COUNTRY PRIVATE SECTOR DIAGNOSTIC

CREATING MARKETS IN SRI LANKA

Private Sector-Led Inclusive Growth from Islands of Excellence

Executive Summary

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EXECUTIVE SUMMARY AND MATRIX OF ACTIONS

Sri Lanka is a country of paradoxes. With the lowest poverty rates, best social indicators, and highest per capita income in South Asia, Sri Lanka's economic performance since independence had generally been hailed as a success before the current debt crisis. However, past performance occurred amidst many distortions and an economy less open than its peers, largely reflecting the strong involvement of the state in the economy. Even if this interventionist model of economic policy and the presence of many state-owned enterprises (SOEs) served the country well through the years of conflict and their aftermath, it is no longer sustainable. Indeed, after the rapid growth of the peace dividend in the years post-2009, the economy has faltered and progress on social indicators has stagnated. Many of market distortions remain and have been exacerbated by COVID-19. Understanding how, despite these handicaps, Sri Lanka achieved positive economic and social outcomes in the past provides the building blocks of a realistic, forward-looking growth strategy—one of the objectives of this Country Private Sector Diagnostic (CPSD). The research for this report was conducted prior to the current crisis, but the recommendations remain relevant to implement public policies that will support private sector led inclusive and sustainable growth.

ES.1 STATUS OF THE ECONOMY

In 2019, Sri Lanka became one of two upper-middle-income countries in South Asia, before falling back to lower-middle-income status in 2020. While in the immediate postwar period (2009–2013) gross domestic product (GDP) growth averaged a healthy 6.5 percent, it slowed from 2014–2018 to 4.3 percent and reached an 18-year low of 2.3 percent in 2019. This was before the COVID-19 outbreak, which has further weakened immediate growth prospects substantially and exacerbates an already challenging environment of low growth and pressures on fiscal and external accounts. The World Bank projects that the economy will contract by 3.6 percent in 2020 and the recovery in 2021 will be tepid at 3.3 percent. Fiscal sustainability is a concern with public debt reaching approximately 100 percent of GDP in 2020, not including large SOE debt estimated at 12 percent of GDP. In April 2022, as this report went to publication, Sri Lanka has indicated that it would no longer service its foreign debt and might negotiate with investors for restructuring the debt. The authorities also indicated that they were engaging the IMF.

The key drivers of growth in the last decade have been the favorable export performance of the apparel sector and tourism sectors; the boost to consumption, partly on account of remittances; and the government's infrastructure investments following the end of the war. From 2009–13, about half of the growth performance was the result of higher productivity, possibly reflecting the impact of the reconstruction effort, the industrial upgrading in the apparel and garment sectors, and the performance of the information technology (IT) and light manufacturing sectors, which compete in some of the most competitive destination markets.

Notwithstanding the generally good growth performance, the extent of integration into the global economy has declined considerably since the new millennium, and private investment has been structurally much lower than in peer countries. This is symptomatic of the changes in economic policy direction that Sri Lanka has experienced in the past 50 years. The positive growth that Sri Lanka experienced over the past two decades was preceded by a period beginning in 1977 where the state began to gradually disengage from the management of the economy, through trade liberalization and privatization or commercialization of SOEs. However, this push for change stopped rapidly and was even reversed in the late 1980s. A second wave of reforms and the boom of the textile and clothing sectors generated growth in the 1990s. Since the 2000s, despite its strategic location on trade routes and proximity to large markets, the country has become significantly less open: trade accounted for only 52.9 percent of GDP in 2017, down from 88.6 percent in 2000, a low number for a midsize economy. The share of private investment in total gross fixed capital formation fell from 89.8 percent in 2000 to 81.8 percent in 2017, reflecting both the impact of the last stages of the civil war and strong public sector and debt financed investments. Moreover, from 2015 to 2017, private investment at 16.5 percent of GDP was significantly below the levels in China and India of 29.5 percent and 20.1 percent of GDP, respectively. This weakening investment performance reflects not only the difficult business environment and the presence of the state, but also—more recently—the lack of macroeconomic stability. It is also correlated with a decline in the World Bank's Logistic Performance Index from 2.75 in 2012 to 2.6 in 2018, in contrast to the performance in Vietnam where it increased to 3.27 over the same period.

The deceleration of growth starting in 2013 reflected lower public investment and a subsequent contraction in construction, as well as a slowdown in manufacturing. It highlights the weakness of the foundations of Sri Lanka's growth performance and the inability of the state—despite its central presence in the economy—to provide an environment conducive to such growth. This all the more so because the state's public investments suffer from a considerable efficiency gap, estimated at 30 percent (World Bank 2019g) and have not generated the return on investment needed to finance the corresponding loans. This has been associated with the build-up of unsustainable macroeconomic imbalances and large external financing requirements, resulting from a high fiscal deficit. Considerable increases in external debt, weak revenue mobilization, and large losses suffered by SOEs have constrained fiscal space and created an acute balance of payments crisis. Since April 2020, Sri Lanka has lost access to the international capital markets, and in April 2022, authorities announced a suspension of repayment of certain Fx-denominated loans.[1]

Growth has failed to deliver the qualitative results expected by Sri Lanka's population:

- **The employment intensity of growth has declined, and there is a lack of high-quality jobs,** especially outside Colombo. While the official unemployment rate is low, the share of informal employment in low-quality jobs is large. At the same time, many skilled workers choose not to work in the private sector, as they prefer prestigious civil service or SOE positions, the latter employing around 250,000 people. Moreover, high-quality job opportunities for workers have not always materialized, leading to outward migration.
- **Structural transformation has been slow.** The export product mix of Sri Lanka has not changed much and remains much less complex than in aspirational peers like Costa Rica, Malaysia, and Thailand. Some transformation in production and employment has happened: the share of agriculture in GDP declined from 14.3 percent (2002) to 7.7 percent (2018), and agriculture's share of employment declined from 38 to 26 percent, while employment in services increased from 38 to 46 percent over the same period. Agriculture employment remains, however, higher than in some aspirational peers (Costa Rica, Malaysia). In fact, a large part of the economy—including the apparel and agriculture sectors—continues to operate in the low-skills labor-intensive space at wages comparable to those in lower income countries like Bangladesh.
- **There is significant spatial disparity in economic and social development, with several regions of the country significantly lagging the relatively prosperous region around Colombo.** Regions affected by the civil war (in the Northern Province, Mullaitivu, Mannar, and, to a lesser extent, Kilinochchi), Batticaloa in the Eastern Province, and Monaragala in the Uva Province remain far behind in levels of poverty, infrastructure, and economic development.

Finally, the economy is facing the economic fallout of the COVID-19 pandemic[2], which has adversely affected several sectors, including tourism, and further constrains the already tight fiscal space. Moreover, rapid aging poses an additional constraint on the country's future growth performance.

ES.2 KEY CONSTRAINTS ON THE ECONOMY

Attempts to resume growth and accelerate structural transformation in the Sri Lankan economy face a number of obstacles, some of which have been present for a long time.

The Cost of Doing Business for Outsiders

The policy environment is often unpredictable and nontransparent, and policy decisions lack consistency; both contribute to a complex investment climate. Policies are subject to frequent shifts (reversals in trade and tax policies, in particular for sectors that benefit from protection owing to political connections). Periods of inward- and outward-oriented policies have alternated. Policy decisions also lack consistency: for instance, in 2012, "hub" regulation laws were passed with the goal of becoming a logistics hub, while maintaining a 40 percent equity cap for foreign investors and high levels of protection. Examples of lack of coordination were found in several policy areas reviewed in this report: education policy, innovation policy, transport and logistics, and tourism.

A highly restrictive trade regime with average customs duties on imports of 22.3 percent because of para-tariffs creates a bias against exports and diversification by directing private investments into protected sectors served by Sri Lanka–based firms. Import protection has been driven partly by the desire to protect national production, and partly by fiscal exigency: taxes on international trade accounted for a high average of 18 percent of tax revenue during 2014–19, much higher than in other upper-middle-income countries, where the average is about 1–3 percent. Access to foreign-sourced inputs also becomes more costly because of high taxation and controls at the border.

The investment climate is poor for most firms. The poor quality of the regulatory environment constrains investment decisions. However, some foreign investors and larger companies can access far better terms, notably under Board of Investment (BOI) sanctioned regimes and BOI zones. The success of some of the exporters attests that investment climate conditions can be improved when needed.

Gaps in Supply of Essential Inputs

Constrained fiscal space and inefficient management of some large-scale projects have limited the ability of the government to address key infrastructure gaps, especially in transport and energy. There is a particularly urgent need to upgrade airport and port infrastructure (expansion of the Port of Colombo terminals) and improve internal road connectivity. At the same time, while the country enjoys almost 100 percent electrification, the cost of electricity is high, and generation is at capacity. Procuring additional generation capacity through an improved public-private partnership (PPP) framework, and a better economic incentive structure implying a gradual shift to cost-reflective tariffs, combined with rebalancing the generation mix toward renewables would be needed to support a faster growth trajectory.

With the government owning about 40 percent of the banking system, large budget deficits are to a significant extent funded by state-owned banks. Furthermore, the state provides guarantees to state banks to facilitate lending to SOEs and occasionally allows for outright dismissal of loan obligations. As a result, the private sector, in particular small and medium enterprises (SMEs), is deprived of resources that are needed to support innovation and productivity-enhancing investments. Furthermore, the preferential access to finance for SOEs distorts competition with the private sector and in turn affects the quality and cost of services in these sectors.

Most land is publicly owned (80 percent). Land use is highly fragmented and can be subject to regulations, such as the restriction of the use of agricultural land in some regions to certain crops (rice for instance) and restrictions on foreign use of land. Also, ownership of vast tracks of land by some public entities leads to underutilization and misallocation.

ES.3 HOW DID SRI LANKA GROW DESPITE CONSTRAINTS IN THE PAST?

Many of the above constraints have been prevalent in the past, including periods when Sri Lanka enjoyed rapid economic growth and poverty reduction. Understanding how this came about provides guidance in charting a growth strategy in the future. Some of the constraints have endured for a long time because they are politically sensitive and may be challenging to relax in the near term. A growth strategy must take this into account and identify reforms that are both economically salient and politically feasible.

In reviewing Sri Lanka's past economic performance in the wake of several obstacles, three lessons emerge:

a. **Making use of the global marketplace.** In some sectors (textile and clothing, tourism, IT, high-end manufacturing) companies have been expanding their footprint to the global marketplace where the distortions prevalent in the domestic market are not present and demand is unlimited. In this process, companies have been able to become competitive and upgrade production to more sophisticated products and markets.

   Recent successes in mainly export-focused niche sectors, such as IT-enabled services and light value-added manufacturing show that Sri Lankan firms can be internationally competitive, including in the most competitive destination markets (for selected sectors). Sri Lanka's private sector is changing, including recent growth of sophisticated IT-services exports (business process management [BPM] in legal, accounting, and financial services; knowledge process outsourcing [KPO] services in data analysis and software operations) and new investment and exports in precision and high-quality manufacturing and agro-food processing (advanced technical apparel and textile-based products and customized rubber-derived products for instance).

   To fully harness Sri Lanka's comparative advantage and integrate it further into global value chains, the country needs to build on the innovative drive in the large existing manufacturing sectors, such as apparel, and entrepreneurial dynamism in niche sectors, such as information and communications technology (ICT) and high-tech products. These sectors, if scaled up, hold the potential to drive Sri Lanka's full transformation to an upper-middle-income country. Improved access to external markets is essential in this respect: the size of the country's domestic market is too small to allow production of higher technology products at the scale necessary to fully support their growth potential. In this context, it will be essential to step up efforts at greater integration in global value chains: concluding bilateral free-trade agreements could be the key to accessing large markets and becoming a more attractive destination for new investments.

b. **Finding a way to work around the distortions.** One important characteristic of the Sri Lankan economy is the coexistence of structures typical of advanced economies with those of lower-income economies. There are large conglomerates that are generally efficient and operate at the global production frontier, while most of the private sector is small with low productivity firms in the informal sector—many of them in the agriculture and service sectors. Conglomerates—a few large enterprises—are active in sectors as diverse as transport, apparel, retail, light manufacturing, and tourism. Many are long-established companies that have significant market shares, and sometimes protected positions in some of their sectors of activity, and as a result, have been less affected by complex regulations. In addition, many globally competitive firms, including foreign-owned corporations, operate in export processing zones, which has allowed them to circumvent restrictive labor regulations and access more efficient trade regimes.

   Leaving aside these large firms, Sri Lanka's private sector is dominated by the informal sector (in terms of number of firms), albeit to a lesser extent than in some South Asian peers. While there are numerous SMEs, they are not dynamic enough to drive structural transformation toward a more typical upper-middle-income country.

c. **Addressing interdependent distortions.** Some of the distortions in the system are the result of a complex equilibrium and fundamental redistribution effects and cannot be easily removed without simultaneously addressing other constraints. Important sensitive policy areas such as land, infrastructure, and education reflect redistributive or compensating policies that will be difficult to disentangle.

   For instance, even though Sri Lanka has a good education system with among the best indicators in South Asia and boasts pockets of highly qualified labor, skills gaps are noted by employers as one of the important constraints to their development. Notably, lack of graduates from public education in science, technology, engineering, and mathematics (STEM) fields and technical and vocational skills that can more easily be used in the private sector are among the most significant shortcomings noted by employers. While there are private providers of education, to the extent authorized, the regulatory environment fails to properly monitor their quality.

   Meanwhile, students graduating from public universities in Sri Lanka cannot find good jobs in part because they are taught skills that are less relevant for the modern-day private sector, and in part because they prefer prestigious government jobs over private sector jobs. Absent any civil service reform, there will be little uptake for improved education. Furthermore, proposals to introduce private universities have been met with strong resistance from education professionals.

ES.4 THE WAY FORWARD

With this backdrop of an economy that needs to accelerate economic growth but is faced with numerous constraints. This CPSD proposes the following steps to promote a more dynamic private sector in the country (table ES.1).

With a limited domestic market, Sri Lanka cannot compete at scale in most industries. It must differentiate itself by further diversifying into higher value-added industries and harnessing opportunities for regional integration. Recent successes in knowledge and quality-intensive sectors (spanning sectors from value-added agricultural products, to specialized manufacturing and IT-enabled services) could be scaled up with appropriate upstream policies. The second pillar of private sector-led growth should be on scaling up tourism, as soon as recovery from the COVID-19 crisis will permit, and then investing in more sophisticated and varied tourism offerings.

A focus on green and sustainable development will leverage Sri Lanka's natural assets and a well-preserved environment while contributing to the fight against climate change. The environmentally sustainable use of natural assets is central to the tourism industry, but also to several key natural-resources connected sectors such as agriculture and marine-based production mentioned below. Mitigation of the impact of climate change will also be integral to future private sector growth through an increase in renewable energy use (a key objective for the energy, urban, and transport sectors) and better management of coastal areas.

Through SOE reforms, the government can mitigate the mounting fiscal risks and costs negatively affecting macrofiscal stability, a key determinant for foreign investments. It can further use its state-owned business enterprises as catalysts for private investments and partnerships instead of displacing them. This would require the government to modernize and consolidate the legal and regulatory framework governing SOEs, reduce the competitive neutrality concerns affecting the level playing field, and strengthen the corporate governance and performance of its key SOEs through specific measures recommended by the World Bank integrated SOE diagnostic, which complements this report (World Bank 2020c).

Strengthen Innovation Ecosystem to Enable Dynamic Industries

There are innovative industries in Sri Lanka, but overall, the country scores relatively low on innovation metrics, and the public sector underinvests in innovation. In 2018, Sri Lanka adopted its Innovation and Entrepreneurship Strategy 2018–2022 with the involvement of significant private sector players. The National Innovation Agency was created to implement it. To more fully realize the potential of producing value-added goods and services, public policies supporting innovation must be less fragmented and more oriented toward commercial efforts. This supposes stronger links between public policies and the private sector, with a more diverse array of incentivizing plans and publicly funded facilities to provide space for innovation, as well as better links between university research and commercial use.

Support "Islands of Excellence" in IT, Specialized Manufacturing, and Agribusiness

Sri Lanka has several islands of excellence in sectors that have the potential to grow and further contribute to exports. There is manifest and latent comparative advantage in several sectors, such as ICT (as demonstrated by artificial-intelligence-based KPO services), resource-based industries (coconut and rubber derived industrial applications and products), and light specialized manufacturing (with high value-added content such as high-end textiles or electronic sensors) that have driven growth in recent times and have the potential to drive it in the future. These sectors do not systematically compete on price, even though the cost of the work force remains attractive compared to competitors, but rather on providing tailored value addition to their customers: they have in common the ability to adopt innovative production techniques and customize production to clients' needs. Another common characteristic is their ability to maintain high quality standards that are demanded by the most sophisticated markets and customers.

Beyond strengthening government support to education, innovation, and standards that will help accelerate the growth of high-value manufacturing and services, offering a better business environment and land for new investments is critical. In the short-term, an expansion of BOI processing zones is needed. However, in the long term, instruments and practices that have proven successful in the context of the BOI (such as customs and trade facilitation measures) should be rolled out to the rest of the economy and remaining restrictions on foreign investment and ownership considered for elimination.

Exploit Tourism Potential to Create Jobs in Lagging Regions and Balance External Accounts

Tourism remains one of the most important sectors in the Sri Lankan economy as the second-largest export earner, a significant employer (169,000 direct and 219,000 indirect jobs), and a key source to finance the balance of payments. The number of annual tourist arrivals has grown more than 500 percent over the last decade—from about 450,000 in 2009 to around 2.3 million in 2018, equivalent to roughly a 23 percent annual growth rate over this time period. The direct contribution from the industry, estimated at US$4.4 billion (2016), accounts for about 5 percent of the country's GDP. Furthermore, tourism-specific investments accounted for close to 10 percent of total foreign direct investment (FDI) in 2018. Tourism is also important because of its inclusivity, being the sector that is most geographically diverse, having the largest share of SMEs and registering a significant growth in the female employment share since 2018. However, women's employment in the tourism sector remains well below the industry average, accounting for less than 10 percent of the industry, compared to the global average of 65 percent.

To ensure growth in the tourism sector in the medium term, there is a need to improve logistics and connectivity and address shortages of skilled and service-oriented workforce, which would be important to provide high-value tourism services. The capacity of tourism and hospitality training institutes in regions outside Colombo needs to increase to address future demand. There is also the need to build strategic capacity for policy formulation within government agencies dealing with tourism and enhance interagency coordination. Post-COVID-19, it will take longer than expected to regain the confidence of tourists to return; now is the moment to review how this could be facilitated.

TABLE ES.1 MATRIX OF INVESTMENT OPPORTUNITIES AND GOVERNMENT MEASURES TO CREATE MARKETS

PRIORITY SECTORS	SHORT-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (12-24 MONTHS)	MEDIUM-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (3-5 YEARS)
Enabling sectors and objectives		
Finance Deepen the supply of the sector, while targeting dynamic sectors (working around distortions).	*Opportunities for private investment* • Post-angel-stage VC funding. • Increased credit to MSMEs. *Measures* • **Increase capital requirements for the sector, which could facilitate consolidation and/or exit of nonviable institutions and harmonize capital requirements between banks and NBFIs.** • Review asset quality of NBFIs (after pandemic). • Eliminate lending interest rate caps. • Create a risk-sharing facility for MSME credit. • Facilitate creation of venture capital fund for post-angel-stage investment in promising start-ups.	*Opportunities for private investment* • Consolidation in the NBFI sector. *Measures* • Establish comprehensive financial consumer protection framework. • Rationalize the agencies overseeing different subsectors of the financial system into two supervisory agencies: the CBSL and a newly created FMA. FMA could oversee financial consumer protection across all financial services. • **Enact amendments to the Banking Action to: (a) enhance bank resolution framework for banks and NBFI; and (b) subject state-owned banks to the banking law.** • Enact modern secured transactions law and create modern uniform online registry of security interests for movable assets (tangible and intangible). • **Develop new legal framework, including for emerging areas such as digital finance and fintech.**
Power Boost renewables while preparing for the future (compensating for distortions).	*Opportunities for private investment* • None in the short term. *Measures* • **Launch a multi-project competitive tender for renewable energy procurement, including large (utility-scale) projects.** • **Assess feasibility, and identify appropriate business models and financing structures for the proposed Sri Lanka-India transmission line.**	*Opportunities for private investment* • Renewable energy PPPs. *Measures* • Prepare a short- and medium-term implementation and financing plan based on the Long-Term Generation Expansion Plan 2018–2037 with prioritized investments. • Progressively move to cost reflective tariffs to improve the financial standing of CEB; consider as transition a transparent direct subsidy to CEB. • Develop India-SL transmission line.

PRIORITY SECTORS	SHORT-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (12-24 MONTHS)	MEDIUM-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (3-5 YEARS)
Education and skills Boost TVET offerings and industry-university links (compensating for and working around distortions).	*Opportunities for private investment* • TVET PPPs. *Measures* • **Reinforce university–private sector coordination to match skills to demand and promote innovation (improve fiscal incentives; review IPR policies; fund innovation spaces).**[a] • **Develop Sector Skills Councils in priority sectors (TVET) with a view to aligning the supply of skilled labor with demand. Offer firms incentives to build in-house training capabilities.** • **Improve governance of the TVET sector and coordination among the ministries** responsible for training institutions to improve efficiency and enhance the quality of training programs.	*Opportunities for private investment* • Internationalization of universities: attracting international students; foreign investments in universities (with the BOI); links with foreign universities for research. • Private sector investment in universities focused on the provinces. *Measures* • Improve university faculty in priority fields such as STEM: promote PhD scholarships; fill vacancies; hire foreign nationals. • Establish an independent quality assurance council. Review quality of EDPs; reform National Vocational Qualifications (course accreditation; quality assurance). • Differentiate missions between teaching, research and innovation, and community services and regional development. • Restructure the Skills Development Fund to allocate resources competitively.
Transport and logistics Develop future transport and value-added logistics services (better use of the global marketplace)	*Opportunities for private investment* • **Development of the East and West Container Terminals using a landlord port model and evaluate strategic private sector participation.** *Measures* • Improve institutional strength and capacity development to bolster SLPA as a regulator. • Develop a master plan to improve city-port and port-hinterland connectivity (including feasibility studies and financing options). • Perform needs assessment for new gateway supply chain advanced logistic infrastructure. • **Complete the extension of the BIA terminal.**[b] • **Roll-out the Sri Lanka customs National Single Window with the appointment of a high-level steering committee.**	*Opportunities for private investment* • Value-added storage facilities (cold storage, third-party logistics, and MCC/LCL services). • Value-added services (bunkering, marine, and so forth) related to Hambantota port activities. *Measures* • Finish highway expansion projects. • Expand Jaffna International Airport runway. • Automate port-gate clearances and transfers between extended port gates, inland ports, and other customs authorized economic zones, industrial parks, and container freight stations.
IT infrastructure Prepare for a more open market (compensating for distortions).		*Measures.* • Review regulations to allow local loop unbundling and address last-mile connection competition issues.

PRIORITY SECTORS	SHORT-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (12-24 MONTHS)	MEDIUM-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (3-5 YEARS)
Traded sectors		
Tourism Plan for volume growth and develop new upscale offerings (better use the global marketplace).	*Measures* • Strengthen intra-island and international air connectivity.[c] • **Reinforce capacity of tourism ministry to manage future growth in value-added and environmentally sustainable tourism** (new destinations, branding, MICE, wellness tourism). • Establish a single regulatory agency to manage national parks and identify future development sites; review the Flora and Fauna Protection Act to assess the potential for protected areas to be opened to tourism in an environmentally sustainable way.	*Opportunities for private investment* • Underdeveloped sites (east and South coast, nature reserves), MICE, wellness tourism. *Measure:* • **Develop more sustainable tourist destinations with public investment in connectivity, marketing, and destination development.** • **Train the 50,000–60,000 new hospitality staff needed, including measures to attract and retain women to the hospitality sector.**
IT-enabled services Facilitate the supply of labor, key skills, and inputs to a growth sector (better use of the global marketplace).	*Opportunities for private investment* • Post-angel-stage VC funding (see above). *Measures* Prioritize IT skills at the university level • **Improve labor laws and facilitate granting visas for qualified expatriates (for example, French Tech Visa).** • **Develop a comprehensive strategy to prop up the start-up ecosystem: improve access to business facilities, advice, and finance and regulatory reform to address taxation, capital repatriation, and bankruptcy.**	*Opportunities for private investment* • Continued expansion of the BPM sector. *Measures* • Improve the regulatory environment to address issues regarding data localization and management and digital transactions (signatures, payments).
Manufacturing Expand space and facilitation measures for high-growth firms (better use of the global marketplace and working around distortions).	*Opportunities for private investment* • Value-added manufacturing relying on skilled manual labor and quality assurance. *Measure* • **Create new BOI zones outside Colombo to accommodate demand from prospective investors. Consider specific needs of industries (logistics, industry clusters) and the economic viability of multiple zones.**	

PRIORITY SECTORS	SHORT-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (12-24 MONTHS)	MEDIUM-TERM MARKET CREATING OPPORTUNITIES FOR INVESTMENT AND GOVERNMENT MEASURES (3-5 YEARS)
Innovation policy Increase emphasis on innovation policies in connection with export sectors (better use the global marketplace)	*Measure* • Incentivize private investment in R&D (tax incentives, credit guarantees, and lending facilities) targeting innovative sectors. • **Redirect public support to private innovation adoption: business advisory services (for example, Colombia) and technology extension services (for example, India), as well as innovation vouchers and collaborative grants.** • **Reduce fragmentation of government R&D programs and duplication of agencies.**	*Measure* • Develop channels for greater access of innovative firms to international markets and international sources of knowledge by enhancing market knowledge and facilitating regional integration with key trading partner countries.
Access to land Better use fallow public lands while improving land information systems (compensating for distortions)	• Adopt the policy of parcel-based land registry and cadastral map for all land ownership and land use rights in Sri Lanka. • **Revise the registering property processes to 3 steps (from the current 9).** • **Carry out or review an inventory of State Land Assets with a view to putting them to commercial use .**	• **Establish a new policy on state land and building asset management incentivizing public asset monetization and revising permitting, leasing, and granting concessions on state lands.**
Taxation and trade		• Gradual reduction of para-tariffs as fiscal situation improves. Target para-tariffs based on analytical work and consideration of priority sectors for the government growth strategy.

Note: Priority measures are in boldface. BIA = Bandaranaike International Airport; BOI = Board of Investment; BPM = business process management; CBSL = Central Bank of Sri Lanka; CEB = Ceylon Electricity Board; EDP external degree programs; fintech = financial technology; FMA = Financial Markets Authority; IPR = international property rights; IT = information technology; LCL = less container load; MCC = multi-country consolidation; MICE = meetings, incentives, conference/conventions and exhibitions/events; MSMEs = micro, small, and medium enterprises; NBFI = nonbank financial institution; NCRE = nonconventional renewable energy; PPP = public-private partnership; R&D = research and development; SL = Sri Lanka; SLPA = Sri Lanka Ports Authority; STEM = science, technology, engineering, and mathematics; TVET = technical and vocational education and training ; VC = venture capital.

a. Also relevant to innovation policies below.

b. Also of relevance for the tourism sector.

c. See also transport above.

NOTES

1 Sri Lanka's credit rating was downgraded by S&P (to 'Selective Default') 'Fitch (to 'C') and Moody's (to 'Cd') after authorities announced suspension of interest and principle repayments in foreign currency.

2 The successive national lockdowns affected not only tourism but also domestic consumption.

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