



The Pathfinder Economic Alert

Improving the Business Climate In Sri Lanka

The Pathfinder Foundation with the assistance of Volunteers for Economic Growth Alliance (VEGA) and USAID, recently commissioned a study to identify the policy and regulatory reforms that are required to make Sri Lanka a leading country in investor friendliness. Improving the business climate is not an end in itself. A better business environment is a means for the achievement of the national objective of rapid economic growth resulting in increase in the living standard of the people and reducing poverty.

In order, to achieve the investment target (35% of GDP) set by the Government an investor-friendly business environment is the *sine qua non* for the achievement of the national investment target.

To promote mainly Foreign Direct Investment (FDI), the Government is focusing on improving the country's performance on the Ease of Doing Business Index (DBI), of International Finance Corporation/ World Bank. Sri Lanka was ranked 102nd of 183 countries included in this index in the latest report, the same rank as last year.

The Ease of Doing Business report is an important entry point for consideration of reforms for the enabling environment for business. The Central Bank acts as the focal point for Government efforts to improve Sri Lanka's score on the DBI. But, as the IFC cautions, the Doing Business Index is not comprehensive and improvements in the business climate typically require a broad agenda of reforms. Indeed, the Ease of Doing Business report is not the only international survey of business climates. Various international institutions carry out similar surveys of the business environment and related conditions in Sri Lanka, as listed below:

Survey Name	Sponsor	Sri Lanka Rank/Total Countries in Survey
1. Global Competitiveness Survey	World Economic Forum	52/142
2. Ease of Doing Business Report (DBI)	International Finance Corporation	102/183
3. Perception of Corruption Index (CPI)	Transparency International	91/178
4. Index of Economic Freedom (IEF)	Heritage Foundation and The Wall Street Journal	107/179
5. Logistics Performance Index (LPI)	World Bank and partners	137/155

6. Global Innovation Index (GII)	INSEAD	82/125
7. Human Development Index	UNDP	91/169
8. Business Environment	Economist Intelligence Unit	66/82
9. Enterprise Survey	World Bank	No rankings

Among these surveys, Sri Lanka's best performance is on the World Economic Forum's Global Competiveness Report (GCR) for 2011-12. The country ranks 52nd, in a field of 142 countries, an increase of ten places from the previous year's report. This increase in the GCR ranking is largely attributable to improved post-war security and related macroeconomic stability. (Several other GCR variables actually declined.) On all of the other surveys, Sri Lanka ranks in the middle of the pack or lower. The country's worst index performance is on the Logistics Performance Index – which measures trade logistics - where Sri Lanka ranks near the bottom. The Economist Intelligence Unit also gives Sri Lanka a low ranking on its business environment putting the country just below the 20th percentile in its universe of countries.

Policy Issues

These surveys, other research studies, and interview data with officials and businessmen identify a number of overall policy issues in the current business environment. These include:

- Issues related to macroeconomic and political stability, e.g., only two years since the end of the war, budget deficit;
- Mixed signals from the Government on the role of the private sector:
 - Need for strong endorsement of the private sector as the engine of growth;
 - Growing state participation in business;
 - Commitment to improving the ranking in the DBI not overall business climate.
 - Concerns regarding the Under Utilizing and Under Performing XXXX
- The need for Government focal point for improving the overall business climate beyond the DBI;
- Supreme Court decisions affecting approved investments;
- Upgrading critical infrastructure with regard to logistics.

Operational Issues

At the operational level, where businesses interact with Government agencies numerous issues related to the legal and regulatory environment have been highlighted. Ten functional areas for starting and operating a business are identified below. However, the scope of some topics has been expanded beyond the Doing Business definitions in order to address the concerns of both domestic and foreign investors. The ten functional areas are listed below.

Essential Processes for Starting and Operating a Business

1. Starting a Business
2. Site Selection and Dealing with Construction Permits
3. Acquiring and Registering Property
4. Access to Finance and Getting Credit
5. Protecting Investors
6. Taxes, Incentives, and Paying Taxes
7. Trading Across Borders
8. Enforcing Contracts
9. Closing a Business
10. Employing and Terminating Workers

A number of factors may constrain the implementation of these functions and thereby reduce business efficiency and increase costs. These factors include:

1. Laws, regulations and judicial decisions
2. Procedures for the implementation of regulations
3. Capacity of institutions responsible for regulations and procedures
4. Corruption and rent seeking
5. Industry/project specific factors

Summary: Priorities for Improving the Overall Business Climate and the Ease of Doing Business Ranking

The Policy Environment

The study of the PF identified the following actions to enhance the policy environment for business:

- Seek Government commitment to a reform agenda for improving the overall business climate;
- Empower a focal point in the Government for implementation of the reform agenda and monitoring progress;
- Request a Government policy statement expressing its commitment to private sector-led development;
- Request clarifications regarding relevant Supreme Court judgments as to the circumstances in which legal actions could go forward against approved investments;
- Create a “land bank” for investors to expedite release of state land for investment.

The Legal and Regulatory Environment

For each topic, the study recommends action for 1) improving performance on the DBI and 2) improving the overall business climate.

1. Starting a Business

To improve DBI score: Streamlining registration forms and procedures should improve the Doing Business ranking, including standardization of information requested from various registration agencies.

It is also noted that Sri Lanka is marked down on the DBI because the Ministry of Labor takes a long time to formalize EPF and ETF numbers. In practice, EPF and ETF numbers are provided on the date of application and are immediately in force. Doing Business should regard this procedure as complete *de facto* in one day, not one month as reported in the Doing Business report.

To improve the overall business climate: A single form for all agencies involved in processing business registrations. A virtual one-stop shop for online registrations that includes all concerned agencies. Online payment of a single registration fee.

2. Site Selection and Constructions Permits

To improve DBI score: Reduction in the number of procedures and consequent reduction in time required for completion of procedures. The DBI needs to take into account that fact that only a limited number of new businesses require defense clearance.

The Public Utilities Commission has set a new performance standard for electricity installation of 14 days from the date of application for installations within 50 meters of an existing main line. This measure is scheduled to go into effect in early 2012. Doing Business currently reports that 42 days are required for electricity connection.

To improve the overall business climate: Move towards global best practice. Reduce the number of procedures; cluster related procedures; review the continuing relevance information requirements; simplify procedures, standardize information requirements, and eliminate duplicative submissions.

Process permits online to increase efficiency and reduce opportunities for improper payments.

3. Registering Property

To improve DBI score: Re-engineer key procedures for property registration for relevance and efficiency. The three main procedures include: obtaining necessary documents from the local authority, deed registration at the relevant land registry, and obtaining the certificate of ownership.

To improve the overall business climate: Upgrade the system of land titling and registration to reduce reliance on paper documents and increase use of secure automated systems. Property registration should be mandatory.

4. Access to Finance and Getting Credit

To improve DBI score: Negotiate the status of the new credit information facility – the secured transaction registry – with IFC.

Doing Business requires private and public credit information bureaus. At present, Sri Lanka's single credit information bureau effectively meets the needs of financial institutions for credit information. This bureau is a hybrid public-private entity overseen by the Central Bank. The shareholders are private and state banks. The recent creation of a Secured Transactions registry for moveable assets used as collateral may meet the Doing Business requirement for two types of credit information institutions. The operation of the Secured Transactions Registry should clarify the rights of borrowers and lenders and further strengthen the DBI score in this area.

To improve the overall business climate: Consider ways and means of establishing venture capital firms or funds.

5. Protecting Investors

To improve DBI score:

While there is no need to introduce to actions to improve DBI score, the Government has recently taken steps to strengthen disclosure of related party transactions, protection of minority shareholders, and director's liability provisions in the regulations for listed securities.

To improve the overall business climate : Seek clarification from the Supreme Court regarding 1) the criteria for determination of legal standing of persons competent to invoke Fundamental Rights Jurisdiction of the Supreme Court relating in investments approved by the State and 2) the circumstances in which the court would wave the time bar specified in Article 126 of the Constitution for applications challenging investments approved by the state.

Clarify Government policy on direct participation in business.

6. Taxes, Incentives and Paying Taxes

To improve DBI score: Continue efforts to reduce the number of taxes and tax payments.

In 2010-11, the Ministry of Finance has reduced a number of tax rates and eliminated some taxes. The effects of these changes are yet to be seen. Doing Business has counted monthly EPF and ETF contributions as separate tax payments – a total of 24 payments. The Central Bank is negotiating the status of these payments with the IFC to consider these payments as one per year per fund.

To improve the overall business climate: Continue reform of tax administration, mainly using information and communication technology, intra agency and inter agency networking and reducing the need for frequent interaction with the Department of Inland Revenue.

Improve and eliminate BOI incentives.

7. Trading Across Borders

To improve DBI score:

Customs and the Port Authority are working on reforms to streamline procedures. An online system for processing customs declarations should be in place early in 2012.

To improve the overall business climate: Review all export licenses, registrations and certificates for their continuing relevance and necessity. Simplify procedures and make available online in a unified program. Review export cesses, fees and taxes in the context of overall tax reform.

8. Enforcing Contracts

To improve DBI score: Analysis of ways and means to improve the efficiency of the commercial court system and implementation of agreed measures.

The DBI on enforcing contracts deals exclusively with judicial proceedings for contract enforcement. Sri Lankan firms are increasingly seeking to avoid taking disputes to court by including mandatory arbitration in contracts, using mediators, or ombudsmen.

To improve the overall business climate: Analysis of the pros and cons of creating a Sri Lankan law of contracts.

9. Closing a Business

To improve DBI score:

The DBI and the Sri Lankan law deal with bankruptcy as the rationale for closing a business.

To improve the overall business climate: Review of regulations on closing a business with a view to simplifying and organizing the text in a more concise and clearer presentation.

10. Labor

Labor is reviewed for the DB report but is not included in the DB Index. In other words there are no international rankings on “employing workers”.

To improve the overall business climate: Reduce the difficulty and costs of laying off workers due to bankruptcy, contraction of business & improve efficiency and competitiveness.

Organization for Action

In conclusion the Pathfinder Foundation study makes the following recommendations for private sector action for continuous improvement of the overall business climate in Sri Lanka.

- Establish a mechanism for action with Government and public sector participation.
- Agree on a reform agenda
- Mobilize for advocacy
- Analyze policy options as needed
- Launch targeted advocacy communications and education
- Monitor progress on reforms and actual improvements in the business climate
- Develop and implement a new strategy and a programme of action for investment promotion

This is the Twenty-first in the series of Economic Alerts issued by the Pathfinder Foundation. Readers' comments via email to pm@pathfinderfoundation.org, www.twitter.com/pathfindersl are welcome. For complete study please visit www.sanvada.org