Pathfinder Economic Flash

EASE OF DOING BUSINESS: Low Hanging Fruit for the New Regime

At the conclusion of the parliamentary election a new government has been formed under the Premiership of Hon. Ranil Wickremesinghe. It is important to emphasise the need for introducing immediate policy reforms to accelerate economic growth and development. The new government's manifesto sets out a major reform program. In this regard, the Pathfinder Foundation (PF) has frequently highlighted the need for macro-economic policy adjustments as a pre-condition for sustained growth. While such stabilization is necessary to create a conducive growth framework, priority should be attached to implementing programs which bring about an attractive investment climate as quickly as possible. This is particularly urgent as the current set of domestic and international circumstances make it difficult to stimulate the lagging growth rate through macroeconomic policy adjustments.

Making use of the 'honeymoon' period

It is now a common belief that soon after an election victory every newly formed government has a 'honeymoon' period during which the policy-makers can introduce "bitter pills" for the treatment of the economy. Knowing that changes inflict short-term pain on certain sections of the population, mature political leaders and their economic policy teams implement corrective actions during this 'honeymoon' period. The benefits of implementing such structural reforms take longer to trickle-down to the population at large. This article seeks to recommend some measures which could be initiated during the 'honeymoon' period to generate immediate benefits in the form of a better climate for existing businesses and prospective investors, both domestic and foreign. This is clearly a major priority for the new government as set out in its manifesto.

Why not go for low hanging fruits: Improve the Ease of Doing Business

There are ‘no cost’ or ‘low cost’ policy actions that can be implemented by the new government which involve the introduction of changes to laws, regulations, procedures and various processes mainly relating to government ministries, institutions or the bureaucracy, both at the national and local levels.

The ease of Doing Business Index (DBI) draws upon some important criteria for starting and doing businesses in a country. It captures several important dimensions of the regulatory environment as it applies to local firms. It provides quantitative measures of regulations for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency. The DBI also measures regulations on employing workers. Maintaining the rule of law and avoiding impunity in order to create a propitious environment to boost investor confidence, protecting minority investors and enabling tax concessions are also taken into account.

The DBI is not about eliminating the role of the state from private sector development. On the contrary, it recognizes that the state has a fundamental role in private sector development. A key premise of the Index is that economic activity requires good rules. These include rules ‘that establish’ and clarify property rights, reduce the cost of resolving disputes, increase the predictability of economic interactions and provide contractual partners with core protections against abuse. The objective is to have regulations designed to be efficient, accessible to all who use them and simple in their implementation’ (IFC).

Key drivers of the economy

The DBI focuses on the regulatory environment for small and medium-size enterprises. These enterprises are key drivers of competition, growth and job creation, particularly in developing economies. Where regulation is burdensome and competition limited, success tends to depend on whom one knows. But where regulation is transparent, efficient and implemented in a simple way, it becomes easier for aspiring entrepreneurs to compete on an equal footing and to innovate and expand. In this sense the DBI values good rules as a key to social inclusion. Enabling growth—and ensuring that all people, regardless of income level, can participate in its benefits—requires an environment where new entrants with drive and good ideas can get started in business and where good firms can invest and grow, thereby creating more jobs. The IFC points out that the DBI functions as a barometer of the regulatory environment for domestic businesses. To use a medical analogy, the DBI is similar to a cholesterol test. A cholesterol test does not tell us everything about our health. But our cholesterol level is easier to measure than our overall health, and the test provides us with important information, warning us when we need to adjust our behavior. Similarly, the DBI does not tell us everything we need to know about the regulatory environment for domestic businesses. But its indicators cover aspects that are more easily measured than the entire regulatory environment, and they provide important information about where change is needed.

The DBI also offers policy-makers a benchmarking tool useful in stimulating policy debate, both by exposing potential challenges and by identifying good practices and lessons learned. They are also easily achievable involving little or no costs, as mentioned above. In addition, they do not crowd out reforms in other areas which are necessary to develop a competitive economy.

A tool for removing constraints to business

Any government with visionary leadership and a team of experienced policy-makers and implementers can easily find ways and means of removing barriers to trade, investment and innovation. For example the Development Projects Act envisaged in the election manifesto of the governing party can act as a tool to ease the doing business environment. Hitherto successive governments have declared the launch of 'One-Stop Shops' covering key aspects of the business environment. However, all these 'One-Stop Shops' have only added an additional burden on the investors as all the regulatory and bureaucratic barriers remained intact. In this situation the proposed Development Projects Act can be used to introduce reforms which make the operations of institutions, such as the Board of Investment, Export Development Board, Central Environment Authority Forrest Department, Land Registry etc., more business friendly.

Catching up for lost time

Sri Lanka lags behind competitive Asian economies such as Thailand, Malaysia and Vietnam as well as other emerging markets. It is currently ranked 99 in the DBI.

However, it is important to recognise that quick results can be achieved in terms of improving this ranking. For instance, Georgia has improved its ranking about 75 places in five years.

These reforms are relatively painless and cost free. The improved economic policy credibility and coherence they generate would strengthen Sri Lanka's resilience to growing investor uncertainty towards emerging Asia.

This is the Sixty Seventh Economic Flash of Pathfinder Foundation. Readers' comments are welcome at www.pathfinderfoundation.org