



Pathfinder Economic Flash

Sri Lanka – China Bilateral Relations Building on a Robust and Durable Foundation

A No-Strings Attached Relationship

Sri Lanka and China have had historical links that can be traced back several centuries. The Rubber-Rice Pact (1952) was a major watershed in forging close, cordial and durable relations in the post-independence era. China provided steadfast support to Sri Lanka in the fight against Terrorism. It was also prompt in providing generous support in financing development following the end of the conflict, particularly the unprecedented infrastructure development program which has addressed a key bottleneck constraining Sri Lanka's growth prospects for decades. China has provided unhesitating support at times when other friends of Sri Lanka have shown reluctance.

It must also be recognized that China's robust support to Sri Lanka has had no strings attached and has been firmly based on the principle of non-interference in internal affairs.

China's Support for Infrastructure Development

China has played a major role in improving both internal and external connectivity. Its support has assisted in strengthening domestic connectivity by addressing the long-standing backlog in road development. The much delayed completion of the Southern Highway was expedited with, inter alia, Chinese support. The Katunayake/Colombo Expressway which has been spoken about for many years, is being completed this year. The President Rajapaksa's recent visit to China has resulted in agreements to fund, inter alia, the Colombo – Kandy/Kurunegala Highway, the Northern Expressway and the extension of the Southern Highway from Matara to Kataragama. In addition, external connectivity has been improved through China's support for the construction of the Hambantota Port, the Colombo South Harbour and the Mattala International Airport. These very large-scale investments in improving connectivity have the potential to transform economic opportunities, including export development; and promote reconciliation through better economic integration within the domestic economy.

China's support for the Norochcholai Power Plant is assisting in making the much delayed transition to a more cost effective electricity generation mix. Access to cheaper power is a crucial determinant of the economy's competitiveness.

Promoting FDI and Tourism: The Next Phase of the Relationship

China's support for infrastructure development is playing a crucial role in opening up new opportunities in the Sri Lankan economy through better internal and external connectivity as well as uninterrupted power supplies with a cheaper generation mix. However, it is now imperative to translate the potential created by these investments into concrete economic activities which yield attractive returns, particularly as a significant share of the financing is on non-concessional terms (the Pathfinder advocates whether financing is grant aid, concessional, commercial or domestically mobilized all commercial enterprises, irrespective of the ownership must generate return on investment and be professionally managed. Otherwise, these assets that have been built and the opportunities that have been created will be wasted). Progress in this connection would be the best means to transmit maximum benefits to the people. This can be achieved by promoting private investment, domestic and foreign.

Here again, China can play a leading role. As China rebalances its economy from external to domestic demand, it is likely that the Yuan will be allowed to appreciate, as it would have to be an important component of the policy mix necessary to achieve this objective. This will provide further encouragement for Chinese companies to look for investment opportunities abroad. The authorities are already encouraging a “going abroad” policy for their companies. The challenge for Sri Lanka in the next phase in the bilateral economic relationship is to complement “borrowing for infrastructure development” with “FDI for exports and productive employment”.

China also offers considerable prospects in the tourism sector. It is estimated that there will be 90 million outbound Chinese tourists this year. They have now overtaken the Americans as the highest spending tourists. The Maldives have been successful in boosting arrivals from China. Sri Lanka has fallen behind. The improved domestic connectivity and the direct Sri Lanka Airlines flights to Beijing, Shanghai, Guangzhou & Kunming can now be leveraged to achieve a substantial boost to tourists from China. The Pathfinder Foundation (PF), with the able support of its partner organization – the Chinese People’s Association for Peace and Disarmament (CPAPD), recently mounted a tourism mission from the Jiangsu Province in China which is expected to lead to 30,000 additional tourists within 3 years from this Province alone.

A New Approach to PPPs

The evolution of Sri Lanka – China cooperation in infrastructure development has also seen a commendable shift in the government’s attitude to PPPs. The Colombo – South Harbour development is a major PPP between China Harbour Engineering Company Ltd and Sri Lanka Ports Authority. It has also now been announced that PPPs will have a major role in the road development projects signed during the recent Presidential visit to China.

A Welcome FTA

It is also noteworthy that there has been an announcement regarding an agreement in principle on signing a bilateral FTA. In this FTA, it is reported that many Sri Lankan product items with export capacity will receive preferential treatment for accessing the waste Chinese market. This is a welcome development. A recent Verite Research article highlighted very vividly how far Sri Lanka has fallen behind in pursuing trade agreements at a time when the rest of the region and the world are moving aggressively down this road, particularly as the Doha Round of Multilateral Trade Negotiations has stalled.

In recent years, China has played the leading role in Sri Lanka's development. Up to now, the focus has been on much needed infrastructure development to address long standing backlogs. The next stage of the relationship needs to focus on FDI and tourism to maximize the benefits for the people of Sri Lanka.

Eminent Persons Group: Envisioning People – to – People Relations

It is timely to take a strategic perspective on the long term evolution of the Sri Lanka – China bilateral relationship. It is even more important as the ‘dragon’ emerges as an ever more dominant global economic power. The PF and the CPAPD are working jointly to establish an Eminent Persons Group for this purpose. The objective of this high level Group is to provide guidance to develop a framework on further strengthening the economic, cultural and other relations between the two countries within a longer term planning horizon. This is a track two initiative which will complement the efforts of the two governments.

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