Investment Climate and Challenges Ahead

Doing Business in Sri Lanka

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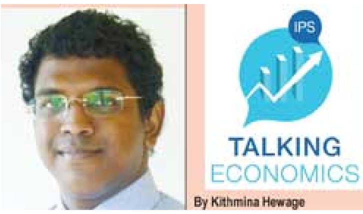

Sri Lanka's investment climate is deemed to be favourable with the ease of investment improving from 57.5 per cent in 2015 to 58.96 per cent for 2016. This is indicated in the World Bank's recently released annual'Doing Business Report', which gives significant coverage tothe country's relatively stronger position compared to its South Asian counterparts. With only Bhutan and Nepal ranked better than Sri Lanka, several news sources have heralded the performance of the country relative to the South Asian region.However, while comparisons to the region are important, the growth of mega-regional trade agreements such as the Trans-Pacific Partnership (TPP) requires consideration of countries beyond the immediate regional focus. Due to the availability of tax-free export opportunities to large markets such as the US in garments and other related sectors, investment is likely to divert away from Sri Lanka towards TPP members (e.g. Vietnam). Therefore, this article briefly analyses disaggregated data of selected indicatorsfor Sri Lanka to obtain a view beyond South Asia.

Bureaucratic Bottlenecks

Notably, Sri Lanka has made most progress in areas related to physical infrastructure ("Dealing with construction permits" and "Getting Electricity").This could possibly be attributed to knock-on effects from the emphasis on infrastructure investments over the past decade. As important policy reforms, the World Bank also specifically notes streamlining the internal review process for building permit applications and eliminating a requirement to notify the Registrar of Companies about the stamp duty payment for the initial issuance of shares. However, Sri Lanka appears to perform worst in areas that require institutional coordination. These inefficiencies in turn appear to create bottlenecks in the creation of new businesses while restricting their growth. For example, Sri Lanka is ranked at 153 in registering property.Even though the country is ranked better than most other South Asian countries, indicators demonstrate stagnation while other regional partners show steady improvements. For example, Sri Lanka's cost of registering property (as a percentage of property value) remains stagnant while Bangladesh, Laos, and Vietnam have significantly reduced their costs (Figure 1).

Sri Lanka takes approximately three times longer (1318 days) than countries such as Vietnam, Cambodia, and Laos, to enforce a contract. Similar trends can be identified throughout the Report where rankings fail to illustrate the country's poor performance in light of rapid improvements elsewhere. Therefore, in order to mitigate the potential of being "left behind" in domestic and foreign investments by competitors, it is imperative that institutional reforms are immediately initiated in the country.

Getting Credit

The negative effects of bureaucratic bottlenecks are exacerbated by constraints in gaining access to finance. The lack of options for SMEs to finance business ventures deters entrepreneurship and also hampers SMEs from expanding. Beyond the rankings drop (caused mainly due to methodological changes in measurement),a comparison of the indicators demonstrates the institutional weaknesses that pervade access to credit as well. Weak legal rights mainly influence the country's poor performance in this sector. The strength of collateral and bankruptcy laws to protect the rights of borrowers and lenders is considerably lower than other developing countries. As shown below (Table 2), Sri Lanka has secured a meagre three out of twelve important policy prescriptions based on the strength of legal rights that facilitates lending. In contrast, Vietnam and Cambodia have scores of seven and eleven, respectively. The Report suggests that ideally, a country should implement at least six of the prescribed policies to enable business creation and growth. Similar to previously noted indices, Sri Lanka's performance remains stagnant while other developing countries have gradually improved their regulatory mechanisms.

Trading Across Borders

The Report measures three sets of procedures associated with time and costs (excluding tariffs) within the process of exporting and importing a shipment of goods - documentary compliance, border compliance, and domestic transport. As a relatively small economy, it is vital that local businesses have access to international markets. The recently introduced " Economic Reforms" for Sri Lanka highlights the need to integrate the country's businesses into global value chains. However, the Reportsheds light to some of the key institutional and structural factors thwartingsuccessful participation in global value chains.

Successful participation in global value chains depends heavily on expediting the trading processes (e.g., customs clearance times), and addressing non-tariff barriers, which act as a hindrance to movement of goods. The Report notes reasonable gains over the years to reduce clearance times and document compliance costs. However, continuous advances are necessary to fully accommodate SMEs around the country to participate in international trade.For instance, the Report notes that 72 hours and 58 hours are needed for border compliance and documentary compliance in imports, respectively. In contrast, countries which have successfully integrated into global value chains such as Singapore require 35 hours for border compliance and just one hour for documentary compliance when importing.To make the best use of value chains and become a preferred source of value addition, the process of importing, adding value, and exporting should be carried out in a promptmanner. It should be noted that the Report highlights only one among a plethora of factors that facilitates the successful integration of developing economies into global value chains. Yet, it acts as an important indicator of the challenges the economy faces.

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