
LKI *Policy Briefs* are extended analyses on policy issues.

Strengthening Engagement in Australia-Sri Lanka Relations

Ishara Tilakaratna
and
Michael Iveson
June, 2024

Abstract: *The Lakshman Kadirgamar Institute of International Relations and Strategic Studies (LKI) hosted an expert roundtable consultation on 01 February 2024 on “Strengthening Engagement in Australia-Sri Lanka Relations” moderated by Amb. Ravinatha Aryasinha, Executive Director of LKI, featuring Ishara Tilakaratna and Michael Iveson. The discussion brought together a diverse range of experts and stakeholders from the economic, security and political sectors, including representatives from the Australian High Commission and the Ministry of Foreign Affairs. Subsequently, LKI has also participated in several discussions relating to Australia-Sri Lanka bilateral relations, and these outcomes are also incorporated into this review. This report which outlines the important aspects through the lenses of political and strategic, social and cultural and economic, aims to better inform policy related to the Australia-Sri Lanka bilateral relationships.*

Ishara Tilakaratna, Research Intern, Lakshman Kadirgamar Institute of International Relations and Strategic Studies. She is currently completing an undergraduate degree in Political Science and International Relations at the University of Melbourne, Australia.

Michael Iveson, Research Fellow (Global Economy), Lakshman Kadirgamar Institute of International Relations and Strategic Studies.

Strengthening Engagement in Australia-Sri Lanka Relations

Contents

Stakeholders in Attendance	1
1. Political and Strategic Relations	3
a) Sri Lanka's Engagement with Australia.....	3
b) Maritime Security	3
c) Governance	5
2. Social and Cultural Relations.....	7
a) Sport.....	7
b) Overseas Sri Lankans.....	8
3. Economic Relations	11
a) Trade	11
b) Investment.....	13

Stakeholders in Attendance

Name	Organisation and Affiliations
<u>Moderator</u>	
Ambassador Ravinatha Aryasinha	Executive Director, Lakshman Kadirgamar Institute of International Relations and Strategic Studies
<u>Presenters</u>	
Ms Ishara Tilakaratna	Research Intern, Lakshman Kadirgamar Institute of International Relations and Strategic Studies
Mr Michael Iveson	Research Fellow (Global Economy), Lakshman Kadirgamar Institute of International Relations and Strategic Studies
<u>Experts</u>	
Ambassador Admiral Thisara Samarasinghe	Former Sri Lankan High Commissioner to Australia
Ambassador Somasundaram Skandakumar	Former Sri Lankan High Commissioner to Australia
Ms. Yasoja Gunasekera	Additional Secretary/West, Ministry of Foreign Affairs
Rear Admiral Y. N. Jayarathna	Former Chief of Staff of the Sri Lankan Navy and Former Joint Chief Hydrographer of Sri Lanka
Dr. Paikiasothy Saravanamuttu	Executive Director, Centre for Policy Alternatives
Dr. Pavithra Jayawardena	Senior Lecturer, Department of International Relations, University of Colombo
Ambassador V. Krishnamoorthy	Director General, Office for Overseas Sri Lankan Affairs, Presidential Secretariat
Ms. Samantha K. Jayasuriya	Director , Office for Overseas Sri Lankan Affairs, Presidential Secretariat
Mr. Brendon Kuruppu	Former Sri Lankan Cricketer & Administrator
Dr. Dayaratna Silva	Executive Director, Pathfinder Foundation
Dr. Roshan Perera	Senior Research Fellow, Advocata Institute
Dr. Lakmini Fernando	Research Fellow, Institute of Policy Studies
Mr. Shakthi De Silva	Researcher, National University of Singapore
Ms. Priyanka Samaraweera	Executive Director – Research & Policy Advocacy, Board of Investment
Ms. Anoma Premathilake	Director – Market Development, Sri Lanka Export Development Board

Mr. Shalaka Wijeyaratne	Executive Director – Investment Promotion & Marketing, CHEC Port City Colombo Pvt. Ltd.
Mr. Gerard Victoria	Director / CEO – Aviation and Member – Group Management Committee, Hayleys Advantis Limited
Mr. Ruwan Rajapakse	Managing Director – Jiffy Products S.L. (Pvt) Ltd, Sri Lanka-Australia-New Zealand Business Council
Ms. Lalita Kapur	Australian Deputy High Commissioner
Dr. Paul Zeccola	First Secretary Political & Economic, Australian High Commission, Sri Lanka
Ms. Tanya Warnakulasuriya	Senior Program Manager, Australian High Commission, Sri Lanka
Mr. Trivan Annakkarage	Policy Research & Information Officer, Australian High Commission, Sri Lanka

1. Political and Strategic Relations

a) Sri Lanka's Engagement with Australia

The discussion began with an acknowledgement of the historical significance of the Australia-Sri Lanka diplomatic relationship. Australia was one of Sri Lanka's earliest diplomatic relationships, standing as the fourth country that Sri Lanka developed a diplomatic relationship with, and has maintained a major partner ever since. The first state visit of Sri Lanka to Australia was in 1951, when Prime Minister D.S Senanayake visited upon the initiation of the Colombo Plan in 1950. However, this historical significance has been undermined in recent history, as there was over 60 years between official state visits. It was not until 2017 that an incumbent Sri Lankan head of state had visited Australia again; both President Hon. Maithripala Sirisena and Prime Minister Hon. Ranil Wickremesinghe both visited Australia on two separate occasions. In fact, President Sirisena's visit to Australia also marked the first ever state visit by an incumbent Sri Lankan President to Australia.

The discussion emphasised the growing need for Sri Lanka to engage with 'middle powers' like Australia on the international stage. Much of the discourse around Sri Lanka's foreign policy has focussed heavily on managing the power dynamics in the Indian ocean, namely with China, India and the US, and experts highlighted that Australia's integration in the regional architecture and influence at multilateral forums makes it a strong bilateral partner to engage with on contested issues. Given Sri Lanka's limited bargaining power and the absence of a clear foreign policy posture, it is vital that Sri Lanka sustains its relationships with 'middle powers' beyond India and China in the region. Sri Lanka has maintained bilateral relationships with all major powers in the Indian Ocean and recognised the importance of developing a robust foreign policy that enables engagement with all partners without risks of exclusivity. For example, Australia's largest two-way trading partner is China and Australia has maintained a positive relationship with China even throughout regional turbulence. Experts also recognised that the development of these relationships could be catalysed by Sri Lanka's Chairmanship of the Indian Ocean Rim Association and that Sri Lanka must implement effective measures with the backing of this multilateral organisation, which would demonstrate their credibility and commitment to security in the region.

b) Maritime Security

The main focus of the discussion centred around maritime security and the strategic importance of countering transnational crime (e.g. illegal fishing, drug smuggling, and irregular human migration). This included discussion around maritime surveillance and maritime domain awareness, key priorities of Australia in the Indian Ocean. One expert discussed ongoing engagements such as joint naval exercises and efforts to curb drug smuggling from Afghanistan to Australia, emphasising the importance of IORA as a platform to strengthen these efforts. Australia is currently co-leading India's Maritime Safety and

Security (MSS) workstream for the next two years and has endorsed India's leading role in the region. As a founding member of IORA, Australia has shown strong and active support for the organisation's endeavours and welcomes Sri Lanka's focus of enhancing dialogue and fostering regional cooperation during its chairmanship; the Australian representatives in Colombo are already working closely with the IORA Secretariat of the Ministry of Foreign Affairs.

Further discussions highlighted the importance of Maritime Domain Awareness (MDA) at the heart of maritime governance, and Australia's priorities in the governance of the Indian Ocean. A Maritime Domain Awareness assessment was conducted over several years in Sri Lanka, Bangladesh and Maldives, and a report was produced for the government that provided observations of the maritime domain, threats, interests and capabilities, as well as areas for improvement¹. This report will be used to inform training workshops and capacity building, which is already underway in Sri Lanka. Australia hosted an additional workshop at LKI that focussed specifically on the details, benefits and challenges of MDA².

Australia's approach to MDA is a whole-government endeavour and involves all agencies in the maritime domain; in many countries, there is limited cross-ministry coordination and information sharing in Sri Lanka and many other countries, so it is vital that these agencies are brought together for MDA. Experts acknowledged these challenges in Sri Lanka and that many sectors do not have a focal point for the maritime domain, which means that much work needs to be done to build capacity. The Australian experts outlined the need for a higher level coordinating body and that many countries have done this at the level of the Prime Minister's Office to align agencies. This promotes accountability, responsibility and coordination, which is essential for MDA. Experts questioned whether Sri Lanka had the capacity to absorb the efforts from the Australian partners given the ongoing economic and political instability and that Sri Lanka must conduct its own assessments before agreeing to implementation. The establishment of a coordinating body will be essential for Sri Lanka's MDA efforts and better development of maritime domain facilities, which Australia emphasised their support for.

MDA cannot be achieved in isolation and the workshop promoted cooperation with neighbours and information sharing, which creates an environment where all countries work together to understand all aspects of their maritime area, from fishing to piracy. By collecting information and concisely unifying all data, MDA offers an effective and efficient monitoring of the maritime space to identify anomalous vessels and investigate threats. Much of the information and data required for MDA is already in the hands of certain parties, countries or partners, so MDA encourages collaboration rather than repeating work that already exists.

¹ Report titled: Governing in Sri Lanka's Maritime Space, authored by David Brewster, Simon Bateman and Anthony Bergin at the Australia National University National Security College.

² Workshop titled: Building Maritime Domain Awareness in Sri Lanka, hosted by the Australian High Commission in Sri Lanka and the Australian National University, in collaboration with LKI.

Australia has also delivered various forms of tangible support to Sri Lanka in their capacity building efforts, including providing vessel monitoring systems for all of Sri Lanka's 4,800 multi-day fishing vessels. This system allows authorities to monitor the location of fishing boats and enforce governance over location and duration of fishing within the EEZ. This also enabled the rescue of a Sri Lankan fishing boat captured by Somali pirates earlier in 2024, when the captain sent a signal through the system to alert the authorities of the danger. Despite geographical differences, collaborative projects between Australia and Sri Lanka, such as the coastal forecast system developed through the University of Western Australia under an Australian grant program, have established a strong working relationship in the Indian Ocean that ought to be maintained. The forecast system and the web interface provides five day forecasts of wind, currents, waves and storms, as well as subsystems for oil production, oil and chemical spills, and will produce output in Sinhala, Tamil and English.

Furthermore, the discussion emphasised that Australia's relationship with China poses less issues to Sri Lanka, unlike other bilateral relationships, and it should therefore not be considered a 'blocking country' in this regard. This enables Sri Lanka and Australia to continue their engagement in sensitive areas such as maritime domain awareness and blue economy, without compromising other important bilateral relationships.

Experts stressed the need for policymakers to address common challenges in the region and that Australia has an important voice in implementing policies through IORA. While this was warmly received in the discussion, one expert highlighted the overreliance of the bilateral relationship on maritime efforts, and that it is crucial for Sri Lanka and Australia to move beyond this specific area to bolster the relationship. Australia have demonstrated that they are willing to work with Sri Lanka as a close friend and partner, and the relationship must develop through new partnerships and utilising the diaspora base. IORA could be the platform to facilitate this but must not isolate maritime issues; instead, IORA could focus on education, agriculture and cyber security, all of which overlap with the priorities of a blue economy approach.

c) *Governance*

The discussion around governance recognised the need for honesty and transparency in the bilateral relationship and that Sri Lanka must accept responsibility for recent mistake in governance. Sri Lanka's credibility has been damaged on the international stage due to its own economic and political failures and relationships must be rebuilt based on results. Experts acknowledged that while Sri Lanka has missed opportunities in the past, Australia has always supported governance reform and been available as a bilateral partner in this regard. Similarly, Australia has never tried to hold Sri Lanka to account for poor governance, but has instead prioritised support for the people.

Australia's support for the people during periods of instability was particularly event during the economic and political crisis in 2022. Australia was the first bilateral partner to provide emergency financial support to Sri Lanka at the onset of the economic crisis and between

2021 and 2023, Australia provided a total of AUD\$75 million to address humanitarian challenges. This was in addition to their ongoing Overseas Development Assistance, which was AUD\$23 million between 2022 and 2023. The financial support and emphasis on humanitarian aid demonstrated their priorities as a bilateral partner and that Sri Lankans appreciated the approach. However, experts also recognised that there are limitations to this approach and that Australia must have robust mechanisms in place to hold Sri Lanka to account without the concern of how it may be perceived.

The discussion also mentioned the Australian government's Governance for Growth programme, which invested AUD\$29 million between 2016 and 2025 to promote democracy, governance and rule of law in Sri Lanka. This is also complemented by a recent 10-year subsidiary agreement, signed in January 2024, which commits AUD\$30 million to supporting governance reform in Sri Lanka. This will also be accompanied by public sector capacity building and empowering local experts to improve governance, rather than Australia directly instructing local officials how to work. Experts agreed this was the most effective and sensitive approach to governance but emphasised the need for honesty and transparency in the relationship.

2. Social and Cultural Relations

a) Sport

One of the most important social and cultural binders between Australia and Sri Lanka during their historical relationship has been sports; namely, cricket. Although on the pitch the competition has varied, efforts off the pitch have created a strong bridge between Australian and Sri Lankan cricket fans that has been at the heart of soft diplomacy. One expert summarised the timeline of this relationship and recognised the role that Australian cricket coaches and players have played in bringing important matches to Sri Lanka. This enhanced tourism directly but also placed Sri Lanka on the map for many cricket fans, whose awareness and knowledge of Sri Lankan cricket may have translated into cultural appreciation.

Behind the scenes, Australia has also played a significant role in capacity building for sports. One expert referenced a historical incidence where the Australian Cricket Board funded wages for a position on the Sri Lanka Cricket Board and this marked a turning point for Sri Lankan cricket. Another expert expressed their gratitude to Australia for the support in sourcing coaches, physios, trainers, and other technical experts since 1995, which has contributed to the development and elevation of Sri Lankan cricket. This has continued throughout periods of political and economic instability, including during the insurgencies in the Southern Province and the economic crisis of 2019 and onwards. Australia also continued to play matches in Sri Lanka during these unstable periods and one expert described the fixtures as a ‘unifying experience’ for the Sri Lankan people in a time of disharmony.

However, despite such support and cooperation in cricket, one expert outlined their disappointment in the lack of cooperation and capacity building in other sports. Cricket has received important financial support, but this has crowded out development in other sports. Australia and Sri Lanka signed a Memorandum of Understanding in October 2023, which underlined the need for technical expertise and knowledge transfer in Sri Lankan sport, but there has been very little indication that any progress has been made so far. Experts recognised that this could also be constrained by inefficiencies on the Sri Lankan side of the agreement, as Ministries often sign MoUs and agreements without follow-up or progress, but they encouraged Australia to be more proactive in this regard and encourage development. The discussion also considered various areas for positive engagement in sport, including sports medicine, sports science, and physiotherapy, and experts recognised that Sri Lanka could benefit from the significant research and innovation being carried out in Australia in these sectors.

Finally, experts considered the Ministry of Sports’ role in sports development and how Australia could work with civil servants to establish sports centres and create policies that attract investment into Sri Lankan sports but also lay the foundation for a self-sustaining sports model in Sri Lanka. The discussion called for capacity building within the Ministry of

Sport and encouraged civil servants to learn from the Australia-Sri Lanka bilateral relationship and project it onto other sports through partnerships with other countries. There was also an acknowledgement that this must also include women's sports and promote inclusivity as a way of bringing people together.

b) Overseas Sri Lankans

Another significant component of the Australia-Sri Lanka bilateral relationship is through overseas Sri Lankans. Census data estimates that there are approximately 1.8 million people of Sri Lankan origin currently residing overseas, which represents members of the Sinhalese and Tamil diaspora. Research suggests that Australia has a geographical advantage when welcoming Sri Lankan emigrants, particularly when compared with similar English-speaking destinations such as the US, UK and Canada. Australia has also become an important destination for Sri Lankan emigrants due to a sense of belonging in Australia, which has been largely driven by the perception of Australia's education system and job market. Prospective migrants often view Australia as a long-term, stable destination where they can extend their stay far beyond their initial period of voluntary migration.

One expert conducted research into the composition of overseas Sri Lankans in Australia and found that Sri Lanka has significant influence in Australian culture. For example, a Sinhala-medium stage drama was launched in Melbourne before it was shown in Colombo. It was also suggested that this is not a unique experience as many Sri Lankan artists have begun operating in Australia as they are able to charge higher prices and generate more revenue amongst Sri Lankans in Melbourne than you are able to in Colombo. This demonstrates the overwhelming influence and stature of the Sri Lankan diaspora in Australia and how it is an important factor of the Australia-Sri Lanka bilateral relationship.

However, one expert questioned the effectiveness of the tourism model amongst overseas Sri Lankans, given their integration into Australian society. Anecdotally, they described how Sri Lanka should expect to see much larger volumes of tourists from Australia, given the scale of the diaspora, as neighbours, colleagues and friends travel to Sri Lanka because of direct engagement with overseas Sri Lankans. They documented that in North America and Europe, tourism seems to reflect the size of the diaspora much more. Other experts acknowledged that a significant component of this is geographical and regional substitutes for Sri Lanka in the tourism market, as well as affordability of travel, and that Australian tourists can often achieve similar standards and types of tourism elsewhere. This discussion also led to further considerations around capacity building in tourism, particularly regarding adventure tourism and other niche markets that could attract additional visitors, and how Australia could support Sri Lanka in fulfilling its tourism potential.

Reflecting on the history of Sri Lankan emigration to Australia, experts discussed the initial patterns of migration between 1960 and 1980 and how they contrasted current trends. The communities that formed in Australia were more upper-middle class Sri Lankans that emigrated to Australia for retirement or specific employment. However, contemporary

migration patterns are more weighted towards young professionals and higher education students who are choosing to pursue their careers in Australia and are less invested in returning to Sri Lanka or providing support.

The discussion highlighted the importance of education in the bilateral relationship and identified key statistics that reflected this. In 2023, over 15,000 Sri Lankan students were enrolled in various Australian universities, both in Australia and Sri Lanka. Sri Lanka currently hosts several Australian university campuses and more than 30 Australian institutions have invested directly in tertiary education in Sri Lanka. This investment has come through official private investment channels but also in the form of grants, humanitarian assistance and scholarships. The most notable programme is the Australia Awards Scholarship, which will host 24 Sri Lankans in 2024, as it is part of DFAT's official support to Sri Lanka. Moreover, the New Colombo Plan has also awarded scholarships to Australian students and, from 2014 to date, has welcomed 934 scholars to undertake study and work-based experiences in Sri Lanka.

Those who have been settled in Australia for a longer period have been more likely to express a desire to contributing to Sri Lanka from abroad. Experts discussed the most effective ways to engage with the diverse interests and political priorities of overseas Sri Lankans, given that the composition has varied so much since the earliest period of Sri Lankan emigration to Australia. One concern about the relationship with overseas Sri Lankans in Australia arose when discussing their desire to contribute officially. One expert told of a network of over 300 medical professionals in Sri Lanka – potentially more – who are informally contributing to family activities rather than going through official channels. Their key concern is around transparency and accountability of engagement, particularly regarding financial contributions, and experts called for grassroots-level mechanisms to better engage with the diaspora and create an effective system. Although this is a long, drawn-out process, it will act as the foundation for channelling future resources properly for generations to come.

The discussion called for more a more accommodating structure for returning Sri Lankans and that demonstrating the possibility of a prosperous return is vital for addressing 'brain drain' and building a more sustainable economic model. Experts expressed their concerns about Sri Lankan emigration to Australia and emphasised the drawbacks in opportunities afforded to Sri Lankans. One expert cited the example of highly experienced medical professionals working in less technical roles that they are overqualified for in Australia, rather than returning to Sri Lanka to contribute to the healthcare system. This mismatch in qualifications and the limitations of the Australian system to recognise medical qualifications sourced from certain countries has led to Sri Lankans being underutilised in Australia but still choosing to remain outside of their home country due to limited prospects and instability.

One expert presented an Indian model of engagement with its diaspora, whereby the Ministry of Foreign Affairs organises an annual summit that brings together ambassadors and high commissioners representing India abroad. The purpose of this summit is to identify different development priorities and how overseas Indians can support such projects and targets, which

has experienced overwhelming success. Experts discussed suitable ways in which Sri Lanka could further utilise its diplomatic representation abroad to engage overseas Sri Lankans with domestic goals but also recognised that governance and credibility poses a significant challenge to such a mechanism. Domestically, there must be policies and structures in place that welcome overseas Sri Lankans back to the country and enable them to participate economically; this ranges from opening offices for international businesses based abroad, or simply guaranteeing proper opportunities to those returning from their higher education courses.

3. Economic Relations

a) Trade

The discussion on the economic relationship between Australia and Sri Lanka began with an interactive presentation that discussed the current bilateral trade and investment relationship. Top-level demonstrates that Australia-Sri Lanka bilateral trade is very low, with very few of Sri Lanka's major exports, namely apparel and tea, being supplied to the Australian market. In 2022, only 2% of Sri Lanka's apparel exports and 1% of tea, coffee, and spices exports were sold in Australia. Total two-way trade in goods and services between Australia and Sri Lanka was valued at \$1.5 billion in 2022 with Australian exports driven by education services and agricultural products. Australia's total investment in Sri Lanka was \$77 million in 2022, and Sri Lanka's total investment in Australia was \$134 million. Australia exports very little to Sri Lanka and this was dismissed as a focus area due to most exports moving from developing to developed countries in under comparative advantage theory.

Three constraints were identified in the Australia-Sri Lanka trade relationship, and these were broadly summarised by a) Sri Lanka's absence in regional agreements, b) geographical preferences, and c) Sri Lanka's lack of competitiveness. It was also acknowledged that while these constraints vary in intensity and overlap in certain sectors, it is mainly the third constraint that is at the centre of Sri Lanka's weak economic relationship with Australia. Australia have placed emphasis on enhancing Sri Lanka's role in regional trade, specifically referring to the Indian Ocean region and its fundamental role as a hub for global trade and energy security. The Indian Ocean hosts one than one-third of the world's bulk cargo traffic and two-thirds of global oil shipments; it is under this backdrop that Australia reiterated their support for economic security and trade through Sri Lanka's chairmanship of IORA, given that Colombo is at the centre of this network.

Australia has strong regional ties with Southeast Asia through agreements such as the Regional Comprehensive Economic Partnership (RCEP), the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the ASEAN-Australia-New Zealand Free Trade Area (ASEAN-ANZ FTA), and other bilateral free trade agreements (e.g. China-Australia FTA). Although experts acknowledged that some of Australia's regional agreements have not directly and tangibly benefitted Australian trade in the past, others have been incredibly successful and signal to the global markets that Australia is willing to engage with a diverse range of bilateral partners for economic growth. The participation of countries such as China, Indonesia and Vietnam, all which export goods that compete with Sri Lanka's typical basket of exports, leads to better regulatory and legislative frameworks in these relationships that facilitates trade.

The India-Australia relationship has improved significantly in the last 5 years and Australia is actively supporting India's agenda in the Indian Ocean region. Australia has an interim trade agreement with India and is currently negotiating an FTA; the High Commissioner of Australia to Sri Lanka, H.E Paul Stephens, recently outlined at a roundtable discussion that

Australia needs India's resources, while Australia educates many Indian students, and that this agreement signals that there are many other areas for future cooperation. This holds important implications for Sri Lanka and South Asia as promoting trade between Australia and such a major regional power will inevitably have positive spillover economic spillover effects through improving access to resources, increasing traffic on important shipping routes, and increased employment opportunities in the region through outsourcing, offshoring, or input exports.

Southeast Asian partners have significantly improved transparency and reduced non-tariff barriers to trade with Australia, which has built strong relationships and established preferential trading environments. Experts discussed that tariffs are not the most significant hurdle in trade with Australia; tariffs were unilaterally reduced in the 1980s and destroyed the manufacturing sector in the process. Australia's low tariffs across all sectors are not necessarily a major constraint to trade, but the benefit of engaging in regional agreements would materialise through alignment in legislation and regulation. This would reduce non-tariff barriers and improve the efficiency of trade.

Meanwhile, Sri Lanka is less integrated in regional economic agreements. The absence of FTAs and the increased bureaucracy required for bilateral trading relationship while not engaging in regional trade agreements disincentivises trade with Sri Lanka. One expert described the complicated tariff structures that exist in Sri Lanka, which makes it one of the most difficult countries to trade with in Asia.

It was acknowledged that Sri Lanka has expressed interest in joining RCEP, and the consensus was that this would be a great target. Experts also recognised that Australia would have a role in approving Sri Lanka's participation in RCEP and that Australia's support for Sri Lanka as it modernises its trade regime and undergoes industrial transformation will be vital. However, experts also recognised that this is a longer, drawn-out process that is not a short-term solution for declining terms of trade.

Southeast Asia also benefits from some geographical advantages in trade with Australia, particularly Indonesia, due to strong trade links and shipping infrastructure in the region. While Sri Lanka also benefits from a strategic location on major shipping routes, the geographical advantage of Southeast Asia as a midpoint between China and Australia has enabled the growth and development of export sectors in Southeast Asia for trade with Australia. Sri Lanka's strategic location on major shipping routes has failed to unlock the economic potential of its own trade with Australia and Southeast Asia and instead supports trade between Europe and Asia through its ports and infrastructure.

Sri Lanka's export sector mainly 'looks West', with an emphasis on the United States of America, the European Union and the United Kingdom. Examining the apparel sector, Sri Lanka sends over 50% of its apparel exports in these destinations while Australia only receives 2%. Access to concessional trade agreements such as the Generalised Scheme of Preferences' in both the U.S and E.U has maintained Sri Lanka's competitiveness in these

markets and facilitates supply to these regions. However, it was recognised that such concessional access has supported otherwise uncompetitive industries in Sri Lanka and disincentivised innovation.

Data shows that the manufacturing value-added and merchandise exports as a share of GDP have both continuously declined in the last 20 years, owing to the failure of Sri Lanka's manufacturing sector to innovate and improve efficiency. The failure to integrate technology and more advanced methods of manufacturing have left Sri Lanka uncompetitive in global markets. The discussion referenced 'premature deindustrialisation', which captures the essence of Sri Lanka's manufacturing decline; Sri Lanka's manufacturing sector has slowed down before transitioning to a service-led economy, placing increased pressure on the current account, national debt and currency stability. These issues were recognised as domestic challenges and not unique to the Australia-Sri Lanka bilateral relationship but emphasise the impending need for foreign direct investment in Sri Lanka's domestic industries to enable them to compete more effectively in international markets. FDI can bring improved capital, technological advancements and other capacity building efforts to unlock the potential of the export sectors and promote export-oriented economic growth.

b) Investment

While recognising that Australia-Sri Lanka trade is insignificant in the current economic climate, emphasis was placed on the potential for FDI to bolster this relationship through more formal links. Sri Lanka renewed its Trade and Investment Framework Agreement (TIFA) with Australia in 2023, which indicates that there is clear interest in the Sri Lankan market. One expert suggested that a successful trade relationship must be built on the foundations of FDI and enable Australian businesses to invest in Sri Lanka to build trade links. This would involve scaling up existing businesses or injecting capital into Sri Lankan industries to produce goods that are tailored to the Australian market.

One expert outlined that the desire to invest or not invest in Sri Lanka is not reliant on the presence of an FTA, but rather less direct economic metrics. Examples included political stability, consistency and predictability, as most foreign investors have long-term priorities and require an effective net present value on their investment. One critical concern from prospective Australian investors in Sri Lanka is the impact of sudden policy changes, particularly those that emerge because of governmental and ministerial changes. One expert quoted the chemical fertiliser ban in 2021 as a perfect representation of the instability that exists in the Sri Lankan economy, which ultimately deters investors. This has hindered long-term economic growth.

Experts also emphasised other challenges faced by Australian businesses aiming to invest in Sri Lanka. Lack of transparency, weak legislation, and a general lack of clarity in the investment landscape have proved major barriers to entry for foreign investors. Many experts gave anecdotes of foreign investors 'lacking direction' in their approach to Sri Lanka, and many criticised the capacity of the government and other public sector institutions when

facilitating potential FDI. This is not unique to Australian investors and experts recognised the similarities between Australia and other developed countries aiming to engage with Sri Lanka economically. Despite all these challenges, one expert highlighted that Australian investors are still ‘knocking on the door’, which is a testament to the economic potential of Sri Lanka if it can facilitate such investments. This economic potential was also underlined with Sri Lanka’s geographical proximity to India, a market of over 1 billion people that investments in Sri Lanka could capitalise on. This is a very attractive prospect for investors and Sri Lanka should foster collaboration with partners who can expand this trading relationship. This could involve the revival of the India-Sri Lanka FTA or the Economic and Technological Cooperation Agreement (ETCA), the creation of a maritime hub that would support the trade of goods from all corners of the globe into the Indian market, integrating Sri Lanka in global supply chains, and leveraging its strategic location when unlocking trade and investment opportunities.

The discussion also captured the need for renewable energy infrastructure, and how Australia could build capacity in this sector. Successful investment projects included those by United Solar, who have recently secured a significant renewable energy project in the northern provinces. This deal is expected to inject over \$1 billion USD into renewable energy infrastructure and support Sri Lanka’s green transition. Experts recognised Australia’s technical expertise in this area and reiterated their support for Australian renewable energy investment in Sri Lanka. One expert also acknowledged the need for Sri Lanka to adopt sustainable practices in its domestic industries in the presence of the EU’s recent update to the Carbon Border Adjustment Mechanism (CBAM). Sri Lanka must facilitate the green transition in its export sectors to maintain access to the EU market, so the multiplier effect of such investments in renewable energy has significant implications for Sri Lankan exports to the West.

Other sectors were identified as important areas for Australian investment and collaboration in Sri Lanka, such as in the education and IT sectors. However, for this potential to be fulfilled, one expert described the complex regulation that covers foreign ownership and investment in these sectors and how it disincentivises prospective investors. This was particularly potent in discussions with entrepreneurs and start-up enterprises at HatchWorks, a Colombo-based incubator that provides a space for business professionals and entrepreneurs to connect, work, and develop their projects. Australia has demonstrated its support for HatchWorks and the start-up landscape in Sri Lanka and outlined some of the challenges facing small businesses and start-up enterprises, especially given the economic and political turbulence in recent years.

The discussion covered the need for capital mobilisation and more transparent legislation and governance to empower local businesses and attract international investors. Start-up businesses in Sri Lanka have had difficulty communicating with the central government agencies and expressed the need for business and investment to be made ‘more straight forward’ in Sri Lanka, otherwise it creates perverse incentives for small businesses to relocate or ‘offshore’ their activities to more liberal zones and thus relocate the benefits of an

emerging start-up enterprise landscape. One expert identified the Board of Investment (BOI) and Export Development Board (EDB) as public sector institutions that could benefit from Australian support and investment, particularly through capacity building efforts and governance reforms to address structural issues that have spillover effects on Sri Lanka's entrepreneurial landscape.

Copyright and Terms of Use

ISBN 978-955-3503-10-7

© 2024 Lakshman Kadirgamar Institute of International Relations and Strategic Studies (LKI). LKI is not responsible for errors or any consequences arising from the use of information contained herein. The views expressed are not the institutional views of LKI.