2 NATIONAL OUTPUT AND EXPENDITURE

2.1 Overview

The economy recorded a real growth rate of 6.4 per cent in 2012 on the back drop of two consecutive years of 8 per cent expansion. This was a creditable performance as it was realised in a challenging environment. Positive investor sentiments that enhanced economic activities, relatively low interest rates, stable exchange rates and a reduction in government taxes spurred growth in 2011 but led to imbalances in the trade account of the balance of payments while broad money growth was at elevated levels with an increase in credit growth. The policy measures adopted by the government and the Central Bank in the first quarter of 2012 to improve the macroeconomic environment lowered domestic demand. The slowdown in both advanced and emerging economies as well as uncertainty on account of the European sovereign debt crisis, fiscal sector concerns in the US, geo-political issues and higher oil prices dampened the demand for exports. Meanwhile, the country experienced adverse weather conditions which particularly affected agriculture and economic growth during the second half of the year.

On the production side, economic growth was mainly driven by the momentum in the Industry sector. The expansion in the Industry sector by 10.3 per cent in 2012 was predominantly sustained by the increase in construction activities which continued to grow at a high rate as in the previous year. The growth in the construction sub sector also impacted favourably on output growth in the mining and quarrying sub sector as well. Manufacturing, the largest sub sector within the Industry sector, decelerated in terms of value added growth due to the slowdown in both domestic and external demand. Services sector growth moderated to 4.6 per cent in 2012 from the relatively high growth in the previous year. The subdued performance in external trade activities and the deceleration in the transport sub sector mainly contributed to the slowdown in the sector. Meanwhile, banking, insurance and real estate and the hotels and restaurants sub sectors expanded, albeit at a lower rate than in the previous year. Despite the adverse weather conditions that prevailed during the second half of the year which hampered the momentum in the Agriculture sector its growth improved to 5.8 per cent in 2012 when compared to the growth of 1.4 per cent in the previous year. Paddy production recorded high growth in the Maha season, but was adversely affected during the Yala season, while the contribution of most export agriculture crops was also relatively low in 2012. Other food crops, fishing and livestock performed well during the year.

Table 2.1 Sectoral Composition and Increase in Gross Domestic Product by Industrial Origin at Constant (2002) Prices

Sector	Rate of Change (%)		Contribution to Change (%)		Share of GDP (%)	
	2011(a)	2012(b)	2011(a)	2012(b)	2011(a)	2012(b)
Agriculture	1.4	5.8	2.1	10.0	11.2	11.1
1. Agriculture, Livestock and Forestry	- 0.2	5.3	- 0.2	8.2	9.9	9.8
1.1 Tea	- 1.2	- 1.2	- 0.2	- 0.2	1.0	0.9
1.2 Rubber	2.1	- 6.8	0.1	- 0.3	0.2	0.2
1.3 Coconut	3.0	6.0	0.4	1.0	1.0	1.0
1.4 Minor Export Crops	- 19.0	- 5.0	- 1.3	- 0.3	0.4	0.4
1.5 Paddy	- 8.4	1.3	- 1.9	0.3	1.5	1.5
1.6 Livestock	7.3	6.4	0.7	0.8	0.8	0.8
1.7 Other Food Crops	2.4	10.0	1.1	5.6	3.6	3.7
1.8 Plantation Development	5.7	8.8	0.2	0.3	0.3	0.3
1.9 Firewood and Forestry	4.1	5.4	0.3	0.5	0.6	0.6
1.10 Other Agricultural Crops	7.0	6.8	0.3	0.4	0.4	0.4
2. Fishing	15.5	9.3	2.3	1.9	1.3	1.3
Industry	10.3	10.3	36.0	47.1	29.3	30.4
3. Mining and Quarrying	18.5	18.9	5.1	7.3	2.5	2.8
4. Manufacturing	7.9	5.2	16.7	14.1	17.3	17.1
4.1 Processing (Tea, Rubber and Coconut)	0.9	6.5	0.1	0.6	0.6	0.6
4.2 Factory Industry	8.3	5.2	15.7	12.8	15.7	15.5
4.3 Cottage Industry	7.0	4.6	0.9	0.7	1.0	1.0
5. Electricity, Gas and Water	9.2	4.4	2.7	1.7	2.4	2.4
5.1 Electricity	9.6	4.3	2.5	1.4	2.2	2.1
5.2 Gas	5.7	5.1	0.1	0.1	0.2	0.2
5.3 Water	6.1	7.1	0.1	0.1	0.1	0.1
6. Construction	14.2	21.6	11.6	23.9	7.1	8.1
Services	8.6	4.6	61.9	42.9	59.5	58.5
7. Wholesale and Retail Trade	10.3	3.7	29.0	13.5	23.6	23.0
7.1 Import Trade	14.3	1.0	14.0	1.4	8.5	8.1
7.2 Export Trade	10.1	0.8	4.9	0.5	4.1	3.9
7.3 Domestic Trade	7.5	6.8	10.1	11.7	11.0	11.1
8. Hotels and Restaurants	26.4	20.2	1.7	1.9	0.6	0.7
9. Transport and Communication	11.3	6.2	19.1	13.9	14.3	14.3
9.1 Transport	11.3	6.0	15.6	11.0	11.8	11.7
9.2 Cargo Handling-Ports and Civil Aviation	7.2	5.7	0.6	0.6	0.7	0.7
9.3 Post and Telecommunication	13.4	7.9	2.9	2.3	1.9	1.9
10. Banking, Insurance and Real Estate etc.	7.9	6.7	8.5	9.3	8.8	8.9
11. Ownership of Dwellings	1.2	1.7	0.4	0.7	2.6	2.5
12. Government Services	1.2	1.4	1.2	1.6	7.1	6.8
13. Private Services	7.2	5.5	2.1	2.0	2.3	2.3
Gross Domestic Product	8.2	6.4	100.0	100.0	100.0	100.0
Net Factor Income from Abroad	4.3	- 89.2				
Gross National Product	8.4	5.5				

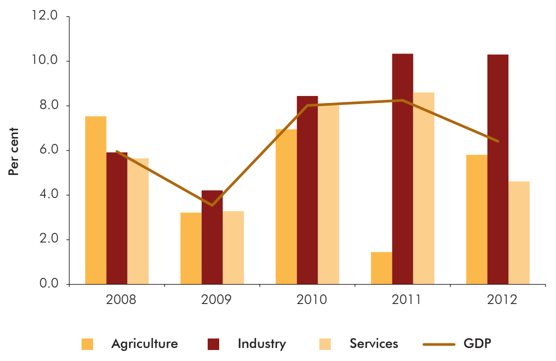
(a) Revised
(b) Provisional

Source: Department of Census and Statistics

According to demand side estimates, the slowdown in domestic consumption was the main reason for the lower growth recorded during the year. Consumption expenditure, which recorded a high growth in real terms during 2011 slowed down as reflected in the deceleration in domestic output and imports of goods. Expenditure on investment activities continued to improve, although at a lower rate than in 2011 in real terms, which could be considered a positive development for future growth prospects. Lower domestic demand was reflected by the considerable deceleration in imports in real terms. Consequently, the widening of net external demand slowed down markedly in 2012; thereby reducing its negative impact on macroeconomic stability.

Gross National Product (GNP) which is Gross Domestic Product (GDP) adjusted for net factor income from abroad (NFIA) grew at a lower rate than the overall growth in GDP during 2012. This indicates a higher growth in outflows in the income account during the year which was

Chart 2.1 Annual Growth Rate



due to growth in interest payments and repatriation of profits by foreign enterprises operating in the country. Meanwhile, inflows declined during the year due to lower interest earnings as a result of the low interest rate environment prevailing in global markets.

Per capita income increased to Rs. 373,001 in 2012 from Rs. 313,576 in 2011. The growth in per capita income was mainly due to the increase in nominal GDP during the year. The increase in income was reflected in wages of both public and formal private sectors as well. However, the relatively high growth in the per capita income in US Dollar terms, observed during recent times slowed down in 2012. This was mainly due to the considerable depreciation of the rupee against the US Dollar as a consequence of allowing more flexibility in exchange rate determination in 2012.

GDP at market prices grew at a marginally lower rate in 2012 compared to 2011. The deceleration in growth was due to the combined outcome of slowdown in real economic expansion and the relatively high GDP deflator in 2012. The GDP deflator which is an implicit price indicator representing overall economic activities in the country has moved in tandem with the Colombo Consumers' Price Index (CCPI). The value of the domestic economy grew to Rs. 7,582 billion, which was equivalent to a value of US Dollars 59 billion.

Domestic savings improved by 27.6 per cent in 2012 recovering from the contraction in 2011. Domestic savings as a percentage of GDP was 17.0 per cent in 2012. The lower growth in consumption expenditure particularly on account of lower imports improved the domestic savings rate. The progress of domestic savings was adversely impacted by the increase in government dis-savings, which was a result of the slowdown in government revenue in 2012. This widened the current account deficit. The continued decline in net factor income from abroad dampened the growth in national savings. However, the continued expansion in private remittances from abroad helped improve overall national savings during the year to 24.0 per cent of GDP. Hence, although investments as a percentage of GDP increased to 30.6 per cent, the resource gap, which is the difference between national savings and investment, as a percentage of GDP improved during the year.

2.2 Sectoral Output, Policies, Institutional Support and Issues

Agriculture

Despite disruptions, the overall Agriculture sector grew at a higher rate in 2012 than in 2011. The first half of the year produced a bountiful Maha season harvest with conducive weather conditions that prevailed. Droughts and floods that occurred during the second half of the year, disturbed the normal agricultural seasons. Despite these adverse weather conditions, the Agriculture sector grew by 5.8 per cent in 2012, recovering from the modest growth of 1.4 per cent in 2011. All sub sectors, except for tea, rubber and minor export crops contributed positively towards this growth. Despite the marginal contraction recorded in the fourth quarter, coconut production expanded during the year, contributing positively to the growth in the Agriculture sector. The paddy sub sector recovered from the 8.4 per cent contraction in 2011 and registered a growth of 1.3 per cent despite the significant setback in production during the Yala season. Livestock, other food crops, plantation development, firewood and forestry and other agricultural crops sub sectors contributed positively to the growth in the Agriculture sector throughout the year. The fishing sub sector also contributed with an expansion of 9.3 per cent towards the growth in the Agriculture sector. Favourable weather conditions, particularly during the first half of the year, improvements in the fishing fleet and attractive price levels that encouraged a high level of harvesting jointly contributed to this growth. Consequently, the Agriculture sector contributed an 11.1 per cent share of the total GDP in 2012, compared to 11.2 per cent in 2011.

Export Agriculture

In 2012, tea production declined marginally by 0.4 per cent to 326.3 mn kg due to adverse weather conditions. Drought weather conditions that prevailed in all tea growing areas in the first half of the year and the unusual cold weather conditions in high grown areas towards the latter part of the year impacted tea production. The decline was mainly evident in high grown tea which declined by 7 per cent to 72.7 mn kg and medium grown tea, which declined marginally by 0.5 per cent to 52.3 mn kg. However, low grown tea production increased by 2 per cent to 201.2 mn kg over that of 2011. Tea production in the smallholder sector, which has the highest contribution of 71.4 per cent to the total tea production, increased by 2.7 per cent to 233 mn kg in 2012. Meanwhile, tea production in the corporate sector, which mainly consists of tea grown in medium and high elevations, declined by 7.4 per cent to 93.2 mn kg. In terms of varieties of tea produced in 2012, orthodox black tea production declined by 0.6 per cent to 300.1 mn kg while CTC (crush, tear, curl) tea production increased by

Table 2.2 Agriculture Production Index (2007-2010 =100) (a)

Item	2011 (b)	2012 (c)	Change (%) 2011/2012
Agriculture and Fishing	111.2	116.3	4.6
1 Agriculture	106.6	110.1	3.3
1.1 Agriculture crops	106.8	109.2	2.3
Tea	105.1	104.7	-0.4
Rubber	117.9	113.3	-3.9
Coconut	99.1	103.8	4.7
Paddy	104.1	102.8	-1.2
Other Crops	110.6	119.3	7.9
1.2 Livestock	105.0	116.7	11.1
2 Fishing	133.3	145.7	9.3

Source : Central Bank of Sri Lanka

(a) The average values used for the base values in the production index was changed from the period 1997-2000 to 2007-2010.
(b) Revised
(c) Provisional

2.65 per cent to 23.2 mn kg while value added tea (organic and instant tea) production declined by 16 per cent to 2.6 mn kg.

Tea prices at the Colombo Tea Auction (CTA) remained elevated during the year. The average price of high, medium and low grown tea increased by 13.6 per cent, 9.5 per cent and 7 per cent, year-on-year, to Rs.379 per kg, Rs.352 per kg and Rs.408 per kg, respectively. Accordingly, the annual average price of all teas at CTA increased to Rs.391.64 per kg in 2012 from Rs.359.89 per kg in 2011. The shortage of global black tea supply largely contributed to the buoyancy in tea prices at CTA from the second quarter of the year. However, the average export price of tea declined to US Dollars 4.41 per kg in 2012 from US Dollars 4.62 per kg in 2011.

Rubber production declined by 3.9 per cent to 152 mn kg in 2012 over the previous year. This was mainly a result of the reduction in tapping days due to torrential rainfall and the decline in natural rubber prices from the highest ever prices recorded in 2011. The two largest contributors to total rubber production, Sheet Rubber and Latex Crepe Rubber, declined by around 2.4 per cent and 39 per cent to 59.2 mn kg and 36.6 mn kg, respectively. Lower rubber prices affected the better agriculture practices of rubber smallholders adversely, thereby affecting

Table 2.3 Trend in Principal Agricultural Corps

Category	Unit	2011(a)	2012(b)
1. Tea			
1.1 Production (c)	kg mn	327.5	326.3
1.2 Total Extent	hectares '000	222	222
1.3 Extent bearing	hectares '000	186	184
1.4 Cost of Production (d)	Rs/kg	355.02	391.39
1.5 Average price			
- Colombo Auction	Rs/kg	360.68	392.4
- Export (f.o.b.)	Rs/kg	510.41	563.94
1.6 Replanting	hectares	1,209	1,288
1.7 New planting	hectares	31	280
1.8 Value added as % of GDP (e)		1.3	1.3
2. Rubber			
2.1 Production	kg mn	158.2	152.0
2.2 Total extent (f)	hectares '000	129	131
2.3 Area under tapping (f)	hectares '000	101	104
2.4 Cost of Production	Rs/kg	129.56	136.00
2.5 Average price			
- Colombo Auction (RSS 1)	Rs/kg	508.80	416.47
- Export (f.o.b)	Rs/kg	535.40	420.74
2.6 Replanting (g)	hectares	3,050	2,161
2.7 New planting (g)	hectares	3,004	2,449
2.8 Value added as % of GDP (e)		1.2	0.9
3. Coconut			
3.1 Production	nuts mn	2,808	2,940
3.2 Total Extent	hectares '000	395	395
3.3 Cost of production	Rs/nut	10.27	11.63
3.4 Average price			
- Producer price	Rs/nut	28.98	22.90
- Export (f.o.b.) (h)	Rs/nut	39.15	28.80
3.5 Replanting / Under Planting (i)	hectares	1,517	4,774
3.6 New planting (i)	hectares	1,553	4,814
3.7 Value added as % of GDP (e)		1.4	1.1

(a) Revised
(b) Provisional
(c) Including green tea
(d) Includes green leaf supplier's profit margin
(e) In growing and processing only
(f) Based on rubber land survey -2003 conducted by the Dept. of Census and Statistics & Rubber Development Department
(g) Extents covered by cultivation assistance schemes of the Rubber Development Department
(h) Three major coconut kernel products only
(i) Extents covered by cultivation assistance schemes of the CCB

Sources:
Sri Lanka Tea Board
Tea Small Holding Development Authority
Department of Census and Statistics
Rubber Development Department
Coconut Cultivation Board
Coconut Development Authority
Ministry of Coconut Development and Janatha Estate Development
Plantations Companies
Sri Lanka Customs
Central Bank of Sri Lanka

yield despite the fertilizer support programme. As a result, the yield in rubber declined to 1,459 kg per hectare in 2012 from 1,566 kg per hectare in 2011. Domestic consumption of natural rubber in Sri Lanka declined by 1.5 per cent to 110.04 mn kg in 2012 primarily due to contraction in demand from industries catering to the export market where Latex Crepe is used as one of the main inputs for high end products.

The average prices of different rubber varieties declined in 2012 compared to record prices earned in 2011. The subdued demand from major tyre manufacturing markets in East Asia, improved rubber production in other rubber producing countries and the build up of carryover stocks in the international market contributed to the decline in natural rubber prices. The average prices of both Ribbed Smoked Sheet 1 (RSS1) and Latex Crepe IX declined at the Colombo Rubber Auction (CRA) by 19 per cent to Rs.417 per kg and 29 per cent to Rs.411 per kg, respectively, in 2012 compared to 2011. During this period, export prices of RSS1 and Latex Crepe IX also declined by 24 per cent and 23 per cent to Rs.447 per kg and Rs.407 per kg, respectively.

Coconut production recorded its highest production in 2012 since year 2001. Coconut production increased by 4.7 per cent to 2,940 mn nuts, in 2012 largely due to the lagged effect of favourable weather conditions that prevailed in the major coconut growing areas i.e. Gampaha, Kurunegala and Puttalam (*coconut triangle)* in 2011. Furthermore, adherence to good management practices such as improvement in fertilizer application and methods for moisture conservation by growers also supported high coconut production.

All coconut kernel products except desiccated coconut production, improved during the year. Coconut oil production increased by 46.2 per cent to 81,862 metric tons (equivalent to 649.2 mn nuts) in 2012 benefiting from increased coconut production and increased import levies on palm oil during the year. The Special Commodity Levy (SCL), which was introduced for edible oil imports from May 2012, was increased further from November 2012 to encourage local coconut oil production. Accordingly, importation of palm oil (both palm kernel oil and crude oil) declined significantly to 63,723 metric tons in 2012 from 135,340 metric tons in 2011. However, desiccated coconut (DC) production declined by 12.7 per cent to 41,645 metric tons (equivalent to 324.8 mn nuts) in 2012, which could be largely attributable to the fall in external demand during the second half of the year. Accordingly, the export of desiccated coconut fell by 8.9 per cent to 41,776 metric tons in 2012. Meanwhile, improved coconut production helped expand the value addition industries in 2012 including cream, milk and milk powder of coconut, which are mainly produced for the export market.

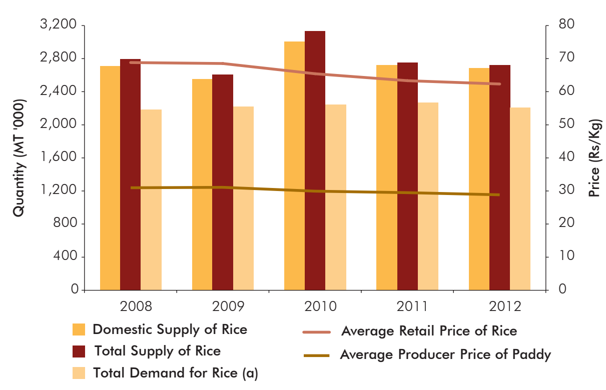
Coconut prices remained low in 2012 at the Colombo Coconut Auctions (CCA) compared to 2011 largely due to the increase in supply. The average auction price of coconut at the CCA declined to Rs.27.80 per nut in 2012 from Rs.34.70 per nut in 2011, while the average retail price of coconut varied in the range of Rs.32.40 to Rs.38.20 during the year. The decline in prices was seen with respect to other coconut products such as coconut oil and desiccated coconut, at the CCA.

The minor agricultural export crops sector showed a mixed performance in 2012. Cinnamon production declined by 5.9 per cent to 17,165 metric tons. The drought conditions that prevailed in 2012 in the major cinnamon growing areas negated the expected higher yield from cinnamon despite the availability of subsidised fertilizer, the increased matured extent of cinnamon plantation during the past several years and favourable export demand for Sri Lankan cinnamon products in the international market. Pepper production in 2012 grew substantially by 72 per cent to 18,604 metric tons, blessed by favourable weather in major pepper growing areas during the flowering and fruiting period and also due to increased matured extent of new planting. Accordingly, export of pepper increased by around 108 per cent to 10,532 metric tons during the year supported by favourable prices fetched for pepper exports. Cashew production has been increasing with the surge in demand from the hotel and tourism sector. In 2012, domestic production of cashew grew by 67 per cent to 2,000 metric tons while exports declined by around 53 per cent to 145.8 metric tons reflecting increased domestic demand. The extent of cultivation has been increasing significantly after the end of the conflict with more estates in the Northern Province contributing to the cashew industry. The growth in cloves production declined in 2012 as in the previous year due to the cyclical harvesting pattern of clove. (The production and extents of minor export crops are given in table 14 of the Statistical Appendix).

Domestic Agriculture

Total paddy production in 2012 declined marginally by 1.2 per cent to 3.84 mn metric tons as the combined outcome of increased paddy production in 2011/12 Maha season and a decline in production in 2012 Yala season. Paddy production in 2011/12 Maha season bounced back strongly, recording a growth of 36 per cent to around 2.72 mn metric tons compared to the production in 2010/11 Maha season. The phenomenal increase in paddy production was mainly due to favourable weather conditions that prevailed throughout the Maha season and the revival of paddy production supported by major and minor irrigation schemes. In 2011/12 Maha season, the national yield increased by around 5 per cent to 4,444 kg per hectare, over the average yield in the last five years. The total extent of paddy cultivation in the North Western Province reduced by 23,522

Chart 2.2 Rice: Supply and Demand



(a) Revised

Table 2.4 Paddy Sector Statistics

Item	Unit	2011 (a)			2012 (b)		
		Maha	Yala	Total	Maha	Yala	Total
Gross extent sown	hectares '000	730	493	1,223	702	365	1,067
Gross extent harvested	hectares '000	613	489	1,103	685	305	990
Net extent harvested	hectares '000	544	437	981	611	272	883
Production	mt '000	1,996	1,898	3,894	2,717	1,129	3,846
	bushels '000	95,655	90,965	186,620	130,212	54,107	184,319
Yield (c)	kg/ hectare	3,668	4,347	3,970	4,444	4,145	4,353
Credit Granted	Rs.mn.	2,340	1,958	4,298	3,694	1,785	5,479
Rice imports	mt '000	-	-	28	-	-	36
Paddy equivalent of imports	mt '000	-	-	40	-	-	52

(a) Revised.
(b) Provisional
(c) Yield per hectare for Maha and Yala are calculated using data from the Department of Census and Statistics which are based on crop cutting surveys while total yield is calculated by dividing total production by the net extent harvested.

Sources: Department of Census and Statistics
Sri Lanka Customs
Central Bank of Sri Lanka

hectares, owing to limited water availability in minor irrigation areas in the province. Meanwhile, paddy production in the Northern Province recorded a significant increase in 2012 of around 24 per cent to 259,936 metric tons supported by increase in lands harvested and improved yield.

The long delay in the south west monsoon affected the paddy production of the Yala season of 2012. Paddy production in 2012 Yala season declined by 41 per cent to 1.13 mn metric tons due to the impact of dry weather conditions experienced during this period. This was the lowest recorded paddy production in the last five years. As a result of the low and erratic rainfall pattern during 2012 Yala season compared with the normal seasonal rainfall pattern, the water levels in major and minor reservoirs reached a very low level. Approximately 35,800 hectares of paddy lands were fully affected by the drought and the yield declined by 5 per cent to 4,145 kg per hectare. However, the rice equivalent of 2012 paddy production is estimated to be in excess of the country's annual total rice consumption requirement. The guaranteed paddy purchasing prices of the government were increased from the 2013 Budget to Rs.32 per kg and Rs.35 per kg for Nadu and Samba, respectively, from the previous prices of Rs.28 and Rs.30 per kg, respectively.

Production of many other field crops (OFCs) increased in 2012, largely due to the increased production in the Maha season and farmers shifting to production of OFCs during the Yala season owing to limited water supply for paddy. The total production of OFCs, which includes maize, green gram, cowpea, black gram, ground nuts, potato, big onion and chili increased by 18.25 per cent to 935,180 metric tons in 2012 compared to 2011. (The production and extent of cultivation of selected OFCs in the Maha season and Yala season are given in table 18 of the Statistical Appendix). The remunerative prices fetched for these crops in the domestic market, improved seed production and availability, increase in cultivation extent in the Northern Province and increased fertilizer usage due to the fertilizer support programme also fueled the high production of majority of these crops. In line with the increased production of these crops the imports of such crops declined in 2012. Further, to boost domestic production of such crops, imports were discouraged by way of increases in SCL. Accordingly, in 2012, the SCL on green gram, black gram, big onion, chili, ground nuts, potato, millet and kurakkan was increased. In 2012, the country produced maize, cowpea and ground nuts in excess of the estimated national demand while the domestic production of black gram and red onion was also sufficient to cover around 87 per cent and 98 per cent of estimated national demand, respectively. Domestic production of big onion was sufficient to cover about 37 per cent of estimated national demand. The government anticipates to produce the entire domestic requirement of most of the field crops by 2015, and export the excess.

Vegetable production in 2011/12 Maha season increased although it declined during the Yala season. Vegetable production increased by 15 per cent to 587,975 metric tons in 2011/12 Maha season while it declined by 7.8 per cent to 411,293 metric tons in 2012 Yala season due to the impact of drought conditions. Accordingly, total vegetable production in 2012 increased by 4.4 per cent to 999,268 metric tons compared to 2011. The share of total vegetable production from the Eastern Province improved to 7.3 per cent in 2012 from 4.3 per cent in 2011 while that of the North-Western Province increased to 10 per cent in 2012 from 8.4 per cent recorded in the previous year. Vegetable supplies appear to be expanding in some provinces, which is likely to have a favourable impact on prices in the future. The fertilizer support programme contributed significantly towards increasing vegetable production during the year.

Three sugar factories, namely, Pelwatta, Sevanagala and Galoya contributed to the national sugar production in 2012. Domestic sugar production increased marginally by 2 per cent to 35,658 metric tons in 2012. The contribution to the national sugar production in 2012 from Pelwatta was 64 per cent, followed by Sevenagala at 27 per cent and Galoya at 9 per cent. The production at the Pelwatta sugar factory, which depends on rainfed cultivation, declined by 21 per cent to 22,712 metric tons. This was mainly due to the substantial decline in cane supply during the year due to drought conditions. However, sugar production at the Sevanagala factory grew by 60 per cent to 9,631 metric tons mainly due to the increase in the cultivation extent of cane where paddy and banana were previously cultivated. The cultivation shift was mainly due to the increase in average producer price to Rs.4,000 per metric ton of sugar cane. The Galoya plantation, previously known as *Higurana* sugar factory, also commenced its commercial operations in 2012. Their contribution to national sugar production amounted to 3,316 metric tons in 2012 and production is expected to increase to 13,200 metric tons in 2013. The Galoya plantation also recorded a high yield (83 metric tons per hectare) with the adoption of better agriculture practices for their new cultivation, which includes cultivation of high yielding varieties, proper irrigation systems, field maintenance and timely supply of materials and inputs for farmers. In 2012, the domestic production of sugar was sufficient to meet approximately 6 per cent of the annual sugar requirement of the country. The government expects to increase sugar production up to 40 per cent of the total domestic requirement by 2020.

Fishing

Total national fish production in 2012 increased by 9.3 per cent to 486,170 metric tons driven by substantial increases in coastal marine fishery and inland fishery. Of total production, marine fish production grew by 8.3 per cent to 417,220 metric tons mainly driven by marine coastal fishing, which grew by 15.8 per cent to 257,540 metric tons. However, off shore fish production (deep sea fishing) declined by 2 per cent to 159,680 metric tons. The increase in fuel prices effective from February 2012 and relatively high ice prices reflecting increased electricity charges pushed up the cost of production per trip of a multi day boat. This was partly offset by the fuel subsidy introduced by the government for them since March 2012. These developments reduced the trip duration of multi day boats encouraging fishing in coastal areas. During 2012, the highest growth in marine fishery was recorded from the

Table 2.5 Fish Production

Metric Tons '000

Sub-Sector	2011 (a)	2012 (b)
Marine (c)	385	417
Aquaculture and Inland Fisheries	60	69
Total	445	486

(a) Revised
(b) Provisional
(c) Coastal and deep sea sector

Source: Ministry of Fisheries and Aquatic Resource

Northern Province, which grew by 28 per cent to 59,340 metric tons. As a result, the share of marine fish supply from the Northern Province to the total supply also increased to 14 per cent, mainly due to the higher catch from the Jaffna district. The inland fishing sector grew by 16 per cent to 68,950 metric tons in 2012. The proper management of water bodies with community participation, establishment of community based mini hatcheries, increase in fish fingerling production and free issues of fingerlings contributed to this growth.

Livestock

The increasing trend in domestic milk production continued in 2012, supported by concerted efforts of the government to promote the dairy sector. Total milk production, which mainly includes cow and buffalo milk increased by 16 per cent to 299.3 mn liters in 2012. Milk collection in the formal sector, which includes large milk processors, increased by 28 per cent to 183.6 mn litres in 2012 from 143.7 mn litres in 2011. The growth in cattle milk production in 2012 was largely driven by the increased average farm gate price of liquid milk up to Rs.50 per liter, which led to an increase in the number of milch cows by 11 per cent in 2012. Increased contribution from the Northern and Eastern provinces, improvement in infrastructure, which includes the number of chilling centres of both large milk collecting organisations as well as small to medium scale collectors, the various dairy development programmes introduced by the government in the dairy sector contributed to the overall improvement in the industry. The milk collection from farms under the National Livestock Development Board (NLDB) also increased by 20 per cent to 3.4 mn liters in 2012 due to the higher yield of imported milch cows. Further, the milk collection of Milco increased by 30 per cent to 68 mn liters of raw milk in 2012 leading to produce 4.6 mn kg of milk powder, a growth of 25 per cent. Increase in milk collection of Millco enabled to stabilize producer prices at Rs.50 per liter in 2012. Domestic milk production as a per cent of the total national milk requirement for consumption, increased to 40 per cent (100 ml per person per day) in 2012 from 33 per cent in 2011. The import of milk powder declined by 5.5 per cent to 79.4 mn kg in 2012.

Table 2.6 Livestock Sector Statistics

Sub-Sector	2011(a)	2012(b)
1. National Herd (No.) (mn)	1.6	1.6
Neat Cattle	1.2	1.2
Baffalo	0.4	0.4
2. National Milk Production (mn litres)	258.3	299.3
Cow Milk	203.5	237.6
Baffalo Milk	54.8	61.6
3. Milk Products (mn litres)	21.4	29.3
4. Producer Price - Cow Milk (Rs./litre)	50.00	50.00
5. National Egg Production (No) (mn)	1,185.3	1,457.1
6. National Poultry Meat Production (mt '000)	116.8	122.5

(a) Revised
(b) Provisional

Sources: Ministry of Livestock Development
Department of Census and Statistics

The successive measures taken by the government to improve the competitive market environment for poultry manufactures contributed to increase the poultry products in 2012. Chicken production grew by 5 per cent to 122,490 metric tons while egg production showed a significant increase by 23 per cent to 1,457 mn eggs in 2012. Both layer production and broiler chick production showed a considerable growth in 2012 as a result of measures adopted by the NLDB together with the private breeding farms to increase market supply of day old chicks (DOC) to alleviate the market shortage of DOC supply that prevailed in 2011. As a result, the prices of DOC reduced significantly in 2012 thereby improving chicken and egg production. Though the price of DOC reduced in 2012 through increased market supply, poultry feed prices increased significantly in the year with the soaring cost of imported ingredients. The maximum price of branded chicken was also increased to Rs.380 per kg from Rs.350 per kg with effect from November 2012 helping to increase the profit margins of the broiler producers. In the meantime, egg prices which declined in the first half increased during the second half, reflecting the consequences of increasing cost of production.

Forestry

The Forestry Department initiated several projects in 2012 to improve the management of natural resources while contributing to support livelihood development initiatives. The projects, "Sri Lanka Community Forestry Programme" and "Participatory Coastal Zone Restoration and Sustainable Management in Eastern Province of Post Tsunami Sri Lanka" were commenced with the financial assistance of Australia, the United Nations Development Programme (UNDP), Global Environmental Facility (GEF) and International Fund for Agricultural Development (IFAD). Further, a project on "Sri Lanka REDD readiness" (Reducing Emissions from Deforestation and Degradation) was developed and a US Dollars 4 mn grant has been approved for Sri Lanka by the UN-REDD programme for a period of three years from 2013. This project targets to protect, better manage and wisely use forest resources, thus contributing to the global battle against climatic change. Moreover, 24 private companies carried out commercial scale forest plantation in 452 hectares in 2012 to foster forestry in the country.

Agricultural Policies and Institutional Support

The strategies undertaken for the development of the tea sector continued in 2012 targeting to improve productivity, value addition and competitiveness by the Sri Lanka Tea Board (SLTB) and Tea Research Institute (TRI). The "Tea Promotion and Marketing Fund" under the SLTB commenced its targeted global tea promotion and marketing activities in 2012. Accordingly, SLTB participated in 16 trade fairs and carried out several other promotional activities to popularize Ceylon Tea and the Lion Logo at global level. Poor leaf standard is a major concern in most tea factories. In order to improve the leaf standards, the SLTB directed tea factories to maintain minimum quality of green tea leaf (60 per cent immature undamaged leaf) to ensure highest quality of tea exports. Further, the SLTB continued to finance several subsidy programmes in 2012 to promote good manufacturing practices. Under the "Tea Factory Modernizing Subsidy Scheme", 43 tea factories were facilitated to enhance their scale of tea production, bringing the total tea factories financed under this scheme to 240 by end 2012. Further, a subsidy was granted to tea growers and manufacturers to improve leaf transportation systems, leaf collecting sheds and leaf collecting crates while the subsidy for replanting and new planting was also increased by Rs.50,000 and Rs.100,000 to Rs.350,000 per hectare and Rs.250,000 per hectare, respectively, to meet the increasing cost of such activities. The uninterrupted provision of energy resources, at an affordable cost, is considered to be a challenge in tea processing. A trial carried out in an up country tea factory by TRI showed that about 23 per cent of electrical energy could be saved if the firewood which is used to produce thermal energy at factories is used after reducing its moisture from 48 to 25 per cent. Firewood is the main source to produce thermal energy in tea factories. 40 per cent is consumed for withering leaves and 60 per cent is for drying operation. The effective use of firewood would be beneficial to the factories.

Several measures were implemented in 2012 to improve the productivity in rubber cultivation and also to expand rubber cultivation extent. In order to enhance rubber cultivation, Budget 2012 proposed to develop 10,000 hectares of smallholder rubber lands in

Ampara and Mahaoya areas by 2015 of which cultivation in 550 hectares was completed in 2012. Further, under the project, "Smallholder Plantations Entrepreneurship Development Programme" funded by the International Fund for Agricultural Development (IFAD), planting 5,000 hectares of rubber was completed during 2008 to 2012 (1,202 hectares in 2012) in Monaragala district, which is a nontraditional area for rubber. Moreover, a survey is currently conducted to identify suitable lands in the Vauniya and Mullaitivu districts for rubber cultivation and also to establish a new plant nursery for the supply of plants. The Census of Rubber lands 2010/11 conducted by the Rubber Development Department reveals that the total area under rubber plantation has increased by 8 per cent to 125,645 hectares compared to the Census in 2002. Further, it reveals that the land size of less than 50 acres has increased by 28 per cent to 75,119 hectares, while that of 50 acres or beyond has reduced by 13 per cent to 50,526 hectares due to expansion in private sector growers encouraged by increased natural rubber prices in recent times. However, of total private sector lands (79,395 hectares), 71 per cent of lands are less than 5 acres. This is a major concern in respect of increasing the productivity in the rubber sector. To promote cultivation of high yielding rubber clones with improved secondary characters such as high timber volume and disease resistance, The Rubber Research Institute (RRI) introduced three new high yielding clones (95-55, 87-372, 90-1) for commercial cultivation and a further low intensity harvesting system (S4/D4) was also introduced for regional plantation companies (RPCs) during the year.

Institutional support was strengthened to face the challenges in the coconut sector enabling to reach the production of 3,650 million nuts by 2016. Weligama Coconut Leaf Wilt Disease (WCLWD), coconut mite infection, the severe drought that prevailed in the coconut growing areas, falling producer prices and external demand were the major challenges faced by the coconut sector during the year. In 2012, the Coconut Research Institute (CRI) received support and technical assistance of the Food and Agriculture Association (FAO) for development capacities of early diagnosis, spread prevention and integrated management of WCLWD. Accordingly, around 179,000 affected palms have been uprooted (around 86,000 palms in 2012) and were compensated by end 2012. To face the issue of coconut mite infection, six more predatory mite mass culturing laboratories were established and a total of 48,850 predatory mites were issued to growers by CRI. Further, a parasitoid was imported from Thailand to develop a biological control programme for *Plesispa beetle*, which is emerging as a serious pest, causing considerable damage to young seedlings. Two new high yielding verities of "Kap Suwaya" (CRISL 2012) and "Kap Setha" (CRISL 2013) were released to growers in 2012. The value addition effort in the form of new innovations of coconut milk based ice cream and spray drying jaggery (palm sugar) were introduced to the market in 2012. Meanwhile, the government has extended compensation to drought affected growers by providing coconut seedlings free for up to 5 acres per grower.

During the year 2012, a number of initiatives to accelerate the production, improve yield, develop and disseminate efficient agronomic practices were introduced. The establishment of "Rice Export Zones" was given high priority in government policy to reap the maximum benefit of the revival in the paddy sector. In 2012, high potential rice growing areas were identified as "Rice Export Zones (REZ)" and around 2,214 hectares were cultivated with the involvement of 3,300 farmers. In order to mill their paddy, 22 millers were also identified to process the paddy grown in REZ and the Institute of Post Harvest Technology (IPHT) trained the selected millers and farmers on post harvest handling technology. Further, farmers who cultivate green gram, kurakkan, maize etc., were encouraged to cultivate a new cultivation season during the period August to October outside the traditional cultivation cycle. In 2012, green gram was cultivated in a higher extent in the districts of Hambantota and Monaragala during this new season. The IPHT developed an energy efficient high capacity flour shifter contributing to increase the capacity of process line activities thereby reducing the processing cost. This will reduce the price of rice flour and also promote rice flour products. The Rice Research Institute (RRI) released three new rice varieties (Bw 367, Ld 368 and Bg 369) in 2012 with high yield and more tolerance to diseases than existing 3½ months paddy varieties. Further, the Field Crop Research and Development Institute (FCRDI) also developed a high yielding soya variety (MISB-1) during the year. This will help to increase the domestic production of soya bean, contributing to sustain a small and medium sector based on consistent supply of domestically grown soya. Regulations were enforced in 2012 to transport selected fruits and vegetables using plastic crates to improve post harvest handling practices among the stakeholders. Meanwhile, three new sugar cane varieties namely, SL 90 6237, SL 95 4443 and SL 96 128 with high cane and sugar yielding were recommended and released for commercial cultivation under both irrigated and rain fed conditions. The Sugar Research Institute (SRI) is multiplying these varieties to provide foundation seed cane for further multiplication by sugar industries.

Development activities in the dairy sector set on fast track in line with the Livestock Master Plan. It has been identified that the higher growth of milch cows is essential to foster milk production in the country. NLDB has been allocated the task of supporting breed development by establishing nucleus farms. Accordingly, NLDB imported 2,000 high yield cattle from Australia in the breeds of *Friesian/Jersy Friesian* in 2012. Further, the "*Live Stock (Dairy) Breeding*" project also contributed to carry out 203,753 numbers of artificial inseminations of cattle and buffaloes during the year. Moreover, under the Heifer Calf Rearing project, dairy farmers were supported to feed and manage their artificially born improved female calves. Meanwhile, SCL on milk powder imports was increased to Rs.107 per kg with effect from November 2012 with a view to encourage domestic milk powder production. The government has pledged a loan of Euro 30 mn to Milco, which is a company owned by the government, to upgrade their existing milk factories on par with increasing raw milk collection.

Several policy stimuli contributed to sustain the growth momentum in the fishery sector in the backdrop of emerging challenges. The government implemented a fuel support scheme for fishermen from March 2012 to partly absorb the increased cost after the fuel price revision in February 2012. During the year, the government spent Rs. 2970 mn under this scheme. Further, under the "*Diyawara Diriya*", a subsidized loan scheme targeted to improve fishery resources, Rs. 908 mn was disbursed among 632 beneficiaries in 2012 where the interest cost of 4 per cent is borne by the government. The country's largest fishery harbor "*Dikowita*" with modern facilities which would facilitate to increase the deep sea fishing thereby increasing both domestic fish availability and exports was successfully completed in 2012. Further, three more fish canning factories were established in 2012 bringing the total number of fish caning factories to four. The average production of all four factories in 2012 was 38,000 canned fish per day (each includes 280 grams of fish) which is around 22 per cent of total market supply. In 2012, Sri Lanka imported 18,857 metric tons of canned fish at the cost of around US Dollars 41.8 mn. In order to encourage investment in the local fish canning industry, the SCL on imported canned fish was increased from Rs. 75 to Rs. 100 per kg in November 2012.

Several measures were introduced in the Budget 2013 to support the agriculture sector and to provide relief to stakeholders affected by adverse weather conditions. The budget proposed to write off the interest payment together with rescheduling of loans obtained by paddy farmers who were affected by the drought and also to provide seed paddy free of charge for such farmers to continue cultivating in the upcoming Maha season. Further, it was proposed to implement a "Crop Insurance Scheme" for all farmers who are beneficiaries of the existing fertilizer support scheme. Guaranteed paddy prices under the government paddy purchasing scheme were also increased to ensure a stable market environment for paddy. To promote organic fertilizer usage a higher paddy purchasing price (Rs.40 per kg) was proposed. Further, it was also proposed to develop four fishery harbours at Silawathura, Gandara, Gurunagar, Kalamatiya and the rehabilitation of Mirissa, Hikkaduwa, Beruwala, Galle and Hambantota fishery harbours and all anchor lodges and fishing landing centers to facilitate faster growth in fishery activities through a modern fishery harbour network. In order to boost the poultry industry, formula pricing for poultry products has been proposed, replacing the price ceiling, which will take into account the cost of production while the income tax was also reduced to 10 per cent.

Industry

The positive contributions from all sub sectors enabled the Industry sector to expand by 10.3 per cent in 2012 as in 2011. Factory industry which is the largest sub sector in the Industry sector recorded a growth of 5.2 per cent in 2012 compared to 8.3 per cent and 7.5 per cent in 2011 and 2010, respectively. This was mainly due to the sluggish demand in global markets for exports and low domestic demand reflecting the impact of policy measures adopted. The electricity, gas and water sub sector also decelerated compared to the previous two years, partly due to the decline in high value added hydro power generation in the electricity sub sector. Construction and mining and quarrying sub sectors expanded at impressive rates with the boom in both public and private sector construction activities. During the year, the Industry sector contributed to 30.4 per cent of the total GDP, compared to 29.3 per cent in 2011.

Mining and Quarrying

The mining and quarrying sub sector expanded by 18.9 per cent in 2012, from 18.5 per cent in 2011. This sub sector consists of two sub components, namely, gem mining and other mining, which accounted for 18.5 per cent and 81.5 per cent of the share of the mining and quarrying sub sector, respectively. The other mining component, which is the largest contributor in the sub sector, includes the extraction of construction related material, together with minerals such as graphite, phosphate, mineral sands and salt production. This component expanded by 21.1 per cent in value added terms in 2012, from 18.8 per cent in 2011, bolstered by the high demand for materials such as sand, rock metal and lime from the construction sector. Graphite production expanded during the year. Mineral sands and phosphate production contracted compared to the previous year, with the latter due to low demand for fertiliser, as a result of unfavourable weather conditions that affected the Agriculture sector. Gem mining expanded by 10.2 per cent in value added terms during 2012, despite the low demand from major export destinations in the US and Europe. Local gem and jewellery exporters were able to move to wealthy Asian markets, for example, China, Malaysia and Indonesia, which helped to mitigate the negative impact from Western countries to some extent. Despite the expansion in the value added contribution in the sub sector, and the penetration into Asian markets, gem and jewellery exports in volume terms contracted by 7.8 per cent in 2012.

Manufacturing

Processing

The processing sub sector, which represents industries that process tea, rubber and coconut grew by 6.5 per cent in 2012 compared to 0.9 per cent in 2011. The growth in coconut processing industries supported by the expansion recorded in coconut production helped outweigh the impact of the decline in tea and rubber production during the year, resulting in an overall expansion in the sector in value added terms. Measures taken under the Budget of 2012 through tax concessions encouraging local value addition of primary agricultural exports contributed to the development in the processing industries. Furthermore, the commencement of tea production in closed factories and new factories and the modernisation programmes for tea factories launched by the Ministry of Plantation Industries to improve local value addition of tea also helped the growth in processing industries.

Factory Industry

Despite the subdued global economic environment and the policy measures implemented domestically to place the economy on a more sustainable path, the expansion of production in several industries helped buoy factory industry performance in 2012. The ability to manufacture products of a high quality and finding new markets helped sustain production in many export oriented industries while domestic demand for several products was boosted by the expanding tourism industry. In the meantime, reflecting the demand arising from the ongoing development projects of the government and commercial construction activity, the manufacture of several products for the construction industry also increased during the year.

Despite weaker global economic activity, wearing apparel production in the country increased in 2012, albeit at a much slower pace than in the previous year. Output of the wearing apparel sector increased by 4.2 per cent in 2012. Weaker economic activity, particularly in the EU region, has dampened demand for Sri Lanka's exports. However Sri Lanka remains a source of premium, reasonably priced apparel for both the EU and the USA. The apparel industry has therefore been able to sustain its performance despite the slowdown of these major economies which continue to be key export destination markets. Apparel manufacturers continue to strive to diversify their business to other markets. Meanwhile, the textile products sector, which mainly comprises weaving of textiles and finishing of textiles, recorded a commendable growth in 2012. The supply of textiles to the domestic market was supported by strong demand from tourists, according to market sources.

The rubber and plastic products sub-sector sustained its performance through 2012. While output of the sector grew marginally by 0.3 per cent, this growth was recorded despite a marginal

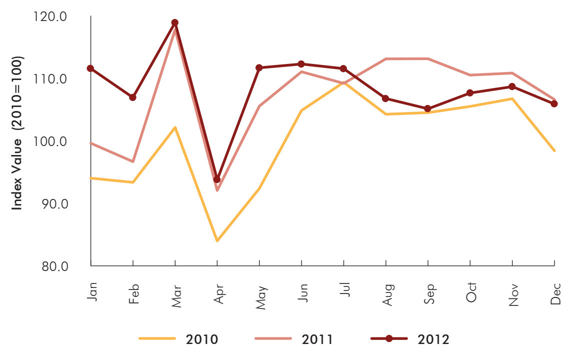
Table 2.7 Industrial Production Index (IPI)
2010 = 100

	Division (Weight in the IPI is given within parentheses)	Index 2011 (a)	Index 2012 (b)	Year-on-year Change %
1	Food Products (23.7%)	108.5	106.9	-1.5
2	Beverages (8.1%)	110.2	107.4	-2.5
3	Tobacco Products (8.4%)	106.0	99.9	-5.7
4	Textiles (1.6%)	99.8	113.9	14.1
5	Wearing Apparel (23.0%)	113.8	118.5	4.2
6	Leather and Related Products (0.8%)	94.0	92.9	-1.1
7	Wood and Products of Wood, except Furniture (0.1%)	107.9	98.4	-8.8
8	Paper and Paper Products (0.1%)	89.0	98.8	11.0
9	Printing and Reproduction of Recorded Media (0.7%)	100.5	106.3	5.8
10	Refined Petroleum Products (2.2%)	106.3	81.3	-23.5
11	Chemicals and Chemical Products (6.3%)	67.5	78.1	15.7
12	Pharmaceuticals, Medicinal Chemical and Botanical Products (0.1%)	133.0	138.8	4.4
13	Rubber and Plastic Products (10.5%)	116.6	116.9	0.3
14	Other Non-metallic Mineral Products (7.2%)	116.7	117.5	0.7
15	Basic Metals (1.0%)	110.2	98.1	-11.0
16	Fabricated Metal Products,except Machinery and Equipment (3.8%)	89.6	111.7	24.7
17	Electrical Equipment (2.3%)	98.7	98.4	-0.4
	Industrial Production Index	107.2	108.4	1.1

(a) Revised
(b) Provisional

Source : Central Bank of Sri Lanka

Chart 2.3 Industrial Production Index



decline in the production of tyres and tubes, which have a substantial share of more than eighty per cent in the rubber and plastic products sub-sector. The downturn in economic activity in Europe and the resultant fall in import demand has adversely affected tyre exports. Nevertheless, production of other rubber products such as gloves as well as plastic items increased, resulting in the growth recorded by the sub-sector. While production of gloves was supported by continued demand from foreign markets, the expansion of production of plastic products was supported largely by domestic demand.

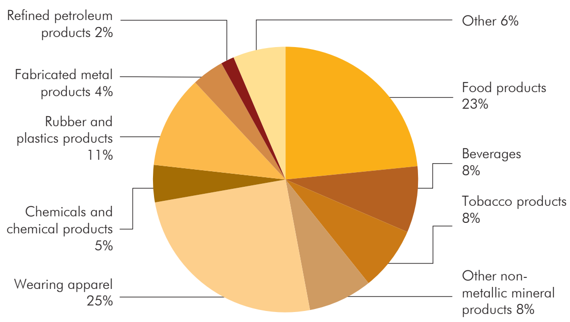
The fabricated metal products sub-sector, which mainly comprises ship building and ship repairing, performed well in 2012. This sub-sector benefitted from orders secured from India and Singapore**.** Given the fast expansion of the tourism sector, local demand for small and medium scale boats for leisure activities has increased while the increasing demand for fishing boats has also supported the performance of this sub-sector.

The chemicals and chemical products sub-sector showed an improvement in its performance during 2012. The expansion of this sub-sector in 2012 was driven by increased production of fertilizer, soaps and detergents as well as paints and varnishes. While the expansion of agriculture and construction related activity in the country is likely to have supported increased production of fertilizer, and paints and varnishes, demand from the tourism sector is likely to have supported the expansion of production of soaps and detergents. A decline in the manufacture of fertilizer during the latter half of the year however, weighed down on the performance of the chemicals and chemical products sub-sector during the second half of the year. Meanwhile, several measures have been taken by the government to promote the use of organic fertilizer in paddy cultivation. As per the national Budget for 2013, manufacturing, distribution, and marketing of organic fertilizer have been exempted from all direct as well as indirect taxes. Increased use of organic fertilizer is expected to reduce dependence on chemical fertilizer in the future.

Production in the non-metallic mineral products sub-sector expanded in 2012. Production of cement, lime and plaster, with a share of more than fifty per cent in the sub-sector, drove this expansion in output. Although there has been some slowdown in residential housing construction activity, demand arising from the government's infrastructure development projects and commercial construction activity supported the production of cement for the domestic market. Production of glass and glass products also increased in 2012. However, articles made of concrete, cement and plaster as well as porcelain and ceramic products recorded declines, thus negating to some extent the expansionary impact of cement production on the industrial production index (IPI).

Production of malt liquor as well as non-alcoholic beverage products such as soft drinks and bottled water recorded growth although a decline in liquor production resulted in the beverages sub-sector slowing down in 2012. While the excise tax applicable to liquor production was raised in 2012, the consequent higher prices of liquor resulted in a decline in distilling, rectifying

Chart 2.4 Composition of Industrial Production - 2012



and blending of spirits. Nevertheless, production of malt liquor increased in 2012. This increase could be attributed to a shift in consumption patterns in relation to liquor as well as the expansion of the tourism industry. Production of soft drinks, mineral water and bottled water, which accounts for over a quarter of beverage products meanwhile, recorded an impressive growth of nearly 10 per cent.

A contraction was recorded in respect of tobacco products in 2012. Higher prices of tobacco products due to higher excise taxes applicable resulted in lower domestic demand, in turn leading to lower production. The decline in demand for tobacco in recent years can be attributed to both upward price revisions and public health concerns relating to consequences of tobacco.

Industries in the food sub-sector recorded varied performance during the year. Production in the dairy products sector, which accounts for nearly a fifth of food production in the IPI, declined during the year. While domestically produced fresh milk is sufficient only for about a third of the milk requirement of the domestic dairy products sector, the processing of milk products, based largely on imported milk powder was impacted by the depreciation of the rupee and the imposition of higher tariff on milk imports to protect the local milk industry. The bakery products sub-sector, with a weight of about 30 per cent in the food sub-sector, also recorded a decline in production in 2012, primarily as a result of the higher import tax imposed on wheat, the upward adjustment of the administered price of wheat flour in the domestic market and increasing rice consumption. Production of starches and starch products, which mainly consists of processing of wheat for export, declined during much of the year, as a result of higher taxes imposed by a key export destination country. In contrast to the performance of these sub-sectors, processing and preserving of fish recorded an impressive growth of 25.2 per cent, year-on-year. This growth could be attributed to the increase in the fishing fleet over the past several years, the establishment of factories for canning of fish and measures taken by the government to develop the fisheries industry, particularly in the Northern and Eastern provinces. Production of noodles, macaroni and similar food items meanwhile, recorded significant growth of nearly 20 per cent, which could be attributed partly to the expansion of tourism. The manufacture of prepared foods such as sausages also recorded growth of around 7 per cent.

Factory production of coke and refined petroleum suffered a setback in 2012. Sanctions imposed by the USA on Iran have led to disruptions in supplies of crude oil to Sri Lanka, which in turn resulted in lower capacity utilization of the refineries by the CPC. CPC refineries are best suited for refining Iranian light crude oil, which differs from crude oil produced by other countries in terms of quality, particularly the sulfur content. While Iranian light crude oil gives the best yield when used in CPC refineries, lower crude oil imports from Iran resulted in production in this sub-sector declining significantly. Total crude oil imports declined by 28.2 per cent in 2012, while crude oil imports from Iran decreased by 56.8 per cent to 834,000 MT in 2012 from 1,932,000 MT in 2011. In line with this reduction in crude oil imports, production of auto diesel and petrol declined by 18.0 per cent and

26.7 per cent, respectively. Production of aviation fuel, liquid petroleum gas and fuel oil also declined, by 40.0 per cent, 27.6 per cent and 16.7 per cent, respectively.

Industrial Policies and Institutional Support

The government continued its regional industrial development policy during 2012 through the Ministry of Industry and Commerce (MIC). Development of infrastructure needed for promoting industry continued by way of establishing industrial estates in different parts of the country. Development work in relation to industrial estates established parallel to the "Wadakkil Wasantham" and "Nagenahira Navodaya" programmes continued in the Northern and Eastern provinces. Accordingly, about fifty per cent of the Phase II of the Trincomalee Industrial Estate and about sixty per cent of the development work in relation to the Mannar Industrial Estate was completed by end 2012. Further, a suitable land area has been identified and cabinet approval has been obtained to develop the industrial estate in Vavuniya. The Ministry has identified salt based industry, the manufacture of fishing gear, boat manufacturing, fish processing & palmyrah based industry as potential industries to be developed in the Northern Province. Preliminary work in relation to the industrial estates of Mathugama (Pallegodawatta) is near completion and infrastructure development will commence in 2013.

The government demonstrated its commitment towards productivity improvement through energy efficiency, waste management and quality enhancement programmes conducted by the MIC. Fifteen manufacturers located in the Homagama, Makandura and Dankotuwa Industrial Estates have been included in the "Energy Efficiency Improvement" programme and comprehensive energy audits of five factories have begun. Meanwhile, the industrial waste management programme and improvement of by-products through waste exchange in the industry sector are currently taking place in parallel. Similarly, a programme for enhancing the quality of concrete and cement based products has also been initiated by the MIC with a view to improving industrial productivity and facilitating the booming construction sector.

The National Enterprise Development Authority (NEDA), which is the apex body of the government for the Small and Medium Enterprise (SME) sector along with other state institutions, provided support to industries. The "Gamata Obina Viyapara" programme was continued by the NEDA in the regions connecting potential industrialists with suitable business ventures. Similarly, the NEDA provided necessary technical training to selected entrepreneurs under the "Divi Neguma" cottage industry development programme of the government. The District Enterprise Forum (DEF) established island-wide by the MIC focused on addressing issues relating to service markets, policy and the regulatory framework applicable to the Micro and SME sectors.

The government continued with its initiatives aimed at developing a technology and research friendly culture in order to encourage innovation. A National Regulatory Framework for Nanotechnology innovations and applications was undertaken by the National Science Foundation (NSF) with financial support from the International Development Research Centre (IDRC- Cananda). Further, construction work in relation to Phase I of the National Centre of Excellence (NCE) of the Nanoscience Park was commenced. Accordingly, work in relation to the Centre for Research and Innovation, Technology Commercialisation Centre Incubation Cells, and the Administrative Centre was commenced. Meanwhile, the NEDA has undertaken to carry out a feasibility study to establish a Technology Development Fund (TDF) in Sri Lanka in collaboration with the Malaysian Technology Development Corporation (MTDC). The TDF is expected to facilitate the use of technology in the SME sector through technology transfer, provision of venture capital and commercialization.

Various state institutions took measures to develop industry in the Northern and Eastern Provinces. The Industrial Development Board (IDB) has established district offices in Mannar, Mullattivu and Kilinochchi districts with activities to commence in 2013. Meanwhile, the Achchuveli Industrial Estate is to be reactivated with Indian government support. The preliminary activities in this respect have been completed and the Sri Lankan Government and the Indian Government have entered into a Memorandum of Understanding (MOU) for developing infrastructure facilities such as telecommunication, electricity and internal roads. The Ceylon National Chamber of Industries (CNCI) has extended its services to the Micro and SME sectors in the Northern and Eastern Provinces, with the objective of encouraging operational and business excellence.

The investment incentive structure governing investments coming under the purview of the Board of Investments of Sri Lanka (BOI) was rationalised during 2012 in order to streamline the existing tax structure under a single regime. Accordingly, BOI legislation was harmonised with the Inland Revenue Act and the new incentive regime was implemented along with amendments to six different acts. These amendments include the VAT (Amendment) Act No. 7 of 2012, IR (Amendment) Act No. 8 of 2012, NBT (Amendment) Act No. 9 of 2012, PAL (Amendment) Act. No. 10 of 2012, ESC (Amendment) Act no. 11 of 2012, and the Finance Act No. 12 of 2012. This new incentive regime focuses on three different industrial sectors, categorised under small, medium and large projects. With a view to encouraging large investment projects, 6-12 year tax holidays were introduced. Five-year tax holidays followed by a concessionary tax rate of 12 per cent were granted to focus sectors in fabric, pharmaceuticals, milk powder and cement industries, to promote import substitution. Incentives provided to expand large scale and strategic import replacement enterprises include deferring of tax liabilities on importation of machinery and equipment. Meanwhile, projects likely to bring economic and social benefits to the country would qualify as Strategic Development Projects and will be granted special incentives under the Strategic Development Projects Act No. 14 of 2008.

The Joint Apparel Association Forum (JAAF) has been instrumental in implementing strategies for the development of the apparel sector. The proposed apparel trading hub, which envisions tax free trading of apparel, minor value addition to imported garments, establishment of headquarters of major apparel buyers and provision of ancillary services within a free port area has taken effect with the passing of the Finance Act No. 12 of 2012. Further, with the objective of promoting recognized retail brands to open shops in Sri Lanka, the apparel market was deregulated, allowing 40 per cent of production to be sold to the domestic market. Further, a unified income tax rate of 12 per cent on both exports and domestic sales was introduced in order to increase production of apparel to both the domestic and foreign markets. These measures were taken in order to enable local consumers to purchase high quality garments domestically as well as to promote tourism. Meanwhile, JAAF focused on market diversification strategies, revamping of small and medium scale apparel industrialists and image building programmes to achieve sustainable growth in the industry amidst tight competition from other exporters. The introduction of a 'National Compliance Standard' and the E-CUSDEC is expected to facilitate a low cost and hassle free trading platform for exporters.

BOX 4 Developing Technology Business Incubators for a Technopreneurial Culture

A technopreneur is an entrepreneur engaged in businesses that involve technology. Classic examples of world renowned technopreneurs can be drawn from the information technology industry and electrical and electronic equipment industry. These technopreneurs have been the driving force behind the rapid penetration of technologies in their countries, which has propelled economic growth. A technopreneurial culture converts techno savvy business ideas into marketable products, instrumental for high value addition and export diversification and acts as a key tool for improving regional and national competitiveness. Accordingly, many countries, particularly South East Asian countries, that selected the technopreneurial culture as the fastest route to economic development have taken measures to promote technopreneurship encouragement policies through the establishment of technology business incubators. These are increasingly becoming popular in national level strategies of emerging economies due to their ability to address the grass root levels through the development of the Small and Medium Enterprise sector. Therefore, creating a technopreneurial culture with the proliferation of technology business incubators is necessary for Sri Lanka in order to move to a substantially higher income level and sustain a high level of economic growth, through further diversification of the economy by promoting innovation and the use of such innovation for commercial purposes.

A Technology Business Incubator (TBI) is a physical or virtual entity which fosters innovative technological ideas to grow into high tech commercial businesses. TBI can also refer to business incubators that lever technology expertise, engage in technology transfer and develop assimilated technologies to suit local circumstances. Generally, TBIs provide various support facilities to innovators and startup companies through the early stages of development and change. These support facilities include skills development, access to finances, intelligence services, legal consultancy services, high speed internet facilities, shared work space, and assistance in formulating a growth strategy. They are different from bank loans and venture capital firms, in that, apart from providing financial and business assistance they nurture a research and development culture and are actively engaged in technology transfer and development. However, they are linked with financial institutions and venture capital firms as these are an integral part for the success of a TBI. TBIs are generally established within the tertiary educational system[1] where new product ideas are best generated from. They are frequently linked to core technology organisations as well, where these organisations provide internships, technology transfer and even purchase of innovative product ideas to develop into commercial industries. At the national level TBIs are formed to develop the Small and Medium Enterprise sector, where technology transfer and innovation are crucial for growth. They are also established as a fundamental part of larger science parks.

The TBI concept, which has its origins in the West, is now being imitated by emerging economies, to achieve high and substantial growth driven by high tech exports and technology advancement. For example, Malaysia, which emerged from being a resource based economy into a knowledge based economy, embarked on an extensive national incubation programme to promote technopreneurs. Likewise, TBI is a key tool used in the empowerment of rural women and regional development. The Spark Programme in China was such a pioneering attempt aimed at developing the rural economies by means of science and technology. Other examples include the Rural Technology Business Incubator at IIT Madras, The Tianjin Women's Incubator (TWBI) in China and the Tiruchirappalli Regional Engineering College – Science and Technology Entrepreneurs Park (TREC-STEP) in India. However, TBIs have had little presence in Sri Lanka till recent years. Nevertheless, with the growing need for export diversification into high value added products and to promote SMEs, this concept has been implemented in several tertiary education institutes in Sri Lanka with funding from international agencies. TBIs have been established in information technology, engineering, science and agriculture, but these TBIs are currently functioning at a minimal level.

The Electrical and Electronic Incubator at the University of Moratuwa

In 2011, a Memorandum of Understanding was signed between the University of Moratuwa (UOM) and the Ministry of Industry and Commerce (MIC) in a fresh attempt to establish an Electrical and Electronic Technology Incubator (EETI). This step was taken by the state with a view to promoting the electrical and electronic industry, through encouraging innovations and supporting entrepreneurship development. The EETI receives financial support from the MIC and provides integrated incubator support to its members drawing from existing resources within the university. Although, the EETI has generated a number of innovations to date, which possess immense potential to grow into high tech industries in the future, it is still at an incipient stage.

1 Tertiary Education Institutes include both Universities and Vocational Training Institutes

As a result, these innovators face numerous constraints, which need to be addressed in order to develop these innovations to the commercialization stage. Insufficient physical work space, limited financial assistance, lack of trusted vendors, specialized equipment and a professional mentor; and difficulties in doing business are some of the constraints faced. Nevertheless, in order to adopt a technopreneurial culture and support the SME sector it is necessary to develop the EETI to a more sophisticated level. Further, introducing this concept to other tertiary educational institutes, national science parks and less developed regions is necessary in order to promote techno savvy industrial development.

The Way Forward

Current government policies have laid a platform conducive for research and development, entrepreneurship and regional development. However, there has not been a concerted effort for developing these varying sectors through establishing TBIs, despite its suitability in local circumstances.

A TBI is a tool that can be used for both economic and social development of a country. It creates an enabling environment for technopreneurs and therefore is a key element of a 'Technology Enterprise Ecosystem'. Likewise the outreach to the rural SME sector, which forms the backbone of an economy, will contribute towards regional development by creating new employment opportunities, empowerment of women and uplifting living standards. The support these startup companies receive at the early stages of the business cycle places them on a solid platform, which ensures business success in later years. The infusion of technology helps improve productivity and the manufacturing processes of businesses.

Hence, it is pivotal to create a conducive environment for breeding TBIs. This can be achieved through collective collaboration of the state, international agencies and the private sector. The national policy thrust should aim at introducing this concept at the regional and grass root level. Developing TIG (Tertiary Education Institutes, Industry and Government) linkage, collaboration with international funding bodies, establishing a strong venture capital network, a sound legal framework, entrepreneur friendly tax policies, improving the ease of doing business, a robust science and technology policy, capacity building programmes for implementers and awareness programmes for the industry sector are some of the areas that need to be addressed in going forward.

The government took various measures to develop the gem and jewellery industry in Sri Lanka in 2012. The National Gem and Jewellery Authority (NGJA) provided modern machinery, tools and equipment for the small and medium scale jewellery manufacturers in the Gampaha and Galle Districts. The government has also taken steps to minimize environmental issues arising from gem mining by promoting environmental friendly mining techniques and acceptable trade standards. Accordingly, a new circular was issued for mechanized mining, while special gem mining projects were undertaken with the direct supervision of the NGJA as an exemplification for environmentally friendly mechanized mining. Meanwhile, steps have been taken to liberalise the clearance of gems at the Bandaranaike International Airport on the payment of US dollars 200 as service fee to Sri Lanka Customs at the Airport itself. This measure, which was introduced by the Budget 2012 is expected to enhance the supply of raw gem stones that are imported to cut and polish for re-export.

Industrial chambers have engaged in value added activities to create a conducive and favourable economic environment for local industrialists. The Ceylon National Chamber of Industries (CNCI) has established an internationally recognised mechanism to provide training in relation to food safety and certification to food processing companies and tourist restaurants. The CNCI signed a special Memorandum of Understanding with the Ministry of Tourism for this purpose. Sri Lanka Chamber of Small and Medium Industries (SLCSMI) has partnered with a commercial bank to encourage their clientele to enroll with the chambers in order to enable them to obtain its services. Meanwhile, the SLCSMI initiated the establishment of regional offices throughout the country.

Cottage Industry

The cottage industry sub sector, which consists of small scale industries registered a growth of 4.6 per cent in 2012, as against the growth of 7.0 per cent in 2011. The Ministry of Traditional Industries and Small Enterprise Development carried out several initiatives to promote and improve cottage industries throughout the country. The Divi Neguma National Programme on Cottage Industry, Industrial Production Village Programme, Palmyrah/ Kithul Sector Development Programme and the Handicraft Sector Development Programme are some of those programmes that helped in creating and improving new small scale industries and self employment opportunities while supporting the growth in the sub sector. Some of these programmes are directed towards training the workforce in such industries and helping the producers to expand their markets by meeting potential buyers through exhibitions. Benefits of such initiatives are expected to bring better performance of the sector in future years. The demand from the growth in the construction sector for small scale building material production and the growth in the tourism sector for handicraft products also impacted positively towards the growth in this sub sector.

Electricity, Gas and Water

The electricity, gas and water sub sector expanded by 4.4 per cent compared to the growth of 9.2 per cent in 2011. Electricity, which consists of the largest share in the sub sector, faced a major setback due to the dry weather conditions that prevailed in reservoir areas that limited high value added hydro power generation particularly in the third quarter of the year. Hence, total hydro power generation registered a negative growth rate of 28.6 per cent. Thermal power generation, which is the high cost source of electricity increased significantly to offset the loss of hydropower generation and registered a growth of 22.9 per cent in 2012. However, heavy rainfall during the fourth quarter helped in increasing hydropower generation significantly and helped recover the value added in the sector. Consequently, the electricity sub sector grew by 4.3 per cent compared to previous year's growth of 9.6 per cent. Input costs including fuel and other costs grew during the year resulting in an increase in the intermediate cost of the electricity sub sector. The gas sub sector expanded by 5.1 per cent compared to the previous year's growth of 5.7 per cent. Liquid Petroleum (LP) gas distribution to both domestic and industrial consumption expanded during the year. The water sub sector expanded by 7.1 per cent in value added terms. This growth is reflected through the increase in the volume of water distributed by the National Water Supply and Drainage Board (NWSDB) by 7.7 per cent and the increase of consumer accounts of the NWSDB by 9.8 per cent in 2012.

Construction

Sustaining the high growth momentum recorded during the past year, the construction sub sector recorded an impressive growth of 21.6 per cent compared to 14.2 per cent in 2011. This is the highest growth registered by the sub sector in the past ten years. The sub sector contributed to 8.1 per cent of the overall GDP and 23.9 per cent of the change in GDP growth from 2011 to 2012 becoming the growth driving sub sector in the Industry sector. Compared to the share of 6.6 per cent and contribution to the change of 10.3 per cent in 2009, this indicates the improved performance of this sub sector after the ending of the war. Public sector construction projects, particularly in the areas of infrastructure development projects such as road development, power projects, port and airport development and housing development projects provided a substantial impetus to the growth in the sector. The private sector contributed towards the growth in the sub sector particularly with hotel and housing construction activities. The growth in the sub sector is reflected through the increase in imports of investment goods and building materials by 21.7 per cent and 13.5 per cent in volume terms in 2012. Furthermore, loans and advances by the commercial banks to the private sector for construction activities grew by 22.9 per cent in 2012, compared to 14.5 per cent in 2011. As per the price index compiled by the Institute of Construction Training and Development (ICTAD), the cost of construction activities had increased by 12.2 per cent during the year compared to the increase of 5.4 per cent in 2011.

Services

Growth in the Services sector, which is the largest sector of the economy, accounting for 58.5 per cent of GDP moderated to 4.6 per cent in 2012 from 8.6 per cent in 2011. The deceleration in this sector was largely due to the slowdown in external trade activities attributable to both external and domestic factors. Externally, the fragility in global economic conditions particularly from major export markets in Europe, limited the growth in the export trade sub sector. Domestically, the impact of policy measures implemented in early 2012 to stabilise the macro economy restricted imports of certain goods resulting in a slowdown in the import trade sub sector. Amid growth decelerating conditions, which had a disproportionate impact on the Services sector, domestic trade, transport and communications, banking, insurance and real estate and hotels and restaurants sub sectors recorded positive growth contributing to the expansion in the Services sector. Accordingly, the Services sector contributed 42.9 per cent of the change in overall GDP growth compared to 61.9 per cent in 2011.

Wholesale and Retail Trade

Growth in the wholesale and retail trade sub sector moderated to 3.7 per cent in 2012 from the 10.3 per cent growth recorded in the previous year. The deceleration in this sub sector significantly contributed to the slow down of overall economic growth in 2012, as it has the largest share in overall GDP. The deceleration was largely due to the significant slowdown of import and export trade activities, which recorded only marginal expansions during the year. The growth in the wholesale and retail trade sub sector was supported mainly by the growth in the domestic trade sub sector, on account of lower but positive growth in domestic demand during the year.

Value added growth in the import trade sub sector slowed down substantially in 2012 to 1.0 per cent compared to the expansion of 14.3 per cent in 2011. The need to reduce high trade deficit experienced in 2011 was addressed through an array of policy measures, which delivered the desired result by slowing down import demand in 2012. Consequent to these developments, the growth in the import trade sub sector slowed down considerably during 2012. Although overall price levels in international markets fell in US Dollar terms, these prices increased by 8.9 per cent in rupee terms during the year. The deceleration in the volume of imports can be seen in two import categories namely, consumer goods and intermediate goods; volumes of which fell by 11.0 per cent and 4.1 per cent, respectively. The drop in these imports was mainly due to the decline in domestic demand for consumer goods imports and the slow growth in the manufacturing sector, which caters to both domestic and foreign markets, exerting downward pressure on the demand for intermediate goods. However, investment goods imports recorded a growth of 21.7 per cent in volume terms as per CBSL trade indices. This expansion is supported by the growth in the construction sub sector and the tax concessions received by importers of machinery and equipment in the Budget of 2012 to encourage local industries.

The export trade sub sector recorded a marginal growth of 0.8 per cent in 2012 compared to the growth of 10.1 per cent recorded in 2011 in value added terms. This sharp deceleration was the result of weak global demand due to turbulent economic conditions in major export markets and the decline in commodity prices in the world market. As per CBSL trade indices, the volume of exports contracted by 0.4 per cent while the average price of exports (in US Dollar terms) also registered a contraction of 7.1 per cent compared to 2011. Amid the contraction of the price of agricultural commodities in US Dollar terms by 2.3 per cent in the world market, agricultural exports contracted by 5.6 per cent in volume terms, as per CBSL trade indices. This trend of contractions in both volume and price was seen in all major agricultural crops, namely, tea, rubber, coconut, vegetables and minor agricultural crops. Industrial exports expanded marginally by 1.4 per cent, while prices in US Dollar terms declined by 9.1 per cent, on average. Almost all major industrial export categories, including food, beverages and tobacco and textiles and garments, registered declines in volume terms. Mineral exports also declined by 3.0 per cent despite the significant increase in prices by 92.2 per cent.

The domestic trade sub sector, which represents the trade of domestically produced and traded goods grew by 6.8 per cent in 2012, compared to the growth of 7.5 per cent in 2011. Compared to the high growth recorded in previous years, expansion in this sub sector moderated in 2012. A combination of factors could have caused this moderation. High interest rates and the ceiling on private sector credit that curtailed domestic demand, affected domestic production and hence the supply of goods as reflected by the slowdown in the manufacturing sub sector. This would have dampened the expansion of the domestic trade sub sector. Further, the destruction of agricultural crops such as paddy during the Yala season due to unfavourable weather conditions also limited the expansion of the sub sector.

Hotels and Restaurants

The hotels and restaurants sub sector recorded a growth rate of 20.2 per cent in 2012 compared to 26.4 per cent in the previous year, maintaining the positive momentum realised as a result of the peace dividend. Further, the tourism sector passed the landmark of one million tourist arrivals in 2012 growing in line with the targets set for the sector. Earnings from tourism exceeded US Dollars 1 billion, the highest recorded in a calendar year, recording a growth of 25.1 per cent. The higher growth in tourist earnings compared to that of arrivals reflects the increase in average spending by tourists during 2012. However, guest nights and occupancy rates have both declined in graded hotels in 2012. This could be attributed to the rapid expansion in the hotel sector with an increase in unregistered hotels, guest houses and home stays, a concept promoted by the Sri Lanka Tourism Development Authority, attracting more local and foreign tourists. The industry is largely benefitted by rapid infrastructure development and transport facilities such as domestic rail and air transport, supporting efficient tourist mobilisation. Realisation of the benefits of new hotels established, and hotel refurbishments are also expected to boost the growth in the sub sector in future years.

Transport and Communication

Value addition in the transport and communication sub sector increased by 6.2 per cent in 2012, compared to 11 per cent growth rates recorded in the previous two years. Deceleration was visible in all three components of the transport and communication sub sector, namely transport, cargo handling, ports and civil aviation, and post and telecommunication.

The transport sub sector grew by 6.0 per cent as against 11.3 per cent in the previous year. The deceleration was mainly due to the slowdown in goods transport, which was associated with the moderation in domestic production of goods as reflected in the deceleration in the manufacturing sub sector and external trade. The growth in passenger transport was witnessed through the expansion in public transport services. The total number of passenger kilometres run by the Sri Lanka Transport Board and private bus operators increased by 8.1 per cent in 2012, with the expansion in the bus fleet during the year, supporting the growth in passenger transport services. The addition of new engines to the rolling stock of the Sri Lanka Railways in 2012 was instrumental in improving the passenger kilometres and freight ton kilometres operated by railway services, resulting in a growth of 4.9 per cent in the railway transport sub sector in 2012 compared to 2.8 per cent in 2011. Passenger kilometres flown by Sri Lankan Airlines and Mihin Lanka increased with the improvement in tourist arrivals during the year, contributing positively to the growth in the sub sector. Further, passenger kilometres flown by domestic airlines increased, indicating an improvement in internal air travel with the pent-up domestic demand for travel to the North also contributing to the growth in the sub sector. Meanwhile, the growth in the vehicle stock in terms of goods and public transport vehicles declined in 2012 according to new motor vehicle registrations contributing to the slow down in the transport sub sector.

Cargo handling, ports and civil aviation sub sector recorded a 5.7 per cent growth during 2012, compared to 7.2 per cent in 2011, as a result of the sluggish performance in external trade activities. The Port of Colombo including the South Asia Gateway Terminal (SAGT) handled annual container throughput of 4.19 million Twenty Foot Equivalent Units (TEUs) in 2012 recording a drop of 1.8 per cent. Transhipment volume (excluding re-stowing), which usually accounts for the largest share of the throughput, recorded a drop of 1.9 per cent, while domestic container throughput dropped by 2.5 per cent. Ship traffic declined by 4.6 per cent in 2012. Deceleration in this sub sector during the year was mainly due to the slowdown in external trade. However, the decline in activity was offset to some extent by the increase in profits of the Colombo Port during the year due to depreciation of the rupee. Meanwhile, air cargo volumes also expanded during the year exerting a positive impact on growth in the sub sector.

Post and telecommunication sub sector expanded by 7.9 per cent in 2012. In the telecommunication industry, both fixed access lines and mobile subscribers that grew exponentially in previous years, showed signs of slowdown. However, the number of internet and email subscribers still expands at a rapid pace. Based on current trends in the telecommunication sector, it is evident that voice services have reached saturation level. Nevertheless, the sector still has growth potential in terms of providing services such as broadband through the expansion of infrastructure with improved capacity, coverage and reliability. Improvements in state of the art communication services are instrumental in realising the targeted knowledge hub concept, as stable communications infrastructure is a key factor in providing knowledge-based services. Postal services recovered from the setback recorded in the previous year and registered a growth in terms of the volume of inland and foreign mail/parcels handled during the year.

Banking, Insurance and Real Estate

The banking, insurance and real estate sub sector expanded by 6.7 per cent compared to 7.9 per cent in 2011. The monetary and fiscal measures employed proactively to stabilise the economy coupled with heightened global challenges primarily caused this deceleration in sectorial growth. The credit ceiling imposed on licensed banks during the year reduced the credit extended to the private sector to 17.6 per cent from 34.5 per cent in the previous year, restraining the growth momentum. Further, the recorded growth in 2012 was achieved amidst the upward revisions in policy interest rates in February and April, which stimulated the rising trend in funding costs fuelled by the low level of money market liquidity. However, the overall banking sector grew in a substantial manner in terms of income levels and profits in 2012. Moreover, during the year several commercial banks successfully concluded low cost offshore credit facilities broadening their funding portfolio. The insurance sub sector recorded favourable growth during the year, amidst a challenging environment which was supported by a significant increase in profit levels. Nevertheless, the licensed finance and specialised leasing establishments were mostly affected by the increase in finance and other operating expenses coupled with the steep decline in vehicle imports curtailing their core business. However, during the year several specialised leasing firms successfully migrated to licensed finance company status, providing the avenue for public deposit mobilisation, which is comparatively low cost and would quantify in future years. The growth in the sub sector is positively catalysed by the rapid expansion of the branch network and other services outlets covering many financially untapped areas of the country.

Government Services

The government services sub sector recorded a growth of 1.4 per cent compared to 1.2 per cent in 2011. Total public sector employment increased by 1.2 per cent in 2012 to 1.2 million indicating the increased value added contribution from the public sector.

Private Services

The private services sub sector expanded by 5.5 per cent in 2012 against 7.2 per cent growth in the previous year. The growth of the sub sector was constrained by the restrictions on private credit expansion and the high lending rates that prevailed throughout the year, which affected credit driven private sector investments. However, activities such as private education services and tourism allied private services recorded a substantial growth congruent with the high level of economic activities.

2.3 Expenditure

According to expenditure approach estimates consumption growth slowed down considerably during 2012 while spending on investment activities also grew at a lower rate than in 2011 in real terms. Hence the slowdown in the growth momentum during 2012 could be mainly attributed to dampened growth in consumption expenditure. This was reflected by the lower growth in domestic production in 2012 compared to 2011 and the decline in consumption goods imports. The slowdown of Gross Domestic Expenditure (GDE), which includes the total spending on consumption and investment activities in the economy, to 15.0 per cent from an expansion of 23.5 per cent in 2011. This was mainly on account of the stabilisation policy measures introduced in February and March 2012, which resulted in a considerable deceleration of imports as well as the slowdown in private sector credit growth. Further the sum of GDE and net exports of goods and services which is equivalent to the GDP of the country grew by 15.9 per cent in current market prices.

Consumption

Consumption expenditure continued to expand in 2012 but at a lower rate than in the previous year. This was consistent with overall economic growth as consumption expenditure accounts for the largest share of the economy within expenditure approach estimates. The deceleration in total consumption expenditure came from both the private sector and the public sector during the year. The lower growth in private sector spending could be attributed to relatively restrained consumer spending during the year. Meanwhile, imports of consumer goods contracted with the tight policy

Table 2.8 Aggregate Demand

Item	Current Market Prices (Rs.mn) 2010	2011 (a)	2012 (b)	Constant (2002) Prices (Rs.mn) 2010	2011 (a)	2012 (b)
A. Domestic Demand						
Consumption	4,524,188	5,536,095	6,295,894	2,145,036	2,422,786	2,556,181
(% Change)	14.0	22.4	13.7	7.6	12.9	5.5
Gross Domestic Capital Formation	1,545,500	1,960,179	2,322,732	768,341	827,480	882,311
(% Change)	30.8	26.8	18.5	14.5	7.7	6.6
Total Domestic Demand	**6,069,688**	**7,496,274**	**8,618,626**	**2,913,377**	**3,250,266**	**3,438,492**
(% Change)	**17.9**	**23.5**	**15.0**	**9.4**	**11.6**	**5.8**
B. External Demand						
Exports of Goods and Services	1,254,021	1,508,565	1,729,033	723,880	803,507	804,793
(% Change)	21.6	20.3	14.6	8.8	11.0	0.2
Imports of Goods and Services	1,719,605	2,460,830	2,765,283	991,714	1,190,057	1,196,008
(% Change)	27.8	43.1	12.4	12.6	20.0	0.5
Net External Demand	**-465,584**	**-952,265**	**-1,036,250**	**-267,835**	**-386,551**	**-391,215**
C. Total Demand	**5,604,104**	**6,544,009**	**7,582,376**	**2,645,542**	**2,863,715**	**3,047,277**
(% Change)	**15.9**	**16.8**	**15.9**	**8.0**	**8.2**	**6.4**

(a) Revised
(b) Provisional

Sources: Department of Census and Statistics
Central Bank of Sri Lanka

measures adopted which reduced demand for credit for consumption purposes from the private sector; the depreciation of the rupee which increased the cost of goods from foreign markets; and the higher tariff on some imported items which had a negative impact on the demand for those imports.

Private consumption expenditure (PCE) is divided into 12 sub sectors with the largest share being incurred on food, beverages and tobacco. As income levels increase the share of spending on essential items such as food decline gradually while consumption of non-food items increase. This trend was observed in 2012 with the food, beverages and tobacco item category accounting for 37.7 per cent of total PCE compared to the 40.4 per cent share recorded in 2011. The relatively stable price levels in this category according to the CCPI compared to the non-food category contributed towards the relatively low growth in this expenditure category. Meanwhile food and drink imports which account for 7 per cent of total imports declined due to lower domestic demand as well. Further, food production increased with domestic agricultural crops, livestock and fish production, indicating higher consumption of food items of local origin. Meanwhile spending on clothing and footwear declined during the year accounting for a share of 5.4 per cent of total PCE.

Spending on housing, water, electricity, gas and other fuels has increased by 14.7 per cent in 2012. The data for 2012 indicates an increase in the consumption of electricity, water and gas sales to the domestic sector. Meanwhile, the higher price for electricity and gas also contributed for the growth in this expenditure category. Consequently the share of this category within PCE was 12.4 per cent in 2012 which was marginally lower than in 2011.

Private consumption expenditure on both health and education grew in 2012. The growth in health expenditure slowed down to 3.7 per cent while spending on education recorded a higher growth of 26.1 per cent. The share of these expenditure categories for health and education were 1.6 per cent and 0.4 per cent respectively. These remained at a low level as in previous years, as a result of the high level of public sector participation in the provision of these services.

Transport expenditure grew considerably in 2012. This spending category which accounts for over one fifth of private consumption increased further to 23.5 per cent of total PCE**.** The increase in spending on this category stemmed from the upward revision of some public transportation fares

Table 2.9 Composition of Private Consumption Expenditure at Current Market Prices

Item	Share of Total PCE (%)			Rate of Change (%)	
	2010 (a)	2011 (a)	2012 (b)	11/10	12/11
1. Food, Beverages and Tobacco	39.6	40.4	37.7	27.7	7.7
2. Clothing and Footwear	6.0	5.5	5.4	16.1	13.3
3. Housing, Water, Electricity, Gas and other Fuels	11.2	12.5	12.4	39.0	14.7
4. Furnishings,Household Equipment and Routine Maintenance of the House	4.9	4.3	3.9	9.4	5.4
5. Health	2.0	1.8	1.6	9.6	3.7
6. Transport	21.2	21.1	23.5	24.4	28.8
7. Leisure, Entertainment and Culture	2.5	2.1	1.9	5.6	6.6
8. Education	0.3	0.3	0.4	22.2	26.1
9. Hotels, Cafes and Restaurants	1.3	1.3	1.7	20.3	50.5
10. Miscellaneous Goods and Services	4.8	4.1	3.9	6.0	10.2
11. Expenditure Abroad of Residents	9.3	9.3	11.1	26.1	37.2
12. Less: Expenditure of Non - Residents	3.2	2.7	3.5	7.4	48.9
Total Private Consumption Expenditure	**100.0**	**100.0**	**100.0**	**25.1**	**15.5**

(a) Revised
(b) Provisional

Source: Department of Census and Statistics

together with increased mobility. Meanwhile the upward revision of fuel prices contributed towards this expansion as well.

As income levels rose private spending on recreational activities, such as hotels, cafes and restaurants continued to grow at a high rate in 2012. This was seen in the increase in the share of this consumption category. The increase in mobility within the country in the post-war period contributed to the continued growth in this sector. Meanwhile spending on leisure, entertainment and culture increased although at a relatively low rate of 6.6 per cent. The increased spending by Sri Lankans' abroad by 37.2 per cent also contributed to the expansion in PCE during the year.

Government spending expanded during the year by 5.6 per cent. This growth was lower than the 10.9 per cent recorded in 2011. Consequently, government spending as a percentage of GDP declined to 13.5 per cent in 2012 from 14.8 per cent in 2011. The growth was a result of the increase in expenditure on salaries, interest payments and transfer payments. However, the efforts to curtail current expenditure coupled with the higher growth in overall GDP resulted in a decline in recurrent government expenditure as a percentage of GDP in 2012.

Investment

Investment expenditure, which is a major determinant of future growth prospects continued to expand in 2012 albeit at a lower rate than in 2011. The growth in investment (gross domestic capital formation) was mainly due to the expansion in the construction sector which was the key driver of economic activity in 2012. All types of construction activities, i.e., residential and non-residential, grew at a high pace in nominal terms during the year reflecting the positive sentiments about the economy. The policy measures introduced to curtail imports had a relatively low impact on the growth in investment of machinery and equipment. Total spending on investment was estimated at Rs. 2,323 billion which was 30.6 per cent of the GDP. Hence, although growth in investment in nominal terms slowed down in 2012, it continued to improve as a ratio of overall GDP.

Private sector investment accounts for over 75 per cent of total investments. Hence, the slowdown in private sector investment activities was the major reason for low growth in investment in nominal terms and the low growth in price levels of investment goods imports. The tight policy measures adopted, including high interest rates, the credit ceiling and import dampening policies

Table 2.10 Investment and Employment in Enterprises Registered Under Board of Investment of Sri Lanka (BOI) and Ministry of Industry and Commerce (MIC)

	No. of Projects		Envisaged and Actual Investment (Rs.million)						Employment (No.)	
	2011 (a)	2012 (b)	2011 (a)			2012 (b)			2011 (a)	2012 (b)
			Foreign	Local	Total	Foreign	Local	Total		
BOI (Under Act No. 4 of 1978)										
Projects Approved	183	251	280,172	148,351	428,524	453,934	223,037	676,971	49,462	53,056
Under Section 17 (c)	160	219	277,655	147,215	424,870	450,290	222,689	672,979	48,868	50,886
Under Section 16	23	32	2,517	1,136	3,654	3,644	348	3,992	594	2,170
Projects Contracted Under Section 17 (c)	164	160	238,489	133,573	372,062	273,008	131,941	404,948	44,701	37,314
Realised Investment Under Section 17 (d)	2,019	2,045	657,686	374,926	1,032,613	828,313	452,524	1,280,837	450,913	n.a
Commercial Operations (d)	2,693	2,492	267,556	3,988,236	4,255,792	264,875	3,995,598	4,260,473	399,310	367,347
Under Section 17 (c) (d)	1,887	1,784	245,717	3,976,886	4,222,603	245,126	3,985,230	4,230,356	361,347	334,330
Under Section 16 (d)	806	708	21,839	11,350	33,189	19,749	10,368	30,117	37,963	33,017
MIC										
Projects Registered (d)	2,006	2,048	-	-	150,268	-	-	153,303	299,902	303,762

(a) Revised
(b) Provisional
(c) Includes expanded projects
(d) Cumulative as at end of year

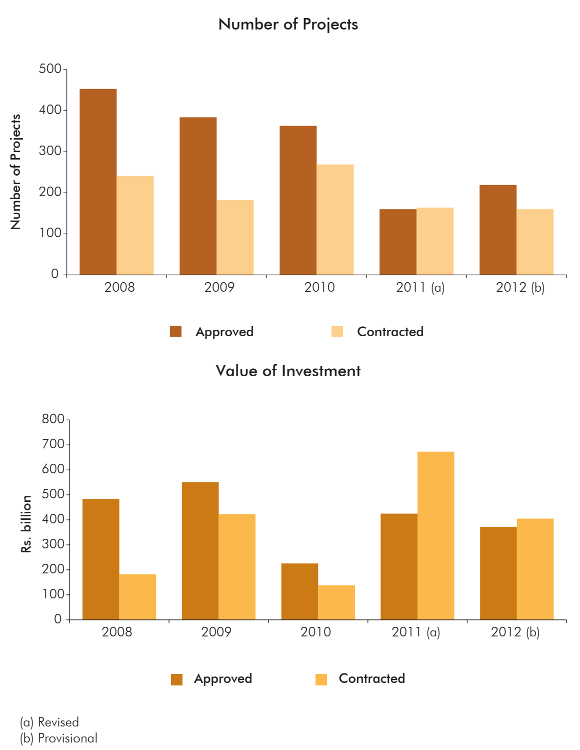
Sources: Board of Investment of Sri Lanka
Ministry of Industry and Commerce

contributed towards reducing investment activities. Continued investment by the private sector, which includes foreign investors, reflects the investor confidence in the economy. A high level of investment by the private sector was observed in hotels and telecommunications sectors.

Inflows of Foreign Direct Investment (FDI) in 2012 grew by 26 per cent to US dollars 1,338 million, with infrastructure related projects accounting for 45 per cent of the FDI inflows. Projects in relation to infrastructure development included those in telephone and telecommunication network development; development of port container terminals; fuel, gas and petroleum related projects; power generation, housing and property development, and construction of office complexes. FDI flows to the manufacturing sub sector, which accounted for nearly a quarter of the total FDI received, were mainly in textiles, wearing apparel and leather products; food, beverages and tobacco; rubber products; fabricated metal, and machinery and transport equipment. The services sector attracted FDI mainly to the insurance and hotels and restaurants sub-sectors.

Total investments in projects approved under Section 17 and Section 16 of the BOI Act in 2012 are estimated at Rs.677 billion, which is 58 per cent higher than that recorded for 2011. This increase was mainly due to local and foreign investments in the services sector. In the manufacturing sub sector, the number of projects which were approved under the food, beverages and tobacco more than doubled during 2012 when compared to 2011 with a large number of small scale project approvals. Likewise, an increased number of projects have been approved in

Chart 2.5 Investment in Approved and Contracted BOI Projects (Including Projects Expanded)



(a) Revised
(b) Provisional

non-metallic mineral products during 2012. Investments in projects contracted under Section 17 of the BOI Act increased by 8.8 per cent in 2012 and the total estimated investment value of these projects was Rs. 405 billion. In 2012, the realised investment in projects approved by the BOI was Rs. 248 billion. Meanwhile, 42 companies with an estimated investment of Rs. 3 billion were registered with the MIC during 2012.

The government's commitment to improving the capital stock of country was evident in continued growth in the public investment programme despite the challenges faced in the fiscal sector during the year. Public sector investment activities grew by 28.1 per cent accounting for 22.6 per cent of overall investment activities that took place during 2012. Public sector involvement in areas such as transport infrastructure developments including road network, airports and ports and power generation activities were some of the developments that were consistent with promoting the five hubs which have been identified as the key drivers of economic growth in the future.

Availability and Utilisation of Resources

The total amount of resources available in the economy, which includes domestic output and imports, grew at a lower rate of 14.9 per cent during 2012. Although both output and imports decelerated, the latter slowed down

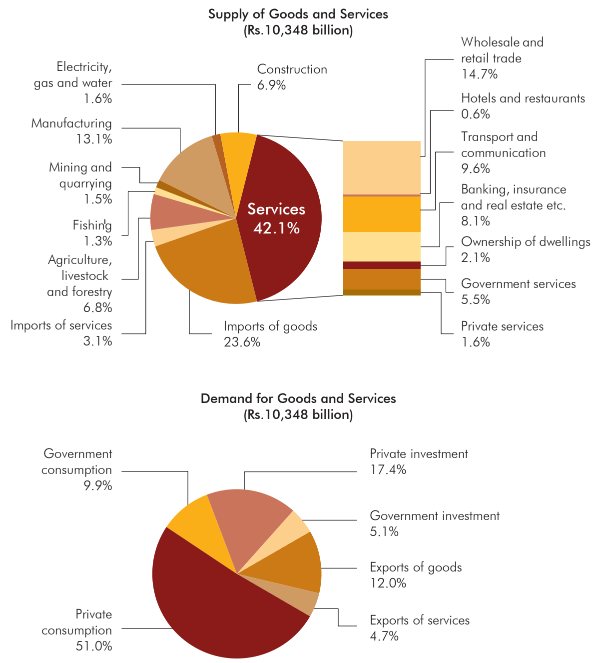
Table 2.11 Total Resources and Their Uses at Current Market Prices

Item	Percentage Share %		Percentage Growth %	
	2011 (a)	2012 (b)	2011 (a)	2012 (b)
A. Resources				
Gross Domestic Product	72.7	73.3	16.8	15.9
Imports of Goods and Services	27.3	26.7	43.1	12.4
Total	100.0	100.0	23.0	14.9
B. Utilisation				
Consumption	61.5	60.8	22.4	13.7
Gross Domestic Fixed Capital Formation	19.7	21.2	22.1	23.5
Private	15.6	16.4	24.3	20.9
Government	4.1	4.8	14.3	33.6
Changes in Stocks	2.1	1.3	100.7	-29.2
Export of Goods and Services	16.8	16.7	20.3	14.6
Total	100.0	100.0	23.0	14.9

(a) Revised
(b) Provisional

Sources: Department of Census and Statistics
Central Bank of Sri Lanka

Chart 2.6 The Economy in 2012 (at current prices)



at a considerably higher rate in 2012. Hence the slowdown in imports was the major contributor towards the lower expansion in resource availability in the domestic economy. As a result, the composition of resource availability grew in favour of domestic resources which accounted for 73.3 per cent of the total resources while the remainder was met by the external sector. In monetary terms total resources were estimated at Rs. 10,348 billion. The expansion in resources fell in real terms as well with a growth of 4.7 per cent when compared to 11.5 per cent in 2011.

The economy needs resources to meet its consumption, investment and export requirements. The composition of utilisation shifted in favour of investment with the share improving by about half a percentage point, while consumption fell accordingly. This indicates that the significant drop in imports had a higher impact on consumption than investment related spending during the year as well. Meanwhile, the share of exports of goods and services recorded a marginal decline in nominal terms during 2012. The decline

Table 2.12 Consumption, Investment and Savings at Current Market Prices

Item	Rs. million		% Change		As a per cent of GDP	
	2011 (a)	2012 (b)	2011 (a)	2012 (b)	2011 (a)	2012 (b)
1. Gross Domestic Product at Market Prices	6,544,009	7,582,376	16.8	15.9	100.0	100.0
2. Consumption Expenditure	5,536,095	6,295,894	22.4	13.7	84.6	83.0
Private	4,568,393	5,274,451	25.1	15.5	69.8	69.6
Government	967,702	1,021,443	10.9	5.6	14.8	13.5
3. Investment	1,960,179	2,322,732	26.8	18.5	30.0	30.6
Private	1,550,676	1,798,086	29.1	16.0	23.7	23.7
Government	409,503	524,646	18.8	28.1	6.3	6.9
4. Domestic Savings	1,007,914	1,286,482	-6.7	27.6	15.4	17.0
Private	1,079,770	1,392,887	-10.0	29.0	16.5	18.4
Government	-71,856	-106,405	40.0	-48.1	-1.1	-1.4
5. Domestic Savings - Investment Gap	-952,265	-1,036,250	-104.5	-8.8	-14.6	-13.7
6. Net Factor Income from Abroad	-72,041	-148,422	-3.2	-106.0	-1.1	-2.0
7. Net Private Current Transfers from Abroad	506,630	681,714	24.2	34.6	7.7	9.0
8. National Savings	1,442,503	1,819,774	1.7	26.2	22.0	24.0

(a) Revised
(b) Provisional

Sources: Department of Census and Statistics
Central Bank of Sri Lanka

in the share of exports was mainly due to the lower share of goods exports as services exports expanded during the year. The higher growth in service sector exports is a favourable development in terms of diversification of the export structure as well as transitioning towards higher value added exports.

Of the supply of resources, the share of the domestic sector increased due to higher contribution from the industry sector. The contribution of the agriculture sector declined in 2012 while the services sector remained unchanged**.** Domestic services constituted the largest share of 42.1 per cent while industrial sector output accounted for 23.1 per cent. In the context of imports of goods and services the share of goods declined by over one percentage point whilst the share of services imports grew.

Savings

The domestic savings ratio improved to 17.0 per cent recovering to some extent from the set-back experienced in 2011. The turnaround in domestic savings was a result of improved savings from the private sector, which increased by 29 per cent, as the dis-savings of the government sector deteriorated when compared to 2011. The worsening in government dis-savings was the result of the lower growth in government revenue during the year. Further the curtailment of foreign spending in terms of lower expansion in imports also reflects the improved position in terms of savings as a result of some of the policy measures introduced during the year.

National savings also improved with the favourable development in domestic savings. National savings increased to 24.0 per cent of GDP, an improvement of two percentage points from the previous year, recording a growth of 26.2 per cent during the year. The favourable developments in domestic savings were further supplemented by the growth in net private transfers boosted by the depreciation of the currency. Net private transfers grew by an impressive 34.6 per cent in rupee terms during 2012 predominantly with the higher inflow of foreign remittances. The higher deterioration in NFIA had a negative impact, on national savings, dampening its growth to some extent. Meanwhile the resource gap narrowed in 2012 to 6.6 per cent of GDP from 7.9 per cent of GDP in 2011. The continuing negative resource gap indicates the level of dependence on foreign financing to meet the investment needs of the country and highlights the importance of further improving national savings to facilitate higher investments which is required to sustain a high economic growth.