SRI LANKA GROWTH DIAGNOSTIC ANALYSIS

Framing and connections to trade policy

Center for International Development, August 28, 2016

Collecting the evidence – what is constrained?

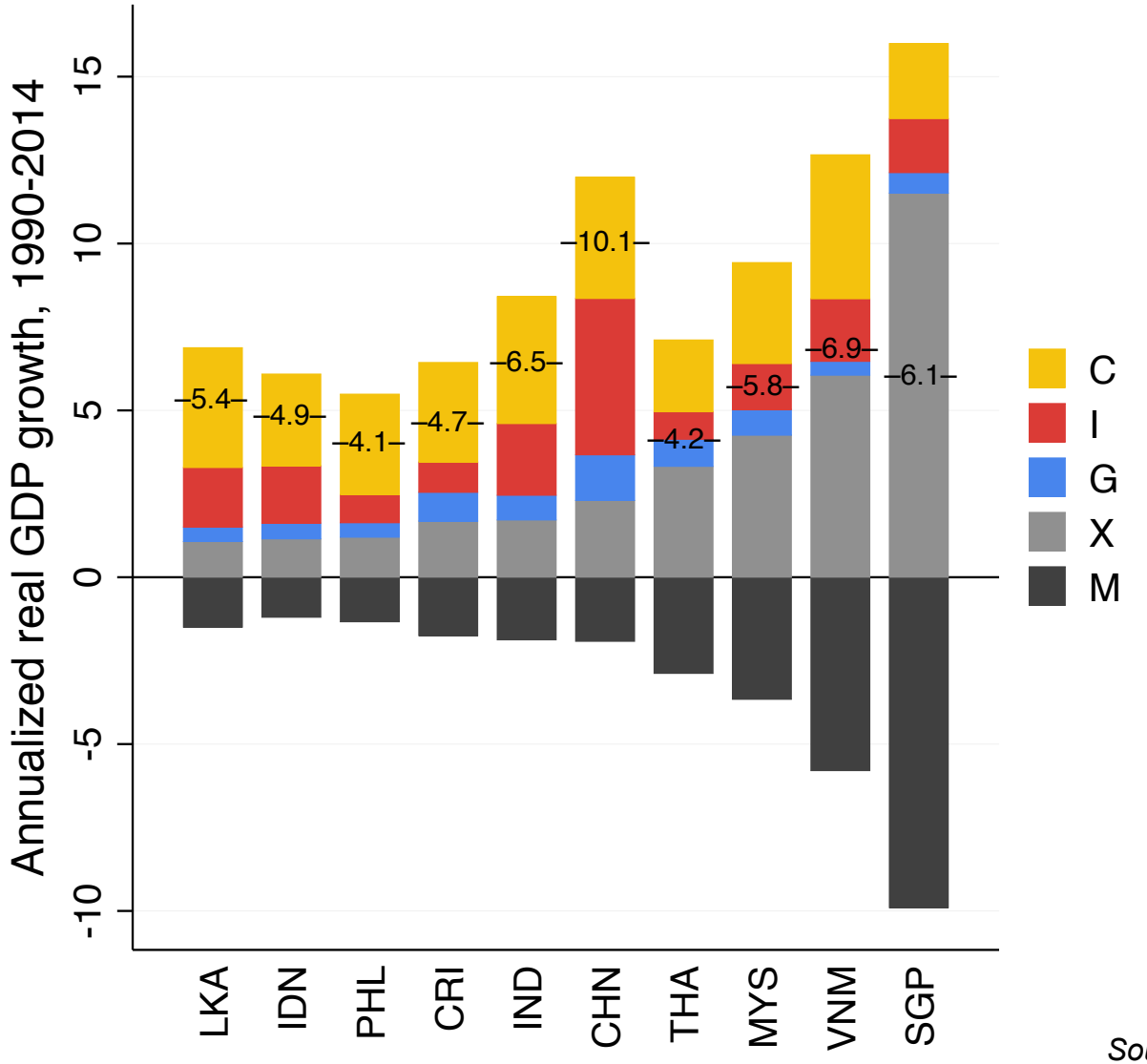
	What appears healthy	What appears constrained
GDP growth by expenditure type	• Overall GDP growth • Growth contribution from investment, government & household consumption	• Trade component of growth (low, stagnant exports; persistent trade deficit)
GDP growth by sector	• Construction & real estate • Retail, logistics, hospitality, recreation (possibly including tourism) • Finance, insurance, technical / support • ICT (growing, though still small)	• Agriculture & fisheries • Manufacturing • Public sector
Exports by product category	• Goods first exported in 1980s or earlier • Garments, agriculture	• New export products • Manufactures (machinery & electrical)
Exports of services	• Finance/insurance, logistics, tourism	• ICT / BPO
Exports by quality, sophistication	• Quality of garment exports • Export products associated with lowest income & “know-how”	• Quality of non-garment exports (mixed) • Export products associated with mid-to-high income & “know-how”
FDI	• Tourism, logistics, finance, & construction investment	• Overall FDI • Manufacturing (electronics, vehicles, materials) & energy investment

CHALLENGE: Identify the constraints that **bind growth** of **exports** and **externally-oriented FDI**, specifically in **new activities**, and **do not bind growth** in construction, tourism, logistics and finance.

Framing: Background and Country Context

WHAT PART OF GROWTH IS CONSTRAINED?

Sri Lanka's growth has been strong, but internally-oriented



Sri Lanka's long-run growth pattern is typified by relatively low contributions from exports: 1.07 percentage points of growth rate come from exports (lowest of its peers).

Contributions from investment and consumption growth match peers.

Source: own calculation using data from WDI

The export component of growth has been weak in recent decades

Annualized real GDP growth, export component

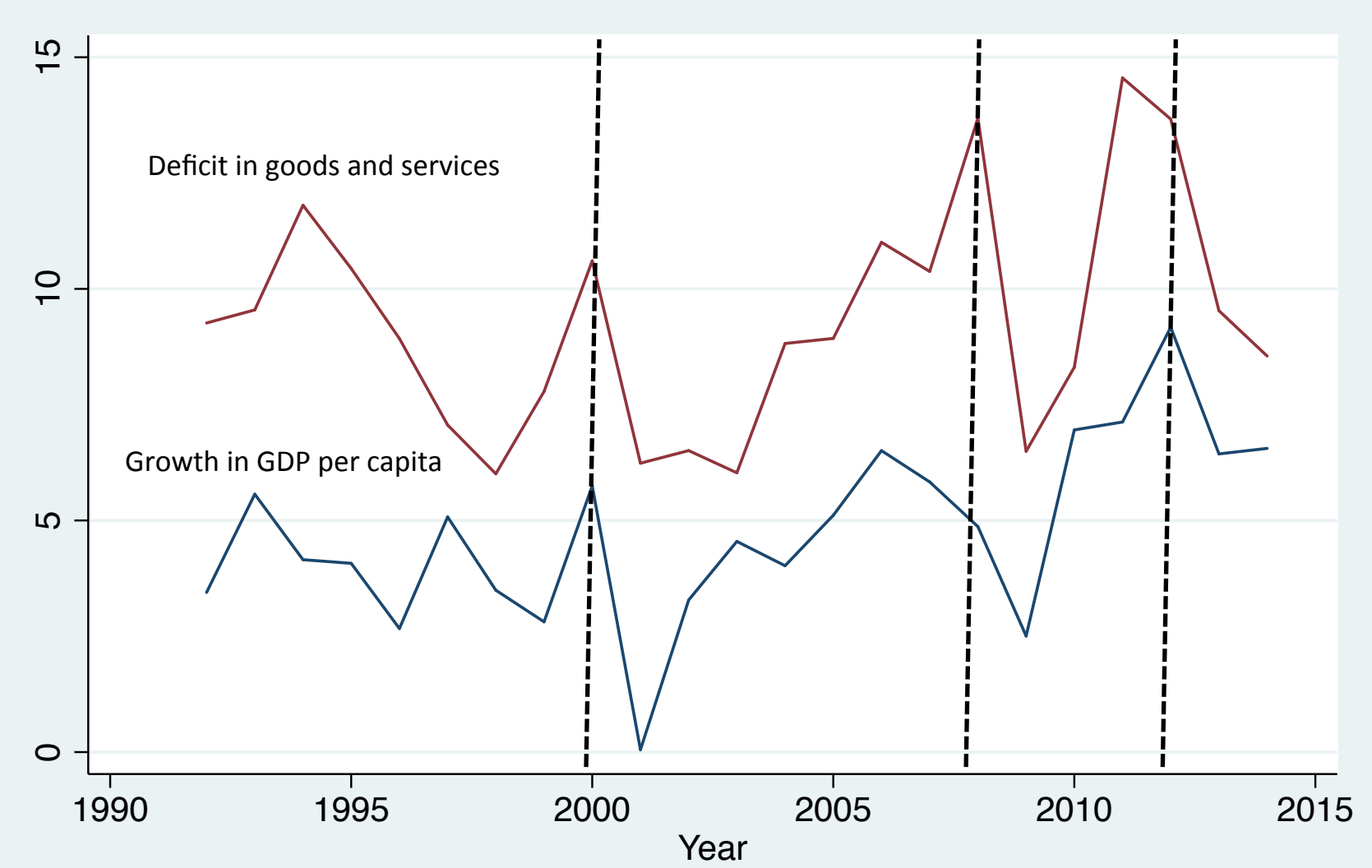
	1990-1994	1994-1998	1998-2002	2002-2006	2006-2010	2010-2014	Whole period
SGP	14.03	8.99	19.74	22.90	9.17	6.32	11.51
VNM	2.57	5.00	3.92	6.56	4.78	6.30	6.05
MYS	10.36	11.11	4.64	6.96	1.78	1.81	4.26
THA	3.61	0.19	3.51	4.58	2.11	2.50	3.32
CHN	3.96	1.29	2.71	5.63	2.00	1.42	2.30
IND	6.78	0.93	1.51	2.55	1.87	1.90	1.72
CRI	2.86	3.86	0.57	4.37	0.73	1.10	1.68
PHL	0.74	4.92	2.19	2.51	0.79	0.84	1.20
IDN	2.22	0.07	0.46	1.53	1.04	1.17	1.15
LKA	2.24	2.20	0.59	1.44	0.55	1.53	1.07

Each cell contains component of GDP growth coming from exports alone.

Sri Lanka's export performance was particularly weak after the 1990s, and esp. low relative to peers in the mid-2000s.

Source: own calculation using data from WDI

Moreover, growth has been constrained by the balance of payments

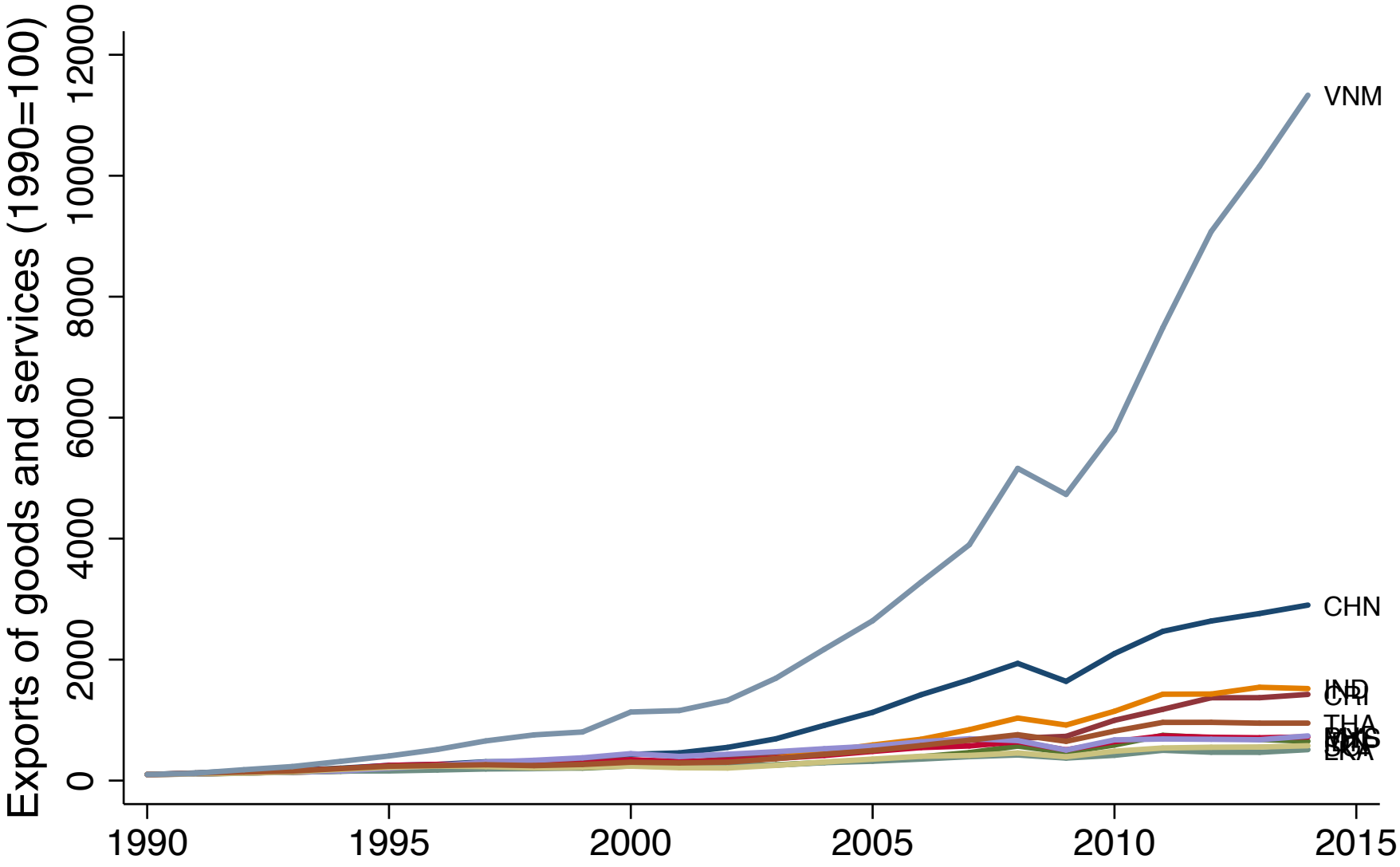


Source: WDI

Framing: Background and Country Context

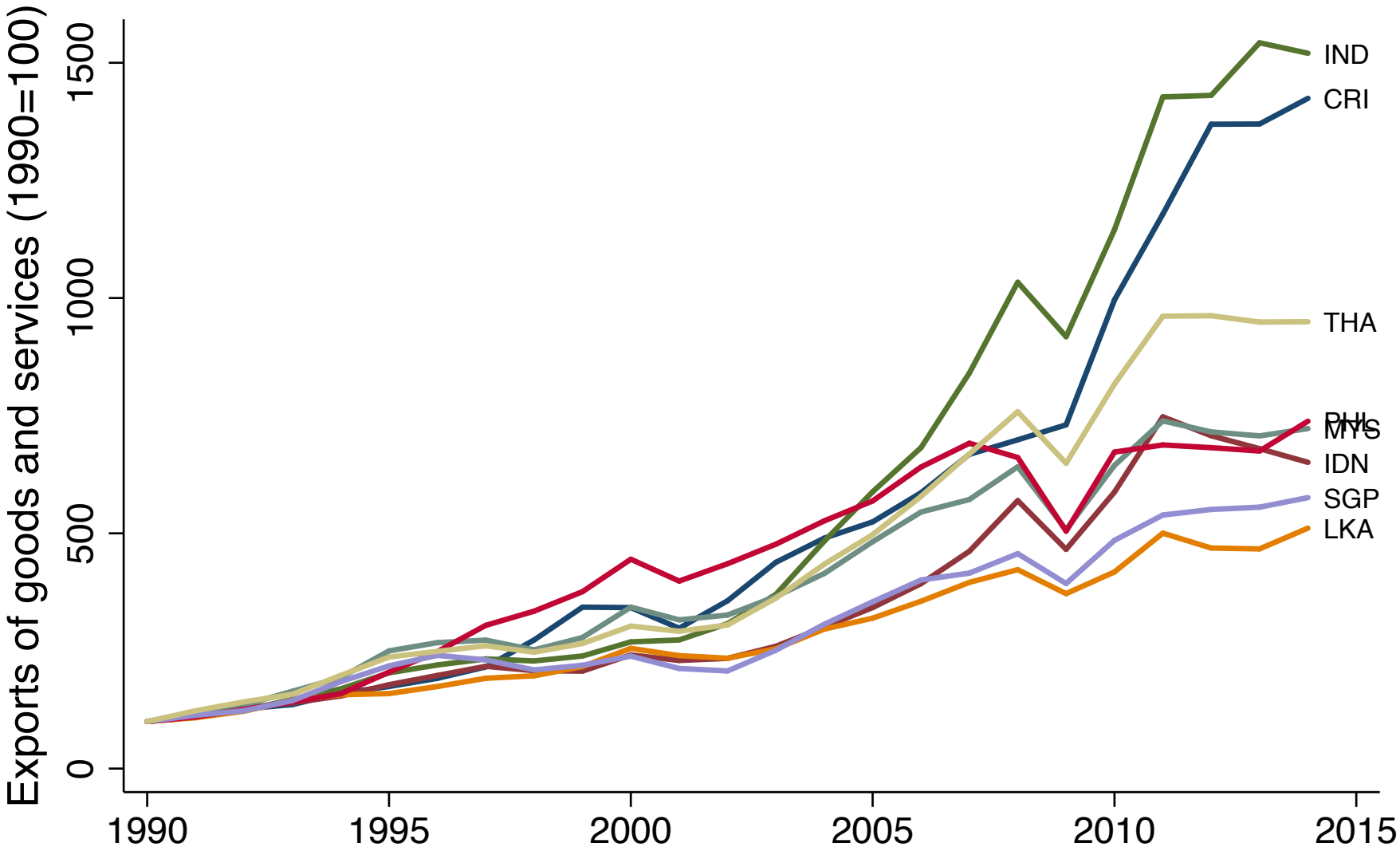
ANALYSIS OF EXPORT PERFORMANCE

Export growth: lagging behind peers



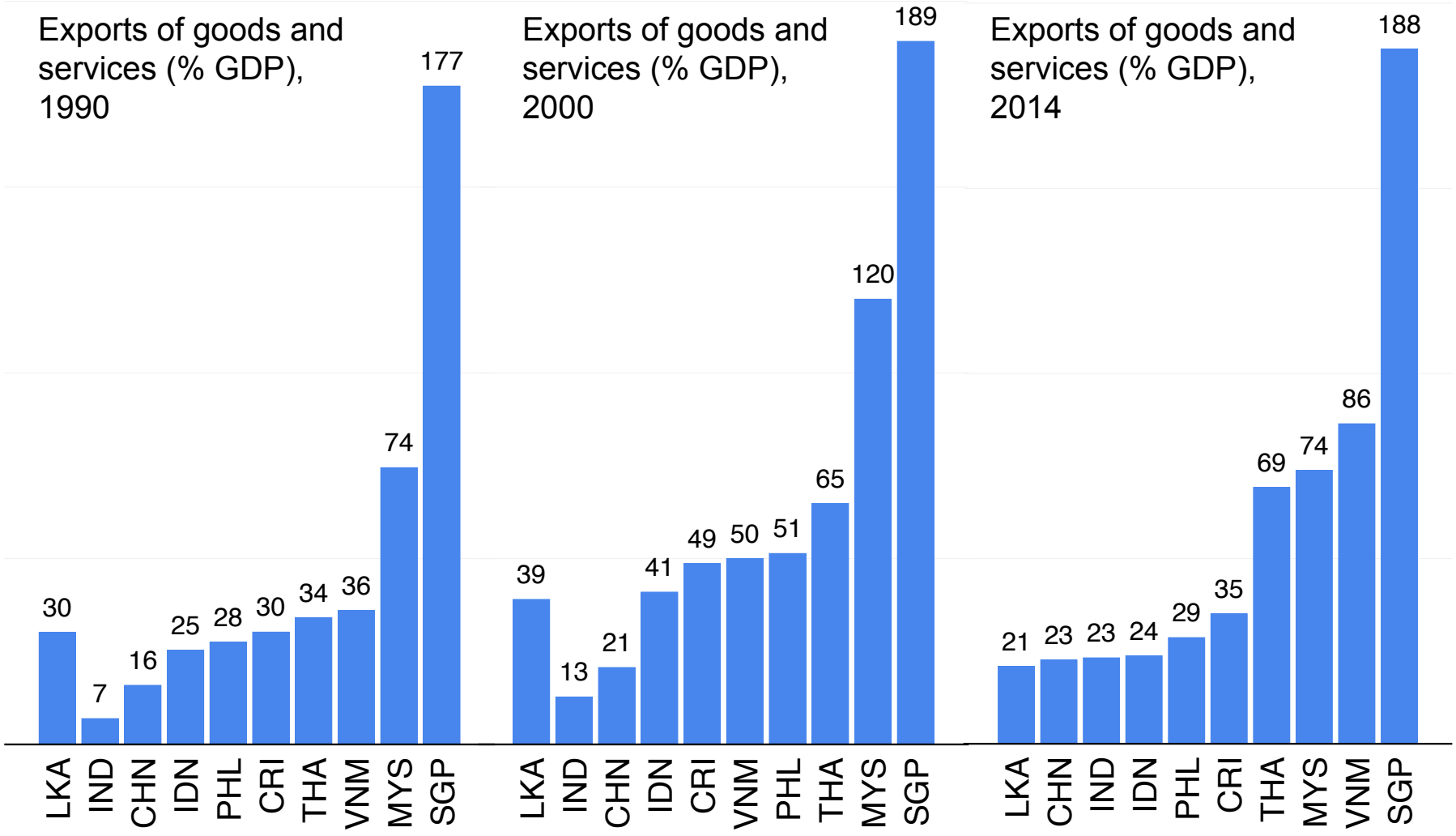
Source: UN Comtrade, via CID. Not adjusted for inflation.

Export growth: lagging behind peers (detail)



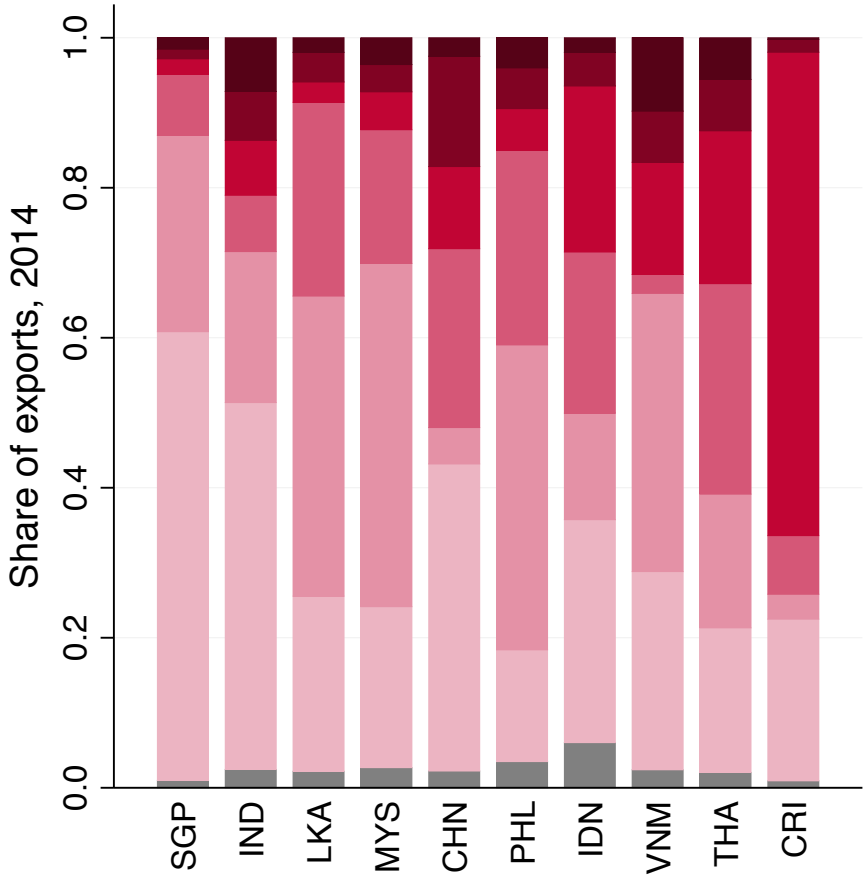
Source: UN Comtrade, via CID. Not adjusted for inflation.

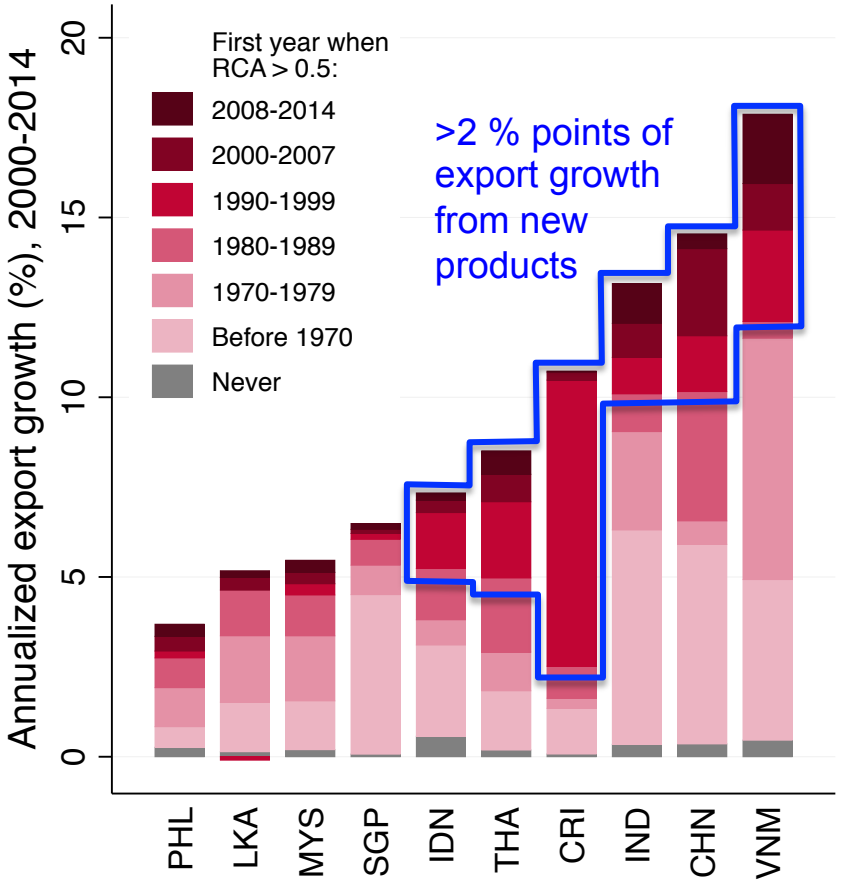
…and share of exports in GDP has also decreased to lowest among peers



Source: WDI

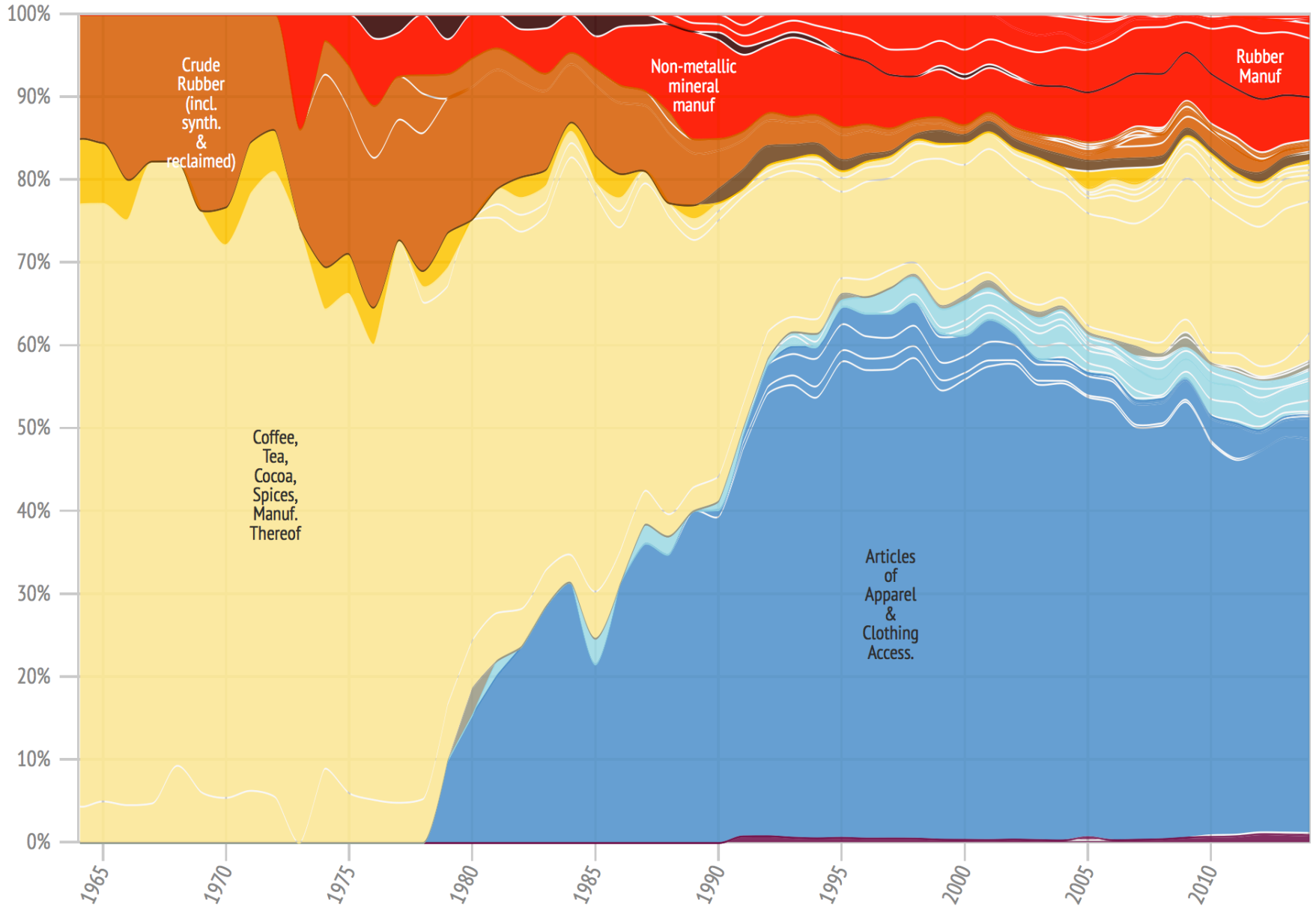
Diversification: relatively little of exports or export growth comes from new products



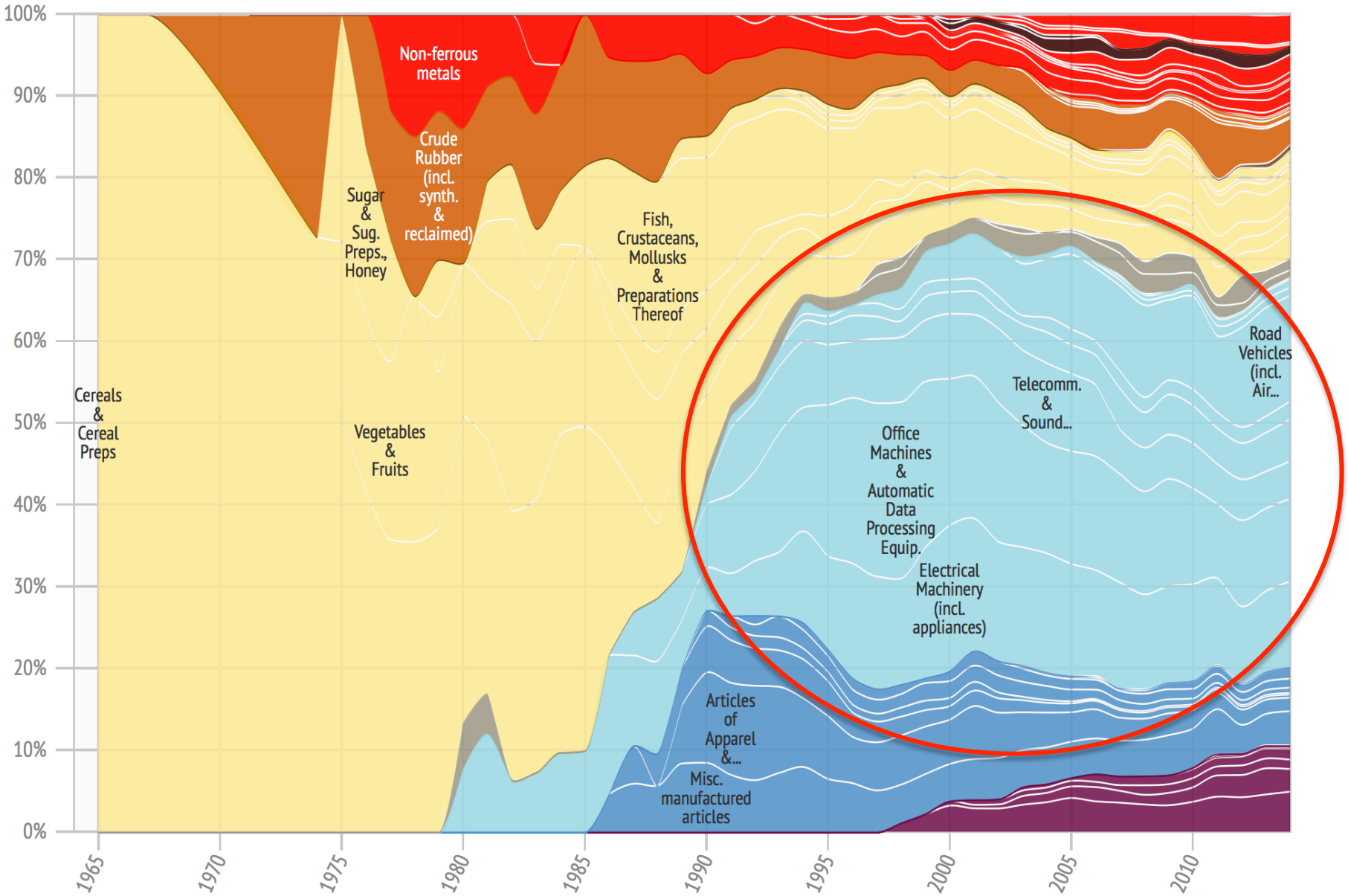


Source: UN Comtrade, via CID

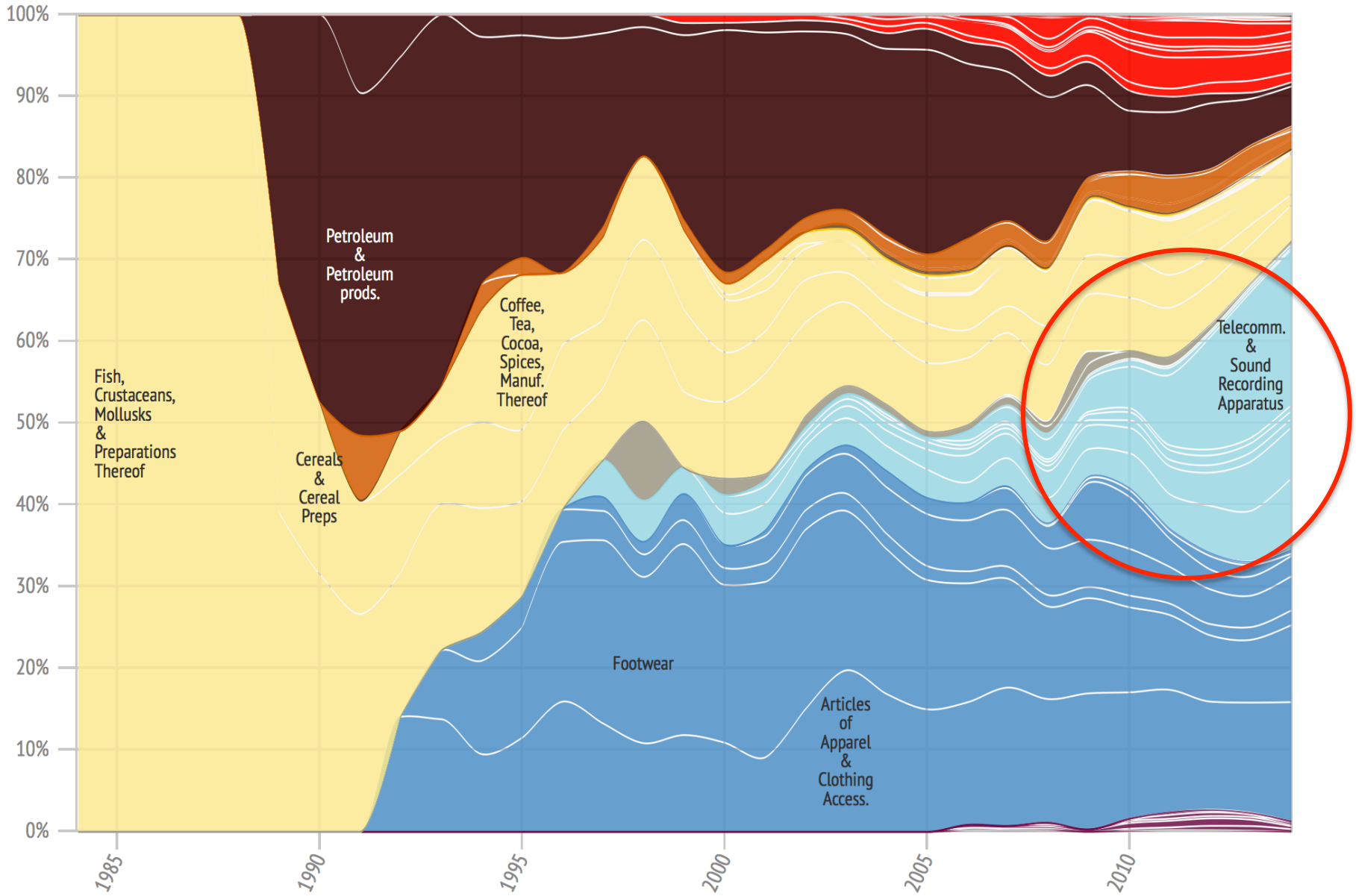
Most of current exports appeared before 1995:



As opposed to Thailand:



As opposed to Vietnam:



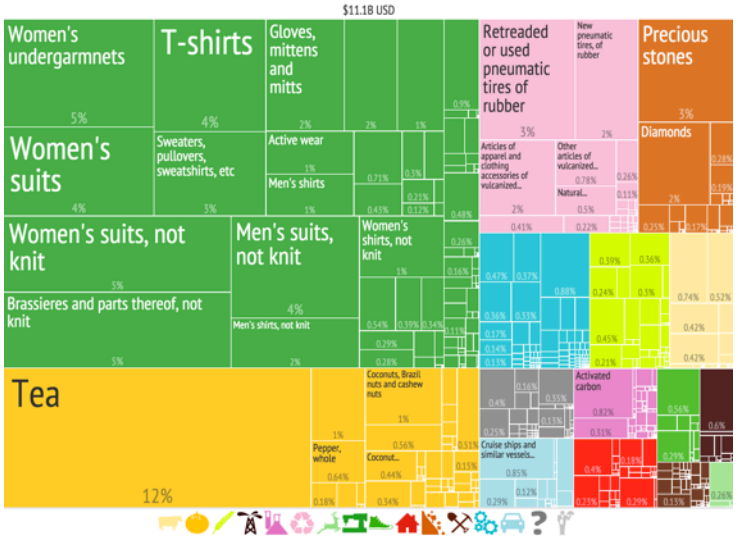
By sector: Sri Lanka is concentrated in textiles & apparel (& vegetable products) and lacks machinery & electrical manufactured exports vs. comparators

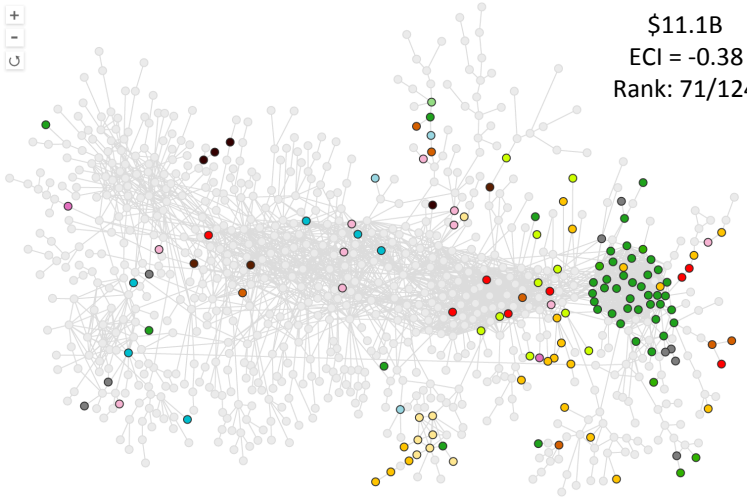
HS Chapter	LKA	IND	IDN	PHL	VNM	CHN	THA	CRI	MYS	SGP
Textiles & Apparel	46%	12%	8%	3%	17%	11%	3%	0%	1%	0%
Vegetable Products	19%	7%	14%	6%	6%	1%	5%	13%	7%	1%
Plastics & Rubbers	9%	3%	5%	2%	3%	4%	12%	2%	5%	5%
Stone & Glass	6%	14%	2%	2%	1%	3%	5%	1%	2%	3%
Machinery & Electrical	4%	8%	10%	60%	36%	46%	34%	68%	46%	33%
Food Products	3%	2%	4%	3%	2%	1%	7%	3%	2%	2%
Animal Products	3%	5%	2%	1%	5%	2%	2%	1%	1%	0%
Other Manufactured	2%	2%	3%	5%	6%	10%	4%	7%	4%	5%
Transport Equipment	2%	8%	3%	4%	1%	3%	11%	0%	1%	2%
Chemical Products	2%	12%	4%	2%	1%	4%	5%	1%	3%	13%
Wood Products	2%	1%	6%	2%	2%	2%	2%	1%	2%	2%
Footwear & Headgear	1%	1%	3%	0%	9%	3%	0%	0%	0%	0%
Extractives	1%	19%	30%	8%	6%	1%	5%	0%	21%	23%
Metals	1%	8%	5%	4%	3%	8%	4%	1%	4%	3%
Service	1%	0%	0%	1%	0%	1%	1%	0%	1%	7%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Exports per capita	543	242	745	774	1,619	1,725	3,530	6,472	9,591	50,299

Data is 2014. Source: UN Comtrade

So now Thailand's and Sri Lanka's export baskets look very, very different.

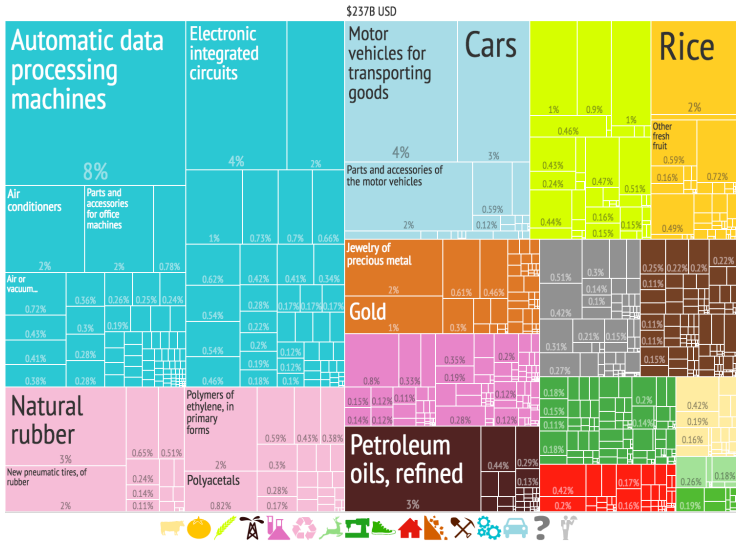
Sri Lanka's Exports, 2014

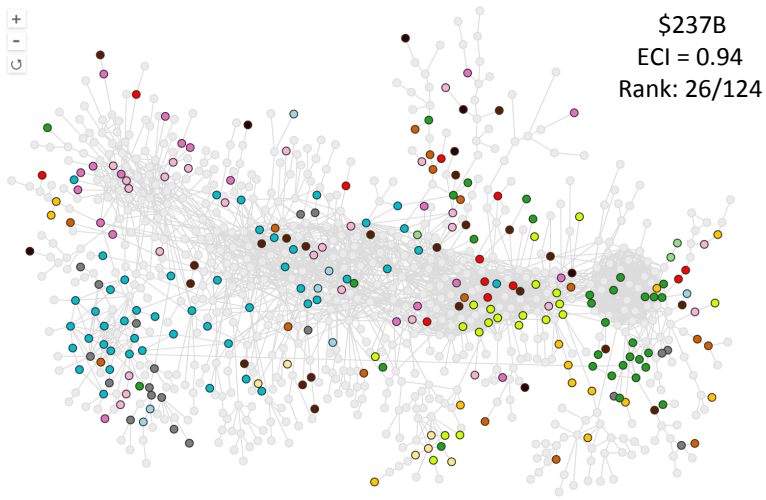




$11.1B
ECI = -0.38
Rank: 71/124

Thailand's Exports, 2014

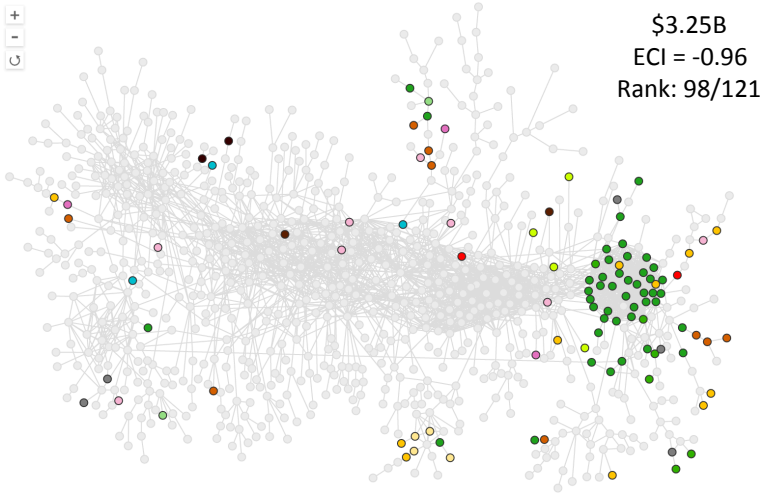




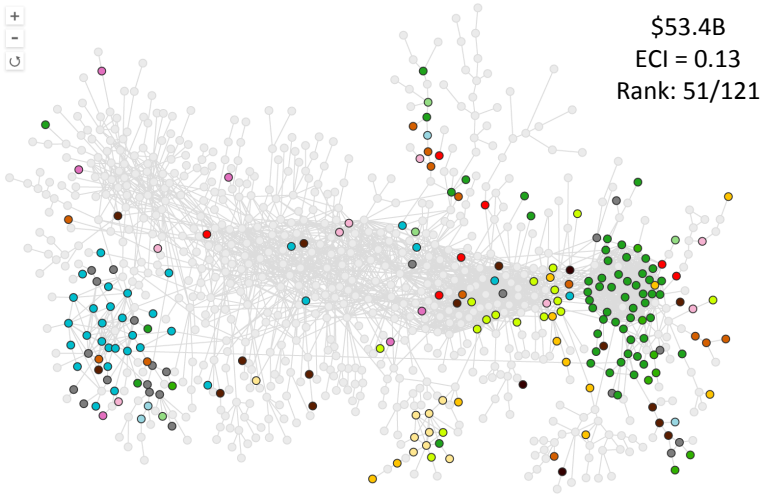
$237B
ECI = 0.94
Rank: 26/124

And they continue to evolve at different rates:

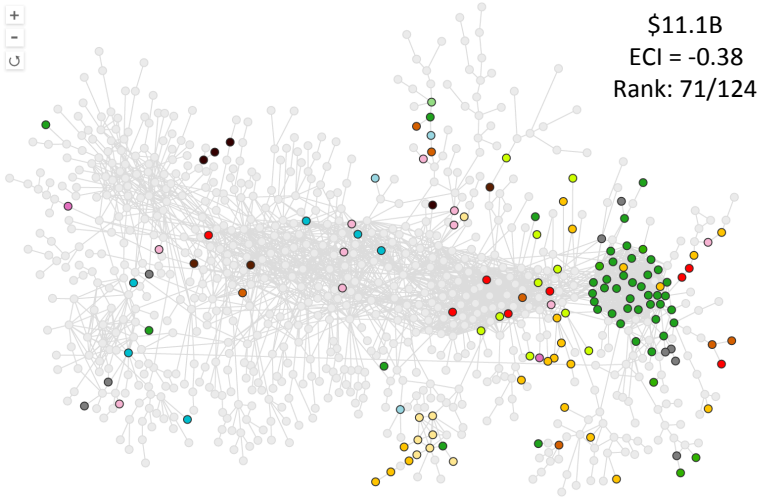
Sri Lanka's Exports, 1995



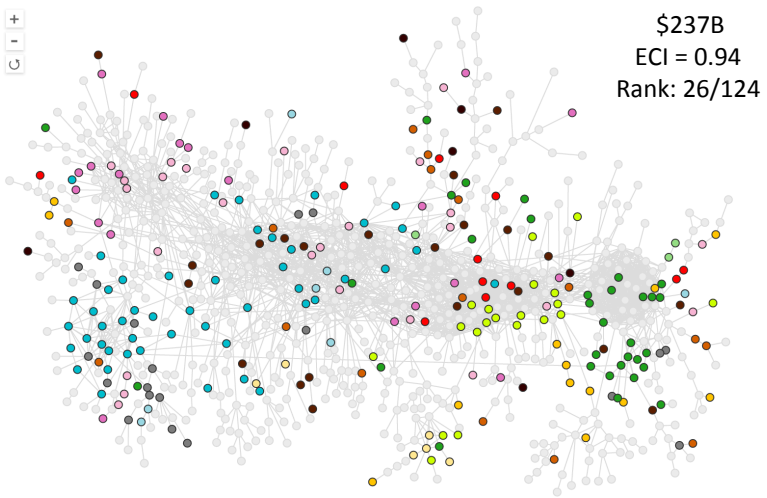
Thailand's Exports, 1995



Sri Lanka's Exports, 2014

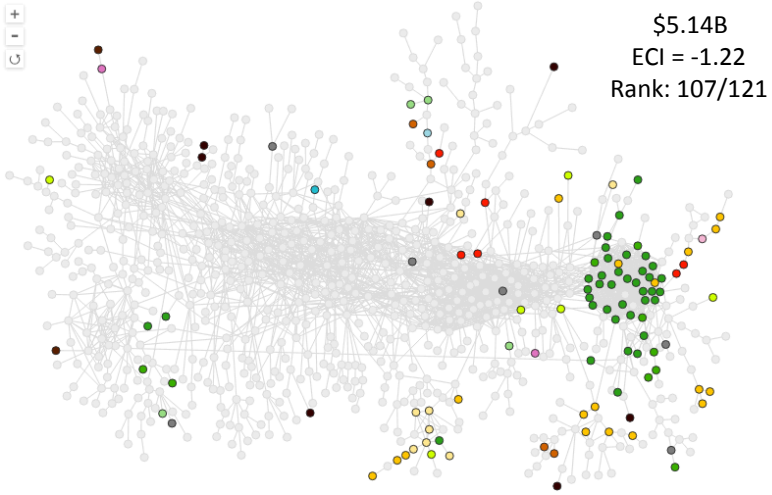


Thailand's Exports, 2014

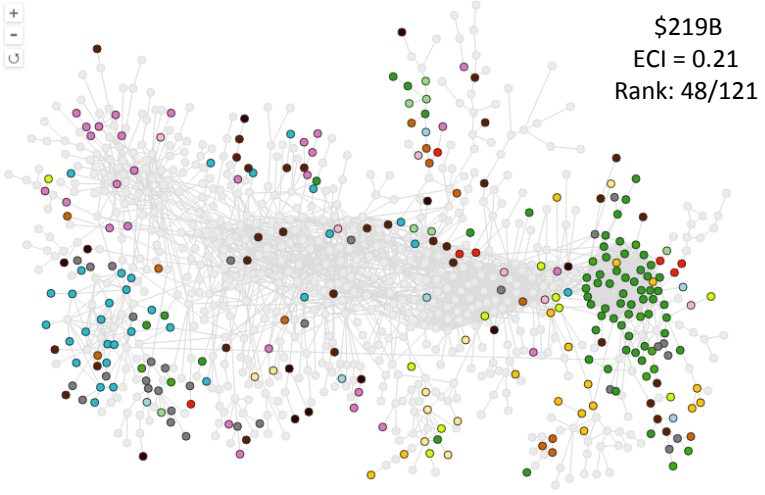


The evolution for Vietnam & China:

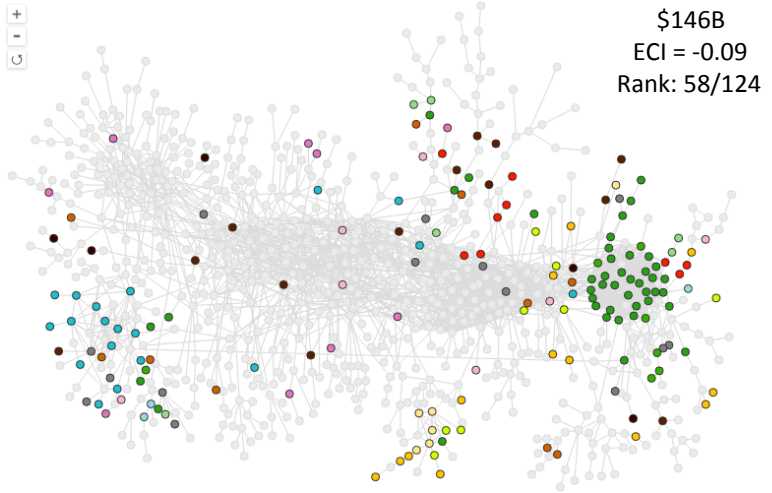
Vietnam's Exports, 1995



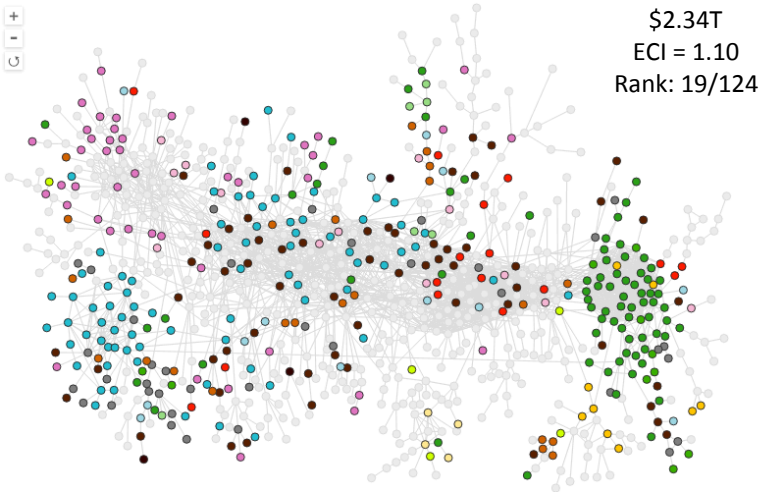
China's Exports, 1995



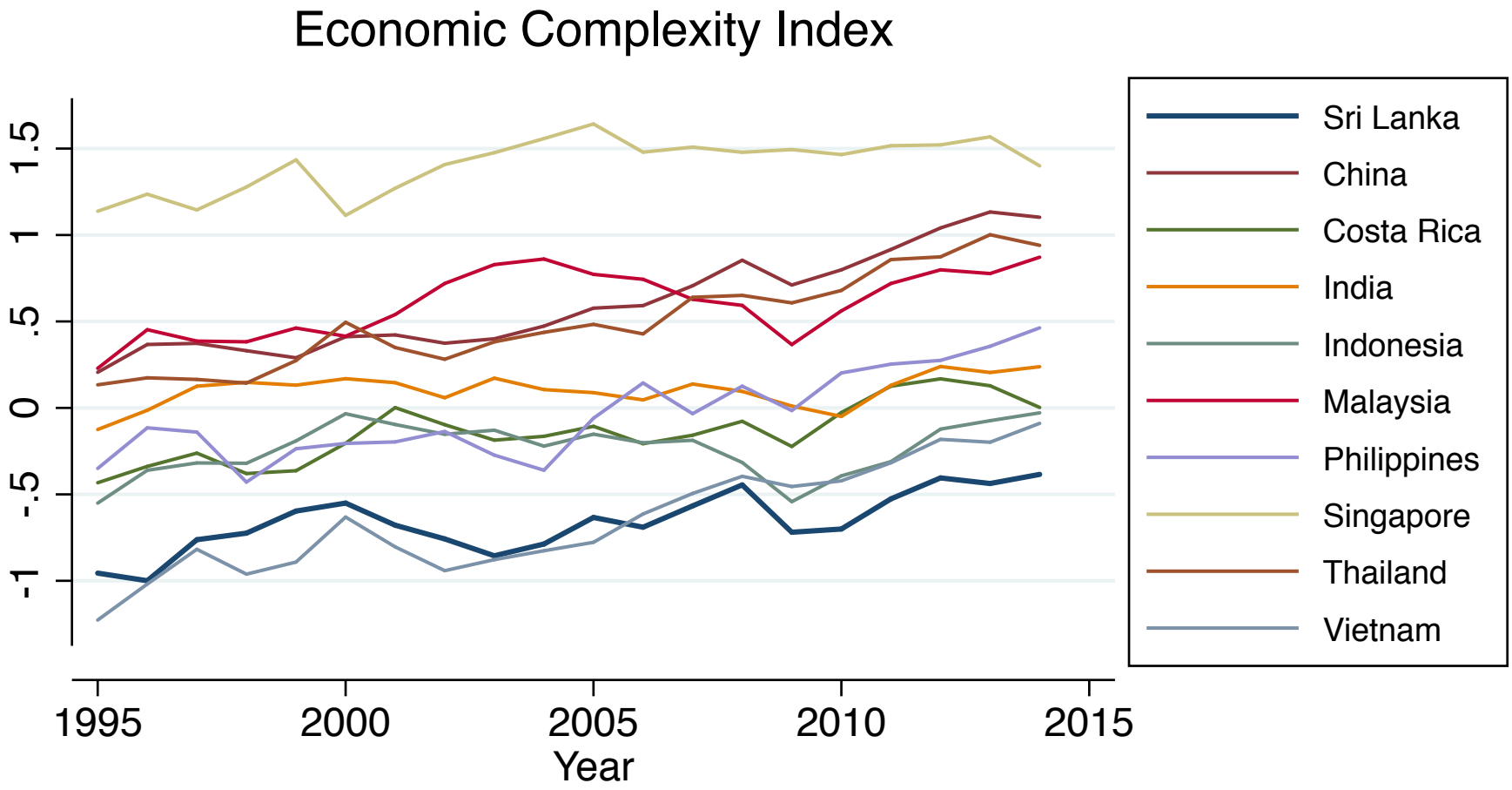
Vietnam's Exports, 2014



China's Exports, 2014

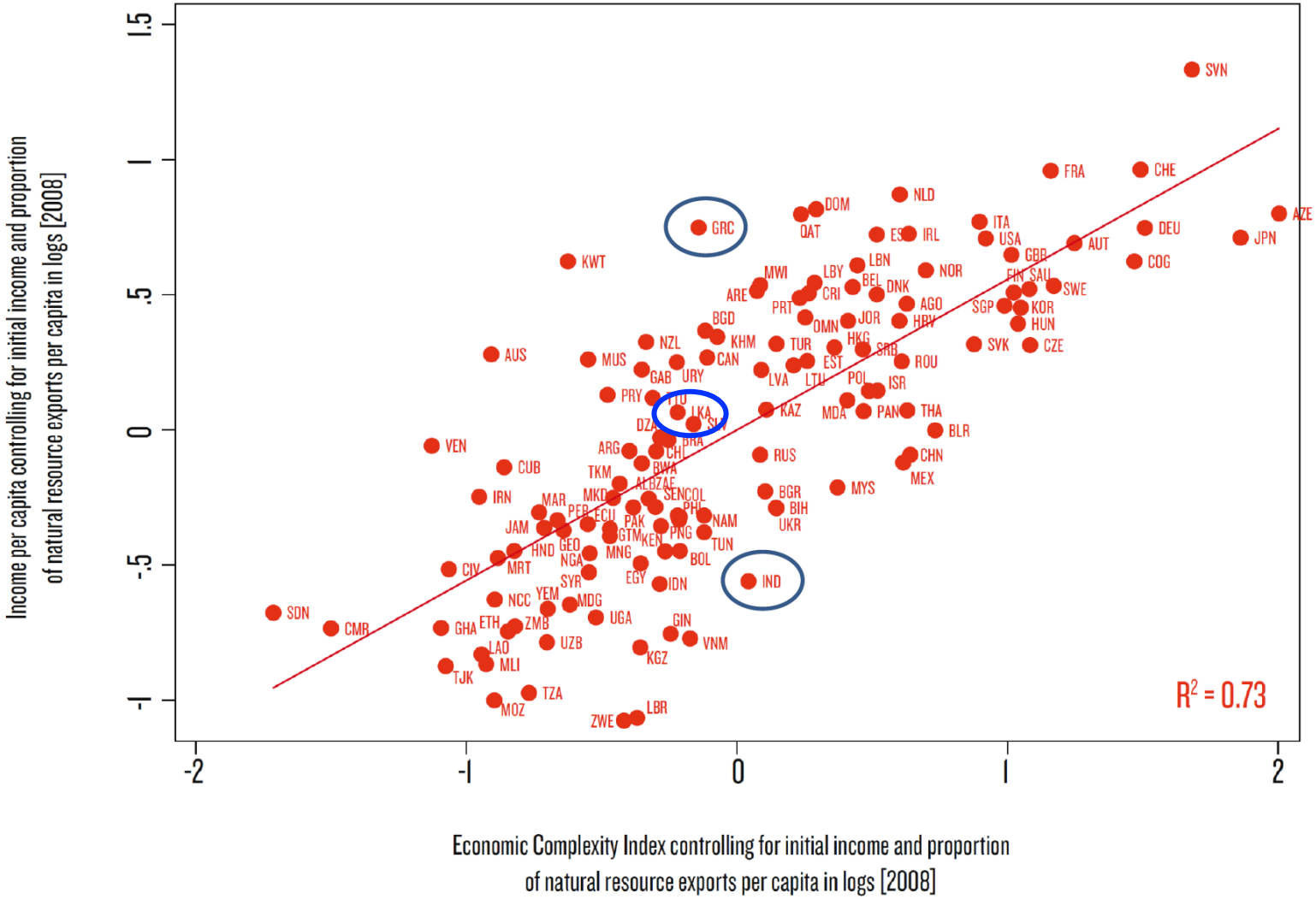


Sri Lanka's economic complexity is evolving at a slower pace than that of comparator countries.

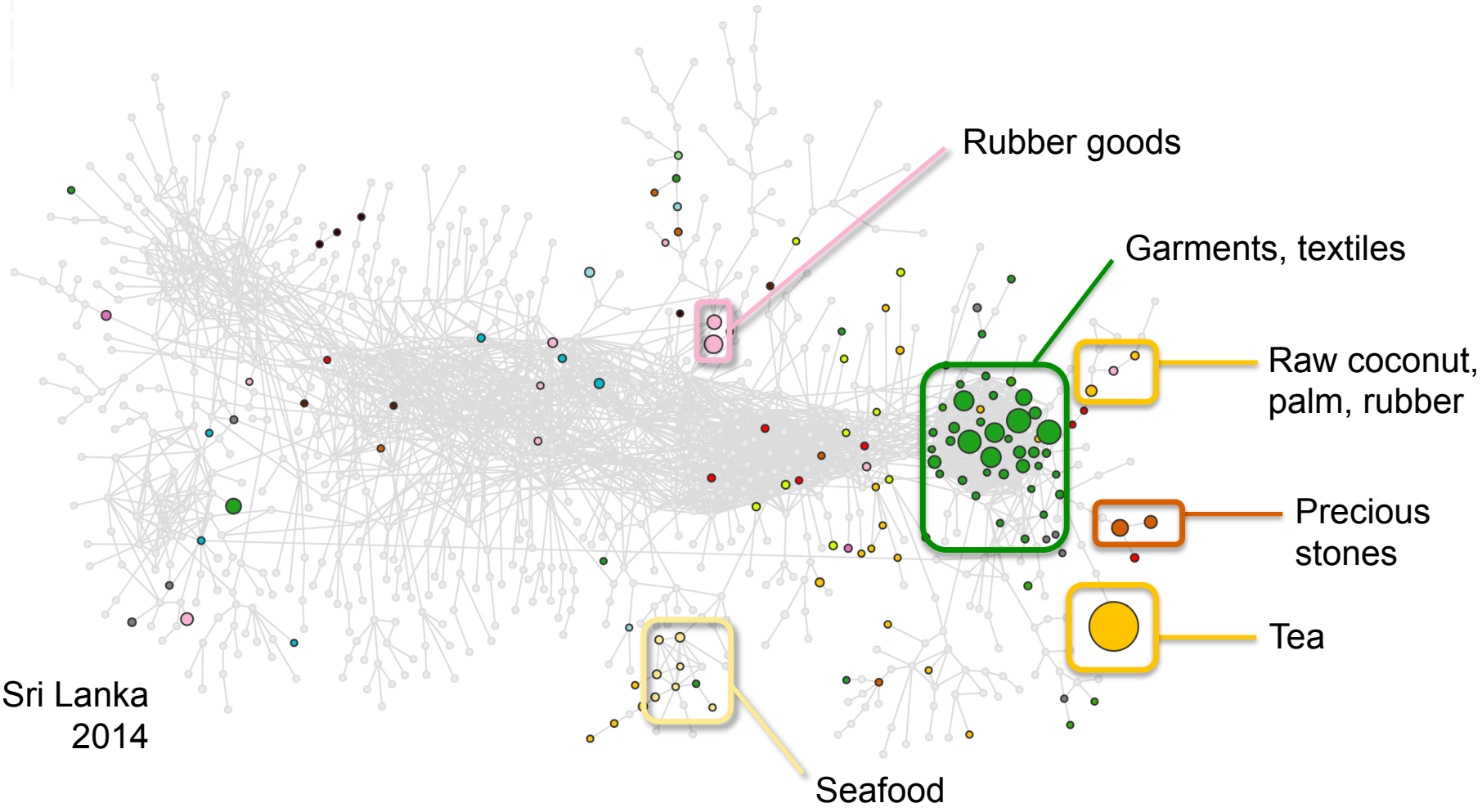


Data source: Atlas of Economic Complexity

So why does this matter? Because economic complexity has a strong relationship with income level and growth!

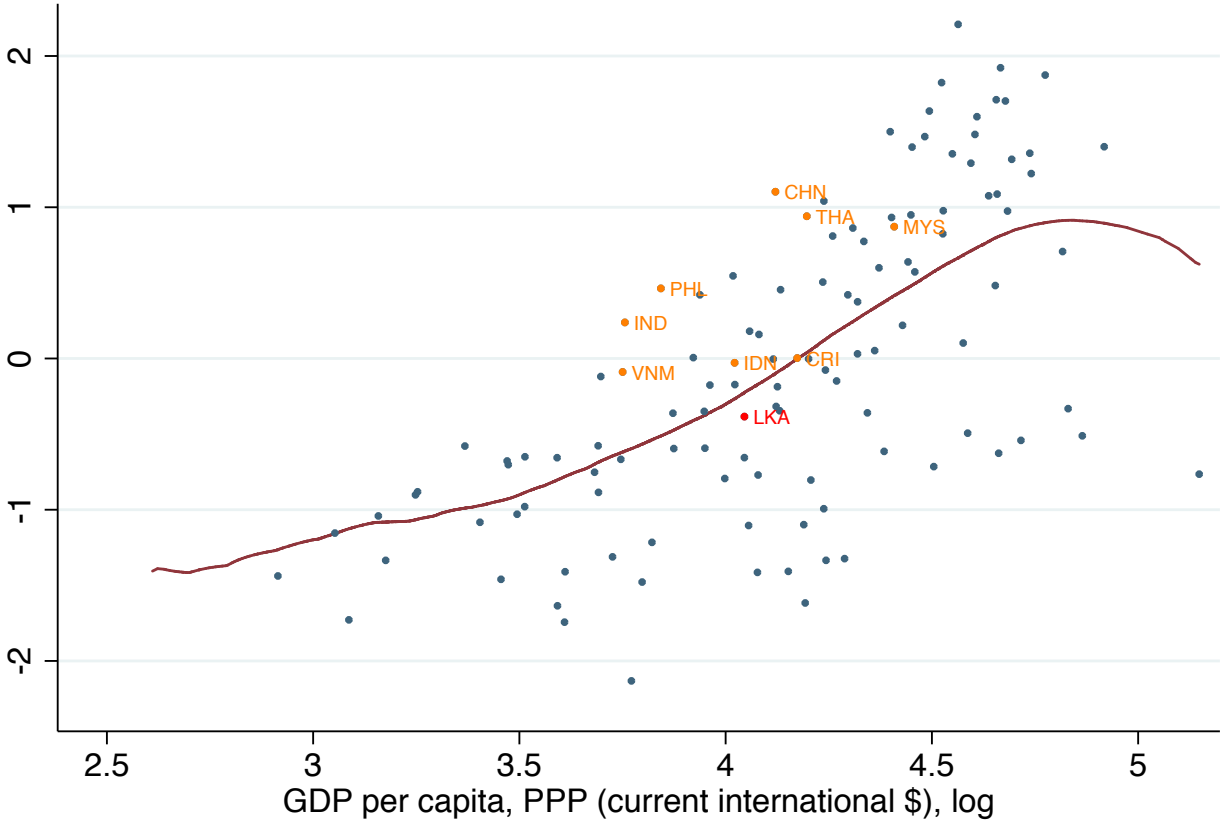


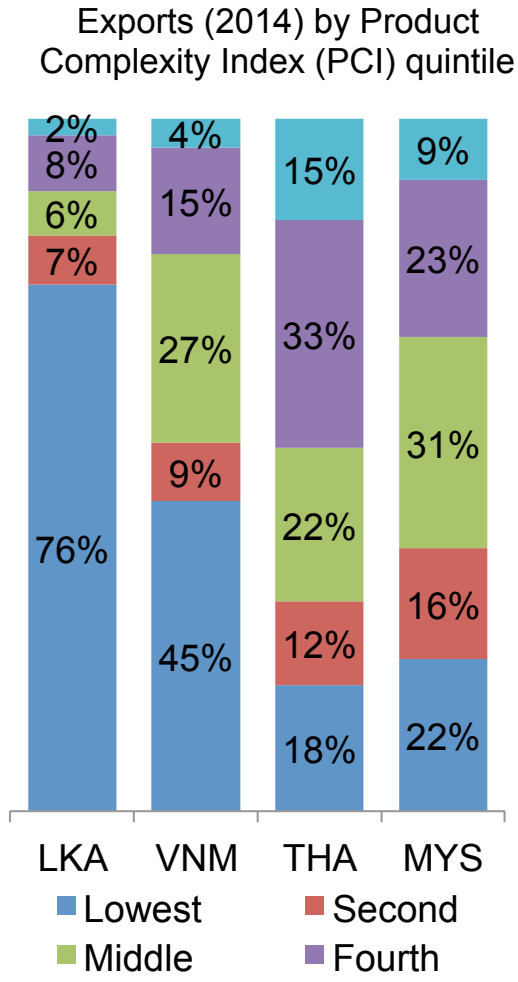
Exports are in periphery of Product Space: suggesting current exports tend to be low-complexity with low embodied knowhow



Source: Atlas of Economic Complexity

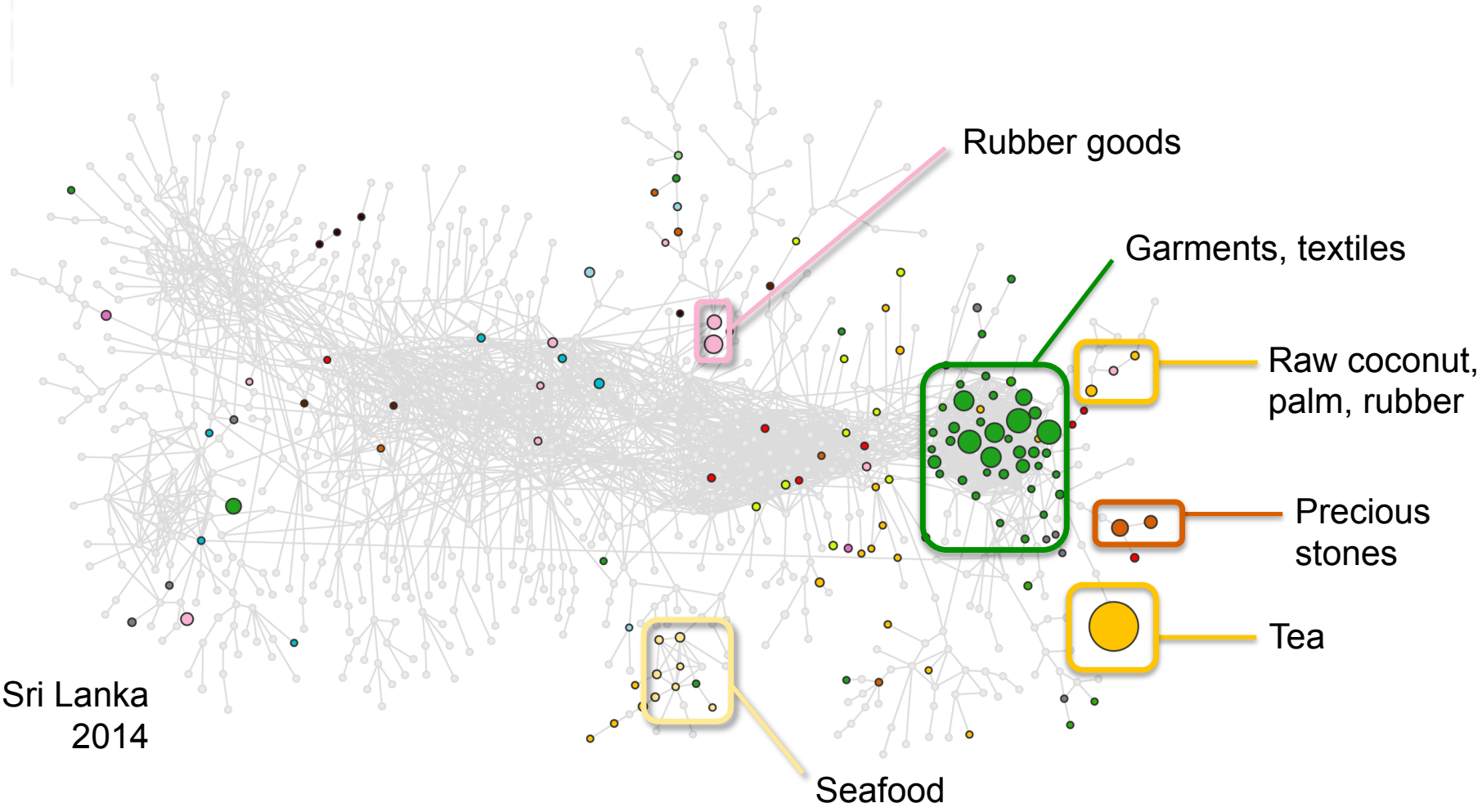
Current comparative advantage: Sri Lanka's exports are focused in low-complexity products





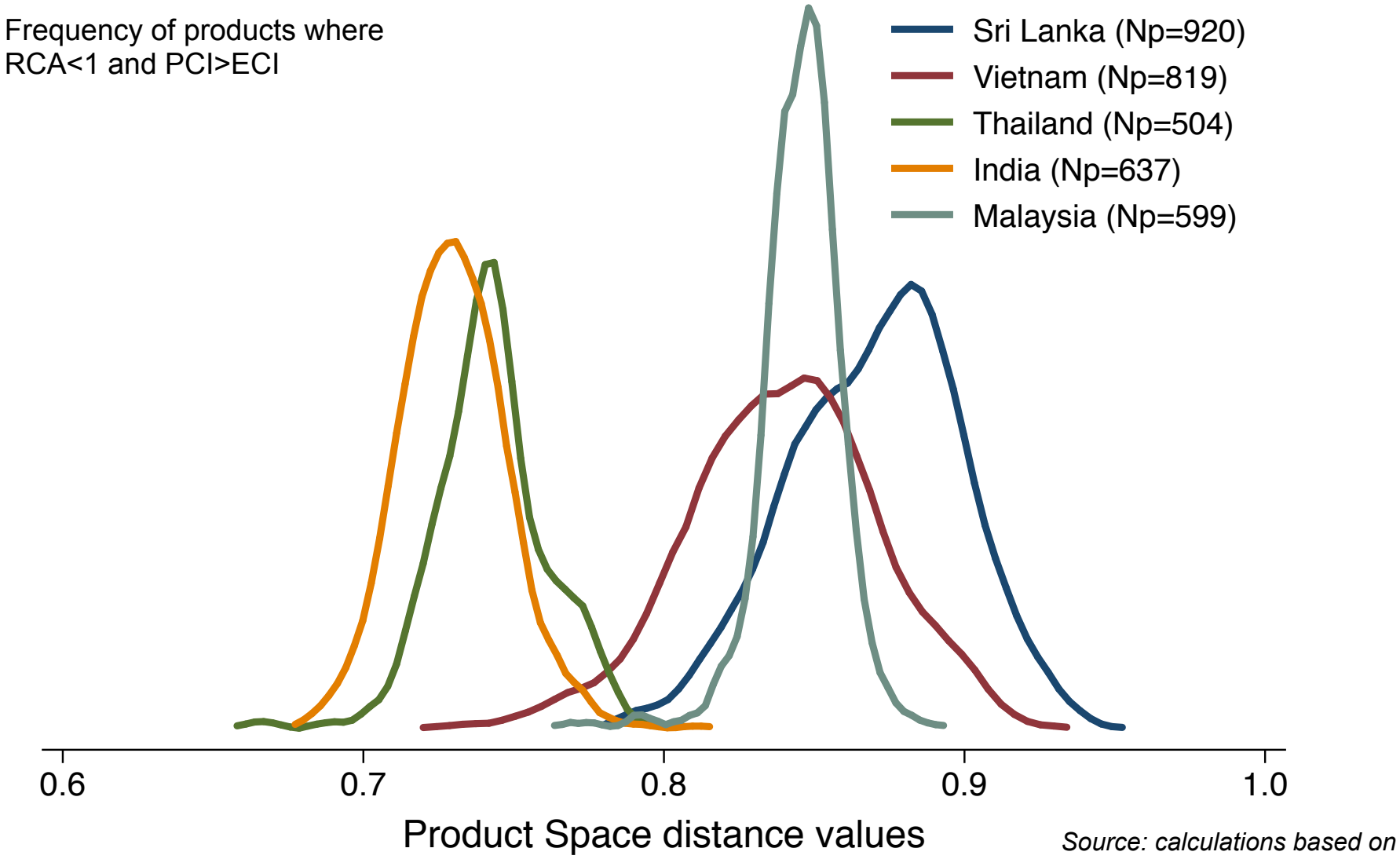
GDP and ECI data from 2014. Source: calculations based on data from Comtrade and WDI.

Exports are in periphery of Product Space: suggesting new products are “distant” from Sri Lanka’s current comparative advantage



Source: Atlas of Economic Complexity

Relatively many unexported products, but at greater "distance" from current comparative advantage



Source: calculations based on data from Comtrade

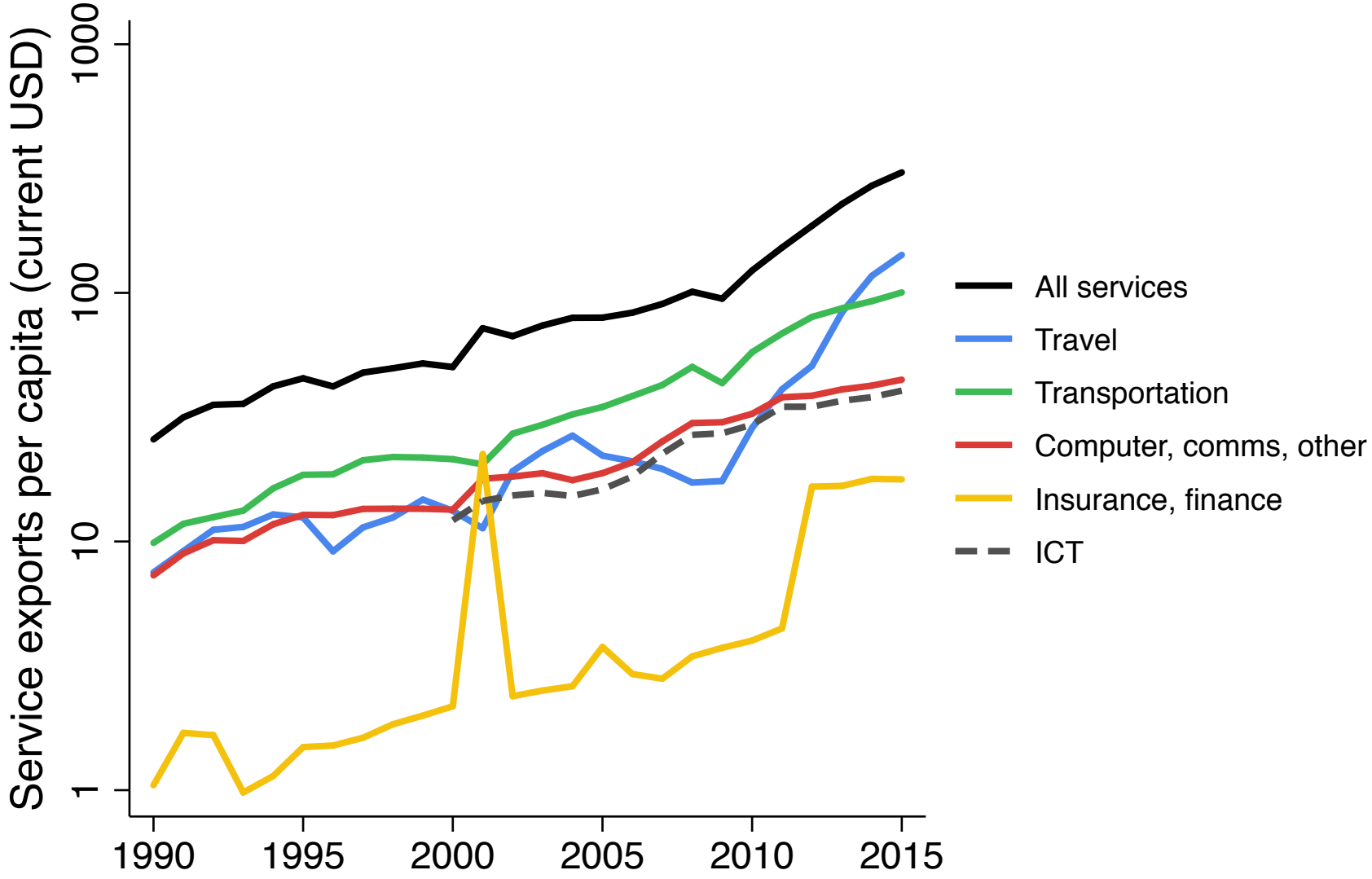
Service exports: Sri Lanka performs relatively well in exports related to logistics & insurance/finance, while there is much room to grow in tourism & ICT exports

Service exports per capita, 2014
(BoP, current USD)

	Service exports	Transport services	Travel services	Insurance and financial services	Computer, communications, other services	ICT services
Sri Lanka	270	93 (34%)	117 (43%)	18 (7%)	42 (16%)	38 (14%)
Indonesia	92	15 (16%)	40 (44%)	1 (1%)	36 (39%)	28 (30%)
India	121	14 (12%)	15 (13%)	6 (5%)	85 (70%)	81 (68%)
Vietnam	121					
China	206	28 (14%)	77 (38%)	7 (3%)	94 (46%)	65 (32%)
Philippines	257	19 (7%)	51 (20%)	3 (1%)	184 (72%)	181 (70%)
Thailand	817	85 (10%)	567 (69%)	4 (0%)	161 (20%)	143 (18%)
Malaysia	1406	160 (11%)	756 (54%)	27 (2%)	464 (33%)	327 (23%)
Costa Rica	1497	81 (5%)	643 (43%)	18 (1%)	755 (50%)	636 (42%)
Singapore	27561	9401 (34%)	3498 (13%)	4582 (17%)	10080 (37%)	7559 (27%)

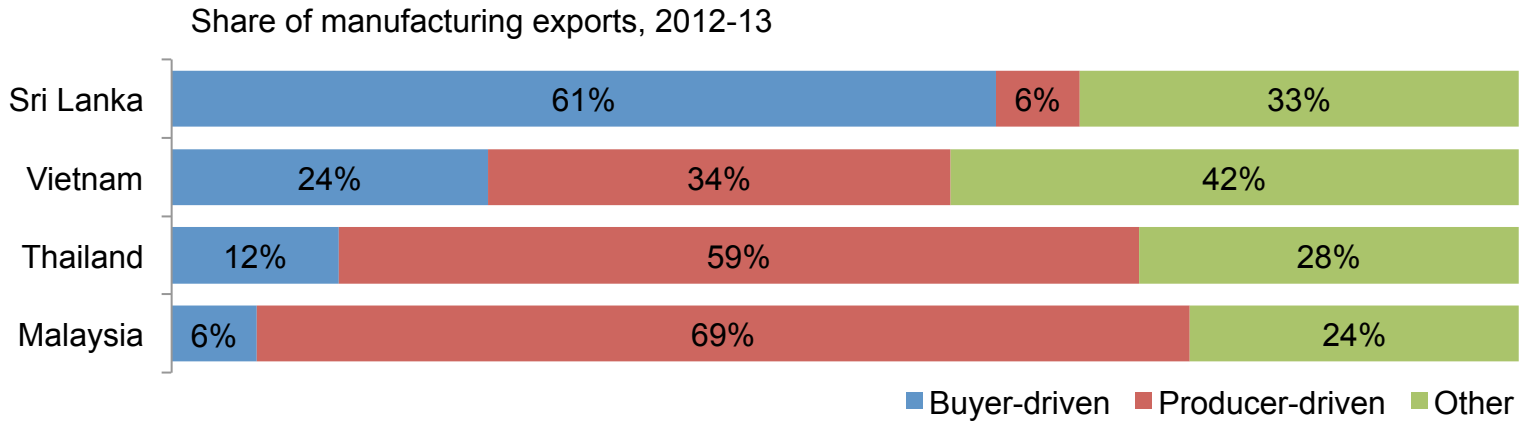
Notes: Transport service exports are services related to the movement of non-resident goods & passengers. Travel service exports are services consumed by visitors (including tourists). Disaggregated data not available for Vietnam. Source: WDI

Service exports: growing in all categories; fastest growth from travelers (post-conflict period)



Source: WDI

Global Production Sharing: “Producer-driven” exports are missing in Sri Lanka



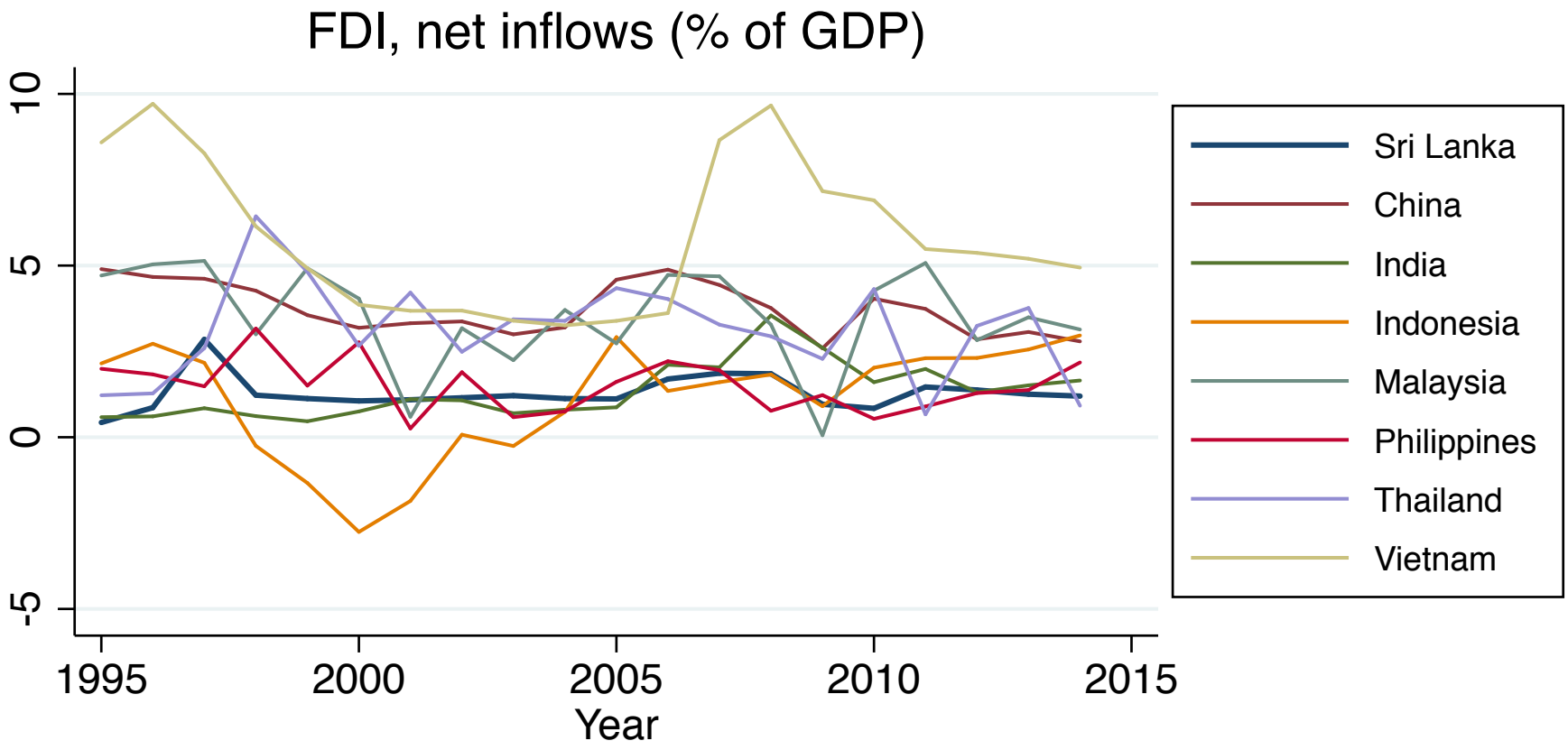
Production Network Type	Buyer-driven	Producer-driven
Economic Sectors	Consumer non-durables	Consumer durables, intermediate goods and capital goods
Typical Industries	Apparel, footwear, furniture, toys and diamonds	Automobiles, computers, aircraft and semiconductors
Drivers	Commercial capital	Industrial capital
Core Competencies	Design, brand, marketing	R&D, production
Barriers to Entry	Economies of scope	Economies of scale
Ownership of Firms	Local firms (predominantly in developing economies)	Multinational corporations
Main Network Lines	Trade-based	Investment-based
Predominant Structure	Horizontal	Vertical

Table source: Gereffi (1999), via Devadason (2008). Graph source: Athukorala 2016

Framing: Background and Country Context

ANALYSIS OF INVESTMENT PERFORMANCE

Little FDI over last 20 years, especially in comparison to Vietnam, Thailand, & upper middle income countries



Data source: WDI

Large-scale FDI: low for manufacturing (electronics, vehicles, materials) & energy; strength in tourism, logistics, finance & construction investment

Estimated capital expenditure per capita, 2009 – March 2016 (annualized)

Construction	18	12	30	77
Manufacturing	16	60	106	212
Sales, Marketing	16	7	14	25
Logistics, Distribution	15	5	4	16
Business Services	8	3	7	6
Electricity	7	2	36	32
ICT Infrastructure	4	2	1	6
Headquarters	2	1	1	5
Retail	2	4	3	12
Customer Contact Centers	1	0	0	0
Design & Testing	1	1	1	7
Education & Training	0	0	0	3
Research & Development	0	0	1	1
Maintenance & Servicing	0	0	0	2
Shared Services Centres	0	0	0	2
Extraction	0	5	8	16
Recycling	0	0	1	0
Technical Support Centres	0	0	0	0
Total	89	102	212	424

Cluster

Logistics, Transport	19	5	9	15
Financial Services	16	3	11	10
Tourism	13	3	4	9
Materials, Construction	8	9	27	61
Energy	6	6	67	80
Electronics, ICT	5	12	24	54
Vehicles, Transport Equip.	4	36	11	38
Food, Beverages, Tobacco	3	4	10	14
Physical Sciences	3	4	13	44
Environmental Tech	3	5	6	36
Apparel & Wood	2	1	11	3
Retail Trade	2	3	3	12
Industrial	2	6	6	16
Life sciences	1	1	2	16
Professional Services	1	0	1	3
Consumer Goods	1	1	1	6
Creative Industries	1	4	7	6
Total	89	102	212	424

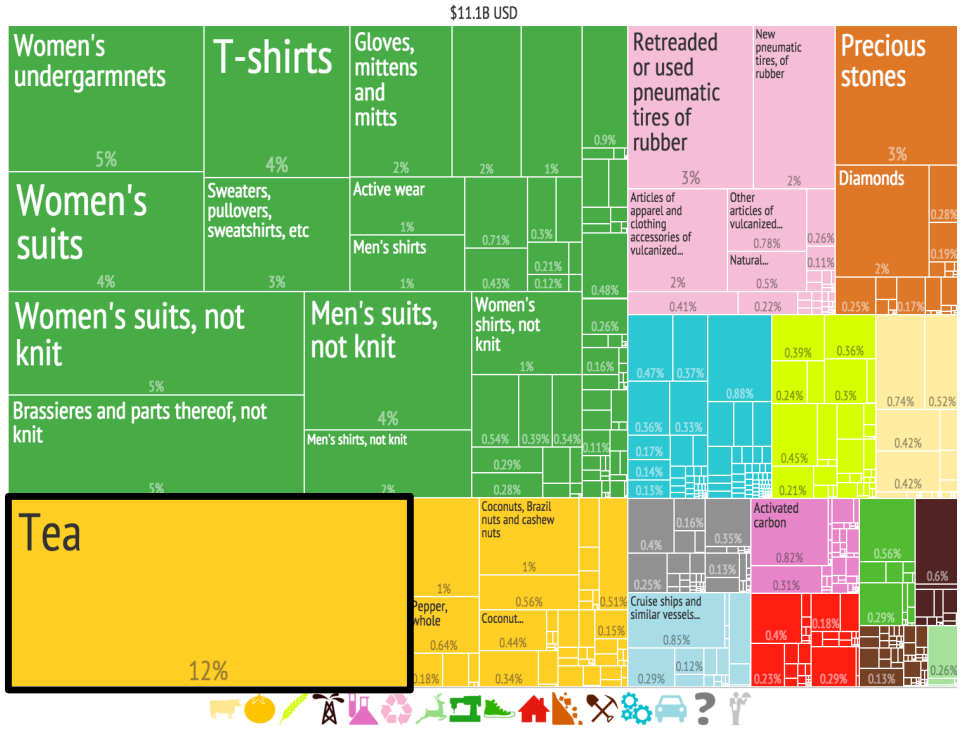
Source: fDi Markets, April 2016. Note: dataset is based on estimates of large, high-profile FDI projects

Shortage of Labor?

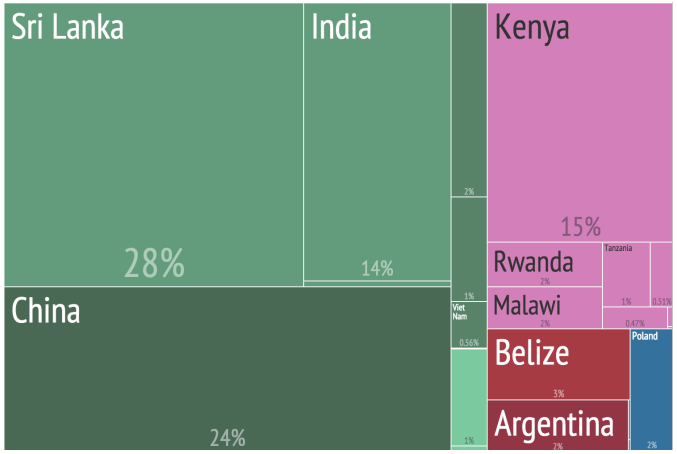
THE “PROBLEM” OF THE RESERVATION WAGE

Wage ceiling: Primary export industries tend to face competition from low income countries

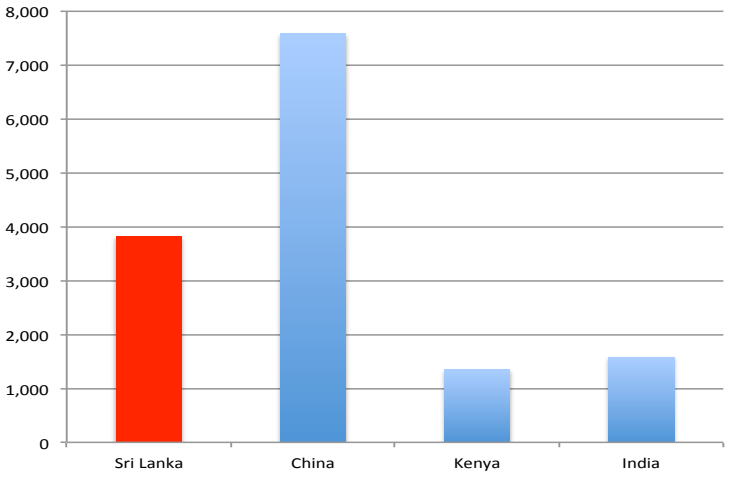
Exports, 2014



Global Share of Tea Exports (Net) in 2014



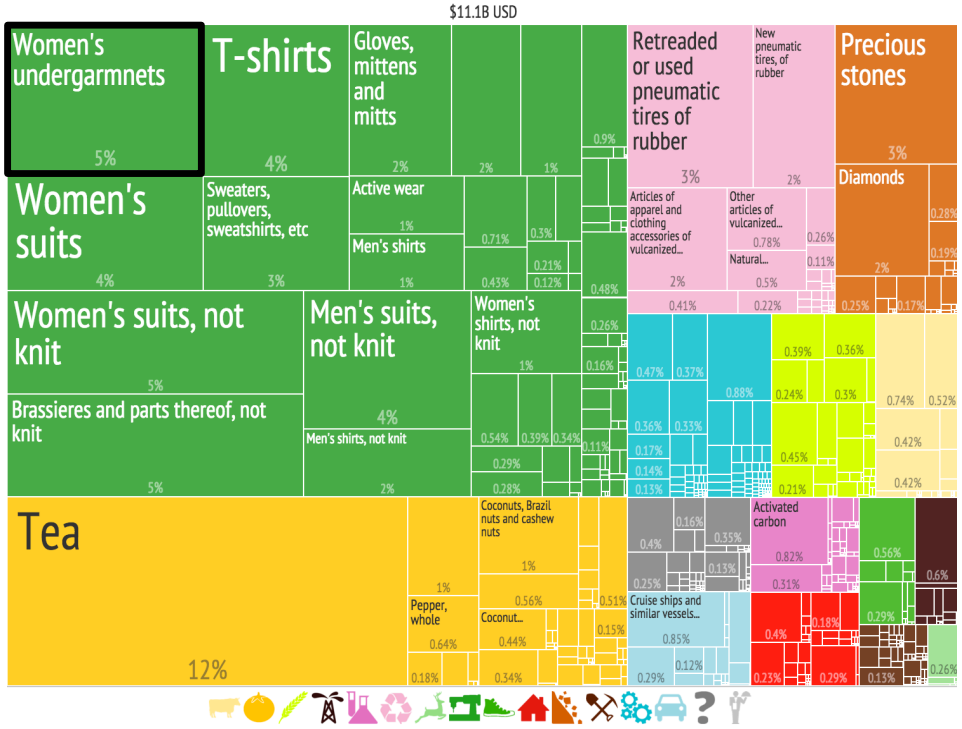
GDP per capita (USD) in 2014



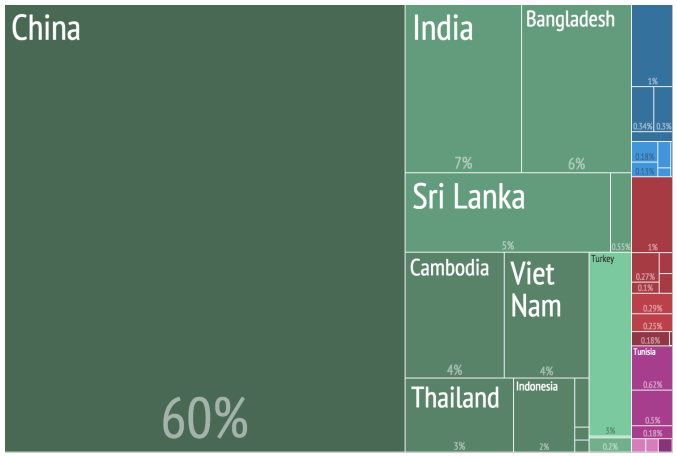
Data source: World Development Indicators

Wage ceiling: Primary export industries tend to face competition from low income countries

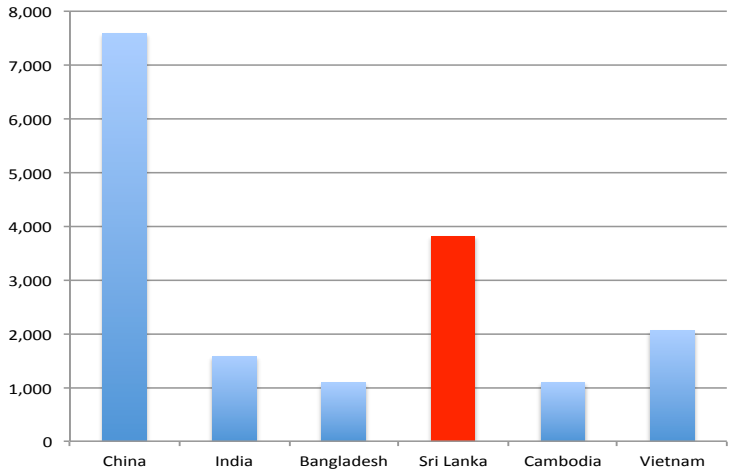
Exports, 2014



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

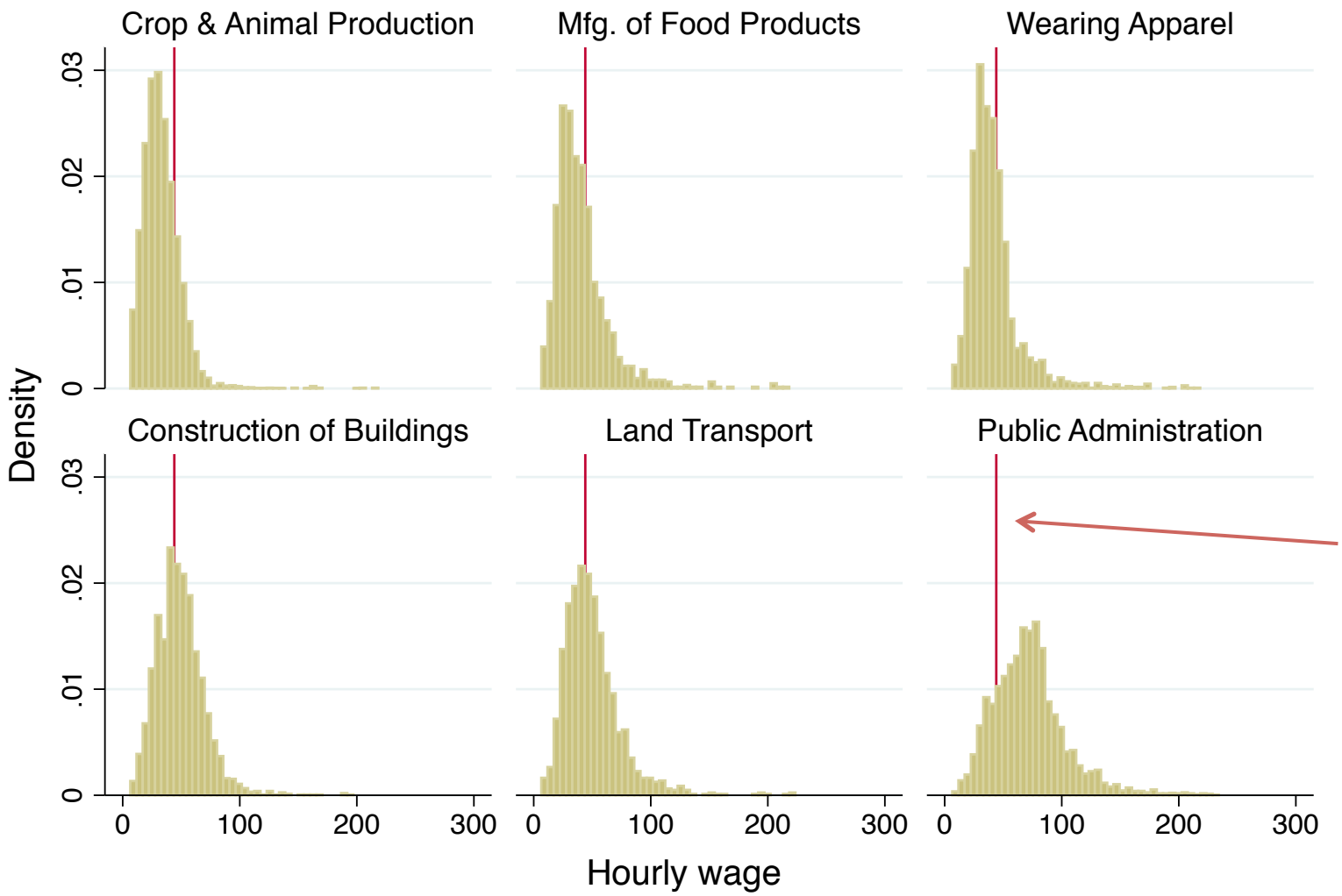


GDP per capita (USD) in 2014



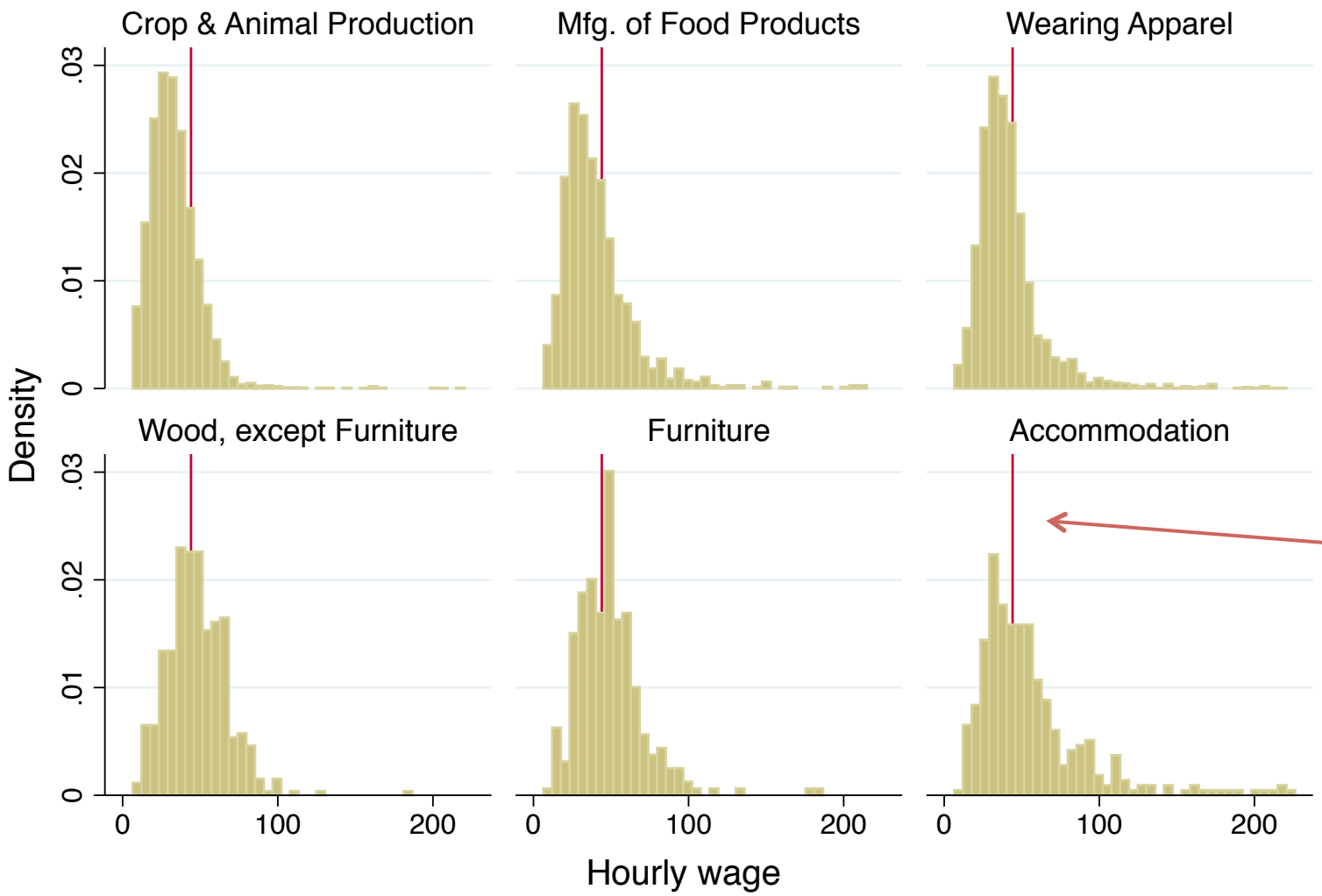
Data source: World Development Indicators

Sri Lanka's largest export-oriented industries struggle to pay competitive wages versus non-tradable services



Source: Calculations using Labor Force Survey 2013-14

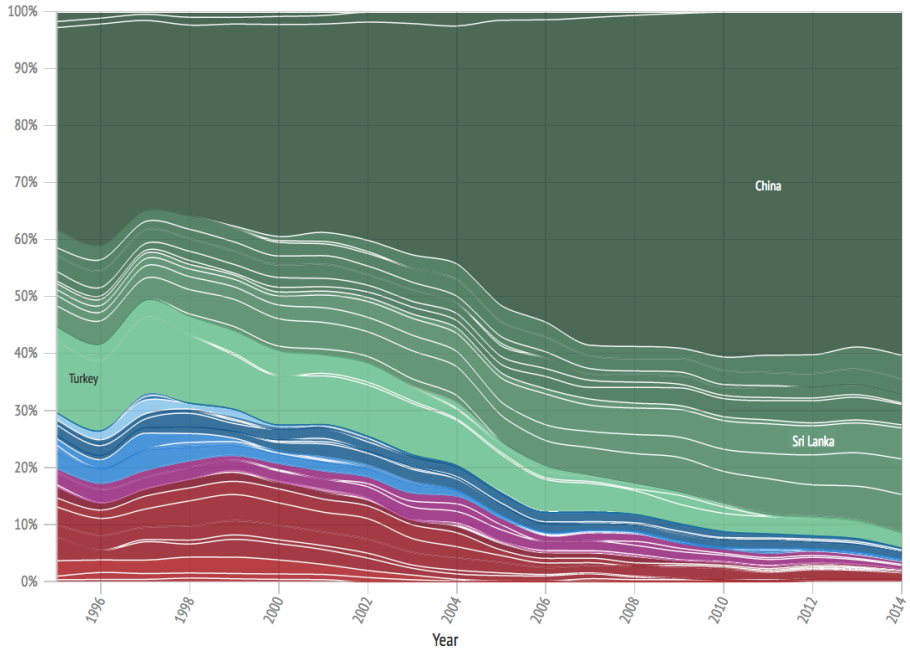
This necessitates diversification into new exporting industries, including tourism, that can pay higher wages



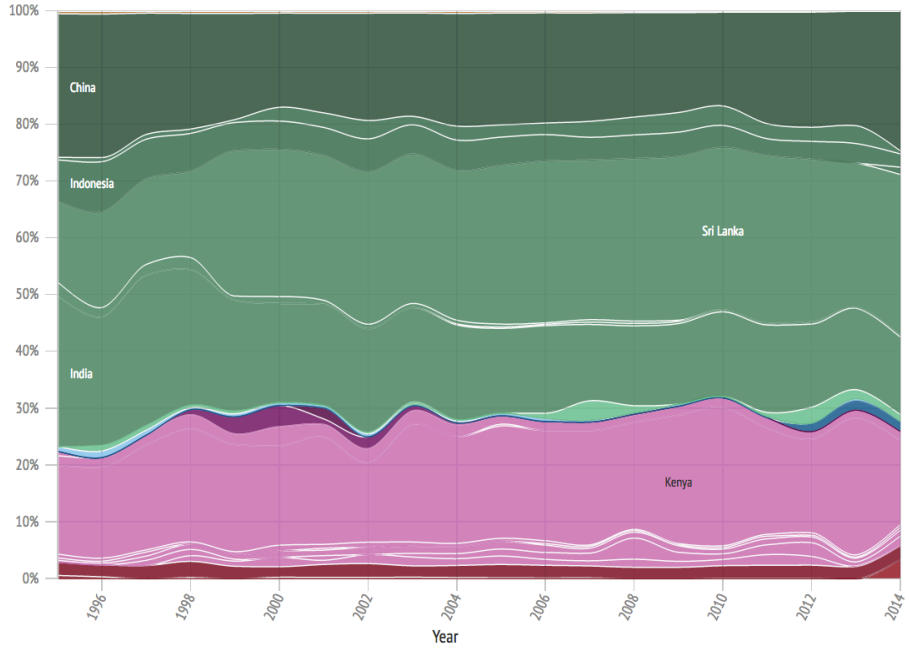
Source: Calculations using Labor Force Survey 2013-14

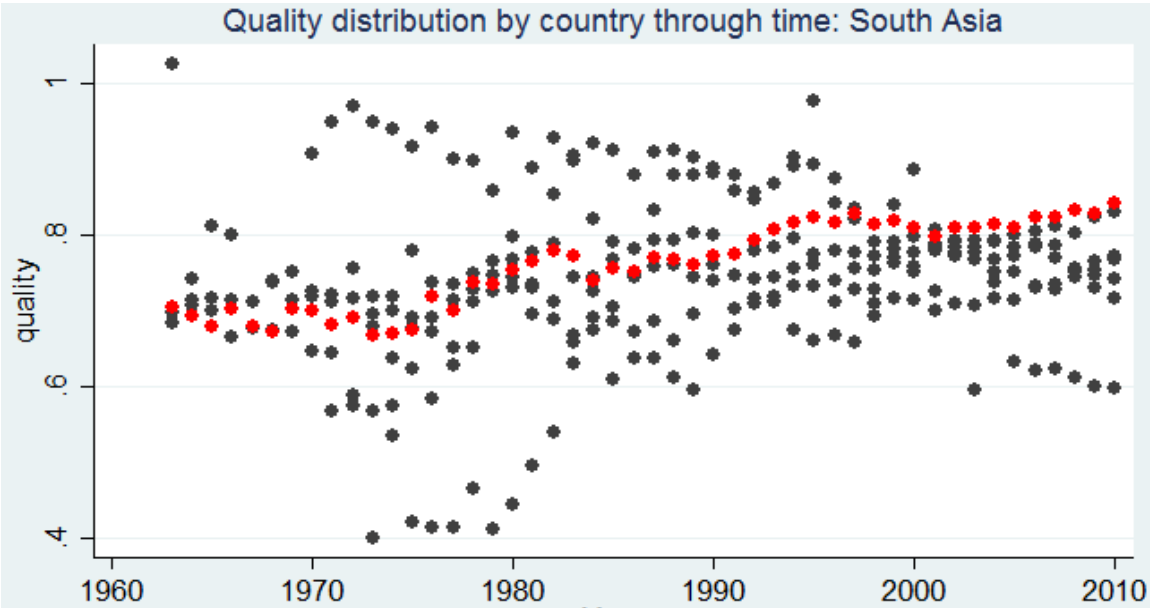
Meanwhile, Sri Lanka's historically strong exports may continue to maintain global market share through innovation, higher quality, the supply of niche products and presence in buyer-driven global value chains.

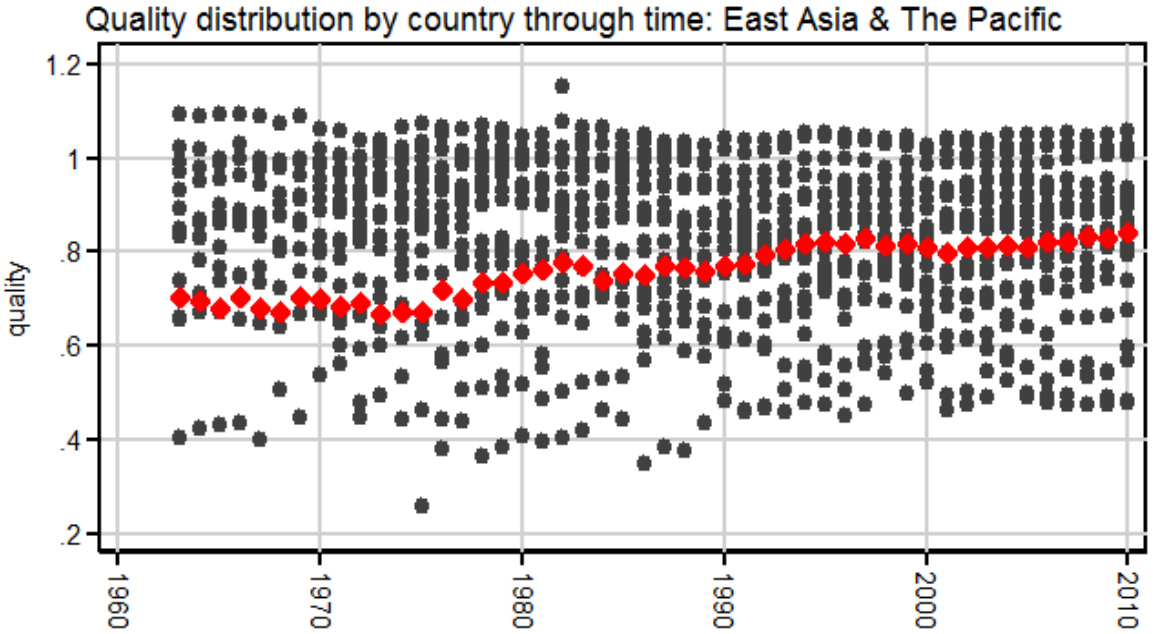
Global Share of Women's Undergarments Exports (Net), 1995-2014



Global Share of Tea Exports (Net), 1995-2014





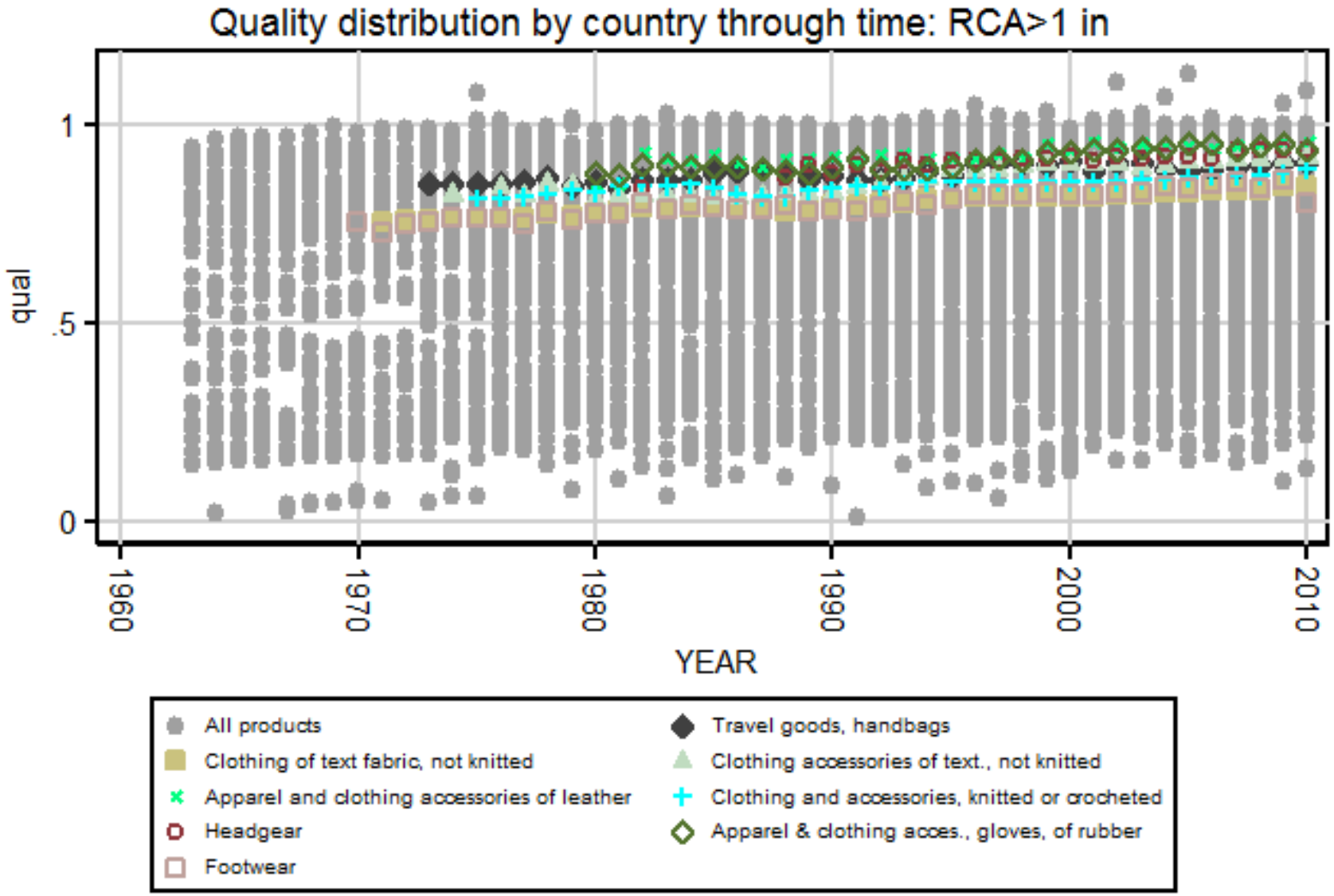


Steady increase in overall export quality over time

- Index of implied export quality; scaled to 90th percentile = 1.
- Useful for comparisons *within* product categories (not between them)
- By 2000s, Sri Lanka leading South Asia region; still room to grow quality compared to East / Southeast Asia Pacific

Source: CID calculations, based on methodology from Henn, Papageorgiou and Spatafora (2013)

Growth in quality driven by shift towards high quality in garments and related goods



Source: Own calculations based on Henn, Papageorgiou and Spatafora (2013), WDI

Growth Diagnostic Findings

EMERGING CONCLUSIONS AND REMAINING QUESTIONS

Working Summary of Constraints (1)

** Conclusions still being updated and finalized

Issue	Current Assessment
Innovation / coordination	Binding. Domestic innovation is limited, underlying the need for increased private sector coordination and leveraging stronger knowhow inflows. This is both a causal problem and an outcome.
Finance	Non-binding, but concerns about no risk taking and access to start-up capital.
Electricity	Non-binding, although issues of voltage consistency are of concern. Inadequate plans for supply expansion are also a concern.
Water and wastewater	Non-binding, but a shortage of wastewater facilities may constrain high polluting industries. Communicable disease burden is low, firms have adequate water access. Water is a concern for the future (droughts/floods/supply) and industrial scale wastewater is undersupplied.
Transport	Potentially binding. Port and related infrastructure is good. Basic provision of road infrastructure is good but there is evidence that congestion along major corridors is a serious constraint to the transport of goods and people. Work remains to clarify the importance of the constraint in more rural districts. Additional analysis needed regarding air and rail transport.
Education	Non-binding in most areas, including the supply of tertiary education. Some skills appear to be in low supply (IT, Engineering, Management) but low private sector demand for educated labor overall. Vocational training is providing an effective means to identify and fill skill gaps.
Health	Non-binding, performs well on indicators of health. Firms are not constrained by health of workforce.

CHALLENGE: Identify the constraints that **bind growth** of **exports** and **externally-oriented FDI**, specifically in **new activities**, and **do not bind growth** in construction, tourism, logistics and finance.

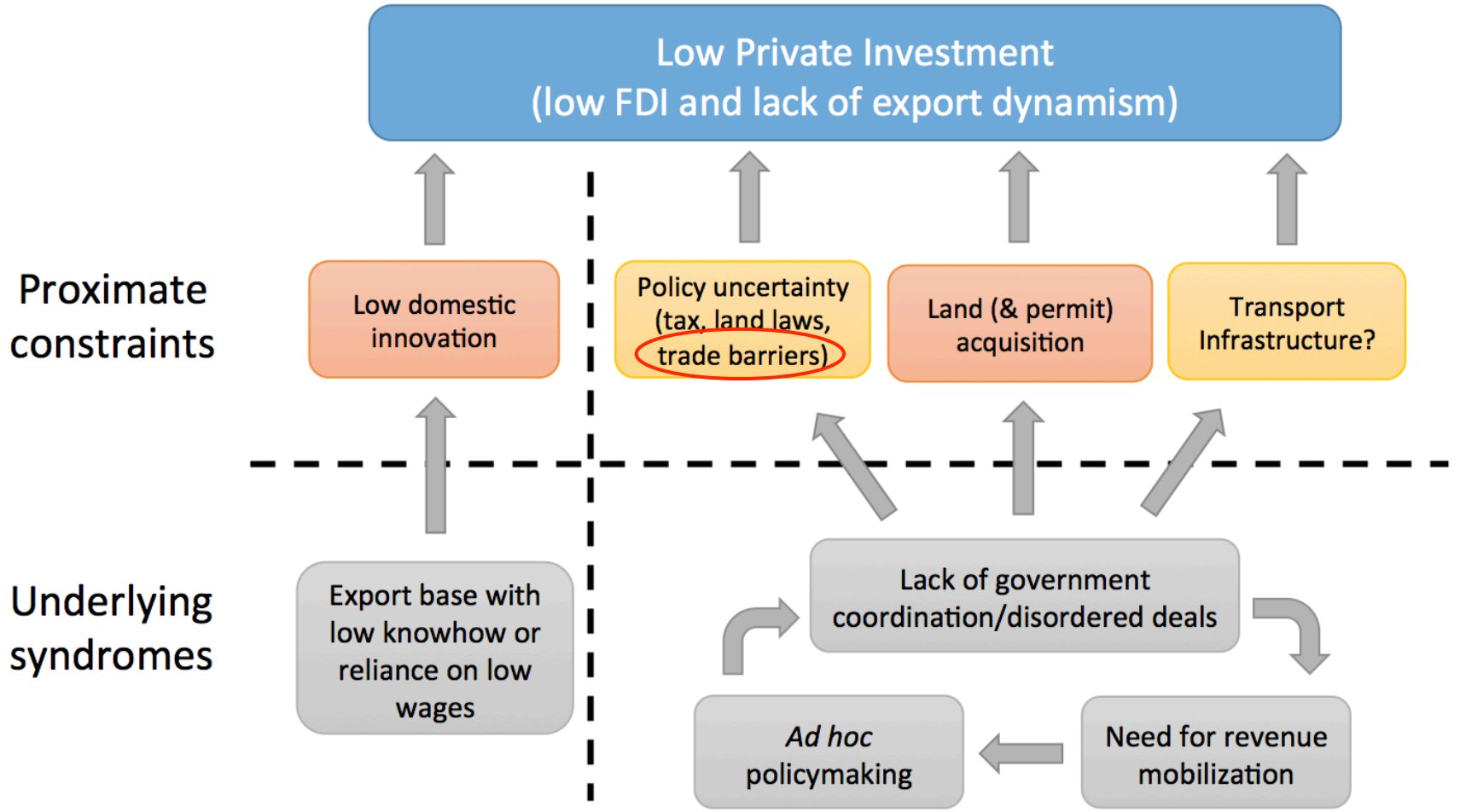
Working Summary of Constraints (2)

** Conclusions still being updated and finalized

Issue	Current Assessment
Macro-fiscal policy	Non-binding. Primary issue is low revenue and resulting fiscal imbalances – other issues as described in IMF. Balance of payment imbalances leave Sri Lanka vulnerable is left vulnerable to bouts with inflation, painful currency depreciation or dangerous drawdowns of reserves.
Policy instability	Currently binding for some FDI. Policy instability in taxes (VAT/capital gains) may be resolved in the near term but the problem also extends to land and trade policy.
Labor regulations	Problematic, but not binding. Existing exporting industries find it difficult to attract labor based on wages, despite strong protections. The problem tends to be less one of releasing workers and more one of attracting and retaining workers versus higher wage non-tradables.
Access to land	Binding. The process of acquiring right to develop land is slow and unclear; the retention of transfer of state land resources is opaque. High opportunity cost of *de facto* unavailable state land (due to lack of gov't coordination). However, this is not binding in several parts of the country where existing export processing zones have high vacancy rates.
Crime, legal, corruption, etc.	Non-binding. Government functions appear adequate to keep these microeconomic risks at a level well below that of relevant comparator countries.
Barriers to international markets	Potentially binding. Now considering whether trade policy is itself a constraint. New trade agreements represent an opportunity for exports/FDI. The structure and complexity of trade barriers creates an anti-(new) export bias that may be highly problematic.

CHALLENGE: Identify the constraints that **bind growth** of **exports** and **externally-oriented FDI**, specifically in **new activities**, and **do not bind growth** in construction, tourism, logistics and finance.

Growth Syndrome: One conceptualization; this is still under development



** Conclusions still being updated and finalized

Connections to Trade Policy

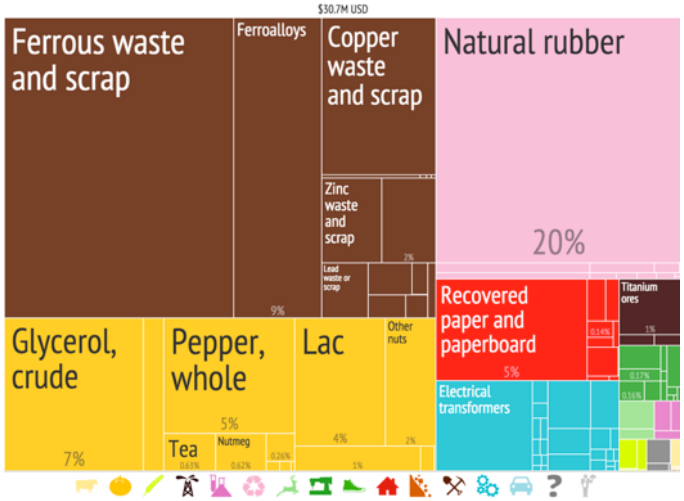
TRADE AGREEMENTS & BROADER TRADE POLICY

Trade in light of the growth diagnostic…

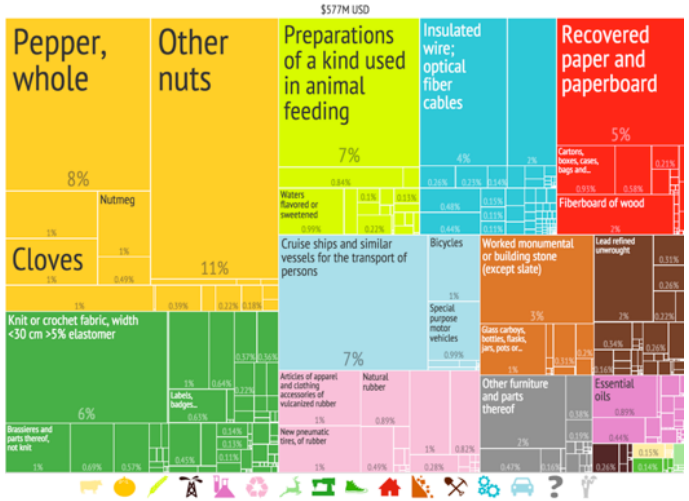
- Trade Agreements:
  - Provide opportunities to grow exports, diversify exports and attract new knowhow. This is of critical importance for more jobs, better wages and sustaining growth.
- Trade Policy:
  - May represent a key constraint to the diversification of exports and overall growth.

India-Sri Lanka Free Trade Agreement (ISFTA): A noteworthy jump and transformation can be seen in Sri Lanka's exports of goods to India after 2003. Sri Lanka's exports to India increased by a factor of 18.8 ($30.7M to $577M) between 1995 and 2014, while Sri Lanka's imports from India increased by a factor of 16.0 ($397M to $6.36B).

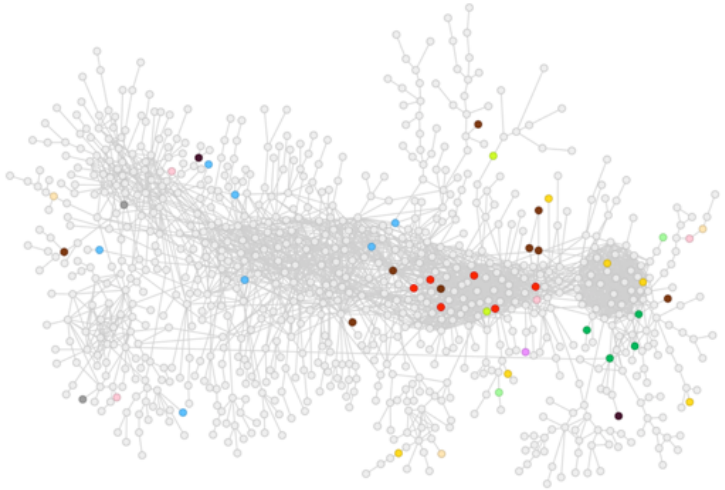
Sri Lanka's Exports to India, 1995

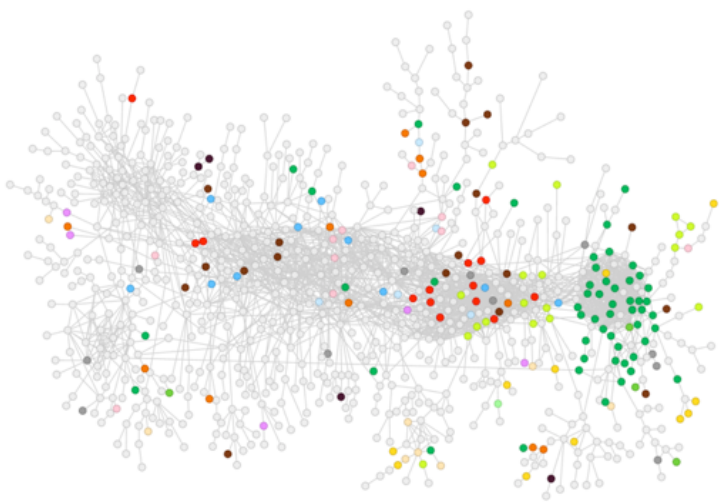


x 18.8



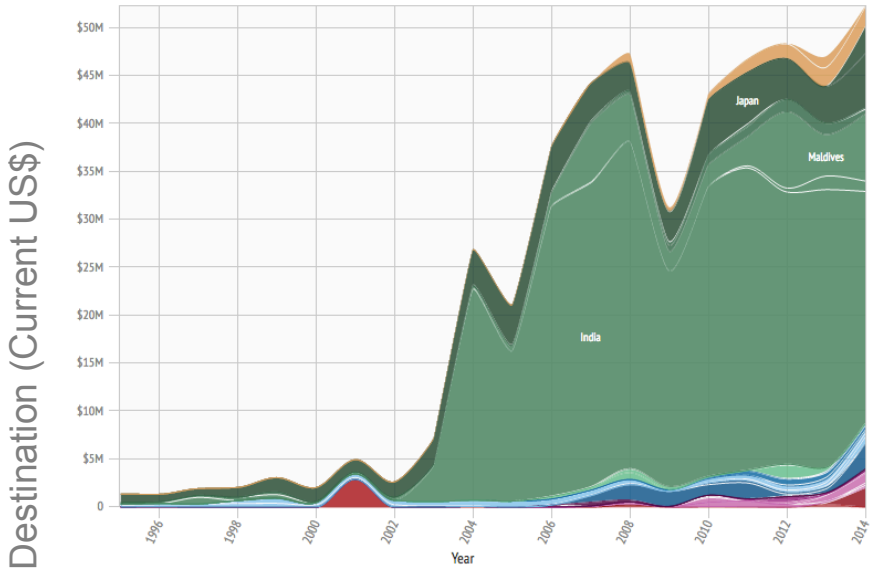
Sri Lanka's Exports to India, 2014



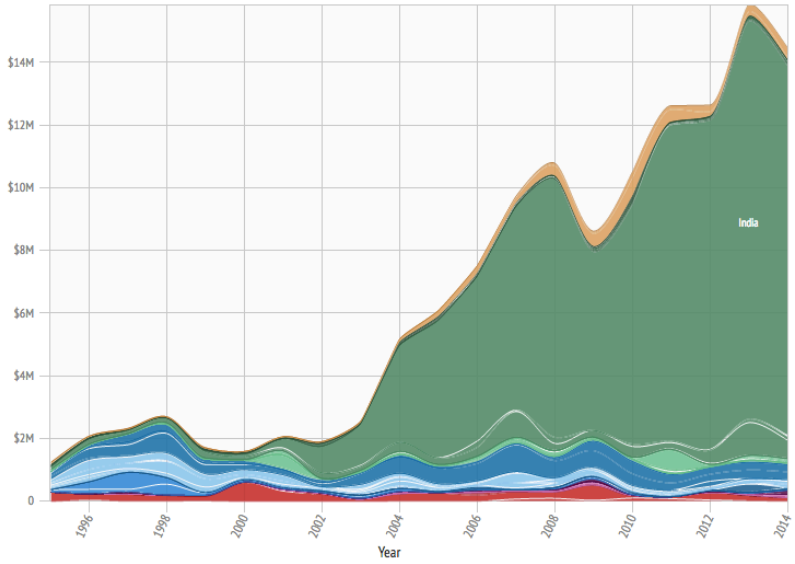


Several products stand out (all became duty free):

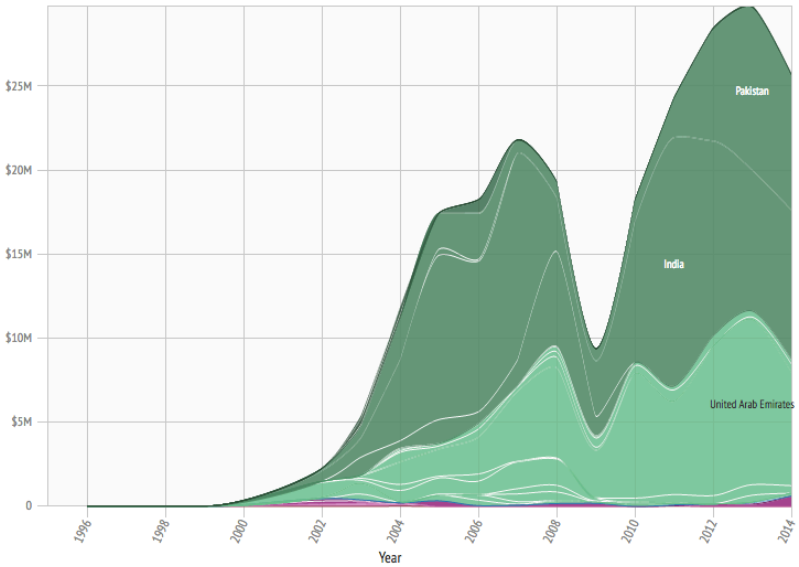
Insulated wire (8544)



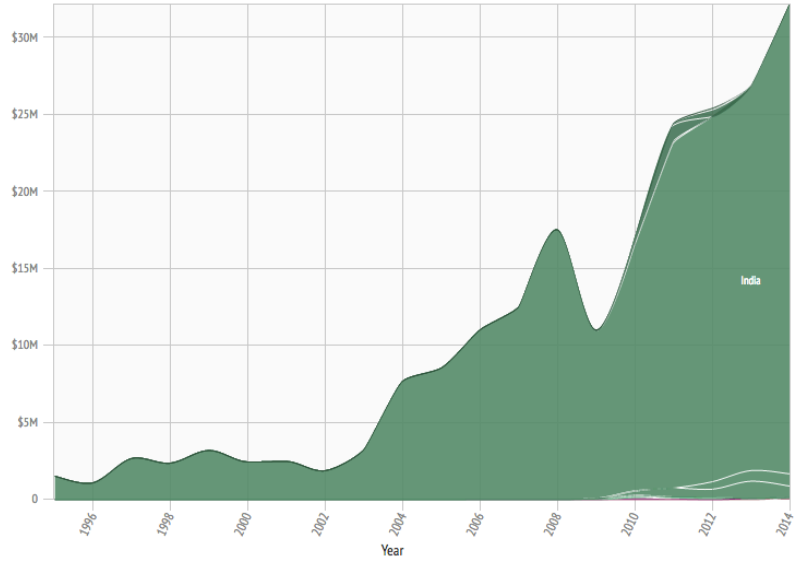
Other furniture and parts (9403)



Wood fiberboard (4411)



Recovered paper and paperboard (4707)

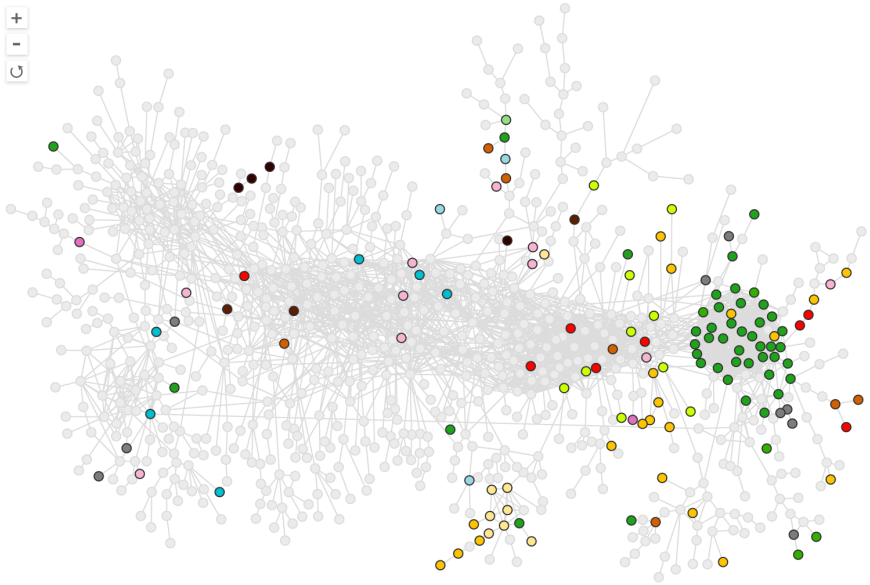


ISFTA has supported limited knowhow growth

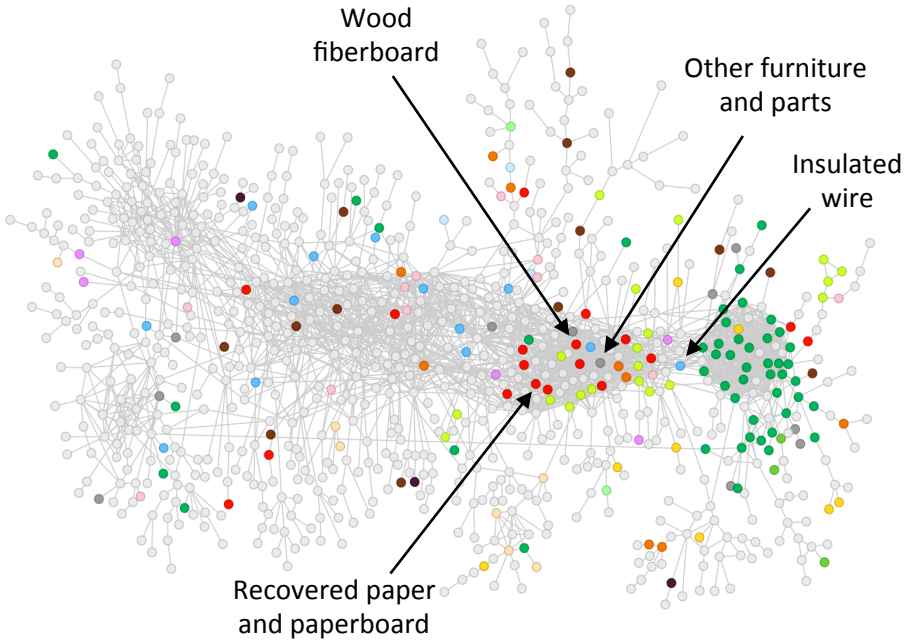
Sri Lanka diversified into "nearby" areas of the products space, building upon existing capabilities, at least in its exports to India.

Some of these exports remain single-market products, while others (such as insulated wire) have begun to reach other markets as well.

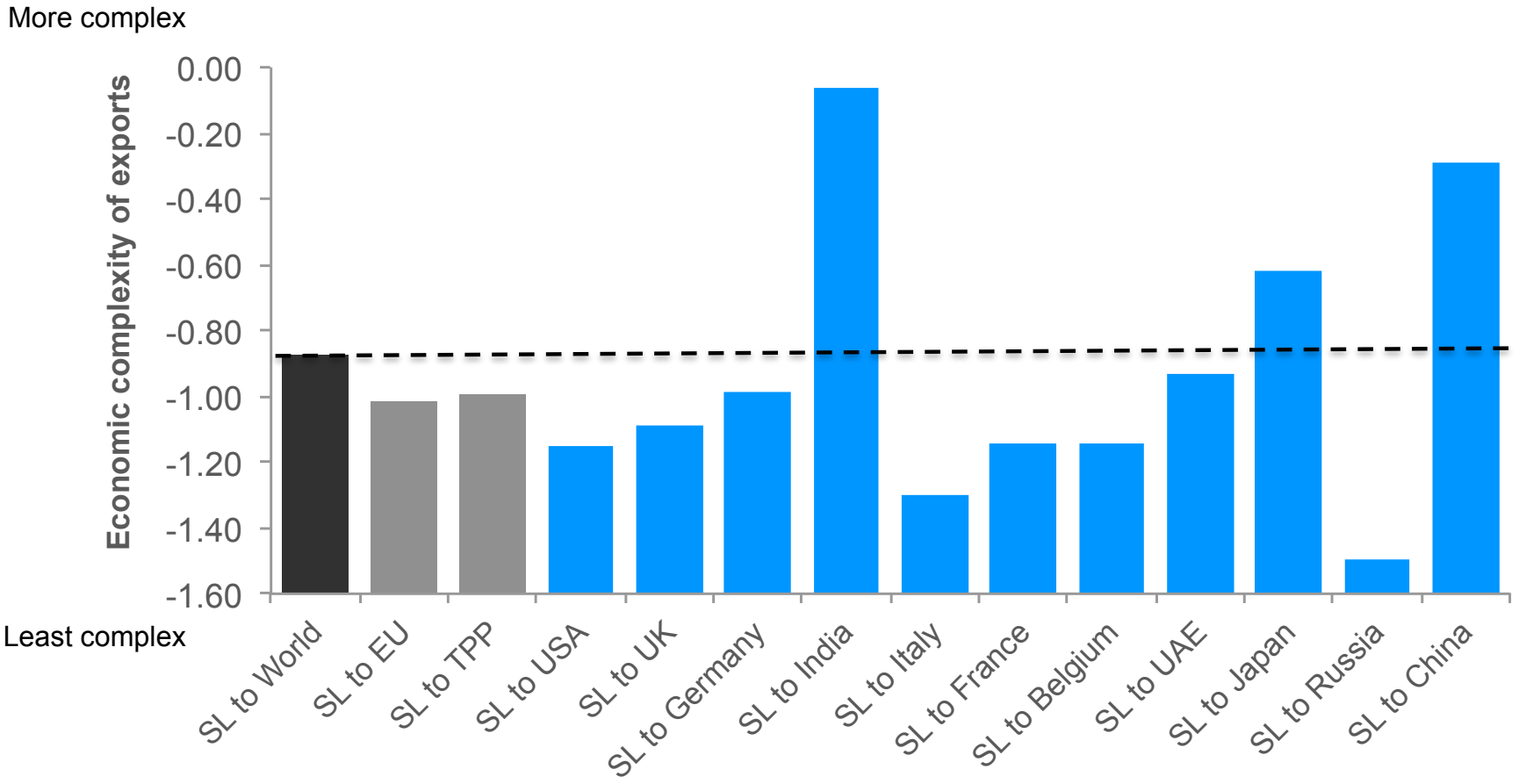
Sri Lanka's Exports, 2014



Sri Lanka's Exports to India, 2014



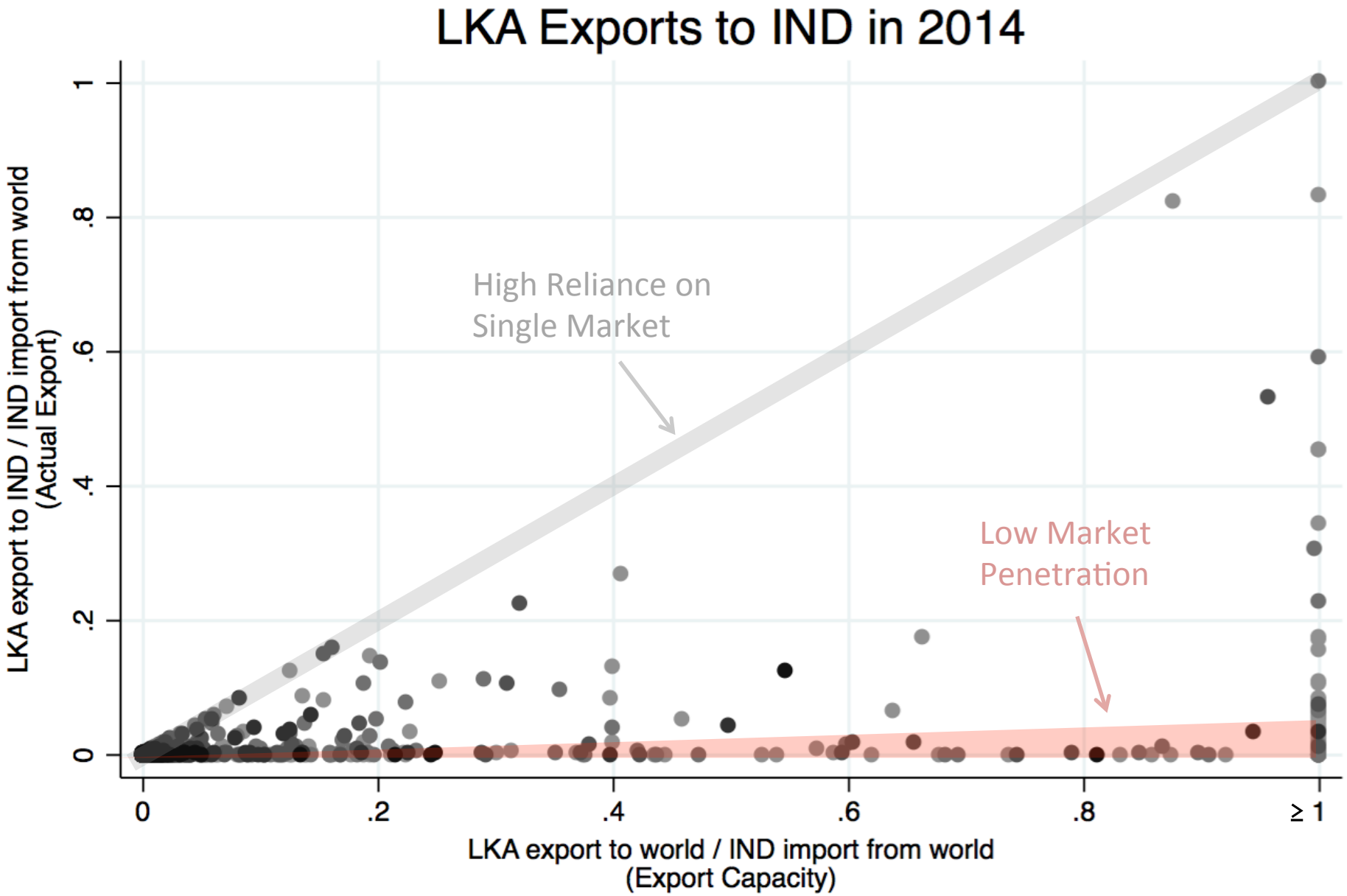
ISFTA has, in part, helped to make Sri Lankan exports to India more complex than its exports to other major trading partners.



Note: ECI values differ from those on Atlas of Economic Complexity due to choice of product code (HS4 used here, Atlas uses SITC4). Source: calculations based on data from UN Comtrade

But why hasn't the agreement allowed for Sri Lanka to diversify further and faster across the product space?

- Intensive margin: There are many products that Sri Lanka already exports but which do not enter the Indian market.


LKA Exports to IND in 2014
High Reliance on
Single Market
Low Market
Penetration
LKA export to IND / IND import from world
(Actual Export)
0
.2
.4
.6
.8
1
0
.2
.4
.6
.8
≥ 1
LKA export to world / IND import from world
(Export Capacity)
Darker markers represent more complex products
Data source: Atlas of Economic Complexity

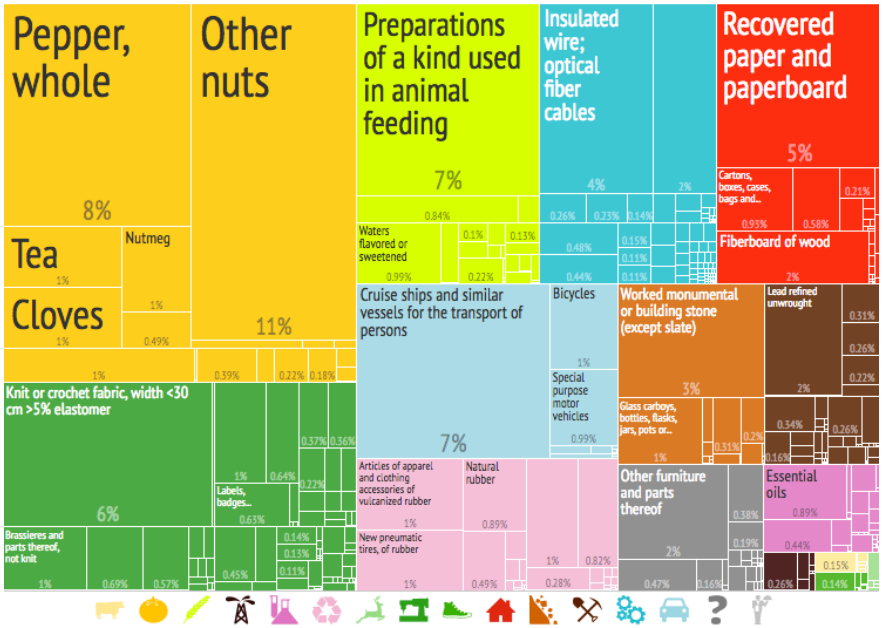
But why hasn't the agreement allowed for Sri Lanka to diversify further and faster across the product space?

- Intensive margin: There are many products that Sri Lanka already exports but which do not enter the Indian market.
  - Some quota restrictions and many border issues identified by Draft Trade Policy Framework (via IPS): Lack of border control and transparency/ information sharing; Unawareness of customs officials; Non-acceptance of standard certifications; Excessive time taken for lab testing; Excessive testing; Complexity in obtaining new regulatory information; Labeling requirements; No help desk.
- Extensive margin: FDI is needed for longer jumps. ISFTA should make Sri Lanka attractive for FDI from firms seeking better access to India, but this is largely lacking.

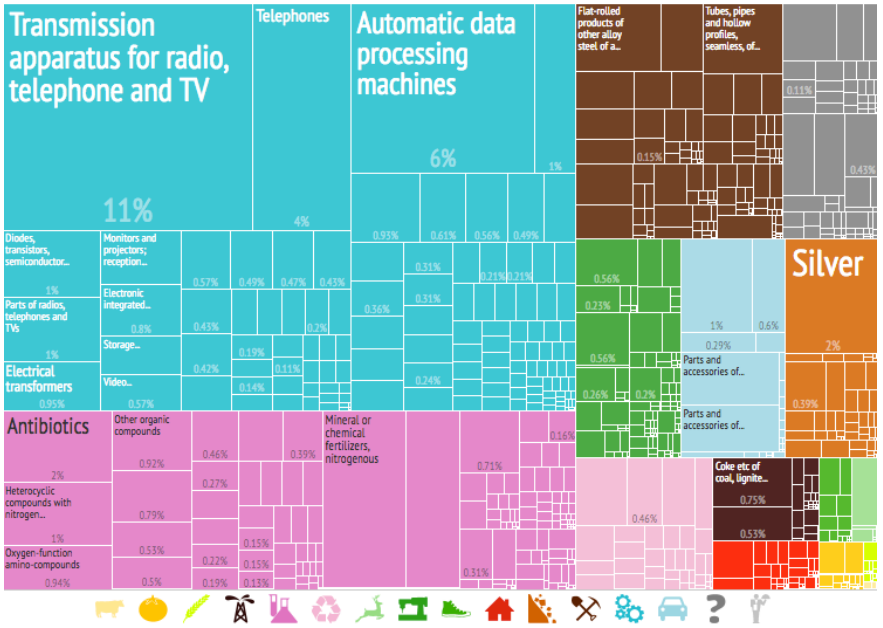
Ex: Chinese Exports to India

In 2014, China exported $54 billion USD worth of goods to India, representing 13% of India's total imports. In the same year, Sri Lanka supplied less 0.02% of India's total imports. China also exported a much different and more diversified set of products to India. For many of these products, Chinese firms could gain preferential access to the Indian market through investment in operations in Sri Lanka.

Sri Lanka's Exports to India ($577 million USD)



China's Exports to India ($54 billion USD)



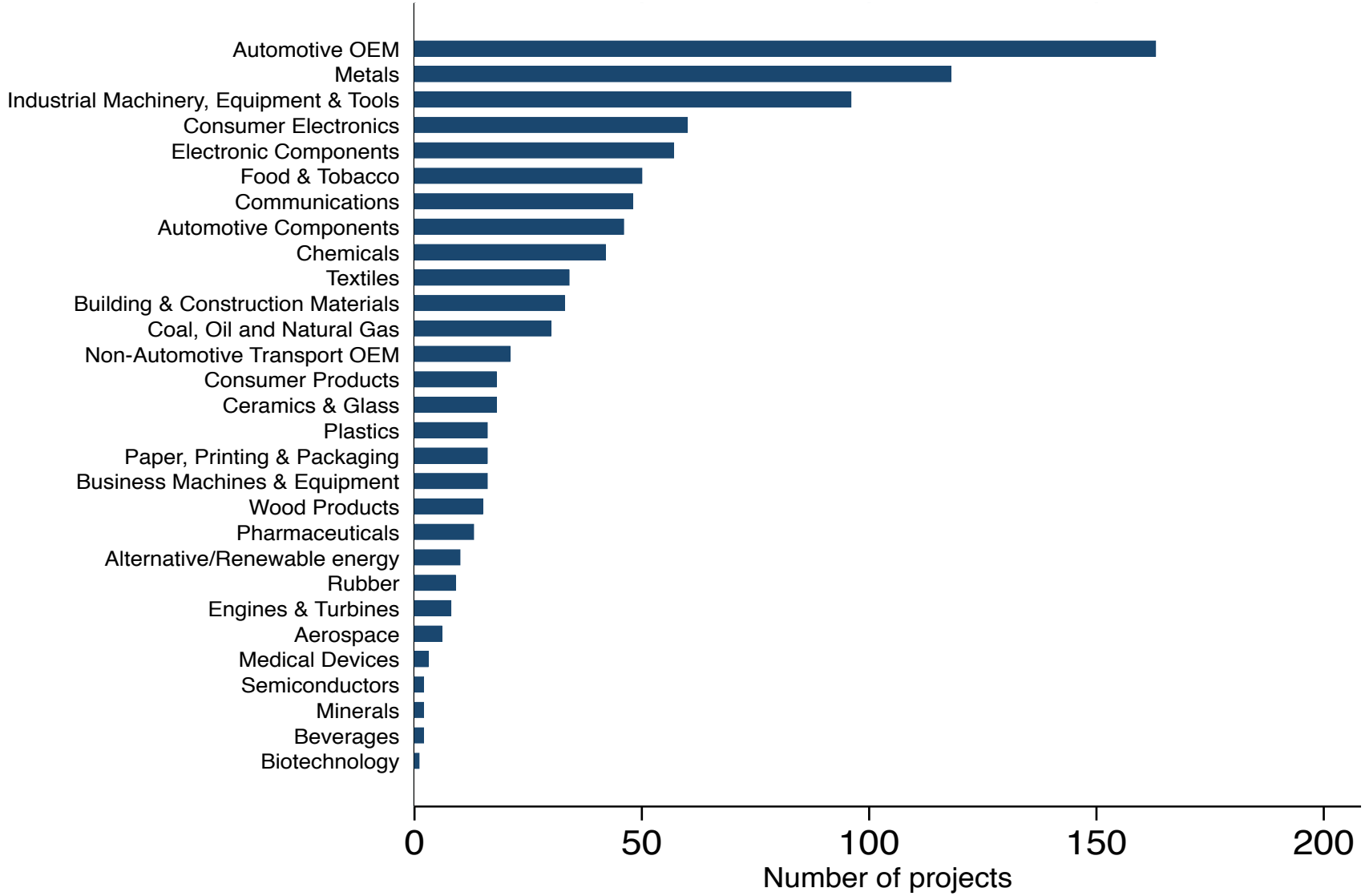
Preferential Access to India is a Major Value Proposition

Top 40 Exports from China to India in 2014

HS4 code	Product name	Exports (million USD)	Bilateral Export Share (%)	Share in Indian Market (%)	MFN Duty to India (simple avg.)	ISFTA Duty to India (weighted avg.)	Difference
8525	Transmission apparatus for radio, telephone and TV	5,940	11.0%	85.2%	6.0	0.0	-6.0
8471	Automatic data processing machines	3,280	6.1%	63.6%	0.0	0.0	0.0
8517	Telephones	2,350	4.4%	41.6%	0.0	0.0	0.0
3102	Mineral or chemical fertilizers, nitrogenous	1,530	2.8%	70.8%	6.1	0.0	-6.1
7106	Silver	1,140	2.1%	29.1%	10.0	0.0	-10.0
3105	Mineral or chemical fertilizers, mixed	1,000	1.9%	50.0%	5.3	0.0	-5.3
2941	Antibiotics	815	1.5%	83.3%	7.5	0.0	-7.5
8473	Parts and accessories for office machines	732	1.4%	52.1%	2.5	0.0	-2.5
2933	Heterocyclic compounds with nitrogen hetero-atom(s) only	718	1.3%	68.8%	7.6	0.0	-7.6
8541	Diodes, transistors, semiconductor devices, including photovoltaic cells	693	1.3%	59.0%	0.0	0.0	0.0
8905	Floating or submersible drilling platforms	692	1.3%	27.8%	5.0	0.0	-5.0
8529	Parts of radios, telephones and TVs	660	1.2%	59.0%	8.3	0.0	-8.3
7225	Flat-rolled products of other alloy steel of a width > 600 mm	613	1.1%	38.7%	5.8	0.0	-5.8
7304	Tubes, pipes and hollow profiles, seamless, of iron or steel	593	1.1%	63.8%	10.0	0.0	-10.0
8708	Parts and accessories of the motor vehicles	546	1.0%	15.8%	10.0	0.0	-10.0
8504	Electrical transformers	514	1.0%	40.2%	8.0	0.0	-8.0
2922	Oxygen-function amino-compounds	507	0.9%	69.0%	7.5	0.0	-7.5
8414	Air or vacuum pumps; ventilating or recycling hoods	503	0.9%	36.0%	8.0	0.0	-8.0
2942	Other organic compounds	499	0.9%	61.5%	7.5	0.0	-7.5
8714	Parts and accessories of motorcycles, bicycles or carriages	472	0.9%	86.4%	17.8	0.0	-17.8
8528	Monitors and projectors; reception apparatus for television	457	0.8%	39.2%	6.7	0.0	-6.7
8542	Electronic integrated circuits	432	0.8%	30.0%	1.5	0.0	-1.5
2921	Amine-function compounds	428	0.8%	65.5%	7.5	0.0	-7.5
2704	Coke etc of coal, lignite or peat, retort carbon	406	0.8%	41.1%	10.0	0.0	-10.0
3808	Insecticides, rodenticides, fungicides, herbicides	383	0.7%	41.7%	10.0	0.0	-10.0
3904	Polymers of vinyl chloride or of other halogenated olefins, in primary forms	366	0.7%	27.8%	7.5	0.0	-7.5
8482	Ball or roller bearings	332	0.6%	38.9%	7.5	0.0	-7.5
9013	Liquid crystal devices	329	0.6%	78.3%	5.8	0.0	-5.8
8904	Tugs and pusher craft	325	0.6%	61.2%	10.0	0.0	-10.0
8523	Storage devices, smart cards, discs, tapes etc	321	0.6%	31.0%	8.0	0.0	-8.0
8521	Video recording apparatus	307	0.6%	53.7%	10.0	0.0	-10.0
8507	Electric storage batteries	306	0.6%	51.5%	10.0	0.0	-10.0
7227	Bars and rods, hot-rolled, in irregularly wound coils, of other alloy steel	304	0.6%	84.1%	5.0	0.0	-5.0
5903	Textile fabrics impregnated with plastics	303	0.6%	86.2%	10.0	4.0	-6.0
8415	Air conditioners	301	0.6%	38.9%	10.0	0.0	-10.0
6002	Knit or crochet fabric, width <30 cm >5% elastomer	300	0.6%	77.3%	10.0	4.0	-6.0
2915	Saturated acyclic monocarboxylic acids	288	0.5%	29.5%	7.7	0.0	-7.7
2713	Petroleum coke	285	0.5%	18.5%	3.8	0.0	-3.8
2918	Carboxylic acids with additional oxygen function	270	0.5%	74.9%	7.5	0.0	-7.5
8544	Insulated wire; optical fiber cables	266	0.5%	33.0%	6.6	0.0	-6.6

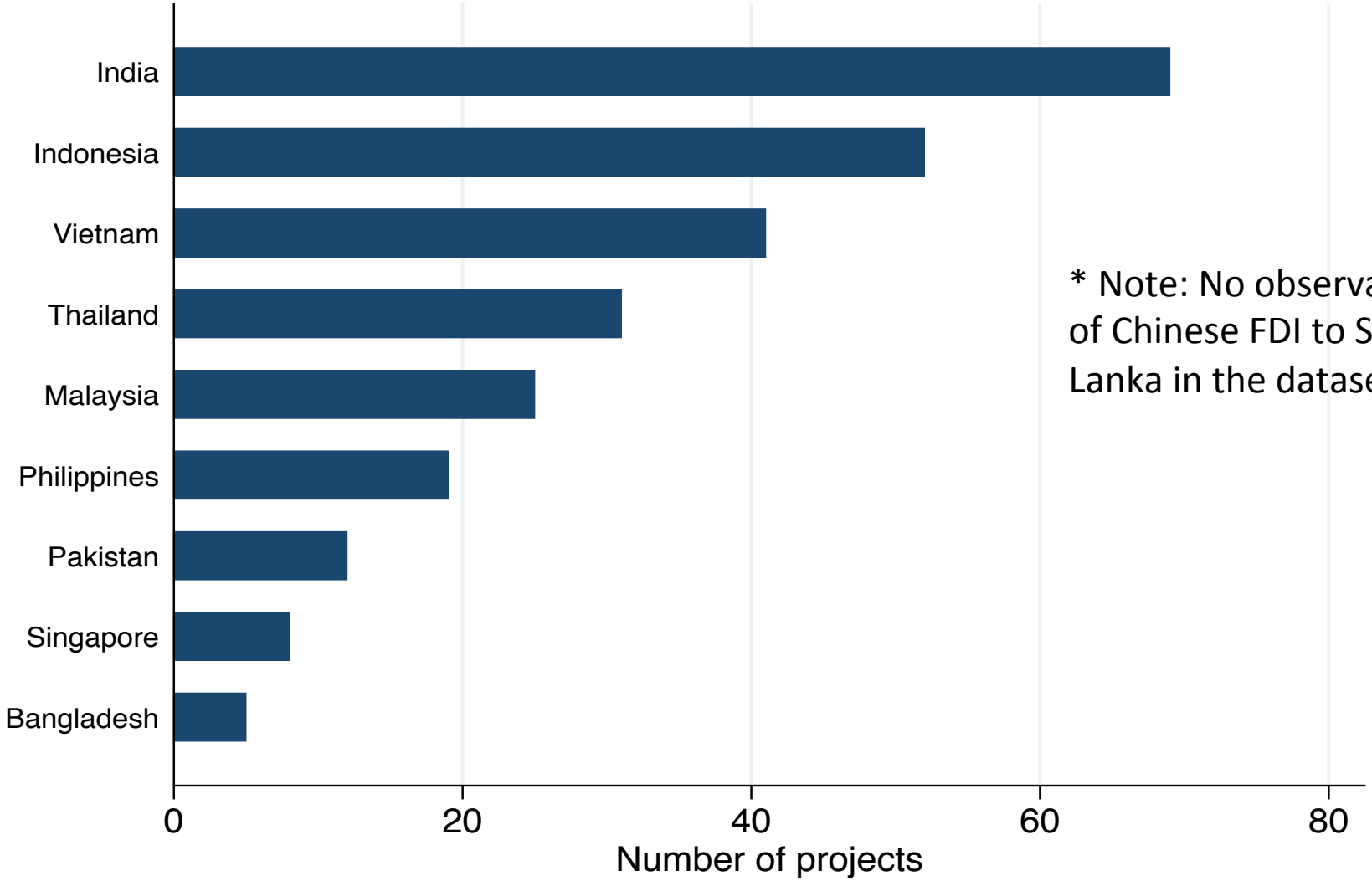
Sources: UN Comtrade; World Integrated Trade Solutions Database; Handbook on the India-Sri Lanka Free Trade Agreement

Chinese FDI in Manufacturing (per international media announcements): Sectors



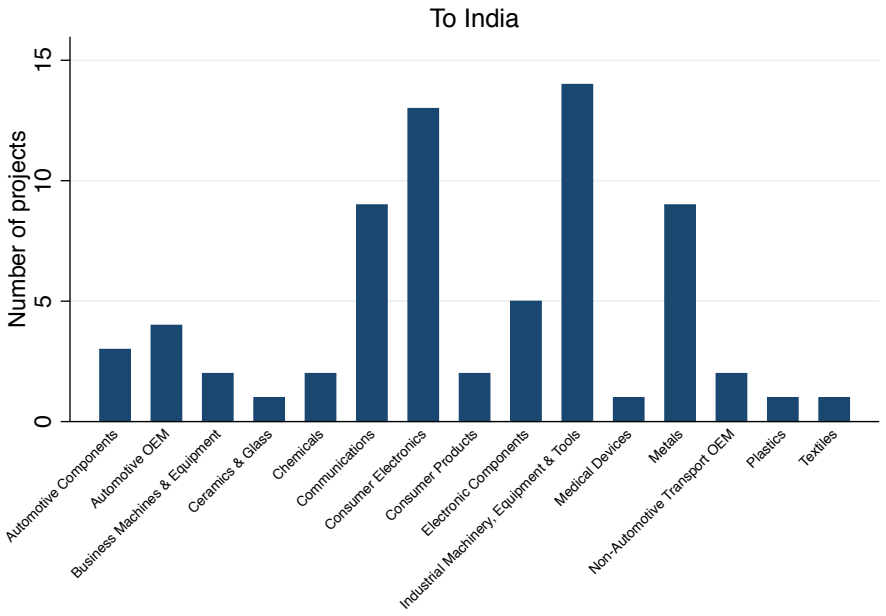
Source: fDi Markets as of May 2016

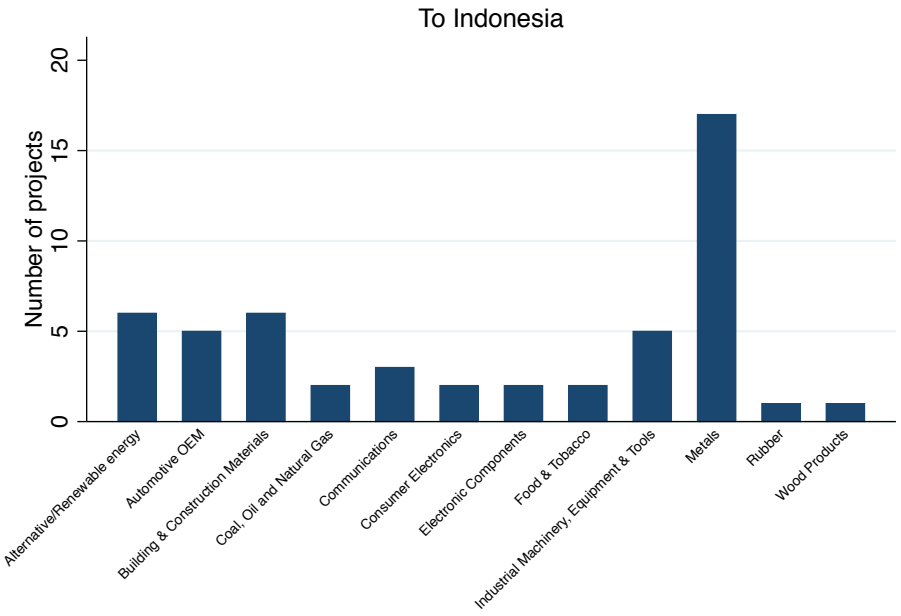
Chinese FDI in Manufacturing (per international media announcements): Destinations among comparators

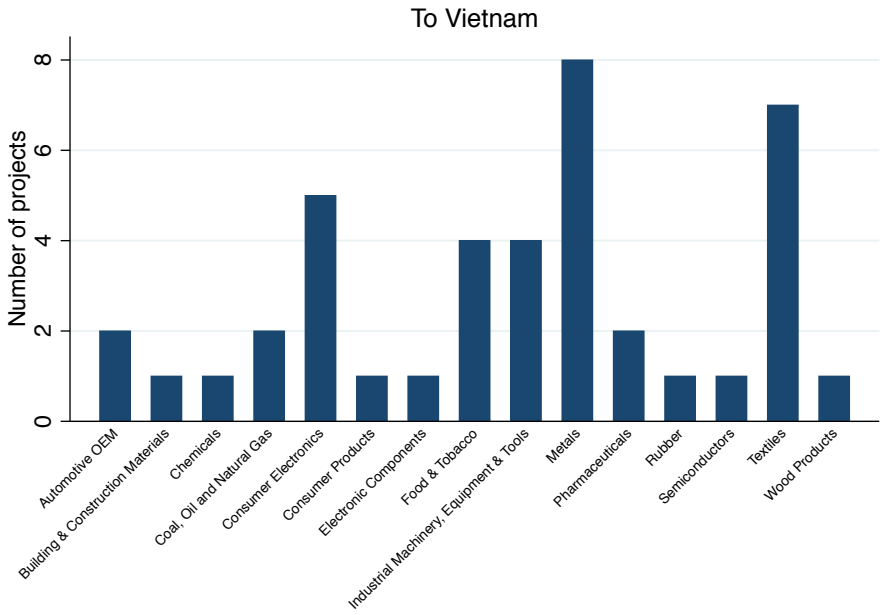


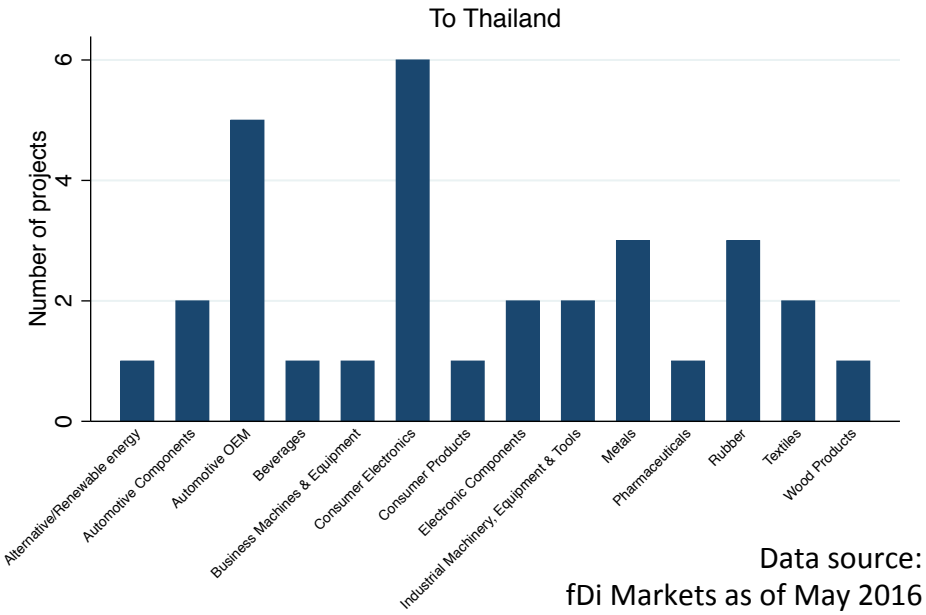
Source: fDi Markets as of May 2016

The absence of Chinese FDI is striking vs. comparators:









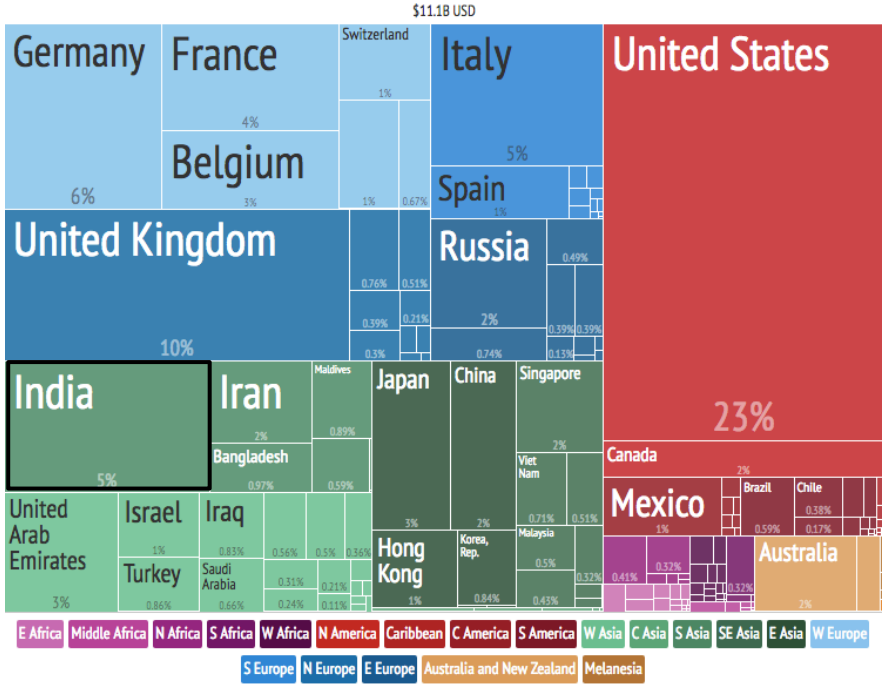
Data source:
fDi Markets as of May 2016

But why hasn't the agreement allowed for Sri Lanka to diversify further and faster across the product space?

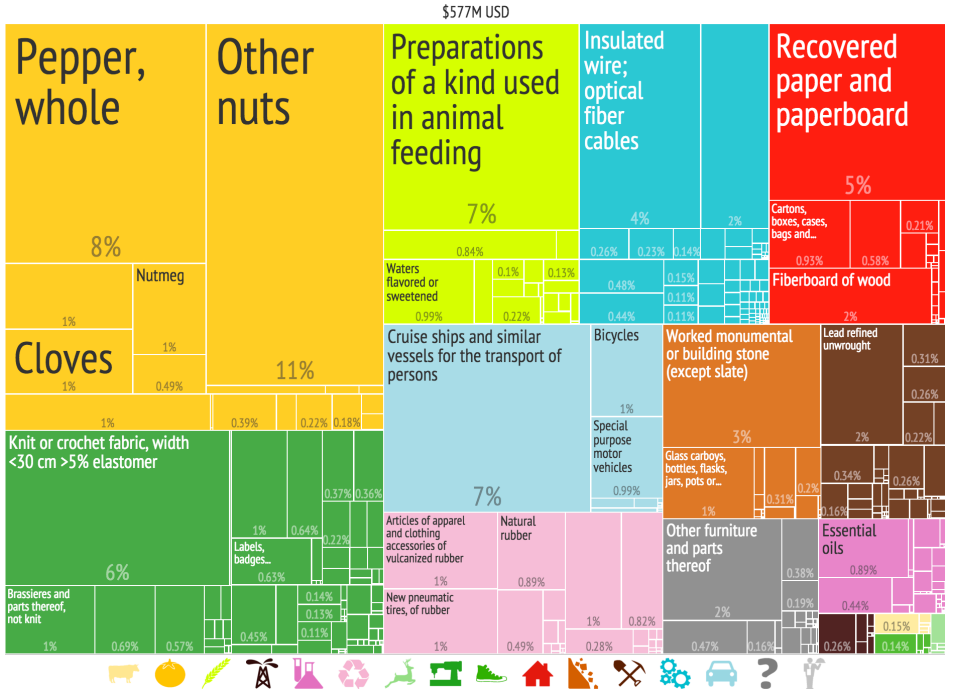
- Intensive margin: There are many products that Sri Lanka already exports but which do not enter the Indian market.
  - Some quota restrictions and many border issues identified by Draft Trade Policy Framework (via IPS): Lack of border control and transparency/ information sharing; Unawareness of customs officials; Non-acceptance of standard certifications; Excessive time taken for lab testing; Excessive testing; Complexity in obtaining new regulatory information; Labeling requirements; No help desk.
- Extensive margin: FDI is needed for longer jumps. ISFTA should make Sri Lanka attractive for FDI from firms seeking better access to India, but this is largely lacking.
  - Rules of origin may be made more favorable
  - But this alone cannot explain the absence of this kind of FDI

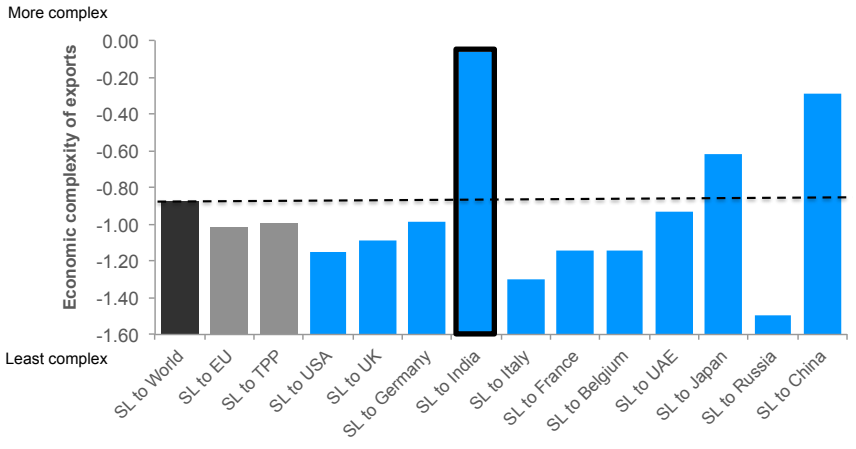
Which countries would be most strategic for new trade agreements?

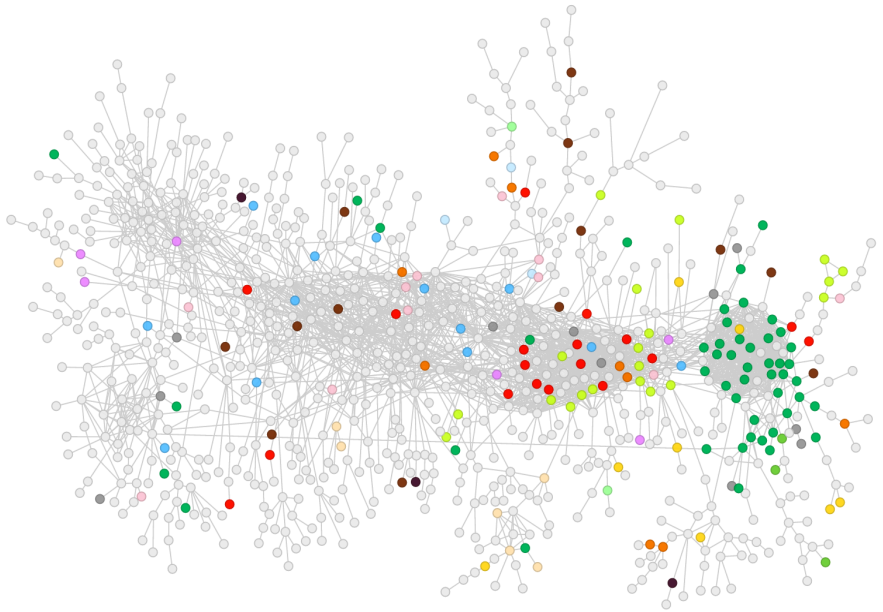
Sri Lanka's Export Destinations (2014)

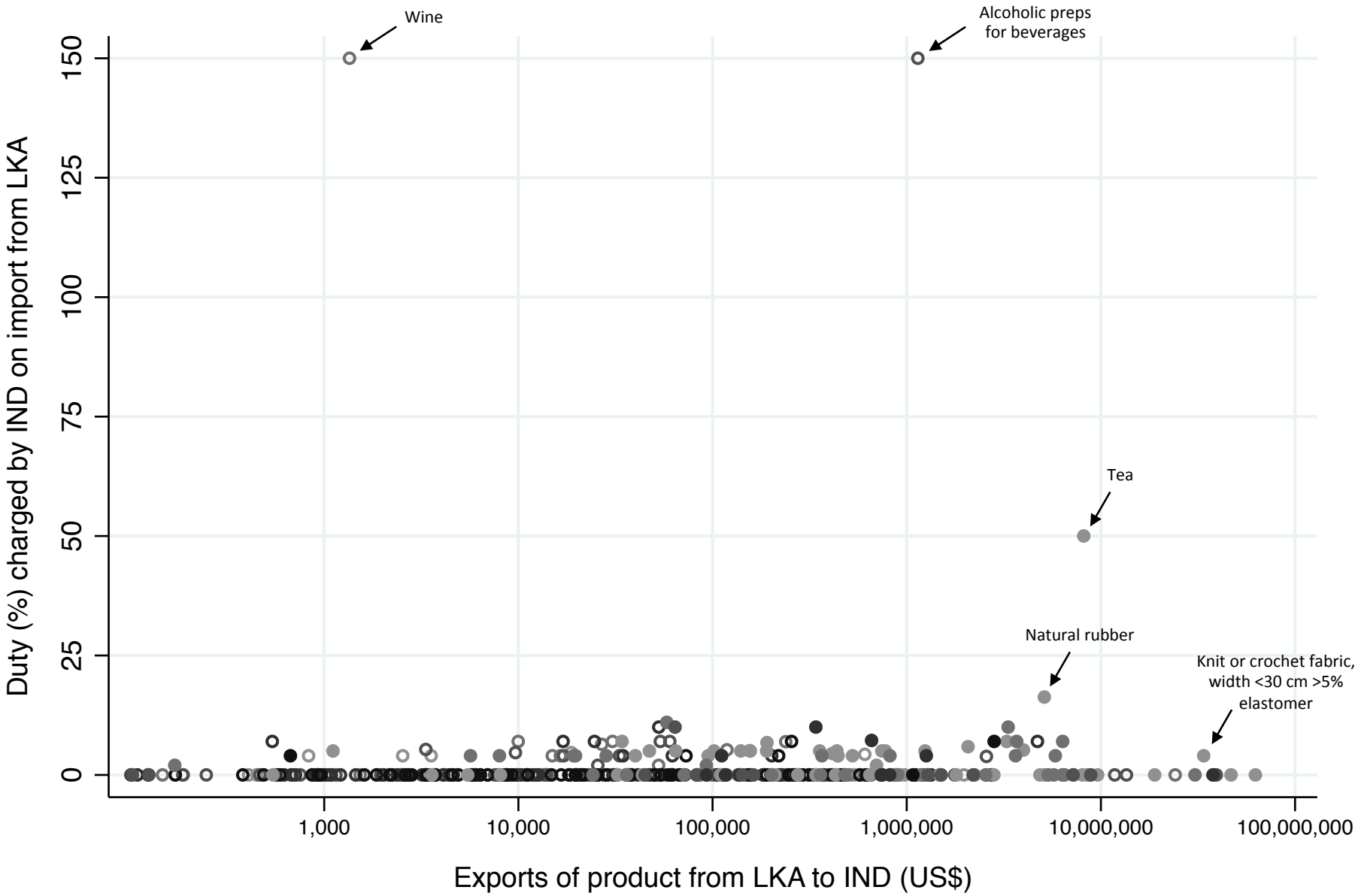


Sri Lanka's Exports to the India (2014)



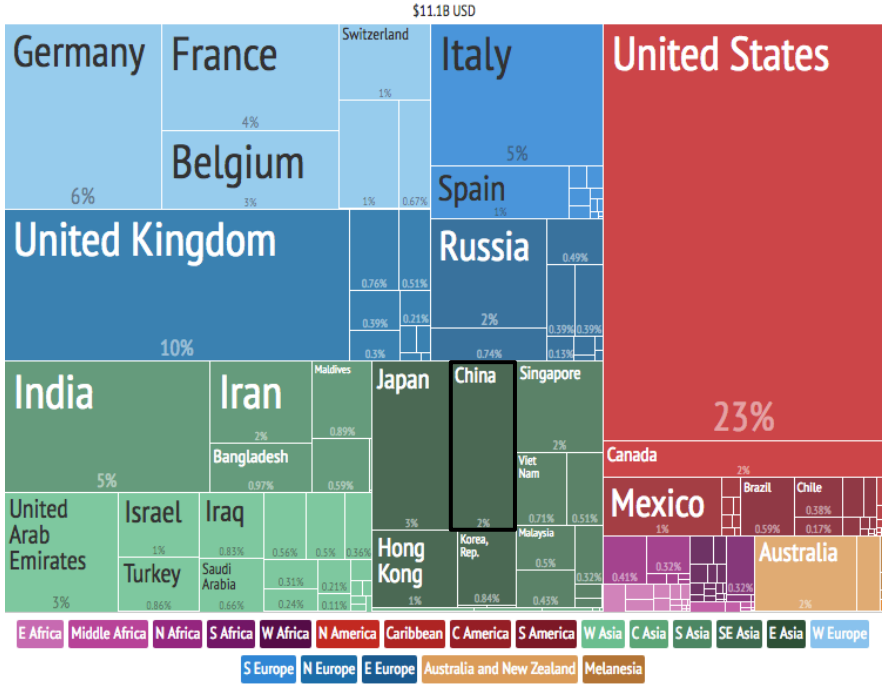




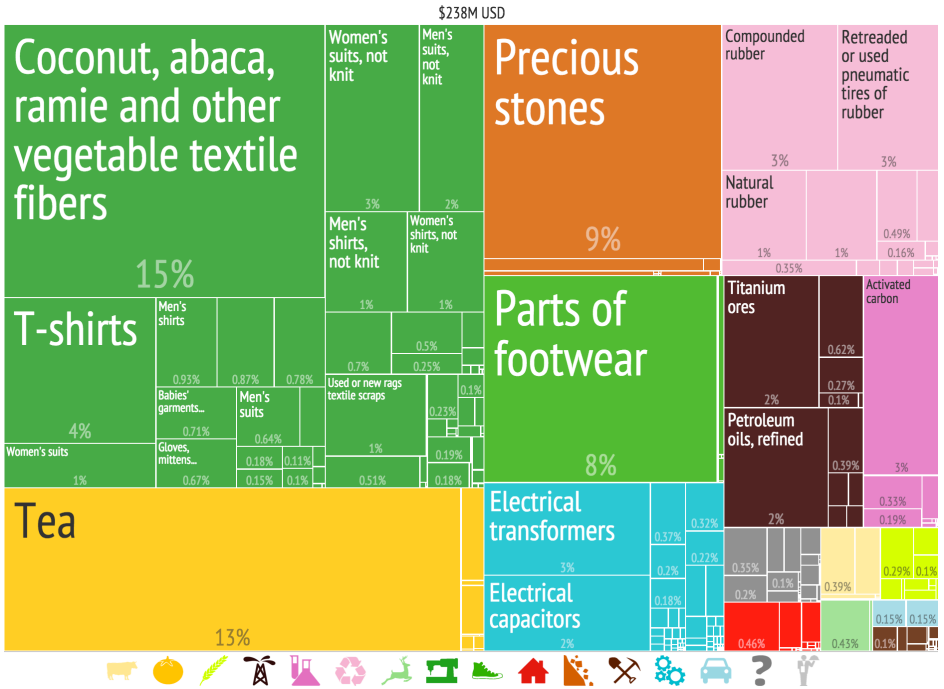


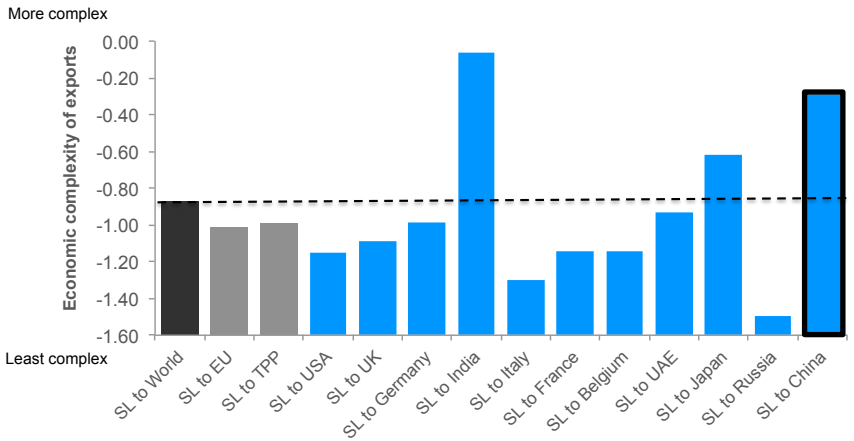
Darker markers represent more complex products. Filled markers represent products where Sri Lanka has a revealed comparative advantage.
Data sources: WITS-TRAINS Database (using 2010 tariff info) & Atlas of Economic Complexity, 2014

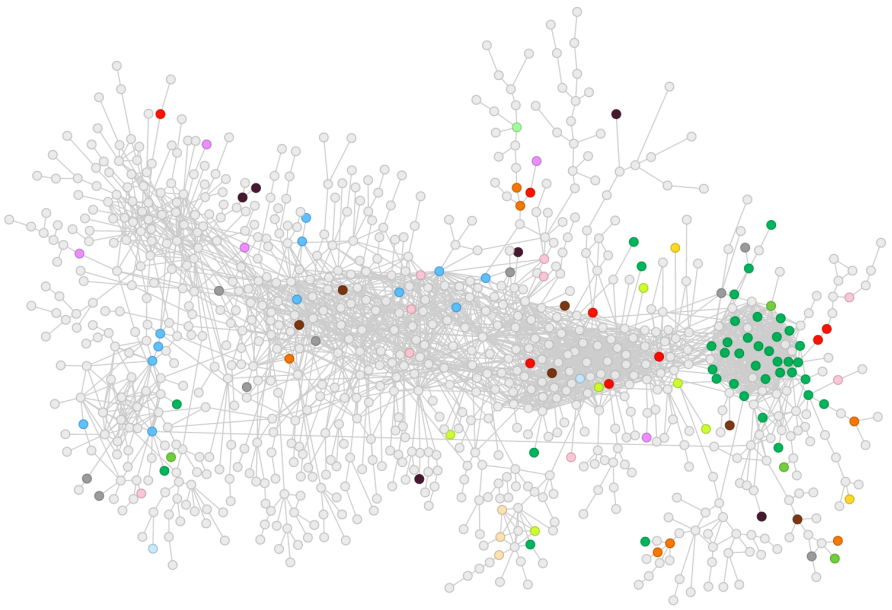
Sri Lanka's Export Destinations (2014)

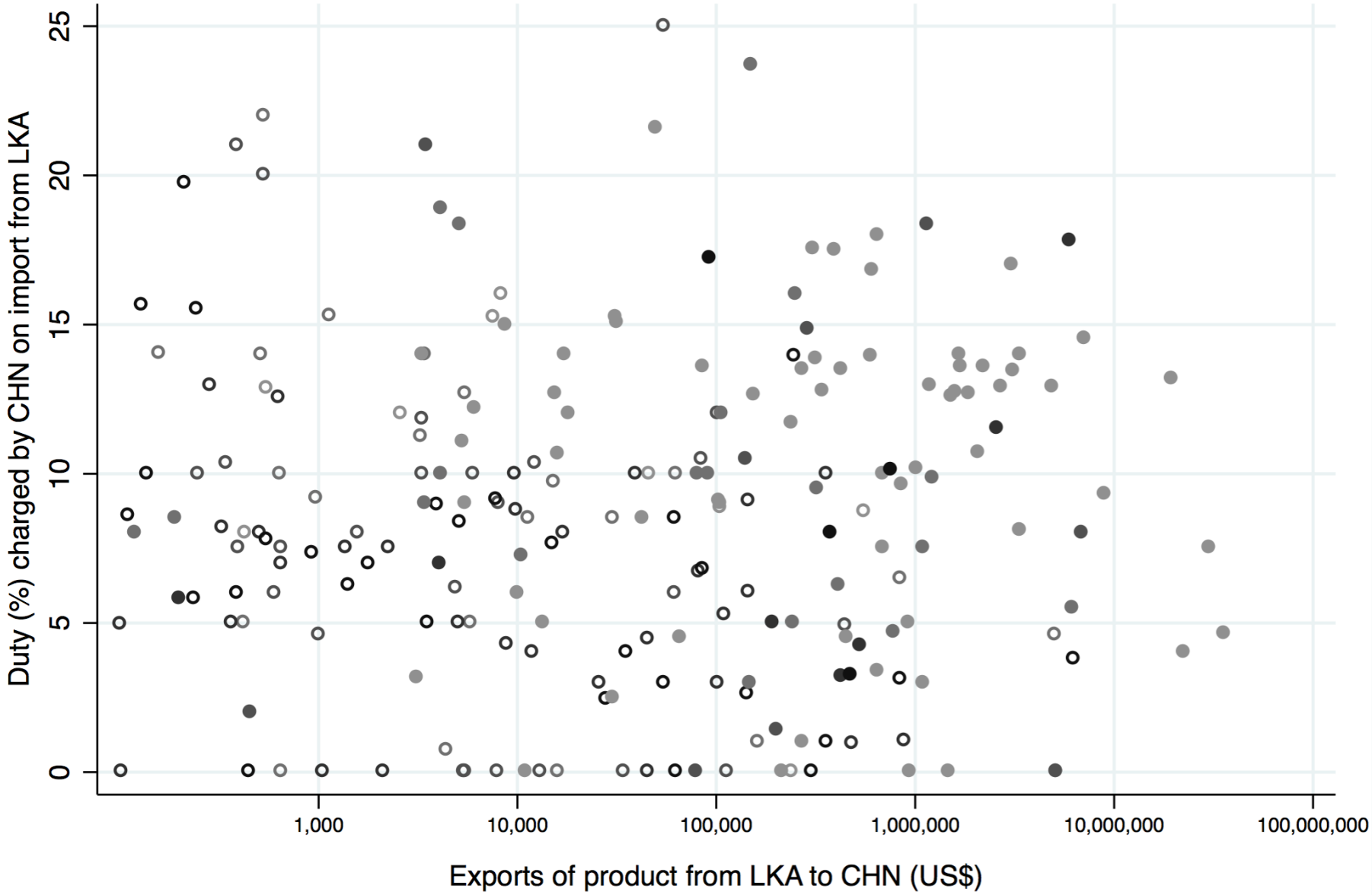


Sri Lanka's Exports to the China(2014)









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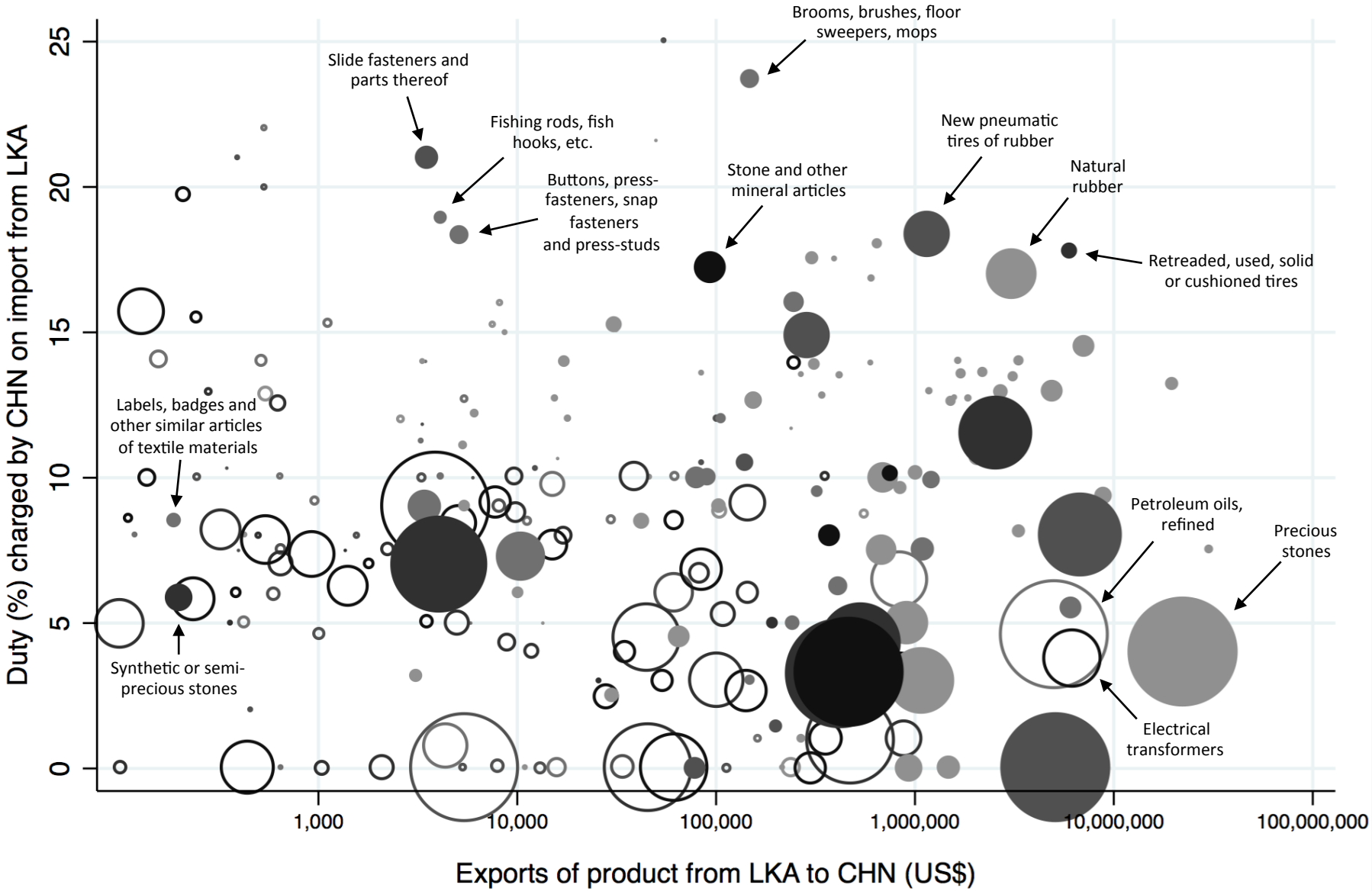

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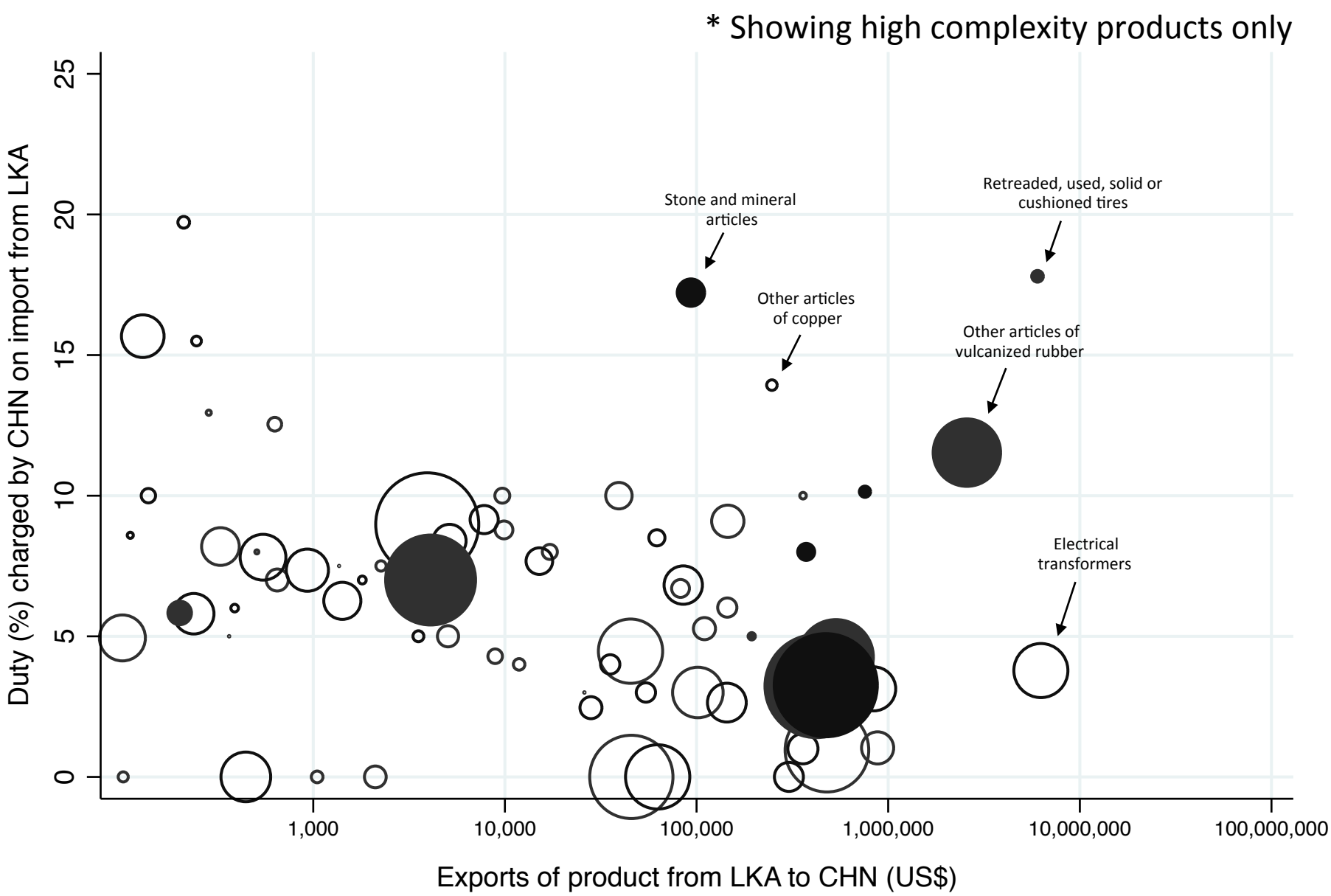

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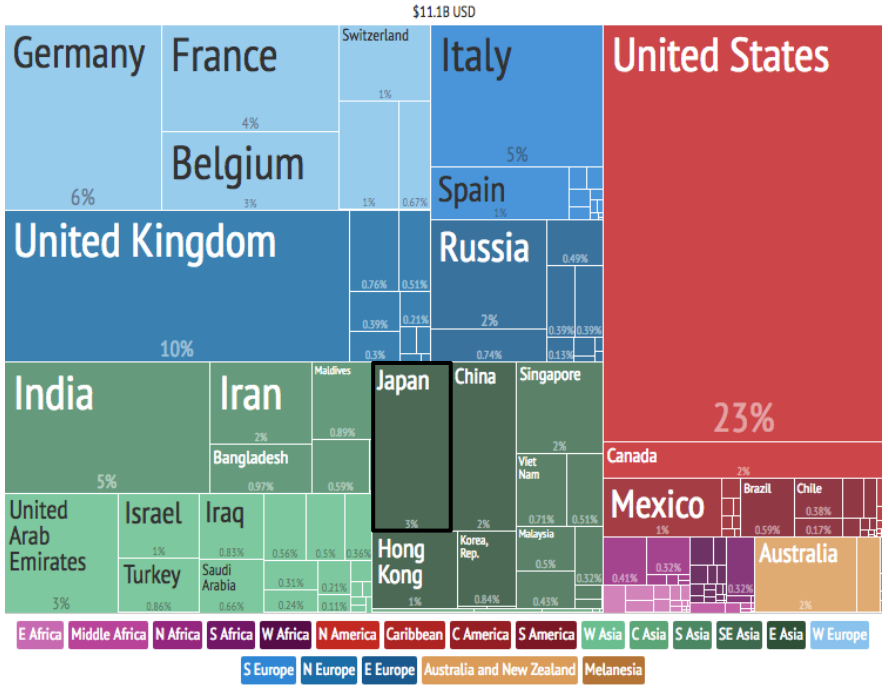
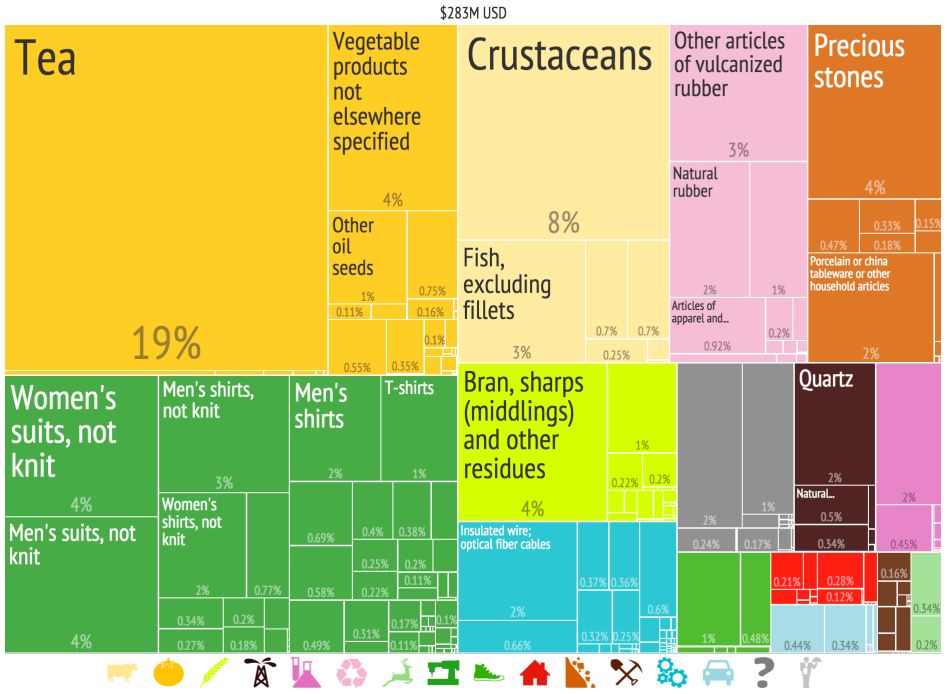
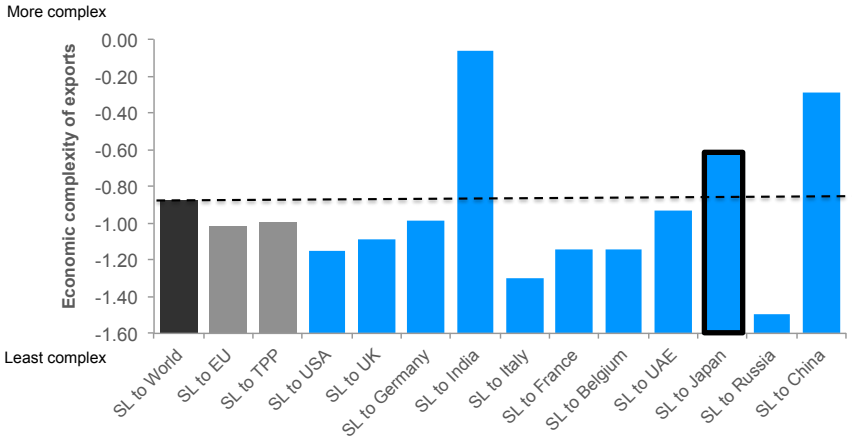
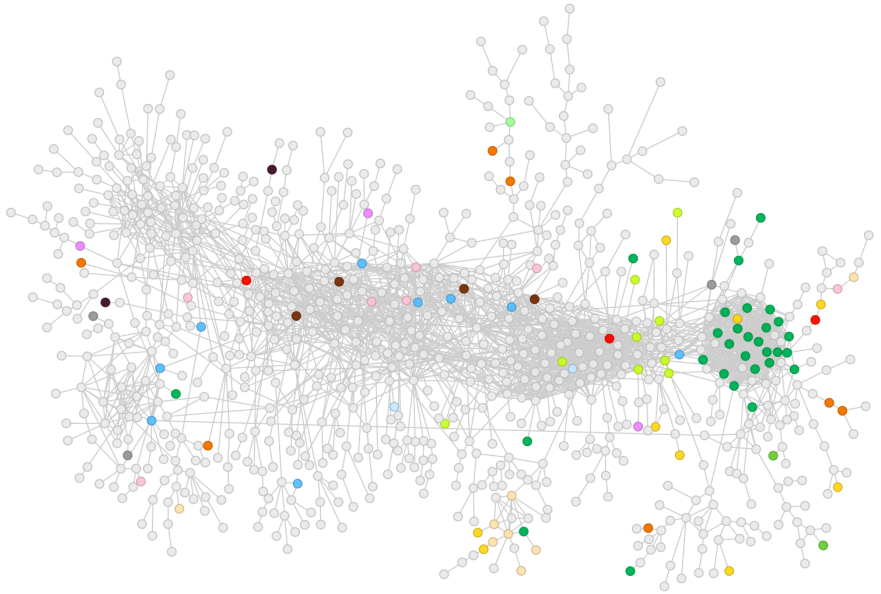
Sri Lanka's Export Destinations (2014)

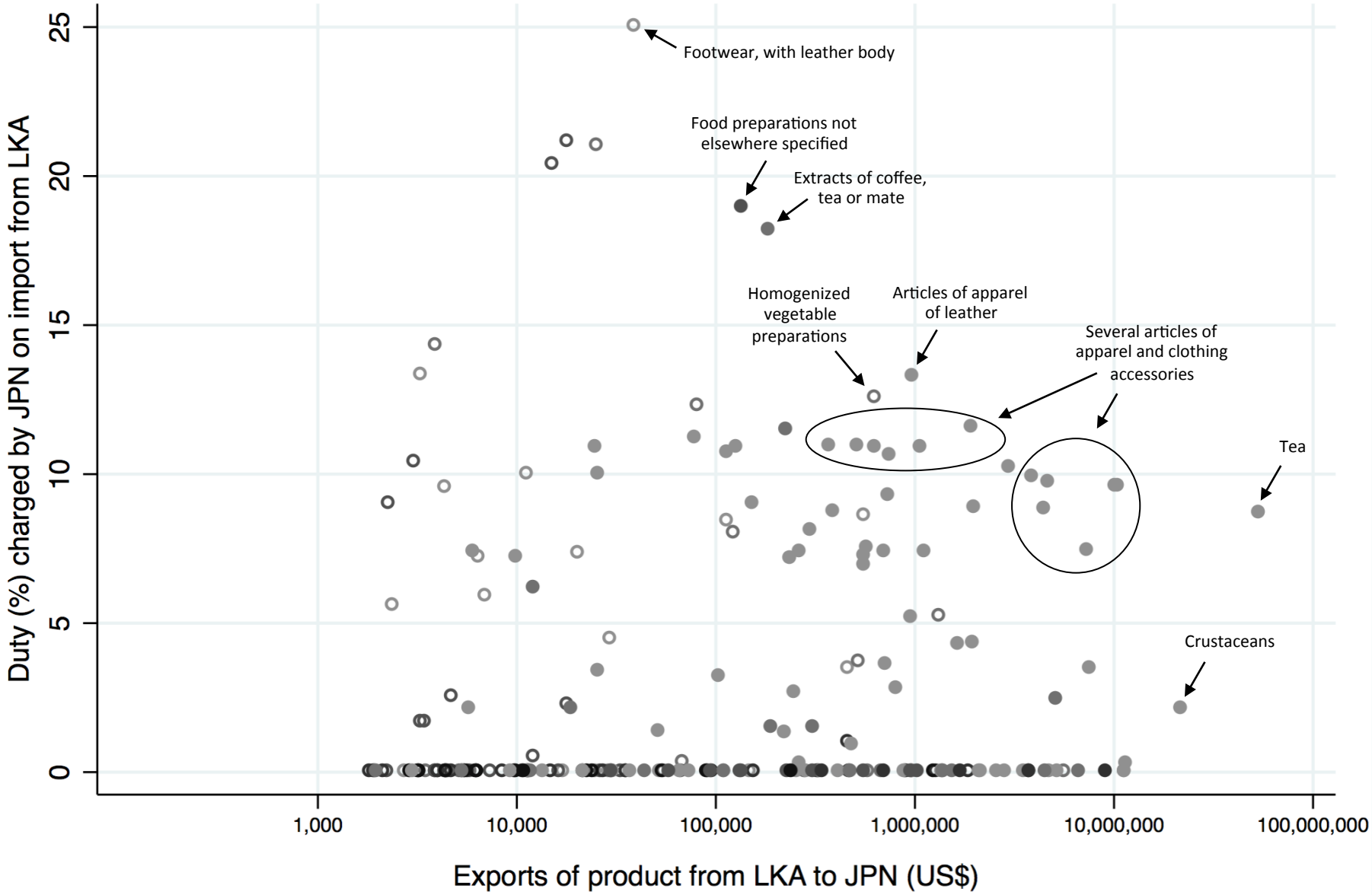


Sri Lanka's Exports to the Japan (2014)









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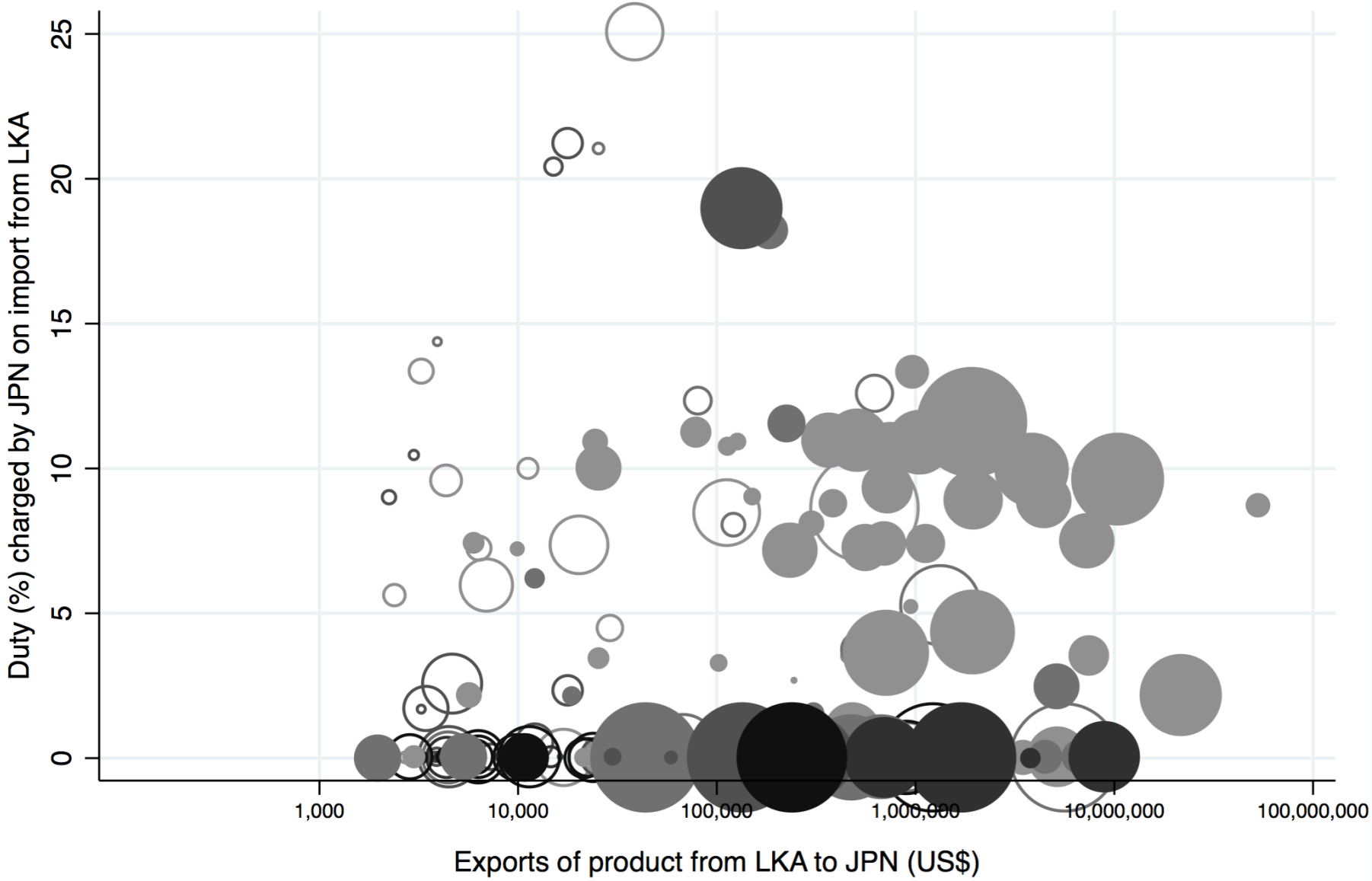

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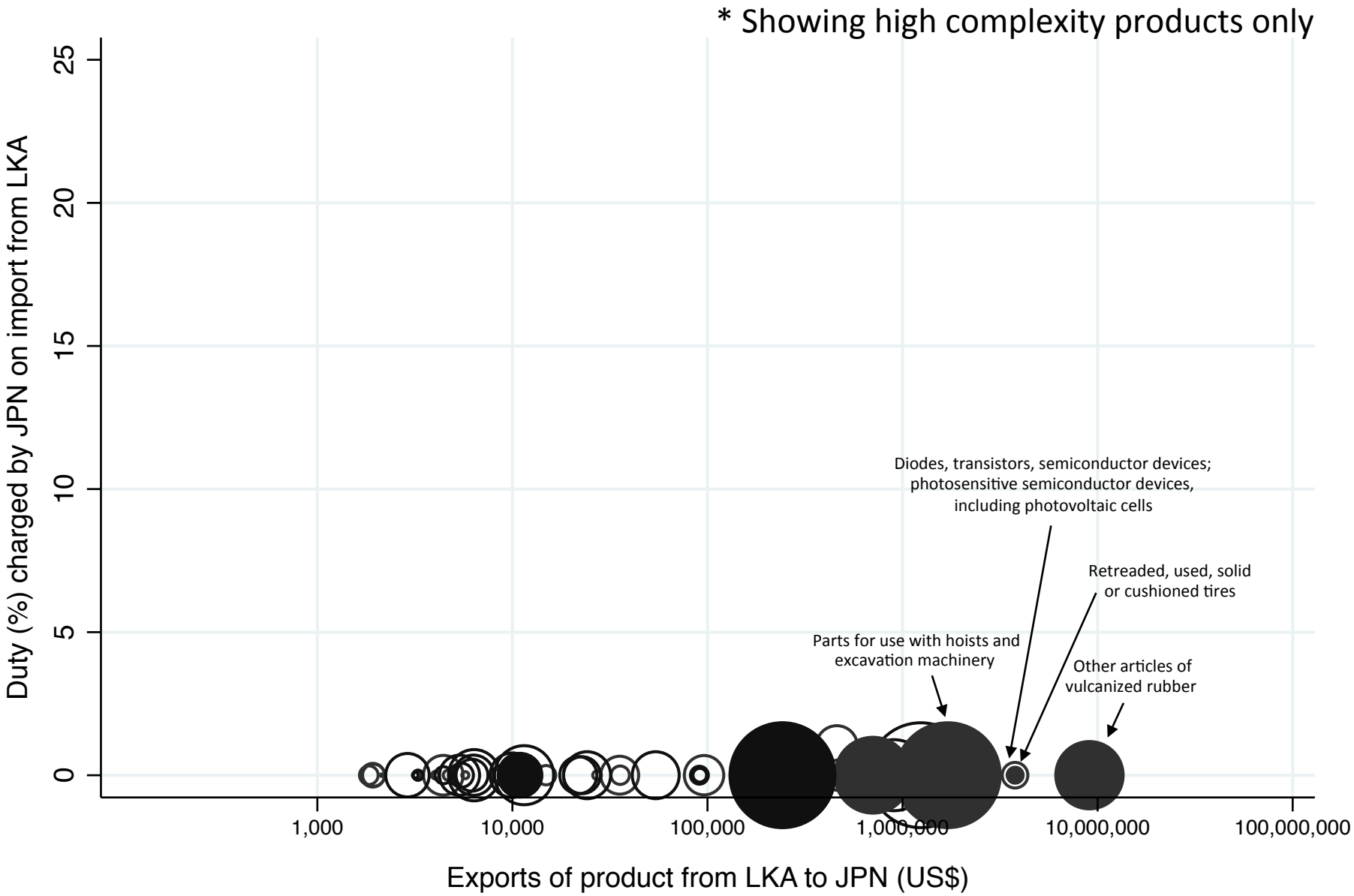

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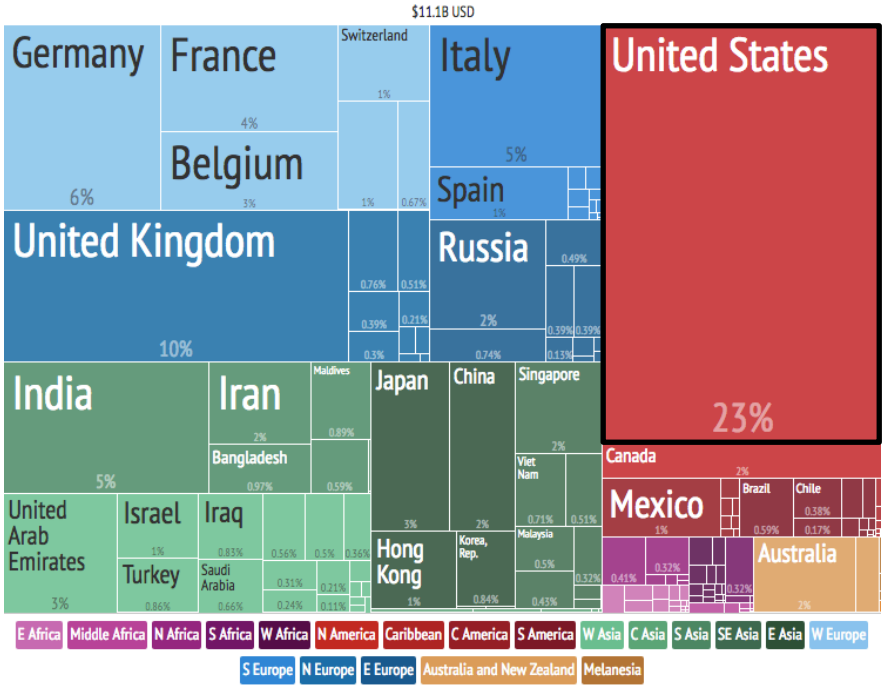
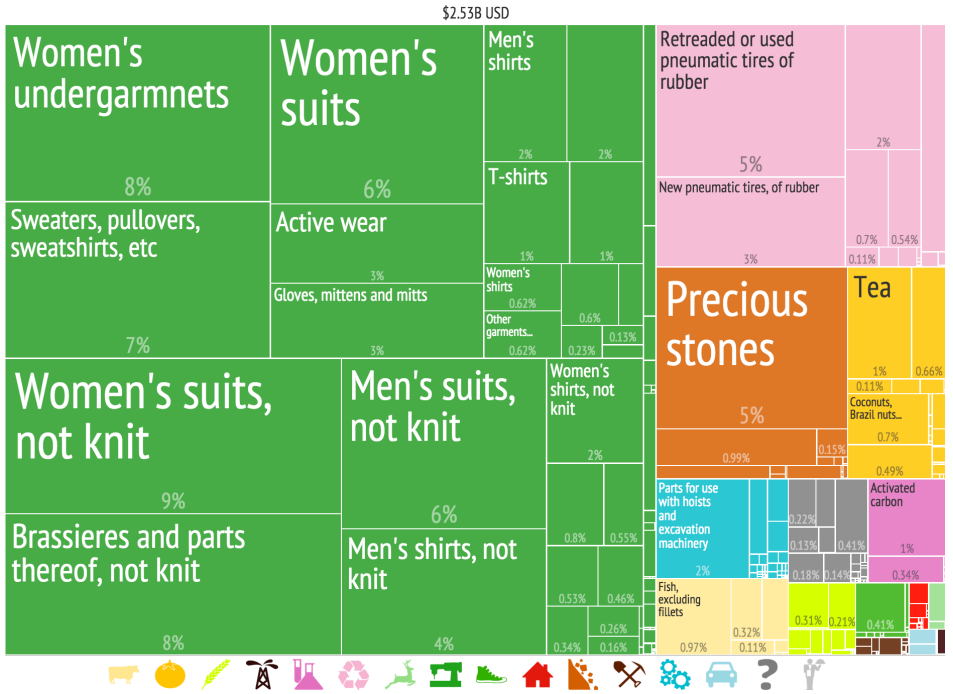
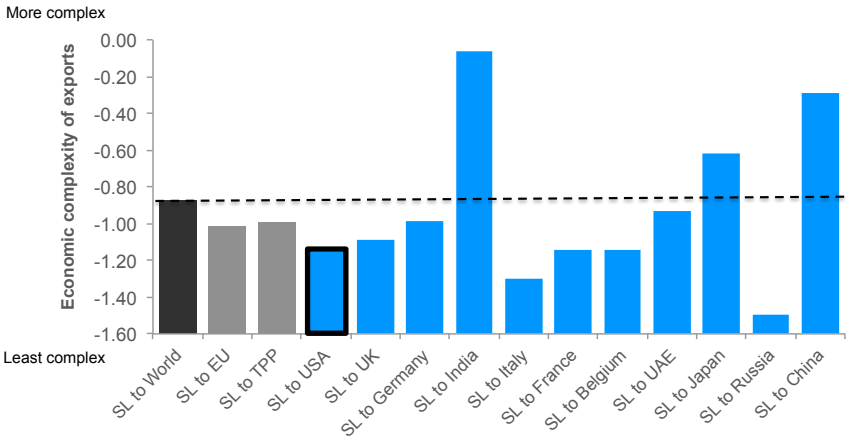
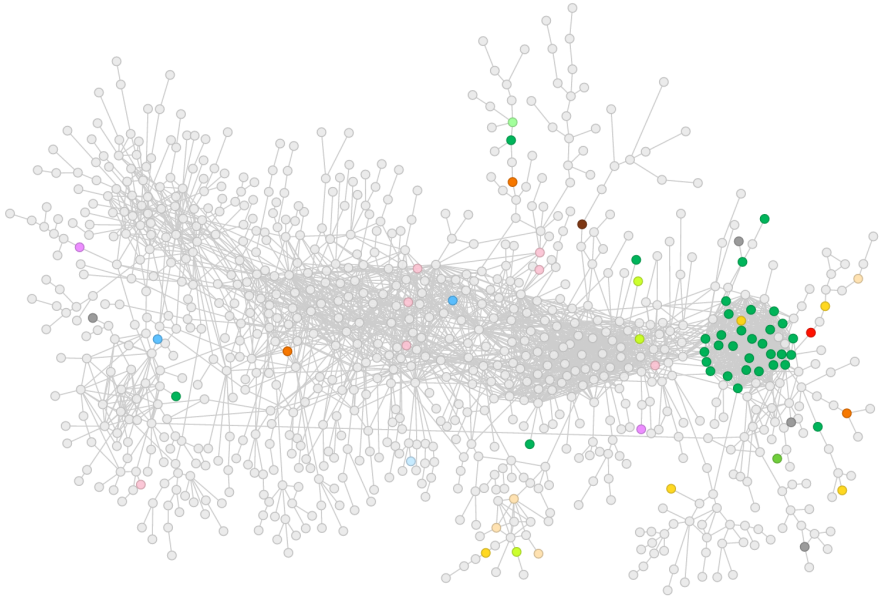
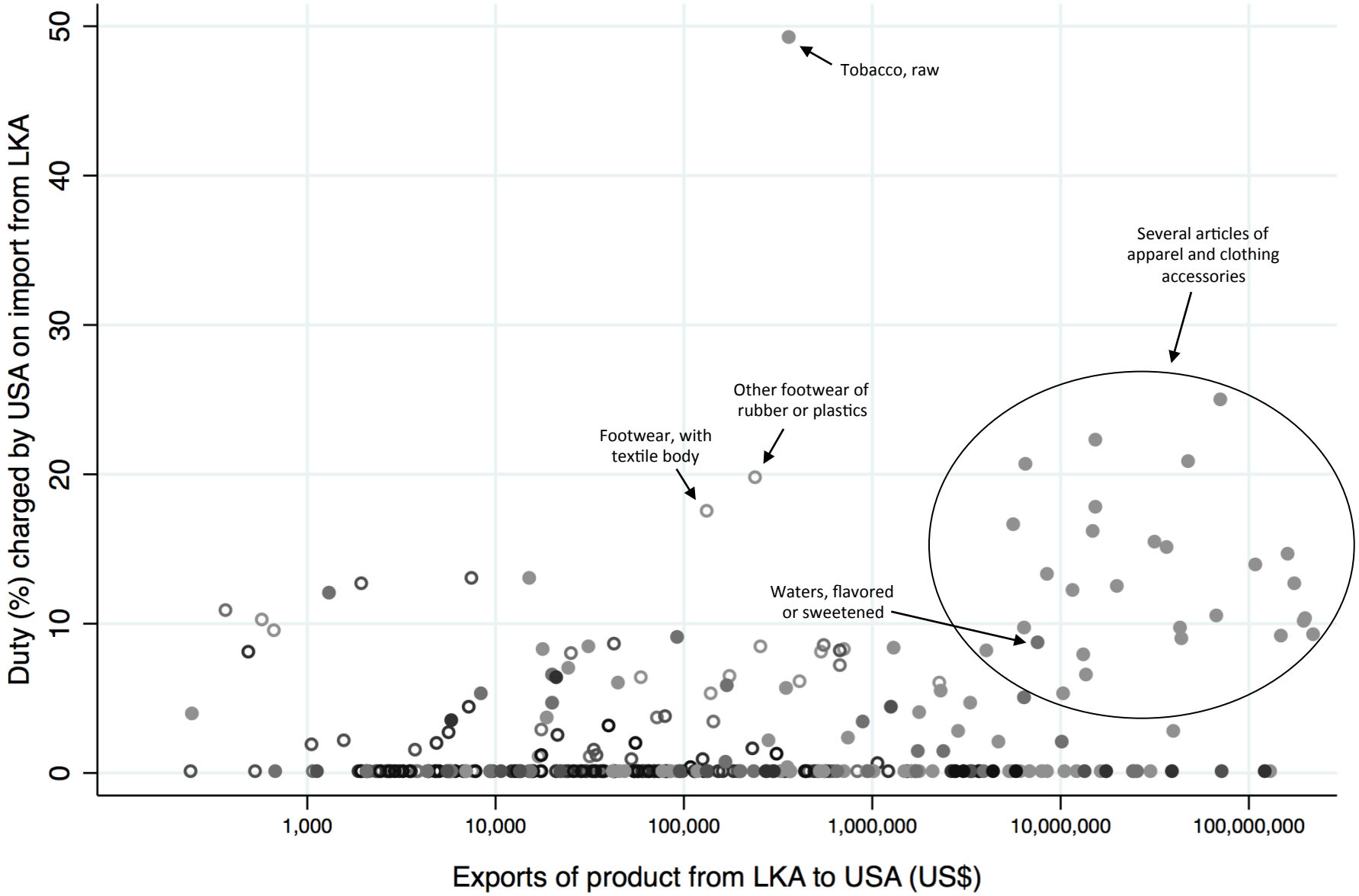


Sri Lanka's Exports to the United States (2014)









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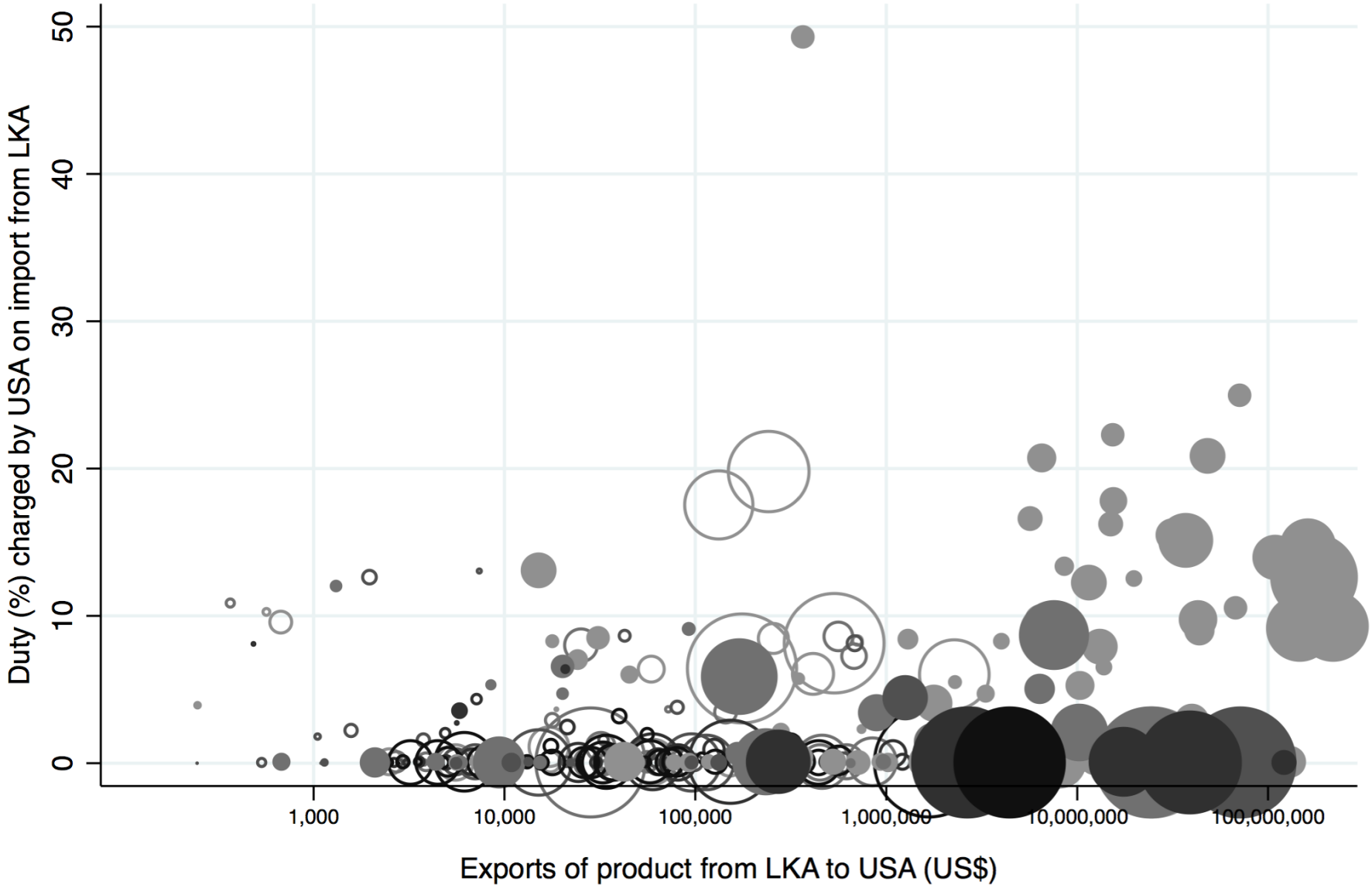

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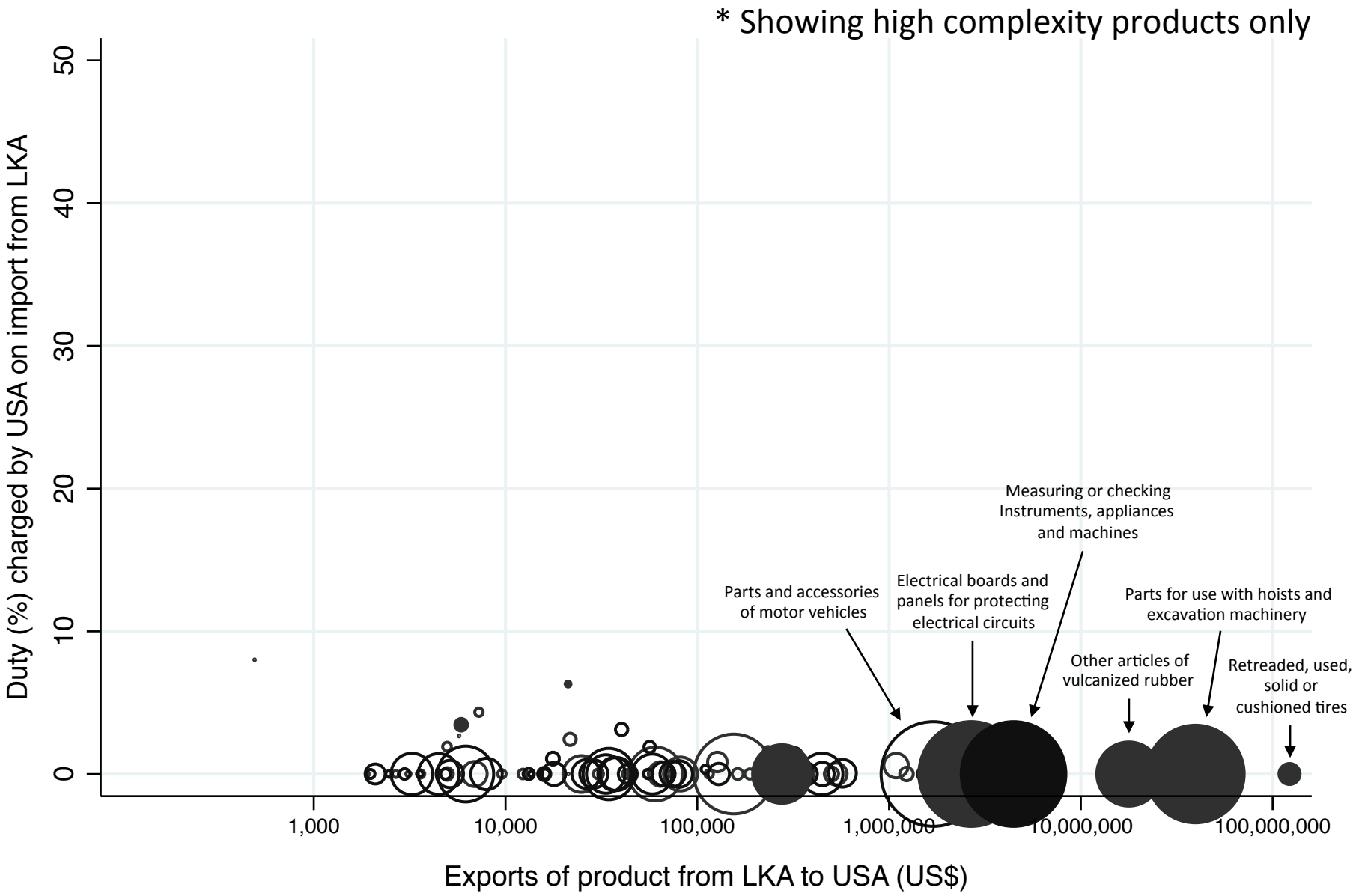

Marker sizes represent size of country imports. Darker markers represent more complex products. Filled markers represent products where Sri Lanka has a revealed comparative advantage.
Data sources: WITS-TRAINS Database & Atlas of Economic Complexity, 2014

Trade in light of the growth diagnostic…

- Trade Agreements:
  - Provide opportunities to grow exports, diversify exports and attract new knowhow. This is of critical importance for more jobs, better wages and sustaining growth.
  - ECTA: Other trade barriers should be identified and addressed (intensive margin problem). But these barriers are unlikely to solve the current lack of manufacturing FDI (extensive margin problem). Sri Lanka should be careful not to lose preferential access for complex products.
  - Other agreements: China and Japan appear to be more promising for the purposes of diversification than the U.S. or E.U., but FDI would still be needed for longer jumps in the product space.

Trade in light of the growth diagnostic…

- Trade Policy:
  - May represent a key constraint to the diversification of exports and overall growth.

Draft Trade Policy Framework:

On Import Policy and Liberalization (p.26):

"Although the country remained 'committed' towards outward orientation which began in 1977, the pace of trade reforms proceeded at a 'mixed pace'. However, the policy stance reversed in the last decade, and Sri Lanka's openness to international trade has declined since 2000, with a level of openness close to that seen during the import-substitution era before 1977. While various measures have been introduced as part of the liberalization process of WTO, these have been overshadowed by a general increase in tariffs and introduction/increase in rates of other charges on imports including para-tariffs which have proliferated over time. These measures have been taken for both revenue and protectionist purposes. Thus, the tariff regime remains non-transparent, complex and unpredictable, which needs to be rectified taking into account national development objectives and priorities."

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* Is there also an anti-export bias? Or an anti-(new) export bias?

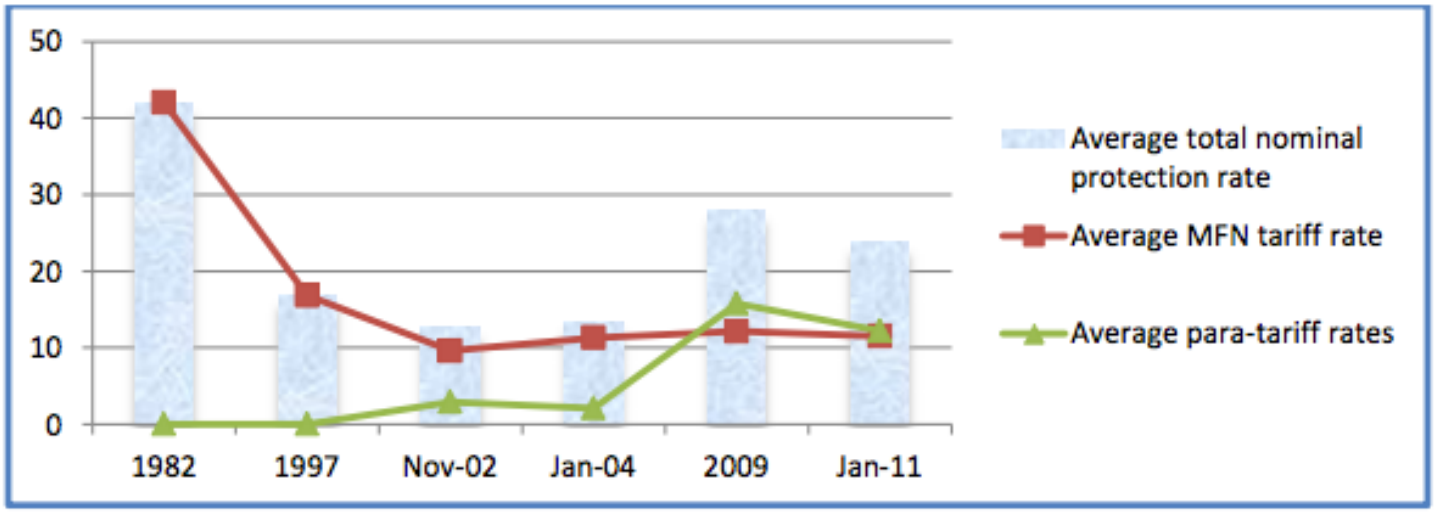
List of Import Taxes in Force (2010 and 2015)

	2010	2015
Protective Taxes		
Customs Duty	0, 2.5, 6, 15 or 28	0, 7.5, 15, 25
Ports and Airports Development Levy	2 or 5	5
Surcharge	15	-
Commodity Export Subsidy Scheme	Varies	Varies
Regional Infrastructure Development Levy	5, 7.5 or 10	-
Non-Protective Taxes		
Value Added Tax	12 or 20	11
Social Responsibility Levy	2	-
Nation Building Tax	3	2
Excise Duty	Varies	Varies
Special Commodity Levy	Varies	Varies

Source: Pursell and Ahsan (2011); SLC (2015), "Tariff Guide", Sri Lanka Customs, Colombo

- Complex: Numerous para-tariffs that vary at the product-level
- Uncertain: Frequent changes in para-tariff schedule are the norm (see Customs website)
- Non-transparent: Changes in schedule and firm level exemptions from tariffs and para-tariffs lack transparency
- Distortionary? Very. Anti-export bias?

Figure 4: Nominal protection in 1982, 1997, 2002, 2009, and 2011 (in percent)



Source: derived from data in Pursell and Ahsan (2011)

Table source: IPS, State of the Economy 2015. Graph source: Kaminski & Ng (2013)

Firms report significant and varied issues

> Coconut production in Sri Lanka is not sufficient to meet orders from foreign buyers. **Currently, coconut import is NOT allowed** due to quarantine issues. Allowing imports of coconuts can help us expand our export volumes
>
> - Coconut based product manufacturer

Ban on import goods can hinder production expansion

Duty exemptions for import goods protect some industries but not others

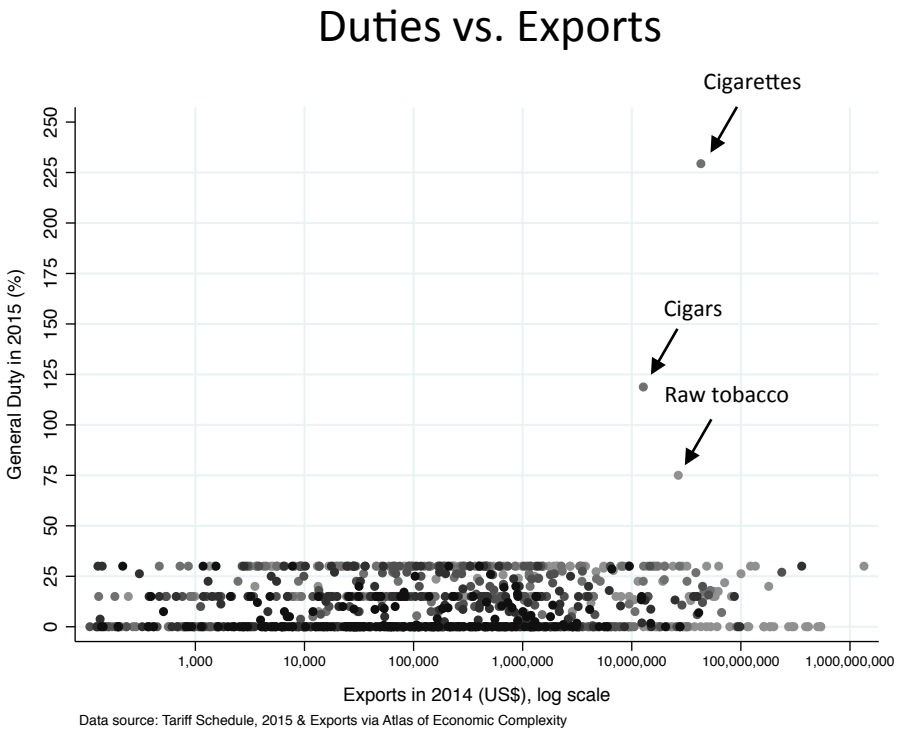
> The printing and packaging industry association **lobbied Ministry of Finance and Ministry of Industry & Commerce for many years** to get import duty exemption for papers. It could have been easier if the government sees the industry as a potential growing sector
>
> - CEO of a printing company

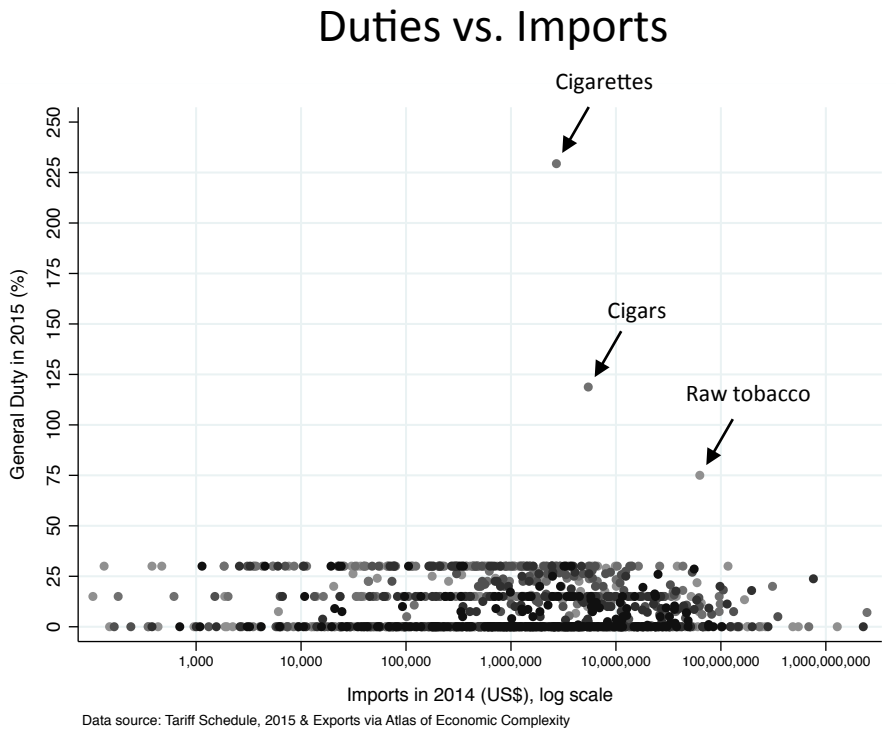
> **Importing chemicals is particularly tricky** although chemicals consist of a major part of our products. Some chemicals like methanol are classified as explosive materials even though they are not. We have to send our **samples to the laboratory for each shipment.**
>
> - BOI approved rubber-based product manufacturer

Customs clearing processes for import goods can be constraining

Source: Firm interviews conducted by CID in June-August 2016

Is there an anti-export bias?

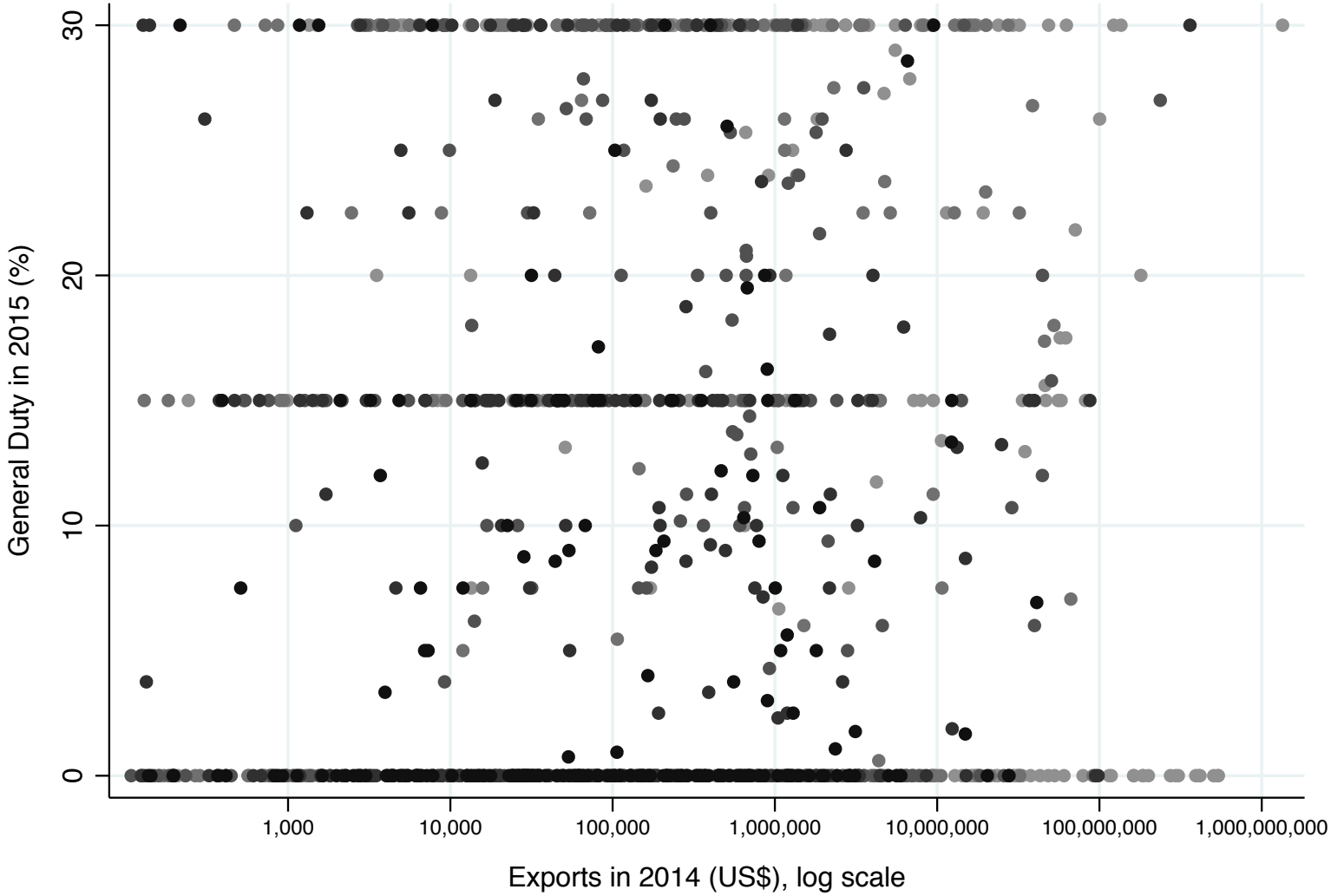




Notes: Darker markers represent more complex products. General duties are simple averages at the HS4 level, leaving aside some specific tariffs under: poultry (HS 207), eggs (HS 407), potatoes, tomatoes & onions (HS 701-703), frozen vegetables (HS 710) , preserved vegetables (HS 711), dried legumes (HS 713), pepper (0904), rice (HS 1006), rice flour (HS 1102), raw sugar (HS 1701), other sugars (HS 1702), alcoholic beverages (HS 2203-2208), cigars (HS 2402), and refined petroleum (HS 2710)

- Exports: Positive but not statistically significant relationship.
- Imports: Negative and statistically significant relationship – 1 % point increase in the duty is associated with $350,000 less imports of the product.

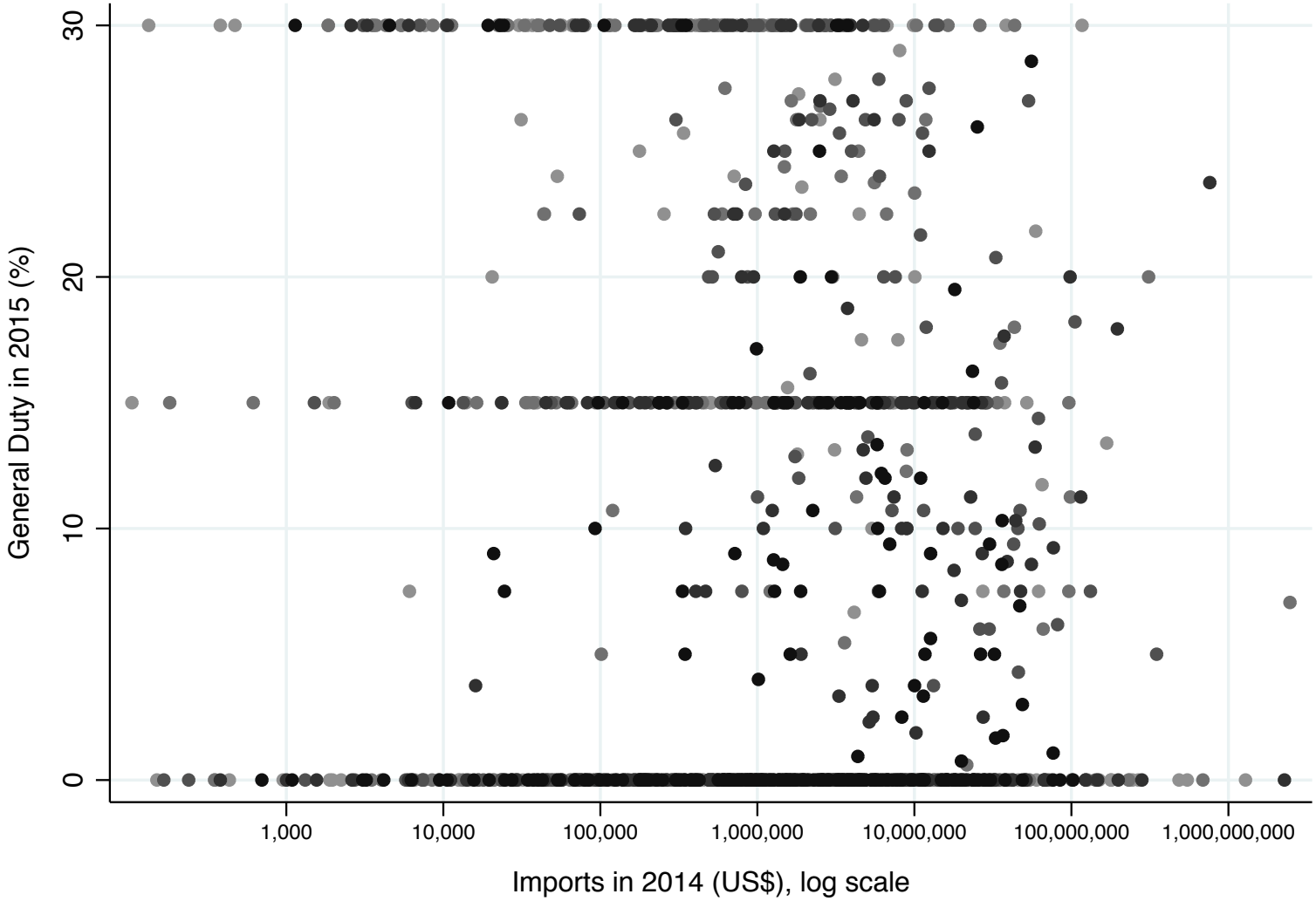
Based on the MFN rate alone, it is not obvious that duties are used as a tool to protect exiting exports:



Data source: Tariff Schedule, 2015 & exports via Atlas of Economic Complexity

Notes: Darker markers represent more complex products. General duties are simple averages at the HS4 level, leaving aside some specific tariffs under: poultry (HS 207), eggs (HS 407), potatoes, tomatoes & onions (HS 701-703), frozen vegetables (HS 710) , preserved vegetables (HS 711), dried legumes (HS 713), pepper (0904), rice (HS 1006), rice flour (HS 1102), raw sugar (HS 1701), other sugars (HS 1702), alcoholic beverages (HS 2203-2208), cigars (HS 2402), and refined petroleum (HS 2710)

Not surprisingly, there is an inverse relationship between the MFN rate and product imports:



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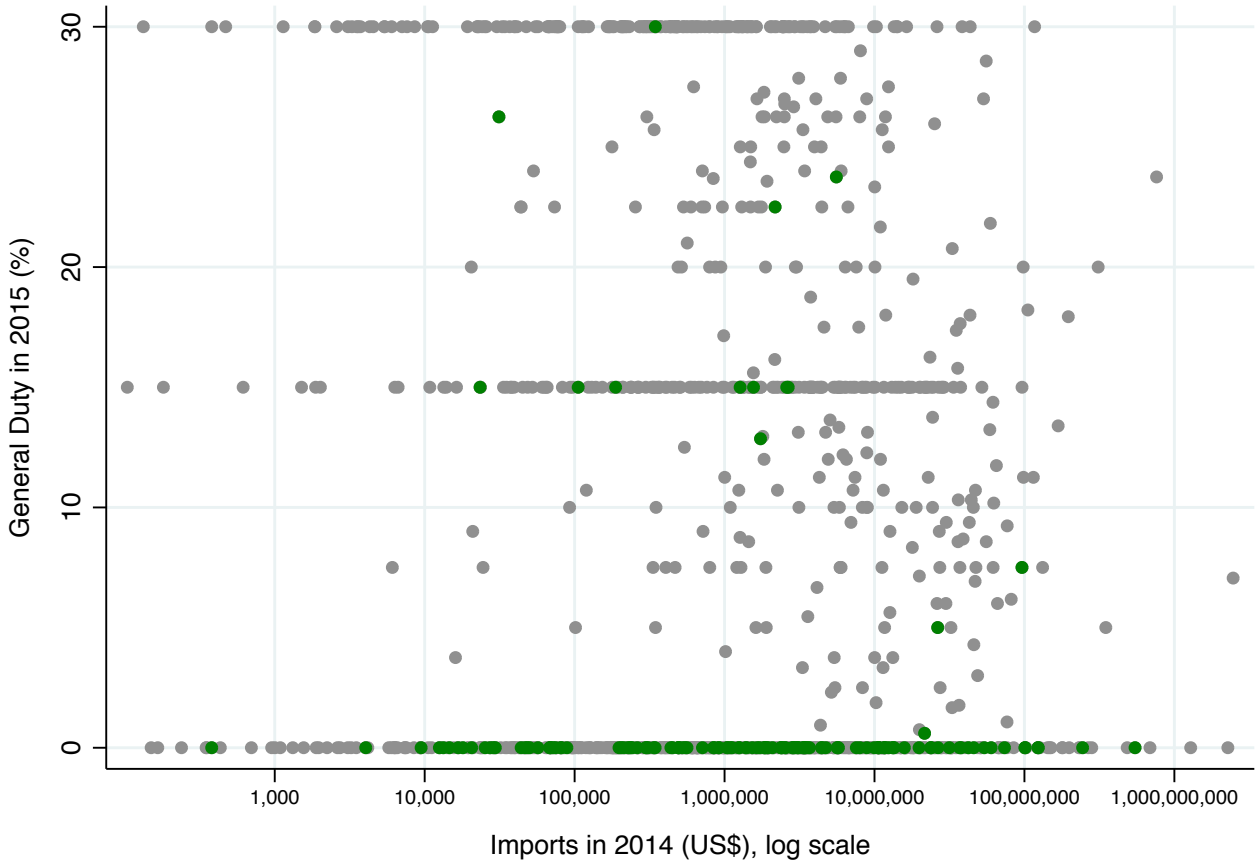
However, without good data on para-tariffs this line of analysis is not particularly useful…

HS Hdg.	HS Code	DESCRIPTION	ICL	Unit	Preferential Duty									Gen. Duty	VAT	PAL	NBT	Cess	Excise (Spl.Pr.) Levy	SCL
					AP	AD	BN	GT	IN	PK	SA	SF	SD							
85.12		**Electrical lighting or signalling equipment (excluding articles of heading 85.39), windscreen wipers, defrosters and demisters, of a kind used for cycles or motor vehicles.**																		
	8512.10	- Lighting or visual signalling equipment of a kind used on bicycles		u					Free	Free		10.83%	4.5%	15%	12%	5%	2%			
	8512.20	- Other lighting or visual signalling equipment		u					Free	Free		10.83%	4.5%	15%	12%	5%	2%			
	8512.30	- Sound signalling equipment		u					Free	Free		10.83%	4.5%	15%	12%	5%	2%			
	8512.40	- Windscreen wipers, defrosters and demisters		u					Free	Free		10.83%	4.5%	15%	12%	5%	2%			
	8512.90	- Parts		kg					Free	Free		10.83%	4.5%	15%	12%	5%	2%			
85.41		**Diodes, transistors and similar semiconductor devices; photosensitive semiconductor devices, including photovoltaic cells whether or not assembled in modules or made up into panels; light emitting diodes; mounted piezo-electric crystals (+).**																		
	8541.10	- Diodes, other than photosensitive or light emitting diodes		u					Free	Free		Free	Free	Free	12%	5%	2%			
		- Transistors, other than photosensitive transistors :																		
	8541.21	-- With a dissipation rate of less than 1 W		u					Free	Free		Free	Free	Free	12%	5%	2%			
	8541.29	-- Other		u					Free	Free		Free	Free	Free	12%	5%	2%			
	8541.30	- Thyristors, diacs and triacs, other than photosensitive devices		u					Free	Free		Free	Free	Free	12%	5%	2%			
	8541.40	- Photosensitive semiconductor devices, including photovoltaic cells whether or not assembled in modules or made up into panels; light emitting diodes :		u					Free	Free		Free	Free	Free	Ex	Free	Ex			
	8541.50	- Other semiconductor devices		u					Free	Free		Free	Free	Free	12%	5%	2%			
	8541.60	- Mounted piezo-electric crystals		u					Free	Free		Free	Free	Free	12%	5%	2%			
	8541.90	- Parts		kg	Free				Free	Free		Free	Free	Free	12%	5%	2%			

Source: Sri Lanka Customs National Imports Tariff Guide, 2014

HS Hdg.	HS Code	DESCRIPTION	I C L	Unit	Preferential Duty									Gen. Duty	V A T	P A L	N B T	Cess	Excise (Spl.Pr.) Levy	S C L
					AP	AD	BN	GT	IN	PK	SA	SF	SD							
52.05		**Cotton yarn (other than sewing thread), containing 85% or more by weight of cotton, not put up for retail sale.**																		
		- Single yarn, of uncombed fibres :																		
	5205.11	-- Measuring 714.29 decitex or more (not exceeding 14 metric number)		kg					Free	Free		Free		Free	Ex	Ex	Ex			
	5205.12	-- Measuring less than 714.29 decitex but not less than 232.56 decitex (exceeding 14 metric number but not exceeding 43 metric number)		kg					Free	Free		Free		Free	Ex	Ex	Ex			
	5205.13	-- Measuring less than 232.56 decitex but not less than 192.31 decitex (exceeding 43 metric number but not exceeding 52 metric number)		kg					Free	Free		Free		Free	Ex	Ex	Ex			
	5205.14	-- Measuring less than 192.31 decitex but not less than 125 decitex (exceeding 52 metric number but not exceeding 80 metric number)		kg					Free	Free		Free		Free	Ex	Ex	Ex			
	5205.15	-- Measuring less than 125 decitex (exceeding 80 metric number)		kg					Free	Free		Free		Free	Ex	Ex	Ex			
55.12		**Woven fabrics of synthetic staple fibres, containing 85% or more by weight of synthetic staple fibres.**																		
		- Containing 85% or more by weight of polyester staple fibres :																		
	5512.11	-- Unbleached or bleached		kg					Free	Free		Free		Free	Ex	Ex	Ex	Rs.100/= per kg		
	5512.19	-- Other		kg					Free	Free		Free		Free	Ex	Ex	Ex	Rs.100/= per kg		
		- Containing 85% or more by weight of acrylic or modacrylic staple fibres :																		
	5512.21	-- Unbleached or bleached		kg					Free	Free		Free		Free	Ex	Ex	Ex	Rs.100/= per kg		
	5512.29	-- Other		kg					Free	Free		Free		Free	Ex	Ex	Ex	Rs.100/= per kg		
		- Other :																		
	5512.91	-- Unbleached or bleached		kg					Free	Free		Free		Free	Ex	Ex	Ex	Rs.100/= per kg		
	5512.99	-- Other		kg					Free	Free		Free		Free	Ex	Ex	Ex	Rs.100/= per kg		

Putting aside para-tariffs and looking more closely at the general duty:



Data source: Tariff Schedule, 2015 & imports via Atlas of Economic Complexity

Product Category	Avg. Duty
Animal & Animal Products	20.7
Vegetable Products	21.1
Foodstuffs	27.4
Mineral Products	3.1
Chemicals & Allied Industries	3.8
Plastics / Rubbers	10.6
Raw Hides, Skins, Leather, & Furs	21.1
Wood & Wood Products	12.3
Textiles	**1.6**
Footwear / Headgear	19.4
Stone / Glass	14.3
Metals	7.9
Machinery / Electrical	3.8
Transportation	7.3
Miscellaneous	11.8
Total	***9.5***

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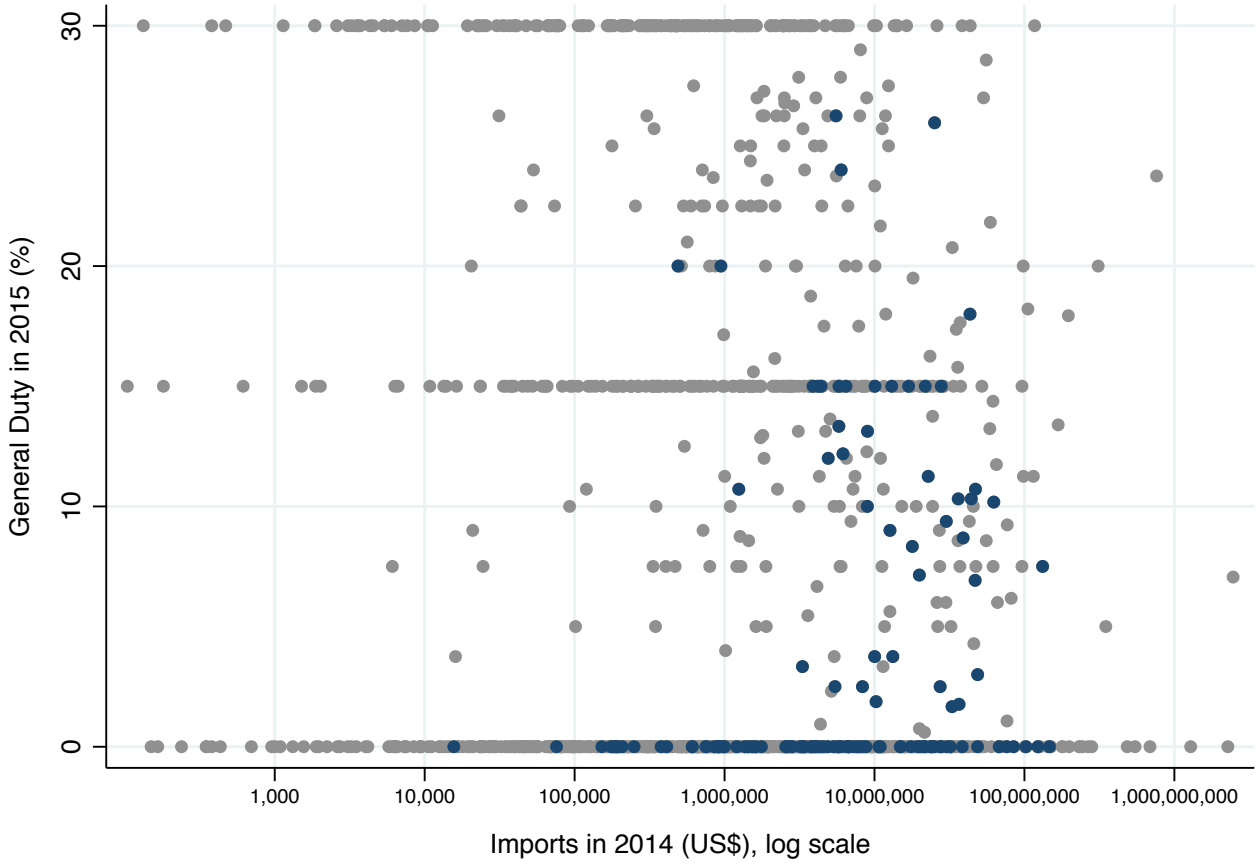

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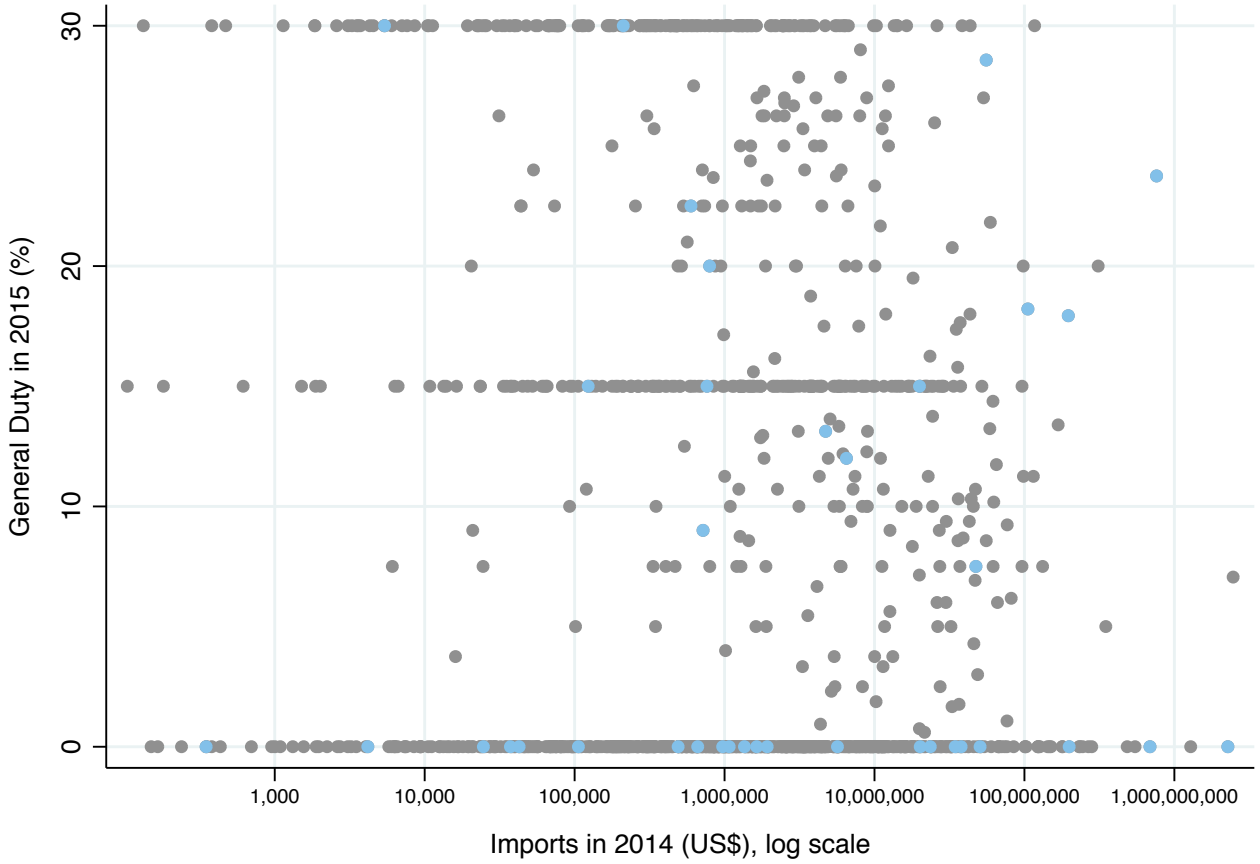

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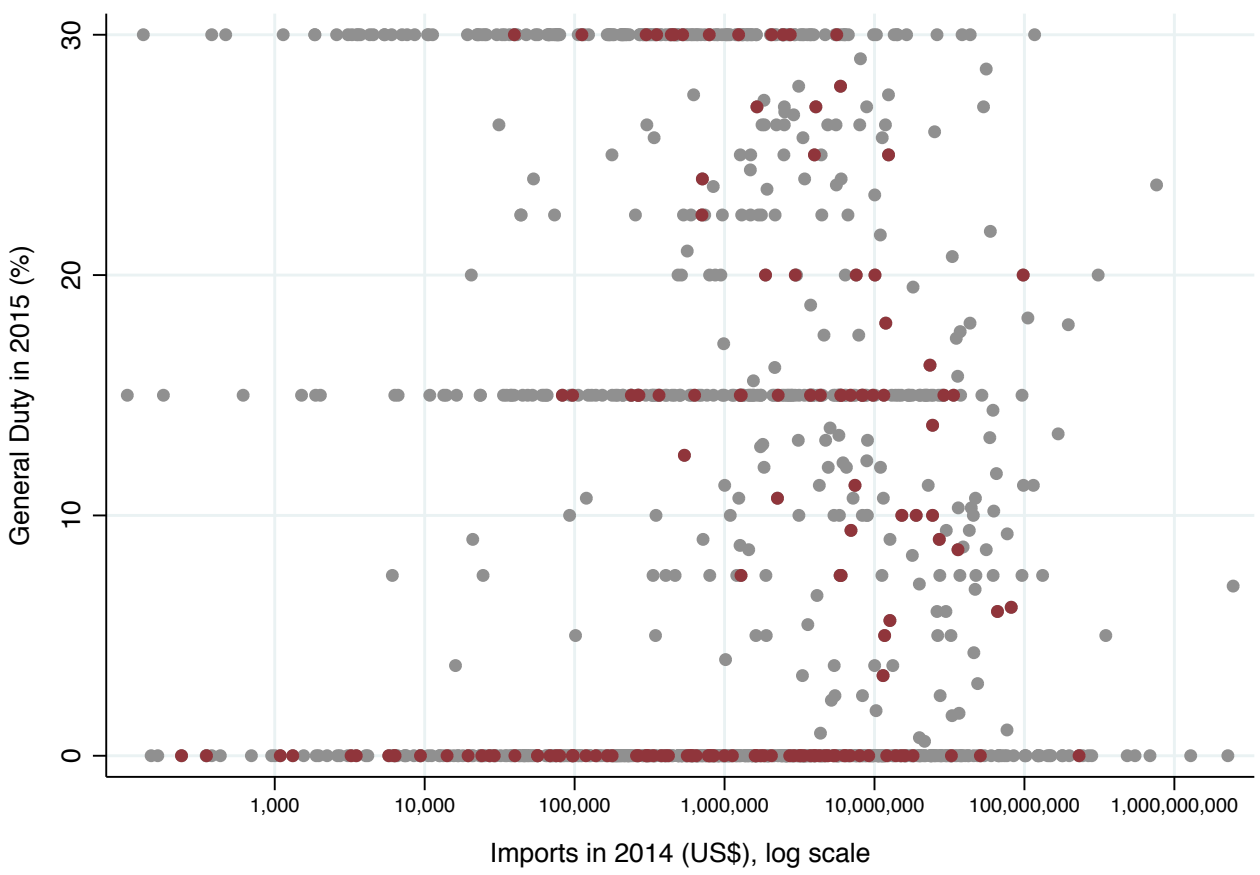

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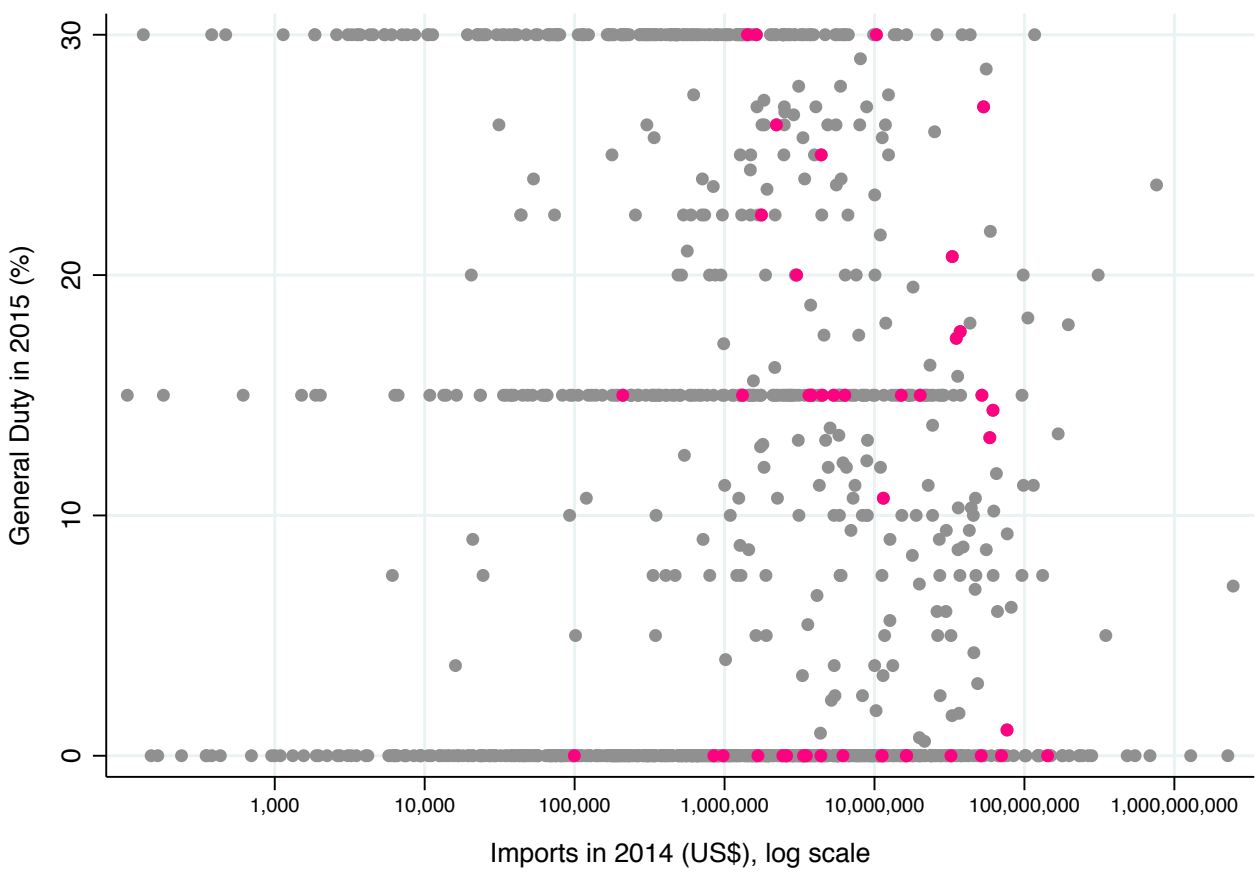

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Why not export motorcycles (assuming you have the knowhow)?

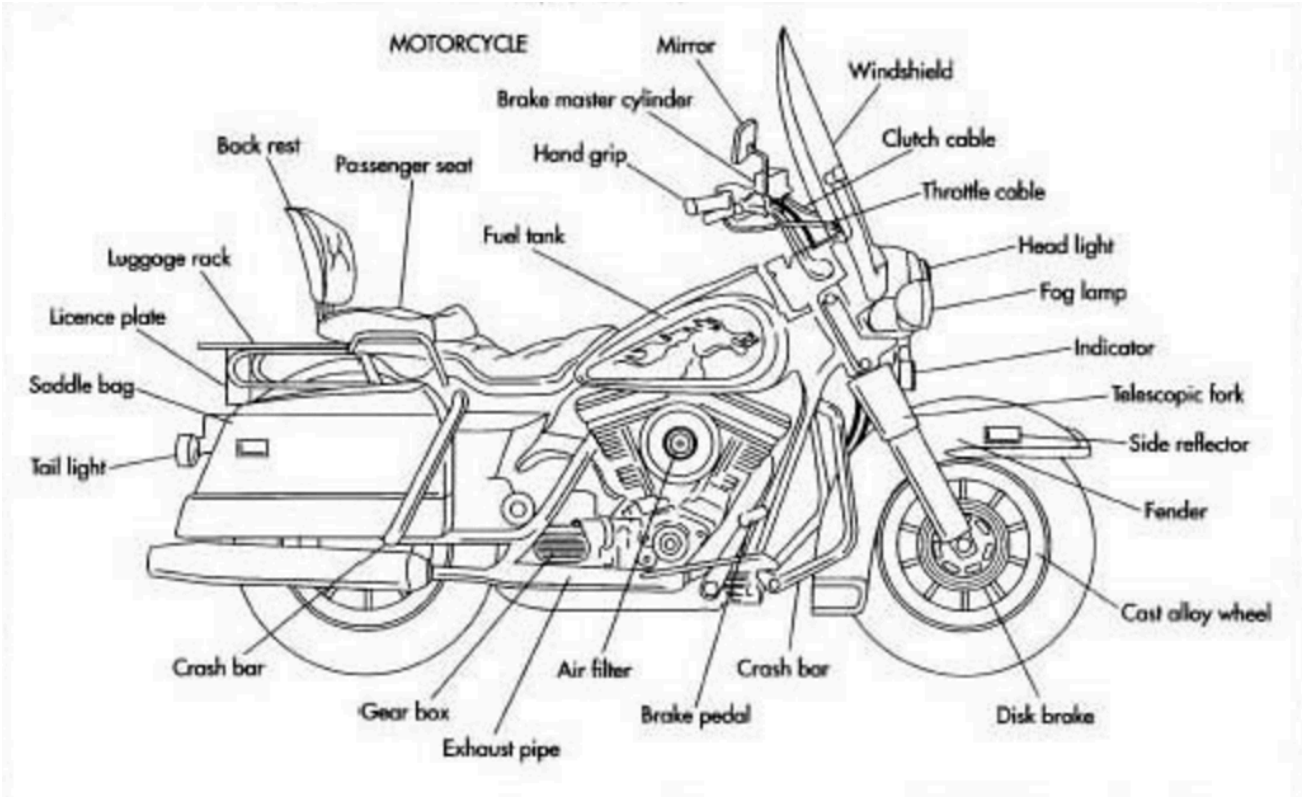

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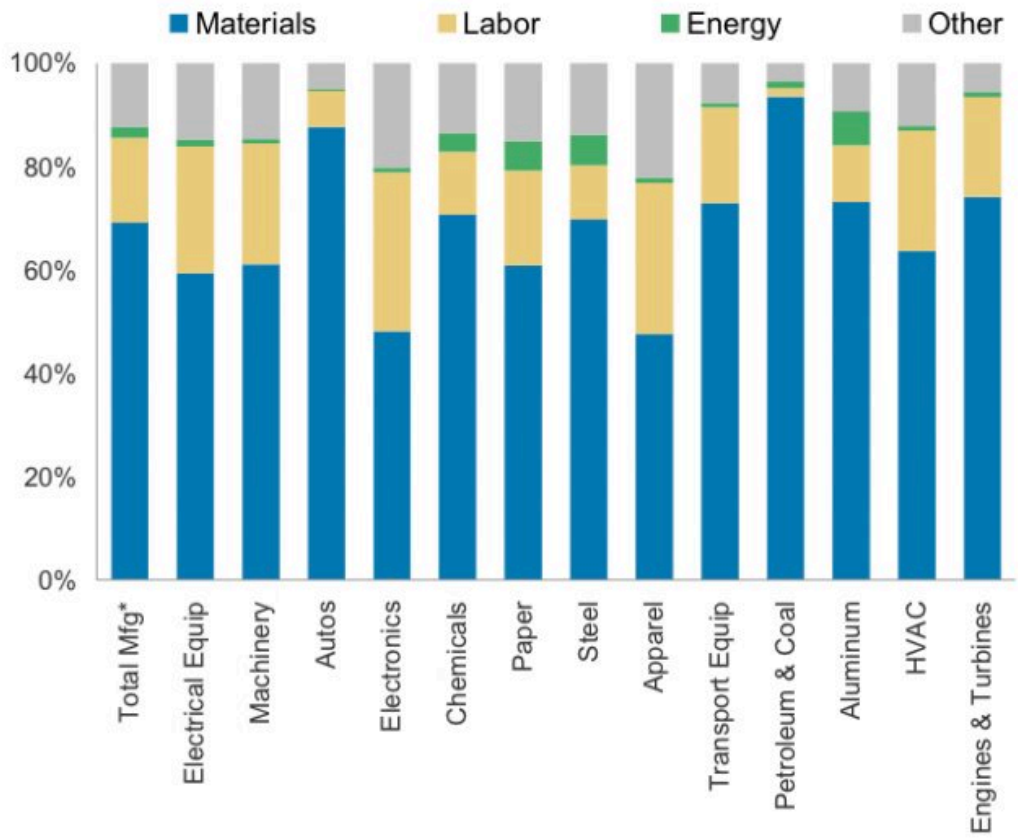
Exhibit 48

Components of US Manufacturing Costs



Source: US Census Bureau, Morgan Stanley Research

Hypothetical Example:

Say that 75% of the cost to manufacture a motorcycle is materials and that you have a 20% margin. Then for every $125 in revenues:

- $75 is spent on materials
- $25 is spent on all other inputs
- $25 is profit

But if you input your materials and the duty is 20% (incl. para-tariffs), then:

- $90 is spent on materials
- $25 is spent on all other inputs
- $10 is profit (a 60% reduction)

If *ad hoc* changes leave you with a duty of 35%, then:

- $101.25 is spent on materials
- $25 is spent on all other inputs
- -$1.25 is loss (why risk it?)

So what? You can and do provide exemptions!

There are several problems:

- Imperfect information - What exemptions am I eligible for? Duty-free? Exemptions from para-tariffs?
- Uncertainty – Will I actually receive those exemptions in practice? Will conditions change?
- Transaction costs – How much time and money does it take to get the information and an adequate level of certainty?
- *The above are all problems that must be more acute for new export industries versus established industries.*
- Linkages to the rest of economy/spillovers – If I am able to operate in Sri Lanka but reliant on the exemptions, then I am going to continue to rely on external suppliers rather than domestic suppliers. Domestic suppliers are stuck with the same import duty costs that I have managed to avoid.
- Government revenue implications are tricky, as with other tax exemptions

Trade in light of the growth diagnostic…

- Trade Policy:
  - May represent a key constraint to the diversification of exports and overall growth.
  - High nominal rate of protection with high variance across products. Import duties (tariffs and para-tariffs) are complex, uncertain and their application is non-transparent.
  - A bias against new export industries emerges from the structure ***and*** the uncertainty of charges on imports. Firm-level exemptions from these charges do not fully solve the problem.
  - There is also a bias against backward linkages between exporters and the rest of the economy. Revenue implications are complex.
  - *Export policy (pp. 50-63) and trade facilitation (pp. 63-70) of Draft 1 of Trade Policy Framework is full of excellent recommendations. How will you prioritize scarce resources? How will you mobilize more resources? How can this shift be coordinated and updated over time?*