

China-Sri Lanka Economic Relations: An Overview

Saman Kelegama
Institute of Policy Studies of Sri Lanka

Presentation to the Sri Lanka-China Business Forum, organized by
the Ceylon Chamber of Commerce, 25 September 2009

Outline of Presentation

- Background
- Trade Relations
- Role of APTA in Expanding Trade Relations
- Investment Relations
- Aid and Technical Assistance
- Educational Links
- Sri Lanka's Contribution to China
- Prospects and Conclusion

Background

- Historical relationships between China and Sri Lanka date back over 20 centuries based on shared religious and cultural values
- The visit of the Chinese scholar monk, Fa Xian, in the 5th century AD to study Buddhist scriptures is a prominent event in Sri Lanka's history
- The Chinese navigator, Zheng He of the Ming Dynasty, sailed to Sri Lanka many times, laying the initial foundation for trade and cultural exchanges between the two countries
- In the 15th century, a Sri Lankan prince visited Beijing and settled down in Quanzhou, Fujiang on his way back home, whose descendents are still living in Quanzhou and Taiwan
- More recently, economic and political ties have been cemented, culminating in the establishment of formal diplomatic relations in 1957:
 - 1952 – Sino-Lanka rubber-rice pact
 - 1962 – First Agreement on Economic and Technological Cooperation

Background Cont.

- 1963 – Maritime agreement between China & SL
 - 1981 – Formation of Sri Lanka-China Society
 - 1982 – Signing of Sino-Lanka Joint Trade Committee
 - 1984 – Signing of Sino-Lanka Economic and Trade Cooperation Committee
- Amalgamated in 1991 to form the Sino-Lanka Joint Commission for Economic and Trade Cooperation
- 1994 – Formation of Sri Lanka-China Business Cooperation Council
 - 2007 – landmark state visit to China by President Rajapakse on the occasion of golden jubilee celebrations of diplomatic relations, where 8 bilateral agreements & MOUs were signed
 - 2009 – Signing of an investment facilitation agreement between the China Development Bank & the Central Bank of Sri Lanka
 - Throughout the 50 years since the establishment of formal diplomatic relations, China has provided assistance for Sri Lanka's development in many ways, while Sri Lanka has also helped China on several occasions

Trade Relations

- China represents one of the fastest growing economies in the world and is the leading Asian exporter of textiles & garments to the US & EU
- While bilateral trade between China & SL continues to grow, the balance of trade has been accordance to the trading strength of the two nations

| Year | Exports to China (US\$ Mn) | Imports from China (US\$ Mn) | Trade Balance (US\$ Mn) |
|------|----------------------------|------------------------------|-------------------------|
| 2005 | 29.4 | 630.6 | -601.2 |
| 2006 | 25.4 | 779.7 | -754.3 |
| 2007 | 34.2 | 923.8 | -889.6 |
| 2008 | 46.8 | 1091.5 | -1044.7 |

Source: Central Bank of Sri Lanka Annual Report 2008

Trade Relations Cont.

- Total trade between the two countries has been steadily increasing over the years and has almost doubled between 2005 (US\$ 660) and 2008 (US\$ 1138.3)
- While Sri Lankan exports to China have grown over the last 5 years, imports from China have grown at a faster rate than exports, resulting in an expanding trade deficit (US\$ 1044.7)
- These figures are further enlarged when Sri Lanka's trade with Hong Kong is also considered
- Total trade between Sri Lanka and China + Hong Kong is US\$ 1937.3
- China and HK together provide SL's 2nd largest source of imports (US\$ 1786.1), exceeded only by India (US\$ 3443.0)
- China and HK makeup SL's 13th largest destination for exports (US\$ 151.2)

Trade Relations (China + Hong Kong)

| Year | Exports to China + HK (US\$ Mn) | Imports from China + HK (US\$ Mn) | Trade Balance (US\$ Mn) |
|------|---------------------------------------|---|----------------------------|
| 2005 | 93.6 | 1278.8 | -1185.2 |
| 2006 | 97.3 | 1438.7 | -1341.4 |
| 2007 | 100.0 | 1648.6 | -1548.6 |
| 2008 | 151.2 | 1786.1 | -1634.9 |

Source: Central Bank of Sri Lanka Annual Report 2008

Major Traded Items

- Sri Lanka's major exports to China include raw coconut coir, apparel items, tea-whether or not flavoured, natural rubber, diamonds & other precious stones, titanium ores & concentrates and bicycles & other cycles
- Exports of raw coconut coir & apparel items have shown significant increases in 2008
- Exports of bicycles & other cycles have gained prominence from 2007
- Sri Lanka's major imports from China include electrical machinery & equipment, boilers & machinery & parts, cotton, iron or steel & its articles, man-made staple fibres, knitted or crocheted fabrics, fertilizers, railway locomotives & inorganic chemicals
- Imports of railway or tramway locomotives have recorded significant increases after 2006
- Hong Kong is one of SL's main sources of textiles, which serve as inputs for garments production, thus being a key trading partner
- SL exports of tea to HK rose sharply in 2008, accounting for the large increase in exports to China + HK in 2008
- SL exports to China + HK accounted for 1.9% of total SL exports in 2008, whereas SL imports from China + HK accounted for 12.8% of SL imports

Sri Lanka's Top Ten Exports to China (2006-2008)

| Description | Value (US\$ Million) | | |
|--|----------------------|-------|-------|
| | 2006 | 2007 | 2008 |
| Raw coconut coir | 5.612 | 2.451 | 8.732 |
| Articles of apparel & clothing accessories | 0.859 | 1.606 | 4.167 |
| Tea, whether or not flavoured | 1.877 | 3.018 | 3.632 |
| Other natural rubber | 1.471 | 1.626 | 3.108 |
| Diamonds & other precious stones | 0.191 | 1.751 | 2.933 |
| Titanium ores & concentrates | 1.064 | 2.629 | 2.332 |
| Other retreated or used tires of rubber | 1.317 | 1.858 | 2.277 |
| Bicycles & other cycles | - | 0.278 | 1.704 |
| Zirconium ores & concentrates | 3.458 | 3.073 | 1.457 |
| Activated carbon | 0.453 | 1.077 | 1.299 |

Source: Department of Customs, Sri Lanka

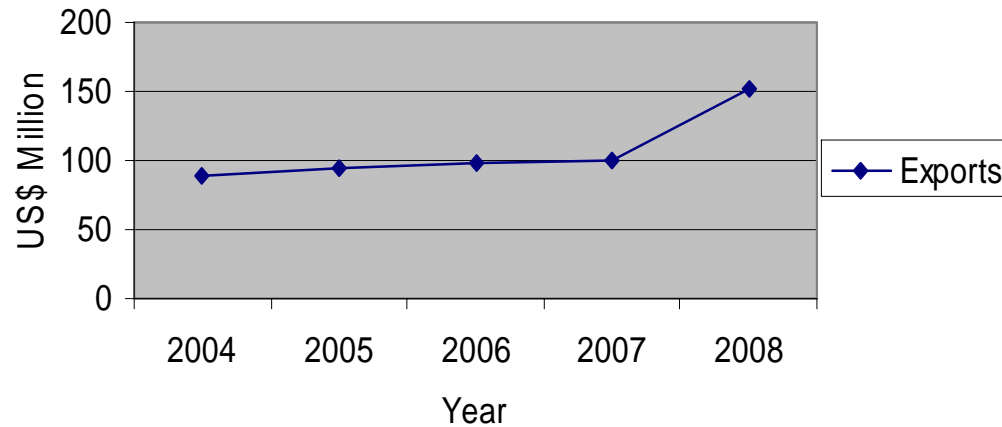
Sri Lanka's Top Ten Imports from China (2006-2008)

| Description | Value (US\$ Million) | | |
|--|----------------------|---------|---------|
| | 2006 | 2007 | 2008 |
| Electrical machinery & equipment | 97.832 | 114.128 | 130.527 |
| Boilers & machinery & parts | 78.971 | 88.924 | 113.588 |
| Cotton | 74.439 | 98.107 | 102.815 |
| Iron or steel & its articles | 61.855 | 73.863 | 93.866 |
| Man made staple fibres | 61.937 | 66.166 | 64.560 |
| Knitted or crocheted fabrics | 55.380 | 55.106 | 56.220 |
| Fertilizers | 14.012 | 42.452 | 45.270 |
| Railway or tramsway locomotives | 0.893 | 19.433 | 27.481 |
| Inorganic/organic chemicals | 14.369 | 16.999 | 19.196 |
| Coated, covered or laminated textile fabrics | 15.478 | 17.870 | 18.174 |

Source: Department of Customs, Sri Lanka

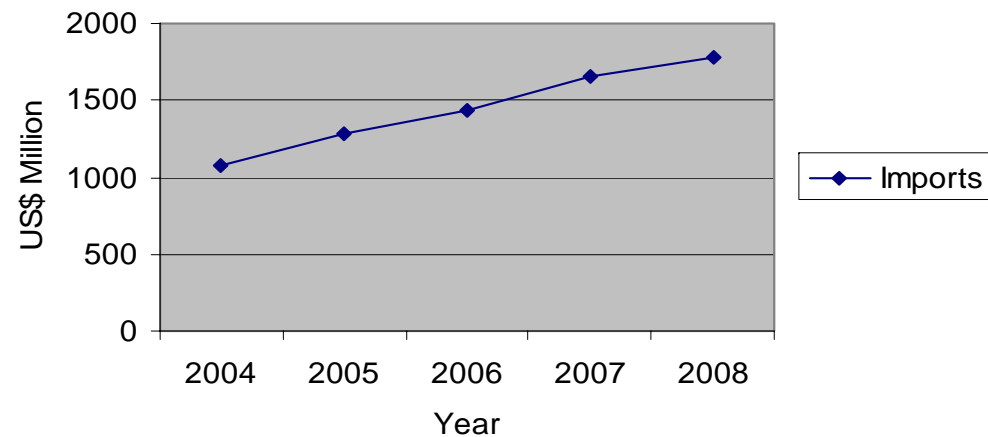
Trade Relations Cont.

Exports to China+HK



The large increase in SL exports to China + HK in 2008 is mainly due to the sharp increase in tea exports to HK, combined with large increases in exports of raw coconut coir & apparel items to China

Imports from China+HK



Role of APTA in Expanding Trade Relations

- SL & China are both members of APTA (formerly Bangkok Agreement), a preferential trade agreement where members give each other a margin of preference (MOP) over the general tariff (MRN) level
- This is a potential avenue by which trade between the two countries can be significantly expanded, but has thus far been under-utilized
- Under APTA, China already provides tax concessions for over 1700 products imports from SL at a MOP of 27%, which covers around 50% of total exports to China from SL
- These concessions are expected to increase to cover over 2000 export products within the next 1 ½ years
- However, usage of tariff concessions by SL exporters is very low – SL has used less than 5% of preferential tariff lines granted by China
- Out of APTA eligible exports, 15% is completely untouched by SL exporters
- Important export items including titanium ores & concentrates and retreaded or used tires receive no preferences under APTA

Role of APTA Cont.

- Major exports such as tea and coconut products receive MOPs of 50% and 20% respectively, but the reduction in duty for the latter is from 5% to 4%, which is marginal
- APTA will provide ample opportunities for business expansion, sourcing & attracting FDI to SL
- Most local exporters are not aware of APTA concessions. Thus trade authorities need to raise awareness among exporters about the APTA agreement in order to increase its usage
- The 4th round of negotiations is scheduled for completion in October 2009, which aims to widen the coverage of preferences to at least 50% of the number of tariff lines & provide a tariff concession of at least 50%
- The 4th round of negotiations is extending into areas beyond the traditional tariff concessions in order to deepen trade cooperation & integration (non-tariff measures)

Investment Relations

- China has become a major investor in SL
- Total Chinese FDI to SL in 2008 was almost 1.9 billion rupees compared to 1239 million rupees in 2006
- When investment by HK is also taken into account, total FDI into SL is 11.69 billion rupees
- China + HK provided the 4th largest source of FDI into SL in 2008 (US\$ 101.211 Mn)
- Presently 16 Chinese businesses have invested in garment, leather, telecom, & electronics manufacturing facilities in the island
- These sectors all have significant importance in SL's economy; as export items & as having a role in overall economic performance
- Entrepreneurs from China have been provided with an exclusive EPZ at Mirigama, and depending on the progress, additional space will be provided at Godagama, Matara & the Eastern Province
- All Chinese entrepreneurs who invest a minimum of US\$ 25Mn are provided with a SL passport on the basis of a "second home" passport

FDI by Country, 2008

| Country | FDI (US\$ Mn) |
|-------------------|---------------|
| Malaysia | 150.407 |
| India | 125.925 |
| Netherlands | 117.222 |
| China + Hong Kong | 101.211 |
| UK | 87.436 |

Source: Board of Investment, Sri Lanka

Investment Relations Cont.

- HK-based conglomerate Huichen Investment Holdings Ltd will invest US\$ 28Mn to develop the zone located at Mirigama
- China's most popular Huawei Technologies have heavily invested in SL & all SL Telecom companies have agreements with Huawei Technologies
- SLCBCC has played a major role in facilitating Chinese investment in SL:
 - Organizing high-powered business delegations to China & receiving business delegates from China
 - Organizing seminars on "How to do business in China" for local business persons
 - Organizing/Assisting trade fairs & exhibitions for Chinese business organizations
 - Establishing a 'Chinese Products and Service Information Desk' at the National Chamber of Commerce of Sri Lanka

Leading Chinese Projects in Sri Lanka under BOI (as at end 2008)

| Name of Enterprise | Activity | Realized Investment (Rs. Million) | Employment |
|----------------------------------|---------------------------------|-----------------------------------|------------|
| Tigo (Pvt) Ltd. | Cellular Mobile Tel. Service | 23168.9 | 463 |
| Textured Jersey Lanka (Pvt) Ltd. | Fabric & Related Products | 5019.4 | 1751 |
| Creative Cycles (Pvt) Ltd. | Bicycles, Export Bicycle Wheels | 394.1 | 232 |
| Collins Fashion (Pvt) Ltd.* | Apparel & Textile Products | 212.6 | 636 |

* China & Taiwan

Source: Board of Investment, Sri Lanka

Aid and Technical Assistance

- There has been strong economic cooperation between China & SL ever since the 1952 rubber-rice agreement
- China has been an important donor in SL over several years, contributing to several major projects including:
 - The BMICH
 - Nilabe Hydropower Station
 - Central Mail & Telegram Complex
 - Supreme Court Complex
 - Gin Ganga Flood Protection Project
 - Udawalawe Fresh Water Fish Breeding & Experimental Station
 - Polonnaruwa Water Supply Project
 - Veyangoda & Pugoda Textile Mills
 - Restoration of Abayagiri Dageba

Aid Cont.

Current Projects funded by China:

| Project | Cost (US\$ Million) |
|---|---------------------|
| <i>Projects Completed in 2008:</i> | |
| Procurement of 100 Carriages for SLR | 27.20 |
| Rural Electrification VII | 24.20 |
| <i>Key Projects being Implemented:</i> | |
| Puttlam Coal Power Project | 455.00 |
| Supply of 15 Nos. Diesel Multiple Units | 38.68 |
| National Performance Art Theatre | 10.86 |
| Maintenance Requirements at the BMICH | 7.20 |

Source: Department of External Resources

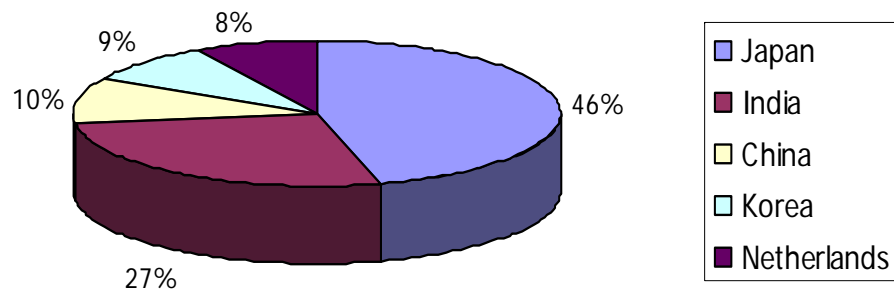
Aid Cont.

| Project | Cost (US\$ Million) |
|---|---------------------|
| <i>Key Projects to be Implemented:</i> | |
| Colombo-Katunayake Expressway | 248.00 |
| Hambantota Port Development Project – Phase II | 100.00 |
| Hambantota Bunkering Facility & Development Project | 75.00 |
| Purchase of 6 Commercial Aircraft | 81.14 |
| Puttlam Coal Power Project – Phase II | 372.9 |
| Rehabilitation of Southern Breakwater & the Approach Channels of the Panadura Harbour | 5.18 |
| Housing Project for Public Servants | 22.50 |
| Repair & Refurbish the Supreme Courts Complex | 0.39 |

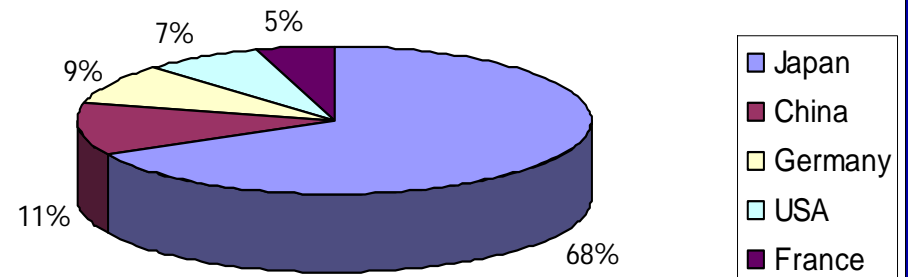
Source: Department of External Resources

Foreign Financing Commitments & Disbursements - 2008

Foreign Financing Commitments 2008 (US\$ mn)



Disbursement of Foreign Financing 2008 (US\$ mn)



Aid Contd.

- SL's relations with China have been getting stronger over the past several years, especially as Western Governments began cutting aid by making various allegations on human rights violations
- China has announced that it will give 1 million US dollars in humanitarian aid to SL to help the civilians affected by the conflict. China's provision of 20Mn Yuan tents have also reached SL
- China increased its aid to SL from a few million dollars in 2005 to about \$ 1 billion in 2008, and is expected to replace Japan as the major aid donor to SL
- On 13 August 2009 SL signed 2 key developmental projects (Colombo-Katunayake expressway & Hambantota bunkering project) worth US\$ 350Mn with the Exim Bank of China
- The signing of the 2 agreements will pave the way for infrastructure requirements which will have an immense impact on the future socio-economic development of SL
- China provided significant assistance following the tsunami disaster in SL. US\$ 1.5Mn was provided in monetary support & relief goods

Aid Cont.

- China also undertook reconstruction projects in tsunami-affected areas (China-SL Friendship Village, China-SL Red Cross Village, restoration work in 3 fisheries harbours)
- SL Railway modernizing work has begun, and China has agreed to provide latest railway engines & power sets. 100 railway passenger carriages have been supplied & 3 out of 15 promised power sets have already arrived
- From 2007, SL has been trying to launch a communication satellite, for which China has agreed to provide financial & technical assistance. Negotiations are currently underway in reaching an agreement regarding this project
- China has contributed where some of SL's major donors have not been forthcoming in assistance – eg. Energy projects
- China has recently emerged as the major provider of military equipment & assistance to SL & has cooperated with SL to modernize & expand the SL Defense Force
- Increased assistance of late is valuable to SL, given the drying up of funds from traditional partners such as the US & EU, and also less access to concessional finance from multilateral donors

Educational Links

- Exchanges in education between the two countries began with China providing 7 scholarships to SL students in 1974. Since then, an increasing number of SL students have gone to China for further education – the Chinese Government awards approximately 23 scholarships to SL annually
- 100 SL students were granted Chinese scholarships in 2007 & a series of training programmes for SL Government officials, scholars, journalists & entrepreneurs were arranged
- In May 2007 the Confucius Institute of the University of Kelaniya was inaugurated in order to facilitate academic exchange between China & SL
- This year the Yunnan Province in China has decided to provide full scholarships to 20 SL students
- Support may also be extended to the promotion of teaching Chinese language in SL in order to enhance the existing relations even further
- Technical education & training received in China would greatly benefit Sri Lankans who can then establish their own industries in SL
- There are also some Chinese students studying & researching Buddhism, Sinhala & tea cultivation in SL

Sri Lanka's Contribution to China

- Given the vast difference in size, and pace of economic growth between the 2 countries, the China-SL economic relationship may seem a one-way street, with all benefits flowing from China to SL
- However, SL has made its contribution in a small way over the years:
- SL co-sponsored the draft resolution to restore China's legitimacy in the UN in 1971
- SL signed a special agreement with China in 1997 in support of Chinese admission to APTA, where both countries have benefited from tariff concessions
- In early 2000 the SL government rendered valuable support for China's entry into the WTO

Sri Lanka's Contribution Cont.

- SL played an active role in helping China to obtain 'observer status' to SAARC
- SL set up a consulate in Shanghai to increase its diplomatic representation in China, and is planning to open another consulate in Chengdu by October this year. The consulate in Shanghai coordinated the signing of 3 Sister City Agreements between SL & Eastern China, which will entail cooperation in economy, trade, science, technology and tourism & also harness resource mobilization for economic & infrastructure development & greater market access
- China has been appreciative of SL's unshaken support for the 'one China policy', with respect to issues of Taiwan & Tibet that are matters of China's core national interests
- The help offered by SL to China after the disastrous earthquake that destroyed the Sichuan province & the support extended in Beijing during the Olympics period is also important

Prospects

- China's growing middle class (projected to reach 400mn by 2010) will have increasingly differentiated tastes and thus provide a major market opportunity that should be captured by Sri Lankan exporters (eg. niche markets in apparel & tea that are not focused in the US & EU)
 - After many years, China has opened its borders to Sri Lankan tea imports. Tea exporters were encouraged to participate in a tea fair in Hong Kong as a means to penetrate the huge Chinese market (tea has become one of the top imports from SL to HK)
 - The Sri Lankan tea company 'Heladiv' opened 3 exclusive tea boutiques in the Fujian province and Beijing in August 2009
 - The company aims to open 100 boutiques in China by 2011 and 20 by the end of this year

Prospects

- Other Sri Lankan products which have further potential in the Chinese market include:
 - Gems & jewelry – the demand for gems & jewelry is rapidly mounting with the rising income of the Chinese population, and SL has a MOP under APTA for this sector, which should be exploited
 - Herbal products, spices, seafood, vegetables, coconut shell charcoal, rubberized coir cushions
- Possibility of Chinese imports flooding the domestic market. However, Chinese imports have provided lower cost high quality alternatives for consumers in SL. It has also contributed to lower cost raw materials for production

Prospects

- China is an important potential source of tourism – Tourist arrivals from China have risen from 2,208 in 2000 to 16,274 in 2006, a growth of 637%
- However numbers fell to 10,413 & 10,015 in 2007 & 2008 respectively, with the overall tourism industry experiencing a setback due to the civil war and financial crisis
- SL has pinned its hopes on Chinese visitors to boost the nation's flagging tourism industry. It is encouraging to note that tourist arrivals from HK have picked up in 2008, doubling from 210 in 2007 to 421 in 2008
- Improved air connectivity can further enhance tourism – steps are already underway:
 - There are 3 direct flights from Beijing to Colombo & another 3 to Hong Kong
 - SL Airlines has started a holiday promotion, offering tickets for less than 6000 Yuan (\$900)
 - Visa procedures have been simplified for Chinese citizens visiting SL

Prospects

- The Sri Lankan Embassy in Beijing together with the BOI held 2 seminars on “Investment Opportunities for Chinese Entrepreneurs” in March 2009, which attracted over 90 entrepreneurs from sectors such as infrastructure, real estate, fisheries & agriculture, paper manufacturing, steel, leather products, solar & energy and cosmetics & telecommunication
 - China’s FAW & SAIC car companies are currently negotiating with the BOI of SL to setup their manufacturing plants in SL. These companies will export vehicles from SL to Latin American countries & to some African countries
 - Recently, SL’s Micro car company & China’s DMC car company began negotiations to launch a joint car project
 - Following an offer by SL of an oil exploration block to China, the China National Petroleum Cooperation (CNPC) has begun oil exploration work in SL
 - An investment facilitation agreement was signed between the China Development Bank & the Central Bank of Sri Lanka on July 25 2009. Under this agreement, the CDB will initially place a US dollar deposit with the CBSL, while also progressing towards long-term economic ties between the two institutions

Conclusion

- The close cultural and historical links enjoyed between the two countries have been built upon in enhancing economic relations over the last 5 decades
- China provides a significant export market, a source of FDI into SL, a source of affordable imports and a steady flow of aid & economic assistance
- As China continues to prosper in the world economy, many countries have felt China to be a threat, however SL should see this as an opportunity – the China-SL relationship is a fine example for 'big country-small country relations' with mutual benefits experienced by both countries

Thank You

www.ips.lk