2

NATIONAL OUTPUT AND EXPENDITURE

2.1 Overview

The Sri Lankan economy sustained its growth momentum recording a real economic growth of 7.4 per cent during 2014, compared to 7.2 per cent in 2013. On the domestic front, the favourable macroeconomic conditions supported by relaxed monetary policy stance on par with low and stable inflation contributed towards sustaining the economic growth. On the external front, the recovery in United States, gradual recovery in Eurozone supported export growth. However, fall in global commodity prices encouraged imports which affected unfavourably on the growth in net external demand. As per the production approach estimates, economic growth was mainly driven by the growth in the Services sector followed by the healthy performance in the Industry sector, while the contribution of the Agriculture sector remained low consequent to negative impact of the unfavourable weather conditions. On the expenditure front, growth in both consumption and investment supported the increased domestic expenditure, while net external demand slowed down during the year, both in nominal and real terms. Expenditure on private consumption expanded, encouraged by low interest rates and the increase in disposable income, while expenditure on government consumption also grew with the increase in expenditure on salaries and wages, and purchases of other goods and services. The increase in investment expenditure was a combined outcome of the growth in both the government and the private sector investments mainly on account of construction activities. Accordingly, investment as a percentage of Gross Domestic Product (GDP) increased to 29.7 per cent in 2014. Meanwhile, both domestic and national savings increased to 21.1 per cent and 27.0 per cent of GDP, respectively. The continuous growth in private savings largely contributed to the growth in domestic savings, amidst the increase in government dis-savings. Significant growth in net current transfers on account of workers' remittances contributed to improving the national savings, while some improvement in Net Factor Income from Abroad (NFIA) also impacted positively on national savings during the year. Accordingly, resource gap, the difference between national savings and investment, narrowed to 2.7 per cent of GDP in 2014, thereby reducing the reliance on foreign financing sources.

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

Sector	Rate of Change (%)		Contribution to Change (%)		Share of GDP (%)	
	2013(a)	2014(b)	2013(a)	2014(b)	2013(a)	2014(b)
Agriculture	4.7	0.3	7.1	0.5	10.8	10.1
1. Agriculture, Livestock and Forestry	4.5	- 0.2	6.0	- 0.3	9.5	8.8
1.1 Tea	3.4	1.2	0.4	0.2	0.9	0.9
1.2 Rubber	- 9.1	- 32.3	- 0.3	- 0.8	0.2	0.1
1.3 Coconut	- 16.1	7.9	- 2.3	0.9	0.8	0.8
1.4 Minor Export Crops	8.5	- 15.0	0.4	- 0.8	0.4	0.3
1.5 Paddy	19.5	- 16.7	3.8	- 3.6	1.6	1.2
1.6 Livestock	6.3	3.1	0.7	0.3	0.8	0.8
1.7 Other Food Crops	4.3	7.0	2.2	3.4	3.6	3.6
1.8 Plantation Development	3.3	0.3	0.1	0.0	0.3	0.2
1.9 Firewood and Forestry	5.0	3.1	0.4	0.2	0.6	0.5
1.10 Other Agricultural Crops	7.6	- 2.5	0.4	- 0.1	0.4	0.3
2. Fishing	6.2	4.5	1.2	0.8	1.3	1.3
Industry	9.9	11.4	41.6	48.2	31.1	32.3
3. Mining and Quarrying	11.5	11.0	4.4	4.3	2.9	3.0
4. Manufacturing	7.5	8.0	17.6	18.6	17.1	17.2
4.1 Processing (Tea, Rubber and Coconut)	0.6	4.8	0.0	0.3	0.5	0.5
4.2 Factory Industry	7.9	8.5	16.9	17.9	15.6	15.8
4.3 Cottage Industry	5.1	2.5	0.7	0.3	1.0	1.0
5. Electricity, Gas and Water	10.3	4.5	3.4	1.5	2.4	2.4
5.1 Electricity	11.3	4.2	3.3	1.2	2.2	2.1
5.2 Gas	1.6	9.3	0.0	0.2	0.2	0.2
5.3 Water	3.8	5.1	0.1	0.1	0.1	0.1
6. Construction	14.4	20.2	16.1	23.8	8.7	9.7
Services	6.4	6.5	51.3	51.3	58.1	57.6
7. Wholesale and Retail Trade	5.5	8.0	17.4	24.5	22.7	22.8
7.1 Import Trade	2.9	9.4	3.2	9.9	7.8	7.9
7.2 Export Trade	6.7	4.6	3.6	2.4	3.9	3.8
7.3 Domestic Trade	6.9	8.1	10.6	12.2	11.0	11.1
8. Hotels and Restaurants	22.3	11.5	2.1	1.2	0.8	0.8
9. Transport and Communication	9.4	7.3	18.5	14.4	14.6	14.6
9.1 Transport	9.4	7.3	15.2	11.9	12.0	12.0
9.2 Cargo Handling-Ports and Civil Aviation	3.1	4.0	0.3	0.4	0.7	0.6
9.3 Post and Telecommunication	11.4	8.0	3.0	2.1	2.0	2.0
10. Banking, Insurance and Real Estate etc.	5.9	6.6	7.3	7.8	8.7	8.7
11. Ownership of Dwellings	2.9	1.3	1.0	0.4	2.4	2.3
12. Government Services	2.8	1.4	2.7	1.3	6.5	6.2
13. Private Services	7.3	5.4	2.3	1.7	2.3	2.3
Gross Domestic Product	7.2	7.4	100.0	100.0	100.0	100.0
Net Factor Income from Abroad	- 36.8	- 1.1				
Gross National Product	6.6	7.5				

(a) Revised
(b) Provisional

Source: Department of Census and Statistics

2.2 GDP, GDP per capita and Gross National Product (GNP)

GDP at current market prices was estimated at Rs. 9,785 billion (US dollars 75 billion) in 2014 compared to Rs. 8,674 billion (US dollars 67 billion) in 2013. Accordingly, GDP increased by 12.8 per cent during the year, a slight deceleration compared to 14.5 per cent growth registered in 2013. This was mainly due to deceleration in the overall price level of the economy, as measured by the GDP implicit deflator which declined to 5.1 per cent during the year from its 6.7 per cent growth in 2013, albeit the real economic growth held above the previous year's growth.

GDP per capita was estimated at Rs. 473,261 for 2014, compared to Rs. 423,484 in 2013. It recorded an 11.8 per cent growth which was a slight slowdown compared to 13.6 per cent growth in 2013, mainly attributable to the deceleration in

BOX 2 Upgrading the National Accounts Compilation Process in Sri Lanka[1]

National accounts of a country which are compiled based on internationally accepted guidelines assess the economic progress during a given period of time. At the same time, these statistics help generate series of macroeconomic indicators which describe developments of an economy. Sri Lankan National Accounts are currently compiled by the Department of Census and Statistics (DCS) in compliance with guidelines of the System of National Accounts (SNA) 1993 and 1968. However, with the theoretical advancements taking place during the recent past, National Accounts compilation process witnesses a substantial methodological improvement. Accordingly, the DCS has taken necessary measures in improving National Accounts compilation techniques in Sri Lanka on par with developments in the international context. In this exercise, the DCS will adhere to SNA 2008 guidelines, the most recent guidelines followed by many statistical bureaus in the world in compilation of national accounts statistics.

Major Changes Taking Place Related to National Accounts Compilation

In adhering to the SNA 2008 guidelines in upgrading the National Accounts compilation process, the DCS has already initiated an array of changes which are to be implemented from 2015 onwards. Some major changes that are taking place in this exercise related to compilation of Gross Domestic Product (GDP), one of the major macroeconomic indicators derived from National Accounts, can be summarised as follows.

- Revising the base year to 2010
- Broadening the coverage of GDP by capturing almost all the economic activities of the country in accordance with International Standard Industrial Classification Revision 4 (ISIC Rev.4)
- Presenting GDP under a new sectoral classification
- Estimating quarterly GDP under expenditure approach
- Publishing annual GDP under income approach simultaneous to production and expenditure approaches
- Estimating GDP under production approach using the concept of basic price

Revising the Base Year to 2010

The real GDP growth of a country is estimated using constant prices. Accordingly, price impact included in GDP estimated under current market prices is removed using the methods of revaluation, deflation or extrapolation as appropriate in calculating constant price GDP in each year commencing from a particular year at the prices of that particular year, which is known as the base year. For this purpose, it is very important to identify a suitable base year with less economic fluctuations since the prices of that year are considered as fixed in calculating constant price GDP commencing from that year. Further, SNA guidelines emphasise the need of changing the base year at least once in five years specially to capture the structural changes taking place in the economy such as changes in consumption patterns, appearance in new products and services etc. However, in Sri Lanka the base year for existing constant price GDP series is 2002. It is evident that the Sri Lankan economy experienced noticeable structural changes in the recent past; especially after the end of the internal conflict connecting Northern and Eastern provinces to the rest of the economy and creating a peaceful environment to broaden the economic activities, which urge the need of changing the base year. In accordance with these developments, necessary steps have already been taken to change the base year to 2010 in estimating real GDP with effect from 2015 while a series of constant price GDP under new base year will be available from 2010 onwards. Accordingly, percentage change in constant price GDP in each year, estimated based on new base year would reflect the real growth of the economy commencing from 2015.

Broadening the Coverage of GDP

One of the major criticisms against the current methodology of GDP compilation is that it does not adequately capture some economic activities which describe evolving changes and structural shifts of the economy. Under the new framework, economic activities such as household sector production as well as services such as art and entertainment, information technology and other information services, and scientific research and development etc.,

[1] The Central Bank of Sri Lanka acknowledges the information provided by the Department of Census and Statistics (DCS)

which are not adequately covered under the current system will be covered based on Sri Lanka Industrial Classification which is derived from the ISIC Rev.4. It is noteworthy that this could result in a considerable change in GDP in absolute terms. However, there are material changes taking place related to the methodology of estimating value added of some economic activities under the new framework. This might also impact the absolute value of GDP either to increase or decrease. Consequently, absolute value of GDP, which is generated as an overall outcome of these changes under the new methodology could be higher or lower than that of under the existing system. Further, any changes in absolute value of GDP might have an impact on some indicators which are expressed as a percentage of GDP. Hence, the relative indicators computed based on the GDP estimates derived under the new methodology can not be directly compared with such relative indicators which are computed under the existing system.

Presenting GDP in Three Approaches and under a New Sectoral Classification

GDP is currently estimated under three approaches namely Production, Expenditure and Income. It is presented under production approach on quarterly and yearly basis and under expenditure and income approaches on yearly basis. One of the remarkable changes taking place in presenting GDP under the production approach is that the economic activities which are related to the areas of Agriculture, Industry and Services are no longer considered as sectors of the economy. Under the new methodology, a new sectoral classification would be introduced following the international guidelines. Thus, it is not the economic activities that are considered as sectors, but the economic stakeholders who engaged in such economic activities are being categorized into five sectors namely, 'Financial Sector', 'Non-financial Sector', 'General Government Sector', 'Household Sector' and 'Non Profit Institutes Serving Household'. GDP would be estimated for each economic activity under each of these sectors. Further, an 'External Sector' also would be included where necessary in order to make relevant adjustments related to international transactions. This would enable to quantify the relative importance of each sector and the contribution of each sector to the economy. Hence, analysis of national accounts could be made in a different angle. Further, this sector classification would permit for international comparisons and analysis with the countries that follow a similar kind of sectoral classification.

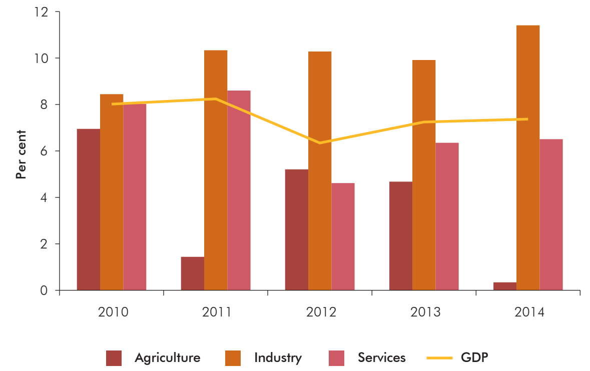
Under the new framework, it is expected to publish GDP data in income approach as well, parallel to production and expenditure approaches. Accordingly, income generated under the income items of Compensation of Employees, Gross Operating Surplus, Mixed Income, Consumption of Fixed Capital and Other Taxes less Subsidies on Production would be estimated and adjusted to taxes and subsidies on products in order to estimate GDP under the income approach. Compensation of Employees includes salaries and wages payed for workers by companies/institutions of the economy while Operating Surplus is the income generated from factors of production other than labour. Mixed Income is generated only for household sector engaged in production activities by utilising household labour. Consumption of Fixed Capital is the income generated for fixed assets which are used in the production process. The income generated by the government during the production process by means of license fee, fixed charges etc. excluding the taxes on products are considered as Other Taxes on Production while subsidies granted during the production process are considered as Subsidies on Production. Income generated under each of these items will be estimated under each of the sectors described in the sector classification.

Quarterly estimates of GDP in expenditure approach, in addition to annual basis, would also be available from 2015 onwards under the new framework. Consequently, expenditure would mainly be estimated under two items namely Final Consumption Expenditure and Gross Capital Formation while expenditure on imports and exports would be adjusted to derive GDP in expenditure approach.

Estimating GDP under Production Approach Using the Concept of Basic Price

Value addition of each economic activity under the new methodology would be estimated based on basic prices. According to the SNA 2008, basic price exclude any taxes on products the producer receives from the purchaser and passes on to government, but include any subsidies the producer receives from the government and uses to lower the prices charged to purchasers. Accordingly, GDP at market prices is obtained by adjusting the total value added of an economy by adding taxes on products and deducting subsidies.

Chart 2.1 Annual Growth Rate



the GDP implicit deflator. Meanwhile, per capita GDP in US dollar terms also increased to US dollars 3,625 in 2014, from US dollars 3,280 in 2013 moving forward the country within the middle income per capita trajectory.

GNP, which is derived by adjusting GDP for NFIA, grew by 13.0 per cent in nominal terms during 2014 compared to the growth of 13.8 per cent in 2013. As in the previous years, the NFIA remained negative due to factor income paid exceeded the factor income received. However, the higher growth in GNP compared to GDP was attributable to the significant deceleration in the negative growth of NFIA during the year. Accordingly, NFIA declined only by 6.2 per cent in 2014 compared to the significant drop of 46.0 per cent recorded in 2013. This was due to the comparatively higher growth in factor income receipts, both compensation of employees and investment income, than the factor income payments during the year.

2.3 Sectoral Output, Policies, Institutional Support and Issues

Agriculture

The Agriculture sector slowed with a growth of 0.3 per cent in 2014 compared to 4.7 per cent in 2013 mainly due to adverse weather conditions prevailed during the year. As a result, the share of the Agriculture sector decreased to 10.1 per cent of GDP in 2014 from 10.8 per cent of GDP in 2013. The paddy and rubber sub sectors contracted drastically, while the tea sub sector slowed marginally compared to the previous year. Favourable expansions in sub sectors of other food crops, coconut and fishing contributed positively towards the growth in the Agriculture sector while both minor export crops and other agricultural crops sub sectors contracted during the year. The decline in paddy sub sector was the combined outcome of the decline in production in both the Yala and Maha seasons. Tea sub sector was also moderated due to unfavorable weather conditions which prevailed during the year and the decline in demand from some of the major export destinations. The growth in the other food crops sub sector was mainly attributable to the positive growth in highland crops and vegetables. This was supported by the farmers shifting to supplementary crops due to limited supply of water during the first half of the year. Moreover, the substantial recovery in the coconut sub sector also restrained the negative impact of the other sectors within the Agriculture sector. In the meantime, the sub sectors of livestock, plantation development, and firewood and forestry also contributed positively to the growth in the Agriculture sector.

Paddy

The paddy production in 2014 declined by around 27 per cent to 3.38 million metric tons due to drought weather conditions which resulted in a decrease in the quantum of rice produced during the year. Paddy production in 2014 was lower due to a significant decline in the extent cultivated and low yields arose from adverse weather conditions that prevailed in both the Yala and Maha seasons. The lower paddy yield in 2014 at 4,264 kg per hectare in comparison to 4,329 kg per hectare in 2013, and the reduced net extent harvested at 792,947 hectares in comparison to 1,067,338 hectares in the previous year, contributed to the reduction in paddy production in 2014. The Yala season was the most affected with a decline of 35.5 per cent in paddy production, while the Maha season reported a decline of 21.4 per cent. Consequently, the production of rice in 2014 was estimated at around 2.1 million metric tons, a decline of 27.1 per cent from the estimated production of 2.9 million metric tons for 2013. Rice production in 2014 was sufficient to meet only 11 months of the domestic consumption. Meanwhile, the government encouraged farmers to cultivate other crops, which require less water in paddy lands, in order to economise the usage of water in depleted reservoirs during the Yala season.

The shortage in the supply of paddy in 2014 caused an increase in retail rice prices and the government took measures to stabilise rice prices while augmenting the supply with imported rice. Paddy prices in the open market in 2014 remained higher than the guaranteed price of paddy specified by the government for purchases made under the Paddy Purchasing Scheme. In line with the increase in paddy prices, the average retail prices of Samba and Nadu, the most used varieties, increased in 2014 by 16.3 per cent and 27.2 per cent, respectively. Consequently, the government initiated several measures to restrain the increase in rice prices including the reduction of tariff on rice imports and the maintenance of a buffer stock of rice under the Department of Food Commissioner. Accordingly, the effective rate of tariff on imported varieties of rice was reduced from Rs. 25 per kg to Rs. 1 per kg in 2014 and as a result total rice imports increased to 600,000 metric tons during 2014 in comparison to 23,000 metric tons imported during 2013. Imports of rice supplemented the domestic supply of rice available for household consumption and industrial use.

Chart 2.2 Rice : Supply and Demand

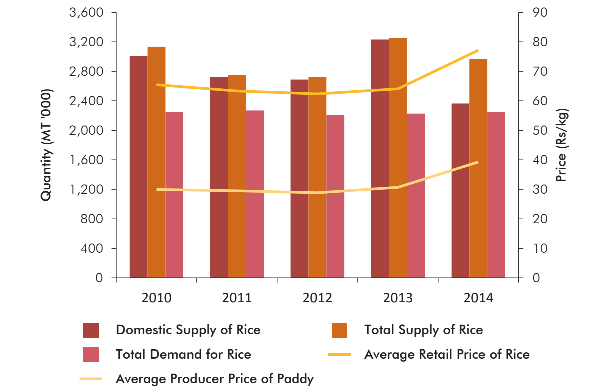


Table 2.2 Paddy Sector Statistics

Item	Unit	2013 (a) Maha	2013 (a) Yala	2013 (a) Total	2014 (b) Maha	2014 (b) Yala	2014 (b) Total
Gross Extent Sown	hectares '000	780	448	1,227	651	313	964
Gross Extent Harvested	hectares '000	742	447	1,188	580	301	881
Net Extent Harvested	hectares '000	665	403	1,067	521	272	793
Production	mt '000	2,846	1,774	4,621	2,236	1,145	3,381
	bushels '000	136,393	85,042	221,435	107,155	54,872	162,027
Yield (c)	kg/ hectare	4,281	4,408	4,329	4,222	4,204	4,264
Credit Granted	Rs.mn	3,444	1,880	5,324	3,122	1,414	4,537
Rice Imports	mt '000	-	-	23	-	-	600
Paddy Equivalent of Imports	mt '000	-	-	33	-	-	858

(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

Tea

The tea industry performed well in 2014 backed by high tea prices and a near record level of volume of production. Tea production in 2014 at 338 million kg was only marginally lower than the historically highest volume of 340 million kg recorded in 2013 in the history of the tea industry. The low grown tea production volume, which accounts for 62.1 per cent of the total production, increased by 0.8 per cent to 210 million kg in 2014, while the production of high and medium grown tea dropped by 0.4 per cent and 6.4 per cent to 78.9 million kg and 49.2 million kg, respectively. The large volume of tea production recorded in 2014 was despite the vagaries of weather which impacted the manufacture of tea. Tea production at all elevations declined during the first quarter of the year due to drought conditions. Medium grown tea, however, showed a significant decrease in production during the third quarter vis-a-vis the corresponding period of the previous year, although this shortfall was more than compensated with a significant increase in high and low grown tea volumes in the third quarter. Smallholders' share in the national tea production, which is largely derived from tea holdings in low grown elevations, increased to 73.2 per cent in 2014 from 72.1 per cent in 2013 aided by relatively high green leaf prices.

Tea prices at the Colombo Tea Auction (CTA) remained buoyant in 2014 except during the last quarter of the year. The relatively high tea prices that prevailed in the first nine months of the year were mainly due to global supply shortages of orthodox black tea in the first quarter and the improved export demand in the second quarter. The average tea price in 2014 increased to Rs. 461.86 per kg from Rs. 444.42 per kg in 2013. The Free on Board (FOB) average price per kg at Rs. 649.44 also increased by 4.1 per cent from Rs. 623.91 in 2013. The highest increase in tea prices at CTA was reported on low grown tea (3.2 per cent), followed by high grown tea (3.0 per cent). However, the average price of medium grown tea showed a marginal decline of 2.4 per cent. The average price received by tea smallholders for green leaf increased to Rs. 68 per kg in 2014 from Rs. 65 per kg in 2013. Meanwhile, tea prices started to decline from August 2014 as demand from Russia and the Middle East slowed down amidst geopolitical tensions and the slowdown in the Russian economy arising from the imposition of sanctions and the significant decline in international petroleum prices.

Rubber

Rubber production declined for the third consecutive year owing to unfavourable weather conditions and weak international prices. Rubber production dropped by 24.4 per cent to 98,573 metric tons in 2014 from 130,420 metric tons in 2013. The decline in rubber production was largely due to continued dry weather conditions during the first half of the year and the heavy rains in the third quarter, which disrupted latex tapping. The production of sheet rubber, which accounts for nearly 50 per cent of the total production, declined significantly by 22.7 per cent to 48,539 metric tons, while the production of latex crepe accounting for 12.0 per cent of total rubber production, reduced by 23.0 per cent to 11,832 metric tons in 2014. The production shortfall and lower prices in the international market led domestic rubber product manufacturers to rely on imported rubber. Import of rubber increased to 29,220 metric tons in 2014 from 11,150 metric tons in 2013. Furthermore, rubber smallholders affected by the decline in rubber prices slowed tapping operations resulting in the reduction of smallholders share in total rubber production.

Global natural rubber prices showed a steep decline in 2014 reflecting the slowdown in global demand and large stockpiles accumulated in major consuming countries. The average price of natural rubber per metric ton in the global market declined by 30 per cent to US dollars 1,956 in 2014 from US dollars 2,795 recorded in 2013.

Natural rubber production in Asia, which caters to arounds 95 per cent of the world demand for natural rubber, is estimated to have fallen by around 3 per cent to 10.8 million metric tons in 2014, while stockpiles in China and Japan have increased. Meanwhile, weakening crude oil prices prompted the demand for synthetic rubber placing further downward pressure on natural rubber prices. Decline in natural rubber prices caused smallholders in major producing countries to switch over to other crops or shifting to other agriculture activities leading to a reduction in production. Reflecting international developments, rubber prices at the Colombo Rubber Auction also declined to lowest levels in 2014 continuing the decreasing trend witnessed during the recent years. The highest decline of 24.1 per cent was seen in ribbed smoked sheet 1, while prices of latex crepe 1X and scrap crepe declined by 22.0 per cent and 22.4 per cent, respectively in 2014.

Coconut

The coconut industry recovered its growth spurt in 2014 reaping the benefit of high rainfall experienced in major coconut growing areas in 2013. Coconut production increased by 14.2 per cent to 2,870 million nuts in 2014 supported by the lagged effect of favourable weather conditions experienced during the previous year for coconut production. The production of desiccated coconut in 2014 increased significantly by 72.5 per cent to 50,367 metric tons in comparison to 29,198 metric tons in 2013. Meanwhile, the production of coconut cream, coconut milk powder and coconut milk grew by 24.8 per cent to 24,708 metric tons in 2014 reflecting the high export demand for these commodities. However, nuts available for coconut oil production declined by 8.9 per cent to 318 million nuts in 2014 largely due to increased demand for coconut from other industries such as desiccated coconut manufacturing. Meanwhile, imports of palm oil, a close substitute for coconut oil, increased by 57.8 per cent to 141,993 metric tons in 2014 supported by the reduced quantum of domestic coconut oil production and the decline in global palm oil prices. During the year, a number of coconut oil mills were modernised and new mills were established to produce virgin coconut oil supported by high export demand. Exports of virgin coconut oil in 2014 increased to 7,278 metric tons from 2,101 metric tons in 2013.

Table 2.3 Agriculture Production Index (2007-2010 =100) (a)

Item	2013 (b)	2014 (c)	Change (%) 2013/2014
Agriculture and Fishing	121.9	118.6	-2.7
1 Agriculture	115.2	109.8	-4.7
1.1 Agriculture Crops	112.9	106.3	-5.9
Tea	109.1	108.5	-0.6
Rubber	97.2	73.5	-24.4
Coconut	88.7	101.3	14.2
Paddy	123.6	90.4	-26.8
Other Crops	125.4	133.0	6.1
1.2 Livestock	132.1	136.5	3.4
2 Fishing	153.7	160.4	4.3

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

Coconut prices increased in 2014 reflecting higher demand from domestic manufacturers of coconut products and increased export demand amidst supply shortages in the world market. Higher demand for coconut resulted in an increase of average farm gate nut prices to Rs. 32 per nut in 2014 from Rs 31 per nut in 2013. Higher farm gate prices also led to a hike in the retail price of coconuts and an increase in the cost of production of desiccated coconut, coconut oil and other kernel based products. The average retail price of a coconut increased to Rs. 45.60 per nut in 2014 from Rs. 43.20 per nut in 2013, while the average price of coconut oil rose to Rs. 282 per liter in 2014 from Rs. 259 per liter in 2013. The average price of desiccated coconut increased to Rs. 297 per kg in 2014 from Rs. 239 per kg in 2013. Meanwhile, desiccated coconut exports in 2014 grew by around 73 per cent reflecting the increased global demand for desiccated coconut amidst supply shortages in the Philippines, the largest global supplier of desiccated coconut.

Minor Export Crops

Minor export crops fared badly due to drought conditions in major growing areas. The production of pepper, nutmeg, cloves, citronella, and arecanuts declined while cinnamon, cocoa, cardamom and betel production grew marginally.

Table 2.4 Trends in Principal Agricultural Crops

Category	Unit	2013(a)	2014(b)
1. Tea			
1.1 Production (c)	kg mn	340.0	338.0
1.2 Total Extent	hectares '000	222	222
1.3 Extent Bearing	hectares '000	184	185
1.4 Cost of Production (d)	Rs/kg	422.70	433.97
1.5 Average Price			
- Colombo Auction	Rs/kg	444.42	461.86
- Export (f.o.b.)	Rs/kg	623.91	649.44
1.6 Replanting	hectares	1,591	1,195
1.7 New Planting	hectares	263	401
1.8 Value added as % of GDP (e)		0.9	0.9
2. Rubber			
2.1 Production	kg mn	130.4	98.6
2.2 Total extent (f)	hectares '000	134	134
2.3 Area under tapping (f)	hectares '000	105	111
2.4 Cost of Production	Rs/kg	150.00	160.00
2.5 Average Price			
- Colombo Auction (RSS 1)	Rs/kg	376.78	285.76
- Export (f.o.b)	Rs/kg	389.91	362.96
2.6 Replanting (g)	hectares	2,024	1,475
2.7 New planting (g)	hectares	2,979	1,304
2.8 Value added as % of GDP (e)		0.2	0.1
3. Coconut			
3.1 Production	nuts mn	2,513	2,870
3.2 Total Extent	hectares '000	392	418
3.3 Cost of Production	Rs/nut	13.58	13.67
3.4 Average Price			
- Producer price	Rs/nut	29.59	31.51
- Export (f.o.b.) (h)	Rs/nut	29.36	38.91
3.5 Replanting / Under Planting (i)	hectares	4,541	5,796
3.6 New Planting (j)	hectares	23,668	30,771
3.7 Value added as % of GDP (e)		0.8	0.8

(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 the data compiled by 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 Coconut Cultivation Board (CCB)
(j) The extent newly planted is calculated based on the amount of coconut seedlings distributed by CCB at a conversion rate of 158 seedlings for One hectare

Sources: Sri Lanka Tea Board
Tea Small Holding Development Authority
Minister of Plantation Industries
Department of Census and Statistics
Rubber Development Department
Coconut Cultivation Board
Coconut Development Authority
Plantations Companies
Sri Lanka Customs
Central Bank of Sri Lanka

The reduced pepper harvest, which was severely affected by the continuous drought during the flowering and fruiting seasons, affected exports of pepper, while pepper prices increased reflecting the high demand during the year. Meanwhile, the decline in clove production was mainly due to the cyclical harvesting patterns which produces a bumper harvest every other year. The prices of cloves also remained relatively high in the year. However, the cashew production grew significantly during the year supported by the expanded extent in recent years. The demand for arecanuts substantially increased mainly due to higher export demand, particularly from India, which resulted in an increase in arecanut prices during the year. Meanwhile, the production of coffee remained unchanged during the year.

Other Field Crops

The production of other field crops increased in 2014 driven by remunerative prices and government policies aimed at enhancing the domestic supply of such commodities. The production of other field crops at 1,035,012 metric tons grew by 7.2 per cent due to the combined result of a 11.4 per cent increase in production during the 2013/14 Maha season and a growth of 0.6 per cent in the 2014 Yala season. In an effort to conserve the limited quantity of water available for cultivation, farmers utilised their paddy lands for the cultivation of other field crops. The remunerative prices fetched for these crops supported by the high Special Commodity Levy (SCL) imposed on imports of such commodities also helped to increase local production. Consequently, the production of maize, kurakkan, black gram, gingerly, manioc, red onions, big onions and mustard increased although crops such as sorghum, soya beans, ground nuts and sweet potatoes showed a decline in production. Moreover, the government continued to encourage local production of these crops to reach self sufficiency levels. Accordingly, maize, ground nuts, gingerly and cowpea production exceeded the estimated domestic requirement in 2014. The big onion production increased by 45.3 per cent to 101,166 metric tons in 2014 aided by government policies aimed at expanding the cultivation of big onion to several areas in the country through measures such as the provision of seeds at concessionary prices and improved extension programmes. Consequently, the import of big onion declined by 10.9 per cent to 150,530 metric tons in 2014 from 168,900 metric tons in 2013.

Vegetables

Vegetable production increased by 7 per cent to 1,279,155 metric tons in 2014. The growth of vegetable production in 2014 was supported by 7.9 per cent increase in production during the 2013/14 Maha season and a 6.1 per cent growth during the 2014 Yala season. Vegetable prices decreased significantly with the improved supply during the Maha harvesting period commencing January to April 2014. However, the supply of vegetables decreased considerably from mid April 2014 as the inter-seasonal cultivation of vegetables in March (after harvesting paddy) was not carried out in many areas due to the shortage of water and the delay in the Yala cultivation due to drought conditions. The reduction in supply of vegetables led to a substantial increase in prices from May to mid July 2014. However, with the supply of the Yala harvest reaching the market, prices declined from mid July onwards. Meanwhile, the heavy rainfall and flood experienced towards the end of the year caused severe crop damages resulting in a sharp decline in the market supply of vegetables and increase in the prices of vegetables during the months of December 2014 and January 2015.

Sugar

Domestic sugar production slowed down during the period under reviewed with the reduction in sugar production at Palewatta sugar factory. As a result, total sugar production declined by 1.4 per cent to 52,342 metric tons in 2014. Sugar manufacture took place in three factories (Palewatta, Sevanagala and Gal Oya) while the Kantale factory, which was not in operation in 2014, continued with sugar cane cultivation with an intention to recommence operations in the near future. The production at Gal Oya factory (earlier Hingurana factory) increased by 90 per cent to 19,961 metric tons as sugar cane supplies of private growers improved supported by an increase in extent cultivated and the use of high yielding varieties. A high price of Rs. 4,000 – 4,200 per metric ton of sugar cane was offered by sugar factories in order to encourage farmers to grow sugar cane for the domestic sugar industry. However, production at the Pelwatta factory, which is based on rainfed cane supply, declined by 36.7 per cent to 17,964 metric tons mainly due to drought conditions that prevailed during the year. Meanwhile, production at the Sevenagala factory was marginally higher at 14,417 metric tons in comparison to 14,190 metric tons in 2013. Although sugar production declined marginally during the year, domestic sugar manufacturers in 2014 were able to meet 9.2 per cent of the sugar demand in the country in comparison to 8.8 per cent in 2013.

Fisheries

The fisheries sector expanded moderately in 2014. Fish production in 2014 increased by 4.3 per cent to 535,050 metric tons supported by an increase in marine fish production by 3.0 per cent and an increase in inland fisheries by 13.2 per cent. In marine fish production, the

Table 2.5 Fish Production

Metric Tons '000

Sub-Sector	2013 (a)	2014 (b)
Marine (c)	446	459
Aquaculture and Inland Fisheries	67	76
Total	513	535

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

Source: Ministry of Home Affairs & Fisheries offshore sector grew by 1.4 per cent and while coastal fish production, which also includes lagoon fisheries, grew by 4.1 per cent. The lower than expected growth in offshore fish production was largely attributable to weather conditions which reduced fishing activity in the seas. Consequently, the share of deep sea fish production in total marine fish production declined to 39 per cent in 2014 from 40 per cent in 2013. Therefore, the prices of large fish varieties remained high throughout the year in comparison to the last two years. However, small fish prices remained lower during the year reflecting the growth of coastal and lagoon fisheries. In the inland fishery sector, inland capture increased by around 25 per cent and shrimp farm production increased by 16.3 per cent, while aquaculture declined by 76.1 per cent. Inland fish production largely took place in the first half of the year as drought conditions affected inland fish production during the latter half. Meanwhile, the average daily production of canned fish increased by 16.9 per cent to about 14,200 fish cans per day from 12,150 fish cans per day in 2013 whilst imports of canned fish declined by 14.9 per cent to 18,591 metric tons in 2014 from 21,835 metric tons in 2013.

Livestock

Milk production grew by 1.1 per cent to 330 million litres in 2014. Cattle milk production increased by 2.9 per cent to 273 million litres whilst buffalo milk production declined by 6.0 per cent to 60 million litres. During the year, the growth in milk production was affected by drought conditions and the spread of the Foot and Mouth Disease (FMD). As a result, the number of milking cows decreased by 6.0 per cent to 384,280 of which buffalo milking cows declined significantly by 12.0 per cent to 90,460. However, favourable producer prices for raw milk, the shift of consumer demand in favour of domestic milk products and growing demand for raw milk from large milk collectors provided the impetus to continue the growth momentum of domestic milk production in line with the targets set under the National Livestock Sector Master Plan. Milk collection by large collectors grew by 0.8 per cent to 202 million litres. Meanwhile, milk production at NLDB also increased from 8.7 million litres in 2013 to 10 million litres in 2014 with increased contribution from imported high yielding cows. During the last two years, NLDB has imported 2,000 cows from Australia, which also supported to meet the industrial demand of raw milk.

Table 2.6 Livestock Sector Statistics

Sub-Sector	2013(a)	2014(b)
1. National Herd (No.) (mn)	1.6	1.4
Neat Cattle	1.2	1.1
Buffalo	0.4	0.3
2. National Milk Production (mn litres)	329.2	332.9
Cow Milk	265.2	272.7
Buffalo Milk	64.0	60.2
3. Milk Products (mn litres)	37.0	42.0
4. Producer Price - Cow Milk (Rs./litre)	59.9	58.7
5. National Egg Production (No) (mn)	1,636.8	1,741.4
6. National Poultry Meat Production (mt '000)	144.5	151.0

(a) Revised
(b) Provisional

Sources: Ministry of Social Services, Welfare and Livestock Development

The poultry sector continued to grow in 2014. Egg production increased by 6.4 per cent to 1,741 million in 2014 while chicken production also increased by 4.5 per cent to 150,980 metric tons. Increased supply of egg in the market resulted decrease in average retail prices per egg from Rs.14.06 in 2013 to Rs.12.80 in 2014. Meanwhile, increased chicken production was mainly driven by the increased contribution of large chicken manufacturers in the country encouraged by the measures introduced by the Government. Despite the increase in chicken production, chicken prices also increased in 2014 comparison to 2013 mainly due to increased cost of production arose from high feed prices prevailed in the year.

Forestry

The forest cover of Sri Lanka decreased during 2014. During 2014, 1,611 hectares were deforested for timber extraction and 904 hectares were reforested. The government intends to increase the forest cover of the country up to 35 per cent of the total land area by the year 2020. Accordingly, the Forest Department started a forest enhancement programme in 2014.

Agricultural Policies and Institutional Support

Sri Lanka Tea Board (SLTB), Tea Research Institute (TRI) and Tea Small Holdings Development Authority (TSHDA) continued regulatory and development activities for the development of the tea sector in 2014. Under the subsidy scheme of replanting and new planting, around 1,309 hectares were replanted/newly planted at a cost of Rs. 339 million during the year. Accordingly, a total of 6,239 hectares were replanted/newly planted under this scheme during the last five years which was equivalent to 3.4 per cent of the total tea bearing extent of the country. Further, 15 tea factories were modernised in 2014 under the factory modernisation subsidy scheme (FMSS) bringing the total number of tea factories modernised under this scheme up to 246 since 2007 of the total 713 tea factories operating in Sri Lanka. The modernisation process is expected to have improved labour productivity and Good Manufacturing Practices (GMP) thereby helping to maintain the quality of tea and increase the net sale average (NSA) prices of tea. Moreover, SLTB established a fund for "Tea Promotion and Marketing" in 2010 and the funds were raised through a special levy on tea exports. In 2014, around Rs.1,158 million was raised and Rs.800 million was utilised for global marketing campaign of Ceylon tea. The benefits of such promotional activities were reflected in the premium prices fetched for Ceylon tea and the increased export income. Further, SLTB successfully implemented a programme i.e. "Best Leaf 60" to maintain the immatured and undamaged tea leaf at 60 per cent of the total tea leaves bought by the factories with a view to improve the leaf standards. Further, measures were implemented to improve the leaf transportation systems, leaf collecting sheds and leaf collecting crates. Meanwhile, SLTB suspended the registration of tea factories which showed low net sales average (LNSA) due to non compliance of GMP standards while increasing the fine imposed under the Tea Control Act up to Rs. 500,000 from Rs. 50,000 for such factories. In addition, arrangements were made to distribute machinery and equipment among tea small holders through tea factories with a view to popularising mechanisation for tea plucking in tea small holdings and reducing the cost of production. In collaboration with the Sri Lanka Sustainable Energy Authority (SLSEA), TRI embarked on a project plan for 2012-2016 to further enhance energy efficiency in the tea sector.

The main strategies implemented in the rubber sector focused on improvement of productivity in existing rubber plantations and expansion of rubber cultivation to non traditional areas (Ampara, Vauniya and Mullaitivu). The subsidy scheme for rubber replanting (Rs. 175,000 per hectare) and new planting (Rs. 150,000 per hectare) continued during 2014. During the year, new planting in traditional and nontraditional areas were around 723 hectares and 582 hectares, respectively. Meanwhile, replanting in the smallholder rubber lands was carried out in 1,341 hectares. The extent replanted and new planted during the last five years totalled 15,734 hectares and 13,569 hectares respectively, which would help reach the rubber production targets over the medium term. Moreover, the Budget for 2015 and Interim Budget for 2015 proposed a guaranteed purchase price scheme for rubber small holders. Under this scheme, it was proposed to pay the difference between monthly average prices of RSS rubber in the Colombo

Rubber Auctions and the guaranteed purchase price (Rs. 350 per kg) for small holders. Accordingly, a sum of Rs.4 million was distributed among 2,000 beneficiaries under this scheme as at end January 2015.

Institutional support for the promotion of replantation, modernisation of coconut industries, activities on research and combating spread of diseases successfully continued during the year. The loan scheme of "Kapruka Nipaum Diriya" continued in 2014 providing financial assistance up to a maximum loan amount of Rs. 2 million at 6 per cent interest rate with a view to developing and modernising existing coconut industries and starting coconut based manufacturing industries. Accordingly, 61 new loans were disbursed during 2014 under this scheme. Meanwhile, the capital expenditure incurred by government institutions for the development of the coconut sector increased to Rs. 767 million in 2014 in comparison to Rs. 751 million in 2013. Further, the fresh coconut exports were banned in December 2014 due to a severe fresh coconut shortage in the domestic market towards the end of the year, though the taxes and levies on coconut product imports and exports remained broadly unchanged.

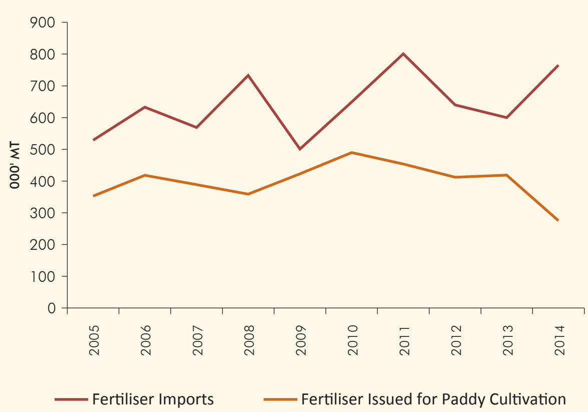
The projects under the Livestock Master Plan initiated by government institutions continued successfully in 2014. The national surveillance programme against Highly Pathogenic Avian Influenza (HPAI) was further strengthened, albeit no evidence of the virus HPAI (H5H7) was found in Sri Lanka in 2014. However, there was a severe outbreak of Foot and Mouth Disease (FMD) in the country significantly impacting cattle and buffalo milk production in 2014. Meanwhile, the NLDB signed an agreement with a foreign supplier to import 2,500 high yielding dairy cattle in 2015 in addition to the 2,000 hybrid cows already imported. MILCO implemented a programme to modernise its existing milk factories in order to enhance its production capacity to meet the increasing domestic demand for fresh milk. Accordingly, the production process of the MILCO factory in Polonnaruwa was modernised in 2014 and the modernisation of factories in Digana and Ambewela is expected to complete by end 2015. Meanwhile, the government had planned to relocate the Narahenpita milk factory in Badalgama in the Gampha district with state-of-the-art technology. With this modernisation, MILCO intends to increase its capacity to meet about 50 per cent of domestic dairy milk demand.

Medium term strategies for the fishery sector highlighted the necessity to increase fish production from deep sea fisheries and enhance fishing activity in the North and East. Towards this end, several measures were implemented during the year which included strengthening the national fishing fleet by adding 712 boats with outboard engines and 118 multiday boats and the granting of loans under the "Diyawara Diriya" scheme amounting to Rs. 281 million with an interest concession of Rs. 40 million. Further, a total of Rs. 3,000 million was allocated for construction and upgrading of fishery harbours and anchorages to facilitate deep sea fishing. A project to purchase 2 mother vessels to facilitate multiday fisheries was proposed at an estimated cost of around Rs. 326 million. As a result, the fishery industry is expected to benefit from increased duration of fishing operations in deep seas. Further, government initiated measures to establish a Vessel Monitoring System (VMS) immediately. For the successful implementation of this project, the cost for installation of necessary equipment in every multiday boat such as transponders is expected to be provided to fisherman through a loan scheme. In 2014, 35 multiday boats were equipped with transponders. Meanwhile, introduction of VMS would help strengthen the international standards and compliance applicable for deep sea fishing while eliminating illegal, unregulated and unreported fishing (IUU) operations by Sri Lankan flagged

BOX 3 Direct Cash Transfers as an Alternative Method to Disburse the Fertiliser Subsidy

For more than five decades, successive governments in Sri Lanka have subsidised the provision of fertiliser with the aims of increasing agricultural output and ensuring higher returns for farmers. The current fertiliser subsidy scheme, which provides a 50 kg bag of fertiliser for Rs. 350 was introduced in 2005 initially for paddy cultivation. This scheme was then extended to several other plantation crops in 2007, and finally, to cover all other crops in 2011 where fertiliser was given at Rs. 1,200 per 50 kg bag. Based on average international prices of fertiliser, the local market prices in 2014 would have been around Rs. 2,280, on average, if the subsidy was not provided. During the period 2005-2014, the government expenditure on the fertiliser subsidy has amounted to Rs. 238.3 billion. As a percentage of total government expenditure, the annual expenditure on the fertiliser subsidy has averaged about 2 per cent.

Chart B 3.1 Fertiliser Usage in Sri Lanka



Although the introduction of the fertiliser subsidy increased crop yields, several issues associated with the scheme have often been highlighted.

a) The existence of two methods of subsidies, one for the paddy sector and another for other crops, resulted in paddy farmers selling fertiliser at a higher price. This behavior of profit seeking by farmers may have resulted in lower utilisation of fertiliser in paddy sector than envisaged under the subsidy scheme.

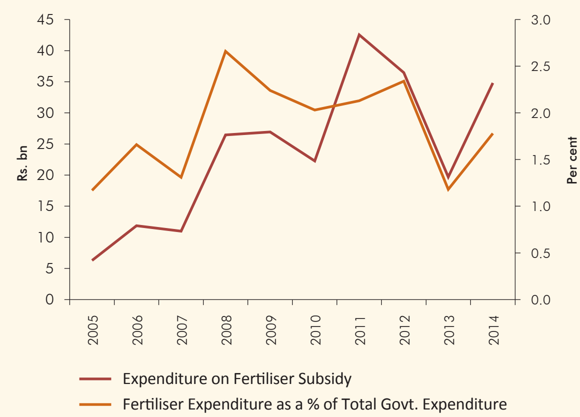
b) Limited storage and transport facilities, lack of funds and insufficient resources at Agrarian Services Centres affected the efficient distribution of fertiliser. Long delays in supplying fertiliser and under weighing of fertiliser bags added to the cost of farmers.

c) The delays in payments by the government to private importers/distributers of fertiliser occasionally resulted in shortages of fertiliser in the market during the cultivation season that affected timely application of fertiliser to reap the maximum harvest. The quality of fertiliser imports was also subject to criticism.

d) Providing fertiliser at subsidised rates also raised concerns of excessive usage of fertiliser in some sectors. Lack of proper supervisory and advisory services contributed to worsen the situation.

e) There have also been allegations that the officials involved in distribution were involved in rent seeking through corrupt practices, leading to leakages. This made the administration of the scheme more challenging, as, in addition to the cost of distribution and administration, the government had to maintain systems to monitor and control such leakages.

Chart B 3.2 Expenditure on Fertiliser Subsidy



With these shortcomings, along with the need to rationalise government expenditure in the process of fiscal consolidation, it is appropriate to review the existing fertiliser subsidy scheme with a view to improving its efficiency to optimise the expected social and economic benefits of the scheme.

In this regard, strategies used by other countries in the distribution of subsidies are worth considering. In some countries such as Brazil, India and Indonesia, a Direct Cash Transfer System (DCTS) is used as an alternative mechanism to disburse subsidies directly as cash/bank transfers to the ultimate beneficiaries instead of distributing subsidies in kind[1], in the forms of kerosene,

1 For instance, assume that a farmer uses six 50 kg bags of fertiliser, each of which is worth Rs. 1,800 but provided at Rs. 350 under the fertiliser subsidy scheme. Therefore, the total subsidy on fertiliser used by this farmer is Rs. 1,450 X 6 = Rs. 8,700. The same subsidy could be matched by a Direct Cash Transfer System where the farmer's bank account is credited Rs. 8,700. This would reduce administrative costs, leakages, market distortions while allowing the farmer to optimise fertiliser use.

rice, fertiliser, etc. This enables the goods that were earlier distributed at subsidised rates to be distributed at market determined prices, thus reducing market distortions. In January 2013, the government of India commenced implementing a Direct Benefit Transfer (DBT) scheme in selected districts covering seven subsidy programmes including fertiliser subsidy to disburse subsidies in the form of cash directly to bank accounts of targetted beneficiaries with a view to optimising the intended benefits through a market environment. Reasons for shifting away from the distribution of fertiliser in kind were cited as weaknesses such as dual pricing, unresponsiveness to customer needs, poor targeting of beneficiaries, overuse of fertiliser, distortions and leakages. Nevertheless, the success of this policy lies in the accuracy and efficiency in identification of targetted beneficiaries. Another issue faced by India in providing direct cash transfers to beneficiaries is that most households below the poverty line do not have bank accounts, while several villages do not even have a bank branch.

The advantages and limitations of having a DCTS-type arrangement to distribute fertiliser subsidy are described below:

Advantages: Under DCTS, the subsidy amount would be directly credited to the bank accounts of the beneficiaries, which ensures that the subsidy reaches the targeted beneficiaries. Once funds are transferred to the beneficiary, he/she is able to purchase the required amount of fertiliser at the market price. Since the subsidy is credit to the bank accounts of beneficiaries, the access of the farming community to financial services will increase, thus promoting financial inclusion that has multiple benefits. Further, DCTS would provide an incentive for farmers to use fertiliser more efficiently by preventing over-use, while also facilitating more efficient, cost effective, and timely distribution of fertiliser. As the market prices would no longer be distorted, farmers may also be encouraged to substitute inorganic fertiliser with organic fertiliser, which would result in a more balanced and efficient application of nutrients in agriculture. The cost of administration of the subsidy scheme borne by the government could be reduced as DCTS is relatively easy to administer, and leakages would be lower. Overall, DCTS would allow better targetting of subsidy payments while bringing in efficiency and transparency, contributing to the reduction in the fiscal deficit.

Limitations: The identification of beneficiaries is the most difficult task under DCTS, which highlights the need for a sound beneficiary identification survey. With any subsidy scheme, some intended beneficiaries may be excluded from such programmes, while some of those who are not eligible may benefit. Further, if banking infrastructure is limited and people have to travel long distances to access banking facilities, DCTS is unlikely to deliver expected benefits. As the level of financial literacy is low in rural areas, it is necessary to link all rural banks and rural post offices to a larger banking network while conducting programmes to enhance financial literacy among rural communities in order to make DCTS an efficient alternative for the existing fertiliser subsidy scheme. In addition, under DCTS, farmers would entirely depend on private sector suppliers, whose distribution networks in remote areas may be weak. Further, fluctuations in global market prices could cause high volatility in the price faced by the farmer, thus creating uncertainty. As timing of fertiliser use is time-sensitive, cash transfers must be made on time in order to make it fully effective. Above all, as farmers are not bound to spend the cash they receive under DCTS on fertiliser, this system could become counterproductive resulting in lower yields in agriculture.

In conclusion, the above discussion highlights the deficiencies in the current fertiliser subsidy scheme in Sri Lanka and analyses alternative methods of subsidy provision that are used in other countries. In particular, DCTS, and its advantages and limitations are considered. Replacing the current fertiliser subsidy scheme with an alternative such as DCTS would require due consultation of all stakeholders and, if adopted, must be implemented gradually in order to minimise any short term repercussions that may arise from such a shift. Better identification of beneficiaries, enhancing financial literacy and financial inclusion, improving agriculture extension services and developing an effective monitoring mechanism to minimise any misuse of direct transfers must be focused on in the interim.

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fleets operating in deep sea. The European Union (EU), which is the main market for Sri Lankan sea food exports, imposed a ban on Sri Lankan fish exports to the EU effective from January 2015 due to poor compliance of Sri Lankan fisherman to international standards and regulations. Therefore, the effective implementation of VMS in compliance with international regulations on deep sea fishing would be essential to secure markets for Sri Lankan sea fish exports in EU and other destinations.

Institutions under the Department of Agriculture carried out number of programmes to support domestic agricultural activities. Four new varieties of rice were released in 2014, while a new big onion variety with better adaptability and a higher yield was also released as MIBO 1 for local cultivation. Several new varieties of field crops are in the pipeline for release in 2015. The trails on National Coordinated Varietal Testing (NCVT) were conducted for six locally developed chilli hybrids. The NCVT trails and varietal adaptability trails were conducted to test the adaptability of two big onion lines. Meanwhile, special attention was given to increase the cultivated extent of other field crops with mid-season cultivation due to drought conditions experienced during 2014. Further, many programmes were conducted under the food security assurance special program and cultivation of cowpea, soya beans, black gram, peanut and gingerly was introduced in many nontraditional areas such as Hambanthota, Vavunia and Kilinochchi. The activities such as farmer training, seed certification and establishing sales outlets were continued. Institute of Post Harvest Technology (IPHT) continued with their project of popularising the value added products of supplementary field crops. Young Agro-Entrepreneur programme was carried out with the intention of attracting youth to the agriculture sector. Under this programme more than 800 young Agro-Entrepreneurs were identified and facilitated covering the entire island. The programme on establishing commercial scale farms continued in 2014 with 261 new farms earmarked to upgrade their capacities. Meanwhile, the programme on organic fertiliser promotion also continued during the year and organic farming projects were introduced in the Anuradhapura district with a special focus in areas where increased incidences of kidney diseases have been reported.

Several policy measures were proposed in the Interim Budget for 2015 under the Hundred Day Programme to boost the domestic agriculture economy. Under the government guaranteed paddy purchasing scheme, arrangements were made to increase the purchase price of samba to Rs. 50 per kg while nadu price to Rs. 45 per kg. Further, steps were undertaken to increase the producer price of both potatoes and tea leaves to Rs.80 per kg. Also, the guaranteed purchase price for RSS rubber was increased from Rs. 300 per kg to Rs. 350 per kg. Meanwhile, the producer price of fresh milk was increased by Rs. 10 per litre from the existing Rs. 60 per litre in order to promote milk production. While no changes were proposed on the existing fertiliser subsidy scheme, an emphasis was made with respect to upgrading the quality of fertiliser distributed under the scheme. Amongst other proposals, a 50 per cent waiver for the loans and advances extended to farmers by commercial banks, which stand past due at present, was proposed subject to a maximum loan amount of Rs.100,000.

Industry

The Industry sector recorded a significant growth of 11.4 per cent in 2014 compared to 9.9 per cent in 2013. This expansion was supported by the positive contribution from all major sub sectors, thereby increasing the Industry sector share to 32.3 per cent of GDP, from

31.1 per cent of GDP in the previous year. The construction sub sector grew significantly, contributing to the high growth in the Industry sector. Meanwhile, the manufacturing sub sector expanded benefitting from the growth in the factory industry sub sector. The mining and quarrying sub sector benefited from the expansion in construction activities. In the meantime, the electricity, gas and water sub sector decelerated compared to the previous year, primarily due to the decline in the high value added hydro based power generation.

Mining and Quarrying

The mining and quarrying sub sector expanded by 11.0 per cent in 2014 compared to 11.5 per cent in 2013. This sub sector comprises of activities related to gem mining and other mining. The other mining, which grew by 13.8 per cent in 2014 compared to 11.6 per cent in 2013 was the largest contributor to the growth in mining and quarrying representing 83.7 per cent share in the overall sub sector. Growth in this sub sector was supported by the increased demand for granite, sand, lime etc., due to expansion in construction activities. Further, expansion in the production of other minerals also contributed positively towards this growth. The production of graphite which comes under other mining expanded marginally in contrast to its contraction in 2013. Production of phosphate expanded further during the year catering to the increased demand from the fertiliser industry. Despite the contraction in the previous year, mineral sands production expanded at a higher rate, which was reflected by the significant increase in the mineral exports volume index. However, gem mining sub sector contracted by 1.6 per cent, which is also reflected by the contraction in gem exports volume during 2014.

Manufacturing

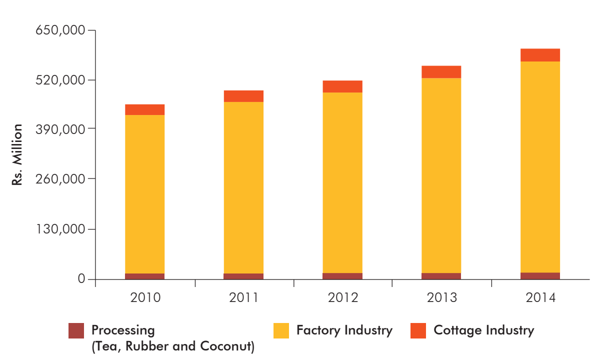
Processing

The processing sub sector, which covers the processing of tea, rubber and coconut grew by 4.8 per cent in 2014, compared to the marginal growth of 0.6 per cent during 2013. The growth in the sub sector was mainly benefited from the significant recovery in coconut production. This was also reflected by the surge in export of kernel products and other coconut exports in volume terms during the year. Tea exports volumes also grew at a higher rate compared to the previous year reflecting the growth in tea processing industry, amidst unfavourable developments in both supply and demand sides. Extreme weather conditions affected the production side, while the political and economic unrest in Russia and the Middle Eastern countries, affected the export demand. Rubber sub sector which suffered during the year also experienced similar developments where unfavourable weather conditions affected the production, while the decline in world prices for natural rubber caused increase in rubber imports thereby reducing the demand for local rubber.

Factory Industry

In terms of value addition, factory industry which accounts for around 16 per cent of Gross Domestic Product (GDP) recorded a substantial growth of 8.5 per cent in 2014 compared to 7.9 per cent in 2013. Improved performance of all categories of factory industry contributed to the overall growth. The growth of factory industry was largely facilitated by increased domestic and international demand and the favourable domestic

Chart 2.3 Value Added in Manufacturing Sector (2002 Constant Prices)



macro-economic environment which prevailed during the period. Export market oriented industries, such as textile, wearing apparel and leather products category as well as chemical, petroleum, coal, rubber and plastic products category recorded a substantial growth of 11.5 per cent and 8.5 per cent respectively in 2014. Benefiting from lower interest rate, low inflation and enhanced business and consumer confidence, the food, beverages and tobacco products category, the major contributor to domestic market oriented industries also showed notable performance and recorded a growth of 8.1 per cent in 2014.

Factory Industry Production Index

Factory industry output, the largest contributor to the manufacturing sub sector, continued to expand in 2014 with improved external and domestic demand alongside conducive domestic macroeconomic environment. The Factory Industry Production Index (FIPI[1]), an indicator used to measure the quantity of output in factory industry, recorded an overall growth of 6.3 per cent in 2014 with increased production in major sub sectors. Persistently low interest rate atmosphere supported by price stability stimulated domestic demand and boosted the factory industry output in 2014. Exports oriented industries such as wearing apparel and rubber products, continued to be the leading contributor to the growth in industry output. However, high value added industries, such as electrical, electronic and mineral products, remained to be explored to operate at full potential level. Hence, it is essential to implement appropriate policies to capitalise country's untapped potential to elevate the industrial sector to reap the maximum benefits in the technological stream.

1 The Factory Industry Production index (FIPI) is computed covering 17 major industries. The weights are assigned for each industry using 2010 as the base year. However, the next revision of FIPI is due in 2015, thereby effect of any significant structural changes in the industrial sector took place since 2010 will be given due consideration.

Table 2.7 Factory Industry Production Index (FIPI)
2010 = 100

Division	Index 2013 (a)	Index 2014 (b)	Index Year-on-year Change %
1 Food Products (23.7%)	105.3	103.4	-1.8
2 Beverages (8.1%)	102.4	111.8	9.2
3 Tobacco Products (8.4%)	96.7	87.6	-9.3
4 Textiles (1.6%)	128.5	132.9	3.4
5 Wearing Apparel (23.1%)	124.9	149.5	19.7
6 Leather and Related Products (0.8%)	98.3	98.2	-0.1
7 Wood and Products of Wood, except Furniture (0.1%)	114.6	108.9	-4.9
8 Paper and Paper Products (0.1%)	123.4	126.6	2.6
9 Printing and Reproduction of Recorded Media (0.7%)	110.3	112.4	1.9
10 Refined Petroleum Products (2.2%)	83.4	86.0	3.1
11 Chemicals and Chemical Products (6.3%)	74.1	82.2	10.8
12 Pharmaceuticals, Medicinal Chemical and Botanical Products (0.1%)	185.1	142.8	-22.9
13 Rubber and Plastic Products (10.5%)	118.2	134.2	13.6
14 Other Non-metallic Mineral Products (7.2%)	103.2	102.9	-0.3
15 Basic Metals (1.0%)	102.4	112.9	10.3
16 Fabricated Metal Products, except Machinery and Equipment (3.8%)	111.2	97.1	-12.7
17 Electrical Equipment (2.3%)	107.6	99.5	-7.6
Factory Industry Production Index	108.3	115.1	6.3

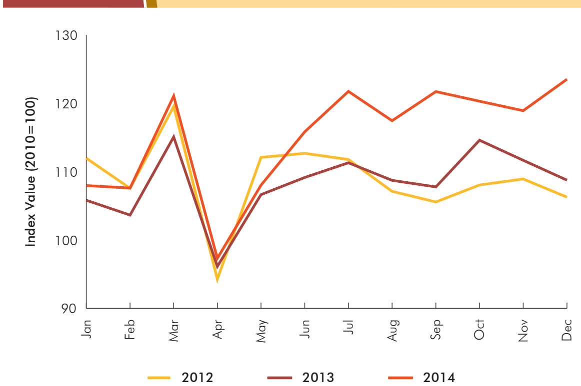
(a) Revised
(b) Provisional

Source : Central Bank of Sri Lanka

Notes: 1) Weight in the FIPI (2010=100) is given within parentheses.
2) Industrial Production Index (IPI) has been renamed as Factory Industry Production Index (FIPI) in 2013.

Wearing apparel sub sector, one of the leading export oriented industries and a dynamic contributor for Sri Lanka's economy, continued its growth momentum. The wearing apparel sub sector recorded a growth of 19.7 per cent in 2014, and continued as a leading supplier of premium and price competitive apparel

Chart 2.4 Factory Industry Production Index

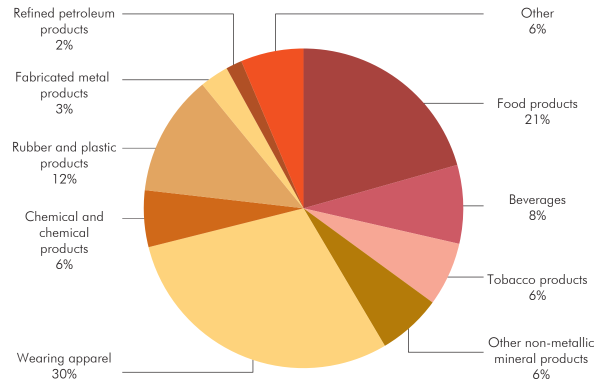


for the EU and the USA markets. International reputation as a reliable and a quality manufacturer following ethical practices such as free of child labour, free of forced labour etc. as well as eco-friendly international standards in the production process enabled the Sri Lankan apparel industry to remain competitive in the world market. Further, a conducive business environment and locational advantage made Sri Lankan apparel industry more attractive in the region. The textile products sub sector recorded a 3.4 per cent growth in 2014 with an increase in demand for locally manufactured textile from the wearing apparel sub sector and an increase in demand for local fabrics from tourists.

The beverages sub sector recorded a 9.2 per cent growth in 2014. This growth mainly reflects the enhanced performance in the leisure industry with the highest number of tourist arrivals over 1.5 million in 2014. Manufacture of liquor products, which contributes for about 60 per cent of the beverages sub sector, recorded a year-on-year growth of 8.3 per cent. However, production of soft drinks, mineral water and bottled water declined marginally in 2014.

The rubber and plastic products sub sector expanded further during the year 2014, despite the lower domestic rubber production, benefitting mainly from increased raw rubber imports due to falling global natural rubber prices. According to the FIPI, the rubber and plastic products sub sector recorded a growth of 13.6 per cent during 2014 compared to 1.1 per cent in 2013, supported by an increase in local and international demand for rubber tyres, tubes and other rubber based products. Production of solid tyres and air tyres, which contribute largely to the output of rubber products, increased in the backdrop of favourable developments in the foreign and local automobile industries. Similarly, the external demand for rubber gloves remained satisfactory, underpinning the higher growth in the manufacture of industrial, surgical and household gloves to the export market. Meanwhile, production of plastic products grew by 22.3 per cent in 2014 supporting the overall growth of the rubber and plastic products sub sector.

Chart 2.5 Composition of Factory Industry Production Index (FIPI) - 2014



Production in the chemical and chemical products sub sector showed favourable performance during the year. According to the FIPI, the chemical and chemical products sub sector recorded a year-on-year growth of 10.8 per cent in 2014. Growth in this sub sector was mainly supported by the increase of production of fertiliser, soap, detergent and paint and varnish products.

The coke and refined petroleum products sub sector, which consists entirely of refined petroleum products of the Ceylon Petroleum Corporation (CPC), recorded a year-on-year growth of 3.1 per cent in 2014. The CPC improved its capacity utilisation and increased the output during 2014 with the usage of more suitable types of crude oil blends (Oman and Murban). Refinery yield of high end products, such as gasoline and diesel, improved during this period showing a significant year-on-year growth of 6.3 per cent and 27.3 per cent, respectively.

Food products sub sector showed signs of recovery and recorded a mixed performance during 2014. According to FIPI, the food products sub sector experienced some setback in the first half of 2014, and regained its momentum in the latter half of the year. However, in overall terms, the output of the food sub sector declined by 1.8 per cent during the year. The output of food products such as bakery products, dairy products, starch and starch products, prepared meals and animal feed products, contracted during this period. Similarly, starch and starch products, which consists mainly of production of processed wheat for export, declined during the year mainly due to a higher tax imposed by Indonesia on wheat flour imports. However, production of cocoa, chocolate, sugar confectionary, processing and preserving of meat and fish products showed a positive performance in 2014.

The output of the tobacco sub sector recorded a decline of 9.3 per cent in 2014 compared to 2013 mainly due to the drop in demand. The higher cigarette prices due to an increase of excise duty and public health concerns relating to tobacco consumption reduced the demand for tobacco products during this period. The demand is expected to decline further in coming years with the impact of the government regulation on the compulsory display of 80 per cent pictorial warnings on the tobacco packages and consequent improvement in public awareness.

The output of non-metallic mineral products showed a modest performance in 2014. Production of cement, lime and plaster, which account for more than 50 per cent in non-metallic mineral products sub sector, recorded mixed performance in 2014, while the production of porcelain and other ceramic products also experienced a slowdown affecting the performance of non-metallic mineral sub sector. However, production of cutting, shaping and finishing of stones sub sector recorded a growth in 2014.

Fabricated metal products sub sector, which mainly comprises of ship building and ship repairing, showed a mixed performance in 2014. The Sri Lankan ship building industry experienced some setback in 2014 due to heightened competitions from regional countries for ship building. However, the ship repairing showed an enhanced performance during 2014. Further, recent development in marinas in most parts of the country is expected to attract new investments and create new opportunities in the period ahead.

Industrial Policies and Institutional Support

Institutional support continued for the development of the industrial sector in 2014 by providing fiscal concessions, technical assistance, upgrading infrastructure facilities and establishing Industrial Estates (IEs). The work relating to IEs rapidly progressed under the initiatives by the Ministry of Industry and Commerce (MIC) in support of regional industrialisation. There exist 27 IEs in which 304 industrial plots are in commercial operation and another 38 are under construction. Among these, 29 industrial plots are to be constructed outside the Western province. The development work of the Trincomalee IE (Stage I) was completed and 5 industrial plots are in commercial production providing 875 employment opportunities, while another 2 are under construction. The Stage II of the Trincomalee IE is currently in progress. Meanwhile, the development work of Mannar IE was completed during 2014 and the activities relating to establishment of an IE in Thiraimadu of Batticaloa district were commenced. In the Mannar IE, 2 garment factories approved by the BOI have started commercial production with an investment of Rs. 506 mn and another factory is commissioning machinery for the manufacturing of fish meal and fish oil. The MIC has planned to construct 3 factory buildings at Ampara Nawagampura IE to setup garment factories to promote industries in the Eastern province. The MIC has also planned to develop 2 dedicated IEs at Welioya and Musali to establish industrial zones exclusively for the apparel industry with the construction of 10 garment factories.

Institutional support for development of Small and Medium Enterprises (SMEs) continued in 2014. The District Enterprise Forums and the Regional Enterprise Forums of the National Enterprise Development Authority (NEDA), aimed at developing a proper mechanism for providing business development services to the entrepreneurs at district and regional level continued during the year. Through "Gamata Obina Viyapara" aimed at promoting businesses at village level, the NEDA arranged study programmes in Hambantota and Vavuniya districts to identify viable and competitive business opportunities, issues and suggestions for development of competitive business sectors. A special programme was launched for university graduates with the support of Carrier Guidance Units of universities to develop entrepreneurial skills of graduates. The Entrepreneurship Development Programme for vocational trainees was also launched to improve entrepreneurial skills and to provide financial facilities and new technology to businesses. The NEDA plans to implement several entrepreneurship development programmes in the Northern and Eastern provinces covering handicraft, handloom and light engineering industries. In addition, handloom villages are to be established in Mulathivu and Batticaloa districts. The NEDA also developed a software package named "issue tracker", a technical tool, to track issues in the SME sector emerging from various enterprise forums at regional level.

Several initiatives were taken to improve the use of new technology for boosting industrial production, productivity and to reduce cost of production. The Sri Lanka Gamma Centre, the first government owned entity with multipurpose Gamma Irradiation facility, was established in Biyagama in 2014. This Facility will provide irradiation services for industry products such as latex gloves, agriculture products, food, spices and other export products which require sterilisation. It will support advancement of many sectors including medicine and agriculture and also help expanding the export market by improving the quality of local products. Further, it will save foreign exchange used to import this service from overseas. The National Non-Destructive Testing Centre was established in Kelaniya, considering the need to have a dedicated entity to provide non-destructive testing services to industries such as construction, heavy machinery, ship building, and aerospace. This facility will support the development of the industrial sector by assuring the quality, safety and reliability of industrial components, assemblies and structures. The Sri Lanka Institute of Nanotechnology (SLINTEC), which was established under the national nanotechnology initiative, commenced construction of a Technology Incubation Centre. The funding for this construction is provided by the Urban Development Authority and it is expected to complete the construction by September 2015. The SLINTEC also started a synthetic organic chemistry programme and intends to manufacture Active Pharmaceutical Ingredient, which is currently imported. Also, a pilot plant for conversion of Sri Lanka Ilmenite to Titanium Dioxide was created by the SLINTEC.

The Export Development Board (EDB) arranged trade fairs, exhibitions, training programmes and various other activities to promote industries oriented for the export market. Global Rubber Conference was held in Sri Lanka for the first time with the participation of renowned entrepreneurs in the rubber industry and Sri Lankan rubber manufacturers and exporters. The conference facilitated regulatory authorities and commercial players of the rubber industry to provide updates on current trends and future challenges faced by the industry. The First Sri Lankan International Ornamental Fish Trade Conference was also held with the participation of more than

300 local and international delegates, enabling many top global fishery experts and exporters to meet at one place for the first time in South Asia.

Support for the development of the industrial sector was further strengthened with the proposals in the interim Budget for 2015, which include several measures to promote domestic industries and local production/value addition. Customs duty applicable on cement and steel billets was removed to reduce the high input cost and to promote the construction industry. Taxes on imported spare parts were fully removed for those who engage in the manufacturing/ assembling of motor cycles and three wheelers to encourage domestic production and local value addition. In order to encourage vegetable and food processing industry in the country, a 50 per cent tax reduction was proposed for the entrepreneurs who commence businesses in this sector. In order to encourage local construction companies to expand their activities overseas, the profits earned from such activities are to be exempted from income tax. Meanwhile, the Budget presented in November 2014, contained several proposals to promote export related industries. This includes setting up of 300 factories in every divisional secretary area for export and import competing industries along with few tax concessions such as 7 year half tax holiday for investors undertaking new investments in excess of Rs. 500 million. These measures are expected to boost the local industrial sector performance and contribution towards the national production.

Cottage Industry

The cottage industry sub sector grew by 2.5 per cent in 2014, compared to 5.1 per cent in 2013. The sub sector was benefitted from the initiatives taken by the institutions such as Ministry of Traditional Industries and Small Enterprise Development and Sri Lanka Chamber of Small and Medium Industries in areas such as capacity development, entrepreneurship development, access to finance, and market facilitation for the cottage industries. Measures taken to upgrade handloom textile weaving centers to produce unique and quality products catering to the international demand supported the growth in the sub sector. Meanwhile, the Palmyrah Development Board had taken several initiatives to uplift the palmyrah industry by providing machinery and other equipment and necessary technical assistance thereby encouraging the use of modern technology. These steps along with the continued growth in the construction and tourism activities contributed positively towards the growth within the sub sector.

Electricity, Gas and Water

The electricity, gas and water sub sector expanded by 4.5 per cent in 2014, compared to 10.3 per cent growth in 2013. Electricity, which accounted for the largest share within the sub sector, recorded a growth of 4.2 per cent compared to the growth of 11.3 per cent in the previous year. The contraction in high value added hydropower generation by 34.3 per cent due to dry weather conditions prevailed in the catchment areas, particularly during the first half of the year, lowered the growth recorded in the electricity sub sector. Meanwhile, the total thermal based power generation, which has a lower value added compared to hydropower generation due to higher input cost recorded a significant growth of 58.8 per cent. However, the addition of the second phase of the Lakvijaya coal power plant to the national grid, which is relatively cost effective to other thermal power generations, supported positively to the growth within the sub sector during the third quarter of the year. Meanwhile, the gas sub sector expanded by 9.3 per cent over the 1.6 per cent growth in 2013. This was reflected by 6.4 per cent growth in total gas sales in volume terms compared to 3.2 per cent growth in 2013. Meanwhile, the water sub sector grew by 5.1 per cent in 2014, compared to the growth of 3.8 per cent in 2013. This growth was largely reflected by the increase in the volume of water, distributed by the National Water Supply and Drainage Board (NWS&DB) by 9.0 per cent. The number of consumer accounts of NWS&DB also increased by 7.3 per cent in 2014 reflecting the growth in the water sub sector.

Construction

The construction sub sector grew significantly by 20.2 per cent during 2014, in comparison to 14.4 per cent growth during 2013. The growth in the construction sub sector was partly reflected by the increased public investments in infrastructure development activities. Phase II of the Southern Expressway, Phase I and Phase II of the Colombo Outer Circular Highway, Northern railway line and Multi-purpose Deduru Oya Reservoir Project were some of the major public investments which were in progress during the period. Further, the public sector housing development projects to provide permanent houses for the families living in temporary structures were also carried-out during the period. The private sector involvement in the construction sub sector was reflected by 22.3 per cent increase in credit to the private sector by commercial banks for construction activities during 2014, compared to 16.6 per cent in 2013. Meanwhile, the credit granted to personal housing by the commercial banks also increased by 28.7 per cent during 2014, compared to 9.1 per cent in 2013 reflecting the increase in the personal housing construction activities. Further, large-scale private construction activities such as hotel projects and apartment complexes also contributed to the growth in the construction sub sector.

Services

The Services sector, the largest sector of the economy with a share of 57.6 per cent of GDP, grew by 6.5 per cent in 2014 compared to 6.4 per cent growth in 2013. This growth was mainly attributable to the expansion in wholesale and retail trade sub sector, largely on account of the growth in the domestic trade along with import trade activities. Further, the banking, insurance and real estate sub sector also grew at a higher rate compared to the previous year. A significant contribution from the transport and communication sub sector was witnessed during the year supporting the sectoral growth. Further, the hotels and restaurants sub sector also showed a healthy performance during the year, albeit the sub sector grew by a slower rate compared to 2013. Meanwhile, the government services and the private services sub sectors slowed down in 2014 compared to 2013.

Wholesale and Retail Trade

The wholesale and retail trade sub sector, which accounted for 39.5 per cent of the Services sector, recorded an 8.0 per cent growth during 2014 when compared to 5.5 per cent growth in 2013. In value added terms, the import trade sub sector grew at a healthy rate during the year, while the export trade sub sector grew at a lower rate, compared to 2013. Meanwhile, the domestic trade sub sector continued its positive growth momentum into 2014, driving the growth in trade activities.

The import trade sub sector grew by 9.4 per cent during 2014 compared to the slower growth of 2.9 per cent recorded in 2013. This revival was reflected by 9.5 per cent growth in the import volume index in 2014, compared to the contraction of 1.5 per cent experienced in 2013. Accordingly, import of consumer goods increased significantly by 20.2 per cent during the year compared to 6.6 per cent in 2013, due to higher demand for both food and drink, and other consumer goods. The surge observed in the vehicle imports was the main contributor to the growth in other consumer goods imports. Moreover, intermediate goods imports which is the major contributor in import volumes, increased by 10.6 per cent in 2014 recovering from 6.1 per cent contraction in 2013. This was mainly due to the rebounding of imports of petroleum products, and textile and textile articles, the two major intermediate goods imports, which contracted in 2013. However, investment goods imports recorded a marginal growth of 0.3 per cent compared to 1.0 per cent in 2013, mainly due to contraction in machinery and equipment, and building material imports, the two main components of the investment goods imports, while the transport equipment imports rebounded.

The export trade sub sector grew by 4.6 per cent during 2014 in comparison to 6.7 per cent in 2013. The export trade sub sector which grew at a higher rate during the first quarter moderated continuously during the subsequent quarters. The exports volume index which grew by 6.7 per cent in 2013 slowed down to 4.3 per cent during 2014, mainly due to the contraction of exports in the fourth quarter of the year. Industrial exports, the major contributor to the country's goods exports, grew by 3.6 per cent in volume terms during the year compared to 7.0 per cent in 2013. This was mainly due to the deceleration in textile and garments exports on account of the contraction observed during the fourth quarter. Meanwhile, growth in agricultural export volumes remained at the same levels as in the previous year. Exports of coconut and tea recorded a higher growth in 2014 while exports of rubber continued to contract in volume terms. However, the mineral export volumes rebounded during 2014 in contrast to the contraction in the previous year.

The domestic trade sub sector which is the largest sub sector in the wholesale and retail trade sub sector grew by 8.1 per cent in 2014, from 6.9 per cent in 2013. This growth was largely influenced by the improved consumer demand encouraged by low interest rates and improved income levels. Further, the higher industrial production observed during 2014 provided the supply side impetus towards the continuous growth in the domestic trade sub sector. Meanwhile, significant growth in highland crops and vegetables amidst substantial contraction in paddy production in both the Yala and Maha seasons also supported this growth. Further, development of road and communication networks facilitated the trade linkages thereby supporting the value added in the domestic trade sub sector.

Hotels and Restaurants

The hotels and restaurants sub sector expanded at a slower pace of 11.5 per cent during 2014, compared to 22.3 per cent in 2013. Tourist arrivals which grew by 26.7 per cent in 2013 decelerated to 19.8 per cent in 2014. However, this was well above the United Nations World Tourism Organisation's 2014 annual estimates of 4.7 per cent growth for the entire world and 7.1 per cent growth for the South Asia, in international tourist arrivals. Further, the room occupancy rate in graded hotel establishments approved by the Sri Lanka Tourism Development Authority (SLTDA) increased to 74.3 per cent in 2014, from 71.7 per cent in the last year. Meanwhile, earnings from tourism surpassed the US dollars 2 billion landmark by the end of the year, registering an annual growth of 41.7 per cent. However, attracting high-end tourists is essential to maintain a higher value added in this sub sector.

Transport and Communication

The transport and communication sub sector grew by 7.3 per cent in 2014, compared to 9.4 per cent in 2013. Decelerations in the transport and post and telecommunication sub sectors compared to the previous year dampened the growth in the sub sector. However, the cargo handling - ports and civil aviation sub sector grew in line with the revamp in the external trade activities, compared to the previous year.

The transport sub sector expanded by 7.3 per cent during 2014, in comparison with 9.4 per cent in 2013. The passenger and goods transportation sub sector, the major contributor to the transport sub sector, grew by 7.3 per cent, a comparatively lower rate compared to 9.5 per cent in the previous year. The total number of passenger kilometres operated by the Sri Lanka Transport Board (SLTB) and private bus operators increased by 4.1 per cent and 8.2 per cent, respectively, in 2014 compared to 2.5 per cent and 2.7 per cent growth in 2013. Meanwhile, the railway transport sub sector grew by 4.0 per cent, which is above 2.2 per cent growth in 2013. The passenger kilometers operated by the Sri Lankan Railways increased by 9.3 per cent during the year. Further, the freight ton kilometers transported by the Sri Lankan Railways recovered during 2014 recording a growth of 13.2 per cent compared to 7.3 per cent contraction in the previous year. Operations in Northern railway line also recommenced during the year, further expanding the railway network. However, the passenger kilometers collectively flown by Mihin Lanka and SriLankan Airlines contracted by 2.7 per cent compared to 4.7 per cent growth recorded in 2013. Further, the freight ton kilometers flown by SriLankan Airlines and Mihin Lanka contracted by 1.0 per cent during 2014, compared to 0.7 per cent contraction in 2013. However, the passenger kilometers flown by the domestic aircraft operators grew significantly during the year continuing its positive contribution to the sector.

The cargo handling - ports and civil aviation sub sector grew by 4.0 per cent during 2014 compared to 3.1 per cent in 2013. This growth was largely due to the revival of external trade activities during the year. Accordingly, the container throughput and transshipment volumes (excluding re-stowing) in terms of twenty-foot equivalent units (TEUs) collectively handled by the Sri Lanka Ports Authority, South Asia Gateway Terminals and Colombo International Container Terminals grew by 13.8 per cent during the year, compared to the moderate growth of 3.8 per cent in 2013. Further, the cargo tonnage handled by the Sri Lankan ports which grew marginally by 2.0 per cent in 2013 recorded a higher growth of 12.3 per cent during 2014. Further, air cargo tonnage handled by the Bandaranaike International Airport increased slightly during the year.

The post and telecommunication sub sector grew by 8.0 per cent during 2014, compared to 11.4 per cent growth in 2013. The telephone density of the country increased to 120 per 100 persons at end December 2014 from 112.4 per 100 persons at end December 2013, led by the incline in cellular subscribers together with the gradual increase in fixed access wired subscribers, albeit the continuous decline in the fixed access wireless connections. Further, reflecting the demand for data communication services, broadband data usage in both fixed and mobile communication continued to grow benefitting from the exponential growth in mobile broadband connections. The vast popularity in the smart devices with open-source platforms that enable execution of third party mobile applications and attraction in utilities such as mobile payment mechanisms, mobile-banking, and social networking significantly supported this upsurge in data usage. Meanwhile, the postal service also continued its contribution to the sub sector, which is reflected by the increase in mails handled.

Banking, Insurance and Real Estate

The banking, insurance and real estate sub sector grew by 6.6 per cent in 2014, compared to 5.9 per cent growth in 2013. The sub sector expanded at a healthy rate during the second half of the year outweighing the subdued performance recorded in the first half. The banking sector increased its net profit by 17.9 per cent during 2014 recovering from 9.8 per cent contraction in 2013. Accordingly, return on equity of the banking sector improved to 16.5 per cent in 2014 from 16.0 per cent in 2013. The net loans and advances portfolio of the banking sector increased by 13.7 per cent at end 2014, ahead of 8.8 per cent growth at end 2013, reflecting increased business activities during the year. Meanwhile, non-bank financial sector also recorded better performance compared to 2013, as reflected by significant improvement in profitability benefiting from increased margins. However, profit before tax of the insurance industry declined during the year mainly due to the growth in claims incurred, amidst the increase in premium and investment income. Meanwhile, the real estate businesses showed comparatively better performance encouraged by the continuous decline in interest rates.

Government Services

The government services sub sector grew by 1.4 per cent during 2014, compared to 2.8 per cent growth in the previous year. This was reflected by the increase in public sector employment where primary employees who have low level of value added increased at a higher rate compared to senior, tertiary and secondary level employees.

Private Services

The value added growth in the private services sub sector grew by 5.4 per cent during 2014, compared to 7.3 per cent growth in 2013. The importance of the private services increased over the years along with the increase in disposable income creating the demand for such services. Services such as photography, beauty care and entertainment were in demand, and activities such as domestic staff services reached to a more formalised venture. Moreover, services such as private education had undergone a transition from mere tuition classes to private universities level, while increasing its scope from kindergarten to postgraduate qualifications, covering almost all the sectors in education. Further, private healthcare services also contributed significantly to the growth in private services expanding continuously with more sophisticated technology and medical services in line with the increased demand.

2.4 Expenditure

The estimates under the expenditure approach of national accounts revealed that both consumption and investment expenditure grew in real terms during 2014, while net exports contracted. Gross Domestic Expenditure (GDE), which consists of the aggregate consumption and investment, grew by 8.7 per cent compared to 4.9 per cent growth in 2013. This was a combined outcome of the growth in investment expenditure by 11.5 per cent and consumption expenditure by 7.6 per cent in real terms during 2014. Increase in investment expenditure was driven by both private investment activities and increased government capital expenditure. Meanwhile, the growth in consumption expenditure was reflected by the growth observed in consumer goods imports.

Table 2.8 Aggregate Demand

Item	Current Market Prices (Rs.mn)			Constant (2002) Prices (Rs.mn)		
	2012	2013 (a)	2014 (b)	2012	2013 (a)	2014 (b)
A. Domestic Demand						
Consumption	6,295,894	6,940,569	7,716,177	2,555,330	2,638,171	2,838,734
(% Change)	13.7	10.2	11.2	5.5	3.2	7.6
Gross Domestic Capital Formation	2,318,253	2,560,214	2,904,987	881,172	968,014	1,079,593
(% Change)	18.3	10.4	13.5	6.5	9.9	11.5
Total Domestic Demand	**8,614,147**	**9,500,783**	**10,621,164**	**3,436,502**	**3,606,185**	**3,918,326**
(% Change)	**14.9**	**10.3**	**11.8**	**5.7**	**4.9**	**8.7**
B. External Demand						
Export of Goods and Services	1,730,467	1,949,158	2,185,039	804,793	852,276	894,038
(% Change)	14.7	12.6	12.1	0.2	5.9	4.9
Import of Goods and Services	2,766,060	2,775,711	3,021,530	1,196,008	1,192,420	1,305,700
(% Change)	12.4	0.3	8.9	0.5	-0.3	9.5
Net External Demand	**-1,035,593**	**-826,553**	**-836,491**	**-391,215**	**-340,144**	**-411,662**
(% Change)	**-8.8**	**20.2**	**-1.2**	**-1.2**	**13.1**	**-21.0**
C. Total Demand	**7,578,554**	**8,674,230**	**9,784,672**	**3,045,288**	**3,266,041**	**3,506,664**
(% Change)	**15.8**	**14.5**	**12.8**	**6.3**	**7.2**	**7.4**

(a) Revised
(b) Provisional

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

Further, low domestic interest rates and increase in disposable income encouraged consumption. However, net exports in real terms deteriorated by 21.0 per cent in 2014 due to higher growth in imports compared to exports. Increase in imports was mainly on account of consumption and intermediate goods encouraged by decline in world commodity prices. As a combined outcome of these developments, GDP in real terms indicated a slower growth of 7.4 per cent compared to 8.7 per cent growth in GDE in 2014. The growth in GDP in nominal terms, slowed down to 12.8 per cent from 14.5 per cent growth recorded in 2013. The deceleration in implicit GDP deflator to 5.1 per cent from 6.7 per cent in 2013 contributed to this slowdown. Accordingly, GDP in nominal terms amounted to Rs. 9,785 billion during 2014 compared to Rs. 8,674 billion in 2013.

Consumption

Consumption expenditure, the main expenditure component continued to expand by 11.2 per cent in nominal terms to Rs. 7,716 billion during 2014, above the 10.2 per cent growth in 2013. However, private consumption expenditure (PCE) which is the major contributor to the total consumption expenditure grew at a slower pace compared to the government consumption expenditure in 2014. Accordingly, private consumption expenditure grew by 10.3 per cent in 2014 and accounted for 82.9 per cent of the total consumption expenditure, while government consumption expenditure grew by 15.9 per cent and accounted for 17.1 per cent of the total consumption expenditure. The increase in importation of consumer items in value terms as well as in volume terms reflected the increased demand for consumer goods.

Food, beverages and tobacco category, the major contributor to the PCE grew by 5.6 per cent in nominal terms during 2014, compared to 7.6 per cent growth in 2013. As a percentage of total PCE, the share of this category continued to decline as the concentration on necessary items such as food and beverages decreases with the increase in income levels. This was also reflected by the decline in ratio of expenditure on food and beverages to the total household expenditure as per the Household Income and Expenditure Survey 2012/13. Accordingly, the share of the food, beverages and tobacco items declined to 35.3 per cent of the PCE

Table 2.9 Composition of Private Consumption Expenditure at Current Market Prices

Category	Share of Total PCE (%)			Rate of Change (%)	
	2012	2013 (a)	2014 (b)	13/12	14/13
1. Food, Beverages and Tobacco	37.7	36.9	35.3	7.6	5.6
2. Clothing and Footwear	5.4	5.4	5.7	10.0	15.4
3. Housing, Water, Electricity, Gas and other Fuels	12.4	13.2	13.6	17.4	13.1
4. Furnishings, Household Equipment and Routine Maintenance of the House	3.9	3.8	3.9	6.4	12.4
5. Health	1.6	1.6	1.6	11.0	11.6
6. Transport	23.5	23.3	22.8	9.0	7.7
7. Leisure, Entertainment and Culture	1.9	1.9	2.2	9.1	26.6
8. Education	0.4	0.4	0.5	26.7	30.1
9. Hotels, Cafes and Restaurants	1.7	2.0	2.4	29.5	32.3
10. Miscellaneous Goods and Services	3.9	3.8	3.6	7.8	3.8
11. Expenditure Abroad of Residents	11.1	12.3	13.1	22.2	17.0
12. Less: Expenditure of Non - Residents	3.5	4.7	4.5	45.4	7.4
Total Private Consumption Expenditure	**100.0**	**100.0**	**100.0**	**10.0**	**10.3**

(a) Revised
(b) Provisional

Source: Department of Census and Statistics

from 36.9 per cent recorded in the previous year. However, a significant increase in importation in food and beverages both in value and volume terms could be observed during the year due to substantial moderation in domestic agricultural production suffered from adverse weather conditions. Meanwhile, expenditure on clothing and footwear category increased substantially reflecting the shift in consumer behaviour along with the change in lifestyles. This was also reflected by the surge in importation of clothing and accessories in volume and value terms during the year.

Consumption expenditure on housing, water, electricity, gas and other fuels by the private sector increased by 13.1 per cent in 2014, albeit at a lower rate in comparison with the 17.4 per cent growth in 2013. Considering the household demand, units of electricity and water distributed to the domestic sector and gas sales for domestic usage further expanded during the period reflecting the growth in consumption. However, administratively determined prices in items such as liquid petroleum, water, electricity and gas remained relatively stable during the first eight months of the year and were adjusted downwards towards the latter part of the year. These lower prices contributed to slower the nominal growth of the consumption expenditure in these categories.

Consumption expenditure on transport by the private sector in nominal terms grew by 7.7 per cent in 2014 recording a deceleration compared to 9.0 per cent growth in 2013. This was mainly attributable to steady passenger transport fares on bus and train services which prevailed during the year on par with relatively stable fuel prices.

The private sector consumption expenditure on health and education categories continued to grow in nominal terms by 11.6 per cent and 30.1 per cent, respectively, in 2014 compared to 11.0 per cent and 26.7 per cent growth in 2013. The increased expenditure on these categories reflected the change in consumer demand towards private health and education services. Factors such as convenience, preference towards high quality services, increased availability and customised services supported the increased demand towards private health and education services. However, due to substantial involvement of the government sector in provision of health and education services for free of charge, the share of the private consumption expenditure on the above sectors remained at lower levels.

Consumption expenditure on leisure, entertainment and culture as well as the hotels, cafes and restaurants categories by the private sector continued to grow by 26.6 per cent and 32.3 per cent, respectively, in 2014 as compared to 9.1 per cent and 29.5 per cent growth during the previous year in nominal terms. Shift in lifestyles of the people with the increase in disposable income and increased domestic mobility supported this expansion. Accordingly, the respective shares of the two expenditure items increased to 2.2 per cent and 2.4 per cent as a percentage of PCE during 2014, reflecting the increased consumer demand towards recreational activities.

Government consumption expenditure grew by 15.9 per cent during 2014 in nominal terms, compared to 11.3 per cent growth in 2013. Government expenditure on salaries and wages increased by 12.1 per cent during the year, mainly on account of the increase in Cost-of-Living Allowance by Rs. 1,200 for public servants and new recruitments to the government service. Further, government expenditure on other goods and services also increased by 36.2 per cent thereby contributing to the growth in government consumption expenditure.

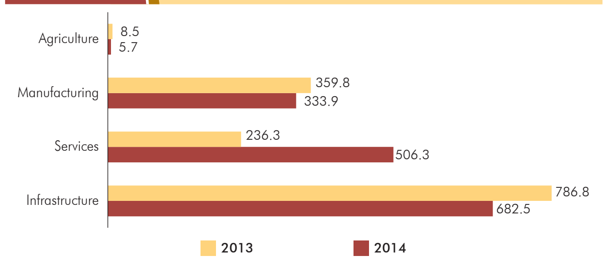
Investment

Investment expenditure in nominal terms grew by 13.5 per cent in 2014 to Rs. 2,905 billion, as compared to the growth of 10.4 per cent in 2013. Supporting the growth in investments, both public and private investment expenditure grew during the year. Expansion observed in construction activities, which is the major contributor to investments, was largely attributable to this growth. This was due to the continued infrastructure development activities of the government and the growth in private construction activities in the areas of residential and other construction, largely benefitting from the low interest rates remained during the year leading to increase the credit to the construction sector. Further, changes in stocks also grew at a higher rate during the year. Investment on machinery and equipment and land improvement and plantation development slowed down during the year compared to 2013. With these developments, total investment accounted for 29.7 per cent of GDP compared to 29.5 per cent in 2013.

Private investment in nominal terms which includes foreign direct investments grew by 13.8 per cent and accounted for 77.0 per cent of total investments in 2014. The growth in private investments was reflected by 22.3 per cent growth in the private sector credit granted for construction activities by the commercial banks during 2014. The private sector involvement in construction was prominent in personal housing, apartment complexes and hotel projects. Private investment as a ratio of GDP stood at 22.9 per cent at the end of the year, compared to 22.7 per cent in 2013.

Foreign Direct Investments including loans received by Board of Investment (BOI) registered companies in 2014 amounted to US dollars 1,528 million compared to US dollars 1,391 million in 2013, recording a year-on-year growth of around 10 per cent. Nearly 33 per cent of total inflows (US dollars 506 million) during the period was on account of the services

Chart 2.6 Foreign Direct Investment* of BOI Enterprises (USD million)



* including loans

NATIONAL OUTPUT AND EXPENDITURE

2

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		Estimated Investment (Rs.million)						Employment (No.)	
	2013 (a)	2014 (b)	2013 (a)			2014 (b)			2013 (a)	2014 (b)
			Foreign	Local	Total	Foreign	Local	Total		
BOI (Under Act No. 4 of 1978)										
Projects Approved	214	194	341,863	251,415	593,277	95,010	155,230	250,240	39,104	30,192
Under Section 17 (c)	176	170	337,103	251,184	588,287	93,391	154,892	248,283	37,050	27,006
Under Section 16	38	24	4,760	230	4,990	1,619	338	1,957	2,054	3,186
Projects Contracted Under Section 17 (c)	145	145	370,654	248,044	618,698	98,833	154,976	253,809	41,768	24,669
Realised Investment Under Section 17 (d)(e)	1,997	1,951	958,958	553,063	1,512,021	1,133,006	622,696	1,755,702	n.a.	n.a.
Projects in Commercial Operations (d)	2,649	2,718	351,230	4,032,999	4,384,229	423,102	4,096,373	4,519,475	396,493	409,949
Under Section 17 (c)	1,937	2,000	329,552	4,022,783	4,352,335	400,113	4,085,780	4,485,893	362,987	373,026
Under Section 16	712	718	21,678	10,216	31,894	22,989	10,593	33,582	33,506	36,923
MIC										
Companies Registered (d)	2,100	2,192	-	-	202,219	-	-	203,764	305,161	306,781

(a) Revised
(b) Provisional
(c) Includes expanded projects
(d) Cumulative as at end of year
(e) Cumulative actual investment values are given

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

Note: Projects approved and contracted under Sec.17 of the BOI Act are exempted from customs and exchange control regulations subject to the fulfilment of the investment threshold or any other specified requirements.

sector related projects in hotels and restaurants, IT-BPO and other services sub sectors. Infrastructure development projects attracted about 45 per cent of total investment flows (US dollars 682 million) whereas, inflows to the manufacturing sector amounted to US dollars 334 million.

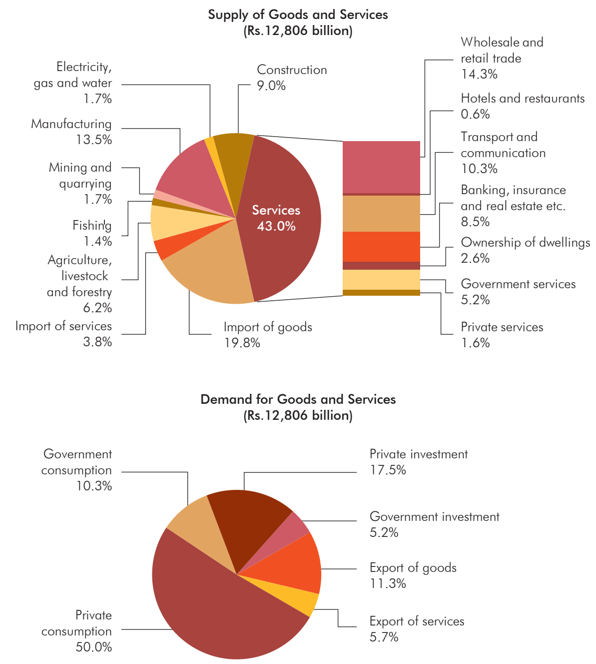
Total estimated investments of projects approved under section 17 and 16 of the BOI Act in 2014 are estimated at Rs. 250 billion. Estimated investments of project approvals in food, beverages and tobacco, textile, wearing apparel and leather, chemical, petroleum, coal, rubber and plastics and fabricated metal, machinery and transport equipment sectors recorded a higher investment value compared to last year. However, investment value of project approvals in the services sector dropped substantially while the estimated investment of approved project in non-metallic mineral products sector was also lower compared to the last year. However, the estimated investment value of projects contracted under section 17 was Rs. 254 billion which was nearly 60 per cent lower than in 2013. Estimated investments of projects commenced commercial operations under sections 17 and 16 of the BOI Act were Rs. 4,519 billion as at end 2014. The cumulative realised investment of the BOI by end 2014 was Rs. 1,756 billion.

Public investment expenditure in nominal terms increased by 12.3 per cent in 2014 compared to 13.7 per cent in 2013. Government investments were primarily directed towards physical infrastructure development and other rural development activities. Construction activities carried out during the year related to roads, railways, power and energy, and water supply and irrigation developments represented the greater portion of public investments. Government investment as a ratio of GDP stood at 6.8 per cent in 2014 compared to 6.9 per cent in 2013.

Availability and Utilisation of Resources

Resource availability in the economy in nominal terms amounted to Rs. 12,806 billion in 2014 compared to Rs. 11,450 billion in 2013, which is a growth of 11.8 per cent compared to 10.7 per cent growth in the previous year. This growth was a combined outcome of the increase in GDP, albeit at a lower rate of 12.8 per cent compared to 2013, and increase in external resources at a higher rate of

Chart 2.7 The Economy in 2014 (at current prices)



8.9 per cent compared to the previous year. Further, the contribution of domestic resources increased to 76.4 per cent compared to 75.8 per cent in 2013, in sustaining growing domestic demand. In real terms, import of goods and services grew at a significantly higher rate than GDP i.e., imports of goods and services grew by 9.5 per cent against the contraction of 0.3 per cent observed in 2013, while GDP grew

Table 2.11 Total Resources and Their Uses at Current Market Prices

Item	Percentage Share %		Percentage Growth %	
	2013 (a)	2014 (b)	2013 (a)	2014 (b)
A. Resources				
Gross Domestic Product	75.8	76.4	14.5	12.8
Import of Goods and Services	24.2	23.6	0.3	8.9
Total	**100.0**	**100.0**	**10.7**	**11.8**
B. Utilisation				
Consumption	60.6	60.3	10.2	11.2
Gross Domestic Fixed Capital Formation	22.2	21.5	15.8	8.5
Private	17.0	16.5	14.9	8.9
Government	5.2	4.9	19.2	7.3
Changes in Stocks	0.2	1.2	-81.7	548.1
Export of Goods and Services	17.0	17.1	12.6	12.1
Total	**100.0**	**100.0**	**10.7**	**11.8**

(a) Revised
(b) Provisional

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

by 7.4 per cent compared to 7.2 per cent growth in 2013, reflecting the broadening of resource availability from external sources.

Available resources were utilised for consumption, investment and exports. Resources were mostly utilised for consumption purposes, which represented a share of 60.3 per cent of total utilisation of resources. However, resource utilisation on investment, which is the sum of gross domestic fixed capital formation and changes in stocks, grew at a higher rate of 13.5 per cent compared to the growth in consumption and export of goods and services. Further, share of exports of goods and services within total utilisation was 17.1 per cent in 2014, which is almost the same as in 2013.

Savings

Domestic savings increased to Rs. 2,068 billion by 19.3 per cent in 2014 compared to 35.2 per cent growth in 2013. This lower growth was mainly attributable to the extensive increase in government dis-savings, despite continuous expansion in private savings during 2014. The worsening in government dis-savings was mainly due to the lower growth in government revenue against the increased government recurrent expenditure during the year. This slowdown in the growth of domestic savings compared to 2013 was further reflected by the high growth in consumption expenditure. In the midst of these developments, domestic savings as a ratio of GDP improved during the year to 21.1 per cent compared to 20.0 per cent in the previous year.

National savings increased to Rs. 2,642 billion by 18.1 per cent during the year in comparison with 23.1 per cent growth in 2013. The net current transfers from abroad, which grew significantly by 11.6 per cent during the year

2

NATIONAL OUTPUT AND EXPENDITURE

Table 2.12 Consumption, Investment and Savings at Current Market Prices

Item	Rs. million		% Change		As a per cent of GDP	
	2013 (a)	2014 (b)	2013 (a)	2014 (b)	2013 (a)	2014 (b)
1. Gross Domestic Product at Market Prices	8,674,230	9,784,672	14.5	12.8	100.0	100.0
2. Consumption Expenditure	6,940,569	7,716,177	10.2	11.2	80.0	78.9
Private	5,803,277	6,398,345	10.0	10.3	66.9	65.4
Government	1,137,291	1,317,832	11.3	15.9	13.1	13.5
3. Investment	2,560,214	2,904,987	10.4	13.5	29.5	29.7
Private	1,965,012	2,236,841	9.5	13.8	22.7	22.9
Government	595,202	668,147	13.7	12.3	6.9	6.8
4. Domestic Savings	1,733,661	2,068,496	35.2	19.3	20.0	21.1
Private	1,801,394	2,196,187	32.2	21.9	20.8	22.4
Government	-67,733	-127,692	14.9	-88.5	-0.8	-1.3
5. Domestic Savings - Investment Gap	-826,553	-836,491	20.2	-1.2	-9.5	-8.5
6. Net Factor Income from Abroad	-226,086	-240,065	-46.0	-6.2	-2.6	-2.5
7. Net Current Transfers from Abroad	728,678	813,128	5.8	11.6	8.4	8.3
8. National Savings	2,236,253	2,641,560	23.1	18.1	25.8	27.0

(a) Revised
(b) Provisional

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

compared to the growth of 5.8 per cent recorded in 2013, continuously supported the improvement of national savings. Further, slowdown in deterioration of NFIA also positively contributed to the recorded growth in national savings. Accordingly, national savings as a ratio of GDP increased to 27.0 per cent from 25.8 per cent in 2013. These developments contributed to narrow down savings-investment gap to 2.7 per cent of GDP in 2014 from 3.7 per cent of GDP in 2013.