2 NATIONAL OUTPUT AND EXPENDITURE

2.1 Overview

Sri Lanka's gross domestic product (GDP), in real terms, grew by an impressive 8.3 per cent in 2011, the highest growth witnessed during the past six decades. This is an unprecedented achievement as it was the first time that Sri Lanka realised economic growth of 8 per cent or above in two consecutive years in post-independence history. This high growth was underpinned by the conducive macroeconomic environment, strong domestic demand, improved investor confidence, continued expansion of infrastructure facilities and improved doing business environment amidst the fragile global economic recovery. From the production side, the remarkable growth in Industry and Services sectors contributed significantly to the growth while the Agriculture sector suffered a set-back.

The contribution from Industry and Services sectors to the overall growth was significant in 2011. Industry and Services sectors grew by 10.3 per cent and 8.6 per cent, respectively, while the Agriculture sector grew moderately by 1.5 per cent. The Industry sector emerged as the highest growing sector with impressive performance by almost all the main sectors namely, manufacturing, construction, electricity and mining and quarrying. This was the highest growth rate in the Industry sector witnessed during the last 33 years. The Services sector maintained its buoyancy, growing by 8.6 per cent largely driven by the performance in wholesale and retail trade, hotels and restaurants and transport and communication sub sectors. The Agriculture sector suffered heavily during the first quarter of the year due to excessive rains and resultant floods, but recovered during the remaining period recording an annual growth of 1.5 per cent compared to a decline of 1.4 per cent during the first half of the year. Accordingly, the share of Agriculture to GDP declined marginally to 11.2 per cent while those of Industry and Services increased to 29.3 per cent and 59.5 per cent, respectively.

The aggregate demand generated by domestic economic activity increased by 11.6 per cent in real terms during 2011 compared to the growth of 9.4 in 2010 with the expansion of domestic consumption and investment activities. The excess in domestic demand was met by the higher growth in imports, which grew at 20 per cent compared to a slower export growth of 11 per cent. The net external demand widened due to higher demand for imports with the increase in domestic demand. In 2011, the real increase in domestic consumption and investments were 13 per cent and 7.7 per cent, respectively. The higher increase in both domestic consumption and investment reflects the increase in real purchasing power with low inflationary pressure in the economy

2

NATIONAL OUTPUT AND EXPENDITURE

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

Sector	Rate of Change (%)		Contribution to Change (%)		Share of GDP (%)	
	2010 (a)	2011 (b)	2010 (a)	2011 (b)	2010 (a)	2011 (b)
Agriculture	7.0	1.5	10.4	2.2	11.9	11.2
1. Agriculture, Livestock and Forestry	6.4	- 0.1	8.7	- 0.1	10.7	9.9
1.1 Tea	13.8	- 0.9	1.8	- 0.1	1.1	1.0
1.2 Rubber	12.7	1.8	0.4	0.1	0.3	0.2
1.3 Coconut	- 14.3	3.0	- 2.5	0.4	1.1	1.0
1.4 Minor Export Crops	35.6	- 19.0	2.0	- 1.3	0.6	0.4
1.5 Paddy	17.5	- 8.4	3.7	- 1.9	1.8	1.5
1.6 Livestock	2.9	7.3	0.3	0.7	0.8	0.8
1.7 Other Food Crops	4.4	2.5	2.1	1.2	3.8	3.6
1.8 Plantation Development	5.4	5.7	0.2	0.2	0.3	0.3
1.9 Firewood and Forestry	3.1	4.1	0.2	0.3	0.6	0.6
1.10 Other Agricultural Crops	8.1	6.6	0.4	0.3	0.4	0.4
2. Fishing	12.2	15.5	1.8	2.3	1.2	1.3
Industry	8.4	10.3	30.2	36.0	28.7	29.3
3. Mining and Quarrying	15.5	18.5	4.1	5.1	2.3	2.5
4. Manufacturing	7.3	7.9	16.0	16.6	17.3	17.3
4.1 Processing (Tea, Rubber and Coconut)	5.8	0.9	0.4	0.1	0.6	0.6
4.2 Factory Industry	7.5	8.3	14.8	15.7	15.7	15.7
4.3 Cottage Industry	5.5	7.0	0.7	0.9	1.1	1.0
5. Electricity, Gas and Water	8.0	9.2	2.4	2.7	2.4	2.4
5.1 Electricity	8.2	9.6	2.2	2.5	2.1	2.2
5.2 Gas	7.3	5.7	0.2	0.1	0.2	0.2
5.3 Water	4.5	6.1	0.1	0.1	0.1	0.1
6. Construction	9.3	14.2	7.7	11.6	6.7	7.1
Services	8.0	8.6	59.4	61.8	59.3	59.5
7. Wholesale and Retail Trade	7.5	10.3	21.7	29.0	23.2	23.6
7.1 Import Trade	9.3	14.3	9.3	14.0	8.1	8.5
7.2 Export Trade	3.6	10.1	1.9	4.9	4.0	4.1
7.3 Domestic Trade	7.6	7.5	10.6	10.0	11.1	11.0
8. Hotels and Restaurants	39.8	26.4	2.0	1.7	0.5	0.6
9. Transport and Communication	11.9	11.3	19.9	19.1	13.9	14.3
9.1 Transport	11.4	11.3	15.7	15.6	11.5	11.8
9.2 Cargo Handling-Ports and Civil Aviation	16.8	7.2	1.4	0.6	0.7	0.7
9.3 Post and Telecommunication	13.2	13.4	2.8	2.9	1.8	1.9
10. Banking, Insurance and Real Estate etc.	7.5	7.9	8.4	8.4	8.9	8.8
11. Ownership of Dwellings	0.9	1.2	0.3	0.4	2.8	2.6
12. Government Services	5.4	1.2	5.3	1.2	7.6	7.1
13. Private Services	5.8	7.2	1.8	2.1	2.4	2.3
Gross Domestic Product	8.0	8.3	100.0	100.0	100.0	100.0
Net Factor Income from Abroad	- 16.6	4.3				
Gross National Product	7.9	8.4				

(a) Revised
(b) Provisional

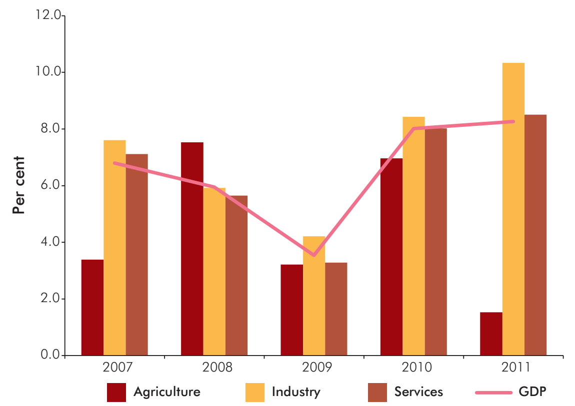
Source: Department of Census and Statistics

and higher investor confidence in the conducive macro-economic environment that prevailed in 2011.

In 2011, Gross National Product (GNP), defined as GDP adjusted for net factor income from abroad (NFIA), grew by 8.4 per cent in real terms compared to the growth of 7.9 per cent in 2010. The NFIA remained negative as in the previous years, but improved in real terms by 4.3 per cent, mainly due to the increase in the deflator for 2011 resulting in a higher growth in GNP when compared to the growth in GDP.

GDP per capita for 2011 increased by 15.5 per cent to Rs. 313,511 from Rs. 271,346 in the previous year. This indicates an improvement in living standards, on average, as the growth in per capita income surpassed the increase in inflation. In US dollar terms, per capita GDP increased by

Chart 2.1 Annual Growth Rate



18.2 per cent, from US dollars 2,400 to US dollars 2,836. The increase in GDP per capita in US dollar terms was the combined outcome of comparatively higher economic growth and the relatively stable exchange rate of the rupee against the US dollar during the year.

GDP at market prices grew by 16.7 per cent in 2011 compared to 15.9 per cent in the previous year. GDP at current market prices was estimated at Rs. 6,543 billion (US dollar 59.2 billion) in 2011 compared to Rs. 5,604 billion (US dollars 49.6 billion) in 2010. This increase was reflected by the 8.3 per cent real economic growth and 7.8 per cent increase in the overall price level of the economy, as measured by the GDP deflator.

In the backdrop of a significant increase in consumption expenditure, domestic savings declined in 2011. As a percentage of GDP, domestic savings declined by 3.9 percentage points to 15.4 per cent mainly due to the significant decline in private savings driven by the sharp increase in private consumption with increased consumer confidence and lower market interest rates. The increased consumption expenditure in Northern and Eastern provinces and pent up demand for consumer durables have also contributed to the overall increase in expenditure. However, the decline in government's dis-saving to 1.1 per cent of GDP from 2.1 per cent in 2010 was an encouraging development. Net factor income from abroad remained negative as usual but deteriorated at a lower rate compared to the 25.1 per cent decline in the previous year. Despite the 24 per cent increase in net private current transfers, national savings as a percentage of GDP declined by 3.3 percentage points to 22.1 per cent. However, gross investment as a percentage of GDP increased by 2.3 percentage points to 29.9 per cent in 2011 reflecting a negative National savings-investment gap of 7.8 per cent, which was financed through foreign savings and a draw down of foreign reserves.

2.2 Sectoral output, Policies, Institutional Support and Issues

Agriculture

Despite the extreme weather conditions experienced in the first quarter of the year, which negatively affected the agricultural production particularly the Maha harvest of paddy and other food crops, value added in the Agriculture sector grew by 1.5 per cent in 2011 over the growth of 7 per cent in the previous year. Main contributory factors to this growth were the bountiful Yala harvest in paddy and other food crops in second half of the year and expansion in fishing and livestock sectors throughout the year along with the recovery in coconut production. Production of minor export crops dropped during the year mainly due to the high base of the previous year. Moreover, the share of the Agriculture sector in the GDP decreased to 11.2 per cent in 2011 from 11.9 per cent in 2010 indicating the higher performance in the other two sectors.

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

Item	2010 (b)	2011 (c)	Change(%) 2010/11
Agriculture and Fishing	108.8	111.6	2.6
1 Agriculture	107.3	106.7	-0.6
1.1 Agriculture Crops	107.9	106.5	-1.3
Tea	106.4	105.5	-0.8
Rubber	114.0	117.7	3.2
Coconut	92.2	100.1	8.6
Paddy	115.0	103.6	-9.9
Other Crops	108.1	109.3	1.0
1.2 Livestock	103.2	108.1	4.8
2 Fishing	115.3	133.3	15.6

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

Source: Central Bank of Sri Lanka

Export Crops

Total tea production in 2011 declined marginally by 0.8 per cent to 328.6 million kg over 2010. The decline in production was evident in all three elevations during the first two months due to excessive rains while medium and high elevations were affected in the third quarter due to dry weather conditions. During the year, medium grown tea production declined by 6.3 per cent to 52.6 million kg while high grown production and low grown production grew only marginally by 0.2 per cent to 79.3 million kg and 0.3 per cent to 196.7 million kg, respectively. The small holdings, bearing the cultivation extent of around 120,664 hectares of tea contributed 69 per cent of the total tea production in 2011. The upward revision of estate sector wages during 2011 reduced producer margins though the extension of the fertiliser support scheme to the estate sector, which was previously limited to tea smallholders, helped reduce the cost of production of the plantation companies. The favourable export prices helped sustain the average production level of tea manufacturers during the year. A notable development during the year was the increase in Cut, Tear, and Curl (CTC) tea production by 5 million kg to 23.7 million kg. However, Orthodox Black tea, which is the country's major category of tea production declined by 2.5 per cent to 301.9 million kg during the year.

The average price of tea of all elevations at the Colombo Tea Auction (CTA), which remained higher in the first quarter of 2011 compared to corresponding period of 2010, continued to decline during the rest of 2011. Accordingly, the annual average of all prices at CTA declined to Rs. 360.68 per kg in 2011 compared to Rs. 371.54 per kg in 2010. The decline in auction prices in 2011 after the first quarter was largely due to the moderation in demand with the political uncertainties in some countries in the Middle Eastern and North African region together with the increase in the supply by other tea producing countries. However, the average export price of tea increased to US$ 4.60 per kg in 2011 from US$ 4.40 per kg in 2010.

Rubber production in 2011 increased by 3.2 per cent to 157.9 million kg over the previous year. The growth in rubber production was mainly supported by favourable weather conditions and receiving highest ever prices for natural rubber during the year. The total extent under rubber tapping increased by around 4 per cent to 101,720 hectares. The new planting extent also increased by 9 per cent to 1,534 hectares in 2011 reflecting the growers' response to the high prices. Higher growth in production is also due to sound agricultural practices such as the increase in application of fertiliser to the mature rubber cultivation and increased fixing of rain guards and improvement of labour productivity with the support of government's extension services.

The average prices of all varieties of rubber recorded the highest ever prices in 2011. The annual average price of Ribbed Smoked Rubber (RSS) No.1 increased by 26 per cent to Rs. 509 per kg, while the average Latex Crepe (LC) No. IX also increased by 26 per cent to Rs. 575 per kg compared to 2010. Natural rubber prices increased to unprecedented levels in the first nine months of 2011 with soaring prices of rubber futures and increases in demand for natural rubber from emerging economies. However, the natural rubber prices during the fourth quarter showed a sharp decline due to lower demand from major buyers like China and also the build up of stocks in the market. Accordingly, the average price of LC No. IX declined to Rs. 417 per kg during the last quarter from Rs. 627 per kg during the first nine months of 2011. The prices of other varieties such as RSS and Scrap Crepe also moved in the same direction.

The coconut production, which showed a sharp decline in 2010, recovered during 2011 increasing by 8.6 per cent to 2,808 million nuts. This was mainly due to improved weather conditions in the major coconut growing areas. However, the domestic coconut oil production declined by 18.5 per cent to 53,093 metric tons (equivalent to 392 million nuts) during the year largely due to increase in edible oil imports with the reduction in customs duty on edible oil importation by Rs.25 per kg in early 2010 followed by Rs.20 in the late 2010 and also encouraged by low international edible oil prices in 2011. Accordingly, during the year palm oil and coconut oil imports increased by 79 per cent to 138,939 metric tons. However, the production of desiccated coconut (DC) grew by 62 per cent to 46,620 metric tons (equivalent to 363.5 million nuts) in 2011 over the previous year. The significant improvement in the DC industry was largely driven by the increase in international demand and the better export prices. The production of coconut cream and milk powder also showed impressive progress, reflecting the increase in coconut value addition industries.

Higher coconut prices that prevailed in the first half of 2011 decelerated during the second half of the year with increased domestic production. During the first half, wholesale and retail coconut prices escalated to unprecedented levels due to relatively poor harvest in the fourth quarter of 2010. The average auction price of coconut, which remained at Rs. 37.64 per nut in the first half of 2011, declined to Rs. 31.75 per nut in the second half of the year. A similar trend of lower prices in the second half was also seen in Coconut Oil, Copra and DC at the Colombo Coconut Auction.

The production of other export agricultural crops showed mixed performance in 2011. Cinnamon production increased by 11 per cent largely due to higher prices fetched by cinnamon and cinnamon products which reflected increased export demand. Increased fertiliser application and the increased extent of cinnamon as a result of replanting and new planting during the last several years also contributed to increased production. The extent of cinnamon has increased by 4,471 hectares to 30,522 hectares during the period from 2005 to 2010. In contrast, pepper production declined by 38 per cent in 2011 largely due to adverse weather conditions in the flowering and fruiting period in major pepper growing areas. Accordingly, exports of pepper declined during the year despite the black pepper prices remaining robust due to higher export demand. Clove production also declined significantly by 42 per cent in 2011.The price of cloves increased with the high export demand and short supply. The clove production mainly depends on the nature of flowering and fruiting cycle of the crop which produces a bumper harvest one year followed by a poor harvest in the following year. Among other crops cardamom, cocoa and betel production increased by 19 per cent, 1 per cent and 2 per cent respectively, while citronella, nutmeg- mace production declined by 37 per cent and 7 per cent, respectively (The production of these crops are given in Table 14 of the Statistical Appendix).

Table 2.3 Trends in Principal Agricultural Crops

Category	Unit	2010(a)	2011(b)
1.Tea			
1.1 Production (c)	kg mn	331.4	328.6
1.2 Total Extent	hectares '000	222	222
1.3 Extent Bearing	hectares '000	186	185
1.4 Cost of Production (d)	Rs/kg	314.17	350.00
1.5 Average Price			
- Colombo Auction	Rs/kg	371.54	360.68
- Export (f.o.b.)	Rs/kg	496.27	510.41
1.6 Replanting	hectares	1,399	1,202
1.7 New Planting	hectares	5	28
1.8 Value added as % of GDP (e)		1.6	1.3
2.Rubber			
2.1 Production	kg mn	152.9	157.9
2.2 Total Extent (f)	hectares '000	126	127
2.3 Area under Tapping (f)	hectares '000	98	102
2.4 Cost of Production	Rs/kg	119.83	120.50
2.5 Average Price			
- Colombo Auction (RSS 1)	Rs/kg	403.02	508.80
- Export (f.o.b)	Rs/kg	377.54	535.40
2.6 Replanting (g)	hectares	5,941	2,847
2.7 New Planting (g)	hectares	1,413	1,534
2.8 Value added as % of GDP (e)		1.0	1.2
3.Coconut			
3.1 Production	nuts mn	2,584	2,808
3.2 Total Extent	hectares '000	395	395
3.3 Cost of Production	Rs/nut	11.27	10.00
3.4 Average Price			
- Producer Price	Rs/nut	22.24	27.56
- Export (f.o.b.) (h)	Rs/nut	24.64	39.15
3.5 Replanting / Under Planting (j)	hectares	2,684	1,518
3.6 New Planting (j)	hectares	2,920	1,501
3.7 Value added as % of GDP (e)		1.4	1.4

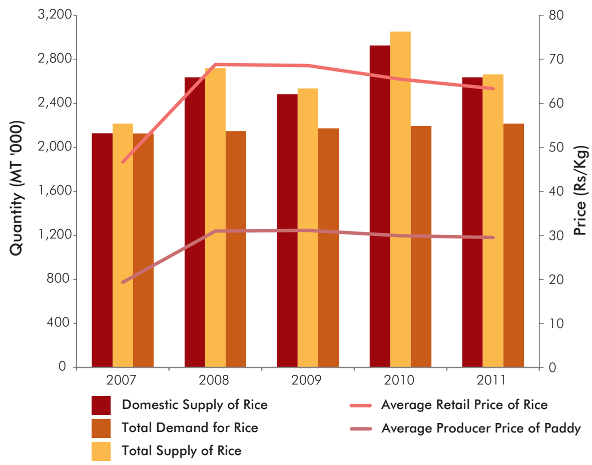
(a) Revised.
(b) Provisional.
(c) Including green tea.
(d) Includes green leaf supplier's profit margin.
(e) In growing and processing only.
(f) Based on Rubber Land Survey -2003 conducted by the Dept. of Census and Statistics & Rubber Development Department.
(g) Extents covered by cultivation assistance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

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

Domestic Agriculture

Total Paddy production in 2011 declined by 10 per cent to 3.87 million metric tons over 2010 due to the decline in paddy production in

Chart 2.2 Rice : Supply and Demand



2010/11 Maha season despite the significant improvement in production during 2011 Yala season. The decline in Maha production was due to direct and indirect effects of the flood experienced in January and February 2011, which is considered to be the highest ever crop damage reported in any season. Direct crop damage was estimated to be 25 per cent (185,861 hectares) of the cultivated extent in the Maha season while the indirect damage is reflected in the significant decline of the yield. The yield is estimated to have declined to 3,668 kg per hectare from 4,583 kg per hectare in 2009/10 Maha season and total production declined to 1.996 million metric tons compared to 2.629 million metric tons in 2009/10 Maha season. Districts of Batticaloa, Trincomalee, Ampara, Polonnaruwa and Anuradhapura, which are usually considered as surplus areas of paddy, were largely affected by the flood. However, total extent cultivated during 2010/11 Maha season was higher by 84,013 hectares to 730,050 hectares over 2009/10 Maha season largely due to new lands cultivated in the Northern and Eastern provinces (50,948 hectares).

Paddy production in 2011 Yala increased by around 12.4 per cent to around 1.88 million metric tons, which is the highest ever production in any Yala season. The cultivation of a higher extent during the Yala season was facilitated by the government in order to compensate for the production loss during the Maha season. To encourage the paddy farmers, measures were taken to reschedule cultivation loans granted to farmers whose lands were destroyed fully or partially due to the flood. Further, the favourable weather conditions and sufficient and timely release of water for cultivation during the season and the fertiliser support ensured that the targeted production during the Yala season was reached. The government purchased 75,172 metric tons of paddy during Yala season (Nadu at Rs. 28 per kg and Samba at Rs. 30 per kg) through the Paddy Marketing Board and released 109,000 metric tons of paddy to the market during the year.

Production of many field crops declined in 2011 largely due to the impact of adverse weather conditions during 2010/11 Maha season. Even though the production of kurakkan, maize, green gram, cow pea, soya beans, black gram, gingelly,

Table 2.4 Paddy Sector Statistics

Item	Unit	2010(a)			2011(b)		
		Maha	Yala	Total	Maha	Yala	Total
Gross Extent Sown	hectares '000	646	419	1,065	730	488	1,218
Gross Extent Harvested	hectares '000	643	416	1,060	613	478	1,091
Net Extent Harvested	hectares '000	574	376	950	544	426	970
Production	mt '000	2,630	1,671	4,301	1,996	1,879	3,875
	bushels '000	126,029	80,074	206,103	95,655	90,034	185,689
Yield (c)	kg/hectare	4,583	4,444	4,528	3,668	4,415	3,995
Credit Granted	Rs.mn.	1,402	1,139	2,541	2,340	1,958	4,298
Rice Imports	mt '000	-	-	126	-	-	28
Paddy Equivalent of Imports	mt '000	-	-	180	-	-	40

(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

and green chilli declined in 2010/11 Maha season it was partly offset with the increased production in the Yala season (The production and extents of field crops are given in Table 18 of the Statistical Appendix) supported by higher farm gate prices. Meanwhile, production of potato, red onions and big onions increased in 2011 compared to 2010 largely due to the increase in the extent of cultivation in the Northern Province and the increase in the Special Commodity Levy on imports of such crops targeting the harvesting time. Further, the increase in domestic production of big onion seeds also contributed to the growth in big onion production. Production of raw ginger and turmeric also increased significantly due to increase in the extent of cultivation with the support extended by the Department of Export Agriculture (DEA). Meanwhile, the declining trend in imports of some field crops such as maize, green gram and red onion continued in 2011 in line with the increase in domestic production of such crops.

Total vegetable production of the country increased by 11.8 per cent to 956,722 metric tons in 2011 compared to 855,994 metric tons in 2010 due to higher production in the second half of the year. This was due to farmers being encouraged by increased vegetable prices caused by crop damage in the first half of 2011 and subsequent farmer assistance programmes conducted by the government in the second half of the year. The government support programmes such as extension of fertiliser support for vegetable farmers, supply of seeds for farmers affected by floods to cultivate vegetables during the interim season in March and implementation of the "*Divi Naguma*" programme to promote home gardening also helped increase vegetable production. This had a considerable impact on decrease of vegetable prices compared with previous years particularly during the months from June to August. Further, the significant improvement of vegetable supply from the Northern province, particularly the Jaffna District also helped reduce price pressure in the vegetable market throughout the year.

The sugar production increased by 11.3 per cent to 34,876 metric tons in 2011 largely due to increased production at the Pelawatta Sugar factory. Sugar cane production increased during the year due to favourable weather conditions and the increase in producer prices of sugar cane, which helped increase the contribution from small scale growers of sugar cane. However, the total production of sugar was lower than targetted due to labour shortages faced by the Pelawatta factory during the time of planting and harvesting and the decline in sugar recovery rate at the Sevanagala factory. The domestic production in 2011 was sufficient only to meet 5 per cent of the annual sugar requirement of the country. In the meantime, in line with the government policy, the Sugar Reaserch Institute (SRI) initiated several programmes during the year in order to expand sugar cultivation in the country. In collaboration with Kantale Sugar industries, SRI established a nursery in Kantale to provide improved planting materials to farmers for multiplication. Further, SRI also implemented a programme in Kilinochchi District to popularise sugar cane plantation in the District, which has favourable climatic conditions for sugar cane cultivation.

Fishing

Total fish production in 2011 increased by 15.6 per cent to 444,830 metric tons. While marine fish production grew by 16 per cent to 385,270 metric tons, the inland fish production grew by 13.6 per cent to 59,560 metric tons during the year. The highest growth was witnessed in deep sea fishing (25 per cent) in the marine fish sector compared to coastal fishing (9.8 per cent). In 2011, all the provinces except the Eastern Province showed an increase in fish catch supported by favourable weather conditions. Fish production in the Eastern Province declined by around 4 per cent due to adverse weather conditions and its contribution to total marine fish production declined from 28 per cent in 2010 to 23 per cent in 2011. However, the fish catch in the Northern Province increased significantly by 38 per cent in 2011 reflecting increased participation of people in the fishing industry in the Province. However, the relative contribution of the Northern Province in total marine fish production in 2011 was only 12 per cent compared to that of 41 per cent in 1983. Therefore, it is necessary to increase the fishery fleet in the

Table 2.5 Fish Production

Metric Tons '000

Sub sector	2010(a)	2011(b)
Marine (c)	332	385
Aquaculture and Inland Fisheries	52	60
Total	384	445

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

Source: Ministry of Fisheries and Aquatic Resources

Northern Province alongside the improvement in fishery infrastructure to reach the full potential of production in the Province. Meanwhile, the improvement recorded in the inland fishery sector was largely a result of releasing 44 million fish fingerlings and 11 million fresh water prawns during the year. Retail prices of large varieties of fish in 2011 remained relatively high during the second half of the year compared to the corresponding period of 2010 largely due to the decline in the fish supply from the Eastern Province while the prices of small varieties remained somewhat subdued throughout the year largely due to improved coastal fish catch in the Southern and North Western provinces.

Livestock

Total milk production in 2011 grew by 2.3 per cent to 253.2 million litres. Cow milk production grew by 3.4 per cent to 198.4 million litres while buffalo milk production declined by 1.4 per cent to 54.8 million litres. The growth in cow milk production was mainly driven by the increased average producer price of cow milk up to Rs. 50 per litre (Fat/SNF=4.2/8.3) from Rs. 33.20 per litre. Moreover, the increase in milking cows in the country supported by measures introduced by the government and the expansion of regional milk collection centres and chilling centres of the formal milk collecting firms also influenced the progress made in the dairy sector. In 2011, milking cow population and the average daily milk collection grew substantially in the Northern Province reflecting the successful reestablishment of the traditional livelihood of the war deprived people in the Province. However, the progress in the Eastern Province was somewhat hindered due to the impact of floods in the early part of the year. Meanwhile, the contribution of small milk product manufacturers to total milk products further improved in the year supporting to increase value added milk products in the country. In line with the target of attaining self-sufficiency in the dairy sector, the domestic milk production as a per cent of total national milk requirement increased to 32.5 per cent (100 ml per person per day) in 2011 from 30 per cent in 2010. However, the imports of milk and milk products also have increased during the year reflecting the increasing trend in demand for dairy products.

During the year, chicken production marked a growth of 12 per cent to 116,760 metric tons while egg production grew by 4 per cent to 1,185 million. The measures implemented to subdue price hikes in the poultry market helped gradually improve the production of chicken and eggs. The government directed the National Livestock Development Board to import parent birds and hatching eggs of day old chicks to fill the shortage of the day old chick supply in the market. Accordingly, the layer chick production showed a remarkable increase of 42 per cent during the year leading to an increase in egg production. Moreover, six new parent poultry breeding farms were established during the year, which would help sustain the emerging demand for day old chicks. Further, during the year, animal feed production also increased significantly by around 30 per cent while reducing the cost of average feed prices. This reduced the cost of production of chicken and egg

Table 2.6 Livestock Sector Statistics

Sub sector	2010(a)	2011(b)
1. National Herd (No.) (mn)	1.6	1.6
Neat Cattle	1.2	1.2
Buffalo	0.4	0.4
2. National Milk Production (mn litres)	247.6	253.3
Cow Milk	191.9	198.4
Buffalo Milk	55.6	54.8
3. Milk Products (mn litres)	17.8	18.9
4. Producer Price - Cow Milk (Rs./litre)	32.48	50.00
5. National Egg Production (No) (mn)	1,139.9	1,185.3
6. National Poultry Meat Production (mt '000)	104.16	116.76

(a) Revised
(b) Provisional

Source: Ministry of Livestock Development
Department of Census and Statistics

BOX 5 Achieving Self Sufficiency in Milk

The dairy industry has a greater potential for providing extensive and gender balanced employment opportunities. Further, milk plays a key role in providing nutrition with high quality proteins, minerals and vitamins. Therefore, targeting self sufficiency in milk is important. In addition, milk self sufficiency provides food security. The Ministry of Livestock and Rural Community Development (MLRCD) in their Livestock Master Plan (LMP), a medium term plan, published in 2011, plans to reach milk self sufficiency by the end of 2015, which is a challenging task.

Translating milk self sufficiency into numbers the current milk production of 253 million litres has to be increased to 732 million litres by 2015. This level has been arrived at on the recommendation made by the Medical Research Institute of Sri Lanka, based on an average dietary allowance of 100 ml of milk per person per day.

At present around 78 per cent of milk production is cow milk and the balance buffalo milk. The local production is only one-third of the domestic consumption of milk and milk products and the balance is imported at an average cost of USD 251 million, about 1.8 per cent of the import expenditure. The current per capita consumption of milk in Sri Lanka is low compared to the other South Asian countries. The farm gate price of milk is around Rs. 50/- per litre and the average cost of production is reported as Rs. 27.86 per litre.

The cattle and buffalo population is around 1.19 million and 0.41 million respectively as per the livestock statistics in 2011. At present, the cattle population growth rate is low. Cattle and buffalo rearing are carried out in five major agro-climatic zones of up country, mid country, the coconut triangle, low country wet zone and the dry zone.

Poor exploitation of existing genetic potential and existing resources, low productivity, the high cost and lack of high quality breeding material, high calf mortality, slow expansion of the extension system, ineffectiveness of veterinary extension services, unavailability of programmes to assist farmer organisations, lack of proper standards for quality testing of milk at field levels, inadequacy of farm based milk processing and marketing programmes and difficulty in obtaining artificial breeding facilities are some of the major constraints faced by the dairy industry.

The strategic approach proposed by the MLRCD in its LMP presents nine strategies. In those strategies, policy support in terms of land use and strengthening the private sector in activities such as Artificial Insemination (AI) and raising heifer calves as a commercial activity are means to achieving the objective. A social strategy is proposed to empower dairy farmers through self managed farmer societies. In the area of industrial development, strategies for diversifying ownership by encouraging large scale investors and promotion of semi mechanized intensive commercial scale dairy farming can generate far reaching results. As suggested, introduction of new technology to increase productivity will lead to profitability and hence the sustainability of the production system. Ensuring evening milking and the maintenance of scientific dairy management practices can no longer be ignored as presented in LMP.

Upgrading the stock of dairy animals has been paid attention and the National Livestock Development Board (NLDB) has been allocated the task of supporting a breed development programme by establishing nucleus farms. Further, policies for promoting private cattle breeder farms have also been highlighted in the LMP.

Production of low cost but quality cattle feed has also been highlighted. To have an effective extension service and disease control strategy LMP identifies having a Livestock Development Instructor (LDI)/AI Technician per 150 dairy farm family clusters and a Veterinary Unit with a Veterinary Surgeon, two LDIs and other support staff per every 300 dairy farm family clusters. User-driven research, establishment of a Dairy Technology Institute and a dairy farmer focused organisational set up for providing livestock services have been identified as necessary ingredients of the overall strategy.

At present credit programmes are available for the sector covering small dairy farmers as well as large scale dairy entrepreneurs. Introducing a fresh milk drinking culture and eliminating inefficiencies in the milk marketing chain by improving infrastructure facilities at milk collecting points have also been identified in the strategic document.

In the implementation process it is desirable to convert the LMP - the medium term plan - to annual plans with quarterly targets and making all stakeholders aware of their targets and the mechanism for achieving those targets. For example, in achieving the dairy industry targets a comprehensive Milk Road Map (MRM) would be useful. The MRM may be revisited and reviewed periodically.

In the annual plans it is necessary to specify the milk production expected from the five agro-climatic zones which would allow for rational resource allocation.

Monitoring the growth of the cattle and buffalo population in each agro-climatic zone with its right link to production and productivity targets would indicate the rationality of the planning process. The MRM can take steps to strengthen the supply chain of milk i.e. dairy farmers, dairy co-operatives, dairy processors and marketers. Public and regular announcements by the relevant authorities whether the MRM is on track to meet targets would keep the process challenging and credible.

The viability of a vibrant dairy industry lies on making it a commercialised industry with the building up of strong bonding among the constituents of the milk supply chain i. e. the dairy farmers, dairy co-operatives, processors and dairy product marketers. At the initial stage, the dairy industry requires Government policy support particularly to face the competition with imported milk in terms of their form (powdered milk), volumes and prices. Once the marketers are able to build up the right bonding with consumers through availability, proper standards for quality and competitive pricing of dairy products the potential for a competitive and sustainable industry will be realised to pave the way towards building self sufficiency in milk.

References

1. DairyCo, Agriculture and Horticulture Development Board, Warwickshire. (2010), dairy roadmap. http://www.dairyco.org.uk
2. Ministry of Livestock and Rural Community Development. (2011), Livestock Master Plan, A Strategy for Livestock Development for self-sufficiency.
3. Data Source: Department of Census and Statistics.

of poultry farmers in 2011. Accordingly, the average price of chicken declined to Rs. 344 per kg from Rs. 356 per kg and egg prices declined to Rs. 11.80 from Rs. 13.20 per egg during the year over 2010.

Forestry

As per the estimates of the Forest Department (FD), the total forest cover of Sri Lanka stood at 1,951,472 hectares by end 2011. FD continued its development programmes with a special focus on increasing forest cover in the country. With the assistance of the World Food Programme, FD carried out an extensive home gardening programme in Vavuniya and Kilinochchi. Further, Sri Lanka also expects financial assistance under UN-REDD (Reducing Emissions from Deforestation and Degradation) programme in 2012 to further develop forest cover in the country. In 2011, the extent reforested increased to 1,360 hectares compared to 905 hectares in 2010. Further, under the private sector around 448 hectares were also added to the total forest cover during the year.

Several measures were implemented during the year to enhance the productivity, quality of tea and value addition and marketing of Sri Lanka tea in the global market. The subsidy was increased for replantation of tea from Rs.250,000 per hectare to Rs.300,000 per hectare for all tea growers with effect from 2012. At the same time, the subsidy for new plantations was also increased from Rs.50,000 to Rs.150,000. Also, a concessionary loan scheme was proposed for Regional Plantation Companies (RPC) to encourage replantation activities in Budget 2012. Moreover, a committee was set up to form a mechanism to distribute the cultivable but unutilized lands of around 15,150 hectares prevailing under RPCs to suitable tea growers. The “Randalu Strategy” was implemented with the target of maintaining green leaf standard at its highest level by improving the post-harvest techniques. This would improve the quality of tea while reducing refused tea quantities at the factories, thereby substantially improving the tea production volumes and raising export income. “The Tea Promotion and Marketing Fund” was established by collecting a levy from exporters of tea at the point of export exclusively for the purpose of strengthening the worldwide promotional campaign of “Pure Ceylon Tea." Further, a project is under way to automate the pre and post-auction mechanisms at the CTA with a view to making the auctioning mechanisms more transparent, thereby increasing the efficiency of the operations at CTA. Moreover, the Tea Council was reestablished under the Sri Lanka Tea Board Act in order to advise the government with regard to addressing issues relating to the tea sector. The Advisory Board was also re-established under the Tea Control Act for advising the stakeholders on their industry related problems and labour issues.

A new tea product developed by the Tea Research Institute (TRI) namely, "St' Coombs White Tea- Bud Plus" to enhance the value addition was marketed at the CTA, which fetched an average sale value of Rs. 15,000 per kg in 2011.

Institutional support was committed to further increase yield, product quality and efficient use of resources in the rubber sector. New policy measures were introduced in 2011 through the Rubber Development Department (RDD) for sustainable growth in rubber production. The RDD established a programme for part subsidization of fixing rain guards targeting 6,000 hectares in the smallholder sector and 10,000 hectares in the corporate sector. Initiatives were taken for further expansion of rubber cultivation in the Eastern Province and a new plant nursery was started at Maha Oya in the Province in order to provide the new clonal varieties suitable for the region. Moreover, the feasibility study is currently under way to introduce rubber planting in non-traditional areas, especially Anuradhapura, Vavunia and Polonnaruwa. Meanwhile, the Rubber Research Institute (RRI) in continuation of their efforts to improve the technology, designed and constructed a new drying system to reduce the drying period of crepe rubber from 3 days to few hours. Also, two newly developed low intensity latex harvesting (LIH) systems were tested for commercial operations to reduce the cost of production of rubber, extending the life span of the rubber trees.

In 2011, several measures were taken to develop the coconut sector. A programme named, "*Kapruka Purawara*" was implemented with a view to enhance the coconut production up to 3,650 million nuts by 2016. Under this programme, around 4 million coconut plants were distributed in 2011 and another 6 million coconut plants will be distributed in 2012 to promote coconut planting in potential lands. Meanwhile, two new hybrid seed gardens were established in *Marawila* and *Pooneryn* and a land suitability classification project was commenced to identify the suitable lands in non-traditional coconut areas including the Northern Province. As a solution to *Weligama Coconut Leaf Wilt Disease* (WCLWD), Coconut Research Institute (CRI) released a Sri Lanka grown *Green Dwarf* variety (*Kola Kundira*), which was identified to be resistant to the disease for cultivation in disease affected areas. Meanwhile, the Coconut Development Authority has identified the need for improving the National Home Gardening Programme for domestic consumption while improving the supply of coconut in the Coconut Triangle for industries.

Several measures were introduced to increase the yield and production of export agriculture crops. Measures implemented by the DEA mainly targeted to increase replanting and new planting activities while improving the yield of existing cultivations. Further, DEA continued to provide high quality planting materials and technical assistance and extension services in 2011. Presently, the bulk of Export Agricultural Crop exports such as cinnamon, pepper, cloves etc., are in raw form and value addition is low. Therefore, DEA also launched a subsidy programme to improve product diversification alongside quality improvement.

During the year, several measures were introduced to improve best agricultural practices and agriculture support services. The Department of Agriculture (DOA) revealed that mixture of 10 metric tons of organic fertiliser with 75 per cent of recommended inorganic fertiliser for 1 hectare of paddy cultivation has produced a higher yield compared to 100 per cent usage of the recommended inorganic fertiliser in the paddy sector. Also, adding organic manure helps to sustain soil fertility in the long run. The big onion cultivation is seasonal in Sri Lanka and storage of big onion for more than four months is a challenge due to improper post-harvest handling and as a result, the country depends heavily on imported big onion. To overcome this difficulty, the Institute of Post-harvest Technology (IPHT) introduced a new structure to improve the quality of big onion storage. Further, in order to reduce the post-harvest losses in vegetables and fruits, new regulations were enforced under the Consumer Affairs Authority during the year thereby making use of plastic crates compulsory in respect of selected varieties of vegetables and fruits in post-harvest handling. Meanwhile, the cultivation of selected field crops such as Green Gram, Black

Gram and Cow pea in paddy fields during the intermediary period between Maha and Yala was also successfully implemented in 2011. During the year, the Rice Research Institute (RRI) released two new rice varieties of 3½ months age group, (Bw 367 and Ld 368) for commercial cultivation. Further, RRI continued to conduct researches in response to controversial media revelations of arsenic in locally produced rice beyond recommended levels and proved that the arsenic in local rice varieties is within the limits permitted by the World Health Organization. Moreover, in recognition of the large number of unresolved problems of tenant farmers and land owners, action has been taken to make necessary amendments to the existing Agrarian Development Act No. 46 of 2000.

Budget 2012 proposed several measures to promote agricultural products. To facilitate the concept of a "Rice Exporting Economy", it was suggested to extend various concessions including granting tax concessions for the establishment of modern rice processing mills in proposed “Rice Export Zones” in Southern, Eastern, North Central and Northern provinces. The Budget also proposed to provide assistance to promote inter-cropping of cinnamon, pepper, cardamom and cocoa.

Several measures, which were proposed in Budget 2011, were implemented during the year. Accordingly, the fertiliser support programme was extended to cover all crops since May 2011 and under the extended programme, unmixed fertiliser and mixed fertiliser were distributed at Rs. 1,200/50 kg and Rs. 1,300/50 kg, respectively, while continuing fertiliser support for paddy at Rs. 350/50 kg. Therefore, the government bears 90 per cent of the inorganic fertiliser cost in the paddy sector and 65 per cent of all other crops under the existing cost structure. Accordingly, the total cost of the fertiliser support programme of Rs.29.8 billion was allocated from the government budget in 2011. Further, a prioritised national programme “*Divi Naguma*” was implemented in 2011 by the Ministry of Economic Development. Under this programme, a special emphasis was given to promote agriculture aimed at improving livelihood, rural development and food security. In 2011, Rs. 3,864 million was allocated from Budget 2011 and Rs. 1,528 million was spent to distribute 3.6 million seed and fertiliser packets to promote home gardening, 360,000 day old chicks to encourage poultry farming and 1.7 million coconut plants to support plantation of coconut. The provision of Green Nets for the promotion of nurseries and assisting commercial flower cultivation and high value crop production are other major aspects of the programme.

A number of measures were taken to improve the capacity and productivity of the dairy sector to reach the target of selfsufficiency in milk production. The producer price of liquid milk was increased to Rs. 50 per litre (Fat and Solid Non-Fat ratio is at 4.2/8.3) during 2011 from Rs.33.20 per litre with a view to encouraging the dairy farmers. Further, the Livestock Master Plan prepared by the Ministry of Livestock Development to design a plan of action in the dairy sector was approved by the Cabinet of Ministers during the year. Meanwhile, Department of Animal Production and Health carried out a total of 181,725 artificial inseminations in the year contributing to increase the cattle population in the country. Further, 56 new dairy villages were established during the year. Also, a laboratory was established to produce foot and mouth vaccines for cattle which were previously imported.

Several measures were implemented to promote the fisheries sector. The destructive fishing methods in Sri Lankan waters such as bottom trawling, use of dynamite and monofilament nets were banned to improve the sustainability of the fishery sector. Further, fishery industry was exempted from income tax for a five year period commencing April 2011. Fees charged for issue of licences and boat registrations were removed from January 2011. The “*Diyawara Diriya*” loan scheme was introduced by the Ministry of Fisheries in collaboration with a participatory commercial bank to promote deep sea fishing as well as inland fishery and aquatic resources. Opening of the Central Fish Market Complex at Peliyagoda with modern facilities in March 2011 contributed to improve fish marketing and post-harvest handling. Meanwhile, in facilitation of recovery of fishery activities in the Northern Province, total ice manufacturing plants and cold rooms were increased to 15 and 07, respectively, with the total capacity of 107 metric tons per day and 263 metric tons per day, respectively.

Industry

Industry sector grew by 10.3 per cent in 2011 compared to 8.4 per cent in 2010, while the share of Industry sector in the total GDP increased to 29.3 per cent in 2011 from 28.7 per cent in 2010. Reflecting the conducive environment for industries that prevailed during the year, all sub sectors, namely, mining and quarrying, manufacturing, electricity, gas and water and construction recorded higher growth rates.

Factory industry, the largest sub sector in Industry sector, recorded a growth of 8.3 per cent in 2011 compared to 7.5 per cent in 2010. All major categories in the factory industry recorded improved performance resulting from increased domestic activity and the resilience of export industries despite a difficult global environment. The rising private sector consumption, aided by lower interest rates and inflation coupled with post-war optimism, stimulated domestic demand spurring growth in factory industry output. Export market oriented industries maintained their competitiveness amidst the sluggish recovery in traditional western markets by implementing cost saving strategies and product and market diversification strategies.

The Central Bank revised the compilation of the monthly Industrial Production Index (IPI) based on the International Standard Industrial Classification of All Economic Activities (ISIC) from revision 2 to revision 4 during 2011. The ISIC compiled by the United Nations is the international reference for the classification of all productive activities in the economy. The revised IPI according to ISIC revision 4 comprises 23 divisions, which are further disaggregated into 44 groups and 76 classes, to analyse detailed information in the manufacturing sector. The base year of the revised IPI is also updated to 2010 to reflect the emerging structural changes in the industrial sector and enhance the accuracy and reliability when using it as a proxy in the compilation of the Gross Domestic Product (See Box No.6). The growth in the manufacturing sector according to the revised IPI accelerated to 9.2 per cent in 2011.

Growth in domestic market oriented industries was led by the high performance in food, beverages and tobacco products and non-metallic mineral products. The demand for food and beverages remained strong due to expansion in retail trading activity led by higher level of consumer spending and growth in tourism related activity. Increased construction activity by both public and private sector fuelled higher growth in non-metallic mineral product industries, which mainly comprise cement and building materials.

Export industries remained resilient through improved competitiveness despite slower growth in major traditional export markets. The growth in the export market oriented industries was mainly driven by wearing apparel, rubber based products, machinery and equipment, diamonds and gems and jewellery. Gradual recovery in the global markets, albeit lower than expected, boosted export demand for major industrial products. However, in view of slower growth in these markets, export market oriented industrialists adopted competitive measures such as improved design capabilities and best practices in green manufacturing while strengthening closer relations with key buyers of end products.

Manufacture of food products recorded a growth of 8.7 per cent in 2011 compared to 12.5 per cent in 2010. The moderation in growth in 2011 compared to the previous year was primarily due to the high base in 2010 resulting from increased demand for Fast Moving Consumer Goods (FMCGs) and other food products from the Northern and Eastern provinces. Fish based products, bakery products, dairy products, starches and starch products were the main contributors to the growth in food products. Capital investments in machinery and modernisation of existing farms contributed to the high growth recorded in the dairy products. Bakery products performed well amidst strong domestic demand for prepared food. High growth in bakery products also aided the growth in starches and starch products, which is the main raw material for bakery and prepared food.

Manufacture of beverages recorded a growth of 10.2 per cent in 2011 compared to 19.7 per cent in 2010, mainly contributed by the growth in soft drinks, bottled mineral water and distilling and blending of spirits. The production of beverages benefitted from enhanced market access to the Northern and Eastern provinces, increased consumer spending on account of improved income levels as well as the high growth momentum of the tourism sector.

Manufacture of tobacco products, which increased by 7.2 per cent in 2010, recorded a moderate growth of 6 per cent in 2011. The growth in tobacco products was supported largely by improved market access to Northern and Eastern provinces, increased tourism as well as government measures to curb importation and sale of illegal cigarettes.

Manufacture of wearing apparel recorded a significant growth of 13.8 per cent during 2011 compared to 3.2 per cent in 2010. The growth in the apparel sector is commendable in the wake of the slowdown in major export markets in the US and EU regions. Consequently, apparel exports surpassed the significant milestone of US dollars 4 billion in 2011. Sri Lanka's reputation as a reliable supplier enabled the industry to maintain a high growth momentum in traditional markets while increasing exports to other non-traditional markets. Focus on moving up the value chain, strategic partnerships with key customers and supply chain stakeholders together with improvements in quality and productivity also contributed to the high growth in the wearing apparel division.

Chart 2.3 Industrial Production Index - IPI (2009-2011)

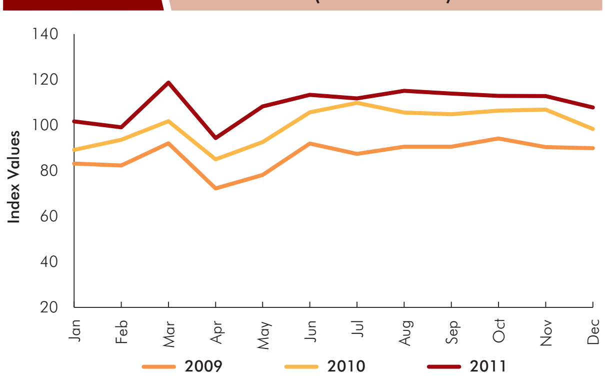


Table 2.7 Industrial Production Index (IPI) (a)

2010 = 100

	Division	2010	2011	Change (%)
1	Food products	100	108.7	8.7
2	Beverages	100	110.2	10.2
3	Tobacco products	100	106.0	6.0
4	Textile	100	100.9	0.9
5	Wearing apparel	100	113.8	13.8
6	Leather and related products	100	94.0	-6.0
7	Wood and products of wood	100	107.9	7.9
8	Paper and paper products	100	88.3	-11.7
9	Printing and reproduction of recorded media	100	100.5	0.5
10	Refined petroleum products	100	106.3	6.3
11	Chemical and chemical products	100	95.3	-4.7
12	Pharmaceuticals	100	133.0	33.0
13	Rubber and plastic products	100	116.5	16.5
14	Non-metallic mineral products	100	116.7	16.7
15	Basic Metals	100	115.5	15.5
16	Fabricated metal products	100	89.6	-10.4
17	Electrical equipment	100	98.7	-1.3
	Overall Industrial Production Index	100	109.2	9.2

(a) Provisional

Source: Central Bank of Sri Lanka

Apparel industrialists continued to explore niche markets in the Asian region and other non-traditional markets to sustain the current growth momentum given the continuing deflationary pressures in the EU region and low growth in the US. In this regard, it is noteworthy that apparel exports to countries other than the EU and the USA, in particular to Japan, India, Saudi Arabia, Australia and Russia have witnessed a marked improvement. Measures to diversify into new markets will also be strengthened by gaining preferential market access to key emerging markets such as China and Russia in the future.

Rubber and plastic products recorded a growth of 16.5 per cent in 2011 compared to 41.1 per cent in 2010. Manufacture of rubber based products recorded a significant growth of 18.3 per cent in 2011 whereas manufacture of plastic products recorded a moderate growth. High level of exports in vulcanised rubber products; rubber tyres, tyre cases, tubes and other articles of rubber contributed to the growth of rubber products. Export of industrial tyres increased due to the gradual build up of inventories that were run down during the recession in the US. External demand for rubber gloves also remained satisfactory during 2011. The domestic demand for rubber based products, mainly tyres, increased as a result of improvements

BOX 6

Revision of Industrial Production Index (IPI)

Introduction

An Industrial Production Index (IPI) is an important indicator of a country's industrial sector performance. IPI compares industrial activity during the current period in reference to a base period in the past to gauge the performance of the industrial sector. It is an important component in the compilation of national accounts of a country to determine the value addition in the Industry sector. Since an IPI can be compiled on a monthly basis, it can also be considered as a leading indicator of GDP. Therefore, a comprehensive IPI provides useful information on industrial sector performance for decision making, policy formulation, research and international comparability of economic data.

The Industry sector in Sri Lanka accounts for a considerable share of 29 per cent of the GDP. Manufacturing is the largest sub sector within the Industry sector and accounts for 60 per cent of the overall Industry sector. Performance of the manufacturing sub sector is currently measured by the Monthly Industrial Production Volume Index (MIPVI), which is also used as a leading indicator in the compilation of GDP. The Industry sector in Sri Lanka recorded an accelerated growth commencing 2010 onwards, supported by enhanced business confidence resulting from post-war optimism. Developments that took place in the Industry sector, particularly in the areas of capacity expansion in existing industries and emergence of new industries in recent years, necessitated the Central Bank to revise the compilation of the IPI during 2011.

The revised IPI is based on the International Standard Industrial Classification (ISIC) revision 4. The ISIC is the formal classification of economic activities based on internationally agreed concepts, definitions and principles published by the United Nations (UN). ISIC provides a comprehensive framework within which economic data can be represented in a more useful format for economic analysis and policy formulation. The latest revision, which is ISIC revision 4 was introduced in 2005.

Current Industrial Production Index

The Central Bank commenced compiling the MIPVI in 1998 with the base year of 1997, based on ISIC revision 2. The MIPVI measures the output in manufacturing sector factory industries in terms of nine major industry categories as indicated in Table B 6.1. Production data for the MIPVI is obtained from 150 companies in the private sector on a monthly basis.

A major weakness in the MIPVI is in the classification of industries into broad categories. As a result, performance of a particular category, for example,

Table B 6.1 Classification of MIPVI - ISIC revision 2

1997 = 100

Category	Weight
1. Food, beverages and tobacco products	46.9
2. Textile, wearing apparel and leather products	22.7
3. Wood and wood products	0.9
4. Paper and paper products	0.4
5. Chemicals, rubber, plastics,petroleum	14.2
6. Non-metallic mineral products	5.1
7. Basic metal products	0.2
8. Fabricated metal products	7.7
9. Products (n.e.s)	1.9
Overall MIPVI	**100**

Source : Central Bank of Sri Lanka

Table B 6.2 Classification of IPI - ISIC revision 4

2010 = 100

Manufacturing Division	Weight
1. Food products	21.4
2. Beverages	8.5
3. Tobacco products	8.8
4. Textiles	1.7
5. Wearing apparel	24.0
6. Leather and related products	0.8
7. Wood products except furniture	0.1
8. Paper and paper products	0.2
9. Printing and reproduction of recorded media	0.7
10.Refined petroleum products	2.3
11.Chemicals and chemical products	6.1
12.Pharmaceuticals	0.1
13.Rubber and plastic products	9.6
14.Other non-metallic mineral products	7.5
15.Basic metals	0.6
16.Fabricated metal products	4.0
17.Computer, electronic and optical products	0.2
18.Electrical equipment	2.4
19.Machinery and equipment (n.e.s)	0.4
20.Motor vehicles, trailers and semi-trailers	0.1
21.Other transport equipment	0.1
22.Furniture	0.1
23.Other Manufacturing	0.3
Overall IPI	**100**

Source : Central Bank of Sri Lanka

of the 'textile, wearing apparel and leather products' category, does not provide a clear indication of the growth of individual sub-categories, as the share of the wearing apparel sub-category is significantly higher than the share of the textile and leather product sub-categories. Further, the 1997 base weights do not reflect the structural changes that has arisen in the industrial sector since then. Subsequent to the introduction of the MIPVI in 1998, the structure and processes in the manufacturing sector have changed noticeably. Emergence of new industries and higher forms of value addition processes in existing industries necessitated to compile a suitable index with a more recent base year, to better reflect the current structure in the manufacturing sector. Therefore, the need to revise the current MIPVI in order to improve the classification, coverage and reliability of industrial production data was recognised by the Central Bank.

Revised IPI based on ISIC revision 4

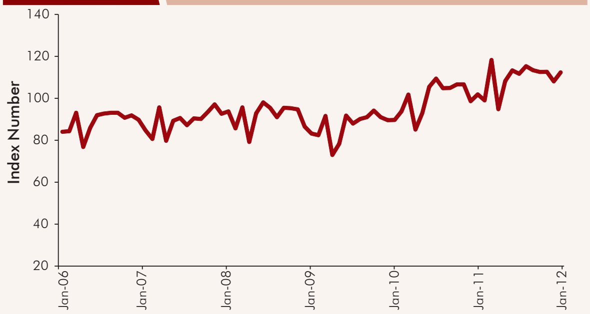
The Central Bank revised the compilation of the IPI from ISIC revision 2 to ISIC revision 4 with a new base year and new industry categories as indicated in Table B 6.2. The weights based on production activity of 2010, reflect the emerging structural changes taking place in the manufacturing sector. For example, food, beverages and tobacco products category accounted for 46.9 per cent of the MIPVI. In the revised IPI, this category accounts for only 38.7 per cent, while it is re-classified into three separate categories namely, manufacture of food products, beverages and tobacco products. The decline in the combined weight of food, beverages and tobacco product categories reflect the structural change in the economy with manufacture of more sophisticated, value added products replacing manufacture of basic consumer products as the economy progresses over time. Furthermore, share of the wearing apparel industry in the revised IPI has increased to 24 per cent from 22.7 per cent in the MIPVI, reflecting increased value addition in the apparel industry.

In terms of classification, the revised IPI comprise 23 major categories as compared to 9 major categories in the MIPVI. As per ISIC revision 4, major categories are defined as divisions. A division is subsequently disaggregated into more detailed groups and thereafter into detailed classes. Classes in the index are the basic manufacturing units, which comprise homogeneous product items and weighted by the value of the class. Consequently, weights of the overall IPI are derived from the value of each class.

Performance of the Industry sector

Performance of the industrial sector, as measured by the revised IPI in terms of seasonally unadjusted data, calculated back to 2006, is shown in Chart B 6.1. As per the revised IPI, performance of the manufacturing sector indicates an upward trend since end 2009. Increase in the IPI is also reflected by the high growth rates recorded in the manufacturing sector during 2010 and 2011. On average, the output in the manufacturing sector factory industries increased by 7.4 per cent during the period 2009 - 11.

Chart B 6.1 Industrial Production Index 2010=100



Conclusion

The revised IPI based on ISIC revision 4 is reflective of emerging structural changes in the industrial sector of the economy. Moreover, the IPI enhances the accuracy in the compilation of the GDP and in forecasting future trends. Further, it improves international comparability of economic performance as a majority of countries compile similar indices based on ISIC revision 4.

Central Bank intends to further expand the coverage of the revised IPI by incorporating production data from a number of emerging industries while enhancing the coverage of existing industries to give a fairer representation of the manufacturing sector. In the context of current dynamic economic environment, the revised IPI is set to meet the growing demand for information from a number of stakeholders. Timely and accurate information pertaining to the industrial output will facilitate policy makers as well as other stakeholders to identify emerging trends and to make informed policy decisions pertaining to the industrial sector.

Reference:

1. United Nations. (2008). International Standard Industrial Classification of all Economic Activities (ISIC): Rev. 4. New York: United Nations.

in transport and distribution activity. Manufacturers of rubber based products also benefited from lower interest rates, which prevailed during 2011. Domestic demand for plastic and PVC products grew in line with the growth in the construction industry.

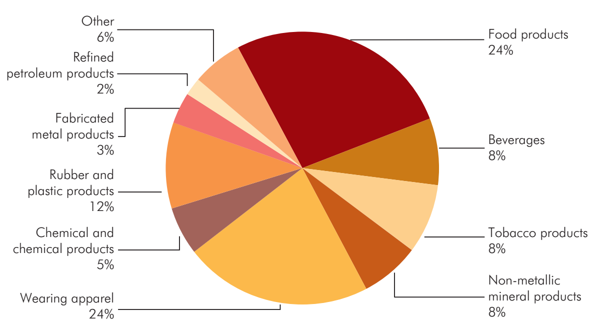
The growth of fabricated metal products, which mainly comprise ship building and ship repairing, slowed down in 2011. The demand for new ships decelerated due to the excess supply of ships of all sizes. Growth in ship repair activity was maintained during 2011 amidst rescheduling of dry-dock repairs by ship owners.

Emergence of new ports and deep water off-shore oil and natural gas exploration in the region is expected to create new demand for ship building in the "Off-Shore Supply Vessels" (OSV) market segment. In addition, there are emerging opportunities in the ship repair sector with the development of the Hambantota Port and the Colombo South Harbour Development Project.

The demand for locally manufactured leisure boats, fishing boats and small and medium scale luxury yachts moderated in 2011. This was mainly due to restrictions placed on high horse power outboard engines and unfavourable market conditions, which prevailed in export markets. However, progressive measures adopted by the Boat-building Technology Institute (BTI) as well as regular boat exhibitions will facilitate development of the local market for high quality boats used in fishing and leisure activity.

Non-metallic mineral products grew by 16.7 per cent during 2011 compared to 17.8 per cent in 2010. The growth in cement, tile and roofing industries accelerated due to sustained demand from large scale government infrastructure projects. Demand for minerals and other construction materials was also fuelled by the ongoing post-war reconstruction activities in the Northern and Eastern provinces. Porcelain and ceramic manufacturers experienced heightened competition and weak export demand from traditional western markets. However, weakness in the demand from export markets was offset by the strong demand for porcelain and ceramic products resulting from the construction of new hotels and refurbishment of existing hotels on a substantial scale.

Chart 2.4 Composition of Industrial Production Index (IPI) - 2011



Manufacture of refined petroleum products, which declined marginally in 2010 recorded a growth of 6.3 per cent in 2011. The growth in this category, which consist entirely of refined petroleum products of the CPC, was mainly due to higher consumption of fuel for transportation and electricity generation activity.

The government continued with the regional industrial development programme through the Ministry of Industry and Commerce (MIC) expanding its coverage to the Northern and Eastern provinces parallel to the '*Wadakkil Wasantham*' and '*Nagenahira Navodaya*' special programmes. Phase I of the Trincomalee Industrial Estate was completed with six factories commencing commercial operations. Infrastructure development of Phase II of this project has commenced and a new industrial estate has been proposed in Thiraimadu, Batticaloa district. The proposed industrial estate in Mannar reached partial completion with two garment factories approved by the Board of Investment (BOI) to commence operations by May 2012. Potential industries for the proposed industrial estates in Vavuniya have been identified in the areas of boat building, fishing gear, fish processing, palmyrah based products and salt based products focusing on regionally available resources. During 2011 industries located within industrial estates in all districts of the country were given concessionary rates for land rentals and machinery imports as a measure to expedite the establishment of new industries. The MIC is in the initial stage of implementing an energy efficiency

Table 2.8 Ex - Factory Profit Ratios of Private Sector Industries (a)

Category	Total Cost of Production (Rs. million)		Total Value of Production (Rs. million)		Factory Profit Ratio (percentage)	
	2010	2011(b)	2010	2011(b)	2010	2011(b)
1. Food, beverages and tobacco products	146,456	187,594	172,283	224,364	15.0	16.4
2. Textile, wearing apparel and leather products	41,236	43,777	46,965	50,037	12.2	12.5
3. Wood and wood products	3,205	3,371	3,642	3,751	12.0	10.1
4. Paper products, publishing and printing	10,273	13,927	11,742	15,900	12.5	12.4
5. Chemical, petroleum, coal, rubber and plastic products	83,398	99,026	98,563	117,901	15.4	16.0
6. Non-metallic mineral products	53,621	66,341	62,161	77,063	13.7	13.9
7. Basic metal products	5,042	5,558	5,864	6,459	14.0	14.0
8. Fabricated metal products, machinery and transport equipment	32,356	30,775	37,578	34,879	13.9	11.8
9. Manufactured products not elsewhere specified	6,411	5,231	7,335	5,992	12.6	12.7
Total	381,998	455,599	446,133	536,347	14.4	15.1

(a) Based on the Industrial Production Survey
(b) Provisional

Source: Central Bank of Sri Lanka

and waste management programme for selected industries located within the industrial estates. The free port concept surrounding the Hambantota port area has opened new avenues to industrialists in emerging sectors, such as motor vehicle assembly, cement grinding, mixing plants and packaging industries.

Government initiated a new tax incentive regime for industrialists. These include incentives based on eligibility according to industry size as small, medium and large scale projects, project expansions and strategic development projects. Additionally, import substitution industries in fabric, pharmaceuticals, milk powder and cement industries qualify for special incentives. Under the new tax incentive regime, investors will receive tax holidays, concessionary income tax rates and exemptions from customs duty on expenditure incurred for purchase of project related plant, machinery and equipment. Strategic development projects, which contribute substantially towards economic development, are eligible for special incentives under the Strategic Development Projects Act. As a step towards transforming Sri Lanka into a competitive investment destination by improving the ease of doing business, the "One Stop Shop" concept under the BOI, which is currently in practice is to be further improved to ensure speedy clearance of project approvals and fast track project implementation. Further, BOI has established an automated Land Bank to facilitate potential investors to find suitable land to locate their intended projects, which could be accessed via the BOI website.

The Joint Apparel Association Forum (JAAF) undertook activities in line with the 5 year strategic plan to develop the apparel sector. The JAAF with the continuous support from the government undertook a number of image building activities in both the local and international arena. The programme titled 'Perception and Retention' has been implemented in the North Central and Central provinces to encourage potential employees to join the industry's workforce. Many leading apparel manufacturers have converted their factories to world class green manufacturing plants in line with global market trends emphasising JAAFs efforts to position the 'Made in Sri Lanka' brand as 'Garments Without Guilt' in the global market. JAAF has proposed deregulation of the apparel market to enable domestic buyers to purchase high quality clothes and encourage textile millers to participate in the import substitution programme thereby enabling them unlimited access to the local market.

The government took several measures through various state institutions to promote industries with significant foreign exchange earning potential. The National Gem and Jewellery Authority (NGJA) took measures to ensure that green and ethical practices are adhered to in gem mining activities, while encouraging industrialists to export gem studded jewellery to enhance the value addition. Based on the recommendation of

Table 2.9 Domestic Cost Structure of Private Sector Industries (a)
(As a percentage of total cost of production)

Category	Power & Fuel		Wage		Raw Material		Interest	
	2010	2011 (b)	2010	2011 (b)	2010	2011 (b)	2010	2011 (b)
1. Food, beverages and tobacco products	3.8	4.5	10.8	11.2	41.2	42.3	1.6	1.4
2. Textile, wearing apparel and leather products	5.4	6.1	15.6	16.8	14.1	15.3	2.8	2.4
3. Wood and wood products	10.5	11.1	17.2	18.1	34.0	34.5	3.8	3.2
4. Paper products, publishing and printing	5.1	6.5	13.6	14.2	20.7	22.7	3.2	2.8
5. Chemical, petroleum, coal, rubber and plastic products	7.3	8.1	14.3	14.7	32.3	33.2	3.0	2.5
6. Non-metallic mineral products	21.6	26.5	15.9	16.2	31.0	32.5	3.0	2.3
7. Basic metal products	10.6	11.2	11.4	12.5	36.8	38.5	1.9	1.6
8. Fabricated metal products, machinery and transport equipment	5.8	7.1	13.0	13.5	29.2	32.1	3.4	2.9
9. Manufactured products not elsewhere specified	6.0	6.4	12.3	12.8	35.3	37.4	1.5	1.2
Total	7.2	6.4	13.0	13.8	33.8	34.2	2.6	1.9

(a) Based on the Industrial Production Survey
(b) Provisional

Source: Central Bank of Sri Lanka

the NGJA, the government approved an advance payment of US dollars 50,000 for the procurement of raw gems from foreign countries for value addition and re-export purposes. The MIC continued to promote the footwear and leather tanning industry by initiating the setting up of an industrial zone in the Puttalam District. Plans are underway to commence a footwear training school with the assistance of an Indian footwear design institute.

Budget 2012 took steps to promote export oriented factory industries by providing a number of fiscal incentives. The corporate tax rate of 15 per cent on profits from exports was reduced to 12 per cent, while exports with a domestic value addition in excess of 65 per cent, which have acquired local patent rights, will be taxed at a maximum rate of 10 per cent per annum. Income of firms with at least 90 per cent of earnings from the export of manufactured products is exempted from income tax. Cess imposed on selected commodity exports such as rubber, minerals and raw materials, which have a potential for further processing and domestic value addition was increased. These fiscal incentives reflect the government's policy to encourage local innovation as well as enhance domestic value addition of export oriented factory industries.

Budget 2012 made further provisions for research and development with the objective of encouraging local innovations and technological research. A research allowance was granted to lecturers and researchers to encourage them towards research activity. Income tax on research income was reduced to 16 per cent while a triple reduction of the cost incurred when obtaining research and development services from state institutions was given to private sector firms, to be deducted from taxable income. State institutions engaged in research and technology was exempt from VAT while income tax was reduced to 20 per cent. The Sri Lanka Institute of Nanotechnology (SLINTec), which is a joint venture between the private sector and the government, is exploring possible options for expanding private sector participation in commercialising state research activity. Consequently, an agreement was signed with a private sector investor for the manufacturing of nano titanium dioxide using local mineral resources. The MIC, in collaboration with the National Enterprise Development Authority (NEDA), has initiated a Technology Development Fund (TDF) for Small and Medium Enterprises (SMEs) to facilitate commercialisation of research activity.

The government showed its commitment towards the development of the SME sector during 2011 by way of providing various support services and incentive schemes. The first component of the "*Gamata Obina Viyapara*" under the NEDA was successfully completed while the second component was commenced in Kurunegala, Kandy, Mannar and Batticaloa districts.

This programme identifies suitable entrepreneurs for selected businesses and is carried out with the support of the Divisional Secretaries (DS). NEDA has identified cluster development programmes in selected regions including the Moratuwa Wood Cluster, Wewaldeniya Cane Cluster and Batticaloa Handloom Cluster. A tax holiday of 4 years was granted to SMEs engaged in manufacturing while imports of capital goods and raw material for export oriented industries were exempt from tax. The SME sector will receive research services from state institutions at a nominal fee in order to promote new entrepreneurs.

The mining and quarrying sub sector expanded by 18.5 per cent in real terms with better performance in gem mining and other mining activities in year 2011. Strong performance in other mining sub sector, which accounts for more than 75 per cent of the mining and quarrying sector in terms of value addition, was supported by the increased phosphate production to meet the higher demand with the extension of the fertiliser subsidy to the plantation sector, expansion in mining of mineral sands and graphite in the Northern and Eastern provinces, and the boom in construction activities during the year. Gem mining activities also grew by 17.4 per cent in 2011 as against 7.9 per cent growth in 2010 with the high demand emanating mainly from Thailand and the USA. This growth was reflected by the higher growth in export volume of gems during the year.

The processing sub sector grew only by 0.9 per cent during the year compared to a growth of 5.8 per cent in 2010. The marginal contraction in tea production during the second and third quarters of the year together with lower growth in output of rubber and coconut limited the expansion in processing sub sector.

The cottage industry sub sector expanded by 7 per cent compared to the previous years' growth of 5.5 per cent. Healthy growth in the cottage industry sub sector could be attributed to the boom in the construction sector and the government's efforts to encourage self-employment. The expansion in the construction sector exerted a positive impact on all types of small scale production of building materials. Emergence of the cottage industry with the higher demand in Northern and Eastern provinces was also observed consequent to the completion of resettlement and overall improvement in economic activity, particularly with livelihoods affected by the war returning to normalcy.

The electricity, gas and water sub sector of the Industry cluster performed well recording a 9.2 per cent growth during the year compared to the growth of 8 per cent in 2010 and 3.7 per cent in 2009. The acceleration of this sector was mainly supported by the better performance in electricity generation. The value added in electricity generation grew by 9.6 per cent with the 18 per cent drop in hydro power generation and 35.8 per cent increase in thermal power generation. The water sub sector expanded by 6.1 per cent with the implementation of new water supply projects during the year. Value added of the gas sub sector increased by 5.7 per cent.

The construction sub sector grew by 14.2 per cent in real terms during the year when compared to the 9.3 per cent growth recorded in the previous year. The growth impetus in the construction sector was induced by the enhancement of public sector infrastructure development projects and private sector involvement in construction activities such as commercial and residential building construction projects. The contribution by the private sector to the construction sector was reflected by the growth in credit for construction activities. Mega projects carried out by the government, particularly in the areas of port development, electricity and transportation, are the underpinning factors towards the growth in public sector construction activities. The growth in the construction sector was consistent with the high production and imports of cement and other construction materials. Value of domestic building material production and building material imports including cement increased by 8.6 per cent and 21.2 per cent, respectively, during the period. The price indices published by the Institute for Construction Training and Development (ICTAD) indicates that prices in construction activities had increased only by 5.4 per cent which is below the general increase in price level during the year.

Services

The Services sector, which is the largest sector in the economy contributing 59.5 per cent to the GDP, grew by 8.6 per cent in 2011. Expansion of infrastructure services such as, telecommunication, roads and transport, electricity etc. and increasing income levels helped to sustain the growth of the Services sector. During 2011, services such as domestic and foreign trade, transport, tourism, financial services, and communication, grew at a higher rate.

The wholesale and retail trade sub sector, the largest sector within the Services, grew by 10.3 per cent compared to the 7.5 per cent in the previous year. This sub sector, which suffered a set back in 2009, mainly due to the global economic downturn, recovered strongly in 2010 and the trend continued in to 2011 with healthy growth in all three sub sectors, i.e., import, export and domestic trade.

Value addition in the import trade sub sector increased by 14.3 per cent in 2011 compared to 9.3 per cent in 2010. All three main categories of imports, namely consumer goods, intermediate goods and investment goods reflected sharp increases. The volume of consumer goods imports increased by 25.6 per cent while that of intermediate goods and investment goods increased by 23.3 per cent and 28.2 per cent, respectively. The high growth in investment goods imports was mainly for infrastructure project related items such as building material, machinery and equipment. Growth in the volume of intermediate goods imports was mainly driven by the fertiliser, petroleum products and raw material imports. Growth in consumer goods imports was led by motor vehicles, medical and pharmaceuticals, dairy products and home appliances.

The export trade sub sector grew by 10.1 per cent in comparison to the low growth of 3.6 per cent recorded in the previous year, benefiting mainly from the significant increase in industrial exports, dominated by textiles and garments. Despite the removal of the GSP+ duty concession in August 2010, earnings from textile and garment exports increased by 24.9 per cent in value terms. The volume of the industrial exports increased by 18.5 per cent. The textile and garment exports, the main export item within the industrial exports category, increased by 13.5 per cent. The volume of agricultural exports dropped by 2.5 per cent due to low export volumes of rubber and other agricultural exports. Mineral exports reported a 10.0 per cent increase during the year.

The domestic trade sub sector, defined as the trading of domestically produced and traded goods, grew by 7.5 per cent. This growth was largely influenced by improved consumer demand, higher domestic production, and low inflation and interest rates that prevailed during 2011. Expansion of trading activity in the Northern and Eastern provinces also contributed significantly to the growth of the domestic trade.

The value addition in the hotels and restaurants sub sector recorded a commendable growth of 26.4 per cent in 2011. Tourist arrivals increased by 30.8 per cent in 2011. However foreign guest nights in graded hotels increased only by 21.4 per cent reflecting a higher level of contribution by the unregistered hotels and guest houses to the tourism industry. Majority of the graded hotels were able to sustain a higher occupancy rate of over 70 per cent during the year. Further, local guest nights also grew by 9.8 per cent in 2011 following the 24.5 per cent growth in the previous year.

The transport and communication sub sector, the second largest sub sector within Services, grew by 11.3 per cent in 2011 following 11.9 per cent increase in the previous year. This sub sector achieved the second highest growth in the Services sector with all three sub sectors, namely, transport, cargo handling, ports and civil aviation, and post and telecommunication, contributing significantly to the sector growth.

The transport sub sector, which includes railway, passenger and goods transport, grew by 11.3 per cent. This relatively high growth in the transport sector could be largely attributed to increased internal trading activities and the growth in tourism. The expansion in transport activities is reflected by the significant growth in transport equipment imports, petrol and diesel sales, registration of new motor vehicles and expansion in air travel during the year. The passenger kilometres operated by the Sri Lanka Railways (SLR) increased by 4 per cent while the passenger kilometres operated by Sri Lanka Transport Board and the private bus operators also improved during the year. The total passenger kilometres flown by the SriLankan and Mihin Lanka airlines had increased by 14.8 per cent in 2011.

The cargo handling, ports and civil aviation sub sector expanded by 7.2 per cent in 2011 in comparison to a growth of 16.8 per cent in the previous year. This deceleration in growth was reflected in the marginal expansion in transshipment volumes due to the slow recovery in the global economy. During the year, the Port of Colombo handled 4.3 million Twenty Foot Equivalent container Units (TEUs), showing only a 3 per cent increase. Of the total TEUs handled, domestic volume grew by 12.3 per cent, while transshipment volume (excluding re-stowing), which account for over two thirds of the total throughput, increased only by 0.9 per cent.

Value addition in the post and telecommunications sub sector grew by 13.4 cent in 2011 following a 13.2 per cent growth in the previous year. The total voice line subscriber base, which includes both fixed and mobile connections, grew by 5.4 per cent during the year. As at end December 2011, telephone density (Telephone connections per 100 people) stood at 105.1 comprising 17.3 in respect of fixed telephone lines and 87.8 in respect of mobile phones. The growth in the telecommunications sub sector was supported by the improvement in the mobile broadband subscriber base with increased affordability and the demand from the Northern and the Eastern provinces. The 3G Broadband subscriber base increased by 142.5 per cent to 0.5 million as at end 2011.

The banking, insurance and real estate sub sector grew by 7.9 per cent in 2011. The growth in this sector was supported by the expansion of branch networks, services and the favourable macroeconomic environment that led to a high growth in private sector credit. Profits of the banking and non-bank financial institutions increased in 2011. Both interest based and fee-based financial services of financial institutions grew at higher rates during the year. The performance of the insurance sub sector was benefitted by the expansion in the general insurance business including vehicle insurance along with expansion of economic activities.

The government services sub sector reported only a 1.2 per cent growth in 2011. There were no major public sector recruitment programmes implemented during the year. Retirements from government services also contributed to the deceleration in government sector value addition.

The private services sub sector recorded a 7.2 per cent growth compared to the growth of 5.8 per cent in the previous year. The growth in this sector was largely attributable to expansion of economic activities and the conducive environment for investment in personal services that prevailed during the year.

2.3 Expenditure

Gross Domestic Expenditure (GDE), which consist of the sum of consumption and investment expenditures of the private and public sectors, further expanded in 2011. GDE at current market prices has been estimated at Rs. 7,495 billion, reflecting an increase of 23.5 per cent over 2010. The corresponding increase in aggregate domestic demand for 2010 was 17.9 per cent. The private consumption encouraged by the stable price levels and low interest rates together with the conducive macroeconomic environment for investment caused the higher expansion of the GDE. GDP at current market prices, which is the sum of GDE and net exports of goods and non-factor services (Rs. 952 billion), is estimated at Rs. 6,543 billion, reflecting a growth of 16.7 per cent.

BOX 7 Financial Inclusiveness

Ensuring timely delivery of formal sector financial services at an affordable cost to all members of society can be defined as financial inclusiveness. Access to financial products by the poor can empower them by permitting them to take advantage of economic opportunities, build assets, manage risks, and reduce their vulnerability to external shocks. Hence, financial inclusiveness would contribute positively to economic efficiency, overall welfare of the society and social cohesion. Consequently, financial inclusiveness is now seen as a tool for inclusive growth and ensuring equality and has thus become a policy priority particularly in the developing countries. An inclusive financial system covers; banking penetration, availability of banking services and usage of banking system.

Developed countries too have taken efforts to build inclusive financial systems. The Community Reinvestment Act of the United States of America, under certain conditions, intended to expand access to credit to low income communities. In France, there are laws against financial exclusion. In the United Kingdom promoting financial inclusion has focused on access to banking, access to affordable credit and access to free face-to-face money advice. Moreover, banking sectors of many countries too have taken initiatives in promoting financial inclusiveness. Providing every person a banking account is one such initiative taken by the German Bankers' Association. The South African Banking Association has introduced a special low cost bank account for the financially excluded. Reserve Bank of India has taken new initiatives to introduce a bank led model for financial inclusiveness under which all public and private sector banks have been requested to prepare plans for financial inclusiveness for three years from 2010. Further, banks are advised to offer no frill accounts with nil or very low minimum balance and to provide such accounts with small overdrafts.

The literature shows seven major causes for banking/financial exclusion. Studies have found that even those who do not have a history of bad debt are sometimes "advised" to go to another bank ("Refusal exclusion"). Fulfilling identity requirements of banks to open an account is particularly difficult for the poor, homeless and refugees ("Identity exclusion"). Terms and conditions of banks such as minimum balance required to open an account prevent people from opening accounts or sometimes infrequent usage or early withdrawals results in closure of bank accounts ("Condition exclusion"). In some countries the level of bank charges are exorbitantly high and that prevents low income earners opening bank accounts ("Price exclusion"). People also become unbanked due to non availability of physical access to a bank branch particularly the small rural communities ("Access exclusion"). In the poor or middle income countries the lack of financial literacy can be a major reason for not having opportunity to use banking services ("Illiterate exclusion"). Low income groups tend to think that their interests are not matched with the banks which creates psychological or sometimes cultural barriers leading to non-use of banking services ("Self exclusion").

The lack of collateral or the inability to provide guarantors is one of the biggest problems faced by the poor when seeking for bank credit. They need small scale loans, repayments in small instalments or synchronized with their cash flows. Microfinance successfully addresses these issues. Hence, microfinance has become a powerful tool for promoting financial inclusiveness. Other innovative policies in promoting financial inclusiveness include; agent banking or "Branchless Banking", mobile banking, reforming public banks, providing financial identification using biometrically innovative methods and consumer protection.

Sri Lanka has taken many steps to promote financial inclusiveness. Banks have been encouraged to establish bank branches outside the Western Province. Banks are required to open two branches outside the Western Province when opening one in the Western Province. In the Northern and Eastern Provinces, the number of bank branches and extension offices has been more than doubled from 183 in 2006 to 407 in 2011. Further, facilitation through technology has also been promoted considerably via Automated Teller Machines (ATMs) established in every urban centre and small town in the regions. The ATMs in the country were doubled during the last 5 years. The number of ATMs in the North and East were 219 in 2011 compared with 49 in 2006. Meanwhile as per the 2006 Budget Proposals, all licensed banks were requested to fulfil the mandatory requirement of lending 10 per cent of the credit portfolio to the agricultural sector by end 2009, failing which the balance would be made available to a fund managed by the Central Bank of Sri Lanka (CBSL) to re-lend those funds to the agriculture sector.

CBSL has actively engaged in promoting financial inclusiveness by implementing various concessionary credit schemes since 1970s. CBSL established Regional Rural Development Banks (RRDBs) in 1980s with an extensive branch network in the rural areas.

CBSL is assisting banks to operate microfinance and other credit programmes by providing refinance and credit guarantee. At present there are 21 such credit schemes. Further, CBSL conducts programmes on financial literacy island-wide to minimise "Illiterate exclusion". In 2011, CBSL issued a Direction to all licensed banks to adopt a "Code of Conduct" to safeguard the customer rights which will help prevent "Condition exclusion", "Price exclusion" and to a certain extent "Self exclusion" through increased transparency and competition in the banking industry.

There is room for further improvement of financial inclusiveness in Sri Lanka. In particular, Information Communication Technology (ICT) could be employed effectively to address issues of cost, outreach and credit delivery.

References

1. ADBI, Tokyo (2009), Promoting Financial Inclusion through Innovative Policies.

   http://www.adbi.org/event/2878.financial.inclusion.innovative.policies/

2. Bernanki, Ben S. (2007), The Community Reinvestment Act: Its Evolution and New Challenges. Community Affairs Research Conference, Washington, DC.

   http://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm

3. Chakrabarty, K. C. Financial Inclusion/A road India needs to travel.

   http://www.livemint.com/2011/09/

4. Financial Inclusion Task Force (2010), Mainstreaming Financial Inclusion: Managing money and access to banking, March.

   http://webarchive.nationalarchives.gov.uk/+/http:/www.hm-treasury.gov.uk

5. Kempson, E. (2006), Policy level response to financial exclusion in developed economies: lessons for developing countries. University of Bristol, Paper for Access to Finance, World Bank, Washington, DC.

6. Sarma, M. (2010), Index of Financial Inclusion. Jawaharlal Nehru University, India.

Consumption

Total consumption expenditure increased by 22.4 per cent to Rs. 5,536 billion in 2011. This increase was a combined impact of average price levels increasing by 8.3 per cent and the growth of real consumption by 13 per cent. Of the total consumption, private consumption expenditure (PCE) increased sharply by 25.1 per cent over the growth of 17.2 per cent in 2010. The share of PCE in GDP increased considerably from 65.2 per cent in 2010 to 69.8 per cent in 2011. The government consumption expenditure rose by 10.9 per cent in 2011 compared to the lower growth of 2.5 per cent in 2010, but the share of government consumption in GDP decreased from 15.6 per cent to 14.8 per cent in 2011 reflecting the impact of the sharp increase in private sector consumption.

Table 2.10 Aggregate Demand

	Current Market Prices (Rs.mn)			Constant (2002) Prices (Rs.mn)		
	2009	2010 (a)	2011 (b)	2009	2010 (a)	2011 (b)
A. Domestic demand						
Consumption	3,967,770	4,524,188	5,536,095	1,992,820	2,145,036	2,422,926
(% Change)	4.4	14.0	22.4	3.6	7.6	13.0
Gross domestic capital formation	1,181,449	1,545,500	1,958,833	671,191	768,341	827,480
(% Change)	-2.8	30.8	26.7	2.1	14.5	7.7
Total domestic demand	**5,149,219**	**6,069,688**	**7,494,928**	**2,664,011**	**2,913,377**	**3,250,405**
(% Change)	**2.7**	**17.9**	**23.5**	**3.2**	**9.4**	**11.6**
B. External demand						
Exports of goods and services	1,031,289	1,254,021	1,508,565	665,575	723,880	803,507
(% Change)	-5.9	21.6	20.3	-12.3	8.8	11.0
Imports of goods and services	1,345,216	1,719,605	2,460,830	880,372	991,714	1,190,057
(% Change)	-20.8	27.8	43.1	-9.6	12.6	20.0
Net external demand	**-313,927**	**-465,584**	**-952,265**	**-214,797**	**-267,835**	**-386,551**
C. Total demand	**4,835,293**	**5,604,104**	**6,542,663**	**2,449,214**	**2,645,542**	**2,863,854**
(% Change)	**9.6**	**15.9**	**16.7**	**3.5**	**8.0**	**8.3**

(a) Revised
(b) Provisional

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

Of PCE, the highest expenditure was on food and non-alcoholic beverages, as in the previous years. The share of PCE on food and non-alcoholic beverages declined to 37.8 per cent in 2011 compared to 39.6 per cent that prevailed in 2010. As the demand for food is stable, the increase in the income level has resulted in the drop in the expenditure share. The expenditure share on clothing improved but remained at below 7 per cent. However, expenditure on clothing and footwear articles grew at a higher rate than that of the previous year. When the real household income increases by a significant amount, the expenditure on non-food items are expected to increase substantially.

Private expenditure on housing, water, electricity, gas and other fuels grew by 14.7 per cent compared to the growth of 9.6 per cent in 2010. The higher growth in this category was largely attributable to the increase in LP gas prices and upward revisions of the electricity tariff rates. Prices of fuel were also adjusted on several occasions in 2011.

With the continued increase in household income during the last few years, spending on furnishings, household equipment and routine maintenance activities etc. has been increasing at a higher rate, in nominal terms. However, the expenditure share of this consumption category declined from 5.2 per cent in 2010 to 4.6 per cent in 2011. Considering the relatively low inflation that prevailed during the year, the growth in this expenditure could also be attributed to the real growth in household equipment and services.

During the year, expenditure on health services continued to expand albeit at a lower rate than the overall PCE in nominal terms. Meanwhile, private consumption expenditure on education rose at a higher rate in nominal terms showing acceleration compared to 2010. However, the education sector recorded a very small share of only 0.1 per cent even after this 26.1 per cent growth. The relatively small share of private spending on education could be attributed to the significant role played by the public sector in providing these services free of charge.

PCE on transport, which accounts for the second highest share, recorded a significant growth of 36.2 per cent in 2011. Accordingly, its relative share also increased by about 1.9 percentage points to 23.1 per cent. This growth in the PCE on transport was mainly driven by upward price revisions of petrol and diesel leading to increases in bus fares and other expenses relating to transportation during the year.

In 2011, government consumption expenditure increased with the extension of subsidies and transfers to public sector corporations and households. An increase in the public sector wage bill and higher interest payments

Table 2.11 Composition of Private Consumption Expenditure at Current Market Prices

Item	Share of Total PCE (%)			Rate of Change (%)	
	2009	2010 (a)	2011 (b)	10/09	11/10
1. Food, Beverages and Tobacco	38.2	39.6	37.8	21.5	19.3
2. Clothing and Footwear	5.6	6.0	6.8	25.0	42.9
3. Housing, Water, Electricity, Gas and Other Fuels	12.0	11.2	10.3	9.6	14.7
4. Furnishings, Household Equipment and Routine Maintenance of the House	5.9	5.2	4.6	2.9	11.3
5. Health	2.2	2.0	1.8	6.9	10.4
6. Transport	21.1	21.2	23.1	17.8	36.2
7. Leisure, Entertainment and Culture	2.9	2.5	2.8	1.3	38.6
8. Education	0.1	0.1	0.1	11.2	26.1
9. Hotels, Cafes and Restaurants	1.5	1.3	1.5	3.7	43.4
10. Miscellaneous Goods and Services	5.5	4.8	4.4	2.0	14.5
11. Expenditure Abroad of Residents	8.1	9.2	9.6	34.3	30.2
12. Less: Expenditure of Non-Residents	3.1	3.2	2.8	20.8	8.6
Total Private Consumption Expenditure	**100.0**	**100.0**	**100.0**	**17.2**	**25.1**

(a) Revised
(b) Provisional

Source: Department of Census and Statistics

2

NATIONAL OUTPUT AND EXPENDITURE

Table 2.12 Investment and Employment in Enterprises Registered Under Board of Investment of Sri Lanka (BOI) and Ministry of Industry and Commerce (MIC)

	No. of projects		Envisaged and Actual Investment (Rs.million)						Employment (No.)	
	2010 (a)	2011(b)	2010 (a)			2011 (b)			2010 (a)	2011 (b)
			Foreign	Local	Total	Foreign	Local	Total		
BOI (Under Act No.4 of 1978)										
Projects Approved	437	174	87,417	143,049	230,466	351,880	142,952	494,832	56,828	46,242
Under Section 17 (c)	363	153	82,866	142,733	225,599	349,475	141,816	491,291	55,087	45,707
Under Section 16	74	21	4,551	316	4,867	2,406	1,136	3,541	1,741	535
Projects Contracted Under Section 17 (c)	269	161	55,318	82,494	137,812	238,489	132,894	371,383	34,827	42,715
Realised Investment Under Section 17 (d)	1,991	2,019	533,312	327,766	861,078	657,686	374,926	1,032,613	426,084	450,913
Commercial Operations (d)	2,688	2,673	272,456	3,932,128	4,204,584	267,987	3,940,372	4,208,360	399,906	402,300
Under Section 17 (c)(d)	1,886	1,902	252,296	3,921,611	4,173,907	248,566	3,930,285	4,178,851	361,183	365,271
Under Section 16 (d)	802	771	20,159	10,517	30,676	19,421	10,087	29,508	38,723	37,029
MIC										
Projects Registered (d)	1,940	2,006	-	145,295	145,295	-	150,268	150,268	294,242	299,902

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

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

mainly contributed to the growth in government consumption expenditure. During the year, government consumption expenditure grew by 10.9 per cent in nominal terms over a considerably lower growth of 2.5 per cent in the previous year.

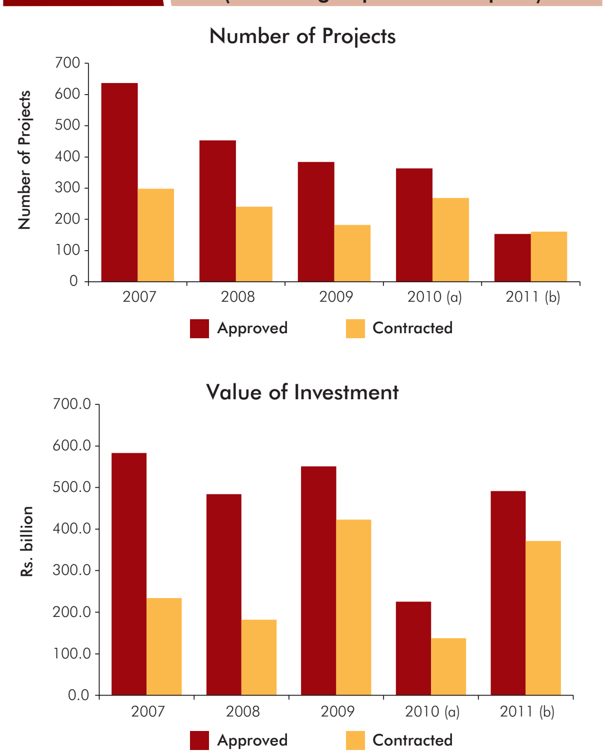
Investment

Total investment expenditure grew by 26.7 per cent in nominal terms during 2011. The total investment expenditure (gross domestic capital formation) in 2011 is estimated at Rs. 1,959 billion compared to Rs. 1,545 billion in the previous year. In real terms, investment expenditure rose by 7.7 per cent, whereas the corresponding growth in 2010 was 14.5 per cent over a low base of 2009. Meanwhile, investment as a percentage of GDP is estimated at 29.9 per cent compared to 27.6 per cent in 2010. The increased level of investment activity was reflected in the significant growth in investment goods imports and the healthy growth in the construction sector. The growth in investment expenditure was led by the private sector, supported by low interest rates, the conducive investment climate and the improved macroeconomic environment.

Private investment expenditure accounted for 79 per cent of the total investment expenditure and expanded by 29 per cent in 2011. The private sector investment/GDP ratio continued to grow from 21.4 per cent in 2010 to 23.7 per cent in 2011. Public investment/GDP ratio also increased marginally during the year.

Foreign Direct Investment (FDI) in 2011 increased by 107 per cent to US dollars 1,066 million. The largest FDI inflow was to the hotels and tourism sub sector, followed by the infrastructure sector, which attracted investments mainly to telephone, telecommunication network

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



(a) Revised
(b) Provisional

Table 2.13 Total Resources and Their Uses at Current Market Prices

Item	Percentage Share %		Percentage Growth %	
	2010 (a)	2011 (b)	2010 (a)	2011 (b)
A. Resources				
Gross Domestic Product	76.5	72.7	15.9	16.7
Imports of Goods and Services	23.5	27.3	27.8	43.1
Total	100.0	100.0	18.5	22.9
B. Utilisation				
Consumption	61.8	61.5	14.0	22.4
Gross Domestic Fixed Capital Formation	19.8	19.7	26.5	22.1
Private	15.4	15.6	34.5	24.3
Government	4.4	4.1	4.9	14.3
Change in Stocks	1.3	2.1	174.9	99.3
Export of Goods and Services	17.1	16.8	21.6	20.3
Total	100.0	100.0	18.5	22.9

(a) Revised
(b) Provisional

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

and fuel, gas and petroleum sectors. Foreign investments in the manufacturing sector were mainly attracted by the textile, wearing apparel and leather products; chemical, petroleum, coal, rubber and plastic products; and fabricated metal, machinery and transport equipment sub sectors. A considerable amount of FDI received for the manufacturing sector was for the revitalisation of the Ceylon Steel Corporation, which is currently awaiting implementation. The cumulative realised investment of the BOI by end 2011 was Rs. 1,033 billion.

The estimated foreign and local investments approved under Section 17 and Section 16 of the BOI Act during 2011 stood at Rs. 495 billion. This was an increase of more than 115 per cent compared to the previous year and amounted to Rs. 230 billion. The food, beverages and tobacco products category and the petroleum, coal, rubber and plastic products category contributed to a substantial component of the investments in the manufacturing sub sector. Amongst the projects that signed agreements during 2011, the non-metallic mineral products category contributed to the largest estimated investment. The textile, wearing apparel and leather products category was the largest contributor among projects, which commenced commercial operations during 2011.

Government investment expenditure was estimated at Rs. 409 billion in 2011, an increase of 18.7 per cent in nominal terms over 2010. Government investment was mainly focused on development of infrastructure facilities in the areas of roads and highways, railway lines and transport, telecommunications, ports and airports, hydro power, irrigation and water supply projects.

Availability and Utilisation of Resources

The total resources available in the economy, consisting of domestic resources (GDP) and foreign resources (imports of goods and non-factor services), at current market prices, increased by 22.9 per cent to Rs. 9,003 billion in 2011. This increase of Rs. 1,680 billion represented an increase of Rs. 939 billion in domestic resources and an increase of Rs. 741 billion in imports of foreign resources. Accordingly, the share of domestic resources of the total resources available declined to 72.7 per cent from 76.5 per cent in 2010, while the remaining 27.3 per cent was made up of foreign resources. In real terms, the availability of resources grew by 11.5 per cent, higher than the previous year's growth of 9.2 per cent. This includes the real growth of domestic resources by 8.3 per cent and import of goods and non-factor services by 20 per cent.

Chart 2.6 The Economy in 2011 (at current prices)

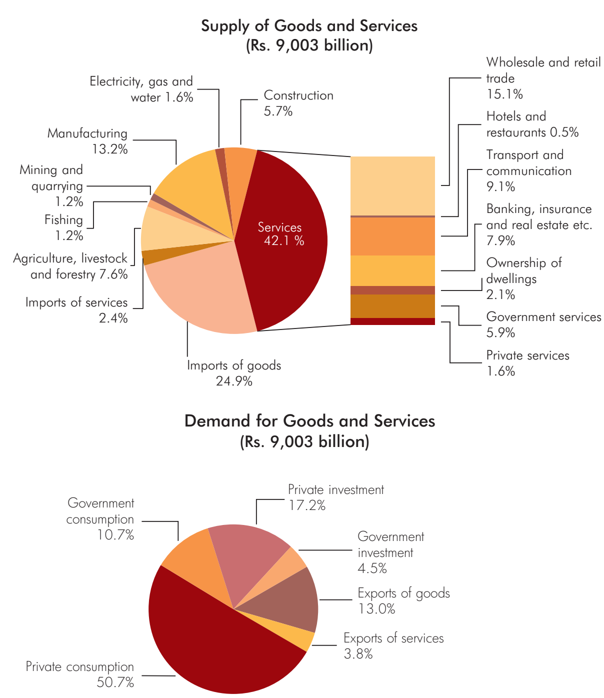


Table 2.14 Consumption, Investment and Savings at Current Market Prices

Item	Rs. million		% Change		As a per cent of GDP	
	2010 (a)	2011 (b)	2010 (a)	2011 (b)	2010 (a)	2011 (b)
1. Gross Domestic Product at Market Prices	5,604,104	6,542,663	15.9	16.7	100.0	100.0
2. Consumption Expenditure	4,524,188	5,536,095	14.0	22.4	80.7	84.6
Private	3,651,578	4,568,393	17.2	25.1	65.2	69.8
Government	872,610	967,702	2.5	10.9	15.6	14.8
3. Investment	1,545,500	1,958,833	30.8	26.7	27.6	29.9
Private	1,200,795	1,549,611	39.1	29.0	21.4	23.7
Government	344,704	409,222	8.4	18.7	6.2	6.3
4. Domestic Savings	1,079,916	1,006,568	24.5	-6.8	19.3	15.4
Private	1,199,731	1,078,424	14.5	-10.1	21.4	16.5
Government	-119,815	-71,856	33.4	40.0	-2.1	-1.1
5. Domestic Savings - Investment gap	-465,584	-952,265	-48.3	-104.5	-8.3	-14.6
6. Net Factor Income from Abroad	-69,776	-72,046	25.1	-3.3	-1.2	-1.1
7. Net Private Current Transfers from Abroad	413,885	513,216	23.0	24.0	7.4	7.8
8. National Savings	1,424,024	1,447,738	24.0	1.7	25.4	22.1

(a) Revised
(b) Provisional

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

Available resources are utilised on consumption, fixed capital formation and export of goods and non-factor services. In 2011, consumption absorbed 61.5 per cent of resources, reflecting a growth of 22.4 per cent, while fixed capital formation absorbed 19.7 per cent, showing a growth of 22.1 per cent (26.5 per cent in 2010). Export of goods and non-factor services grew by 20.3 per cent while its relative share decreased marginally to 16.8 per cent.

Of the total resources available in the economy, at current market prices, the share generated by the domestic economic activity was 72.7 per cent while the remaining 27.3 per cent was imported. The value of domestic services, which has a 42.1 per cent share of total supply, out-performed that of the domestics goods supply, where value added of the services sector contributed significantly to the economy. With the rapid expansion of import expenditure in 2011, the share of imported goods and services in total supply of goods and services increased to 27.3 per cent from 23.5 per cent in 2010.

Savings

Domestic savings were estimated at Rs. 1,007 billion in 2011, a contraction of 6.8 per cent over the previous year. The deceleration in domestic savings could be attributed to the expansion in consumption and the deterioration of the net external demand with increased growth in imports, despite the significant growth in exports earnings. Of the total domestic savings, government savings, which is defined as the difference between government revenue and recurrent expenditure or the current account balance of the government budget, improved in 2011. The dis-savings of the government declined to 1.1 per cent of GDP in 2011 from 2.1 per cent in 2010.

National savings, the sum of domestic savings, net foreign private transfers and net factor income from abroad (NFIA), were estimated at Rs. 1,448 billion in 2011, recording an improvement of 1.7 per cent over the previous year. NFIA remained negative as usual, but deteriorated further by 3.3 per cent in 2011. Although both the foreign receipts and payments increased during 2011, the latter recorded a relatively higher growth resulting in the deterioration in NFIA. Net private transfers, which consist mainly of workers' remittances, grew at a significant rate of 24 per cent in 2011. Improvement in net private transfers helped record a positive growth in national savings despite the decline of domestic savings during the year. However, the increase in foreign private transfers was not sufficient to offset the impact of the significant expansion of consumption in 2011. Hence, national savings as a percentage of GDP declined to 22.1 per cent in 2011 from 25.4 per cent in 2010. Accordingly, the resource gap, i.e., the difference between national savings and investment as a ratio of GDP, increased substantially to 7.8 per cent from 2.2 per cent with the drop in the domestic savings ratio and the increase in the investment ratio.