

Improving Sri Lanka's Business Environment: It's not so difficult

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In his budget speech, Finance Minister, President Mahinda Rajapaksa said Sri Lanka “aims at gaining a ranking among the top 10 countries in Asia Pacific in the Doing Business Index (DBI).” This Insight shows that this is an achievable goal and unpacks three types of corrective action that can help Sri Lanka get there.

The DBI looks at different parts of the business environment and evaluates them in terms of speed and process. Aggregating these parts creates a composite measure in which the countries are ranked based on the ease of conducting business.

Sri Lanka improved six places in the last year and is now ranked 99th in the world. It is also ranked first in South Asia. In Asia Pacific, Sri Lanka is at number 15. To enter among the top 10 on the DBI's Asia Pacific rank (the target set out in the budget speech) Sri Lanka will need to move up at least 11 places in the world ranking.

This analysis finds constructive means to achieve that goal, describing them as a three-step corrective action programme: (1) plug the leaks (2) pick the low hanging fruit and (3) prioritise the weakest link.

Plug the leaks

The first step is to simply preserve the existing gains. That is, to maintain Sri Lanka's overall rank by preventing declines in different components of the index. Exhibit I shows that despite the overall improvement, Sri Lanka declined on half of the index's components.

The overall improvement was not due to improving a little bit across the board but because of the large improvements on some indicators, despite the small declines in others. For example, Sri Lanka improved 16 places in trading across borders but comparatively fell only by seven places in registering property – which was her worst decline.

Keeping one's place in a ranking is like keeping one's place in a race. You can't do it by staying in the same place. In the context where other countries are making improvements, Sri Lanka also needs to keep making improvements in order to avoid falling behind. Therefore, in

addition to the areas in which Sri Lanka declined in rank, there is also vulnerability in the areas that saw no change in rank (see Exhibit I).

Identifying all these areas of vulnerability and ensuring that improvements keep pace with the world is the first step.

Exhibit I: Plug the Leaks			
	2014	2015	Change
DOING BUSINESS INDEX	105	99	↓ 6
Starting a Business	101	104	↓ -3
Construction Permits	60	60	→ 0
Getting Electricity	100	100	→ 0
Registering Property	124	131	↓ -7
Getting Credit	86	89	↓ -3
Protecting Minority Investors	50	51	↓ -1
Paying Taxes	167	158	↑ 9
Trading Across Borders	85	69	↑ 16
Enforcing Contracts	165	165	→ 0
Resolving Insolvency	68	72	↓ -4

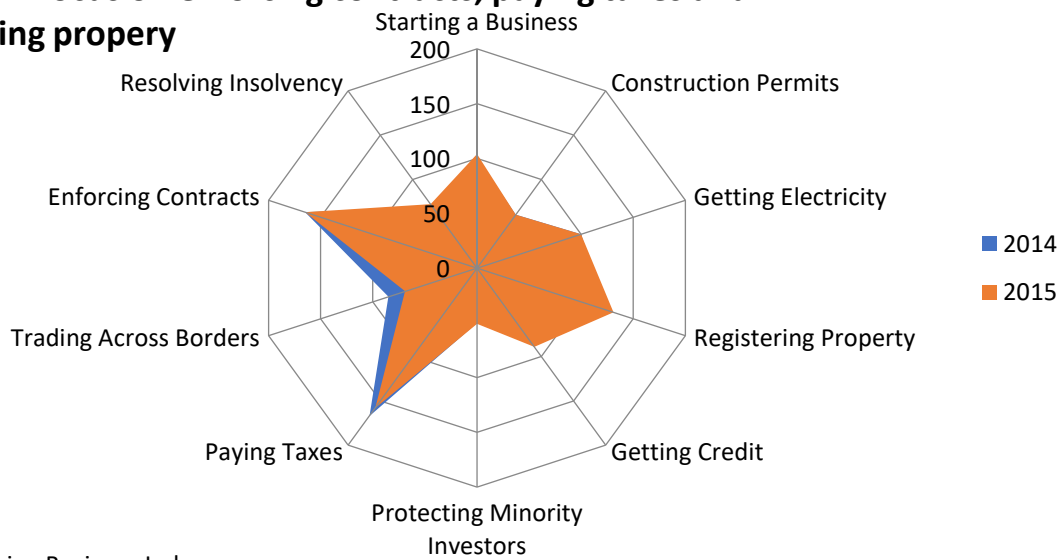
Source: Doing Business Index

Tax - the lowest hanging fruit

The second step is to find areas in which Sri Lanka can with relative ease make huge improvements, that is, pick the low hanging fruit.

One way of identifying the candidates for low hanging fruit is by looking where Sri Lanka ranks poorly. Exhibit II shows Sri Lanka's rank on sub-indices that form the overall DBI. The radar chart shows Sri Lanka doing particularly poorly in 'enforcing contracts', 'paying taxes', and 'registering property'. (Doing worse is captured on the radar chart as being further away from the center).

Exhibit II: Focus on enforcing contracts, paying taxes and registering property



Source: Doing Business Index

Two candidates stand out as low hanging fruit. The first is ‘paying taxes’. The World Bank’s DBI Budget Simulator estimates that just by allowing ETF, NBT and VAT payments to be made quarterly rather than monthly, Sri Lanka’s global DBI rank could increase by 10 places (provided others stayed the same). There are significant benefits to this reform. PwC estimates that moving from monthly to quarterly tax payment cycles for VAT reduces VAT filing time by 35 percent. Plus, implementing this reform is eminently feasible: in the last few years, Burundi, Rwanda, Panama, Romania, Albania and Timor-Leste have all moved from monthly to quarterly tax payment systems.

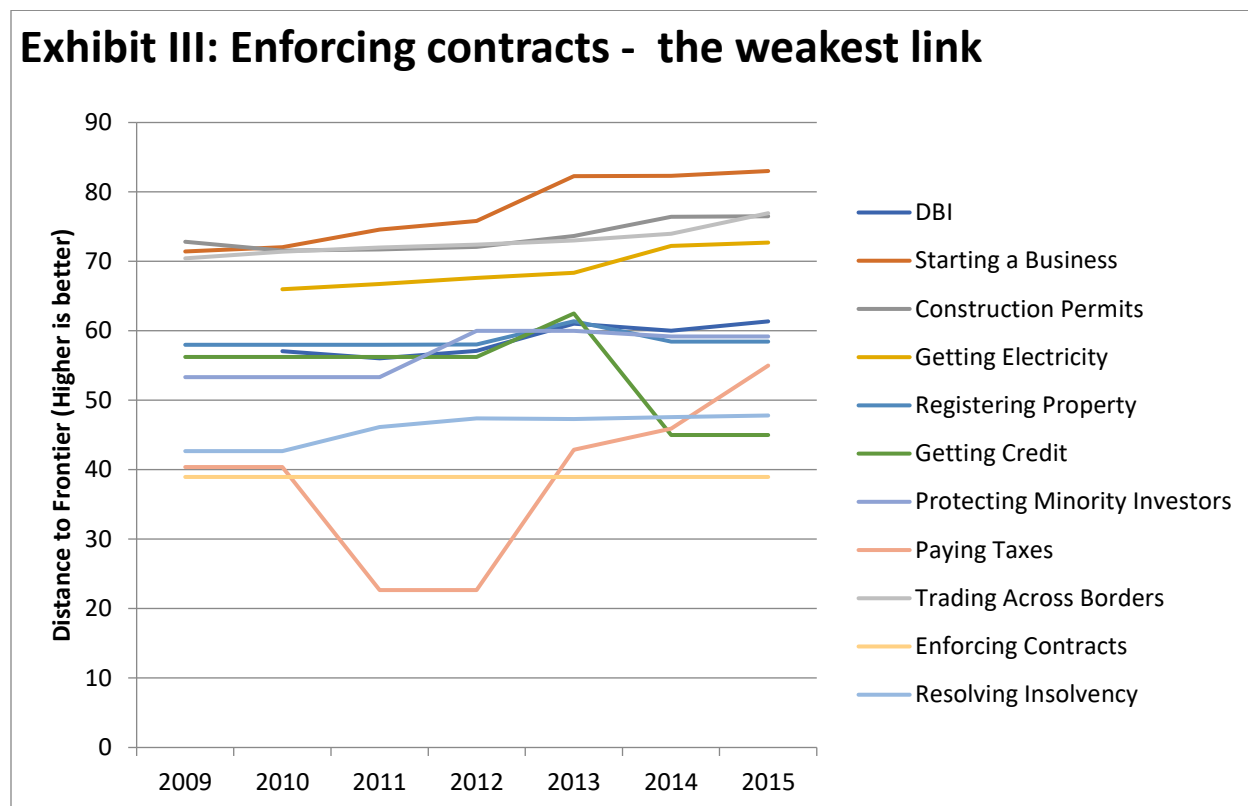
The second low hanging fruit is not an area where Sri Lanka is ranked extremely low but where yet again a small change can make a great difference. Simply by reducing the number of import-export forms from the current seven to Singapore or Korea’s three, the simulator predicts that Sri Lanka’s global rank will rise by nine places.

Protecting the weakest link

In many situations, the attractiveness of a position is only as good as the weakest link. Therefore, identifying Sri Lanka’s worst performing indicator in an absolute sense (‘weakest link’) and improving it will be important for improving the business environment.

The DBI has a Distance to Frontier measure. It shows the distance of each economy to the ‘frontier’, which represents the best performance observed on each of the indicators across all economies. The difference between the ranks and the Frontier measure is like the difference between position and actual distance from the person placed first in a race. You

can have a low position and yet be very close to the front (because everyone else is) – or be very far behind.



On this measure enforcing contracts, getting credit and resolving insolvency are the areas where Sri Lanka is performing worst. Note that the weakest link in both the relative measure (Exhibit I) and the absolute measure (Exhibit III) is enforcing contracts. This is important because investors are more likely to be swayed by the weakest link.

Sri Lanka’s poor score on enforcing contracts also has knock-on effects on other areas of the index such as resolving insolvency and getting credit. This means that even though reforms to the legal system are neither quick nor easy, they remain critical and essential if Sri Lanka’s business environment is to improve. In fact, the results are dramatic. If Sri Lanka reduces the time it takes to enforce a contract from the current 1,318 days to 553 (the East Asia Pacific average) its global DBI rank will jump by 15 places – not to mention the positive knock-on effects with respect to other indicators.

Top three priorities for entering top 10

This Insight provides three constructive steps Sri Lanka can take to enter the top 10 rank in Asia Pacific. Even picking just one initiative within each step can make dramatic improvements. That is, ‘plug the leak’ in difficulties to registering property, ‘pick the low



hanging fruit' by changing tax payment frequency and fix the 'weakest link' by getting the justice system to move faster in enforcing contracts.

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