

Foreign Direct Investment in Developing Sri Lanka's Tourism Industry: Problems and Prospects

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Sri Lanka is one of the major tourist attraction destinations in South Asian region. After the economic reforms in 1977, the successive governments have implemented various attractive policies and programmes to promote tourism in pursuing economic growth and development. Moreover, the government has employed a number of initiatives in order to encourage and attract Foreign Direct Investment (FDI) towards the tourism industry. The aim of this study is to investigate the long-run and the short-run relationship between tourism and Foreign Direct Investment in Sri Lanka. Annual data gathered for the period from 1978 to 2013 were used for the study. Data were analyzed using E-Views while preliminary calculations were done using MS Excel. Augmented Dickey-Fuller (ADF) is used for unit root test, while Engle-Granger is used for co-integration, whereas Granger causality test was employed to find the causal relationships. The empirical evidence shows that there is a statistically significant positive relationship between tourism receipts and Foreign Direct Investment in the long-run and the short run. Granger causality test revealed that there exists two way causality implying that Foreign Direct Investments helped to boost tourism sector while tourism earnings stimulated the Foreign Direct Investment. In addition, this research has identified various problems faced in attracting FDI in the Tourism sector and the appropriate recommendations have been presented in order to realize the major benefits from FDI inflow into the country on tourism industry.

Keywords: Foreign Direct Investment; Tourism; Co-integration; Causality

Introduction

Foreign Direct Investment is defined as foreign investors moving their assets into another country where they have control over the management of assets and profits (Graham & Spaulding, 2005). FDI is considered one of the routes through which developing countries can carry out tourism (UNCTAD, 2008). The development of the tourism industry needs investment in many forms and FDI is on such form. This introduces a causal link from FDI to tourist arrivals as this attracts greater number of visitors due to better amenities. In this backdrop, Sri Lanka is also inviting FDI itself for the reason that FDI plays a major role in contributing to the local resource base available for the investment to obtain sufficient rates of economic growth, which will improve standard of living of the people. In this regard, Sri Lanka offers attractive investment opportunities for foreign companies and has adopted a number of policies to attract foreign direct investment into the country. Hence, Sri Lanka revised its policy extensively in 1977 from one of extensive state controls to one of the far reaching liberalization (Uthayakumar, 2006). The objective of the reform was to attract FDI into the country. As a result, Sri Lanka received Rs.24 Millions of FDI in 1978, and it reached Rs.110,208 Millions of FDI in 2013 (Central Bank of Sri Lanka, 2014). It attracted USD 3,000 Million as Foreign Direct Investment to the country within 5 years to Sri Lanka Tourism Industry. (Ministry of Economic Development, 2011-2016). Several developments in tourism industry have happened in Sri