ECONOMIC REVIEW

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NICARAGUA TODAY

François Houtart

EUROPE, THIRD WORLD, SRI LANKA

Saman Kelegama

JAPANESE INVESTMENT IN LANKA

Piyadasa Ratnayake

WATERSHED MANAGEMENT

Nihal Fernando

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OVERVIEW

For Latin America (and the Caribbean) 1979 was a year of upheavals and change. 30 years after Fidel Castro and his 26th of July Movement defeated Fulgencio Batista, two other dictators of the same ilk were toppled due to popular upheavals: Anastasio Somoza in Nicaragua and Eric Gairy in Grenada. Two revolutionary movements which were committed to radical transformation of their societies, economically, politically and socially, came to power: the Sandinistas in Nicaragua and the New Jewel Movement in Grenada.

Just 10 years later the political landscape of the two countries had changed beyond belief. It would be no exaggeration to say that the Grenadian Revolution committed suicide – an internal coup which resulted in the killing of the charismatic revolutionary leader Maurice Bishop aborted the revolutionary process, confused the masses and paved the way for American military intervention. In Nicaragua, the 10-years war with the Contras, who were funded by the Americans, bled the economy white. Though the young Sandinista government made considerable strides in the areas of education, health etc. (their literacy campaign stands out as the Cuban campaign won the approbation of the UNESCO). The promise to find solutions to the pressing economic problems of the masses remained (to a great extent) unfulfilled. This was because a large portion of the resources had to be spent on saving the country and the People from the marauding Contras. As the decade ended economic problems began to pile up – runaway inflation, shortages, unemployment etc. Because of the US pressure the Sandinista government was unable to acquire much international economic and financial assistance. This all came to a head in 1990, when the UNO coalition headed by the widow of a popular Nicaraguan hero and martyr, Pedro Joachim Chamorro, defeated the Sandinistas by a narrow electoral margin.

But Nicaragua's problems are far from being over. The victory of the UNO brought some reality to the Contra war which ended and scarcities began to ease off, but it led to other complications. The new government did not get as much American aid as expected and as a result the promised economic miracle didn't take place. The Chamorro government is trying to create a difficult balancing act between the Sandinistas, whom it is following a policy of governing from below and the former contra forces who are increasingly flexing their muscles and rightwing hip government for "being soft" on the left. Meanwhile, the problem of the masses are on the rise.

This special feature of Ilankai is a piece by Fr. Francois Houtart, a long time friend and student of Nicaragua, which gives a detailed analysis of the current situation there – particularly how the neo-liberal reforms that are being implemented by the Chamorro government are adversely affecting the economy and the people. He highlights the opportunism of Nicaragua to the Neo-Liberals a country which made a revolution and then was forced back into a path of neo-liberalism. He admits that in 1990 the people punished the Sandinistas but maintains that the revolutionary process which marked the society profoundly, is unlikely to be eradicated. The events in Nicaragua will continue to be of interest to all who are searching for a third way.

Sarath Wijegunaratne's contribution addresses the topical question of how the economic integration of the EC will affect Sri Lanka's trade with the developing world with special reference to Sri Lanka. He also sees certain policy options available to Sri Lanka for effectively meeting the threats posed by the EC and profiting from the opportunities offered by the EC.

Noel Fernando deals with another area which is of extreme importance in our development process – watershed management. He deals with the problem of "degradation of watersheds" which threatens the land and water resources and their economic use and offers some ideas as to how this can be overcome, thereby leading to the optimum use of land and water.

Piyadasa Ratnayake's contribution deals with another topical subject – the role of Japanese direct investment in the economic development of Asia. He pays particular attention to the impact of Japanese investment in the economies of Sri Lanka and Thailand. He states that Japanese direct investment in Sri Lanka is extremely negligible in terms of both scale and character, this may change in the coming years.

T. G.

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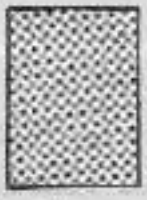

NICARAGUA AT THE DAWN OF THE 500TH ANNIVERSARY: A DIFFICULT BUT SURE STEP ON THE WAY TO NEO-LIBERALISM

François Houtart

In her Christmas message, President Violeta Barrios de Chamorro said: "This year we have taken a big step ahead in the economic sphere. In certain foreign publications one speaks already of the Nicaraguan miracle of having been able to suppress hyperinflation. Our economy has been stabilised..... The whole world has the eyes fixed on Nicaragua. We are the flag-carriers of new democracy in America".

How to interpret this optimistic statement which, moreover, complements itself by certain passages regarding poverty to be overcome and the welfare of the people to be promoted and which promises for 1992 a boost of production? It is, in fact, necessary to take into account all the elements of the situation, to be able to pass judgement and replace them in a global context that really is beyond Nicaragua.

In itself, Nicaragua, a small country with barely 4 million inhabitants, is a negligible quantity in the present context of the nations. But the examination of the behaviour of the Western countries, in its respect, permits to conclude that it assumes a great political importance. In fact, with Cuba, it was the only Latin American country which embarked on the road of a socialist alternative. The electoral rout of 1990 put an end to this venture and re-integrated the country into the camp of strict observance of market economy. It is thus necessary that the experience succeeds.

The Economic Policy of the Government

Some great principles have directed the action of the Nicaraguan Government in the course of these last two years. First of all, it is about stabilising the currency which was the work of the first 12 months. This was obtained after a continuation of weekly devaluations throughout the first year, then the change of the currency, accompanied by a new devaluation of 400% in March 1991. Thanks to the foreign co-operation, the currency was guaranteed by the stock of foreign currency that increased by 90% in the course of the year, that is, up to 190 million US Dollars.

The second principle has been that of the liberalisation of prices and imports. All the grants still remaining from the time of the Sandinists were cancelled. A certain number of taxes on imports have been heavily reduced, thus permitting the entry of a number of consumer goods.

In the third place, it is necessary to point out the reduction of budget and State expenses by more than a quarter and the privatisation of nationalised enterprises. Linked with an effort of salvage of tax, these diverse measures have permitted to reduce seriously the tax deficit (less than 5% in the course of the last half-year of 1991). But the structure of tax income changed seriously, passing from 36% to 31% for the direct tax and from 62% to 68% for the indirect tax, favouring the possessors.

Lastly, there was the re-negotiation of foreign debt. This last one was considerable indeed, rising to 10,800 million dollars, or 2,299 dollars per inhabitant. The Somoza regime had left a debt of 1,300 million and empty coffers. The reconstruction of the country, then the war and the social policy of the Sandinists had added to that. Mexico, Venezuela and Colombia counted 1,407 million, due, above all, to petroleum. They gave up the reimbursement of 1,337 million, permitting that of the remaining 70 million to be repayed in 40 years. The United States renounced the payment of State debt (68% of the American debt), that is, 259.5 million.

At the same time, Nicaragua paid 300 million US$ to the Inter-American Development Bank and to the World Bank in order to recover its capacity of loans. By way of comparison, the export of coffee would have to bring in 70 million US$ in the course of the year 1991-92. This reimbursement was achieved thanks to donations amounting to 135 million on the part of Colombia, Spain, Mexico and Venezuela and loans of 193 million. The Paris Club (the richest 15 countries) reduced in December 1991 a debt of 820 million to 290, plus the liberty of bilaterally negotiating the rest. Nicaragua thus obtained the condition of re-negotiation, the best in all the countries of the South, this being the equivalent of a remission of 75%.

The debt in relation to former socialist countries is 4,230 million dollars of which 3,000 million was with the former USSR. This must still be re-negotiated.

These diverse economic measures register themselves, obviously, in the context of dominant principles of current world economy. They have been conditioned largely by the requirements of the donors. Thus, the AID, the body of foreign co-operation of the American Government, demanded by contract the privatisation for obtaining aid from the United States. They delayed some grants, because they felt that the necessary policies in this regard have not been adopted. The IMF and the WB have conditioned their support through the classic measures of austerity and reduction of States expenses. The Paris Club has compared the measures regarding the debt with the application of the new democracy. As for the remission of the American debt, it had as a price the renunciation of the complaint by Nicaragua to the International court in the Hague court the mining of harbours and organising and financing of the war waged by the Contras.

In other words, the effort of reclaiming national sovereignty brought about by the Sandinist regime, as well as efforts of social distribution of wealth, were sacrificed on the alter of economic re-integration in world market economy.

The short-term economic consequences

The privatisation is done for the benefit of various sectors. First of all, there are former proprietors, at times, even Somozists who reclaim their nationalised properties. Often the values of their enterprises have gone up considerably by the efforts of the workers and by the investments of the Sandinist government. Then there are the new investors, linked often directly or indirectly to the current political power and who, within the most strict law, take the control of whole sectors of economic activity. Lastly there are foreign investors, from Latin America, United States, Asia, in agro-exports or industry. The free trade zone system has been started already so that Asian capital may produce textiles to be exported to the United States, the quotas of exports from these countries being exhausted.

As industrial reconversion in Europe was largely supported by public funds, the policy of privatisation itself is financed by public international organisations. The Inter-American Development Bank has granted a donation of 3,800 million dollars for financing the programme of privatisation of about a hundred enterprises.

A typical case in point is the case of two Taiwanese enterprises, Jyh Chou and Pow Yow. The Nicaraguan government has signed an agreement with them in principle for a concession of 30 years, renewable, for the exploitation of forests. It is an extent of 470,000 hectares of which 210,000 of tropical wood, situated in the north of the Atlantic Coast. This concerns 25% of the territory. The initial investment will be 25 million US$ and the value of the exports, from the second year, would reach 45 million.

The reactions were numerous. An organisation founded on 15 August 1991, the Nicaraguan Foundation for Conservation and Development (FUNCOD), expressed the possibility of ecological dangers. In 1960, 60% of the territory of Nicaragua was covered with forests. In 1990, not more than 20% of it remained, that is, some 25,000 sq. km. Central America has world's highest rate of deforestation. The fires devastate each year a considerable number of hectares. In 1991, in Nicaragua, more than 300,000 hectares were destroyed. The FUNCOD claims that the exploitation of such an extent of forest will change the ecosystem of the Atlantic Coast.

The promoters say that this will give 4,000 jobs in a region where unemployment reaches 85% of the active population. They promise a plan against fire and reforestation of 150,000 hectares. But the local authorities are sceptical. The North Atlantic Regional Council, citing the law on Autonomy, asserts that this agreement violates the latter, as it has not been consulted by the central government. In December a true coup d'état brewed in the region, brought about by one of the Miskito leaders, a former Contra, Brooklyn Rivera and some claim that the promoter of the project, a certain Mr. Chang, a Nicaraguan of Taiwanese origin, had a part in these political manoeuvres.

The policy in favour of imports has permitted the shops to be filled with various goods and commercial displays. Christmas in 1991 has seen a veritable flood of products invading the shops and the supermarkets. Household electrical goods, audio-visual equipment, computers seem to take away all the votes. The domestic electrical consumption is now expanding so that the production of energy may not keep pace any more. Several power stations are now under consideration. One needs to import electricity from Costa Rica. The number of vehicles has almost doubled on since 1990 to the point of the traffic in Managua is becoming difficult at times. Within a year the number of those killed in road accidents has risen by 57%. The foreign food products are sold everywhere, often at prices higher than those of Belgium.

At the same time, the local producers, especially the small enterprises and the craftsmen, go bankrupt, close down or they are taken over by higher national or foreign investors. Certain categories of small specialised producers such as the manufacturers of shoes for example, disappear from the scene.

For 1992 it is anticipated that 45 enterprises will be returned to their former proprietors and 30 more will be privatised in the fields of urban services and tourism. The staff of the public services will be reduced further by 10%.

The longer-term economic problems

The real problem of inflation is in the longer-term. In fact, if Nicaragua has become the most expensive country in Central America, it is because the cordoba is overvalued. But a devaluation without accompanying measures will not solve the fundamental problems. Thus, a dilemma remains to be solved.

Moreover, it is indeed the problem of production that is in question. The country now has foreign aid and relative development of commercial activities. The production has gone down in all the fields. The production of coffee has been reduced by 39% between the last two cycles. The volume of exports of meat has fallen by 36% in volume and 41% in value. The production of cotton remained almost unchanged and only the sale of bananas was multiplied by two.

The reasons are numerous and diverse according to the sectors, yet the lack of

credit on the hand and the opening of internal market for imports of consumer goods on the other are important factors. Some 300 enterprises have closed their doors. Textile and the metal industries have been the hardest hit. The result is that the commercial deficit increased from 295 million US$ to 402 million between 1990 and 1991.

To revitalise production, investments are necessary and one of the problems will be the role of foreign contributions and conditions that will be involved. The role of free trade zones risks not yielding big benefits for the country, by way of employment or financial revenues.

The social consequences

The first social consequences of the "adjustments" is the increase of unemployment. This spreads to all the sectors of economic activity. In 1991 it has increased by 10%, among the salaried employees, reaching a level of 46% of the active population, without counting a rate of 20% of underemployed. The hardest hit sector was that of public services which reduced itself by 30.7%. Industry saw a fall of 12%, agriculture 11% and trade 7%. In Managua alone, by the end of the year, there were 115,672 people without employment.

In the whole country one counts some 747,000 unemployed persons, that is, 53.5% of the visible and invisible unemployment. This figure could rise to nearly a million in 1992. Every year some 40,000 young men reach the employment market.

The income of the workers is also constantly going down. At the time of the devaluation of March 1992 which reached the rate of 400%, the wages were revalued by 200%. In January 1991, the average salary was 165 US$ per month and in December 120.2. In agriculture it was 35 US$. In relation to a constant whole of basic products necessary for the life of an average family, the salary represented 83.3% in January 1991 and 73.5% at the end of the year. For the agricultural worker, it represented, according to the FIDEG, 23.6%. The same source says that 70% of the population can't meet their basic needs and 20% live in total misery. One needs to remember that the PIB has lowered itself by 42% between 1980 and 1990.

In the field of health, the indicators are more discomforting. The medical consultations have gone down by 26% in 1991, the rate of hospitalisation has been reduced by 13%. The consultations for infants have gone down by 25.6% and the prenatal consultations by 10.3%. According to Dr. Porra, secretary of the health workers' trade union, the infant mortality, in 1991, has cost the life of some 2,000 infants more than in the previous year. As a result of the adjustment policy the health budget has been reduced by 30%. The infant mortality rate reached 71.8 per thousand births in 1990.

The housing problem is hardly in a better position. In 1985 the housing deficit was considered at 350,000 units. Today the government itself puts it at 400,000. Yet, Nicaragua always has a very high figure of demographic growth, one of the highest in the world (for the years 1980-85 the average rate of growth was 3.3%). For the period 1990-95, the latter is considered at 3.2. Without taking into account the increase of the population, one would need, at the present rate, 33 years to solve the housing deficit. The present plans of construction for houses of 30 m² are about 12,000 units and they are rentable only with a monthly rent of 40 US$ which is not affordable for the majority of poor families.

For education, the reductions have been very heavy too. The literacy programmes have been omitted or "privatised". The rate of literacy, that had been reduced to 12% in 1982, has risen again to 25% in 1991, i.e. about a million people. The number of non-school-going children has increased considerably. From 1992 the parents will have to pay 5 cordobas (1 US$) monthly for primary education and 10 (2 US$) for secondary one. Today, 34% of children of school-going age do not have access to education. The budget of universities has been reduced too.

In short, as Cardinal Obando y Bravo, Archbishop of Managua, admits, the country is sinking into an economic model where the rich become richer and the poor become poorer. It is hardly astonishing to learn that between 1982 and 1990 the criminality rate increased from 36 to 75 per 10,000.

Certainly, all these negative indicators did not take place after 15th April 1990, date of the new government holding power. The war and the deterioration of economy had already had their influence upon these factors prior to this date. What is grave in this case is the fact that the policies embarked upon in a context clearly more favourable, of peace and foreign aid, do not direct towards the improvement of the social situations, but on the contrary, mainly benefit the most favoured social sectors.

Speaking of the war, one needs to recollect that it still has a number of negative consequences today. Thousands of war casualties are in need of physical and social rehabilitation. The orphans count by thousands; the material weight of military operations remains considerable. There are, for example, some 130,000 mines to be destroyed and the experts say that the disposal of these mines will be more difficult to be solved than the problem of the 600,000 explosive devices in the Gulf region. In fact, in Nicaragua, they are found in mountainous and rainy regions. For the next 3 or 4 years, a sum of 4 million US$ will have to be devoted to this.

The reorganisation of the civil society

It is not a question of only economic adjustment with disastrous consequences on the disadvantaged population, it is a case of the whole society undergoing a transformation in depth. Despite the war and the enormous economic difficulties, the Sandinist regime had succeeded in promoting a social policy and mobilising the working-classes. The present government states that the measures of restriction will lead to the boost of economy and notably the production. The Minister of Finance, in a televised message, congratulated the Nicaraguan people on having accepted a policy of austerity that will bring better days. But he does not say who pays the price of this austerity.

The content of education is revised from top to bottom. The new school manuals have been provided from the academic year of 1991. They were financed by the AID (the American co-operation) and contain the "new" thinking. Seven million manuals financed with Finnish aid from the time of the Sandinists have been destroyed. The University which was open to the working-class circles is undergoing pressures so that it becomes more elitist

again. Fortunately the universities resist. But new private universities are being set up. In 1991 some 7,000 young men were unable to enter higher education for want of space.

Cardinal Obando y Bravo announces the opening of a new Catholic University by pontifical right. He asks the government for premises on the outskirts of Managua, former military buildings. New careers will begin there: oceanography, architecture, management of agricultural enterprises and also sciences of education, sociology and theology. One needs to remember that the Central American University, run by the Jesuits, gave its support to the revolutionary project.

The means of mass communication are changing too. One of the two television channels has been privatised and transmits essentially programmes coming from Miami or run by Cuban refugees in Mexico. The commercial publicity has invaded the other channel, on the American model. Several new channels are underway, one of which will begin in January 1992. The cable TV has been introduced, permitting the picking up of American channels.

The Catholic Church is gradually reclaiming its social space in the civil society. The Cardinal proposes the name of the Minister of Education. We have already talked about the new Catholic University. A cathedral is under construction which would have to be inaugurated by Pope John Paul II on the occasion of the 500th anniversary of the "discovery" and evangelisation of America. 90 % of the costs is being covered by an American businessman, an owner of a chain of fast food restaurants. The Opus Dei announces its arrival in Nicaragua to organise residences for students.

The working class resists

In the face of the totality of measures, various types of reactions took place. In 1990 on two occasions there were almost-general strikes. One of them nearly degenerated into an insurrection if the Sandinist Front did not intervene to calm down the people. Government measures had affected all the social sectors at the same time, from the peasants to the students, going through the urban workers. In 1991 there were two big strikes in the public sectors health and education.

Several other conflicts arose in the industrial sector, notably in the sugar refineries. There was one loss of life. The cause was notably the handing over of the plants to their former owners. Between April and October 1991, 38 labour conflicts were reported: 9 in the industrial sector, 11 in agriculture and 18 in the sector of services.

The government instituted a "dialogue" between the economic forces of the country: employers, workers and State who must, in principle, meet for six months. Long and painful negotiations resulted in government promises regarding employment and obtaining of a quota of 25% in favour of the workers in the process of privatisation of the enterprises. The solution proposed by the trade unions was the establishment, in each enterprise or group of privatised enterprises, of a limited company possessing 25% of the capital and where the workers are the proprietors: the shares must be handed over to none other than workers of the enterprise in question.

The dialogue was interpreted in various ways. For some it was a victory for the workers. For others this appears as a concession made to the prevailing economic system. We would say that in the present circumstances, it involved a mechanism of defence in a position of weakness. However, this, at times, gives the workers an unforeseen power. Thus, in the banana enterprises that were the only ones expanding in the year 1991, one had to elect a board of management of the organisation that was to preside over the privatisation. The private interests being divided, it is the workers' candidate who was elected.

The strategy of trade unions, elaborated by the Nicaraguan Workers' Front (NWF) which groups together 85% of union members, the former Sandinist trade unions of industrial, rural or services workers, is particularly defensive. Saving the most possible employment seems to be its central axis. The margin of manoeuvre is hardly too big — in the face of a dominant economic system, non-Sandinist trade unions quite closer to employers' interests and a Sandinist political opposition which up until now has been unable to develop an alternative project.

The Community Movement, run by Miguel D'Escoto and which gathers together the local organisations, has known a moment of intense activity when the parliament decreed new laws on urban and rural property. These legal prescriptions would have called into question a part of the agrarian reform and the redistribution of urban properties. There was a mobilisation by the working-class against these laws and finally they came up against the veto of the presidency. This was a victory of the Community Movement in the political sphere.

In the countryside the agricultural trade union ATC and the Union of Farmers and Stockbreeders (UNAG) have fought so that the privatisations take into account the agricultural workers and the small producers too. The two organisations were active in re-inserting former Contras and demobilised servicemen in agricultural production.

The resistance was serious in the fields of health and education too. It expressed itself particularly through claims regarding employment. The universities established a common front to defend higher education and obtained a certain amount of concessions from the government.

On the whole, however, one must see that the forces of the working-class are on the defensive, their possibility of action is limited, all the more so, as the splashing visibility of consumption gives the illusion that one day it could be extended to everyone.

The political objectives of a hegemonic class movement

In a paradoxical manner, the logic of the neo-liberal system requires at the same time the diminution of the State and particularly its role in the economic sphere and the appropriation of the latter as an instrument of hegemonic reconstruction. The privatisation and the financial measures in fact favour several sectors of the bourgeoisie. The transformation of the cultural apparatuses accompanies the process, tending to favour the values that ensure reproducing of the "new democracy", the vision of excellence the bourgeoisie wants to give itself and until social struggles made culpable.

The re-establishment of the material bases of the bourgeoisie is done at an

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The European Community and its Impact on Trade with Developing Countries: With Special Reference to Sri Lanka

Saman Kelegama

(Fellow, Institute of Policy Studies, Colombo)

In 1993, the European Community (EC) will create one of the world's largest markets (approximately 40 per cent of world trade) with no internal frontiers and with free movement of goods and services, capital, and labour. Countries that are not members of the EC are concerned that the EC would become more protectionist and create a "Fortress Europe". Only recently has there been a recognition of the opportunities offered by this large and rapidly growing market to non-member countries as well as threats. This paper, comprising four sections, analyses the emerging EC market and its impact on Sri Lanka's external trade. Section I provides an introduction. Section II examines the EC's trade with developing countries with special reference to threats and opportunities. Section III analyses Sri Lanka's trading patterns with the EC and Section IV sets out some policy options for Sri Lanka to meet the new challenges posed by the EC.

1. Introduction

The primary stimulas to intensify European integration originated from the growing perception that Europe was lagging behind the U.S.A. and Japan in terms of technological development and world market shares for high-tech products. The fragmentation of the European market in particular was seen as a major obstacle to the development of new products and new technologies. Moreover, European leaders felt that Europe should play a more powerful and influential role in the field of international trade relations, notably within the triangle comprising of the United States, Japan, and Europe.

The creation of the EC internal market has been deemed a massive supply-side economics programme designed to strengthen competitiveness, accelerate economic growth, and promote technological development on a wider level. The internal market is expected to generate manifold state and dynamic benefits. It will give a boost to the EC economy (add about 6 per cent to GDP) and, as a consequence, will also stimulate economic growth world wide. It will reduce inflation (consumer prices will be 6 per cent lower), create new jobs (1.8 million new jobs), and provoke an extensive restructuring process and the development of new technologies.

In 1993, a very large trade grouping with 380 million consumers will emerge in Europe, to be known as the European Economic Area (EEA = European Community [EC] + European Free Trade Association [EFTA]). A gradual integration of Eastern European economies into the stream of European economic development may also take place during the post-1992 period. Consequently, in the next few years, the trading conditions in the European market will change rapidly. Some of the factors that will influence such a change will be: economies of scale in production and realizing the internal market, the outcome of GATT negotiations, and closer economic cooperation with Eastern Europe. Developments such as these will have serious consequences for suppliers outside Europe, in particular, developing countries.

The implications and repercussions of the EC market on economic relations with developing countries have to be studied thoroughly in order to enable these economies to adjust accordingly and react positively to impending changes in the international economic environment. The Community has endeavoured to allay the fears of third country enterprises and has maintained that the notion of "Fortress Europe" bears no truth in it as the Community itself has to depend on global trade. But there has been no official policy document in regard to EC trade with developing countries. The only reference is the statement that "the commercial identity of the Community must be consolidated so that its trading partners will not be given the benefit of a wider market without themselves making similar concessions". However, broad principles and guidelines in regard to the Community's trade relations with third countries have been outlined as follows:

(a) The achievement of a single market will benefit both the European enterprises as well as those of the third countries.
(b) Liberalized and free international trade is vitally essential for the Community, hence it will not resort to protectionism.
(c) All its multilateral and bilateral

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commitments with trading partners will be respected,

(d) With the creation of a Single Market, the National Legislative measures will be replaced by Community measures.

(e) The Community intends to seek balance of advantages and reciprocity in its relations with third country partners who would benefit by the economic advantages offered by the single market.

Although it appears that an integrated market with 380 million consumers and a uniform set of norms and standards against 12 different sets of standards, would provide more opportunities for trading partners, in actual practice this may not be the case. EC President, Jacques Delors once said that "as long as our partners do not resort to protectionism or dumping there is no reason for us to take the offensive in these areas. Our prosperity is linked to our openness but this openness must not mean naivety". Thus the implication of the Common market for developing countries does not appear to be very clear.

In the absence of an official policy statement on the Community's trade policy vis-a-vis third countries it is not possible to make specific statements on the implications that would follow for third country partners. However, it is clear that the integration of Europe does not mean that selling in the European market would be easier. It will lead, *inter alia*, to a single set of standards and quality control requirements. New regulations concerning packaging and labelling will come into force. Preventive health measures and environmental concerns will attract a great deal of attention. This would mean that the EC's trading partners themselves will have to go through a process of adaptation to remain competitive in the market.

Economists are uncertain about the exact impact of the EC on third world countries. Some economists say that the completion of the EC will reduce imports into the EC from developing countries by 15 per cent on the assumption that the long-run dynamic gains of the single market are fully realized. Some others have argued, on the other hand, that as a result of higher incomes in the EC (assuming that incomes increase by at least 5 per cent) imports from developing countries into the Community would increase by about 15 per cent. Thus what appears to be the case is that there will be threats as well as opportunities for developing countries from the EC. However, as will be shown in this paper, current trends point to more threats than opportunities emerging from the Common market.

II. EC Trade with Developing Countries

(a) Background

In its trade with developing countries, the EC adopts an eclectic system of trade preference and import restrictions. Under the LOME Convention, 68 African, Caribbean, and Pacific (ACP) countries have been accorded duty-free access for their exports of manufactured items and most agricultural products not covered under the Common Agriculture Policy (CAP). Twelve developing countries in the Mediterranean basin have free access to the EC market for most manufactured and semi-manufactured goods with restrictions only on imports of textiles and clothing. Agricultural products not covered by CAP benefit from tariff reductions. In contrast, the developing countries in Asia have a lower preferential status in the EC market than the ACP and the Mediterranean developing countries. Asian developing countries benefits from tariff preferences under the Community's Generalized System of Preferences (GSP) scheme. These preferences have been eroded over the years by reduction in the Most Favoured Nation (MFN) status by consecutive rounds of GATT negotiations, and increasing limits placed on access to preferential rates. Let us briefly examine some of the specific threats.

(b) Threats

(1) Preferential Trade may exist in the EC

Although it is said that preferential trading policies would be eliminated with the advent of a Common market, some scholars have argued that unequal treatment of developing countries will continue even after European integration. It is argued that some sort of a preference scheme (non-GSP form) will prevail for ACP and Mediterranean countries to offset adverse effects to these countries that result from the integration of Spain and Portugal to the EC.

(2) Increase in Non-Tariff Barriers

During the last ten years, EC trade policy has been characterised by an increasing recourse to a wide array of non-tariff barriers (NTB). These include:

(i) Voluntary Export Restraint (VER).
(ii) Subsidies and Common Agricultural Policy which regulates agricultural imports.
(iii) Anti-dumping policies.
(iv) Procurement policies and technical standards.

In mid-1988, there were 138 VERs in the EC representing about half of all VERs maintained by industrialized countries. The use of VERs has been rapidly increasing in the EC. VERs are increasingly applied to imports from developing countries and affect agricultural products, textile and clothing, machine tools, transport equipment and footwear.

Regarding subsidies, a major form of EC subsidies affecting imports from developing countries relate to agriculture in the context of the Common Agricultural Policy. There are also indirect and implicit subsidies for industry. It is said that there will be greater restrictions on state subsidies in the future in order to promote effective competition in the EC. As regards anti-dumping, at present the EC can, under Article 115, authorize member-states to impose restrictions on imports when there is a threat to the domestic industry. With the removal of border controls after 1992, recourse to Article 115 will no longer be possible. Whether all these measures will be implemented as declared remains to be seen. Technical standards are discussed in the context of the post-1992 period later in the text.

During the formation of the EC, considerable economic adjustment will take place in less developed EC countries, such as, Portugal, Spain, Greece, etc. It is felt by 'EC observers' that the adjustment cost may be transferred to developing countries in the form of restrictive non-tariff barriers.

All in all, the experience so far has proved that the stronger the European Community gets, the more protectionist it becomes. It is noteworthy that the EC market is becoming increasingly self-sufficient. For instance, although the EC is the largest importer and exporter of textiles and clothing, most of the trade in this sector takes place within the EC market. Moreover, in 1975, 51.4 per cent

of total EC trade volume took place within the EC and by 1990 the total increased to 59.2 per cent.

(3) Income Effect may not cause a positive Trade Effect

The positive income effect in the EC may fail to produce the expected positive trade effect in developing countries. The dynamic trade creation effects arising from increased competition and economies of scale may offset the benefits from trade diversion effects. Thus, as European industries become efficient, some amount of import displacement may occur with adverse consequences for developing countries. Estimates for potential percentage decline in EC imports from developing countries is quite high; office machinery: 66–68 per cent, footwear: 25–35 per cent, textile/clothing: 6 per cent, artificial fibre: 48–58 per cent, carpets: 20–24 per cent, and electrical household appliances: 24 per cent (Smith and Venables, 1988, Emerson, *et al.*, 1988). Thus, in the long-run, there can be an increase in trade within a self-sufficient Europe, thus limiting access to many developing countries.

(4) Closer ties with Eastern Europe may not be favourable for developing countries

Closer ties with Eastern Europe will lead to preference for exports of Eastern Europe to those of developing countries, and diversion of EC aid to Eastern Europe. Low-cost exports to the EC from Eastern Europe will reduce the market in the EC for exports of developing countries, especially of garments, shoes, processed foods and vegetables.

Along with trade diversion, investment diversion will also take place. The EC may divert investment to Eastern Europe as profitable opportunities arise. It is worth nothing that during the 1980s there has been a considerable EC disinvestment in Africa and Latin America. Less investment and aid to developing countries will adversely affect the development efforts of developing countries, thus reducing their export trade.

(5) The EC will use reciprocity as a bargaining chip in gaining access to European markets

Reciprocity will be a major drawback for developing countries, who will be forced to open their economies to European manufactures if the developing countries desire to sell their manufactured goods to Europe. If reciprocity is defined as equivalent sales rather than equivalent access, as defined by mutually agreed tariffs and non-tariff barriers, then it will be more desirable for developing countries.

(6) The issue of European standards

European industrial standards will be developed by the European Committee for Standards (Comite European de Normalization — CEN) and the European Committee for Electrotechnical Standardization (Comite European de Normalization Electrotechnique — CENELEC) as appropriate. The CE mark, which confirms that a product meets the set standards is as good as a passport to the European market. The standards that are enforced for high-technology products have already hit Japanese exports of high quality TVs called High Definition Television (HDTV). Moreover, European standards for food products (e.g. additives, colourings, flavours, preservatives, etc.) will be set according to the wishes of the most demanding of the EC member states much to the dissatisfaction of those engaged in food processing in developing countries, where present standards may not conform to the European standards.

There is some doubt as to whether developing countries will be able to meet such standards considering the financial, infrastructural, and technological constraints that they encounter. By imposing stringent standards, the EC may have found a way of circumventing GATT rules and implicitly establishing protectionist barriers against developing countries.

(7) EC quotas for Textiles and Garments may not materialize

It is likely that the EC quota system will be revised to meet the needs of the poorer European countries such as Spain, Greece, and Portugal, and the European quota reduced, in volume terms, to a level lower than the total amount of individual country quota received by developing countries. On the other hand, depending on the advantage, potential European quotas may not be considered as a substitute for existing country quotas, which will retrict exploitation of the European market as a whole.

(8) Local Content Regulations will come into play

LDC enterprises within the EC may be requested to use high levels of local inputs, i.e. European raw material (50 per cent) in their manufactures to qualify for non-quota trade. Due to such threats, big Asian enterprises, especially in Japan, Hong Kong, and Singapore, appear to think that they must penetrate the EC before it is made virtually impossible to do so after 1992. Already, some cash rich companies have invested heavily by buying large European companies in order to set up garment and automobile manufacturing factories.

(c) Opportunities

(1) Exporters who satisfy the requirements in one EC member-state will satisfy the requirements of all the other member states, as any tests they are subjected to in one country and certificates of conformity issued there, would be valid throughout the EC.

(2) Interaction between the private sector in developing countries and European firms, especially through joint ventures, will enhance the economic prospects for developing countries.

(3) The liberalization of the Common Agricultural Policy will benefit established food exporters in developing countries and the abolition of Article 115 in regard to dumping will benefit all exporters.

III. The Implication of the EC for Sri Lankan External Trade

Sri Lanka's relationship with Western Europe and Eastern Europe in economic, political, and social spheres is shown in Table 1. Clearly, Western Europe is important for Sri Lanka not only in the field of international trade but also in other areas. From the EC perspective, however, Sri Lanka does not appear significant in the area of international trade. For instance, in 1990, Sri Lanka accounted for only 0.04 per cent of the EC imports. Although this is the case, as Table 1 shows, for Sri Lanka, EC is important in many ways.

The strategic importance of the EC for Sri Lanka's international trade is highlighted in Table 2. As can be seen in Table 2, there was a surplus in trade in 1989 and

TABLE 1
SRI LANKA'S RELATIONSHIP WITH EUROPE IN ECONOMIC, POLITICAL AND SOCIAL SPHERES
(All Figures are for 1991)

Factor	*Western Europe*	*Eastern Europe*
1. Exports (goods+services) Rs. mn. (percentage)	24,730	546
	(31%)	(1%)
2. Imports (goods+services) Rs. mn. (percentage)	23,535	380
	(18%)	(0%)
3. Aid Receipts — Rs. mn. (percentage)	1,772	0
	(7%)	(0%)
Repayments — Rs. mn. (percentage)	1,740	45
	(36%)	(1%)
4. Investment* — Rs. mn. (percentage)	1,617	4
	(17%)	(0%)
No. of projects 1991 approvals — Rs. mn.	2,157	11
(percentage)	(14%)	(0%)
No. of projects	70	1
5. Tourist Arrivals — Nos. (percentage)	192,054	4,755
	(60%)	(1%)
6. Remittances — Rs. mn. (percentage)	3,440	15
	(19%)	(0%)
7. Employment — Nos. **	295	0
	(0%)	(0%)
8. Asylum seekers***	22,852	0
	(82%)	(0%)
9. Media Representation	7	0

Source: Dias Bandaranayake, Foreign Affairs Study Group, Colombo, August, 1992.

Notes:

* Joint ventures are categorized under major investing country.

** Based on the data from the Sri Lanka Bureau of Foreign Employment and licensed agencies only (estimated as 40 per cent of the actual).

*** Incomplete data.

TABLE 2
SRI LANKA — EC TRADE, 1985–1990

Year	*Imports (cif. Rs. Mn.)*	*%*	*Exports (fob. Rs. Mn.)*	*%*	*Balance of Trade*
1985	7622	15.5	6474	18.9	-1148
1986	7673	15.0	7623	23.0	-50
1987	10293	17.2	8711	22.0	-1583
1988	12165	17.3	10943	23.5	-1222
1989	12553	16.6	13996	25.6	+1463
1990	15468	14.7	19359	25.9	+3891

Source: Department of Commerce, Monthly Bulletin of Statistics, Dec., 1990.

TABLE 3
EXPORTS TO THE EC: COUNTRYWISE PERCENTAGE SHARES (1987–1990)

Country	*1987*	*1988*	*1989*	*1990*
Belgium	2.0	3.6	5.5	5.1
Denmark	0.3	0.3	0.5	0.3
France	1.9	1.9	2.6	2.3
Germany (FR)	7.5	7.1	6.2	6.7
Greece	0.1	0.1	0.1	0.1
Ireland	0.3	0.2	0.2	0.2
Italy	1.0	1.0	1.4	1.9
Netherlands	2.9	3.4	2.9	2.6
United Kingdom	5.5	5.4	5.7	5.7
Portugal	0.2	0.2	0.1	0.1
Spain	0.5	0.4	0.4	0.5
EEC Total	**22.2**	**23.5**	**25.6**	**25.5**

Source: Sri Lanka Export Development Board.

1990. The surplus in these years was created by higher export earnings from garments and textiles, tea, desiccated coconut and rubber. 25.9 per cent of Sri Lanka's total exports went to the EC in 1990 compared with 18.9 per cent in 1986. In fact, the EC is the second largest buyer of Sri Lankan exports after the USA. Imports from the EC (mainly electrical machinery, mechanical machinery, and others) declined from 17.3 per cent of toal imports in 1987 to 14.7 per cent in 1990.

An analysis of the geographical destination of exports to the EC show that Germany is Sri Lanka's the largest export market, followed by the U.K. (Table 3). The increase in garment exports to the EC made the major contribution to the expansion of exports to the EC. The EC, which imported 26.6 per cent of Sri Lanka's total garment exports in 1990 compared with 25.5 per cent in 1987, is the second largest buyer of garments after the USA (Table 4).

Sri Lanka's garments exports to the EC is governed by a bilateral agreement under the GATT Multi Fibre Agreement (MFA). Under this scheme, export quotas for the EC are available for four categories of garments covering: men's and women's trousers, blouses, shirts,and winterwear. Sri Lanka's EC quota has increased substantially (33 per cent) over the 1989–91 period and the quota utilization rate has remained at a satisfactory level of around 80 per cent during the same period.

The fate of the MFA, of course, depends on the Uruguay Round of GATT negotiations which has stalled temporarily. The original intention was to integrate trade in textiles and garments back into GATT but the EC has maintained that increased liberalization of trade in textiles and garments by the EC countries needs to be reciprocated by strengthening GATA rules, viz., discipline in regard to safety standards, subsidization and countervailing measures, as well as opening up of developing country markets for the EC exports. At present, what appears to be the case is that the MFA will be gradually phased out in 10 years time. From the complete abolition of the MFA, Sri Lanka may stand to lose because more industrialized countries such as, Hong Kong, Taiwan, and South Korea have a competitive edge over Sri Lanka in the European market.

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JAPANESE DIRECT INVESTMENT IN ASIA:
A STUDY ON SRI LANKA AND THAILAND

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INTRODUCTION

Foreign Direct Investment (FDI) in the industrialisation process or in the modernisation activities of developing countries of Asia has become a topic for considerable discussion among politicians, academicians and major international organisations like the UN system, the IMF and the World Bank after the Second World War. Many of them have believed that the promotion of FDI inflows into developing economies is a key solution to resolve some crucial socio-economic problems faced by these countries, like unemployment, deficit in the balance of trade/payments, scarcity of foreign exchange, poor technological capacity, lack of skilled labour and capital, etc.

The above notion was mainly discussed with particular emphasis on the statistical relationship between FDI inflows and growth of real Gross National Product (GNP). The successful economic performances of Asian NIEs (Hong Kong, Singapore, South Korea and Taiwan) were extracted as evidence to show the above relationship. However, some economists argue that there are no significant cases of initiation of national income growth by foreign capital. For example, Lakshman (1991:1) argues that this positive relationship unambiguously reflects causality, running from the FDI variable to the growth variable, raising the egg-or-chicken question. He further asserts that it is doubtful whether modern world history, specifically after World War II, has any significant cases of initiation of national income growth by foreign capital. This argument is quite acceptable if we consider the mere 'initiation of national income growth by the inflow of foreign capital, but it is doubtful whether the acceleration of the rate of growth of national income in most Asian countries, particularly the Asian NIEs, and in ASEAN countries has taken place through the increase of foreign investment or of the volume of available foreign capital.[1]

The inflow of foreign investment into the Asian region is not a new phenomenon, but is something which originated mainly during the colonial period. This long-persistent foreign capital in Asia can be divided into two major categories[2] according to their homogeneity of nature: the first is the perfect enclave investment which consists of the colonial rulers' investments in mining and plantation activities and in the creation of some traditional type of Multinational Corporation (MNC); the second is the semi-enclave investment which comprises joint ventures and Export Promotion/Processing Zones (EPZ) or Free Trade Zones (FTZ).[3] The former type of foreign investment (except the Japanese colonial investment in the Korean peninsula and in the Taiwan[4]) was predominantly isolated from the domestic economy of the host country: the most essential production inputs like labour, capital and technology were provided from outside the domestic economy of the host country. In other words, FDI in the Tea, Rubber, Coconut and Sugar Cane plantations of Asia did not generate much backward or forward linkages and this resulted in the poor transfer of the growth benefits of FDI to the local economy (Lakshman, 1991:2).

Although the latter type of investment has also substantially consisted of the full enclave elements, it has had some backward influence on the improvement of production and productivity of host country through transfer and diffusion of modern technological know-how and advanced management systems. The successful economic performances of the Asian NIEs and of ASEAN can be largely explained as resulting from following this semi-enclave type of investment. In recent decades, both socialist and capitalist countries in Asia have introduced a series of far-reaching reforms which have stimulated their economies by removing various import-export restrictions and granting various incentives[5] for these

semi-enclave investments, to deduce a significant contribution to elevating economic development through industrialisation.

This paper is the one-third-way result of an on-going joint research project on "The Pattern of Economic Development and Foreign Aid in Asia" under the assistance of the Monbusho International Scientific Research Programme. The study undertaken by me comprises a survey on the "Role of Japanese FDI in the Economic Development of Sri Lanka and Thailand". The survey is intended to be carried out within three years in three major steps as indicated below: firstly, the growth pattern of Japanese overseas investment and its significance in Asian economies, particularly Sri Lanka and Thailand; secondly, the role of Japanese investment in economic development of both countries at macro-level; and thirdly, the micro-level contribution of Japanese FDI to various economic activities of the host countries' local economy. The present paper consists of the analysis of the first step which is mainly based on the statistical and literary survey conducted during the last year. The purpose of this paper is to ascertain the growth pattern of Japanese FDI as a supplier and its relative significance within Asian as a demander. It will, in particular, this will attempt to examine the general characteristics of the composition and structure of Japanese FDI in relation to that of total foreign investment in these countries using case material of Japanese FDI in Asia with special emphasis on Sri Lanka and Thailand. However, it will exclude the Japanese colonial investments and perfect enclave FDI in the discussion due to coverage of the study.

JAPANESE FDI IN OVERSEAS : AN OVERVIEW

The inflow of Japanese investments into various countries of the world was initiated in the mid-1950 and came in small volumes of capital. This was dramatically increased during the last four decades, particularly in the 1970s and 1980s. The gradual development of domestic capital at home and its increasing dependence on international trade and foreign resourses resulted in this movement of Japanese capital overseas. With its sharp increase in Asian countries during the last two decades, it not only arose as a major political issue in the discussions on economic development in Asia, but also gradually became a major topic for academicians in both Japan and in the host countries. Major academic efforts on the Japanese side[6] emerged in the mid-and late 1970s and inevitably they reflected the specific features of the decade. Japanese FDI in this decade concentrated on resource extraction, on import-substitution manufacture for the host countries and on the production of parts and components required by final manufacturers in Japan. However in the 1980s, these characteristics of Japanese investment changed dramatically both in scale and in character and now, export-oriented firms began to dominate (Phongpaichit, 1990:28). On the host country side, many economists engaged themselves in the analysis of the backward and forward linkages between Japanese FDI and the host country economy, laying particular emphasis on the experiences of Asian NIEs and ASEAN economies.[7]

The inflow of Japanese FDI into the Asian region has occurred according to the changing pattern of two major factors: firstly, the condition of the host countries demanding investment, such as their social, political and economic stability, availability of resource endowments

TABLE 1

JAPANESE FOREIGN DIRECT INVESTMENT IN KEY REGIONS, 1951-1990 (UNITS: US $ MILLIONS, %)

	1951-60	1961-70	1971-80	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
North America:													
Amount	88	824	8886	2522	2905	2701	3544	5495	10441	15357	22328	33902	27192
Share	39	26	27	28	38	33	35	45	47	46	48	50	48
C. & S. America:													
Amount	85	481	5601	1181	1503	1878	2290	2616	4737	4816	6428	5238	3628
Share	37	15	17	13	20	23	23	21	21	14	14	8	6
Middle East:													
Amount	1	150	1925	96	124	175	273	45	44	62	259	66	27
Share	0.4	5	6	1	2	2	3	0.4	0.2	0.2	1	0.1	0.0
Europe:													
Amount	3	636	3831	798	676	990	1937	1930	3469	6576	9116	14808	14294
Share	1	20	12	9	9	12	19	16	16	20	20	22	25
Asia:													
Amount	49	703	9081	3338	1384	1847	1628	1435	2327	4868	5569	8238	7054
Share	22	22	28	38	18	23	16	12	10	15	12	12	12
Africa:													
Amount	1	91	1352	573	489	364	326	172	309	272	653	671	531
Share	0.4	3	4	6	6	5	3	1	1	1	1	1	2
Oceania:													
Amount	2	279	2276	424	421	191	157	525	992	1413	2669	4618	4166
Share	1	9	7	5	6	2	2	4	4	4	6	7	7
Total Amount	228	3165	32919	8931	7703	8145	10155	12217	22320	33364	47022	67540	56911

* Nominal price values.

(human and materials), condition of the domestic capitalist sector, economic policy towards foreign capital and foreign trade and the level of incentives for foreign investment; and secondly, the nature of the economic environment of the supply side in Japan.[7] On the supply side, three major reasons have caused the increase of Japanese investment in the Asian region, viz. (a) the constraints on further accumulation of already accumulated industrial capital at home required overseas locations for further accumulation. The argument runs on the gradual loss of the comparative advantage of Japanese manufactured products[8] at home due to the scarcity of raw materials, high cost of production, particularly the cost of labour, tightening environment regulations and loss of stocks; (b) the transformation of the financial condition of the Japanese economy, specifically the appreciation of the Yen[9] and the liberalization of capital outflows[10] and trade friction with the USA and EC or the imposition of various tariffs and quotas against Japan by advanced countries. The appreciation of the Yen caused a lesser demand for Japanese products in international markets as a result of the high price. Here too, there was a lesser comparative advantage for Japanese products which were produced in Japan itself; (c) the structural change of the Japanese economy[11] along with the change of industries from labour-intensive to capital-intensive.

The growth pattern of Japanese FDI during the last four decades in key regions of the world is given in Table 1. The data reveals the gradual increase of Japanese overseas investment which is closely associated with the structural change of the Japanese economy and the other key factors mentioned above. The cumulative Japanese FDI in the two decades, 1951-70, amounted to US $ 3,393 Million, which is approximately 10 times higher in 1971-80. Again, this was further increased by eight times in 1981-90. However, this upward trend of Japanese investment overseas not only declined in terms of total capital by 16 per cent in 1990 compared to the previous year, but also declined in terms of the number of projects from 6,589 in 1989 to 5,863 in 1990 or by 11 per cent. This is a very uncommon feature of Japanese FDI inflows during the last decade (except 1982).

Although we have emphasized the rapid inflow of Japanese FDI into Asian economies, it comprises only one-eighth or 12 per cent of the total, and also shows a downward trend. For example, until 1987, Japanese FDI in Asia composed nearly 40 per cent of the total, but thereafter it began to decline and remained at around 12 per cent during the last five years. However, if we consider the cumulative total of Japanese FDI in Asia for the period 1951-90, it amounts to 15 per cent and 30 per cent of total overseas capital and firms respectively. This reveals that a large number of firms (about 18,634 cases) are operating in the Asian region with relatively small volumes of capital. Moreover, although the share of Japanese investment in Asia is small and declined in the last few years as a result of its large concentration in North America, the absolute terms of Japanese FDI increased sharply in Asia, particularly in NIEs and ASEAN, rather than the share. This could be the largest single country investment in the Asian region.

At present, nearly 75 per cent of the total Japanese FDI is channeled to North America and Europe, and this was 46 per cent and 39 per cent in the 1960s and the 1970s respectively.[12] This indicates that Japanese investors still consider the economic conditions of the host country rather than the low wage rates and the economic incentives available, when they move to foreign countries for investment activities. The main reason behind this is that most Japanese firms prefer to invest in foreign countries in collaboration with domestic capital which is largely available in the host countries. North America and Europe are not only developed in this context, but also have a considerably improved industrial environment, i.e. human and material resources, infrastructure facilities and a quite developed domestic market. These factors which are highly preferable for Japanese investors, are not available sufficiently in the developing countries of Asia.

Another aspect of Japanese FDI is that, activity-wise, it has not shown a significant change during the last four decades (Table 2). However, both manufacturing and non-manufacturing activities increased substantially in North America and Asia during the period 1971-80. Although the share of manufacturing investment in Asia declined from 13 per cent in 1971-80 to five per cent in 1981-90, the investment in absolute terms increased more than three times, being second only to North America.

TABLE 2

JAPANESE FOREIGN DIRECT INVESTMENT BY REGION AND BROAD ACTIVITY (UNITS: US $ MILLIONS, %)

Region	Manufacturing						Non-Manufacturing					
	1951-70		1971-80		1981-90		1951-70		1971-80		1981-90	
	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
N. America	217	6.1	2,212	6.2	37,893	14.1	694	19.8	6,686	20.5	86,921	32.4
C. & S. America	275	7.7	2,505	7.0	3,491	1.3	292	8.2	3,097	9.4	30,743	11.5
Asia	320	9.0	4,243	12.9	14,091	5.3	430	12.0	4,830	14.7	22,814	8.5
Europe	36	1.0	308	2.5	11,696	4.4	803	16.9	3,034	9.2	41,061	15.3
Other	82	2.3	1,867	5.7	1,861	0.7	626	17.5	3,653	11.1	17,672	6.6
Total	930	26.1	11,640	35.4	69,032	25.8	2,645	74.0	21,280	64.6	199,211	74.3

Source:

Takehsan, W. T., Japanese Direct Investments in Asia with Special Reference to South Asia and Sri Lanka: Some Implications for Economic Growth of Developing Countries. *Annual Bulletin of Research Institute for Social Science*, No. 9, March 1991, Ryukoku University, Kyoto, Japan.

Growth Pattern of Japanese FDI in Asia

Although Japanese investment still represents a minor percentage in domestic investment (except Singapore) and in the share of total Japanese FDI in Asian countries, Japanese FDI became a major political issue in the development policies of Asia in the 1980s, especially in ASEAN countries. Along with the increase of Japanese investment in these countries, investment from Western countries, particularly the USA, gradually declined. Many countries in Asia deem that Japanese FDI will play a greater role in their industrialisation activities because the Japanese firms are recently activated on export-oriented manufacturing, using advanced technologies.

Table 3 presents data on the percentage distribution of Japanese FDI in Asian countries country-wise and region-wise separately to facilitate the understanding of the growth pattern of Japanese capital directly invested in this continent. Four little dragons or so-called Asian NIEs and ASEAN countries concentrated more than 90 per cent of the Japanese FDI during the period 1950–90 (except 1987). South Asia and other countries are negligible in this context: the share of Japanese capital moving into four major countries of South Asia (Bangladesh, India, Pakistan and Sri Lanka) amounted less than two per cent over the 1980s (except 1983). This uneven distribution of Japanese capital inflows into the Asian region reveals that they follow the pattern of the host country's resource endowment and economic condition in particular, and the political stability and other factors in general. For example, a large portion of the total Japanese investment in ASEAN, particularly in Indonesia, was concentrated on resource-related projects or on resource extraction. Until 1985, Indonesia was one of the largest destinations within the ASEAN region for Japanese capital in almost all years. The country is well-known as rich in various resources.[14] Thus, Japanese firms often move into relatively developed countries in Asia. This explains the low level of Japanese investment in the Philippines and in South Asia which remained at low levels of economic performance[15] and had poor resource endowments.[16] Thus, most Japanese firms have concentrated more on the economic conditions of the host countries rather than on their economic policies towards foreign investment such as unconditional economic incentives. For example, an increase in the share of Japanese capital moving into Thailand during the last three years (1988–90) is emphasized by Lakshman (1991:12) as a result of its very high growth rate in the ASEAN region. In 1990, the Japanese share of capital in Thailand accounted for the highest level second only to Hong Kong. In addition, the availability of domestic capital for joint ventures also caused this dramatic expansion of Japanese capital in Thailand surpassing other countries. Generally, most Japanese firms favoured joint ventures rather than fully-owned subsidiaries, with even small collaboration accepted. These requirements of Japanese firms were most probably available in the above countries since they had developed the domestic capitalist sector considerably.[17]

The distribution pattern of Japanese FDI by industry (only the manufacturing sector) and its changes during the last four decades are also important to understand the nature of activities of both Japanese and host country firms, and the changing pattern of international comparative advantage of Japanese products. Table 4 presents data on the Japanese FDI by industry to illustrate the pattern of concentration of Japanese capital in each industry decade by decade. During the first two decades (1951–70), textiles, electrical/electronic equipment and iron & steel/non-ferrous metals have concentrated 58 per cent of the total Japanese investment in Asia, in the manufacturing sector. However, in the 1970s, the first two items declined sharply and iron &

TABLE 3

JAPANESE TOTAL INVESTMENT IN ASIAN COUNTRIES: PERCENTAGE DISTRIBUTION, 1951–90

Region	1951–70	1971–80	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
East Asia:	19.5	37.0	13.7	41.5	43.2	42.9	33.1	62.5	65.1	50.6	41.7	40.5
China				1.2	0.2	7.0	6.9	9.7	25.2	5.3	5.3	4.9
Hong Kong	3.5	17.7	9.9	28.8	30.4	25.3	9.0	21.6	22.1	29.9	27.0	25.7
Rep. of Korea	4.4	12.2	3.3	7.4	7.0	6.6	9.3	18.7	13.3	5.7	7.4	8.0
Taiwan	11.5	7.1	7.6	4.0	5.6	4.0	7.9	12.5	7.5	6.7	6.0	6.3
South East Asia:	76.5	72.1	85.0	57.3	52.5	55.8	84.7	36.0	31.3	48.7	57.0	58.0
Indonesia	37.9	46.0	72.9	29.6	20.2	22.9	28.2	10.7	11.2	10.5	7.7	15.7
Malaysia	6.5	6.6	0.9	6.0	7.8	8.7	5.5	6.8	3.3	7.0	8.2	10.3
Philippines	9.8	6.0	2.2	2.5	3.5	2.8	4.2	0.9	1.5	2.4	2.5	3.7
Singapore	5.0	10.0	8.0	11.0	13.4	13.8	23.4	13.0	10.2	13.4	28.1	17.9
Thailand	12.0	3.4	0.9	6.8	3.9	7.3	3.3	5.3	5.1	15.4	15.5	16.4
Brunei	11.3	0.1	0.1		0.1	0.3	0.1	0.1				
South Asia:	4.0	0.9	1.3	0.7	4.1	1.3	2.3	0.7	0.6	0.7	1.4	1.5
India	1.8	0.3	0.5	0.2			0.9	0.5	0.4	0.4	0.2	0.4
Other	2.3	0.6	0.8	0.5	4.1	1.3	1.4	0.2	0.2	0.3	1.2	1.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
ASEAN(a)	65.7	72.8	84.9	57.9	52.5	55.5	64.6	36.7	31.3	48.7	57.0	58.0
NIEs(b)	34.5	37.0	31.7	53.3	60.4	49.7	49.6	63.8	53.1	58.7	59.5	47.5

Note:
(a) Indonesia, Malaysia, The Philippines, Singapore and Thailand
(b) Hong Kong, South Korea, Singapore and Taiwan.

TABLE 4

DISTRIBUTION PATTERN OF JAPANESE FDI IN THE MANUFACTURING SECTOR OF ASIA (%)

Activity	*1951-70*	*1971-80*	*1981-90*
Food	7.2	2.9	7.2
Textiles	33.4	19.1	6.7
Lumber & Pulp	4.7	3.0	2.7
Chemicals	5.9	16.5	13.6
Iron & Steel/Non-ferrous Metals	10.6	23.5	12.6
Machinery	4.7	6.1	9.8
Electrical/Electronic Equipment	14.1	11.7	25.8
Transport Equipment	4.4	5.9	10.2
Other	15.0	11.2	11.4
Total	100.0	100.0	100.0

steel/non-ferrous metals emerged as a dominant industry, contributing about one-quarter of the total investment. In this decade, the major product areas in the manufacturing sector of Japanese FDI in Asia were iron & steel/non-ferrous metals, chemicals, textiles and electrical/electronic equipment, in order of merit. Their rate of contribution was about 71 per cent of the total manufacturing sector.

These changes, specifically the emergence of chemicals as a major product, and the decline of the share of some products reveal the problems which were faced by Japanese firms at home and in the international market in the 1970s. Heavy industries in Japan mainly confronted an increase in the cost of raw materials and high competition with Asian NIEs which produced similar products at a low level of production cost for the international market. These two factors caused the decline of the comparative advantage of Japanese products originated at home and thereby changed the manufacturing structure. However, the Japanese firms overcame the above problems by introducing energy-saving devices and developing new products under research and development (R&D) efforts undertaken by both the public and the private sector.

In the last decade, (1981-90), electrical/electronic equipment arose as a dominant product, amounting to more than one-fourth of the total products. At the same time, the share of transport equipment and machinery increased considerably and textiles declined rapidly. Five major products such as chemicals, iron & steel/non-ferrious metals, machinery, electrical/electronic equipment and transport equipment have altogether accounted for 72 per cent of the total manufacturing sector. These changes also imply a similar pattern of problems faced by Japanese firms in the 1970s; particularly, the appreciation of the Yen and the high cost of labour resulted in the rapid loss of the comparative advantage of many products over the 1980s. Consequently, many Japanese firms shifted to product areas like electrical/electronic equipment, machinery, chemicals and transport equipment in which Japan still had the comparative advantage in the world market. These products required a high level of technological know-how in the production process, which still remained at a lower level among firms in the NIEs and the ASEAN. This has helped Japanese firms to continue with these products, enjoying a comparative advantage on a large scale. However, this situation may not remain unchanged for long because the above two groups will soon catch-up with the Japanese.

FOREIGN DIRECT INVESTMENT IN SRI LANKA AND THAILAND

The promotion of foreign investment in the industrial sector, especially in the export-led industries, has been a significant policy issue for financing the development of the industrial sectors in both countries (Sri Lanka and Thailand) since the 1960s. The policy issues in this context have been introduced mainly under the framework of Import Substitution Industrialisation (ISI) and Export Oriented Industrialisation (EDI) with special attention paid to overcoming some specific socio-economic problems faced by these two countries.

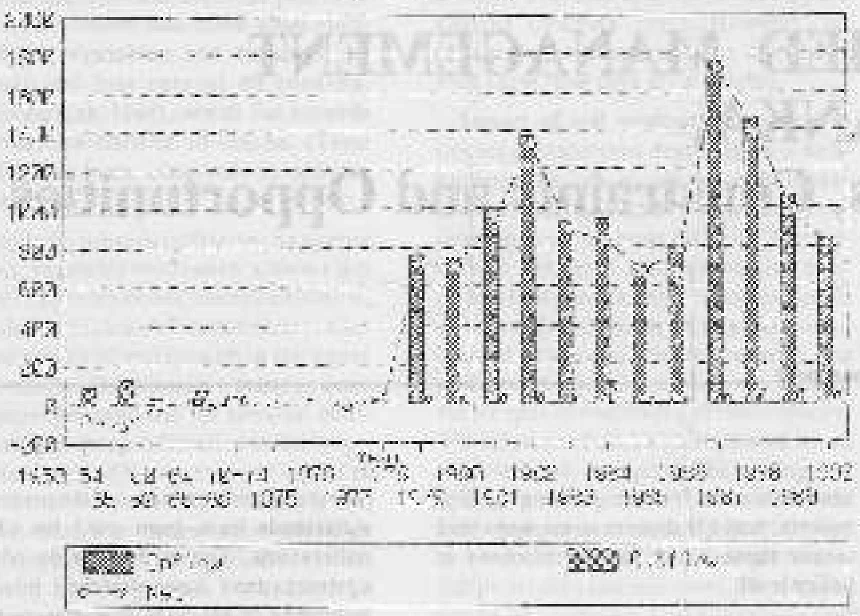
Under the ISI policy, Sri Lanka[18] and Thailand[19] established a framework for encouraging investment, including foreign investment, upto the later 1970s and early 1980s, respectively. Both countries had never felt an urgent need to promote foreign investment as a means to achieve economic development. However, both provided a variety of facilities and incentives to attract FDI under some specific regulations or restrictions which were needed for the protection of domestic firms. Faced with the emergence of a high debt burden, a huge trade deficit and many other socio-economic constraints in the late 1970s, both governments introduced various incentives and facilities under the EOI policy to attract FDI within a relatively open economic framework, abolishing restrictions encountered by foreign investors under the previous policy. At present, both countries are following a relatively similar policy towards foreign investment, providing various incentives under an open-door policy.

In addition, both countries introduced specific types of administrative facilities for foreign investment, aiming at the centralisation of the administrative decision-making process on FDI. This was mainly expected to minimize bureaucratic red tape towards foreign capital as much as possible. The Greater Colombo Economic Commission (GCEC) and the Foreign Investment Advisory Committee (FIAC) in Sri Lanka and the Board of Investment (BOI) in Thailand[20] are the main administrative bodies, responsible for the promotional and administrative activities related to foreign investment. Although, the BOI in Thailand deals with administrative matters on foreign investment regardless of their location and activities, the GCEC and the FIAC in Sri Lanka were engaged separately in promotional and administrative work on FDI projects which operate within the IPZs and outside, respectively. However, the GCEC became the "one stop centre" to service foreign investors after merging with the FIAC in January 1990. At present the GCEC deals with all foreign investments irrespective of their location and type of activity.

Pattern of Foreign Investment in Sri Lanka

Although the origination of foreign inward investment in Sri Lanka took

FIGURE 1
BALANCE OF PAYMENTS DATA ON FOREIGN DIRECT INVESTMENT,
(Unit: Rs. Million)



Sources: Central Bank of Ceylon/Sri Lanka, *Annual Reports*, various issues, Colombo, Sri Lanka.

place at least during the mid-19th century in the plantation projects of the British government, this paper excludes this period and deals with an analysis on FDI inflows into Sri Lanka after independence (1948). In first two decades after 1948, foreign investment declined consistently in spite of favourable government policy on foreign investment in the 1950s. Figure 1 reveal the dramatic withdrawal of foreign investments from Sri Lanka throughout the 1950s and the 1960s.[21] Outflow of investment occurred mainly in the Tea and Rubber plantations and this was not replaced by an inflow into other sectors of the economy during the first 20 years after independence. The reasons for this huge withdrawal are difficult to identify, but various views have been preferred by various economists. For example, Lakshman (1988: 407) noted four major reasons for this withdrawal viz. (a) effective competition from countries in other regions for foreign plantation capital which was invested in Sri Lanka; (b) certain contradictions in Sri Lankan policy towards FDI (e.g. the policy of indigenisation of foreign trade while generally promoting FDI); (c) increasing incidence of social legislation such as the

(Cont. on page 23)

TABLE 5

SRI LANKA: PATTERN OF FOREIGN INVESTMENTS APPROVED UNDER FIAC AND GCEC (UNITS: RS. MILLIONS, %)

Year	Investment Approved Under FIAC (Rs. Mn.) (a)			Investment Approved under GCEC (Rs. Mn.) (b)			Total Investment (Rs. Mn.)			Percentage of Foreign Investment	Average Foreign Investment Per Project	
	No. of Projects	Foreign Investment	Local Investment	No. of Projects	Foreign Investment	Local Investment	No. of Projects	Foreign Investment	Local Investment		FIAC	GCEC
1977	11	13	59				11	13	59	20	1.2	
1978	19	53	37	49	578	417	68	631	454	59	2.8	11.8
1979	63	800	651	40	813	253	103	1613	918	64	12.7	20.3
1980	73	3043	1285	46	2698	566	119	5741	1851	76	41.6	58.7
1981	82	3497	2280	18	981	882	100	4478	2362	65	42.6	54.5
1982	71	986	754	16	1171	429	86	2157	1183	65	14.1	73.2
1983	92	3275	2242	13	190	94	105	3465	2136	72	35.6	14.6
1984	87	823	1115	15	436	242	102	1259	1357	44	9.5	29.1
1985	48	234	276	13	182	104	61	416	380	49	4.9	14.0
1986	87	425	787	10	138	50	97	563	837	39	4.9	13.8
1987	68	383	895	31	592	220	99	975	1115	47	5.6	19.1
1988	83	528	1295	31	1106	607	114	1634	1902	46	6.4	35.7
1989	57	1621	2878	23	1608	382	80	3229	3260	50	28.4	69.9
1990	74	395	1116	40	2235	484	114	2630	1600	62	5.3	55.9
1991*	82	1132	806	38	3491	677	120	4622	1482	76	13.8	91.9
Total	945	19019	16207	386	16579	5157	1331	35598	21364		20.1	42.9
Approvals Cancelled*	129	960	926	49	1740	255	178	2699	1231		–	–
Agreements In Force*	817	18059	15331	334	8893	2903	1151	26952	18477	–	–	–

Note:

(a). Projects approved without concessions under section 17 of the GCEC Law (FIAC Type Projects)

(b). Projects approved with concessions under section 17 of the GCEC Law.

(*). As at September 1991.

Source: JETRO, *Official records on FDI in Sri Lanka*, Tokyo Office, Japan, 1991; GCEC, *GCEC Activities and Performance*, Colombo, Sri Lanka, 1991.

WATERSHED MANAGEMENT IN SRI LANKA: Some Issues, Constraints and Opportunities

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1. Introduction

Land and water exist in an intimate relationship. It is the interaction between these two primary resources which makes the very existence of human being possible. Any attempt to disturb the natural and dynamic balance between these resources will seriously jeopardize the sustainability of the resources base.

A 'watershed' refers to a topographically delineated area that is drained to some point of interest in a stream, a river, a reservoir. It is synonymous with the term 'catchment area.' When the point of interest is the point of out-fall of a river to sea, the terms 'drainage basin' or 'drainage area' are also used.

'Watershed management' can be and has been defined in many ways depending on the main objective of managing a particular watershed. However, considering the intimacy of land and water resources and the need to ensure sustainability of these resources, it can be defined as the development and management of the resources of a watershed in such a manner as to sustain the productivity and utility of land and water resources for the best economic use of the people and social welfare of the country.

The objectives of this paper are to: (1) Highlight, briefly, the extent to which the degradation of watersheds in Sri Lanka threatens the sustainability of lands and water resources and their economic use with special reference to agriculture; (2) surface some selected priority issues that need attention of the national policy makers; and (3) discuss some ways and means those issues can be resolved at policy level.

2. Factual Status of Watersheds and Watershed Management

2.1 Historical Profile

History provides adequate evidence on the measures taken by our ancestors to conserve land and water resources. This is particularly evident from the measures taken for the utilization of these two resources for agriculture and related other activities. In the past, rice cultivation on hill slopes and steep terrains was practiced on levelled terraces following natural land contours to areas were protected from erosion by bunding and planting trees like 'bamboo'; chena cultivation was done in a conservative manner by leaving adequate time between two successive cultivations to allow soil regeneration and restoration of natural soil fertility. The typical 'Kandyan forest garden', which is a mixture of perennial tree crops producing a multilayered canopy covering soil surface and providing economic returns to family, is considered even today as one of the most ecologically sound land use practices.

In ancient village tank systems, the watershed areas of the tanks were not used for chena cultivation. There were four types of village tanks (Goldsmith et al 1984) in traditional villages, one of which was used as an erosion control tank or a silt trap. However, due to increasing pressure of land, the protected waterbeds have been used for chena cultivation. The paddy fields of the upstream tank have stretched into the watershed of the next downstream tank in the cascade, thereby conducing soil erosion and silting of downstream tank.

The practice of traditional land use and soil conservation measures gradually diminished with the increasing pressure on these lands, notably with the introduction of plantation agriculture during the British period. However, the harmful effects of uncontrolled and destructive land development for tea plantations and their impact on soils, land productivity and river regimes as well as on downstream water availability have been expressed as far back as 1873, when a scholar (J D Hooker) pointed out the danger of uncontrolled opening up of land for plantation crops and the effect this had on the soil and river regime downstream (quoted in Manipura 1971). An another independent observer, who submitted a memorandum to Central Board of Agriculture based on his countrywide observations from 1916 to 1951, reported an eye-witnessed account on the soil erosion and watershed degradation in many parts of the country and the gradually increasing adverse impacts (Wickramaratne 1951).

2.2 Magnitude of the Problem

Soil Erosion: Many attempts have been made in the recent past to quantify the extent of watershed degradation, particularly in the hill country wet-zone watershed areas, and to arrest the watershed

degradation by different techniques, approaches and agencies. The watershed degradation in these upper watershed areas is consequent to the unhealthy land use and management methods practiced in tea plantations and other areas cultivated to vegetables and tobacco. An annual soil loss rate of 40 tons/ha. (Krishnarajah 1984), which far exceeds the tolerable limit of 10 ton/ha. (Tams 1980), has been observed in old tea plantations.

Similarly, tobacco cultivation on steeper slopes, vegetable cultivation without soil conservation measures, chena cultivation, grassland fire, and deforestation are other major causes of soil erosion in the upper watersheds. The extensive damage done by improper land use for tobacco cultivation and chena cultivation in the intermediate zone of Nuwara Eliya District as well as in other parts of the country is well documented. One measurement campaign conducted over a short period in chena, tobacco and vegetable cultivation in Hanguranketha area reported soil erosion rates of 70, 38 and 18 tons/ha/year for tobacco, capsicum and carrot, respectively (Krishnarajah 1984).

Although soil erosion rates in various land use types in the upper watershed are available, only limited data are available in respect of the dry and intermediate zone watersheds. In the dry and intermediate zones, deforestation and chena cultivation are the two major factors causing watershed degradation. A catchment management study in the watersheds of Nachchaduwa and Hurulu wewa reservoirs reports that land use composition in the micro-watersheds varies considerably from season to season, particularly the chena cultivated area where the variations was from 9% to 43% in a three year period. The soil erosion rate in the chena areas was 9 tons/ha/year on average (Somasiri 1991). Another experiment evaluated an annual soil loss of about 308 tons/ha/year on land planted tobacco on 30% slope in Maha Oya watershed (Tams 1980).

Development and other activities: At present there is a countrywide boom in the development activities, particularly clearing land for housing schemes and other buildings as well as for construction of rural roads in hilly areas. These activities too can be thought to be contributory to soil erosion to a certain degree. Also the old tea plantations in the hill country are being gradually converted to homesteads. Mining for gems too is considered a major cause of erosion in Ratnapura District (Narresa 1991). However, no conclusive soil erosion rates associated with these land uses are available.

Impact of soil erosion: The common impact of watershed degradation is well-known. The loss of soil not only makes the soil surface hard but makes root development of plants difficult. The loss of soil nutrients reduces on-site crop productivity and farmers' incomes. Landslides and floods cause damage to human life and public and private property. The sedimentation of reservoirs reduces both the life span of reservoirs and their capacity. The siltation of canals increases recurrent maintenance budgets. The change in hydrological regime in the watersheds in turn changes river regime and affects the volume, distribution and timing of water inflow to tanks and reservoirs. The delayed filling of irrigation tanks accompanied with flash inflow can make the availability of irrigation water unreliable and can force farmers to forgo cultivation either partially or fully. All these impacts impose heavy and perhaps irreversible social and economic costs to the nation both in the short and the long-run.

River regime: As the quantitative data are very few the impact of watershed degradation is known only qualitatively. However, a few information can be quoted. Two studies reported that clearing forests in steep sloping catchments could increase the peak river flood discharge and river sediment discharge by 40% and 100% respectively (Gomez 1977, Ponnudorai 1977 respectively). An annual average increase of rainfall/runoff ratio by 1.28% in wet zone catchments and by 0.75% in dry zone catchments has been observed (Abernethy 1976). The same study has observed increases of rainfall/runoff ratios by 1.54% and 2.17% for Kelani Ganga and Nilvala Ganga river watersheds. Another study has observed an increasing trend in the annual discharge in Kirindi Oya in the period 1953–1974 (Maddumabandara 1985) which is thought to be a consequence of enhanced runoff due to deforestation and loss of vegetative cover in the watershed. A recent study (Maddumabandara et al 1988) concludes that although average annual rainfall in the upper Mahaweli Basin has decreased by 20% since the 1880s, this reduction is not fully reflected in the river regimes and river flows due to land use changes and watershed degradation during the more recent decades. Instead, an increasing trend of runoff/rainfall ratios and a parallel increase in the river sediment yields, with a significant decline in dry weather flows have been observed. On the other hand in Kotmale Oya Basin, where there has been less land use changes, a declining trend of these ratios has been observed.

Reservoir sedimentation: A study done in 1956 (Szechowycz 1956) estimated that it would take nearly 450 years from that year for Senanayake Samudra (Gal Oya) Reservoir to fill up to the minimum water level at a measured silt influx of 343.24 acre feet per year (50,297 tones/year), which corresponds to a siltation rate of 0.9 acre feet per square mile of catchment area per year (3.5 tons/ha/year). even in 1956, this siltation rate was much higher than the average tolerable limit of 0.7 acre-feet per square mile (2.7 tons/ha/year) for other reservoirs of the world at that time. The study concluded that although the soil erosion rate was not alarming at the time of study, it would increase in nearly the same proportion to the increase of the population in the watershed, unless a proper system of land use was not adopted. A study conducted in 1930 (Joachim et al, 1930), based on sediment sampling of Mahaweli river at Peradeniya reported a sediment contribution of 115 tons/ha/year from the upper watershed. A recent study (Nedeco 1989) computed a sediment load of 15 million tons of silt passed in the upper Mahaweli watershed during 1952–1982, 70% of which was trapped by Polgolla barrage constructed across the river.

Catchment runoff to reservoirs: A recent study which investigated the causes for the significant reduction of catchment inflow to Mahakandarawa Tank, which is a major reservoir in the North Central Province (NCP) dry zone rehabilitated in the early 1980s, concluded that unplanned restoration of a large number of minor tanks in the catchment area was the major cause for this reduction (Kariyawasam et al. 1986). This signalled a new dimension to watershed management in Sri Lanka, which is the need to understand properly the hydrology of larger watershed

units before small tanks situated within the watersheds are restored in isolation.

3. Issues, Constraints and Opportunities

3.1 Data and research gaps

Although the soil erosion rates have been assessed in different land use settings, a similar emphasis has not been given to quantifying the on-site and downstream impact of soil erosion. As a result, there is not much basic information available on following influences: the reservoir sedimentation and impact on life span and capacity of the major reservoirs; the influence on the hydrological regimes of the rivers and increased threat of flood or drought; influence on the hydrological regimes of the watersheds of dry-zone reservoirs and the potential threat on the sustainability of irrigated agriculture; soil nutrition losses and the resulting loss of on-site crop yields and farmers' income; and influence on the siltation of irrigation canals and the resulting impact on recurrent maintenance budgets. It is necessary to evaluate the social and economic costs associated with the above impacts to convince policy-makers and political figures to promote watershed management as a national priority. Unfortunately, the present arrangements for the following are not very effective: monitoring basic watershed management activities; collecting basic management data and information, identifying priority watersheds; and conducting research. This needs the early attention of the policy-makers.

A wide range of preventive measures is being undertaken to prevent soil erosion in watersheds and preserve them, by a wide range of government institutions. The preventive measures are: regulation of land use; afforestation and preservation of critical watershed areas by declaring them as reserves and sancturaries; improvement of on-farm land use practices; and physical engineering measures. Several strategies including the Integrated Rural Development Approach; donor-funded special projects; subsidy and incentive schemes; farmer demonstrations; and pilot projects are being adopted to implement watershed management activities and to obtain people's participation in these activities.

3.2 Institutional Arrangements

A closer examination of the implementation of the above measures reveal the following weaknesses and constraints.

i. About 38 government agencies under 12 ministries are involved in various aspects of watershed management including research, extension and actual implementation.

ii. Although there are six comprehensive legal codes that provide for the conservation of soil, land and forest, they have not been effectively enforced for the protection of land or for legal action against environmentally harmful action on land and water resources. In spite of the existence of these legal enactments the problem of watershed degradation has worsened.

ii. Different agencies implement conservation activities within their specialized disciplinary boundaries. For instance, forest conservation and management are the objectives of the forest department as enunciated in the national forest policy, soil conservation in the tea plantations is the objective of the government agencies dealing with the tea sector, while soil conservation in the agricultural lands is in the agenda of the Department of Agriculture. The degree of co-ordination and linkage between these different agencies is weak.

iv. No single agency or a working arrangement among these agencies exists to study the specific problems of specific watersheds in a multi-disciplinary manner and to prepare comprehensive plans for the selected priority watersheds. For instance, there are a number of donor-funded as well as government programs that focus on Upper Mahaweli watershed areas, but the inter-agency and inter-program linkages are not very effective. This situation can lead to some degree of replication of work. It was only recently a conservation review committee was set up to review the issue related to conservation of natural forests under the Ministry of Lands.

v. The management aspects of the dry-zone watersheds have not received the same emphasis as those of the upper watersheds. Although the problems are known, they have not been adequately diagnosed quantitatively.

One option to ensure proper linkage and coordination among these agencies is to set up a National Steering Committee on Watershed Management with a supporting technical secretariat. It will also be necessary to develop a master-plan for watershed management. This proposed secretariat can be strengthened with people from relevant disciplines who should take the lead role in providing technical backing and input required by the committee to address and resolve key issues connected with watershed management.

3.2 Minor Tank Restoration

A distinct feature of the watersheds in the intermediate and dry zones is that a large number of small tanks are scattered within a watershed area of a larger downstream reservoir. Some of these tanks are in working condition while others are abandoned. The management problems in this setting have not received adequate attention of the policy-makers.

The potential impact of the restoration of a large number of minor tanks situated in the watershed of a downstream tank was evident from the Mahakanadarawa case mentioned earlier. Even now, the restoration of minor tanks is being done without a proper assessment of its aggregate downstream impacts. In the present administrative setup the minor irrigation works are overseen by the provincial irrigation departments while many of the inter-provincial schemes are overseen by the central irrigation department. Thus, there is a greater chance that these activities can continue to take place in an uncoordinated manner even in the future. It should also be noted that the watershed boundaries of the major rivers as well as of the major reservoirs do not follow the administrative boundaries of the provinces. This has resulted in a situation where the watersheds of many large reservoirs are located outside the boundary of the provinces within which these reservoirs and command areas are situated.

This situation calls for a need to adopt a more rational approach in dealing with the management of watersheds in the dry and intermediate zones. This approach should encompass not only the land use and soil conservation in the watersheds but also the minor tank restoration, considering the larger watershed as a single unit while paying due consideration to the total hydrology of that unit. One institutional innovation may be to set up

provincial level steering committees on watershed management to ensure coordination among all relevant provincial and central departments that are operative within a province, so that all development activities in watersheds can be done in an integrated manner. The provincial steering committees should also be linked to the national steering committee already proposed in this paper.

3.4 Dry-zone watersheds

The farmers in the dry zone primarily depend on tank-based agriculture for their livelihood. Many village tanks, particularly in the intermediate and dry zones, suffer from insufficient inflow that makes it impossible for annual double cropping of paddy or other crops under those tanks. The reliability of seasonal filling of many minor tanks is far below a level desired for risk-free cultivation of crops twice a year. Therefore, chena has become a source that not only supplements a substantial part of the village farmers' income but sustains their livelihood. Experience shows that in the years of low rainfall when the irrigation potential in village tanks remains very low, many farmers resort to chena cultivation. Although the typical chena cultivation is destructive to the environment and to the sustainability of minor tanks, it has become an essential component of the village tank system. Any attempt to improve income and profitability of the agricultural production in village tank system has to integrate the upland chena cultivation as an integral component of the system.

On the other hand, the demand for land is gradually increasing. In response to this growing pressure, the landless people are being granted lands in the upland areas under the Presidential Land Task Force. Although this may not be the ideal use of the dry-zone watersheds this practice is now inevitable. Imposing conservative local agricultural practices in uplands has therefore become a greater need of the time than trying to eliminate such land use. This has resulted in a new policy directive to assist the people granted with upland allotments by a package of technical know-how and extentsion on ways and means to maximize productivity and profitability of rain-fed upland farming. Adopting such measures as water-harvesting techniques in the uplands would be inevitable to sustain the livelihood of people settled in the upland areas.

These situations have implications on the watershed management in the intermediate and dry zones. The increasing farming activities in the upland areas can promote watershed degradation which in turn may promote siltation of the tanks and affect their hydrological regime. The vegetative cover in the watershed acts as a moisture reservoir for rainfall and regulate quantity and temporal distribution of runoff to tanks in a manner favourable for irrigation with less risk to farmers. The upland farming would easily disturb this regulatory function of the watersheds. On the other hand, it would also increase the consumptive use of water and would consequently reduce catchment yield. Both these consequences are detrimental to the sustainability of tank-based irrigated agriculture. Therefore, the tradeoff between upland farming in the upstream and irrigated farming in the downstrem in the typical socio-economic environments of dry-zone tanks has to be properly studied and clearly understood as a guidance for future land alienation policies. Modern catchment modelling and flow simulation techniques will be useful tools for this purposes. Also new techniques and technology for conservation farming in the uplands have to be generated while searching for techniques of enhancing and regulating runoff to downstream tanks. Research and development are required to understand tradeoff between these dual and competing uses of watersheds in order to guide future policy decisions in this regard. Such research issues should receive due attention in the research agenda of all concerned agencies.

Another issue that deserves attention is the growing interest in adopting commercial farming on the upper command areas and its implications on the sustainability of land and water resources. Recent studies (Shand et al. 1990, Land Commission 1987) have advocated the idea of irrigation of 'above the command' lands through pumping water from canals, river channels and groundwater for semi-perennial and perennial high value crops, perhaps on a commercial scale. The cultivation of upper command areas will be a necessary economic option for the future to enhance the productivity and profitability of agriculture. However, this option will be definitely attractive to the commercial private sector. Also the present policy of the government is to encourage and promote private sector intervention in all possible avenues. The cultivation of upper command areas will generate potential avenues for economic development, but it also can be counter-productive in the long-run, if appropriate measures are not taken to conserve soil and productivity of land. In this regard, the adverse experiences of tobacco cultivation on steep land slopes without soil and land conservation measures by the local private sector during the last 15-20 years provides adequate evidence. This evidence warrants a careful policy study and analysis on various issues before any initiative is taken in the future in this regard. These include the research and recommendations of appropriate crops, land types and land use practices; the identification and allocation of lands for upper command areas for cultivation; feasibility of tapping surface-water and groundwater and rights and access to water resources; the regulatory role of the government in preventing and controlling watershed degradation resulting from large-scale commercial farming; and ways of promoting conservation farming, in order to ensure the sustainability of land and water resources.

3.5 People's Participation

The forest, chena, village tank, irrigation infrastructure, command area and homestead are the mosaic of a typical dry-zone watershed. Therefore, the conservation of dry-zone watershed should essentially focus on the full range of measures that promote the conservation of these basic components.

There are increasing attempts to obtain people's participation in watershed management activities. People's participation is necessary because land capable of bio-mass production in the different mosaics is used by local people to sustain their livelihoods. As the primary renewable resource users, local people are the de facto watershed managers. Therefore, an essential strategy in any watershed management activity must be based on educating, encouraging, assisting and empowering local people and in obtaining their full participation to sustain land and water resources as well as their productivity.

One difficulty in convincing upland farmers of the necessity for conservation is the common belief that their efforts will largely accrue benefits to downstream users, and not to them. This is not always the case. The upland farmers themselves can gain on-site benefits through enhanced crop yields by adopting conservation farming in uplands. A study conducted in Sri Lanka (Herath 1986) indicates an annual benefit of Rs. 1,275/ha/year from stone terracing of tobacco land. Another comparative evaluation on exploitative and conservation farming over a period of eight years indicates gradually declining short-term benefits from the former and increasing long-term benefits from the latter. The net annual benefit from conservation upland farming was Rs. 5,290 after eight years (quoted in Widanapathirana 1991). This signals the need for adopting different strategies to convince farmers of the necessity for conservation and obtaining their participation in conservation farming.

Participation is a function of land users' current motivation and behavior. Motivation and behavior are in turn related to the perceived value, renewability and security of land. Inducing motivation and new behavior to preserve and conserve watersheds on participatory basis should be possible. But it need a careful examination of appropriate approaches, strategies and implementation mechanisms perhaps on a trial and error basis. An opportunity exists in the present provincial council administration system where the planning development interventions and authority and decision making power are devolved to village level. The possibilities of changing the perceptions and behavior of villagers in land use and implementing participatory watershed management activities at the village level should be explored through this new administrative arrangements. Various strategies like subsidies, incentive schemes, demonstration plots, and pilot programs may be some initially useful interventions in this exercise.

3.6 Irrigation Rehabilitation

Irrigation rehabilitation programs have potential to do a great deal in watershed management. Unfortunately, watershed management has not been considered an integral component of the rehabilitation programs undertaken so far. The scope of activity of a rehabilitation program can be easily extended to cover the watershed area as well as the homesteads and upland areas as these are mosaics of another watershed of a downstream tank. For instance, the main canals of irrigation tanks in hilly areas usually traverse a contour with a sloping highland on one side of the canal. Usually, the canals are desilted and upgraded but no action is taken to improve vegetative cover of the upper slopes that brings silt into canals with the lateral inflow of water. Planting suitable trees on these lands and in homesteads and reforestation of degraded watersheds can and should be incorporated into irrigation rehabilitation programs. These programs also provide an opportunity to obtain the participation of farmers in these activities through the proposed farmer organizations in these systems.

Many minor tanks are heavily silted and some have reached their operational limits due to continuous siltation over time. There is a general request from farmers to remove accumulated silt in the minor tanks to increase their storage capacity. These requests are usually not accommodated in rehabilitation programs due to cost considerations. The irrigation engineers usually discourage dredging minor tanks because of the high cost coupled with low apparent direct economic gains and benefits. However, a minor tank is typically a silt trap of another downstream tank. A cluster of minor tanks may be trapping a considerable amount of silt that would otherwise enter larger downstream reservoirs. Sufficient data are not available to understand the extent to which the minor tanks regulate the sedimentation of larger reservoirs and the associated economic benefits. Also increased dry season tank storage generate other social benefits to the farming community including recharge of domestic wells around the tank. With a proper understanding of this indirect economic and social benefits, it may be possible to entertain the request of the farmer to desilt minor tanks. It is necessary to study, at least on a sample basis, the relative social costs and benefits, technical constraints and ways of alleviating such constraints of dredging minor tanks.

3.7 Guidelines for Development Activities

There is a need to incorporate measures that minimize damage to vegetative cover and earth slopes from the construction of roads and buildings etc. These construction activities can lead to accelerated soil erosion and consequently to downstream sedimentation. The civil engineering design of rural roads and appurtenant structures and construction methods should be reviewed with a view to incorporate adequate safeguards to minimize or arrest soil erosion. There is potential for incorporating structural and agronomic conservation measures and to lay provisions for adhering to those design and construction standards. National guidelines for design, construction and maintenance of rural physical infrastructure should be prepared and disseminated in this regard.

3.8 Land Tenure Problems

Land tenure is an important factor in watershed management. There are many systems of land tenure, some of which hinder the adoption of watershed conservation activities. For instance, it is easy to adopt soil conservation measures in privately owned land, but it may be difficult in other lands, e.g., land which is encroached state-land or leased or land which is with hidden tenancy. Although the local land user is interested in maximizing economic returns through conservation measures, his enthusiasm, initiative, time horizons, level of risk taking, and therefore, his investment are likely to differ significantly depending on the land tenure. While larger private land owners are able to defer short returns and wait for long-term benefits, marginal farmers with various land tenure arrangements are unable to do so. Studies are required to understand the relationship between land tenure problems and watershed management in order to formulate clear policy directions and strategies to implement watershed management interventions within the different land tenure complexities.

4. Concluding Remarks

Soil erosion is a communal and national failure, and not an accident. Soil erosion in Sri Lanka has caused an irreversible damage to watersheds and in turn to land and water resources. Watershed management is therefore a national priority.

Although watershed management has received attention of the policy makers, there are many issues that need firm policy commitment and support. Policies should be formulated on the basis of a

careful examination of all related issues supported by data, information, research, experimentation and special studies. This paper highlighted some selected areas that should receive attention in this exercise.

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accelerated rate. The legal positions permit some to grow rich rapidly: a number of government members have benefitted largely. Others resort to corruption. The climate is not still sufficiently reassuring in order that the capital placed abroad returns to the country. In fact, the bases of this relative class prosperity are less solid, as very few of the profits are made on production and the traditional agro-export economic activities are not expanding fast.

The political climate has darkened due to an intense struggle within the neo-liberal project itself. A certain number of politicians of the 'UNO' are waging a battle for a radicalisation of the system, based on a more rapid elimination of Sandinism. The principal leaders here are the Vice-President Virgilio Godoy, the Speaker of the Parliament Alfredo Cesar and the Mayor of Managua Arnoldo Aleman. They have succeeded in enrolling the majority of traditional parties united with the 'UNO' and they maintain ambiguous links with the minority of the Contras who have taken back arms. They are quietly backed by the American Embassy. The statements of Cardinal Obando y Bravo and even the last pastoral letter go in the sense of declarations of this political right, criticising the government for its inefficiency, the trade unions for their destabilising action and the army and the police for their incapability to respect law and order.

The government wing has succeeded at the end of the year 1991 in recovering some 'UNO' MP's who, with the Sandinists, ratified the presidential veto on the laws of property and prevented the right from triumphing. This is what the President's Minister, Antonio Lacayo, son-in-law of Mrs. Violeta Barrios de Chamorro, calls the establishment of a new centre, thanks to which he hopes to be able to govern.

The Sandinist Front held its Congress in July 1991. It was preceded by regional congresses, which were attended by both the people called 'the pragmatists' and 'the believers in a revolutionary line'. The working-class movements were well represented in the Sandinist assembly. The national leadership was renewed. But it is difficult for the Front to formulate positions that balances between the necessity to assure the economy of an economic base of survival in a global circumstance very unfavorable to the working-class milieux and the continuation of a revolutionary project that could really transform the society. The dilemma is illustrated by the divergent positions of the two Ortega brothers. Humberto, the army chief, defends the need of the order for country's economic recovery and Daniel affirms the working-class calling of the Front, its anti-imperialist positions and the requirements of a vigilant social struggle.

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POLICY MAKING AND THE FUTURE

Kala Maheswaran

1. Introduction

A structure to understand the significance of the various policies is necessary to be examined due to the complex nature of the formulation and the subsequent enforcement and enactment of the same. The published material on policies define policies in three categories viz. infrastructure, markets and price. The evaluation of the total policies enforced through acts, bills etc. elucidates the fact that these policies are addressed at various levels. Anyhow, the terms policy used through out the published material convey the substance of the policies but the level of implementation in the heirachical order is seldom emphasised. This phenomenon causes certain confusion in the interpretation of the same in a contextual sense. Infrastructure, market and price policies as they are presented in the current situation represent varied levels of enforcement. The objective of this brief article is to discuss these policies in a different structure so as to identify the possible levels at which the individual policies are enacted and enforced. The layers in the structure proposed are three: Macro-economic Policy level, Environment-economic policy level and the Administrative policy level. The afore mentioned policies–infrastructure, market and price, are then examined in the light of the latter structure to understand the purpose and the level in which either of the three categories of policies – infrastructure, market and price, are formulated and then implemented to meet user needs.

2. Policy Making – A Model for the Future

In the light of the different interpretations of the varied levels of policies formulated: a model is proposed to examine a type of categorisation that could be considered for the future. This proposed model is of three levels i.e. Macro economic policy level; economic–environment level and administrative level.

Level 1 which is the marco–economic policy level, is applied to the macro level policies existing in the current context which are targetted towards long term goals viz. saving and earning foreign exchange, employment generation and self reliance in selected food items (rice, sugar etc.). These policy stands have come to pass through various bills, acts and statutes approved by parliament and implemented through various state agencies at various levels in the government structure, in various forms.

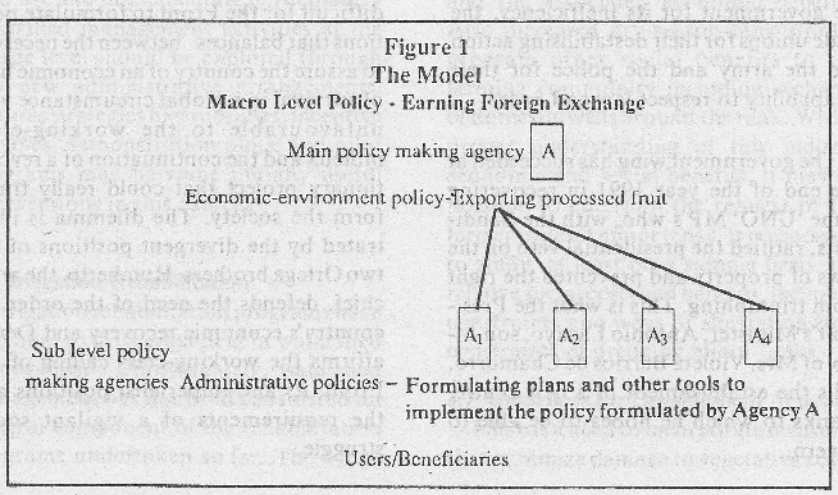
Level 2: Economic environment policies, are proposed to capture the policies formulated to meet the changing economic environment and the environment in general. Policies in this level are more in response to the dynamic economic and environmental conditions that are determined by the national, regional and global economic situations, plans and attitudes that arise to meet changing needs of the beneficiaries/users of these various policy stands. These policies would generally encompass short and medium term goals.

Level 3 is for policies formulated for administrative purposes and in the model are considered as administrative policies. In order to explain the workings of this model with the above described policy levels the model is examined with an example; i.e. a policy stand to export processed fruit. This policy stand although falls under the macro economic policy stand of earning foreign exchange, but since the facutal policy stand with regard to the export of fruit is in response to a given market condition at a given point in time. This policy stand would be considered, in its formulation and implementation in level two of the model i.e. economic–environment policies. The need to implement this policy stand at the field level for results would require another set of policies that would be necessary to mobilise the respective government agencies to act at the field level to make this policy stand a reality (see figure 1).

The policy formulated at Agency A to implement moves through agencies A 1, A 2, A 3 and A 4.

For purposes of implementation the agencies A1–A4 would formulate policies to enable the delivery of tangible and intangible inputs to the beneficiaries in terms of credit, rebate on equipment to be utilised for processing, protection in the purchase of raw materials, market intelligence to producers etc. These policies which are administrative policies would be the basis for individual agencies to develop tools–strategies and plans for action and contact with the users/beneficiaries.

Figure 1
The Model



3. The Purpose for a Model

As stated in section 1 this model is proposed to identify the level in which individual policies, formulated for implementation could be placed in a heirachical order to evaluate the type of action, the nature and the position a particular policy stand holds with regard to the context within which it is formulated.

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various labour laws, with implications for profitability of investment; and (d) widespread left-wing political movements which advocated nationalisation of foreign assets.

Along with this large outflow of foreign capital from the country, a few investors moved into the import substitution industries of the country in the 1950s as well as in the 1960s. This was a result of the government's inducement policy towards foreign capital such as import restrictions on similar products which are produced in the domestic market, exchange controls and various tariff and other incentives. According to Athukorala (Feb., 1984:23–24), in the 1950s and the 1960s, there were nine and 40 foreign-affiliated producing firms, respectively. Chemicals, machinery and equipment and food & drink were the major production areas attractive to the above foreign firms.

According to balance of payments data there was a substantial improvement in the net inflow of foreign investment into the country between 1970 and 1977: its cumulative net inflow remained at Rs. 3.8 million. However, Athukorala (Feb., 1984:25) noted that there was a marked decline in direct foreign investment in this period. The number of firms created with foreign capital during the period 1970–77 was 20 which was doubled in the 1960s. The following factors were often cited by various economists as explanations for this rapid decline of FDI (Athukorala, 1984:25, Lakshman, 1988:409): (a) unfavourable atmosphere for FDI created by the nationalisation attempt; (b) related legal enactments (mainly the Business Undertakings (Acquisition) Act of 1971); (c) stringent criteria adopted in approving investments; and (d) gradual exhaustion of import-substitution manufacturing opportunities in the economy. The government's attempt at the development of manufactured exports under the frame of import-substitution in spite of these main constraints, perhaps, resulted in the rise of a contradiction between ISI and FDI activities. The majority of the projects set up in this period under foreign investment concentrated largely on export-oriented activities rather than on import-substitution.

The inflow of FDI saw an upsurge in Sri Lanka after 1977, the year known as a turning point in policy reforms. While most restrictions on foreign investment and export-import activities were removed, extraordinary incentives[13] were offered for attracting inward FDI under a relatively open trade policy. The FDI inflow during the post-1977 period through the FIAC and the GCEC are shown in Table 5. Generally, the data in the Table reveals a sharper increase in FDI in FIAC type projects than in the GCEC type, on the basis of approvals as well as of agreements in force over the period. This was probably due to the limitation of GCEC approvals on projects for manufacturing industry. However, the FIAC approved both manufacturing and non-manufacturing investments without limitation to any specific region. This largely resulted in increasing FIAC type projects in diversified economic activities within the country over and above GCEC type investments.

Although the number of projects cancelled after approval in both institutions did not much differ, the number of foreign investments approved and are in force under the FIAC amounted to 95 per cent, whereas it was only about 51 per cent under the GCEC. The main reason for this poor progress of GCEC approved projects, as given by the supply side of FDI, is the official restraint which still lingers in this institution towards FDI.

In general, the trend of inward FDI in Sri Lanka could be examined under three sub periods which have been highly correlated with the socio-economic problems faced by the country in such period: the first sub-period is 1979–83; the second is 1984–87 and the third is 1988 to date. The first period is not only the most progressive stage of the inflow of foreign investment into the country, but also remains the peak years in this regard, particularly 1980 and 1983. The

TABLE 6

SRI LANKA: FOREIGN INVESTEMENT IN FIAC PROJECTS (APPROVED) AND GCEC PROJECTS (CONTRACTED) IN THE MANUFACTURING SECTOR, CUMULATIVE TOTAL 1977/ SEP. 1991 (UNIT: RS. MILLION, %)

	Cumulative Investment, FIAC			Cumulative Investment, GCEC			Total Cumulative, FIAC and GCEC					Share of Foreign Invest. of Total
Sector/Company	No. of Projects	Local Invest.	Foreign Invest.	No. of Projects	Local Invest.	Foreign Invest.	Total Project No.	Share %	Local Invest.	Foreign Investment Amount	Share (i)	Investment (%)(ii)
Manufacturing Sector	403	8224	4031	225	3167	12214	628	100	[illegible]	16245	100	66.1
1. Food, Beverages & Tobacco	33	715	821	4	28	22	37	6	743	843	5	53.0
2. Textiles, Wearing Apparel & Leather Products	136	1699	1082	54	658	2737	190	29	2357	3820	23	61.5
3. Wood & Wood Products and Paper and Paper Products	25	179	185	3	7	28	28	5	186	213	1	53.4
4. Chemicals, Petroleum, Coal, Rubber and Plastic Products	73	1300	454	35	488	1385	108	17	1788	1839	13	51.5
5. Non-metallic Mineral Products	47	837	809	28	476	1105	75	12	1313	1914	13	59.3
6. Basic Metal Products	53	839	393	—	—	—	53	8	839	393	3	35.5
7. Fabricated Metal Products, Machinery & Transport Equipment	7	36	52	13	84	435	20	3	160	487	4	75.3
8. Manufactured Products	16	219	77	83	949	2135	82	12	1168	2212	16	65.4
9. Other	38	235	112	8	477	2365	46	7	733	2480	17	77.2

Note:

(i) Amount of Foreign Investment in Each Product / Total Foreign Investment in all Products × 100

(ii) Amount of Foreign Investment in Each Product / Total Investment in Each Product × 100

substantial political stability of the country during these years might be the major reason for this upsurged in trend. The second period symbolises the bare survival of inward FDI in Sri Lanka. This period is well-known as an atrocious period in the Sri Lankan economy in the post-independence period. Communal violence and both Sinhalese and Tamil insurgencies[23] against the present government gave rise to political unrest in the country and thereby weakened the country's economy.[24] Furthermore, the imposition of various protectionists measures by developed countries on the garment sector wherein was the largest concentration of FDI in Sri Lanka, also led to the discouragement of further approvals of investment in this industry. The above factors caused the wane of FDI inflow into the country in this period. Although the Tamil insurgency still persists in some parts of the country, viz. the North and the North-East, FDI began to reintegrate from 1988. However, it is premature to emphasize that this upward trend will continue in the long-run because Sri Lanka has still not become a priority area for high-tech or sophisticated industrial investment by large MNCs in major developed countries.

Table 6 indicates the sector-wise distribution was the manufacturing sector of foreign investment, this facilitates the understanding of the attractive areas for foreign firms in Sri Lanka. Over the 15 years ending September 1991, there were 628 projects approved/contracted by both the FIAC and the GCEC, of which more than one-fourth (both in number of firms and value of investment) accounted for the textile and garment sector. During the period 1974–77, there were 13 factories with joint ventures of which nine factories, or 69 per cent, were garment industries. The reason behind this spate of investment in textiles and garments both before and in the early 1980s was that investors from Asian NIEs, on whom quotas were being clamped, decided to take advantage of the fact that Sri Lanka did not yet (until around the mid-1980s) face trade barriers in the attractive US and EEC markets (People's Bank, June, 1982:10). In the recent past, although the GCEC and the FIAC discouraged DFI inflows into this sector and various import restrictions were enforced for the garment sector by the USA, still for all this sector remained the dominant industry among foreign investment in Sri Lanka. Another significant characteristic of the composition of FDI in this country is that the majority of projects tend to attract labour-intensive asembly operations and simple processing activities based on a low level of technology. Therefore, it is reasonable to note that technologically advanced sophisticated production processes are very rare among the inward FDI in Sri Lanka.

TABLE 7

SRI LANKA: FOREIGN EQUITY CAPITAL PARTICIPATION IN THE MANUFACTURING SECTOR (FIAC TYPE PROJECTS ONLY)*

	1971 (Rs. Million)				*1977-Oct. 1989. Actual Investment (Rs. Million)*			
Country	*Number of Projects*	*Total Equity*	*Foreign Equity*	*Country Share in Foreign Equity, %*	*Number of Projects*	*Total Equity*	*Foreign Equity*	*Country Share in Foreign Equity*
Developed Countries:	34	192.6	117.6	96.3	302	17659	10338	74.1
U.K.	15	146.2	82.0	67.2	84	4680	2569	18.4
U.S.A.	4	6.4	5.9	4.8	63	2568	844	6.0
Europe (Other than U.K.)	5	18.2	15.0	12.3	91	3612	1599	11.5
Japan	10	21.8	14.7	12.0	64	6799	5326	38.2
Asian NIEs:	3	4.3	2.5	2.1	138	7289	2853	20.4
Hong Kong	3	4.3	2.5	2.1	71	5810	2500	17.9
Singapore	—	—	—	—	67	1479	353	2.5
South Asia:	4	4.2	2.0	106	30	1086	762	5.5
India	4	4.2	2.0	1.6	30	1086	762	5.5
Total	41	201.1	122.1	100.0	470	26036	13653	100.0

Note:

* Although the data in 1971 comprised only FDI in the manufacturing sector, the period 1977 to October 1989 includes actual foreign equity in manufacturing and non-manufacturing activities.

Source: Athukorala Premachandra, Direct Foreign Investment and Manufactured Export Expansion: The Case of Sri Lanka. *Vidyodaya Journal of Arts, Science and Letters*, Vol. 12, February 1984, University of Sri Jayewardenepura, Nugegoda, Sri Lanka.

TABLE 8

DISTRIBUTION OF PROJECTS COUNTRY-WISE IN THE IPZ – 1977–90

Country	*Number of Projects*	*Percentage Share*
Developed Countries:	64	50.4
United Kingdom	10	7.9
North America (a)	7	5.5
Europe (b)	37	29.1
Japan	10	7.9
Asian NIEs:	54	42.5
Hong Kong	24	19.0
Rep. of Korea	18	14.2
Singapore	5	3.9
Taiwan	7	5.5
South Asia:	9	7.1
India	5	3.9
Pakistan	4	3.1
Total	127	100.0

Note: (a) USA and Canada, (b) Includes Australia.

Source: Udayapala, M. K., Unpublished country paper presented at a Seminar held in Shanghai, China from 2nd to 6th September 1991 on the *Role of Export Processing Zones in the Promotion of Exports and Foreign Investments.*

The available data on the main sources of foreign investment in FIAC-type projects for 1971 and for the period 1977 to October 1989 are given in Table 7. Over the 19 years ending October, 1989, the position of country-wise investment in Sri Lanka changed sharply in terms of both the number of projects and value of investment: the total equity investment of Asian NIEs and South Asian increased from 1.7 per cent in 1971 to 25.9 per cent in the period 1977 to October 1989, while the dominant position of the United Kingdom weakened markedly (from 82 per cent to 18.4 per cent). At the same time, although Japan's relative position of foreign equity in the period 1977 to October 1989 made it a dominant investor, Asian investors, remained at the highest position in terms of the number of projects. The relative position of the USA and Europe (except the UK) has improved considerably in terms of the number of projects, but remained stagnant in terms of equity capital. This means that these two groups of countries have largely increased the number of projects (from 9 to 238) under a small volume of capital endowment.

Nevertheless, the above position changes if we take into consideration the nationality-wise ownership of equity capital in GCEC projects of the IPZ. Unfortunately, data pertaining to investment country-wise in the GCEC are not properly available. Recently, an officer of the Sri Lanka Export Development Board has given brief account of the sources of foreign investment in the IPZ, which is summarised in Table 8.

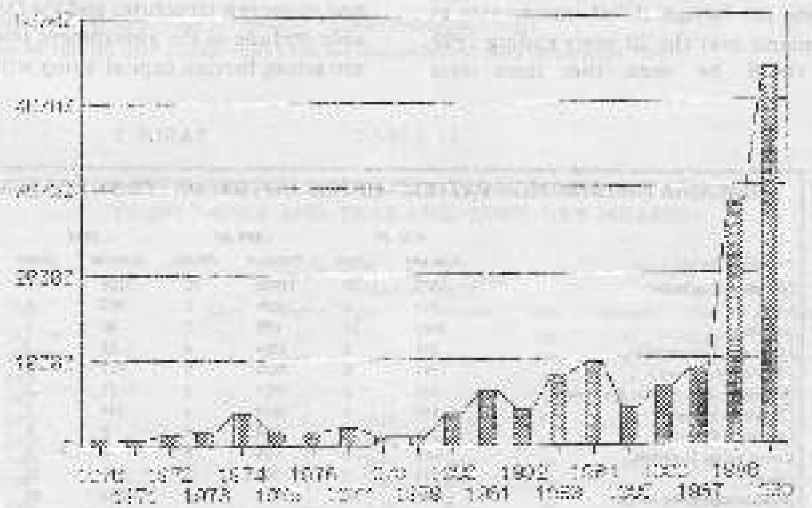
The most significant feature of the Table is the sharp improvement in the relative position of the NIEs and South Asian investments in terms of the number of projects. The share of these two groups comprises about 50 per cent of the total firms, of which Hong Kong and South Korea were responsible for 19 and 14 per cent of the total (24 projects by Hong Kong and 18 projects by South Korea with local collaboration) respectively. The majority of investors in these countries invested mainly in the garment sector or in simple processing activities which required a low level of technology. Many of these activities were those relocated in Sri Lanka after the gradual loss of comparative advantage producing in the home countries, as a result of the high cost of production, mainly labour, and as a result of trade barriers enforced by developed countries, particularly the USA.

So far we have examined thoroughly the growth pattern of FDI inflows into Sri Lanka during the last four decades. This discussion has manifested Sri Lanka's failure to spur on the sustained and dynamic investors in the developed countries, although the country's aspiration was to project itself as a "new investment centre" in Asia by bedouing the trumpet of being a haven for FDI since 1977. This means that the favourable incentives and various policy reforms have not helped much to achieve the expected targets of foreign capital in Sri Lanka. This failure is not only the result of political instability and increasing violence in the country after 1983, but also of the lack of domestic capital and entrepreneurs available domestically for joint ventures with advanced MNCs. Furthermore, the poor investment climate, specifically the poor infrastructure, may also have caused this enfeeblement of FDI inflows into Sri Lanka.

Pattern of Foreign Investment in Thailand

Historically, most of the business activities in Thailand, including investment, had been dominated by Chinese ethnic groups.[3] Many such activities largely revolved on rice trading at the very beginning. However, the majority of the indigenous or native people, specifically the military-based government of this country, resented this domination of the Chinese community and attempted to nationalise the Chinese owned major economic activities during the period 1930–1960. This attempt anticipated the transfer of Chinese-run business, like rice trading, manufacturing, banking etc., to state control. Thus, although the Thai political authority planned to expand state capital by limiting Chinese capital, weak state structures proved incapable of managing state capital on a large scale. This resulted in the retransfer of most of the government-owned enterprises back to the private sector in the 1960s and the 1970s (Phongpaichit, 1990:79). In this way, the Thai government intended to create an impressive investment climate by giving responsibility to the private sector to develop its own domestic capital

FIGURE 2
GROWTH PATTERN OF NET FOREIGN INVESTMENT IN THAILAND 1970–89



Source: (a) [illegible], Japan Direct Investment and Technology Transfer to Thailand, Paper presented at the Economic Research Institute, Economic Planning Agency, Tokyo, [illegible]
(b) [illegible], S., and Tambunlertchai, S., The Role of Foreign Capital in the Manufacturing Sector Development in Thailand, [illegible] Research Programme Series No. [illegible], IDE, Tokyo, [illegible]

in diversified areas. It is well known that Thai enterprises have developed their production capabilities not only in the domestic market, but also in the international market during the last two decades.[2] The major production areas in this context were agro-based industries, textiles, garments, jewellery, etc.

As a result of this considerable improvement of domestic capital, the country has achieved a relatively high rate of growth during the last two decades as compared to many South and South-East Asian countries: it has achieved an extremely high rate of growth, especially from 1987 to 1990. The rate of growth of the real Gross Domestic Product (GDP) increased by 9.5, 13.2, 12.0 and 10.0 per cent in 1987, 1988, 1989 and 1990 respectively (Asian Development Bank, 1991:21). These faster rate of growth of the economy have been accompanied by a tremendous surge in foreign direct investment (Chiranuvat and Taniguchi, 1992:4). Conversely, this sharp upsurge of FDI inflow into the country spurred on its high rate of growth and also considerably improved the domestic capital which became available for various collaborative manufacturing ventures with foreign firms.

Figure 2 demonstrates the general trend of the net foreign direct investments in Thailand over the 20 years ending 1989. It could be seen that there were three distinguishable periods of FDI inflow into the country, viz. (a) 1970–79; (b) 1980–87; and (c) 1988–89. In the first period, foreign equity capital in both manufacturing and non-manufacturing industries has indicated an insignificant increase or a lag-expansion in current Baht terms as compared to the other two periods. However, the foreign investments in absolute terms increased from 991 Million Baht in 1970 to 3,816 Million Baht in 1980, which reveals an upsurge of more than four-times. The most striking change of inward FDI one can observe is the sharp increase of foreign capital in the second and third periods. Total foreign investments grew dramatically from about 16.1 Billion Baht in 1970–79 to 52.7 Billion Baht and 72.0 Billion Baht in 1980–87 and 1988–89 respectively. This sharp upsurge of FDI inflows in the early and late 1980s and its lag in the 1970s largely related to the political and economic factors which took place in Thailand during the periods concerned. Several coups and related domestic political instability, communist violence in the North-East and the South, unfavourable attitudes of domestic firms towards foreign firms, and long-term wars in the neighbouring countries of Vietnam and Cambodia have caused the lagging of inward FDI in the 1970s.[3] The substantial stability of political, social and economic structures and the favourable attitude of the government towards attracting foreign capital along with the disappearance of some major problems faced in the 1970s have considerably affected the tremendous surge of foreign capital in diversified activities in the 1980s.

Table 9 presents the data on the distribution pattern of net inflow of FDI by sector to facilitate the understanding of the dispersion of foreign capital in various industries. A noteworthy feature of foreign investment during the period 1970–86 was the high degree of non-manufacturing activities. This sector accounted for more than two-thirds of the total receipts of FDI in which mining and quarrying, construction and trade constituted approximately half the total capital. However, the nature of concentration of foreign capital changed dramatically from 1987, making the manufacturing share more than 50 per cent of the total FDI inflows. This reveals that Thailand has become an attractive location for sustained and dynamic investment activities among major investors or large MNCs in developed countries. The amount of capital invested in the manufacturing sector surged from 4,749 Million Baht in 1987 to 20,452 Million Baht in 1989, increasing by four-times within three years.

Within the manufacturing sector, textiles and electrical appliances were the attractive product areas for foreign firms in the 1970s. These two products had been responsible for 57 per cent of the

TABLE 9

THAILAND: DISTRIBUTION PATTERN OF NET INFLOW OF FDI BY ECONOMIC SECTORS (UNIT: MILLIONS OF BAHT, %)

	1970–85		1980–85		1986		1987		1988		1989	
Economic Sector	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share	Amount	Share
Manufacturing Sector	5429	32	11826	32	2124	31	4749	52	16748	58	20452	47
Food	662	3	579	2	281	4	421	5	1220	4	1910	5
Textiles	2943	17	883	2	85	1	598	11	1110	4	2000	5
Metal and Non-metallic	205	1	1294	4	—22	—	360	4	1369	5	2800	7
Electrical Appliances	1397	8	2428	8	917	9	1139	13	5203	18	6502	16
Machinery & Transport Equipment	420	2	1003	3	—15	—	149	2	721	3	714	2
Chemicals & Paper	853	4	1610	4	686	7	868	10	1647	6	2465	6
Petroleum Products	318	1	3054	8	8	—	10	—2	834	2	1138	—3
Construction Materials	67	—3	86	0	5	2	6	1	27	0	89	1
Other	577	2	787	2	674	10	797	3	2107	8	4561	11
Non-Manufacturing Sector	10998	68	24870	68	4784	69	4295	48	11899	42	23290	57
Agriculture	252	1	418	1	209	3	286	3	303	1	452	1
Mining and Quarrying	2518	13	7707	21	260	3	132	2	455	2	567	1
Construction	2674	13	6183	17	1235	18	1243	15	1938	7	2973	9
Trade	4256	21	6595	18	1789	28	852	9	3913	14	6762	16
Transport and Travel	1077	5	1331	4	295	4	221	2	498	2	484	1
Financial Institution	1065	10	334	—1	533	7	440	5	2724	10	3506	8
Housing and Real Estate	392	2	859	2	47	1	525	7	991	3	3982	8
Hotel and Restaurants	185	1	673	2	100	1	95	1	553	2	3794	8
Other Services	379	2	1436	4	415	4	526	6	886	3	1222	3
Total	16427	100	36743	100	6908	100	9044	100	28744	100	43743	100

total manufactured FDI in this decade. However, in the first half of the 1980s, textiles declined dramatically and metal and non-metallic, electrical appliances, machinery and equipment, chemicals and paper and petroleum products emerged as attractive production areas for foreign firms in the manufacturing sector. Their overall rate of contribution amounted to 80 per cent of the total foreign capital; in which electrical appliances was the dominant product which alone constituted about 29 per cent of the total manufactured foreign investment. The major point coming out of the data (Table 9) is the dominant role played by electrical appliances in the manufacturing sector throughout the period beginning from 1970 to 1989, covering nearly half of the total investment in 1989. Nevertheless, it is reasonable to conclude that there appears to have been a broad dispension of inward FDI in the manufacturing sector, particularly after the mid-1980s. A remarkable feature of this favourable diversification of inward FDI is that advanced countries have always been highly active as dominant investor countries. Table 10 presents data relating to the nationality-wise ownership of equity capital in both the manufacturing and non-manufacturing sectors for the period 1970–89.

The major point being proved by the data is that developed countries have always been very active as investor countries in Thailand. Developed countries, altogether, were responsible for more than two-thirds of the total inward FDI over the period 1970–89; however, there is a well-marked erosion of the relative position of the United States after the mid-1980s. Until 1985, the United States was the largest investor in this country, but fell sharply from 54 per cent in 1985 to approximately 12 per cent in 1989. This was a result of the dramatic increase of Japanese investment in Thailand after the mid-1980s. At present, Japan is the biggest single investor in this country taking 52 per cent and 41 per cent of the total inward FDI in 1988 and 1989 respectively.

Another significant aspect of the nationality-wise distribution of FDI in Thailand is the sharp increase in the share of developing countries, particularly that of Asian NIEs. Their percentage share in total FDI increased from 18 in1970–80 to 30 in 1989; Hong Kong and Singapore were responsible for almost all the share of NIEs and ASEAN until 1986; thereafter, Singapore declined and was replaced by Taiwan. In 1989, Hong Kong, Singapore, Taiwan and Japan shared about 70 per cent of all inflows of FDI as Asian investment in Thailand.

The rapid upsurge of foreign investment in Thailand is mainly explained by the following reasons: (a) political, social and economic stability; (b) favourable foreign policy towards FDI; (c) low level

TABLE 10

THAILAND: NET INFLOW OF INWARD FOREIGN DIRECT INVESTMENT BY COUNTRY, (UNIT: MILLIONS OF BAHT, %)

	1970–80		*1981–85*		*1986*		*1987*		*1988*		*1989*	
Country	*Amount*	*Share*	*Amount*	*Share*	*Amount*	*Share*	*Amount*	*Share*	*Amount*	*Share*	*Amount*	*Share*
Developed Countries:	14256	71	22040	66	5387	78	6896	77	20784	74	28203	65
Japan	5870	29	8975	27	3049	44	3269	36	14591	52	17751	41
North America(a)	6523	33	10594	32	1330	19	1827	20	3238	12	5175	12
Europe	1863	9	2471	7	861	13	1772	20	2870	10	5142	12
Other Developed	—	—	—	—	147	2	28	1	47	0	135	0
NIEs and ASEAN:(b)	3512	18	3978	13	1458	21	2031	22	8122	28	13404	30
Hong Kong	2352	12	2797	9	956	14	796	9	3054	11	5783	13
Singapore	1180	6	1181	4	403	6	535	6	1521	5	2216	5
Rep. of Korea	—	—	—	—	5	0	22	0	298	1	254	1
Taiwan	—	—	—	—	133	2	687	7	3162	11	4992	11
Malaysia	—	—	—	—	8	0	—9	0	47	0	55	0
Philipines	—	—	—	—	—59	—1	4	0	4	0	—2	0
Other	2235	11	6879	21	63	1	117	1	—662	—2	2135	5
Total	20003	100	32897	100	6908	100	9044	100	26244	100	43742	100

Note: (a) Data in the first two periods (1970–1980, 1981–85) includes only the United States, and thereafter, data from Canada also is added.

(b) Data for some Asian countries in the two periods (1970–80, 1981–85), is not available country-wise, and these are included under the category of "Other".

Source: Same as Figure 2.

TABLE 11

JAPANESE DIRECT INVESTMENT (APPROVALS/NOTIFICATIONS) IN SRI LANKA AND THAILAND, (UNIT: US $ MILLION)

	Sri Lanka				*Thailand*			
			Share of Asia (%)				*Share of Asia (%)*	
Year	*Case*	*Amount*	*Case*	*Amount*	*Case*	*Amount*	*Case*	*Amount*
1951–70	—	—	—	—	236	91	15.30	12.10
1971–75	6	4	1.17	0.36	258	118	7.71	3.40
1976	—	—		—	27	19	5.51	1.53
1977	2	0	0.39	0	38	49	7.44	5.66
1978	1	0	0.15	0	50	32	7.49	2.39
1979	6	1	0.79	0.10	68	55	8.96	5.64
1980	4	2	0.62	0.17	58	33	8.98	2.76
1981	10	2	1.40	0.06	52	31	7.30	0.93
1982	9	3	1.35	0.22	66	94	9.87	6.79
1983	28	67	3.39	3.63	73	72	8.85	3.90
1984	10	6	1.48	0.37	76	119	11.28	7.31
1985	6	1	0.88	0.07	51	48	7.45	3.34
1986	2	1	0.24	0.04	58	124	7.08	5.33
1987	1	1	0.07	0.02	192	250	14.31	5.14
1988	2	1	0.12	0.02	382	859	22.00	15.42
1989	5	1	0.29	0.01	403	1276	23.61	15.49
1990	9	5	0.60	0.07	377	1154	25.15	16.36
Total	119	98	0.64	0.21	2465	4424	13.23	9.31

of production cost, specifically labour cost; (d) decline of the comparative advantage of labour-intensive products originated in NIEs and Japan; and (e) substantial improvement of the investment climate through the development of infrastructure facilities and domestic capital endowment.

Pattern of Japanese Investment in Sri Lanka and Thailand

It has already been noted in the foregoing parts the pattern of Japanese FDI and its significance in the Asian region in general, and the trend of inward foreign investment in Sri Lanka and Thailand in particular. This part is mainly intended to provide a brief account of Japanese investment in both countries during the last four decades. However, many difficulties are encountered in this discussion due to the scarcity of data and the dissimilarities in the sources.[9] Hence, this analysis is mainly based on the data available from Japanese sources pertaining to Japanese investment in Asia, specifically Sri Lanka and Thailand.

Although both countries strove to entice Japanese capital into their industrial sector by offering various incentives during the 1980s, there have been only very little or insignificant Japanese investment inflows into Sri Lanka throughout the period 1950–90. However, it was very significant in Thailand compared to any other country in Asia, particularly after the mid-1980s. The general pattern of FDI inflows from Japan to both countries and their share of Japanese total FDI in Asia is presented in Table 11 to illustrate the general pattern of Japanese capital dispersion in both countries.

Table 11 shows that Japanese FDI in Thailand was rather insignificant until 1987 (less than 7 per cent of total Japanese FDI in Asia), but that it had a tremendous upsurge to 15.4, 15.5 and 16.4 per cent in 1988, 1989 and 1990 respectively. During the period 1950–90, the total amount of inward Japanese capital in this country amounted to US $ 4,424 million which comprised 9.3 per cent of the total Japanese investment in Asia and 1.4 per cent of the total Japanese FDI in the world. On the other hand, the number of Japanese projects established in Thailand also increased dramatically after 1986, comprising about one-third of all Japanese projects in Asia. The year 1989 is the peak year of Japanese investment inflow into this country. It is noteworthy that both the amount of capital and the number of projects declined by 6.5 and 9.6 per cent respectively during the period 1989–90. Nevertheless, in the recent past, Japanese capital has played a greater role in the manufacturing and non-manufacturing activities of the country, a role which was played by the United States of America prior to 1986. While, on the one hand, the rapid rate of economic growth, the gradual improvement of domestic capital and socio-economic stability have been the major inducements enticing the Japanese investors to move into this country, on the other hand, the appreciation of the Yen, high production costs, various environmental regulations, etc., in the home country pushed them to look for other countries.

The notable point revealed by Table 11 is the insignificant concentration of Japanese capital in Sri Lanka as compared to Thailand or any other country in the ASEAN and East Asian countries. Although the Sri Lankan government has attempted to encourage Japanese investors by adopting similar incentives and policies on FDI like Thailand, perhaps even more than Thailand after 1977, less than two per cent (except in 1983) of total Japanese investment in Asia flowed into Sri Lanka. This was seen by various economists as a result of very capitalist underdevelopment in Sri Lanka. Another reason for this negligible proportion of Japanese capital in Sri Lanka is that the country has still not matured to meet some major preconditions required by advanced countries like Japan. The growth of certain types of labour-intensive low-technology industries from NIEs and Japan is the major outcome of the aforesaid immaturity of the country. This kind of FDI often excepted to achieve short-term benefits rather than long-term prospects from Sri Lanka. Consequently, the majority of inward Japanese FDI in Sri Lanka invested in a large number of projects operating at a low level of technology. For instance, during the period 1951–85, 70 Japanese firms in the manufacturing sector invested only $ 26 million, contributing a mere US $ 0.41 million per venture (Export-Import Bank, 1986: 238–239). According to Fonseka (in Lakshman, 1991:17), there were only 39 Japanese firms in the manufacturing sector during this period (1951–85) and not 70 as indicated by the Japanese source; the total paid-up capital in the 39 ventures amounted to a little over Rs. 242 million, giving an average of Rs. 6.2 million per venture. The equity capital invested ranged from Rs. 15,000 in the smallest venture to Rs. 50 million in the largest. The above analysis reveals the insignificant contribution of Japanese investment in the manufacturing sector of Sri Lanka (regardless of discrepancies in the Japanese and Sri Lankan sources) compared to Japanese FDI in Thailand.

Table 12 presents more details on Japanese investments, classified by industrial activity in both countries. As could be seen in the Table, Japanese FDI in both countries largely concentrated on the textile industry, contributing one-third and one-tenth respectively of the total manufacturing sector in Thailand and Sri Lanka. As we described several times in the foregoing sections, Japanese investment by industry too remained at an insignificant level in Sri Lanka as compared to not only Thailand, but also to any other country in South-East or East Asia. Japanese capital in the manufacturing sector of Thailand was more than 17 times and seven times higher in terms of value and cases, than in that of Sri Lanka.

It is also interesting to note that the majority of Japanese firms in Sri Lanka are rather small in terms of the average size of investment compared to those in Thailand: the average size of investment of firms in the manufacturing sector is US $ 0.41 million and US $ 0.94 million in Sri Lanka and Thailand respectively. The peculiar pattern of Japanese FDI inflows into Sri Lanka is that their firms mainly aimed at achieving quick benefits rather than long-term prospects, at a low level of technology. This has been largely manifested in the dispersion of Japanese investment in Sri Lanka, i.e. a large proportion of investment (64 per cent) in the non-manufacturing services industry and the absence of investment in high-tech industry like chemicals and machinery or a negligible proportion of investment in other major activities of the manufacturing sector.

However, the pattern of dispersion of Japanese FDI in both the Manufacturing

and the non-manufacturing sector in Thailand has disclosed their aspiration for long-term prospects rather than short-term benefits. This can be attested to through statistical evidence emerging from available data and from the results of our discussions with some selected Japanese firms in Bangkok. Statistically, more than two-thirds (71 per cent) of the total Japanese investment in this country is engaged in manufacturing activities of which textiles, food, machinery and chemicals, in that order, were the most attractive areas for Japanese investors. Moreover, there is only a relatively small amount of investment concentrated in most activities (except construction) in the non-manufacturing sector. At our discussions, some Japanese firms in Bangkok stated that they would not leave Thailand like a migrant bird even if labour costs and other production costs increased in future, these cost escalations being very common among the MNCs located in the Asian region. These two attestations, therefore, reveal that Japanese investors aimed at achieving long term prospects by providing a significant leadership for industrial development in Thailand.

According to a survey on Japanese investment in Thailand (Chiasakul and Tangtortan, 1991:58), Japanese investment in mineral, metals and ceramics have contributed to the development of Thailand's construction and metal-working industries. Thus, Japanese FDI concentrated heavily on major industrial activities in Thailand, while it remained insignificant in Sri Lanka. This means that policy level efforts have not yet helped to entice Japanese capital into major industries in Sri Lanka. This failure of Sri Lanka could be ascertained clearly through the elucidation of the major factors which paved the way to the success of increased Japanese investment in Thailand. According to many academic works, it is emphasised that Thailand has had a long tradition of free trade and private enterprise, and that it has been successful in establishing a valid industrial base (Wong, 1987:110). This resulted in gradually strengthening the local capitalist class and thereby improving the bargaining power of Thai investors with major Japanese firms. In Thailand, this kind of development took place steadily, aided by her long-term stability as an independent state. However, this did not occur in Sri Lanka due to the foreign domination of the economy:[3] the Portuguese, the Dutch, the British and the Indians exploited the country's commercial sector for over 300 years. This was the major reason behind the very capitalist underdevelopment in the country and consequently, its failure to entice Japanese capital into Sri Lanka.

SUMMARY AND CONCLUSION

The significant points arising from the foregoing discussion on Japanese direct investment in Asia with special emphasis on Sri Lanka and Thailand could be summarized as follows:

Until the mid-1980s, the flow of Japanese investment overseas concentrated mainly on resource extraction and import substitution. The nature of investment activities changed from time to time in terms of the comparative advantage of products made at home. This change took place mainly as a result of the emergence of Asian NIEs, producing similar products for the world market at lower levels of production cost than those of Japan.

After the mid-1980s, a large number of Japanese investors moved into manufacturing industries, producing parts and finished goods for the export market based on sophisticated technology of the so-called high-tech products. These high-tech products helped the Japanese firms to retain their comparative advantage in the international market. These developments, both before and after the mid-1980s, largely related to the structural changes of the Japanese economy, particularly the appreciation of the Yen, change of conditions of labour, government policy towards overseas investment

TABLE 12

JAPANESE INVESTMENT (APPROVALS/NOTIFICATIONS) IN SRI LANKA AND THAILAND CLASSIFIED BY TYPE OF INDUSTRY, TOTAL AS AT MARCH 1988 (UNIT: US $ MILLION)

	Sri Lanka			Thailand		
Type of Industry	Cases	Investment	Share of Investment	Cases	Investment	Share of Investment
Manufacturing Sector	30	36	37.50	(100.0)	538	207	71.21	(100.0)
Food	1	0	0	(0.0)	139	60	8.44	(11.8)
Textiles	14	3	3.12	(10.0)	127	177	24.83	(34.9)
Wood and Pulp	1	0	1.00	(0.0)	24	7	0.98	(1.4)
Chemicals					58	49	7.62	(10.6)
Metal & Non-metallic	3	1	0.12	(1.0)	43	35	4.62	(6.6)
Machinery	—	—	—	—	47	43	2.31	(3.3)
Electrical Appliances	5	2	2.25	(6.3)	23	24	3.66	(5.1)
Transport Equipment	1	0	2.00	(0.0)	39	26	5.67	(7.9)
Other	3	2	25.84	(16.3)	38	21	4.55	(7.0)
Non-Manufacturing Sector	22	60	62.62		423	103	27.23	
Agriculture, Forestry and Fishing	10	1	0.12		22	12	1.65	
Mining and Quarrying					21	7	0.28	
Construction					25	20	1.79	
Trade	5	0	5.00		181	112	19.38	
Finance, Insurance					71	12	1.57	
Transport and Travel					8	1	0.14	
Services and Real Estate	—				7	0	0.00	
Services	5	57	54.64		9	13	1.83	
Other	1	1	2.72		49	15	1.57	
Total	52	96	99.62		961	310	100.00	

Note: ( ) Share of each project in total manufacturing investment

and the emergence of Asian NIEs as little dragons.

The major important factors which enticed the Japanese firms to move overseas were the low cost of labour, availability of resources, condition of the domestic capitalist sector or the availability of local entrepreneurs and socio-economic stability, rather than the economic policy attitudes towards foreign investment in the host countries. Among these, the last two factors remained the dominant inducements for Japanese firms to channel investment into any foreign country. This was witnessed the concentration of the dominant share of Japanese direct investments on advanced countries, mainly North America and Europe, and on some relatively developed Asian countries like the NIEs and the ASEAN (except the Philippines).

The noteworthy feature of Japanese investment in the Asian region is that the share of Japanese investment in Asia out of the total Japanese overseas investment remained a small percentage, although, in absolute terms, it upsurged dramatically conquering the relative position of America after the mid-1980s. Moreover, the rate of increase of Japanese investment in Asia is slower than that of the diffusion of NIEs investment in the Asian region in the 1980s. Nevertheless, Japan still leads as the single largest foreign investor in Asia.

Even though the relative size of Japanese investment in the total domestic capital of each country of Asia is not much significant, Japanese FDI prevailed as a major political issue in the industrial development policies of most of the developing countries of Asia. However, it is insignificant in both scale and character in the Indian sub-continent because the region remained one of the poorest in both resource endowment and economic performance. In general, the behavioural pattern of Japanese investors in foreign countries reveals that they were inclined more towards joint ventures rather than towards fully-owned subsidiaries; but this was not quite possible in South Asia due to the dearth of local entrepreneurs who would be ready to enter into business alliances with Japanese investors.

It has been found that not only Japanese investment, but also other foreign investment in Sri Lanka is extremely negligible in terms of both scale and character. The dominant reasons arising from the foregoing analysis could be summarized as follows: (a) poor resource endowment; (b) low rate of economic growth and resultant economic instability; (c) political and social unrest in the recent past; (d) underdevelopment of the domestic capital sector and poor industrial environment; and (e) relatively small volume of export-import between Japan and Sri Lanka. In contrast, the upsurge of Japanese investment in Thailand could be explained largely as a result of the prevalence of a situation quite opposite to that given under the above five factors. The country is well known not only as having recorded a very high rate of growth among the ASEAN in the recent years, but also as possessing a considerably developed domestic capital sector which is available for collaborative ventures with foreign investors. However, the pattern of Japanese investment inflow into foreign countries indicates that it will, perhaps, begin to surge upwards in Sri Lanka too in the near future with the increase of labour and other input costs in Thailand, and with the gradual improvement of the industrial environment in Sri Lanka.

Although we have emphasized various factors relating to Japanese direct investment in Asia, specifically in Sri Lanka and Thailand, it is necessary to conduct a detailed survey on this subject, to ascertain the main attractive and unattractive factors for the inflow of Japanese capital into Thailand and Sri Lanka respectively. Furthermore, it is also essential to carry out a study on the role of Japanese investment in the economic development of both countries, particularly the implications of Japanese FDI in changing the industrial structure, in generating employment opportunities, in improving the balance of trade/payments, in transfering technology and in contributing to the domestic industrialisation, of the two countries.

FOOTNOTES

1. DFI by MNCs from advanced countries like the United States, Japan, Europe, and recently the Asian NICs, has been significant in each of the NICs and ASEAN-4 economies, and, in a number of industries, foreign multinationals have played crucial roles in stimulating growth (Naya and Ramstetter, 1991:4).
2. See Lakshman (1991:1-2) for more details on categorization of foreign direct investment in Asia.
3. The EPZ/FTZ special manufacturing enclaves boomed since the 1960s, despite some economists' doubts about their benefits. Although the first FTZ was set up at the Shannon airport in Eire (Ireland) in 1959 (someone indicated, in 1956), the first such kind of enclave zone was established in Taiwan in 1965. During the last three decades, this concept was diffused to many countries whether socialist, capitalist, developed or developing. At present, there are about 51 FTZs operating in developing countries (outside Europe), of which nearly 40 per cent (20 zones) are located in the Asian region (Westlake and Jayawardena, 1985:31; People's Bank, 1982:4-5).
4. Japanese colonial investment in the Korean peninsula and in Taiwan largely concentrated on domestic agriculture and related industries unlike the enclave investments of European colonial governments. According to Oshima (1987:138), the Japanese colonial government developed industries more in Korea than in Taiwan, and agriculture more in Taiwan than in Korea, both grew fairly rapidly.
5. "All FPZs waive customs duties on imported raw materials and other goods if the final product is sold elsewhere. But there are other incentives too, ranging from long tax holidays on profits to subsidised rents and services, Swiss-style bank accounts and an absence of bureaucratic controls. Some offer investors unrestricted repatriation of profits. Others have their own administrative authorities, their own infrastructure, separate banking facilities and even their own commercial policy. Sometimes strikes are banned and minimum wage laws waived" (Westlake and Jayawardena, 1985:31).
6. The major studies on Japanese direct investment overseas by Japanese scholars emerged mostly in the 1970s, i.e. Kojima (Feb., 1973; June, 1973; 1978), Yoshihara (1976, 1978, 1988), Ozawa (1979, 1985), Sekiguchi (1979, 1980, 1983) etc.
7. There are several studies on Japanese FDI from the perspective of host countries in ASEAN and South Asian countries. See Phongpaichit (1990; 1988), Lakshman (1982, 1988, 1991, 1991(a)), Chiasakul and Taniguchi (1991), Hill and Johns (1985), Hiemenz (1987).
8. See Phongpaichit (1990:28-93) for a descriptive analysis of major factors relating to the demand side of host countries and the supply side of Japan for direct investment in Asia.
9. "The data show that by 1979, Japan no longer had comparative advantage in textiles, textile yarn and thread, or clothing. It had been losing comparative advantage in these industries compared to the NICs and ASEAN. ..... In electrical and electronic parts and components, Japan still enjoyed comparative advantage in the world markets, but in the key subsectors of semi-conductor assembly, the ASEAN countries already had an advantage against Japan, and the NICs were restructuring to shift from assembly to design and fabrication work" (Phongpaichit, 1990:42).
10. The Yen had been appreciated unexpectedly against the dollar from 1971 onwards; it had risen 142.3 per cent against the dollar in the last two decades (1971-90).
11. The first significant step came in October 1969 when overseas investment upto $ 200,000 was guaranteed automatic approval. Then, in the following year, the limit of automatic approval was increased to $ one million. And finally, in July 1971, the limit was abolished altogether, and overseas investment was completely liberalized (Yoshihara, 1978:3).
12. The rate of economic growth in Japan increased by about 10 per cent per year in the 1950s and the 1960s. This remained at around 6.6 and 4.0 per cent during the periods 1965-80 and 1980-89 respectively. Along with this rapid rate of growth in the long-term, many structural changes took place in the Japanese economy in areas like production, employment, trade, etc.
13. In value terms, there was about US$ 134.6 billion worth of Japanese investment concentrated in North America during the period 1951-90. This comprised about half the total Japanese investment overseas.

14. Indonesia is exceptionally well endowed with natural resources, the most important of which are its oil and gas reserves. The country's total oil reserves were estimated in 1985 at 9,600 million barrels; this is of particular interest to Japan which is a very heavy consumer of hydrocarbons and which has relatively few other sources of energy outside the Middle East (Wong, 1987:89).

15. Countries in South Asia were defined by the World Bank as low-income economies (those with a GNP per capita of $ 580 or less in 1989). The growth rate of real GDP per capita in this region was about 1.2 per cent, 1.7 per cent and 3.0 per cent in 1965–73, 1973–80, and 1980–89, respectively. Moreover, nearly half of the world's poor live in South Asia, a region that accounts for roughly 30 per cent of the world's population (World Bank, 1990:2; 1991:3).

16. As a group, South Asian countries are not nearly as resource-rich as the ASEAN economies. In fact, they are, on the whole, endowed with a small resource base relative to their population size, much like the NIEs (Wong, 1987:7).

17. See Suehiro (1989:42–286) for a descriptive analysis of the historical development of industrial capital in Thailand, such as the rise of capitalist groups during the period 1855–1932, economic nationalism in the period 1932–47, bureaucrat capitalist development in 1947–57, emergence of multinational and domestic enterprises in 1960–1980 and capital accumulation in the last decade.

18. In the first decade of the post-independence period, the Sri Lankan government applied a fairly liberal policy on the approval of FDI. However, upto about the end of the 1960s, no steps were taken towards diversifying the export structure. In the 1970s, the foreign investment approval procedure turned out to be more selective and stringent. However, first priority was given to encourage export-oriented industries under ISI policy. In the post-1977 period, the government introduced unprecedented incentives for FDI which was intended to invest in export-oriented industries in the IPZs. At the same time, the government abolished export-import restrictions, entering into a more open economy (See Athukorala, Feb., 1948:21–23; July/Aug., 1984:4–6; Lakshman, 1988:400–405; Centre for Society and Religion, April, 1983:1–10; Vatage Enterprises, June, 1977:2–9).

19. The government policy of Thailand towards FDI highlighted both the provision of incentives and the imposition of restrictions until the beginning of 1980. The major reason behind this was that the Thai government had never felt an urgent need to promote foreign investment as a means to achieve economic growth. There are six national development plans (1961–66, 1967–71, 1972–76, 1977–81, 1982–86 and 1987–91) implemented in Thailand during the last three decades. The first two plans were expected to foster industrialization and encourage joint ventures under the policy of import-substitution. In the third plan, the emphasis was shifted towards the promotion of manufactured exports and increased import-substitution of intermediate goods and raw materials. In the fourth plan, emphasis was given to the provision of incentives to encourage linkage between industry and agriculture. The last two plans placed special emphasis on effective investment incentives to remove various restrictions to export and to generate more employment opportunities (Wiboonchutikula, 1987:12–13; Phongpaichit, 1990:78–81).

20. Beside the BOI in Thailand, there are at least another four major government institutions connected with export promotion policy-making; (a) the Cabinet; (b) the Economic Ministers Committee; (c) the National Economic and Social Development Board; and (d) the Export Promotion Development Committee (Vorathepputipong et al, 1989:9).

21. Data on inward FDI in Sri Lanka during the period 1950–77 is not available for proper analysis and therefore, balance of payments data on FDI was used to arrive at the general pattern of FDI inflow and outflow.

22. See People's Bank, (June, 1982:9) for details on visible incentives for foreign investment in Sri Lanka.

23. Sri Lanka is one of the notorious countries in Asia for human rights violations in the recent past. According to a European Human Rights Team, 60,000 people have "disappeared" in southern Sri Lanka since 1987, when security forces responded to a compaign of terror by leftist rebels (The Japan Times, 1990:16). Furthermore, Sri Lanka's civil war has claimed at least 17,000 lives since rebels from the Tamil minority began their violent struggle in 1983 (The Daily Yomiuri, 1992:4). Both these sources of information stated that, possibly, scores of people were still vanishing each week.

24. The growth rate of real GDP in Sri Lanka remained at around five per cent per annum from 1980 to 1985, but thereafter, it declined to 4.3 per cent, 1.6 per cent and 2.1 per cent in 1986, 1987 and 1989 respectively (Asian Development Bank, 1991:21).

25. See Suehiro (1989:71–90), Phongpaichit (1990:78–80) for more details on the gradual rise of the Chinese capitalist group in Thailand in the 19th and 20th century.

26. According to Phongpaichit (1990:79) during the 1960s and the 1970s, Thai enterprises were not only confined to producing goods for the domestic market, but branched out into successful export business in jewellery, garments, processed food, artificial flowers and other consumer goods. Several Thai-owned conglomerates emerged, such as Siam Cement, Charoen Pokphand, Mitr Phol and Saha Union.

27. See Turton (1991:365) for a descriptive analysis of the political unrest of the country within itself and with neighbouring countries in the 1960s and the 1970s.

28. The available material pertaining to Japanese direct investment in Sri Lanka is not quite adequate for a satisfactory analysis, there is also a certain degree of confusion in the available statistics, making it difficult to ascertain whether they refer to "approved", "contracted" or "actual" investment (See Lakshman, 1988:409–410; 1991:164). Furthermore, although there are various sources of data on Japanese FDI in Thailand available in Japan as well as in Thailand and other countries, the data give different pictures on the same figures depending on the different sources. Therefore, it is quite difficult to estimate the approximate actual Japanese investment in both countries. This constraints was minimized by using only the data available in the Japanese sources pertaining to the above subject.

29. "The history of Ceylon (Sri Lanka) records the exploitation of its commerce by the Portuguese, the Dutch, the British and the Indians for over three hundred years. Even at present its entire trade is run by foreigners, foreign capital, foreign labour and foreign brains. The non-Ceylonese element has kept a stronghold on the business, trade and industries of the country, and few opportunities have been allowed to the average Ceylonese to engage in trade and industries, either by Government or by business firms" (Imperial Government, Ceylon Banking Commission, Sessional Paper XXII, Ceylon Government Press, Colombo, December 1934:22, in Lakshman, 1988:406).

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TABLE 4
EXPORT DESTINATION OF SRI LANKAN GARMENTS
(Value Percentage)

Country	*1987*	*1988*	*1989*	*1990*
USA	67.3	66.2	68.9	66.4
EC	25.5	27.1	23.9	26.6
Canada	2.6	2.6	2.5	2.7
Sweden	1.0	0.6	0.7	0.8
Norway	0.4	0.3	0.3	0.4
Japan	--	0.6	1.3	1.0
Others	3.2	2.6	2.4	2.1

Source: Compiled by the author using Sri Lanka's Customs Returns.

It is worth focussing on the possible threats in the non-quota market for garment exports. In the EC, Sri Lanka will have to face competition from: (a) Portugal and Spain — members-states with low-cost labour, (b) Mediterranean countries such as Turkey and Morocco, which have preferential agreements with the EC, (c) Eastern European countries with a lower wage structure, which are likely to join the EC or, at least, get preferential treatment, and (d) ACP countries which receive preference from the EC. These factors have to be seriously recognized by the Sri Lankan garment exporters.

Textile and garment producers in the Community have vigorously pursued a variety of new marketing and production strategies and this aspect must also be taken into account. Notably, technical innovations in labour-saving equipment that is taking place in the EC clothing industry can offset the advantage that developing countries such as Sri Lanka has in cheap labour. The following are some of the recent developments in the textiles and garments sector: (a) lasers being introduced in the cutting process, (b) computer-aided design and automatic handling of materials, (c) new automated sewing operations, and (d) a shift away from mass production of standardized products towards small-scale production of more exclusive and high fashion products to serve more affluent markets (this has been particularly the case in Germany and Italy).

Besides garments, Sri Lanka's major exports to the EC are desiccated coconut, sheet and crepe rubber, tea in bulk, coconut mattress fibre, and coconut oil. Most of these exports enter duty free to the EC market either under MFN or GSP. These products normally contribute over 45 per cent of total foreign exchange earned from the EC countries.

It is clear from the list of products mentioned above that Sri Lanka's major exports to the EC, other than graments, are traditional items and a few non-traditional forms of traditional items. It must be noted that most of Sri Lanka's traditional exports will face severe competition from Asian, Caribbean and African countries. In order to face this challenge Sri Lanka should consolidate its existing base and expand its traditional exports. Availability of traditional exports in required quantities and at competitive prices will induce exporters to manufacture from traditional items semi-processed and processed non-traditional items such as, packeted tea, tea bags, flavoured tea, activated carbon, coconut oil deodorized and in packs, coir mats, speciality rubbers and rubber-based products such as gloves, mats, rubber parts for machinery and toys.

Products such as foliage, artificial flowers, precious stones, leather products, umbrellas, textiles, etc., may find the single market too difficult to penetrate mainly due to non-tariff barriers. It appears that these products and fresh and processed fruits and vegetables will be protected to provide a favoured status to the poor members of the EC, viz., Portugal, Greece, Spain, Ireland and Denmark. Whatever losses of export earnings from these products, which amount to 30-35 per cent of foreign exchange earnings from the EC, will have to be covered by increasing the exports of established products and potential new products. Already, Sri Lanka has requested further GSP consessions for items such as, coconut oil, fresh foliage, passion fruit juice, fresh cut flowers, gherkins, etc.

What are the potential new products? Apart from the already mentioned value added products from traditionals, identification of new products is not easy, and above all such products may emerge according to the theory of comparative advantage. However, various studies conducted by the Sri Lanka Export Development Board have identified certain products (not necessarily brand "new" products) for development and promotion in the foreseeable future. Among them, those that can be promoted in the EC are: cashew, tobacco, essential oils, brooms and brushes, animal food, natural fibre products, medicinal herbs, porcelain ware, marine food, imitation and costume jewellery, glycerine, metallic ore, among others (see Kelegama *et al.*, 1992).

IV. Policy Options for Sri Lanka

For effectively meeting the threats posed by the EC and profiting from opportunities offered by the EC, Sri Lanka should consider the following measures:

(1) Sri Lanka lacks the resources to invest in companies in the EC to manufacture garments or to grow foliage. However, she can establish a few trade centres and distribution outlets. Large companies or conglomerates should be encouraged to establish sales and distribution outlets in target EC countries. It is said that Sri Lanka is far behind most Asian countries in the eatablishment of sales and distribution outlets within the EC. In fact, this is an area that needs immediate attention. These centres need proper planning in regard to site, selection of companies, products for promotion, etc., for cost effective operation. The cost of establishment and market promotion will have to be subsidized by the government and the marketing efforts will have to be closely monitored along with changes occurring in the single market. The non-tariff barriers such as quotas, standards, consortia formations, competition and changes in comparative advantages of other Asian countries should be closely monitored and reported to Sri Lanka

by Sri Lankan embassies in the EC countries.

(2) The share of industrial products (except garments) in Sri Lanka's exports to the Community remains marginal, compared with that of the agriculture sector. This reflects the non-availability of manufactured goods in sufficient volume and a competitive prices. The answer may partly be to look for joint ventures in selected areas with the Community enterprises, with possible buy-back arrangements. Such arrangements are normally effective in circumventing protectionist barriers. This would invole a comprehensive evaluation of our export and investment promotion policies and a vigorous drive to promote joint venture arrangements.

(3) Consumer demand for many products varies across the Community because of differences in taste, habit, language, culture and income. The diversity of consumer tastes, and the products and services needed, to satisfy them, may increase as incomes are expected to rise in the post-1992 period. Sri Lanka may hope to exploit these trends by identifying particular market segments and catering to them.

(4) It may be necessary to canvass more vigorously, in association with other similarly placed countries, for strengthening and extension of the Community GSP Scheme as a means of protecting Sri Lanka's export interests. For example, in processed agricultural products, there is a possibility of the Community enterprises in the food processing business merging to achieve economies of scale in the enlarged market. The resulting composition would be damaging to Sri Lanka.

(5) Identification of sectors where special policy instruments could be utilized for inducing appropriate changes required for exports to the single market. For example, technological upgrading and establishing new manufacturing units embodying needed technology in the identified sectors so that the country could manufacture the products to the standards required by the EC, as well as maintain their competitiveness.

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In short, one may say that Nicaragua is hardly an exception on the whole of the Southern nations which adopt neo-liberal orientations, participate in the new phase of capitalist accumulation. In a certain way, the policies followed are comparable to those of Argentine, Brazil, Costa Rica, Guatemala, Peru or even Pakistan, Indonesia, India, the Philippines, Morocco, Kenya or Ivory Coast. What distinguishes Nicaragua however from these other societies, is the fact that the country in question has known a revolution. It is true that a majority vote had punished the Sandinists in 1990, following the difficulties produced by the war, the economic blockade and some political errors, but the revolutionary process has profoundly marked the society and it cannot be eradicated by mere decrees. For neo-libaralism, it is however important that the project follows its course, as it possesses in this country an added symbolic value which makes it exemplary.

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