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Sri Lanka: New Economic Opportunities and a New Vision

Standing at the threshold of its 70^{th} anniversary of independence, Sri Lanka has undertaken commitments for a new journey of transforming itself into a dynamic hub of the Indian Ocean, with an orientation for a knowledge-based, highly competitive social-market economy. This has been enshrined in the new and ambitious 8-year development plan, "Vision 2025: A Country Enriched," that sets out a course of reforms to make the country more competitive and lift the standards of living for all Sri Lankans. Some highlights are selected and briefly discussed below.

The vision document puts forward a range of far-reaching structural reforms to achieve these targets. While long term economic planning is not a novel move in itself, Sri Lanka's ownership and awareness of its shortcomings, and its apparent willingness to overcome them through such reforms must be acknowledged.

The overall target of the 8-year development plan is to implement a comprehensive economic strategy to address constraints to growth within the next three years. It aims to raise per capita income to USD 5,000 per year, create one million new jobs, increase FDI to USD 5 billion per year, and double exports to USD 20 billion per year. If these intermediate targets are met, Sri Lanka could enter the upper-middle income country bracket by 2025.

The approach lays emphasis on three key reforms: liberalising trade and investment, attracting foreign investment, and restoring emphasis on exports. These targets, however, will not be easy to achieve in the current structural context. Up until now, growth was primarily driven by non-tradable activities, in particular through government infrastructure spending based on heavy commercial borrowing. Persistent fiscal deficits have resulted in poor investor confidence, and low levels of foreign direct investment (FDI) as well as private domestic investment. Further, export performance has been weak, and the uncompetitive exchange rates, alongside high effective protection rates have resulted in a strong anti-export bias. Sri Lanka's exports are therefore still concentrated on a few, mainly low-technology products, and investment policies have failed to attract transformational, knowledge-based investments. Moreover, according to the World Bank, in 2016 the government debt was approximately 78 percent of its GDP, which in itself is not a problem, but combined with low tax revenues, it becomes a matter of concern. However, as a fairly large developing economy, it has the potential to sustain high levels of debt and to pursue an upward path to economic development.

The Vision document does recognise these macroeconomic structural drawbacks and sets forth a list of solutions to tackle them. Sri Lanka is currently ranked at 111 in the World Bank's Doing Business Index amongst 190 countries. Prime Minister Wickremesinghe's target is to bring Sri Lanka into the top 70 countries in the Doing Business Index by 2020. With regards to improving the business and investment climate, the document proposes reforms like simplifying the process of registering a business and/or property, easy access to construction and electricity permits, reforming labour laws, protecting minority investors and so on. However, such far reaching reforms to increase the ease of doing business require un-contentious political support across party lines, which cannot be taken for granted in the post- conflict scenario as it is today. This concern was reiterated by the World Bank's June 2017 Sri Lanka Development Update, where it pointed out that implementation of reforms was rather slow despite enthusiasm in policy circles.

With regards to trade, the document outlines a new Trade Policy which aims to create a more liberal, simple, transparent, and predictable trade regime. This could be the defining component of

Sri Lanka's economic future. Since the country has a domestic market of only 20 million consumers with a modest per capita income, it must rely on external demand for sustained, high, and long-term growth. Its strategic geographical location - in the middle of the East-West sea route in the Indian Ocean, halfway between the Suez Canal and the Strait of Malacca, the key maritime choke points to the East and West, and along routes from the Strait of Hormuz, through which most of Asia's energy supplies transit, provides it with a unique inherent advantage to transform itself into the "hub of the Indian Ocean."

Sri Lanka-EU relations in this New Era

The EU plays a vital role in Sri Lanka's economic growth. Based on 2014 numbers, the EU is Sri Lanka's fourth largest import partner, and its largest export partner— Sri Lanka exported more than EUR 2.5 billion worth of products to the EU which represents approximately 32 percent of Sri Lanka's total exports. However, these exports are primarily in agro-food and semi-manufactured products. The vision 2025 can potentially open doors to diversification of exports in both goods and services. Sri Lanka will benefit immensely from export of services in the fields of Knowledge Process Outsourcing (KPO), Business Process Outsourcing (BPO) and software product solutions. The EU has also funded several projects which have provided technical assistance to enterprises. It has assisted in sectorial diversification, improved productivity and competitiveness, and created platforms for one-to-one business match-making between EU and Sri Lankan enterprises.

It is imperative for any growth model in Sri Lanka to take into account the historical-social context of disparities among its different communities in the access to resources and opportunities, and therefore include policies of rehabilitation and reconciliation in its broad framework of reforms. The EU's rights-based approach to development cooperation can encourage responsible transformation in the country. In May this year, Sri Lanka became a beneficiary of the GSP+ Scheme of the EU, which removes a significant part of the remaining import duties on Sri Lankan products. The Scheme enables Sri Lanka to foster its economic development through increased trade with Europe, and at the same time also provides incentives to take tangible measures towards sustainable development. GSP+ is granted on the condition of Sri Lanka's commitment to ratify and effectively implement 27 international conventions on human rights, labour conditions, protection of the environment and good governance. The removal of customs duties for Sri Lanka will therefore be accompanied by rigorous monitoring of the country's progress in implementing these conventions.

The EU is also working with the Government of Sri Lanka to support the development of SMEs and better enable them to export to the European market. Since 2006, the European Investment Bank had signed and implemented agreements with Sri Lanka to provide credit lines worth EUR 160 million to finance small and medium scale projects in infrastructure, tourism, energy and telecommunications. So overall, there is a stable base that exists for cooperation, and it should receive the much needed renewed vigour through the vision 2025, that will strengthen exchange between the two actors.

From the Sri Lankan perspective it is even more important to build relations with not just the EU, but also with other powerful Asian players like India, China and Japan. By prioritising needs for economic development, it has been able to enter into strategic partnerships with many regional powers at the same time. For instance, on one hand it has attracted large Chinese investment, and on the other it enjoys free trade agreements (FTAs) with India and Pakistan. The Vision 2025 also sets out the possibilities for Sri Lanka to play a more prominent role in SAARC.

Broader Perspective

In the Sri Lankan context, apart from focusing on trade, investment and economic growth, it is also important to ensure that this growth is pursued in an equitable and sustainable manner. Eight years on, since the end of the Civil War, its reminiscences manifest in persistent inequalities between the different ethnic communities. Therefore, economic growth must also enable economic empowerment, reinforce social cohesion, and contribute to peace and reconciliation. Development of rural economies, providing sustainable livelihoods for the people in the northern province affected by a prolonged conflict, and investment in reconstruction and infrastructure development will contribute to a more inclusive and equitable post conflict recovery and development. The Vision 2025 recognises these challenges and in its 'new approach to growth' it envisions to make Sri Lanka a social market economy, that ushers in a fairer, more inclusive society. The document also throws light on sustainability and environmental concerns. It outlines a plan to develop non-renewable sources of energy, and lays out a framework for more efficacious natural disaster management.

All in all, Sri Lanka's Vision 2025 lays out a decisive plan for the future. It gives a clear and welcoming signal to foreign and domestic investors, builds a strong foundation for its external relations, and most importantly, reassures the citizens of a brighter tomorrow. If backed by political will and implemented with the same enthusiasm and vigour, Sri Lanka could be heading towards a promising path to prosperity, thus reshaping its international image.

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