Locking-in and locking-out business and economic reconciliation in the conflict-affected region of Sri Lanka

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Abstract
Using economic geography concepts, this paper compares four groups of investors to the conflict-affected region of Sri Lanka and critically analyses the key factors that are "locking-in" and "locking-out" investment, business development and employment creation. It argues that foreign/Diaspora investors were mostly being influenced by political and social factors, and thus far had not invested significantly in the region. Traders from the non-conflict-affected region of the country had benefitted the most due to opportunistic behaviour, their acceptance of the political realities and the short-term economic opportunities that had opened up. Large investors from outside the region, on the other hand, had either been disappointed with the economic situation or had invested due to a sense of social responsibility and long-term business prospects. Local SMEs within the conflict region were hit hard by the opening of the war-affected economy and have been unable to cope with the change. Political, economic, and social factors had all contributed to their unwillingness and inability to expand their businesses. The paper concludes that the climate for investment must be improved significantly by creating a strong "path-creating" environment and "de-locking" investment inhibiting factors. There must be better collaboration amongst different types of businesses, and coordination amongst different stakeholders. If done well, enhanced investment and employment creation could make a significant impact on reconciliation and long-term peace in the country.

1. Introduction

Since the end of the warin Sri Lanka in May 2009, the conflict-affected region of the North and East has undergone enormous economic and social change. Low investment and youth unemployment had been critical factors leading up to the onset of the war and during the conflict. It is essential to understand how the situation has changed since the end of the war and the challenges that remain to generate private sector investment and employment generation. This is especially important because investment and employment generation in the region have the potential to contribute to long-term peace by creating a peace dividend. The "Northern market" opened for traders from the South[1] allowing for more business connections amongst communities, and large companies from the South have also opened up retail outlets to sell their goods. Though some recognised that the potential for business development, investment and job creation in the region is strong, the degree to which this potential has been realised in the last four-five yearsis not yet known due to insufficient research. Past research has primarily focused on the provincial macro-economic situation andthe general livelihood situation of people. Overall, there is a dearth of literature on the key factors that are currently influencing investment and employment creation in the conflict-affected region.

The theoretical foundations for this paper are the concepts of economic geography, which provide key insights into how businesses choose to allocate resources and make investment decisions.Economic geographers have historically stressed the importance of location in business decisions. For example, Sobri and Ossai-Igwe found that location was the

[1]For this research, "South" includes the region outside the North and East, particularly those from Colombo, the capital city.

most important factor in determining the investment and creation of small businesses in Nigeria (2011: 110). Not only does location affect economic decisions, but social, governance and political factors are also affected by location. Indeed, over the last decade, economic geographers have increasingly been encouraged to move into multi-disciplinary studies without a focus on purely economic or cultural issues (Amin and Thrift, 2000 and Rodriguez-Pose, 2001). However, there needs to be more empirical studies using evolutionary and institutional economic geography (Kusar, 2011). One can expect the conflict-affected region of Sri Lanka to benefit from investment and political decision-making in different ways from other regions in the country. Storper (2011) notes that “explaining the growth and change of regions and cities is one of the great challenges for social science” (p333). One key cause of major change is a “shock”, which could come in a number of forms including an opening of an economy, whereby firms may choose to invest and relocate to this new economy to benefit from lower production costs or markets (Storper, 2011:339). The end of war and opening of the economy in the North and East of Sri Lanka can be considered such a “shock”.

This paper partially fills a number of gaps in the current economic geography literature. Importantly, there is a gap in economic geography research on how broader issues of national politics affect regional development (Mackinnon et al, 2009: 138). Adding to the existing literature on economic geography, this research uses fundamental concepts of “lock-in”, “path-dependence” and “path-creation”, and analyses the current investment and employment creation situation of the region of post-conflict Sri Lanka. This study argues that political, economic, social and other factors affectinvestors’ decision-making in the previously conflict-affected region, and acknowledges that private sector investment can make a significant contribution to economic reconciliation in the country through employment generation. Overall, investment can be an important bridge for peace by providing jobs with high social returns, or it could also be the great divider depending on who benefits and who does not. The paper does not discuss employee perceptions of employers, nor factors affecting government’s investment.
This paper is based on interviews in August – September 2013 with key government officials, investors and business leaders in the conflict-affected region of Sri Lanka. Because the study was largely qualitative in nature, a purposive sample of twenty-two respondents were chosen, with those interviewed some of the most relevant people in their respective sectors. They represented those from within the region who wanted to expand their businesses, those from the rest of the country who saw a new market and wanted to quickly benefit from early-mover advantages, those large investors from the South who have been looking at investment from a long-term perspective, and investors from outside the country with past ties to the region.

The interviewees included Presidents of four district chambers representing local businesses from the North and East, two senior bank managers from the North, and nine large businesses from the South which had invested in the North and East, two senior Tamil government officials whose responsibilities involve trying to improve the investment climate in the North and East, and two other non-governmental institutions facilitating investment in the country. Three informal discussions were also held with three people from the Tamil Diaspora who visited Jaffna from UK, Canada and Australia at the time the interviews took place. All interviews were held independently and confidentially. Thus, names of the individuals as well as institutions are not disclosed in this paper.

The paper is structured as follows. After a brief overview of the economic situation in the conflict-affected region, the paper provides a theoretical overview of the literature on economic geography and how businesses take decisions on where to invest. This is followed by an overview of the key findings and, thereafter, detailed discussion on each of the four groups of businesses.

2. Background

The three-decade war created a business and employment vacuum in every sector in the North and East. The vacuum started to fill immediately after the end of the war with many entrepreneurs seeing opportunities to start or expand their businesses. Indeed, since the end of the war, the Government of Sri Lanka has been trying to attract private investment not only into the North and East, but also to the country as a whole, from local as well as foreign investors, with mixed results. Since the end of the war, and particularly since the completion of the A9 road, the main land route connecting the North to the South, there has been a large increase in inter-regional trade. However, as can be seen in Table 1 below, latest statistics from the Central Bank of Sri Lanka indicate that the Northern Province makes the lowest contribution in all the sectors except Government Services. Notably, its contribution in manufacturing is non-existent. It is important to note that compared to other provinces, there has been very little investment by the private sector into the conflict-affected Northern and Eastern Provinces.

Table 1: Percentage Contribution by Each Province to Different Sectors of the Economy, 2011

Sector	Sub-sector	W	C	S	N	E	NW	NC	Uv	Sa	Total
Agriculture	Agriculture, Livestock, Forestry	9	16	12	4	8	13	12	13	12	100
	Fisheries	23	0	25	7	23	15	4	1	1	100
Industry	Mining and Quarrying	35	7	26	7	7	4	5	3	6	100
	Manufacturing	57	7	8	0	4	12	3	3	6	100
	Electricity, Gas and Water	34	44	5	1	3	4	2	2	6	100
	Construction	37	6	23	4	13	6	5	4	2	100
Services	Wholesale and Retail	55	8	10	1	3	10	3	3	6	100
	Hotels and Restaurants	41	18	28	2	2	5	4	0	0	100
	Transport and Communication	40	12	10	3	5	11	6	5	9	100
	Banking, Ins. and Real Estate	76	5	4	1	3	4	3	2	2	100
	Ownership of Dwellings	51	11	10	2	4	8	4	4	6	100
	Government Services	25	12	9	16	12	8	6	5	6	100
	Private Services	50	7	10	5	7	10	4	4	6	100

Source: Economic and Social Statistics of Sri Lanka; Central Bank, 2013; Key: W: Western, C: Central, S: Southern, N: Northern, E: Eastern, NW: North Western, NC: North Central, U; Uva, S: Sabaragamuwa

3. Economic Geography and Decision-Making of Investors

Economic geography as a discipline is of significant value in the study of regional development as it identifies the location as a key factor in determining the economic decisions of individuals and businesses (Storper, 2011:341). In many countries, it is often seen that regions do not benefit equally from investment, national level growth and some regions always lag behind others. Economic geography theory provides key insights into why regional inequalities occur and therefore informs the study about the kinds of economic issues that affect investment and improvement of the employment situation in a region. Krugman (1998) argues the forces thattend to promote geographical concentration of businesses (centripetal forces) such as large market size and labour markets, work against the forces that seek to spread it (centrifugal forces) such as immobile factors and high land rents. So large regional disparities, such as between Sri Lanka's conflict-affected region and other reference regions thatare better off, could worsen depending on which forces are dominant. Though one could expect centripetal forces to dominate, it is possible that over time investors and entrepreneurs may feel that it may be more profitable for them to move to the lagging regions. This could be done through small advantages given to create "lock-in" effects that become self-generating. There could also be factors that continue to "lock-out" investment. Though acknowledging the fact that it is essential to understand regional differences on investment and employment creation, this study, however, does not do a comparison of regions within Sri Lanka. Its focus is on the "lock-in" and "lock-out" factors affecting investment and business creation in the conflict-affected region.

There are three sub-disciplines of economic geography that are in vogue currently: new economic geography, evolutionary economic geography and institutional economic geography. Whilst the new economic geography has provided insights on regional development primarily through the application to economic models, a fundamental weakness from the perspective of this research is its emphasis on ergodicity, which is an assumption that institutional structures are stable over time (Mackinnon et al, 2009: 132). This assumption cannot be accepted for this research because the conflict in Sri Lanka has without doubt created institutional decay, particularly in the North and East, and there has also been institutional change after the end of the war. Moreover, its assumption that actors are utility-maximising individuals without regard given to the "real world" context reduces the value for this research. The concept of "time" is also important because of the historical nature of the conflict and the post-conflict environment, but new economic geography generally ignores the value of "history" in decision-making (Bochma and Frenken, 2006: 280)

An acceptance of changing economic and political structures is important especially from the context of how Sri Lanka has been affected by the conflict and how the country tries to sustain peace. Therefore, evolutionary economic geography and institutional economic geography, which put to the forefront institutions, path dependence and "lock-in" effects (Mackinnon et al, 2009: 133) are more valuable for this research. Path dependence theory generally looks at the changes over time of industries and how trajectories of change may persist as the "path" become reinforcing. Theorists argue that changes to the path that firms take are generally through innovation (Martin and Simmie, 2008: 184). But given the evolutionary background with which the theory has at its roots, processes are generally irreversible and go through different stages: pre-formation, path creation, path lock-in after and path dissolution (Martin and Simmie, 2008: 186). New paths are created based on a new context created, notably through a "shock". Thus path dependence and path creation are different stages of a long-term process. Martin purports through his model that regional development is either on a lock-in path or one of continuing evolution, but Drahokoupil further expands this argument and suggests that the two could in fact happen simultaneously in a "punctuated co-evolution" (Drahokoupil, 2012:168). Thus, during a period of rapid change such as when the war ended in the North and East of Sri Lanka, incremental changes that were occurring until then are then followed by a period of intense change that can create lock-in.

This evolutionary process does not take place without the influence of institutions, which are formal and informal social and political "rules" in society (Essletzbichler and Rigby, 2007; Nelson, 2002; Pelikan, 2003). Thus, one can easily surmise that social and political factors affect the decision-making of investors and businesses in new development regions. Institutions are "containers of socio-economic organisation" (Amin, 2001: 1237), which influence and become embedded in regions at different levels (Essletzbichler and Rigby, 2007: 557). Hodgson argues that institutions are "both objective structures 'out there' and subjective springs of human agency" (Hodgson, 2006: p6). Pike et al (2009) contend that evolutionary approaches to the study of regions can benefit greatly from a "thorough going connection with the interactive and holistic capability of geographical political economy to connect economic, social, cultural, ecological and political concerns" (p179).

Given that the focus of this paper is the conflict-affected region of Sri Lanka, it must be noted that for the purposes of this paper, a region is not one that is based simply on administrative boundaries. In economic terms it can be defined simply as "a unit where economic activity takes place" (Behrens and Thisse, 2007:460), as long as economic distinctions can be made amongst regions. Beyond the purely economic definition, Mackinnon et al (2009), quoting Paasi (1991) and Storper (1997) also suggest that it can further be considered as one that is "constructed and reproduced through a range of socio-spatial relations, connections, practices and discourses" (p129). Thus the conflict-affected area of the country can be taken as a region of study from multiple perspectives. It should also be noted, however, that this region could easily also be separated into other regions within it, such as the North and the East, or coastal region and inland region. Regions are never separated from each other and there is always spatial interaction amongst regions based on a number of factors such as trade or goods and investments (Behrens and Thisse, 2007: 460). Thus, the conflict-affected region interacts with the "South" as well as the external economy in distinct ways.

Whilst many economic geographers study the interaction of firms within a region, this paper focuses specifically on the factors that are influencing the investment decisions in the conflict-affected region. As it has been only four years since the end of the war, the "shock" to the regional economy through its "opening for business" needs to be understood first in terms of the nature of the change taking place. The region is in essence going through a new path-creating process that would lead to lock-in of different paths and investments. Therefore, this paper provides insights on the key factors influencing investor decisions that will contribute to the economic path creation in the region. Path dependence is place dependent (Martin and Sunley, 2006) and vice versa. As a follow up to this study, it would be important to also understand the interactions amongst these investors in greater detail. This paper therefore makes a preliminary contribution to future studies on the regional economy of the conflict-affected region from an economic geography perspective.

4. Key Findings

4.1 Summary

The region is going through multiple path creating changes through business investment, with different groups of businesses acting and being influenced in different ways. The research identified a number of factors that are creating "lock-in" and "lock-out" effects for investors. Table 4below highlights the twentykey factors mentioned as affecting increased investment to the conflict-affected region by foreign investors, Southern traders, large Southern investors and local SMEs. Some of the factors have become essential "lock-in" (I) factors for increased investment, whereas others are thus far significant "lock-out" (O) factors that are preventing businesses from investing in the region. Some of the factors (coloured in grey) were felt to be irrelevant depending on the investors. The end of violence was seen as the only important factor recognised by all groups as helping to bring in investment to the conflict-affected region. All other factors varied significantly. Political factors (P) affected the foreign investors and local SMEs the most, and it was mainly to lock-out further investment. Interestingly, political factors had no effect on Southern traders and large Southern investors. They were mostly influenced by economic factors (E), predominantly the degree of improvement of government infrastructure. The importance of social factors (S) varied across all groups. Interestingly, law and order, presence of regulatory processes, and presence of legal institutions were not mentioned as important factors for investment in this region, though one could not entirely discount their importance. Indeed, the presence of legal rules (L) for doing business was considered important for foreign and large Southern investors. One geographic factor (G) was included.Detailed analyses of the findings are given in the sections that follow Table 2.

Table 2: Key Determinants "locking in" and "locking out" Investment

No.	Type of Factor	Key Factors	Foreign Investors	Southern Traders	Large Southern Investors	Local SMEs
1	P	End of Violence	I	I	I	I
2	P	Political Stability	O	I	I	O
3	P	Lack of Political Devolution	O			O
4	P	Anti-government sentiment	O			O
5	P	Presence of the Army	O			O
6	E	Cost of starting/expanding Business			O	O
7	E	Government Infrastructure	O	I	I	
8	E	Government Incentives			O	
9	E	Access to Finance		I	I	O
10	E	Markets for Short term profits		I		I
11	E	Resources for Long term profits			I	
12	E	Attitudes of workers	O		O	O
13	E	Quality of Skills Available	O		O	
14	E	Third Party Business Facilitation		I	I	I
15	L	Legal rules			I	
16	S	Sense of Responsibility			I	
17	S	New Business Culture of Region	O			O
18	S	Language of region (Tamil)	O / I			I
19	S	Entrepreneurial Ambition	O	I	I	O
20	G	Regional Isolation	O		O	

Key: P– Political, E– Economic, L– Legal, S– Social, G– Geographic, I– Lock-in factor, O– Lock-out factor

4.2 Diaspora Investors – Waiting for Change

Of the four groups, foreign investors, particularly from the Diaspora had been the least attracted by opportunities available in the previous conflict-affected region.One would have expected the Tamil Diaspora, with a close affinity to the region to come into the region in a large way after the end of the war, but this was not the case. Many were indifferent to the economic and employment issues facing the region. Those interested in the region had primarily been those who had a political interest in setting the "governance" agenda at the forefront instead of looking at the economic development of the region and ways of improving the employment situation. Government officials in the North and East complained that large sections of the Diaspora saw devolution of power, and in the extreme case, separatism, as the biggest priority for the region. Significant amounts of funds were being used to promote political change and lobbying the international community against the government, but only a fraction of that was coming into the country as investment. Despite the end of the war, the region was far from being perceived as politically stable. Secondly, Tamil government officials in the region felt that another reason why the Diaspora wasnot interested in investing was because they felt that increased investment would have a positive impact on the image of the government. Indeed, some local business leaders and politicians had purposely asked Diaspora investors who were interested in investing to wait until there was a better political climate, including greater devolution of power. The discussions with officials in the North concluded that there appeared to be insufficient recognition of the economic discomfort faced by the people who were unable to leave the region for the past thirty years. A large number of Tamils in the Diaspora sent remittances to relatives in the region, but funds were mainly sent for "consumption" rather than "investment" and even this had started to decrease with the difficult times faced by those in Western countries. Currently, though there was affinity with the region, few appear to have plans or hopes of returning to live in the region and contribute directly to its economic development.

There were Diaspora investors who had an interest in investing and contributing to economic development. However, some officials in the region expressed their disappointment that many of those in the Diaspora who had an interest and come to see what opportunities were available had not found any "safe" investments other than purchasing land. Though many had recognised the improvement in infrastructure, it was still insufficient for any serious large investor. Also, given their lack of knowledge about the business situation on the ground in the North and East and the way things work there, the risks were too high. To reduce this risk, investments that do come from outside the country would have to have some sort of partnership with businessmen in the region. Interestingly the knowledge of Tamil itself was not a strong reason to invest in the region, though knowledge of the language had helped them talk to local businessmen. There was still a clear cultural mismatch between local businessmen and those exposed to the more formal means of doing business in Western countries. For the Diaspora investors, there was a need for legal rules as they may have been used to in their countries of residence and the potential local partners were not used to that. Many investors who had come into the region to invest had not met "like-minded people" or gained the trust of the local population, as the ways of working are different. Some Diaspora investors perceived that local partners appeared "desperate" for partnerships, and had asked these potential local partners for guarantees on investment and strong management skills before funds are disbursed, but often potential local partners had little more to offer than an interest in partnering. They werealso waiting for a change in attitudes and work-practices, but that may not come in the short term.

The only sector that had seen some investment from the Diaspora had been the tourism sector, partly because small hotels employed very few people and could be managed with one or two skilled people to ensure smooth operations. Investors had found that the quality of labour in the region was low, both in terms of attitudes and skills. Many hotels had management staff from outside the region. Houses owned by those living abroad had been expanded and converted into small hotels and rooms were being rented out mainly to tourists from within the country. Overall, the Diaspora's contribution to improving the economic development and youth employment situation in the region had been very low compared to its potential.

4.3 Early Entrant Southern Traders – In Search of Quick Profits

So far most of the businesses that had come to the conflict-affected region from the South were those that had wanted quick returns rather than long-term business relationships. As soon as the war ended, many businesses from the South, especially traders from Colombo, opened up branches for their goods in all districts of the North and East, and large profits were made as the closed economy opened up. A significant boost to trading took place when the main arterial land route to the North, the A9 road, opened and goods were able to move quickly and freely. Indeed, there have not been any factors thatcould be considered as "lock-out" factors. Southern traders had either seen all political, economic and social factors as being positive or been indifferent to them. This was mainly because their views had been on short-term gains. Risks were largely borne by facilitators such as banks, consumers or third-party middlemen. Importantly, their actions have had a negative impact on the perception of Southern businesses by the local businesses in the North and East, with many believing that Southern businesses had been more exploitative and over-competitive than they should have been.The group was indifferent to the political challenges facing the region and to a large extent saw the region as simply "a market" to be tapped. The political stability that had been generated by the end of the war had been sufficient, and they had used their entrepreneurial ambition and creativity to find gaps in the market.

In the last couple of years, the group was doing well in the region, albeit with lower profits than in the first two years after the end of the war. Those that faced saturated markets in the South and those that had managed with low fixed costs had been particularly successful. Consumer goods that were previously not available such as electronic goods were now common in all middle-class homes. Traders of all types of goods set up retail outlets or provided opportunities for people to purchase items without outright payments. Indeed, with much stronger marketing skills, better products and stronger networks of retail outlets compared to the existing local businesses, Southern businesses have optimised market opportunities. When possible, they had bypassed local middlemen and also given post-dated checks to retail outlets maximising on profits.

Complementing the increased trade from the South, many financial organisations including banks and leasing companieshad set up branches in the North and East. These institutions have helped to provide access to finance and facilitate a greater influx of traders. Banks recognised early on that due to large remittances coming from relatives abroad, many middle-class families had the capacity to deposit large sums of money, which in fact has been the case. Encouraged by leasing companies and credit/finance arrangements to pay for goods over many months, there had been increased sales despite the fact that in many cases people have purchased goods that they could not afford over the long term.

Whilst large profits were made by these companies early on, times have now started to change. As one senior banker stated, "After the war, banks thought that there would be a boom in the economy, but that has not been the case. Banks have given loans without much responsibility. The problem is that this generation of businessmen has not seen a proper banking system and not been disciplined. Nobody is there to guide them. Banks should have been more careful after understanding the ground level situation." This clearly shows that even institutions that were generally risk averse assumed that money could be lent and self-employment initiatives would be undertaken with prudence. Whilst banks had wanted to be seen as doing something for the conflict-affected region, they have now sacrificed their reputation and credibility amongst the beneficiaries who blame them for giving them loans.

4.4 Strategic Large Southern Investors – Focus on Infrastructure, Incentives and Tapping the Labour Pool

Like the Southern traders, large local investors from the rest of the country had, to a large degree, been satisfied with the general political climate and the lack of devolution was not of significance to them. The improvement in infrastructure, particularly the road network was mentioned as being an important incentive for investors to come into the region. These large investors had also benefitted from lucrative loans from banks due to their reputation. The government officials had a close hand in facilitating the approval of legal procedures, and as one investor said, "it was only a matter of time" when they would be given approvals, rather than if they would be given them.

Nevertheless, whilst they saw a number of positive factors enabling them to decide to invest, there were also a number factors keeping investment out. Many large businesses from the South that were interested in a long-term investment, like some foreign investors, appeared to be waiting for the optimal time to invest as the region developed more and perhaps government incentives were given. Indeed, industrialists, except for a selected few, had hardly been visible.

On the whole, the government was providing the same general package of incentives to potential investors to the North and East as they did for those in the rest of the country. Notably, five large garment investors from the South had been given leased land at concessionary rates in the North, but the infrastructure around those areas were currently far from optimal and many were yet to receive suitable access roads and in some cases water supply. It was clear from discussions with these investors that one of the main reasons these companies had set up factories there was mainly because of “social responsibility” rather than business profit. Indeed, profit margins were and will probably continue to be low compared to their other plants in the rest of the country for all these businesses, but given the long-term nature of their investments that appears not to be a priority. These investors, encouraged by the government, felt that they needed to play their part in improving the economic wellbeing of those in the region. Government officials mentioned that the companies were also keen to choose regions that were poorer because they needed a lower skilled work force that could be trained. It was believed that higher skilled and educated persons may not stay and may have higher expectations about jobs. Indeed, there was a perception that youth from Jaffna and Vavuniya (the two largest towns in the North) were not interested in working hard because of remittances from relatives abroad and their emphasis was on higher education as opposed to achievement in employment as a key measure of success.

The lack of good facilities at the Trincomalee harbour was the main reason for several large Southern investors who visited the East to be discouraged. The second important constraint was the lack of land to set up large investments.The third big constraint was the lack of suitable skilled employees. Many large investors felt that all skilled staff would have to be brought in from outside the region to take on positions if an investment was made. Some garment factories had been attracted to the region particularly because of the low skilled labour.Like in the case of the Diaspora investors, the sector that had fared very well in terms of investment had been the tourism sector, but at a larger scale.However, youth attitudes about work and tourism had made it difficult to employ suitable people. Whilst this was changing slowly since the sector was well established in the region now, much more needed to be done on changing youth attitudes, especially by helping to create hope.

Whilst the government has made a significant contribution to improve the large infrastructure, more effort was required to understand the needs of these large businesses. However, other than infrastructure investments by the government, the North and East hadalso benefitted from other support from external donors to facilitate improved investment and job creation for youth. Thus far, a bilateral development agency through one of theirprograms has invested Rs.57 billion in 21 companies and generated 2,200 direct jobs and 2,350 indirect jobs for youth. It sought a good balance between Sinhala, Tamil and Muslim enterprises and catalysed Rs.111 billion in investment from the 21 companies. The need for this kind of facilitation appears to be essential to bring in new large Southern investors, but at the same time it was also essential to ensure that new investments from outside did not destroy existing local businesses. If not for this facilitation, some businesses felt that it was difficult to expect established medium size businesses to invest in production from the North. As one investor said speaking of another facilitation agency, “We would not have made investments in the north if not for a facilitator”. Another said, “We needed someone to control the suppliers so that our supply would be regular. In the beginning, it was very difficult, but now things are smooth.” Despite these efforts, this kind of facilitation was only available for a selected few investors. If the region was to benefit more from investment, more politically independent facilitators are needed.

4.5 Local Businesses –Continued traditions and uncertainty, and unexpected indebtedness

For the local businesses, with the end of the war and opening up of the economy, profits have declined despite expectations that there would be an improvement. Despite many being pleased with the end of the war, the political change they had expected had not come through, but with the influx of traders from the South, the economic change had been significant. The local businesses had remained traditional, unwilling to change with the increased competition from the South. Perceiving that improved incomes and business was an entitlement due to them after the end of the war, local business had remained rooted in the old ways of doing business. Overall, these businesses had been largely unable to cope with the change.

Those in Jaffna, the biggest town in the North, hadbeen very politically conscious throughout the conflict and seen many periods of loss and gain. The businesses thatprofited most before the end of the war were those that had strong political connections to politicians from the North. Prices were generally set and businesses had the power to decide on the supply of the products, and consumers had hardly any choices. Importantly, as local businesses functioned without much competition for many years, there had hardly been any sort of business strategies used to improve their businesses. As a group, they believe that the political situation was a strong prerequisite for improved business and it was essential for a reduction in army presence in the region. Their inability to access finance at concessionary rates to expand businesses and good skilled workers had made them very uncompetitive. They also lacked entrepreneurial skills and attitudes, perhaps partly because of the closed economy in which they operated for many years.

It must be noted that the three-decade war had not consistently been a period of war, and it was difficult for local businesses to forget that they hadexperienced temporary periods of peace that have later resulted in resumption of conflict. When the war started in 1983, the period in 1987 when the Indian Peace Keeping Force came into the North, and later when the Jaffna peninsula was taken over by the army in 1990 brought in economic instability. Moreover, in 1995 the land route to the rest of the country was cut and businesses had to manage in an increasing localised market. The ceasefire in 2002-2003 significantly improved business profits and brought high expectations that there would be long-term peace, but again this was not to be when the LTTE broke the ceasefire and restarted the war. Even now, despite the end of the war and the first democratically elected provincial council in place, the continued heavy army presence is a reminder that the region is still coming out of the horrors of war.

Due to the war, there had been a large exodus of local business people, and those who remainedwere largely the vulnerable and the less skilled. A large cross-section of those with entrepreneurshipskills, money and influence had left the region. They had settled in Colombo or abroad and sought a better life. With a continuous cycle of departures, the best skilled in the region continued to move out. Those who remained were traditional in their outlook and uncomfortable with change. Because of the lack of novel technology and business acumen from outside, they had fared very badly in the “open market” that had previously been closed and protected them from outside competitors.There was a perception by the local community that Southern business facilitators such as banks were not helping those in the North.Indeed, the few that were benefiting from business facilitation including seed capital and market linkages were doing a lot better than others.

Overall, with their success in the closed market, optimism that business would further expand had been met with failure in many cases. Few had succeeded in competing with Southern businessmen and been able to use the loans successfully. Many local partners to Southern traders had been taken advantage of with local businesses having to bear most of the risks of failure. For example, local retail outlets facing low sales have been told to take on more stock by distributors, putting the burden of sales squarely on the shoulders of local businesses rather than Southern distributors. Large amounts of stock were left unsold in many retail outlets. Local businesses, eager for more sales did not realise the danger of increased stocks with lower sales and the difficulties they would face. There had been hardly any respectable business people to act as role models for new entrepreneurs from the region. The only role models are those "successful" relatives abroad. Within the group, there were very few relatives who could be considered as successful businessmen, who could come back and become role models for the young entrepreneurs. It is essential that businesses of the youth in the region succeed so that the region can evolve beyond the "dependency mentality".

5. Conclusion

Overall, the investment, business development and employment creation environment in the previously conflict-affected region has been far below what was probably expected at the time of the war. The investment trajectory created by the "shock" of the end of the war has been largely sub-optimal, and the "path creation" continues to be in dynamic flux. It is clear that the path dependency of the effects of the war continue to hold back Tamil businesses from both the region as well as from the Diaspora.Whilst all investors are pleased that the war is over, there are clearly a large number of factors that are preventing greater investment in the region.

The growth of the region and its ability to create a strong environment to provide a peace dividend to the people of the region as well as profits to businesses requires de-locking many of the inhibiting factors specific to each of the groups. Some factors may take several years, if not decades for them to change, but the seeds of this change must be sown early to ensure a positive trajectory. Moreover, businesses as well as the government will be required to change their approach to ensure that they contribute better to the development of the region.

Political factors, particularly the need for greater devolution of power and a reduction of army presence were felt to be important by the Diaspora investors and the local SMEs in the region. Three of the most important economic factors were access to finance, availability of skilled workers and presence of business facilitators. If these factors could be improved greater investment will come into the region, particularly from large local investors from the South. There were a number of social and cultural factors that were reducing the improvement of investment. This was particularly the case of local SMEs, which had seen their highly protected business practices becoming uncompetitive in the current business climate. Their inability to change with the times had been a particularly large drawback.De-locking the political factors to allow greater investment will require the political leadership amongst all major political parties, particularly the government and the main opposition Tamil party, the Tamil National Alliance, to find an amicable and long-lasting solution to the long-standing ethnic issue. The ability of these parties to create confidence will have long-lasting effect of foreign direct investment and local business confidence.

In the current context, all businesses, investors and institutions appear to be working in isolation and the economic situation is not looked at holistically. Indeed, when one looks at the key economic factors that need to be de-locked, it is clear that there needs to be strong coordination and responsibility by businesses of all types in its investment agenda to meet the economic needs of the region, especially in relation to youth employment. Stronger coordination will require better communication, better research on the ground situation, and time and collective action by multiple stakeholders. The private sector representatives from different groups need to work hand in hand with business facilitators and government officials to ensure success. The government could do more to provide the incentives that could encourage businesses to invest in the conflict-affected region. At the moment, the path forward has not been locked-in, but as this study indicates the factors that will contribute to the future growth is known. But, the path to be created is one where investment helps to sustain peace in Sri Lanka.

Given its relevance to long-term peace and stability in the country, and its impact on employment in the region, more research is required on private investment in the North and East of the country. It would be particularly useful to undertake a quantitative survey to compare the lock-in and lock-out factors given in this paper, and understand the weightage of each factor. The literature on economic geography would also benefit from further research on the interaction of these groups of investors, and how the location specific issues are affecting their interaction.

6. References

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