



**Qualitative assessment of the local enabling environment
for private enterprise in the Eastern Province of Sri Lanka**

POLICY BRIEF



Australian Government
AusAID



The Asia Foundation

QUALITATIVE ASSESSMENT OF THE LOCAL ENABLING ENVIRONMENT FOR PRIVATE ENTERPRISE IN THE EASTERN PROVINCE OF SRI LANKA

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The views expressed in this report are of those of The Asia Foundation and do not represent those of the commissioning agencies, the facilitators of this study, or any single individual interviewed during the research phase.

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1. Introduction

From March to April 2008, The Asia Foundation conducted a qualitative assessment of local economic governance in Sri Lanka's Eastern Province. This Policy Brief presents the assessment's main findings and resulting policy implications.

Local economic policies and the conduct of local government officials shape the enabling environment for private sector dynamism and sustained economic growth. In Sri Lanka's Eastern Province, which has been affected by civil war for over two decades, economic growth is particularly critical to its recovery. The overall purpose of this assessment was therefore to provide local government officials, the business community, and the general public with relevant information about major impediments in the business environment in the Eastern Province as a starting point for policy discussions and reform.

The assessment captured the opinions and perceptions of those who are most directly affected by the quality of local economic governance: business owners themselves. The Foundation and its technical partner, Quantum

Strategic Services Pvt. Ltd., convened 36 focus groups in six urban localities (Municipal Council areas of Batticaloa and Kalmunai, and Urban Council areas of Ampara, Kathankudy, Kinniya, and Trincomalee) in the districts of Ampara, Batticaloa, and Trincomalee. The 215 focus group participants were grouped according to their business sectors, which included "manufacturing and construction," "wholesale and retail trade," and "services and other." One focus group in each locality was composed of business owners and public sector officials who were already working closely together to improve the business environment in their communities.

Focus group facilitators solicited participants' views in a set of pre-defined areas that The Asia Foundation has found, through previous research in Sri Lanka and other countries in Asia, have a significant impact on the local business environment. The Foundation used these areas as indices for its quantitative Sri Lanka Economic Governance Index 2007, which covered all provinces except for the Eastern and Northern Provinces due to logistical and security concerns.

2. Main Findings

There were no notable differences in business owners' views across business sectors. While there were some differences in views across the six localities, there was, overall, a high level of agreement among focus group participants on several main barriers and conditions that have a detrimental affect on their businesses and profits:

1) Petty corruption

In each locality, focus group participants spoke of the significant impact of petty corruption on their businesses. Participants reported the need to pay bribes to public officials when performing a wide range of tasks, including registering their businesses, applying for business licenses and permits, and undergoing regulatory inspections. Across localities, Divisional Secretariat officials and the police were the most often-cited perpetrators of corruption, but focus group participants also mentioned officials from the District Secretariats, Municipal Councils, Grama Sewakar (Village Headmen), and Land Registry and Health departments. In many cases, participants felt that the official charges levied by government to perform business-related functions were reasonable, but that the unofficial payments were crippling.

2) Lack of motivation, professionalism, and support among public officials in their dealings with the business community

Participating business owners also cited an overall lack of professionalism among public officials when it comes to their interaction with the private sector. Focus group members described an overall climate of “indifference,” lack of support for private sector activity, lack of a problem-solving orientation, and lack of attention to the central role that the private sector plays in economic growth. Business owners also described the public officials they interact with as “incompetent,” noting that

many lack knowledge of the procedures and regulations they have been tasked with implementing, resulting in failure to provide proper guidance to business owners. All focus groups complained of long delays in obtaining important business-related services.

Many participating business owners also pointed to examples of public officials expediting paperwork or not asking for bribes from people with whom they have personal or political connections. Some racial and gender-based discrimination (interestingly, reported preferential treatment for women) was cited. Discriminatory practices and favoritism were said to be particularly high in Kalmunai, Kinniya, and Trincomalee.

It is interesting to note that focus group participants in the Batticaloa Municipal Council area expressed the view that overall, they were generally satisfied with the services offered to businesses in their locality (although they had critiques of some more specific aspects of public officials' performance) and that practices of bribery, discrimination, and favoritism were only moderate in their community.

3) Lack of information and transparency, and lack of consultation

Focus group participants confessed their lack of knowledge about some core aspects of their interactions with government, including processes for businesses registration, and in particular the specific laws and regulations with which they are required to comply. They also complained of an overall (and perhaps intentional) lack of transparency in some areas, such as the basis for calculating the tax rate on businesses. Access to business-related information was cited as “poor” in all localities. Focus groups also noted that the business community was not invited by local

government to participate in public meetings or other consultative mechanisms through which they could provide input on issues of mutual concern.

4) Opaque and cumbersome procedures for business registration and obtaining licenses and permits

In most areas, participants felt that the registration process was cumbersome, riddled with delays, and made more difficult due to bribes and lack of guidance from local officials. The process of obtaining permits and licenses from local authorities was viewed by participants as generally easier and lower-cost (both in terms of official and unofficial costs), although nearly all focus groups said it was difficult to deal with other relevant authorities. In general, business owners said that they want to do what is required, but in some cases the costs – in terms of both time and money – seem to be too high. Only in the Batticaloa Municipal Council area did participants feel that overall, the registration, licensing, and permitting process was reasonable.

5) Poor infrastructure

Poor roads and drainage systems were cited in all focus group areas as detrimental to business. Other infrastructure problems cited included electricity, water, garbage collection, market facilities, and street lighting, although the quality of these services reportedly varied across localities.

6) Lack of business premises and insecure property rights

In all focus group areas, participants cited the lack of business premises/commercial space (often due to large areas of state-owned land) as a major obstacle to business start-up and expansion. As a result of this scarcity, rents and sale prices were reportedly high. Most business owners were renting space, and most lacked basic written contracts for their rented or leased space, resulting in an insecure status and reduced incentives to make improvements to their businesses.

7) Civil and local conflict, and dispute resolution

Overall, focus group respondents reported an overall reduction in civil conflict and an improvement in the security situation. However, respondents in Kalmunai, Kathankudy, and Trincomalee expressed a high level of concern about an ongoing, general lack of security in their localities. Four day-to-day manifestations of the conflict continue to affect business owners in all focus groups: illegal taxation by armed groups, checkpoints, road closures, and parking restrictions. Although the practice of illegal taxation (i.e., extortion) has reportedly decreased, it was cited in all areas as a continuing, significant problem. The delays and rent-seeking associated with checkpoints and road closures increase the cost of doing business. Parking restrictions on main roads (imposed to reduce the threat of bombings) restrict customers' access to businesses.

With respect to business-related disputes, the incidence of such disputes varied across localities, but participants reported an overall high level of satisfaction with resolution through informal mechanisms (e.g., Chambers of Commerce, local leaders) and the Mediation Boards. In Kalmunai, where businesses often sought resolution through formal mechanisms (e.g., the courts and police), satisfaction was lower.

8) Natural disasters

Participants in all areas spoke of the financial and infrastructure damage wrought on their businesses by recent natural disasters: the December 2004 tsunami in particular (with the exception of Ampara, which is not on the coast), but also seasonal heavy flooding. When talking about the issue of corruption, focus group respondents frequently mentioned tsunami relief and rehabilitation as a major locus of corruption in their communities.

3. Policy Implications and Recommendations

The full assessment of local governance in the Eastern Province outlines a process that local officials and business owners may wish to pursue to jointly analyze, prioritize, and begin to address the obstacles faced by the business community that hamper economic growth. The findings above, however, suggest at the outset a number of policy reform areas that merit a closer look by government officials. Some policies and practices can be addressed at the local level, while others will require vertical coordination and integration with provincial and/or national-level policy:

- Work to eliminate informal charges and illegal taxes levied on the business community (most likely through a proper set of incentives for public officials).
- Provide ongoing training and incentives for local officials who have regular contact with the business community to increase their skills, motivation, and customer service orientation, and increase their understanding of the contribution of the private sector to improvements in standards of living at the local level.
- Streamline the process for business registration and the obtaining of licenses and permits.
- Create effective, user-friendly mechanisms (e.g., One-Stop Shops) to provide relevant information to the business community about business registration, licensing, and permitting procedures; laws and regulations; taxation; and lease registration.
- Create regular mechanisms for collegial interaction, information-sharing, and joint problem solving between the business community and local government officials, both elected and appointed. Local-level action plans that are created and implemented through public-private partnerships can make significant contributions to an improved enabling environment for business.
- Explore ways that business development services can most efficiently and effectively be designed and delivered to the local private sector.
- Consider ways to increase available space for private enterprises (e.g. creation of commercial zones, improved urban planning).
- Improve infrastructure, particularly roads and drainage systems.
- Implement plans and procedures for disaster risk reduction and mitigation.
- Further strengthen the capacity of local-level formal (Mediation Boards) and informal dispute resolution mechanisms to address small business disputes. Increasingly, larger firms (and more complex issues) will require the services of the courts, and thus the deficiencies in the formal legal system must be addressed.
- Continue to pursue lasting peace and improvements in the security situation in former conflict areas.



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