



The Pathfinder Economic Alert

Investing in the Northern Province: Constraints and Countering Them.

From War and Destruction to Peace and Reconstruction

Both before and following the end of Sri Lanka's 30-year separatist war in May 2009, it was recognized that rapid economic recovery in the Northern Province would be the key to lasting reintegration and reconciliation within a united country. Nearing the two and a half year point since the cessation of hostilities, the Pathfinder Foundation (PF) examined the current pace and scope of economic development in the North, with a specific focus on private sector investment. The premise is that rapid economic growth in the North will largely depend on the private sector, in combination with essential government investments in physical and social infrastructure and business environment policies that are tailored to the special needs in the Northern Province.

In undertaking this study the PF reviewed reports published by the Government, bi-lateral and multilateral agencies and non-governmental organizations. This was followed by discussions with the Northern chambers, a selected group of academics and individual entrepreneurs. Discussions with the BOI, commercial banks and the Central Bank also provided insights into the constraints and possible solutions with regard to improving the investment climate in the Northern Province.

The Situation Today

In 2010, the Northern Province share of national GDP was 3.4%. Per capita income stood at Rs.161K (\$1,463), just 59% of the national average of Rs.271K (\$2,464), and the poverty rate in the province was at least double that of the country as a whole. Starting from this low base, the challenge becomes: "How fast can the North grow, to at least, the national averages?"

There are early signs of economic recovery that is encouraging. The traditional agriculture, fishing and commercial retail sector is picking up speed, fueled by pent-up demand and inflows of foreign remittances. National suppliers of agricultural equipment such as Browns Group and supermarket chains such as Cargills, are highly visible with increasing sales volumes. Property developers are present, including Diaspora investors such as Tilko Hotels, several new tourism

projects are contemplated, garment factories are finally getting off the ground in Vavuniya and Kilinochchi, and broadband internet connectivity is increasingly available.

Nonetheless, there is incontestably a long way to go. The pace of new investments is not as fast as desired, particularly by locally based SMEs. While figures differ, the best estimate is that 750 SMEs were in the Jaffna district before the war, of which only about thirty are now operating. A vivid example is the Achchuveli industrial estate in Jaffna, effectively destroyed during the war and now being rehabilitated, where over fifty SME factories were located previously. Similarly, commercial-scale agriculture including horticulture and tree crops is just beginning to restart, led in this instance by national agribusiness leaders such as CIC Holdings, Hayleys and again Cargills.

Overall, the stage is being set for new investments in manufacturing, agribusiness, tourism, and other new sectors such as business process outsourcing (BPO) and private health and education services. While traditional economic activity at the micro and small-scale farming and non-farm level, where the majority of the population earns its livelihood, needs to be consistently encouraged and supported, the most promising prospects for growth across the province will be the revival and expansion of regionally based SMEs together with the entry of increasing numbers of domestic, foreign and Diaspora investors.

Government Initiatives

The Sri Lankan government has expressed its commitment to rapid economic advancement in the North. Its major flagship initiatives focus on resettlement (including demining and immediate recovery assistance), reconstruction of basic infrastructure, and initial recuperation of economic livelihoods. Early accomplishments and ongoing activities are detailed in the government's Joint Plan for Assistance: Northern Province 2011, including government as well as international donor expenditure commitments. Also important are the program's very clearly stated "key principles" that explicitly spell out the expected role of the private sector in assuring sustainable economic growth once the front-end public sector investments are in place—for example, encouragement of private sector-led "commercial agriculture chains and processing plants through joint ventures with farmers for input supply, production and marketing."

Private sector initiatives

Business chambers in the North are also actively engaged in promotion initiatives. Two prime examples are the Chamber of Commerce and Industry of Yarlpanam in Jaffna and the Vavuniya District Chamber of Commerce, Industry and Agriculture. .

The Ceylon Chamber of Commerce (CCC) has its own programs in the North. Most notable is the Youth Business Sri Lanka (YBSL) entrepreneurship development program, implemented through CCC-affiliated Northern chambers. The CCC also maintains an extensive database on the Northern economy as part of its Regional Economic Development Initiative (REDI) and has

facilitated several visits to the North by CCC member companies to pursue business opportunities.

Key Constraints and the Pathfinder Foundation Recommendations

The ten constraints to accelerated investments in the North identified by the PF study are interrelated.

Figure 1: Constraints to Private Investment in the Northern Province



Constraint #1: Peace, reconciliation mindsets, investor confidence

Perceptions of the peace and reconciliation process in the North are first and center in interviews with private sector leaders, particularly in the North but also the South where a cautious approach to investment prevails. Investors, both domestic and foreign, need confidence in long-term social and political stability in order to undertake sustainable projects with long-term profit potential vs. strictly short-term returns. This is especially relevant to the Tamil Diaspora. In analyzing what the concerns really are, two “reconciliation mindsets” emerge. One involves issues of a political nature and the other is more focused on economic and business factors.

Action Recommendations

- Continue to urge all stakeholders to reach a “political solution” that will maximize confidence in making long-term investments in the North.

- While mindful of security requirements in the North, the private sector need to work with the government to limit investment constraints related to the continued presence of security forces.
- Promote and share information in the North on tangible, significant investment projects by Colombo-based companies in partnership with enterprises in the North, detailing the win-win elements for investors,

Constraint #2: Physical infrastructure + industrial estates

Reconstruction and expansion of physical infrastructure in the five Northern Province districts is essential for economic growth. Constraints in this category include access to improved roads, power, water, irrigation, telecommunications, rail, seaports, airports and other social and administrative infrastructure, as well as industrial estate facilities operated by the state or in partnerships with the private sector. The speed and quality of infrastructure construction will dictate the pace of private investment in the North.

Action Recommendations

- Advocate in favor of expedited government policy decisions to initiate new mega-infrastructure Public Private Partnerships (PPPs) in Sri Lanka, including the North.
- Particularly regarding internal air travel, urge the government and the airline companies to establish regularly scheduled, multiple weekly flights between Colombo and Jaffna.
- Encourage the rehabilitation of existing industrial estates and investments in new Special Economic Zones in the North by the BOI and as PPPs. ***In this regard recent announcement that the government with Indian assistance had initiated development of Achchuveli Industrial Estate is an welcome initiative.***
- Urge the government, to the degree feasible, to set aside small-scale construction contracts for Northern based SME construction companies.
- Pursue possibilities of joint government-private investments and private management of medium-scale agricultural enterprises on underutilized government farms or neglected state plantations in Northern districts.

Constraint #3: “Solid” private investment projects/sectors

The third constraint is more within private sector control. “Solid” investment projects, also defined as “viable” or “bankable” projects, require clear evidence of markets, supply chains, production technology, labor resources, business management experience and other key factors that will determine an investment’s profitability.

Action Recommendations

- Produce and update a comprehensive “Investment Opportunities in the North” resource document that details investment potential in all sectors, for use in pro-active investment promotion. As well as a “Register of Prospective Investors” of Northern investors seeking business partners from overseas/Diaspora, the South.

- Encourage value and supply chain development across all economic sectors as a basic model for integration of SMEs, producer associations and out-growers.
- Place a special focus on “non-traditional” sectors, particularly those connected to “Knowledge Hub” investments including private educational Institutions and hospitals, BPO, etc.

Constraint #4: Workforce skills, entrepreneurship, youth aspirations

Investors need skilled labor and qualified professionals to staff their business operations. Due to war related dislocation of the population and the disruptions in educational and training programs in the North, there is a prevailing lack of skilled employees and general labor market deficiencies—a theme repeatedly emphasized by the private chambers and individual business owners. On the other hand, unemployment rates are currently very high, particularly among youth. How to prepare and train young people coming onto the job market is seen as an urgent social and economic priority.

Action Recommendations

- Re entrepreneurship development, support regional chamber initiatives in the North, the YESL junior achievement program and the like.
- Produce and update labor market analyses and advocate by the private sector and political leadership for effective means to meet requirements of investors

Constraint #5: Credit, finance and equity capital

Constraints related to credit, finance and equity capital affect investors at all levels.

Action Recommendations

- Incentivise the expansion of credit and other asset-based finance to enterprises in the North.
- Encourage the increased use of “Value Chain Finance,” integrating commercial banks within specific supply chains and increasing credit for small producers and SMEs.
- Promote the formation of private venture capital firms with domestic and Diaspora partners, to invest in in the North and East.

Constraint #6: Land issues (private and state-owned land)

Almost all investments in the North need land. Most land in Jaffna is held privately, estimated at over 80% in the Jaffna district as a whole, where in addition to land ownership being the principal source of subsistence and small-scale commercial livelihoods there are intense feelings of attachment to the land rooted in the history and culture of the region. By contrast, a very high percentage of land in the four Vanni districts is state-owned and in principle available for lease for manufacturing sites and agribusiness enterprises—the latter in particular for medium to large-

scale plantation crops, irrigated horticulture, and dry land farming in addition to traditional paddy cultivation.

Action Recommendations

- Advocate for maximum transparency in both interim and final procedures under the *Bimsaviya* Land Title Registration program, to assure fair and expedited regularization of private land ownership across the province.
- Work to streamline and expedite leases of state-owned land.
- Prepare “Land Banks” of available leases on a fast track basis
- Encourage the stimulation of land markets in the North through auctions (sales) of state lands to private buyers, to reduce artificially high price of privately held land.

Constraint #7: Investment approvals and incentives

Investors need multiple approvals for almost any new project, even relatively small ones. Investors in the North, as much as their counterparts in the South, typically encounter prolonged delays in obtaining building permits, valuations, soil testing, environmental clearances, service connections for electricity and water, before an investment can start. This is viewed as a crucial issue for accelerating investments in the North particularly. As one Diaspora commentator expressed it, “filling out all kinds of forms and applications (appears to) take precedence over viability, sustainability and performance measurement of capital investment projects.”

Action Recommendations

- Streamline and expedite the investment approval process in the North
- Re-examine the “special additional incentives” regime for the North to determine credible rationales for their reinstatement or modification.
- To attract Diaspora capital, advocate for politically acceptable business and personal incentives for Diaspora investors, including both in specific projects and venture capital.

Constraint #8: “Mixed signals” (government vs. private sector)

Questions surrounding private sector vs. government-led development in the North are a subset of private sector concerns on a national level. Which economic sectors are unequivocally reserved for private investment? Where will Public Private Partnerships be essential?

Action Recommendations

- At a national level, continue to advocate for unequivocal statements by government on the role of private investment in specific economic sectors.
- In the North, work closely with central, provincial and district government authorities to address specific “mixed signal” concerns.

Constraint #9: Other “Doing Business” factors

The World Bank “Doing Business Index” (DBI) measures the ease of doing business across ten categories, from “starting a business” (company law, registration, etc.) through “closing a business” (bankruptcy and insolvency processes). The Pathfinder Foundation with the assistance of VEGA/USAID have carried out a detailed study on the above.

Action Recommendations

- Produce and periodically update a sub-national “Doing Business in the Northern Province” information database
- Feed provincial data into the national DBI database, collaborating with the Central Bank, the International Finance Corporation, the Economic Intelligence Unit of the Ceylon Chamber of Commerce, and other relevant entities

Constraint #10: The “India Equation”

The “India equation” refers to potentially significant but untapped trade and investment with India, specifically between the Southern Indian States and the Northern Province of Sri Lanka. South India as a whole is experiencing double-digit growth rates and is home to over 250 multinationals.

Analysts emphasize subcontracting and participation in supply chains of India-based manufacturing companies, particularly in Chennai and including both Indian firms and multinationals.

Action Recommendations

- Advocate and help facilitate the realization of major investments in ports, rails, roads and the Palaly airport as critical infrastructure
- Facilitate specific near-term investments involving exports to India (manufacturing supply chains, BPO ventures, etc.), that demonstrate the potential of bilateral trade and investment as a driver of economic growth in the North.

Ownership to the Northern Businesses: An Implementing Organization

To follow through on the combined action recommendations and achieve lasting impacts, an effective implementation entity is seen as an absolute necessity. For a sub-national region such as the Northern Province of Sri Lanka, international best practice argues for leadership by a competent entity that coalesces the key private sector, government and civil society stakeholders in the region. An additional central recommendation of the study is therefore to identify how to establish this capacity, ideally within a leading business chamber, which would become the “sub-national nerve center” to move forward on all action agendas. A tentatively proposed “Alliance to Promote Private Investment in the North “(APPIN)” is recommended.

This is the Twenty –second in the series of Economic Alert’s by the Pathfinder Foundation.

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