

# What will it take Sri Lanka to Build a World Class Export Economy?

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# Outline

- Background
- Underlying reasons for poor export performance
- Building a world class export economy
- Way forward

# Background

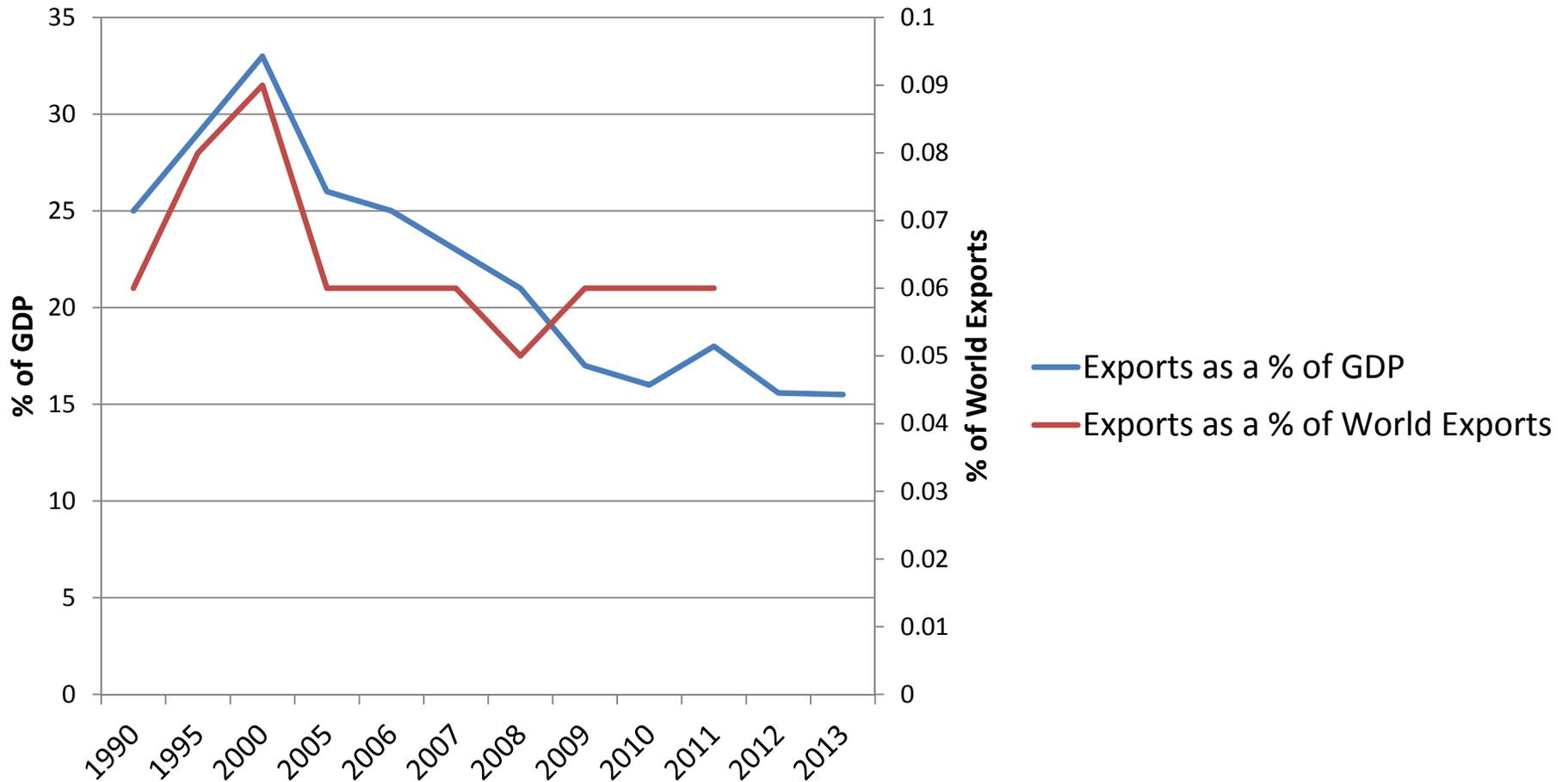
SL's recent export performance has been far from satisfactory since 2000:

- Declining exports/GDP ratio
- Declining world export share
- Steep fall in SL's share of exports from developing countries
- SL has fallen behind its competitors

Thus SL's export problem is fundamentally 'homegrown' – cannot be blamed on world markets

# Declining Export Share

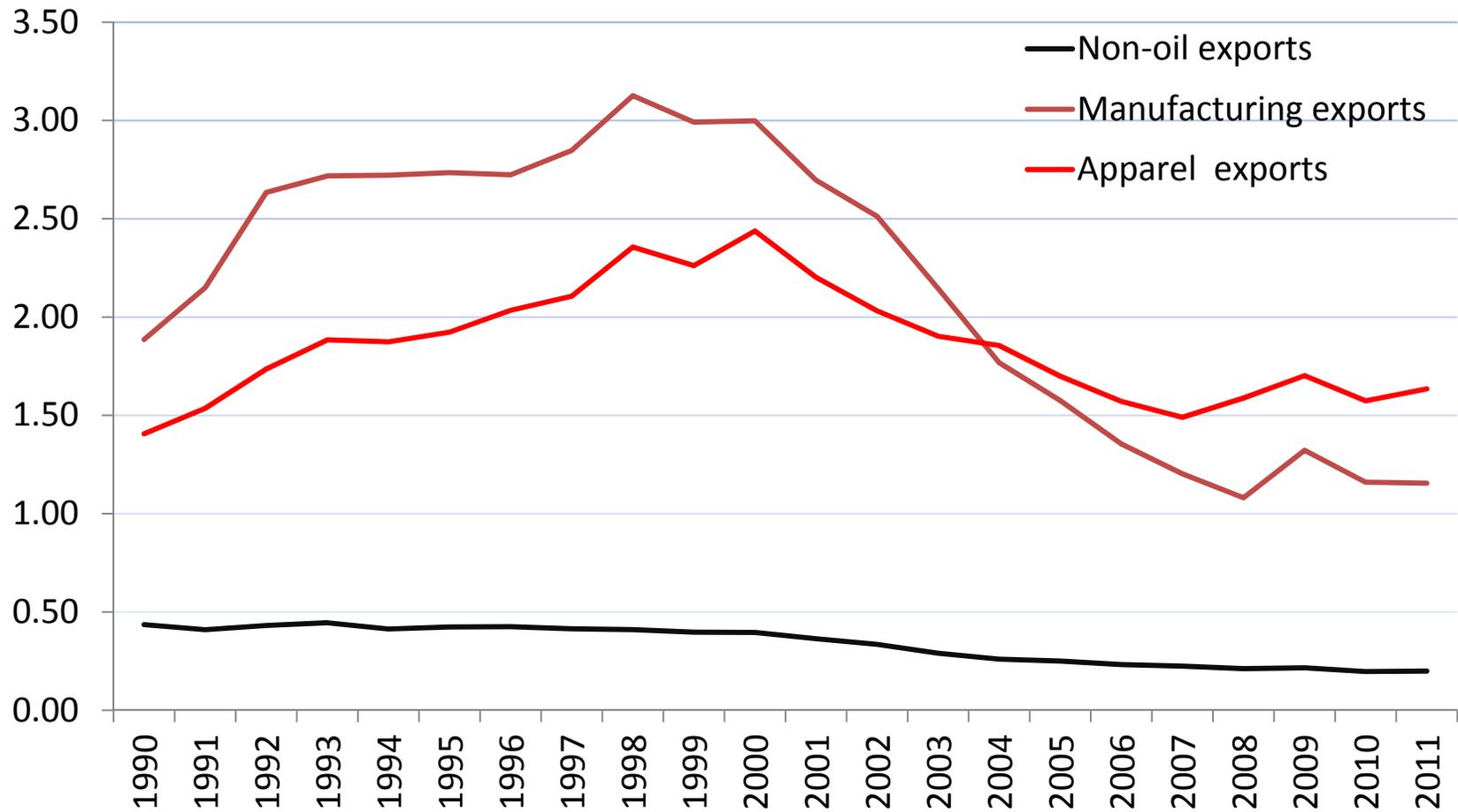
## Sri Lanka's Export Share, 1990-2013



Sources: Central Bank of Sri Lanka & IMF Direction of Trade Statistics

# Declining Export Share Cont.

Sri Lanka's Share in Exports from Developing Countries, 1990-2011



Source: Athukorala, 2013

# SL Exports in the Global Context

- Sri Lanka has not done well in exports compared to its competitors
- Vietnam was in par with Sri Lankan exports in 1990 with US\$ 2 bn per annum exports but today while Sri Lanka exports US\$ 11 bn, Vietnam exports US\$ 120 bn
- Bangladesh was behind Sri Lanka in its annual exports in 1990 was US\$ 1.6 bn but today it exports US\$ 24 bn

# SL's Apparel Exports from a Global Context

- Ready-made garments (RMG) are the leading export item of Sri Lanka but is losing its global market share since 2000 declining from 1.4% to 0.9% in 2012
- During 2000 and 2012 SL's competitors have increased their global share: Vietnam from 1% to 3%, Bangladesh from 2% to 5% and China from 18% to 38%
- During 2005 to 2012 USA imports of RMG from China increased by 17%, from Vietnam by 14%, Bangladesh by 12% while from SL declined by 3%

Underlying Reasons

# Problems in the Incentive Framework

## *Trade Policy*

Steady reversal of trade policy in recent past

Increasingly protectionist & complex regime

- Modest increase in tariff protection, but heavy imposition of para-tariffs

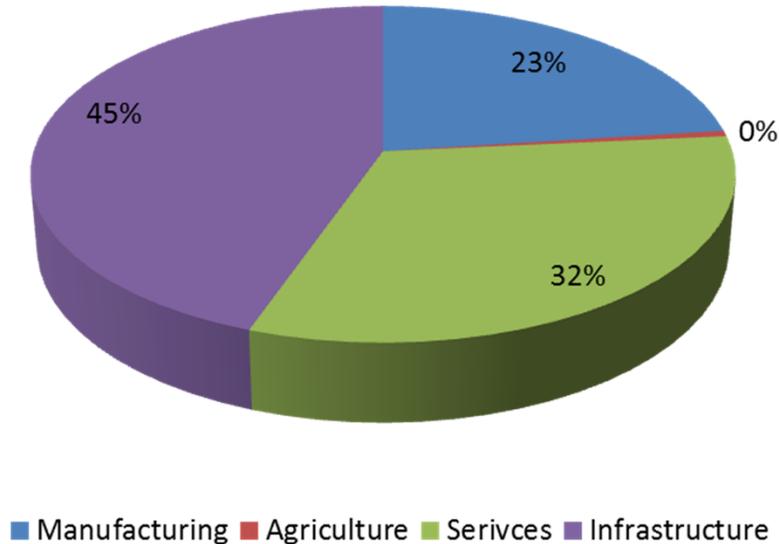
Restrictive regime reflected in global indices

- Ranked **103** out of 132 countries in “market access” sub index of *Enabling Trade Index*

# Problems in the Incentive Framework Cont.

## *Foreign Direct Investment*

Composition of FDI Flows, 2012



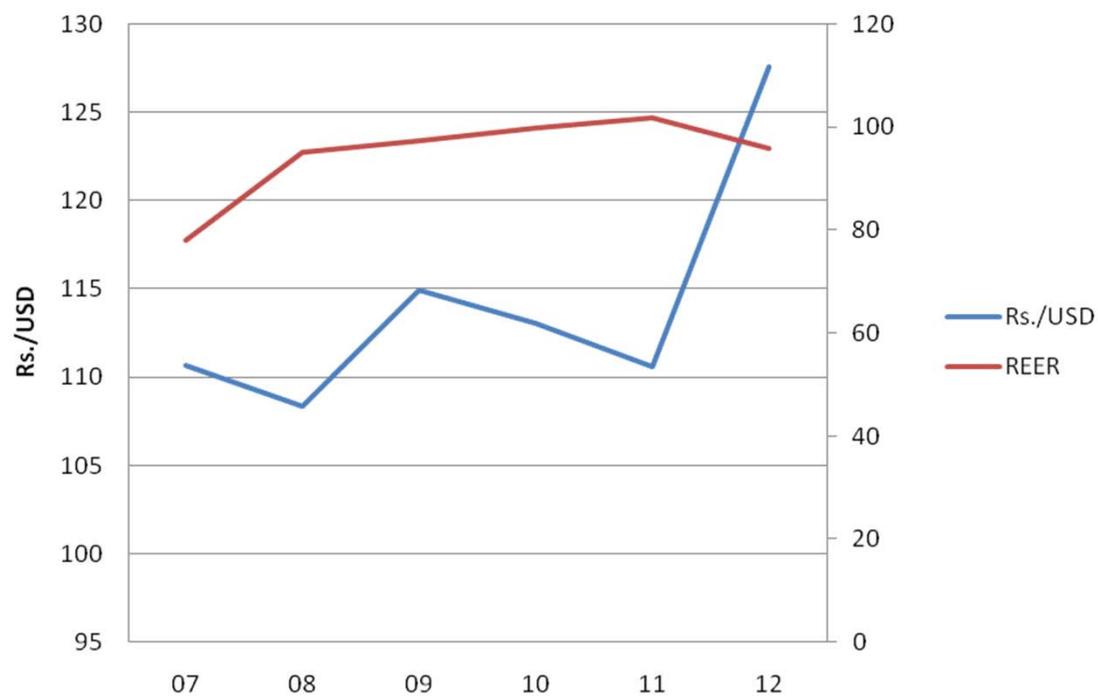
Source: BOI, 2013

- Strategic Development Projects (SDP) Act enacted in 2008
- Projects identified under the SDP Act largely confined to investments in IT/BPO, tourism & infrastructure
- Decline in export oriented FDI inflows and export-oriented foreign projects
- Non-tradables attract most FDI

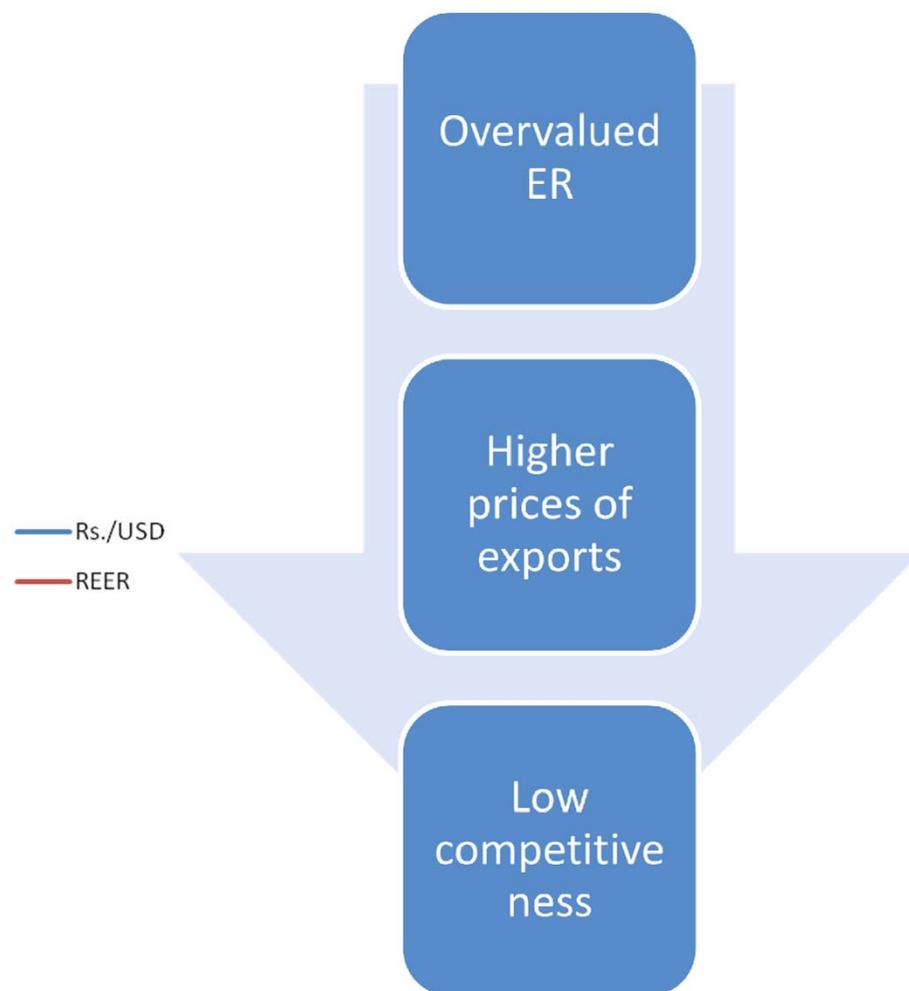
# Problems of the Incentive Framework Cont.

## *Exchange Rate Policy*

Trends in Nominal and Real Exchange Rate Movements, 2007-2012



Source: CBSL, *Annual Report 2012*



# High Trade-Related Costs

## Energy

Industrial Electricity Tariffs, 2012

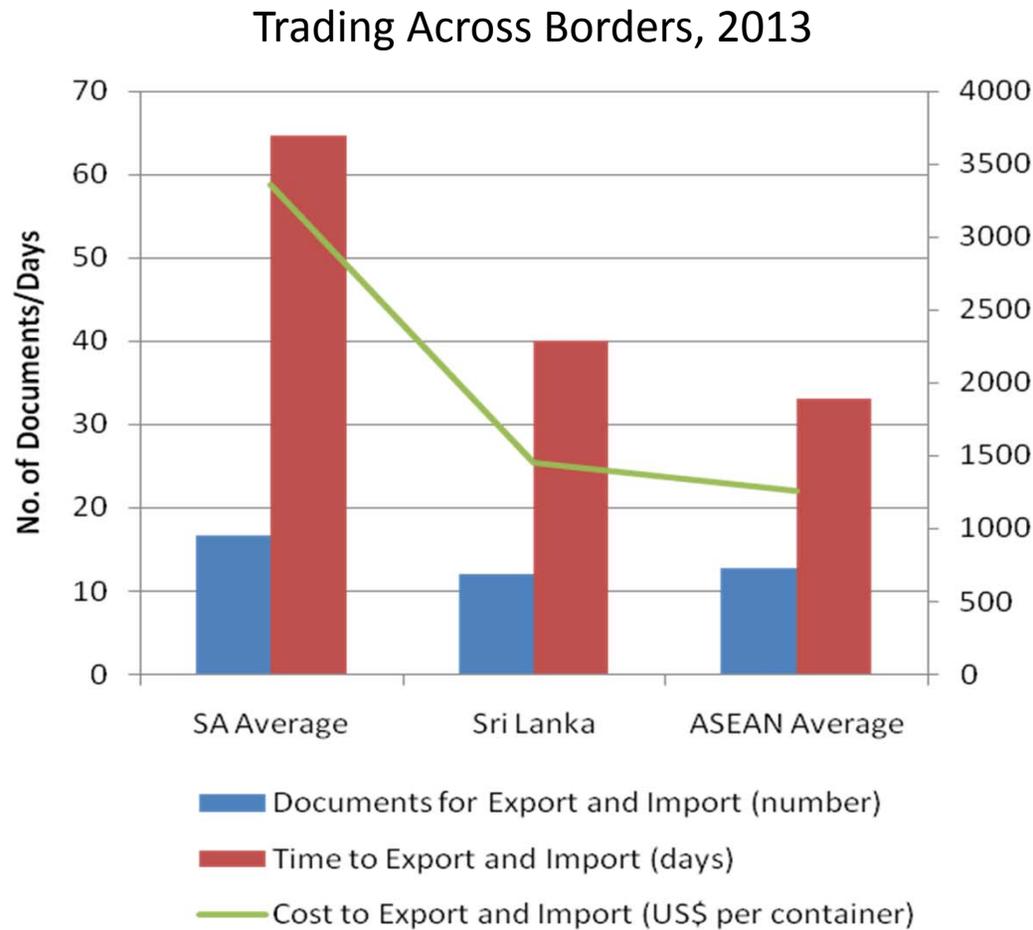


Source: Siyambalapitiya, 2013

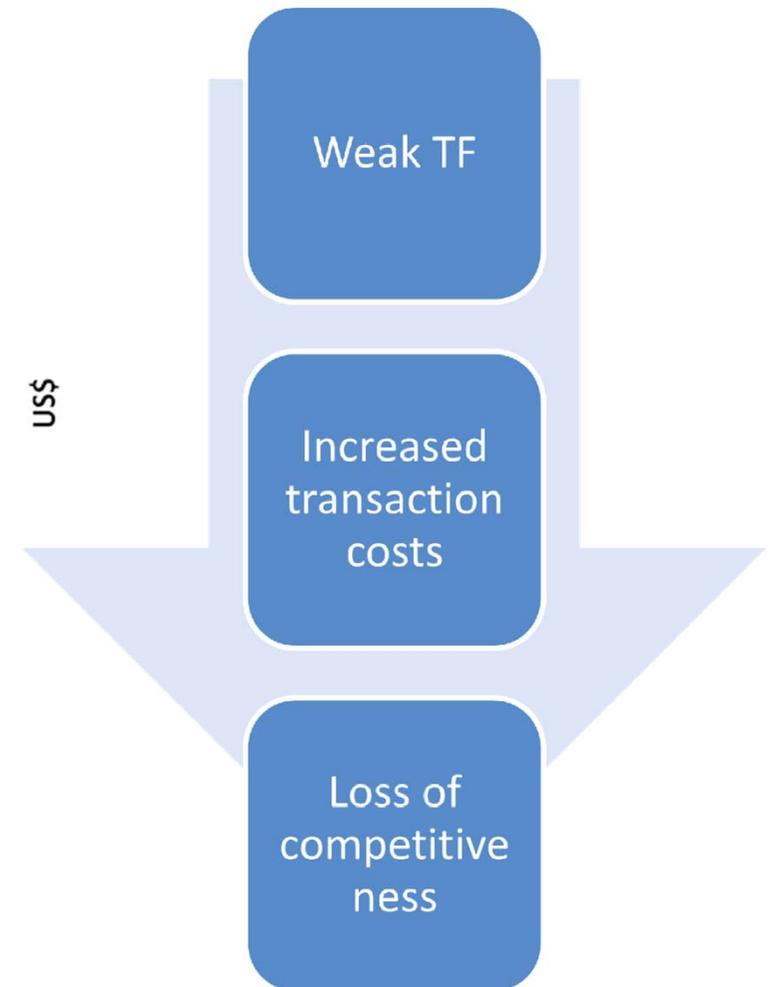
- Lack of cost-reflective electricity prices
- Ad hoc tariff revisions
- Price hike of petroleum products in 2012:
  - **25-40%** surcharge on electricity tariffs in 2012
  - **54-79%** increase in peak industrial tariffs in April 2013

# High Trade-Related Costs Cont.

## Trade Facilitation

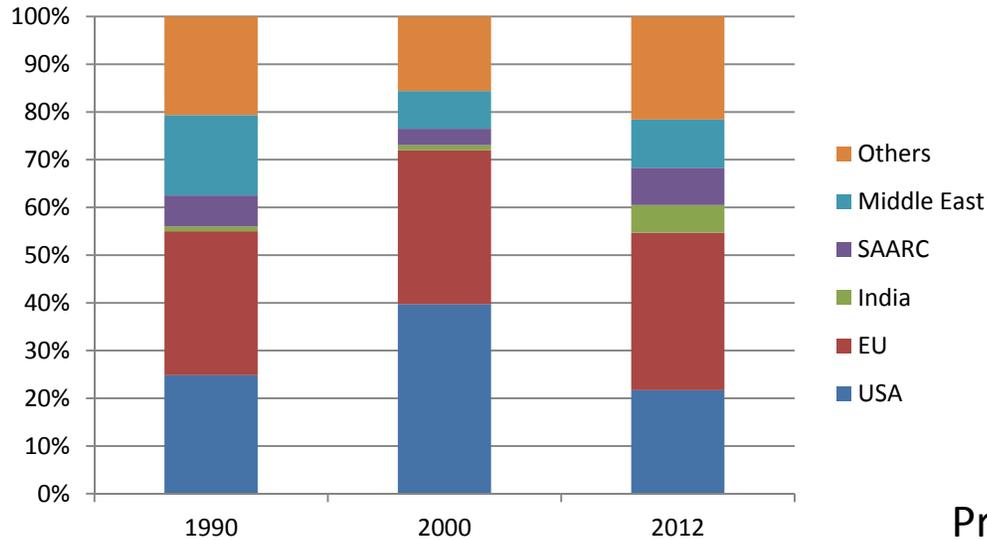


Source: World Bank, *Doing Business 2013*



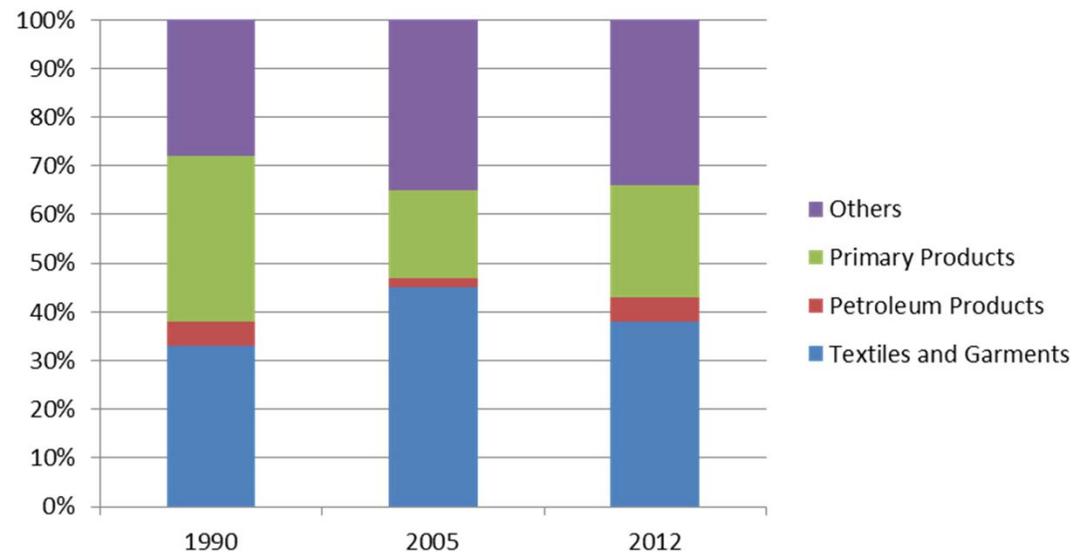
# Export Concentration

## Market Diversification



- SL faced with both product and market concentration

## Product Diversification



Source: CBSL, *Annual Report*, Various Issues

## Export Concentration Cont.

- More focus on diversifying markets – sending more exports to ‘rising Asia’ a current priority
- But this will do little to increase exports – SL lacks products to export to these markets
- Existing markets have untapped scope
- Appears that product concentration is causing market concentration
- Thus product concentration requires the most attention

## Export Concentration Cont.

### *Case of Apparel Sector*

- Accounts for nearly **40%** of total exports and over **90%** destined to the US and EU
- **40-80%** of SL's exports to the USA, UK, France & Germany are apparel, but apparel imports account for less than **3%** of total imports by these countries
- The problem is not what is demanded by those markets, but what SL is able to supply
- Thus *product* concentration is the root cause

# Focus on Simple Products

- Close to 99% of Sri Lankan exports are simple products that could be copied by competitors easily
- Value of high-tech exports in Sri Lanka have fallen sharply from US\$ 102 mn in 2008 to US\$ 57 mn in 2010
- Sri Lanka's share in high-tech exports averages at **1.8%** compared to 75% in Korea, 27% in Thailand and over 50% in Singapore and Malaysia

Building a  
World Class Export Economy

# Liberal Trade Regime

Re-embracing an outward-oriented policy regime  
crucial

- SL experience over the past 3 decades clearly demonstrates that an outward-oriented policy regime – even when severely strained by political & macroeconomic instability – can yield a superior development outcome compared to a closed-economy

# Stable Investment Regime

Stable enabling environment crucial for the operation of private sector

- *Macroeconomic stability:*
  - Exchange rate, inflation, wages, & interest rates
- *'Good institutions':*
  - Law & order
  - Property rights protection
  - Political stability
  - Policy certainty (consistent and predictable policies)

# Export Diversification

Strategic focus on product diversification – better use of existing preferential & free trade agreements – current utilization low

In expanding the export basket, East Asia offers important lessons:

- Fitting into “Global Production Sharing” (GPS) within vertically integrated global industries (mostly in machinery & transport equipment)
- Processed food exports

# Global Production Sharing

- GPS opens up new opportunities for countries to participate in a finer international division of labour & to specialize in different tasks of the production process
- MNEs are the key players in GPS
- FDI & trade policies are co-determinants of the location choice of MNEs within production networks
- **Penang** (Malaysia) is a model example for SL of achieving export success through plugging into global production networks
- Can the SL Commercial Hub Operations No. 01 of 2013 which has declared identified areas as free ports and bonded areas dedicated for off-shore business activities facilitate this ?

## Global Production Sharing Cont.

### Factors behind Penang's success:

- Focused investment promotion
- Post-investment care (FDI promotion continued after bringing the investor into the country)
- Effective personal involvement from top level of Govt
- Infrastructure development (an innovative 'land bank')
- Vocational training & skill development
- Fostering MNE-local firm links

## Identify Potential Exports: Processed Food Exports

- Processed food has emerged as a dynamic export product line for developing countries

### Share of Processed Food in Total Food Exports

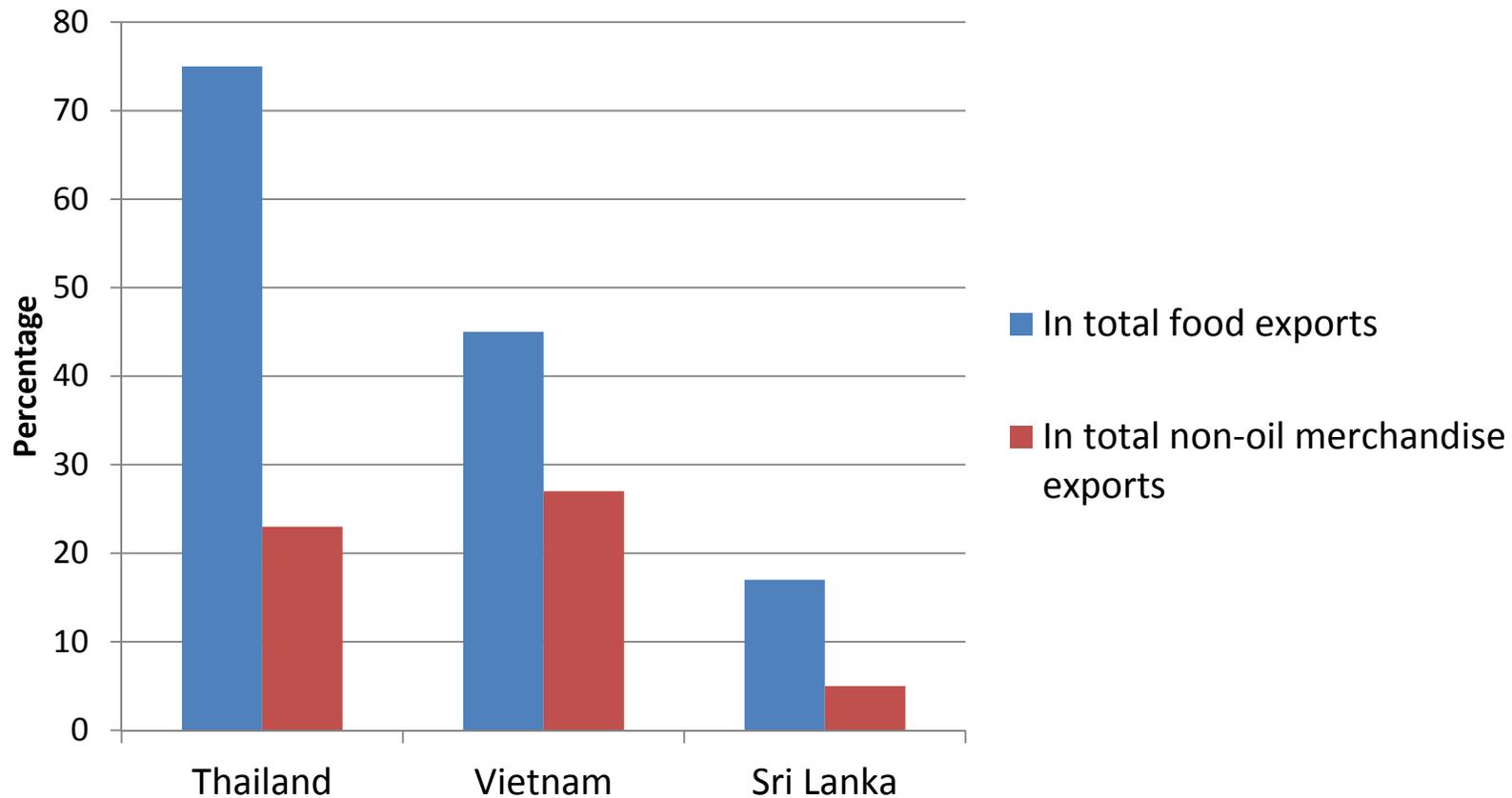
	1990-81	2000/01	2010-11
Developed countries	42.5	63.5	70.3
Developing countries	40.5	55.7	62.5
Low-income countries	27.2	33.5	43.5
<b>Middle-income countries</b>	<b>38.5</b>	<b>54.0</b>	<b>59.0</b>
High-income countries	54.8	59.9	64.1
World	49.1	60.9	65.1

Source: Athukorala, 2013

# Processed Food Exports Cont.

- SL has so far failed to capitalize on this opportunity

Share of Processed Food Exports (2010-11)



Source: Athukorala, 2013

# Emerging Sectors – “Host the Winners”

## IT/BPO

- SL ranked **among top 25** in A.T. Kearney’s Global Services Location Index in 2011
- **5<sup>th</sup> largest export revenue earner** for the country with US\$ 392 Mn in 2010
- Has been resilient in the face of the global recession
- 100% value addition
- Key area: Financial & Accounting Outsourcing (FAO) – SL ranked **among top 20** centres of excellence for FAO
- Current export markets include North America, EU, Australasia & East Asia
- Significant opportunities emerging in the Middle East – ICT sector in ME expected to grow at 8-10% annually compared to a global average of 3%

# R & D

- Overall R&D expenditure is low (0.11% of GDP) but what is alarming is the private sector share in this is only 18%, where as in other successful exporting nations private sector share is above 65%
- There is a need to increase R&D expenditure in export firms –South Korea's Hyundai and KIA are the most fuel efficient cars today; Brazil's Emraer is one of the leading jet manufacturers and has partnership with both Boeing and Airbus; Taiwan's Acer and Asus are now two leading Notebook manufacturers in the world; South Korea's Samsung Galaxy smart phones have a competitive edge over Apple i-phones and Samsung will become the top home appliance maker by 2015, etc. – all due to heavy investment in R&D
- To encourage innovative producers and users of multimedia technology, in accordance to knowledge-based society framework to leapfrog to the 21<sup>st</sup> century, Malaysia established the Multimedia Super Corridor in 1996

# Way Forward

Formulate and implement a clear strategy for long-term export development

- Re-embrace a more consistent liberal trade & investment regime
- Work on macroeconomic fundamentals and stability
- Improve trade facilitation process
- Incentives I: assistance to upgrade technology and R&D
- Incentives II: “Host the Winners”
- Measures to attract more FDI into export-oriented industries
- Strategic focus on product diversification
- US\$ 20 billion export target by 2020 can be achieved with such a strategy

Thank you