

Japan – Sri Lanka Economic Relations: 60 Years and Beyond

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Among the many events organized to mark the 60 years of diplomatic relations between Japan and Sri Lanka was the 17th Joint Committee Meeting of the Sri Lanka – Japan and Japan- Sri Lanka Business Cooperation Committees and the subsequent full day conference on Japan-Sri Lanka Economic Cooperation on 6th December at the BMICH. One of the key speakers at the seminar was Dr. Saman Kelegama, Executive Director of the Institute of Policy Studies of Sri Lanka (IPS). The Island Financial Review spoke to Dr. Kelegama after the seminar on the 60 years of economic relations between the two countries and prospects for increasing trade and investment between the two countries in the coming years.

Q: How do you see the 60 years economic relationships between Sri Lanka and Japan?

A:It evolved from cultural ties that were built based on Buddhism, which then moved on to Sri Lanka becoming an aid recipient from Japan, and then on to trade and investment linkages between the two countries over the last 60 years. Japan was the largest aid donor to Sri Lanka up until 2007, and was a major contributor to Sri Lanka's infrastructure development. This led to the transformation of Sri Lanka's relationship with Japan from aid to trade and then investment. In the year 2000, Sri Lanka was the 8th largest recipient of Japanese aid. Today Japan is Sri Lanka's 8th largest trading partner, 2nd largest aid donor, and the 10th largest source of FDI (in 2011).

Q: As a major donor what are the key projects that Japan supported in Sri Lanka?

A:Since 1982, Japan has been the largest aid donor to Sri Lanka till 2007. Japanese assistance comes to Sri Lanka through two major institutions in Japan: JICA (Japan Investment Cooperation Agency) and JBIC (Japan Bank for International Co-operation). The former

manages grant aid and technical cooperation, while the latter manages the soft loan components of aid flow. The last noteworthy project with JBIC assistance was the Upper Kotmale Hydro Electric Project. Other key Japanese funded projects included the Colombo Port expansion, parts of Mahaweli Development, Samanalaweva, Kukulegaga Projects, Colombo Airport Aerobridges and Expansion, telecom network expansion, and the railway and road rehabilitation projects. Besides infrastructure, Japanese aid has contributed to a number of institutional building projects such as, Sri Jayawardenapura Hospital, Peradeniya Teaching Hospital, Medical Research Institute, Institute of Computer Technology at the University of Colombo, Airport Quarantine Centre, and Rupavahini Corporation.

Q: As a trading partner, is Japan still important, given the emergence of China and India as big powers in Asia?

A: Sri Lanka's biggest trading partner is India, with nearly US\$ 5 billion in trade. Trade with China is nearly worth US\$ 2 billion. In 2011, Sri Lanka's trade with Japan amounted to US\$ 1.2 billion. Japan is Sri Lanka's 5th largest source of imports, and its 10th largest export destination. Sri Lanka's imports from Japan are dominated by vehicles, machinery, electronic goods, and audio/camera equipment; while Sri Lanka's exports to Japan are dominated by tea, fish, rubber products, apparel and textiles, and ceramics.

When trading with a nation like Japan, it is not sensible to give importance to the existing trade imbalance between the two countries, with Sri Lankan exports being far less than Japanese imports. Trading with the world means that with some trading countries Sri Lanka will have a deficit, and with others a surplus. The benefits to Sri Lankan consumers and producers from Japanese imports are enormous, and that is what matters in the end.

Q: What are the emerging opportunities to increase Sri Lankan exports to Japan and earn more foreign exchange?

A: Japan is a tea drinking nation, but it is not a major market for Sri Lankan tea. There is a need to popularize Sri Lankan tea in the Japanese market, and in this context, the Japanese ITOCHU Corporation is planning to make a concerted effort to market Sri Lankan tea in Japan. There is a high demand for certain fish/sea related products in Japan that Sri Lanka should exploit such as, sea cucumber and tuna. Sri Lanka can also export labour, especially health workers, to cater to the ageing population in Japan. In addition, about 20,000 Japanese tourists visited Sri Lanka in 2011, and this number could be increased to about 100,000 in the next two to three years by promoting Buddhist tours (marketing on the curiosity to learn about Theravada doctrine by Mahayana Buddhist), Ayurvedic spas, and leisure sports like Golf.

Q: Why has Sri Lanka failed to attract large Japanese FDI?

A: The preferred destinations for Japanese FDI since the early 1980s were North/East and South East Asia. Out of the entire Japanese investment in Asia during 1991 to 2000 period, only 4.8% came to South Asia, whereas 41.7% was in North East Asia (China, Korea, Hong Kong and Taiwan) and 53.5% in East Asia (ASEAN). Generally, Japanese investors prefer joint-venture than fully-owned subsidiaries, and South Asian countries did not always meet this requirement as

much as East Asia did, where their domestic capitalistic system was more advanced. Sri Lanka was in a strong position to attract Japanese FDI after the liberalization of the economy in 1977. In 1982, an Investment Protection Agreement was signed with Japan to facilitate more Japanese investment in Sri Lanka. Four leading Japanese companies — Sony, Sanyo, Maruberi, and Bank of Tokyo— were in the pipeline for investment in Sri Lanka in 1983, but soon after the 1983 riots, these companies basically wrote-off Sri Lanka. Thereafter, Sri Lanka attracted only small quantities of Japanese investments.

Korea, Hong Kong, and Singapore, who are late comers as investors to Sri Lanka when compared to Japan, have more investment in Sri Lanka today compared to Japan. Unlike FDI from the West and some countries in the East, Japanese FDI is extra sensitive to uncertain economic conditions and normally shy-away from such destinations. That is why Japanese FDI declined during the conflict years of 1983-2009. Now Sri Lanka has a fresh opportunity to attract more Japanese FDI.

Q: What is the current situation and emerging trends in regard to Japanese FDI ?

A: There are about 37 firms with Japanese FDI operating in Sri Lanka now, compared to 22 firms in 2002. The largest Japanese investments are in Colombo Power, Colombo Dockyard, FDK Lanka, DIC coatings, State Chemifa Lanka, Toyota Lanka, and Tokyo Cement. The largest Japanese investment was seen during 1997-2007 in Sri Lanka Telecom, by Nippon Telephone and Telegraph Corporation, but they are no longer present. The Japanese investment in Sri Lanka is still small compared to, say India, where in Chennai alone there are some 300 firms with Japanese FDI.

With regards to the emerging scenario, a number of Japanese firms are mentioned – ZucInternational in Solar energy; Teoria Investment Company in hotel/ leisure industry, Kiyoshi Kinura in fisheries industry, Bansay Securities in Treasury Bills and Bonds, etc.

Q: What are the potential areas in Sri Lanka for Japanese investment?

A: ITO/BPO services and outsourcing, call centres, agriculture, agro processing and agro technology, fresh vegetables and fruit exports, shipping and logistic, apparel, motor vehicle assembly, warehousing, cold stores, deep sea fishing, fish canning processing industries, urban commercial leisure and property development, marina related property development, tourist transportation, and leisure activities.

Q: Can Japanese FDI in Sri Lanka benefit from the large Indian market given that there is a FTA between Sri Lanka and India?

A: Some Japanese investments in Sri Lanka are already benefitting from the growth and development of the Indian Economy. Two examples are Colombo Dockyard and Noritaki Porcelain. The former does ship repairing work and other types of subcontracting to India, while the products of the latter are in high demand among Indian tourists visiting Sri Lanka.

The growing motor vehicle industry in India, Chennai in particular, may be a potential area to target from Sri Lanka. Vehicle components like rubber tyres and other such products can be supplied from Sri Lanka. There are close to 4,000 duty-free tariff lines to the Indian market under the bilateral FTA. These tariff lines could be closely studied to identify products that could be manufactured in Sri Lanka at a lower cost, and exported to India.

Q: What has Sri Lanka got to do to attract more Japanese investment in the future?

A: There are many aspects that Sri Lanka has an edge over its competitors when attempting to attract Japanese investments. The living standards are higher than in the region and some ASEAN countries. If Japanese investors are based in Colombo, they will have access to quality medical services, international schools for kids, the amenities in a modern city like supermarkets and Japanese restaurants. In fact, Sri Lanka ranked 58 out of 142 countries in the prosperity index compiled by the London-based Legatum Institution, surpassing, for instance, countries like the Philippines.

Sri Lankan Airlines flies four times a week to Narita – Tokyo non-stop, and there are connecting flights to Tokyo by other airlines on days when Sri Lankan Air Lines do not fly to Narita. So, all these are positive aspects for a Japanese investor to consider, when deciding to operate from Sri Lanka.

There are concerns about the limited size of the domestic market, but even for an import substitution FDI, there is always room to use the bilateral FTAs with India and Pakistan to reap economies of scale by exporting in a later stage. The challenge however to policy makers is to: (1) maintain stability in the macroeconomic environment, (2) rectify existing anomalies of the investment regime, and (3) maintain consistency and predictability of policies. If these challenges could be met, attracting more Japanese FDI will not be a major problem.

Sri Lanka has engaged in a few trade and investment promotional missions to Japan, to sensitize potential Japanese business people. The Japan-Sri Lanka Business Corporation Committee in Japan, and its counterpart in Sri Lanka, which were formed in 1979 are playing a key role in promoting and strengthening the economic links between the two countries.

One of the oldest Japanese FDI projects in Sri Lanka is Noritake Porcelain which started operation during the closed economy in 1973. Its continued operation despite turbulent times in Sri Lanka, and when other Noritake sub-branches were pulled out from ASEAN countries, is a testimony to the fact that business can be done in Sri Lanka despite challenges.