

# 2011 And Beyond Trade And Investment Prospects In Asia And Implications For Sri Lanka

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*The recently released Asia-Pacific Trade and Investment Report (APTIR), was the subject of analysis and discussion at a seminar organised by the Institute of Policy Studies (IPS), under the theme of “2011 and beyond: Trade and Investment prospects in Asia and implications for Sri Lanka”. The seminar provided a forum for a panel of analysts to discuss the implications of the report, which was published by the United Nations Economic and Social Commission for Asia-Pacific (ESCAP), and reviews recent trends and developments in regional trade. The seminar was held under the patronage of Chief Guest Sarath Amunugama, Senior Minister for International Monetary Cooperation and the Chairman of the 67th session of ESCAP.*

*By Chiranthi Rajapakse*

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In his welcome address, Saman Kelegama, Executive Director, IPS, outlined the objectives of the seminar. He noted that while the economies of many Western countries were once again experiencing a dip, Asian economies were growing and the challenge for Sri Lanka was to decide how best to make use of the opportunities provided by Asia's growth.

In his address Minister Amunugama focused on several main aspects; the global scenario in which the APTIR report was presented, the response of the Asia Pacific region to the problems identified in the report, and the implications of the findings for Sri Lanka.

Regarding the global economic situation, the Minister noted that the three powerhouses of industrial economic growth – the US, EU and Japan, were facing a major crisis. Though there were signs of recovery, this had not been followed by an expansion in employment. The implications of this for Sri Lanka, the Minister stated, could include a tendency towards protectionism among these powerful economies, resulting in a restriction of imports from

Asia.

In such a situation 'no country could lie down and play dead' the Minister observed. He went on to outline three possible responses; first for the countries affected to consider their own manufacturing industries and restructure their manufacturing bases, second to look at their internal markets, and thirdly to focus on intra regional trade.

The Minister expressed his view that focusing on intra regional trade was the option that Sri Lanka should be considering. "Smaller economies have to strategise as to how they can benefit from this intra regional trade. This is the crux of the matter," the Minister observed. In order to improve intra regional trade the Minister recommended that the implementation of trade agreements and tariffs should be seriously looked into. "I don't think this can be decided on by simple nationalist sentiment," the Minister observed, pointing out that the Sri Lankan domestic market was limited not only by numbers but also by purchasing power and therefore Sri Lanka could not afford to depend solely on its internal market.

Anushka Wijesinha, Research Economist, IPS, in his presentation, highlighted the key messages of the report. The report noted that after witnessing a free fall of exports during 2009, developing countries of Asia and the Pacific bounced back strongly in 2010, with exports growing at 17.3 percent. The report also observed that services exports started to recover in 2010 and that FDI flows began to return to the region during the past year. Wijesinha discussed the post crisis trade and investment opportunities identified in the report, namely; high potential for intra regional trade, increased opportunities in services trade, and new opportunities in climate smart goods and technologies. Wijesinha also noted that the report emphasised the need for countries to improve trade facilitation in order to take advantage of these opportunities. Other areas discussed in the report included the need for the effective participation of Small and Medium Enterprises (SMEs) in global and regional value chains, and the need to strengthen regional trade agreements (RTAs).

In the panel discussion following the Minister's speech, Narhari Rao, Lead Economist, Asian Development Bank, Sri Lanka Country Office, spoke on the topic of 'Dynamic and resilient Asia: How can Sri Lanka and South Asia plug in?' Rao focused on putting the report into the perspective of the present economic situation. He expressed his view that the economic crisis was worse today than it had been in 2008, when there had been a coordinated global effort to stimulate demand. "The reason why the situation is much more serious now is that the major developed countries have run out of policy options," Rao noted.

Rao also addressed the question of whether the Asia Pacific region would be able to sustain

itself on internal and regional demand during the next few years. "My answer to that is no. It can, only to a limited extent stimulate intra-regional trade where there is increase in domestic demand, but it cannot de-couple itself," Rao stated. Rao also emphasised that it was important to take note of the report's recommendations on trade facilitation. In conclusion he also touched on the need for Sri Lanka to consider how it could diversify its exports and manufacturing.

### **Asian Economies Are Growing At Double Or More The Speed Of The Developed Economies, And That Consequentially Sri Lanka Should Try To Navigate Towards These Markets.**

Anura Ekanayake, immediate past Chairman, Ceylon Chamber of Commerce and Member, Board of Governors, IPS, focused on the theme of 'Era of "Two speed" growth' and the directions in which Sri Lankan firms should navigate'. Ekanayake defined what is meant by 'two speed growth'; namely that developing Asian economies are growing at double or more the speed of the developed economies, and that consequentially Sri Lanka should try to navigate towards these markets. Ekanayake discussed ways in which private firms could achieve this; he pointed out that in Asia, linkages were primarily established on the basis of relationships over a long period of time, rather than based on informational databases and websites; and establishing such linkages would take time. He further noted that products manufactured for the West could not be shifted to Asian markets without any adjustment, since consumer preferences were different. "We need to recognise that navigation towards Asia involves very severe adjustments," he stated.

In his remarks, Mafaz Ishaq, Director, Calamander Capital Singapore (Colombo Office), discussed ways in which Sri Lanka could increase its share of the investment flow in Asia. Ishaq broadly identified the different types of foreign investors who might be attracted to Sri Lanka and discussed some of the concerns that these investors face. Ishaq started with what he termed as "...the public media relations disappointment after the end of the civil war in May 2009 in dealing with the diaspora," and noted that the lack of public and media relations had led to the re-emergence of political risk on the country in the eyes of certain investors. He pointed out that some international publications such as the OECD's Country Risk Classification Report gave Sri Lanka a score of six, from a range of zero to six, alongside Angola, Georgia, Uganda and Iran. "In essence the general perception is that Sri Lanka is a very risky place to do business. This has led to many investors avoiding Sri Lanka as an investment decision," Ishaq stated.

Ishaq also emphasised the need for stability in government policy in order to attract investors. "Conflicting signals seem to be the norm" he observed. However he noted that,

“basic investor policy has not changed,” and observed that the view that Sri Lanka’s policy landscape is one that is highly unstable was unrepresentative of the broad levels of stability experienced throughout most of the economy. He also emphasised the need to reduce bureaucratic uncertainty in order to make procedures more streamlined for potential investors.

The remarks by the speakers were followed by a short question and answer session; the seminar provided a timely forum to facilitate an informed discussion regarding the recently published report, identify its key messages, and discuss the resulting implications for policy formulation in Sri Lanka.

## **Saman Kelegama**

### **Executive Director, IPS**

Let me welcome all of you for this seminar on Trade and Investment prospects for Asia and implications for Sri Lanka. This seminar is based on the recently released ESCAP report on Asia Pacific Trade and Investment for the year 2010 and 2011. It was released about a month ago by ESCAP in Bangkok. I would like to extend a special welcome to our chief guest Honourable Sarath Amunugama, Minister of International Monetary Corporation, he is also the Chairperson of the 67th session of the UN ESCAP so we’re very pleased that he’s here as the chief guest.

Now the objective of this seminar is to examine the implications of the findings and the recommendations of this report for Sri Lankan policy. As all of you know the world is changing very rapidly, we’re living in a globalised world, economies are changing very rapidly, many western countries are once again facing a slight dip – so the double dip many economies were talking about – we’re experiencing it now. While we see that in the western countries, the Asian economies are growing, they may not be growing up to their potential but they’re certainly growing faster than the western countries. So how best can a country like Sri Lanka make use of the opportunities of the Asia’s growth? What are the challenges, these are the topics we will be discussing today.

As you can see in the programme, the key highlights of the report will be highlighted by our research economist Anushka Wijesinha and there after we will have a panel discussion looking at the implications for Sri Lanka. Starting with Narhari Rao who will be looking at the dynamic and resilient Asia: How can Sri Lanka and South Asia Plug-in? Followed by Dr. Anura Ekanayake, governing board member of the IPS and the former Chairman of the Ceylon Chamber of Commerce who will look at how the firms will navigate the private

sector to the two speed growth we're witnessing today and finally Mr Mafaz Ishaq will look at investment flows in Asia and how Sri Lanka can leverage on the investment flows. I thank all the panelists for accepting our invitation to be part of the discussions today. I hope all of you who accepted our invitation and who are here will benefit from the elaborations today. Thank you.

**Sarath Amunugama**

### **Senior Minister for International Monetary Cooperation**

Distinguished members of the head table, ladies and gentlemen, I'm honoured to be here on the invitation of IPS and to say a few words about the ESCAP report which was presented about a month ago. I'm in an agreeable position because I was in Bangkok when this report was presented; I had a sneak preview of what was in it. Rather than go into the details of the report, I would like to talk about three aspects, which follow the publication of the report. The first is the global scenario in which this report has been presented. Of course it has changed somewhat from the time when it was presented in Bangkok, but we can refer in general terms to that. Secondly, what is the response of our region – the Asia Pacific region, to the problems that have been identified in this report. And thirdly what are the implications of these findings for own country, our own economy and for our own plans. Someone mentioned the double dip in Western economies. Today, the three powerhouses of industrial economic growth – the US, EU and Japan, are all facing a major crisis. Look at the recent developments in the US when President Obama had to come out with a bail out package which has still not been worked into law – you will find that he is trying to address a major aspect of the so called recovery in the Western economies. That is though there are signs of recovery or growth, that is not attended to by or not followed by an expansion in employment. Today you will be seeing perhaps an unprecedented – 10 % of the American workforce is unemployed. This will create tremendous resonances – in economic terms, political terms. That is one area we have to look into. That is going to affect whatever plans we're going to make.

If you look at the European Union, with the fiscal crisis, in many countries – and if you look at the present crisis Japan is going through – I was reading a magazine yesterday that said that the last five Prime Ministers of Japan didn't survive more than 365 days. So you can see the type of crisis that is affecting the powerhouses of manufacture and industry. This has very implications for us. First there is a contraction in demand, as we saw in 2008 and 2009. And even more than that what will happen in the future, there will be a tendency towards protectionism in each of these powerhouses. We already see the signs of that in the United States where if you look at the Republican contenders, the tea party, if you look at all the

developments in American politics it is very clear that the country is moving very much towards an introspective approach of trying to generate growth and employment in the short run – perhaps at the cost of the type of imports that they indulged in during the past few decades. One of the fundamental contradictions of the American economy – what you call the post Greenspan age – when, since the dollar is not only the international currency but also the reserve currency of the United States, which gives them greater flexibility to attract large amounts of dollars into the country, and with this surplus create what was called the ‘you never had it so good’ type of economy starting with Ronald Reagan, living way beyond their means. I’m relieved to note that their budgetary gap is much greater than ours though we’re subject to a lot of debentures.

So this is going to correct itself, or will have to correct itself, in terms of trying to restrict imports from particularly Asia. The signal has already come from China. Already Asian economies have to be wary – that period of large employment creating manufacturing and industrial growth in the Asia Pacific region will have to be looked into afresh, in terms of demand from the large Western countries, particularly if you look at the EU, US and Japan. Now given this situation how have these big countries which have export led growth, manufacture led growth – how are they responding? The big test is China. If you take China and India, China is largely – much more than India, the model for export related growth, which is based in the use of cheap labour. Finally when you’re planning, you have to look at what is called your comparative advantage. The writings of Mr Justin Lin who is the deputy in the world Bank, he’s the senior most official in the bank and his very stimulating and frank writings are a very good guide to the type of policy making, hard nosed policy making we have to think of in our countries. The first thing Justin says is what did China trade on? Basically cheap labour. Cheap and controlled labour. On the back of that they were able to establish huge industries which could meet the growing – the ‘never had it so good’ demand which was generated primarily in America but also in the other European countries. So now that comparative advantage, which still persists by and large, is now challenged, because now the markets of these leading economies will try to either restrict the import of these cheap goods by various tariff barriers, fiscal measures, by various arguments, or they will try to pressurise these countries to adjust their own currencies and so on to make them less competitive with their own products. There is a big attempt by the developed countries to ask for the revaluation of the yuan. They’re doing that because with the yuan becoming more expensive, then they’re own economies and manufacturing industries can become more competitive. It’ll cost more to the American consumer, which will lead to a shrinkage of the demand.

No country can lie down and play dead – they have to respond. I can see three responses,

which will have an impact on the type of future we envisage. The first is much more hardheaded look at their own manufacturing industries. You can see the transition of the Chinese economy now where they're going more for services, more for advanced technologies, for example if you take Huawei technologies, they're global number one. So like that they will go for selected areas of growth. Singapore also did that. They saw the writing on the wall and they made the adjustments to the type of manufacture that can find a steady market. This is very much an opportunity which we I'm sad to say we're not making good use of. Today there's a shift of the more labour oriented industries to Philippines and Vietnam. I believe in the report also there's a reference to that. It's a glorious opportunity, which we seem to be missing. If you look at the FDIs, if you look at the type of Chinese investment, which is moving out of China, I don't think we're getting even a small fraction of that. We're about two years behind. Statistics are available in the report for the type of investment that is moving over from China to Vietnam and Philippines.

Number two is to look at their internal market. India and China particularly, but to some extent countries like Vietnam which have about 80 million population, Philippines, they can progress to some extent at least by catering to their domestic market. This market is being targeted particularly the Chinese policy makers - the Chinese equivalent of Parliament - they took a decision to balance growth with harmony. What does that mean in economic terms? It means more and more goods must go into the internal parts of China. There's a huge disparity between growth in the littoral areas - ports -the shipping areas, particularly the southern ports - areas like Shanghai where growth is phenomenal, but compared to rural areas there's a big gap. So the government has taken a very considered decision that even if their growth which is based on manufacture and export - even if there is some dipping of that - they can address that internally. Things are right there, because if you have for 10 or 20 years, 10 % growth you create a middle class in your country. There's a middle class in China, a growing middle class in India, growing middle class in Russia, where this growth process creates a reservoir of people who can perhaps, as much as the Western consumer, begin to enjoy those products. And you can see that in China. It can be seen even in the relationship with us - there are fairs which are targeted for the South Asian market. You will find many of our ministers going for these and making statements or relationship. That's an indication of their strategy to have multi polar growth within the country and not depend on these port cities.

Number three is what we should be considering - that is intra regional trade. One is to restructure your manufacturing base, second is to look at your internal markets, third is to look at intra regional trade. Very much on the agenda in the next couple of years will be intra regional trade, which is also I think the focus of this report.

Intra regional trade is a nice term – but different countries have to react differently to this. Countries that were leading exporters can find it easier to move into this, into the other big markets in the region. Smaller economies have to strategise as to how they can benefit from this intra regional trade. This is I think the crux of the matter and it is what Sri Lanka should be doing. Just now it's pretty dismal. If we're going to look at intra regional trade there're some basic things we have to look into particularly in the light of the fact that most South Asian countries are manufacturing the same things. Our economies have been geared to manufacture virtually the same thing. If you go to Bangladesh, Sri Lanka, Burma, most of it is what we have experienced – everyone is making use of cheap labour to go into areas like textiles and small-scale manufacturing. So we're competing with each other. In that situation what can we do? We must seriously look at the agreements and tariffs, which should be addressed if we're thinking of finding a bigger market. I don't think this can be decided on by simple nationalist sentiment. We're not in a position to do that. If we had a big domestic market we could. Many years ago in France they had what is called the Fortress France economy. They said everything France needs will be manufactured here. No one need come in – that was virtually De Gaulle's attitude. They could do that to some extent because they had a large enough internal market. China could do that, though it is not feasible for them because of their need for foreign currency and so on. India can do it. Vietnam can do it. But Sri Lanka can't do it. Our domestic market is limited not only by numbers but only by purchasing power. Even if we have large numbers of people, the people who are willing to buy this type of products are limited. We have to have consensus on that. It's useless to say that we're making shampoos or shoe polish or something like that and that we must stop competition. I remember the time when we were starting local industries. They said we're going to stop bringing paper clips. All the paper clips can be made by the Government or in Sri Lanka. Then the fellow who was asked to make this – a poor industrialist in Kotte, he came and said, this nationalistic feeling, but all the clips you need for the next 10 years I can produce in one day. After that what am I supposed to do? Of course that's an extreme case. But finally you have to reckon with your market. So I don't think this idea that you can keep out everything on the basis of local tariffs, strategies – of course it can last – but you'll be making paper clips. It's really a choice that the country has to make. Are you going to go on making paper clips, shampoos and leave it at that? Of course you can do that. But then you're working on a very narrow front.

On the other hand we can look at the tariffs and trade agreements so that we can have preferential treatment. In this situation – no thanks to us, we have been very fortunate. Just across we have some of the best markets, Indian market, Bangladesh market. If you have trade agreements, if you have SAFTA, free trade arrangements with other countries – we have agreements with Pakistan too as well as India – no one is talking saying that Pakistan

is trying to come and grab the Sri Lankan market. India is one, Pakistan is another. It is not whether it's one particular country - it so happens they have a large market. It could be China, it could be Russia. Those are large markets.

We have to discuss seriously the working of the existing agreements with India and Pakistan, and the proposed SAFTA agreement, also the CEPA agreement - also these are a package which we have to analyse in the interests of Sri Lanka. This is only a wide brush stroke - there are so many things, what are the competing products, how can we collaborate - to my mind in Sri Lanka we have to concentrate on getting into the supply chain of big companies. I don't think it's realistic to expect all the big manufacturers to rush to here. Those are some of the political fantasies. But our real strength will be to get involved in the supply chain of regional production that is bound to come.

There are other factors - we have to find investment, we have to find energy, we have to find good governance, we have to have connectivity - we are moving in those directions. That has to be now compressed into some serious thinking and I welcome this report. It has good things as well as bad - one of the bad things is that there are very few references to Sri Lanka! But certainly it gives us a good opportunity to reflect on these issues and to take these matters seriously. Because if we don't take these matters seriously and take the correct decisions, others will. And as you know, time and tide wait for no man. And certainly for no woman!

**Anushka Wijesinha,**

**Research Economist, IPS**

### **Key Highlights Of Asia-Pacific Trade And Investment Report 2011 (UNESCAP)**

I will attempt to give highlights from the Asia Pacific Trade Investment Report published by ESCAP. One of the arms of ESCAP is ARTNeT, of which IPS is a partner of, which is why we're teaming up to give you some highlights. As the Honourable Minister said much of the report takes a pan Asia Pacific view so my comments will be largely focused on the region as a whole. I'll read some elements relating to Asia Pacific region and Sri Lanka but I'll keep the harder task of the Sri Lankan context to the panelists.

This year's report reviews recent trends and developments in regional trade and investments and identifies some of the emerging challenges within the context of the changing global economy after witnessing a free fall of exports in 2009 at the height of the crisis. Developing countries of Asia and Pacific bounced back very strongly in 2010 with

exports growing in 17.3 percent in 2011 and in 2012 the report expects this growth rate to stabilise at historical rates, just over 9% in 2011 and 8 1/2 % in 2012. Services exports started to recover and FDI flows began to return to the region last year.

Another piece of good news is that the fear of the repeat of the great depression style protection measure will not occur, however I'll deal with some of those issues a little later on. For least developed countries in the region- they fared pretty well as shown by examples of Cambodia and Bangladesh. In this report apart from the very specific issues, the report identifies three emerging opportunities that we should not miss out on particularly if the Asia Pacific region wants to maintain trade as an engine of growth. The report highlights these opportunities coming in three main areas; one, a rise in intra regional trade. Some points were also mentioned by the Honourable Minister. especially South South Trade. The second is a greater focus on trading services and the third I think it's a fairly new idea which we rarely discuss is that trying to get a first mover advantage in potentially lucrative products in what we call climate smart goods and technology (CSGTs).

I'll first provide you with a quick snapshot of the highlights of this region's recovery, the good news is that the exports in the region's recovery reached pre crisis levels in end of 2010. The total exports 5.5 trillion US\$ in 2010 is in fact slightly above that of the pre-crisis 2008 level of 5.3 trillion US\$. It is an unprecedented development given the depth of this great recession that traversed the globe in 2009. Two important contributory factors need to be stressed, first the crisis has increased intra regional trade. Since the start of the crisis Asia Pacific exported 51% in its total exports to its own region. The EU and US now account for about 29% of Asia Pacific exports. Secondly China was at the centre of the recovery both at the regionally and globally, China has emerged after the crisis as the largest exporter of merchandise in the industry and the second largest importer behind the United States. Developing Asia is also leading the way with its service industry. In 2010 the developing countries exports grew at 19%, almost twice as fast as developing countries grow services exports which was 11%. China tops this list with a growth of 32% followed by Hong Kong, Singapore and India. However despite this spectacular growth, two issues must be noted. One unlike in goods trade, intra regional trading services have been limited with much of the trading services directed to outside the region. The second is the dominant orientation of the region towards merchandise exports with goods being most acceptable to external demand shots. The report notes policy makers should be encouraged to promote further develop the services within their national economies and also take a regional view.

With regard to FDI a positive sentiment, the region remain at the forefront in attracting FDI in flow. It must be said that it's largely concentrated in a few economies China, India, Singapore and Hong Kong; together these economies account for almost three quarters of

FDI influx to the region.

At the same time the FDI in South and Central Asia has stagnated in recent years while other Asia and developing countries are emerging as important overseas investors. In the midst of lot of this positivity there are down side risks for this regional trade investment. I will first focus on one of them, which was also in the comments that the minister made. On this looming threat of protectionism; While we didn't see depression style protectionism emerge, protectionism remain largely subdued during the peak of the crisis, now the continued lethargic performance in many OECD countries together with increased competition among developing countries might trigger a chain of discriminative protectionist measures. The risk of this emerging protectionism has not been eliminated although contrary to expectation it hasn't returned with the type of vengeance that has been seen previously but rather it has been creeping and emerging a lot less conspicuously.

Despite affirmations by the leaders of the G20, they made affirmations continuously especially in the G20 summit last November I believe, that the G20 grouping that took protectionism measure will be restricted, they will not resort to that this time but according to the latest evidence published by the Global Trade Alert published by the University of St Gallen Switzerland which brings together some of the top trade economists and trade intelligence units across the world this government resolve among these countries to avoid protectionism has weakened as prospects for the global economy has dimmed. Unanticipated developments at the time of those affirmations; the US debt situation, consequences of the Japan's earth quakes earlier this year, rising inflation rates and of course election cycles have left G20 economy's leaders resorting to short-term popularity winning measures that dangerously border on strong protectionism. There was a joint report released in May 2011 by the WTO, OECD and UNCTAD called G20 Trade and Investment Measures, that more subtle protectionist measures have been found in the past six months alone than in any previous reported period. There also appears to be an increase in tendency to use non tariff barriers, non tariff measures as well as murky protectionism, some of them in the category of green measures. Measures that are classified by governments to be greening the economy. While the G20 is also a culprit to it the Asia Pacific region is also a major culprit, the report says it uses more murky measures, that's what it's called murky protectionist measures than rest of the world.

I will now briefly go through the post crisis trade investment opportunities that have been identified in the report. First there are enormous opportunities in intra regional trade, I think this can't get stressed enough as the region regain its dynamism we need to bear in mind the growing population, increased incomes widening middle class that's creating unprecedented demands for good and services in the region and this trend will continue. As

implied by the analysis in the report the presence of economies of scale, division of labour and production networks, all create strong intra industry trade opportunities between economies in the South, South Asia, South East Asia and East Asia. The second is in services trade, many opportunities exist in low skill, labour intensive service sectors such as tourism, back office IT and construction, I think this is a strong indication for Sri Lanka also, the report emphasizes the fact that strong domestic regulatory reforms is key to the expansion of regulatory services. In Sri Lanka too we need to take a strong look at our domestic, legal and regulatory frameworks and the reform requires various services in the sub sectors in order to set the stage for the country to leverage in the increasing services trade regionally and globally.

The third, we hear about intra regional trade all the time, we hear about services trade all the time but this was a new element introduced in this report I think, we might often assume in Sri Lanka we're yet to reach that level of technology but this report takes a different view saying that countries like Sri Lanka can capitalise on climate smart technology. It talks about creating innovative and creative capacity of local producers to engage in the production of climate smart goods and technologies. Regional smart value chains can provide good opportunities to many less developed countries in the region to become parts and components suppliers to leading CSGT exporters. At the same time the capacity of domestic SMEs in the area of CSGT should be enhanced so that they can be enhanced into suppliers of low carbon products and effectively integrated to what is now called low carbon chain.

The 2011 report states that based on 2008 data that there was a trade potential in this niche of almost 30 billion US\$, there's a good potential because the region would need additional investments of 600 billion US\$ a year between now and 2050 to reduce its carbon emissions to the desired levels. Apart from China, Japan and South Korea who have already positioned themselves as global exporters of these technologies others have not yet fully taken the opportunity. According to the report, Vietnam, Malaysia, Thailand and India have great potential in Solar power systems, Thailand and Sri Lanka in energy efficient lightings and New Zealand and Singapore in clean coal technologies.

I want to focus mainly two areas that the report discusses its modalities to take advantage of the opportunities we've discussed. First is trade facilitation, this has particular relevance to Sri Lanka and IPS - we've been doing lot of work on trade facilitation and several studies also. Few interesting points from South Asian and Sri Lankan perspective; it's very well established that trade facilitation is essential for greater and deeper integration of countries like Sri Lanka and others into the regional and global economy. There have been studies that have shown that generally transactions cost can be reduced by 10% and it can increase

the country's exports as much as 3%. As you know trade facilitation refers to cutting red tape, stream-lining procedures, involved in moving goods from factory in the exporting country for the warehouse of the buyer in the importing country. In an age of Just in Time deliveries, Global production networks, electronic exchange of information, countries that do not have positioned procedures in place will find it increasingly difficult to gain fully from trade. The economies of the region have made good progress in cutting tariffs, as this has been the focus of trade negotiation but we need to remember that tariff cost take up more than 10% of overall cost of trade, the focus now has to be on tackling non tariff barriers, inadequate logistics services and lot work need to be done in this area. In the Asia Pacific Region it still takes 3 times longer to trade procedures than in developed countries' economies. Perhaps on a regional perspective it'll still cost more for countries in the Asia Pacific region to do business within the region than in the more distanced countries in the developed world.

I'll focus a minute on our region, South Asia. Studies have shown that intra regional trade in South Asia would rise by 60% and trade with the rest of the world for over 30% if trade facilitation efficiency improvements can be made. These are some of the statistics highlighted in the trade facilitation work IPS have been doing. Other studies even put this number the increase in intra regional trade at 75%, about US \$ 5.8 billion while it maybe unfair for me to benchmark South Asia with OECD for example - I think it'll give something like a shock therapy, so I'll mention this benchmarking - according to the Trading Across Borders pillar of the world Bank's Doing Business report, the time taken for exports from South Asia on average is 32 days, while in the OECD its 10-½ days. For imports its 32 days in South Asia and OECD it is 5 days. In terms of documents required for imports and exports, it is double in South Asia oppose to OECD. However all is not gloomy, progress is being made in 2009 ADB study showed that between 2006-09, the region did reduce for example the time necessary for export procedure by 20% and time required to complete import procedures by 30%. These improvements need to continue.

This year's 2011 FTR report makes several bold recommendations to achieve progress on trade facilitation including accelerating implementation of national electronic single window systems. For trade documents, the developments of the regional agreement for crossword electronic trade documents and including trade facilitation measures and clauses in bi lateral and multi lateral regional agreements that are under negotiations. In Sri Lanka it is also important to think of high level mechanisms for taking trade forward for example National Trade Facilitation Council or National Trade Facilitation Task force that could drive this forward at a national level. So that was the first area of action is trade facilitation. Second refers to effective participation of SMEs Small and Medium enterprises in global

and regional value chains. SMEs remain a critical source of employment in many economies of Asia Pacific if they contribute to 60% of jobs and income. In Sri Lanka although accurate data on SMEs are hard to come by there are estimates for that SME's constitute nearly 90% of industry establishments 20% of industrial value added and 20% of employment in the industrial sector. Now these SME's export potential need to be enhanced. In Sri Lanka I think there are estimates that over 70% of the exporters are SMEs that is just the number of exporters, the bulk of the export value doesn't come from them it comes from larger exporters. Meanwhile in the Asia Pacific it's a bit diverse, the share of SMEs contribution values in the Asia Pacific region ranges from 4.2 in Malaysia to a staggering 69.2 SMEs contributions to exports in China and 20% in Vietnam. But we must remember the definition of SMEs vary across these countries in fact even within Sri Lanka within different institution. Despite the existence of various support mechanisms for most economies including in Sri Lanka mini loan schemes, these enterprises are still in a disadvantage position with regard to essential business factors, access to capital and technology, managerial skills, trained labour, branding and networks. And these are critical to pushing SME's to integrate with regional and global value chains and becoming solid exporters.

The third aspect is strengthening regional trade agreements as building blocks of the trading system. The region has been very active in signing RTAs. For the last ten years about 50% of all RTAs that have been entered into globally, came from the Asia Pacific region. As the business sector knows well having RTAs does not mean it's well utilised. Only 38% of exports of Asia Pacific economies are destined for partners, which they have an RTA with. Even out of this, even smaller shares use concession, among the main reasons are the complex rules of origin. The cost of compliance of these rules often exceeds the preferential benefits. The cost of compliance is estimated to range from 3% of value of exports to companies in developed countries to a much higher 8% in low income countries. In addition traders and producers lack sufficient information on how to use these preferences and they more so for smaller businesses than others.

The end results are that the benefits recorded by RTS are not fully utilised by those engaged in trade. Sri Lanka like other economies, continues to focus like many others in the region, on export led growth but I think that it needs to take a critical look at rebalancing in terms of product diversification and destination diversification. Diversification in markets from traditional developed markets to regional emerging markets, also as the Honourable Minister said, looking at domestic markets, diversification products and services, strengthening the market participation in regional and global value chain and of course in keeping with the theme of growth in harmony also more equitable distribution of benefits, cost of trade needs to be looked at.

In closing let me just refresh that it's clear that the Asia Pacific region has rebounded strongly from the crisis; it has become a driver of growth and an anchor of stability of the global economy. It's clear that Sri Lanka needs to look at Asia with renewed focus and identify how it can effectively compete in a changing global economic landscape. In addition to the opportunities emerging from the economic shifting to economic dynamism to Asia we must bear in mind the near term risks, for example the continuing fiscal struggles in EU countries fragile consumer demand in US and EU. Inflationary pressures due to increase in rice and fuel prices that would impact inflation are some of the issues Sri Lankan stakeholders need to remain focused while looking at the changing balance of trade & how to capitalize on that. The report is also available online.

**Narhari Rao**

**Lead Economist, Asian Development Bank, Sri Lanka Country Office**

**Dynamic And Resilient Asia**

**How can Sri Lanka and South Asia plug in?**

What I'd like to do is to put this report in the perspective of the situation we're in today. Because the current situation, globally is such that it's very hard to really make any kind of forecast and still less to talk about what trade will be like. But nevertheless the report makes a fair amount of observations based on empirical evidence and tries to give some directions for the future. But, basically, you know what the report does not say is that; it does not really look at the true scenarios, it doesn't in this very uncertain global situation that we are in today. It's hard to just look at one possible outcome and it would have been better if the report had focused on two or three scenarios of what is likely to have. So what I will do is that I will look at three or four issues – the first one, what will be the implications of a slowdown in the developed economies and not just a slowdown but it could be even worse than that. The Honourable Minister made a reference to double debt, the recession, jobless youths, political fallouts of that, globally and domestically, and effect of protectionism. You know all these issues are extremely important and have a bearing on how the region Asian Pacific will do.

Related to that is another critical question, will Asia continue to grow if things deteriorate? It looks as though actually things will get worse, and what is the best manner or method of managing the external slowdown – what can these countries do. What should South Asia do in the emerging global scenario? And I'll try to link it to the recommendations and observations of the report.

The important point is compared to 2008 which is really the point of reference in the report, in trying to draw influences after the slowdown, post-crisis, what happened. In fact the title of the report is post-crisis, trade and investment opportunities. What the report is not seeing is actually is we're not out of the crisis yet. It is far worse today, in my opinion than what it was in 2008. The reason why it is worse today, is that in 2008 there was a coordinated global effort to stimulate demand, fiscal deficits were raised all over the world. Monetary policy was made more relaxed, which was subsequently followed by quantitative easing. And there was a lot of global coordination at that point of time. The global economy recovered somewhat. Asia in fact did very well with stimulus packages and recovered relatively quickly.

The situation in 2011 is very different. And I might also add it's much more serious than in 2008. The reason is that the recession in G3 which is really Europe, America and Japan seems much more likely now than what was thought even six months back. And even if it is not a recession, there's consensus amongst virtually all economies that growth will be anaemic, it may not be a recession because you know, recession is a technical terms of two quarters having negative growth. But if the economy grows at the rate, which Japan has been growing for the last ten years, then it doesn't really help matters very much. The reason why the situation is much more complex and serious now is that the major developed countries have run out of policy options, they really don't know what to do now because due to higher fiscal deficits needed to further 2008 recession and post-crisis period, has led to large public debts and these public debts have almost become unsustainable now. Monetary policy has its potency because interest rates are already close to zero and what is being done by quantitative easing is just that Central Bank is buying the treasury bonds in a bid to lower the long term interest rates.

Now these are unprecedented steps they haven't had for 40 or 60 years but I know they have been undertaken. And worse still there's actually no international coordination now anymore and in a sense what is compounding the problem is what the Honourable Minister was referring to that even in individual countries policy choices are been compromised, because of political differences. Whether you look at United States, Europe, Greece, Italy or Spain, there are a lot of problems, I mean these countries have not even agreed on a set of policies which over the next five to ten years can tackle the problem later on.

I think the impact of this in Asia has yet to be felt. Asia is still in fact doing quite well, countries are growing but the impact of these, outcome of this overall global scenario will be felt in Asia and most countries will need to take policy measures and Sri Lanka is also one of those countries which will be affected. The report notes that export growth will come down to become half of what it was last year. And that by itself is a very important thing in a

region that is, - when I'm talking about a region I am talking about Asia Pacific - largely export oriented. It also notes the growth prospects will be highly uncertain and although not very explicitly, it does say that maybe the region can't de-couple itself from the developed countries, and I think that's absolutely true. Because even if you look at the pattern of trade; if you look at the figures carefully it's really while intra regional trade has increased, trade with the G3 zones still remains dominant, and there's no denying that and there's no substitute for that either. And I will come to that later and what it actually really implies is that when you say de-couple yourself what set of policy measures are required. So in the years to come - that is I'm not just talking about the next year or two because beyond that is way difficult to predict - what will happen is that the region, that is Asia Pacific will continue on the internal and regional demand, but is that possible- can it sustain itself?

My answer to that is no. It can actually only to a limited extent stimulate intra-region trades where there is increase in domestic demand, but it cannot de-couple itself in the sense that it can say that it has been able to insulate itself from 80-90% of what happens to the rest of the world. No, that's not the case. Asia is very much part of the global scenario. The report says that a few things that could help this process of de-coupling; one is this growing urbanisation in India and China, meaning that it creates middle class, it creates demand, it then means that the region's economy can grow by it self to a much large extent than what it could earlier.

The report also talks about fighting climate change, this can open up new business opportunities, tourists, climate smart, goods and technologies (CSGT) and of course some countries in the region have already become leaders in it which are Japan, China and Korea. These products would include wind power generation, and energy efficient lighting. I think some of this part is absolutely right, it's a large industry by itself, estimated 400 billion or 600 billion. And some of the products in this could be products that don't involve high technology and those could be pursued by countries like Sri Lanka. I think I also agree entirely with the report that the potential for trade and investment in services have not been fully exploited - not even partially exploited. And definitely it does require change in the regulatory regime and liberalising trade and services.

As the Honourable Minister pointed out, I think it is absolutely right, that this rising labour cost is going to make certain industries uncompetitive in China and with the right kind of policy and environment some of these could, or actually most of them could shift to other low cost economies in the region. This has not been exploited and it could quite well be done provided that one tends to think about this from now and says okay- for these industries to come or these products to shift to, let's say, Sri Lanka. What are the measures that I need to take - is the investment plan appropriate for that or not. The domestic

consumption needs to grow in a majority of Asian countries along with trying to increase intra-region trade component out of domestic consumption. When you say consumption must increase, it means that investments have to stop and exchange rates needs to be more market based. Now this is something on which there's no consensus in the Asian countries. When the Asian crisis broke out, savings became the major means of protecting themselves and savings and excessive investments; the mirror image of that was rising foreign exchange reserves and most Asian countries indulge in that because they felt that was one way of protecting themselves and it helped them in the 2008 crisis.

But what it really means is that if for consumption is to increase, you really have to change your exchange rate and you need to have a much more flexible policy, I don't think there is agreement in China and to a lesser extent there is not even a much agreement on that in Sri Lanka. Today's newspaper talks about a controversy between IMF and Central Bank of Sri Lanka on a simple policy, so when you can't agree in Sri Lanka I mean it's highly unlikely they will agree in China which has much more implications globally. So basically I think this de-coupling hypothesis- there are short term, medium term limitations to these kind of measures, there's no doubt about it. And we must understand that intra-regional trade could become more important than what it is and it has become important over the last decade. But non-regional trade will still remain dominant for some time to come, that's because of the technology gap, you can't avoid that. For example aircrafts of some quality are still made in either in Europe or in America. So you can't say we can live without them - you can't.

Ok now let's turn to how best to manage the global economic turmoil. I think it's very important to have much greater coordination of economic policies than what it is happening currently. Today it's a free for all and every country is following its own policy. For a while the market tends to put some pressure to adopt some measures, some half-hearted measures are taken in Parliaments of this country but then they go back to their own systems so there's no coordination. I think we need to adopt flexible policies, and when I say all that it really applies to every country including Sri Lanka.

And if this global slowdown is more pronounced then I think fiscal stimulus cannot be ruled out whether it needs higher debt, higher fiscal deficits. I don't think that there's any doubt that the Asian countries will go in for greater stimulus. Well monetary expansion is a bit of a question mark, simply because it depends on the inflationary pressures being felt in different economies. At the moment many countries are facing inflationary pressures and some of the larger ones like India are also in the midst of it, inflationary range at 8-10%. So that's where I think India has been tightening the monetary policy and doesn't really have the scope for an expansionary monetary policy. I think these countries need to have flexible

exchange rate management and it's important for Asian countries, which have really come up because of trade, that they don't fall to the temptation of protectionism. Because this could be only harmful in the long run. Take some examples - if America does take some protectionist measures it doesn't mean that Asian countries should do the same. No, I don't think it still helps them in any way because it might make their exports less competitive in the US. But it won't certainly make US imports into these countries more competitive, so protectionism is really not an answer and I think liberalised regional trade investment and services and of course one should strengthen regional ties.

What really impressed me about the report was the emphasis on - it's something that is being talked about quite a bit but it's always good to re-emphasise - the whole area of trade facilitation. If that area is weak then the whole trading system is weak. And I think you need to have competitiveness on the long run, trade facilitation needs to be given a lot of emphasis. I think supporting SME's is important because it has not received the kind of attention that is required.

Finally I want to touch upon one area because I'm not really clear in my mind how this has to be tackled. Very easily everyone says that one should diversify exports or diversify manufacturing production and economy. Even the Honourable Minister said that. You know, what is the means of achieving that, it was a set of two or three policies then I guess Sri Lanka would have a much stronger and diversified manufacturing ways. Is this really trade policy, or is it through trade agreements, is it trying to get in through a supply chain with other countries. I think answers to these issues are very important from a long run perspective, particularly for countries like Sri Lanka, which have fairly narrow manufacturing ways. Thank you very much

**Dr. Aruna Ekanayake,**

**Immediate past chairman of the Ceylon Chamber of Commerce and member of the Board of governors of IPS.**

### **Era of 'Two-Speed' Growth: How should Sri Lankan firms Navigate?**

When I was invited to join this panel to discuss the report of ESCAP, I was very happy to accept the invitation; because there are so many unknown things at this point of time. I thought that this is a very good and an easy way of learning what is going on. Why I say this is; look at the date of the report - it was published in July 2011 and I think this means the actual work would have been accomplished at least three-six months before. Even the write up of the final conclusion would have been done a few months ago. And now since what was

triggered in the global economy by the way the US handled the sovereign debt issue and subsequent happenings have created a situation where one wonders whether some of the directions indicated in the report are in fact going to be realized; perhaps the overall reaction is clear, that is there is 'two-speed' growth; one speed for the developed economies and another speed for the developing economies primarily led by Asian developing economies.

But whether those speed numbers will remain as forecast is another matter altogether. I have been asked to talk about how should Sri Lankan firms navigate in the scenario of two-speed growth. And what is implied in that title in very simple terms is that if developing economies, Asian economies are growing at double or more the speed of the developed economies then we should and try and navigate towards that, and Sri Lanka should navigate towards that.

I have to address this; just to some share thoughts; I don't think anything at this point of time can be conclusive, because so many changes are happening at the same time, but I would like focus on the point raised by Dr Rao, and the point with which he finished. How can private firms diversify export towards Asia, because that is essentially what is implied by this title.

Take the example of Sri Lanka - around 60% of total exports go to US, EU and Japan. I don't have the number for South Asia, but I believe it must be in the range of 10-15% of total exports, perhaps a little more. The slowing down of the global economy is happening right now, today. I haven't seen any serious analyst - a student of the world economy - saying that things are going to change for the next two years. Generally every one seems to say that we need to be prepared; the world economy is going to grow very slow for the next two to three years. So the issue here right now is, if you take Sri Lanka, our firms have to decide which way to navigate, and then begin to navigate; that's the area I would like to focus on. As very correctly Dr Rao mentioned, I believe it is easier said and done. Just look at it a little more deeply.

When we talk of private firms, for convenience we assume a kind of a monolithic entity - that their interests will be the same and they will all act in a same direction. But when you look a little more carefully, you can see that even in the case of Sri Lanka, there are a handful of large firms we may even be call multi national companies which have large operations as well as share holdings multinationally. And then we have bigger group of large conglomerates. And then we have a huge number of medium, small and micro enterprises. We don't have a good handle on the numbers and contribution to the economy but definitely the numbers are 80-90% of the total. In terms of employment it is about half;

perhaps in terms of export value addition also it is about half. I'm subject to correction here, my data may be a little old.

How do multi nationals, very sophisticated companies, take business decisions? They do have research departments, they at least have a strategy department, which follows global developments and figures out how to take strategic decisions. They do have close relations with research bodies, central banks, micro trade organisations and so on.

Now if talk about Sri Lankan firms, when the sovereign debt crisis started unfolding, and US was getting perilously close to a deadline to expand the deficit limit, most Sri Lankan global sophisticated companies started looking at it. And what was the reading? They were saying, it means that, US exchange rate might depreciate. There may be devaluation. US bond market, bond yields will rise sharply because it is dangerous to lend to US now. And thirdly, there will be some impact on the stock market. What is happening? It is still fluctuating very violently; we really don't know where it will settle down; but clearly what happened was the stock market took up a big hit. But the exchange market and the bond markets strengthened in favour of US. This is a broad generalisation, but that's the reaction, which happened.

I am only saying - I'm not planning to offer any explanation -perhaps one liner, that obviously the global investors sought comfort in the global currency.

But even the multi national type of companies who have the capacity and have the luxury of analysing these trends -at this moment don't know what to do. The current strategy is to watch, wait and see.

Now the large domestic conglomerates don't have all that. They tend to observe what is going on in the domestic economy. And the signals in the domestic economy, by and large, are quite comfortable, yes there is a little bit of worry on the exchange rate scenario, but no one is talking about a very sharp depreciation of Sri Lankan currency. There may be some adjustment - may be going up and down in the coming months - depending on the domestic market developments, demand and supply for currency.

If you take the next level, the medium companies, mostly react to the domestic market and local market signals. Micro entities respond to signals in the neighbourhood. This is the reality, now how does that match with the proposition of navigating firms towards Asian markets? In the first place, the emerging signals have to be read and a decision has to be taken that it is the right direction to go.

In the business sector - very correctly - apart from analysis they rely heavily on the past experience, what has worked. Take for example, the case of EU GSP plus and the apparel industry. There was no huge hit on the apparel industry. In fact the apparel industry in recent months has done quite well. All sorts of growth number are been talked of - but they are definitely in the range of 40-50 %.

So if you serve your customers well, manage your costs well, perhaps there is a chance to survive without doing too much change. That is debatable obviously, but companies can take that path. If you want to change then the reality is, at business level the challenges are enormous. Just because the global forecast says there is a demand for activated carbon in China, you can't manufacture carbon and then look at people to buy. You have to establish linkages.

Particularly with Asia, by experience we know that linkages and networks are not really established based on a informational data base, web sites and e mail. These linkages are primarily established on the basis of relationships, mutual understanding and track record over a long period of time.

So establishing such a track record very quickly in order to navigate towards Asia is an enormous challenge. With our work in trade chambers we can say there is enough anecdotal evidence of the difficulties of the area.

This can be done, can be overcome, if we have the right products and services to export to these markets. Now assuming the same things that we produce for the west and the developed countries - if it's without any adjustment simply shifted to other markets, to India for example - this cannot be accepted. Because consumer preferences are different, there are cultural difference, and geographic, climatic differences.

Our biggest export is apparels and what we are exporting to Europe and US will be okay perhaps for a small part of India. So there is huge investment involved in product development. The same thing applies to services as well. You can't just adapt what has been done in one part of the world to another part of the world over night.

And in doing so there can be redundancies; in plant and equipment as well as people. When you shift- now you want different type of plant and equipment to manufacture those, and different types of people to do that work. We need to recognise a navigation towards Asia or plugging into the Asian world involves very severe adjustments. Even if it works it will take a fairly long period of time.

I fully agree with some of the points made by the previous speakers about the importance of trade facilitation, making it easier to do business, and Sri Lanka

In Sri Lanka the private sector has to figure out how to adjust, what are the industrial strategies and the public sector will have to facilitate the process. We in the private sector take heart from the sharp improvement in the global competitive commerce index, we know that it is real - from 62 to 52 in one year. The faster we grow on that track - within the first 20-25 - can make a huge difference in how the private sector responds to the current enormous challenge.

And my last word of course is that although we have not felt the impact of what is going on in the developed world as of this point of time, all of us who are involved in business know that there is a time lag. And with the time lag we can be hit hard. And that is something we need to be careful of and we need to plan for.

I think on one hand the institutions like IPS have to promote this dialogue to try and help in the process of how we can understand what is going on. Authorities in the public sector will have to make it easy to do business. Get better ratings in the competitive index, doing business index - they are all inter related. The immediate fall of that is that when you that, the sovereign ratings on debt will improve which means the private sector will also be able to access the global debt and capital markets at better terms.

Even if individual firms have good ratings, the sovereign rating still has as a role to play. So the authorities can help enormously. The private sector has to be very agile, nimble and quick to take decisions and move on. That's what we have to deliberate on. Thank you

**Mafaz Ishad, Director**

**Calamander Capital Singapore (Colombo Office)**

### **Investment Flows in Asia: Can Sri Lanka Leverage on it?**

Investors fall into many categories, and have many motivations for where they place their investments. Some rational and some not. Large institutional investors in emerging economies, both for direct investment and portfolio investment are generally driven by three factors;

Firstly -they're so large they need to be there. The economy is so large they feel their absence, would preclude them from being perceived as a global player. Typically along the

lines of China, India, Brazil, Indonesia, Russia, Turkey plus other countries. Secondly there are resource economies that are so critical to the function of other economies that the economy has a strategic natural resource that others need. Countries like Nigeria, Mongolia, Congo, Australia, Qatar, Saudi Arabia, Angola, Papua New Guinea, South Africa to name a few. Thirdly there are those that are the generally well managed economies, and the institutions feel a need to be a part of it. Botswana, Mauritius, Singapore come to mind.

So what type of foreign investors are typically attracted to Sri Lanka? There are four basic categories that I will examine. The first is what I call the 'here for good' - to borrow a prominent bank's moniker. The long term investors are in Sri Lanka for a myriad reasons, but has decided to stay and make the most of it. HSBC, Standard Chartered, and a number of foreign banks have been here for a number of decades and a few cases over a century. Nestle, Unilever, Coke Cola, British American Tobacco, Bata, Noritake, and others have all had association in this country for decades.

Number two is the opportunistic - all investors are essentially opportunistic. Their ability to hold and develop the investment varies, mainly based on their time horizon. Foreign investors looking to make a quick buck in Sri Lanka have for the most part been burnt. This is essentially true in most markets. Speculators have their place in all markets. Look at the recent prices of gold and oil but buy and flip can be dangerous - when adopted as a national strategy. The poignant case of real-estate in Dubai serves as a reminder. Those of us here for defined time horizons - for Calamander it's a period 5 to 7 years or longer - are on the lookout for what there may be relatively cheaper, or at least what may be reasonably priced market evaluations.

I find it increasingly hard to find good deals - given the frothiness of the stock market. The number of opportunities is increasing but so is the relative valuation. Three years ago I would be talking to a very well run tea factory owner about a valuation of about four to five times earnings. Recently one was offered to us at 12 times earnings. An IT company that is barely profitable wanted three times revenue. The Sri Lanka opportunity however remains viable. Fate has generally been kind to Sri Lanka. We are blessed with geographic attributes that are highly sought after - being at the bottom of the Indian sub-continent and being on the main East-West trade route. With temperate climates and monsoons, things grow here year-around. Landscape, beaches, tropical forests, wild life, heritage architecture all contribute to making it an increasing desirable tourist destination. Coupled with its natural bounties is a fairly nice demographic pyramid, literacy above 90%, and free trade agreements with India and Pakistan. So why wouldn't an investor be attracted to this opportunity? I will discuss this a little later.

Thirdly we have portfolio investors – those looking for investment in either debt or equity securities that can be added to a portfolio for a utility function. The most sought after share for this type of investor has been a country proxy such as John Keells Holdings. The oft told barometer of the stock market's performance since the end of the war, though that has stumbled of recent. Couple this with a trading market price with the earnings ratio of 19, down from a high of 29.5 in February, and the price to book of 2.4, and a dividend deal of 1.5 – and the Colombo Stock exchange looks relatively expensive compared with Singapore, Kuala Lumpur, Bangkok – at 10 to 14 times earnings – in fact the CSC is more in-line with the much deeper and more liquid Bombay stock exchange at 18 and a half P/E.

The fourth category is what I term foreigners buying holiday homes here; and inherently becoming investors. This category came storming into the country during the peace-talks honeymoon period in 2002 to 2004; when the 100% tax was temporarily lifted. They tended to be western expatriates, with extensive Asian experiences who would become Asiaphiles and pounced on the market opportunity to own a piece of paradise. A number of them have subsequently become boutique hotel owners or make a business of marketing and renting out their villas or when they are not here, developing land they have acquired for an agri-business project. A number of investors I know fall into more than one category, and I think it would bode well to address some of their and our own concerns.

To start with, what I might term the public media relations disappointment after the end of the civil war in May 2009 in dealing with the diaspora. Mathias Keittle, a German researcher who has been following Sri Lanka for the past 25 years, recently wrote an article titled – 'Crucifixion of a country for defeating terrorism', which appeared in last Saturday's Daily FT and strikes a definite chord. I quote the first paragraph... 'Sri Lanka eliminated a dreaded terrorist group with intractable global links but received little credit for it. Unlike elsewhere in the world, Sri Lanka succeeded in resettling 300,000 IDPs. There are no starving children for the NGO's to feed but this gets ignored. Sri Lanka avoided mass misery, epidemics and starvation; but the West takes no notice of this. Sri Lanka has attained enviable social, economic standards for a developing country while eliminating terrorism; but gets no acknowledgement. The Government of Sri Lanka and its President continue to enjoy unprecedented popular approval to democratic elections. But this is dismissed. The economy continues to boom but remains un-encouraged by the West.' This is a German researcher who has been following Sri Lanka for the last 25 years.

This lack of public and media relations has led to the re-emergence of political risk on the country in the eyes of certain investors. If you look at the general perception as evidenced by Sri Lanka's reputation – in some international publications – for example: the OECD's Country risk classification report gives Sri Lanka a score of 6, from a range of 0 to 6,

alongside Angola, Georgia, Uganda and Iran. Similarly the MIGA World Investment and Political risk report 2009 – published last year – perceives Columbia, Uganda, Argentina to have less political risks than Sri Lanka. The Aon Political risk map and the Maplecroft 2011 Political risk map put Sri Lanka in the company of Libya, Egypt and Peru. In essence the general perception is that Sri Lanka is a very risky place to do business. This has led to many investors avoiding Sri Lanka as an investment decision, resulting in an FDI of less than 500 million in 2010. Incidentally the AEON reports three key areas of concern illustrate their lack of ground experience. First strikes, riots and civil commotions, supply chain disruption and sovereign debt re-payment are the top three risks. Areas which no investor in Sri Lanka would put in his or her top five or 10 risks. Considering the tremendous opportunity that Sri Lanka presents at the dawn of peace, investments should have been much higher. However as risk has been priced highly, investors have been reluctant to expose themselves to the Sri Lankan market.

There are two key reasons why investors should look at Sri Lanka. Firstly the risk is priced too highly, secondly instead of building the infrastructure – which involves higher risks – purchasing existing assets in Sri Lanka where prices have been already been adjusted for risk – significantly reduces one's risk profile. In fact that means that assets in Sri Lanka are undervalued by the international market as a result of the excessive risk premiums. On the other hand the relatively risk free stock market is over-valued. Calamander's position is to invest in under-valued real assets with solid economic potential.

The prices at the moment have risk accounted for and a level of risk that is excessive. Short of a catastrophe, political risk can be easily managed allowing Calamander to exploit Sri Lanka's potential.

Number two is what we call policy stability. The greater cause for concern is the instability of government policy. Car taxes went down, and have come back up again, there was a great deal of confusion as to whether visas were going to be introduced for tourists. And conflicting signals seem to be the norm. For example the Wall Street Journal picked up, that in spite of introducing an investor friendly budget, President Rajapaksa had boasted about nationalising Sri Lankan Airlines, Sri Lanka Insurance and a number of other cooperations. Sri Lankan Airlines wasn't nationalised of course, the management contract with Emirates was not extended. Sri Lankan Insurance was nationalised as a result of a Supreme Court judgement. This policy climate is highly opaque and a cursory glance will leave any observer confused and bewildered. Coalition governments, specially as diverse as that of the current government entail ideological conflict. This leads to policy instability as a President has to balance a range of interest groups and supporters. For example within the present party the party the SLFP, the left, wants to introduce a mixed economy. The economically right

winged UNP cross-overs prefer a liberal free market state. And the nationalist right wing is more concerned about the environmental impact. The energy sector illustrates this well. Although power generation has been liberalised, none of the sectors such as distribution or marketing have been in any meaningful way. Moreover Sri Lanka is investing a great deal in wind power in order to reduce its carbon footprint.

Although policy may have been better in the past, implementation was decidedly slower – for example the Katunayake express way which has been in the pipeline for over 20 years, has come to fruition under this government. The Government was also successful in dealing with the legal issues that have been plaguing the Southern expressway. The same thing has been said of urban re-generation and the most celebrated achievement – bringing the 25-year civil war to a close. Over all this government may have inferior policy, but superior implementation. An example of note is the education sector. While previous governments have always been half hearted in educational form, especially in the higher education sector, this government has not only allowed a private medical college to develop, but has also upgraded the Homagama hospital to a Teaching Hospital in order for the project to go ahead. There has actually been no Government policy that has seriously affected any investor. For example the car tax affected consumers rather than investors. The government never introduced the visa requirement, which was being considered. Basic investor policy has not changed, and the view that Sri Lanka's policy landscape is one that is highly unstable, is unrepresentative of the broad levels of stability experienced throughout most of the economy.

Public service should attract the best talent. There are some amazingly well run government departments. Passport and immigration come to mind – where it is possible to get a passport in a day. This is unheard of even in super-efficient Switzerland. However the level of competence and professionalism, exhibited by a great deal of officialdom appears to be far from satisfactory.

Although there is a distinct urge for development and reform at the highest levels, the lack of competence among the lower ranks is obvious. Firstly, technical skills sometimes leave much to be desired. At a higher level there sometimes seems to be a lack of awareness of the repercussions of certain policy decisions; a reluctance to consult with relevant stakeholders before formulating and implementing policy, leading to abrupt changes of policy as stakeholders become aware of changes. For example in Kalpitiya the development of a tourism zone was temporarily halted as due consultation with local communities had to be undertaken. Similarly legislation introducing pensions for the private sector was almost covertly introduced through the budget. With no consultation and the legislation itself being fairly vague, it led to a great deal of mistrust among the private sector workers which led to

a protest in the Katunayake free trade zone, which forced the Government to back down.

The rule of law; the legal system in Sri Lanka suffers from many issues generally faced by the judiciary in developing countries. Firstly there are significant delays in justice. According to the World Bank doing business rankings, it takes an average of 1318 days to enforce a contract, compared to a regional average of 1059. Cases in Sri Lanka take years and a Senior Executive in a large blue chip firm observed to us that they go to almost extreme lengths to avoid legal proceedings as they take a very long time to conclude. According to some accounts only 2-4% of cases are taken to court because of the delays, results and expense. Secondly the competence of judges is often questionable especially on technical matters including technology and financial products. Why hasn't the FCC launched a probe of the high profile investor who at a very public forum, admitted to passing on insider information and felt there was nothing wrong with it. I believe that the comments were made in July, yet still nothing.

There are good reasons to discuss the high level of risk attributed to the legal system. Firstly it's a common law system with well-established procedures, precedents, conventions and a healthy professional body; the legal infrastructure encompasses the entire island not only the capital. Moreover, sound legal advice is readily available from highly skilled and experienced practitioners dispensing impartial advice. The trend is likely to accelerate with greater business involvement in Sri Lanka increasing the linkage with the international economic and legal systems.

Fourthly considering the rather poor state of the system often both parties are reluctant to take the case to court -settling issues out of court is a common and a efficient way of achieving a decent level of fairness. Sri Lankan's recovery rate on closed businesses are 47 cents on the dollar while the regional average is 28 cents and Vietnam's recovery rate is a mere 18 cents on the dollar.

Bureaucratic uncertainty; Firstly no clear procedures exist for investors in Sri Lanka at the moment. The Board of investments was designed to be a one stop shop for investors, however it is in transition and is being absorbed by the Ministry of Economic Development, it is unclear what the future role is going to be. The new three million dollar limit at the BOI for incentives is, I believe premature, we still need to provide incentive to people to come, maybe set the bar at 500 thousand and work it from there. Moreover in the past BOI approval did not mean that the investor did not need to deal with other government authorities. Investors often complain that they not only have to deal with the BOI but the tourism authority, health ministry, the local government and anyone else who takes an interest in the project. On the positive side, the access to information procedures have

become significantly transparent and easy to access as a result of the Government's effort to place information online public domain. For example customs procedures and rates which used to be very difficult to keep track of have now become significantly easier as a result of implementing an online system.

We should also steal some regional ideas with pride, hiring a foreigner is relatively difficult-a company or multinational really doesn't want to have an expatriate here unless it's necessary. They would much rather have a Sri Lankan do the work for many different perspectives. However this is one of the few locations people do like to come and work even in Asia. I've never for example heard someone wanting to go and work in Seoul, Korea. A lot of foreigners complain about doing business here as if it's all Sri Lanka's fault. Investing in projects in Sri Lanka is not about the 20,000 foot view, and flying in and out, what I believe is called parachute management. You need to understand the ground realities of what you're investing in and work through the issues at hand, no matter what is going on and not leave it to a local partner to sort out. Property speculation is a fool's game but draws people to it in droves, but there's a fair amount going on herewith both locals and foreigners. The 100% tax on foreigners buying property is frankly a joke, not one person who's meant to has paid it. It is far better to remove it and announce a general amnesty and say no foreigner can own land, and offer them 50, 75 or 99 year leases and ask them to pay a 10% tax which regularises the transaction. This will probably make a huge dent in the national debt and make clear to all the sundry who the rightful owners are. They should offer the same incentives as Singapore namely; non-residents cannot own land and property and only above the third story, permanent residences can own up to 18,000 square feet of land. Colombo is probably the nicest major city in South Asia to live in, it should be experiencing a real-estate boom, we need to develop a concept along Malaysia - my second home. Through this we should be able to attract close to 50,000 retirees from Europe and Middle East. What a boost this would be to the local economy as they escape the European winter or the Middle Eastern summer. Capital has been king in the past and even now it is emerging as ideas, those who can think out side the box and presume ideas to succeed in the long run. There is a crying need for real venture capital in the country and incentives to bring in not just the capital but also along with it the expertise. We need to encourage entrepreneurs and not just large companies to come here and set up build real businesses.

Being located in a strategically advantageous geographical location Sri Lanka has a huge potential to become a maritime, aviation, knowledge and commercial regional hub to integrate the domestic economy with the international market, capitalising the human as well as natural resources of the country. Sri Lanka also has potential as a viable destination of choice for the worldwide IT and the BPO market. In concluding I propose that Sri Lanka

remains a highly attractive investment destination but the high level of perceived risk means that potential investors have been wary of investing, however careful analysis of the levels of investment risk in Sri Lanka indicates that market perceptions are much higher than they should be. Thank you