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The Regulation of Foreign Investments in Sri Lanka: A Policy-Based Perspective

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Abstract

Sri Lanka has been a host State to foreign investment since it adopted an open economic policy in the late 1970s, from which time it has entered into successive investment treaties. Foreign investment in Sri Lanka recorded a steady, though not exponential, growth during the fractious years of civil strife. Sri Lanka entered the present decade hoping to rapidly scale its foreign investment via strong post-war leadership, but found its attractiveness as a host State challenged by other countries in South and Southeast Asia that offered better incentives and conditions. In addition, several negative experiences in dispute resolution fora left the State reeling, as it found itself having to pay compensatory sums that often far outweighed the projected benefits of the investment. The island State, once prized for its strategic location, has found this to be a double-edged sword, as regional superpowers vie for investment opportunities in Sri Lanka that would indirectly yield security benefits in the Indian Ocean, rather than revive or improve its export performance or inject other types of investment that Sri Lanka also needs.

Against this backdrop, this paper presents and attempts to analyse the Sri Lankan experience of foreign investment. It aims to assess the political background to foreign investment in Sri Lanka, as well as associated legal developments and the State's treatment of investors – including disputes to which Sri Lanka was a party. In the process, it will comment, by use of comparative information from other countries, on policy and legal measures that the State could have taken – or could take in the future – to ensure that investing in Sri Lanka is seen as a worthwhile commercial venture by diverse actors, and not only as a strategic move by regional powers. The authors contend that Sri Lanka has previously relied unsuccessfully on a 'leader-driven' model, which relies on those currently in power and their preferred foreign partners to grow foreign investment. They argue in favour of rapidly moving to a holistic and rules-based approach that goes well beyond making investment treaties, and present a multi-step plan of political and legal measures towards this end.

Keywords: Foreign Direct Investment, Dispute Resolution, Foreign Policy, South Asia, Sri Lanka

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Abbreviations

AIIB	Asian Infrastructure Investment Bank
BITs	Bilateral Investment Treaties
BOI	Board of Investment of Sri Lanka
CPC	Ceylon Petroleum Corporation
FCN	Friendship, Commerce and Navigation treaties
FDI	Foreign Direct Investment
ICSID	International Centre for Settlement of Investment Disputes Convention
IIA	International Investment Agreements
IT	Information Technology
LCIA	London Court of International Arbitration
LTTE	Liberation Tiger of Tamil Eelam
MFN	Most Favoured Nation
pb	per barrel
SCB	Standard Chartered Bank
TIPs	Treaties with Investment Provisions
TRIMs	Trade Related Investment Measures
UNP	United National Party
WTO	World Trade Organisation

1. Introduction

This paper provides a policy-driven analysis of the regulation of Sri Lanka's foreign investment, proceeding in two parts. Part 1 outlines the political and legal history of Sri Lanka's experience with foreign investment. It considers Sri Lanka's regulatory framework for foreign investment, including its international investment treaties and analyses international cases in which Sri Lanka has been a party.

It is a premise of this paper, however, that investment treaties and international cases have played a limited role in facilitating foreign investment in Sri Lanka. The authors note a weak correlation between Sri Lanka's investment treaties and the inflow of investment to the country. Part 2 of this paper, therefore, focuses on the political challenges – both national and geopolitical – and broader legal impediments (including rule of law indicators) to growing Sri Lanka's foreign investment. The authors analyse these challenges and impediments through a comparative study of the successful experiences of other countries in the Asia-Pacific, particularly Singapore and New Zealand, in attracting consistently high foreign investment.

The authors find that Sri Lanka is currently in a difficult grey zone between a 'leader-driven' model of foreign direct investment (FDI), in which FDI depends on strong political leaders and their own networks, and a 'rules-based' model that prevails in developed countries, in which investors rely on clear and efficient frameworks without the complications of frequent policy changes, cronyism and graft. They conclude that Sri Lanka needs to move resolutely and quickly to the latter model with a multi-step program, which will help to attract consistently better levels of FDI than competitor host States in Asia.

2. Recent History of Foreign Investment (1970s – present)

2.1. Political Background

Reaction to colonial era practices in Ceylon

In the colonial era, foreign investment in the region was characterised by unequal powers and extractive practices by foreign entities. This was apparent in colonial Ceylon, for example, in the tea and other plantation industries. As one commentator noted, the 'tea industry was dominated by sterling companies based in London and managed by British-controlled agency houses in Colombo.'[1]

Spurred by local resentment of these colonial-era practices, Sri Lanka moved to nationalise foreign-owned property after its independence in 1948. This development culminated in large-scale nationalisation of industry in 1971-1972 under the government of Prime Minister Sirimavo Bandaranaike, the then leader of the left-leaning Sri Lanka Freedom Party (SLFP) which was founded

[1] Historyofceylontea.com. (n.d.). *SHIFT OF FORTUNES OF SRI LANKA'S TEA ENTERPRISE*. [online] Available at: http://www.historyofceylontea.com/ceylon-publications/maxwell-fernando-archive/shift-of-fortunes-of-sri-lankas-tea-enterprise.html [Accessed 03 Jan. 2019].

by her husband S.W.R.D. Bandaranaike in 1951. Mrs. Bandaranaike's government pursued a closed economy in keeping with socialist policies, which stymied the inflow of foreign investment.[2]

1977 as a turning point in Sri Lanka

Mrs. Bandaranaike's government was swept out of power by the resounding electoral victory of the pro-market United National Party (UNP) in 1977, led by J.R. Jayawardene. The assumption of power by the UNP in 1977 has been described as a paradigm shift in Sri Lanka's economic history.[3] The government of Prime Minster Jayawardene, who later became Sri Lanka's first President in 1978 after a major constitutional change that replaced a Westminster-style system with an executive Presidency, reopened Sri Lanka's economy to international trade and foreign investment, via several measures.

These measures, more fully described in Section 1.2 below, included establishing free trade zones, and creating a Greater Colombo Economic Commission in 1978 to facilitate foreign investment and drive economic development. Beginning in 1980, the Sri Lankan government also began entering into successive bilateral investment treaties ('BITs') and other treaties with investment provisions ('TIPs') with partner countries.

Sri Lanka's BITs and TIPs (collectively, 'international investment agreements' or 'IIAs') now number thirty-four in total,[4] the last of which was part of the Sri Lanka-Singapore Free Trade Agreement that was signed in January 2018 and according to the Ministry of Trade and Industry of Singapore is Sri Lanka's 'first and modern comprehensive free trade agreement.'[5] As indicated in Figure 1, however, Sri Lanka's BITs with major partner countries have not shown a correlative effect on Sri Lanka's foreign investment, which has grown haphazardly since the liberalisation of the economy in the late 1970s.

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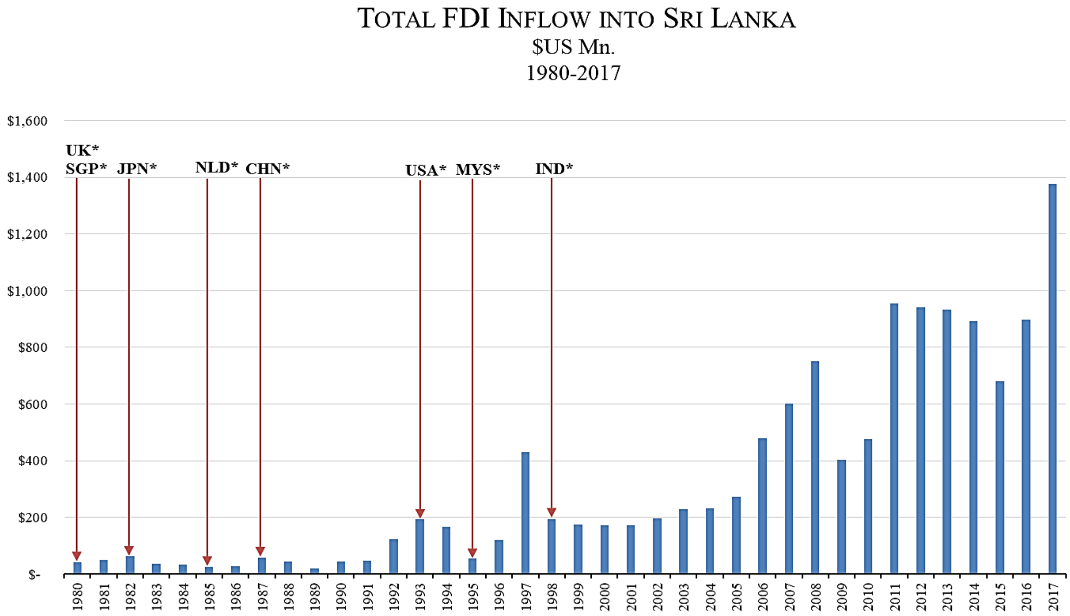
[2] Id.
[3] Id.
[4] UNCTAD Division on Investment and Enterprise. (2013). *Sri Lanka: Bilateral Investment Treaties.* [Online]. Available at: http://investmentpolicyhub.unctad.org/IIA/CountryBits/198#iiaInnerMenu [Accessed 4 Jan. 2019].
[5] Chia, L. (2018). *Singapore and Sri Lanka Sign Free Trade Agreement.* [Online]. Available at: https://www.channelnewsasia.com/news/singapore/singapore-and-sri-lanka-sign-free-trade-agreement-9886990 [Accessed 2 Jan 2019]

Figure 1: Sri Lanka's FDI growth, showing BITs with major partners



Sources: World Bank, World Development Indicators Database and Central Bank of Sri Lanka
*Notes: *BITs signed*
FDI is taken as defined on the IMF's Balance of Payments and International Investment Position Manual 6 Ed. (BPM6)

1983-2009: The years of civil war

The modern political history of Sri Lanka helps to explain the uneven growth in FDI. The UNP government, for all its economic reforms, did little to address the ethnic tensions in Sri Lanka that had been building for decades; and in particular, since the introduction of the 'Sinhala Only' Act in 1956 by the SLFP government of S.W.R.D. Bandaranaike.[6] The 1956 legislation replaced English as the official language with Sinhala, the language spoken by the Sinhalese majority who comprised approximately 70% of Sri Lanka's population at the time.[7] The complacency, and even complicity, by the UNP on the issue of ethnic relations eventually had calamitous political and economic effects.

Specifically, festering nationalist sentiments and minority grievances led to the outbreak of civil war in July 1983, which resulted in a (conservatively) estimated 80,000 deaths.[8] In the midst of the war, there was also a shift back towards a more protectionist economy, consistent with the centre-left policies of President Chandrika Kumaratanga (the daughter of S.W.R.D. Bandaranaike and Sirimavo Bandaranaike), who served as President of Sri Lanka from 1994 to 2005. It has been noted that 'protectionist pressure began to build in 2001, and from 2004, the relatively open trade policies of the

[6] The Official Language Act No. 33 (7 July 1956).
[7] Usip.org. (2001). *Simulation on Sri Lanka: Setting the Agenda for Peace*. [online] Available at: https://www.usip.org/sites/default/files/srilanka.pdf [Accessed 03 Jan. 2019].
[8] Usip.org. (2001). *Simulation on Sri Lanka: Setting the Agenda for Peace*. [online] Available at: https://www.usip.org/sites/default/files/srilanka.pdf [Accessed 03 Jan. 2019].

past were explicitly and systematically reversed … through the proliferation of a variety of para-tariffs.'[9]

Counter-intuitively, however, the bitter years of civil war in Sri Lanka did not stem the inflow of foreign investment. As has been observed, FDI increased from USD 47 million in 1979 to USD 752 million in 2008.[10] The civil war continued until a 'no-holds-barred military assault' ended it in 2009, under the government of then President Mahinda Rajapakse.[11] President Rajapakse's victory over the Liberation Tiger of Tamil Eelam (LTTE) rebels gave him the public support to remain in power until 2015, despite the increasing authoritarianism of his government, widespread allegations of corruption, and concern over a new foreign policy that strongly favoured China over India, Europe, and the United States (US).

Coalition governance since 2015

After decisively winning the 2010 presidential election, President Rajapakse lost the next election held in January 2015 to a candidate from his own party and his former Health Minister, Maithripala Sirisena. President Sirisena, who was elected on a manifesto promising '*yahapalanaya'* (good governance) has since governed in a coalition arrangement with the pro-market UNP, led by Ranil Wickremesinghe as Prime Minister, whose party won the national parliamentary elections held in August 2015.

The economic policy of the coalition government has been largely driven by Prime Minister Wickremesinghe, who is concurrently the Minister of National Policies and Economic Affairs. Key leadership positions in economic policy, including the Chairman of the Board of Investment of Sri Lanka and the Minister of Development Strategies and International Trade, have also been filled or appointed by the UNP.

Foreign investment initially declined from USD 0.9 billion in 2014 to USD 0.7 billion in 2015, a decrease that was attributed to policy uncertainty around the new coalition government,[12] which is an unprecedented alliance between members of the left-leaning SLFP and the pro-market UNP. As shown in Figure 2, however, foreign investment rebounded in 2016, and in 2017, rose to its highest-ever figure of USD 1.4 billion (USD 1.9 billion when including loans to the Board of Investment of Sri Lanka).

As observed in Part 2 of this paper, a substantial portion of foreign investment in 2017 came from China.[13] Before discussing the challenges to diversifying FDI and steadily increasing it to the

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[9] Ratnasabapathy, R. (2017). *Reviving Sri Lanka's exports and attracting FDI to the export sector – Echelon*. [online] Echelon.lk. Available at: http://echelon.lk/home/reviving-sri-lankas-exports-and-attracting-fdi-to-the-export-sector/ [Accessed 03 Jan. 2019].

[10] Thilakaweera, B., (2012). *Economic Impact of Foreign Direct Investment in Sri Lanka.* Staff Studies. 41(1) https://ss.sljol.info/article/download/4684/3784/ [Accessed 03 Jan. 2019]

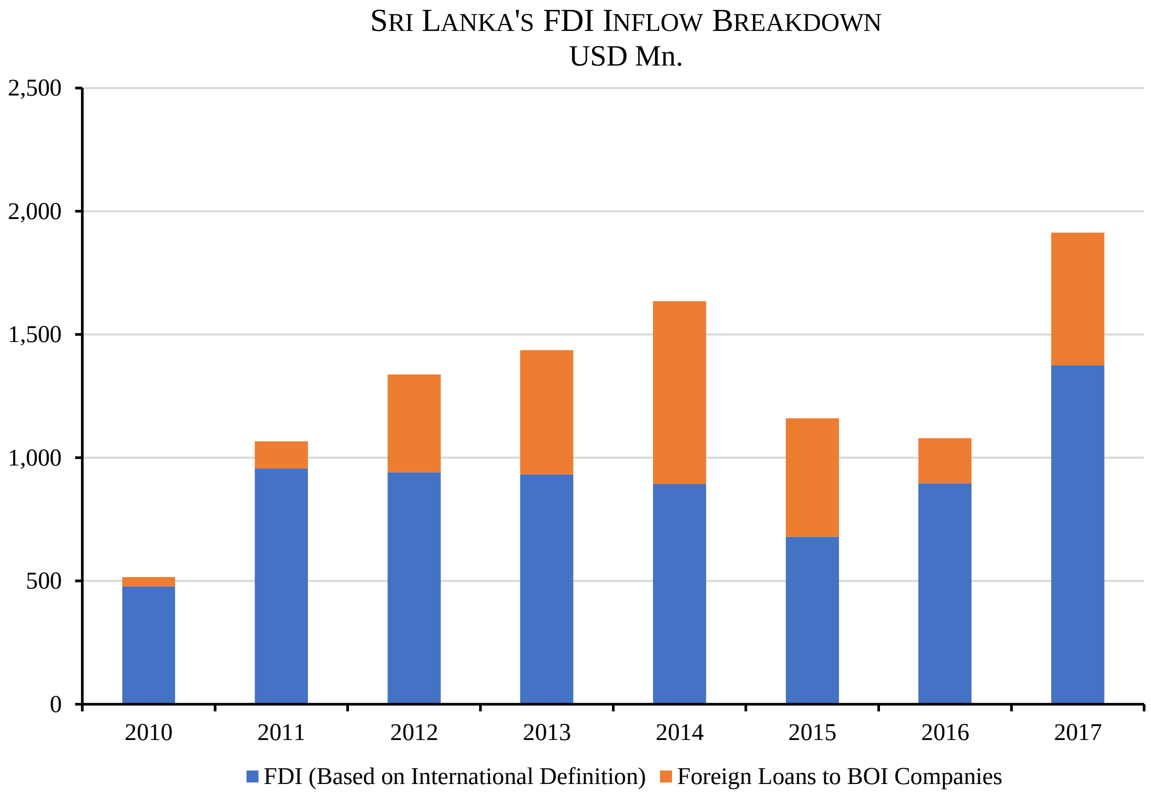
[11] Pethiyagoda, K. (2017). *Sri Lanka: A small state response to a multipolar world.*https://www.lowyinstitute.org/the-interpreter/sri-lanka-small-state-response-multipolar-asia

[12] World Bank. World Development Indicators Database. [Accessed 03 Jan 2019]; and Ft.lk. (2017). *FDI in 2016 dips 54% to $ 450 m as policy inconsistency weighs*. [online] Available at: http://www.ft.lk/article/594657/FDI-in-2016-dips-54--to---450-m-as-policy-inconsisten [Accessed 27 Nov. 2017].

[13] Information provided to authors by the Board of Investment of Sri Lanka (BOI).

government's current target of USD 5 billion in annual FDI by 2020,[14] it is worth understanding how foreign investment has been regulated in Sri Lanka and the perceived 'losses' to Sri Lanka of that regulation due to arbitral decisions in favour of foreign investors.

Figure 2: Sri Lanka's FDI breakdown



Source: Board of Investment, Sri Lanka and the Central Bank of Sri Lanka.

2.2 Regulatory Developments

International Context

The treaties of Friendship, Commerce and Navigation (FCN), which have been operational since the 18th century,[15] are regarded as precursors to modern BITs. These treaties were more concerned with trade than investment, and also contained provisions relating to peaceful navigation. However, their rules on the treatment of foreign nationals, and concepts such as the Most-Favoured-Nation (MFN) treatment, were transposed from FCN treaties to modern BITs. One feature of FCN treaties that is particularly relevant to the Sri Lankan context is that they envisaged contracting parties who were quite evenly balanced in bargaining power.

[14] Government of Sri Lanka, *Vision 2025: A Country Enriched*. [online] Available at: http://www.pmoffice.gov.lk/download/press/D00000000061_EN.pdf [Accessed 3 Jan 2019].
[15] Id, at p. 180.

The post-World War II era brought a different investment framework to that of FCN treaties. Newly independent states were poor and required financial assistance, yet there was no State capable of providing such assistance, since even relatively affluent nations had been weakened by the war. International financial institutions were established and were tasked with promoting foreign investment in newly independent States, hoping that the influx of capital would help spearhead economic growth. Such States began to invite foreign investment, and as the law of international trade and investment became more formalised, the legislative framework evolved as well.

The creation of the World Trade Organization (WTO) in 1995 brought in new standards to regulate global trade.[16] However, its signature investment agreement – the Agreement on Trade-Related Investment Measures (TRIMs) – remains surprisingly threadbare. The proliferation of BITs, in comparison to the TRIMs, exposes an underlying truth: States do not want to give up the bargaining power they possess vis-à-vis another State in a bilateral context by agreeing to common standards in a multilateral context.

Sri Lankan Framework

From a local perspective, as described above, Sri Lanka underwent a wave of nationalisation after gaining independence. After a closed-market system failed to generate economic growth, the government instituted an open economic model from 1977 and developed a legal regime to support this endeavour. The first step in this process was the creation of the Greater Colombo Economic Commission in 1978,[17] which was renamed the Board of Investment of Sri Lanka (BOI) in 1992.[18] The BOI aims to be a 'one stop shop' for the facilitation of foreign investment. It has the authority to grant approval for projects[19] under section 17 of the BOI Act,[20] and for projects under the Strategic Development Projects Act No. 14 of 2008.[21]

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[16] Wto.org. (2017). *WTO | Understanding the WTO - what is the world trade organization?*. [online] Available at: https://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm [Accessed 3 Jan. 2019].
[17] The Commission was created through the Greater Colombo Economic Commission Law No. 4 of 1978.
[18] The Commission was renamed as the Board of Investment of Sri Lanka [Act No. 4 of 1978].
[19] Section 16 of the Board of Investment Law (No. 4 of 1978), as amended (hereinafter, the "BOI Act"). This section permits entry of foreign investment without any fiscal concessions; the minimum required investment ris US$ 250,000. Trading is not permitted for those entering under this section. For more information, see the Board of Investment website, available at http://www.investsrilanka.com/wp-content/uploads/2018/07/legal_brochure_new.pdf [last accessed on].
[20] Id. Projects entering under section 17 require a higher investment commitment and are exempt from the application of several laws such as the Inland Revenue, Exchange Control and Customs [insert full name of Acts] provided the specified requirements are fulfilled.
[21] Id. Projects deemed to be of strategic importance to the country are granted approval in terms of this law, which provides the greatest possible fiscal exemptions, including the following laws:
The Inland Revenue Act, No. 10 of 2006
The Value Added Tax Act, No. 14 of 2002
The Value Added Tax Act, No. 14 of 2002
The Excise (Special Provision) Act, No. 13 of 1989
The Economic Service Charge Act, No. 13 of 2006
Nation Building Tax Act No. 09 of 2009
Port & Airports Development Levy Act No. 18 0f 2011
Customs Ordinance (Chapter 235)
The Sri Lanka Export Development Act No. 40 of 1979
The Betting and Gaming Levy Act No. 40 of 1988

Sri Lanka permits foreign investment to take place through a company incorporated under company registration laws,[22] or with the additional protection of a contract between the investor and the government, which may take place under the broader framework of a BIT. Currently, there are BITs in force between Sri Lanka and the following jurisdictions (stated in the order in which they came into force): South Korea, Singapore, United Kingdom, Switzerland, France, Sweden, Romania, Japan, Belgium-Luxembourg Economic Union, Netherlands, Denmark, Norway, China, Finland, Italy, United States, Malaysia, Thailand, Indonesia, India, Egypt, Pakistan, Germany, Australia, and the Czech Republic.

While not mandatory, investors may find it more advantageous to invest through a BIT, for additional protection to the investment. However, it is unclear whether Sri Lanka's BITs have had a positive impact on its foreign investment. As noted by Professor Sornarajah:

> 'Many smaller developing States have signed a large number of treaties *without witnessing* significant inward *investment flows* … Institutions which have assiduously promoted *investment* treaties, have expressed *scepticism* of the proposition that there is a *correlation* between *investment* treaties and *flows* of *investment*. They now seem to take the view that other factors such as *political stability and economic circumstances* play a greater role in *promoting investments*.' [23]

In addition to the standards in its BITs, Sri Lanka's membership of the WTO has mandated that certain standards – like MFN treatment and National Treatment Standard – be maintained in the treatment of investors and investments.[24]

2.3 Case Law

Given the political challenges to foreign investment in Sri Lanka – including civil strife and continued policy uncertainty, and the resulting likelihood of disputes – the means of dispute resolution in Sri Lanka, as well as how the government responds to legal action against it, are crucial factors by potential foreign investors in the country.

As in other countries, the primary method of resolving a legal dispute is the court system. The law relating to commercial disputes was developed almost exclusively by domestic courts.[25] In disputes involving foreign investment, however, international arbitration tribunals generally hear cases between investors and states.

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[22] k.practicallaw.thomsonreuters.com. (2017). *Doing business in Sri Lanka: overview*. [online] Available at: https://uk.practicallaw.thomsonreuters.com/w-007-2092?transitionType=Default&contextData=(sc.Default)&firstPage=true&bhcp=1 [Accessed 3 Jan. 2019].
[23] Sornarajah, M. (2017). *The International Law on Foreign Investment*. 4th ed. Cambridge University Press, p.222. (Emphasis added).
[24] Board of Investment website, *supra* note [22].
[25] Sloss, D. and Van Alstine, M. (2017). *International Law in Domestic Courts*. [online] Available at: http://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1891&context=facpubs [Accessed 3 Jan. 2019].

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At present, there are several options for arbitration. Almost every nation, including Sri Lanka, has its own arbitration centre.[26] Sri Lanka is also a signatory to the New York Convention[27] governing international arbitrations, and a contracting State of the International Centre for Settlement of Investment Disputes (ICSID) Convention.[28] Though Sri Lanka's record as a host State for foreign investment is not impressive, its record in international dispute resolution is remarkable, as is evident from the three decisions explained below.

i. Asian Agricultural Products Ltd. v. Democratic Republic of Sri Lanka (1990)

Sri Lanka was a party to the second ICSID arbitration involving an Asian host State, known as the 'AAPL case,'[29] which involved the destruction of a shrimp farm in an area of Sri Lanka where hostilities took place. The investor was a Hong Kong company, which alleged that rebel fighters took refuge in the shrimp farm, and that security forces retaliated by destroying the farm and killing many people.

The claimant company asserted the liability of the government, under the BIT that existed between the UK and Sri Lanka. It invoked Article 2 of the BIT, which guaranteed full protection and security to the investment, and Article 4(2), which required the government to pay adequate compensation for losses suffered by investors due to war or any other civil disturbances. The tribunal rejected the claimant's contention that Article 2 of the BIT imposed a strict liability on the government and was also unwilling to proceed against the government on the basis of Article 4(2), as it was not clear from the evidence whether the government forces were solely to blame for the attacks.

The tribunal proceeded, however, to hold the Sri Lankan government liable under general principles of international law, stating that it failed to take reasonable measures to prevent the destruction and loss of life. That an ICSID tribunal chose to use general principles of international law (instead of specific treaty provisions) to solve a question of international investment law was controversial, causing considerable debate in legal circles and in academic writing.[30] Though the government thereby had grounds to challenge the award or refrain from paying compensation, it chose to honour the award. This was probably because several other investors would have been keeping a watchful eye on the proceedings, with a view to making decisions on investing in Sri Lanka.

[26] The Arbitration Centre of the Institute for the Development of Commercial Law and Practice (ICLP), situated in Colombo, had ambitious plans to become the arbitration hub for South Asia but unfortunately, the ethnic conflict prevented this from happening. The ICLP facilitates many domestic arbitrations. Since Sri Lanka is a signatory to the New York Convention, the awards given by the ICLP can be enforced in many other jurisdictions.

[27] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958. Available Online: https://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/New-York-Convention-E.pdf

[28] *ISCID Convention, Regulations and Rules 2006, Available Online: https://icsid.worldbank.org/en/documents/icsiddocs/icsid%20convention%20english.pdf*

[29] *ASIAN AGRICULTURAL PRODUCTS LTD (AAPL) v REPUBLIC OF SRI LANKA* [1990] CASE No. ARB/87/3 (International Centre for the Settlement of Investment Disputes (ICSID)

[30] Id. Sornarajah notes, at p. 97, that "the competence of the tribunal to deal with such issues must be raised. It was never intended by the creators of ICSID that ICSID tribunals should have jurisdiction to deal with general areas of state responsibility. C.F. Amerasinghe also wrote a critique of the award, in *Prawn Farm Arbitration*, Sri Lanka Journal of International Law, (1992) 98, in which he questions the composition of the tribunal and its competence to decide on matters of international law.

ii. Mihaly International Corporation v. Democratic Republic of Sri Lanka (2002)

A later case, which Sri Lanka won but which spawned a range of literature on the definition of 'investment', and what types of pre-contractual undertakings can be included as 'investment,' is that of *Mihaly v. Sri Lanka*.[31]

Mihaly International Corporation was a Canadian power company, which wanted to build a power generation facility in Sri Lanka. During negotiations between its subsidiary, Mihaly (Canada) and the government of Sri Lanka, several documents including letters of intent were exchanged between the parties, which expressly denied the existence of any legal obligations until signing of the final contract relating to the investment. This planned final contract never transpired. All that remained from the abandoned negotiations were some initial costs borne by Mihaly (Canada) for preparatory work associated with the project.

Mihaly (Canada) was sufficiently frustrated about the waste of time and money that it wanted to take action against the government. As Canada was not a party to the ICSID Convention and, therefore, could not invoke its jurisdiction, Mihaly (Canada) assigned all its interests and claims to a related company, Mihaly (USA), which initiated the ICSID claim and invoked provisions of the US-Sri Lanka BIT. Mihaly (USA) requested reimbursement of pre-investment and development expenses, including lost profits.[32] Sri Lanka raised objections on two grounds. First, it contested the jurisdiction of the centre and tribunal, by questioning the purported relationship between Mihaly (Canada) and Mihaly (US). Second, it contested the existence of an 'investment' under Article 25 of the ICSID Convention.

While the tribunal held that Mihaly (US) had capacity to file the claim, it agreed with the state's second objection, and found that the company's pre-investment expenditures did not amount to 'investment' under Article 25 of the ICSID Convention.[33] The tribunal therefore found it unable to consider the substantive matters of the case and dismissed it. Although Sri Lanka proposed that the claimant pay costs, the final award required each party to bear its own costs.

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[31] *Mihaly International Corp. v. Democratic Socialist Republic of Sri Lanka* (ICSID Case No. ARB/00/2), 17 ICSID REVIEW 142 (Spring 2002) (hereinafter "the award"). See comments on the award as well as the classification of pre-investment expenses as investment in Dugan et al, Investor-State Arbitration, Oxford University Press, 2008, at pp. 288-289. The award was also analysed by Robert N. Hornick in "The Mihaly Arbitration: Pre-Investment Expenditure as a Basis for ICSID Jurisdiction", Journal of international Arbitration 20(2): 189-197, 2003. See also Devashish Krishnan, A Notion of ICSID Investment, available at https://www.transnational-dispute-management.com/article.asp?key=1348 [last accessed on 3 Jan 2019]; and Dilini Pathirana, who analyses the cases from a Sri Lankan perspective in relation to BITs and investor-state arbitration in *An Overview of Sri Lanka's Bilateral Investment Treaties: Status Quo and Some Insights into Future Modifications*, Asian Journal of International Law, 7 (2017), pp. 287–31.

[32] Hornick, *The Mihaly Arbitration*, note 24, p. 190

[33] Though the concurring opinion of Arbitrator Suratgar suggested that pre-investment expenses should be considered under the definition of investment, and this view was supported by Robinson, nevertheless, such a position is not favoured by Hornick, who points out that "the potential benefit of providing an international forum in which to arbitrate pre-investment disputes must be carefully weighed against the potential burden to states. This burden is likely to be much greater in the case of pre-investment disputes than in the case of investment disputes." (Hornick, p. 192).

iii. Deutsche Bank AG v. Democratic Republic of Sri Lanka (2012)

The third and final concluded international case, known as the 'Deutsche Bank case'[34] is actually one of four related cases that arose from oil hedging activity by the Ceylon Petroleum Corporation (CPC), a governmental entity. In early 2007, CPC entered into hedging agreements with five banks – namely, Standard Chartered Bank (SCB or Standard Chartered), Citibank, Deutsche Bank (Deutsche), People's Bank of Sri Lanka and the Commercial Bank of Ceylon. These hedging agreements between CPC and the banks proposed to limit CPC's liability if the price of oil rose further, by fixing a ceiling price of USD 130 per barrel (pb) and a floor price of USD 100 pb for what CPC would purchase through the banks.

Unfortunately for CPC, the price of oil dropped drastically from USD 130 pb at the end of 2006 to around USD 60 pb after the 2008 global financial crisis. The agreement, therefore, became onerous for the CPC and by extension, for the Sri Lankan government. It eventually suspended the transaction on the basis that the hedging agreement was 'substantially tainted.'[35]

This resulted in CPC defaulting on its payments, which led to SCB and Citibank filing action against CPC, and Deutsche filing action against the State. Standard Chartered filed action in the High Court of London, which held in favour of the bank, for a sum of USD 180 million. Citibank took its claim to the London Court of International Arbitration (LCIA), in April 2011, with the seat of arbitration in Singapore.[36] Its claim, made against CPC rather than against the State, was in a sum of USD 192 million plus interest. CPC succeeded because it could prove that it was the speculative nature of the contract that was at issue, and not the hedging derivative contract. The speculative contract was beyond CPC's capacity and, therefore, the contract was void.

By contrast, Deutsche initiated arbitral proceedings against the State of Sri Lanka, at ICSID in Washington DC. The tribunal had to consider whether the hedging agreement between Deutsche and CPC was an 'investment.' This was done by testing the facts against the terms of both the Germany-Sri Lanka BIT and Article 25 of the ICSID Convention.[37] The tribunal relied somewhat loosely on Deutsche's negotiations and correspondence with the CPC and Central Bank of Sri Lanka to hold that the hedging contract was indeed an 'investment' and awarded Deutsche USD 60 million.[38]

[34] *Deutsche Bank Ag v. Democratic Socialist Republic of Sri Lanka* [2012] ICSID Case No. Arb/09/02 (International Centre for Settlement Of Investment Disputes Washington, Dc)
[35] Woo, J. and Heo, U. (2009). *Corruption and Foreign Direct Investment Attractiveness in Asia*. [online] Wiley Online Library. Available at: http://onlinelibrary.wiley.com/doi/10.1111/j.1943-0787.2009.01113.x/abstract [Accessed 3 Jan. 2019], note 29.
[36] Hepburn, J. (2017). *Domestic law in international investment arbitration*. Oxford, p.159.
[37] *ISCID Convention, Regulations and Rules 2006* Article 25 deals with the jurisdiction of the centre. Article 25 (1) reads thus: "The jurisdiction of the Centre shall extend to any legal dispute arising *directly out of an investment*, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally. (Emphasis added).
[38] UNCTAD. (2009). *Investment Settlement Dispute: Deutsche Bank v. Sri Lanka.* [Online]. Available at: http://investmentpolicyhub.unctad.org/ISDS/Details/337), [Accessed 3 Jan. 2019]

Ongoing case

More recently, a British investor has filed action against the Sri Lankan government at the ICSID under the UK-Sri Lanka BIT[39] over the re-acquisition of land close to the Parliament complex in Kotte (near Colombo), which had earlier been given to construct a hotel. The case has been filed by the investor, Raymond Eyre and his company Montrose Developments, and will likely again see Sri Lanka cooperate with the process and respect the outcome.

Policy implications of the cases

A point of concern from the above concluded cases is the manner in which arbitral tribunals interpret treaty provisions. In the Deutsche Bank case, the tribunal broadly interpreted the term ‘investment,’ but did not justify why it did so by referring to valid sources of law. Even though tribunals are not bound by the same standards as courts of law, their awards can later be persuasively cited by judges and become concretised into judicial standards.

A related point of concern is the extent to which arbitral tribunals tend to repeat the decisions of previous tribunals, in a similar manner to the rules of judicial precedent. Arbitral tribunals are not expected to follow precedent, but there seems to be a growing trend to do so.[40] This may be influenced by the fact that the same set of arbitrators repeatedly sit on tribunals, or that arbitrators follow the same line of thinking.

Therefore, if a previous tribunal has adopted an extremely liberal interpretation of a particular term there is a danger of that term becoming the standard definition after being adopted a few times.[41] This is a cause for concern for Sri Lanka, which has lost two out of three ISCID cases, on points that could have been challenged.[42] Such experiences may induce developing States like Sri Lanka to reconsider its recourse to ICSID arbitration and instead look to other options.

3. Current context and policy priorities

The analysis in Part 1 above of Sri Lanka’s political history and its experience of regulating foreign investment reveals Sri Lanka’s challenges to steadily increasing its FDI. Despite establishing its BOI

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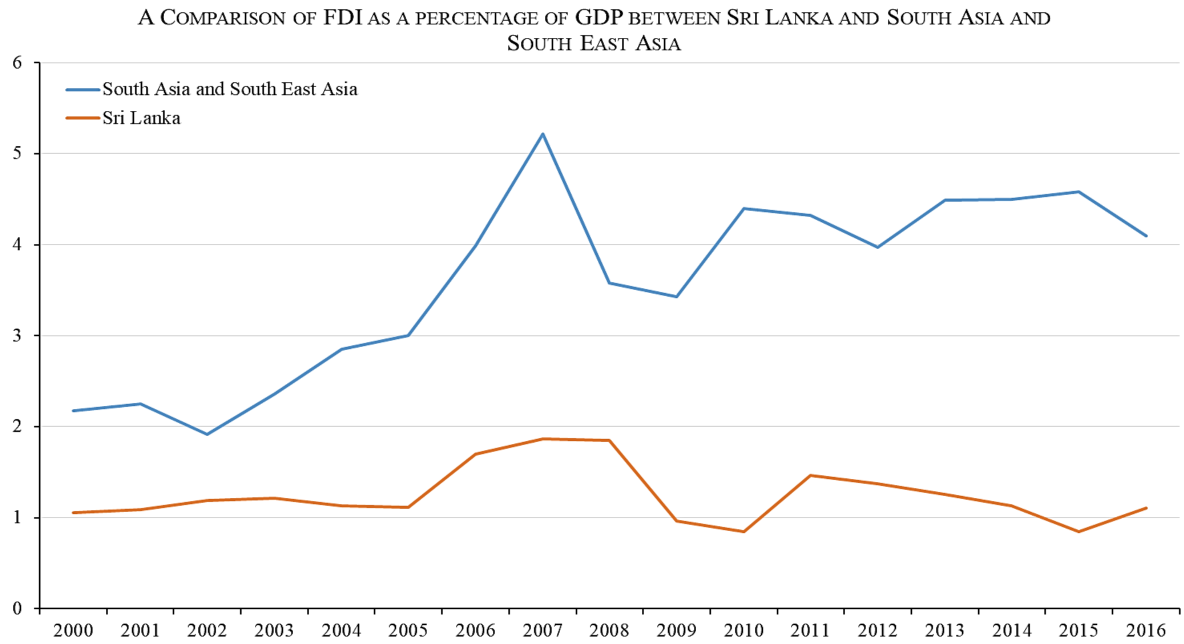
[39] *Raymond Charles Eyre and Montrose Developments (Private) Limited v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/16/25. Also see The Sunday Times, 'Re-acquisition of Kotte land: British investor takes Lanka to ICSID', accessible at www.sundaytimes.lk/171022/news/re-acquisition-of-kotte-land-british-investor-takes-lanka-to-icsid-265337.html (last accessed 6 March 2018).
[40] Kaufmann-Kohler, G. (2006). *Arbitral Precedent: Dream, Necessity or Excuse?*. [online] Arbitration-icca.org. Available at: http://www.arbiicca.org/media/4/77507134886347/media012319143087130009500 01.pdf [Accessed 3 Jan. 2019].
[41] Sornarajah has raised the issue of the legitimacy of arbitral tribunals making “soft law.” Sornarajah, note 1, p. 423
[42] In the Deutsche case, for example, the tribunal did not consider that the state was a client of the bank, and that the bank owed an ethical duty to inform the client of any unfavourable conditions that might arise from the contract. It is also contended that the complexities of the hedging agreement were beyond the comprehension of the CPC officials, but were very well understood by the banks. Clearly, the CPC entered into the hedging agreement without fully understanding the implications of a crash in oil prices. The dissenting opinion in the Deutsche award refers to all these factors, which the majority opinion glossed over.

and other relevant national institutions, having over two dozen BITs and complying with international legal decisions even when they could have been challenged in law, Sri Lanka is yet to see a sustained upward trend in its FDI, a factor which has in turn constrained its economic growth.

Sri Lanka's relatively unimpressive record in attracting FDI can be seen in Figure 3 below and is amplified when comparing Sri Lanka to neighbouring economies.[43] This disparity does not simply reflect economic fluctuations and it is necessary to also examine the underlying domestic factors in Sri Lanka.

Figure 3: FDI as Share of GDP in South and South East Asia vs. Sri Lanka, 2000-2016



Source: World Bank, World Development Indicators. Accessed March 2018
Note: South Asia and South East Asia countries include: Afghanistan, Bangladesh, Bhutan, Brunei, Cambodia, India, Indonesia, Lao PDR, Malaysia, Maldives, Myanmar, Nepal, Pakistan, Philippines, Singapore, Thailand, Timor-Leste and Vietnam.
A simple average was calculated.

3.1 Political Challenges

The lack of steady growth in Sri Lanka's FDI can be attributed to multiple intersecting factors, which can be broadly categorised as *political* and *legal* factors. Among the political factors, explained in this section 2.1, the key challenge has been a lack of policy consensus and consistency – both at the national level and with respect to Sri Lanka's foreign policy. In particular, there has not been a sufficient and cross-partisan will to move quickly to a user-friendly and rules-based framework of FDI, which can attract diverse sources of foreign investment for reasons other than infrastructure projects. These challenges are detailed below.

[43] Id.

Partisan Policymaking and 'Leader-Driven' Investment

Sri Lanka's national political system remains highly partisan, with a civil service and civil actors (e.g. think tanks) that are relatively weak[44] and, therefore, unable to support consistent policies on foreign investment. As described in section 1.1 above, governments have swung between socialist, open-market, and social market systems since the 1970s. Although a return to a closed-market system is no longer likely, the governments of the day nevertheless continue to pursue different investment policies and institutional structures without a multi-party, democratic consensus on basic policy tenets that can survive a change in government.

In the absence of such a cross-partisan consensus, FDI in Sri Lanka has depended on individual leaders and their networks, rather than on the BOI and more broadly, a national institutional and policy framework. The clearest recent example of this is the authoritarian Rajapakse government and its personally-driven procurement of large infrastructure projects, particularly those funded by China. These included highways, port development projects in Colombo and Hambantota, and major hotel development projects with foreign chains.[45]

Drawbacks of 'Leader-driven' Investment

This 'leader-driven' model of foreign investment has at least two drawbacks, compared to the 'rules-based' model in developed countries, in which investors rely on a clear and efficient legal framework that operates irrespective of the leader or party in power. The first drawback is that a 'leader-driven' model is, almost by definition, more prone to economic leakages via corruption than a rules-based model. There remains an unfortunate tolerance for corruption in Sri Lanka, among segments of the public who consider it a trade-off for efficiency.[46] Repeated studies make clear, however, that corruption is not conducive to economic development and specifically, does not increase FDI.[47]

The second drawback of a 'leader-driven' model of foreign investment is that it is dependent on the personality and proclivities of the leaders in power. A relatively uncharismatic leader, for example, may be less successful in securing FDI than his or her more persuasive predecessor. Moreover, investors may need to devote considerable time to ingratiating themselves with incumbent leaders, to enter and remain in the market. Even if they do this, they could still be driven out of the market for spurious or otherwise unpredictable reasons, as happened in 2008 in Sri Lanka when the Rajapakse government took actions that induced Emirates Airlines to end its management contract with Sri Lankan Airlines.

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[44] Aliff, S. and Sarjoon, A. (n.d.). *The Role of Civil Society in Democratic Governance: State-Civil Society Relations In Democratization: Special Focus On Contemporary Sri Lanka*. [online] Ir.lib.seu.ac.lk. Available at: http://ir.lib.seu.ac.lk/bitstream/handle/123456789/424/KALAM%20iv-26.pdf?sequence=1 [Accessed 3 Jan. 2019].
[45] Annual Performance Report. (2014). [online] Ministry of Highways, Ports & Shipping. Available at: https://www.parliament.lk/uploads/documents/paperspresented/performance-report-ministry-of-highways-ports-and-shipping-2014.pdf [Accessed 3 Jan. 2019].
[46] Jayasuriya, R. (2015). *Was corruption under the Rajapaksa regime "Efficient"?*. [online] Dailymirror.lk. Available at: http://www.dailymirror.lk/73697/was-corruption-under-the-rajapaksa-regime-efficient [Accessed 3 Jan. 2019].
[47] Woo, J. and Heo, U. (2009). *Corruption and Foreign Direct Investment Attractiveness in Asia*. [online] Wiley Online Library. Available at: http://onlinelibrary.wiley.com/doi/10.1111/j.1943-0787.2009.01113.x/abstract [Accessed 3 Jan. 2019].

Foreign Policy Challenges: Non-Alignment in Name

As a related issue to the absence of a clear *national* framework that encourages foreign investment, there has been inconsistency in Sri Lanka's *foreign* policy. In principle, Sri Lanka has had a 'non-aligned' foreign policy since the Cold War,[48] which maintains neutrality between the great powers. In practice, however, its foreign relations with the US, Europe, China and India, have significantly changed course with successive elections and governments.[49] Each government in Sri Lanka has sought to 'rebalance' the (perceived and actual) foreign tilts of its predecessor – a practice that has unfortunately resulted in a swaying foreign policy, rather than a 'balanced' one that would be expected from a non-aligned stance.[50]

Recent experience illustrates this problem. In the aftermath of the civil war that ended in 2009, Sri Lanka faced international criticism (largely, but not solely, by Western governments and non-governmental actors), including at the UN Human Rights Council in Geneva.[51] The Rajapakse government responded by engaging less with the US and India (who supported resolutions in the UN Human Rights Council on human rights and transitional justice issues in Sri Lanka)[52] and engaging significantly more with a small array of governments who expressed little or no interest in issues of human rights and justice, especially with China.[53]

Unsurprisingly, therefore, the greatest growth in FDI in the final years of the Rajapakse government (2012-2014) came from China, with China becoming the top source of FDI in 2013.[54] Equally, FDI declined in these years from India, Japan, and the UAE, with a modest increase in FDI from the US.[55] After the government changed in 2015 and reviewed the Colombo Port City project (now known as the Colombo International Financial City or CIFC), Chinese investment declined markedly in the years 2015 and 2016 – as shown in Figure 4.

As Figure 4 also shows, however, Chinese investment surged again in 2017. This appears to reflect the government's decisions in 2016 to allow the CIFC to resume (albeit under a long lease, rather than the freehold arrangement envisioned by the Rajapakse government) and to accept major new Chinese investments; decisions that appear to be driven by concern over the low levels of foreign investment

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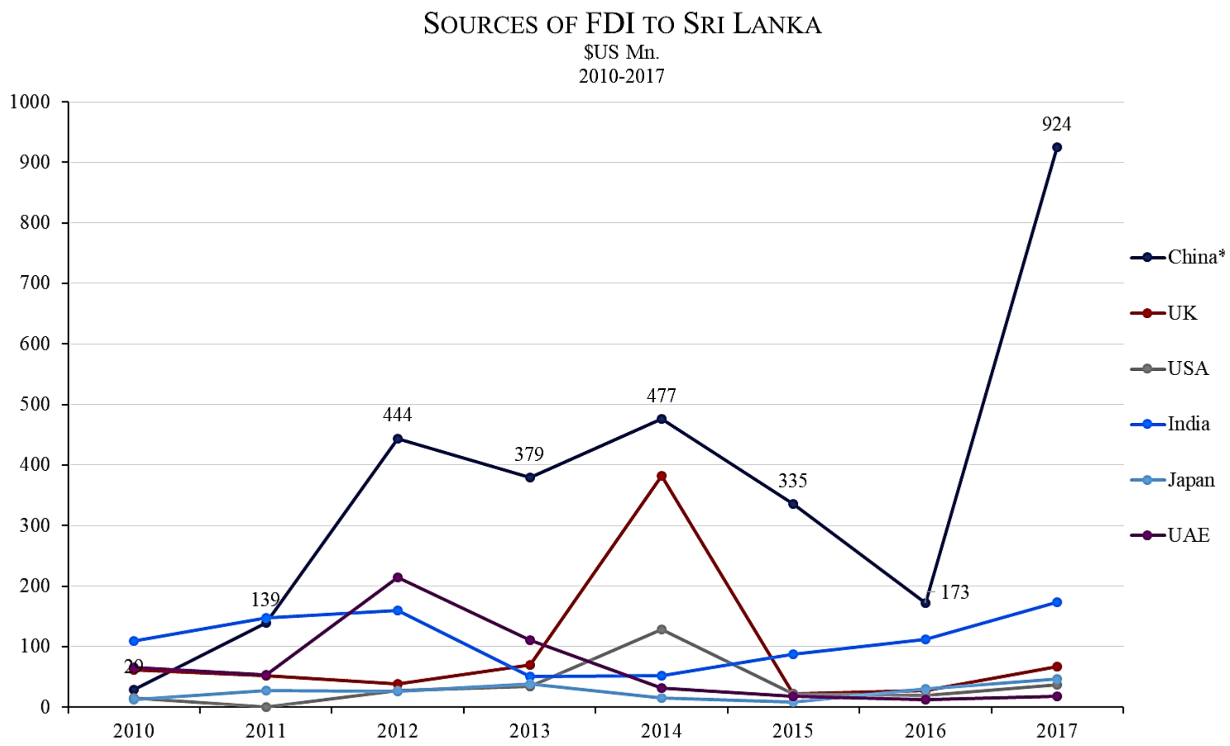
[48] The Island (2012). Non Aligned Summit in Colombo, 1976. [online] Available at: http://www.island.lk/index.php?page_cat=article-details&page=article-details&code_title=45077 [Accessed 3 Jan. 2019].
[49] De Mel, N. (2017) *Remarks at the Sri Lanka Foreign Policy Forum*, available at https://soundcloud.com/lk_institute/day-1-session-1-foundations-of-sri-lankan-foreign-policy
[50] Ibid.
[51] Ramakrishnan, T. (2015). U.N. body asks Sri Lanka to probe 'rights abuses'. *The Hindu*. [online] Available at: http://www.thehindu.com/news/international/unhrc-adopts-consensus-resolution-on-sri-lanka/article7712259.ece [Accessed 3 Jan. 2019].
[52] Sathiya Moorthy, N. (2016). *UNHRC Bug Now Bites India, But Sri Lanka Is Where the Action Is Still… | The Sunday Leader*. [online] Thesundayleader.lk. Available at: http://www.thesundayleader.lk/2016/09/19/unhrc-bug-now-bites-india-but-sri-lanka-is-where-the-action-is-still/ [Accessed 3 Jan. 2019].
[53] Mfa.gov.lk. (2013). *China – Sri Lanka Relations an All Weather Partnership – Vice President of China*. [online] Available at: https://www.mfa.gov.lk/ta/4419-china-sri-lanka-relations-an-all-weather-partnership-vice-president-of-china/ [Accessed 17 Oct. 2017].
[54] Deyshappriya R., (date) *China is Sri Lanka's biggest source of FDI, but there's room for more*. Available at: http://blogs.lse.ac.uk/southasia/2017/09/12/china-is-sri-lankas-biggest-source-of-fdi-but-there-is-room-for-more/ [Accessed date 3 Jan 2019]
[55] Id.

in 2015 and 2016 and about servicing accumulated external debt.[56] Most notably, the government agreed to a USD 1.1 billion investment by China Merchants Port Holdings in the Hambantota port, the first instalment of which it received in 2017.[57]

Figure 4: Sources of FDI to Sri Lanka 2010-2017



Source: Board of Investment, Sri Lanka
*Notes: *China figure includes Hong Kong*

The swings in the sources of foreign (and especially Chinese) investment underscore the recurring challenge of Sri Lanka's foreign policy. That challenge is to maintain consistently good relations with all major powers, in a manner that doesn't interrupt the potential flow of investments from any bloc or country, and which maintains the confidence of even politically 'unconnected' investors.

Limits of Playing the 'China Card' to Increase FDI

The strategic concern of India and other countries, about China's rise in stature and its presence in Sri Lanka, has prompted some to argue that Sri Lanka should play the 'China card' against these countries,

[56] Nimal Sanderatne, *2018 crucial for strengthening foreign reserves to meet massive debt repayment in 2019*, available at http://www.sundaytimes.lk/180121/columns/2018-crucial-for-strengthening-foreign-reserves-to-meet-massive-debt-repayment-in-2019-278032.html [Last Accessed 17 Nov 2018].
[57] Ft.com. (2017). *China-owned port in Sri Lanka could alter trade routes*. [online] Available at: https://www.ft.com/content/f0d88070-9f99-11e7-9a86-4d5a475ba4c5 [Accessed 21 Nov. 2017]. The Maritime Executive. (2017). *India and China Face Off at Sri Lankan Port*. [online] Available at: https://maritime-executive.com/article/india-and-china-face-off-at-sri-lankan-port [Accessed 3 Jan. 2019].

to secure more investment from them.[58] This, however, would be at best a limited approach, and at worst a risky strategy, for Sri Lanka. In particular, it will be difficult for Sri Lanka to secure substantial investments from India and other countries in the short to medium term, given their relative lack of investment funds, compared to the USD 50 billion that China has already spent worldwide to support its expansive and long-term Belt and Road Initiative.[59]

Moreover, to the extent that investment can be sourced from India, Japan and similarly concerned countries, playing to their fears is unlikely to incentivise the type of FDI that Sri Lanka most needs – including FDI to stimulate exports and tap into global supply chains.[60] Instead, playing the 'China card' is more likely to induce additional 'strategic' investments that mitigate other countries' anxieties about Chinese investments. Indeed, among the investments that India and Japan appear to be considering at the time of writing are investments in an airport close to Hambantota port[61] and in the port of Trincomalee on Sri Lanka's east coast.[62]

To increase and diversify FDI for its own varied needs, it is, therefore, important that Sri Lanka move beyond simply playing into India's fears or China's interests and that it focuses on developing a broader, investor-friendly framework via the multi-step plan detailed in section 2.3 below.

Comparative analysis

Competitor host States in the region offer instructive examples of how to build an effective and *consistent* policy on foreign investment and it is especially worth examining the successful examples of democracies, given that it is easier to achieve a consistent policy in a one-party State like Vietnam or China. In the region, two useful examples are New Zealand (a liberal democracy) and Singapore (which might be described as a directed democracy, governed in practice by a single party, albeit with elections).[63]

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[58] Srinivasan, M. (2016). *'Sri Lanka a pearl in the Indian Ocean'*. [online] The Hindu. Available at: http://www.thehindu.com/news/international/south-asia/xi-jinping-to-launch-port-city-in-sri-lanka/article6415994.ece [Accessed 26 Nov. 2017].

[59] Perlez, J. and Huang, Y. (2017). *Behind China's $1 Trillion Plan to Shake Up the Economic Order*. [online] Nytimes.com. Available at: https://www.nytimes.com/2017/05/13/business/china-railway-one-belt-one-road-1-trillion-plan.html [Accessed 29 Nov. 2017]. The exact amounts are unclear (Shepard, W. (2017). *Why the Ambiguity of China's Belt And Road Initiative Is Perhaps Its Biggest Strength*. [online] Forbes.com. Available at: https://www.forbes.com/sites/wadeshepard/2017/10/19/what-chinas-belt-and-road-initiative-is-really-all-about/#5138ab9de4de [Accessed 24 Nov. 2017]

[60] Wignaraja, G. (2017). *Sri Lanka's Future Lies in Emulating Factory Asia - The Lakshman Kadirgamar Institute*. [online] The Lakshman Kadirgamar Institute. Available at: http://www.lki.lk/publication/sri-lankas-future-lies-emulating-factory-asia/ [Accessed 30 Nov. 2017]

[61] Srinivasan, M. (2017). *India keen to run Sri Lanka airport*. [online] The Hindu. Available at: http://www.thehindu.com/todays-paper/tp-international/india-keen-to-run-sri-lanka-airport/article19477500.ece [Accessed 23 Oct. 2017].

[62] Slpa.lk. (2016). *Trincomalee Port*. [online] Available at: http://www.slpa.lk/port-colombo/trincomalee [Accessed 21 Nov. 2017].

[63] Nzhistory.govt.nz. (2018). Treaty of Waitangi | NZHistory, New Zealand history online. [online] Available at: https://nzhistory.govt.nz/politics/treaty-of-waitangi [Accessed Date?].

Importantly, New Zealand and Singapore are also multicultural nations that have long prized *ethnic harmony* as a bedrock of their stable political environments. New Zealand has pursued this since at least 1840, the date on which the British Crown signed the Treaty of Waitangi with indigenous Maori chiefs.[64] More recently, New Zealand has facilitated the peaceful relations of its peoples by enacting the New Zealand Human Rights Act of 1993, and by a Human Rights Commission which implements a pro-diversity cultural programme.[65] While, in Singapore, ethnic harmony has been facilitated by use of English as the country's main working language, notwithstanding recognition of three other official languages (Malay, Mandarin and Tamil).[66] A common language has enabled easy interaction among the Malay, Chinese and Tamil communities – Singapore's three main ethnic groups. Singapore's language policy is complemented by other measures to ensure interracial harmony, including an electoral system that guarantees significant minority representation in Parliament and ethnic quotas in public housing schemes.[67]

As a result of these policies, those considering whether to invest in New Zealand and Singapore can remain confident that a peaceful multiculturalism will prevail in those countries, and thereby not adversely affect their investments.

Both countries also have *strong national brands*, to underscore their drive for foreign investment. New Zealand has maintained its '100% Pure New Zealand' brand since 1999, despite a change of the party in government in 2008 and another in 2017.[68] Singapore has periodically changed its national brand (it was previously known as the 'Garden City' and most recently, the government adopted a 'Passion Made Possible' brand that shows a mindset of enterprise and determination).[69] However, it has pursued a consistent objective in rebranding, namely to highlight different positive aspects of Singapore and 'adaptability to customer needs.'[70] It has also been noted that Lee Kuan Yew's almost daily pronouncements on Singapore's governance and foreign relations provided a 'sub-text [that] was really nation branding, even if no one overtly mentioned the term.'[71] This helped investors to trust Singapore to maintain a strong governance framework, with stability in its foreign relations.

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[64] No. 82 of 1993; available at http://www.legislation.govt.nz/act/public/1993/0082/latest/DLM304212.html

[65] Hrc.co.nz. Human Rights Commission: The NZ Diversity Action Programme. [online] Available at: https://www.hrc.co.nz/your-rights/race-relations-and-diversity/race-relations/our-work/nz-diversity-action-programme-te-ngira/ [Accessed 19 Apr. 2018].

[66] Republic of Singapore Act (Act 9 of 1965, as amended), section 7, available at http://statutes.agc.gov.sgf

[67] For two different perspectives on these policies, see (1) Chan Sek Keong, *Multiculturalism in Singapore: A Way to a Harmonious Society*, Singapore Academy of Law Journal (2013), at p. 84, available at http://journalsonline.academypublishing.org.sg/Journals/Singapore-Academy-of-Law-Journal/e-Archive/ctl/eFirstSALPDFJournalView/mid/495/ArticleId/500/Citation/JournalsOnlinePDF; and (2) The Economist, 15th December 2006, *Singapore expands its paternalistic policy on race*, available at https://www.economist.com/news/asia/21711939-president-will-now-be-chosen-partly-racial-criteria-singapore-expands-its-paternalistic

[68] See http://www.purenewzealandproducts.com or http://buypurenewzealand.com/

[69] Straits Times, *Singapore's new international brand by STB and EDB: Passion Made Possible*, 24 August 2017, at www.straitstimes.com/singapore/singapores-new-international-brand-by-stb-and-edb-passion-made-possible

[70] Koh Buck Song, *Brand Singapore: Nation Branding After Lee Kuan Yew in A Divisive World*, 2nd edn (2017).

[71] Ibid.

Lastly, New Zealand and Singapore have demonstrated a consistent commitment to enhancing three key factors in attracting FDI: (i) plentiful and high-quality *human resources*, which enables businesses to scale rapidly; (ii) *infrastructure and connectivity*, both physical and digital;[72] and (iii) a *corruption-free* society. Both countries have consistently ranked among the best in the world on all three of these aspects.

2.2 Legal Issues and Needs

Overlapping Laws and Institutions

Sri Lanka also has to streamline its legal regime that governs foreign investment, which includes the following laws:[73] the BOI Act,[74] the Companies Act,[75] the Exchange Control Act,[76] the Strategic Development Projects Act,[77] and the Finance Act.[78] In addition, there are many governmental agencies whose approval may be required to commence operations, and administrative delays on their end can be disastrous for an investment.

To speed up the process, the BOI has proposed an online one stop shop (OSS), i.e. a 'single window' virtual platform that would receive an application for investment and forward it to the various institutions whose approval is required. Currently, a staggering 25 different authorities are involved, indicating the complexity of the current bureaucracy.[79] Until the OSS is operational, investors must obtain the approvals themselves or utilise the investment facilitation services of the BOI.[80]

While the BOI prides itself on being efficient and facilitative and should be commended for recent strides in increasing FDI, there remains work to do towards a user-friendly and uniform legal framework. This was highlighted in the 2015 and 2017 US Investment Climate Statements on Sri Lanka, which described Sri Lanka as a 'challenging place to do business, with high transaction costs related to an unpredictable economic policy environment.'[81]

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[72] On the importance of infrastructure for attracting FDI to Sri Lanka, see Ravinthirakumaran, K et al, (2015). *Determinants of Foreign Direct Investment in Sri Lanka*, available at https://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=ACE2015&paper_id=104, who correspondingly note that with regard to human resources, maintaining low wages is *not* important.

[73] Investsrilanka.com. (n.d.). *Invest in Sri Lanka: Legal Aspects*. [online] Available at: http://www.investsrilanka.com/wp-content/uploads/2018/07/legal_brochure_new.pdf [Accessed 15 Nov. 2017].

[74] No. 4 of 1978 as amended and its Regulations

[75] No. 7 of 2007

[76] No. 24 of 1953 and its Regulations

[77] No. 14 of 2008 as amended

[78] No. 12 of 2012 Part (iv) as amended (Hub Operation Regulations)

[79] Investsrilanka.com. (2016). *One Stop Shop (OSS) for Investment Services, Sri Lanka*. [online] Available at: http://www.investsrilanka.com/vision_of_oss [Accessed 20 Oct. 2017].

[80] Investsrilanka.com. (2016). *Services Provided by BOI - Investment Facilitation*. [online] Available at: http://www.investsrilanka.com/services/investment_facilitation [Accessed 20 Oct. 2017].

[81] Department of State, USA. (2018). *Investment Climate Statements.* [Online]. Available at: https://www.state.gov/e/eb/rls/othr/ics/index.htm, [Accessed 23 July 2018]

Transparency, Governance and Land Issues

The 2017 US Investment Climate Statement specified several drawbacks, including that the government's 'overall provision of services is impeded by inefficiency,' 'economic growth is stymied by lingering opaque government procurement practices,' and 'foreigners are prohibited from purchasing land and real estate except for apartments above the 3rd floor.'[82] It notes that the Underutilized Assets Act of 2011, which resulted in the seizure of 37 companies, would be of concern to investors. It also observes that, 'local investors cite the risks of contract repudiation, cronyism, damage to reputation, and de facto or de jure expropriation as concerns, although the [new government] has started to address these issues.'

Comparative Analysis

Singapore is a highly instructive example of a transparent, rules-based system. Its FDI has grown consistently in the past 20 years, and Singapore is now a global leader in attracting and optimising investment for economic growth.[83] In addition to having over 40 international investment agreements,[84] it has a remarkable 22 free trade agreements (FTAs), including one with Sri Lanka signed in January 2018 – thereby offering investors a much greater market size beyond its small population.[85] By contrast, besides its recently concluded FTA with Singapore, Sri Lanka has only five agreements (bilateral FTAs in goods with India and Pakistan and three regional FTAs).

Investors in Singapore are generally subject to the same laws as local companies (with the exception that foreigners are restricted in buying freehold land), and there is no law that compels foreign investors to transfer ownership to local interests.[86] There is also no share capital requirement, and no restrictions on reinvestment or repatriation of profits. The government agencies that regulate investment are listed on one website and are accessible remotely to investors.[87] Furthermore, laws that regulate investment are clearly accessible and help investors learn about the legal system prior to deciding to invest and setting up operations. Singapore is currently in the process of setting up a new OSS named Enterprise Singapore.[88]

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[82] Id.
[83] See https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD?year_high_desc=false, last visited 23rd July 2018.
[84] Ministry of Trade and Industry of Singapore, available at https://www.mti.gov.sg/Improving-Trade/International-Investment-Agreementslast visited 5th November 2017. Newer generation FTAs contain investment chapters that generally go beyond the scope of standard investment agreements, covering elements such as investment liberalisation and investment facilitation.
[85] International Enterprise Singapore, available at https://www.iesingapore.gov.sg/Trade-From-Singapore/International-Agreements last visited 7th November 2017.
[86] There are, however, a few restrictions in the financial services, professional services and media sectors.
[87] This is extremely useful to investors, who otherwise do not know what to expect until they have physically visited the authority in question. See, Contact Singapore, available at https://www.contactsingapore.sg/en/investors-business-owners/invest-in-singapore/government-assistance last visited 7th November 2017.
[88] (2017) https://www.iesingapore.gov.sg/Media-Centre/News/2017/9/Enterprise-Singapore-to-replace-IE-Singapore-and-Spring-Singapore

Singapore is also a standard-bearer in commercial dispute resolution, allowing for maximum party autonomy in arbitral proceedings. It takes an estimated 164 days to enforce a contract in Singapore.[89] New Zealand is almost as efficient (216 days), whereas enforcing a contract in Sri Lanka takes a protracted 1318 days.[90] Singapore's leading role in dispute resolution is supported by the presence of several major international law firms in the city state.[91] This helps to position Singapore as a welcoming place for foreign investment as there is an ample supply of legal practitioners whose firms are already familiar to foreign investors, who are aware of legal developments in both Singapore and competitor markets, and who can propel local lawyers and policymakers to meet or exceed the best international standards.

3.3 A Multi-Step Plan

Political Measures

The analysis in Sections 2.1 and 2.2 above indicates that a crucial challenge in attracting FDI to Sri Lanka has been the policy inconsistency associated with successive changes of government. Sri Lanka needs a cross-partisan policy on foreign investment, which should start with the specific and achievable task of formulating a clear and politically sustainable *national brand*. This is especially important because studies have shown a correlation between a strong national brand and inward FDI.[92] In this regard, the government can learn from and emulate the national branding experience of New Zealand as outlined in Section 2.1 above.

As a related matter, Sri Lanka can learn from New Zealand's and Singapore's emphasis on building *social cohesion*, especially among its ethnic communities. Due to improvements in its human rights record, Sri Lanka recently regained GSP+, a preferential tariff arrangement with the EU that it lost in 2010 under the Rajapakse government.[93] This is a clear example of how non-economic improvements yield economic benefits. Sri Lanka must similarly prioritise building an enduring respect among its different communities. This is a good in and of itself but will also help address any lingering doubts potential foreign investors have as to whether the country is committed to, and can ensure sustainable peace.

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[89] World Bank. (2017). *Time Required to Enforce a Contract (days).* [Online]. Available at: https://data.worldbank.org/indicator/IC.LGL.DURS?year_high_desc=false, [Accessed 23 July 2018].
[90] Ibid.
[91] SIDRA. (2017). *The Singapore Dispute Resolution Institutions – What and Why (Part 1 of 4).*[Online]. Available at: http://www.sidra.academy/blog/singapore-dispute-resolution-institutions-part-1/ [Accessed 27 Nov. 2017].
[92] See, for example, Kalamovayand M., and Konrad, K. (2009), *Nation Brands and Foreign Direct Investment*, at http://www.tax.mpg.de/fileadmin/templatesnew/pdf/nation-brands-09-09-28_with_figure.pdf. After considering branding examples such as Britain's "Cool Britannia." The authors state at p.27, "We show that FDI flows into a host country rise as its nation image, the value of its intangibles, improves. We also show that this effect is not driven by 'fundamental' or 'economic' variables … We found that the Anholt Nation Brands Index, our measure for intangibles in the host country, has a large positive effect on FDI: a one-point increase in the index is associated with a 27% increase in the inflow of inward FDI."
[93] See *The EU grants enhanced market access for Sri Lanka as a reform incentive* (2017) at https://eeas.europa.eu/delegations/sri-lanka/26153/eu-grants-enhanced-market-access-sri-lanka-reform-incentive_en

Implementing a transparent and comprehensive policy of environmental, labour and other *governance standards* for foreign investment and loans will help address investor concerns discussed in Section 2.1 above, about inconsistencies in Sri Lanka's foreign policy and possible reversals of agreed projects. The standards should be robust enough to ensure (i) sustainable and shared economic benefits of infrastructure development projects, and (ii) confidence of the general public, and of any new government in Sri Lanka, that predecessor governments have agreed to foreign loans with due process and on terms that are in Sri Lanka's long-term interests. Developing this policy will take time but as a minimum, Sri Lanka and China can begin by adhering to the Environmental and Social Framework that has already been adopted by the China-initiated Asian Infrastructure Investment Bank (AIIB).[94]

Finally, Sri Lanka must address two longstanding deficiencies in its attractiveness as a host State for foreign investment; *corruption*, and limited *human resources* to attract large-scale investments. While the current government's manifesto of good governance has led to many improvements, including the resumption of judicial independence[95] and media freedom,[96] there has been little progress in addressing the country's record of corruption, and especially with regard to allegations made against the previous government.

Part of the problem may lie in the sheer volume and scale of those allegations. If so, Sri Lanka may benefit from adopting the approach that Hong Kong took decades ago, to transcend its sordid history of corruption until the mid-1970s. Hong Kong took the first step to ending this history when it established its Independent Commission Against Corruption in 1974.[97] Faced with an apparent mountain of cases, involving many who were still working in the public sector, the government later took the bold decision of granting a partial amnesty, whereby only the most serious cases of the past would be pursued.[98]

The announcement of a partial amnesty in 1977 provided a new lease of life to the police and others (who had been previously been implicated) to pursue the few most egregious cases.[99] Their eventual success in doing so assuaged the public's sense of injustice about the *past*, while also establishing ICAC's status as a serious bulwark against corruption in the *future*. Likewise, the current government in Sri Lanka should adopt a vigorous but practical focus (whether by a partial amnesty or otherwise) in pursuing the allegations of corruption in the past decade. Without this focus, the most serious

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[94] See AIIB, https://www.aiib.org/en/policies-strategies/framework-agreements/environmental-social-framework.html China appears willing and interested to set some other regulatory standards, as indicated here: http://www.cciced.net/cciceden/POLICY/RPR/op/ydyldc/ Other useful reference points for governance standards are that of the ADB at and the Japan International Cooperation Agency: https://www.jica.go.jp/english/our_work/social_environmental/index.html

[95] Welikala, A. (2017) *What is Happening in the Sri Lankan Supreme Court?*, at http://groundviews.org/2017/11/16/what-is-happening-in-the-sri-lankan-supreme-court/

[96] Freedom House. (2017). Press Freedom's Dark Horizon. [Online]. Available at https://freedomhouse.org/report/freedom-press/freedom-press-2017. [Accessed on 23 July 2018].

[97] ICAC. (2016). ICAC: Brief History. [Online]. Available at: http://www.icac.org.hk/en/about/history/index.html [Accessed on 25 July 2018l

[98] Lam, L., SCMP. (2014). Forty years since its creation, how the ICAC cleaned up corruption in Hong Kong. [Online]. Available at: www.scmp.com/news/hong-kong/article/1428093/forty-years-its-creation-how-icac-cleaned-corruption-hong-kong. [Accessed on 23 July 2018].

[99] Ibid.

allegations – and thereby also the lack of confidence in 'clean' governance among the general public and potential investors – will remain unaddressed.

The long-term challenge of improving Sri Lanka's human resources can be alleviated somewhat by harnessing Sri Lanka's large diaspora, who comprise over 8% of all Sri Lankans.[100] The current government laudably introduced a system for obtaining dual citizenship in 2015, pursuant to which several thousand members of the diaspora have re-engaged with their country of birth. However, more can be done, including allowing those holding an 'Ex-Sri Lankan' visa (available to non-Sri Lankan citizens of Sri Lankan origin) to undertake employment in the country.[101]

Legal Measures

Several of the recommended political measures above have a strong legal dimension. In addition, while the legal regime in Sri Lanka is relatively stable as far as investment is concerned, a few more specific and carefully considered initiatives could help bolster this regime to become a selling point for investors. Among these, completing the setting up of *an effective OSS platform* would go a long way in promoting Sri Lanka among potential investors.

Allowing *foreign law firms* to operate in Sri Lanka would also help develop local expertise in handling legal issues relating to foreign investments, and strengthening local capacity to engage in desired forms of dispute resolution, particularly in arbitration. Moreover, foreign law firms in Sri Lanka would offer potential investors internationally-recognised points of contact and information 'on the ground' about local investment opportunities and procedures. In time, they may also add pressure to accelerate the currently lengthy and economically punishing time to enforce contracts in domestic courts.

Another promising possibility is for Sri Lanka to join the *Information Technology Agreement of the WTO*, which has a membership that controls more than 97% of world trade in information technology (IT) products.[102] This would help Sri Lanka attract more FDI in fields related to IT[103] and enable Sri Lanka to improve and upgrade its technological infrastructure to attract a wide range of FDI.[104]

Sri Lanka's recent major investments have been concentrated in infrastructure development. While this is useful, the authors are of the view that Sri Lanka also needs export-related FDI, which in turn will fuel export-driven growth. Given Sri Lanka's small population, the government is rightly now

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[100] Hausmann, R., (2017) at https://www.youtube.com/watch?v=_kn_3imLWqw; LBO, *Sri Lanka should rethink immigration, diaspora policies: Hausmann*, at http://www.lankabusinessonline.com/sri-lanka-should-rethink-immigration-diaspora-policies-hausmann/; and De Mel, R. *Opinion: Economic Priorities in Sri Lanka's Foreign Policy*, at www.lankabusinessonline.com/opinion-economic-priorities-in-sri-lankas-foreign-policy/

[101] For other valuable suggestions on expanding the size and skills of Sri Lanka's human resources, see https://www.lki.lk/publication/fixing-sri-lankas-labour-market-comparative-lessons, last visited 23rd July 2018.

[102] See *Information Technology Agreement of the WTO*, available athttps://www.wto.org/english/tratop_e/inftec_e/inftec_e.htm [last visited 30th November 2017]; and De Zylva, A. et al, Is Sri Lanka Sitting on the Bench of Asia's Booming Digital Economy, available at http://www.lki.lk/publication/is-sri-lanka-sitting-on-the-bench-of-asias-booming-digital-economy/ [Accessed 20 June 2018].

[103] Ratnasabapathy (2017), *supra* note [11].

[104] Mayes, S. (2017). *Opinion: FDI in Sri Lanka, a real estate perspective*. [online] Lanka Business Online. Available at: http://www.lankabusinessonline.com/opinion-fdi-in-sri-lanka-a-real-estate-perspective/ [Accessed 7 Oct. 2017].

pursuing a *network of FTAs* in the region, including with Thailand and Malaysia. Concluding its planned FTAs with India and China remains vital, as these agreements would help position Sri Lanka as a gateway to a multi-billion consumer population and thereby attract more export-oriented FDI.

Conclusion

During the decades of civil strife and war, it was easy (and perhaps understandable) to blame Sri Lanka's lacklustre performance in attracting foreign investment on security concerns. However, even after the war ended in 2009, Sri Lanka has struggled to consistently grow its FDI and it lags behind the performance of regional peers in South and South-East Asia, which has in turn constrained the country's economic growth. This underwhelming record is despite the existence of a number of national institutions to encourage foreign investment, numerous IIAs with other countries, and complying with international legal decisions on cases related to foreign investments even when they could have been legitimately challenged.

The authors have argued that this mediocre performance largely reflects a combination of *political weaknesses*, including a 'leader driven' model for attracting foreign investment and an inconsistent foreign policy, as well as *legal issues*, such as overlapping laws and a poor record for transparency. To address these issues and attract greater foreign investment, they suggest moving swiftly and resolutely to a rules-based approach that goes beyond signing investment treaties. Based on the successful experience of other countries in the Asia-Pacific, the authors have presented a multi-step plan of requisite political and legal measures.

The government has laudably begun some of these measures but it needs to quickly complete and appropriately introduce others, during its possibly short-lived time to pursue them on a bipartisan basis in the current coalition. This would go a long way to ensuring the sustainability of these measures and helping to secure Sri Lanka's future prosper.