CONSTRAINTS TO SUSTAINED AND INCLUSIVE GROWTH IN SRI LANKA

An Initial Diagnosis and Key Topics for Discussion

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7 January 2016
Sri Lanka has seen strong economic growth over the long-term
Growth that has become exceptional with the onset of peace.
And this growth has been matched by progress across broader measures of well-being.
What are some of the challenges ahead?

- Is growth constrained by exports and the balance of payments?
- Are government revenues too low?
- Is structural transformation a challenge?
- Is urbanization too low?
- How challenging will it be to make growth inclusive of the different regions and sectors?
Is growth constrained by exports and the balance of payments?
But growth is limited by the Balance of Payments
Hitting the constraint shows up in the exchange rate

Daily Exchange Rate (Sri Lankan Rupee to U.S. Dollar), 2010 - 2015

Data source: Wiki Exchange Rates
External debt is already pretty high as a share of exports and primary income (including remittances)! The difference from expected value is +119 percentage points.
Are government finances too weak?
Sri Lanka’s government revenues are significantly lower than other middle-income countries. 

Government revenues as a share of GDP

Source: World Development Indicators
Public savings are negative, the deficit is substantial

Table 1. Sri Lanka: Selected Economic Indicators, 2012–20

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<td><strong>GDP and inflation (in percent)</strong></td>
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<td>Real GDP growth</td>
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<td>Inflation (average)</td>
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<td>Inflation (end-of-period)</td>
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<td>3.6</td>
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<td>Core inflation (end-of-period)</td>
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<td><strong>Savings and investment (in percent of GDP)</strong></td>
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<td>National savings</td>
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<td>25.9</td>
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<td>25.6</td>
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<td>-1.4</td>
<td>-1.8</td>
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<td>Private</td>
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<td>Government</td>
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<td>4.6</td>
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<td>Private</td>
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<td><strong>Public finances (in percent of GDP)</strong></td>
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<td>Revenue</td>
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<td>12.3</td>
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<td>Expenditure</td>
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<td>19.9</td>
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<td>Central government balance</td>
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<td>-5.9</td>
<td>-6.7</td>
<td>-7.4</td>
<td>-7.3</td>
<td>-7.2</td>
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<td>Central government domestic financing</td>
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<td>4.6</td>
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<td>5.1</td>
<td>6.7</td>
<td>6.7</td>
<td>6.5</td>
<td>6.7</td>
<td>6.8</td>
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<tr>
<td>Government debt (domestic and external)</td>
<td>79.2</td>
<td>78.3</td>
<td>75.9</td>
<td>77.0</td>
<td>78.1</td>
<td>78.2</td>
<td>78.0</td>
<td>77.9</td>
<td>77.8</td>
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</table>

Source: IMF Country Report No. 15/335 (December 2015)
Sri Lanka’s fiscal deficit currently exceeds its level of public investment.

Data source: IMF Country Report No. 15/335 (December 2015)
Is structural transformation a challenge?
Currently, the share of GDP from agriculture is what would be expected based on Sri Lanka’s level of income.
But employment in agriculture remains well above what would be expected, implying low productivity.
Productivity in agriculture in very low compared with industry and services

Data source: World Development Indicators
Sri Lanka’s exports are focused in garments, tea and rubber products.

Exports, 2014

- Women's undergarments: 5%
- T-shirts: 4%
- Gloves, mittens and mitts: 2%
- Rubber products: 0.9%
- Retreaded or used pneumatic tires of rubber: 3%
- New pneumatic tires, of rubber: 0.3%
- Precious stones: 3%
- Diamonds: 0.78%
- Other articles of vulcanized...: 0.26%
- Natural rubber: 0.11%

- Women's suits: 4%
- Men's suits, not knitted: 3%
- Women's suits, not knitted: 5%
- Brassieres and parts thereof, not knitted: 4%
- Men's shirts, not knitted: 2%

- Tea: 12%
- Coconut, Brazil nuts and cashew nuts: 1%
- Coconuts: 0.54%
- Coconut Husks: 0.39%
- Coconuts, not further worked: 0.16%
- Coconuts, or parts thereof, not further worked: 0.43%

- Rubber: 2%
This has been the case for a long time!
Sri Lanka’s export basket has changed little since mid-1990s
We can compare its current export basket to the trajectory of export diversification in other countries.
Thailand’s export basket in 1991 was similar to Sri Lanka’s now, but then it changed a lot!
Thailand’s exports in 1962
Thailand’s exports in 2010

![exports diagram](image-url)
Turkey’s export basket in 1994 was similar to Sri Lanka’s now, and then it changed!
Costa Rica in 1996 was similar to Sri Lanka today, but then it changed!
In Sri Lanka, many exports are under competitive pressure from lower income countries.
Tea: Low income competitors

Global Share of Tea Exports (Net) in 2014

GDP per capita (USD) in 2014

Data source: World Development Indicators
This is also the case for many garment exports, like women’s undergarments.

Exports, 2014
Women’s Undergarments: Low income competitors

Global Share of Women’s Undergarments Exports (Net) in 2014

GDP per capita (USD) in 2014

Data source: World Development Indicators
Meanwhile, rubber products show a different trend
Retreaded Tires: Middle and high income competitors

Global Share of Retreaded Tires
Exports (Net) in 2014

GDP per capita (USD) in 2014

Data source: World Development Indicators
Richer countries get more from tourism revenue per capita

Tourism receipts received per capita, 2013
Sri Lanka

Data source: World Development Indicators

Difference from expected value = -598 US$ per capita
Remittance income is probably not going to be an engine of growth in the longer (or shorter) run.

+120 US$ per capita
Implications

• Sustained growth involves not just more of the same
• As they grow, countries diversify and evolve their comparative advantage into new areas
• These tend to be more complex and able to compete while paying higher wages
• This process is not just about shifting from agriculture to manufacturing but within each sector and into services such as ICT, BPO, KPO, bunkering and tourism
• Transformation involves chicken and egg problems that need attention
• What can the government do?
  – Are there limits to tax incentives as a tool, given the low tax revenue ratio?
Urbanization is surprisingly low
Urbanization is surprisingly low in Sri Lanka!

Difference from expected value = -40.0 percentage points
Questions

• Why did it not urbanize faster in the past?
  – Few urban exports?
  – Few rents?
• Is the check in the mail?
• What would it take to seize the potential gains from urbanization without the bad side?
  – Where will the new industries locate?
  – What goes into efficient, productive urbanization?
  – Will you have the fiscal resources to make it happen?
The challenge of regional and social cohesion
Growth rates by industry are quite heterogeneous.

Growth rate 2010-2014

- Hotels and Restaurants
- Construction
- Mining and Quarrying
- Industry
- Fishing
- Transport and Communication
- Manufacturing
- Electricity, Gas and Water
- Banking, Insurance and Real Estate etc.
- Wholesale and Retail Trade
- Services
- Private Services
- Agriculture, Forestry and Fishing
- Agriculture, Livestock and Forestry
- Ownership of Dwellings
- Government Services

Growth rates by industry are quite heterogeneous.
And different regions focus on different activities
Estate sector production is regionally focused

Caveat: Five districts not included in data (Jaffna, Mannar, Mullativu, Trincomalee, and Vavuniya)

<table>
<thead>
<tr>
<th>Extent under Tea by District, 2002 ('000s of hectares)</th>
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<tr>
<td>Extent under Rubber by District, 2002 ('000s of hectares)</td>
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<td>Extent under Coconuts by District, 2002 ('000s of hectares)</td>
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</tbody>
</table>

Data source: Census of Agriculture, 2002 - Agriculture and Environmental Statistics Division, Department of Census and Statistics
As are other agricultural activities

Palay Production, Yala 2014
(‘000s of metric tons)

Palay Production, Maha 2014-15
(‘000s of metric tons)

Cattle Population, 2014
(‘000s of cattle)

Data source: Agriculture and Environmental Statistics Division, Department of Census and Statistics
Different provinces concentrate on different manufacturing industries

**Rubber & Plastic Products**  
(% share of province manufacturing output)

**Apparel, Dressing & Dying of Fur**  
(% share of province manufacturing output)

**Textiles**  
(% share of province manufacturing output)

Data source: Annual Survey of Industries 2012, Department of Census and Statistics
Questions

• As tea and garments become less important, as agricultural employment shrinks and other activities become the engines of growth, how will the different social groups and regions fare?

• Where will the benefits and the burden of adjust fall?
What are some of the challenges ahead?

• Is growth constrained by exports and the balance of payments?
• Are government revenues too low?
• Is structural transformation a challenge?
• Is urbanization too slow?
• How challenging will it be to make growth inclusive of the different regions and sectors?
Thank you!