Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
Confederaziun svizra

Embassy of Switzerland in Sri Lanka

Economic Report 2021

Sri Lanka

28 June 2022

Executive Summary

Sri Lanka is currently in the midst of a severe economic crisis and has defaulted on its foreign debt commitments for the first time in its history. Its total debt is US$ 51 Billion while its debt commitment for 2022 is US$ 7 Billion. Its reserves of US$ 1.9 Billion is mostly made up of loan deferrals, currency swaps and credit lines from bilateral partners. There are severe disruptions to the distribution of essential goods and services such as food, medicines, electricity, cooking gas and fuel. This has caused widespread protests, sporadic violence, the appointment of a new Prime Minister and Cabinet of Ministers and ongoing calls for President Gotabaya Rajapaksa to resign. The deterioration of Sri Lanka's economy accelerated from 2019 after Sri Lanka instituted ad-hoc policies on revenue generation, a chemical fertilizer ban and foreign exchange. This was heightened with the negative impact of the COVID pandemic on Sri Lanka's overall inflows from tourism, industry and remittances. It is an unfortunate development for Sri Lanka which showed considerable promise after the end of the war in 2009 and a political transition in 2015 focused on Democratic reforms, reconciliation and the window of opportunity to create the framework for a mixed market economy. The failure of political and economic reforms resulted in multiple crisis between 2018 and 2019 including a 52 day constitutional deadlock and the Easter Sunday attacks of 2019 which further stifled the Sri Lanka economy. This resulted in President Gotabaya Rajapaksa winning the Presidential elections in November 2019 on a platform of national security and a governance system change. However, due to the COVID pandemic and severe economic challenges from 2019 to 2021 combined with Sri Lanka's systemic haphazard and reactionary policy making processes and clear financial mismanagement the newly elected government could only perpetuate economic decline resulting in a total collapse by 2022. Sri Lanka will now have to go through difficult austerity measures and rely on balancing its economic diplomacy in the Indian Ocean between the Quad group of countries including India and China. In 2022 it will be critical for Sri Lanka to institute economic reform measures focused on restructuring its debt with the assistance of the International Monetary Fund (IMF), other multilateral agencies and bilateral donors. While this presents serious challenges it may also afford Sri Lanka the opportunity to reform its governance system and establish a better more sustainable economic model for the future.

Embassy of Switzerland in Sri Lanka
63, Srimath R.G. Senanayake Mawatha (Gregory's Rd.)
Colombo 7, Sri Lanka
Phone: +94 11 269 51 17
E-mail: colombo@eda.admin.ch
Embassy's website: www.eda.admin.ch/colombo

TABLE OF CONTENTS

1 ECONOMIC OUTLOOK AND ECONOMIC POLICY DEVELOPMENTS

The roots of Sri Lanka's economic failure begins from the historical trends of Sri Lanka's political economy. Ever since its independence in 1948 the direction of Sri Lanka's political economy and indeed its economic policy has been fostered by its two main competing political blocs encapsulated in the Liberal - Open Market oriented United National Party (UNP) and the Socialistic - Protectionism oriented Sri Lanka Freedom Party (SLFP). These two parties did try to work together from 2015 to 2019 in a cohabitation government to cooperate and develop a common understanding on establishing a 'mixed market' economic model as mentioned in the executive summary. However, their politico economic policy differences were too polarized leading to failure and the abrupt liquidation of the cohabitation reform focused government in late 2018. This led to a high degree of political instability which fed into economic instability reorienting Sri Lanka's polity towards a strong national security discourse and the public call for "system change". In late 2019, taking advantage of public sentiment President Gotabaya Rajapaksa was elected to power under a newly formed party called the Sri Lanka Podujana Peramuna (SLPP). In mid-2020 the SLPP obtained an overwhelming 2/3rds majority in parliament through elections to establish its own single party oriented coalition. President Gotabaya Rajapaksa who heads this government is a retired Lieutenant Colonel and the former Defence Secretary under his brother former President Mahinda Rajapaksa between 2005 and 2015. His first act after being elected as President was to appoint his brother as the Prime Minister. The SLPP then used its 2/3rds majority in parliament in late 2020 to pass the 20th Amendment to the Sri Lankan constitution and concentrate powers in the Executive Presidency while simultaneously weakening parliamentary oversight, checks and balances through independent commissions on preventing corruption, policing, human rights, the right to information, procurement, judicial services and state auditing. Simultaneously, President Gotabaya Rajapaksa also established a number of Presidential Commissions, Task Forces and while introducing a number of retired military officers into civilian administration roles overseeing governance functions including customs, health and agriculture. This was to carry forward the program on his election manifesto "Vistas of Prosperity and Splendour" which also referred to the UN's Sustainable Development Goals.

However, it became apparent through 2020 and 2021 that the SLPP led government did not appear to have a clear economic vision in its policy framework. This was because it contained a number of political alliance partners and blocs which had competing economic ideologies ranging from liberal to socialist. The SLPP was made up of political elements that reflected the economic thinking of the UNP and SLFP from over 70 years of pushing Sri Lanka towards protectionism and the open market simultaneously. The SLPP began to splinter into factions based on these divides eventually leading to the collapse of its government. Furthermore, the SLPP fell into the trap that has been plaguing Sri Lankan governments for decades in that it did not realize the true gamut of Sri Lanka's economic risks. Despite what government or party is in power, government promises of transparent investment laws to foster foreign direct investment under a stagnated and sophisticated legal and regulatory framework continued. Sri Lanka has also not been able to deal with high levels of corruption for decades and Global Financial Integrity (GFI) estimates that Sri Lanka has at least US$ 20 Billion the equivalent of approx. 20% of its GDP in illicit financial flows. Although, the government had a number of economic specialists in its camp such as former Treasury Secretaries and former Central Bank Governors, they collectively failed to give the government and President Rajapaksa independent advice and fair warning about policies that will lead to economic collapse. This perpetuated the deterioration of economic governance system that had no identifiable political-economic ideology or parameters. The subservient role of an overinflated government bureaucracy to an all-powerful Executive President who had only a military background and an inner circle of military personnel as advisers accelerated the collapse of Sri Lanka's economy.

From the time the SLPP came to power in 2019 it tried to introduce a number of 'stimulus packages' with tax relief measures on Value Added Tax (VAT), construction and telecommunications levies with tax exemptions for the agricultural, fisheries, livestock and

IT sectors. There were complete removals of the Capital Gains Tax, Nation Building Tax, withholding tax on interests and a Debt Tax on banks and institutions. Crucially, these measures went against a number of conditions set by the IMF in order for Sri Lanka to continue enjoying a US$ 1.5 billion tranche which was supposed to end in 2020. The IMF recommended that the new government not breach its prescribed fiscal deficit targets, stressed the risks associated with mounting foreign and domestic debt and was especially critical of the government's tax cuts in 2020 and 2021. But this advice was not followed. As mentioned earlier at the very outset the SLPP government's economic policy direction was based on President Rajapaksa's manifesto "Vistas of Prosperity and Splendour". While this program envisaged a 5 year economic development plan with an annual GDP growth of 6.5%, increasing GDP per capita to US$ 6,500, 4% unemployment, 5% inflation and the budget deficit below 5% it was unclear as to how Sri Lanka would achieve these goals. They ultimately proved to be unrealistic. Instead, due to the impact of COVID and ad hoc economic policies the GDP contracted -3.6% in 2020 to its worst performance in history and only recovered to 3.7% in 2021. Sri Lanka's financial inflows through 2020-2022 were not enough to meet external liabilities and country reserves declined to around US$ 90 Million in late 2021 and only currency swaps, credit lines and loan deferrals from India, China and Bangladesh worth US$ 1.9 Billion keeps Sri Lanka barely afloat currently. One of the key hallmarks of Sri Lanka's economic decline in 2021 was its short sighted policy to defend its currency using its reserves. This created a severe shortage of foreign currency in the local market and for international trade. At one point in 2021 due to a shortage of US Dollars in the market three different exchange rates were observable in Sri Lanka; the official Central Bank rate, commercial bank rates and a black market rate. When the Central Bank of Sri Lanka finally removed its "soft peg" in March 2022 the Sri Lankan Rupee depreciated by 44% within a few weeks causing hyper-inflation. Sri Lanka's Year on Year (YoY) inflation for May 2022 reached 45% while food inflation has reached 58% and transport inflation 76%. Sri Lanka's debt situation through 2020 - 2022 reached 119% of GDP resulting in ratings agencies such as Fitch, Moody's and Standard & Poor downgrading Sri Lanka sovereign ratings multiple times until Sri Lanka finally defaulted on its payments in April 2022.

Sri Lanka will now have to go through a painful process of debt restructuring, privatization and austerity. The newly appointed Prime Minister Ranil Wickremasinghe has a liberal economic mind-set and is open market oriented. Since he has also been appointed as the Minister of Finance he will have to provide leadership and cohabit with President Gotabaya Rajapaksa and guide Sri Lanka through a difficult recovery including negotiations with the International Monetary Fund (IMF). In February 2022 the IMF staff report for the 2021 Article IV consultation for Sri Lanka recommended a number of measures to restore macroeconomic stability and debt sustainability. This includes substantial revenue-based consolidation including rate increases and base broadening and energy pricing reforms, monetary policy tightening focused on reducing the risk of inflation, gradually restoring market determined and flexible exchange rate which is carefully sequenced and establishing social safety nets which are strengthened through increased spending, widened coverage and improved targeting. The IMF has also recommended that Sri Lanka develop a comprehensive debt strategy. In the short term, Sri Lanka is trying to negotiate US$ 4 Billion bailout package from the IMF and has appointed Clifford Chance and Lazard to negotiate restructuring US$ 7 - 12 Billion debt for 2022 of its US$ 51 Billion overall debt to the IMF, other multilateral donors and bilateral donors such as China, India and Japan. Sri Lanka's economic recovery will involve a sophisticated and complex approach to geo-politics because it is locked in a proxy 'Cold War' in the Indian Ocean between China and the Quad group of countries; India, the USA, Japan and Australia. China currently holds 13% of Sri Lanka's total debt and is only third behind the 47% owed through ISBs and 22% due to multilateral financial institutions. Negotiations on restructuring Sri Lanka's debt to China will be extremely complicated because it sees debt as collateral or leverage in its geo political ambitions in Sri Lanka and the Indian Ocean. Sri Lanka has a number of strategic assets which may be "leveraged" in exchange for bilateral support including the Chinese funded Hambanthota Port and Port City in Colombo and the largest natural harbour in the world in the Eastern Province of Trincomalee while its Northern Provincial coast is only 27 kilometres away from South India.

2 PRIORITY SECTORS AND OPPORTUNITIES FOR SWISS COMPANIES

The service sector is the biggest contributor to Sri Lanka's GDP with 58% and 46% of all labour. There is considerable growth in the IT programming and telecommunications sub sectors of Sri Lanka's services economy. Industries come second with 25% contribution to GDP with 26% of all labour working in the industrial sector mainly in manufacturing, and construction to a certain degree. Last but not least, Agriculture employs 27% of Sri Lanka's labour force while its contribution to GDP has always been around 7% in the last few decades. This is because the agricultural sector is labour intensive and badly in need of new technology and possibly mechanization. While there was considerable growth in agricultural subcategories such as cereals, oleaginous fruits and tea Sri Lanka's traditional rice paddy and beverage producing crops saw a contraction from 2020 – 2022 mainly due to an ad-hoc ban on chemical fertilizer. There are a number of Swiss companies currently operating in Sri Lanka with a vast presence across sectors such as agricultural manufacturing, pharmaceuticals and fertilizer and industrial manufacturing focused on electrical equipment. Switzerland has around US$ 450 Million in Foreign Direct Investments (FDI) in Sri Lanka making it the 11th biggest source of overall FDI's to Sri Lanka. There are also a number of potential investors who have an interest in renewable energy and tourism but due to the current economic crisis in Sri Lanka these projects are focused now into long term development instead of rapid expansion. Traditional Swiss imports to Sri Lanka include electrical machines, chemicals and pharmaceuticals, textiles and garments, clocks and watches. However, there is a growing sector in developing products for the Internet of Things (IOT) and Information Communication Technology (ICT) including Business Process Outsourcing (BOP). According to data provided by the World Bank by 2020 35% of individuals were using the internet in Sri Lanka while 139% of the population had mobile cellular subscriptions. Sri Lanka's Information and Communication Technology Agency (ICTA) is focusing on improving digitalization by partnering with multilateral agencies and developing interconnectivity between government partners to improve everything ranging from the food supply chain all the way up to civil registrations and business registrations. To cut down costs and improve efficiency the Sri Lankan government will attempt to digitalize its services and the Sri Lankan economy in general and there is a huge potential for Swiss investors to participate in such as process despite the current economic downturn.

Switzerland's Import Promotion Program (SIPPO) working in partnership with the State Secretariat for Economic Affairs (SECO) intends on assisting Sri Lanka's Export Development Board (EDB) to broaden its horizons in terms of exports to Switzerland and select European Free Trade Association (EFTA) and European Union (EU) countries in 2022. Although there is no finalization in terms of the sectors that may have potential export interests towards EFTA and EU markets there is a possibility that it will be in the fish, seafood, processed food and value added textiles categories. Swiss companies would be well poised to take advantage of these sectors through investments if the market potential to export to Europe from Sri Lanka expands considerable in the upcoming years. Overall Switzerland is well established in terms of its trade links to Sri Lanka and is well placed to participate in Sri Lanka's economic development. However, due to Sri Lanka's economic downturn investing in Sri Lanka presents a high risk at this current stage because its domestic market is extremely weak and its only potential is as a manufacturing and industrial hub to cater to other countries in the Indian Ocean region. This is because Sri Lanka is facing a liquidity crisis and GDP per capita contraction of 4.1% in 2021 according to the World Bank. In time, as Sri Lanka's economy starts to recover past 2023 there may be opportunities for Swiss companies focused on the renewable energy and organic agriculture sectors in terms of the domestic market. But these will have to be long term investments with a focus of about 5 – 10 years in the return in investment. All investors although prone to risk may want to look more closely at Sri Lanka's free market zones including within the Colombo Port City and Southern Port of Hambanthota. As mentioned in the executive summary, there is a possibility that the Eastern Port of Trincomalee which is strategically positioned to cater to the East Indian market and South East Asia may also develop potential as a free market zone. To better understand the investment climate in Sri Lanka, businesses could contact the Board of Investment (BOI) of Sri Lanka or participate in BOI forums.

3 FOREIGN ECONOMIC POLICY

3.1 Host country's policy and priorities

Since the 1970's Sri Lanka's economic policy has constantly attempted to transition towards making its external sector more export oriented with a focus on reorienting trade agreements. Sri Lanka is a member of the World Trade Organization. It also has a limited number of bilateral free trade agreements with partner countries in the region such as India and Pakistan. It is party to multilateral free trade arrangements in the South Asia region such the South Asian Preferential Trade Agreement (SAPTA). However, liberalization has been relatively slow and there are no multilateral initiatives with a significant impact beyond the South Asia region. This is because Sri Lanka's economic policy is determined by two competing political ideologies in the form of its two main political blocs which push the free market or protectionism at any given time depending on which faction is in power. These competing interests created a unstable 'hybrid economy' which transitioned between 'open' and 'closed' every 5-10 years creating a degree of policy instability which eventually led to the economic crisis of 2022. Over a 21 year period, Sri Lanka's export of goods and services fell to 14% of GDP in 2021 from 39% of GDP in 2000 while imports have fallen from 49% of GDP to 24% according to the World Bank (WB) and the Central Bank of Sri Lanka (CBSL) during the same period. Sri Lanka's current account deficit increased in 2021 to -9.5% of GDP in nominal terms, the worst it has been in 4 decades since 1980 when it was -16.4% when Sri Lanka was facing a similar type of economic collapse. Due to its economic collapse Sri Lanka will now drastically have to cut down on non-essential and non-export oriented imports and improve value added exports significantly on the short term. It will then need to redefine its foreign economic policy in the upcoming decades so it can avoid a similar type of economic collapse again. Until then it will have to rely on currency swaps, loan deferrals and credit lines from India, China and other bilateral donors for imports. In this respect it is foreseen that Sri Lanka will have to redefine and enter into a number of pending bilateral negotiations over economic agreements with bilateral partners. The Comprehensive Economic Partnership Agreement (CEPA) with India would be a good example of this. Its finalization has been delayed by Sri Lanka for years in a bid to address concerns of the local business community. The other would be a Sri Lanka – China Free Trade Agreement (SLCFTA) which has been pending for about 10 years. Sri Lanka's CEPA with Pakistan also remains under negotiation with no significant progress in the period under review although the target date for its conclusion was 2016. Sri Lanka does have existing bilateral free trade agreements. These include the India-Sri Lanka Free Trade Agreement (ISFTA) which provide tariff concessions 4,554 for products on both sides, the Pakistan-Sri Lanka Free Trade Agreement (PSFTA) with tariff concessions for 5,310 products. There is also the Singapore-Sri Lanka Free Trade Agreement (SLSFTA) which came into force in 2018 and covers 80% tariff concessions for all tariff lines coming into effect over 15 years. In terms of multilateral agreements Sri Lanka is a part of the South Asian Free Trade Agreement (SAFTA) which provides tariff concessions 4,744 products with a total import value of approx. US$ 4 million annually while exports are approx. US$1 Million. Sri Lanka benefits from Generalized System of Preferences concessions. It reobtained additional concessions granted by the EU under its GSP+ facility in 2017, due to improvements in human rights. The GSP extension by the USA, which was under review for workers' rights issues, has also been granted again. But these agreements may come under threat if there is a significant deterioration in Sri Lanka's human rights record in 2022.

3.2 Outlook for Switzerland (potential for discrimination or comparative advantage)

Sri Lanka and Switzerland have an agreement to promote protection of investments since 1981 and an agreement to avoid double taxation since 1983 in revision to include OECD standards. Despite a serious bilateral crisis in late 2019, there is no significant risk for sole discrimination of Swiss exporters or/and importers. However, due to a lack of foreign exchange Sri Lanka has instituted a number of import restrictions and tariffs which discriminate a number of imports including Swiss imports. Swiss traders should study these regulations closely before engaging in business and trade in Sri Lanka.

4 FOREIGN TRADE

4.1 Developments and general outlook

In 2021 India regained its position from China as the main trading partner of Sri Lanka. But it was stilly closely followed by China and then the USA. These three countries make up 42% of the total bilateral trade with Sri Lanka. Sri Lanka has trade surpluses with the USA, UK, Germany and the Netherlands while it had large trade deficits with China, India, the UAE, Malaysia and Singapore. The USA made up 25% of all exports followed by the UK with 7% and India with 6%, Germany with 6% and Italy with 4%. This was mainly from the garments industry. China made up for 23% of all imports closely followed by India with 22% and the UAE with 6%. Sri Lanka's main import was petroleum products. In 2021 Sri Lanka's trade deficit grew to -3.8% compared to -1.3% of GDP in 2019 according to the World Bank and it will stay at -3.8% for 2022. The primary reason for the expansion of the trade deficit in 2021 according to the Central Bank of Sri Lanka (CBSL) was a significant increase in imports despite selected import restrictions which then outpaced export growth. A sharp revival in imports due to the normalization of economic activities and higher energy prices resulted in the widening of the deficit towards the end of 2021 and early 2022. Because Sri Lanka was using its reserves to defend the Sri Lankan Rupee throughout 2020 – 2021 and simultaneously paying back debt this created foreign exchange shortage resulting in debt repayment and Balance of Payments (BoP) crisis.

Sri Lanka has always had a systemic problem characterized by continuous increase in domestic demand for imported goods and higher interest payments outpacing an improvement in the export of merchandise goods. In 2021 the BoP deficit grew by 26% to US$ 8 Billion similar to the rise in 2020 by 24% year-on-year. In response to the growing BoP deficit from 2020 – 2021 Sri Lanka introduced import restrictions that temporarily suspended imports of "non-priority goods" and placed a large number of import items on a licensing regime. The IMF in its Article IV consultation in 2022 estimates that the gross savings from imports in 2020 were 7% of all imports amounting to around US$1.2 billion and incremental savings in 2021 was about 4% of imports amounting to around US$ 0.8 Billion from mainly consumer goods and especially personal vehicles. However, two thirds of the impact coming from restricting intermediate goods and capital goods were imports used as input in domestic production and supporting investment. The IMF believes that while these restrictions helped relieve BoP pressure, they inhibited trade and adversely affected economic growth, distorted markets. The IMF believes that Sri Lankan authorities should phase out import restrictions within a set time period.

4.1.1 Trade in goods

On a cumulative basis, earnings from exports grew to highest it has been in a single year growing by 24% to approx. US$ 12 Billion. For the first time in a decade earnings from exports grew in relation to GDP from 12% in 2020 to 14% in 2021. Earnings from industrial exports were the main contributor with 77% followed by agricultural exports at 21%. Industrial exports earnings grew by 26% Year on Year (YoY). This was mainly due to exports and garments the single largest export with a 40% total share rising by 22%. They were followed closely by rubber products which grew by 33% with the main products being solid tyres and rubber gloves. Agricultural exports also grew by 16% YoY. The primary reason for this was an increase in earnings from tea, rubber, spices and unmanufactured tobacco. However, according to the IMF Article IV report for 2022 Sri Lanka's exports have remained concentrated in low complexity - value-added products reflecting Sri Lanka's relatively restrictive trade regime. This hinders diversification by incentivizing investments into protected sectors. As for direction of exports, the primary destinations were the USA (24%), UK (7%) and the EU (23%) being mainly Germany, Italy, Belgium and the Netherlands with 16%, Asian countries such as India, China, Japan, China, Hong Kong, Singapore, Vietnam, Bangladesh and the Maldives (10%), Middle Eastern countries such as Turkey, UAE, Iraq, Iran and Israel (9%) and other countries (18%).

Even amidst the continuation of import restrictions and outpacing exports the expenditure on imports rose in 2021 by 28% recording US$ 20 Billion. Accounting for almost 60% of *import imports expenditure on intermediate goods increased by 35% to US$ 12 Billion in 2021. The largest category is this sector were fuel imports on account of crude oil, refined petroleum including cooking gas and coal increased by 32% to US$ 3 Billion. Furthermore, the import expenditure on textiles and textiles which is the 2nd largest import item surpassed the US$ 3 Billion mark for the first time in history. This mainly due to increased expenditure on fabrics and yarn which were utilised to meet the higher demands for Sri Lankan garments from major export destinations such as countries in the EU, the UK and the USA. Overall, it could be seen that the elevated price levels in global commodity markets, including fuel prices, an overreliance on refined petroleum due to the intermittent closures of Sri Lanka's only oil refinery and higher expenditures on medical and pharmaceutical items such as accounted for the increase in imports despite extremely low imports of personal motor vehicles. In terms of import sources, China (23%) and India (22%) account for the bulk of imports followed by the UAE (6%), Singapore (3%) and Malaysia (3%), other Asian countries such as Japan, Thailand, Indonesia, Pakistan, (20%) and other countries (12%).*

4.1.2 Trade in services

The surplus in the services account recorded a notable increase in 2021 compared to the previous year, but remained lower than the pre-pandemic 2020 and pre-Easter Sunday attacks 2019 levels. This was mainly due to the growth in earnings from computer services, gradual improvement in earnings from tourism and improvements in freight related to sea and air transport services. As a result, the surplus in the services account came to US$ 1.6 Billion in 2021 compared to US$ 800 Million in 2020. The surplus in the services account increased due to higher inflows observed on account of information technology led business process outsourcing (IT/BPO) related services and improvements in the transport sector. The tourism sector also showed signs of revival during the latter part of the year but collapsed in 2022 with the economic crisis affecting tourist services.

4.2 Bilateral trade

4.2.1 Trade in goods

There is a discrepancy between the Sri Lanka to Switzerland customs import statistics while the export statistics are only slightly different, mainly due to gold exports not registered in the Sri Lankan statistics. Switzerland figures from Swiss Customs show imports of US$ 227 Million while the Central Bank of SL lists only US$ 146 Million in exports to Switzerland. While Swiss customs statistics indicate exports of US$ 95 Million, the Central Bank of Sri Lanka show imports to the tune of US$ 99 million from Switzerland. Swiss data indicates a growing deficit in favour of Sri Lanka in the balance of trade in 2021 totalling around US$ 132 Million which is 38% higher than the deficit from 2020 which was US$ 81 Million and increased by only 28% compared to 2019. Making up 43% of total imports, textiles, clothing and shoe merchandise imports to Switzerland from Sri Lanka experienced a slight 1% decrease. This was in comparison to the 10% increase of machine and electrical imports, which make up 17% of all imports from SL to Switzerland. Forestry and agricultural and seafood products which make up 11% of total imports rose by 19%. There was a drop of 27% in precision instruments, clocks and watches and jewellery imports to Switzerland which make up 8% total. Meanwhile, there was a drop in exports of about -12% to Sri Lanka mainly due to drastic drop in textiles, clothing and shoes of -96%. In 2020 this category made up 20% of all exports while in 2021 its share fell to 1%. There was also sharp drop of -22% in chemical and pharmaceutical products which make up 18% of all exports to Sri Lanka. This was while machines, appliances and electronics which make up 47% of all exports saw a 4% increase in 2021. In the opposite trend in terms of imports there was a drastic increase of 34% for precision instruments, clocks and watches and jewellery exports which make up around 4% of all exports. In 2021, Swiss tourists to Sri Lanka relative to 2020 fell by 53% to 2,974 but this was lower than the massive reduction of 78% between 2020 and 2019 due to the shutdown of the airport for tourists and the global impact of the Covid-19 on tourism. It is forecast that tourism numbers will stay at this level for 2022 or may further reduce due to the economic crisis. Between 2016 and 2019 Swiss tourists to Sri Lanka averaged around 30,000 annually.

5 DIRECT INVESTMENTS

5.1 Developments and general outlook

Total Foreign Direct Investment (FDI) inflows fell by 10% to US$ 598 Million in 2020. In 2018 before its economic travails Sri Lanka received US$ 1.8 Billion in FDI's. However, Sri Lanka also considers major projects financed with foreign borrowings as investments. In 2021 Sri Lanka received US$ 1.6 Billion in such funds. The Asian Development Bank (ADB) was the main contributor with US$ 613 Million for road infrastructure, education and water security. In terms of overall FDI stocks Singapore remains in peak position with US$ 4 Billion in investments followed by the China and India with US$ 2 Billion each and the Netherlands, Hong Kong and Malaysia with US$ 1 Billion a piece. In 2021 India remained the top investor with US$ 142 Million followed by the Netherlands with US$ 100 Million. From 2021 towards Mid-2022 India has provided Sri Lanka with US$ 4 Billion in currency swaps, credit lines and deferrals on humanitarian grounds due to Sri Lanka's economic crisis. With the total collapse of Sri Lanka's economy in 2022 there is a high likelihood that FDI's will be affected and reduced further. Excluding the Chinese funded Colombo Port City free market zone and a new pharmaceutical manufacturing zone in another China funded Hambanthota Port there are no concrete investment plans being implemented yet. China and India are two of the biggest investors in Sri Lanka and the Sri Lankan government struggles to find a balance between these two competitive powers in the Indian Ocean. However, it will need the assistance of all major players in the Indian Ocean, such as the USA, Japan, European countries and Australia as well to mobilize large scale long term funding for manufacturing and infrastructure projects for the East and South of Sri Lanka. Both these areas contain strategic ports and locations for all countries in the Indian Ocean. With Sri Lanka's economic collapse there is a high likelihood that all major players in the Indian Ocean will attempt to gain control of these strategic assets.

5.2 Bilateral investment

According to a survey conducted by the Embassy of Switzerland in 2011 the cumulative Swiss investments in the country amounted to US$ 550 million across approx. 25 companies. However, according to data from the Central Bank of Sri Lanka in 2022 Switzerland's total debt stock was around US$ 438 Million. This means that from being the 8th biggest in 2017 foreign direct investor in Sri Lanka Switzerland has dropped to 11th place. It is currently unknown as to how this number was reduced except for the possibility that this reduction takes into account the exit of Holcim Cement from Sri Lanka. Nevertheless, Nestlé has a remarkable presence in Sri Lanka. It is implementing a multi-year new investment program of around US$ 100 million. There is also one or the other Swiss SME that is expanding its investment stock (e.g. Variosystems) or has recently established itself in Sri Lanka (e.g. Swiss Photon AG). While the COVID pandemic affected economic environment continued into 2021 and every Swiss owned enterprise was affected this seems to have multiplied in 2022 with the economic crisis. However, the creation of a Free Market zone through the Port City Authority Act in the new Colombo Port City may give Swiss companies new opportunities in Sri Lanka.

6 ECONOMIC AND TOURISM PROMOTION

6.1 Swiss foreign economic promotion instruments

Since 2004, the Swiss Business Circle Sri Lanka brings together representatives of Swiss business interests. The circle meets 3 to 4 times a year, the Embassy providing the secretariat. The Embassy maintains direct contact with Switzerland Global Enterprises (S-GE), representatives. The (SL) chapter of the Swiss-Asian Chamber of Commerce is also an active player in fostering bilateral ties and has increased activity over the last 6 years. The Embassy maintains regular contacts with the various local Chambers of Commerce and the Board of Invest (BOI) for Sri Lanka. These provide useful assistance whenever trade enquiries require a more substantial input. The Embassy assists Swiss companies and future investors as a *"door opener" for trade and service opportunities. In the past years, the Embassy organized a number of workshops and projects with Swiss businesses, the Sri Lankan government and Sri Lankan businesses including specifically from the hospitality and tourism industry. In 2022 Switzerland's Import Promotion Program (SIPPO) working in partnership with the State Secretariat for Economic Affairs (SECO) intends on assisting Sri Lanka's Export Development Board (EDB) to broaden its horizons in terms of exports to Switzerland and selected European Free Trade Association (EFTA) and European Union (EU) countries in 2022. Although there is no finalization in terms of the sectors that may have potential export interests towards EFTA and EU markets there is a possibility that it will be in the fish, seafood, processed food and value added textiles categories.*

6.2 The host country's interest in Switzerland

There is potential for Switzerland as a tourist location, however only the elite class of Sri Lanka can afford tourism visits to Switzerland. Presently, the majority of visiting persons are relatives of the 55'000 strong Sri Lankan Diaspora living in Switzerland. A restrictive visa practice aims at controlling illegal immigration. With a new direct connectivity between Colombo and Zurich, operated on a seasonal basis by Edelweiss Airlines, there is a significant potential for increasing the number of Sri Lankan and Swiss tourists in both directions. There is also potential for cooperation between Sri Lankan and Swiss tourism schools and vocational training institute despite this COVID pandemic. This was demonstrated by a MOU signed in May 2021 between the Sri Lanka Institute of Tourism and Hotel Management and the Ecole Hoteliere de Lausanne (EHL) which was invited and supported by the State Secretariat for Migration (SEM) to be a knowledge partner and conduct a gap analysis study towards improving the quality of tourism education on par with international standards.

ANNEX 1 – Economic structure

Economic structure of the host country

	2017	2021
Distribution of GDP		
Primary sector	**6.9 %**	**6.9 %**
Manufacturing sector	**26.8 %**	**25.9 %**
Services	**56.8 %**	**58.3 %**
- of which public services	**-**	**-**

Distribution of employment		
Primary sector	**26.1 %**	**27.3 %**
Manufacturing sector	**28.4 %**	**26.0 %**
Services	**45.5 %**	**46.7 %**
- of which public services	**-**	**-**

Source(s): Central Bank of Sri Lanka Annual Report 2021 & Department of Census and Statistics, Sri Lanka

ANNEX 2 – Main economic data

Host country's main economic data

	2020	2021	2022
GDP (USD bn)*	**80.7**	**82.4**	**81.9**
GDP per capita (USD)*	**3.6**	**3.7**	**3.6**
Growth rate (% of GDP)*	**-3.6**	**3.577**	**2.573**
Inflation rate (%)*	**4.2**	**12.1**	**17.2**
Unemployment rate (%)*	**5.5**	**5.3**	**5.1**
Fiscal balance (% of GDP)*	**-12.8**	**-11.4**	**-9.6**
Current account balance (% of GDP)*	**-1.3**	**-3.8**	**-3.8**
Total external debt (% of GDP)**	**66.4**	**65.6**	**64.2**
Debt-service ratio (% of exports)**	**35.2**	**30.0**	**-**
Reserves (months of imports)**	**3.1**	**1.5**	**1.0**

* Source: IMF, World Economic Outlook (April 19, 2022)

** Source: IMF, Article IV Consultation (or host country statistics) [April 2022]

ANNEX 3 – Trade partners

Trade partners of the host country Year: 2021

Rank	Country	Exports *from the host country* (USD million)	Share	Change [1]	Rank	Country	Imports *to the host country* (USD million)	Share	Change [10]
1	USA	3,108	24%	0%	1	China	4,756	23.0%	+0.7%
2	UK	938	7.5%	-1.5%	2	India	4,625	22.4%	+3.2%
3	India	829	6.6%	+0.6%	3	UAE	1,413	6.80%	+0.4%
4	Germany	758	6.1%	+0.4%	4	Malaysia	803	3.9%	+0.4%
5	Italy	581	4.6%	+0.1%	5	Singapore	792	3.8%	-0.5%
6	Netherlands	426	3.4%	+0.5%	6	USA	511	2.5%	-0.6%
7	Belgium-Luxembourg	343	2.7%	+0.3%	7	South Africa	484	2.3%	+0.9%
17	*Switzerland*	146	*1.2%*	*+0.3%*	31	Switzerland	99	0.5%	-0.3%
	EU	2,967	23%	-7.9%		EU	1479	7.2%	-1.9%
	Total	12,498	100%	+24%		Total	20,637	100%	+28%

Source(s): Central Bank of Sri Lanka Annual Report 2021

[1] Change from the previous year in %

ANNEX 4 – Bilateral trade

Bilateral trade between Switzerland and the host country

	Export (CHF million)	*Change (%)*	**Import** (CHF million)	*Change (%)*	**Balance** (in million)	**Volume** (in million)
2017	91	-11.8%	150	+12.1	-59	237
2018	107	+18%	166	+10.4%	-59	273
2019	87	-18.9%	182	+9.5%	-95	269
2020	103	+18%	175	-3.8%	-72	277
2021 *(Total 1)**	**83**	**-18.9%**	**200**	**+14.2%**	**-116**	**283**
2022 (I-VI)**	**-**	**-**	**-**	**-**	**-**	**-**

*) ‘Economic’ total (total 1): not including gold bars and other precious metals, currencies, previous stones and gems, works of art and antiques

**) Change (%) from the previous year

Exports	**2020** (% of total)	**2021** (% of total)
1. Machines, appliances, electronics	41.7%	54.2%
2. Chemical and Pharmaceutical products	23.3%	21.6%
3. Textiles, clothing, shoes	20.3%	1.2%
4. Precision instruments, clocks, watches and jewellery	7.7%	13.2%

Imports	**2020** (% of total)	**2021** (% of total)
1. Textiles, clothing, shoes	45.1%	50%
2. Machines, appliances, electronics	21.1%	20%
3. Precision instruments, clocks, watches, jewellery	15.4%	9.5%
4. Forestry and agricultural products, fisheries	13.1%	14%

Source: Federal Office for Customs and Border Security

ANNEX 5 – Main investing countries

Main investing countries in the host country **Year: 2021**

Rank	Country	**Direct investment** (USD, stock)	Share	**Variation** (stock)	**Inflows over past year** (USD)
1	Singapore	4,163	23.2%	+196.0%	11
2	China	2,250	12.5%	+2.8%	23
3	India	2227	12.4%	+23.5%	142
4	Netherlands	1363	7.61%	-8.9%	100
5	Hong Kong	1208	6.7%	+13.2%	39.
6	Malaysia	1074	6.0%	+2.8%	28
7	United Kingdom	905	5.0%	+21.3%	61
8	British Virgin Islands	575	3.2%	+38.8%	7
9	United Arab Emirates	482	2.6%	+15.3%	2
10	Mauritus	480	2.3%	+7.3%	13
…	EU	2173	12.1%	+4.2%	163
11	*Switzerland*	438	*2.4%*	+0.4%	5
	Total	17891	100%	+31.0%	598

Source(s): Central Bank of Sri Lanka Annual Report 2021