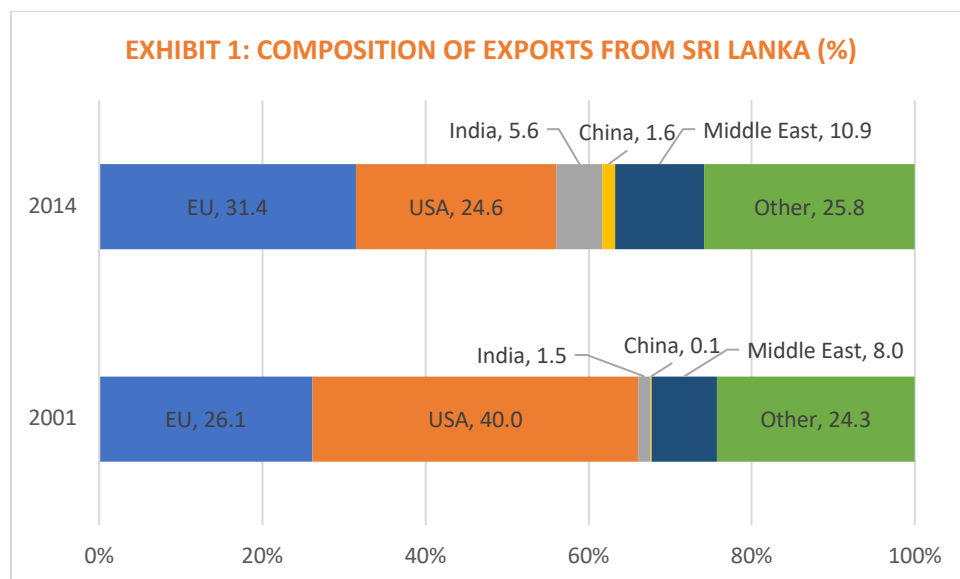


## Export Competitiveness: Moving from USA towards Asia

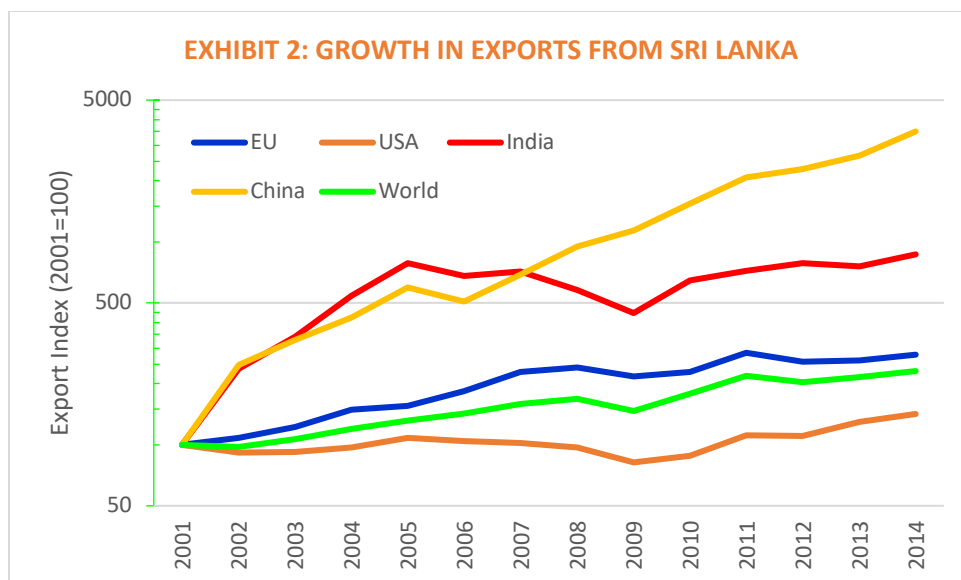
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Previous Insights on Sri Lanka’s trade prospects have dealt with two problems: the concentration of markets and the concentration of products. The first is because over 50 percent of exports go to the USA and the EU, the second is because over 50 percent of export value is in tea and apparel. It has been pointed out that product concentration is the key problem to overcome – markets will become available if Sri Lanka can come up with more competitive export products.

The data in the present Insight gives some hope that Sri Lanka could evolve more competitive products and balance its export dependence by moving towards Asia. It also suggests that this move has been greatly assisted by trade agreements – especially with India and China.



*Source: Statistical Appendix, Central Bank Annual Reports (various years)*



*Source: Verité Research calculations using Central Bank Annual Report statistics*

### **Growth is Tilting to the East**

While Sri Lanka’s total exports remain tilted to towards the USA and the West, growth is tilting to the East, and more towards Asia.

In 2001 Sri Lanka sent 40 percent of its exports to the USA and 26 percent to Europe. India and China together accounted for just 1.6 percent (see Exhibit 1). But by 2014 the composition has seen a significant shift. The USA now accounts for under 25 percent India and China, starting from a very low base, represent the fastest growth – combined, they show a fivefold increase in exports (just under a fourfold increase to India and over a 15 fold increase to China).

Europe’s share has increased by close to the same percentage as India and China combined, but it represents only a 20 percent growth because of the high base. Exports to the Middle East have grown faster at over 35 percent.

The tilt is seen in the fact that the rate of export growth increases to the east of the USA. Exports to the Middle East grow faster than to the EU, exports to India grow faster than to the Middle East and exports to China grow faster than to India.

The consequence of the tilt is that China’s and India’s share in the country composition of exports has become significantly more prominent over the last decade and a half – while their total share remains small in comparison to Europe and the USA.

### **It helps to have Trade Agreements and Preferential Access**

The growth trends in exports reveal a close link between Sri Lanka’s export performance and preferential trade arrangements.

The difference in the growth of exports can be isolated by creating a growth index.

Exhibit 2 shows such an index, where the quantity of exports in 2001 to any region is indexed to 100. The growth of exports to the USA is slower than average growth of exports to the world, and the growth of exports to China is the highest, with India coming in second.

The growth in exports to India can be explained by the Free Trade Agreement (FTA) signed in 2000. Exports grew extremely fast till 2005. However, much of this initial growth was driven by customs tax arbitrage (imports of copper and palm oil to India were taxed more than in Sri Lanka), not based on Sri Lanka's competitiveness in production. When India corrected these anomalies in 2005, exports derived from these inputs crashed (see Exhibit 2). Therefore, while non-copper and palm exports to India kept growing robustly post 2005, the total exports show a declining growth rate until 2009 because the copper and palm oil-based exports were unraveled at that time.

China became a member of Asia Pacific Trade Agreement (APTA) in 2001. As a member Sri Lanka gained preferential access to the Chinese market for the first time. This is consistent with the very fast growth in exports to China post 2001. As the growth rate tapers off (the low hanging fruits reaching their limits) in 2006, the APTA member countries further expanded the concessions extended to each other with the conclusion of the third round of trade liberalization in 2006. Growth of exports to China sees a further sustained burst after that.

### **Losing preferential access and its impact**

Up until 2005, apparel exports accounted for over 80 percent of exports to the USA. That is when the preferential access (in terms of a quota)—through the Multi Fibre Agreement (MFA)—that Sri Lanka had to the USA apparel market came to an end. This explains the steady decline in exports to the USA after 2005 up until 2009. Since then however, growth has picked up, with industry positioning itself as a high-value exporter to high-end market segments. The impact, however, is still clear; the growth to the USA has been lower than the overall growth of exports to the world and the share of the USA has dropped from 40 percent in 2001 to 25 percent by 2014.

Sri Lanka received preferential access to the EU in 2005, securing GSP plus status. However, the country lost GSP plus status in 2010. The impact of this loss is not as easily detected in the numbers as with other agreements. Amongst other factors, Sri Lanka did not have a high ability to utilize the concessions for apparel due to yarn-forward rules applied by the EU for apparel exports. According to this rule, only apparel made using fabrics manufactured from yarn stage in Sri Lanka were eligible for duty free access and most apparel manufactures in Sri Lanka used yarn imported from other countries, and could not benefit from the GSP plus concessions.

### **Importance of being competitive**

This Insight points out that Sri Lanka's export growth, starting from a low base, has been steadily tilting towards Asia. It also shows that this tilt is facilitated by the gaining and losing of preferential trade access. Sri Lanka has gained much more in preferential access to India

and China than to Europe and the Middle-East (and the numbers show the impact). It has also lost important access to the USA, and again the impact is quite clear.

However, preferential terms are not a sustained solution for export growth. The data shows such growth being vulnerable to adjustments in arbitrage opportunities and also tapering off over time.

Sustained export growth therefore will continue to depend on the fundamentals of economics: Sri Lanka's export offerings increasing in scope and becoming more competitive in the world—improving in quantity, quality and cost-effectiveness. For that, Sri Lanka needs to deal with trade barriers 'within' the country that are reducing feasibility and increasing costs.

Preferential trade can provide an initial boost—as it has done, and it has tilted the growth focus towards Asia. Sustaining it will depend on internal country policies and structures being focused towards improving competitiveness.

*(Verité Research is an independent think-tank based in Colombo that provides strategic analysis to high level decision-makers in economics, law, and media. Comments are welcome. Email [publications@veriteresearch.org](mailto:publications@veriteresearch.org).)*