ISAS Brief
No. 819 – 25 January 2021

Post COVID-19: Positioning Sri Lanka as South Asia's Dubai

Ganeshan Wignaraja

Summary

Using the policy tool of setting up a dedicated special economic zone (SEZ) for services, the Colombo Port City (CPC) in Sri Lanka aspires to become an international financial centre after the pandemic. However, global uncertainties in the COVID-19 economic era and decision-making lags by previous governments suggest that it will take time to realise this ambition. Implementing a competitive SEZ framework and conducive national policies will markedly improve the CPC's chances of success and help position Sri Lanka as South Asia's Dubai.

In early January 2021, President Gotabaya Rajapaksa's government approved the drafting of a law to set up a Commission to oversee activities at Colombo Port City (CPC), which will be a special economic zone (SEZ). The Board of Investment is also targeting annual foreign direct investment (FDI) inflows of $1.5 billion (S$1.99 billion) over the next three years. These steps underline Sri Lanka's ambitious plans to attract services FDI into the CPC in a bid to position the country as South Asia's 'new Dubai' – a premier financial services hub rivalling Dubai to the West and Singapore to the East – in a post COVID-19 world economy. Projections by the United Nations Conference on Trade and Development suggest that global FDI flows could fall by 40 per cent in 2020 from their 2019 value due to the economic fallout from the pandemic. A partial recovery in global FDI flows is expected in 2022 linked to the availability of COVID-19 vaccines, the announcement of a large fiscal stimulus for the United States (US) by the Joe Biden administration and improved business confidence.

The city of Dubai is widely regarded as a developmental success story in the Middle East and globally. It powered the economic rise of the United Arab Emirates (UAE) to become a high-income economy with a per capita income of over US$40,000 (S$53,000). Within three decades or so, Dubai has transformed itself into an enviable international hub for FDI, particularly in commerce, financial services, aviation services and tourism. It has leveraged its strategic location between Asia and Europe and developed some 30 SEZs. Political stability, excellent branding as an investment destination, competitive investment incentives, world class infrastructure in its SEZs, an open labour market to attract skilled workers and professionals, along with consistent business-friendly economic policies, explain Dubai's success in attracting FDI.

One of Sri Lanka's major assets in the eyes of foreign investors is its strategic geographical location – a few miles off India's southern coast and close to the main Asia-Europe sea route. This, coupled with its relative port efficiency, has contributed to the emergence of the deep-water Colombo Port as an important transshipment hub to India. Other national assets include the development of an increasingly high-end garment industry based on skilled labour and exceptional natural and cultural tourism endowments.

On the liabilities side, however, Sri Lanka's small internal market of 22 million people with a relatively smaller middle-class of consumers could be a disadvantage for manufacturing FDI compared to larger neighbours like India or Bangladesh. Sri Lanka's business environment is also seen as being mired in red tape and not being very friendly to foreign investors according to the World Bank's Doing Business indicators. More recently, ratings agencies like Moody's have highlighted Sri Lanka's debt repayment challenges and argued that it is at risk of sovereign debt distress which is a worrisome new label for the country.

With the liabilities weighing on the country's FDI potential, Sri Lanka's foreign investment inflows remain below par. As South Asia's first economic reformer in 1977, it was expected to reap a peace dividend following the end of a 30-year civil conflict in 2009. Between 2010 and 2019, FDI inflows into Sri Lanka averaged less than US$1 billion (S$1.32 billion) annually. Although FDI flows in 2020 will be less than expected due to the pandemic, this could be changing. For instance, Browns Investments signed a memorandum of understanding for a US$1 billion (S$1.32 billion) mixed development project in the CPC in December 2020. Furthermore, South Asia's largest tyre factory, Ferentino Tyre Corporation (Pvt) Limited, was opened in January 2021 with an investment of US$250 million (S$ 331.43 million). Scenario analysis by the Lakshman Kadirgamar Institute suggests that the CPC SEZ can be a game changer for modern services development in Sri Lanka leveraging the twin advantages of a strategic geographical location and international best practices SEZ framework. This multi-purpose office/leisure city is an engineering marvel being developed on 269 hectares of reclaimed land by China Harbour Engineering Company Ltd (CHEC), a Chinese state-owned enterprise. Contrary to popular perceptions, it is an investment project (CHEC will make an initial foreign investment US$1.5 billion [S$1.99 billion]) rather than one financed by a commercial loan. The CPC SEZ could be an important project to transform the country's services sector not only by promoting FDI but also facilitating clustering of businesses. Notable spillovers can be gained from sharing resources and costs by locating financial and related services activities in the CPC. PricewaterhouseCoopers estimates that the economic impact of a fully operational project will be significant, adding as much as 10 per cent to Sri Lanka's gross domestic product on an annual basis. Global uncertainties in the COVID-19 era (such as questions about the effectiveness of vaccines against the new Coronavirus strains) and decision-making lags by previous governments, however, suggest that it will take time for the CPC to become fully operational.

Sri Lanka should rapidly implement a CPC SEZ framework that has several best practice elements including, 1) a transparent and competitive tax regime; 2) a clear arbitration framework for parties to solve commercial disputes; 3) strong anti-money laundering rules; 4) an open international labour market; and 5) modern and cost competitive infrastructure. It also means that like the UAE, Sri Lanka's national economic policies should be transparent and predictable in the medium-term emphasising a market-oriented economy, a neutral foreign policy, a world class education system and movement towards political and social stability. Indeed, putting in place a competitive SEZ framework and conducive national policies will markedly improve the CPC's chances of success and help to position Sri Lanka as South Asia's Dubai after the COVID-19 pandemic.

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Dr Ganeshan Wignaraja is a Non-Resident Senior Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute at the National University of Singapore (NUS). He can be contacted at gwignaraja@gmail.com. The author bears full responsibility for the facts cited and opinions expressed in this paper.