



Pathfinder Economic Flash

Prime Minister Abe's Visit: An Opportunity to Make up for Lost Time.

The Prize on Offer.

The Prime Minister Abe's visit to Sri Lanka offers the chance to reflect upon the fact that Japan has been a steadfast and generous partner throughout Sri Lanka's post-independence era. At the San Francisco conference Sri Lanka drew upon Lord Buddha's teachings to plead for the magnanimous treatment of Japan at the end of the World War II. This constituted a landmark in the bilateral relations between the two countries. Since then, Japan has been generous in its support to Sri Lanka at both the bilateral and multilateral levels. Prime Minister Abe's visit can serve to open a new chapter in bilateral economic relations based on sharply increased flows of Japanese FDI.

Most Generous Development Partner.

Historically, Japan has been Sri Lanka's most generous development partner. When Sri Lanka was a low-income country and eligible for foreign aid (until 2010), Japan was by some distance the largest source of bilateral aid. In addition, the Japanese occupied the pre-eminent position within the Asian Development Bank which was often the largest source of multilateral concessional assistance to Sri Lanka. (The World Bank was the other major source of multilateral development finance.) Japan's generosity as a development partner manifested itself, therefore, at both the bilateral and multilateral levels. More recently, Japan has supported the establishment of the 'Miloda Training Institute' setup by the Ministry of Finance and Planning.

The Lost Opportunity.

As the Pathfinder Foundation (PF) has pointed out previously, a massive opportunity was lost in the 1980s. Following the appreciation of the Yen in the aftermath of the G7's Plaza and Louvre Accords and the increasing protectionist pressures in the US and Europe, Japan embarked upon systematically exporting capital on the back of its much stronger currency. Sri Lanka was one of four Asian countries chosen as destinations for Japanese investment. This may be attributed to the excellent bilateral relations between the two countries and Sri Lanka's greater openness to FDI following the 1977 reforms. The other three countries were Indonesia, Malaysia and Thailand. Sadly, Sri Lanka missed out on this great opportunity due to the 1983 communal disturbances which broke out just at the time a delegation of over 30 potential Japanese investors were physically present in the country. While Sri Lanka lost out on that occasion, the other three countries gained from very large-scale Japanese investment

which was a very important determinant of the transformative progress achieved by them during the mid-1980s.

Making up for Lost Time.

It is now opportune for Sri Lanka to make up for lost time. As Sri Lanka has graduated to lower-middle-income country status and is no longer eligible for foreign aid, Japan is well placed to be an important source of much needed FDI. Transforming the growth model from foreign commercial borrowing driven infrastructure development to FDI driven export-led growth is arguably Sri Lanka's most important and urgent development challenge. It will not be possible to meet the government's growth targets in a manner that makes a real difference to people's lives without such a transition. The smallness of the domestic market and Sri Lanka's budget and external debt dynamics makes this imperative. Japan is, therefore, well placed to continue its historical role of playing a major part in Sri Lanka's development process this time around through enhanced FDI. These flows can provide the markets, technology, business processes and management skills which are much needed to fulfil Sri Lanka's undoubted potential. Prime Minister Abe's visit constitutes a good opportunity to kick-start this process.

The Regional Dimension.

In this connection, there is an important regional dimension which can be utilized to Sri Lanka's advantage. Japan and India have common strategic interests and a flourishing bilateral economic relationship which is likely to become even more extensive. Japan is already financing the extremely ambitious Delhi-Mumbai Corridor Project. This involves the construction of super highways, railroads, power stations and even whole new cities. It is a multibillion dollar mega project. In addition, a large number of Japanese companies are currently operating in India, many of them in Chennai. There is every reason to believe that Japan – India economic relations are going to be a rising wave that can be surfed by Sri Lanka.

The Modi government is attaching the highest priority to India's bilateral relations with Japan. In addition, the excellent personal chemistry between the two Prime Ministers can only help to give further momentum to an already burgeoning bilateral relationship. Japan's economic footprint in India will inevitably increase. This will generate opportunities for Sri Lanka to tap into existing and/or new supply chains of Japanese companies operating in India. The Japanese authorities have already demonstrated a keen interest in promoting this process.

In addition, many Japanese companies operate in India with regional Headquarters in Singapore. As their Indian activities expand, these and other companies, which are new entrants, could well be amenable to having a presence within the South Asian region. Japanese expatriates and their families have found Sri Lanka to be a conducive place to live.

It could well be timely to make a concerted effort to attract the regional offices of Japanese companies to locate in Sri Lanka.

The Policy Challenge.

For these potential benefits to materialize, it is important that Sri Lanka creates an enabling environment for foreign investment. It is well known that Japanese investors tend to be risk averse – more so than their Chinese and South Korean counterparts. Hence, high priority should be attached to creating a predictable and consistent policy environment to realise the full potential that exists for Japanese investment in Sri Lanka. With this in mind, it is concerning that Sri Lanka's latest ranking on the World Economic Forum's Global Competitiveness Index has regressed from 65 to 73 (out of 144 countries). Five years after the end of the conflict, it is important that such a trend is reversed if Sri Lanka is serious about creating a propitious climate for Japanese and other foreign direct investment. This is crucial to improve the development prospects of the country.

A Catalytic Visit to Transform the Economy.

Prime Minister Abe's visit can act as a catalyst to initiate a new chapter in Sri Lanka – Japan economic relations. Japanese investment can, just as it did for Indonesia, Malaysia and Thailand in the 1980s, help to project the Sri Lankan economy onto a transformative path.

*This is the Fifty Second Economic Flash published by the Pathfinder Foundation.
Readers' comments are welcome at www.pathfinderfoundation.org*