



SIERRA LEONE

**DIAGNOSTIC STUDY OF
THE INVESTMENT CLIMATE
AND THE INVESTMENT CODE**

May 2004

**Foreign Investment Advisory Service
a joint service of the
International Finance Corporation
and
The World Bank**



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This report has been prepared by the Foreign Investment Advisory Service (FIAS), a joint facility of The World Bank and the International Finance Corporation, in response to a request by the Minister of Finance to provide an overview of the issues with respect to the investment climate in Sierra Leone. FIAS visited Sierra Leone in February 2004 to conduct a diagnostic review of the foreign investment climate; FIAS returned to Freetown in March 2004 to facilitate a workshop on the investment climate and the draft investment code with public and private sector stakeholders.

The FIAS team interviewed a range of foreign and domestic investors from different countries and various sectors, representatives of foreign investors including chambers of commerce, foreign investor associations, accounting firms, and law firms. The FIAS team worked closely with officials in many different ministries and agencies.

Our main counterparts came from the Ministry of Finance and the Ministry of Trade and Industry. The World Bank office in Freetown was extremely supportive in providing guidance, arranging our meetings, taking care of all logistics and support for the mission and the workshop. Additionally, the FIAS mission worked closely with the World Bank country team from the Africa region, and we are grateful for their support. The members of the FIAS team would like to express their gratitude for all those in the government and private sector in Freetown who made the field work for this study possible. This work was funded through the FIAS Trust Fund and UK Department for International Development.

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EXECUTIVE SUMMARY

- i. After many years of civil war and the ensuing years of post-conflict political and economic recovery, Sierra Leone appears ready to tackle the systemic problems inhibiting investment and growth of the private sector. There is broad agreement between the government and the private sector that the key to Sierra Leone's future growth lies in the development of the private sector through productive foreign and domestic investment.
- ii. The following report provides a "snapshot" of the main issues impeding investment and private sector growth, but is by no means exhaustive. The goal of this report is to document the main issues, provide analyses, and offer recommendations on steps which could help to improve the situation. Additionally, the mission was asked to review the investment code and provide recommendations to the authorities; these recommendations are also included in the report for information and solely represent the views of the FIAS mission and not the World Bank Group.
- iii. Sierra Leone is a country endowed with rich natural resources and a strategic position geographically in terms of export potential. It has suffered and survived years of internal conflict but has emerged within the past few years as a country ready for peace. Yet, there are many factors that inhibit prospective investment in Sierra Leone. The most obvious difficulty faced by any investor is the present state of the country's infrastructure. The situation with the supply of electric power and water is difficult for any investor; the state of the roads is a major constraint to investment, particularly once the investor leaves Freetown. Telecommunications are improving but still adversely affect investment. The port is improving, but again more needs to be done.
- iv. The concomitant deterioration of the infrastructure has left the government with a formidable responsibility to bring the infrastructure even back to where it was in the past. The lack of infrastructure, combined with open allegations of corruption, an inadequate legal and regulatory framework and a fragile justice system, will require substantial efforts by public and private sector alike to make Sierra Leone an attractive investment target in the future.
- v. In addition, Sierra Leone faces the daunting task of streamlining, harmonizing, and simplifying the legal framework of the country. The legal system, though based on English law, has not kept up with legal developments in other common law countries over the years. Many of the laws are out-of-date; in other areas, new laws are required. And, while an investor may have the legal right to be able to access land for investment, in practice land is not always readily available. Furthermore, land is rarely used as security for loans from banks and other financial institutions since the courts are lax in enforcing a secured lender's rights in case of default on loans.

vi. Within the body of laws, the new investment code, when enacted, should help to assuage investors of some of the uncertainties that have existed in the past. If the investment code is enacted in accordance to international best practice, this will be a signpost to investors that this aspect of Sierra Leone's legal framework has been improved. Thus, the second part of the mission's assignment was to review the latest draft of Sierra Leone's first-ever investment code. This review was intended to advise the government whether the draft was consistent with international best practice with respect to the structure and wording of investment codes in Africa and elsewhere. All agree that the investment code will be an important cornerstone for investment promotion in Sierra Leone. To become an effective promotional tool for the attraction of investment, it will be important for the government to ensure that the initial version of an investment code in Sierra Leone is enacted in accordance with international best practices and acceptable to the general expectations of prospective investors.

vii. Finally, in addition to legal system reform, the judiciary needs to be restructured, re-staffed, re-trained and somehow, made to operate without any corrupt influences. This is a tall order in any society. Without a major effort to change the judicial system and the people operating within the judicial system, this will remain a major constraint on investment for a long time.

viii. Fortunately the government has decided to face all of these difficulties head on. The enactment of an investment code in accordance with international best practice will be a significant first step to improving the investment climate. In addition, this report contains a number of recommendations which will have a positive effect on the investment climate, if these recommendations are implemented. Not every step forward will be an easy one; but if the government can muster the political will to make the improvement of the investment climate one of its main priorities, then the private sector in Sierra Leone and future foreign investors will warm to the task themselves and make their positive contribution to the economic development.

A Introduction

1. This report has been prepared in response to a request by the Minister of Finance to provide an overview of the issues with respect to the investment climate in Sierra Leone. The members of the FIAS team would like to express their gratitude for all those in the government and private sector in Freetown who made the field work for this study possible.
2. After many years of civil war and the ensuing years of post-conflict political and economic recovery, Sierra Leone appears ready to tackle the systemic problems inhibiting investment and growth of the private sector. The government has taken bold steps to ensure both political and macroeconomic stability which will make it possible for increased level of investment and private sector development.
3. Sierra Leone has successfully passed through its post-conflict period, and is now ready to tackle the problems inhibiting development. Sierra Leone is endowed with under-utilized resources both natural and human; thus any improved use of these endowments will have a strong, positive effect on the economy and the level per capita income. Although it is widely accepted among both government and private sector operators that Sierra Leone might not become the next global center for foreign investment, it is also widely believed that any additional dollar of investment will have a strong impact on the economy.
4. The following report provides a “snapshot” of the main issues impeding investment and private sector growth, but is by no means exhaustive. The goal of this report is to document the main issues, provide analyses, and offer recommendations on steps which could help to ameliorate the situation. It is also clear from both the fieldwork and the public-private sector workshop held in March 2004 that this report is the first step in the long process of reform which the Sierra Leone authorities seem keen to undertake.
5. The report is organized as follows: the first section gives a general overview of the political and economic situation in Sierra Leone; the next section presents a general overview of the investment climate, highlighting the main problems and offering recommendations; the third section summarizes the analysis and FIAS’s specific recommendations on the draft investment code that FIAS reviewed in March 2004, the final section summarizes the situation and makes recommendations for actions that would improve the investment climate..

1. Political and Security Issues

6. The political and security situations in Sierra Leone have improved since the cessation of conflict in neighboring Liberia in late 2003. The government has completed its disarmament, demobilization, and reintegration program (December 2003) for ex-combatants. The UN-sponsored Special Court was launched in March 2004 and has issued indictments against rebel, military, and militia leaders accused of war crimes.

These developments, together with a strong policy team in government, have had a positive impact on economic activity. At the same time, the United Nations peacekeeping forces in Sierra Leone (UNAMSIL), which currently number around 12,300 troops, are expected to be withdrawn by the end of 2004, after which the security situation could change. At the same time, the removal of foreign troops will free up domestic resources consumed by UNAMSIL.

2. Macroeconomic situation

7. The economic situation in Sierra Leone has continued to improve over the period 2002-2003, with real GDP growing on average by around 5.9 percent per annum. CPI-based inflation accelerated slightly in 2003 to 6.6 percent (annual average). The higher rate of inflation is attributed to a large exchange rate depreciation vis-à-vis the US dollar (with the resultant pass-through effects), higher global fuel prices, as well as to the expansion of broad money (domestic credit). The external current account deficit, excluding official transfers, is expected to widen to about 28 percent in 2003 from 17 percent in 2001. The main source of the current account deterioration is an increase in imports, mainly fuel and manufactured goods, as a result of the reconstruction process and cessation of hostilities in Liberia. At the same time, officially reported export growth has been strong over the period, mainly due to the adoption of the Kimberley Process Certification Scheme which provides a system to track diamond exports and thus has made Sierra Leone diamonds more attractive on the world market.

Table 1. Basic Macroeconomic Indicators, 2001-2005

	2001	2002	2003	2004	2005
			Estimates	Projections	
Real GDP growth (percent)	5.4	6.3	6.5	6.8	7.1
Nominal GDP growth (percent)	11.8	10.5	13.6	11.7	10.2
CPI (annual average)	2.2	-3.1	6.6	4.8	3.5
Exports (growth rate)	2.8	34.4	31.7	18.5	36.5
Current Account (as a percent of GDP)	-17.2	-22.6	-27.7	-29.8	-21.3
Gross Domestic Investment (% GDP)	6.1	10	17.1	24.2	16.3

Source: International Monetary Fund, 2004

3. FDI in Sierra Leone

8. Data on private investment (foreign and domestic) confirm that the stocks and flows of FDI remain low, even in comparison with other African countries, with average stock of FDI/GDP between 2-3 percent from 1999 to 2003, most of which has been

deployed into the mining sector.¹ However, Sierra Leone has been accorded AGOA status increasing the potential for the production of manufactured goods for export to the United States. Also, the nascent privatization program has attracted the interest of some international investors in mining (rutile, diamonds and bauxite). Sierra Leone's attractiveness as a location for FDI is negatively affected by a range of factors including: political instability – regional and domestic, the small domestic market, a cumbersome bureaucracy, corruption and an ineffective judicial system (see below).

B. Investment Climate Analysis

9. This section covers many aspects of the Sierra Leone economy and infrastructure which taken together form the climate for investment and are themselves the foundations of private sector development. Given the limited scope of the study, this section does not attempt to raise every issue or even to present a detailed analysis of every important barrier impeding the growth of the private sector. Rather, it purports to raise issues for discussion in both the public and private sectors and stimulate the formulation of an action plan to address the main problems.

1. Legal Framework -- Introduction

10. The legal and regulatory framework is an essential component of a country's investment climate. While other aspects of the investment climate initially may be more important to an investor, once these other aspects are evaluated and accepted, the investor will turn to the legal regime and the impact it will have specifically on the proposed investment. An investor wants clarity, stability, openness and fairness in a country's legal regime. All of these are important factors in assisting an investor to make an investment decision. Should the investor risk his money in Sierra Leone given the present legal and regulatory framework? The evaluation of the legal framework will focus on the past, present and future in an attempt to judge if the risk is worth taking in such an environment.

11. Sierra Leone's legal system is based upon the English law tradition. Many of the current laws and the judicial system of Sierra Leone reflect what was present in England many years ago. Much of the legislation and the structure and administration of the judicial system of Sierra Leone has not changed over the years. One obvious reason for this is the effect of the conflict situation that has existed in the country for a long period. In addition, previous governments in the 1970s and 1980s do not appear to have modernized the legal and judicial framework of the country, resulting in legislation and a judicial system which have not been able to keep up with the progressive steps which other countries have taken during this period.

12. What can be said of the future? With the conflict situation over, the government has been focusing on the legal framework in the country and steps are being taken to

¹ UNCTAD, *World Investment Report: 2003*, online data base. According to UNCTAD, Sierra Leone's neighboring countries achieve FDI/GDP ratios of around 25 percent.

update old legislation, introduce new legislation and reform the judiciary (see paragraphs 40 to 43 below). Investors will welcome all of these steps, but there is much to do, even to bring the legal regime from the past into the present.

13. When reviewing the legal and regulatory framework, the investor will be very specific. Which legislation is applicable to the proposed investment? If the legislation is unfavourable, can it be changed? Is there an investment code and does it provide guarantees and other protections in accordance with international best practice? Does the company law provide the investor with sufficient protection, both in the operation and liquidation of the investment? Are the tax laws stable and administered fairly? Can the investor plan on a level playing field that will not be changed to suit political exigencies? What is the court system like, and does corruption influence judicial decisions? These are only some of the questions that a serious investor will ask when looking at the legal and regulatory framework. Following in more detail are some of the areas to be reviewed by a prospective investor.

a. Business Registration

14. To initiate company registration an applicant is required to provide to the registration authorities documents similar to those which are required in any other common law jurisdiction. The registration process takes between one and two weeks. It is not considered by investors to be a complicated or particularly onerous administrative requirement.

15. The Ministry of Trade and Industry and the Sierra Leone Export Development and Investment Corporation (SLEDIC) have focused much of their efforts, both in making comments on the draft investment code and in their day-to-day practices, on shortening the time period it takes to register a company in Sierra Leone. Their aim is to ensure that an investor can have a company registered within three days of submitting the required documents. SLEDIC wishes to introduce a so-called “one-stop shop” concept at its offices in Freetown, with its initial focus on the time it takes to set up a company.

16. There are many other registration and licensing requirements in Sierra Leone that need to be shortened or removed, and concentrating efforts on the time it takes to register a company merely deflects attention from the more difficult administrative hurdles that should be reviewed and revised.

b. Company Law

17. The Companies Act (Cap. 249) became law in 1929. It is based on the English Companies Act which existed at that time. There have been major substantive changes to English company law since then, but only a few to the Sierra Leone version. Now that the conflict conditions are over, one of the first pieces of legislation being reviewed and revised by the Attorney General’s Chambers is the Companies Act. Consultants have been retained and have drafted amendments to the Companies Act to bring it into the modern world. The government plans to hold workshops with relevant stakeholders to

discuss the proposed revisions to the Companies Act prior to introducing a bill in Parliament this year.

c. Law Reform

18. The Law Reform Commission was formed in 2003. One of its first responsibilities is to tackle the issue of the commercial use of land. Later, the Law Reform Commission will look at the land tenure system as a whole, a much more political and complicated process (see paragraphs 23 to 26 below).

19. Included in the program for the Law Reform Commission will be the introduction of new laws on bankruptcy and anti-money laundering. These are considered by government to be of high priority. The Attorney General has noted that in addition to the program of the Law Reform Commission, there is an on-going program of law revision being undertaken by the government under the supervision of the Attorney General's Chambers.

20. Since there is little knowledge about the Law Reform Commission, its program and methodology, FIAS suggests that the government review the Uganda Law Reform Commission website to see how this process is being handled in another African country.

Box 1. Basis For A Commercial Legal Framework

- Clarity and certainty of the legal framework
 1. Specific meaning of the law is understood
 2. Understanding of applicability to fact situation
- Publicity of the rule of law
 1. Allows access to applicable laws
 2. Use of technology to enhance access
- Predictability in the application of the law
 1. Reduces likelihood of change in interpretation
 2. Increases expectations in administration of the law
- Stability of the legal, political and policy frameworks
 1. Reduces likelihood that government will unilaterally change the basic conditions
 2. Permits planning of investment decisions
- Fairness, possibility of legal options and due process
 1. Access to independent dispute resolution
 2. Mechanism to permit independent dispute resolution

d. Tax and Customs

21. The mission did not focus on the specifics of the Income Tax Act and the Customs & Excise Act because other experts have been looking at these acts while the

mission focused on the draft investment code. With regard to the income tax and customs issues that are contained in the draft investment code, our comments are noted in paragraph 64 2) below as they relate to incentives.

e. Bankruptcy Law

22. There is no law on bankruptcy in Sierra Leone, only the provisions of the outdated Companies Act which deal with failing and failed companies. As noted above, the government intends to introduce a bill on bankruptcy to Parliament this year.

f. Land Law

23. As in most countries in Africa, the questions of land ownership and land tenure in Sierra Leone are complex, deeply personal and highly political issues. The legal aspects of land tenure in Sierra Leone are bifurcated into two regimes based as much on geographical grounds as on social or political grounds. The first regime is for the Western Area, which includes Freetown and the surrounding areas. The second regime covers the provinces that comprise the remaining areas of Sierra Leone.

24. In the Western Area, a system of freehold land has been introduced. Title to land can in this area be transferred using the usual common law mechanisms for this purpose. Foreign companies can own land outright, through wholly-owned or controlled companies established under the laws of Sierra Leone. Because Freetown is definitely overcrowded and will continue to be so, several people interviewed noted that it is becoming more and more difficult for an investor to find land in the Western Area, even if an investor can own freehold land.

25. The system of land tenure in the provinces is more complex. Land in these areas is owned by the people and under the control of the Paramount Chief in the area. Therefore an investor cannot own land outside of the Western Area but can lease land. Land leases in the provinces can be for as long as 50 years. However, there is a total lack of information about the land leases in the provinces, as some persons interviewed claimed that land leases in the provinces could be for as long as 75 years and others thought that leases could only be for 21 years, but renewable. In the most northern areas of the country, it was also noted that women cannot acquire a right to use land in their own names.

26. Some have questioned whether Sierra Leone needs to have a land tenure system with two completely different structures and administrative procedures. In a post-conflict situation, the Government might be more able to make significant structural changes in such complex issues as land tenure, but there needs to be a strong political will for this course. This political will did not evidence itself during the mission.

g. Legal reform

27. It is not surprising, taking into account that Sierra Leone is emerging from a long and bitter conflict situation, that the country's legal and regulatory framework is unsettled. Especially during the years of conflict, the rule of law was abandoned in favor of the authority of the gun. This situation is not conducive to a transparent, accessible and equitable legal regime. The difficulty today is not that there is much to do to improve the legal framework in the country; the difficulty is setting priorities since it will be impossible to improve everything at the same time.

28. Since the government has acknowledged that the promotion of investment is of the highest priority in the country, it would be logical to include in the list of early priorities for the lawmakers the revision of old laws and the enactment of new laws which directly affect the business environment in Sierra Leone. From the discussions which the mission had with the government, it is evident that priorities are being set in these areas, with the initial major piece of legislation being the revision of the outdated Companies Act.

29. The basic law affecting business, the Companies Act, is at the top of the list of legislation under review. A proper and modern companies act is fundamental to an efficient and effective legal environment. Along with this priority, government has focused on a new bankruptcy law and a new anti-money laundering law, both of which will be significant foundations for the investment climate and the business environment in the country. The mission was unable to meet with the Law Reform Commission to determine the other legislative priorities being tackled by the Law Reform Commission. It is hoped that business-related legislation will be looked at as quickly as possible by the Commission.

30. As part of the process of introducing an investment code, government should also be reviewing the Income Tax Act and the Customs & Excise Act to ensure that the changes being proposed in the draft investment code are reflected in the legislation that covers these important revenue-generating legislative enactments. The mission made this recommendation frequently during the visit to Freetown and once again, we summarize international best practice in this area at paragraph 64 2) below.

31. The investment climate will also be affected considerably by the land law legislation in Sierra Leone. The present bifurcated system has strong historical roots and precedent. However, it may or may not be conducive to healthy investment climate. Presently there are constraints in the Western Area as far as finding available land. Whether an investor can obtain freehold land or not is not a relevant concern if the investor cannot find land at all. With respect to the provinces, there are strong views on either side.

Recommendations.

- The government should continue with its current review of the Companies Act and move to enact amendments before the end of the year.
- The Law Reform Commission should devise a plan over the next several years, establishing priorities with respect to which laws will be reviewed and revised first.
- The proposed bankruptcy law should be enacted as soon as possible.
- If the government finally decides to include the proposed investment incentives in the investment code, care should be taken to ensure that all fiscal incentives in the investment code are similarly added to the relevant legislation, including the Income Tax Act and Customs & Excise Act.
- A review of the land tenure laws should be undertaken to determine ways in which land can be made more readily available for investors.

2. Infrastructure (including Banking)

a. Infrastructure

32. The backbone of the investment climate in any country is the basic infrastructure available to all investors. One result of the conflict situation is that the infrastructure in Sierra Leone is worse than the infrastructure of almost any of its neighbors. The cost of replacing and improving its infrastructure is far beyond the country's ability to fund these projects. Yet, delays in improving the infrastructure will have a direct and dramatic effect on the investment climate. This vicious circle must be broken.

33. We should be clear about what comprises the "infrastructure" of a country. While more obvious elements include electric power, telecommunications, water and sewerage, roads, ports and airports, investors also consider other elements to be part of a country's infrastructure. These include availability of high quality hotels, reliable and comfortable cars and other means of transport, the availability of land and the availability of financing from local banks and other financial institutions. When any of these elements is missing or below international standards, this will affect the investor's view of the infrastructure necessary to support the proposed investment.

b. Banking and Finance

34. While the mission did not undertake a detailed review of the financial sector, there is little doubt that current banking practices and procedures inhibit investment in Sierra Leone. On the lending side, banks are taking very little risk. Loans are made almost solely by overdraft. There is virtually no term lending. Banks rarely accept real property as security for loans, since the courts hardly ever permit a lender to perfect the security. This is true in both urban and rural areas. The result is that investors cannot use one of their most valuable assets, land and buildings, to secure local lines of financing.

35. With the pressure of inflationary increases over the past couple years, bank lending rates (more accurately, overdraft interest rates) are in the range of 30-40% per annum. Depositors are fortunate if they receive interest on their savings accounts a rate of 10% below the bank lending rates. There is little incentive for banks to do more than invest in government securities, given the high interest rates which exist in Sierra Leone. This attitude is not conducive to the development of a healthy investment climate.

36. There are several government-owned banks scheduled for privatisation. The sooner these banks are privatised, the more likely that competition will develop in the banking sector. The Bank of Sierra Leone, which seems to taking a *lasser-faire* attitude toward interfering with the private sector, should consider what steps it might take to encourage the commercial banks to assume more risk with the private sector.

Analysis

37. Where infrastructure has been so damaged or has been allowed to deteriorate and the government is not able to sufficiently repair or develop the same to acceptable minimal levels, the government should consider policies that will encourage the development of infrastructure by the private sector. This can be done either by providing concessions for the development and operation of various infrastructure facilities or by providing tax incentives to private investors to develop these facilities on their own. However public-private partnerships are defined, the government should consider working with the private sector to facilitate development projects which will result in an improved, modern and efficient infrastructure.

38. The encouragement of private sector infrastructure development should become part of the government's investment promotion strategy. Using the promotional tools available to the government, through its own Ministries, its embassies abroad, and eventually through a restructured and revitalized SLEDIC, a separate program could be designed to encourage the investment in infrastructure by the private sector.

39. The presence of an active and vibrant banking sector is as much a part of the infrastructure of a country as the more physical assets described above. To the extent that the banking system is moribund and unwilling to take risks on a conventional basis, investors will be required to fund more of their investments from their own resources. The inability to leverage their own resources from local banks and other financial institutions will have a dampening effect on the investment climate.

Recommendations

- Because the basic infrastructure of the country has deteriorated so much, the government should continue to prioritise those aspects of infrastructure which need to be rehabilitated first.

- The investment incentives in the relevant legislation should be amended to provide forms of tax relief for investors who develop infrastructure that would otherwise have been provided by the government.
- A more active promotional program should be developed to encourage private sector investment in infrastructure.
- The government should encourage the National Commission for Privatisation to accelerate the privatisation of government-owned banks.
- The government should review the steps that could be taken immediately to ensure that land used to secure financial facilities from banks and other financial institutions can be more easily and quickly alienated through the court system.

3. Judiciary

a. Court Procedures

40. The mission focused its efforts on the High Court and did not review the magistrate's courts or any other aspect of the judicial system. The situation in the High Court has been dire. About 1,000 cases are filed each year in the High Court. Because there is an acute shortage of judges, the existing judges are overworked. The largest percentage of cases filed in the High Court deal with debt recovery; breach of contract claims are also high. Adjournments by legal counsel are frequent, and cases can take as long as three years to be heard and decided. Cases can routinely have multiple adjournments before the final hearing takes place.

41. To qualify to be a judge of the High Court, a barrister must be in practice for a minimum of ten years. However, once a barrister has been in practice this long, there is little financial incentive to be a judge because a High Court Judge's compensation is so low. To some extent this has been temporarily rectified by DFID who is topping off some of the High Court Judges' salaries. UNDP is doing the same with some of the magistrate's salaries. As another part of DFID's efforts in this area, DFID will finance the computerisation of the registry of the High Court. At present all files, records and decisions in the High Court are written manually.

42. Court fees are low and are not a disincentive to using the court system. However, barrister's fees are very high. This forecloses access to legal redress to the economically disadvantaged in the country.

43. The major disincentive to use of the court system in Sierra Leone is corruption in the judiciary. The perception amongst existing investors and the private sector in general is that a court case can only be won by the party who pays the most for the decision. Foreign investors will not accept the High Court as a suitable forum for resolving investment disputes as long as the allegations of corruption are taken as being an accurate reflection of the current situation. There is also a lack of internal discipline in the court system, and this too compounds the situation for litigants.

b. Labor Disputes

44. An Industrial Court has been established in Sierra Leone. It is supposed to be the venue for the resolution of labor disputes. Several comments were made, however, that employees are more likely first to bring their complaints to the Minister of Labor than they are to file with the Industrial Court.

Analysis

45. Investors regard the ability to resolve disputes fairly and promptly as fundamental to a favourable investment climate. Where a judicial system operates inefficiently and ineffectively, where corruption is rampant, where an investor cannot get a fair and timely hearing in a court of law, in such an environment an investor will surmise that there are other aspects of the investment climate which are unfavourable and which are likely to interfere with the investor's ability to develop and operate the investment. It would take many other very positive aspects of the investment climate to override this perception. These are not present in Sierra Leone in abundance today.

46. An unfair judicial system and process will be readily confirmed by those investors that are already operating in the country. It is a corollary of investment promotion that the best tool for promoting investment in a country are those existing investors who have already taken the plunge. To the extent that these investors decry the judicial system and process, one of the fundamental protections being sought by investors will be undermined. It is possible that the government does not perceive the existence of an unfair and inefficient judicial system to be a barrier to investment. But it truly it, even more so when corruption is seen to be part of the failing of the system and process.

Recommendations

- The Anti-Corruption Commission should give special and immediate attention to any allegations of corruption in the judiciary.
- The government should explore ways to improve the quality and quantity of High Court Judges. Since DFID is presently involved in supporting the judiciary, further assistance should be sought in this regard.
- The Chief Judge of the High Court and the head of the Law Society, perhaps in conjunction with the University, should develop programs to improve the procedures at the High Court, particularly focusing on the attitudes and habits of practicing lawyers.
- The High Court should be computerized and if possible, the publication of decisions through a continuing Law Report process should be conceived, developed and implemented.

c. Privatization

47. Given the limited scope of this study, the treatment of privatization issues is not comprehensive. Privatization is a priority for Sierra Leone, both to achieve macroeconomic stability and to facilitate private sector development; however, major obstacles persist preventing government's achievement of its ambitious objectives. Over the past decade, Sierra Leone's leadership has done little to define the mission of state ownership in the economy, agree on some shared values that are best pursued through private ownership, set a coherent framework policy for privatization, and provide it with clear goals. The creation of the National Committee for Privatization (NCP) was supposed to facilitate this process, but because the NCP has a dual role as the shareholder of SOEs and the executing agency for privatization, this generates both inconsistency and a potential for conflict. Other countries have made sure that these two functions are carried out by two different entities. The ownership of the shares in SOEs could best be maintained by either the Ministry of Finance or another existing government body. In the alternative, a new body could be established to be the shareholder, but this takes time and would require setting terms of reference for this new entity that might best be carried out by the Ministry of Finance. With respect to the execution of the privatization process, the NCP has a skills set in its staff for these activities. The NCP should continue to concentrate on preparing SOEs for the privatization process, including the retention of consultants, where needed, and should not be involved in any matters relating to the holding of the shares in SOEs.

Analysis

48. At present, government lacks the required capacity to manage, restructure, sell, and monitor SOEs. Government's preference for disposing many of the large SOEs through stock-market offerings may be understandable but is highly unrealistic. It is government's feeling that shares in the privatized companies should be held, as much as possible, by Sierra Leoneans. But without a stock exchange, it will take some creative procedures to ensure that the localization of shares of SOEs is done equitably. Additionally, privatization is less likely to be opposed when the workers and managers of the incumbent providers are offered minority shares in the privatized firm. Sierra Leone, however, lacks a stock exchange, many preconditions must be met before one is created, and there are other policy issues that are more pressing.

49. The situation of many SOEs is so fragile that it is possible that no serious investor will be interested in acquiring them. In some cases, liquidation is the only option forward. However, if government allows the liquidation process to take place, this would have a political cost in terms of job losses that the authorities have so far proved unwilling to assume.

Recommendations

- The NCP must be granted full powers to manage the privatization process and select the buyers from among candidates that meet clearly specified technical and financial requirements.
- Government may wish to provide broad policy guidelines, in particular through industrial and regulatory policies, but must shy away from interfering with and micro-managing privatisation.
- Government should remove the ownership of shares in SOEs from the NCP. Instead, government should place these SOE shares in the name of and under the control of the Ministry of Finance, or in another existing government entity.

4. Governance and corruption

a. Anti-Corruption Commission

50. The Anti-Corruption Act was enacted in February 2000. This led to the forming of the Anti-Corruption Commission (ACC) in January 2001 with funding by DFID. The ACC is tasked to counter corruption in Sierra Leone and will pay particular attention to corrupt payments to government officials and the misappropriation of public and donor funds. The ACC is split into three departments: Community Relations, Corruption Prevention and Investigations.

51. The Government and the ACC claim to have a zero tolerance for corruption. In the last four months of 2001 alone, the ACC received 897 complaints of corruption. All complaints received by the ACC are reviewed. As of February 2004, there were 265 ongoing cases being investigated by the ACC. Also as of February 2004, complaints filed with the ACC had led to nine convictions in both the magistrate's court and the High Court. This is seen by some as indicating that the government is not serious about fighting corruption. Many commented that the ACC and the Attorney General were unable to stem what is considered to be a monumental tide in the country. Various reasons were advanced for this position. Even if proving corruption is as difficult as the ACC and the Attorney General claim that it is, success in only 9 cases has not impressed the public as being a serious commitment to reduce or eliminate corruption.

52. One of the alleged weaknesses of the Act establishing the ACC is that the Act puts responsibility on public officials, but none on the private sector. As several people noted during the mission, it "takes two to tango". Corruption needs to be dealt with at both ends of the chain, not just at the receiving end.

Summary of Investment Climate

53. Like every country, Sierra Leone's investment climate balance sheet has entries on both sides. Depending on the sector in which an investor may be interested in

investing, the balance sheet has a different appearance. For example, prospective investors in the mining sector, particularly diamonds and gold, will have a very different view of the investment climate in Sierra Leone than a prospective investor in the manufacturing sector. Again, this result is not unique to Sierra Leone.

54. The assets of Sierra Leone include the natural resources of the country, such as minerals, large amounts of arable land, timber, fisheries and tourism. Each of these the country has in abundance. Sierra Leone also has trained and trainable human resources. The conflict situation disrupted the human resources in the country, but there is an excellent base upon which to build for the future. Other assets include the current political stability, which is in sharp contrast to the situation in the past decade or more, and the location of Sierra Leone in the ECOWAS area, thus enabling exporters to have access to around 250 million potential consumers in ECOWAS.

55. The asset side of the investment climate balance sheet is healthy, and will in time become healthier. However, the liability side of the balance sheet is very unhealthy and must also be taken into account. It is here where the situation in Sierra Leone has many factors that inhibit prospective investment. The most obvious difficulty faced by any investor is the present state of the country's infrastructure. The situation with the supply of electric power and water is difficult for any investor; the state of the roads is a major constraint to investment, particularly once the investor leaves Freetown. Telecommunications are improving but still adversely affect investment. The port is improving, but again more needs to be done.

56. There are, however, other subtler infrastructure constraints that need to be addressed. These include the number of superior class hotels, transport in and around Freetown, the airport at Lungi, the lack of financial support from banks and other local financial institutions, and the low frequency of international flights into and out of Sierra Leone.

57. Along with these infrastructure constraints is one of the most cited problems in Sierra Leone: corruption. While the government deserves full plaudits for establishing and funding the ACC, in fact many people feel that the ACC has not been very effective. Corruption is allegedly rampant in the country and raises its ugly head at all levels. Given the state of the economy and the inability of the ACC to handle more than a few cases at a time, the assumed presence of corruption in government and in the judiciary will have a significant negative impact on investment.

58. The liability side of the investment climate balance sheet only begins with the infrastructure problems. There are other issues that will inhibit investment. The size of the market in Sierra Leone is small. Although there is a large market in ECOWAS, an investor may have problems exporting because of the poor state of the infrastructure in the country. While an investor may appear on paper to be able to access land for investment, in reality land is not always readily available. Furthermore, land is not generally used as security for loans from banks and other financial institutions since the courts are lax in enforcing a secured lender's rights in case of default on loans.

59. While wages may be low, prices are rising rapidly. The government's economic policies will have a definite impact on the attractiveness of Sierra Leone as an investment destination. The stability of the exchange rate and the difficulty in accessing foreign exchange will also affect an investor's view of the country. The country's reliance on donor support on the revenue side will also be a concern to prospective investors. Investors will be concerned that the government will not be able to generate sufficient revenues to replace the contributions that the UN and donor agencies make as part of the annual budget.

60. The last, yet certainly not the least significant side of the investment climate balance sheet, is the legal framework in Sierra Leone. As noted above, the legal system, though based on English law, has not kept up with legal developments in other countries over the years. Many of the laws are out-of-date; in other areas, new laws are required. Within the body of laws, the new investment code, when enacted, should help to assuage investors of some of the uncertainties that have existed in the past. If the investment code is enacted in accordance to international best practice, this will be a signpost to investors that this aspect of Sierra Leone's legal framework has been improved.

61. Not only must the government improve the laws and regulations in a variety of areas, but also the judiciary needs to be restructured, re-staffed, re-trained and somehow, made to operate without any corrupt influences. This is a tall order in any society. Without a major effort to change the judicial system and the people operating within the judicial system, this will remain a major constraint on investment for a long time.

62. What do investors want of a country's legal and judicial system? They want stability of the laws; they want predictability and fairness in the application of the laws; and they want transparency, particularly where there is a chance that corruption may raise its ugly head. It is not easy to achieve such a legal framework in any country, and it is certainly not easy to do so quickly. It is imperative, though, that government decision-makers are aware of the impact that the present legal framework has on prospective investors, even those investors that have decided that the other negative aspects of the investment climate balance sheet will not deter their desire to invest.

C. Draft Investment Code

63. The second part of the mission's assignment was to review the latest draft of Sierra Leone's first-ever investment code. This review was intended to advise the government whether the draft was consistent with international best practice with respect to the structure and wording of investment codes in Africa and elsewhere. All agree that the investment code will be an important cornerstone for investment promotion in Sierra Leone. To become an effective promotional tool for the attraction of investment, it will be important for the government to ensure that the initial version of an investment code in Sierra Leone is enacted in accordance with international best practice and acceptable to the general expectations of prospective investors.

64. In FIAS' interim February 2004 report to the government on the draft investment code, there were a number of issues that FIAS recommended be changed so that the investment code would conform to international best practice. These changes that were recommended in the interim report included the following:

- 1) **The investment code should not contain policy statements in the body of the text.** If the government feels strongly that there should be a policy statement associated with the investment code, it would be best to include it in a short preamble to the investment code. It should be noted that the government can and should make policy statements on investment promotion through various government ministries and through statements at such venues as international conferences, through the publication of brochures and other policy statements and lastly through SLEDIC.
- 2) **It is important that any investment incentive offered by Sierra Leone not be explicitly detailed in the investment code itself, though general references to these incentives and the laws governing them can be made in the investment code.** This comment was one of the strongest criticisms of the draft investment code. FIAS' experience is that the applicable legislation only should contain the legal basis for the investment incentives. This is done to avoid inconsistency in the law, to focus the attention of all stakeholders on the legislative support for the investment incentives and probably most important, to ensure that the persons administering the applicable legislation and therefore implementing the investment incentives are in fact the same persons who administer the law on a daily basis. Therefore the investment incentives should not appear in the investment code, but instead in the applicable legislation, which includes the income tax law, the customs and excise law, the immigration law, and in any laws governing specific sectors such as financial institutions, fisheries, mining and tourism. FIAS also advised that the incentives should be performance-based and should apply across the board to both foreign and domestic investors. The investment code itself should merely refer to the applicable laws, and not be considered by the government or the investors as the legal basis under which the government implements the investment incentives.
- 3) **The investment code should not provide for any discretionary decisions by SLEDIC or any part of the government.** International best practices require all discretion to be removed from an investment code. Discretion has been shown to lead, in every country, to abuse, corruption and the creation of an uneven playing field for the investment community. However well-intentioned discretion may be, it does not belong in a modern investment code.
- 4) **Some of the language in the investment code, such as contained in the provisions relating to "national treatment", "dispute resolution" and**

"guarantee against expropriation" needs to be brought more into conformity with international best practice. By changing these provisions to read more like established legislation in this area, investors will be satisfied that Sierra Leone is developing its investment promotion program in line with what other countries are doing in the region, on the continent and beyond.

- 5) **It was recommended that references to the Anti-Corruption Commission, the soon-to-be enacted Anti-Money Laundering Bill and the National Commission for Privatisation be included in the investment code.** With respect to the latter, since privatization is a form of investment, it should be made clear to potential purchasers of government-owned assets that their investments will be treated as such under the investment code.
- 6) **Some of the definitions proposed in the draft investment code were inconsistent with international best practices.** FIAS provided the government with recommendations for changing some of the definitions.
- 7) **It was recommended to exclude from the application of the investment code activities in the sectors of banking, fishing, mining and tourism development.** Each of these activities is covered by separate legislation and provides investment incentives through the specific legislation relating to each such sector.
- 8) **FIAS recommended removing any requirement for an investor to “qualify” for making an investment in Sierra Leone.** Under the draft investment code, an investor had to “qualify” to make an investment; SLEDIC had to make a decision as to whether each investment was eligible for incentives. Any such qualification or approval goes directly against international best practice.
- 9) **With regard to SLEDIC, the investment promotion agency, FIAS recommended that SLEDIC be re-organized and strengthened.** SLEDIC’s role in the investment process must change, discarding the approval and qualification activities in exchange for an emphasis on promotion, data collection, assistance and advice on government policy in the earlier of investment promotion. It was also suggested that SLEDIC should look at various ways in which to operate the “one-stop shop” that had been proposed in the draft investment code. Lastly, FIAS recommended removing the requirement for SLEDIC to issue a letter to the investor confirming eligibility for investment incentives. The investment incentives should be provided under the applicable legislation. To the extent that SLEDIC has any role with investment incentives, this would be against international best practices.

- 10) **FIAS recommended that the proposed Investment Advisory Council not be established under the draft investment code.** While government felt strongly that there should be a council to advise government on investment policy, the formal establishment of another entity in the investment process would clearly confuse investors. If such a council is needed, it was recommended to establish the council on some other basis outside the investment code.
- 11) **The reservation of a large number of business activities for citizens of Sierra Leone was considered too extensive, thereby sending the wrong signal to the international investment community.** Governments often wish to encourage the entrepreneurship of their own citizens, but if this must be done, it should be done in a manner that does not bar serious investors from establishing businesses in Sierra Leone. While the investment code reserved a number of businesses “exclusively” to citizens of Sierra Leone, the draft also provided that foreign investors could operate in these business activities, if they had a Sierra Leonean citizen as a majority partner. By allowing such structures, the desire to provide exclusivity is diluted to where it may be meaningless.
- 12) **FIAS noted the conflict between the desire to provide investment incentives to serious investors on one hand against the government’s need to generate revenues to fund both its general operations and the re-construction of much of the infrastructure that had been destroyed in the conflict on the other hand.** However the conflict is resolved, it is consistent with international best practice for the investment code itself not to contain the investment incentives. Instead all incentives should be put into the applicable legislation, both to avoid confusion and also to ensure ease and consistency of administration and application. As to the level of incentives themselves, FIAS did not take a position on the specific incentives, except with regard to tax holidays, which have been proven over time and in various regions of the world to have virtually no affect on attracting serious investors to a country.
- 13) **With regard to expatriate personnel, FIAS recommended that a specific quota system based on the level of investment not be used.** Instead FIAS recommended having each investor apply to the appropriate authority in Sierra Leone and justify the need for expatriate personnel.
- 14) **It was recommended by FIAS that some changes be made in the provisions relating to the transfer of profits and the repayment of loans.** The general direction of the proposed wording of these provisions was positive, and FIAS recommended some technical changes to make these provisions consistent with international best practice.

- 15) **The guarantee against expropriation should be changed to conform to international best practice.** Again, the general thrust of the proposed wording was positive, but with respect to guarantees against expropriation, investors always look to see that such guarantee provides fair, prompt and adequate compensation in the event that an expropriation does take place.
- 16) **Another recommendation was to remove the priority areas for investment, as contained in the First Schedule.** FIAS described in many meetings why listing priority areas for investment is not consistent with international best practice. Instead of listing these in the investment code, it was recommended to have SLEDIC take the lead on proposing areas for investment to prospective investors.

65. The government accepted many of the FIAS recommendations in preparing the next draft of the investment code. This latter draft was used as the basis for discussion at a public/private sector Workshop that was held in Freetown on 17th March 2004. There were, however, several provisions that the government decided not to change, thereby rendering significant parts of the investment code inconsistent with international best practice. FIAS's last commentary on the investment code was during the Workshop and thus it should be noted that many positive changes have taken place since, through continued work with the World Bank country team staff.

66. Taking into account the extensive and open discussions that took place at the Workshop, FIAS provided the government with its final observations and recommendations before the end of March 2004. Some of the more important issues raised in these communications to the government are as follows:

- 1) **FIAS made technical recommendations on several provisions, in line with the discussions that took place at the Workshop.** These recommendations, while making the text read better, are also consistent with international best practice in each of the areas under review.
- 2) **No progress was made in convincing the government to remove the specific incentives from the draft investment code.** Throughout the process, from the first meetings in Freetown in January/February 2004 through the Workshop and beyond, FIAS was not able to convince the government that putting the incentives in the investment code will have a negative impact on the promotion of investment in Sierra Leone. The reasons remain the same: placing the incentives in more than one law will confuse investors and worse, confuse the persons who administer the laws. The government continues to believe that it is necessary, solely for the purposes of promotion, to include the incentives in the law. FIAS has tried innumerable times to suggest that there are other, more effective ways to promote Sierra Leone and its investment incentives. Leaving Schedule 2 in the draft investment code will have unexpected consequences for the

government and will render the investment code not in accordance with international best practice.

- 3) **In reserving certain areas of business activity for citizens, the government has again rejected FIAS' recommendations and also the sense of the community that was expressed at the Workshop.** A strong recommendation to delete Schedule 1 was made by FIAS, in line with many comments made by private sector participants at the Workshop and in line with FIAS' experience in other countries. Once again, the government feels strongly that it must protect certain areas of activity from encroachment by non-citizen (narrowly defined) investors. The government will find it difficult to advise prospective investors that Sierra Leone provides national treatment for all investors when the government does not treat certain of its citizens equally. This is again inconsistent with international best practice.
- 4) **The government decided to use minimum investment levels to lessen the impact of reserving certain areas of business activity to citizens.** This was discussed at the Workshop as a method for "opening" up certain areas of business activity to others than citizens. The use of specific investment amounts appears to be a quick fix, but it is not. Investments can be made in many ways, not just cash in the bank. It will be difficult to establish whether an investor has put the minimum level of investment into the business. Someone will have to make this judgment, which means this judgment will be discretionary. Any discretionary decisions are subject to influence and should be avoided at all costs.
- 5) **In the provision for dispute resolution, the government unexpectedly introduced the requirement that all disputes between a foreign investor and a domestic investor MUST BE resolved in the courts, or through the arbitration laws, of Sierra Leone.** The earlier draft was very consistent with international best practice; this draft is totally against international best practice. With the court system in Sierra Leone allegedly riddled with corruption, it is difficult to understand why the government would take the position to require foreign investors to use a forum that can be manipulated by a domestic investor, rather than use an unbiased international arbitration process to resolve disputes. FIAS made a strong case for removing this change in the draft, and continues to request the government to remove any requirement forcing foreign investors to resolve investment disputes in the courts of Sierra Leone.
- 6) **The guarantee against expropriation, as was pointed out during the Workshop, needed refinement.** To make the guarantee more in line with international best practices, FIAS recommended changes that would ensure that there was no expropriation except for public purposes and in accordance with the Constitution and laws of Sierra Leone.

67. The government and FIAS have worked well together in their joint consideration of the draft investment code. Taking into account the drafts which the government had been developing since early 2003, it is notable that the drafters of the investment code have made substantial progress toward an investment code that will be in line with international best practices. All of the participants on the Cabinet Sub-Committee who have been involved in the drafting process deserve congratulations for the considerable efforts made to improve the investment code so that it will have a beneficial effect on the investment climate in Sierra Leone.

68. But the job is not finished. Provisions still remain in the draft investment code that differ significantly from international best practice and that FIAS believes will undermine the joint efforts that have been made so far. As the process continues and the draft investment code works its way through the system for consideration by Parliament, FIAS is available to assist in the process to ensure that Sierra Leone passes the best investment code it can. The “proof is in the pudding”, and whether the final draft of the investment code is effective for its purposes can only be judged over time as investors decide whether or not to invest in Sierra Leone.

D. Role and Function of SLEDIC

69. One of the major components of a successful investment promotion program in a country is the investment promotion agency. The agency in Sierra Leone, SLEDIC, has been in existence for more than ten years. Along with other government agencies, it lived through the very difficult conflict situation. Now that the government is in a new phase of reconstruction and development, SLEDIC should be at the forefront of the government’s efforts to attract investment. It clearly is not.

70. As noted above, SLEDIC is unable to perform the principal activities of an investment promotion agency. These activities include:

Box 2. Principal Activities of an Investment Promotion Agency

- Promotion
- Assistance to investors
- Registration and monitoring
- Policy advice to the government

71. In the past, SLEDIC’s role was to approve investments and make discretionary decisions about investment incentives. The new investment code will abolish all such activities for SLEDIC. In order for SLEDIC to perform the activities usually undertaken by an investment promotion agency, it is necessary to reorganize its structure and

strengthen its role. The modalities of this reorganization are beyond the scope of this report, but one central recommendation of this study would be for the government to request international technical assistance for such an endeavor.

E. Summary, Next Steps and Recommendations

72. The present investment climate in Sierra Leone is a direct result of the conflict situation that existed in the country for so long. The concomitant deterioration of the infrastructure has left the government with a formidable responsibility to bring the infrastructure even back to where it was in the past. The lack of infrastructure, combined with corruption, an inadequate legal and regulatory framework and a fragile justice system, will require substantial efforts by public and private sector alike to make Sierra Leone an attractive investment target in the future.

73. Fortunately the government has decided to face all of these difficulties head on. The enactment of an investment code in accordance with international best practice will be a significant first step to improving the investment climate. In addition, in this report FIAS has made a number of recommendations that will have a positive effect on the investment climate, if these recommendations are implemented. Not every step forward will be an easy one; but if the government can muster the political will to make the improvement of the investment climate one of its main priorities, then the private sector in Sierra Leone and future foreign investors will warm to the task themselves and make their positive contribution to the economic development.