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Sri Lanka as a Frontier Market – An Investor Perspective with Alexander Benard

Interviewed by Barana Waidyatilake and Adam Collins*

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***Barana Waidyatilake and Adam Collins** are Research Fellows at the Lakshman Kadirgamar Institute of International Relations and Strategic Studies (LKI). The opinions expressed in this transcript are the speaker's own views and are not the institutional views of LKI.

The Lakshman Kadirgamar Institute (LKI) recently interviewed Alexander Benard, Managing Director of SGI Frontier Capital, as part of the LKI Spotlight series. The LKI Spotlight series features interviews with thought leaders around the world, on key and emerging issues of international relations.

This interview focuses on the attractions and drawbacks of Sri Lanka as an investment destination, lessons to be learnt for Sri Lanka from Chinese investment in frontier markets, the impact of Sino-Indian investment competition on other investors wishing to enter Sri Lanka, and the effects of US isolationism on frontier markets.

Alexander Benard is the Managing Partner of SGI Frontier Capital, a private equity firm working in frontier markets in Asia and Africa. He is also a Non-Resident Visiting Fellow at the Hoover Institution, a leading think tank based at Stanford University. Mr. Benard is also a commentator on US foreign policy, and has published articles in Foreign Affairs, the National Interest, Foreign Policy, and the Wall Street Journal.

See below for a lightly edited transcript of an interview by Barana Waidyatilake, Research Fellow in LKI's Global Governance programme, with contributions from Adam Collins, Research Fellow in the Global Economy programme. The audio of this interview is available as a podcast on LKI's SoundCloud channel. The questions and other aspects of this interview are not the institutional views of LKI, and they do not necessarily represent or reflect the position of any other institution or individual with which the parties are affiliated.

LKI: Mr. Benard, *how in your estimation does Sri Lanka compare to other frontier markets that you have experience investing in?*

Mr. Benard: We invest in frontier markets like Ethiopia, Georgia, Mongolia – compared to these, Sri Lanka is a very easy place to do business. In some ways, it's not even fair to group Sri Lanka with other frontier markets. It is more of an emerging market in some respects, because it has a long history of being a very important business hub in Asia and a transit point for shipping and commerce. That history gives Sri Lanka an economic base that is very strong.

The country has a very robust private sector. Many of its business people have been educated in the UK and the US; they run large companies that do complex things like IT or different types of services, and that economic foundation puts Sri Lanka in a totally different place than other frontier markets. If there are macroeconomic challenges or political challenges here, there is a private sector that has its own engine, and it chugs along no matter what. So, from my standpoint, Sri Lanka – compared to the other markets that we do business in – is a very favourable investment climate.

LKI: The Sri Lankan government has stated a goal of attracting USD 5 billion of annual foreign direct investment (FDI) by 2020. *What do you believe are the key things the government might need to do, to facilitate such a high level of FDI?*

Mr. Benard: The government needs to cut the red tape as much as possible. There is such a large and diverse business community here, that the government just needs to make sure that it's not standing in the way by cutting red tape, lifting restrictions, and creating an open environment where business-to-business interactions can occur without undue interference. There's not much more needed than that. I don't think the government needs to go out of its way to promote certain sectors.

LKI: *Based on your experience of Chinese investment in other frontier markets, what impacts – if any – have you observed of such investment on the political and environmental systems in those countries, and do you see any lessons for Sri Lanka in this?*

Mr. Benard: We see China quite active across all the markets where we invest. A very good example would be Ethiopia. The Chinese government has been very active at the bilateral level, providing different forms of loans and other support for infrastructure. Just to give a few examples – the railway from Djibouti to Addis Ababa, and a light rail system in Addis Ababa. Something like 60-70% of the road networks in Ethiopia have been built by the Chinese.

The way that it works – and Sri Lanka is familiar with this – is that these are typically Chinese loans that are often issued at commercial interest rates, not necessarily concessionary interest rates, and Chinese companies must be hired as part of the contractual arrangement for the loan. Often Chinese labourers are brought in as well. So, China is benefiting in three ways.

The local country benefits of course, because it ends up with infrastructure, but there are a few problems. First, there's often quality problems with the infrastructure, and Ethiopia has seen that already; a lot of the roads built by the Chinese are degrading and are already in need of repair after a couple of years. There's also sometimes a problem with constructing projects that aren't financially remunerative, because they do not go through a proper tendering process. For example, the light rail that was built in Addis Ababa is virtually empty because it wasn't properly planned out – the routes are not along the key corridors in the city.

And then the third problem that we have seen in Ethiopia is that there is often a security angle to the relationship that benefits China. For example, the news just recently broke that the Chinese company which constructed the African Union Headquarters in Ethiopia installed spy equipment in the building, and for the last couple of years has been downloading all the information that has been transmitting in that building onto servers in China.

Sri Lanka should make sure it gets whatever value it can out of the China relationship. China has played an important role here, building the infrastructure and financing big projects that nobody else has been willing to finance. But at the same time, Sri Lanka needs to be very careful about some of the economic pitfalls and needs to structure these deals in the right way. Sri Lanka also needs to ensure the quality of these projects, to ensure that there are good controls in place for environmental and social sustainability, and make sure that they do not become vehicles through which China can advance its own security objectives.

LKI: Some of the arguments you mentioned about quality issues have been circulating in Sri Lanka as well. China is a significant investor here, but so is India. These investments by India and China have been interpreted as strategic competition between the two Asian giants. *If Sri Lanka is engaging with both China and India, and if it's able to get preferential access to both markets – would that help to attract private investors, or might the competition scare other private investors away?*

Mr. Benard: As long as the relationship Sri Lanka has with each of these great powers is on balance healthy and positive, then it's a net benefit to the country and definitely attracts foreign investment. If Sri Lanka has good relations with China, good relations with India, and free trade agreements with everybody, then it makes Sri Lanka that much more attractive of a destination.

That Sri Lanka, in theory, gets the Sri Lanka-India relationship right, can serve as a point of entry into the Indian market – which has over a billion people, is a very attractive place for marketing different services and goods, but a very difficult business environment. Sri Lanka is a much easier place to set up a business. If you can market Sri Lanka as a point of access into the Indian market, that is a huge positive and I think investors would draw a lot of confidence if they see that the Sri Lanka-India relationship is normalising and healthy. On balance, if they are managed properly, these great power dynamics can play very much to Sri Lanka's benefit.

LKI: To move to the final question today – we've seen with the recent steel and aluminium tariffs by President Trump that the US is moving into an economic isolationist position. *Does US economic isolationism pose any significant risk for frontier markets?*

Mr. Benard: The turn towards a more inward focused economic outlook in the US is quite unfortunate; it's not the right thing for the US and I hope it's only temporary. But it is more focused on some of the world's larger economies. The Trump administration is concerned about China and trade imbalances with China, and it's less of a concern vis-a-vis the frontier markets.

In fact, with the frontier markets I've seen, the Trump administration wants to dial up economic engagement, because it realises that there is a strategic dimension. The Chinese are very active with 'One Belt One Road.' Even the Russians are getting more active in some parts of the world, and if the US is not economically active in these regions, then it is going to fall behind.

For example, I was in Washington not long ago having meetings with OPIC, which is the US government's development finance agency. OPIC has been given a specific directive to do more in these critical frontier parts of the world – for example, in Central Asia and in different parts of Africa as well.

So, I think the slight and hopefully, temporary turn towards isolationism is more focused on some large trading relationships of the US. It doesn't really affect US economic engagement with some of these frontier markets, where the Trump administration is trying to dial up economic engagement in some ways. That's my hope at least—let's see what happens.

Further Reading

Alphonsus, D. (2018). ‘China’s legendary loans to Sri Lanka: A tale of 5 myths.’ *Sunday Observer*. Available at: http://www.sundayobserver.lk/2018/07/29/opinion/china%E2%80%99s-legendary-loans-sri-lanka-tale-5-myths.

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Bräutigam, D. (2018). ‘U.S. politicians get China in Africa all wrong.’ *Washington Post*. Available at: https://www.washingtonpost.com/news/theworldpost/wp/2018/04/12/china-africa/?noredirect=on&utm_term=.a69fd7dff452.

US Department of State. (2017). *Investment Climate Statement 2017 – Sri Lanka.* Available at: https://www.state.gov/e/eb/rls/othr/ics/2017/sca/270029.htm.