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Foreign direct investment and economic development: Tracing the investment development path of Sri Lanka

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ABSTRACT. Sri Lanka had implemented the import substitution industrialization (IL-ISI) policy for three decades until 1977 and subsequently had experienced an acute economic stagnation. The export oriented industrialization (OL-EOI) policy was introduced in 1978 with a heavy reliance on foreign direct investment (FDI) to overcome the problems of stagnation. Three decades after the implementation of the OL-EOI policy, many analysts believe that this FDI-reliant East Asian model has failed in Sri Lanka. The present study further re-examines whether OL-EOI policy has actually failed in Sri Lanka, based on the theory of FDI. As an appropriate tool for testing the relationship between FDI and economic development, the investment development path (IDP) is adopted in this study. Our findings reveal that in spite of the FDI climate of the country had drastically deteriorated at four different times during the last two decades, the fact that Sri Lanka has reached the early second stage of the absolute IDP and had entered the early second stage of the relative IDP in the Asian context places her in a significant position. Both these tests confirm that Sri Lanka has not totally failed but exhibits only a slow progress which can be attributed to the slow accumulation of ownership assets and heavy reliance on natural assets. To achieve any significant progress beyond the first stage of IDP, ownership assets need to be enhanced.

KEY WORDS. Foreign direct investment, net outward investment, investment development path, location-specific advantage, ownership advantage, internalization advantage, location specific natural assets, location specific ownership assets, location specific internalization assets.

Introduction

In the process of overcoming underdevelopment, the less developed countries (LDC) have largely practiced the outward looking development policy in the past few decades as an alternative to the self-reliant inward looking development policy. Today, economic liberalization and outward orientation have become the uniform

development strategy in the entire Third World[1]. This development framework is essentially characterized by trade and investment liberalization. Both trade and direct investment are believed to create immense opportunities for economic development in the LDC. Hence, these two elements are referred to as 'engines of growth' (United Nations, 1992). Investment liberalization promotes direct investment (FDI) and international trade. Direct investment primarily engages in manufacturing and exports. Through material imports and output exports, the involving host countries then serve themselves as bases for intra-firm-trade. It is these investment and trade effects that gradually transform economies from the state of underdevelopment to that of development (Dunning, 1996).

In the underdeveloped countries, foreign direct investment is expected to deal with two major development problems. They are usually expressed in terms of two gaps; the resource gap and foreign exchange gap. The dual-gap proposition advocates that these gaps are profound obstacles to economic development. The role assigned to FDI in abridging the resource gap is to provide additional capital to meet investment requirement essential for achieving higher growth rates. Athukorala and Rajapathirana (2004) describe that Sri Lanka received an amount of FDI equivalent to US$ 0.2 million in 1976 and it contributed less than a 0.05% to both net foreign resource inflow (NFRI) and private fixed capital formation (these rates rapidly increased in the later years and their averages for the period 1978-1996 stood at 6.4% and 5.0% while annual FDI inflow reached triple digit level of US$ 183.8 in 1993. And the role of FDI in relation to the foreign exchange gap is to earn additional foreign exchange to finance imports and thereby help the balance of payments. Two more gaps were identified later; namely the budget gap and the technology gap, and consequently the four-gap proposition was formulated (Streeten, 1993). This proposition suggests that the budget gap could be reduced through FDI commissioned economic services projects such as build-own-operate (BOO) and build-operate-transfer (BOT) while the technology gap through high terms-of-trade manufacturing exports produced by FDI based new ventures.

Sri Lanka's economic development is believed to have been thwarted by a few more gaps, which will be described in the next paragraph, at the time the country chose to switch from a self-reliant inward-looking development policy to an FDI-reliant outward-looking policy[2]. The East Asian newly industrializing countries (NICs) were following this model since 1960s and had shown the model was a success. Thus, Sri Lanka also wanted to follow the same model and intended a heavy reliance on FDI (Dunham and Abeysekera, 1987). The new policy introduced as an alternative to the long existed self-reliant policy consisted of three 'lead projects' in conjunction with widespread macroeconomic liberalization. The lead projects included Accelerated Mahaveli Development Project, One Million Housing Development Project, and Export Processing Development Project organized under

the Greater Colombo Economic Commission (GCEC). The first project primarily aimed at gaining self-sufficiency in food, bringing down the cost of food, and generating low-cost electricity required for the industrial development planned under the third project whereas the second project focused on both social welfare and the linkage effects of construction industry. Among the lead projects the third project was considered as the main engine of growth, which was designed to primarily run on FDI. In particular, the economic liberalization, which was the central feature of the new policy package, was chiefly to support this third project. This reveals that the reliance on FDI was highly featured in the new economic policy introduced in 1978.

Sri Lanka's move in 1978 to rely on FDI for achieving accelerated growth rates had a holistic focus to overcome a large number of economic gaps she had been then facing. Firstly, the FDI-reliant policy of Sri Lanka intended to alleviate a few structural gaps such as production structure gap, employment structure gap and export earnings structure gap. The contribution of agriculture and industry to GDP in 1977 was 30% and 15% respectively (Central Bank of Sri Lanka, 1998). Agricultural exports had contributed almost 80% to exports earnings whereas industrial exports had earned 14% (Vidanapathirana, 1986). The manufacturing share in total merchandise exports stood as low as at 4.58% and the total manufacturing exports earnings stood at US$ 29.70 millions (Athukorala and Rajapathirana, 2004). The labor engagement ratio in plantation and industry was so imbalanced and stood at 5:1[3]. Secondly, the new policy intended to alleviate the employment gap (i.e. unemployment). Sri Lanka's unemployment rate was too high and it had been estimated at 24% by the Survey of Consumer Finances in 1973 and at 19.7% by the Land and Labor Utilization Survey in 1975 (Karunatilake, 1987). Thirdly, the smallness of the domestic market, which is the market gap, had created a bottleneck in the development of domestic industries. This emphasizes the market size argument. Large domestic markets provide opportunities for the development of local industries. Sri Lanka, in 1976, with less than a 14 million population, 1.6 per cent population growth, US$ 275 per capita income, barely a 2 per cent of annual growth of per capita income (Karunatilake, 1987), a dependency rate as high as 80%, and a high disparity in distribution of income at Gini co-efficient 0.4 (Central Bank of Sri Lanka, 1998), had a too small domestic market for any vital industry to grow competitively to realize innovations and economies of scale. Consequently, Sri Lanka's manufacturing as well as manufacturing exports were so insignificant.

Being the first in South Asia to adopt FDI-reliant outward orientation policy Sri Lanka wanted to follow the development model of the Newly Industrialized Countries in Southeast Asia. This new policy has continued for almost three decades. However, as it was the case for many other developing countries, the FDI-reliant development policy came under fire in the beginning as it was believed that

this move would encourage neo-imperialism and exploitation. Though the FDI-reliant development policy managed to withstand such criticism and the political changes that took place in the later years, it has become the general impression that Sri Lanka made only a little progress under the FDI-reliant development policy. This notion promotes the following views: (a) Sri Lanka has received only an insignificant amount of FDI, (b) FDI is heavily concentrated in the garment industry (Atapattu, 1997), (c) foreign content in FDI-based industries is too high, (d) outputs and exports of the FDI-based industries are labor intensive, (e) these industries have "provided jobs mainly for unskilled and semiskilled workers and the bulk of them are women. Very few graduates have been able to find jobs..." and as a result the technology transfer is low (Karunaratne, 1987:431). These observations do not seem to have been derived with much theoretical background. Further, without adopting proper model of FDI and economic development, these observations have led to the general conclusion that Sri Lanka has failed while East Asia succeeded in adopting FDI-reliant policy.

On the contrary, Athukorala and Rajapathirana (2004) systematically surveyed the outcomes of investment liberalization in Sri Lanka introduced in 1978 and identified the export oriented foreign direct investment (EOFDI) had produced significant development effects. They noted that "the ability of a country to capture the full benefits of trade and investment liberalization depends crucially on the existence of a favorable macroeconomic environment and political stability. In the Sri Lankan case, these pre-conditions were largely missing for much of the post-reform period, except for two sub-periods between 1977-82 and 1990-94. Any analysis of the outcome of the significant trade and investment liberalization in Sri Lanka needs to be qualified for this lacuna in the overall investment climate" (Athukorala and Rajapathirana, 2004:71). Further, providing numerous evidences on effects of capital formation, trade, economic growth, and employment they challenged the general impression that Sri Lanka has failed. This was followed by the debut of a unique observation on the FDI-reliant development in Sri Lanka by Athukorala (1997). He noted that "it is common place to draw upon the experience of the NICs as a standard in assessing Sri Lanka's achievements. Such practice leads to confusion because the role of FDI in export expansion varies depending on the nature, timing, and topological characteristics of the host country such as the degree of industrialization and the stage of entrepreneurial development" (Athukorala, 1997:387). In support of this argument, Kelegama (2006) pointed out that Sri Lanka could be pushed to the NIC status through attracting 'large-scale FDI', if Sri Lanka had attained macro economic stability, political stability, better infrastructure, technical skills, improved local entrepreneurship, and modern factories for multinational corporations (MNC). These studies connote that Sri Lanka has fared

well in her FDI-reliant development policy despite the fact that certain crucial factors required for achieving FDI-reliant development are either weak or absent.

Though these deviating arguments are useful in analyzing the effects of FDI in economic development in Sri Lanka, they are of little use in determining whether Sri Lanka has succeeded or failed in the FDI-reliant policy because they lack theoretical testing of the problem. Therefore, we find it essential to theoretically examine the case of Sri Lanka absolutely as well as relatively in the Asian context. The Investment Development Path (IDP), proposed by Dunning (1982) is adopted as the analytical tool for this purpose. The IDP is characteristically a measure of overall development position of countries. The distinctive feature of this tool is that it can, on the whole, measure the status and vitality of the FDI-reliant development. In this study, firstly, the absolute Investment Development Path (A-IDP) of Sri Lanka is derived in order to ascertain the relationship between FDI and the stage of economic development. Then, the relative Investment Development Path (R-IDP) is derived in order to comparatively assess Sri Lanka's position in the Asian Investment Development Path. Also, this approach will help gauge the intensity of FDI reliance in Sri Lanka and combine in a holistic manner every lone effect of FDI.

The Investment Development Path

The Investment Development Path establishes a systematic relationship between direct investment and economic development. This relationship was first identified by John Dunning (1982)[4]. The IDP is derived from two factors; the Net Outward Investment (NOI) and the Gross Domestic Product (GDP) of the country concerned. The NOI is the difference between inward and outward direct investment. The NOI and GDP are normalized by dividing by the population of the countries concerned and hence the per capita NOI and GDP are derived. The IDP hypothesis has been expanded by several subsequent studies (Narula, 1996; Dunning and Narula 1996) and now it consists of five distinctive stages of the investment-development. It further suggests that the stages of the development path are determined by the response of the Multinational Corporations (MNC) to the types and extent of advantages provided to them by the host country. The MNC would engage in international operations through mobilizing their internalization (I) skills if they could benefit from their ownerships (O) in cross-border locations. For this, a healthy location advantage (L) is imperative. The locations that cannot provide advantages are not attractive to MNC and thus internalization will not take place at such locations[5]. On the other hand, the higher the location advantage the more intensive will be the internalization in such locations.

The operations of MNC in a particular country (location) are governed by three sets of assets; location-specific natural assets *(L-na),* location-specific ownership assets *(L-oa)* and location-specific internalization assets *(L-ia).* The nature, availability, and augmentation of this triple asset at a certain location determine the likelihood and degree of it to become a host country for cross-border production of MNC. These assets change constantly and their relative augmentation pushes countries from the host country status to investor country status along time. This, in turn, determines the inflow and outflow patterns of direct investment to and from that country. It is, thus, obvious that these assets play a dual role. The changing competitiveness of this asset base at a time absorbs FDI while at other times it emits FDI causing the phenomenon of FDI inflow and outflow. When FDI inflow exceeds outflow, a country will experience negative net outward investment (NOI) position. The reverse of this relationship will result in positive NOI position. Table-I lists out the variables that determine country specific OLI status.

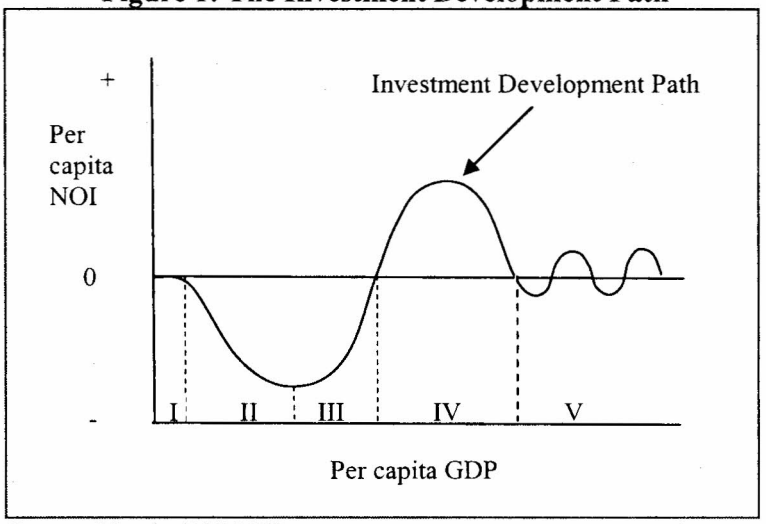
Table I: Country specific *OLI* variables

Category	Variable
Ownership	Resource endowments, Labor endowments, Market size and character, Government policy towards research & development, protection of propriety, promotion of competition, education and training, industrialization. Government attitudes towards; internalization of business, cross-border alliance. Organizational culture of the country, Wealth creating ethos of the country, Nature of corporate governance, Nature of inter-firm rivalry/ cooperation.
Location	Physical and psychic distance between countries, Government intervention; tariff, taxes, quotas, assistance to MNC.
Internalization	Government's policy framework for transfer pricing, mergers. Difference in transaction costs, Enforcement of contracts, Supply of infrastructure, Absorptive capacity.

Source: Dunning (1993: 84)

The Investment Development Path consists of five stages. Stage-I represents FDI hostile posture. Countries in the stage-I opt for self-reliant development policy and reject economic liberalization and FDI-reliant development policy. In consequence, these countries receive a negligible amount of FDI and exhibit a low per capita income and zero or near-zero NOI

Figure 1: The Investment Development Path



Source: Narula (1996:22)

position. Though these countries may possess natural asset related advantages, their ownership and internalization assets hinder augmentation of competitive advantages. The economies indicated in the Stage-II, pursue a liberal and FDI friendly policy. In response, these countries begin to receive FDI and as a result their NOI position will deepen. In other words, these countries will continue to receive more FDI than that of the outflow resulting in a large negative net outflow of FDI in them. The depth of NOI in this stage is self explanatory to the extent of location specific advantages that persist. In the countries of this category, advantages in both ownership and location assets are equally significant and they together push the NOI position downwards. Obviously, these nations enjoy rapidly increasing per capita GDP. In the Stage-III, NOI starts to bottom out. In this stage, though these countries receive a large amount of FDI, a significant amount of FDI flows out from them. This phenomenon is caused by the inter-relationship between natural asset depletion and ownership asset augmentation. In this case, the host country runs out of advantages in some of its natural assets while internalization assets opportune the domestic firms to engage in cross-border operations to benefit from the firm specific ownerships. In this stage, industrial sophistication intensifies and as a result the per capita income improves. With extensive internalization drive, these countries eventually complete the FDI-in-out-cycle (Rajaratne, 1998a) and move to a positive NOI position indicated in the Stage IV. In this stage, advantages in internalization assets overwhelm those of ownership and locational assets and countries remain as net outward investors. By

now, the economic gaps are systematically alleviated and high per capita income level is reached. Finally, in the Stage-V, backed by an advanced liberalization move also, countries tend to mutually rely on direct investment. The investment flows in this stage are governed by the other assets as against the natural assets that were predominant in the early stages. In this stage, the long-run investment equilibrium is attained. The FDI flow patterns and amounts among the countries that belong to this stage are determined by a unique set of ownership assets. Dunning and Narula (1996) identified them as the technology homogeneity, market homogeneity, product and technology collaboration, joint research and development (J-R&D), mergers and acquisitions (M&A), alliance capitalism, and inter-firm stake ownership. In this stage, post-technology intensive (i.e., knowledge intensive) industrial structure with high economic development level is achieved (Rajaratne, 2006). Thus, the IDP hypothesis is identified as the most appropriate tool for examining the investment-development relationship of Sri Lanka. The IDP has been proven to be significant and an acceptable tool by the comprehensive tests carried out by Dunning (1982, 1996) and Narula (1996) for a sample of 88 countries and separate samples for natural-asset-rich countries and created-asset-rich countries (see; appended table III). In this study, Sri Lanka's absolute IDP and the relative IDP in the Asian context will be traced.

The IDP position of Sri Lanka

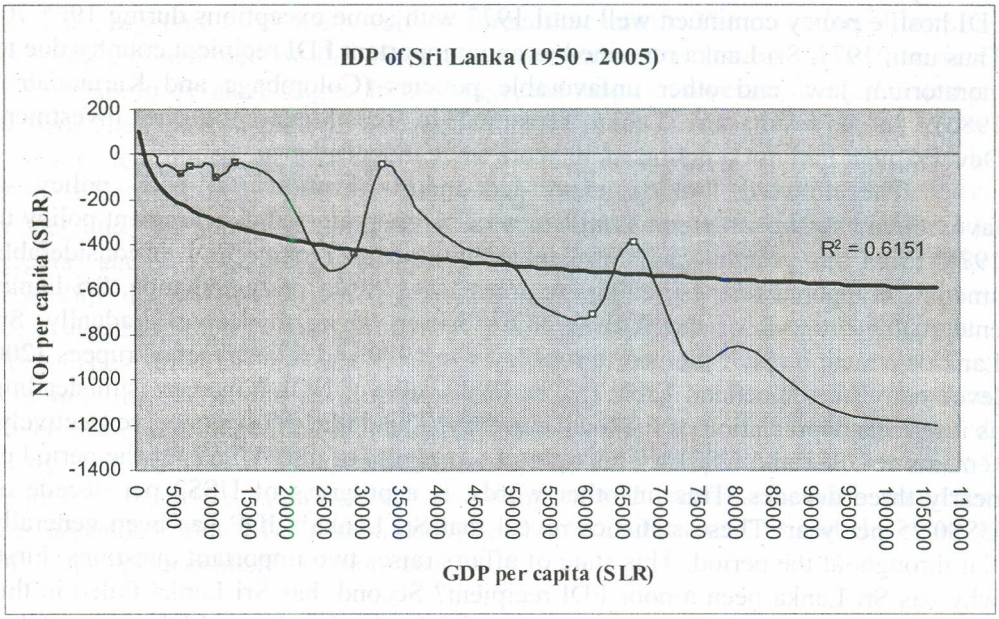
The properties of the IDP hypothesis permit testing either individual country or a group of countries. If a single country is tested, it essentially would become a test of absolute IDP. Firstly, using time series data on per capita GDP at Current Factor Cost prices and per capita NOI at current prices (see, appended Table I), the absolute IDP position of Sri Lanka for the period of 1950 to 2005 is tested. The availability of data in the Balance of Payments Statistics published by the Central Bank of Sri Lanka is satisfactory. But the population data for the years 1997, 1998 and 1999 had to be adjusted as they posed discrepancy. For this test, data were obtained only from the official sources such as Central Bank of Sri Lanka, the Department of Census and Statistics of Sri Lanka, the Asian Development Bank and the United Nations Center for Transnational Corporations.

Sri Lanka shifted from inward-looking import substitution industrial (IL-ISI) policy to that of outward looking exports-led industrialization (OL-ELI) in the year 1978. Until that year, self-reliant development was advocated. However, the prospective role of FDI in economic development had been recognized as early as in 1949 in the first budget speech of independent Sri Lanka[6]. Subsequent policy formulation for FDI under IL-ISI policy appeared in the white paper on FDI in 1955, and policy statements in 1966 and 1972 (Vidanapathirana, 1986). The liberal stance

for FDI that prevailed from 1948 through 1955 was undermined by the Ten Year Development Plan in 1956 which propagated a strong self-reliant IL-ISI policy. And FDI hostile policy continued well until 1977 with some exceptions during 1965-70. Thus until 1977, Sri Lanka remained as an unimportant FDI recipient country due to moratorium law[7] and other unfavorable policies (Colombage and Karunaratne, 1986). As a result, Sri Lanka remained in the Stage-I of the Investment Development Path for a period of 30 years since independence.

The outward looking export-led industrialization (OL-ELI) policy -a favorable ownership asset- was implemented as the preferred development policy in 1978. From this year onward, Sri Lanka continued to receive FDI in considerable amounts compared to the previous regimes. As a result of this change, Sri Lanka entered the Stage-II of the IDP as NOI position began to deepen gradually. Sri Lanka's per capita NOI jumped to rupees 51 in 1979 and it has reached rupees 1200 level today (see; appended Table I). The rupee value of NOI, however, is misleading as it reflects depreciation of the local currency. The dollar equivalence, respectively, remains at US$3 and US$12. This reflects a progress of only US$9 for the period of nearly three decades. This, in other words, is a progress of US$3 per decade or US$0.25 per year. These statistics reveal that Sri Lanka's IDP has been generally flat throughout the period. This state of affairs raises two important questions. First, why has Sri Lanka been a poor FDI recipient? Second, has Sri Lanka failed in this development strategy? The question that Sri Lanka is a poor FDI recipient has generally been raised as a major problem of the FDI-reliant development policy of Sri Lanka (Lakshman, 1997). And the Figure-2 illustrates this position clearly. Sri Lanka's IDP remained relatively shallow during the past three decades. This indicates that Sri Lanka has not been receiving large amounts of FDI. Had Sri Lanka received large amounts of FDI throughout the last three decades, she would have unquestionably reached the Stage- III or above in the IDP by now. But it did not happen because Sri Lanka was unable to bestow sufficient amount of location-bound advantages to the MNC for several reasons. First, diminishing advantage of natural assets partly accounted for the above claim. Price hike and poor supply of natural resources, wage rate hikes, problems in labor supply, and low labor productivity have caused to diminish the advantage of natural assets. Second, Sri Lanka's ownership assets such as markets, labor skills, supply and cost of capital, industrial structure, support industries, infrastructure and its quality, logistics, industrial peace, economic policy. macroeconomic management, and politics and governance did not

Figure 2: The IDP of Sri Lanka



Source: Appended Table I

competitively enhance Sri Lanka's ownership advantage position. Third, some of the ownership assets of Sri Lanka were paradoxical to her investment and business climate. They include the political climate and industrial relations. Fourth, the closure of the sectors such as retail business, distribution, transport and insurance etc (see; BOI, Foreign Investors Guide) for FDI undoubtedly led to location specific disadvantage. The progress of the IDP is gained through both location bound asset endowment as well as the competitiveness in the ownership assets. However, it is mainly the appropriate ownership asset related advantages that steer the IDP.

Apparently, Sri Lanka's IDP has been disturbed several times as the ownership assets of political nature damaged the location specific advantage position (see; Figure 2). First, the widespread communal violence in 1983 caused a serious drawback in the flow of FDI as the investors found Sri Lanka an unsafe location. Several investors, despite their offers had been granted approvals before the outbreak of communal violence, never contracted projects thereafter. Vidanapathirana (1986) observes many such projects up to 1985. The investment approval to contracting ratio during this period has been 7:4 in terms of capital and 2:1 in terms of number of projects (ibid). The appended table-I shows that the per

capita NOI dropped from Rs. -87.65 in 1982 to Rs. -41.94 in 1985. Then, the second down turn in FDI inflow occurred during 1988 to 1989 period due to widespread antagonism launched by the patriotic movement. The per capita NOI dropped from Rs. -105.15 in 1987 to Rs. -38.63 in 1989. The third down turn occurred during 1994 to 1995 due to anti-open economy sentiments propagated by the new government in 1994. The NOI per capita in 1993 stood at Rs. -512.66 but it decreased to Rs. -45.30 in 1995. In the presence of drastic decline of FDI inflows, the President of Sri Lanka had to reiterate that the government would support open economy and encourage FDI (Presidential Secretariat; 1995). Then came the wave of national insecurity in 2001 and it again weakened FDI inflow and as a result the per capita NOI dropped from Rs. -712.40 in 2000 to Rs. -391.85 in 2001. As Sri Lanka's international airport was attacked by the LTTE guerrillas in 2000, international insurance companies imposed an insurance surcharge for the airplanes and ships that arrive at Sri Lanka's air and sea ports. Further, major air-liners and sea-liners refrained from entering the country. In view of these developments, foreign investors found Sri Lanka's investment climate had deteriorated and kept away from investing. These incidents have not only disturbed FDI inflows but also changed the course of the IDP. Thus, Sri Lanka needs to improve her ownership asset position with respect to political, economic, and industrial perspectives in order to improve FDI inflows.

The second question, which requires special examination, is whether Sri Lanka has failed in the FDI-reliant development strategy while East Asia succeeded. Views such as "FDI concentrates in garment industry has created lopsided development in the manufacturing ..." (Atapattu, 1997:84) promoted pessimism in general. Likewise, several ailments diagnosed in Sri Lanka's FDI-reliant policy are mentioned below. They include labor intensity (of production), light manufacturing, insufficient local content, industry concentration, absence of technology transfer, and insufficient employment etc. On the contrary, Athukorala (1997) observes that FDI-reliant policy of Sri Lanka has significant and favorable effects on employment, information related externality, and trade etc. Athukorala and Rajapathirana (2004) repeated that though Sri Lanka was unable to reap the full benefit of the breaking of the political policy cycle with the change of the government in 1994, the liberal policy led to reduction in absolute poverty. Though Sri Lanka's NOI position was less significant, the effects of FDI-reliant policy were significant (Rajaratne, 1998b). Perhaps, these effects are not as exciting as those in the countries like Singapore and Taiwan. Economic development, in this case, has a functional relationship to dynamics of NOI while NOI has a functional relationship to location specific advantage of the host country. The location specific advantage, in turn, is determined by the augmentation of natural and ownership assets structure. Therefore, the degree of economic development needs to be connected to the

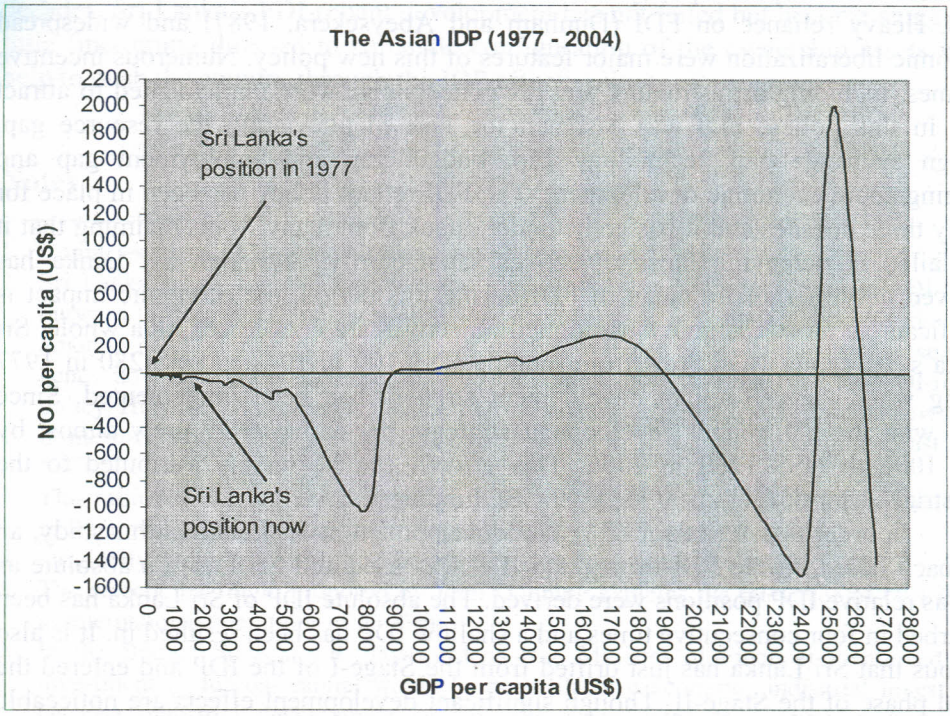
augmentation of natural and ownership assets. In the context of Sri Lanka, there have been predominant weaknesses in the ownership asset structure and as a result, the IDP has slowed down. But Sri Lanka's investment-development scenario is neither withered nor failed. What can most correctly be said is that Sri Lanka's investment-development relationship is less significant at R^2=0.6151 (logarithmic regression statistic). Therefore, Sri Lanka will take long to *catch-up* along the industrial hierarchy of countries (Kojima, 1973) and to move toward the developed *center* (Ozawa, 1993). Any acceleration to this process of catching-up requires re-engineering the structure of ownership assets and thereby improving the NOI position.

The East Asian case

The East and Southeast Asian countries are a classic success story of economic development through FDI-reliant strategy. The East Asian case is relevant here because Sri Lankan case comparatively assessed in that context. Such comparison will further explain Sri Lanka's IDP position and help examine strategies to fine tune the FDI-reliant development policy of the country. Against the point-to point comparison method, which has been habitual to all the existing analyses, the IDP proposition is adopted here because of its qualities to serve as a comprehensive and systematic tool for development comparison. Figure-3 reveals how the Asian IDP has taken its shape since 1977. This is based on cross section data for the years 1977, 1987, 1997 and 2004 for 15 FDI-reliant Asian countries (see appended Table II).

The Asian IDP confirms the stages of the investment development path proposed by Dunning (1982). The Stage-I of Asian IDP continues until a country reaches the per capita GDP US$1000 (the dada described in this section refer to the appended Table II). Thereafter, Stage-II continues until the per capita GDP of US$8000 is reached. Then the countries that reach their per capita GDP of roughly between US$10,000 and 20,000 become net outward investors. Thereafter, the countries reach the long-run equilibrium of NOI. All the SAARC countries except Sri Lanka concentrate in the Stage-I of Asian IDP. Despite the fact that Sri Lanka has lived with the FDI-reliant development policy for nearly three decades and longer than any other country in South Asia, Sri Lanka has only recently entered the Stage-II of the Asian IDP. Along with Sri Lanka, China, Indonesia, and the Philippines comprise the early Stage-II group. China, which is endowed with excellent natural asset base, has drifted fast and entered the Stage-II within a short period of time. India also seems to enter swiftly the Stage-II benefiting from her

Figure 3: The Asian IDP



Source: Appended Table II

competitive asset base. The Asian IDP explains how the NICs benefited systematically from the development opportunities under FDI-reliant policy through appropriate manipulation of their asset structure. This equally confirms that countries with asset competitiveness (both natural and created) tend to drift swiftly along the subsequent stages in the IDP. The late-comer countries such as China and India will prove this proposition. For Sri Lanka, it is imperative to progress from the present double digit NOI position to that of a triple digit to reach the bottom of the Stage-II of IDP. The likelihood of elimination of the gaps, which were introduced earlier in this study, and to achieve higher development levels consequently would be determined by the capability to mobilize the asset base.

Concluding remarks

Sri Lanka's development policy shifted from IL-ISI to that of an OL-ELI in the year 1978. Heavy reliance on FDI (Dunham and Abeysekera, 1987) and widespread economic liberalization were major features of this new policy. Numerous incentive schemes, including infrastructure and tax concessions, were implemented to attract FDI. In this policy, FDI was assigned the task of alleviating the resource gap, foreign exchange gap, technology gap, budget gap and employment gap and bringing about economic development. The FDI-reliant policy has been in place for nearly three decades and it has come under attack from many fronts claiming that it has failed in achieving those objectives satisfactorily. Although Sri Lanka has received only marginal amount of FDI during this period, the economic impact is significant as far as the above mentioned objectives are concerned. As a whole, Sri Lanka's per capita GDP grew from roughly US$ 100 in 1948 to US$ 280 in 1977 during when the self-reliant development strategy had been implemented. Since then, with the FDI-reliant development strategy, per capita GDP grew almost by US$ 1000 to US$ 1280 in 2006. This growth can be mainly attributed to the industrial sector development led by the BOI industries.

In order to assess the FDI-reliant development in Sri Lanka in this study, an approach based on the FDI theory and IDP was used and Sri Lanka's absolute as well as relative IDP positions were derived. The absolute IDP of Sri Lanka has been disturbed in four consecutive times and a shallow IDP has been resulted in. It is also obvious that Sri Lanka has just drifted from the Stage-I of the IDP and entered the initial phase of the Stage-II. Though significant development effects are noticeable in the economy, it is obvious that development is thwarted as NOI does not considerably improve. In our view, this is the real problem of the FDI-reliant development strategy of Sri Lanka. Preceding analyses appropriated theoretically this problem to its root; i.e., the poor endowment of natural and ownership assets. The natural assets help deepen the NOI in the initial stage of the IDP while ownership assets determine its progress in the later stages. Therefore, Sri Lanka's further progress along the IDP will owe to the dynamic configuration of her ownership asset base.

The relative position of Sri Lanka in the context of Asian IDP reveals some useful information. According to the Asian IDP, five countries belong to the Stage-I and they have single digit NOI and per capita income less than US$ 1000. All SAARC countries except Sri Lanka belong to this stage. Sri Lanka, with double digit NOI and over US$ 1000 as per capita income, has entered the Stage-II of the IDP to which many Southeast Asian countries belong. Thus this invalidates the popular argument that Sri Lanka has failed in the FDI-reliant development. Sri Lanka's progress in this stage will depend on the ability to design her asset tructure

to attract the types of FDI that seek efficiency, strategic assets, technology, and alliance etc. The discrepancy of IDP positions between Sri Lanka and the NICs has occurred due to inconsistency in asset configuration throughout the last three decades. Sri Lanka's FDI-reliant development has not failed but become sluggish. A little fine-tuning directed to stimulate configuration of the ownership assets would help to push the country through the IDP effectively.

Notes

1 Countries such as Cuba and North Korea are exceptions.

2 Sri Lanka seems to have followed the model of Asian NICs to formulate FDI-reliant outward looking development policy. However, because Sri Lanka did not receive large amounts of FDI inflows as the NICs did, the FDI-reliance of Sri Lanka became weak and hence now it is believed to be an 'FDI-facilitated' policy rather than an 'FDI-reliant' policy. However, it is obvious that the FDI-reliance was highly featured in the new policy framework though such reliance was impracticable in Sri Lanka unlike in the East Asian NICs.

3 This ratio was derived based on the statistics provided in the unpublished doctoral thesis of Rajaratne (1998) and the statistics published by Vidanapathirana (1986).

4 Originally, Dunning named it as Investment Development Curve (IDC).

5 The eclectic paradigm proposed by John Dunning explains the relevance of OLI factors in international operations of the firm.

6 In the Budget Speech, J.R. Jayawardena (the Minister of Finance) mentioned " ... investment of foreign capital would be particularly welcoming industrial investments because industrial development cannot take place without scientific, technical and industrial knowledge, ... the government has framed its policy not only to enable further foreign capital to be invested in Ceylon, on particular fields of investment in which the aid of foreign investment is desirable, and under conditions which safeguard the mutual interests of this country and of the foreign investors..."

7 In the Budget Speech of 1964-65, N.M. Perera (the Minister of Finance) mentioned "... considering the present critical position of the country's foreign exchange resources, I have decided to declare a moratorium on all remittances, of profits, dividends, interests and other investment income for a period of of one year in the first instance..."

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Appendix

Table I
Per capita NOI and GDP of Sri Lanka

Year	GDP per capita at Current Factor Cost Prices (SLR)	NOI per capita (SLR)	GDP at Current Factor Cost Prices (SLR Mn)	Net Outward Investment (SLR Mn)	Population (Mn)
1950	510	0.25	3822	1.9	7.5
1951	542	0.60	4171	4.6	7.7
1952	520	0.60	4107	4.8	7.9
1953	542	0.88	4390	7.1	8.1
1954	566	1.55	4696	12.9	8.3
1955	578	2.91	4914	24.8	8.5
1956	565	2.78	5028	24.8	8.9
1957	588	4.18	5349	38.1	9.1
1958	615	1.28	5721	11.9	9.3
1959	618	0.94	5930	9.0	9.6
1960	646	-0.29	6331	-2.9	9.8
1961	629	0.61	6353	6.2	10.1
1962	630	0.18	6549	1.9	10.4
1963	652	-0.45	6849	-4.8	10.5
1964	672	0.09	7326	1.0	10.9
1965	676	0.00	7499	0.0	11.1
1966	679	1.21	7741	13.8	11.4
1967	711	0.42	8319	4.9	11.7
1968	834	1.00	9930	11.9	11.9
1969	888	0.88	10834	10.7	12.2
1970	1055	0.14	13187	1.8	12.5
1971	1085	-0.14	13674	-1.8	12.6
1972	1150	-0.14	14720	-1.8	12.8
1973	1368	-0.24	17920	-3.2	13.1
1974	1765	-0.07	23302	-0.9	13.2
1975	1917	0.05	25691	0.7	13.4
1976	2046	0.00	28032	0.0	13.7
1977	2495	0.64	34684	8.9	13.9
1978	2871	-1.66	40479	-23.4	14.1
1979	3457	-50.82	49782	-731.8	14.4
1980	4234	-48.24	62246	-709.1	14.7
1981	5361	-65.29	79337	-966.4	14.8
1982	6270	-87.65	94679	-1323.5	15.1
1983	7395	-57.30	113878	-882.4	15.4
1984	8977	-53.16	140039	-829.3	15.6
1985	9387	-41.94	148321	-662.7	15.8
1986	10169	-49.08	163713	-790.2	16.1

1987	10904	-105.15	177731	-1714.0	16.3
1988	12334	-82.90	203516	-1367.8	16.5
1989	13580	-38.63	228138	-648.9	16.8
1990	17196	-78.22	290615	-1322.0	16.9
1991	19616	-149.12	337399	-2564.9	17.2
1992	22241	-307.31	386999	-5347.3	17.4
1993	25744	-512.66	453092	-9022.8	17.6
1994	29399	-438.67	523300	-7808.4	17.8
1995	33057	-45.30	598327	-820.0	18.1
1996	38029	-259.74	695934	-4753.2	18.3
1997	43918	-415.83	803698	-7609.7	18.3
1998	49882	-483.54	912839	-8848.8	18.3
1999	54357	-680.82	994730	-12459.0	18.3
2000	61155	-712.40	1125259	-13108.2	18.4
2001	66610	-391.85	1245598	-7327.5	18.7
2002	73857	-911.29	1403286	-17314.5	19.0
2003	81393	-859.63	1562737	-16504.9	19.2
2004	92822	-1131.76	1800750	-21956.1	19.4
2005	107057	-1199.73	2098323	-23514.7	19.6

Source: Annual Report, Central Bank of Sri Lanka (various volumes).
Economic Progress of Independent Sri Lanka (1998), Central Bank of Sri Lanka.

Table II
NOI and GDP per capita of selected Asian countries (US$)

Country	1977		1987		1997		2004	
	GDP Per capita	NOI Per capita	GDP Per capita	NOI Per capita	GDP Per capita	NOI Per capita	GDP Per capita	NOI Per capita
Bangladesh	91	-0.02	177	-0.1	330	-1.1	440	-0.8
China	150	-0.08	232	-1.5	860	-34.7	1290	-39.8
Hong Kong	3404	-31.28	8844	-57.5	25200	2006.0	26810	-1419.1
India	174	0.05	325	-0.1	370	-3.8	620	-3.1
Indonesia	319	-6.21	420	-13.4	1110	-22.7	1140	-2.1
Korea (RO)	1012	-3.28	3218	-15	10550	34.9	13980	-6.8
Malaysia	983	-13.83	1793	-28.5	4530	-183.3	4650	-45.2
Nepal	96	-0.02	165	-0.02	220	-1.0	260	-1.1
Pakistan	211	-0.55	348	-0.6	500	-5.1	600	-9.1
Philippine	438	-4.50	568	-6.5	1200	-15.5	1170	-2.0
Singapore	2834	-88.41	7976	-1031.4	22810	-1127.2	24220	-1446.0
Sri Lanka	281	0.07	370	-3.6	800	-7.1	1010	-11.0
Taiwan	1289	-2.64	5324	-13.6	13470	127.4	18000	222.4
Thailand	454	-2.44	929	-19.9	2740	-52.1	2540	-19.7
Viet Nam	160	0.01	220	-1.1	310	-10.7	550	-17.7

Source: Asian Development Report, Asian Development Bank (various volumes).
Key Indicators, Asian Development Bank (various volumes).
World Investment Report, United Nations (various volumes).

Table III

Regression results for investment-development relationship

Type of Regression	*ADJ.R^2*	*F-value*	*N*
Linear regression results (NOI-GDP)			
All countries	0.542	51.69	88
Natural asset rich countries	0.582	36.64	53
Created asset rich countries	0.579	16.33	24
Log-linear regression results (OI-GDP)			
All countries	0.866	342.58	54
Natural asset rich countries	0.809	115.63	18
Created asset rich countries	0.768	57.35	28
Log-linear regression results (II-GDP)			
All countries	0.746	256.85	88
Natural asset rich countries	0.705	127.39	53
Created asset rich countries	0.755	68.87	24

Source: Dunning and Narula (1996: 31)