court before first going through a 'preliminary investigation' (PI) in a magistrates' court would also help unclog the courts. Revisions to the Criminal Procedures Act of 1965, including legislation dropping 'preliminary investigations' and ensuring a case's committal to High Court within seven weeks, are also expected to pass in the next few months.

Training. Better training for police prosecutors and court officials, including legal training for police investigators and prosecutors, could help avoid the following several problems.

(a) Crimes being charged incorrectly or on the basis of little evidence.

(b) Cases being thrown out of court due to incorrect procedures being followed.

(c) Ineffective and slow witnesses. Since physical evidence is rare, testimony is usually what sways a magistrate for or against the accused. Often a witness's story is choppy or muddled, or s/he is intimidated by the court, which also causes delay.

Tackling Corruption and Arbitrariness in the Application of the Law

Higher salaries for all police, prisons, and court officials. The average policeman's salary is around Le 250,000, or US$60, per month (SLP 2010), making a low-level policeman's simple bribe-seeking understandable, if not necessary. Local court officials are currently paid out of chiefdom coffers, not on a monthly basis but only when money is available, though new legislation passed recently seeks to restructure this system. Chiefs and elders receive no resources.

Better monitoring of police and court officials. Anti-corruption monitors within the police or courts could potentially reduce bribery and extortion within the formal system. Since little research has been done on this subject in Sierra Leone, however, it is unclear whether the monitors should ideally be civil servants or NGO workers.

For the customary system, the presence of community-based paralegals could have an impact on extortion and bribe-seeking by local court officials, elders, and chiefs. Though the local courts are supervised by a local court supervisor at the district level, the supervisor is not paid and not supported in any way with resources or training. Local courts are also accountable to customary law officers, who provide the link between the formal and customary systems. Their role is to provide training and supervision to local courts in a certain region, and can also serve as a forum for judicial review. But customary law officers also have obligations to the formal system and are stretched thin.

Better procedures with more checks and balances. The police have been known in the past to make arbitrary arrests without due cause or prior permission, damaging the public perception of the police as being there to protect and serve. Raising the evidentiary requirements necessary for the issuance of warrants would assist in lessening such occurrences.

Alternative sentencing. The amended Criminal Procedures Act, expected to pass in the next few months, aims to ensure that those arrested for minor crimes do not serve undue time in prison, through alternative, deferred, and suspended sentencing, as well as a community service. This would allow judges to put non-violent inmates on probation, saving already overcrowded prisons for violent or repeat offenders.

Improve record-keeping in both systems. One of the greatest opportunities for corrupt practices comes from a hallmark of customary law – that it is unwritten, constantly evolving, and varies slightly from province to province and even within provinces. Fully codifying all of customary law would probably prove to be extremely difficult and expensive, but providing local courts with the means to record all aspects of the proceedings would improve accountability. With all decisions and fines recorded, precedents would be systematically built up, and a kind of case law would be created. And while the law can evolve, the chairman could be held to task for a blatantly divergent ruling. Without published records, it is difficult to keep chairmen accountable for their decisions, making the creation of a systematic recording system imperative.

The same issue exists in the formal system. Though decisions are recorded, since there is no central database it is difficult for lawyers and magistrates to refer to previous cases, especially if those cases were heard in another part of the country. In the formal system, strides should be made to create a computerized database which could collate case rulings from around the country and provide written precedent.

Training for local court chairmen, elders, and chiefs. Local court chairmen, elders, and chiefs need training in making consistent decisions independent of political influence, in mediation and negotiation, and in women's and children's rights. Gauri (2009) writes that the combination of social and political power in the customary system can make leaders more authoritarian, but Kane *et al.* (2005) write that community organizations, counsellors, and social workers, can influence the application of customary laws. Counsellors and NGOs thus have the ability to influence customary officials. Locally trusted and respected NGOs such as Timap for Justice and JSDP have already had some success in such training.

If elders and chiefs were given some legal authority, then it would be easier to hold them accountable. Local court chairmen, elders, and chiefs should have to pass an exam to gain an adjudicating position. Additionally, while the passing of a new Local Courts Act means that the Chief Justice will now appoint local court chairmen, a more democratic election may be beneficial. To increase public participation in community courts in Eritrea, for instance, judges are directly elected from the communities they preside over. Furthermore, it is expected that at least one judge on the court will be a woman (Andemariam 2011). While Sierra Leone and Eritrea have differing histories regarding gender roles – women were schooled, trained, and used as soldiers alongside men in Eritrea's fight for independence from Ethiopia – a similar norm, if applied in Sierra Leone, could help to increase female influence over local courts.

Providing Justice 'On the Cheap'

Paralegals. A new Legal Aid Act seeks to establish paralegal programmes nationwide and to allow paralegals to operate in a more representative capacity. There are only about 200 lawyers in the country, so the bill will enable many defendants to have legal aid who otherwise could not have had it, hopefully reducing excessive pre-trial detention and the country's high conviction rate. Some stakeholders (JSDP and UNDP) are attempting to create a National Legal Aid programme, which will hire public defenders and paralegals to take on cases *pro bono*, including representation in court. Such initiatives are vital. Gauri and Brinks (2008) find that the legal intervention of NGOs and civil society on behalf of disadvantaged groups, such as the poor, are critical for ensuring their legal claims are upheld, which leads to positive engagement. Community-based paralegals can also operate in the customary system, since they are not lawyers trained in formal law. Timap for Justice has had success in creating a nationwide community-based paralegal programme.

Broad-based civic education. Broad-based civic education should provide information-giving sessions to communities so that Sierra Leoneans are more aware of how legal dualism works in their country and what their legal rights are. Participants in cases in either system are more likely to be taken advantage of or denied justice when they are uninformed. Empowering communities through knowledge is a 'cheap' way of increasing access to justice, especially with the proliferation of nationwide community radios. It should be noted that an information campaign about the formal system cannot be viewed as a substitute for investment in the customary system, and that any information campaign needs to be carefully planned so it is not misconstrued as a promotion for one system over the other. Rather, civic education surrounding the justice sector should inform citizens of their options.

13.4 Investing in the Customary System

13.4.1 Historical Focus

Since independence, policymakers have avoided fully dealing with the customary system in a decisive manner. After all, the issues are complicated. While

Freetown and the Western Area rely more heavily on the formal system, the Provinces rely more heavily on the customary system. It is difficult to formulate policies that recognize the importance of the customary sector without elevating it to the level of the central government, and to create a balance between a formal justice system wielding power and money and a customary system wielding popular support and immediate community access.

The common policy response has been to superficially touch on these issues without resolving them permanently. There is a tendency for legal practitioners and government officials to look down on the customary system not as irrelevant, but as inferior, or even as a kind of kangaroo court, and for foreign donors to fail to understand it because it is not familiar to them (Dale and Manning 2007). This attitude also has roots in legislation arising from colonial mindsets. Section 170 of the Constitution of Sierra Leone (1991) puts it at the bottom of the hierarchy of laws, and Section 2 of the Local Courts Act of 1963 defines customary law as

> any rule, other than a rule of general law, having the force of law in any chiefdom of the Provinces whereby rights and correlative duties have been acquired or imposed which is applicable in any particular case and conforms with natural justice and equity and not incompatible, either directly or indirectly, with any enactment applying to the Provinces.
>
> GoSL 1991; 1963

This has had an adverse effect on rural development projects, as aid initiatives fail to catch on permanently in rural communities because their implementers do not understand the social, political, and judicial dynamics at the root of local life.

13.4.2 Post-conflict Focus

In the postwar push for justice sector reform, work on the customary system has largely been ignored in favour of promoting the formal system. With resources for justice sector reform pouring in, the traditional system that had sustained many Sierra Leoneans through colonialism and war has largely been neglected. The local courts are given a fraction of the budget allocated to the Ministry of Internal Affairs, which itself is a fraction of that granted to the formal system, and left to raise much of their funds on their own (see Figure 13.7). Training and monitoring of local court officials is minimal at best, while village and section chiefs are given no training, venues, or funding whatsoever for their role in dispute resolution.

13.4.3 The Mistake Made

Social and Political Capital of Chiefs

Traditional dispute resolution has existed in Sierra Leone for hundreds of years, through colonialism, the war, and through to the present day. While

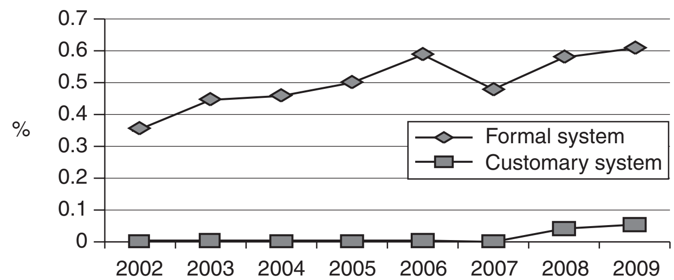

FIGURE 13.7. Actual expenditure on justice sector as a percentage of total expenditure. *Source*: authors, using the Ministry of Finance 2011 fiscal table look-up (MoFED 2011).

chiefs technically have no legal power to adjudicate, over generations they have amassed immense social and political power. Chiefs are also involved in the formal government system at the local government level, and even in parliament – Sierra Leone is one of the only countries in the world that reserves and allocates seats in parliament for Paramount chiefs. They have the same voting rights as parliamentarians, which means they participate in passing national legislation. Sierra Leone can no more ignore the customary system and hope for an adequate rule of law and nationwide access to justice as it can the formal system.

Access to justice and the rule of law are not only legal issues, but rather extend to all sectors. They are issues of accountability, growth, and development in general. Sierra Leoneans, especially in the rural areas, are unlikely to gain knowledge of the law and their rights solely from the formal system. Local chiefs, the Local Court chairman, paramount chiefs, and other leaders are responsible for much of the information filtered through to the populace. Many Sierra Leoneans still view the formal system as new, intimidating, or foreign, and take comfort from tradition.

Though chiefs have no right of adjudication, many people prefer to go to town chiefs over local courts or the police. In a recent decentralization survey, 85% of respondents indicated that the first forums to which they take their disputes are local chiefs or elders (Manning *et al.* 2006). Policymakers have failed to appreciate that even without official sanction, citizens still respect a chief's decisions. Policymakers should provide chiefs with recognition in their efforts to mediate disputes. Strategic public recognition would pressure chiefs to deliver, or face losing credibility and the respect of their subjects. It is thus imperative not to ignore the training of village and section chiefs in dispute resolution and human rights.

Development Initiatives and Community Growth

Sierra Leone's dualistic legal structure is at the base of any development project, since a nation's legal system is at the base of any activity going on within it. Because of respect for local leaders, no outside development initiative – agriculture, education, health, sanitation, food security, structural growth – can be implemented without the tacit approval of local chiefs. No programme can be effective without their positive engagement. Many programmes are new to rural residents. The sight of a police post is strange, new technology that is difficult to grasp, and the idea of standing up to a locally influential family or individual incomprehensible. People do not immediately trust visiting government officials or NGO workers, or do not understand why they are there or how their programmes will benefit the community. Local leaders are essential to communication. Custom is not just legal, but social and economic as well.

The local courts cannot fulfill this role entirely. Though 'customary', they mimic formal courts in their structure and politics. Moreover, members of the formal government in the Ministry of Internal Affairs, sometimes along with Paramount Chiefs, decide on the tenure of local court officials, putting a customary court directly under the jurisdiction of a formal government body (Kane *et al.* 2005). With the recent passing of a new Local Courts Bill, the Chief Justice is now in charge of appointing local court chairmen. Due to issues of accountability, this is not necessarily a faulty policy; but local courts are, in a sense, midway between the formal system and the adjudications of customary chiefs because of it. The opinions and statements of local leaders are worth far more than those of a government minister, and even more than local court officials. 'Put another way, custom has a formidable sphere of social legitimacy by which it is buttressed' (Kane *et al.* 2005).

In that sense, the customary system is far more powerful than the formal. People listen to local leaders, meaning that those leaders have the chance to expatiate on virtually any subject and be assured of an audience: the police force, corruption, user fees at the hospital, school attendance rates, women's rights, child neglect, farming, electricity, or taxes. Knowledge is power; if local leaders are engaged and participate in relaying information to the populace, they commit both themselves and the institutions in their immediate areas to accountable practices.

Local leaders can ensure pregnant women and children are not charged user fees at local clinics, or can push parents to send their children to school. They can ensure the maintenance of community water sources, roads, and other infrastructure. The severity of local leaders' punishment of abusive husbands or their rulings on female inheritance sends a strong signal to the community, and either promotes or represses women's rights. Local courts and chiefs do not merely distribute legal justice, but economic and social justice as well. Because of their influence, local leaders can be either the drivers of development or its greatest opponent. This is also a practical issue. The government does not have the resources to support a parallel structure that has the potential to drive development in the same way a chief can. Furthermore, chiefs often take these initiatives themselves, having a personal investment in the areas they come from. In Somalia in 2003, a group of traditional leaders approached the Danish

TABLE 13.5. Common disputes in local communities.

	Frequency	
Dispute type	Number	%
Loan/money	337	47
Theft	93	13
Child support	47	7
Inheritance	16	2
Land dispute	131	18
Physical attack	94	13
Total	718	

Source: IRCBP 2007.

Refugee Council (DRC) looking for help revising their customary law to bring it in line with both international human rights norms and sharia law (Simojoki 2011).

Gauri (2009) argues that customary legal institutions, because they are based on community rules, can to some extent enforce contracts because of a community's respect for social norms. He also notes that customary institutions are every bit as important as formal ones for fostering economic activity. In a 2007 National Public Services survey (see Table 13.5), 78% of reported disputes had to do with land, theft, loans, or other money-related problems (IRCBP 2007). The people using the customary system are the poorest in Sierra Leone, and its decisions greatly affect their personal economic situations.

13.4.4 Achieving Complementarity

Freedom of Choice

Investing in both the formal and customary system, or 'achieving complementarity', would aid Sierra Leone's development and growth. In addition to the policy options already discussed in this chapter, a push to create two justice systems that operate in a symbiotic relationship enhances the country's social, judicial, political, and economic potential.

Building up both the formal and customary systems gives people a choice over which forum they want to take their cases to, for those cases whose nature does not require that the formal system handle it. This also creates checks and balances within the systems and between them. If citizens find that their cases move through the customary system quickly, with fair results free of corruption or influence, they are more likely to take cases to the local courts. On one hand, this may take some minor cases off the hands of the overburdened magistrates' courts, as well as encouraging businesses to use mediation rather than litigation. On the other, it may push the formal system to improve through competition. When people can identify different avenues of resolution for various types of cases, it leads to an increase in quality of life. Less time is spent resolving disputes and bribing officials, and more time at work.

There has been some concern that strengthening both systems would increase the regional divergence between Freetown and the provinces, given that the former focuses on the formal system and the latter on the customary. If it did, but both the customary and formal systems were accountable, fair, and effective, regional divergence might be a non-issue. But the possibility that the formal system would become a focus while the customary system is ignored is serious, because that would lead to further access to justice issues for those living in rural areas, since their options would remain limited.

However, strengthening both systems would not necessarily highlight that divergence, rather generating more opportunities for individuals to choose the forum to which they want to take a dispute. With the post-conflict influx of NGOs and foreign organizations, a national human rights rhetoric has begun to take shape that transcends whether a forum is formal or customary. Investment in the customary system, and specifically training in human rights and mediation for chiefs, would allow that rhetoric to be internalized by those living in rural areas. This again gives individuals choices over where to take their disputes, especially if a human rights campaign is accompanied by an information campaign. If the formal system is also strengthened, many may end up choosing to access the formal courts, which would actually decrease Sierra Leone's regional divergence.

Defining Roles

It is important, however, that the roles and jurisdiction of the formal courts, the local courts, and village leaders are clearly defined. Though a natural competition would arise with complementarity, that competition will stop short of conflict if roles are defined. Chiefs can mediate, but not adjudicate. Local courts can adjudicate, but serious crimes are sent to the formal system. Defining the roles of the different bodies empowers both the bodies and the people who use them, making all three more efficient, and forcing them to compete for clients by improving service delivery.

These distinct roles should be permanent. While the formal system is perceived to be more adversarial and focused on retributive justice, the customary system is more reconciliatory and focused on restorative justice. Over time, the formal and customary systems have naturally taken on some of the strengths of the other. For instance, policemen are often called on to mediate disputes rather than overload the courts with minor cases, and chiefs often give verdicts rather than mediating. But weaknesses in each system should not be addressed by attempting to transform each system's identifying characteristics. Gauri (2009) argues that local-level legal institutions can act as a stepping stone to a formal process, instilling formal characteristics in an informal setting by absorbing it into the process. Likewise, many can go to the formal system first and then revert back to the customary system because of corruption or other obstacles. The result can be that each system begins to lose the characteristics that make it unique and desirable. For complementarity to be effective, both systems need to rectify their weaknesses while maintaining their strengths.

Though new, it is hoped that the recent passing of an amended Local Courts Act (2011) will be beneficial to complementarity in several ways. First, appointment of local court chairmen will now come from the Chief Justice, allowing checks and balances by the formal justice system (GoSL 2011). The Chief Justice may also mandate that certain forms or records be kept. The negative side is that as the local courts become more 'formal', they lose their 'customary' bent. In the future, direct election as described in the above policy section might be considered. Local courts can also now hear cases involving the land titles of Paramount Chiefs and Chiefdom Councils, allowing checks to be performed by the local courts on other customary officials. Finally, the new bill mandates that any fees collected by a local court should go into a Consolidated Fund, which will be used to pay the salaries of local court officials, hopefully diminishing corruption (GoSL 2011).

Finally, because every country with both formal and customary laws has a different colonial history, it is important to study the ways other nations' customary systems and formal systems interact without assuming direct relevance to the situation in Sierra Leone. To each country, the role and purpose of the customary system is different (Harper 2011). In considering the customary system in Indonesia, Clark and Stephens (2011) write that for every country, it is important to take five steps in analysing the right balance between formal and customary: to understand the history and current context of formal and customary systems, to analyse the individual strengths and weaknesses of both, to identify 'entry points' for reforming hybrid systems, to 'realistically assess' those entry points, and to ensure a sustainable commitment to those reforms. Otherwise, Sierra Leone might default to a formal system which may not be best suited for the needs of the entire population. Without a strong focus on the customary system in Peru, for instance, formal legislation and regulation has rendered those traditions nearly powerless (Desmet 2011).

13.5 Conclusions

While an overhaul of both systems is unrealistic in the short term, a clear commitment to improving access to justice would increase the credibility of the legal system in the eyes of the populace. When the police solicit bribes, a witness does not know which day to appear in court, a family's case drags on for months for a petty larceny charge, or the village chief or local court chairman is politically or socially biased towards one party in a dispute, the Sierra Leonean citizen's first thought is not to chalk it up to under-capacity or a lack of funding. Blame, disillusionment, and distrust are more common responses.

This chapter has argued that Sierra Leone needs to consolidate the gains and improvement it has made over the years in reforming the justice sector by doing the following.

Paying attention to policies specific to the formal or customary systems. While both the formal and customary systems in Sierra Leone are far from efficient or unbiased, new interventions targeting corruption, delays in case processing, and access to justice will not only mitigate those injustices and improve quality of life for the poor, but may foster growth and development in the country as a whole.

Ensuring an equal focus is given to the customary system. Policymakers and NGO workers should make a conscious effort to devote equal time and resources to reforming the customary system. Ignoring it will hinder growth and development and produce an unequal and uneasy relationship between formal and customary bodies that does not necessarily reflect the will of Sierra Leoneans.

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Chapter 14

GIRLS’ AND WOMEN’S EDUCATION AND EMPLOYMENT IN POST-CONFLICT SIERRA LEONE

By Agnes J. S. Pessima

14.1 Introduction

Sierra Leone has a long history of Western-style education dating back to the late 1790s with the arrival of freed slaves from Britain and Nova Scotia. The Methodist ‘negros’ established classes in 1792 to teach their children. Later, the demand for education was stirred among the natives when it was realized that whenever there was work to be done those who were literate were given lighter work and the illiterates did the manual work (Sumner 1963). As the demand for education increased, the number of schools was also increased. Yet over 200 years afterwards Sierra Leone has not been able to reduce the illiteracy rate to below half the population.

There is a correlation between education and employment. The level and type of education acquired determines the type of job opportunities available to individuals. Since over half of the country’s population is illiterate, they can only be involved in jobs not requiring formal training for which literacy and other technical skills are typically important. This paper argues that girls’ and women’s low level of education is responsible for their low representation in formal sector employment in general and their clustering at the margins of such institutions. It discusses the government’s policies and intervention strategies to raise the educational status of the country and of girls and women, and the outcomes of these interventions. Furthermore, the paper argues that several other factors need to be addressed to buttress government efforts in order to realize positive and concrete outcomes.

This chapter is divided into nine sections. Section 14.1 examines the status of education in Sierra Leone before the 1991–2001 rebel war and includes

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the status of girls' and women's education at that time. The new education system is introduced in this section, followed by problems with and content of girls' education. Section 14.2 deals with the Sierra Leone government's responses to international declarations on the expansion and improvement of education. First, we present the response to Education for All (EFA 1990), focusing on the policies and strategies the government put in place to achieve this and discussing their outcomes. These are followed by the effects of the war on girls' and women's education. In Section 14.3 we submit government policies to expand educational provisions after the war, within the framework of EFA. In Section 14.4 we examine the government's efforts to achieve the Millennium Development Goals (MDGs 2000) focusing on MDG 2 and 3. In Section 14.5 we set out a brief summary of the EFA National Action Plan. Our deliberations in Section 14.6 focus on technical and vocational education, including a discussion of the opportunities for skills training available in the country. The arguments in Section 14.7 throw light on the two major employment sectors in Sierra Leone, analysing the nature of each and scrutinizing opportunities presented by each sector for employing girls and women. Section 14.8 proposes ways forward for education and skills training, Section 14.9 contains conclusions together with recommendations for policy formulation. Most often, in this chapter 'employment' is used synonymously with 'formal employment'.

14.1.1 Prewar National Educational Status

Sierra Leone's educational system was inherited from British colonial rule and was very academic. Three decades after independence educationalists in the country observed that, although it produced a relatively high level of education, the graduates were unequipped for work. The academic nature of the system, which emphasized cognitive skills at the expense of psychomotor skills, put girls at a disadvantage in school – since girls were expected to study only 'feminine' subjects like needlework, home management and cookery.

Primary school enrolment in the late 1980s was close to 400,000 but this figure declined to 315,000 in 1989–90 and 1990–91, when the war broke out in Sierra Leone (World Bank 2007).

The Ministry of Education, Youth and Sports conducted another survey in 1992 and found that enrolment rates for primary schools was 35% and 11% for secondary schools even though figures from Donors to African Education showed 48% for primary schools and 16.3% for secondary schools.

The 2005 Poverty Reduction Strategy Paper (PRSP 2005) extract on education confirmed that in the 1990s (the war years), gross enrolment ratio (GER) declined, but its figures were higher than the previous two: 51% in primary schools and 17% in secondary schools. Civil wars always take their toll on the education system as was evident in Mozambique, Sudan, Liberia, Rwanda and other war-torn countries.

14.1.2 Prewar Educational Status of Girls and Women in Sierra Leone

Women make up 51.3% of Sierra Leone's population according to Statistics Sierra Leone's Census Report (SSL 2004). Despite their numerical strength they have not benefited on an equal level with their male counterparts from the provisions of social amenities like education and health. The majority of Sierra Leonean women are illiterate, poor and are denied certain basic rights; for example, the right to education (Pessima *et al.* 2010).

Prior to the war, many rural and deprived families considered girls' education to be a waste of resources. From their perspective, the girl would end up in the private domain engrossed in her gender roles of cooking, cleaning the home, preparing food for the family, caring for the sick and elderly, while the boy ventures out into paid employment to earn an income to care for the family. Parents, therefore, did not mind sacrificing all their resources to educate their sons; this is referring to parents who perceived education as a means to better paid jobs.

Culture and tradition have served as barriers to female education in Sierra Leone. Girls are disadvantaged right at the start when parents take a decision on which of their children should go to school. Girls' labour in the home and their contribution to family income often militate against them. Girls' contribution to family labour is common practice in many developing countries. In Liberia, girls face similar setbacks. Families bound to tradition do not favour Western-type education for their girls. They want them to remain at home to work or attend traditional home schools. Other reasons from Liberia have been fear of sexual violence that continued after the war, and fear of rape because of lack of separate bathrooms (USAID/Liberia 2010). The same is true of Madagascar where household chores, parents' views about girls' education, concern for girls' safety and lack of gender-sensitive school environment keep girls away from school (UNICEF/Madagascar 2005).

In countries where educational provision is poor, girls are more likely to be at a disadvantage. For example, when Mozambique gained independence in 1975 it had a population of 10 million. At that time 93% had not attended any formal school and the problem remained after the war (UNESCO 2000). In such circumstances enrolment rate of girls would be mostly very low. Many studies (for example, Alghali *et al.* 2005 (in Sierra Leone); Santibanes 2010 (in Honduras and Nicaragua)) have shown that poverty militates against girls' participation in education. Even in Ghana, which has a much improved economy compared to her neighbours, there were severe gender and regional disparities in primary enrolment, particularly in rural and deprived urban communities in the early years of 2000 (Peprah 2008). The Sierra Leone Education for All National Action Plan further noted that poverty prevents parents and guardians from paying fees for their children (EFA: NAP 2004). Subsequently, poor educational provision, coupled with poverty, contributed to girls' low participation in education in the prewar years.

14.1.3 The New Education System

Two years after the outbreak of the war, in 1993, the National Provisional Ruling Council (NPRC), the military junta in the early 1990s, implemented the 6–3–3–4 system of education. This new structure was based on the recommendations of a publication titled 'Report of the task force on external examination for secondary schools in Sierra Leone'. The task force was set up in 1988 and the report submitted in 1989. The new structure of education came into being four years later (New Education Policy 1995). This system provides nine years of basic education for all who enter it. It involves six years of primary education and three years of junior secondary school education. Next there are three years of senior secondary schooling before pupils can proceed to tertiary education. Progression into the next three years of secondary schooling is however not compulsory. Pupils can enter into vocational/technical institutions on completion of the basic education cycle. Completion of the rest of the educational process depends, among other things, on the financial status of the child's parent.

14.1.4 Problems with Girls' Education

Girls' enrolment in school is one problem; retention is another. The prime concern of parents in traditional homes is preparing girls for marriage. This preparation takes pre-eminence over every other interest in the life of the girl, for example, over formal education. Due to this, domestic duties engulf much of a girl's post-school day. Some girls help their mothers to sell in the market after school. This results in little or no time to study at home. By the end of the day the girl is tired and unable to study. This leads to poor performance in school and loss of confidence in continuing with academic work. In traditional homes in Sierra Leone, boys are not allowed to do domestic work; therefore they have much time at hand to study after each school day.

The report of a consultative meeting of African Education Ministers held in Mauritius in 1994 on 'School drop-out and adolescent pregnancy' revealed that girls' domestic workload is heavy and affects their concentration and performance in school, often leading to withdrawal from school. In this way, completion of a cycle of schooling becomes threatened. The United Nations Girls' Education Initiative (UNGEI) 2005 GAP Project found that only one-third of girls enrolled in school in Madagascar remain until the fifth grade (adapted in UNICEF/Madagascar, 2005 report). Similarly, in Sierra Leone, retention of girls in the school system is a major problem in their education process.

Also generating retention issues are the problems of unwanted pregnancies, initiation ceremonies and early marriage. It is not unusual for girls to be withdrawn from school for the purposes of initiation and marriage (World Bank 2004). After the initiation ceremony the girl is considered to be an adult. This very often leads to sexual promiscuity, unwanted pregnancy and dropping out of school. At other times they would simply be given away in marriage after the initiation rites. Furthermore, girls are withdrawn from school to help generate income to pay school fees for their brothers. Consequently, girls' enrolment and completion of a full educational cycle becomes problematic due to economic constraints, the barriers of customs and tradition, and parents trading off the value of girls' education against their marriageability (World Bank 2004).

According to the study (World Bank 2004), culture affects girls' education in two ways: as a source of ideas about the educational process, and also as a source of ideas and practices about the rights and responsibilities of women. These can have a negative or positive impact on increasing girls' participation in education. Families are convinced that boys' economic security lies in their ability to secure a good job, while girls' security lies in their marriageability (World Bank 2004).

From the outset of Western education in Sierra Leone, education was thought of as a thing for men only. Such thinking laid the foundation for the current gender disparities in education. The 1985 National Population Census analysis showed that 95.1% of women in Sierra Leone aged five and above were illiterate. Making an analysis of the 1984 GCE 'O' level results, the National Action Plan for Development found that out of 641 pupils who took the examination, girls made up only 25% of the total number. It also observed a high drop-out rate among girls (TRC 2004, vol. 3B).

14.1.5 The Content of Girls' Education

The education of women in third-world countries is very significant to development. Their access to education must not only be for the purpose of raising their socio-economic status, but should also be viewed in relation to the intersection of education and development.

The content of girls' education has been influenced by early socialization. As boys and girls grow up, early socialization creates a distinct dichotomy between male and female which both genders inculcate and nurture as reality.

The colonizers, with their Victorian perception of women, envisioned women's responsibilities as being limited to nurturing and conserving society, while the men engaged in economic and political activities (Synders and Tadesse 1995). This is quite clear from the discrimination in the timetable. In the afternoon girls did needlework and boys did subjects like advanced mathematics and geography (Sumner 1963). The boys would need these to get jobs to earn income for the home. The girls needed to read and write to complement the status of their husbands. Furthermore, they needed to refine their feminine skills and learn new ones to make them better wives and mothers.

At the second International Women's Conference held in Copenhagen in 1980, education was integrated into the conference document, 'Strategies for the Advancement of Women to the Year 2000'. These strategies were accepted by the Nairobi Conference in 1985. Also, at the fourth International Women's Conference (Beijing 1995), additional strategies were set out for implementing equality between men and women in the Platform for Action, a document which was to be used to promote women’s issues even beyond the year 2000 (Skelding 1996). In this document 12 critical issues for the advancement of women were highlighted, and education and training of women were identified as issues of concern for women’s empowerment in their societies. Skelding (1996, p. 5), composing an easy-to-read version of the Education and Training of Women component of the Platform for Action, stated that

> non-discriminatory education benefits boys and girls and contributes to a more equal relationship between men and women. If more women are to become agents of change they need: equality of access and educational qualifications.

Concerning the content of girls’ education, she noted that ‘textbooks do not relate to women’s experience; girls are often denied basic training in mathematics, science and technology’ (p. 6). The issue of textbooks manipulating girls’ choice of career has been much debated, especially in feminist literature (Medel-Anonuevo 1997).

Amara (1997), making a presentation on ‘Teachers’ classroom behaviour: a critical factor for gender disparity in science and education in Sierra Leone’, observed that 18% of pupils entering for the School Certificate/General Certificate Education Examination major in science subjects. When compared by gender 79% were males and 21% females (Amara 1997, in Mahdi 2009). This was four years after the introduction of the new education system of 6–3–3–4. This educational structure was introduced with diversified national curriculum which placed no restriction on female pupils. Before this time, in her 1993 presentation on ‘Factors that influence gender disparity in science education’ at a workshop on gender disparity in mathematics, science and technology, she indicated that more boys selected careers like medicine, engineering and agriculture, while more girls desired to be secretaries, nurses, air hostesses (Amara 1993, in Mahdi 2009). The subjects that pupils study in school determine their future career. It can be seen from the above that boys had prestigious and well-paid jobs because they did subjects that were requirements for such jobs. The career choices of girls – secretary, nurse or air hostess – are not among the most lucrative jobs in Sierra Leone.

14.2 Education for All, 1990

At the Education for All (EFA) Conference held in Jomtein, Thailand, in 1990, basic education was lauded as necessary for tackling the high illiteracy rates round the globe. The UNESCO world illiteracy figure was 774 million people. Sierra Leone pledged to work towards this goal and, together with other participating countries, set out to achieve the following.

- Expanding and improving comprehensive early childhood care education, especially for the most vulnerable and disadvantaged children (goal 1).

- Ensuring that by 2015 children, particularly girls, children in difficult circumstances and those from ethnic minorities have access to complete, free and compulsory primary education of good quality (goal 2).
- Ensuring that the learning needs of all young people and adults are met through equitable access to appropriate learning and life skill programmes (goal 3).
- Achieving a 50% improvement in levels of adult literacy by 2015 especially for women and equitable access to basic and continuing education for all (goal 4).
- Eliminating gender disparity in primary and secondary education by 2005, and achieving gender equality in education by 2015 with a focus on ensuring girls' full and equal access to achievement in basic education of good quality (goal 5);
- Improving all aspects of education and ensuring excellence for all, so that recognized and measurable outcomes are achieved, especially in literacy, numeracy and essential life skills (goal 6) (EFA: NAP 2004, pp. 20–21).

In order to achieve the above in Sierra Leone, the following measures were taken. Non-formal primary education was introduced in areas without any formal school to achieve goal 2; functional adult literacy provision was increased to provide life skills for young people to achieve goal 3; many adult literacy centres were established by various non-governmental organizations like the Sierra Leone Adult Education Association (SLADEA) and the People's Educational Association, Sierra Leone (PEA–SL), to promote literacy and to fulfill goal 4; scholarships and other incentives were given by government to increase children's participation in schooling, especially for girls, in line with goal 5; supply of educational materials and teacher training were undertaken to ensure good-quality education as stated in goal 6.

14.2.1 Non-formal Primary Education

Non-formal primary education (NFPE) is a component of basic education and is in line with EFA goal 2, which is concerned with children in difficult circumstances. The United Nations Children's Fund (UNICEF) and the People's Educational Association, Sierra Leone (PEA–SL) launched the Non-formal Primary Education Project (NFPE) in Sierra Leone in 1992 for out-of-school children. This project was designed to reach a large number of out-of-school children in the country, especially girls and other disadvantaged children in communities without schools. Girls aged 6 to 14 years were special targets for this 3-year programme. Those who performed well later joined the formal school system in class 4 in other areas of the country (EFA: NAP 2004). Skills training was added to the course so that those who could not further their learning would have acquired a skill they could use to generate income in their communities. Many girls have been able to move from this programme into the formal system. However, the implementers have not been able to keep data on the number that have joined the formal system (PEA–SL 2006).

14.2.2 The National Commission for Basic Education, 1994

The National Provisional Ruling Council (NPRC), the military junta mentioned earlier, established the National Commission for Basic Education in 1994 to fulfill the EFA goal of reducing the high illiteracy rate in the country. The commission was to coordinate adult and non-formal education in the country. It was recognized that the high illiteracy rate in the country could not be significantly reduced without massive intervention by the government, assisted by donor agencies. The work to address adult and non-formal education was a large and multifaceted undertaking and so the government focused on literacy and the education of women and girls, particularly those living in rural areas. The framework for this was laid in the country plan for basic education developed by the National Commission for Basic Education, 1994 (New Education Policy 1995). The aims and objectives of the policy on adult and non-formal education were:

- to establish a 13-man Adult Education Committee to work within the framework established by the Basic Education Commission;
- to develop a national plan of action for adult and non-formal education built around the country plan for basic education;
- to devise programmes and strategies for the acceleration of adult literacy;
- to obtain and provide supporting resources (personnel and materials) for these programmes from the government and interested donor agencies, to enable the Department of Education, through the Basic Education Commission, to coordinate, supervise, monitor and evaluate all programmes and interventions in the country aimed at improving the literacy rate and providing adult education for early school leavers (New Education Policy 1995, pp. 25–26).

To achieve these aims and objectives, the Ministry of Education, the Basic Education Commission, and the Adult Education Committee did the following:

- implemented a language policy to facilitate the use of English and indigenous languages in literacy and non-formal education classes;
- provided relevant curricula for all levels of literacy and non-formal education classes;
- devised and established links between the formal education system (especially the basic education component) and the non-formal/adult education systems;

- controlled, coordinated, monitored and evaluated all programmes of literacy, adult and non-formal education in the country;
- created a Non-formal Primary Education section within the Primary Division of the Ministry of Education;
- encouraged the enrolment and retention of female pupils by making primary education free;
- made possible the readmission of ‘girl-mothers’ into the formal system of education (New Education Policy 1995, pp. 26–27).

A new education policy was developed to accommodate changes in the education system. Government thereafter put in place measures to implement the above.

14.2.3 The National Education Action Plan, 1994

The National Education Action Plan (NEAP) was developed to support the new system of education. It addressed all sections of the education system. It concentrated on several issues in educational development which included:

- the coordination of provision for basic schooling (nine years) and for the non-formal education of adults;
- a phased increase in the enrolment of the population of school age and their retention;
- a large and sustained programme of economically productive skills acquisition in association with the upgrading of technical/vocational education – formal and non-formal;
- the increased production, localization and availability of teaching/learning materials for all levels, but especially in support of the Basic Education Reform;
- the strengthening of procedures and support services for the regular assessment of pupil progress, including both continuous assessment and external examination;
- the rehabilitation/construction of educational facilities of all types, including the provision of equipment and furniture;
- the development of adequate guidance and counselling services in schools and colleges;
- a significant improvement in the quantity and quality of training for educational sector personnel of all types, but especially in respect of teachers;
- a major reform of the structure and operation of the Department of Education;

- the establishment of an integral project implementation unit to facilitate cooperation and coordination among different development projects;
- increasing female participation and performance in education;
- strengthening special provision for the education of the disabled, disadvantaged and gifted;
- strengthening of the University of Sierra Leone (New Education Policy 1995, pp. 4–5).

14.2.4 The New Education Policy, 1995

The New Education Policy, developed five years after the Jomtein Conference, was in response to the EFA call. Paragraph B.5 of the policy states that the government will make deliberate efforts to keep women and girls in school at every level of education (p. x). Furthermore, the government emphasized its aim to improve the quality of basic education, reduce the illiteracy rate, especially female illiteracy, and substantially increase the enrolment ratio in basic schooling countrywide. The need to address the gender imbalance in the education system was also underscored by the policy. This would be done through the development of incentives, cost recovery methods, scholarships, community involvement and work study programmes. In addition, the policy of non-discrimination would ensure gender equity in education.

By 2001, the government had introduced free primary education, which resulted in increased enrolment of pupils in primary schools and at junior secondary school level. Primary enrolment increased from 51% in the early 1990s to 90.4% in 2001 (SL–PRSP 2005). Generally, making primary education free increases enrolment in schools, as was the case in Uganda, Kenya and Tanzania (Sperling 2006).

Advocacy for free primary education became a policy concern after the EFA conference in 1990.[1] The Global Campaign Action Plan for universal primary education and gender equality by 2015 includes the strategy of abolishing fees and charges for primary education, and making education free and compulsory for at least six years. It also advocates for the establishment of a time-bound plan for the progressive expansion of free and compulsory education to at least nine years. This will be equivalent to nine years of basic education which had already been adopted by Sierra Leone's New Education Policy (1995), and which became operational with the introduction of the 6–3–3–4 system of education. Nevertheless, the three years following primary education is free only for girls.

Additionally, government and non-governmental agencies like the Forum of African Women Educationalists (FAWE) embarked on sensitizing parents to the importance of young girls' education and encouraging them to send

[1] The Global Campaign Action Plan for universal primary education and gender equality by 2015. Available at www.campaignforeducation.org.

their female children to school. This sensitization was carried out through the electronic media and formal and informal gatherings.

14.2.5 The National Education Master Plan, 1996

The National Education Master Plan (NEMP) was developed to cover the period 1997–2006. It provided support for women's and girls' education, and technical vocational education. The NEMP goal 3 advocates the elimination of gender disparity in access to and participation in education, through the operation of free junior secondary education for girls by 2006 (Alghali *et al.* 2005, p. 5). This was to ensure girls' increased participation in education beyond the primary level to complete the basic education cycle. This would increase their chances of being employed and enhance their economic condition, as goal 6 of the NEMP aimed at using education as a tool for poverty alleviation (Alghali *et al.* 2005). By 2006 all girls at the junior secondary school level were benefiting from free tuition, free books and uniform to enable them to complete the basic education cycle. Yet girls continued to lag behind their male counterparts in education. By the 2006–7 academic year, at primary level in all four regions of the country, enrolment was 46.2% for girls and 53.8% for boys; at the junior secondary school (JSS) level enrolment was 62% for boys and 38% for girls; at senior secondary school (SSS) level it was 62.4% for boys and 35.8% for girls (Ministry of Education, Youth and Sports, Annual Statistics, 2006–7). For the 2008–9 academic year, primary enrolment was 59% for boys and 49% for girls; JSS enrolment was 57% for boys and 43% for girls; and at the SSS level enrolment was 58% for boys and 42% for girls (Ministry of Education, Youth and Sports Annual Statistics 2009). The figures reveal that the provision of free tuition, textbooks and uniforms will not keep girls in school. Parents need further motivation.

14.2.6 Effects of the War on Girls' Education

Girls' enrolment increased with the introduction of free primary education from 40% in 2000 (SSL 2000) to 42.6% in the 2006–7 academic year (MEYS 2007). The gradual expansion of the war through the entire country stifled the government's effort in improving and expanding educational opportunities in Sierra Leone. Many girls and women were abducted. The Truth and Reconciliation Commission (TRC) Report states that 'violations committed against women included killings, rape, sexual violence, sexual slavery, slave labour, abductions, assaults, amputation, forced pregnancy, detention, and torture' (TRC 2004, vol. 2, p. 100). In addition to these violations was mass displacement of the population as they searched for safer havens.

Internal displacement and abduction by the rebels greatly affected girls' education. Both actions led to the abrupt cessation of many girls' participation in educational activities. Although those who were internally displaced had temporary shelter schools, education was not an immediate priority in their lives. Furthermore, the camp schools were not as effective as the children's original schools; this too had a negative effect on the outcome of learning. Girls who were abducted were the most disadvantaged. They were completely removed from their learning environment and many became wives and mothers prematurely (Commonwealth Secretariat 2002).

By the end of the war many of these girls could not go back to school. Others came back sexually battered. Still another proportion could not return to school due to the character transformation that took place in their lives during their stay with the fighting forces, and hence became prostitutes.

14.3 Government Strategies to Expand Education after the War

By the end of the war, government embarked on special programmes to prevent further deterioration in the education system, in recognition of the fact that education is significant in the development of the country. It undertook policy reforms aimed at improving the educational system. Two of these programmes were as follows.

- The Rapid Response Education Programme (RREP) was a new initiative purposely geared towards facilitating the re-entry to the formal school system of school-aged children between 10 and 13 years who had lost formal schooling as a result of the rebel war. The programme lasted for five months, and enabled children who went through it to re-enter the formal school system.

- Complementary Rapid Education for Primary School (CREPS) was aimed at introducing the re-entry of over-aged children into primary school. The six-year primary school syllabus was condensed to three years, so that children in the CREPS programme were expected to complete the programme in three years (Commonwealth Secretariat 2002, p. 162).

These moves caused further increases in primary school enrolment from 260,000 in 2004 to 355,300 in 2005 and an increase in the number of pupils passing the National Primary School Examination from 43,400 in 2004 to 55,800 in 2005. The number of girls passing the examination this same period increased dramatically from 5,176 in 2004 to 20,062 in 2005 (GOSL and UNDP 2008).

In addition to the above, various non-formal primary education programmes were put in place aimed at children in communities without schools, and those who, because of age, could not return to school. Such programmes were community-based and focused mainly on literacy, numeracy and vocational skills training (Commonwealth Secretariat 2002). These programmes were particularly targeting girls. The UNICEF/PEA–SL programme mentioned earlier continued after the war. Other partners providing non-formal primary education were Forum for African Women Educationalists (FAWE), CAUSE Canada, Christian Children's Fund (CCF) and ActionAid.

14.4 The Millennium Development Goals, 2000

In the decade before the Millennium Development Goals (MDGs), 1990–2000, Sierra Leone experienced a decline in economic and human development (GOSL and UNDP 2008). The rebel war ended a year after the declaration of the MDGs and Sierra Leone was faced with the enormous task of reconstruction and rehabilitation of the destruction caused by the war. The war wrought great damage on the educational system. The Ministry of Education, Youth and Sports estimates that 80% of educational infrastructure was destroyed and teaching and learning materials were vandalized (Commonwealth Secretariat 2002). Apart from the destruction of school infrastructure, wars prevent school-aged children from going to school, for example, in Somalia, when the civil war broke out in 1991, school buildings were demolished and educational materials looted. By 2005, only 13% boys and 7% girls were enrolled in primary school (UNICEF/Somalia 2005). Likewise, in Liberia, the conflict caused serious damage to the education system; 80% of educational infrastructure was destroyed, schools and training institutions were closed. A generation of students was deprived of education (USAID/Liberia 2010).

In rehabilitating the entire education system, the government of Sierra Leone constructed 200 primary schools, 30 junior secondary schools and 30 technical and vocational institutions between 2002 and 2006. By 2008, government increased spending on education to 20% of its annual budget (GOSL and UNDP 2008) in its effort to meet the MDGs. MDG 3, 'Promote gender equality and empower women' aimed at eliminating gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015. This was in accordance with EFA goal 5, 'Eliminating gender disparity in primary and secondary education by 2005 and achieving gender equality in education by 2015, with a focus on ensuring girls' full and equal access to achievement in basic education of good quality'. As indicated earlier, the government had already put measures in place to ensure girls' increased access, retention and completion of basic education. The government of Sierra Leone and United Nations Development Programme (GOSL and UNDP 2008) report on 'Achieving the Millennium Development Goals in Sierra Leone' recorded an increase in girls' enrolment of 39% between 1990 and 2004. In addition, women's literacy increased from 16.7% to 23% in the same period (male literacy was 46.9% in this period). In spite of this improvement, government and its development partners are still working on increasing girls' presence in the education system and promoting women's literacy nationwide.

In rural communities, the government and its development partners are implementing the school feeding programme to encourage parents to enrol and retain their children in school. The support to parents, through the school feeding programme, free primary education and free core textbooks, has been found to be motivating in rural areas in Sierra Leone. This is similar to Brazil's Bolsa Escola (school grant programme) where poor families are provided with income subsidies on the condition that they maintain their children's regular attendance at school (Palazzo 2005). This strategy of support to poor families has been yielding positive results as is evident in a programme in Kenya where the provision of school meals raised attendance by 30% (Sperling 2006).

The task of achieving MDGs 2 and 3 is challenging. In spite of the government's effort to increase girls' enrolment through free primary education and support for junior secondary school education, the number of girls decreases as they move up the education hierarchies. For example, in the 2008–9 academic year, girls' total enrolment at senior secondary school level was 42%, while that of boys was 58% (MEYS 2009). This problem is not peculiar to Sierra Leone. In Bangladesh significant progress was made in bringing about gender parity in the 1990s. Between 2001–3 girls had outnumbered boys by 9.11% in secondary schools, but at tertiary level it was 53 women to 100 men because women were discouraged from pursuing higher education (Rowshan 2008). This indicates a strong view that women's participation in education should have a cut-off line. It also suggests that free education is not adequate to achieve the desired goals for girls' education: traditional beliefs about girls' education must change.

The MDG Report on Sierra Leone (2010) showed a high drop-out rate for both boys and girls. It stated that the proportion of pupils starting grade 1 who reached the last grade of primary school in 2005 was 11%, whereas the MDG target is 100% (Multi-Cluster Indicator Survey 3, 2005 in SLPRSP 2010). At the same time the Core Welfare Indicator Questionnaire showed that the Sierra Leone government had made primary education accessible to only 75% of school-aged children. This report reveals that the Sierra Leone government still needs to cater for the remaining 25% school-aged children to achieve EFA goal 2 (ensuring that by 2015 all children – including girls, children in difficult circumstances and those from ethnic minorities – have access to complete free and compulsory primary education of good quality) and MDG 2 (achieve universal primary education). Though universal primary education is slowly being approached, quality and drop-out rates are of major concern.

14.5 Education for All: National Action Plan, 2004

In developing the National Action Plan (NAP) to achieve Education for All (EFA), all four regions of the country made contributions to its compilation. A similar strategy was adopted in Mozambique. After the EFA conference, seminars and conferences were held to disseminate the conclusions of the conference (EFA). Plans were designed for the reform of the Mozambican education system during these meetings. Many other activities followed complemented by surveys carried out by various technical commissions composed of the Ministry of Education staff and university lecturers who analysed problems faced by the education system, particularly in basic education. The outcome of these exercises formed the basis of their Basic Education Master Plan in 1993 (UNESCO 2002).

The EFA National Action Plan contained the priorities set out for achieving basic education in Sierra Leone by 2015. It emphasized the issues of access, equity and quality within the Sierra Leone education system. The major national EFA policy issues are contained in this document. One of the priority objectives of the plan was to eliminate gender disparities in education. Programmes identified to achieve this were:

- sensitization and gender awareness campaign;
- advocacy by stakeholders to encourage the education of girls;
- enactment of legislation on compulsory education discouraging early and forced marriage;
- construction of more schools and literacy centres nationwide;
- training support for females who study mathematics, science and technology;
- education on gender parity issues in mathematics, science and technology (EFA: NAP 2004, pp. 48–52).

The plan recognized that free and compulsory education was a must for achieving EFA. It acknowledged that investing in female education was a cost-effective way of improving the standard of living in the country. It revealed that the government's strategy of a micro-credit scheme (a loan repayment scheme) through the National Commission for Social Action was a policy to invest in the poor population of the country.

It reiterated a major EFA goal which states that all children in Sierra Leone must have access to free, compulsory and quality education by 2015 (goal 2). It emphasized the provision of access to lifelong skills for all young people and adults, and that training must be skewed towards employment. Girls' access to education was emphasized throughout the document. Subsequently, two objectives for achieving EFA goal 5 were the following.

- Accelerate the process of reducing gender disparity in education.
- Increase enrolment, retention and completion rates of women and girls in formal and non-formal education programmes by the year 2010. Provision was also made for war-affected girls to be placed in schools and awarded scholarships (EFA: NAP 2004, p. 21).

Education was recognized in the EFA: NAP as being important in the fight against poverty and for empowering women. Consequently, providing access to education for girls and ensuring retention up to basic education level became key to reducing gender disparity in education. The 2002 Ministry of Education, Youth and Sports report on the status of education showed that 120 out of 3,000 schools were operating double-shift to accommodate more children at junior secondary school level (EFA: NAP 2004). Furthermore, non-formal education was recognized as being a complementary programme to the overall educational system, leading to the development of life skills. A harmonized curriculum was developed and lodged in the Non-formal Education Directorate of the Ministry of Education, Youth and Sports.

14.6 Technical and Vocational Education

The 6–3–3–4 system of education and the 1995 New Education Policy gave prominence to technical and vocational education in the education system in Sierra Leone. This was in fulfillment of EFA goal 3, 'ensuring that the learning needs of all young people and adults are met through equitable access to appropriate learning and life skills programmes'. Before the introduction of the new system of education, only a few schools offered technical/vocational and commercial subjects. In the new system some general schools do offer TVET at JSS and SSS levels. The Ministry of Education, Youth and Sports' policy demands that pre-vocational courses are taught at junior secondary school level, for example, introductory technology, and business studies. At senior secondary school level, the curriculum has a list of technical/vocational education subjects, but the lack of equipment and qualified teachers have stymied many schools from offering these courses (World Bank 2007). In spite of this shortcoming, the government is aware of the significance of training in technical and vocational skills, established the National Council for Technical, Vocational and Other Academic Awards (NCTVA) by an act of parliament in 2001. The Council was to set examinations and ensure quality for all technical and vocational training in the country (Alghali *et al.* 2005).

By 2004, a technical vocational education and training survey showed that there were more than 200 TVET institutions in the country with a total enrolment of 30,000 students in the 2003–4 academic year of which 60% were females (World Bank 2007). However, gender stereotyping by subject was observed in that 90% of students in the technology options were males (World Bank 2007). The Western Area, Bonthe (in the south) and Kenema (in the east) do offer TVET programmes at the Higher National Diploma level (HND). Unfortunately, some districts do not have technology-related programmes beyond that offered by Community Education Centres (CECs) (Samba 2009).

With the proliferation of technical and vocational institutions in the country it became necessary for these provisions to be categorized and assigned levels. Entry requirements were laid down, duration of courses were stated and types of certificates offered were indicated.

Courses offered in TVE institutions are grouped as follows.

1. Agriculture trades
2. Construction
3. Mechanical trades
4. Clothing and textiles
5. Electrical/electronic trades
6. Cosmetology trades
7. Commercial trades
8. Arts and crafts work
9. Hospitality trades
10. Marine trades
11. Information technology
12. Air conditioning and refrigeration
13. Boat building
14. Food processing and preservation

An examination of the above list shows that more male-orientated subjects are provided. Naturally, some trades will attract more females as they are compatible with their gender roles. For example, clothing and textiles, cosmetology, trades, food processing and preservation. Although female students are found in commercial trades, on the whole TVE courses are more inclined to equipping male students. Women are beginning to venture into the electrical and mechanical trades but their number is relatively insignificant. Generally, entry requirements into technical/vocational education institutions are as follows.

Category 'B' community education centres with duration of between 6–18 months. The entry requirement is age of labour. On completion, occupations they could fit into are as follows.

1. Bricklaying
2. Hairdressing
3. Boat building
4. Carpentry
5. Weaving
6. Basketry
7. Masonry
8. Blacksmith
9. Carving
10. Soap making
11. Agriculture worker
12. Tailoring
13. Gardening
14. Sales person in food trade
15. Embroidery
16. Tinsmith
17. Goldsmith

Category 'A' community education centres with course duration of 6–18 months. The entry requirement is completion of primary school education/NPSE. The student will qualify to become any of the following in the list below (Samba 2009).

1. Motor vehicle mechanic
2. Electrical fitter
3. Joiner
4. Painter and vanisher
5. Fitter
6. Baker
7. Tool maker
8. Radio and TV technician
9. Gara tie dyer
10. Welder and fabricationist
11. Electronics technician
12. Mechanic
13. Cook
14. Doctor's receptionist
15. Florist
16. Draftsman
17. Surveyor
18. Bookkeeper
19. Cabinet and upholstery maker
20. Plumber
21. Cosmetologist
22. Sheet metal worker
23. Mechanical drawing personnel
24. Air conditioner and refrigerator technician
25. Bank clerk
26. Pharmacist assistant
27. Hotel specialist
28. Secretary

Category: technical and vocational institutes. These are the standard technical and vocational institutions. The duration of courses is two to three years. Entry requirements are completion of SSS/WASSCE, GCE 'O' level, and OND.

On completion of the courses the recognized occupations they will enter into are (Samba 2009, p. 5) as follows.

1. Building construction
2. Construction draftsman
3. Technical draftsman
4. Electricals
5. Telecommunication technology
6. Electronics technician
7. Customs and excise duty
8. Clothing and textile
9. Automobile mechanics
10. Hotel specialist
11. Machinery
12. Catering and hotel management
13. Assistant business and tax consultancy
14. Home economics
15. Agriculture
16. Computer technology
17. Advanced air-conditioning and refrigeration

Technical and vocational education and training institutions provide five training fields for learners, namely: craft, industry and commerce, profession, agriculture and domestic science.

By 2008 there were 370 registered technical and vocational institutions in the country (Samba 2009). However, there are some unregistered institutions that could be added to this number. The government assists 154 such institutions. At government-assisted institutions the gender enrolment figures were 36% male and 64% female (Samba 2009). It is worth noting that women were concentrated in training components that reinforced their gender roles.

Many TVET institutions, especially those privately owned, are plagued by numerous problems: poor accommodation, inadequate and obsolete equipment and other training materials, and improperly trained teachers. On the whole TVET is largely provided by individuals. Their fees are high and this keeps many potential students out (World Bank 2007).

14.6.1 Training Opportunities for Girls and Women in Formal and Non-formal Training Institutions

The 6–3–3–4 system was to develop the human resources needed to meet the developmental challenges of the country. To reduce wastage, technical and vocational education and training (TVET) were located between the junior secondary school and the senior secondary school to accommodate those completing junior secondary school (New Education Policy 1995). The junior secondary schools were to provide 'opportunities for the continued acquisition of basic skills and knowledge'; introduce 'subjects encouraging the development of nationally desired and saleable skills' (p. 11); and assist in the 'acquisition of abilities appropriate and necessary for entry into modes of employment or self-employment not requiring prior training in specialist skills' (New Education Policy 1995, pp. 11–12).

Training opportunities exist in the country for different types of skills and at various levels of training, as indicated in Table 14.1. The extent to which these

TABLE 14.1. Nature of TVE institutions in Sierra Leone.

Category	Level	Entry requirement	Duration of courses	Certificates gained
Community education centre (CEC) 'B'	Non-formal	Age of labour	6–18 months	National Vocational Certificate
Community education centre (CEC) 'A'	Formal	Completion of primary/NPSE	6–18 Months	Trade test 'B'
Junior secondary technical/vocational (JSTV)	Junior secondary school	National Primary School Examination	3 years	Trade test 'A'
Technical vocational centre (TVC)	Junior secondary school	Completion of JSS/BECE/trade cert. 'A'	1–2 years	Diploma/OND
Senior secondary technical/vocational (SSTV)	Senior secondary school	BECE	3 years	
Technical vocational institute (TVI)	Senior secondary	Completion of SSS/WASSSCE/GCE 'O' level/OND	2–3 years	Diploma/OND/ HND
Professional institutes	Post-secondary	WASSSCE/OND/HND	3–4 years	Diploma/HND/ degree
Polytechnic	Tertiary	WASSSCE/OND/HND	3–4 years	Diploma/OND/ HND/degree

Sources: Samba 2009. *Note*: BECE stands for Basic Education Certificate Examination. 'HND' stands for Higher National Diploma. 'OND' stands for Ordinary National Diploma. JSS stands for junior secondary school. 'SSS' stands for senior secondary school.

are available to women and girls is a case in point. Training opportunities are offered by formal and non-formal institutions. Formal training is provided by government and NGOs while non-formal training is provided by community-based organizations and individuals.

Government policies, based on ILO Convention 100 (1957) on equal remunerations for men and women for work of equal value, reiterate the essence of providing facilities for counselling in vocational training and employment for women, encouraging them to take advantage of these facilities, and allowing them equal access to these occupations.

Formal skills training centres include community education centre 'A' category (CEC 'A'); junior secondary school technical vocational education (JSTVE); technical and vocational centres (TVCs); senior secondary technical vocational education (SSTVE); technical vocational institutes (TVI); professional institutes and polytechnics. But these require prior educational attainment for enrolment, ranging from completion of primary education to the possession of the West Africa Senior Secondary School Certificate Examination (WASSSCE), GCE 'O' level, Ordinary National Diploma (OND) and Higher National Diploma (HND). Many women can therefore not access TVET due to their literacy status and lack of formal qualifications. The total percentage of national literacy is 35.1%. Literacy by gender is 46.9% for males and 24.4% for females (Statistics Sierra Leone 2004). Consequently, though there are various categories of technical and vocational training institutions and centres for skill acquisition, entry requirements pose a limitation on women and girls.

The next limitation posed by formal training institutions is the courses offered. By their socio-cultural orientation, girls' choices are limited. In community education centre category 'A' 28 occupations are catered for and girls and women have 10 options, which are: bakery, gara tie-dye, cook, hotel specialist, florist, bookkeeping, cosmetology, pharmacist's assistant, doctor's receptionist and secretarial studies. The technical and vocational centres provide 6 options for females out of a total of 17 occupations, namely, customs and excise duty, clothing and textiles, hotel specialist, catering and hotel management, home economics, and agriculture. Often girls and women lack adequate information on vocational training, science and technology. Many girls and women are not aware of some of the courses offered at these centres, for example, florist, doctor's receptionist, customs and excise duty. The absence of role models is also a demotivating factor in opting for subjects that could lead to certain vocational or technical skills acquisition.

In addition, the cost of training in formal institutions discriminates against women and girls who are generally poor and may have dropped out of school, or did not go to school, for lack of funds to pay fees. Janjua and Naveed (2009), in their study, 'Skill acquisition and the significance of informal training system in Pakistan: some policy implications', raised concerns over the high cost of formal training in Pakistan marginalizing almost two-thirds of the labour force. This suggests that even where entry is not limited by educational requirements, cost will prevent many women from enrolling in these centres.

Alternatively, non-formal skills training could be acquired from community education centre category 'B'or on the job in apprenticeship, where either a very minimal amount is demanded or where payment is in kind; that is, the apprentice assists the master craftsman in domestic duties. The course duration in formal training ranges from six months to three or four years. Conversely, training acquired through apprenticeship could last longer. Sometimes learners enter into apprenticeship at a very young age, for example, 8, 9 and 10, and would remain until they become adolescents and are ready to operate their own workshops or trades.

14.7 Employment and Income Opportunities for Girls and Women in Sierra Leone

The last population census revealed that about 85.62% of the population aged 15–64 years made up the labour force. However, not all of this population was employed, 96.45% were employed and 3.55% were unemployed at the time of the census (UNFPA and EU 2006). Male participation in employment was 52.6% and female participation was 47.4%. They were engaged in various occupations in the economy, as shown in Table 14.2.

From an institutional and organizational perspective, African economies are usually divided into two broad groups of sectors, namely, the formal and informal sectors (Juma *et al.* 1993). In this regard, these are the two sets of employers and employees in Sierra Leone. The formal sector, being well organized with explicit rules and having rigid bureaucratic procedures, seriously constrains prospective entrants. When a vacancy exists it is advertised and conditions for applying are stated. Next, an interview is conducted for shortlisted candidates. In some instances, when too many people qualify, an examination is conducted for shortlisted candidates, after which an interview is conducted. Literacy is therefore a prerequisite for entry into formal sector employment. In addition, particular skills are sometimes required for filling some vacancies. Women, therefore, with their high illiteracy rate and lack of essential skills, are often at a disadvantage in applying for jobs in the formal sector. Besides, the formal sector, being limited in size at present, could only employ a relatively small percentage of the working population (SL–MDG 2010). The Sierra Leone Integrated Household Survey (SLIHS) report of 2005 revealed that 93% of urban resident women and 94% of rural women who were economically active were not in paid labour (SLIHS 2005 in GoSL and UNDP 2008). However, the GOSL and UNDP (2008) figures show that there has been an increase in female participation in the labour force in Sierra Leone, from 51.3% to 53% between 1990 and 2004. Female participation in the labour force is generally low in many African countries: 40% in Ethiopia, Kenya, Malawi and Uganda. The figure is higher in places like Burkina Faso, Burundi, Gambia, Ghana and Sierra Leone (World Bank and AFD 2010). The alternative employer is the informal sector which does not restrict entrants.

TABLE 14.2. Distribution of the labour force by industry and gender.

Industry	Male and female		Males		Females	
	Total labour force	Distribution of labour force (%)	Total labour force	Distribution of labour force (%)	Total labour force	Distribution of labour force (%)
Crop farming	1,177,873	64.01	568,165	60.42	609,708	67.77
Livestock	7,241	0.39	3,940	0.42	3,301	0.37
Poultry	1,796	0.10	866	0.09	930	0.10
Hunting	1,241	0.07	777	0.08	464	0.05
Forestry	6,180	0.34	4,060	0.43	2,120	0.24
Fishing	48,821	2.65	31,834	3.39	16,987	1.89
Mining	67,644	3.68	58,481	6.22	9,163	1.02
Manufacturing	9,203	0.50	7,236	0.77	1,967	0.22
Electricity/gas/water	8,255	0.45	7,059	0.75	1,196	0.13
Construction	38,307	2.08	27,829	2.96	10,478	1.16
Trade/repairs	263,459	14.32	100,398	10.68	163,061	18.12
Hotels/restaurants	4,890	0.27	2,604	0.28	2,286	0.25
Trans/com/storage	15,654	0.85	14,402	1.53	1,252	0.14
Financial intermediate	6,873	0.37	3,973	0.42	2,900	0.32
Estate/renting/business	10,602	0.58	5,428	0.58	5,174	0.58
Public admin/def/SS	25,804	1.40	21,038	2.24	4,766	0.53
Education	33,550	1.82	22,708	2.41	10,842	1.21
Health/social/WK	19,594	1.06	9,739	1.04	9,855	1.10
Other community/social work	81,157	4.41	43,378	4.61	37,779	4.20
Private HH employee	8,062	0.44	3,895	0.41	4,167	0.46
External org/bodies	3,796	0.21	2,486	0.26	1,310	0.15
Sierra Leone	1,840,002	100.00	940,296	100.00	899,706	100.00

Source: UNFPA and EU 2006.

14.7.1 Formal Sector Employment in Sierra Leone

In Sierra Leone, formal sector employment is provided by government, non-governmental organizations and private firms, all of which require formal entry procedures and are hierarchically structured. For example, in the government civil service, all positions are graded from 1–14. They are also categorized into five classes, namely, the administrative class, the professional and technical class, the executive class, the clerical class and the manipulative class. The senior positions begin from grade 7, while grade 14 is the highest position. The paramount consideration in the appointment of members of the civil service of Sierra Leone is the highest standard of qualification, efficiency, competence and integrity. The appropriate grade for a position is determined by the responsibility of the work, risk involved in the job, consequences or effects of error or work failure, independence of action and initiative expected in accomplishment of work, supervision over others and special qualifications required for successful performance of work. For appointment into senior positions, the following factors are considered: knowledge required for performance of complex duties at senior level, complexity of work, scope and effect of decisions and actions, and independence of action (Bangura 2004). Consequently, in public administration, defence and state security, women form only 0.53% of the total workforce (UNFPA and EU 2006). The emphasis in the formal sector is on procedures and qualifications. The factors responsible for women's clustering in the lower hierarchies of this sector have been discussed above. The majority of women working in the Sierra Leone civil service fall below grade 7.

14.7.2 Informal Sector Employment in Sierra Leone

In this sector, a wide range of economic activities are undertaken. Because of the ease of entry many people (men and women) flood the sector, being an employer of 'last resort' (Khalek 2005). In his essay on 'Viable financial services for development', Khalek (2005) identified three categories of workers in this sector: those who are struggling to survive, the self-employed, and micro-enterprise. The survivors, he stated, are very poor; they simply generate income to live on a daily basis. The self-employed produce goods for sale, purchase goods for resale or offer services for money. Micro-enterprise is very small business and often operates from a fixed location with regular hours. He observed that those working in this sector create their own employment either individually or in small-scale family businesses (Khalek 2005).

The informal sector now characterizes the labour market in Africa and it accounts for 72% of non-agricultural employment in sub-Saharan Africa (Verick 2006). Women make up the majority of informal sector workers in Sierra Leone (UNFPA and EU 2006) due to their exclusion from the formal sector. The ease of entry and the ability to combine income-earning with domestic responsibilities make the sector attractive to girls and women. In

2001 it was estimated that the informal sector accounted for at least two-thirds of the labour force and over 70% of the urban labour force in Sierra Leone (Commonwealth Secretariat 2002). For many women in Sierra Leone participation in the informal sector is a survival strategy, especially after the war which left many of them as heads of households. The informal sector has been creating new jobs, and providing linkages among small-scale manufacturers, promoting labour intensive production processes and integrating local markets (Khalek 2005). It has also 'built associations and mobilized traditional savings and credit schemes to offer sources of capital for women' (Kargbo 2009, p. 12).

Many women in the informal sector are involved in trading. Verick (2006) observed that the informal sector in Africa is dominated by trade related activities and that manufacturing and servicing account for only a small percentage of the sector.

Women have opportunities for employment in the formal sector provided they possess the educational levels and skills required. They also have an open-ended opportunity in the informal sector for employment and income generation.

14.8 Ways Forward

For education to become a tool for poverty alleviation, the level attained and the type and content received determine the employment sector that will absorb the graduates. Preparation for future employment must begin in schools and continue in tertiary institutions, to better equip prospective job seekers. For women to contribute to national development they must be equipped with both cognitive and psychomotor skills.

14.8.1 Education

The government's efforts at increasing girls' participation in education will not yield its desired goal if measures are not put in place to ensure retention, completion and achievement through quality delivery. In post-conflict Rwanda, to promote education, a child-friendly atmosphere with an appropriate learning environment was created. This had a positive effect on girls' education. Teachers, too, were committed to seeing pupils succeed. In child-friendly schools, when classrooms were not sufficient, makeshift classes were held outdoors. This resulted in great progress in enrolling girls in primary school (UNICEF, Rwanda 2007). This suggests that a proper school environment must be buttressed by teacher commitment.

When the school environment is conducive to learning, children's performance may improve. This may in turn lead to more girls remaining to complete a cycle of schooling. In spite of the government's effort to rehabilitate schools damaged during the war and to construct more schools under the Sababu

Education Project,[2] many schools in Sierra Leone are still overcrowded and in some the teacher–pupil ratio far exceeds the official figure of 1:40 (New Education Policy 1995). This is a problem for the teachers as it reduces their efficiency and creates a disadvantageous condition for girls, who are generally less confident, and who may be suffering from harassment from boys that a teacher could not notice. This is likely to lead to girls' inability to cope with schoolwork and could result in poor performance which has been identified as one reason for girls dropping out. Schools must be equipped with better facilities. For example, pipe-borne water, toilet facilities, spacious classrooms, electricity and playing fields could all serve as motivation to the pupils.

Although efforts are underway to train unqualified and untrained teachers through distance education, the government, through the Ministry of Education, Youth and Sports, should make it compulsory for all untrained and unqualified teachers to enrol for training to improve teacher quality. Gender issues should be included in teacher training courses to make teachers gender aware. This may have a positive effect on their classroom behaviour, especially towards girls. The Ministry of Education, Youth and Sports should provide logistics to enhance proper and effective monitoring of schools. Regular in-service training programmes for teachers could contribute to improving teacher quality. The training of teachers should be accompanied by improved conditions of service; this will motivate them to be more dedicated to their work, hence making them more committed to seeing the pupils pass their examinations. Their salaries must be raised in consonance with current living conditions and relevant allowances paid on time. Teacher satisfaction is part of a school-friendly atmosphere. Girls may stand to gain greatly from such a school-friendly atmosphere and this may contribute to reducing drop-out rate among them. Moreover, modern methods of teaching and learning should be introduced in schools in Sierra Leone. Children should be introduced to information technology at an early stage in their learning process. All of the above will contribute to keeping girls interested in the learning processes.

The parents, guardians and the community as a whole should cooperate with school authorities to ensure that pupils achieve in school. Accountability and transparency should be emphasized within the school management system; materials supplied to schools must be used for the benefit of the children. The Ministry of Education, Youth and Sports should follow up on the distributed materials in the respective schools.

The hidden cost of school attendance should be minimized. It has been observed that when school fees are abolished, other charges become the unofficial 'fee'. This was observed in Kenya, Zambia, Malawi and Sierra Leone (World Bank 2007, 2008). This hidden cost becomes a burden on parents, and poor families cannot cope with it. Sierra Leone has a high incidence of poverty (54% in the urban areas and 80% in rural areas (World Bank 2007)) and

[2] Sababu – the rehabilitation of Basic Education Project was later renamed the Sababu Education Project. Sababu means 'opportunity' (Alghali *et al.* 2005).

poverty has been identified as one of the reasons for girls' lower participation in education (World Bank 2004; GOSL and UNDP 2008).

With free primary education and the supply of learning materials in place, government should formulate policies to ensure that parents send their girls to school, sanction those who refuse to do so, and ensure that the sanctions are implemented. This is because education generally opens up opportunities for employment.

Families and communities should be supported somehow as an incentive to retain their girls in school, since some of the reasons given for girls' exclusion or dropping out of school include their contribution to family labour and income generation. Sperling (2011) noted that even modest incentives to parents make a huge difference as scholarships and conditional cash transfer have shown an increase in school attendance for both boys and girls in Bangladesh, Mexico and Brazil. In Sierra Leone, literacy classes could be established in communities and microcredit loan schemes incorporated into each, to be received only by families whose girls are in school. This could increase the adult literacy rate in the country and raise girls' school completion rate. Brazil's 'Bolsa Escole' retained black and indigenous pupils in school. The programme also empowered women as the income benefit was given to mothers who were responsible for monitoring their children's school attendance and performance (Palazzo 2005). In Madagascar, the 'girl to girl' strategy was adopted when it was observed that only one-third of girls enrolled in primary school reached grade 5. The strategy was introduced in 2001. It required teachers to identify girls who were likely to drop out of school and paired them with girls in the fourth and fifth grades. They began to do things in common, walking to school together, playing during break time and doing their homework together. The older girl built the confidence of the younger in the classroom (UNICEF/Madagascar 2005). Mexico's 'Opportunidades' also compensated parents for keeping their children in school. This increased girls' enrolment and retention in the school system. All of the above show that a little more effort could increase girls' school attendance and retention.

Best practices could be adopted or adapted according to the socio-cultural milieu of the receiving country. The microcredit loan scheme which Sierra Leoneans are familiar with and look up to could be used as motivation for parents to enrol and keep their girls in school. Facilitators in community literacy classes should enlighten their learners about the essence of girls' education. In addition, the microcredit loan schemes in the literacy classes could serve other purposes: first as motivation to remain on the literacy programme, and next to create an opportunity for them to generate income to meet the extra charges levied by the schools.

This should be followed by community sensitization regarding the importance of girls' education, and encouraging parents and guardians to enrol their girls in school. The school feeding programme which is currently being implemented in selected communities should be expanded to all rural areas and to schools in deprived communities in urban areas.

Government policy on readmission of girl mothers should be enforced. Some heads of schools still refuse to admit girl-mothers on the moral basis that they would be a negative influence on other girls. Some parents too are reluctant to support such girls on the grounds that it is a waste of limited resources. They prefer the girl to stay at home and nurture her child. Some girl-mothers stay too long at home and eventually lose the confidence to return to school. Depending on the level from which they drop out many revert to illiteracy after a few years, thereby reducing their chances of being gainfully employed, especially in formal institutions.

Ensuring women's and girls' education requires either additional efforts or new initiatives: a gender desk could be created in the Ministry of Education, Youth and Sports specifically to implement or follow up on the strategies contained in the National Education Action Plan that promotes girls' education. These strategies are:

- gradual provision of free and compulsory education for girls at Basic Education Level (this has been achieved, but is to be monitored);
- legislating the minimum marriage age for girls to 18 years (they would have completed secondary schooling by then) and penalties for men/boys who impregnate girls before 18 years;
- promoting counselling and family life education to avoid early pregnancy;
- readmission of girl-mothers into school;
- allowing unmarried female students to continue their courses at tertiary level when pregnant (already in place);
- increasing participation of girls in mathematics, science and technology;
- recognizing non-formal education for girls and its linkage with the formal system;
- providing childcare facilities near learning centres for women learners in adult education programmes and girls in non-formal education programmes;
- allowing unmarried female teachers to enjoy maternity leave when they become pregnant.

Girls' education at basic education level has not become compulsory and girl-mothers are facing discrimination in admission in some schools. A well-established gender desk with the requisite logistics could effectively ensure the smooth implementation of all nine strategies.

14.8.2 Skills Training

A country's development potential is seriously limited by the capacity of its manpower, particularly its middle-level manpower. The World Bank and Agency Française de Developpement (2010) conducted a survey in 18 African countries on gender dynamics that impact work-related indicators such as employment, unemployment, sector of activities and pay gap. The report stated that two sets of people were found to dominate the few jobs available in the labour market in these countries: those with better human capital, that is, education, and those with more power in the home, usually men. These findings reiterate the importance of education as one major factor influencing employment opportunity and throws light on the unequal power relations in the home in African societies.

In addition to education, women need to be trained in appropriate and relevant skills to enable them to either compete with their male counterparts for the limited jobs in the formal sector, or enhance their setting up of micro-enterprises in the informal sector. Training is necessary to fill the middle-level manpower needs of a country. One major problem that girls who drop out of school and women in the wider society face is the lack of the requisite technical and vocational skills (Mahdi 2009). To build their capacities, they need information on training opportunities available in the country where they could learn new skills or develop their basic skills in preparation for either better-paying jobs or improved performance in the informal sector. The training would enable them to produce better-value goods and services and contribute to economic growth in the country. To boost their performance in the agricultural sector, women need to learn new skills as opposed to only the traditional skills. The passing of the Gender Act 'Devolution of Estate' in 2007 entitled women to own property but landownership remains a problem, especially for women in rural areas. This points to the fact that women cannot own agricultural plots that they could invest in. The land problem needs to be reconsidered. Agricultural extension workers should target women farmers even in their backyard gardens. Because of the sensitivity of cultural dictates in some communities, more female agricultural extension workers should be trained. These women could better interact with their colleagues in the performance of their agricultural activities.

Women's employment opportunities must be diversified. In Cambodia, though three-quarters of their employment is in agriculture, the opening up of the garment industry led to rapid employment growth, especially for women. In another post-conflict scenario in El Salvador, recovery of the service sector was a major factor in improving employment opportunities for women. Almost 75% of El Salvadoran women work in the service sector (M'cleod and Davalos 2008). Following these examples, Sierra Leonean women could be trained to work in industry. They could be taught simple operation of machines in addition to doing manual work, in the available industries in the country. To buttress this, much premium should be placed on technical and vocational education for women. At technical and vocational training centres women should be counselled to take advantage of the variety of skills offered and not just cluster into what are considered to be feminine skills.

The World Bank report on gender mainstreaming in Afghanistan underscored the significance of technical and vocational training in increasing women's employment opportunities. The report stated that vocational training enables women to acquire the appropriate knowledge and skills to meet basic needs, open doors to job opportunities and raise women's standard of living. In Afghanistan, where strict adherence to culture is emphasized, women are allowed to work in the repair of computers, mobile phones, and other electronics (Solotaroff and Hashili 2007). In Sierra Leone these are not popular areas for women as they are considered to fall within the male domain. At the myriad of community education centres throughout the country, women should be counselled to train in non-traditional skills. In addition, female role models in non-traditional jobs should be recruited at these training centres. To attract more women, training must be less expensive. Furthermore, if women are training for self-employment, training should include business planning techniques (Solotaroff and Hashili 2007) and appropriate social skills to enable them to perform better on the job. As the New Education Policy (1995) laid premium on technical and vocational education, the infrastructure of government technical and vocational education institutions should be upgraded and expanded to accommodate more learners. Government and development partners could equip them with modern technologies and other relevant training materials. Government should increase the number of private institutions they are currently supporting to help improve quality of delivery in private institutions. In training institutions and centres, internship should be a must. This will ensure quality on completion of the training programme.

The government and/or development partners should establish financial lending facilities at community level that cater for women's businesses. The loan conditions should adopt local initiatives such as having someone in the community to stand as guarantor for the borrower. This is an acceptable practice in rural communities. Such loans could enable women to set up their own enterprises if they fail to get employment elsewhere. The lending institutions should have field officers to monitor the performance of the women in their businesses and to offer advice where necessary. The institutions should also encourage women who receive loans from them to save a minimal amount of their profits with them. This could be one way to reduce the rate of defaulting.

At the formal level, the EFA: NAP programme 5 (training support for females who study mathematics, science and technology) must be adhered to. Further, studies in these subjects could be obtained from both private and government-owned tertiary institutions including vocational and technical institutions. As the formal labour market in Sierra Leone is limited in scope (UNFPA and EU 2006; SL–MDGs 2010), women should be trained to be self-employed. The 2004 Housing and Population Census revealed that 1,388,161 persons were in self-employment, and of these 702,554 were males and 680,607 were females

(UNFPA and EU 2006). The formal employment sector could be expanded by creating more jobs and/or encouraging foreign investors to establish various enterprises in the country.

14.9 Conclusion

We have looked at the educational and employment status of girls and women in a post-conflict context. We have described the government's efforts in policy reforms to increase girls' participation in education. We also examined training opportunities available in the country. Examining the employment sector, we observed that girls and women outnumbered men in the informal sector.

The paper has revealed that poverty, parental perception of girls' education, gender division of labour and emphasis on girls' marriageability all pose serious hurdles to girls' education, and subsequently their formal employment. It also revealed that lack of the requisite skills is a hindrance to women's and girls' employment. In the light of these issues, we propose the following for consideration in policy formation.

14.9.1 Education

Concerning education, the paper has addressed several issues that need to be considered in order to increase women's and girls' education and employment. These are presented below for consideration in policy formulation:

- more sensitization is needed for parents who refuse to enrol their girls in school;
- the Ministry of Education, Youth and Sports should mount a strong monitoring mechanism to minimize high and hidden costs of school attendance, ensure the distribution of school materials and adequate accountability and transparency in school management;
- improve on teacher training and include occasional in-service training to ensure quality of educational delivery;
- employ more teachers to reduce the high pupil–teacher ratio;
- gender issues should be included in teacher training courses;
- teachers' conditions of service should be revised in line with current living conditions;
- schools should be equipped with better facilities like adequate accommodation, pipe-borne water, sufficient furniture, separate toilets for boys and girls, electricity and computers;

- greater involvement of parents and community in school management throughout the country;
- giving parents incentives either directly or indirectly in cash or in kind to encourage girls' education.

14.9.2 Employment

On the employment side, the paper has addressed several issues that lead to suggestions for policy that can be briefly stated:

- encourage girls to study subjects that will earn them better-paying jobs, which will necessitate the provision of guidance counsellors in all secondary schools in Sierra Leone;
- entrepreneurial skill development in both formal and non-formal institutions;
- reduce the cost of training in technical/vocational education institutions;
- establish microfinancing at community level;
- train more female agricultural extension workers to reach female farmers with new farming techniques.

Appendix A: Acronyms

BECE	Basic Education Certificate Examination
CCF	Christian Children's Fund
EFA	Education for All
EFA: NAP	Education for All: National Action Plan
ERNWACA	Educational Research Network for West and Central Africa
EU	European Union
FAWE	Forum of African Women Educationalists
GOSL	Government of Sierra Leone
GRADOC	Gender Research and Documentation Centre
JSS	Junior secondary school
MICS3, 2005	Multi-cluster indicator survey 3, 2005
PEA–SL	People's Educational Association Sierra Leone
SL–PRSP	Sierra Leone Poverty Reduction Strategies Paper
SSL	Statistics Sierra Leone
SSS	Senior secondary school
TRC	Truth and Reconciliation Commission
UNFPA	United Nations Fund for Population Activities
UNGEI	United Nations Gender Education Initiative
UNICEF	United Nations Children's Fund
UPE	Universal primary education
USL	University of Sierra Leone
WASSSCE	West Africa Senior Secondary School Certificate Examination

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