1. Introduction

The country’s future direction of economic growth is highlighted in “Sri Lanka; the Emerging Wonder of Asia, 2010” and the “Mahinda Chintana: Vision for Future towards New Sri Lanka – a 5 year development Framework for 2010 to 2016”. In its development policy framework Sri Lanka has set out a target to sustain a GDP growth rate of over 8% per annum and to enhance the per capita GDP to over USD 4,000 by 2016.

Sri Lanka recorded an average annual investment rate of 26.5 per cent of GDP during the period 2002-2012, whereas the average national savings rate for the same period stood at 22.2 per cent. As such the investment requirement in Sri Lanka has exceeded the availability of resources from national savings. This implies the shortage of finances available for investment in the country’s capital stock. This in turn would cause a drop in productivity overtime, higher dependency towards imported goods and the balance of payment to deteriorate.

Accelerating economic growth needs a significant up scaling of investment and improving the overall productivity level. Accordingly, investment / GDP Ratio is expected to increase to a level of 32 to 35 per cent by 2016, and the National Savings is also expected to improve to around 26% in parallel with growing incomes, especially from worker remittances from abroad. However, there will be a continuing investment – Savings gap to be financed from external sources, in the form of both official and private foreign capital inflows. Therefore, enhancing national savings and Foreign Direct Investment (FDI) in bridging the savings and investment gap have become key elements in achieving these high economic targets, through short to long term measures.

While contributing towards financing sustained economic growth over the long term, FDI plays a key role in transferring knowledge and technology, creating jobs, boosting overall productivity, enhancing competitiveness and entrepreneurship, and ultimately eradicating poverty through economic growth and development.

Recognizing the pivotal role of FDI in economic development, all governments try to attract higher levels of FDI by adopting various measures. The Figure 01 below reflects the FDI inflows of selected Asian countries from 2002 – 2012. Indonesia, Malaysia, South Korea, Thailand and Vietnam have recorded significant amount of FDIs as well as phenomenal growth rates in foreign inflows compared to countries like Myanmar, Sri Lanka and Bangladesh.
The per capita FDI inflows from 2002 - 2012 (Figure – 02) also reveal, Sri Lanka’s dismal performance in attracting FDI compared to regional competitors. For instance, in 2012 Sri Lanka’s per capita FDI recorded USD 62 compared to Malaysia (USD 344), South Korea (198), Thailand (USD 129) and Vietnam (USD 94).
International competition for FDI is intense and being a small country with limited natural resources and a small domestic market, it is vital that the attractiveness for FDI or the “Investment Climate” in Sri Lanka to be better than those of comparable competitors for FDI. The lower levels of FDI inflows into Sri Lanka, has given rise to a serious concern on the “investment climate” in the country, which depends primarily on policies and institutions.

A country’s investment climate is generally regarded as the surrounding business environment for private sector activity. The risks and transaction costs of investing and operating a business determine the quality of the investment climate. These costs, in turn, are determined by the legal and regulatory framework; barriers to entry and exit; and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs.

Therefore the challenge faced by Sri Lanka at present, is to create a conducive investment climate that facilitates investments of both domestic and foreign investors.
2. **Methodology**

The methodology adopted in this study for the analysis of Sri Lanka’s investment climate mainly consists of the approach shown in Figure – 03. Firstly, it analyses some selected international rankings related to investment climate to ascertain Sri Lanka’s competitiveness based on such rankings. Secondly, it focuses on identifying key determinants of FDI using “Eclectic Theory” (Dunning 1988). Moreover, the study investigates the international best practices adopted by regional competitors to attract FDIs and benchmark with the performances of Sri Lanka. Finally, the lessons learned from the above approaches will be used within the context of Sri Lankan investment climate to ascertain the major investments gaps prevailing in Sri Lanka.

![Figure 03](image)

**Figure 03** : A schematic representation of the approach used to identify major investment gaps in Sri Lanka.

2.1 **International Rankings**

The indices related to investment climate considered for the analysis include; Ease of Doing Business Index, Global Competitiveness Index, FDI Attraction Index, FDI Potential Index, Index of Economic Freedom, and Human Development Index.
2.2 Eclectic Theory (Key Determinants of FDI)

In order to create a conducive investment environment, it is important to have a good understanding on the key determinants of FDI that promote foreign private capital to a host country.

A popular theoretical framework; ‘Eclectic theory’ explains a flexible approach on FDI determinants using three sets of specific advantages i.e. firm specific advantage, location specific advantage and internationalization advantage which governs the movement of capital to the host country by satisfying investor needs (Figure - 04).

Firstly, the firm specific advantage reveals the advantage a specific firm has over its rivals in terms of its brand name, patent or knowledge of technology and marketing. This enables the firm to compete with the other firms in the markets it serves regardless of the disadvantages of being foreign. Secondly, the location-specific advantages relate to the importance for a firm to invest in a host country and these advantages have made to select a particular host country as the most attractive destination to receive FDI than the others. These advantages include the favourable Policy Framework for FDI, Economic Determinants and Business Facilitation. Thirdly, the internationalization advantage provides benefit for the firm in exploiting its competitive advantage and locational advantage by investing in a foreign affiliate that they control rather than dealing with unrelated firms located abroad.

Figure –04 : Determinants of FDI “Eclectic Theory”
From a macro point of view the main focus of the analysis of this study is confined to “location specific advantage” and not on “firm specific” and “internationalization” advantages.

2.3 International Best Practices

The study tries to analyse the best practices adopted by regional competitors to attract higher levels of FDI inflows. The regional competing countries identified for this analysis include, Malaysia, Vietnam, Thailand, South Korea, Indonesia, Bangladesh and Myanmar. In addition, experiences of other countries in the region such as India and Singapore have also been considered for the analysis.
3 Investment Climate Analysis

Some of the competitive countries in the region who were performing at the same levels in 1990’s have reached 20 -25 times higher FDI levels and much higher export levels compared to Sri Lanka. Hence, the pertinent question is why Sri Lanka failed to attract large inflows of FDIs even after 2009 despite of having peace, political stability and economic growth.

It is assumed that analyzing Sri Lanka’s investment climate using the Eclectic Theory, international rankings and international best practices will help to identify the major investment gaps prevailing in Sri Lanka and to find implementable solutions to improve the investment climate up to the desired levels. Such an initiative will certainly have a strong positive effect on improving the business climate in the country.

3.1 International Rankings

International rankings are often used as a guide to benchmark the relative strengths of a country’s investment climate. There is certainly a strong positive correlation between the country’s business rankings and FDI inflows. The Table – 01 highlights some of the vastly reputed global indices which reflect the attractiveness of a country’s business competitiveness.

It is noted that the rankings of higher levels matter to a great extent when an investor has to decide on his preferred destination and which in turn receives substantially more FDI than those furthest from the frontier. As per the recent rankings Sri Lanka, ranked at 81st in Doing Business Index (IFC, World Bank), 68th in Global Competitiveness Index (World Economic Forum), 159th in FDI Attraction Index (UNCTAD), 68th in FDI Potential Index (UNCTAD), 81st in Index of Economic Freedom (Heritage Foundation & Wall Street Journal) and 92nd in Human Development Index (UNDP).
<table>
<thead>
<tr>
<th>Index</th>
<th>Measurement</th>
<th>Ranking</th>
<th>Total No. of Countries</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Doing Business Index</td>
<td>Investigates a country’s regulatory environment relating to business operations</td>
<td>Sri Lanka: 102 89 81</td>
<td>Other Asian Countries: Singapore 1 1 Malaysia 18 12 Thailand 17 18 Pakistan 105 107 Bangladesh 122 129 India 132 132</td>
<td>185 (2013) World Bank (IFC)</td>
</tr>
</tbody>
</table>
| 2. Global Competitiveness Index | The factors that determine the productivity of a country in terms of;  
(1) Basic requirements (infrastructure, basic human capital) 
(2) Efficiency enhancers (Market efficiency, advanced human capital) 
(3) Innovation factors (business sophistication & innovation) | Sri Lanka: 52 68 65    | Other Asian Countries: Singapore 2 2 Malaysia 25 24 Thailand 38 37 India 59 60 Philippines 65 59 Vietnam 75 70 | 144 (2012) World Economic Forum |
| 3. FDI Attraction Index     | Ranks countries by FDI receive in absolute terms relative to economic size of the country. It is the average of country’s rankings in FDI inflows and in FDI inflows as a share of GDP | Sri Lanka: 159 - -     | Other Asian Countries: Singapore 3 3 Malaysia 36 36 China 43 43 Pakistan 127 127 Bangladesh 144 144 | 182 (2011) UNCTAD |
| 4. FDI Potential Index      | Four key economic determinants captured are;  
(1) Market attractiveness 
(2) Availability of low-cost labour and skills 
(3) Presence of natural resources 
(4) Enabling Infrastructure | Sri Lanka: 68 - -     | Other Asian Countries: China 1 3 India 1 3 Singapore 23 Malaysia 26 Bangladesh 89 | 168 (2011) UNCTAD |
<table>
<thead>
<tr>
<th>Index</th>
<th>Measurement</th>
<th>Sri Lanka</th>
<th>Other Asian Countries</th>
<th>Total No. of Countries</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>6. Human Development Index</td>
<td>The Human Development Index (HDI) is a composite statistic of life expectancy, education, and income indices used to rank countries into four tiers of human development (very high, high, medium and low)</td>
<td>97</td>
<td>92</td>
<td>-</td>
<td>Singapore 18</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Malaysia 64</td>
</tr>
<tr>
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<td></td>
<td></td>
<td></td>
<td>Thailand 103</td>
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<td></td>
<td>China 101</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Philippines 114</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>India 136</td>
</tr>
</tbody>
</table>

It is evident that Sri Lanka has been ranked quite away from the frontiers making it rather difficult to be in the radar of globally renowned serious investors. Further, analysis of the individual indices provides some useful insights into the areas where the investment gaps are much wider compared to other countries in the region.
Doing Business Index

The Doing Business Index, measures the competitiveness of the regulatory business environment of a country and it has shown that Sri Lanka has performed well below the expectations, specially with regard to Paying Taxes, Construction Permits, Registering Property and Enforcing Contracts (Table 02).

Table - 02 : Summary of Doing Business Rankings of Sri Lanka

<table>
<thead>
<tr>
<th>Key Indicator</th>
<th>DB 2013 Rank</th>
<th>DB 2012 Rank</th>
<th>Change in Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starting a Business</td>
<td>33</td>
<td>71</td>
<td>+38</td>
</tr>
<tr>
<td>Dealing with Construction Permits</td>
<td>112</td>
<td>116</td>
<td>+4</td>
</tr>
<tr>
<td>Getting Eclecticity</td>
<td>103</td>
<td>104</td>
<td>+1</td>
</tr>
<tr>
<td>Registering Property</td>
<td>143</td>
<td>164</td>
<td>-21</td>
</tr>
<tr>
<td>Getting Credit</td>
<td>70</td>
<td>80</td>
<td>+10</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>49</td>
<td>46</td>
<td>-3</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>169</td>
<td>175</td>
<td>+6</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>56</td>
<td>54</td>
<td>-2</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>133</td>
<td>134</td>
<td>+1</td>
</tr>
<tr>
<td>Resolving Insolvency</td>
<td>51</td>
<td>49</td>
<td>-2</td>
</tr>
</tbody>
</table>

Source : www.doingbusiness.org

This shows the importance of improving the country’s business regulatory environment to reduce the cost of Doing Business in Sri Lanka in order to compete and attract foreign investments catering especially to the exports markets on a competitive basis.

However, it is noted that Georgia for an example has made 27 regulatory reforms during 2006-2014 period and has been successful in moving from 98th position in 2006 to 8th position in Doing Business Rankings (Box 01).
In this regard it would be beneficial to review the research study carried out by the Board of Investment (2010) with respect to improving Doing Business Ranking of the country. This simulation study has identified 7 key areas to be reformed in order to elevate the overall ranking of Sri Lanka from 102nd to 45th position without compromising on any loss of revenue to the Government (Table 03).
Table 03: Seven Reforms to Improve Sri Lanka’s Doing Business Rankings – from 102nd to 45th Position - (2009 Study – BOI)

<table>
<thead>
<tr>
<th>Area of Improvement</th>
<th>Suggested Improvement</th>
<th>Achievable Highest Ranking (cumulative) 2009 Ranking-102nd</th>
<th>Responsible Line Ministries/ Organizations</th>
</tr>
</thead>
</table>
| 1. Dealing with Licenses | No. of Procedures: 22, Time: 214 days | 90 | Local Govt. Authority (LGA)  
Ceylon Electricity Board (CEB)  
National water Supply & Drainage Board (NWSDB)  
Sri Lanka Telecom (SLT)  
Urban Development Authority (UDA)  
Central Environment Authority (CEA) |
| 2. Registering Property | No. of Procedures: 8, Time: 78 days | 78 | Registrar General Department (RGD)  
Local Govt. Authority (LGA) |
| 3. Enforcing Contracts | No. of Procedures: 40, Time: 65 days | 65 | Ministry of Justice |
| 4. Paying Taxes | No. of Procedures: 62 | 256 hrs, Time: 150 hrs | Dept. of Inland Revenue  
Treasury |
| 5. Getting Credit | Cl Index: 6, LR Index: 6 | 45 | Central Bank  
Ministry of Justice |


Global Competitiveness Index

According to the Global Competitiveness Index report, Sri Lanka ranks at 65th amongst 148 economies for 2013-14 period. Further, Sri Lanka has been interpreted as one of the 20 economies under transition from Stage 1 (Factor Driven) to Stage 2 (Efficiency Driven).

Sri Lanka has performed below average (in comparison with economies in transition) with respect to the “macro-economic environment” and “labour market efficiency” (Figure 05).
FDI Attraction Index and FDI Potential Index

The weak performance demonstrated in Doing Business Index and Global Competitiveness Index would have a direct bearing on Sri Lanka’s lower ranking in FDI Attraction Index (159\textsuperscript{th}). Even though the country ranking on FDI Attraction Index is rather low, the ranking on FDI Potential Index is far better (68\textsuperscript{th}) reflecting that there is a great potential to improve FDI inflows.
3.2 Eclectic Theory

The “Eclectic Theory” discusses the location specific determinants of FDI under three broad segments i.e. Policy Framework, Business facilitation and Economic determinants.

3.2.1 Policy Framework for FDI

Improving the Policy Framework for Investment is regarded as the most sensible and sustainable approach for enhancing the investment conditions of a country. It covers key policy areas such as Economic, political & social stability, Rules regarding entry and operations, Standards of treatment of foreign affiliates, Policies on functioning and structure of markets, International agreements on FDI, Privatization policy, Trade policy (Tariffs and Non-Tariff Barriers in particular) and coherence of FDI and trade policies, Tax Policy and Industrial/Regional Policy.

Countries which are vigorously competing for inward FDI need to focus on the above policy areas carefully and understand the requirement of a clear National Investment Policy Framework along with a comprehensive National Investment Plan. The implementation of the National Investment Plan has to be supported by necessary legal reforms to create a truly attractive, robust and competitive environment for domestic and foreign investment.

In general, Sri Lanka compares favorably in the areas of economic, political and social stability. By bringing the war affected Northern and Eastern Provinces also to the democratic path, the level of stability has been elevated and compared to its regional competitors, the risk factor for investor in terms of civil commotions has become minimal. As far as the macro-economic factors are concerned, Sri Lanka has maintained an average GDP growth rate of 6.5% during the period 2009 to 2012. Foreign investors are free to enter into almost all the sectors of the economy except for very few sectors that are reserved for locals. Sri Lanka is signatory to 27 Bilateral Investment Promotion and Protection Treaties and 38 Avoidance of Double taxation Agreements with countries where Sri Lanka maintains trade and investment relations. These countries include major capital exporting countries as well as developing countries.

The Development Policy Framework of Sri Lanka (Sri Lanka; the Emerging Wonder of Asia, 2010” and the “Mahinda Chintana: vision for Future towards new Sri Lanka – a 10 year development Framework for 2006 to 2016) highlights several features of an investment policy in different places of these documents. However, Sri Lanka does not have a consolidated investment policy and a laid down comprehensive Investment Plan to guide private investments giving right direction that the country should heading towards.

There are several pieces of legislations that have been enacted from time to time to encourage and attract foreign investments. Yet, these laws and policies are not in a consolidated form. The Board of Investment law lays down the provisions for attracting foreign investments to the country, but this law is only for the establishment of the investment promotion agency giving the authority to do so. Subsequently, legal provisions for Strategic Development Projects and Commercial Hub operations have been added
through other legislations to complement the BOI Law. Total foreign ownership is allowed in most areas of the economy. There are only few areas where foreign investment is restricted or limited under the exchange control Act.

The country’s industrial policy has to be supportive enough to promote specific activities in to particular geographical locations and thereby to encourage project clustering and cluster city development. Even though there were special regional development programmes which granted special concessions to attract private investments into Northern and Eastern provinces, this scheme is no longer in operation.

The tax regime prevailing in Sri Lanka appears to be relatively complicated mainly due to imposition of large number of taxes, levies, cesses and duties with a higher administrative cost. This may have not only discouraged private investments into Sri Lanka but also led to a lower compliance rate.

The uncertainty with regard to the Land Policy on foreign investments in Sri Lanka has been prevailing since the Budget 2013. Yet the authorities are to promulgate the relevant legislation.

### 3.2.2 Business Facilitation

Business Facilitation includes Investment promotion (including image-building and Investment -facilitation services), Investment Incentives, reduced hassle costs related to corruption, bureaucratic efficiency, Social amenities (bilingual schools, quality of life, etc.), pre and post investment services, protection of property rights, good infrastructure and other support services.

There have been some positive features observed during the past few years that could have facilitated Sri Lanka to some extent to attract much needed FDIs. The improvement in infrastructure development is a clear example. For instance, the development of economic infrastructure such as roads and transport facilities, as well as the attractiveness of the metropolis and its suburbs and telecommunication networks are positive developments. Even though all such investments do not directly support private sector investments, it helps to highlight Sri Lanka as a convenient location for investment. On the other hand, social infrastructure of relevance to foreign investors, such as good private hospitals with state of the art technology, international schools teaching foreign languages and frequent flights from Sri Lanka to other important cities are distinct improvements. However, lack of modern and developed industrial infrastructure has become a serious impediment in attracting FDI compared to regional competitors.

Tax incentives have been widely used by the competing countries to promote investment and Sri Lanka is no exemption to this. Incentives, especially fiscal incentives have been
associated with higher investment in several countries in the region where incentives are specifically granted for carefully selected few sectors only. Sri Lanka has not been selective to that extent when granting incentives and also not been able to attract the desired level of FDI in to mostly needed sectors and regions of the economy.

Further, most of the countries have readily available structured investment projects to offer to prospective investors enabling them to immediately startup the operations and thereby saving time and cost they have to spend otherwise. Having realized the importance of following this strategy, Sri Lanka too has made an attempt to develop several “structured projects” with the support of the other government agencies focusing on Commonwealth Heads of Governments Meeting in Sri Lanka (CHOGM) in 2013 (www.investsrilank.com). However, this strategy needs to be used in a more dynamic and effective manner if Sri Lanka to gain and sustain higher levels of FDI.

3.2.3 Economic Determinants

The host country economic determinants are broadly classified into; a) market seeking, b) resource seeking, c) efficiency seeking and d) assets seeking. Being a small country with limited natural resources, Sri Lanka needs to act logically to attract market, resource and efficiency seeking FDIs in particular.

**Resource Seeking - FDIs**

Traditional economic theory identifies resource-seeking FDI as those are designed to move production to countries where inputs are available in abundance. Such resource-seeking investment mainly focuses on inputs (resources) such as raw materials, low-cost unskilled labour, skilled labour and technological assets. It was the most common type of FDI in the 19th and 20th centuries, representing the basis of colonial relationships between Europe and other countries. It still remains very significant, but it has been surpassed in importance by other types of FDI in today's more globalized world.

Dunning (1988) defines three groups of resource-seeking companies, firstly who looks for physical resources such as land, oil, minerals, raw materials or agricultural products. Secondly, resource seeker looks for cheap, mostly unskilled labour and finally to acquire technological capacity and management skills.

The advent of globalization and rapid technological advances has triggered fundamental changes to the economic structure of Sri Lanka. In fact, over the past decade, Sri Lanka has been making an effort to transit from an industrial society to a knowledge-based society in order to maintain its competitiveness in the region. It is important to be mindful that the Investors from different sectors will have different needs. Sri Lanka, being a small economy with limited resources such as land and raw materials, has to be mainly dependent on its human resources as the most strategic resource. As such, a basic need expressed by most
investors is the need of an available, skilled workforce to match the industry demand. The issue is particularly acute in areas around science and technology, where a strong demand for skilled workers with competitive wage rates remains worldwide.

**Market Seeking - FDIs**

Most countries in this region have enhanced their market seeking FDI by integrating their economies with larger economies either through bilateral or regional trade and investment agreements.

Regional integration arrangements such as Free Trade Agreements (FTAs), Regional Trading Agreements (RTAs), and Comprehensive Economic Partnership Agreements (CEPAs) are often considered as means to improve member countries’ attractiveness to market seeking FDI. However, such regional integration arrangements are too diverse to allow for generalized verdicts as country-specific factors can often be more important as a stimulus to FDI than regional integration *per se*. For instance, larger economies like China and India are attractive destinations for market seeking FDIs even in the absence of regional integration arrangements.

Moreover, the effectiveness of such regional integration measures obviously depends on the economic strengths and deeper tariff cuts given by the member countries for products of export ability. Past experience invites skepticism in this regard as Sri Lanka has not reached the full potential of the FTAs and RTAs such as Indo-Sri Lanka FTA (ISFTA), Pakistan-Sri Lanka FTA (PSFTA), South Asia Free Trade Agreement (SAFTA) and Asia Pacific Trading Arrangement (APTA) where it has become a member. Moreover, the persistence of various non-tariff barriers means that that these regional trade Agreements are still far from a genuine free trade area.
3.3 International Best Practices

Evaluating key policies and strategies adopted by competing countries, who have been highly successful in attracting FDI, could provide a useful guide when formulating appropriate measures to improve Sri Lanka's business climate and thereby to attract higher levels of FDI.

Some of the key policies and strategies adopted by regional competitors include; a clear National Policy on Investment, National Plan for Investment, Empowered Investment Promotion Agency, Improved Market Access & Investment Protection via International Agreements, a shift towards Structured Projects, High tech Investments and Commercial Hub Provisions, Development of Human Resources to match Industry Demand, Clustering of Projects linked to city development, Image Building & Vigorous Investment Promotion and Branding to Promote Competitive Advantage.

This section attempts to evaluate the effectiveness of the country specific strategies and measures adopted by competing countries to facilitate and promote FDI.

3.3.1 National Policy on investment

This section highlights the importance of (a) National Investment Policy & National Investment Plan (the linkage) (b) Integrated Investment Law (c) Empowered IPA and (d) Land Policy.

(a) National Investment Policy & Plan

An investment policy is the governments’ regulation or law that encourages or discourages foreign investment into its economy. The core principles for Investment Policy making is to ensure that the investment policy is integrated into the overall development strategy of the host country. This will lead to increase the levels of sustainable FDI inflow while balancing the rights and obligations of the host country and the investor in the context of economic development and investment protection.

The national investment policy converts the core principles of Investment Policy into specific investment related policy areas including trade, taxation, Industrial, entry & exist, labour, land, environmental regulations and intellectual property. Once the investment policy is in place it is translated into deed through a well-defined National Investment Plan.

Malaysia, Thailand and South Korea are good examples for countries with well consolidated national plans covering both public and private investments. These plans consist of set targets, implementation plans, monitoring plans, budgetary allocations and right identification of thrust sectors ensuring that they reach the FDI targets as planned. Also
Vietnam and Singapore are two countries that have succeeded in providing a significant role for law enforcement and to create a predictable legal framework (Box - 02).

**BOX – 02 : Best Practices on National Investment Planning**

1. **South Korea**
   To date, South Korea has successfully implemented Seven - “5 year development plan”s, with annual action plans and monthly monitoring councils and the latest Master plan has identified six economic corridors to boost economic development.

2. **Thailand**
   Thailand has adopted a well-targeted and selective approach in attracting niche quality investments in high-technology projects that contribute to the development of skills, technology and innovation. The selected sectors are;
   - Energy conservation & alternative energy : Alcohol or fuel from agricultural products including scrap, garbage or waste Energy conserving machinery or equipment, fuel cells & production electricity or steam power
   - Eco - friendly materials & products : Chemicals
   - High - tech Services Projects

3. **Vietnam**
   Vietnam introduced a master plan in 2007 for the development of Apparel sector by encouraging high value products. Accordingly, Vietnam’s apparel exports grew from USD 8,499 Mn. in 2008 to USD 15,250 Mn in 2012 – nearly a two fold increase with an average annual growth rate of 16%.

4. **Malaysia**
   Malaysia introduced a New Economic Model (NEM) in March 2010 focusing to move the economy up to the status of high-income economy by 2020 with following initiatives;
   - Economic Transformation programme (ETP)- focused on 12 key economic areas
   - Government Transformation Programme (GTP)- good governance & quality of life issues
   - The 10th Malaysia Plan- underpins and monitors these programmes and guides public sector capital expenditure.
Even though Sri Lanka has a development policy framework; Mahinda Chintana, the country also needs to have a good National Investment Plan, especially to attract private investments with detailed implementation plan including a monitoring plan, budgetary allocations and set targets. It has become difficult to achieve the set targets in the absence of proper investment plan on private investments.

**(b) Integrated Investment Law**

The Investment Law that regulates investment in a country may include provisions for investors’ rights and obligations, investment incentives, state administration of investment activities, and offshore investment. The Investment Law also provides for guarantees against the nationalization or expropriation in a non-discriminative manner. The Investment Law designates prohibited and restricted sectors for investment, but there are additional laws that apply conditions to investments in specific sectors.

The amendments made to the Foreign Investment Law in Vietnam in year 2000 (Box 03) has paid rich dividends in attracting FDIs to the country where Inward FDI grew from USD 1,400 Mn in 2000 to USD 8,368 Mn in 2013.

<table>
<thead>
<tr>
<th>Box 03 : Vietnam (Investment Law)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Key features in amended Foreign Investment Law (2000)</td>
</tr>
<tr>
<td>- Right to mortgage land used rights (empowering foreign enterprises the ability to borrow from foreign banks using the assets and property as collateral)</td>
</tr>
<tr>
<td>- Allow the government to provide loan guarantees</td>
</tr>
<tr>
<td>- Allow FDI enterprises to set up reserve funds</td>
</tr>
<tr>
<td>- Reduce profit remittances tax</td>
</tr>
<tr>
<td>- Allow remaining value of land used rights contributed by the Joint Venture business party to be subjected to liquidation</td>
</tr>
<tr>
<td>- Allow FDI enterprise to determine form of the investment and capital structure</td>
</tr>
<tr>
<td>- Reduce red tapes that burdens enterprises such as government restrictions and procedures</td>
</tr>
</tbody>
</table>

In terms of long term investment, legal certainty is regarded as a vital element in order to guarantee investment security. Foreign investors have shown more interest in the countries which have integrated legal framework and law enforcement in addition to infrastructure and human resources in its business environment and these elements should work together in order to create maximum returns on investment.

Sri Lanka does not possess a consolidated investment law per se. However, the relevant laws for investment can be stipulated as; BOI ACT (Establishing the IPA), Exchange Control Act (Entry strategy of FDI) Strategic Development Projects Act (Entertaining Strategic Development Projects), Finance Act No 12 of 2012 and its amendments (Commercial Hub

(c) **Empowered Investment Promotion Agencies (IPAs)**

Best performing investment promotion agencies (IPAs) have been empowered with wider powers and greater responsibilities enabling them to negotiate directly and grant approvals offering incentives in real time and act swiftly to engage investors more effectively for targeted projects in carefully selected sectors. MIDA - Malaysia and EDB - Singapore are two best performing promotion agencies with such characteristics (Box 04).

<table>
<thead>
<tr>
<th>Box 04 : Empowered IPAs</th>
</tr>
</thead>
</table>

**Malaysian Industrial Development Authority (MIDA)**
In 2010, certain provisions of the Malaysian Industrial Development Authority (Incorporation) Act 1965 were amended to give MIDA wider powers and greater responsibilities. These changes enabled MIDA to approve incentives in real time and act swiftly to engage investors more effectively.

- MIDA was empowered to grant approvals for all sectors except utilities & financial sectors and to negotiate directly with investors for targeted projects.
- The National Committee on Investment (NCI) has been established in MIDA to evaluate and decide applications received for manufacturing license, incentives and expatriate posts, among others.

**Singapore Economic Development Board (EDB)**
Singapore EDB is the lead government agency responsible for planning and executing strategies to enhance Singapore’s position as a global business centre and drive the Singapore economy forward.

Through the Economic Development Board (Amendment) Act No. 11 of 2008

- The EDB has been given broader powers to pursue its goal of stimulating the growth and development of the economy.
- The EDB’s role has also been redefined as one that stimulates the growth, expansion and development of the Singapore economy in general and not just as a "total international business centre".

A brief analysis of the Governing Investment Law and Empowerment of selected IPAs are presented in Table 04 below.
# Table 04: Governing Investment Law and Empowerment of Investment Promotion Agencies – (A country Comparison)

<table>
<thead>
<tr>
<th>IPA</th>
<th>IPA Establishment Law</th>
<th>Investment Law</th>
<th>Reporting Authority</th>
<th>Members of the Board</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysian Industrial Development Authority - MIDA</td>
<td>Malaysian Industrial Development Authority incorporation Act (1965)</td>
<td>Promotion of Investment Act No 327 of 1986</td>
<td>Ministry of International Trade &amp; Industry</td>
<td>Senior Government Officials including ; Chairman – Minister in the Prime Minister’s Department Secretary General of International Trade &amp; Industry</td>
</tr>
<tr>
<td>Board of Investment, Thailand (BOI)</td>
<td>Investment Promotion Act (1977)</td>
<td>Foreign Business Law (1999) (amendment of Alien Business Law in 1972 )</td>
<td>Prime Minister of Thailand</td>
<td>Chairman – PM Vice Chairman – Minister of Industry with 10 competent persons &amp; 5 advisors appointed by the PM</td>
</tr>
<tr>
<td>Investment Coordinating Board of Indonesia (BKPM)</td>
<td>Law of the Republic of Indonesia No 01 of 1967 concerning Foreign Investments</td>
<td>New Investment Law No.25 of 2007</td>
<td>President of Republic of Indonesia</td>
<td>Chairman – VC of National Economic Committee of the President of Indonesia</td>
</tr>
<tr>
<td>Board of Investment of Bangladesh</td>
<td>The Investment Board Act of 1989</td>
<td>The Foreign Private Investment (Promotion &amp; Protection) Act of 1980</td>
<td>Prime Minister of Bangladesh</td>
<td>Representatives of the Ministries at highest level- Industry, Finance, Planning, Textile, Jute, Commerce, Energy, Governor of Bank Bangladesh, Chamber Heads</td>
</tr>
<tr>
<td>Board of Investment of Sri Lanka</td>
<td>Board of Investment Law No 4 of 1978</td>
<td>Consolidated Law is not available</td>
<td>Ministry of Investment Promotion</td>
<td>Representatives of Private Sector (5 Nos)</td>
</tr>
</tbody>
</table>

Source: Complied using data available in respective Websites of the IPAs
Other Important Investment Related Policies

It is equally important to have a proper policy framework not only on investment law per se but also on other key aspects related to investment as well, to effectively implement the national Investment Plan. For instance, a clear Land Policy is a prerequisite to setup a business venture.

(d) Land Policy

Suitable lands should be readily available for projects with or without built infrastructure in order to minimize the startup time of a project. Further, a clear policy on ownership of lands by non-citizens should be made available for investors. Moreover, it is of utmost importance to identify the lands for specific large scale projects which require large extents of land for activities such as large scale farming, mining, infrastructure projects on rail transport, Highways and wind power.

Clear Land Use Policies are specified in most countries and generally lands are being allocated to foreigners on lease basis with provision for using as collateral for sourcing funds (Table 05).

Table 05 : Land Policy for Investment : A Country Comparison

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Foreign Landownership</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Malaysia</td>
<td>Possible</td>
<td>Unit of less 72,000 USD (250,000 RIM) no approval needed (of less than 145,000 USD (500,000 RIM) from 1st January 2010). Purchase of unit of more than 72,000 USD do not require government approval if under Malaysia my second home program or other programs as specified by authorities</td>
</tr>
<tr>
<td>2</td>
<td>Korea</td>
<td>Possible</td>
<td>Foreigners from countries that do not allow Korean to own land may be prohibited to acquire land. Additional formalities such as notice or prior approval may be required</td>
</tr>
<tr>
<td>3</td>
<td>Taiwan</td>
<td>Possible</td>
<td>Only if foreigner from a country that allows Taiwanese reciprocity. Freehold ownership is limited to certain type of land, zones and purposes only (including residential)</td>
</tr>
<tr>
<td>4</td>
<td>Singapore</td>
<td>Possible</td>
<td>But need prior government approval if restricted property such as: Vacant Residential Land, Landed Property (house, town house, terrace house), or property in strata development other than condominiums.</td>
</tr>
<tr>
<td>5</td>
<td>Thailand</td>
<td>Possible</td>
<td>Foreign Commercial, Industrial ownership allowed for limited purposes and subjected to prior approval by the BOI or IEAT. Foreign Residential ownership allowed but subject to minimum investment requirement and limited in size (1 rai), zoning and prior approval Minority shareholding (49%) in company that owns land allowed</td>
</tr>
<tr>
<td>6</td>
<td>Cambodia</td>
<td>No</td>
<td>Minority foreign Shareholding 49% in Cambodian Company that own land is allowed</td>
</tr>
<tr>
<td>Rank</td>
<td>Country</td>
<td>Foreign Landownership</td>
<td>Remarks</td>
</tr>
<tr>
<td>------</td>
<td>---------</td>
<td>-----------------------</td>
<td>---------</td>
</tr>
<tr>
<td>7</td>
<td>Philippines</td>
<td>No</td>
<td>Minority foreign Shareholding 40% in Company that own land is allowed</td>
</tr>
<tr>
<td>8</td>
<td>Indonesia</td>
<td>No</td>
<td>Introduced a new Land acquisition law in 2012 for Government projects. Private sector Investors can be involved in PPP projects through partnering with state owned enterprises.</td>
</tr>
<tr>
<td>9</td>
<td>China</td>
<td>No</td>
<td>Private freehold land ownership not available</td>
</tr>
<tr>
<td>9</td>
<td>Laos</td>
<td>No</td>
<td>Private freehold land ownership not available</td>
</tr>
<tr>
<td>9</td>
<td>Hong Kong</td>
<td>No</td>
<td>Private freehold land ownership not available</td>
</tr>
<tr>
<td>9</td>
<td>Myanmar</td>
<td>No</td>
<td>Private freehold land ownership not available</td>
</tr>
<tr>
<td>9</td>
<td>Vietnam</td>
<td>No</td>
<td>Private freehold land ownership is not available</td>
</tr>
</tbody>
</table>

Source: [www.doingbusinessthailand.com](http://www.doingbusinessthailand.com)

In Sri Lanka, more than 80% of land is owned by the state sector and therefore, the demand for state land for development projects are quite high. Hence, it is essential to have a clear land policy to fast track the project implementation process.

Although a new land policy with regard to ownership by foreign nationals have been introduced from December 2012, by the Ministry of Finance prohibiting transfer of lands to foreign nationals or companies with more than 50% of foreign shareholding (by letters dated 27-03.2013 and 21.05.2013), the legislation required to implement this policy has not been promulgated yet.

Further, the said letters issued by the Ministry of Finance refers that the dispossession of Land is permitted by way of lease, for the above categories for a maximum of 99 years subject to a land lease tax. These taxes will be specified in terms of proposed law (subject to an interim payment of 7.5% for projects in BOI Zones and 15% for outside zones of related value for lands).

According to the said letters, the following categories have been exempted from the prohibition of owning lands.

(a) Diplomatic Missions / Inter Governmental or international, Multilateral or Bilateral Missions
(b) Condominium Parcels on or above 4th floor
(c) A company incorporated in Sri Lanka with more than 50% of foreign shareholding and in operation for at least a consecutive period of 10 years and there will be no land tax for these 3 types transfers specified in (a), (b) and (c)
In the interest of National Economy, with the approval of the Cabinet Ministers in-charge of Finance & Land can exempt Foreign Nationals or Foreign Companies from above prohibition provided there is a substantial transfer of foreign remittance to purchase the land subject to the land related tax prescribed by the Minister.

The delay in promulgating the relevant laws has created an uncertainty among foreign investors.

3.3.2 Improved Market Access & Investment protection via FTAs and BITS

The general consensus is that, greater openness to international markets facilitates the economic growth. Many studies have shown that firms with joint venture partnerships, firms that participate in international markets and those facing greater import competition are more productive, particularly in developing countries. In this context, foreign entry encourages technological and managerial know-how transfers and helps to integrate the domestic market with the international market. A higher proportion of market share accounted for imports also puts greater pressure on domestic competitors to improve their productivity and expands the range of available inputs for use in domestic production. Thus, a friendly investment climate would encourage foreign entry and openness to trade.

There is a variety of channels by which a free trade agreement may drive FDI flows. One is that FTAs remove export regulations by lowering trade barriers to facilitate the movement of intermediate and final products between two host countries. Other positive effects of FTAs on FDI could arise from other conditions negotiated in the FTA, such as investment regulations that increase the mobility of capital flows. These regulations make it easier for foreign investors to divert financial resources to their foreign affiliates when the need arises, such as building of a new plant in the host economy.

Empirical evidence has shown that entering into such preferential trading arrangements i.e. FTAs, RTAs and CEPAs with strong economies has enhanced exports led growth resulting higher levels of FDI inflows into industrial sectors.

Hence countries targeting an increase in FDI inflows from a particular source country or region could seek to implement FTAs and other trading arrangements with the other party, using such international agreements as viable tools to achieve their aim.

Competing countries for inward investments are formulating into several bilateral and regional trading blocks which provides preferential market access for exports from host countries (Table 06).
Table 06: FTAs, Exports and FDI inflows of Some Selected Counties

<table>
<thead>
<tr>
<th>Country/Trading Block</th>
<th>Prevailing FTAs (No)</th>
<th>FTAs under Negotiation (No)</th>
<th>Exports (USD Bn.)</th>
<th>FDI (USD Mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>2000</td>
<td>2012</td>
</tr>
<tr>
<td>ASEAN Countries</td>
<td></td>
<td></td>
<td>2000</td>
<td>2012</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5</td>
<td>4</td>
<td>112</td>
<td>265</td>
</tr>
<tr>
<td>Thailand</td>
<td>6</td>
<td>1</td>
<td>82</td>
<td>285</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1</td>
<td>-</td>
<td>62</td>
<td>190</td>
</tr>
<tr>
<td>Vietnam</td>
<td>1</td>
<td>1</td>
<td>17</td>
<td>127</td>
</tr>
<tr>
<td>Myanmar</td>
<td>1</td>
<td>1</td>
<td>6.4</td>
<td>9.6</td>
</tr>
<tr>
<td>ASEAN as a Regional Block</td>
<td>6</td>
<td>2</td>
<td>411</td>
<td>1,254</td>
</tr>
<tr>
<td>South Korea</td>
<td>6</td>
<td>2</td>
<td>144</td>
<td>548</td>
</tr>
<tr>
<td>India</td>
<td>9</td>
<td>7</td>
<td>42</td>
<td>294</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>2</td>
<td>-</td>
<td>5.5</td>
<td>9.8</td>
</tr>
</tbody>
</table>

Source: Complied by BOI using Web based data

Vietnam is one of the best examples where trading arrangements have played a major role in increasing the FDI level from USD 1,298 Mn in 2000 to 8,368 in 2012 and enhancing exports from USD 17 Bn in 2000 to USD 127 Bn in 2012 (Figure 06). This shows the ability to attract market seeking FDI through such trading arrangements with right partners (Figure 07). In comparison to this, during this period Sri Lanka’s FDI increased from USD 173Mn in 2000 to 1,338 in 2012 and exports from USD 5.5 Bn 2000 to USD 9.8 Bn in 2012.
Figure 06: Trade Agreements and Exports – Vietnam
Source: ITC & Board of Investment of Sri Lanka

Figure 07: Trade Agreements and FDI Inflows - Vietnam
Source: UNCTAD & Board of Investment of Sri Lanka
In addition to the above trading arrangements, Bilateral Investment Promotion & Protection Treaties and Avoidance of Double taxation treaties also play a supportive role by complementing to the trading arrangements.

The limited international integration has already made Sri Lankan exporters less competitive in accessing the export markets vis-à-vis the competitors with provisions for preferential market access.

Sri Lanka has signed two FTAs, one with India (2000) and the other with Pakistan (2005). These two countries are located within close proximity and therefore, in spite of the substantial coverage of goods with deeper preferential margins included in these two FTAs, the member countries compete for products of similar nature (e.g. agro products, labour intensive industrial products). With the implementation of ISFTA, India has emerged as the largest source of import destination and third largest export destination for Sri Lanka (rising from 16th rank in 2000). India is also now the largest trade partner of Sri Lanka while Sri Lanka is India’s largest trade partner in South Asia. Yet, past experience invites skepticism in this regard as Sri Lanka has not reached the desired benefits of the FTAs and RTAs such as ISFTA, PSFTA, SAFTA and APTA where it has become a member.

The lower tariff cuts given and the limited product coverage under SAFTA & APTA have made these RTAs less attractive.

This shows the necessity of having preferential trading arrangements by Sri Lanka aimed at greater market access with major economies such as EU, USA, Japan, Australia, South Africa and ASEAN if Sri Lanka to accrue the real benefits.
3.3.3 Improved Business Rankings

As discussed in the section 3.2 above regional competitors have given high priority to improve their respective business environment with a view to attract investments. In this regard, emphasis has been placed mainly on improving country rankings through various means such as regulatory reforms, good governance and development of infrastructure facilities.

Moreover, countries have paid serious attention on reducing utility cost for businesses mainly on energy, considering the sustainability of the projects and to attract efficiency seeking FDIs.

Most of the ASEAN countries have shown a vast improvement in their business rankings during the past decade and also South Korea is a good example of implementing regulatory reforms (Box 05).

<table>
<thead>
<tr>
<th>Box 05: Regulatory Reforms made by South Korea to improve DB Rankings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Since 2009, South Korea has made regulatory reforms to elevate the Doing Business Rankings of their country. It has made one regulatory reform in 2009, two in 2010, one in 2011, three in 2012 and four in 2013, bringing the total number of reforms to 11 and gradually increased its country ranking from 23rd, 19th, 16th, 9th, and 8th position respectively.</td>
</tr>
<tr>
<td>A key reform that has been made is reducing the profit tax rate as well as merging several taxes easing the administrative burden and also lowering the corporate tax rate.</td>
</tr>
<tr>
<td>South Korea’s Regulatory Reforms from 2009 to 2013</td>
</tr>
<tr>
<td>Year</td>
</tr>
<tr>
<td>No. of Reforms</td>
</tr>
<tr>
<td>Elevation in DB Ranking</td>
</tr>
</tbody>
</table>

Sri Lanka has improved its rankings from 89th to 81st place from 2012 to 2013. However, 5 out of the 10 sub indicators considered in formulating the Doing Business Index, Sri Lanka has been ranked above the 100th position exhibiting the need for improving its performance. These 5 weak performing sub indicators include parameters such as paying taxes and dealing with construction permits.
3.3.4 Moving towards high-tech investments (Investment Generating Activities)

In 1978, Sri Lanka liberalized its economy to foreign investment and the rate of unemployment in 1975 was 19.7%. Accordingly, the main focus during the early period was to attract labour intensive and low wage industries in the manufacturing sector such as apparel and textile. However, with the growth in per capita income and declining unemployment rate it may not be possible to sustain such industries in the future. Therefore, certain adjustments are taking place in the industrial sector such as vertical integration, backward and forward integration and product diversification into high tech investments which requires less labour with high skills coupled with attractive wage rates.

The empirical evidence shows that promoting high tech manufacturing industries have been the main focus of most of the regional competitors. Countries such as Malaysia and South Korea have position themselves as Global Outsourcing Hubs for high-tech manufacturing. These countries have given more prominence in manufacturing of modules, components & parts while enhancing local R & D and technology Development. At the same time they have taken initiatives to develop human capital to keeping abreast to cope with new/innovative technological developments. Yet, Sri Lanka has not shown much progress in this regard.

3.3.5. Industrial Infrastructure

Development of quality infrastructure has become a necessary condition to attract investments. The industrial infrastructure plays a key role in this regard.

The industrial infrastructure provides services and facilities necessary for an enterprise to function smoothly. This includes roads, water, power, telecommunication, waste management and built-in-factory premises.

The demand for such infrastructure derives mainly from investors seeking to set up manufacturing facilities. Countries like UAE have built Special Zones with all such industrial facilities to attract quality investments. In most instances such Industrial Zones are located inside free ports with direct access to container handling facilities (Box 06).

Moreover, these Industrial Zones have obtained various prior approvals such as environmental clearances to accommodate projects of diverse nature and thereby to reduce the time taken to commence the business activity and to make it hassle free to the investor.
There are 12 Export Processing Zones currently operating in Sri Lanka. Although 5 of these zones are developed with basic infrastructure facilities, still the country does not provide facilities for plug and play type built-in factories to accommodate high tech industries. Further, due to scarcity of plots in popular zones, over 85% of the projects in manufacturing sector are located outside the export processing zones. This has not only resulted in additional expenditure incurred in providing necessary infrastructure facilities separately for
individual factories, but also in long delays in getting various individual approvals and thereby delaying the commencement of the project.

3.3.6 Structured Projects

To achieve the national investment targets, it is ideal to identify and package some large scale projects. If such financially viable projects can be made readily available with all necessary preliminary clearances such as land and environment, the investment projections become more accurate and realistic. It also reduces hassle cost, related to corruption and bureaucratic inefficiencies, leading to higher levels of FDI. This practice has been used in many countries specially for PPP projects.

In May 2011, the infrastructure division at BAPPENAS of the National Development Planning Agency in Indonesia formulated 79 structured projects and successfully offered to private sector investors through the Public Private partnership (PPP) scheme.

Since 1978, the Board of Investment (BOI) of Sri Lanka has implemented over 1,723 projects and achieved only around USD 8,400 Mn worth of FDI thereby generating USD 5 Mn FDI per project (excluding the 15 projects currently being implemented under the SDP Act). In contrast, the 15 projects approved to date (within 4 years) under the SDP Act are estimated to yield USD 7,200 Mn worth of Investment of which USD 935 Mn has already been realized (Table 07). This shows the importance of considering such large scale projects to achieve national goals and targets.

<table>
<thead>
<tr>
<th>Period</th>
<th>Project Type</th>
<th>No. of Projects Implemented</th>
<th>Total FDI (USD Mn)</th>
<th>Average FDI per Project (USD Mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010-2013</td>
<td>Strategic Development Project (SDP)</td>
<td>15</td>
<td>7,200 (estimated)</td>
<td>480</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>935 (Realized)</td>
</tr>
<tr>
<td>1978 – 2013</td>
<td>Other (Excluding Strategic Development Projects)</td>
<td>1,723</td>
<td>8,400 (Realized)</td>
<td>5</td>
</tr>
</tbody>
</table>

Source: Board of Investment Sri Lanka

The scarcity of readily available structured projects has been a major obstacle to promote FDIs into Sri Lanka. However, BOI, in collaboration with relevant line agencies, has formulated 56 structured projects to be marketed at the Commonwealth Head of Governments Meeting (CHOGM) in November 2013. However, some of these projects lack the necessary ingredients of a truly structured project.
3.3.7 Development of Human Resources to match Industry Demand

Like many other countries and regions, Sri Lanka is also experiencing a sizeable mismatch between job requirements and employees’ skills. More specifically, there is a shortage of manpower in vocational and professional fields which are economically more important in the job market.

To address such issues, countries like Malaysia has established a Talent Corporation (TalentCorp) to formulate and facilitate initiatives to address the availability of talent in line with the needs of the country’s economic transformation. Collaborating closely with relevant government agencies and employers in priority economic sectors, TalentCorp develops demand-driven initiatives focused on three strategic thrusts, specifically (1) Optimize Malaysian talent, (2) Attract and Facilitate Global Talent and (3) Build Networks of Top Talent.

Although the Vocational Training Institutions in Sri Lanka has improved to a great extent with regard to developing a talent pool, the national universities should focus more on industry requirement to revise their curriculum to suit industry needs. Further, a proper skills assessment is not in place for country’s future requirement in demand driven industries. As such the country’s manpower planning has to be done now itself for the next five years considering the sectors or industries that Sri Lanka is targeting to develop during this period.

3.3.8 Clustering of Projects & City Development

When a group of companies collaborate jointly to achieve specific business objectives through finite projects and programmes that are likely to result in enhanced competitive advantage for a particular sector can be defined as a “Project Cluster” or “Industry Cluster”. This will lead to sectoral development initiatives, supply-chain optimisation, realising economies of scale, exploring export market opportunities and potential convergence opportunities. Clusters stimulate innovations and contribute to the increase of competitiveness of local economy and individual businesses and transform business environment into attractive destination for new foreign capital.

Similarly, planning for development in rapidly urbanizing Asia requires a fresh look. Clustering of projects and city cluster development focuses on the provision of infrastructure and services related to a specific industry for its potential growth. Clustering of projects not only serves as hubs for economic growth but also serves as centers for surrounding areas.
Foreign direct investments are one of the most important factors stimulating economy that could lead to regional development. Most of the competing countries in the region have considered cluster approach as a tool for eradicating regional disparities. Since less developed regions suffer from lack of investment capital, various cluster initiatives are seen as panacea.

Observations of clusters in competing countries give grounds to state that the very existence of clusters in particular areas is a crucial element that attracts foreign investors and influences their localization decisions. This is one of the reasons for FDI made in the clusters tend to grow. Foreign investments can play a leading role in a cluster, strengthening the synergy effect in all aspects of the clusters’ operations.

Effective clusters stimulate investments in the development of infrastructure, development of specialized business supporting services and contribute to an increase in personal earnings. They also stimulate the pro export orientation of companies, increase their profitability and thus contribute to overall economic development.

The social effects of clusters include the reduction of unemployment and stimulation of the development of local democracy as clusters are generally developed in areas where manpower is available abundantly instead of people migrating towards locations where the industries have been established with the availability of raw materials and other physical resources.

Automobile & Electronic Industry Cluster in South Korea is a good example of cluster city development (Box 07).

**BOX 07: Automobile & Electronic Industry Cluster - South Korea**

The automobile cluster connects the southern part of Gyeonggi province and the Chungnam province, forming a cluster specializing in high value-added cutting-edge parts and components. The Ulsan area will build a close linkage with the factories in Busan, Daegu and Gyeongbuk and this has led to development of the surrounding city as a cluster city closely linked with schools, universities, research institutes and firms specializing in this new promising sector.

Similarly the electronic cluster has been developed with applied research capabilities concentrating in the capital region and linking similar field industries (i.e. display sector and semiconductor sector) in other regions. As a result the Southwestern part of the country and the Gangwon province have been specialized in this promising sectors and closely linked themselves with firms in the capital region.

Certain clusters have emerged in Sri Lanka for specific industries such as furniture (Moratuwa), gems (Ratnapura) and Information Technology (Colombo and Malambe).
However, the country has not initiated any planned programmes to create competitive industry clusters linked to city development. Nevertheless some initiatives have been made in this regard with respect to development of tourism clusters in identified locations of strategic importance.

3.3.9 Positioning as a “Trading Hub”

Trading hubs are “sanitized areas” designated for carrying on specific trading activities. It provides free and borderless environment encouraging high volumes of trade and services enhancing foreign exchange earnings for the country. Even in the absence of strategic natural resources or products or services of its own, a country can be successful in attracting foreign investments for hub operations such as Entrepot trade, Off-shore business, Front end services, Head-quarter Operations and Logistic services. Many countries have realized the importance of positioning themselves as efficient global trading hubs (Box 08).

**BOX 08: Global Trading Hubs**

**Singapore – a world class Trading Hub**
Singapore being a very small country with no natural resources has demonstrated as a successful trading hub both regionally and globally.

**Thailand - Trading Hubs linked to Industrial Zones**
Some countries such as Thailand have taken a further step by establishing industrial hubs with close proximity to export processing zones. This concept has promoted industrial decentralization in under-developed regions.

**Myanmar – An emerging Trading Hub**
Myanmar is the largest country in mainland South East Asia with a land area of about 654,000 square km. It is located between China, India, and Thailand, with more than 2,800 miles of coastline. This geographic advantage, and its endowed natural resources leaves it well positioned to resume its traditional role as a regional trading hub and key supplier of minerals, natural gas and electric power.

Sri Lanka has introduced a new legislation in 2012 to promote specific activities under the commercial hub concept. Accordingly, free ports and bonded areas have been declared enabling five identified activities namely, Entrepot trade, Off-shore trading, Front end services, Operations of the Headquarters, Logistic services. Specific investment thresholds and annual export or the turnover as applicable has been fixed for each specific category. Special exemptions from an array of legislations have been granted to encourage these activities.
4. Investment Climate Gaps and Recommendations

The analysis of Sri Lanka’s investment climate discussed in Section 3 above (based on International Rankings, key determinants of FDI and best practices adopted by high performing host economies that compete to attract Foreign Direct Investment (FDI)), revealed several gaps prevailing in the investment climate. These investment gaps and appropriate recommendations to improve the investment climate in Sri Lanka are stated below.

4.1 Improving Global Rankings

Since Sri Lanka’s rankings on major business indices are not attractive enough to market Sri Lanka as a desired destination for foreign investment a serious attempt has to be made to improve Sri Lanka’s position in such international rankings.

It is recommended that a proper analysis of Sri Lanka’s rankings to be carried out and identify the critical areas that needs improvements to bring Sri Lanka’s overall business ranking to a higher level while benchmarking with the continuous improvements made by the regional competitors.

**Investment Gap:**
Have not clearly identified the most needed improvements in Doing Business Rankings and its impact on Sri Lanka’s rankings.

**Recommendation:**
Identify the most crucial areas that needs regulatory reforms to improve the DB rankings and also to improve other international rankings related to the business environment.

4.2 National Investment Policy & Plan

The study reveals the essential requirement of having a clear National Investment Plan for both public and private investments with provisions for implementation, Monitoring and Budgetary Allocation to achieve set national targets.

The national plan should also consist of specific investment generation activities such as structured projects to facilitate the implementation process.

**Investment Gap:**
Absence of a detailed investment plan specially to stimulate private investments with a lay down plan for implementation.

**Recommendation:**
Formulation of a National plan encompassing Investment Plan for both public and private investments with provisions for implementation, Monitoring and Budgetary Allocation to achieve set national targets.
4.3 Comprehensive Investment Law

The investment law should be in place to provide the basic legal framework required to facilitate and smooth functioning of the investment plan. It is evident that having a consolidated investment law provides certainty and predictability for investors from the very inception. Such an investment law would include key elements such as; Entry and Exist, Forms of Investment, Investment Guarantee Measures, Rights and Obligations of Foreign Investors and Enterprises with Foreign Owned Capital, State Management of Foreign Investment, Implementation Provisions, Sectors of Investment and other General provisions.

The current Board of Investment Law which is primarily meant to be the country’s investment law is structured mainly to establish the Investment Promotion Agency and provide incentives to attract investments. However, the new global trend is to have a comprehensive investment law covering all key areas of investment related provisions. Thus, it is a timely need to promulgate a new investment law to facilitate the implementation of the national investment plan and thereby to address the development needs of the country.

4.4 Empowered IPA

The BOI Sri Lanka is the lead government agency responsible for planning and executing strategies to attract inward FDI with a view to enhance Sri Lanka’s position as a global business centre and drive the economy forward.

Although with the enactment of GCEC Law in 1978 wider powers had been entrusted with BOI, such powers have been gradually taken away through various Government policies adopted from time to time. As a result of the erosion of the BOI Authority, the main objective of establishing the BOI has not been achieved to a desired level.

Therefore, it is recommended that BOI be given broader powers to pursue its goal of stimulating the growth and development of the economy by attracting higher levels of FDI and redefine the BOI’s role as the key organization that stimulates the growth, expansion and development of the Sri Lanka’s economy.

Investment Gap:
Absence of an integrated Investment Law

Recommendation:
Promulgation of a Comprehensive Investment Law dealing with related provisions to facilitate target investments

Investment Gap:
Investment Promotion Agency (IPA) is not sufficiently empowered to carryout investment

 Recommendation:
Entertrust broader powers to IPA to pursue its goal of stimulating the growth and development of the economy by attracting higher levels of FDI
4.5 Clearly Defined Land Policy

Any Changes made to the land policy should have been done through the legal framework. Sudden changes made to the land policy have created unwarranted difficulties to investors. Further, the prolonged delays in introducing new legislations have made the situation worst by discomforting and discouraging investors and also delaying the implementation of projects. Hence, immediate steps to be taken to promulgate the necessary legislation and publish appropriate regulations on the applicability of relevant taxes.

**Investment Gap:**
The land law related to ownership by foreigners has been changed since January 2013 with no proper legislation or regulation in place leaving foreign investors in an uncertain situation.

**Recommendation:**
Enactment of the law related to land ownership by foreigners without any ambiguity enabling the investors to take their decision to invest in Sri Lanka.

4.6 Seeking Preferential Market Access

It is prudent to engage in serious negotiations with carefully selected partner countries/regional blocks with a view to entering into FTAs/RTAs.

Moreover, the effectiveness of such regional integration measures obviously depends on the economic strengths and deeper tariff cuts given by the member countries for products of export ability. Furthermore, the persistence of various non-tariff barriers means that that these regional trade Agreements are is still far from a genuine free trade area. Hence, Sri Lanka should select strong economies, with import interest for products of Sri Lankan origin (eg. Japan, ASEAN, Australia, South Africa, Middle East, USA, EU, China).

**Investment Gap:**
Sri Lanka has not reached the full potential of the FTAs and RTAs such as ISFTA, SAFTA and APTA where it possesses the membership.

Also, the country does not have preferential trading arrangements with strong economies that could help to enhance export potential.

**Recommendation:**
Consider having FTAs with strong economies and trading blocs with deeper tariff cuts for products of Sri Lankan origin with export potential.
4.7 Modern Industrial Infrastructure

New zones should be developed with special focus on the needs of high tech innovative industries and built-in factories should be made available for investors to start their business activities saving hassle cost and time. The global trend is to locate these new zones within the area of free ports with direct access to container handling facility.

**Investment Gap:**
Zones are not fully developed to offer facilities for plug and play with built-in factories for specific high tech industries.

**Recommendation:**
New zones to be developed focusing on the needs of high tech innovative industries.

4.8 Structured Projects

Identification and structuring of marketable projects in consultation with relevant line agencies on a continuous basis is essential to generate investment activities.

Focus has to be made on identifying financially viable large scale projects of greater impact to the economy. This should encompass identification and reserving suitable lands, obtaining preliminary approvals and clearances for environmental and other project related activities. Structured projects with all relevant preliminary clearances would have a distinct advantage to be marketed to the investors within a short spell of time and to attract suitable, high quality FDI placing Sri Lanka at the leading edge of the Asian region.

**Investment Gap:**
Lack of readily available structured projects has been a serious draw back in achieving national FDI targets.

**Recommendation:**
Formulation of structured projects which are easily marketable. The process should include;
- identifying financially viable large scale projects
- Reserving suitable lands and
- obtaining preliminary approvals for environmental and other project related activities.
4.9 Development of Human Resources to match Industry Demand

There is an apparent need to upgrade the quality of the workforce and to provide individuals with opportunities to optimize their potential if Sri Lanka is to meet the changing demands of the industries. In this respect, having a common platform conducive to skills development in specific sectors is considered as a viable solution to the manpower challenges ahead.

<table>
<thead>
<tr>
<th>Investment Gap:</th>
<th>Recommendation:</th>
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<tr>
<td>Dearth of skills in line with countries economic transformation</td>
<td>Development of a talent pool to match the industry needs</td>
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</table>

4.10 Clustering of Projects & City Development

Most of the competing countries in the region have considered cluster approach as a viable tool for city development and eradicating regional disparities. Since Sri Lanka is in the process of developing cities in the regions, an attempt has to be made to increase its competitiveness through the establishment of suitable clusters. Further, clustering approach is a good proposition to attract foreign investors and influences their localization decisions.

<table>
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<tr>
<th>Investment Gap:</th>
<th>Recommendation:</th>
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<tr>
<td>Similar industries scattered in various parts of the country without a proper plan for clustering and a mechanism to share resources effectively preventing them being competitive.</td>
<td>Develop industry clusters of strategic importance in identified locations leading to city development.</td>
</tr>
</tbody>
</table>

In order to improve Sri Lanka’s investment climate, the country should make its best endeavours to take steps to implement these recommendations according to a proper plan with set targets and timeframes.
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