

# *CONSTRAINTS TO SUSTAINED AND INCLUSIVE GROWTH IN SRI LANKA*

An Initial Diagnosis and Key Topics for Discussion

*Ricardo Hausmann  
Colombo, Sri Lanka  
7 January 2016*



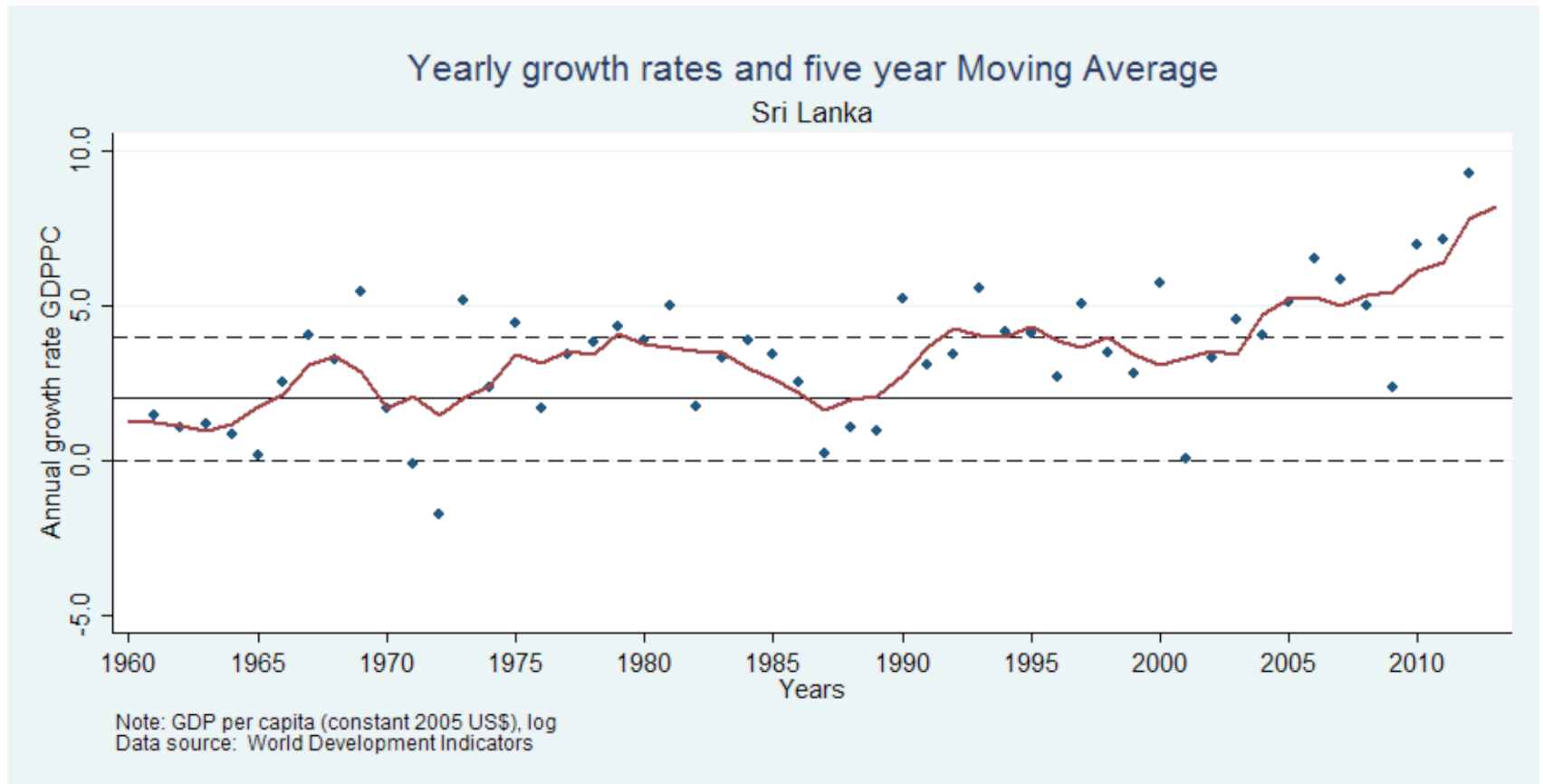
**Center for  
International  
Development**  
*at Harvard University*



Sri Lanka  
**Economic  
Forum** 2016

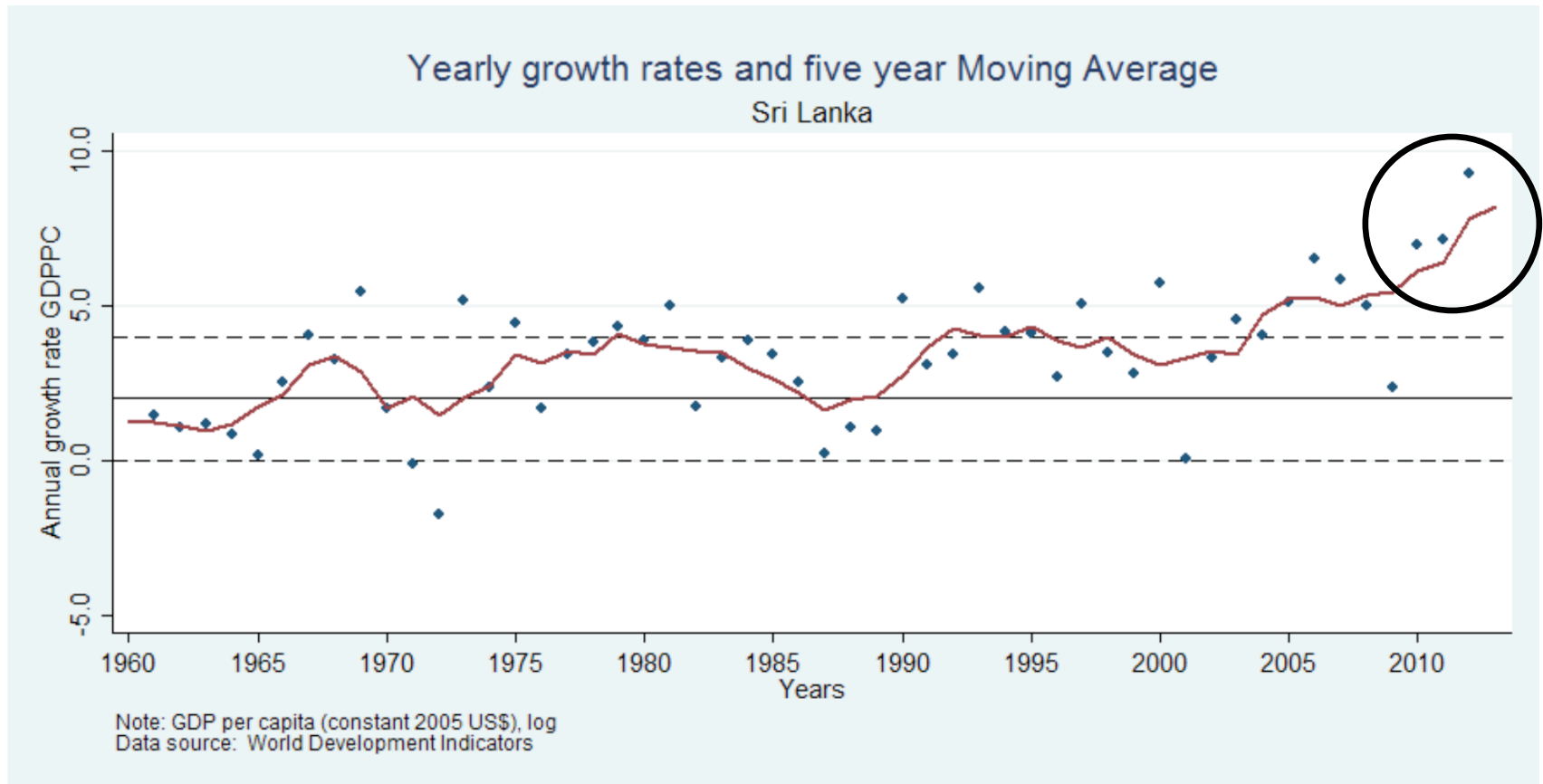


# Sri Lanka has seen strong economic growth over the long-term





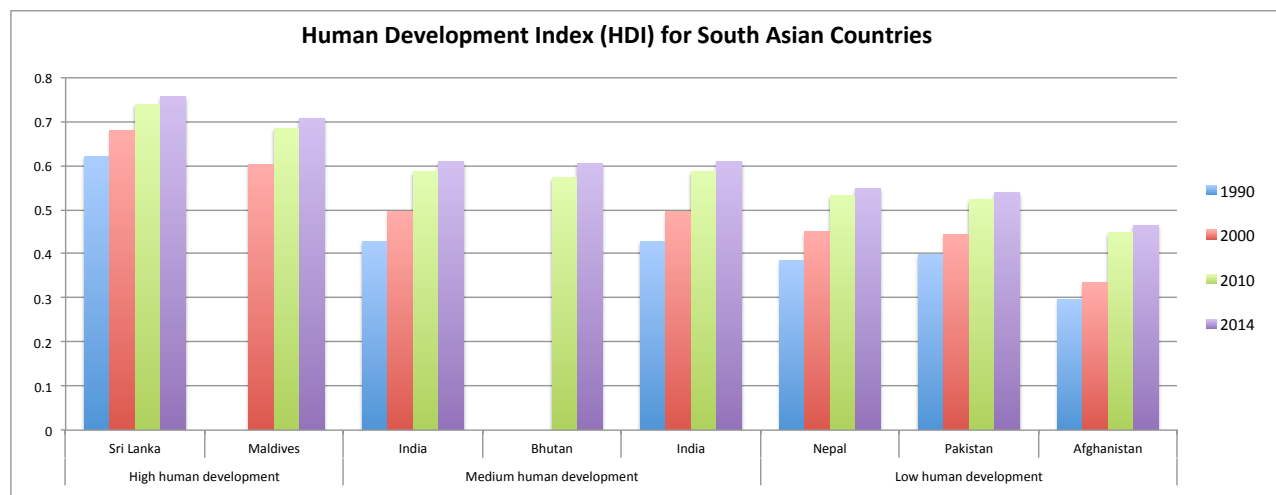
# Growth that has become exceptional with the onset of peace





And this growth has been matched by progress across broader measures of well-being

HDI rank	Human Development Index (HDI)	Life expectancy at birth	Expected years of schooling	Mean years of schooling	Gross national income (GNI) per capita
	Value	(years)	(years)	(years)	(2011 PPP \$)
	2014	2014	2014 <sup>a</sup>	2014 <sup>a</sup>	2014
<b>HIGH HUMAN DEVELOPMENT</b>					
73 Sri Lanka	0.757	74.9	13.7	10.8 <sup>b</sup>	9,779
104 Maldives	0.706	76.8	13.0 <sup>l</sup>	5.8 <sup>z</sup>	12,328
<b>MEDIUM HUMAN DEVELOPMENT</b>					
130 India	0.609	68.0	11.7	5.4 <sup>e</sup>	5,497
132 Bhutan	0.605	69.5	12.6	3.0 <sup>q</sup>	7,176
142 Bangladesh	0.570	71.6	10.0	5.1 <sup>e</sup>	3,191
<b>LOW HUMAN DEVELOPMENT</b>					
145 Nepal	0.548	69.6	12.4	3.3 <sup>e</sup>	2,311
147 Pakistan	0.538	66.2	7.8	4.7	4,866
171 Afghanistan	0.465	60.4	9.3	3.2 <sup>e</sup>	1,885





# What are some of the challenges ahead?

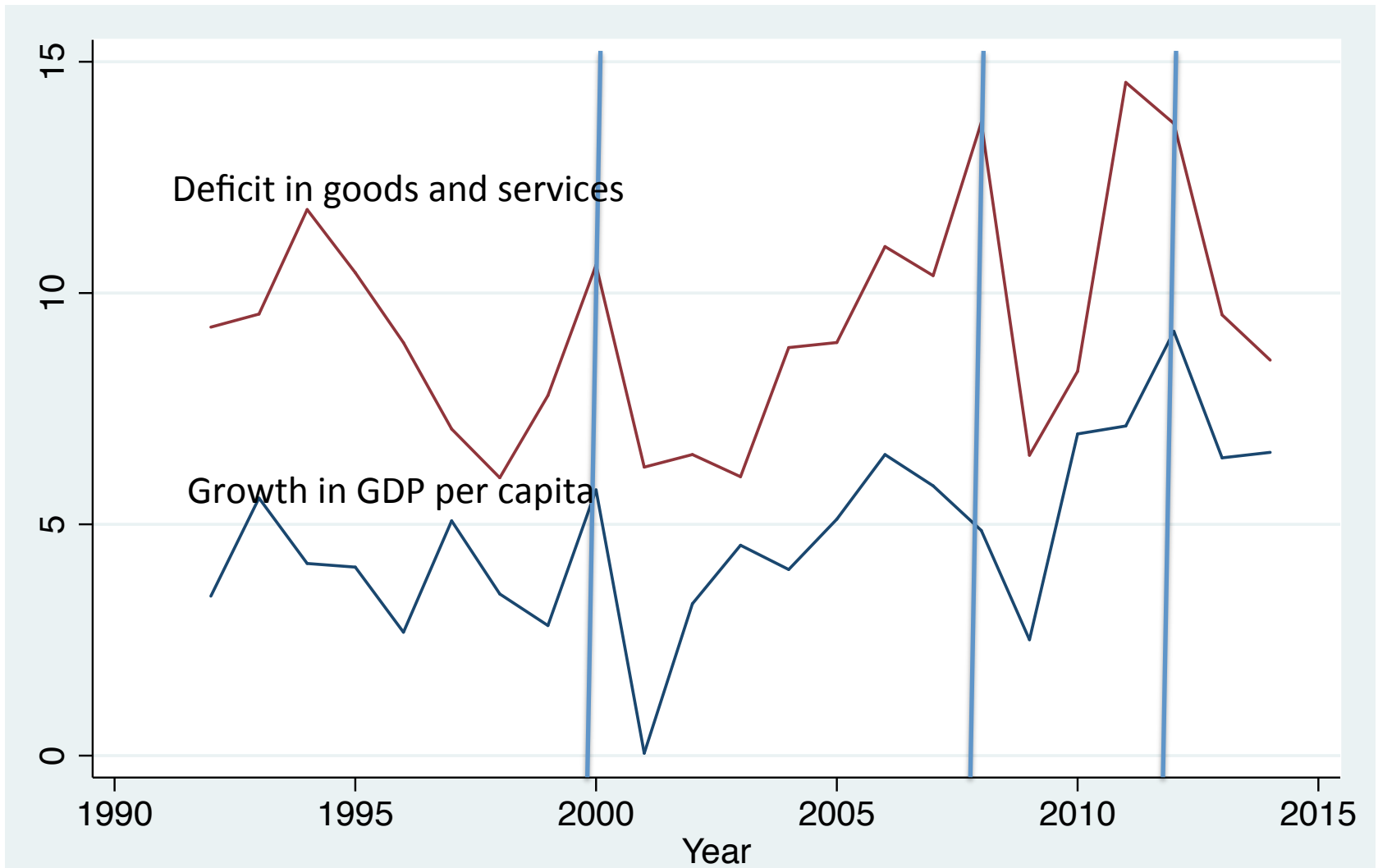
- Is growth constrained by exports and the balance of payments?
- Are government revenues too low?
- Is structural transformation a challenge?
- Is urbanization too low?
- How challenging will it be to make growth inclusive of the different regions and sectors?



Is growth constrained by exports  
and the balance of payments?

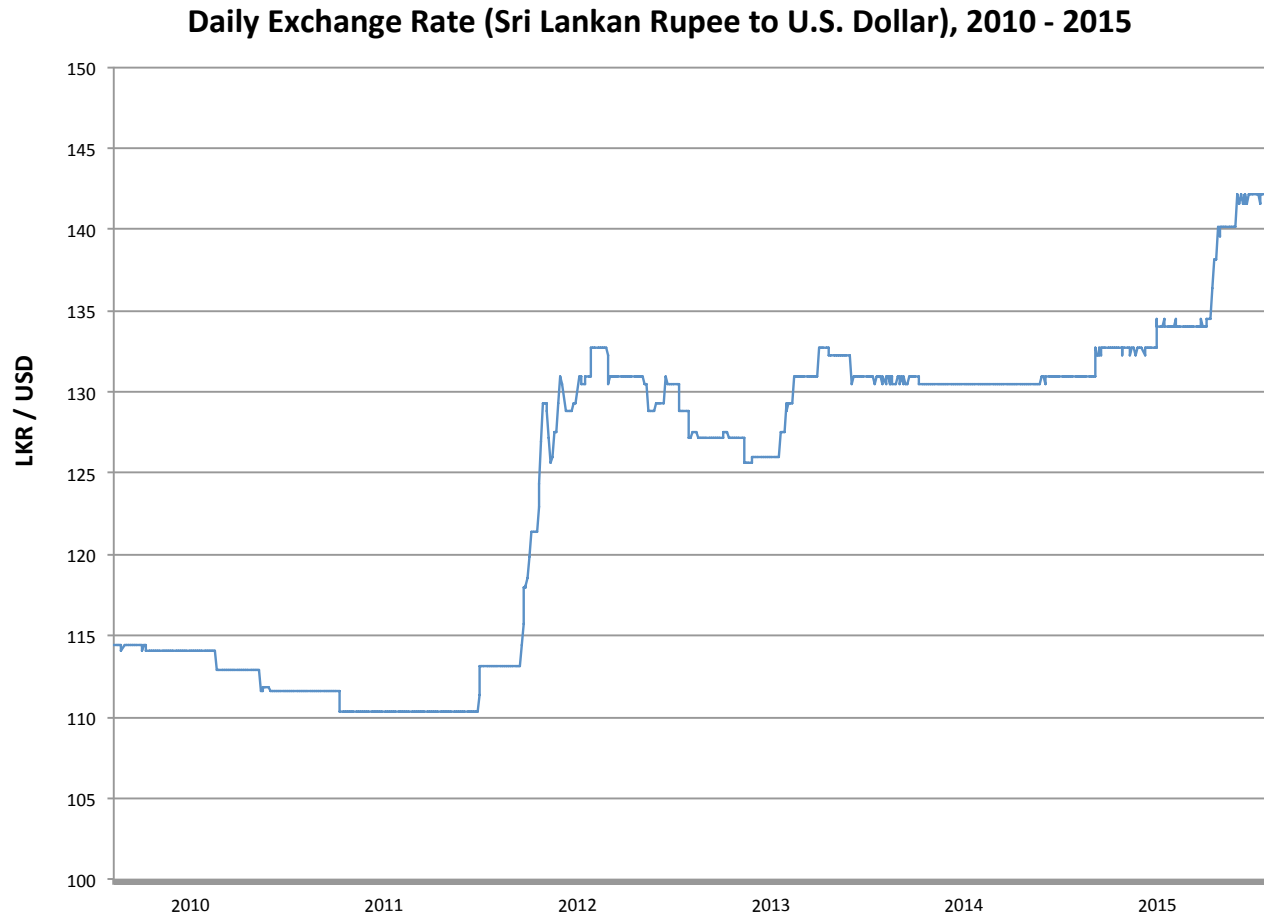


# But growth is limited by the Balance of Payments





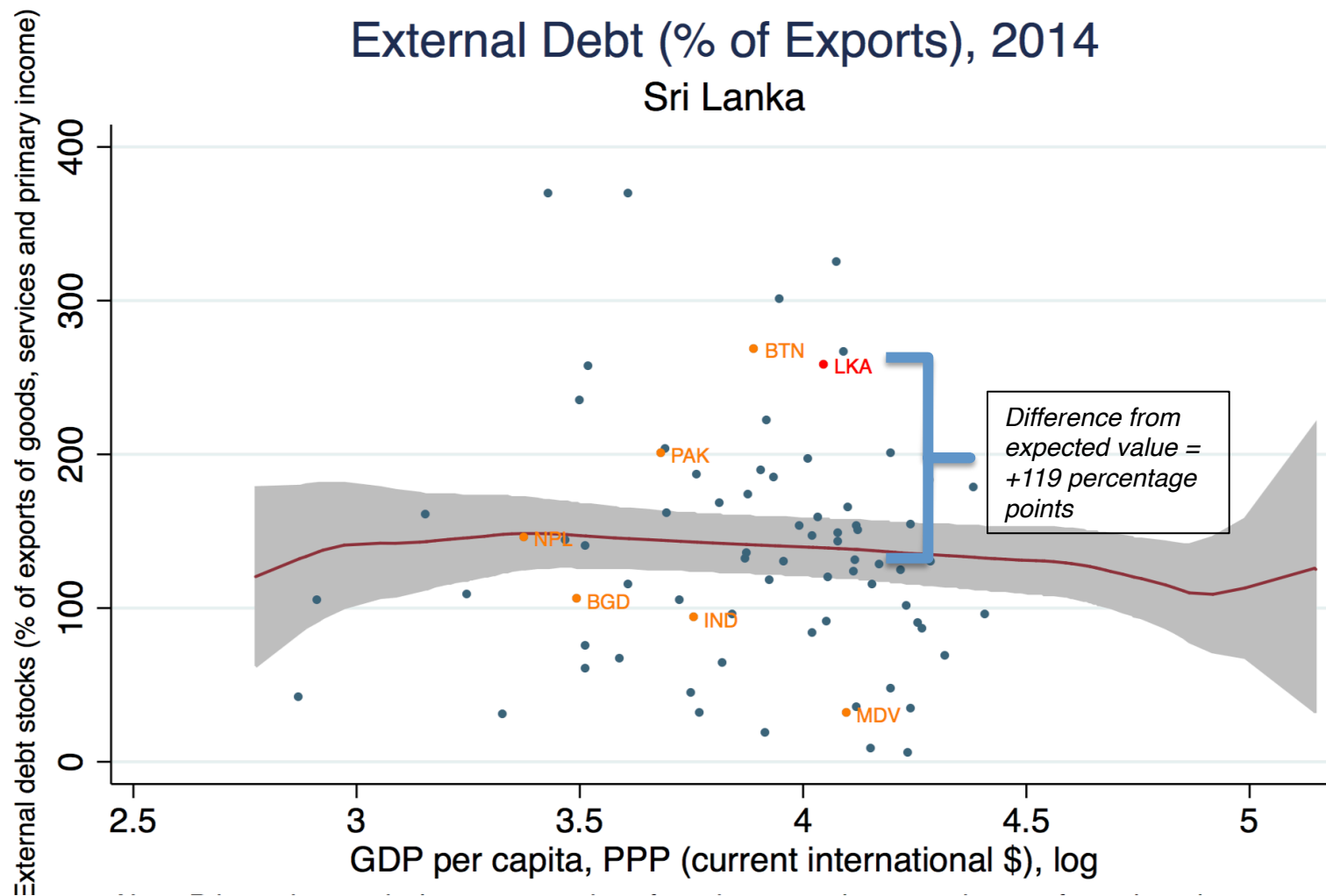
# Hitting the constraint shows up in the exchange rate



Data source: Wiki Exchange Rates



External debt is already pretty high as a share of exports and primary income (including remittances)



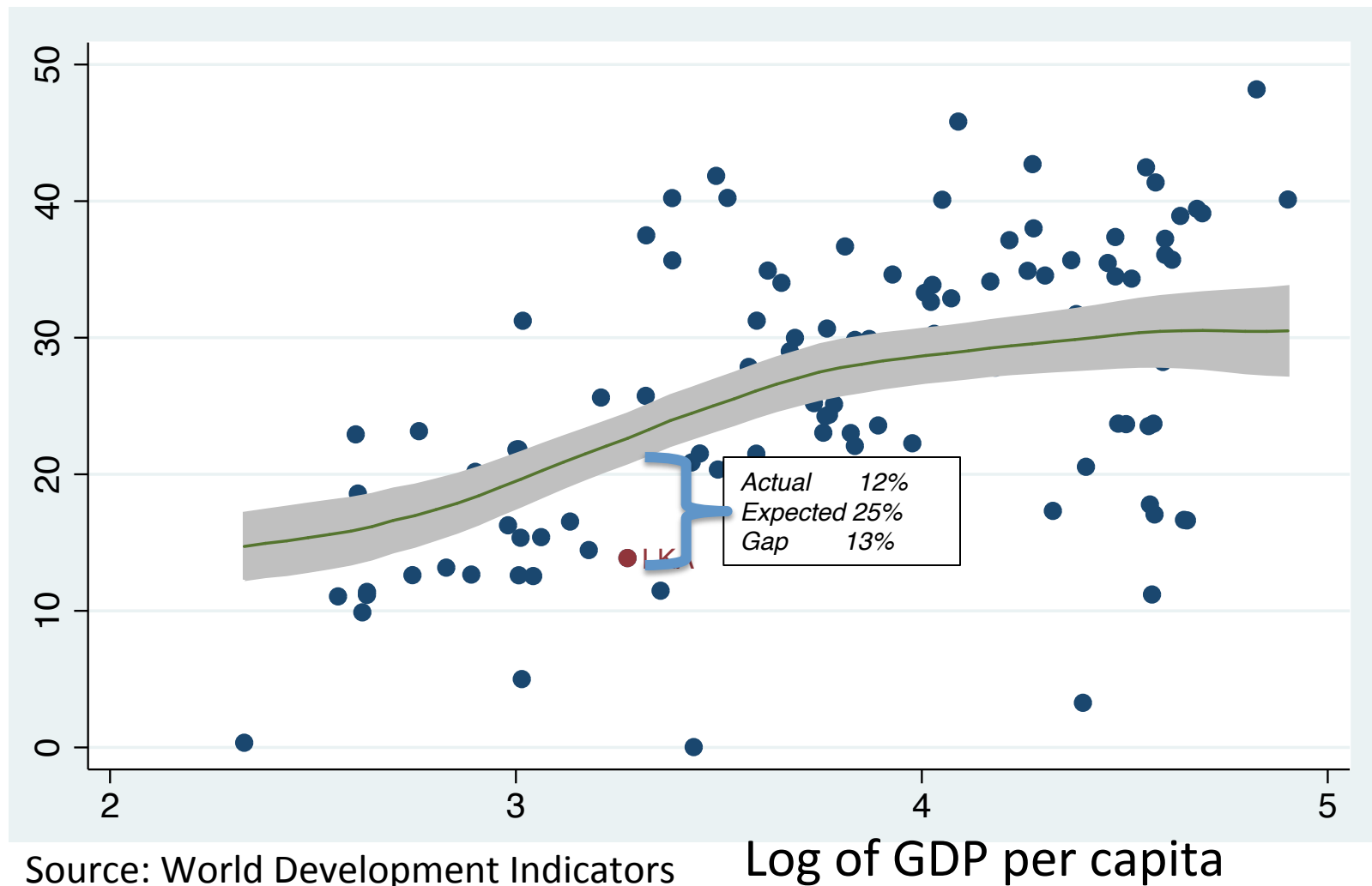


Are government finances too  
weak?



Sri Lanka's government revenues are significantly lower than other middle-income countries

## Government revenues as a share of GDP





# Public savings are negative, the deficit is substantial

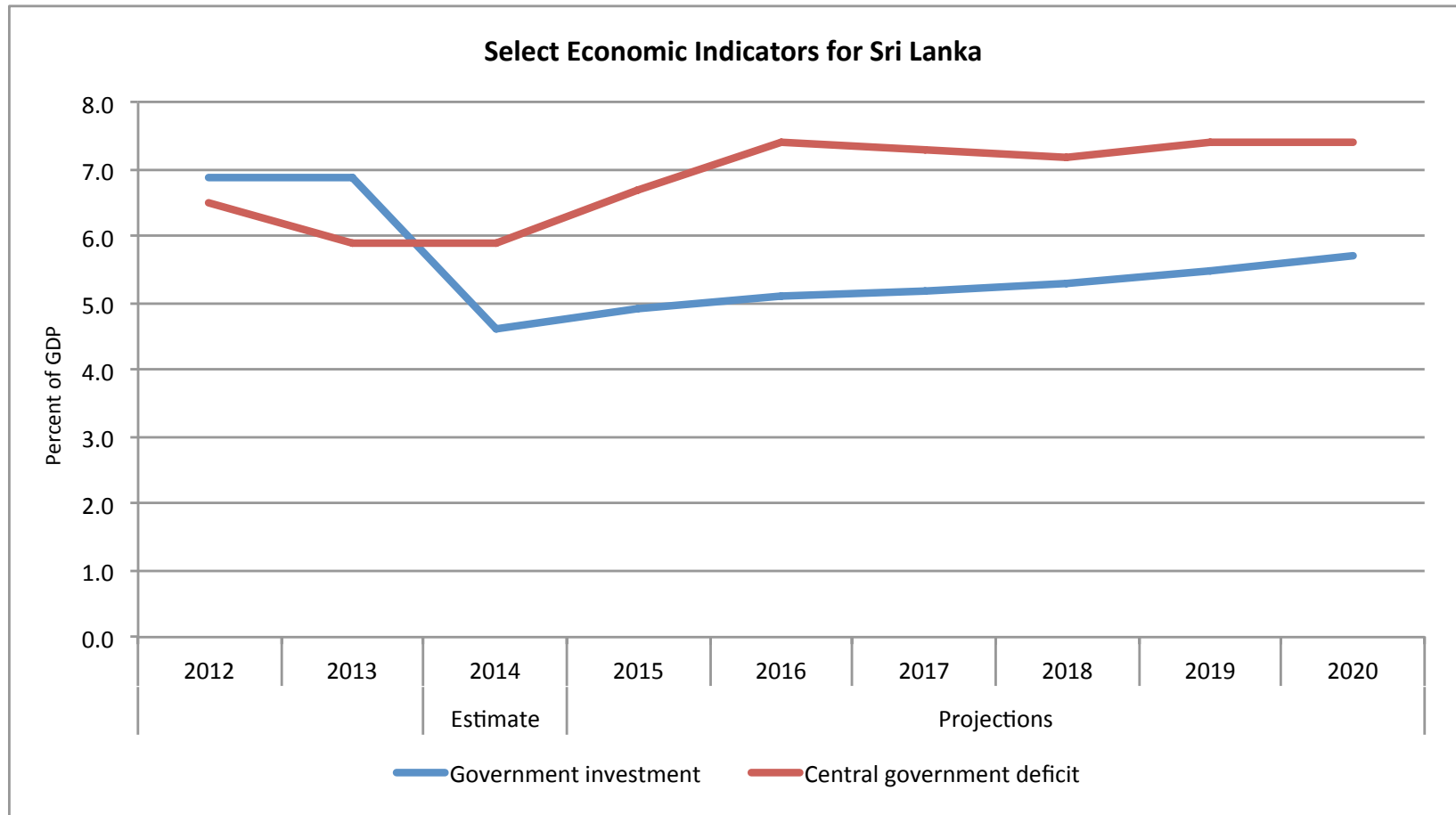
**Table 1. Sri Lanka: Selected Economic Indicators, 2012–20**

	2012	2013	2014	2015	2016	2017	2018	2019	2020
			Est.			Proj.			
GDP and inflation (in percent)									
Real GDP growth	6.4	7.3	7.4	6.5	6.5	6.5	6.5	6.5	6.5
Inflation (average)	7.5	6.9	3.3	1.7	3.4	4.3	5.0	5.0	5.0
Inflation (end-of-period)	9.2	4.7	2.1	3.2	3.6	5.0	5.0	5.0	5.0
Core inflation (end-of-period)	7.5	2.1	1.2	2.3	2.7	4.1	4.1	4.1	4.1
Savings and investment (in percent of GDP)									
National savings	23.9	26.0	23.9	25.9	25.6	25.6	25.4	25.5	25.7
Government	-1.2	-0.8	-1.4	-1.8	-2.4	-2.1	-1.9	-2.0	-1.9
Private	25.1	26.9	25.3	27.7	28.0	27.7	27.3	27.5	27.6
National Investment	30.6	29.9	27.6	27.9	28.2	28.3	28.4	28.5	28.7
Government	6.9	6.9	4.6	4.9	5.1	5.2	5.3	5.5	5.7
Private	23.7	23.0	23.0	23.0	23.0	23.0	23.0	23.0	23.0
Public finances (in percent of GDP)									
Revenue	13.0	12.2	11.6	13.1	12.3	12.5	12.9	13.1	13.6
Grants	0.2	0.2	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Expenditure	19.7	18.3	17.7	20.0	19.8	19.9	20.1	20.5	21.1
Central government balance	-6.5	-5.9	-5.9	-6.7	-7.4	-7.3	-7.2	-7.4	-7.4
Central government domestic financing	4.1	4.6	3.3	5.1	6.7	6.6	6.5	6.7	6.8
Government debt (domestic and external)	79.2	78.3	75.9	77.0	78.1	78.2	78.0	77.9	77.8

Source: IMF Country Report No. 15/335 (December 2015)



# Sri Lanka's fiscal deficit currently exceeds its level of public investment



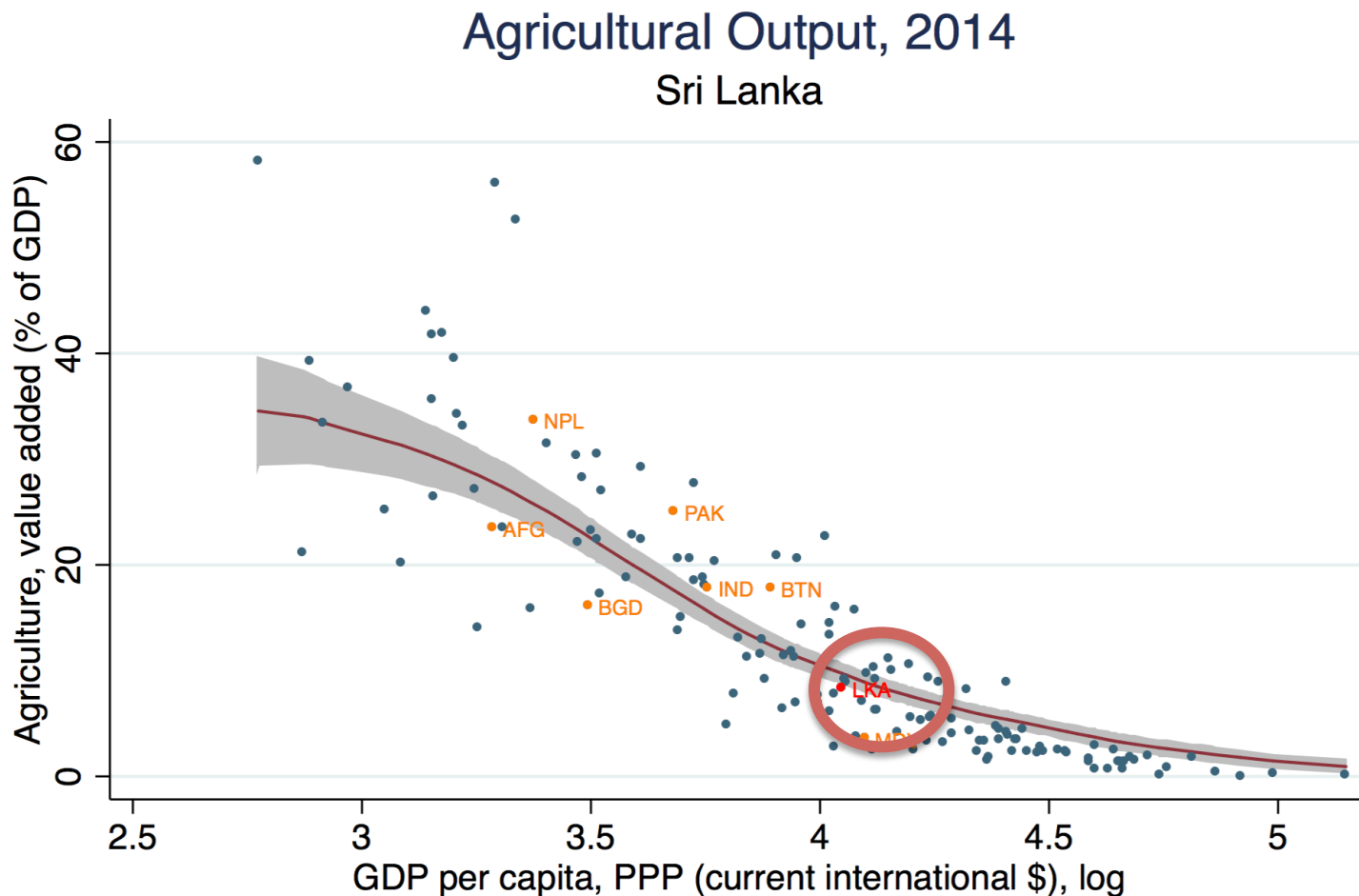
Data source: IMF Country Report No. 15/335 (December 2015)



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

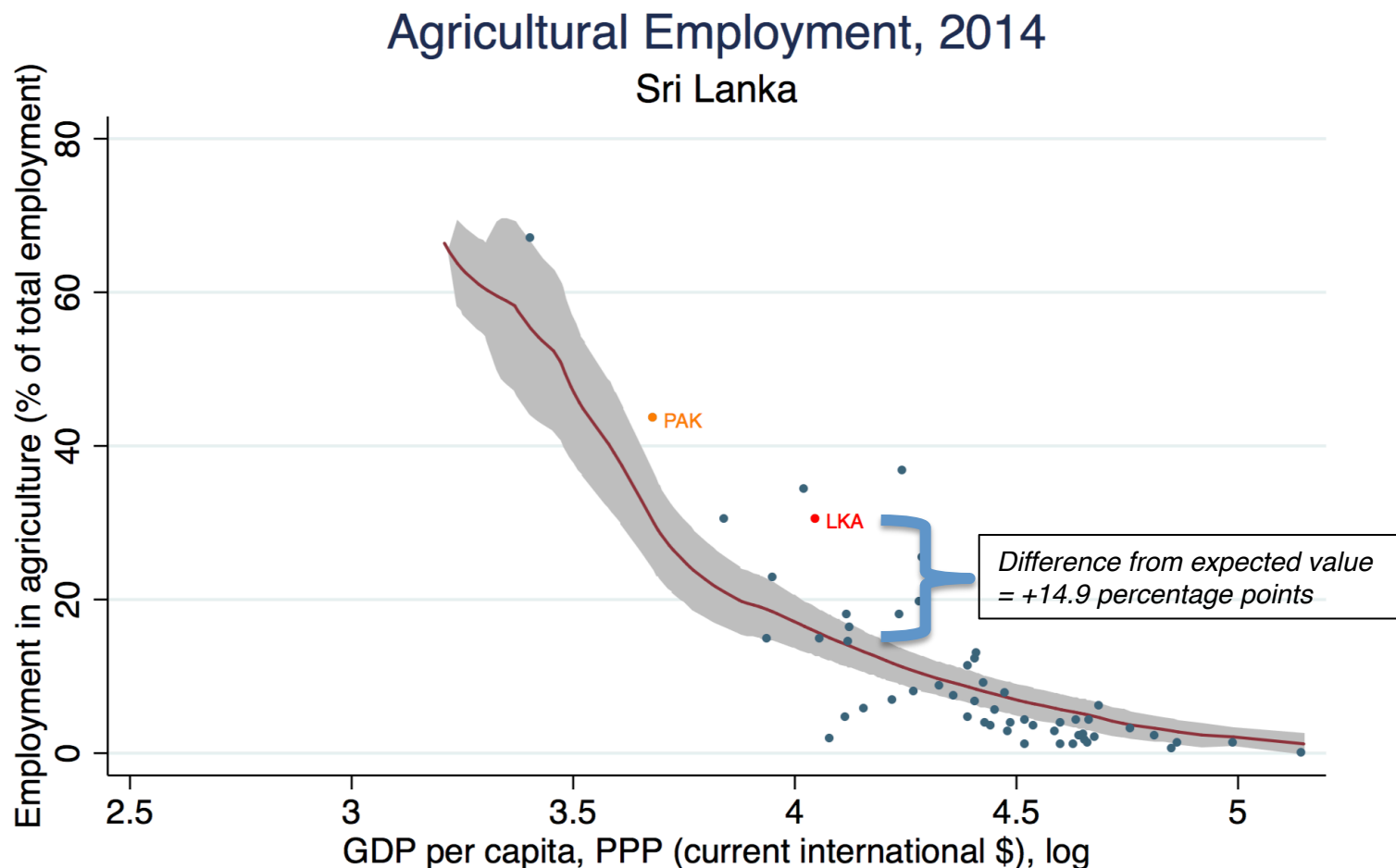


Note: Agriculture corresponds to ISIC Rev. 3 divisions 1-5

Data source: World Development Indicators



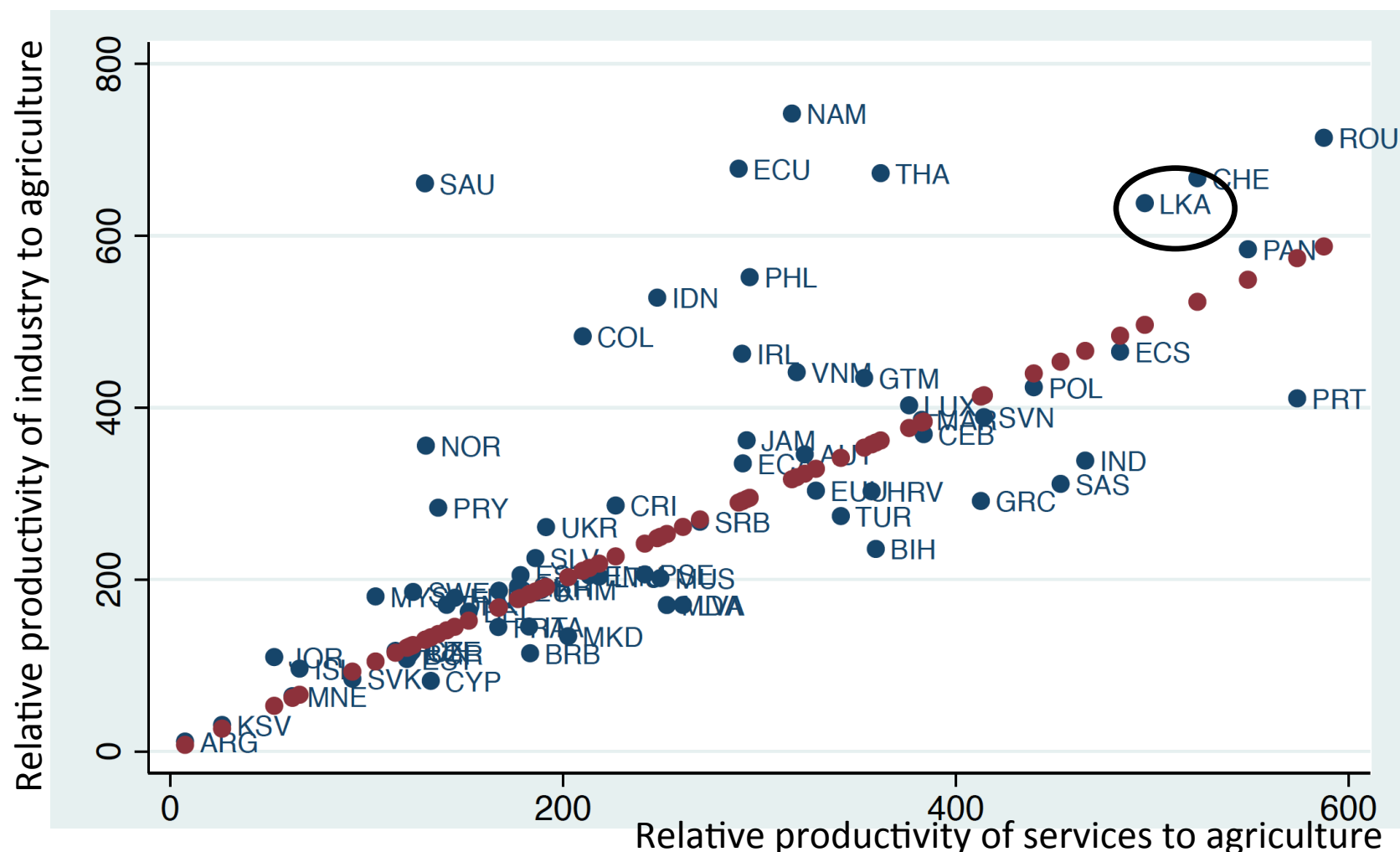
But employment in agriculture remains well above what would be expected, implying low productivity



Note: Agriculture corresponds to ISIC Rev. 3 divisions 1-5  
Data source: World Development Indicators



# Productivity in agriculture in very low compared with industry and services

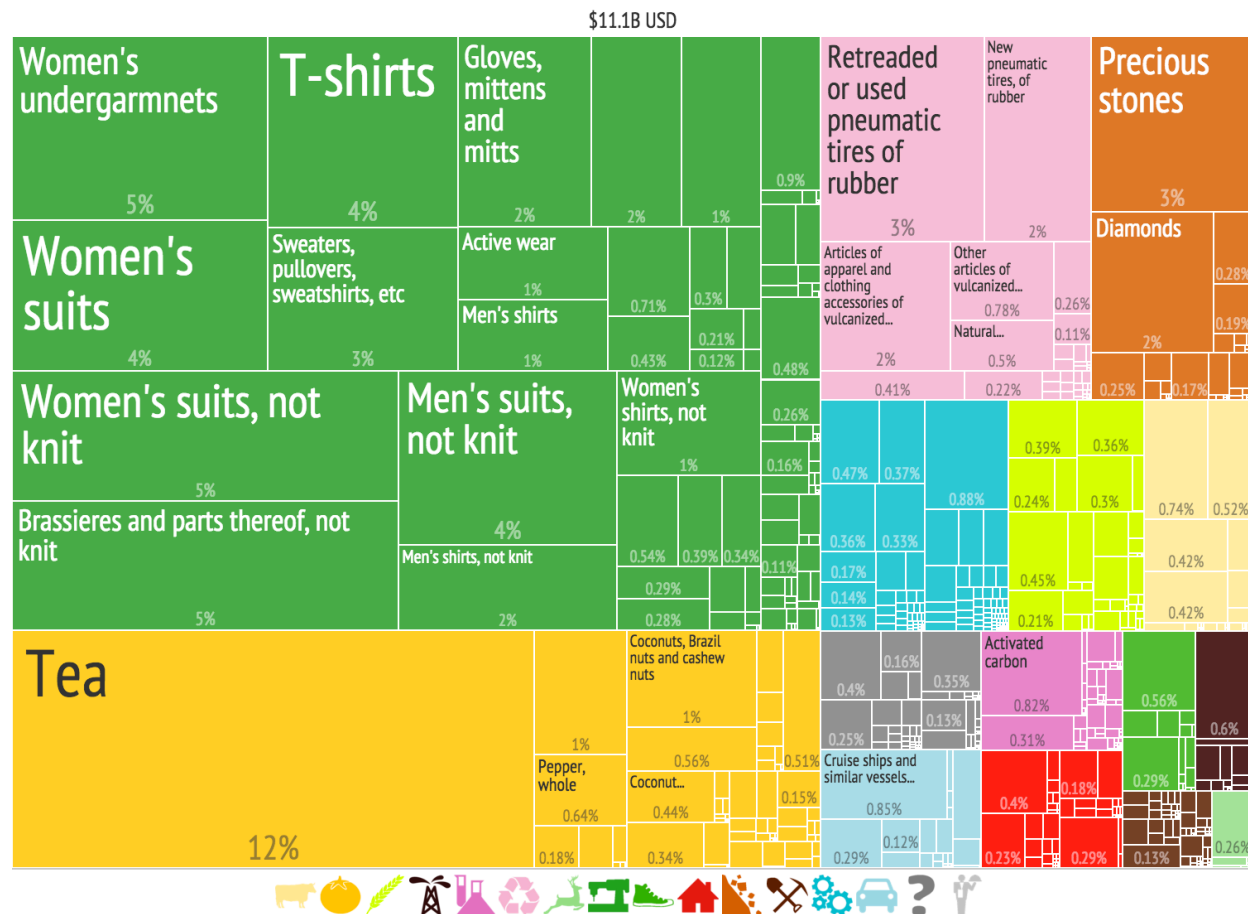


Data source: World Development Indicators



# Sri Lanka's exports are focused in garments, tea and rubber products

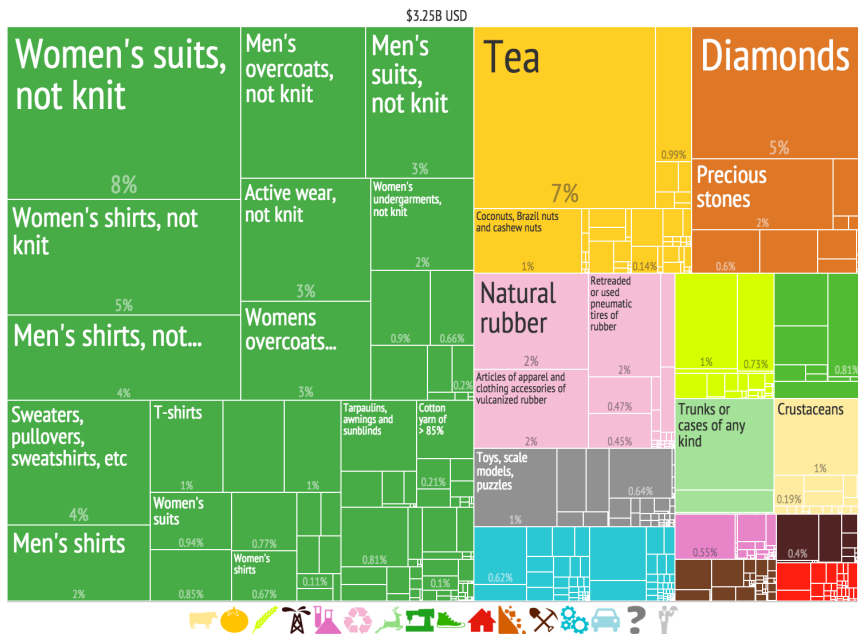
## Exports, 2014



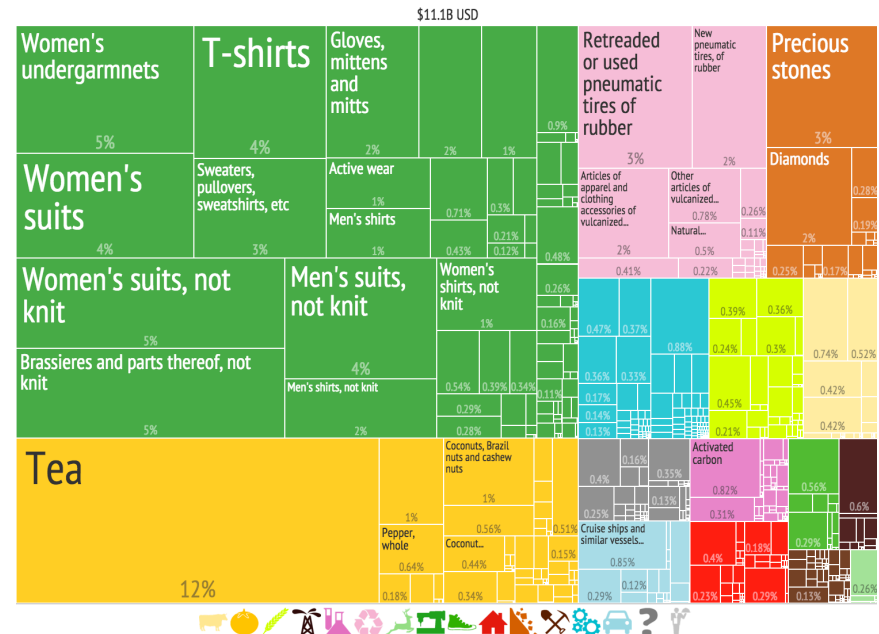


# This has been the case for a long time

## Exports, 1995



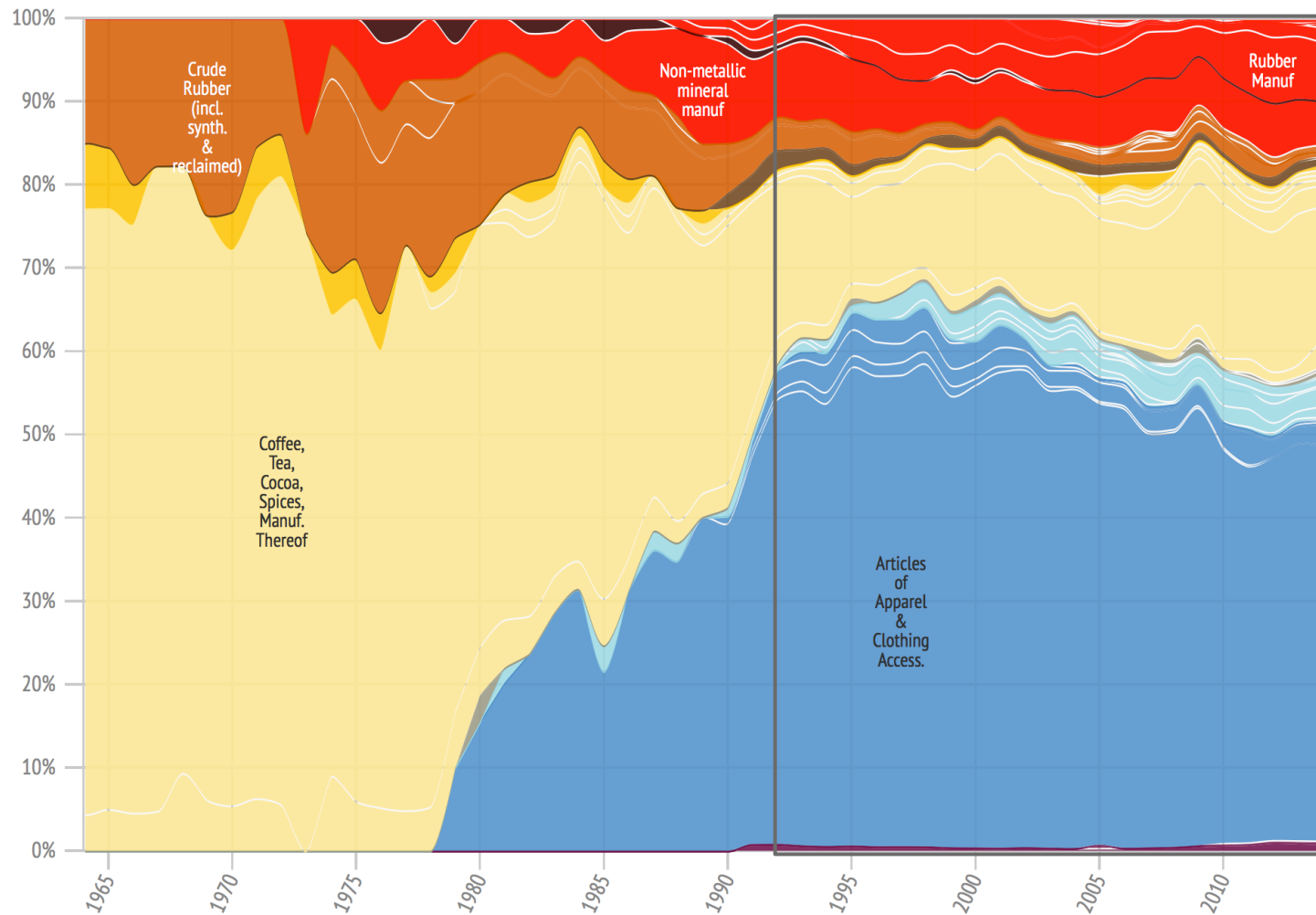
## Exports, 2014





# Sri Lanka's export basket has changed little since mid-1990s

Sri Lanka,  
1962-2014





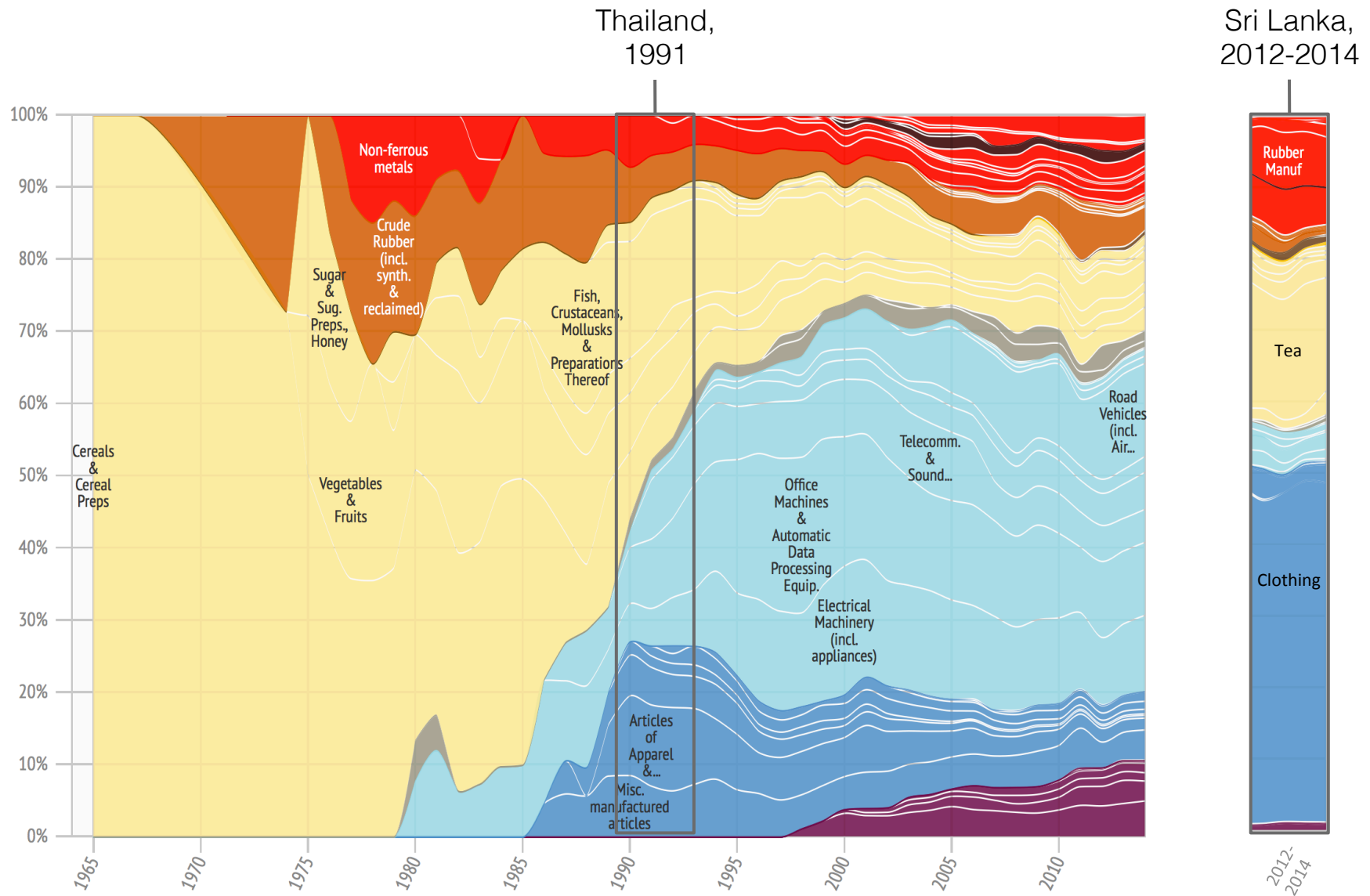
We can compare its current export basket to the trajectory of export diversification in other countries

Sri Lanka,  
2012-2014





# Thailand's export basket in 1991 was similar to Sri Lanka's now, but then it changed a lot

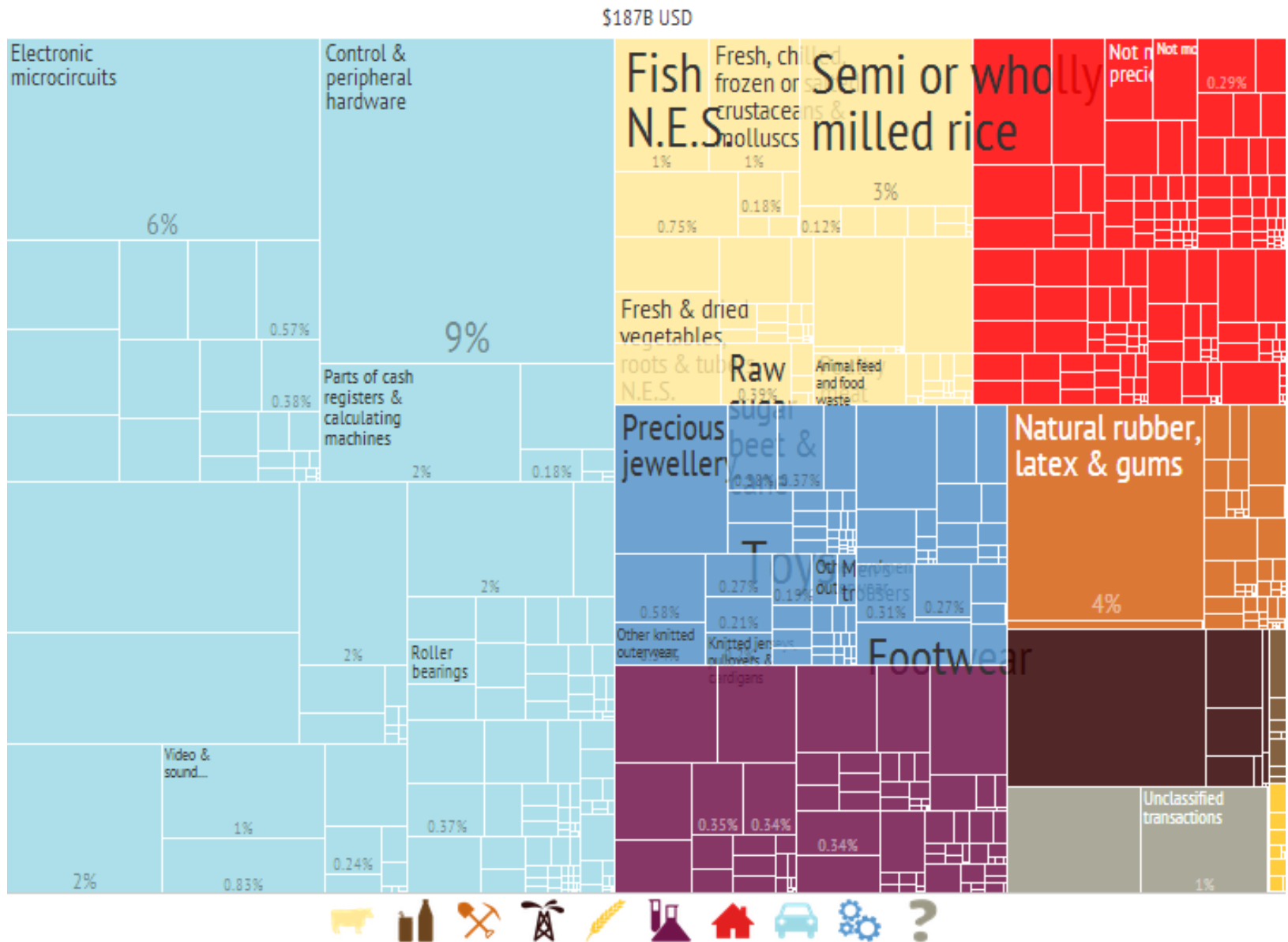




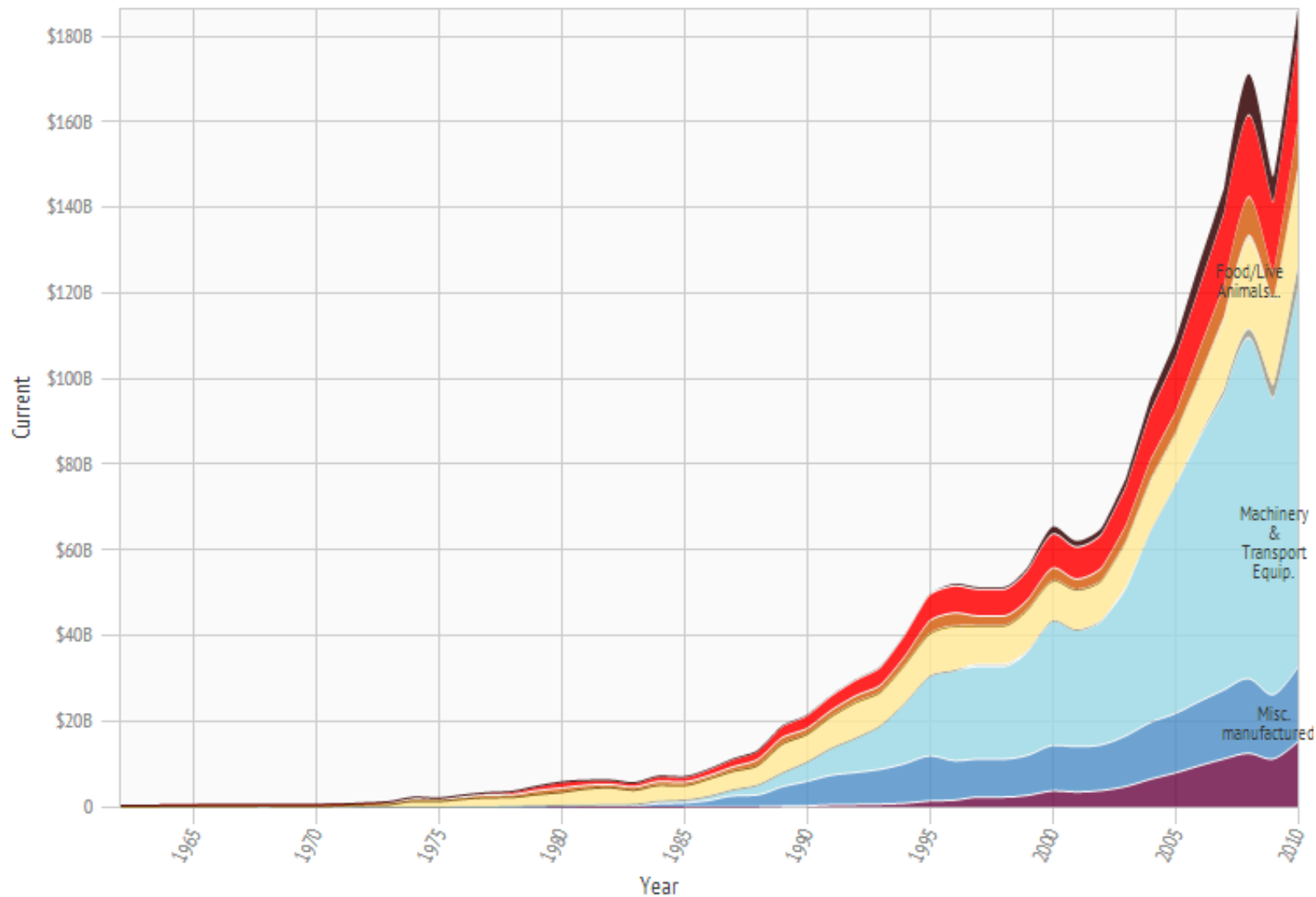




# Thailand's exports in 2010

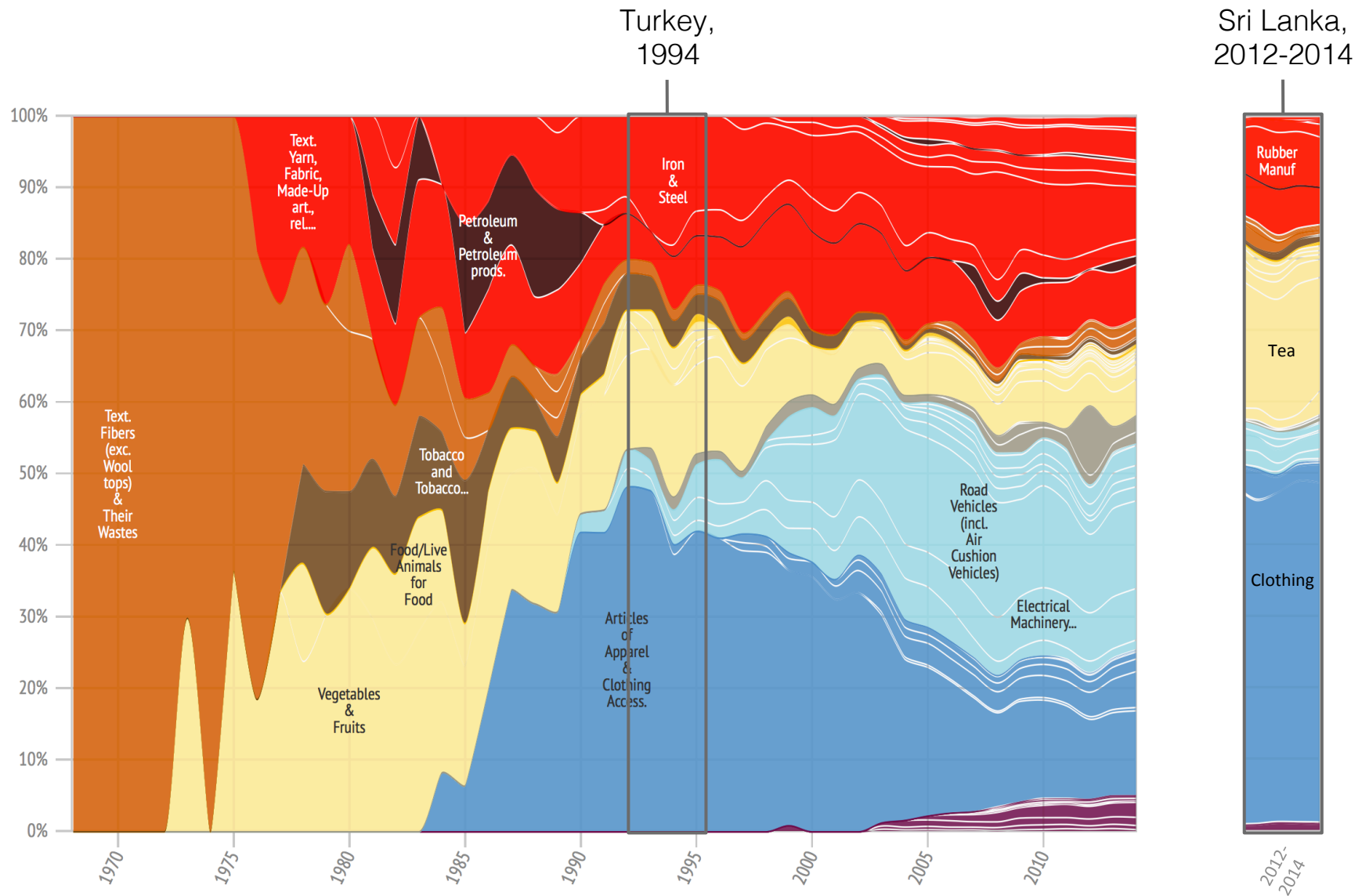






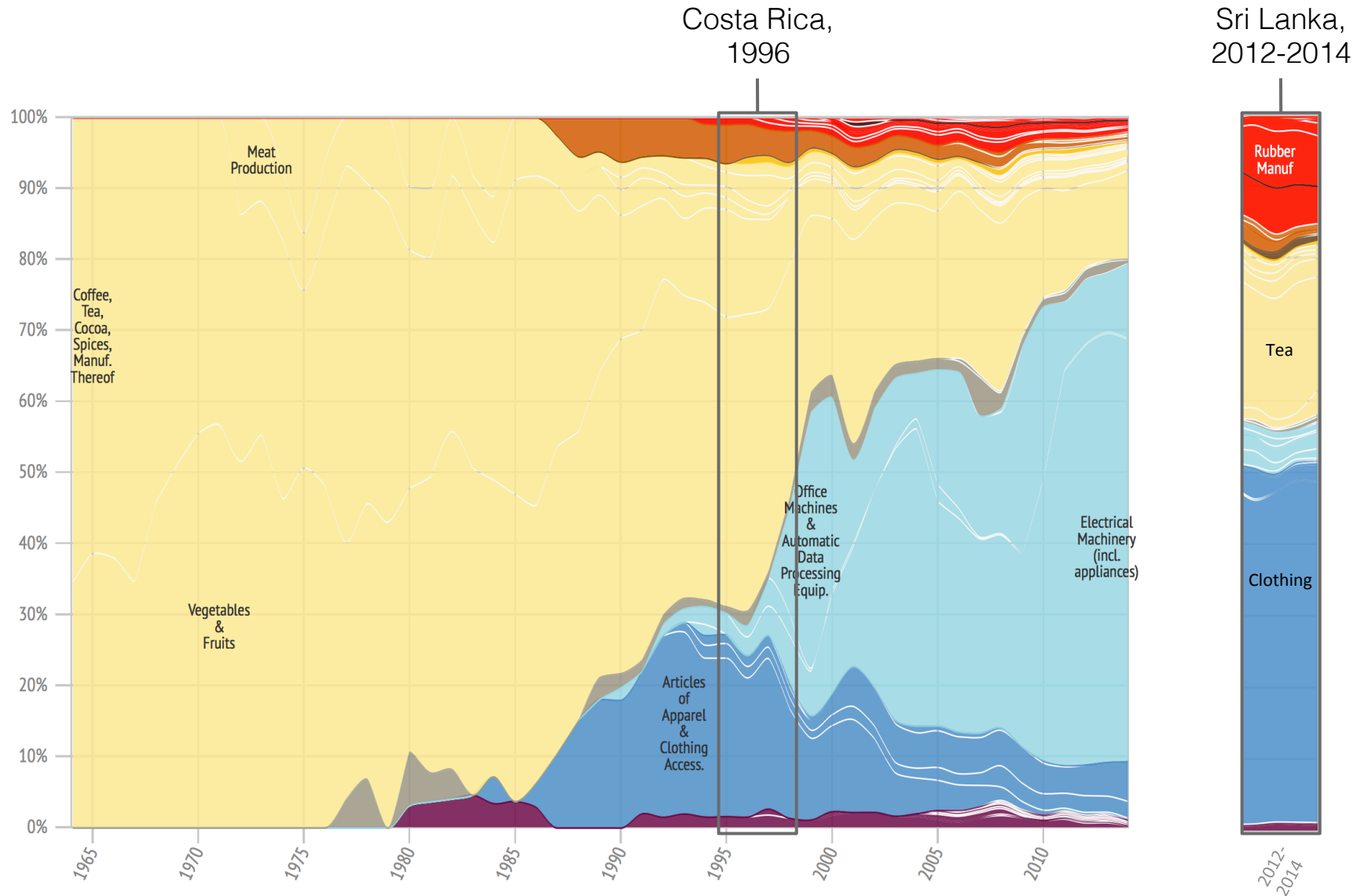


# Turkey's export basket in 1994 was similar to Sri Lanka's now, and then it changed





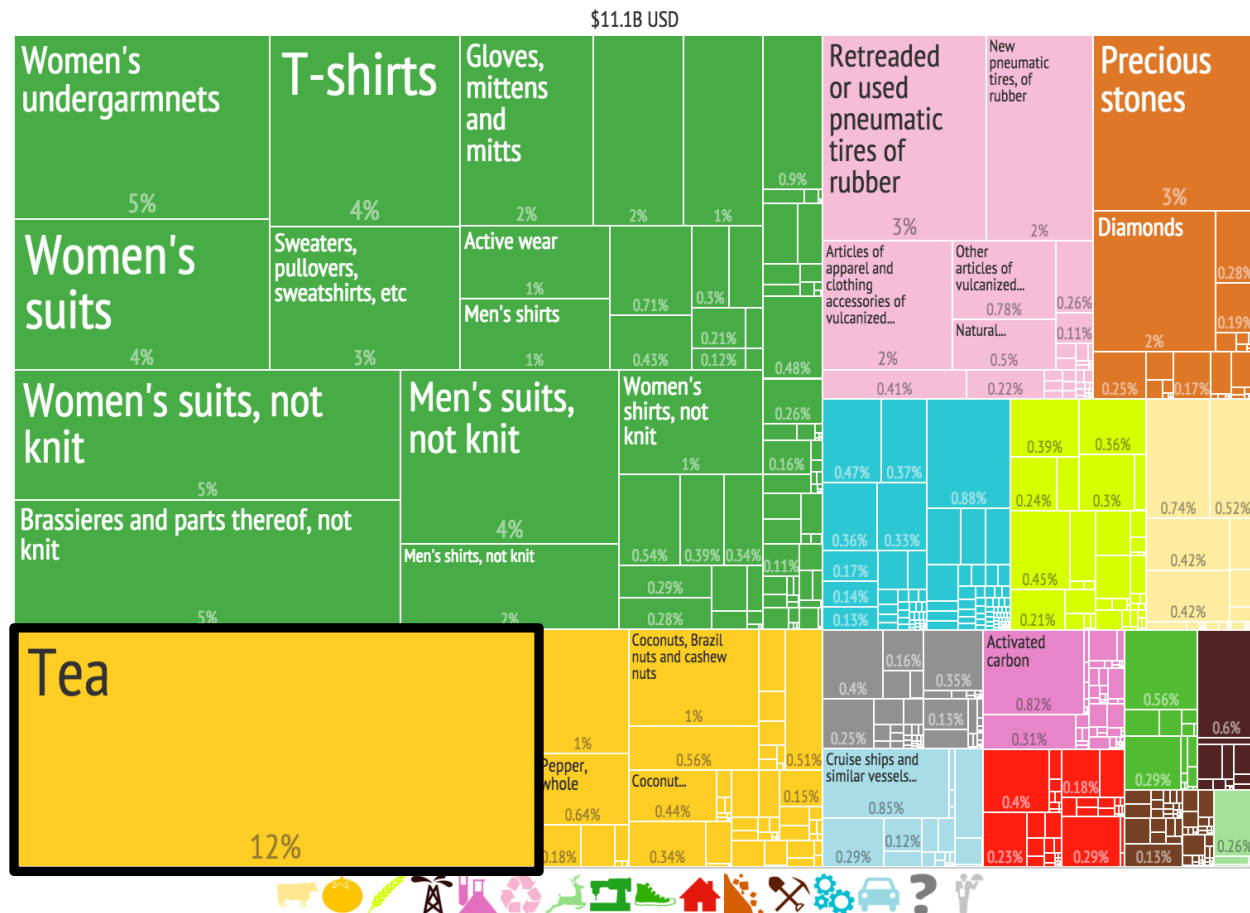
# Costa Rica in 1996 was similar to Sri Lanka today, but then it changed





In Sri Lanka, many exports are under competitive pressure from lower income countries

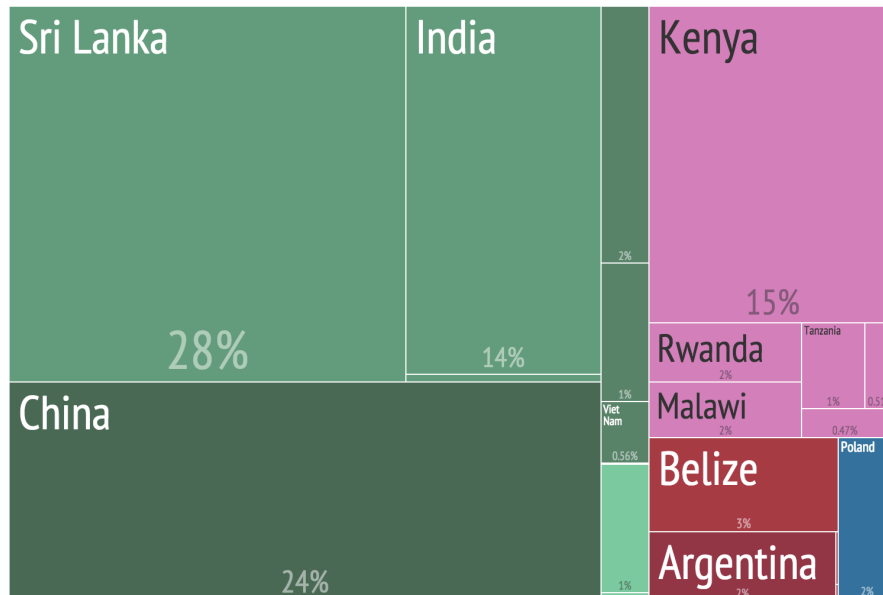
## Exports, 2014



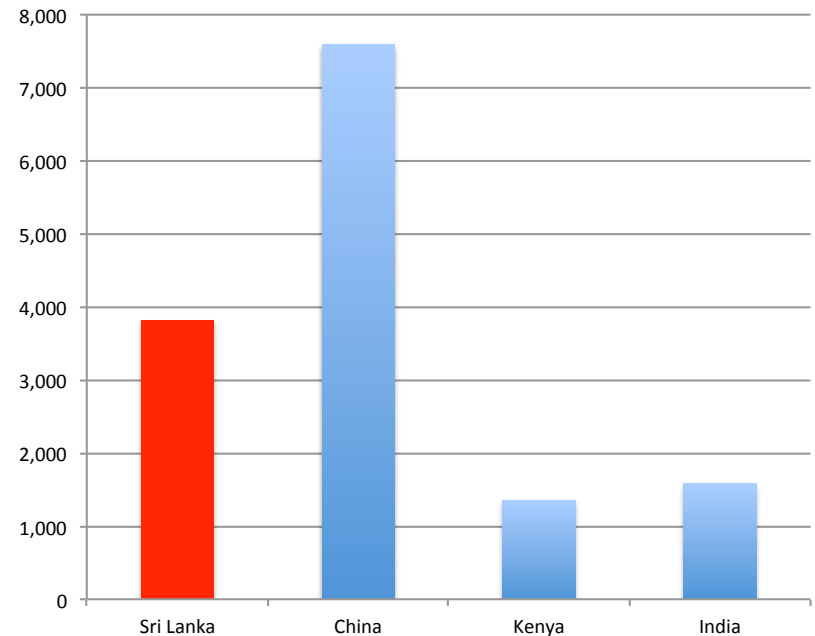


# Tea: Low income competitors

## Global Share of Tea Exports (Net) in 2014



## GDP per capita (USD) in 2014

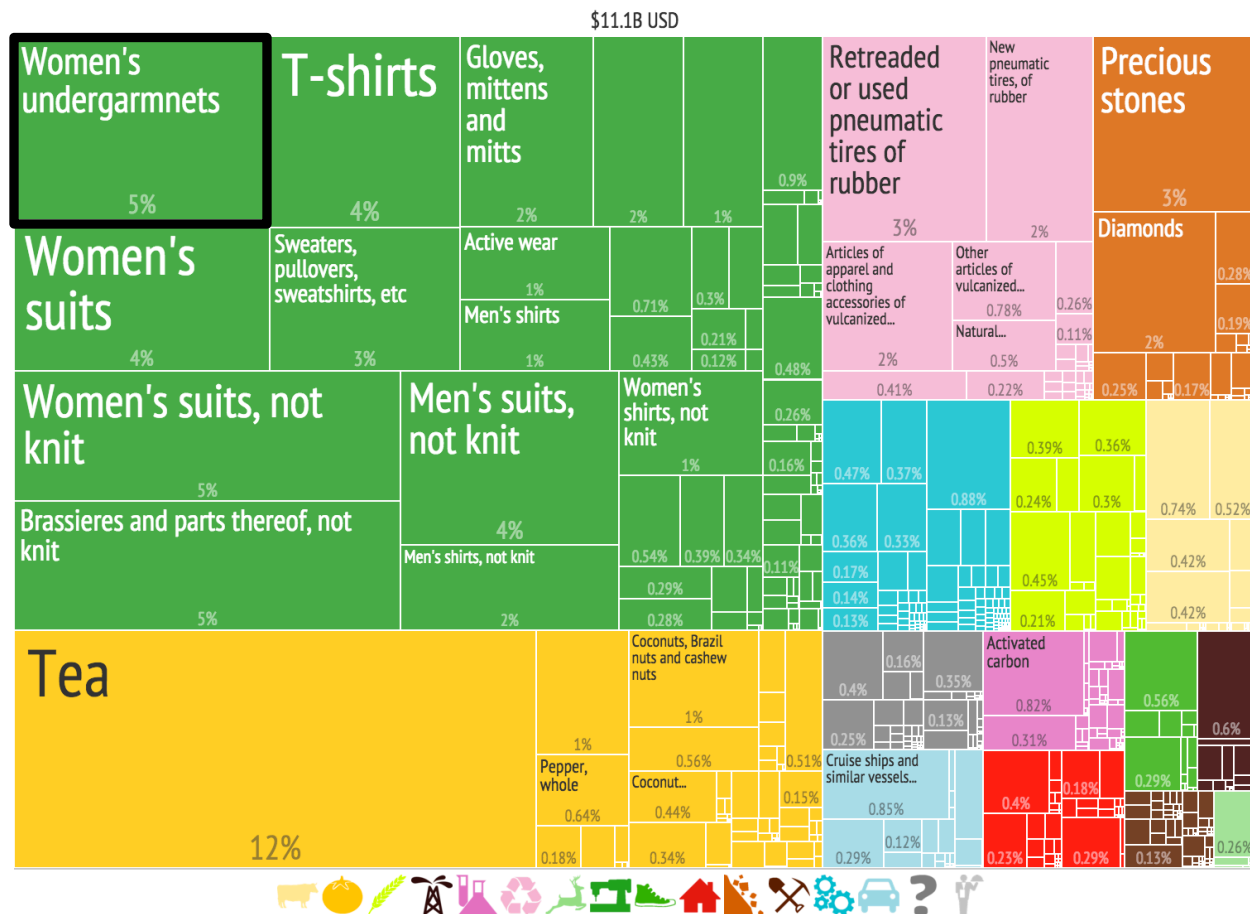


Data source: World Development Indicators



This is also the case for many garment exports, like women's undergarments

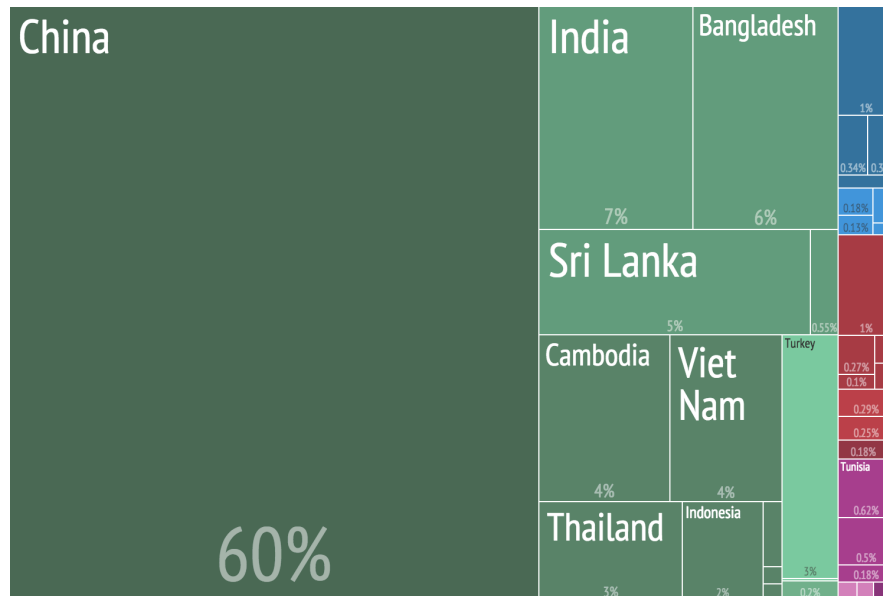
## Exports, 2014



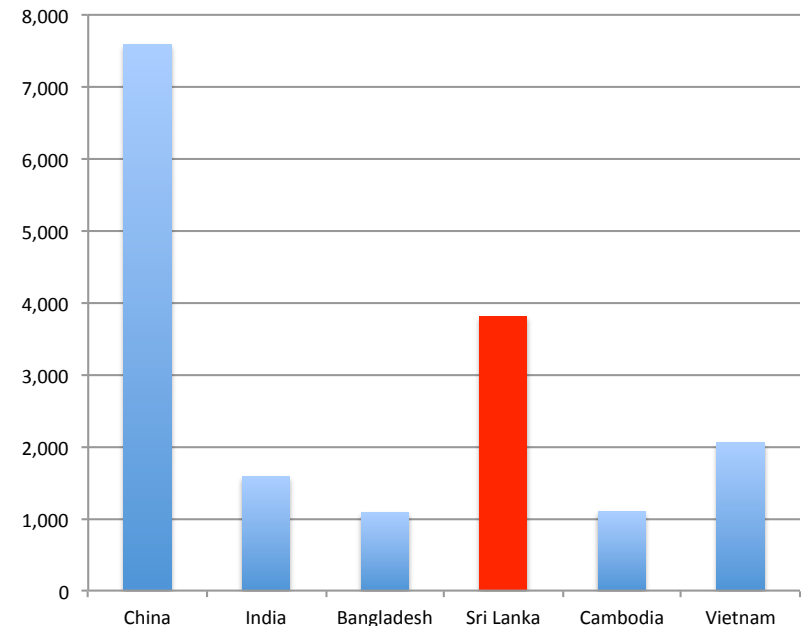


# Women's Undergarments: Low income competitors

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



GDP per capita (USD) in 2014

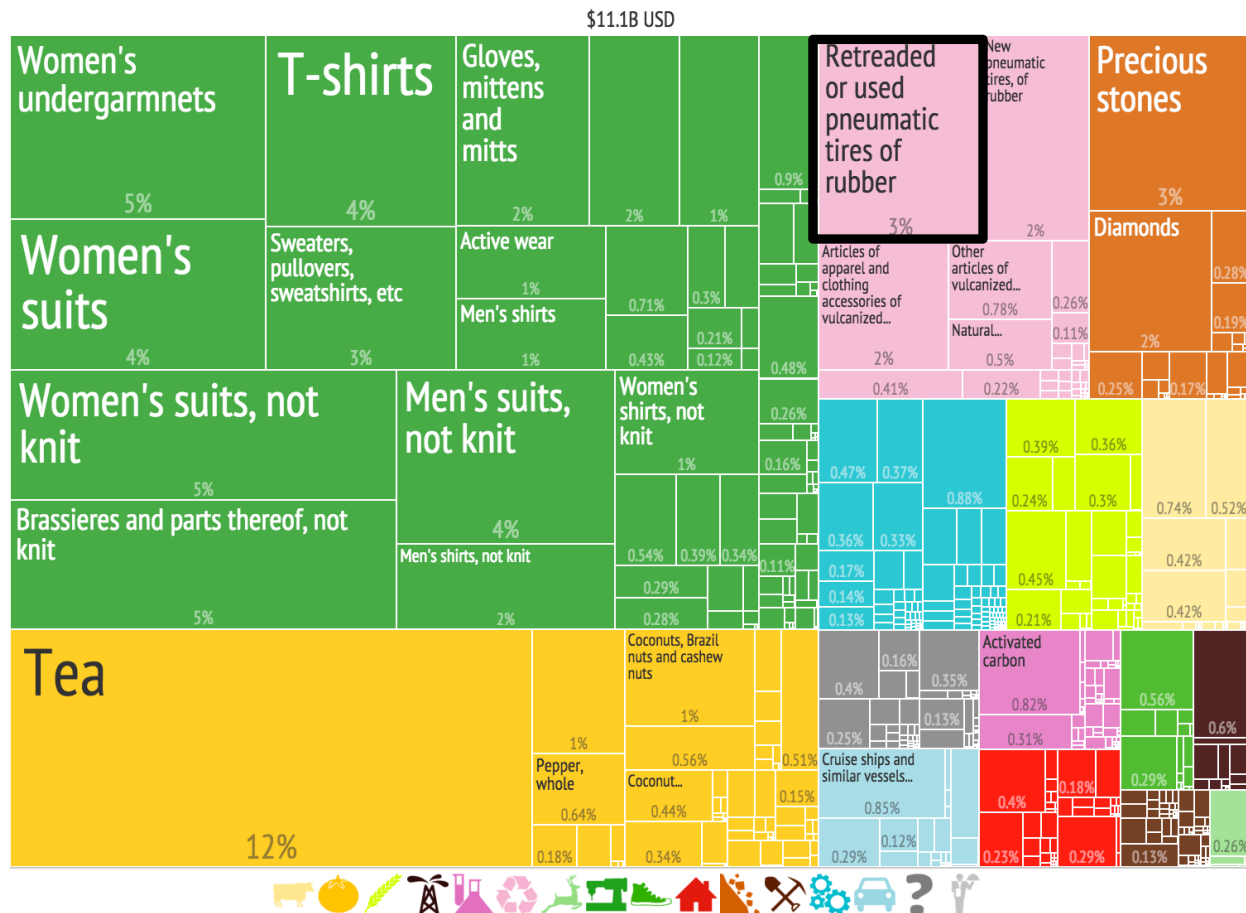


Data source: World Development Indicators



Meanwhile, rubber products show a different trend

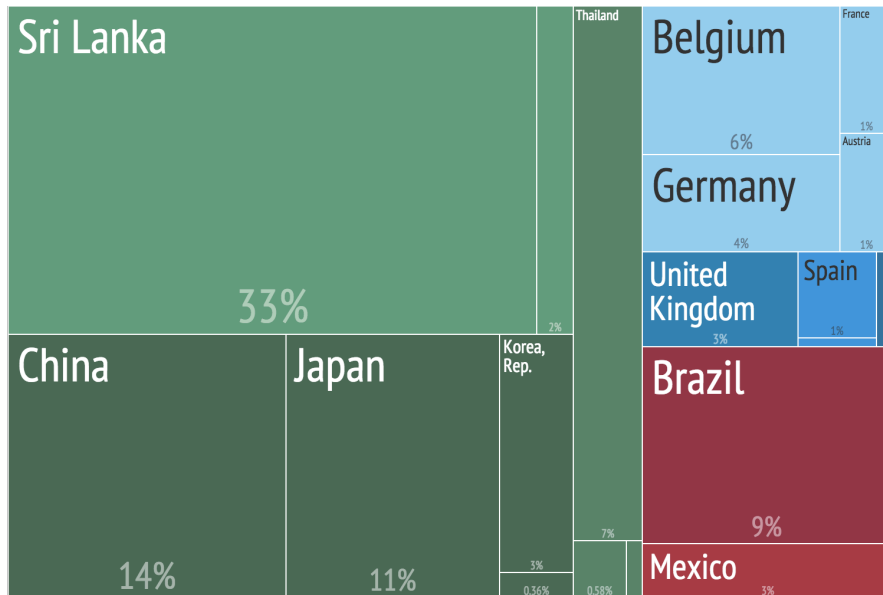
## Exports, 2014



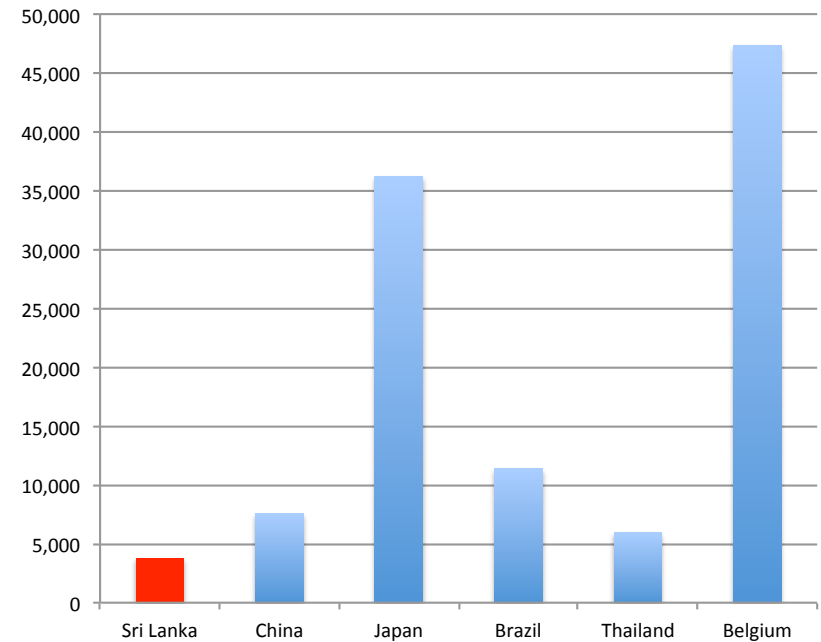


# Retreaded Tires: Middle and high income competitors

Global Share of Retreaded Tires  
Exports (Net) in 2014



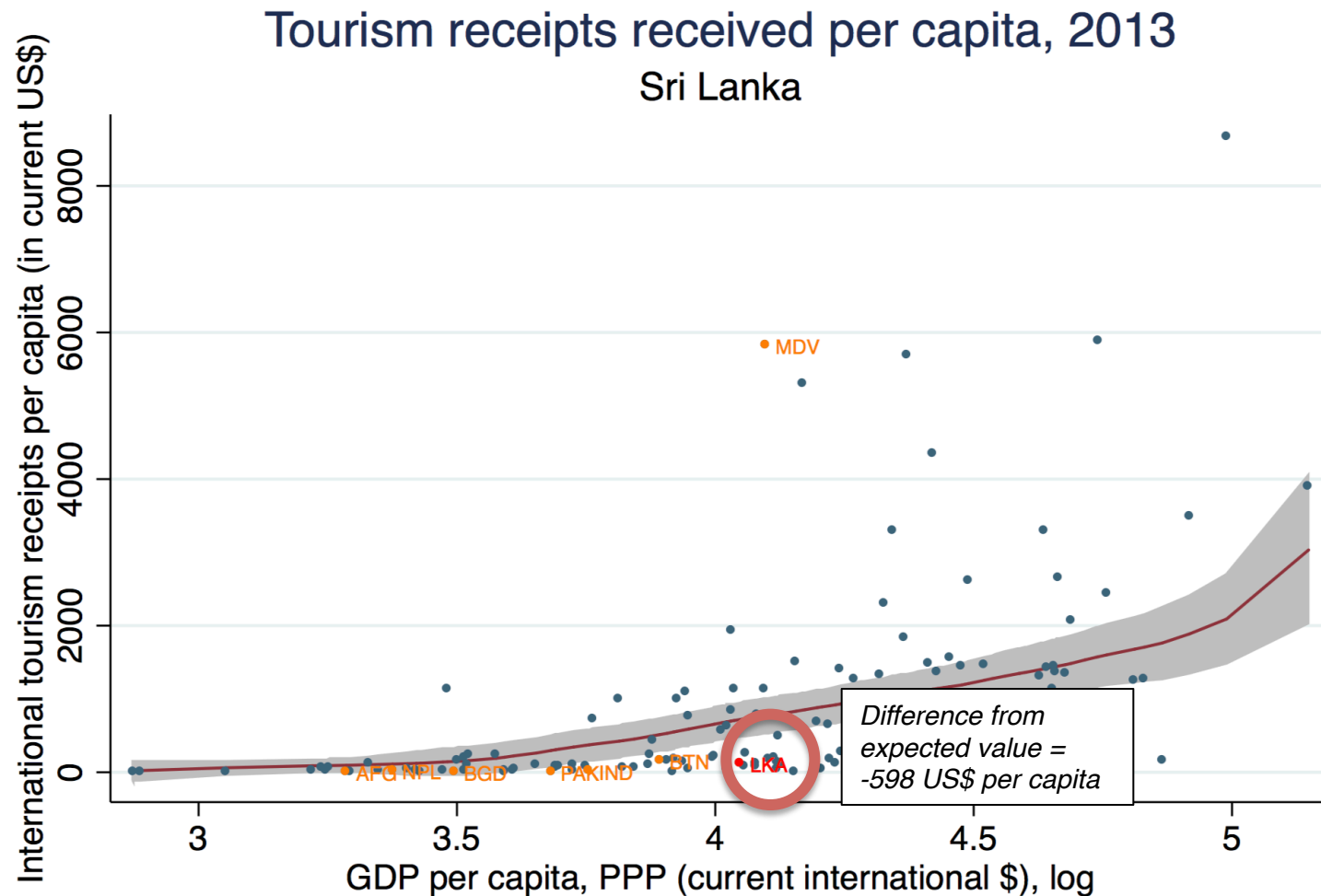
GDP per capita (USD) in 2014



Data source: World Development Indicators



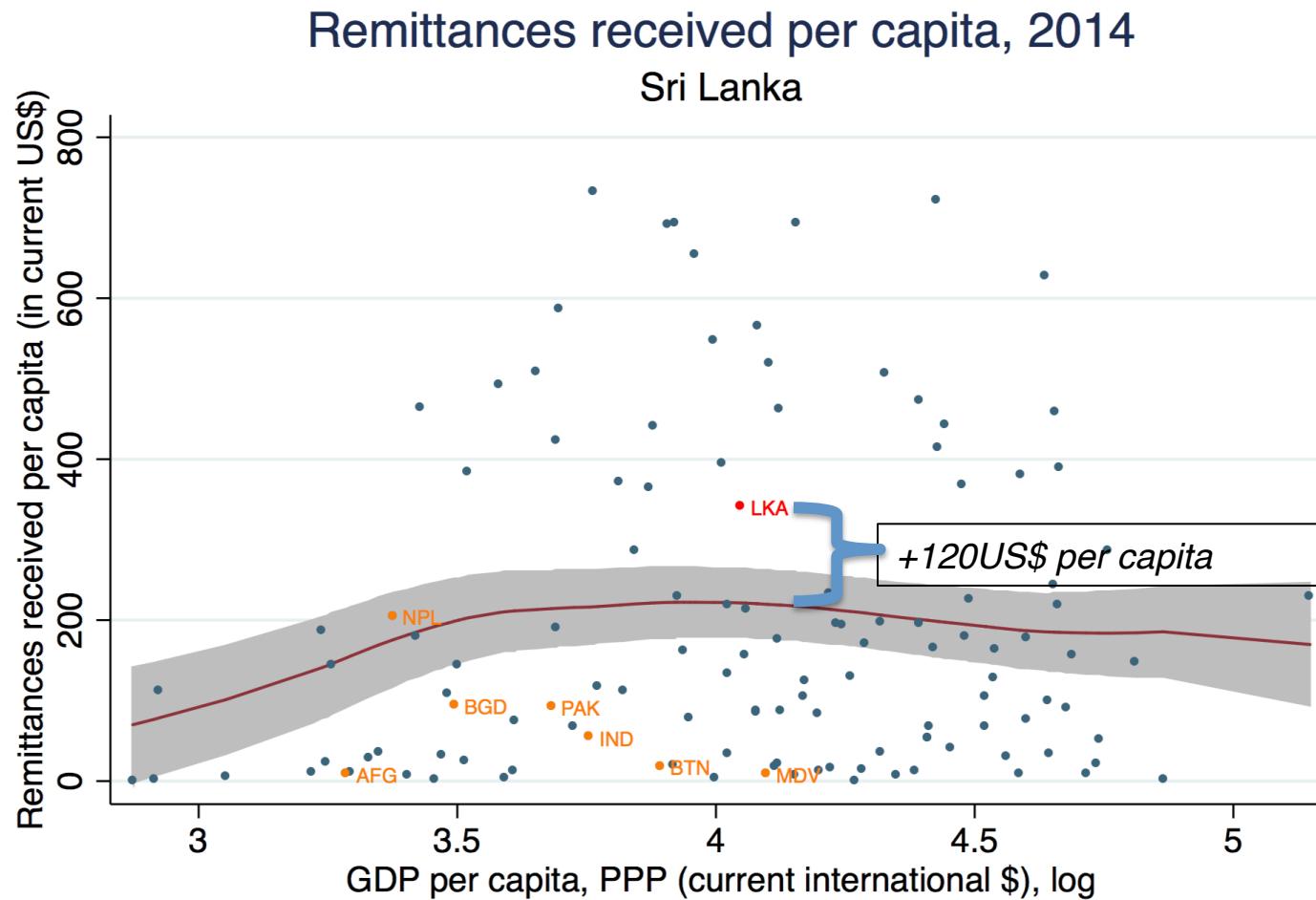
# Richer countries get more from tourism revenue per capita



Data source: World Development Indicators



Remittance income is probably not going to be an engine of growth in the longer (or shorter) run



Data source: World Development Indicators



# Implications

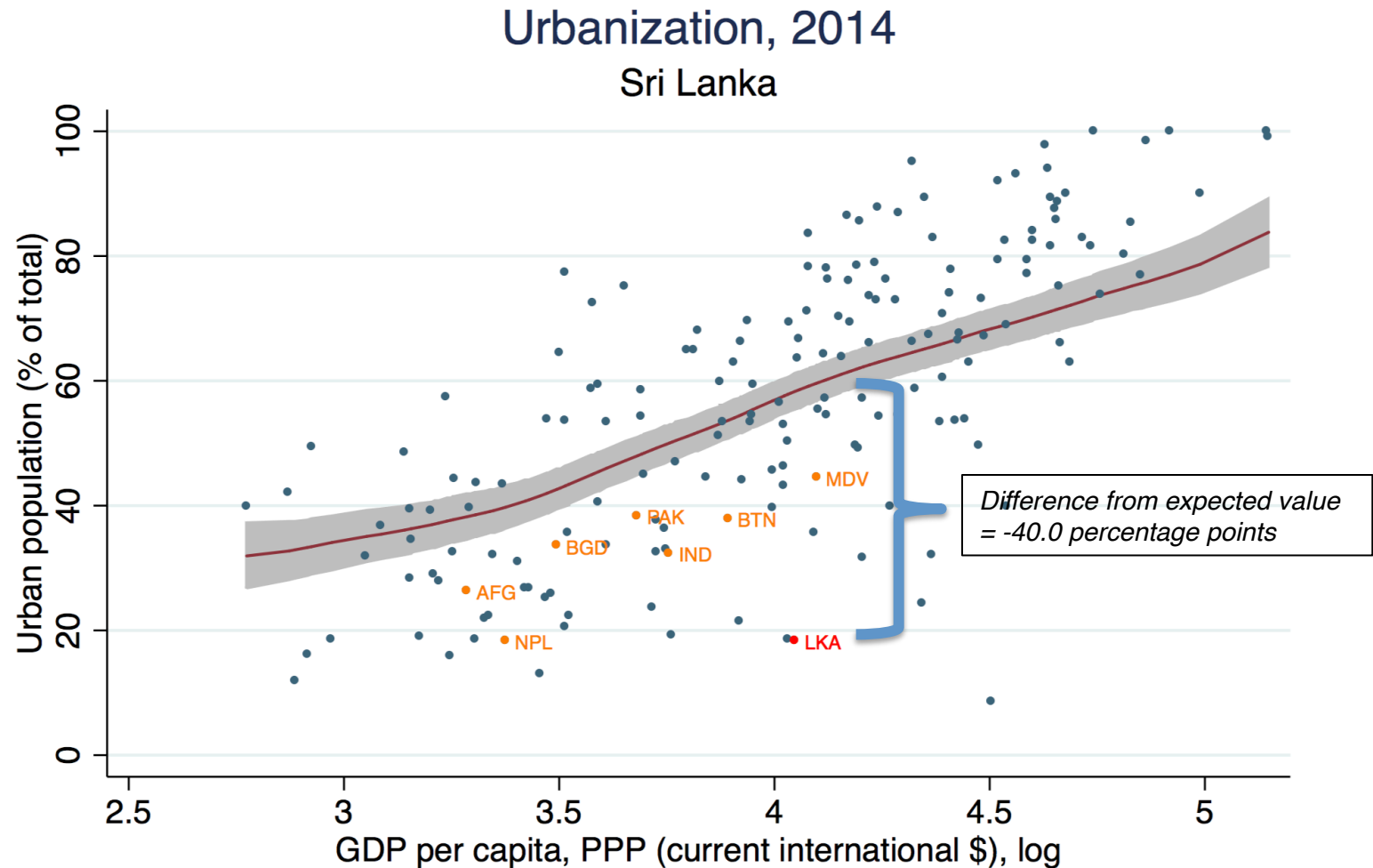
- Sustained growth involves not just more of the same
- As they grow, countries diversify and evolve their comparative advantage into new areas
- These tend to be more complex and able to compete while paying higher wages
- This process is not just about shifting from agriculture to manufacturing but 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



Data source: World Development Indicators



# 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?

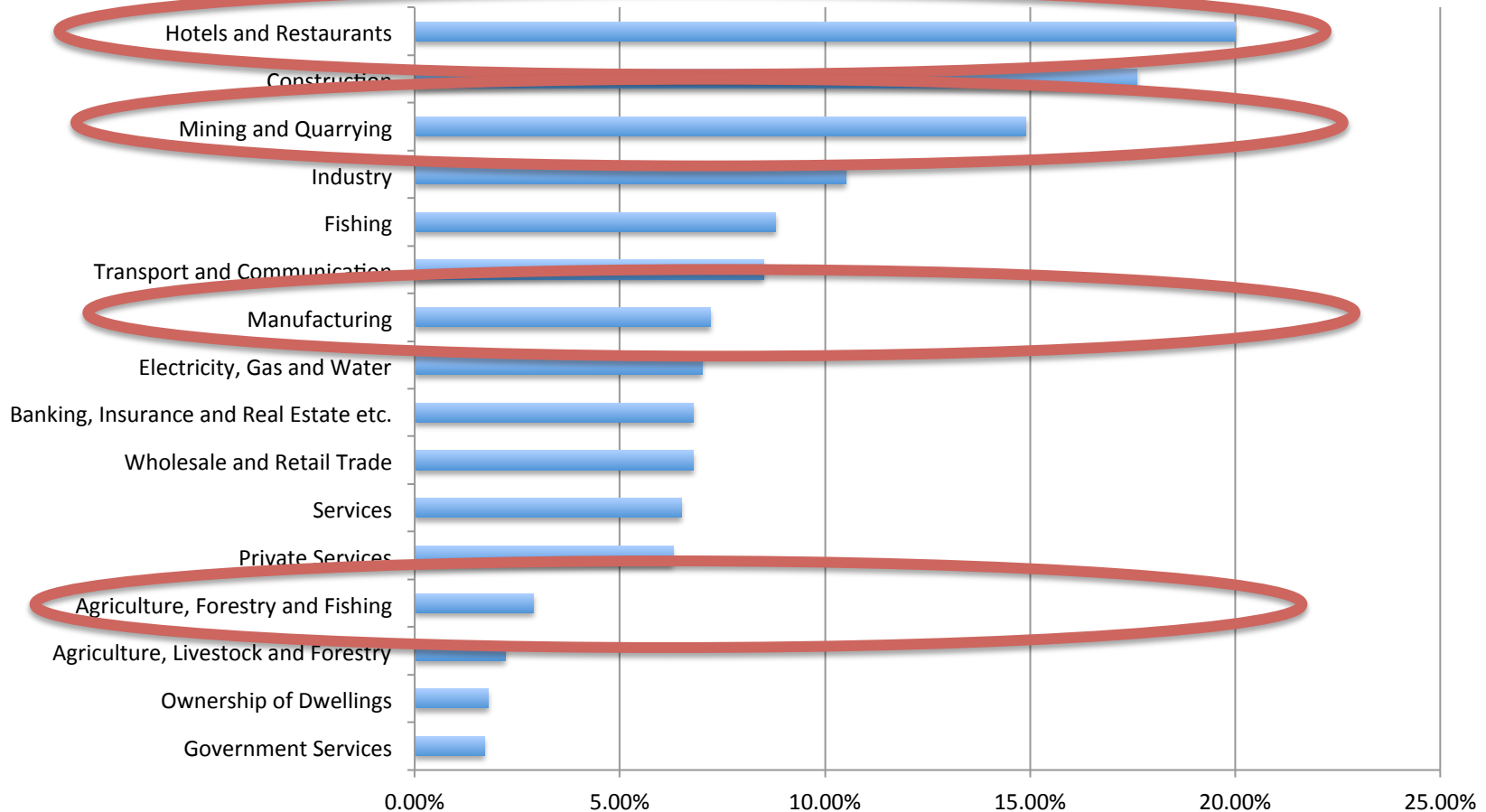


# The challenge of regional and social cohesion



# Growth rates by industry are quite heterogeneous

Growth rate 2010-2014





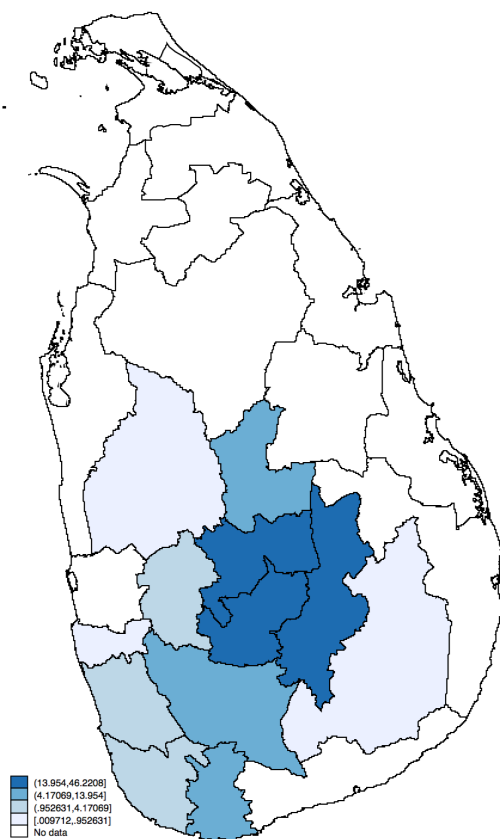
And different regions focus on  
different activities



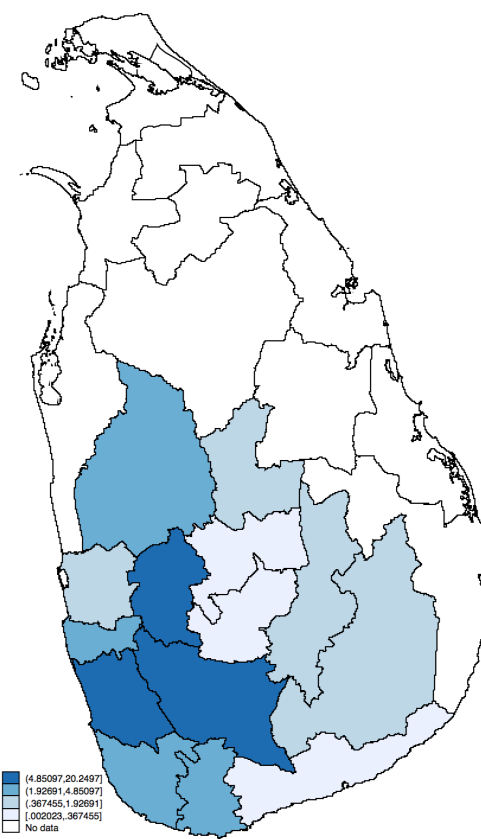
# Estate sector production is regionally focused

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

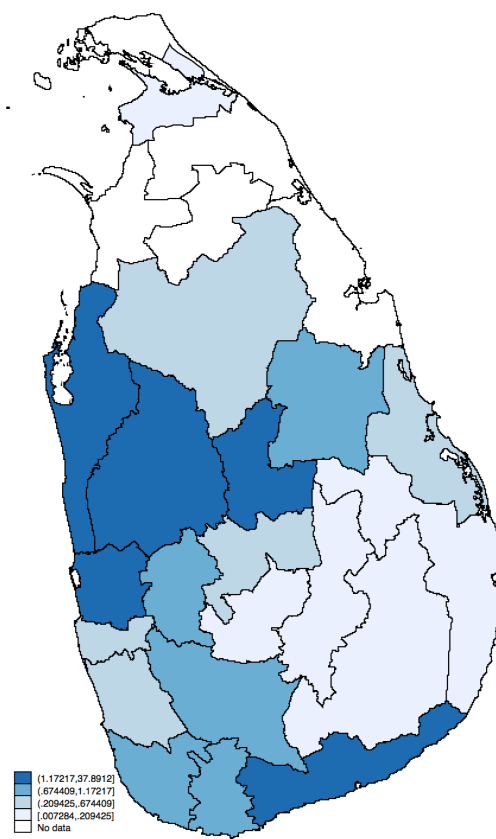
**Extent under Tea by District, 2002**  
(‘000s of hectares)



**Extent under Rubber by District, 2002**  
(‘000s of hectares)



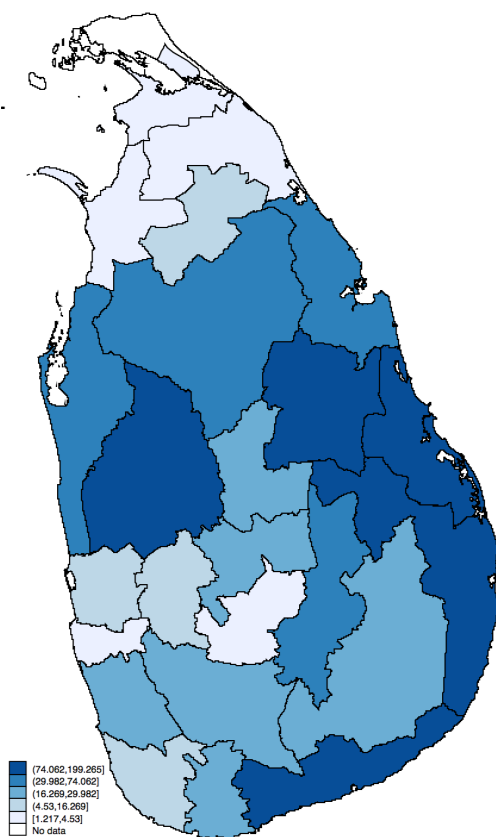
**Extent under Coconuts by District, 2002**  
(‘000s of hectares)



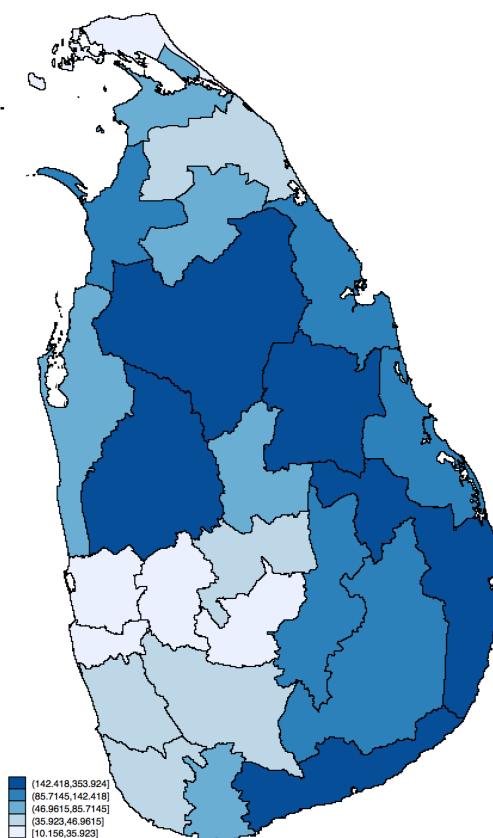


# As are other agricultural activities

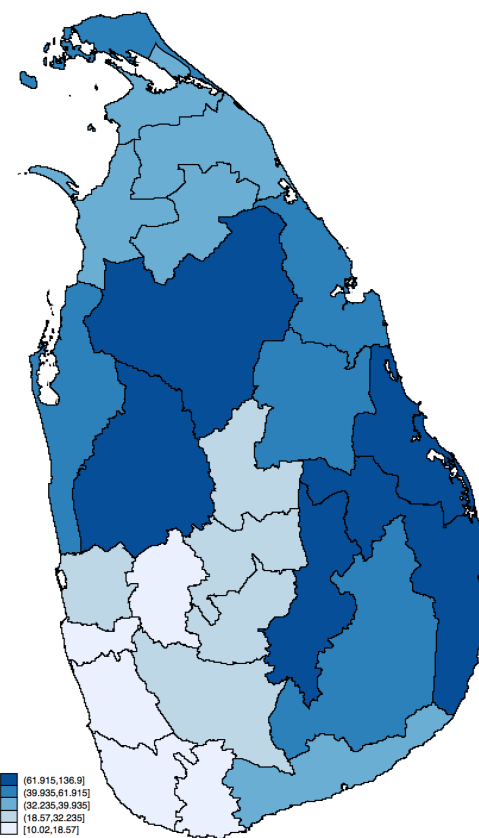
**Palay Production, Yala 2014**  
(‘000s of metric tons)



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



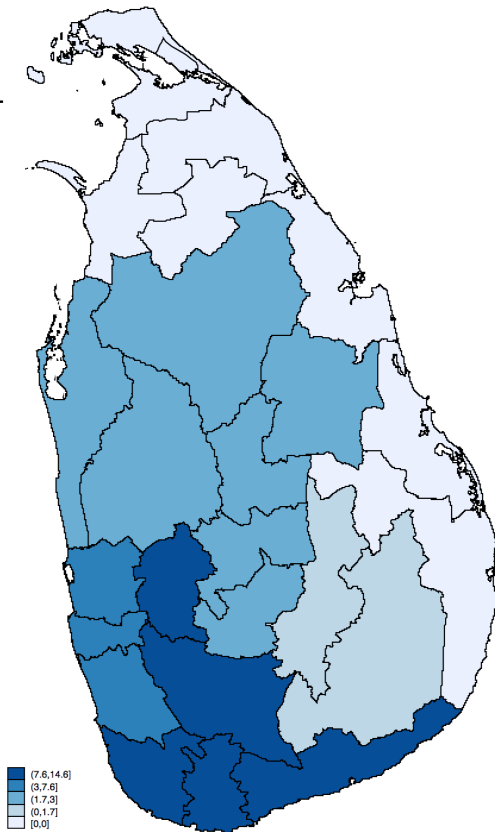
**Cattle Population, 2014**  
(‘000s of cattle)



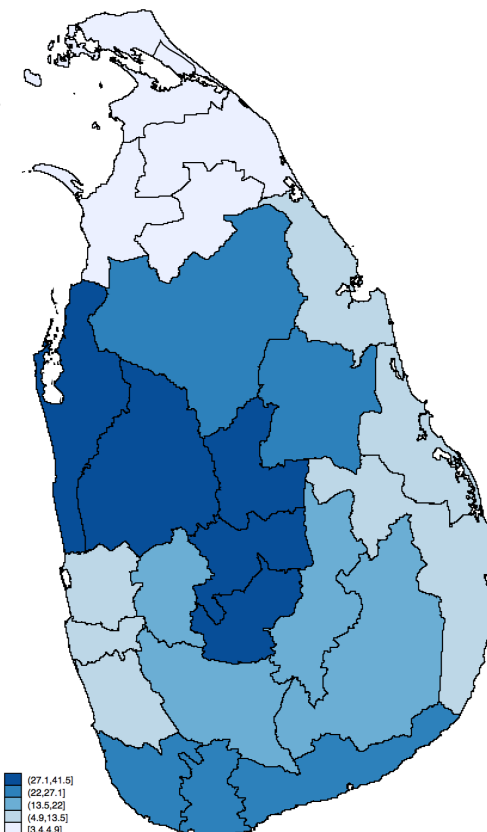


# Different provinces concentrate on different manufacturing industries

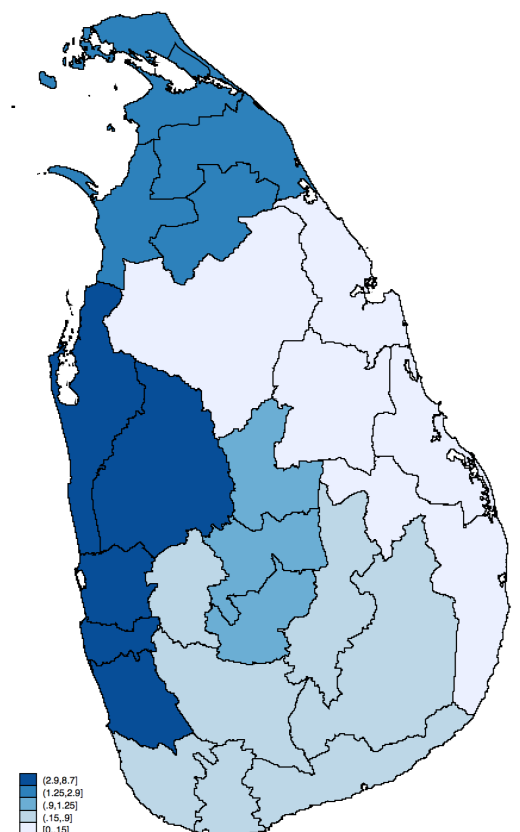
**Rubber & Plastic Products**  
(% share of province manufacturing output)



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



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





# 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!



**Center for  
International  
Development**  
*at Harvard University*



Sri Lanka  
**Economic  
Forum** 2016