Post War Perspectives

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Introduction

Since the liberalisation of Sri Lanka's economy in 1977, Sri Lanka private sector has been destined to become its engine of growth. There have been signs of great optimism for local businesses at different periods, as the country passed seemingly insurmountable barriers. At other times, deep troughs of disappointment reduced confidence as businesses coped with multiple political and economic challenges. The constant has been that large local businesses have remained resilient in a manner that has resulted in moderate growth and profitability. The private sector's search for a greater place in Sri Lanka's economy has been based on the historical trajectory of Sri Lanka's political economy, existing business challenges and future ambitions. This think piece examines specific challenges during an expectedly more optimistic two-year period of Sri Lanka's history – 2015-16. However, it highlights that the period was fraught with challenges, some of which were similar to previous periods, and others that were different - there were both old and new 'elephants in the room[1]'.

Successive governments in Sri Lanka were known for their omnipresence within the economic and business landscape. The relationship between the government and sections of the private sector appeared as being necessary associations of existence, but only for those in entitled positions of influence. Some may argue that hegemonic governance, nepotism, crony capitalism, and rent seeking held much of the business sector back. Simultaneously, others could also argue that the spectrum of the private sector had depended too much on government and should have 'gotten on with business' without waiting for a perfect business climate or blaming the government for its troubles. Indeed, both arguments may have merit - since the dawn of liberalisation, contrary to expectations, the private sector may have neither had an opportunity nor ability to 'lead' in the overall development of the economy.

During the war, the large private sector perceived that public policy priorities revolved around the need for maintenance of security and policy stability (Miriyagalla, 2016). Specifically, the ethnic conflict erupted in 1983 and continued for almost three decades, and the country also witnessed flames of leftist dissent in the South in 1989-90. It was all too common and accepted knowledge that the role of government on security matters was critical. However, this acceptance brought with it opposing discomfort about government inaction, bureaucratic inefficiency, dis-incentivisation and crowding-out behaviour. Businesses close to the coteries of power benefited significantly; others sought opportunities with what was left or what they could create themselves. Overall, the private sector continued to remain resilient, even despite the effects of the war (Miriyagalla, 2016).

The single biggest change for the private sector since liberalisation occurred when the war ended in 2009 through the total military defeat of the Liberation Tigers of Tamil Eelam (LTTE)

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The idiom 'elephant in the room' is an expression for an obvious truth that is going unaddressed.

by the government led by President Mahinda Rajapakse. Having played a waiting game with a high level of resilience for several years, there was no doubt in the minds of the private sector that the end of the war was sufficient for largest local businesses in Colombo to grow consistently. Nevertheless, the government entered a higher trajectory of economic mis-governance and business influence with the victorious completion of the war. Resulting in the country's large scale private sector becoming increasingly doubtful that the policies of the government at the time were of long term benefit and that the country could come out of crony capitalism to present fairer market-based opportunities. Therefore, when the opportunity arose at the next presidential election on January 2015, a large section of the Colombo based private sector voted en-masse for a regime change (Miriyagalla, 2016). Previously lacking a positive message beyond the end of the war to share locally as well as with international investors who questioned the obvious nationalistic and nepotistic nature of private sector growth, they expected a 'better story' to emerge with the change in government in January 2015. The private sector was especially confident because the new coalition government of President Maithripala Sirisena and Prime Minister Ranil Wickremasinghe had pledged transparency, good governance, reconciliation and pro-private sector policy initiatives (Miriyagalla, 2016).

Significance of the Study

The justification for this study was based on multiple factors. Private sector investment and growth which can lead to better jobs, and incomes are critical for the population to benefit optimally from the dividends of peace. Moreover, a better managed process of private sector involvement in growth can ease pressure and dependency on the state. It can also reduce the state-led patronage system which has in the past, played a pivotal role in expanding social divisions along ethnic lines. This is, of course, notwithstanding the fact that there must also be in parallel, redistributive mechanisms and good public service provisions for the marginalised and vulnerable. Foremost among the drivers of private sector growth in the country is the large Colombo based local private sector. Their ability to deliver economic benefits will have the largest ripple effects on society, and thus improving their confidence and reducing barriers are critical.

This think piece aims to fill an important gap in knowledge on key factors affecting investment and business growth among the large private sector[2] in Colombo. Though there have been investment climate surveys[3], qualitative research has not been rigorously undertaken to provide more in-depth insights. Moreover, the available investment climate surveys suggest that though there have been rising and decreasing levels of confidence over time, not much has changed over the past several years as a long-term trend. Indeed, they are litmus tests at specific points in time rather than an analysis of a longer period. Decision making must, however, be based on deeper analysis.

This study acknowledges the fact that views of other stakeholders, especially that of the government could have contributed to further expanding, elaborating and validating the findings. For example, interviews with senior policy makers would have provided 'the other side' of the arguments presented here. However, that was beyond its scope, which is primarily

[2] The definition for large sector used for this study is those businesses having more than 100 employees.

[3] The most popular being the LMD-Neilson Business Confidence Index

about private sector views, confidence and concerns. Future research may focus on the views of government on the private sector as a way of bridging the views, and supporting the adoption of a holistic and partnership approach to private sector development

Methodology

The research was based on 25 in-depth qualitative interviews with private sector leaders of large businesses in late 2016 in Colombo detailing their views about factors affecting business development over the period 2015-16. Individuals were approached via phone calls, emails and with the use of snowballing techniques, following which in-person interviews were held in confidence using a semi-structured questionnaire during the months of October and December 2016.

The research question for this study was "*What are the key factors shaping the business climate and affecting large business creation and sustainability in post-war Sri Lanka since the change of government in 2015?*" The breakup of respondents, based on the sectors that they represented, positions they held and gender are given in the tables below:

	No. of Companies
Business Chambers	5
Banking and Insurance	5
Tourism	3
Market Research	3
Shipping and Logistics	2
Agriculture	2
IT	2
Construction	2
Multi-sector	1
Total	**25**

	Positions
Chairperson	3
CEO	17
Director	4
Senior Manager	1
Total	25

	Gender
Males	22
Females	3
Total	**25**

The study was open to wide ranging comments, though the focus remained on economic and public policy factors. Based on the overall research question, the research study adopted a qualitative research methodology, maintaining a design that was not fixed, but one that remained dynamic as the field research evolved. This interactive model (Maxwell, 2009) considered aspects of setting goals, desk research prior to fieldwork, determination of secondary research questions, confirmation of research methodology and checking of the validity as they feed into each other during the research process to allow for a tight integration. The qualitative methodology was chosen for its inductive research benefits.

The sampling methodology used was stratified purposeful sampling, which involved identifying and interviewing business leaders from diverse backgrounds in Colombo with semi-structured questionnaires. Efforts were made to prevent over-representation on specific sectors, while those most important to the economy were targeted. Whilst maintaining independence from the views and policies of known organisations, the researcher and the research assistant used networks to access key individuals for interviews. The methodology was helpful to "achieve representativeness or typicality of settings, individuals or activities selected", and "capture adequately the heterogeneity of the population", "allow for the examination of cases that are critical for the theories that the study began with" and "illuminate reasons for differences between settings or individuals" (Maxwell, 2009). The number of qualitative interviews was chosen based on the quality of the information obtained to ensure that diverse views were gathered and the final data was "rich". The identities of the individuals interviewed have not be disclosed. Analysis of the information collected was undertaken parallel to the data collection as per best practice.

Sri Lanka's War Economy and Transition to the Peace Economy

Theoretical Framework

In a seminal piece of work on the transition from war to peace, Gultang (1996) states that it is important to differentiate between 'positive' peace and 'negative' peace, the former seeking a long-term assurance of peace looking at direct, structural and cultural aspects, whilst the latter simply is the absence of violence. Several scholars have drawn clear distinctions between the two noting the importance negative and positive peace play in setting expectations after the end of a war. Dhalman (2011), for example, argues that during the period of negative peace, different agendas influence governance and the use of resources, which become "the captive of post-war politics" (p. 181). Moreover, most scholars have been bound by Western liberal thought that promotes economic and political liberalisation through market based economic structures and democracy as being fundamental for peacebuilding (Bercovitch and Jackson, 2009). This has led to the development of liberal peace theory that argues that democracy and liberalisation of the country are essential criteria for long term peace. The theory also encourages the need for law and order, support from external actors, and reconstruction based on top-down and bottom up strategies which are responsive to different needs and flexible to political realities (Bercovitch and Jackson, 2009). The role of the private sector in terms of generating incomes and encouraging employment creation is fundamental within the liberal peace paradigm.

As the relevance of the liberal peace approach has developed, two types of critiques of liberal peace have also emerged – one based on 'power' heavily influenced by scholars such as Mark Duffield[4], Christopher Cramer[5] and Oliver Richmond[6], and the other based on 'ideas' influenced by those such as Roland Paris[7] and Christopher Cramer[8].

The Impact of Liberal Economic Policies Leading to the Start of the Ethnic Conflict

There is wide acknowledgement that the key factors that led to the ethnic conflict in 1983

[4] See Duffield (2007) and Duffield (2002)

[5] See Cramer (2006)

[6] See Richmond (2005)

[7] See Paris (2004)

[8] See Cramer (2006)

were economic. Until the change of government and the liberalisation of the economy in 1977, the country's economy was based on import substitution within a relatively closed economy. By the mid-1970s the country's economy was in crisis with large fiscal deficits and widespread unemployment. The new government was elected with a two-thirds majority and a promise to liberalise the market. Liberalised market and adopted polices meant to promote export-oriented industries. Large commitments were made for large loan-based public infrastructure spending to encourage the private sector.

The change in policy making, meant to improve the economic conditions did so for only a selected region and group of people. In fact, the economic reforms adopted made the situation worse for those in key sectors (Tambiah, 1986). Large sections of the population perceived the benefits as unfair and based on political linkages. Dunham and Kelegama (1994) make the important point that construction projects provided "an invaluable mechanism for the dispensation of patronage" (p. 10). Furthermore, "there was not so much a retreat of the state from economic activities, as a shift in the nature of its predominance and fields of operation…" (Dunham and Kelegama, 1994: 10).

While these policies resulted in strong short-term growth, it could not be sustained due to pressures to the government budget. This was due to price escalations in construction work, which the government budget could not bear. Also, government revenue earned through exports could not match the imports and the debt spiralled upwards. Other government expenditure was curtailed to continue the infrastructure drive.

The section of the private sector that was linked to the government investment drive or had aligned successfully with sectors that had become attractive in the open economy witnessed improvement in incomes. However, rural populations that depended on the key export commodity sectors of tea, rubber and coconut did not benefit from an increase in the exchange rate to help meet foreign debt obligations (Dunham and Kelegama, 1994).

In time, national savings and real wages declined. This was matched by the emergence of a significantly more autocratic government that was ready to use a tough hand to match youth-led violence and silence dissent (Tambiah, 1986). While the Tamil dominated regions of the North and East saw the commencement of the war from 1983, the South witnessed a leftist youth uprising in 1989.

Post-war Economic Policies

The end of the war in May 2009 was far from insignificant for private sector growth, as Sri Lanka was perhaps the only country to have defeated a terrorist group through military means. Considering that the LTTE was the most ruthless terrorist organisation at the time, makes the end of the war more significant for a country in need of development and investment. However, as with many other countries that emerge from the end of war, Sri Lanka's economic path was dependent on its violent history, and the effects of social division and war related spending remained a significant part of the post-war society.

After the ending of the war, the government primarily used public infrastructure investment to drive its growth agenda, without due consideration given to the private sector interests and long-term development. Whilst it was well known that many newly emerging countries developed their countries with an active state, the difference in Sri Lanka's approach was the fact that the Sri Lankan government had side-lined the private sector (Coomaraswamy, 2014).

After the war ended, the private sector expected that investments would grow and the business sector would become more independently dynamic, but this did not happen. It was a fair expectation, given that the economy was now safe for investment and deserved fruitful dividends that could in turn support employment benefits that could reduce the risks of return to conflict. However, continuing its populist policies, the former government drove economic growth through a debt-financed and consumption growth trajectory. There was significant sovereign borrowing without any structural reforms. Moreover, the market economy became more protectionist, and tariffs and taxes were increased over and above normal tariff levels. Furthermore, the government continued its populist and nationalistic rhetoric even after the end of the war. There were also several dictatorial moves such as the impeachment of the Chief Justice and harassment of journalists, which affected the general investment climate. Some of the government actions amounted to blatant corruption.

However, with the end of the war came private sector opportunity. Certain sections of the large business community during the previous regime were allegedly known to have accrued benefits resulting in the procurement of large business deals. Irregularities in procedures were not considered important because the government was effective in taking key decisions and implementing development programmes. The blessing of having completed the war was sufficient for certain members of the community to turn a blind eye when procedures were not followed. As the presidential election approached in January 2015 and the former President, Mahinda Rajapaksa sought an unprecedented third term, those who had not benefitted from the crony capitalism and didn't have access to insider opportunities, felt that a new government was essential to better support the business community. Many others who had supported the Rajapaksa regime felt that they could do even better under a government that was less populist. Indeed, the support to Maithripala Sirisena, by the largest party in the opposition at the time, the United National Party, was sufficient for many private sector leaders to support a change given the party's history of pro-private sector policy making.

The government's development vision could have better considered prudent macro-economic policy making that could catalyse employment and contribute to durable peace. It was noted immediately after the war that appropriate macro-economic policies were required not only to promote economic growth but also social stability (Institute of Policy Studies, 2010). The process of peaceful transition with economic dividends also called for economic reforms. Specifically, reforms were identified as being important to reduce the medium-term dependency on borrowed funds to support reconstruction and social spending (Institute of Policy Studies, 2010). With the end of the war, the government had the mandate and support to undertake far reaching reforms, but instead chose the more populist option of avoiding such reforms and instead trying to engage in large infrastructure development by borrowing high levels of funds. Its monetary policy had also been directed towards financing these borrowings instead of driving growth through private sector development.

By 2014, the government and Central Bank were proud of its $US 3.2 billion investments in the North and East from 2009 – 2013, as it had led to the "creation of new entrepreneurs and job opportunities" (Cabraal, 2014: 1). Expenditure on health and education had also increased. Whilst this investment was indeed commendable, Sarvanathan (2014) argues that it should be seen against the backdrop of the fact that there had been three times greater expenditure on defence, of over $US 2 billion per year over the last four years. Even though the Ministry of Defence included an urban development mandate, one must distinguish between simple recovery and true private sector led growth development with employment creation. Sarvanathan (2014) highlights that investment in the country had been largely borrowed growth rather than earned growth, where there has been insufficient employment creation or increased productivity.

Furthermore, Sandaratne (2014) notes that the government's investment in infrastructure development cannot take credit for the perceived evidence of development, low unemployment and increased income. Indeed, one of the most important reasons for increased incomes of rural people was the remittances sent by people working overseas due to a lack of employment opportunities locally. It was estimated that 20% of the labour force was working overseas (Sandaratne, 2014). Moreover, it is also important to note that because the government continued to maintain a very large defence budget, with much of the funds going to pay for the defence forces (who no longer had a war to fight), the 'employment' strategy for rural youth from the Sinhalese villages reduced the fiscal space to be used for other development work.

By the end of 2013, foreign debt was US$39.7 billion, with debt servicing costs equivalent to 25.3% of export earnings. By the end of 2014, overseas debt had increased to US$ 45 billion. This included loans taken by local state banks, which the government used for more large-scale infrastructure investment. Whilst borrowing may be important for many developing countries to expand their economies, "the extent, costs, terms of borrowing, and the use of funds have significant implications for debt sustainability" (Sandaratne, Jan 4, 2015). The funds borrowed for infrastructure development were initially short term foreign capital, the riskiest source (Institute of Policy Studies, 2010). These were primarily through the sale of bonds and foreign currency denominated treasury bills. Thereafter, loans had come increasingly at more short-term commercial rates. Coomaraswamy (2014), noting the need to take a critical look at the debt situation as the debt-to-GDP ratio had reached 79%, notes "The share of external debt in total debt had increased. Within that, the share of commercial debt has increased. Within that, the share of short-term debt has increased. Are we vulnerable? In my view, we are certainly not in the red-light zone. Sri Lanka is not near a crisis. However, we are in an amber light zone. It is now time for caution." Furthermore, Coomaraswamy (2014) makes an important point with regard to the External Vulnerability Index for Sri Lanka, noting "The comfortable level is 100%. Our liabilities are 125% of our reserves. This is not a crisis level but the amber light is flashing."

The Institute of Policy Studies (2013), also noting its concerns at the time, highlighted that whilst the government had successfully secured greater amounts of foreign loans over the past few years, foreign exchange earnings have not been sufficient to meet the needs for debt servicing (Institute of Policy Studies, 2013). By 2012, the exports-to-GDP had decreased to 16.4% from 33% in 2000 (Institute of Policy Studies, 2013). The Institute of Policy Studies (2013) notes that "The Sri Lankan economy is now trading less and less with the world and this has been accompanied by a fall of Sri Lanka's share of exports in world trade. Evidence suggests that Sri Lanka's total effective rate of protection is higher now than in any previous post-liberalisation period" (p. 5). Declines were seen in all sectors except mining in 2012, with further declines in 2013. It is important to note that whilst Sri Lanka's industrial exports continued to decline, other countries such as Bangladesh and Vietnam saw increases and that the state of the global economy could not be fully blamed for the decreases in demand for products from Sri Lanka. The trade deficit declined in 2012, only because the decline in imports was larger than the decline in exports.

Despite the warning signs from a debt perspective, it may be considered justifiable that growth through expansionary fiscal policy was essential if it had positive private sector development and employment outcomes. Indeed, the government was able to show impressive growth for the country in the first two years after the end of the war, with growth rates over 8%. By 2012, growth had declined to a (still impressive) 6.4% (Institute of Policy Studies, 2013). Thus, the initial optimism of how the economy would react after the end of the war was translated into noteworthy economic indicators. However, closer analysis of the growth indicators showed clear weaknesses in Sri Lanka's post-conflict growth story. Sandaratne (2014, Nov 16) notes that "When the GDP and per capita incomes of a country were increasing, the proportion of revenue to GDP was expected to increase. In Sri Lanka, it has decreased in recent years." Overall, the GDP statistics appeared to be questionable.

It was, however, without doubt that with large foreign and domestic borrowing for government infrastructure investment, the fiscal situation remained weak in 2012 due to low revenue and continued expenditure. In 2012, the government started reigning in expenditure to improve its fiscal situation, and the fiscal deficit was reduced from 6.9% of GDP in 2011 to 6.4% in 2012 (Central Bank, 2013). The government was also compelled to continue its drive to improve its tax collection, but despite continued reforms, tax-based revenue growth was weak (Central Bank, 2013). Though expenditure was reigned in, the government continued its large infrastructure drive primarily funded by non-concessional foreign loans.

Overall, due to the declines in export earnings and continued pressures on the current account due to debt-based infrastructure investment, the country was faced with a situation of depending more than ever before on foreign worker remittances. In fact, foreign employment was actively encouraged to the detriment of the use of skills for Sri Lanka. The reality was that the government had not used the window of opportunity that opened at the end of the war to undertake the needed changes to diversify the economic base to finance the fiscal needs of the country.

Clearly, one of the most important repercussions of loan-based, government driven and infrastructure-led reconstruction efforts was that the supply of funds for the private sector declined as did the demand for such funds (Institute of Policy Studies, 2013). The amount of funds lent to the private sector in January 2013 was one-fourth of what it was in the previous year. To ease the demand for private finance, a window was opened in early 2013 to allow local private banks to borrow foreign capital to be used by local businesses. However, the government subsequently borrowed from these banks and the effects of increased capital for local banks was not translated to benefits for the private sector. Indeed, a more dangerous trend had developed where the government had been purchasing shares of private banks to further compel them to borrow from external sources and then lend back to the government (Sarvanathan, 2014). Overall, the government's macroeconomic policy strategies until late 2014 had significantly affected private sector confidence.

Key Findings

The key findings highlight the views of the respondents on the 2-year period after the change in government in early 2015 until the end of 2016.

Emerging from the Post-War Economy of Nepotistic Enrichment and Social Division

Business leaders felt that the management of post-war ethnic relations had been the key black mark affecting foreign business and investment during the Rajapakse government. Though it was common knowledge that the ethnic conflict had been the single biggest deterrent to business during the war, the country was not able to move past this and improve its image as a peaceful country in the years immediately after the end of the war. Continued nationalistic and extremist statements by government politicians became the norm fuelling perceptions that whilst the war was over, peace had not been won. Overall, given the pledge of reconciliation, good governance and a private sector emphasis, business leaders felt that the new government in 2015 presented the large private sector community with the ideal mix of government priorities. Business leaders felt that since the government came to power, this commitment had been delivered to a large extent over the two-year period and many acknowledged the progress made in managing reconciliation issues and committing the country to ethnic harmony. However, several interviewees felt that such progress was insufficient and unless economic aspects of the country were also given strong emphasis, the investment and business climate could not improve further. Economic benefits through jobs and income growth were felt to be at the heart of peacebuilding.

A 'Politico-Economic Rescue' Coalition Government Emerges

Business leaders during the time of the interviews in late 2016 felt that it was not just the lack of reconciliation that had been of concern during the Rajapakse era but also the increasingly dire economic situation led by debt-fuelled infrastructure development and corruption. The country needed a change that could bring back economic stability and strong governance arrangements based on principles of democracy. Indeed, the winds of change blew in a direction that many private sector leaders previously thought was not possible, and there emerged great optimism that the economic woes that had reduced private sector confidence would be significantly reduced after the change in government. Private sector leaders felt that at the time of the start of the coalition government comprising of the two largest parties – UNP and SLFP - that was pro-reconciliation, pro-private sector and full of technocrats in its leadership team, business confidence could not have been better. Indeed, business leaders highlighted that the private sector optimism at the time was probably on par with the dawn of economic liberalisation in 1977.

However, coalition governments are rife with challenges. Sri Lanka's own short experience over a decade is insightful as described by some business leaders. In 2002, completely drained by the effects of war on the economy and expectations that it could not be ended through military means, voters brought in a coalition government to "rescue" the country through a promise of peace, reconciliation and better economic management. The government embarked on a parallel negotiated peace process and economic reform, both of which failed. Whilst it is beyond the scope of this report to detail the reasons for the failure of the peace-process, it is important to be reminded of the way the economy was managed at the time. The policy document that was presented as the pillar for its economic programme, Regaining Sri Lanka, heavily favoured the development of the Colombo region at the expense of the rural areas. Strong economic reforms were pushed through quickly, but it was the poor who were expected to pay for them. Whilst the LTTE's clear lack of commitment to the peace process was an important concern for the public, arguably more important for the poor was the increase in economic hardship. At the next election, not surprisingly, Rajapakse, promising an end to the war, even when mainstream opinion suggested that it was "unwinnable", easily walked into power. The pro-private sector at the time was disappointed to see that a populist and pro-war figure could take power after only a brief period of relative peace.

With the change of government in 2015 in a similar manner to the "economic rescue operation" in 2002 and the entry of a new centre right regime, it was beyond any doubt to many business leaders that the business and investment climate would improve. However, early actions by the new coalition government highlighted the fact that it was fearful of facing a similar backlash from the poor as seen in 2003 and was, therefore, not prepared to quickly administer a suitable policy portfolio. Indeed, under its first 100-day programme, to the surprise of many, the populist policies such as Samurdhi (welfare) benefits and fertiliser subsidy continued as political survival remained the core priority. The Prime Minister's experience in 2002-3 was felt to be short partly because he had gone too fast with the structural adjustment programme driven through the then 'Regaining Sri Lanka' policy document and the bulk of the pressure having to be borne by the poor, who voted against the government thereafter. In its efforts to proceed more slowly, policy makers in the present government were now appearing to be giving mixed signals about its policy priorities. Business leaders felt that policies lacked coherence on whether they sought to promote private sector investment by reducing government spending or adopt more welfare policies that increased government spending.

The coalition government was felt to be a difficult marriage – it needed to take into consideration the views of the more populist oriented SLFP members as well as reform oriented UNP members. Importantly, from the start, it was clear to the private sector that the government did not have its priorities focused well on business growth and investment. For example, the introduction of the super-gains tax and the mansion tax, which were meant to hit at previous business cronies, who had amassed great wealth, also dealt a blow to general business sentiment from the start. There was an early fall from grace that was dramatic and unexpected, but initially many waited to see a more resurgent economy.

Importantly, for many business leaders, there appeared to be very little difference on how the business climate was developing from before the change in government. Networks and connections to decision makers remained the main means for businesses to find new opportunities. Many business leaders felt that there was no system in place and it was simply the networks and connections businesses gained that enabled positive action.

Policy Inconsistencies without Clear Direction

Importantly, to the surprise of many business leaders, the level of policy inconsistencies had reached unprecedented levels. In fact, they felt that the high level of policy inconsistencies existing in the government at the time was the single biggest deterrent to business confidence. The profound impact of the lack of clear decision making was felt in all quarters with almost all business leaders explicitly mentioning it as a very large confidence deterrent. For a government led by a party that was considered pro-private sector and working with another that was largely in favour of pro-government policies, the challenges were notable. The policy inconsistencies had resulted in many business leaders being perplexed as to why the government did not understand that the lack of direction was harmful for business. The effects of the "arranged co-habitation" resulting from not have a unitary sense of purpose was clear, but at the same time perplexing.

Policy recommendations that were tabled in 2015 were often half-baked and then reversed, reviewed and amended. Recognising that the policy space to develop the country was limited, over-ambitious statements followed by poor prioritisation had prevented some businesses from understanding where best to invest. Moreover, the way the government had continued to retain populist policies had also led many business leaders to believe that the main objective appeared simply to stay in power rather than develop the country through private sector investment and development. For example, the numerous changes to the 2015 budget (for 2016) was a critical confidence deterrent and showed a lack of professionalism and consultation with stakeholders prior to presentation. The 2016 budget (for 2017) also saw some changes, with members within the same government in active disagreement, and suggesting that they would not vote to pass the budget unless specific changes were made. Perhaps the most surprising aspect of policy making has been the poor communication of policy plans. For example, the government's urgent wish to ratify trade agreements with India, China and Singapore was without detailed consultations with the local private sector on how it would be affected. When decisions were taken and communicated, such as the expectation of implementation of the Economic and Technology Cooperation Agreement (ETCA) by December 2016, they were often not followed through.

The fear of the unknown effects of the ECTA had made many business leaders assume that it was unlikely that the benefits to the large private sector would accrue optimally, and their interests would not be fully taken into consideration. Indeed, the business atmosphere remained vulnerable to shifts in global political power and the leveraging influence of countries that continue to see Sri Lanka as one of strategic importance.

Bureaucratic Inefficiency and Weak Policy Implementation

Another factor that business leaders saw as 'holding them back' was the lack of policy implementation. Whilst many acknowledged that the government had presented good ideas on how best to attract further private sector investment and ease business enhancing processes, they questioned the capacity of the leadership to implement their ideas. They did not see the bureaucracy as being empowered and strong enough to deliver on ambitious goals. One example given was the restructuring of the BOI. Though the idea of setting up an Agency for Development and Agency for International Trade had been welcomed, many of the government's actions appeared to be behind closed doors and out of view of large sections of the business community. Leadership for implementation was felt to be lacking and there was not much confidence that the correct bureaucratic structure was in place. Conversations between the government and private sector were mentioned as not being constructive with the needs of the local private sector rarely being considered in a transparent manner. There was also the perception that the government's administrative apparatus was not fully supportive of the political establishment in trying to take a new vision forward.

Corruption, Debt and Lack of Fiscal Consolidation

While inefficiency on policy matters appeared to be very different from the previous regime, the issue that was felt to be common with the previous regime was corruption. Few expected that a government which came to power on a mandate of good governance would be faced with such serious corruption allegations as those that subsequently emerged. Business leaders who were interviewed, were of the view that there was neither any follow through of trials against those in the previous government, accused of corruption, nor a practice of strict anti-corruption procedures within the government. With the present government adopting an economy that could not afford further weakening due to the previous government's debts, continued corruption allegations against it on large fraudulent deals involving the Central Bank, led to the private sector questioning whether the current regime was in fact, ready to turn a new chapter in fiscal management.

Instead, business leaders were disappointed that those who had been accused of corruption were defended, with further decreasing of the fiscal space due to increased debt. Increased losses to the state had weakened the fiscal position of the government to an extent that increased taxes had reduced the disposable income of consumers, further reducing the possibility for businesses to have strong growth ambitions. The private sector saw a government strapped for cash, with a strong possibility that taxes would have to be increased in the future.

Many private sector leaders at the time the interviews were conducted felt that business sentiment had recently improved due to the IMF package, appointment of the new Governor of the Central Bank, and agreement by the two parties for better engagement. This view, however became short lived. Many felt that the alleged misappropriation of funds had enormous ramifications on business sentiment. Indeed, at a time when the debt servicing was at record levels, policies were inconsistent and foreign exchange earnings were declining for some leading sectors. This not only meant that investment confidence would be further weakened, but also that the poor would have to bear the brunt of increased taxes and lower social spending.

Plans for Trade, Export Oriented Industries, and Attracting Foreign Direct Investment

The senior private sector leaders felt that many of the economic priorities of the government revolved around the proposed trading agreements with three countries – China, India and Singapore. All those interviewed felt positive about the importance of the trading agreements for a small country such as Sri Lanka. The opportunities for increased investment and the possibility for access to large markets seemed considerable. Some leaders were ready to face the competition from larger overseas businesses and noted that there was no need to be concerned despite the lack of details. However, many others were unsure if such positive perceptions would translate into reality due to the lack of transparency. Differences were noted among the three trading agreements. Some of the business leaders questioned if there was sufficient support to export related local businesses, and whether the country was ready to prevent anti-dumping. A few others noted that the current free trade agreement with India was tilted to benefit India and there was hardly any practical benefit to Sri Lankan businesses wishing to tap the large Indian market. Notably, there were perceptions that even with good value addition and production of niche products, local businesses had little chance of profiting from trying to access markets that were manufacturing powers.

Some business leaders felt that the ECTA could open up a large market for Sri Lanka and drive investment. However, there is a lack of awareness about the details and that has created some disillusionment. Free trade is important, but since there is a lack of awareness on whether it will align with the needs of the local businesses, the agreements have local industries worried.

Megapolis Development Competing with Regional Development

Private sector leaders felt that the main development response to opportunities that would emerge from the opening of trade with India, China and Singapore would revolve around the plans for Megapolis development. The government has established a Ministry solely focused on implementing the proposal stipulated in a new strategic document open to public review. However, many private sector leaders felt that the plans were insufficiently detailed. While there were long term benefits that would accrue, there were some questions regarding short-term benefits if the trading agreements were to be signed hastily, particularly due to three concerns. While there was a possibility that government proposals could crowd-out private sector opportunities, there was little concern that such development initiatives would be a threat. Rather, the concerns related to the policy space for implementation. Firstly, many leaders stated that many of these plans were unlikely to be implemented if the debt situation continued to remain or further deteriorated. Secondly, the economic impact of these large plans were without a significant assessment of the social infrastructure needs, and thirdly, that the Megapolis plans appeared without a complementary plan for the regions. While some suggested that deprioritising agriculture was important, given the country's move up the development ladder, others felt that there would be a potential negative impact on regional development due to further migration and deterioration of agricultural incomes.

The heavy focus on the urban economy (and lack of opportunities in the regions), especially the Colombo region, had taken its toll on the regional economy, particularly those regions focused on agriculture and plantations. This represented a lack of sensitivity to increases in regional inequality, which had throughout Sri Lanka's post-liberalisation history been the key driver of dissent and conflict. Not surprisingly, the lack of regional development has not supported an increase in revenue of regional businesses and plantation companies. Tea producers were the most affected large companies in the regions, and there was some feeling that the tea sector was being unnecessarily neglected without alternatives being proposed. Overall, the regional economy appeared to be weakening.

Differences among the sectors are insightful. The tourism and IT sectors appeared to be faring a lot better than other key export earning sectors and high on the list of sectors under state patronage. However, even these sectors had some important gaps in development planning. i.e. the absence of a tourism marketing plan, the absence of priority on destinations etc.

Labour Availability and Quality

With Sri Lanka's future development focus on Megapolis development and key sectors that can drive the economy, business leaders felt that such an ambition did not match the current realities regarding labour availability. The country has for decades been witnessing deteriorating levels of education and knowledge creation that is failing to match private sector needs. However, this concern seemed to have increased with businesses leaders feeling that the country was reaching a critical juncture. Success could only be ensured if the right number of quality human resources are available for businesses. Skill gaps and lack of labour in some sectors were likely to pose significant problems to the private sector irrespective of changes to the macro-policy and fiscal situation. Almost all private sector leaders felt that there was a dearth of skilled labour in their sectors. Many felt that the high cost of living and weakening of the economy were key factors pushing people to seek employment outside the country. Others, especially in the IT sector, felt that many businesses were paying good rates and could even attract external talent. Policies to open the labour market would be critical for future business growth and investment.

The shortage and skills of workers remains a critical issue. Many businesses feel that governments have consistently ignored the needs of young people who are upwardly mobile. They also feel that the costs of production are going up partly due to the costs of labour. The labour shortage is affecting the plantation sector, and some companies are using foreign labour discretely. Improving productivity and female labour participation is critical in such instances. The turnover of highly trained people is growing. There is also a brain drain of educated and high-quality labour in the region. The key challenge for the IT sector remains to be the availability of qualified staff, despite high wages.

Conclusion and Recommendations

The purpose of this research was to find the key factors shaping the business climate and affecting large business creation and sustainability in post-war Sri Lanka in the two-year period following the change of government in 2015. It identified seven core factors affecting large local businesses: reconciliation, prioritisation of the private sector, policy making, governance, trade, Megapolis and labour with specific concerns within each factor. On reconciliation, progress on reconciliation was insufficient and unless economic aspects of the country including job creation and increased incomes were also given a strong emphasis, the investment and business climate could not improve. On prioritisation of the private sector by government, there was no progress on developing institutions to build confidence, with the result that connections to decision makers remained the main avenue for businesses to search for new opportunities. On policy making, the level of policy inconsistencies had reached unprecedented levels, there was poor communication on policy plans and lack of transparency in implementation, while the capacity of the leadership to implement ideas was questionable. On governance, for a government that came to power on a mandate of good governance, continued corruption allegations highlight a lack of interest in turning a new chapter in fiscal management. On trade, there was uncertainty of whether the trade agreements being negotiated would translate into reality due to the lack of transparency, and whether support would be provided to export related local businesses and sufficient access provided to large overseas markets. On the Megapolis, there was insufficient consideration given to the debt situation, assessment of social infrastructure needs and complementary plans for the regions to prevent greater regional inequality. On labour, businesses could only grow if the right number of quality human resources were available for businesses. Overall, business confidence was at a low level.

The findings of this study match the confidence level of businesses given in the January 2017 LMD-Neilson Business Confidence Index (January 2017) which showed that confidence had plummeted to a level that was unprecedented since July 2013. While this study highlights that the large business sector in Sri Lanka faces several challenges that keep it from growing and investing further, the country remains with significant potential. While an ideal business environment may not be easy to develop, immediate steps to improve the situation can significantly help the country to move in a positive direction. Core among these changes are improvements to policy making and implementation, reduction of corruption, supporting export-oriented industries to compete internationally, balancing regional development with urban development, and improving the quality and availability of labour.

Key recommendations arising from the research are as follows. On reconciliation, continue to maintain a strong commitment to ethnic harmony and balanced international relationships while also ensuring that economic development is prioritised. On prioritisation of the private sector, ensure that all segments of the private sector can access opportunities in an open and transparent manner. On policy making, ensure that policy making is consistent, cohesive and based on a clear development agenda; commit to economic reforms while pursing policies that can reduce the burdens to the most vulnerable; and improve bureaucratic inefficiency and policy implementation by improving processes and accountability mechanisms. On governance, improve government credibility by reigning in corruption and maintaining the commitment to reduce the debt burden while also driving an ambitious growth agenda that is led by private sector investment. On trade, ensure that the right balance of protection and liberalisation is ensured so that the local private sector can optimally benefit from any future international trade agreements. On the Megapolis, commit to regional development through a balanced economic vision. Finally, on labour, develop a clear plan to ensure that there is strong labour mobility and opportunity creation based on comparative advantages within and outside the country.

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Successive governments in Sri Lanka were known for their omnipresence within the economic and business landscape. The relationship between governments and certain sections of the large private sector appeared as being necessary associations of existence with an expectation that the private sector would become the country's engine of growth. However, since the dawn of liberalisation, contrary to expectations, the private sector may have neither had an opportunity nor ability to 'lead' in the overall development of the economy. This report fills an important gap in knowledge on key factors that affected investment and business growth among the large private sector in Colombo during the period of 2015-16. It also highlights the challenges faced by Sri Lanka's large private sector in the war economy as well as during the transition to a peace economy, and makes key recommendations to support more investment.

The Centre for Poverty Analysis (CEPA) is an independent Sri Lankan think-tank promoting a better understanding of poverty-related development issues. CEPA believes that poverty is an injustice that should be overcome and that overcoming poverty involves changing policies and practices nationally and internationally as well as working with people in poverty. CEPA strives to contribute to influencing poverty-related development policy, at national, regional, sectoral, programme and project levels.

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