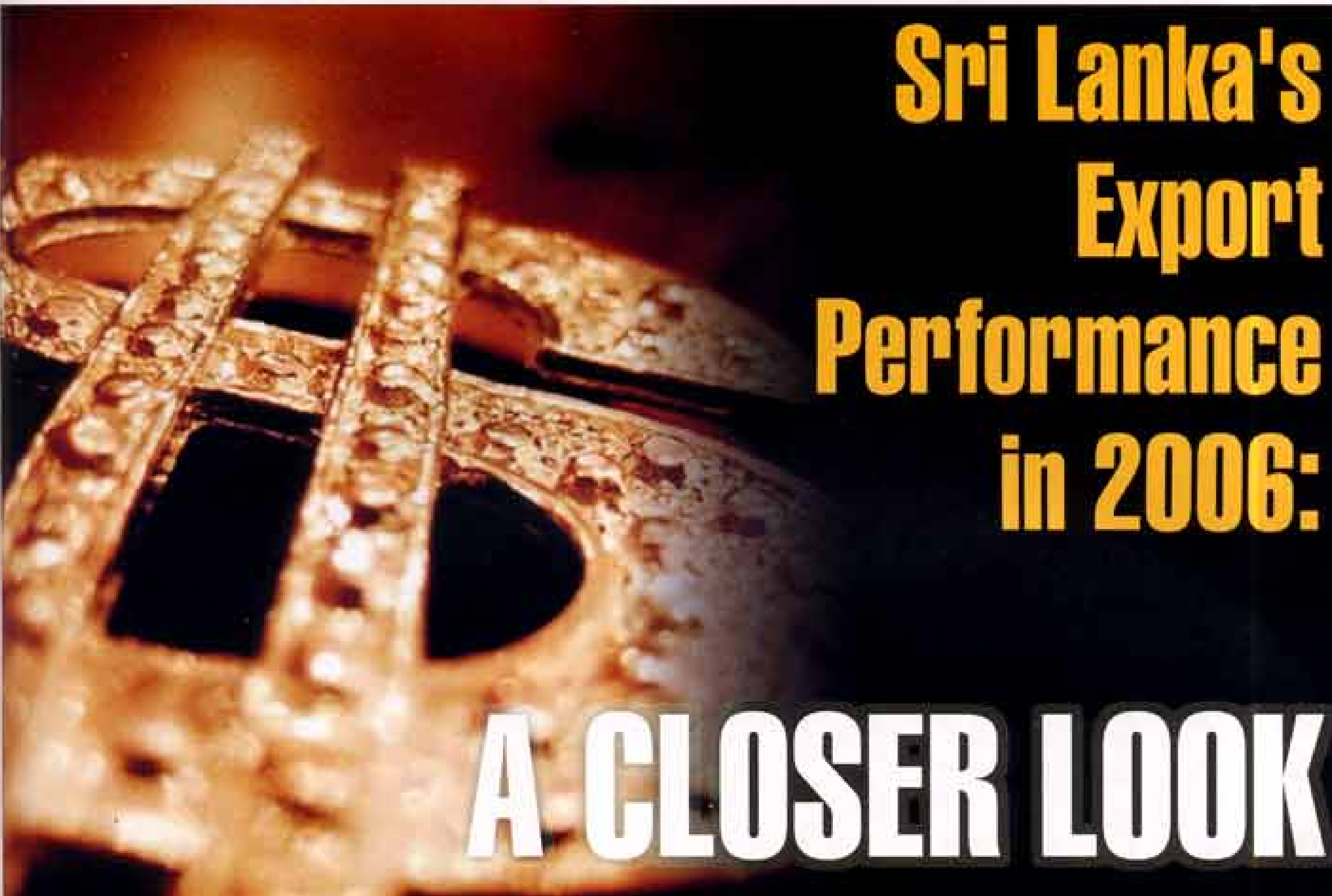
Sri Lanka's Export Performance in 2006:

A CLOSER LOOK



Saman Kelegama
(Executive Director, Institute of Policy Studies of Sri Lanka)

Sri Lanka recorded a GDP of US $ 28 billion (bn.) in 2006. Sri Lanka's exports in 2006 amounted to US $ 6.8 bn. amounting to 24 per cent of GDP. Earnings from exports were much larger than foreign exchange inflows from other sources such as foreign remittances US $ 2.3 bn. (8.3 per cent of GDP), foreign aid US $ 1.2 bn. (4.3 per cent of GDP), foreign direct investment (FDI) US $ 604 million (mn.) (2.2 per cent of GDP), and tourism US $ 410 mn. (1.5 per cent of GDP). (Note all figures are gross values).

The US $ 6.8 bn. export earnings came from US $ 5.3 bn. exports from industries, US $ 1.3 bn. exports from the agriculture sector (excluding fishing) and the residue from others, such as services exports. Industrial exports accounted for 77.2 per cent of overall exports and agriculture exports amounted to 18.6 per cent of overall exports. Three decades ago in 1977, industrial exports amounted only to 14 per cent, while agriculture exports amounted to 79 per cent of overall exports. Clearly, the structure of exports has undergone a complete transformation over the last three decades with the industrial sector playing a key role.

When exports statistics are analyzed at a disaggregated level it is seen that four items played a prominent role in the industrial exports with the textile and garment sector taking the lead. This sector contributed to US $ 3.07 bn. (for the first time, these exports exceeded US $ 3 bn. in 2006) and it was followed by rubber products -- US $ 0.45 bn., gems/diamond/jewellery US $ 0.44 bn., and food and beverages US $ 0.21 bn. In the overall export composition, textile and garment exports amounted to 44.6 per cent, rubber products 6.5 per cent, gems/diamond/jewellery 6.4 per cent, and food and beverages 3 per cent.

Three items played a prominent role in the agricultural exports, viz., tea exports US $ 0.9 bn. (12.8 per cent of overall exports), coconut US $ 0.12 bn. (1.7 per cent of overall exports), and rubber exports US $ 0.09 bn. (1.3 per cent of overall exports). If spices and other agricultural exports are bundled together, their contribution was US $ 0.19 bn. (2.8 per cent of overall exports) and higher than that of rubber exports and also of coconut exports.

The disaggregated data show that the bulk of the export earnings came from a few products although Sri Lanka exported 3,601 products in 2006. It could be said that the export sector, although it has undergone a complete transformation over the last three decades towards industrial products, the diversification has been slow. But as Table 1 shows individual exports have higher ranking than other foreign exchange earners to the country. The earnings from the textile and garment exports surpass all other sources of foreign exchange earnings while the tea exports bring more foreign exchange than FDI and tourism. In 2006, individual export sectors such as rubber products and gems/diamond/jewelley brought in more foreign exchange earnings than the tourism sector. Needless to say, the net foreign exchange earnings will be different given the import dependent nature of some sectors such as textile and garments, tourism, etc. A comparison in terms of net earnings is prevented by data constraints.

Table 1: Eight Largest Foreign Exchange Inflow Sources to Sri Lanka: 2006

Foreign Exchange Earner	Amount US $ Million (% of GDP)
Textiles and Garment Exports	3071 (11 %)
Foreign Remittances	2330 (8.3 %)
Foreign Aid (includes commercial loans)	1200 (4.3 %)
Tea Exports	882 (3.2 %)
FDI	605 (2.2 %)
Rubber Products Exports	448 (1.6 %)
Gems/Diamond/Jewellery Exports	446 (1.6 %)
Tourism	410 (1.5 %)

Source: Estimated from Central Bank and EDB data.

The largest export market for Sri Lanka was USA (amounting to US $ 2 bn., and 29.1 per cent of overall market share). US was followed by UK (amounting to US $ 0.88 bn. and 12.8 per cent of overall market share), India (amounting to US $ 0.49 bn., and 7.1 per cent of overall market share), Belgium (amounting to US $ 0.34 bn., and 4.9 per cent of overall market share), and Germany (amounting to US $ 0.33 bn., and 4.8 per cent of overall market share). The first five major markets accounted for 58.7 per cent of exports. However for individual products, specific markets are important, for example, for tea exports the Russian Federation and UAE are the key markets, likewise for natural rubber Pakistan and Germany are the key markets, for vegetables, Maldives and UAE are the key markets, and so on.

Sri Lanka is a small player in the global export market. Its export performance is not comparable, for instance, with the newly industrialized countries in Asia. Sri Lanka's exports in 2006 amounted to 0.06 per cent of global exports and in per capita terms they amounted to US $ 347. In contrast, for example, South Korea's exports in 2006 amounted to 2.9 per cent global exports and Malaysia's exports amounted to 1.4 per cent of global exports and in per capita terms they amounted to US $ 6,636 and US $ 6,473, respectively. Even though this is the case, exports are a major contributor to the Sri Lankan economy.

Exports grew at 8.5 per cent in 2006 compared to 10.2 per cent in 2005, 12.2 per cent in 2004 and 9.2 per cent in 2003. Exports growth has always been above GDP growth rate and has been a major contributor for maintaining GDP growth levels above 5 per cent in the recent past. The 8.5 per cent growth was achieved by the export sector despite major challenges in 2006. In short, they could be mentioned as follows: (a) uncertainty and delays due to the deteriorating security situation in the country, (b) major strike in the Colombo Port (July) and the Plantation sector (November/December), (c) Clamp on Vanaspathi and Copper exports and imposing restrictions on pepper exports to India under the India-Sri Lanka Bilateral FTA after June 2006 due to concerns in the Indian market, (c) VAT reimbursement by the government being delayed and thus impacting on the cash flow management in export firms, and (d) macroeconomic management related issues.

These macroeconomic issues are basically escalation of interest rates, escalation of fuel prices and electricity tariffs, various taxes/cess imposed from time to time, etc. For example, according to the World Bank survey on Sri Lanka's investment climate (2004), the share of ready-made garment firms owning and sharing a power generator amounted to 76 per cent (compared to 27 per cent in China). It is in fact the more costly and less reliable power supply that ties a firm's scarce capital in expensive power generators. All these have contributed to the increase in cost of production to the exporters. Whether the depreciation of the exchange rate was adequate to offset the increase in cost of production, only a detailed calculation will reveal.

The World Bank has come out with an index called "Ease of Doing Business" and according to its 2007 report (www.doingbusiness.org), Sri Lanka ranks 89 among 175 countries, far below some of its competitors/comparable nations like Mauritius (32), Malaysia (25), Thailand (18), Korea (23) and Jamaica (50). Surprisingly, in the neigbourhood, Pakistan (74) and Bangladesh (88) are ahead of Sri Lanka in terms of ease of doing business. Clearly, there is much room for improvement in the overall business environment.

In addition to these domestic problems, exporters are facing major challenges in the external markets, such as non-tariff barriers (health standards, safety standards, etc.). Due to a drought in Kenya, Sri Lanka regained its traditional position as the largest tea exporter in the world in 2006 but the first quarter data for 2007 indicate that once again Kenya has overtaken Sri Lanka. The GSP-plus scheme and the China Specific Safeguards till 2008 for textile and garment exports have given some room for the Sri Lankan apparel sector to maintain its growth momentum but the situation is becoming tighter by the day due to increased competition in the global market.

Despite tight conditions from the domestic and external markets, the fact that the export sector showed an 8.5 per cent growth performance was remarkable and praiseworthy. There were 4530 export firms operating in 2006 contributing to this success. Had these adverse conditions not been there or were much less in number, the export growth performance would have certainly been in double digit figures.

The world economic outlook for 2007 is not significantly different to that of 2006 although slightly less positive than 2006. The world economy is predicted to grow at 4.9 per cent in 2007 compared to 5.1 per cent in 2006 with the advanced economies (USA, EU, and Japan) estimated to grow at 2.7 per cent in 2007 compared to 3.1 per cent in

2006 and developing Asia (includes China and India) expected to grow at 8.6 per cent in 2007 compared to 8.7 per cent in 2006. Sri Lankan exporters have gone through turbulent times during 1988/89 and have come out of adverse situations with dynamism and vigour. The confidence that the Sri Lankan exporters have gained through surviving such turbulent times should give enough strength to the exporters to weather through a rough period in the coming months. This is evident from the first quarter export growth of 2007, which amounted to 13 per cent.

The National Chamber of Exporters of Sri Lanka (NCE) while recognizing and rewarding the best exporters of the country, has played a key role in making representations to the government on various barriers that exporters face and the need for effective policy action to remove them. This practice should continue with more vigour in the coming years. If the existing impediments to exporters are removed and a better macroeconomic environment comes into being, achieving the US $ 10 bn target for overall exports by 2010 will not be difficult. Textile and garments can target US 4.5 bn. (the initial target that the Joint Apparel Association Forum [JAAF] set for 2007), tea can target US $ 1 bn. and the growing IT exports that is currently performing at US $ 100 mn., making use of India's rapid growth in the IT sector, can target US $ 500 mn. or more by 2010. A US $ 10 bn export figure can bring Sri Lanka closer to the US $ 500 per capita exports level, which for any developing country could be considered as a significant accomplishment.