Chapter 2

NATIONAL OUTPUT AND EXPENDITURE

2.1 Overview

Gross Domestic Product (GDP) grew by 6.8 per cent during 2007, in real terms, compared with 7.7 per cent growth in 2006. The economy grew at a faster pace of 7.3 per cent during the second half compared with a growth of 6.3 per cent during the first half, indicating a further consolidation of progress towards a higher growth path. The Sri Lankan economy recorded more than 6 per cent growth for the third consecutive year in 2007 amidst a number of unfavourable developments, namely high global oil prices, increasing terrorist threat, bad weather conditions and rising inflationary pressure, indicating its intrinsic resilience to face challenges arising from both domestic as well as external fronts.

The economic growth in 2007 was broad based. Industry and services sectors grew by 7.6 per cent and 7.1 per cent, respectively while the agriculture sector grew moderately by 3.3 per cent. The Services sector made the highest contribution of 62 per cent to the overall growth. In the Industry sector, construction, export manufacturing, and mining and quarrying activities performed well. Post and telecommunication, cargo handling, transport, and financial services were the key performing sectors in the services sector. Most of the agricultural activities achieved relatively high growth rates, but the drop in the production of two major crops, tea and paddy, dampened the overall growth performance of the sector. The expansion of the economy generated more employment opportunities, contributing to a further drop in the unemployment rate from 6.5 per cent in 2006 to 6.0 per cent, the lowest annual unemployment rate reported ever.

The deceleration of economic growth observed in 2007 from 7.7 per cent in 2006 to 6.8 per cent indicates a slowing down of the aggregate demand. In the recent years, rising domestic demand provided the impetus for economic growth. This trend was

observed albeit at a lower rate in 2007 as well. Both consumption and investment demand increased by 21 per cent, in nominal terms, during the year. However, consumption expenditure as well as investment expenditure decreased as a percentage of GDP when compared with 2006. The slowdown in domestic aggregate demand reflected the demand management policies adopted by the Central Bank under its monetary policy framework. It was evident that the monetary policies followed to mitigate the growing demand for goods and services, with a view to curtail the rising prices, had an impact on growth performance.

External demand, the demand for exports of goods and services increased stimulating growth prospects in 2007. The rise in demand for industrial and mineral exports contributed mostly to this development. Agricultural exports grew moderately mostly due to supply constraints, although the prices of agricultural commodities reported huge gains following the increasing international prices for primary goods.

Meanwhile, Gross National Product (GNP), defined as GDP adjusted for net factor income abroad (NFIA) grew by 7.1 per cent, a higher rate than GDP growth. The NFIA remained negative, but

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 in GDP (%)		Share of GDP (%)	
	2006	2007(a)	2006	2007(a)	2006	2007(a)
Agriculture	6.3	3.3	10.3	6.0	12.3	11.9
1. Agriculture, Livestock and Forestry	3.4	2.2	5.3	3.6	11.3	10.8
1.1 Tea	- 2.0	- 2.0	- 0.4	- 0.4	1.3	1.2
1.2 Rubber	4.6	7.7	0.1	0.3	0.2	0.2
1.3 Coconut	6.4	3.9	1.2	0.8	1.4	1.3
1.4 Minor Export Crops	2.2	5.1	0.1	0.4	0.5	0.5
1.5 Paddy	2.9	-6.4	0.7	- 1.7	1.8	1.6
1.6 Livestock	8.1	7.9	0.9	1.0	0.9	0.9
1.7 Other Food Crops	3.0	4.4	1.6	2.5	3.9	3.8
1.8 Tobacco	38.7	-25.2	0.1	-0.1	0.0	0.0
1.9 Betel and Arecanuts	6.7	3.3	0.1	0.0	0.1	0.1
1.10 Plantation Development	4.9	5.8	0.2	0.2	0.3	0.3
1.11 Other Agricultural Products	3.2	2.1	0.1	0.1	0.3	0.3
1.12 Firewood and Forestry	6.5	5.2	0.5	0.5	0.6	0.6
2. Fishing	53.5	15.6	5.0	2.3	1.0	1.1
Industry	8.1	7.6	29.8	31.7	28.2	28.5
3. Mining and Quarrying	24.2	19.2	4.7	4.8	1.7	1.9
4. Manufacturing	5.5	6.4	13.1	16.8	17.7	17.7
4.1 Processing (Tea, Rubber and Coconut)	0.8	2.4	0.1	0.2	0.7	0.6
4.2 Factory Industry	5.7	6.7	12.2	15.7	15.9	15.9
4.3 Cottage Industry	5.7	5.6	0.8	0.9	1.1	1.1
5. Electricity, Gas and Water	14.8	4.6	4.6	1.7	2.5	2.5
5.1 Electricity	16.2	4.6	4.3	1.5	2.2	2.2
5.2 Gas	7.6	2.9	0.2	0.1	0.2	0.2
5.3 Water	3.6	7.1	0.1	0.1	0.1	0.1
6. Construction	9.2	9.0	7.4	8.3	6.3	6.4
Services	7.7	7.1	60.0	62.4	59.5	59.6
7. Wholesale and Retail Trade	7.1	6.1	22.9	22.3	24.6	24.5
7.1 Import Trade	6.8	3.3	8.4	4.6	9.4	9.1
7.2 Export Trade	3.6	8.8	2.3	5.9	4.6	4.7
7.3 Domestic Trade	8.9	7.6	12.2	11.8	10.6	10.7
8. Hotels and Restaurants	2.5	- 2.3	0.2	- 0.1	0.5	0.4
9. Transport and Communication	12.6	10.5	19.4	19.2	12.4	12.8
9.1 Transport	11.2	9.4	14.9	14.6	10.6	10.8
9.2 Cargo Handling-Ports and Civil Aviation	20.0	8.8	1.5	0.8	0.6	0.7
9.3 Post and Telecommunication	21.6	21.5	3.0	3.8	1.2	1.4
10. Banking, Insurance and Real Estate etc.	8.5	8.7	9.4	11.0	8.5	8.7
11. Ownership of Dwellings	1.1	1.1	0.5	0.6	3.4	3.2
12. Government Services	5.0	6.0	5.2	6.8	7.7	7.7
13. Private Services	7.8	7.8	2.4	2.7	2.3	2.4
Gross Domestic Product	7.7	6.8	100.0	100.0	100.0	100.0
Net Factor Income from Abroad	-20.9	15.7				
Gross National Product	7.5	7.1				

(a) Provisional

Source : Department of Census and Statistics

Box 4 Explanatory Note on National Income Estimates

The Department of Census and Statistics (DCS) is the official agency responsible for the compilation and dissemination of National Income Accounts. However, in the past, both the DCS and the Central Bank had been compiling and disseminating national income statistics. As this duplication of effort has caused some confusion in the minds of the public, the Central Bank decided to use the statistics compiled by the DCS commencing from 2007.

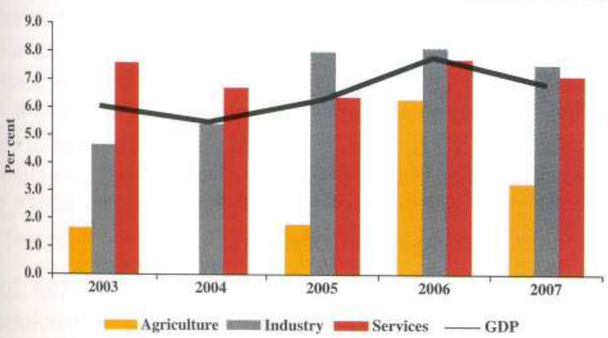
However, the Central Bank continues to compile forecasts of Gross Domestic Product (GDP) and its growth rate, for the purpose of macroeconomic management. Such a practice will be consistent with the compilation and forecasting of the general price level and inflation, where DCS compiles the actual price level and inflation, while the Central Bank forecasts inflation for monetary policy purposes.

In line with this policy, this publication uses the GDP estimates compiled by DCS from 2003 for purposes of comparison. As a result, the ratios that were calculated using GDP estimates compiled by DCS could be different from those calculated using GDP estimates compiled by the Central Bank and published in various statutory reports of the Central Bank. Some macroeconomic variables including savings, investment, government revenue, government expenditure, overall budget deficit, outstanding government debt, external current account balance as a per cent of GDP, as well as the per capita income would vary from those previously published by the Central Bank. Data users and analysts may therefore be cautious in comparing the sources of data.

improved in 2007, mainly due to the increased interest income from investment of official reserves, by 44 per cent, largely owing to higher global interest rates as well as further accumulation of official reserves in 2007. In addition, earnings from the foreign financial assets of the private sector including commercial banks also increased in the light of higher global interest rates.

GDP at current market prices is estimated at Rs. 3,578 billion in 2007, an increase of 21.8 per cent, reflecting the expansion in real economic activity and an increase in the general price level. The overall inflation as measured by the GDP deflator was 14.0 per cent in comparison to 11.3 per cent

Chart 2.1 Annual Growth Rates



recorded in 2006. Accordingly, given the mid year population of 20,010 thousand, GDP per capita for 2007 is estimated at Rs. 178,830, an increase of 21.0 per cent which is well above the increase in the general price level, indicating an overall improvement in living standards, on average. In US dollar terms, per capita GDP increased by 13.7 per cent, from US dollars 1,421 to US dollars 1,617 in 2007. Accordingly, Sri Lanka moved further up as a country of lower middle income category bound by per capita income of US dollars 756 and 2,995 as per World Bank classification.

Domestic savings increased by 26.0 per cent from Rs. 499 billion in 2006 to Rs. 629 billion in 2007 while the domestic savings ratio (domestic savings as a percentage of GDP) also improved from 17.0 per cent in 2006 to 17.6 per cent in 2007. The contraction of consumption ratio and the increase in savings ratio stress the effectiveness of demand management policies adopted by the CBSL. Increased profitability in the corperate sector, was also instrumental in this increase. Government savings, though it remained negative, the level of government dis-savings was lower in 2007, thereby contributing to the upliftment of the domestic savings. National savings also increased due to an increase in net transfers from abroad and improvement in net factor income from abroad as well.

2.2 Sectoral Output, Policies, Institutional Support and Issues

Agriculture

The Agriculture, Forestry and Fishing sector grew moderately in 2007 and registered a growth of 3.3 per cent in value added terms. Remarkable increase in rubber and livestock production and full recovery of the fisheries sector was largely attributable to this growth. Production of minor export crops such as cashew and cocoa, as well as production of fruits and vegetables also increased in 2007. The weather related temporary set-back of tea and paddy production is expected to recover in 2008.

Export Agriculture

Tea production declined marginally by 2 per cent to 305 million kg in 2007. The go-slow action followed by a strike by the plantation workers towards end 2006 and drought weather conditions during early 2007 were contributory factors for the decline in tea production. The drop in application of fertiliser below the recommended levels too might have affected the yield levels.

Tea export earnings rose due to a sharp increase in tea prices offsetting the relatively higher operating costs in the tea sector. Wages, energy prices and fertilizer prices increased substantially during the year. The minimum daily wage of an estate worker increased in June 2007 to Rs. 260 from Rs. 189 reflecting a 38 per cent increase. However, during the year, average export price and Colombo Auction price increased by 31.7 per cent and 40 per cent, respectively. Average price paid to smallholders for bought leaf increased by 40 per cent to Rs. 40.88 per kg. In the tea sector, subsidy schemes for replanting to improve the present annual re-planting rate of 0.2 per cent in the corporate sector by Sri Lanka Tea Board and in the Small Holder Sector by Tea Small Holdings Development Authority were implemented. During the year, tea factory modernization programmes were given high priority towards achieving Hazard Analysis Critical Point (HACCP) Certification, which gives value addition to their products. Development of mini-power stations in the plantation sector was encouraged to provide electricity to tea factories at a lower cost.

Table 2.2 Agriculture Production Index (1997-2000 =100)

Item	2006(a)	2007(b)	Rate of Change (%) 2006/07
Agriculture and Fishing	108.9	111.4	2.3
1 Agriculture	111.7	112.2	0.5
1.1 Agriculture crops	111.6	111.3	-0.3
Tea	108.2	106.0	-2.0
Rubber	113.2	121.9	7.7
Coconut	100.3	103.3	3.0
Paddy	125.4	117.4	-6.4
Other Crops	108.3	112.5	3.9
1.2 Livestock	112.1	120.2	7.3
2 Fishing	92.0	106.6	15.8

(a) Revised
(b) Provisional

Source : Central Bank of Sri Lanka

Rubber production increased by 7.7 per cent to 118 million kg. Despite a labour dispute during the peak cropping period, continued attractive prices helped rubber production to increase, especially through productivity improvements.

Further productivity improvements in the rubber sector could enhance benefits from high prices for natural rubber in the international market. Although the average yield per hectare in Sri Lanka has increased gradually to around 1,260 kg, the potential yield per hectare is about 1,500 kg per year. Smallholders of rubber can adopt short-term as well as long-term methods to increase productivity in their holdings. Application of quality fertiliser at recommended level is important to boost the yield. In addition, adhering to agro management practices recommended by the Rubber Research Institute and use of new technology, cultivation of high yielding clones, improving soil condition by adopting soil management practices in selected unproductive lands, weeding and improving water retention would support increasing the productivity in the rubber industry.

The Rubber Research Institute conducted a series of research for the advancement of the rubber industry. These included, development of a new tapping knife which reduces the skill requirement of tapper, introduction of a portable small scale sheet rubber smoking unit for commercial use (this enables reducing normal drying period for sheet rubber to one day from 6 days) and the development of a low cost weed control mat.

Coconut production rose by 3 per cent to 2,869 million nuts in 2007 benefiting from the conducive weather. However, prices of coconut and coconut based products increased sharply during the year reflecting the world trend of increasing demand for organic oils to produce bio-fuel as an alternative to expensive fossil fuel. High coconut prices adversely affected the desiccated coconut (DC) industry, leading to a closure of some factories and loss of employment.

The government took several measures to improve the coconut industry. A new cess structure was introduced with effect from 23 May 2007 to

Table 2.3 **Trends in Principal Agricultural Crops**

Category	Unit	2006(a)	2007(b)
1. Tea			
1.1 Production (c)	kg mn	310.8	304.6
1.2 Total Extent	hectares '000	222	222
1.3 Extent bearing	hectares '000	193	193
1.4 Cost of Production (d)	Rs/kg	188.40	237.10
1.5 Average price			
- Colombo Auction	Rs/kg	198.87	279.10
- Export (f.o.b.)	Rs/kg	279.97	364.28
1.6 Replanting	hectares	1,338	1,353
1.7 New planting	hectares	16	4
1.8 Value added as % of GDP (e)		1.4	1.7
2. Rubber			
2.1 Production	kg mn	109.2	117.6
2.2 Total extent (f)	hectares '000	120	120
2.3 Area under tapping (f)	hectares '000	97	93
2.4 Cost of Production (d)	Rs/kg	97.20	104.82
2.5 Average price			
- Colombo Auction (RSS 1)	Rs/kg	202.55	234.22
- Export (f.o.b)	Rs/kg	189.86	234.48
2.6 Replanting (g)	hectares	2,372	1,474
2.7 New planting (g)	hectares	922	1,701
2.8 Value added as % of GDP (e)		0.8	0.7
3. Coconut			
3.1 Production	nuts mn	2,785	2,869
3.2 Total Extent	hectares '000	395	395
3.3 Cost of production (d)	Rs/nut	7.00	10.25
3.4 Average price			
- Producer price	Rs/nut	11.97	16.87
- Export (f.o.b.) (h)	Rs/nut	24.26	27.67
3.5 Replanting / Under Planting (i)	hectares	3,785	2,529
3.6 New planting (i)	hectares	4,026	2,957
3.7 Value added as % of GDP (e)		1.2	1.3

(a) Revised.
(b) Provisional.
(c) Including green tea
(d) Includes green leaf suppliers' 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 Holders Development Authority
Department of Census and Statistics
Rubber Development Department
Coconut Cultivation Board
Coconut Development Authority
Plantation Companies
Central Bank of Sri Lanka
Sri Lanka Customs

encourage manufacture of coconut based high value added products for exports. The cess for such products is lower than those with low value addition. Steps have been taken to stop fragmentation of fertile coconut lands. Further, a decision has been taken to prohibit unauthorised felling of coconut trees. The government allowed importation of 30,000 tons of copra up to end February 2008 from countries recommended by the Coconut Research Institute. Further, a temporary ban was imposed on fresh coconut exports and duty waiver on coconut oil imports was granted to ease the rising prices of coconut and coconut oil. The import duty on edible oils, which was maintained at a higher rate of 28 per cent, was reduced temporarily to 10 per cent.

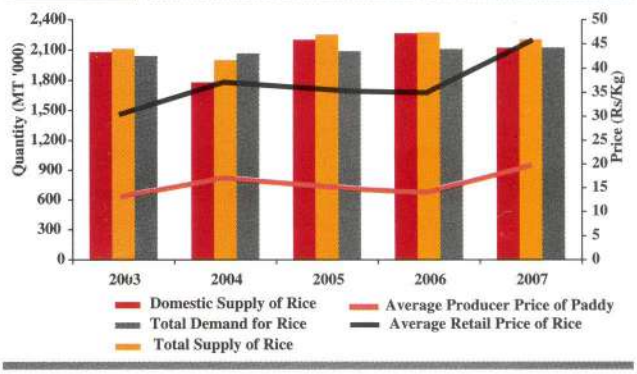
The Coconut Research Institute continued its research activities to improve the productivity, crop conservation and introduction of new coconut-based products. Field programmes for coconut cultivators were conducted in different locations for effective dissemination of technology. Coconut products were promoted through Vidatha Centres with an emphasis on promoting small and medium scale businesses among entrepreneurs to raise their income. In the meantime, a new coconut disease was reported in Matara and Weligama areas. The disease named *Weligama Wilt Disease* is similar to Root Wilt Disease observed in Kerala. There is an aurgent need to address this situation as the disease could spread to other areas as well.

The production of other agricultural export crops such as cinnamon, cloves, pepper showed mixed performance in 2007. The production of cocoa (48 per cent), cashew (20 per cent), betel leaves (6 per cent), pepper (5 per cent) and cinnamon (5 per cent) increased while production of clove (16.4 per cent), arecanut (6.8 per cent) and coffee (1.1 per cent) declined.

Domestic Agriculture

Paddy production decreased by 6.4 per cent to 3,128,881 metric tons in 2007. Paddy output in 2006/2007 Maha and 2007 Yala seasons dropped by 7.7 per cent and 4 per cent, respectively. Displacement of farmers due to security reasons in the Eastern Province and changes in weather largely attributed to this drop. The land area cultivated in the Eastern Province dropped by 35 per cent and 18 per cent, respectively, in 2006/07 Maha and 2007 Yala seasons. Heavy rains and floods that prevailed in October – December 2006 damaged the crop in certain paddy growing districts. In addition, low producer prices of paddy (which ranged between Rs. 13.00 per kg and Rs. 15.00 per kg) in 2006 Yala also attributed to the drop in the extent

Chart 2.2 **Rice : Supply and Demand**



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NATIONAL OUTPUT AND EXPENDITURE

Table 2.4 **Paddy Sector Statistics**

Item	Unit	2006(a) Maha	2006(a) Yala	2006(a) Total	2007(b) Maha	2007(b) Yala	2007(b) Total
Gross extent sown	hectares '000	591	319	910	525	291	817
Gross extent harvested	hectares '000	586	314	900	512	284	795
Net extent harvested	hectares '000	525	283	808	459	255	713
Production	mt '000	2,136	1,206	3,342	1,971	1,158	3,129
	bushels '000	102,350	57,814	160,164	94,449	55,050	149,499
Yield (c)	kg./ hectare	4,069	4,263	4,137	4,298	4,543	4,385
Credit Granted	Rs.mn.	552	438	990	605	522	1,127
Rice imports	mt '000	-	-	12	-	-	88
Paddy equivalent of imports	mt '000	-	-	18	-	-	129

(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

cultivated in Maha 2006/2007. However, the increase in productivity per hectare from 4,137 kg to 4,385 kg helped to limit the drop in total production.

The government paddy purchasing scheme continued to operate in 2007. Accordingly, the Agricultural Products Marketing Authority started purchasing paddy from 2006 Yala season and it purchased long seeds (nadu) at Rs. 16.50 per kg and small seeds (samba) at Rs. 17.50 per kg. The government spent Rs. 1,543 million to purchase 90,997 metric tons of paddy in 2006/07 Maha season while paddy stocks were not received for purchasing during the 2007 Yala season as market prices were higher than the price paid by the government.

Various programmes were implemented to increase productivity in the paddy sector. The "yaya" demonstration programme, which was organized by the Department of Agriculture (DOA) to introduce agriculture practices with new technology to increase productivity, continued further in 2007. Rice production "yaya" programme was conducted with the Granary Area programme covering high potential major irrigation schemes. In 2007, 150 new *Saruketha Yaya* were established and 8,910 farmers and officers were trained to increase the production and productivity of rice. In order to make latest technology available to paddy farmers, 948 maximum yield yaya demonstrations were conducted. Rice-branding programmes were continued for popularizing rice-based products. Initiatives were taken to establish district level agro enterprise development units (Krushi Seva Piyasa) at divisional level and agriculture technology parks were established at Gannoruwa and Bata-atha for training and demonstrating new agriculture technologies for farmers, extension officers, teachers and the general public. Agricultural communication programmes through mass media were also conducted.

Rice prices increased sharply towards the end of 2007 due to several reasons. The demand for rice consumption increased significantly with the sharp increases in wheat flour prices. An El-Nino condition and increase in export tax on wheat has led global wheat production to drop, and supporting prices to rise. This trend is expected to prevail further. Although the government allowed rice imports without customs duty, prices of rice continue to increase, as the supply was not sufficient to meet the increasing demand.

Domestic sugar production decreased by 43 per cent in 2007 mostly due to a decrease in cane supply and labour unrest at the Sevanagala sugar factory. The drought weather condition and relatively higher fertilizer prices too contributed to the decline. The area harvested in 2007 declined by 21 per cent as many farmers have shifted to banana cultivation due to unfavourable market conditions. As a result, the total cane harvest decreased by 40 per cent. Private cane purchases have also declined almost by half. However, assistance was given to rehabilitate the sugar cane farms affected by the Sugar cane Wooly Aphid pest at Lunugala area. A pre-feasibility study was carried out in respect of the proposed Bibile Sugar Development Project. Action has also been initiated to re-commence the Hingurana and Kantale Sugar Factories.

The Sugar Research Institute developed and tested two high yielding commercial sugar cane varieties. They were introduced to the farmers of Sevanagala, Pelwatte and Hingurana sugar factories for further evaluation. Planting materials were supplied to establish nurseries, at the Hingurana sugar industry. Sugar cane varietal adaptability field trials were established at Medagama and Dehigama villages using some 16 potential varieties, with the objective of identifying suitable varieties for the area.

Forestry

Forestry development activities continued with the greater attention of the government, donor agencies as well as active participation of the community and the private sector. The Forest Resources Management Project continued to implement to promote forest maintenance, management and reforestation. Forestry programme for early rehabilitation in Asian Tsunami affected countries, which was initiated in 2006, was completed in 2007. The Forest Department initiated a research level pilot programme called "Jeewa Jawaya" in two districts of Kandy and Polonnaruwa for production of bio-fuel by using Jatropha Curcus seeds. Under the programme 40,000 Jatropha plants were raised with incresed participation of the private sector. The extent of private commercial forest plantation increased to 510 hectares by end 2007.

Fishing

Annual fish production reached the highest ever level of 291 million kg in 2007 recording an increase of 16 per cent and reflecting the complete recovery from tsunami. Both marine and inland and aquaculture fish production increased by 17 per cent and 9 per cent, respectively. This helped total fish production from the sector to its historically highest level in 2007. The prices of fish remained mostly stable during the year mainly due to higher production and interventions through direct purchasing of fish stocks by the Ceylon Fisheries Corporation (CFC) and fish distribution through the CFC trucks with freezer facilities and their stalles.

Several steps have been taken to increase the fish production. In order to increase the capacity of fish landing, the construction of fishery harbours at Hambantota, Ambalangoda and Chilaw is being carried out under the Coastal Resource Management project. Ceylon Fisheries Corporation (CFC) had added its own fishing fleet with two long line vessels, making the fish industry more competitive. They have also commissioned two mother ships to facilitate transportation requirements for multi-day boats operating in the deep sea. A plan is under way for relocation of the St.John's fish market to a more spacious trading complex in Peliyagoda. Nearly 90 per cent of the refurbishments and renovations of the tsunami damaged fishing harbours have now been completed. The construction work of the proposed Dikkowita fisheries harbour is expected to commence shortly. Once completed, this harbour could accommodate 340 multi-day boats, the largest multi-day boat landing harbour in the country. In order to improve the aquaculture sector, a crop calendar was developed by the National Aquaculture Development Authority (NAQDA) that would help the prawn industry to reduce its vulnerability to diseases. In support of the shrimp industry in Puttlam District, a water quality-monitoring laboratory had been established at Buttaluoya. With the objective of fulfilling the demand for foreign aquatic plants and creating employment opportunities, the construction of the Tissue culture laboratory at Rambadagalla has been completed. Almost all the harbours in the country are now inter-linked by Internet Protocol Virtual Private Network (IPVPN) synchronizing the vessel monitoring.

Table 2.5 Fish Production

Metric Tons '000

Sub-Sector	2006 (a)	2007(b)
Marine (c)	216	253
Aquaculture and Inland Fisheries	35	38
Total	251	291

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

Sources: Ministry of Fisheries and Aquatic Resources Development
National Aquatic Resources Research and Development Agency

The government declared a comprehensive policy framework for national agriculture. Key objectives of the policy are to increase domestic agricultural production to ensure food and nutrition security of the nation, enhance agricultural productivity and ensure sustainable growth, adopt improved agro-technologies with a view to reduce the unit cost of production, promote agro-based industries and enhance the income and the living standards of the farming community. The policy has focused on addressing issues associated with food crops, export agricultural crops, floriculture and flora. This also covers plantation crops, livestock and fisheries and aquatic resources.

Several measures were taken in 2007 to increase agriculture productivity to enhance the income and living conditions of farmers and to make food crops available at affordable prices to the public. For this purpose, the DOA implemented a number of research and development projects, extension services, seed production, certification and plant protection programmes in 2007. New rice varieties, which are resistant to salinity, rice thrips and bacterial leaf blight, were developed using

Box 5

Harnessing the Benefits by Effective Utilization of the Exclusive Economic Zone of Sri Lanka

Sri Lanka possesses a territorial sea[1] of 21,500 sq. km and an Exclusive Economic Zone[2] (EEZ) of 517,000 sq. km up to 200 nautical miles from the coastline. The EEZ is expected to expand even further with the delimitation of the outer edge of the continental margin of the country, which would permit Sri Lanka to enjoy the ownership of an EEZ equivalent to 20 times (approximately 1,400,000 sq.km) the land mass it possesses. This right empowers Sri Lanka to explore and exploit natural resources in the zone in a sustainable manner and conduct economic activities.

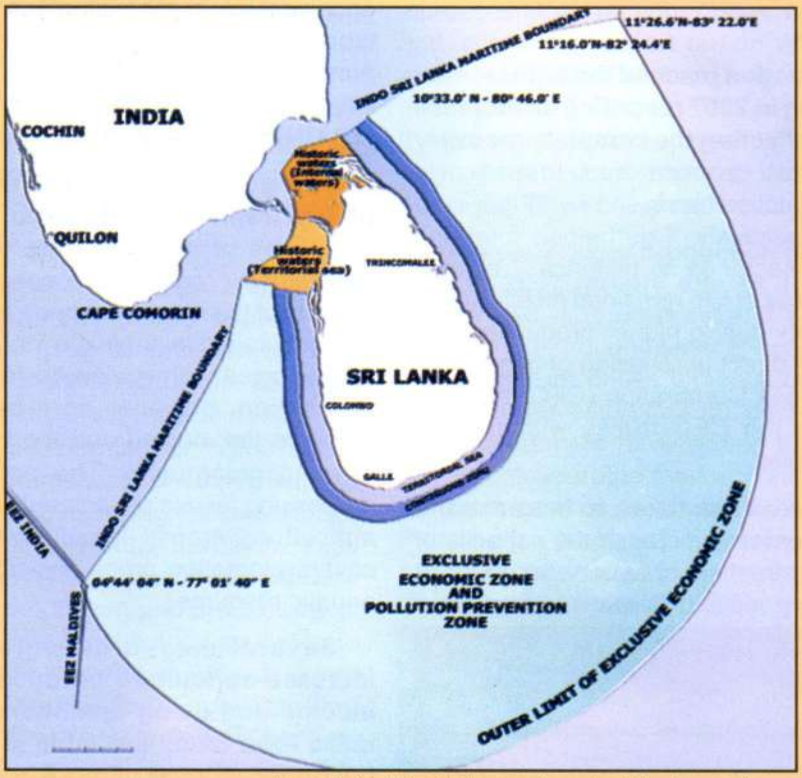
As per presently available data, the ocean area within Sri Lanka's jurisdiction has a very high concentration of living resources. The continental shelf alone is estimated to yield over 180,000 metric tons of fish annually. The deep sea/off shore areas are yet very much underutilized with a potential to enhance the yield with tuna and some demersal fish varieties. Though Sri Lanka is located strategically in the Indian Ocean with easy access to tuna resources and consumer markets in Europe and Japan, the country has not been able to utilize the resources in the deep seas to the maximum potential. The fisheries sector contribution to the

[1] Under the Maritime Law No 22 of 1976, a belt of ocean space adjacent to and measured from the coastal boundary to a maximum of width of 12 nautical miles.

[2] A sea zone over what a state has special rights over the exploration and use of marine resources.

Figure B 5.1[(a)]

Coastal and Maritime Zones of Sri Lanka



Source: National Aquatic Resources Research and Development Agency

[(a)] The above picture shows the coastal and maritime zones of Sri Lanka. There are 12 fishing habours around Sri Lanka and they are Mutwal, Panadura, Beruwala, Hikkaduwa, Galle, Mirissa, Puranawella, Kudawella, Tangalle, Kirinda, Trincomalee (Cod-bay) and Kalpitiya. Hambantota, Ambalangoda and Chilaw harbours are currently under reconstruction.

GDP was only 1.1 per cent in 2007 in comparison to 6.2 per cent in Maldives and 5.3 per cent in New Zealand. Though Sri Lanka is exploiting the coastal fisheries resources close to its Maximum Sustainable Yield (MSY), the deep sea resources largely stays untapped or exploited by foreign vessels illegally. Therefore, it is important to set strategies to harness marine resources belonging to the country to the maximum potential.

Apart from the high living resources available in the Sri Lankan territory of the Indian Ocean, it is also believed to contain large, commercially exploitable mineral and hydrocarbon resources. Deposits containing titanium, zirconium, thorium and potassium have been discovered on the continental shelf. In addition, deposits containing metals such as cobalt, nickel, copper and manganese are also found in the continental rise[3]. Furthermore, studies show that the thick sedimentary formations in the outer skirts of the continental shelf, particularly in Mannar and Cavery basins contain hydrocarbons.

Moreover, Sri Lanka also can promote oceanic recreational facilities, such as surfing, cruise vessels, Blue Whale and Dolphins watching, deep sea diving, sea entertainment and sea sports especially targeting foreign tourists. Although some of these activities have already been introduced in a small scale, there is a huge potential to expand these activities and thereby to generate new employment opportunities and foreign exchange.

A paradigm shift in the operation of fisheries activities is needed to enhance the contribution of the fisheries sector to the economy. In this process, development of necessary infrastructure, resource assessment, establishment of property rights including regulations, legal framework, a quota management system, and coast guard system as well as promoting investments are important. Lack of proper infrastructure is encumbering the proper exploitation of the deep-sea resources. As at present, there are 12 fishery harbours in operation, while three more are under re-construction in the country. In addition, there are 35 anchorages and about 600 minor fishing centres. However, none of these except the Mutwal fishing harbour is capable of handling large deep-sea vessels that are required to harness the available resources in the EEZ. In order to address this issue, initial steps have been taken to build a fishing harbour at Dikkowita, with the capacity to facilitate a large number of multi day boats. An additional advantage of this project is its close proximity to international waters to the south of Sri Lanka which will gain greater access to foreign trawlers.

An assessment of marine fish resources in the Sri Lankan waters is required in determining the level of investment and sustainable intensity of exploitation. National Aquatic Resources Research and Development Agency (NARA) has taken initiatives in this regard with Icelandic Development Agency (ICEDA) to assess the fish stock using catch data. The Food and Agricultural Organization (FAO) has also planned to make an assessment on fish catch on selected species under a Technical Assistance Programme.

To increase utilization of EEZ, it is also important to improve the oceanic fisheries management. In this respect, the focus should be on the establishment of a proper set of laws and regulations and ensure property rights of the sea. Given a legal framework, a system could be developed in collaboration with private sector to maximize the benefit from the EEZ. For this purpose, it may be useful to establish a Quota Management System (QMS) to harness the established maximum sustainable fish catch from the zone during a specified period. The system may be established such a way that licenses could be issued to harvest a specific quantity of resources in a designated area in a sustainable manner while ensuring the fishing rights of the single day boat operators within the coastal belt.

Introduction of new technology in fish catching, fish handling, storing and marketing is also important to improve the productivity. Landing and post harvest technology is very important in the case of off-shore and deep sea tuna fishing and in aquaculture where the post harvest losses are estimated to be very high at around 30 per cent. Investments from local, foreign and joint ventures need to be encouraged in deep sea fisheries which would provide significant returns. It is high time, that the corporate sector looks at the industry more seriously as there is a huge potential emerging in the fishing industry.

[3] The continental rise is an underwater feature found between the continental slope and the abyssal plain. This feature can be found all around the world. It represents the final stage in the boundary between continents and the deepest part of the sea.

Table 2.6 **Livestock Sector Statistics**

Sub-Sector	2006(a)	2007(b)
1. National Herd (No.) (mn)	1.5	1.5
Neat Cattle	1.2	1.2
Baffalo	0.3	0.3
2. National Milk Production (mn litres)	196.6	202.0
Cow Milk	165.0	169.7
Baffalo Milk	31.6	32.3
3. Milk Products (mn litres)	8.6	12.1
4. Producer Price - Cow Milk (Rs./litre)	21.00	21.00
5. National Egg Production (No) (mn)	901.2	915.6
6. National Poultry Meat Production (000' mt)	78.8	100.1

(a) Revised
(b) Provisional

Sources : Department of Census and Statistics
Ministry of Agriculture & Livestock

biotechnological tools. A new variety of orange (Valencia), mandarin, two varieties of Macademia and Dioscorea (Raja ala, Kekulala) and finger millet (Oshadha), which are resistant to blast disease, were released in 2007.

The Budget 2008 proposed several measures to increase local milk production. The guaranteed price paid to milk producers was proposed to increase to Rs. 30 – 40 per litre. In addition, credit facilities at concessionary rates were proposed for the importation of milking cows, development of animal husbandry and to establish small and medium milk processing centres. Milk and dairy products made out of locally manufactured milk were exempted from VAT with effect from 1 January 2008. Funds have been allocated to grant concessionary loans to develop over 50,000 livestock farms in the Northern, North Central, Southern and Uva provinces. Regulations on slaughter of milch cows were strengthened by increasing the fine on slaughter of a milching cow to Rs. 50,000 from Rs. 250. The Budget 2008 allocated Rs 100 million for the establishment of cold storage facilities and milk collection centres at provincial level. Steps were taken to instal milk sales outlets in several towns to popularize and to avail fresh milk to consumers.

The Budget 2008 extended incentives to promote local agriculture production by providing safeguards from imports, availing seed and plant material and technical support. The *"Api Wawamu – Rata Nagamu"* (Let us grow – let us develop) three-year programme was introduced to increase agriculture production and to achieve fully sustainable food production. Further, VAT was removed from local sugar and rice based products with effect from 1 January 2008.

Fertiliser subsidy scheme was continued in 2007. All varieties of fertiliser were availed for paddy cultivation at Rs. 350 per bag of 50 kg while smallholders owning less than 5 acres of tea, rubber or coconut land were provided urea at a concessionary rate of Rs. 1,200 per 50 kg. The cost of fertiliser subsidy amounted to Rs. 11,000 million in 2007 and the allocation for 2008 is Rs. 15,000 million. In the meantime, the government has commenced programmes to popularize the use of organic fertiliser and has allocated Rs. 500 million to promote the production of organic fertiliser in 2008. However, the present fertiliser subsidy scheme can be rationalized in view of rising output prices to reduce the burden on the budget as well as to formalize the distribution of fertiliser across crops.

The government expects to increase the current level of fruit production to one million tons by 2010 to meet domestic requirement and export demand. Development of environment friendly commercial farms and viable production and processing technologies as well as conducting awareness programmes would help to achieve the target. Promotion of extension services, research and development, improvement in infrastructure facilities, encouraging private sector participation, identification of fruit varieties for the international market, increasing food safety, quality and standards, adopting better agricultural practices and promoting fruit preservation methods would also help to promote the fruit industry.

There is huge potential to further increase the production of other field crops such as chillie, cowpea and maize. Although farmers gain high financial returns from cultivation of other field crops (OFC), current level of production is not sufficient to meet even national demand due to several reasons. Lower productivity, high cost of production, degraded lands, unavailability of quality seeds, scattered cultivation and disorganized marketing system are major issues in the other field crops sector. Inadequate availability of high yielding varieties, inadequate technology transfer at village level, high dependency on rain-water, high incidence of pests and diseases, poor soil furtility management, insufficient farm mechanization, lack of input supply mechanisms at farmer level, lack of storage facilities, poor processing facilities in agro-based industries and high priority given for rice, neglecting production of OFC, are the main constraints that need to be addressed to increase the output of OFC.

Further emphasis is needed for increasing output and improving productivity in the agriculture sector. To achieve these objectives increase in demand driven research and provision of sufficient resources for such research and development, adopting new technologies such as usage of hybrid varieties, application of fertilizer at recommended levels, providing adequate infrastructure facilities including access to marketing and further increase in extension services are required. Dissemination of technical, economic and environmental information is necessary to educate farmers while appropriate measures are needed to reduce the post-harvest losses as well as preventing un-matured harvesting. With increase in agriculture output simultaneous development of agri-based industries, which would provide job opportunities to the rural masses, would keep farmers occupied throughout the year. This would also help assuring a stable price to farmers for their products.

Industry

The industry sector expanded in terms of value added by 7.6 per cent over that of 8.1 per cent in the previous year. This growth was achieved through favourable contributions from all four sectors, namely mining and quarrying, manufacturing, electricity, gas and water, and construction. The share of the industry sector increased marginally to 28.5 per cent with the manufacturing sub-sector accounting for a share of 17.7 per cent of the total GDP.

Factory industry, which is the largest sub-sector of the manufacturing sector accounting for more than 55 per cent of the total industrial output, grew by 6.7 per cent in 2007, compared to the 5.7 per cent growth recorded in 2006. All major sub-categories of the factory industry sub-sector, viz., food, beverages and tobacco products; textile, wearing

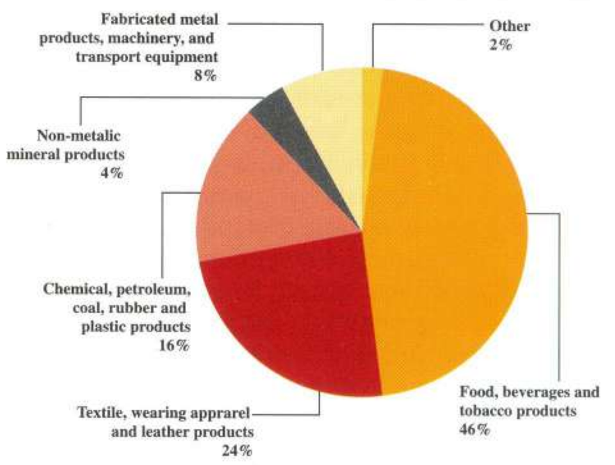
Table 2.7 Value Added in Industry (2002 Constant Prices)

Category	Rs. million		Rate of Change (%)	
	2006	2007(a)	2006	2007(a)
1. Food, beverages and tobacco products	155,842	165,242	5.8	6.0
2. Textile, wearing apparel and leather products	78,870	85,402	4.0	8.3
3. Wood and wood products	1,026	1,109	4.2	8.1
4. Paper products, publishing and printing	1,385	1,533	6.5	10.7
5. Chemical, petroleum, coal, rubber and plastic products	51,714	55,247	8.0	6.8
6. Non-metallic mineral products	13,687	14,445	10.9	5.5
7. Basic metal products	906	930	2.4	2.6
8. Fabricated metal products, machinery and transport equipment	28,378	29,911	4.3	5.4
9. Manufactured products not elsewhere specified	1,564	1,792	7.5	14.6
Total	333,372	355,611	5.7	6.7

(a) Provisional

Source : Department of Census and Statistics

Chart 2.3 Composition of Value Added in Industry - 2007 (2002 Constant Price)



apparel and leather products; chemical, petroleum, coal, rubber and plastic products; non-metallic mineral products; and fabricated metal products, machinery and transport equipment supported this growth in 2007. The higher oil prices, the unfavourable security situation in the Northern and Eastern Provinces and the slowdown in the US economy amidst intensified global competition were the major obstacles faced by the factory industries in 2007.

In 2007, factory industry output was driven by both export and domestic market oriented industries. The private sector, which comprised both Board of Investment (BOI) and non-BOI industries accounted for more than 96 per cent of the factory industry output and continued to play a major role in the expansion of the output.

The export oriented industries, which accounted for more than 75 per cent of the total export earnings of the country performed remarkably well with the benefits received under Free Trade Agreements (FTAs) and the Generalised System of Preferences (GSP+) of the European Union (EU). The major export oriented industries producing apparel products; rubber based products including tyres and gloves; gems and jewellery; electronic equipment; ceramic products and diamond products performed well within the export sector. Export oriented industries continued to benefit from enhanced market access availed through regional trade agreements and the GSP+ scheme, commercial diplomacy, initiatives taken by the government and the major industrialists to promote exports by expanding market destinations, as well as through quality improvement and brand promotion.

The domestic market oriented industries also performed well in 2007 benefiting from the government's regional industrialisation programme and the other initiatives taken by the government. The government granted tax and tariff concessions, implemented mega infrastructure development projects, which directly benefit regional industrialisation and initiated revitalisation of defunct factories. The expansion in construction activities, particularly in housing and shopping complexes also supported the growth momentum of the domestic market oriented industries. Food and beverages; cement, building materials, ceramics, furniture and other wooden products, printing and packaging materials were among the major drivers of the domestic market oriented industries in 2007.

Textile, wearing apparel and leather products which was the major sub-sector of the export oriented industries, accounting for 43 per cent of total export earnings of the country, registered a higher growth of 8.3 per cent in 2007 compared to the 4.0 per cent growth recorded in 2006. The improved performance of this category was realised mainly through the expansion of export activities in the EU supported by tariff concessions offered under the GSP+ scheme. Meanwhile, apparel manufacturers pioneered and used several sophisticated software such as e-fit software to bring the local apparel industry to the forefront of apparel industry innovation. The apparel industry has also taken several measures to set up one-stop-shops for developing fully integrated services for the industry. "Garments without Guilt", which is the major initiative undertaken by the apparel industry, focused on ethical manufacturing and sustainable development, assuring the commitment to ethical working practices, which include not engaging child labour and forced labour. In developing the apparel industry as a knowledge based industry offering innovative products, the industry educates its workforce through workshops, seminars and other training programmes while transforming itself into a sophisticated service provider. The apparel industry also established links with the global Fair Trade Movement which promotes socially responsible business practices. The movement has gained momentum in the US and the EU with more consumers becoming increasingly educated about ethical trade practices.

Major players in the apparel industry in Sri Lanka continued to supply world popular brand products to the international market and these manufacturers were recognised as innovative suppliers by world class branded clothing. With the development of the domestic supply chain of fabrics, the apparel industry is expected to benefit from lower lead times, potential cost savings, employment generation and further investments. MAS Fabric Park, formerly Thulhiriya Textile Park which was reopened with private sector participation, strengthened backward integration in the apparel industry by providing ancillary products to the apparel industry and attracted foreign investment as well. Green initiatives including programmes to reduce energy and water consumption together with solid waste management have become a focused area of the apparel industry. Initiatives were also taken to reduce the carbon footprint by the major manufacturers in view of the concerns of global warming. Cleaner production techniques and waste management methods were introduced by the industry to minimise environmental pollution.

The food, beverages and tobacco products category recorded 6.0 per cent growth in 2007 benefiting from both domestic and export market developments. Processed food and beverages including biscuits, ice-cream, bakery products, processed and canned fruit and vegetables; coconut products, vanaspathi oil, soft drinks and mineral water industries were the major drivers of the growth of this category in 2007. Major players in the food processing and beverage industries increased investment for capacity expansion in 2007 to meet the increased domestic demand.

The chemical, petroleum, coal, rubber and plastic products category grew by 6.8 per cent in 2007 supported by better performance of all sub-categories. The major players of the rubber-based industry introduced and promoted several products including steel-belted radial tyres in international and domestic markets. New players emerged in the tyre industry, focusing on potential export markets availed through trade agreements. The rubber glove manufacturers benefited from the increased demand for industrial and medical gloves in both export and domestic markets in 2007. The plastic and PVC industry also recorded better performance as a result of increased domestic demand and the expanding international market.

The output of non-metallic mineral products category registered 5.5 per cent growth in 2007, which was mainly attributed to increased construction activities in the private sector and the implementation of mega infrastructure development projects by the government. Major cement manufacturers introduced a range of products for different uses and enhanced production capacity by installing new machinery to cope with the rising demand. However, domestic cement manufacturers could not adequately cater to the demand during the second half of the year due to the shortage of raw material owing to the increased global demand, arising particularly from India and China. The diamond processing industry which targets overseas markets, continued to perform well with the support of the government in the form of a VAT reduction and continued promotion campaigns organised by the relevant institutions. The ceramic and tableware industry launched new products and designs especially to cater to fashion conscious customers while special brands and designs were introduced to the business-to-business market such as hotels and restaurants. Meanwhile, the increasing cost of power and fuel continued to be a major burden on high energy consuming industries such as cement, glass and ceramic industries.

The fabricated metal products, machinery, and transport equipment category expanded further by 5.4 per cent in 2007 compared to the 4.3 per cent growth in 2006, reflecting improved performance in both export and domestic markets. This sector was supported by the expansion of the ship building and repairing industry, assembling of motorcycles and three wheelers, increased production of machinery used in agriculture including water pumps, electrical equipment, kitchen appliances and steel furniture. The growth of wires, cables, aluminum products, light fittings and bulb manufacturing industries was led by the growth of the construction sector and external demand. The major manufacturers in the ship building and repairing industry penetrated the regional and international markets by providing high quality services and supplying high-tech vessels whilst increasing investment.

The output of public sector industries declined by 14.1 per cent mainly due to a low performance of refining by Ceylon Petroleum Corporation (CPC) in 2007. The output in CPC which accounted for more than 90 per cent of the public sector output, declined by 14.4 per cent in 2007 due to the decrease of crude oil imports.

The increasing trend of cost of production resulting from increasing raw material cost, higher oil prices and the rising wage bill had a negative impact on profit ratio of the factory industry. The profit ratio in the industrial sector, estimated as the ratio of ex-factory value of production over the total cost of production of 515 non-BOI firms surveyed in 2007 by the Central Bank, increased by 1.4 per cent compared with 2.1 per cent increase recorded in 2006. Profitability of the factory industry in 2007 was mainly attributed to the expanded sales and effective pricing policy. Improvements in labour productivity, adoption of new technologies and better management practices, introduction of energy efficient and waste management mechanisms, winding-up of non-profitable units and product differentiation were among the measures taken by the manufacturers to minimise the cost of production.

The wage bill in the factory industry, as a percentage of total cost of production increased by 1.6 per cent in 2007 compared with 2.4 per cent in 2006. The share of the wage bill in the cost of production decreased due to the increased cost of raw materials, fuel and interest. However, fuel and transport allowances were increased in 2007 in line with the higher oil prices. Several measures were taken by the firms to reduce the wage bill by increasing labour productivity, introducing new technologies, outsourcing

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

Category	Total Cost of Production (Rs. million)		Total Value of Production (Rs. million)		Factory Profit Ratio (percentage)	
	2006(b)	2007(c)	2006(b)	2007(c)	2006(b)	2007(c)
1. Food, beverages and tobacco products	94,864	106,351	111,298	125,117	14.8	15.0
2. Textile, wearing apparel and leather products	24,353	27,035	27,865	31,022	12.6	12.9
3. Wood and wood products	1,887	2,014	2,140	2,287	11.8	11.9
4. Paper and paper products	5,950	6,597	6,794	7,526	12.4	12.3
5. Chemical, petroleum, coal, rubber and plastic products	43,161	51,040	51,130	60,581	15.6	15.7
6. Non metallic mineral products	26,012	30,391	30,743	35,892	15.4	15.3
7. Basic metal products	2,968	3,308	3,452	3,844	14.0	13.9
8. Fabricated metal products, machinery, and transport equipment	16,003	19,195	18,548	22,331	13.7	14.0
9. Manufactured products not elsewhere specified	3,711	4,107	4,202	4,663	11.7	11.9
Total	218,909	250,038	256,172	293,263	14.5	14.7

(a) Based on information received from 515 non-BOI private sector firms
(b) Revised
(c) Provisional

Source : Central Bank of Sri Lanka

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

Category	Power & Fuel		Wage		Raw Material		Interest	
	2006	2007	2006	2007	2006	2007	2006	2007
1. Food, beverages and tobacco products	3.4	3.7	10.1	10.3	39.7	39.8	1.3	1.5
2. Textile, wearing apparel and leather products	4.5	4.9	15.2	15.3	13.1	13.2	2.3	2.6
3. Wood and wood products	9.1	9.5	16.1	16.2	33.2	33.0	4.1	4.4
4. Paper and paper products	4.1	4.4	13.2	13.1	19.5	19.6	3.4	3.6
5. Chemical, petroleum, coal, rubber and plastic products	6.4	6.9	13.3	13.5	30.4	30.7	3.5	3.8
6. Non metallic mineral products	19.9	20.7	14.9	15.0	29.2	29.4	3.2	3.6
7. Basic metal products	9.9	10.2	11.3	11.2	35.9	36.0	2.5	2.6
8. Fabricated metal products, machinery, and transport equipment	5.0	5.4	12.2	12.4	26.9	27.0	4.0	4.3
9. Manufactured products not elsewhere specified	5.2	5.5	12.0	12.1	34.6	34.5	1.4	1.6
Total	6.3	6.7	12.3	12.5	32.1	32.8	2.3	2.6

(a) Based on information received from 515 non-BOI private sector firms

Source : Central Bank of Sri Lanka

of possible supporting services, maintaining performance based payment systems and containing overtime payments. As a percentage of total cost of production, share of power and fuel, raw material and interest cost increased by 6.3 per cent, 2.2 per cent and 13.0 per cent, respectively.

Several incentives were granted by the government to increase the industrial sector output as well as regional industrialisation. Import of plant and machinery by the enterprises qualified under the "*Nagenahira Udanaya*" programme was exempted from VAT, to encourage investment in the Eastern Province. "*Nipayum Sri Lanka*" which is the major regional industrialisation programme initiated by the government continued to provide tax holidays, exemptions from duties and VAT and other benefits to establish or to relocate industries outside Colombo and Gampaha districts. The time period for granting

Table 2.10 Labour Productivity Index in the Non-BOI Private Sector Industries (a)

1995 =100

Category	2006	2007	Change (%)
1. Food, beverages and tobacco products	135.8	139.2	2.5
2. Textile, wearing apparel and leather products	117.3	121.9	3.9
3. Wood and wood products	105.5	108.3	2.7
4. Paper and paper products	106.3	108.9	2.4
5. Chemical, petroleum, coal, rubber and plastic products	144.8	150.2	3.7
6. Non metallic mineral products	117.4	120.2	2.4
7. Basic metal products	105.3	107.5	2.1
8. Fabricated metal products, machinery, and transport equipment	127.5	131.7	3.3
9. Manufactured products not elsewhere specified	113.7	117.0	2.9
Total	123.5	127.9	3.6

(a) Based on information received from 515 non-BOI private sector firms

Source : Central Bank of Sri Lanka

concessions to relocate or to commence investment outside Colombo and Gampaha districts was further extended up to end of March 2009. Under this programme, 41 new industries were established, 14 sick industries were revived and 4 industries were expanded while 3 industries were approved to relocate outside the Colombo and Gampaha districts in 2007.

The Budget 2008 emphasised the need for concentrated and sustained efforts in developing apparel, textile, building material, ceramic, gem and jewellery industries. Apparel industries which are located outside the Colombo District were granted concessionary loans subject to a maximum of Rs.15 million at an interest rate of 10 per cent to enable modernisation. As a measure to encourage the domestic textile industry and production of high quality fabrics, a cess of Rs.50/Kg was imposed on textiles imports for domestic consumption while importation of yarn was exempted from VAT. To expand the gem and jewellery industry, the budget proposed a tax exemption on profits and income arising from gem exports. Exporters of gems and jewellery were permitted to use 50 per cent of export earnings to import raw materials while packaging material for gems and jewellery were also exempted from customs duty. Customs duty was reduced for some categories of chemicals used in the ceramic production to support the development of the ceramic industry.

Ministry of Industrial Development (MID) which is the policy formation entity for the industrial sector has taken several initiatives to increase the industrial sector performance. Under the guidance of the MID and with the assistance of the National Science Foundation, a special project has been commenced to operate a Rapid Prototyping Machine and a Multi Layer Printed Circuit Board (PCB) manufacturing facility at the University of Moratuwa to facilitate electric and electronic, automobile, rubber and jewellery industries to supply new products with different designs to suit to the international market. Further, The MID continued to assist *"Gamata Karmantha"* projects under the 300 factory industries programme. In offering concessions under this programme to invest in the Eastern Province, the minimum requirements such as investment amount and number of employees were relaxed. The establishment of National Cleaner Production Centre and setting up the productivity improvement programmes under the MID supported to increase output and competitiveness of the industries. Further, several initiatives were taken by the government to increase domestic sugar production, such as re-opening of the Hingurana sugar factory as a Public Private Partnership (PPP) project, resumption of production at the Kantale sugar factory and setting up of new sugar factories in Bibile and Monaragala with the intention of producing 50 per cent of domestic sugar requirement by 2015.

Several other relevant authorities and institutions also lent its support to strengthen rapid industrialisation of the country. The BOI which is the central facilitation point for investors in the country under the Ministry of Enterprise Development and Investment Promotion has accelerated the approval process through one day service encouraging both local and foreign investors and launched the Electronic Data Interchange (EDI) mechanism to ease export procedures. To promote two way investments, the BOI signed Memorandums of Understanding with the Board of Investment of Pakistan and China Investment Promotion Agency. *"Negenahira Navodaya"* Development Programme was a new incentive package formulated by the BOI focusing investment promotion in the Eastern Province. Initiatives were also taken to establish Special Economic Zones dedicated to textile manufacturing industries as PPP projects and to improve infrastructure in the existing zones, enabling the provision of outstanding services to the investors. The Rubber Development Department with the assistance of the Industrial Development Board introduced a programme for small scale rubber manufacturers to produce more quality rubber based products for export markets. Productivity improvement and skill development, local and international image building, product and market development, investment promotion in backward integration and Small and Medium Enterprises (SMEs) development were the major initiatives taken by the Joint Apparel Association Forum (JAAF) in 2007 with regard to apparel industry development.

Recognising the importance of development of the SMEs for regional economic development and employment creation, the government has provided several incentives to increase overall activities of the SMEs sector. The main objective of providing assistance to the SMEs was to enhance production and business activities while creating employment opportunities at regional level. Sri Lanka Export Development Board (SLEDB) implemented a number of programmes such as market development, skills development, awareness and training programmes to promote export oriented SMEs in the provinces. The other relevant institutions such as respective line Ministries, Lankaputhra Development Bank and Trade Chambers also worked in line with the government policy initiatives on SMEs development in 2007. The MID made initiatives to establish regional industrial parks in selected areas to assist SMEs.

The growth momentum of the industrial sector was partly affected by external factors such as soaring oil and food prices as well as country specific shocks such as escalating conflicts in 2007. The fuel prices of the country increased in line with the international fuel prices. Since fuel is an important component of the cost structure of the industrial sector, higher price affected the profit margins and investment capabilities of the industries. The Sri Lankan apparel industry faced stiff competition in the international market, particularly in the US market. Sri Lanka has to improve its competitiveness by developing cost minimising strategies and increasing the efficiency of trade facilitation services such as information, packaging, marketing, transport, logistic and financial services in addressing the impending challenges from China and Vietnam. To have continuous market access under the GSP+ scheme, certain areas need to be improved further such as human and labour rights and environmental standards. The domestic market oriented industries faced stiff competition with the imported cheaper products and increased difficulties in maintaining proper supply chain and marketing facilities in the Northern and Eastern provinces due to the escalation of conflict. The lack of skilled labour, low productivity and low competitiveness, the number of procedures for dealing with licences and getting credit facilities, the relatively high business transaction cost, high interest rates and complex tax system are among the major impediments faced by the industrial sector.

During the year 2007, the processing (of plantation crops) sub-sector recorded a growth of 2.4 per cent compared to a growth of 0.8 per cent in the previous year, due mainly to the increased output of rubber and coconut.

The cottage industry sub-sector expanded at a rate of 5.6 per cent, compared with a similar growth of 5.7 per cent in 2006. The growth in this sub-sector was supported by the expansion in timber milling, rock metal products and small scale building material production activities with the increased demand from the construction sector. Small scale production of clothing and food items also indicated an increase in output during the year. However, the overall growth in the cottage industry sector was hampered to some extent by the drop in paddy milling activities with the contraction in paddy production during 2007.

The electricity, gas and water sector recorded a growth of 4.6 per cent over that of a comparatively high growth rate of 14.8 per cent in 2006. Value added in the electricity sub-sector decelerated to 4.6 per cent in 2007, when compared to a relatively higher growth of 16.2 per cent in the previous year. The drop in the low cost hydropower generation by 15 per cent contributed to the deceleration of the electricity sub-sector. The share of hydropower generation in the total electricity generated declined to 40.3 per cent from a corresponding figure of 49.4 per cent in the previous year, due to unfavourable weather conditions in the hydro catchment areas. As a result, the share of thermal power increased to 59.7 per cent to meet the total demand for energy. The increased demand for electricity came from almost all consumer groups including domestic, commercial and industrial sectors. Value added in the gas sub-sector increased by 2.9 per cent during the year while that in the water sub-sector increased by 7.1 per cent with the commissioning of new water supply projects to provide pipe borne water during 2007.

The mining and quarrying sector, which recorded a relatively high growth rate of 24.2 per cent in 2006 expanded further at a rate of 19.2 per cent. Value added in the gem mining sub-sector grew by 13.0 per cent during the year with the increase in the volume of gem exports by 5.3 per cent. Other mining activities also continued to grow at a rate of 21.9 per cent over a high growth of 30.6 per cent in the previous year as reflected by the increased exports in graphite, ilmenite and other mining products. The increased demand generated from the construction sector exerted a positive impact on the growth of the quarrying sector.

The construction sector continued to expand at a relatively high rate of 9.0 per cent during 2007 over a 9.2 per cent growth in the previous year with the positive contribution from both the government sector and the private sector. Construction activities of the government sector were largely concentrated on infrastructure development schemes particularly in road network expansion projects such as the Southern Expressway and the Colombo Circular Highway. The developments in capacity expansion projects in power generation were also seen in 2007. Reconstruction activities also contributed to the growth in the construction sector particularly with the liberation of the Eastern province. The private sector contribution was evident in the continued expansion of condominium and housing projects and other commercial and residential housing activities as reflected by the loans and advances of the banking sector. The growth in this sector was further reflected by the usage of both domestically produced and imported building material during the year. Although there was a shortage in cement supply for a short spell during the latter half of the year, annual cement consumption increased by 10.7 per cent over 2006. With the general increase in price levels during 2007, overall price level of building materials also increased by 11.4 per cent according to the price index published by the Institute for Construction Training and Development (ICTAD).

Services

The services sector continued to be the major sector of economic expansion during the year contributing 62 per cent to overall economic growth, with the share of total GDP remaining at the same level as in 2006. However, the growth momentum of the sector decelerated somewhat from 7.7 per cent in 2006 to 7.1 per cent in 2007. This deceleration could be attributed to the contraction in the hotels and restaurants sub-sector which suffered a set-back during 2007 with the unfavourable security situation and also due to the slowdown in import trade and domestic trade activities.

The wholesale and retail trade sector, which includes import, export and domestic trading activities, grew by 6.1 per cent during the year. The value added of the import trade sub-sector grew by 3.3 per cent in 2007 when compared to a growth rate of 6.8 per cent in the previous year. The main growth impetus of the sub-sector came from imports of investment goods, as reflected by a considerable growth in investment goods imports by 16.7 per cent in volume terms. Further, the high growth in investment goods imports augurs favourably for future growth prospects particularly with high volume growth in building material and machinery and equipment imports. Intermediate goods imports recorded a marginal volume growth of 0.8 per cent accompanied by a drop in crude oil imports during the year. Meanwhile, the contraction in consumer goods by 4.9 per cent had a negative impact on import trading activities. Imports of essential food items such as wheat flour and sugar dropped over 26 per cent in value terms although rice imports increased considerably with the effort to mitigate the price escalations in the domestic market with the shortfall in paddy production. As a whole, import of consumer durables fell in value terms reflecting the impact of the tight monetary policy.

The export trade sub-sector grew by 8.8 per cent during 2007, with impetus from most sub-sectors. Industrial exports, which constitute the largest share grew by 8.4 per cent in volume terms, supported by a 6.8 per cent volume growth in textile and garments which continued to benefit from favourable tariff rates in the EU region. Other industrial exports also expanded by 11.8 per cent in volume terms with higher contributions from exports of food, beverages and tobacco, and rubber based products. Agricultural exports recorded a moderate growth of 2.9 per cent with increased exports of rubber, coconut and other agricultural products following a growth in domestic production. However, tea exports declined in volume terms due to a drop in production although the foreign earnings increased considerably due to higher international prices.

Domestic trade sub-sector recorded a growth of 7.6 per cent over the growth of 8.9 per cent in 2006 due to increased agricultural and industrial output during the year. The increased production in coconut, fishing and other agricultural items such as vegetables and subsidiary food crops had a positive impact on value added even though the drop in paddy production constrained the growth in the sub-sector. The trading of domestic market oriented industrial products such as food, beverages and tobacco products and cement and other building material with increased local demand also exerted a positive impact on growth.

2007 was not a favourable year for the hotels and restaurants sector which contracted by 2.3 per cent in value added terms. The tourism sector had a challenging year with a drop in arrivals by 11.7 per cent while the industry was trying to recover amidst the unfavourable security situation in the country which had a detrimental impact on the tourist industry. Tourist arrivals from both Western Europe and the Asian region fell by 14.9 per cent and 16.4 per cent, respectively. The sector aggressively campaigned during the year in promoting local tourism, which grew by over 30 per cent in terms of guest nights to mitigate the negative impact of the drop in foreign tourists to some extent. But foreign guest nights which accounted for over 70 per cent of total guest nights fell by 11.3 per cent during the year.

Value added in the Transport and communication sector increased by 10.5 per cent in 2007, compared to a 12.6 per cent growth in 2006. This sector recorded the highest growth in the services sector and was driven by the healthy performance in all three sub-sectors namely post and telecommunications, cargo handling ports and civil aviation, and transport. The transport sub-sector which includes both passenger and freight transport recorded an overall growth of 9.4 per cent when compared to a growth of 11.2 per cent in the previous year. The expansion was reflected in the increase in passenger kilometres operated by both cluster bus companies and Sri Lanka Railways (SLR). Road haulage grew at a moderate rate reflecting the improvements in goods transport activities coupled with the increase in domestic production and international trade. In the air travel sub-sector, total passenger kilometres flown by Sri Lankan Airlines increased by 5.2 per cent during the year. Meanwhile, there was an increase in passenger kilometres operated by domestic airlines, showing a recovery from the decline in 2006.

The post and telecommunication sector, which experienced a buoyant growth in the recent past with annual growth rates of over 20 per cent in terms of value added from 2003 onwards continued to expand further by 21.5 per cent in 2007. Fixed access subscriber level including CDMA connections grew by over 45 per cent to reach over 2.7 million connections in 2007. The growth in mobile subscriber level dipped below 50 per cent in 2007 to 47.5 per cent after three consecutive years of over 50 per cent growth indicating that the pent-up demand for these services may have been fulfilled to some extent. As at end 2007, the mobile subscriber level stood at around 8 million users. Although internet and e-mail usage grew by 55.7 per cent, the segment is yet to reach the high usage levels seen in other telecommunication services such as mobile usage.

The cargo handling ports and civil aviation sub-sector grew by 8.8 per cent as against 20.0 per cent growth in the previous year. The deceleration was mainly due to a lower growth in transshipment throughput volumes handled by the Colombo port compared to the previous year with the capacity constraints of Colombo port. During the year, the Colombo Port including South Asia Gateway Terminal (SAGT) handled a volume of 3.38 million TEUs, recording a 9.8 per cent increase. This is the highest recorded TEUs handled by the Colombo port.

Transshipment volumes, which account for over two thirds of the total throughput handled, expanded by 9.7 per cent when compared to 36.6 per cent growth in 2006. Air cargo volumes grew by 5.0 per cent reflecting a relatively lower expansion in aviation industry.

The banking, insurance and real estate sub-sector grew by 8.7 per cent in value added terms. The income in the banking sector increased during the year, with interest income from advances and other investments on securities in an environment of high and volatile interest rates. Non-interest income of commercial banks from securities and activities in the foreign exchange market also increased during 2007. The better performance in insurance services also exerted a positive impact on the value added growth of the sector. Although the real estate sector continued to expand during the year, the initial buoyancy in the sector has subsided to some extent.

Government services sector grew by 6.0 per cent as against an increase of 5.0 per cent in the previous year. Expansion of government forces and the intake of new employees to the government sector contributed to the high growth in government services.

The private services sector sustained its growth momentum with a 7.8 per cent expansion in value added terms as in 2006. The higher performance in private health services, education and other personal services contributed to this growth.

2.3 Expenditure

Gross Domestic Expenditure (GDE) measures the aggregate demand generated by domestic economic activity. Therefore, the GDE could be expressed as the sum of consumption and investment expenditure of both the private and public sectors of the economy. During 2007, the GDE (aggregate domestic demand) estimated at Rs. 3,946 billion at current prices showed a marginal deceleration in nominal terms from a growth rate of 22.1 per cent in 2006 to 21.0 per cent in 2007. This growth was a culmination of both economic expansion and increase in general price level. The slowdown in domestic demand was more prominent in real terms when comparing the real growth of 5.8 per cent with the corresponding figure of 8.6 per cent for 2006. This slowdown was a result of ambitious demand management policies followed by the CBSL to face the escalating price pressure. Although both consumption and investment expenditure increased; the latter grew at a higher rate of 8.7 per cent in real terms. The sum of GDE and net imports of goods and services, which is equal to GDP at market prices, grew by 21.8 per cent to Rs. 3,578 billion in nominal terms.

Consumption

Total consumption expenditure, which includes both the private sector and the public sector, was estimated at Rs. 2,950 billion for the year 2007. Accordingly, consumption expenditure has decelerated marginally to 20.9 per cent in 2007 from 21.2 per cent in the previous year. This increase comprised of a 4.9 per cent growth in real consumption expenditure and a 15.3 per cent increase in the overall price level. Rising per capita income, expansion of employment opportunities, and increase in foreign remittances contributed to the growth in household consumption, while rising profitability induced the corporate sector consumption growth. The share of Private

Table 2.11 **Aggregate Demand**

Item	Current Market Prices (Rs.mn)			Constant (2002) Prices (Rs.mn)		
	2005	2006	2007(a)	2005	2006	2007(a)
A. Domestic demand						
Consumption	2,013,802	2,439,816	2,949,712	1,592,251	1,704,633	1,787,650
(% Change)	15.3	21.2	20.9	3.3	7.1	4.9
Gross domestic capital formation	658,019	822,216	966,700	514,984	583,970	634,669
(% Change)	24.6	25.0	21.2	9.3	13.4	8.7
Total domestic demand	2,671,821	3,262,032	3,946,412	2,107,235	2,288,603	2,422,319
(% change)	17.4	22.1	21.0	4.7	8.6	5.8
B. External demand						
Exports of goods and services	793,153	885,381	1,046,075	678,356	704,408	751,959
(% change)	7.4	11.6	18.1	6.6	3.8	6.8
Imports of goods and services	1,012,192	1,208,757	1,414,100	843,919	902,463	941,891
(% change)	9.6	19.4	17.0	2.7	6.9	4.4
Net external demand	-219,039	-323,376	-368,026	-165,564	-198,055	-189,932
C. Total demand	2,452,782	2,938,656	3,578,386	1,941,671	2,090,548	2,232,387
(% change)	17.3	19.8	21.8	6.2	7.7	6.8

(a) Provisional

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

Table 2.12 **Composition of Private Consumption Expenditure at Current Market Prices**

Item	Share of Total PCE (%)			Rate of Change (%)	
	2005	2006	2007(a)	06/05	07/06
01. Food, Beverages and Tobacco	37.9	41.2	39.7	27.5	16.5
02. Clothing and Footwear	8.5	7.6	7.9	5.4	25.9
03. Housing, Water, Electricity, Gas and other Fuels	10.0	10.2	11.3	19.8	33.8
04. Furnishings, Household Equipment and Routine Maintenance of the House	6.0	6.9	6.5	34.7	13.7
05. Health	1.5	1.5	1.5	20.2	21.6
06. Transport	21.3	19.7	20.4	8.6	25.5
07. Leisure, Entertainment and Culture	2.6	3.0	3.5	39.5	41.3
08. Education	0.1	0.1	0.1	9.3	12.4
09. Hotels, Cafes and Restaurants	1.7	0.8	0.7	-46.9	12.8
10. Miscellaneous Goods and Services	4.3	3.8	3.1	3.1	0.1
11. Expenditure Abroad of Residents	9.9	9.2	8.9	9.3	17.2
12. Less: Expenditure of Non- Residents	3.8	4.0	3.8	23.2	14.9
Total Private Consumption Expenditure	100.0	100.0	100.0	17.5	20.9

(a) Provisional

Source : Department of Census and Statistics

Consumption Expenditure (PCE) remained at 81.5 per cent of total consumption expenditure as in the previous year while the share of government consumption was 18.5 per cent.

2007 saw the expenditure of PCE on food, beverages and tobacco declining from a share of 41.2 per cent in 2006 to 39.7 per cent. Although the share of this consumption group declined steadily from 2002 with the increasing income levels, there has been a reversal in this trend in 2006; which could be attributed to the increase in price level of food items. As the demand for food is relatively stable, the increase in income levels has resulted in the drop in the expenditure share during 2007. Comparatively, the spending on clothing and footwear items grew at a higher rate of 25.9 per cent in nominal terms, while the share of this sector rose up to 9.9 per cent until 2004 and declined thereafter gradually accounting for a share of 7.6 per cent in 2006 and again increased to a share of 7.9 per cent in 2007.

During 2007, there was an increase in the prices of most basic utilities; with electricity tariff rates being revised upwards and the price of gas being hiked up several times with the developments in the international markets, while prices of other fuels such as kerosene also rising by a considerable amount. With these price increases the spending on housing and utility services went up by 33.8 per cent in nominal terms.

Although spending on household equipment and services, which includes furnishings, household equipment and routine maintenance activities increased in current terms, the growth was comparatively lower when compared to the growth of overall consumption. The growth of 13.7 per cent could be attributed to the growth in price levels particularly in the case of building materials used in routine maintenance. This reflects that the consumption of essential needs have taken precedence with the increase in prices.

Expenditure on health services continued to expand during 2007. The share of health expenditure which was stagnant at 1.5 per cent of total consumption remained the same during 2007 as well. Meanwhile, private consumption expenditure on education, which remained at a constant share of 0.1 per cent from 2002 onwards continued to be the same during 2007 as well. The relatively lower level of private spending on these services could be attributed to the significant role played by the public sector in providing these services to the masses.

During 2007, fuel prices increased on several occasions, which resulted in petrol and diesel prices rising by 27.2 per cent and 25.0 per cent, respectively in nominal terms during the year. Consequently, charges on public transport services also went up in tandem with bus fares being revised upwards during the year. As a result, spending on transportation rose by 25.5 per cent with the share increasing to 20.4 per cent in 2007. Also, there was a slowdown in new motor vehicle registration during the year particularly in motor cars, although there was an increase in registration of more economical vehicles.

Expenditure on other consumption needs such as recreation and entertainment and hotels and restaurants increased by over 12 per cent. Expenditure of the residents abroad accounted for a higher share of 8.9 per cent when compared with a share of 3.8 per cent spent by non–residents.

During 2007, the government sector consumption expenditure grew by 21.1 per cent in nominal terms over a considerably higher growth of 40.6 per cent in the previous year. The deceleration in government expenditure could be attributed to the drop in subsidies and transfers to public sector corporations, although subsidies to the household sector continued to grow in nominal terms. Also, the increase in public sector wage bill in all sectors ranging from central government to provincial councils and higher interest payments contributed to the growth in government expenditure.

Investment

Expenditure on investment (gross domestic capital formation) was estimated to have expanded from Rs. 822 billion in 2006 to Rs. 997 billion in 2007, recording a growth of 21.2 per cent in nominal terms. However, the investment to GDP ratio marginally declined to 27.9 per cent from that of 28.0 per cent in 2006 indicating a lower growth in investment activities. The real growth in investment activities was estimated at 8.7 per cent for 2007.

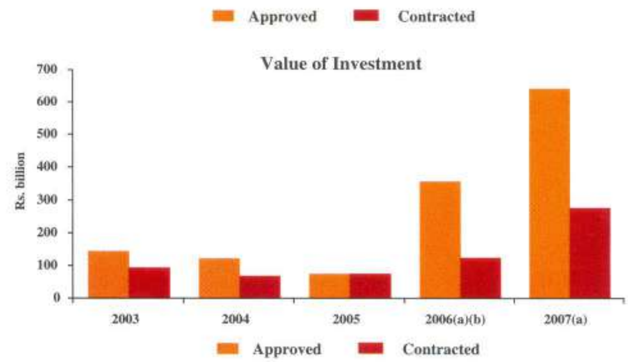
Private investment, which includes the contribution of public corporations and boards, grew by 14.4 per cent in 2007 reflecting the continued investor confidence amidst the security situation over a growth of 27.9 per cent in the previous year. Private sector investment accounted for a share of 81 per cent of total investment. Investor confidence was particularly evident in sectors such as manufacturing, telecommunication, real estate and other personal services such as private health care and education services. Increased activity levels in terms of investment were also reflected in higher import volumes of the same and in foreign direct investment as well.

Foreign Direct Investment (FDI) inflows increased by 21.6 percent to US dollars 734.4 million in 2007. Telecommunication sector accounted for more than 50 per cent of total FDI inflows to the country. The BOI, the apex government institution entrusted to attract and promote foreign and local investment to the country continued to play a major role in enhancing FDI in 2007. More than 70 per cent of FDI were invested in the area of infrastructure development including telecommunication, power generation and housing property and office complex development.

BOI approved 605 new projects in 2007 under Sections 17 and 16 of the BOI Act with an investment commitment of Rs.489.4 billion compared to 364 projects approved in 2006 with an investment commitment of Rs.339.8 billion. The increased investment inflow was reflected in both foreign and local investments. Under the Section 17 of the BOI Act, 87 projects were approved for expansion in 2007 with an investment commitment of Rs.154.5 billion. The accumulated realised investment in BOI projects increased by 28.4 per cent to Rs. 600.8 billion in 2007 compared with Rs.468 billion in 2006.

Of the 605 new projects approved in 2007 under Sections 17 and 16 of the BOI Act, 323 projects were owned by Sri Lankan investors, 167 by foreign investors while the rest were joint ventures. The service sector continued to be the major recipients of investment flows and attracted 356 projects with an investment commitment of Rs.543.6 billion and the factory industry absorbed 249 projects with an investment commitment of Rs.86.6 billion in 2007. Housing and property development, telecommunication, hospital services, hotel, restaurants and entertainment, power generation and other infrastructure development projects were the major recipients in the service sector. Of the factory industry, more than 90 per cent of the investment was absorbed by the food, beverages and tobacco products; textile, wearing apparel and leather products; fabricated metal products, machinery, and transport equipment; chemical, petroleum, coal, rubber and plastic products and non-metallic mineral products categories.

Chart 2.4 Investment in Approved and Contracted BOI Projects



(a) Including expanded projects
(b) Excluding local investment Rs.3,616 billion on Mihin Lanka (Pvt) Ltd

Table 2.13 **Investment and Employment in the Enterprises Registered Under Board of Investment of Sri Lanka (BOI) and Ministry of Industrial Development (MID)**

	No. of projects		Envisaged and Actual Investment (Rs.million)						Employment (No.)	
	2006(a)	2007(b)	2006(a)			2007(b)			2006(a)	2007(b)
			Foreign	Local	Total	Foreign	Local	Total		
BOI										
Projects Approved	401	692	231,738	146,821	378,558	307,093	336,786	643,879	87,550	126,773
Under Section 17 (d)	349	652	223,106	134,487	357,593	304,639	336,074	640,713	72,668	124,161
Under Section 16	52	40	8,632	12,334	20,965	2,454	712	3,166	14,882	2,612
Projects Contracted Under Section 17 (d)	247	303	39,898	83,677	123,575	122,671	128,955	251,626	45,063	63,590
Realised Investment Under Section 17 (c)	1,929	1,976	285,366	182,651	468,017	363,029	237,749	600,778	421,271	451,934
Commercial Operations (c)	2,460	2,418	185,106	177,664	362,770	185,458	180,969	366,427	386,835	376,947
Under Section 17 (c) (d)	1,655	1,608	167,598	167,210	334,808	167,728	170,480	338,208	349,652	339,670
Under Section 16 (c)	805	810	17,508	10,454	27,962	17,730	10,489	28,219	37,183	37,277
MID										
Projects Registered (c)	1,629	1,667	n.a.	n.a.	119,344	n.a	n.a	121,456	273,553	275,883

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

Sources : Board of Investment of Sri Lanka
Ministry of Industrial Development

The service sector absorbed 154 projects with an investment commitment of Rs.160.6 billion of the contracted investment in 2007 under the Section 17 of the BOI Act while the Rs.20.6 billion was absorbed by the factory industry. The major recipients of investments included housing and property development, telecommunication, power generation and infrastructure development projects. Within the factory industry sector, textile, wearing apparel and leather products; chemical, petroleum, coal, rubber and plastic products; food, beverages and tobacco products; non-metallic mineral products and fabricated metal products, machinery, and transport equipment categories were the major recipients of contracted investment in 2007. During 2007, 48 contracted projects were expanded with the investment commitment of Rs.70.4 billion.

Projects that commenced commercial operation under the Sections 17 and 16 of the BOI Act declined marginally from 2,460 in 2006 to 2,418 in 2007. Among the sub-categories of the factory industry, 342 projects were in the textile, wearing apparel and leather products category; 180 projects in the food, beverages and tobacco products category; 165 projects in the chemical, petroleum, coal, rubber and plastic products category; and 100 projects in the fabricated metal products, machinery, and transport equipment category while the service sector absorbed 1,191 projects. Meanwhile, 95 projects were located outside the processing zones as at end 2007.

Government sector investment expanded at a higher rate of 61 per cent during 2007 when compared to a growth of 10.0 per cent in 2006, which transformed to a real growth of 38.2 per cent for 2007. Public sector investment was particularly evident in building and rehabilitation of highways and roads, as well as power sector projects with the participation of the private sector during the year. Further involvement of the government sector was seen in programmes which targeted at social upliftment such as education and health care.

Availability and Utilisation of Resources

The total resource availability in an economy is given by GDP and imports of goods and services. For 2007, this was estimated at Rs. 4,992 billion, showing a nominal growth of 20.4 per cent when compared to an increase of 19.7 per cent in the previous year. Domestic resources grew at a higher rate of 21.8 per cent when compared with the 17.0 per cent growth in foreign resources in 2007. Hence, the share of domestic resources of the total resource availability increased to 72 per cent from 71 per cent in 2006, while the remaining 28 per cent was made up of foreign resources. In real terms, the growth in total resource availability was 6.1 per cent, which was a combination of growth in domestic resources by 6.8 per cent and foreign resources by 4.4 per cent.

Resources are utilized for consumption, capital formation and export of goods and services. Of this, the highest share of 59 per cent of total resources was utilized for consumption, followed by exports of goods and services with a share of 21 per cent while the remaining 20 per cent of resources was used in capital formation. Utilization of resources for both consumption and capital formation grew over 20 per cent with the latter growing at a marginally higher rate while exports of goods and services grew by 18 per cent.

2

NATIONAL OUTPUT AND EXPENDITURE

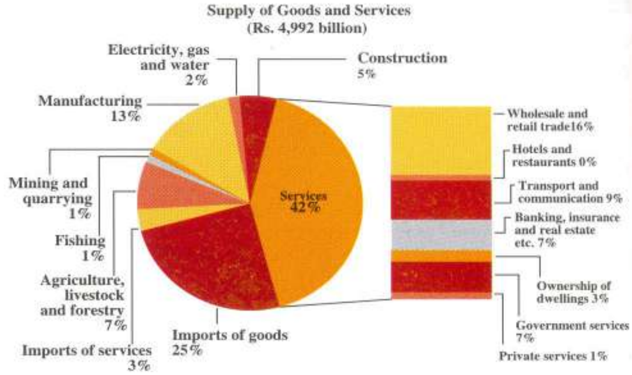
Table 2.14 Total Resources and Their Uses at Current Market Prices

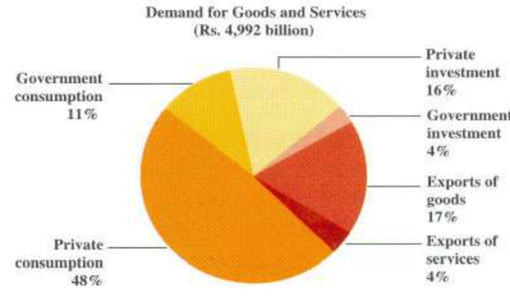
Item	Percentage Share 2006	Percentage Share 2007(a)	Percentage Growth 2006	Percentage Growth 2007(a)
A. Resources				
Gross domestic product	70.9	71.7	19.8	21.8
Imports of goods and services	29.1	28.3	19.4	17.0
Total	100.0	100.0	19.7	20.4
B. Utilisation				
Consumption	58.8	59.1	21.2	20.9
Gross domestic fixed capital formation	17.6	17.7	27.5	21.0
Private	15.1	14.3	30.5	14.3
Government	2.6	3.4	12.3	61.0
Change in stocks	2.2	2.2	7.7	22.7
Export of goods and services	21.3	21.0	11.6	18.1
Total	100.0	100.0	19.7	20.4

(a) Provisional

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

Chart 2.5 The Economy in 2007 (at current prices)





The total supply of goods and services includes both domestic as well as external sources. Of which, domestic services constituted a share of 42 per cent. Domestic goods accounted for a share of 30 per cent, as in the pervious year. Supply of imported goods contracted from a share of 26 per cent in 2006 to 25 per cent in 2007 while the share of imported services remained at 3 per cent.

On the demand side, the share of key aggregates of consumption, investment and external demand remained unchanged when compared to 2006. Domestic demand which includes consumption and investment saw an increasing trend during the past few years, with the share rising from 75 per cent in 2002 to 79 per cent in 2006 indicating a higher growth contribution from the domestic sector. Consequently, the share of external demand fell from 25 per cent in 2002 to 21 per cent in 2006. Being a small nation, as there is a limit to growth in domestic demand if long-term growth momentum were to be sustained, it is imperative that the nation achieves its growth prospects through an expansion in the external sector.

Table 2.15 Consumption, Investment and Savings at Current Market Prices

Item	Rs. Million 2006	Rs. Million 2007(a)	% Change 2006	% Change 2007(a)	Per cent of GDP 2006	Per cent of GDP 2007(a)
1. Gross domestic product at market prices	2,938,656	3,578,386	19.8	21.8	100.0	100.0
2. Consumption expenditure	2,439,816	2,949,712	21.2	20.9	83.0	82.4
Private	1,988,378	2,403,167	17.5	20.9	67.7	67.2
Government	451,438	546,545	40.6	21.1	15.4	15.3
3. Investment	822,216	996,700	25.0	21.2	28.0	27.9
Private	703,044	804,495	27.9	14.4	23.9	22.5
Government	119,172	192,204	10.0	61.3	4.1	5.4
4. Domestic savings	498,840	628,674	13.6	26.0	17.0	17.6
Private	568,967	686,380	13.2	20.6	19.4	19.2
Government	-70,127	-57,706	-10.3	17.7	-2.4	-1.6
5. Domestic savings - investment gap	-323,376	-368,026	-47.6	-13.8	-11.0	-10.3
6. Net factor income from abroad	-40,424	-38,808	-34.5	4.0	-1.4	-1.1
7. Net private current transfers from abroad	197,861	245,006	13.4	23.8	6.7	6.8
8. National savings	656,278	834,872	12.5	27.2	22.3	23.3

(a) Provisional

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

Savings

In 2007, both domestic savings and national savings increased despite the increase in consumption expenditure. Domestic savings increased by 26 per cent, raising the domestic savings ratio (domestic savings/Gross Domestic Product) also from 17 per cent to 17.6 per cent. The resources gap, the difference between the domestic savings and investment as a ratio of GDP mitigated in 2007 as a result of the increase in domestic savings ratio as well as the marginal decline in the investment ratio.

Domestic savings, which include both private and government savings were estimated at Rs. 629 billion, of which the private savings constituted Rs. 686 billion more than compensating the government dis-savings of Rs. 58 billion. Increased profitability in the corporate sector impacted positively on institutional savings while the increase in the interest rates encouraged household savings. Meanwhile, the government savings, which is defined as the current account balance of the government budget, was negative, but improved by a further 17.7 per cent compared to 2006.

National savings, the sum of domestic savings, net factor income from abroad (NFIA) and net private transfers increased by 27 per cent to Rs 835 billion in 2007. The favourable performance of both NFIA and net private transfers were responsible for this improvement. The NFIA continued to be negative, but improved in 2007 mainly due to the increased interest income from official reserves as well as foreign financial assets of the private sector. Net transfers, which consist of worker remittances, increased by 24 per cent to Rs. 245 billion in 2007. Accordingly, national savings ratio (national savings/ GDP) increased from 22.3 per cent to 23.3 per cent.

Box 6 Balanced Regional Development

As countries strive to provide a better livelihood for their people, they face inequalities in opportunities as well as in the distribution of wealth which often lead to significant regional economic disparities. Ideally, growth strategies should aim at balanced regional development where different parts of a country grow at similar rates through enhanced economic and social infrastructures. In such a situation, the benefits of economic progress are made available to all citizens, irrespective of the regions in which they live. Although, this is not easily realizable, concerted action needs to be taken to deliberately implement policies that promote an environment, where all members of society have similar chances to become socially active, politically influential, and economically productive.

Prevailing Regional Economic Disparities

Since the time Sri Lanka gained independence, successive governments have implemented various programmes that have been designed to uplift the regional economy[1]. Despite these efforts, the country continues to be plagued with significant regional economic disparities. Whilst the Western Province (WP) accounted for 50.1 per cent of Gross Domestic Product (GDP) in 2006, each of the other provinces accounted for less than 10 per cent of GDP (Table B 6.1). Even on a per capita basis, WP has a considerable lead over the other provinces. Moreover, the sectoral share of GDP also shows a similar trend, particularly in the services and industrial sectors (Chart B 6.1).

Table B 6.1
Provincial Shares of GDP and Per Capita Income - 2006

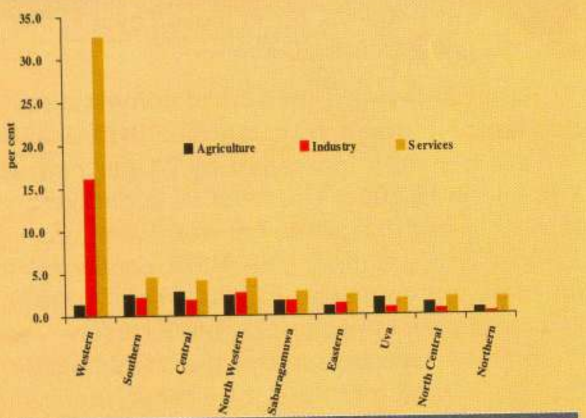
Province	GDP Share (%)	Per Capita Income (Rs.)
Western	50.1	222,598
Southern	9.3	97,377
Sabaragamuwa	6.2	82,575
Central	8.8	85,833
Uva	4.6	92,615
Eastern	4.7	75,364
North Western	9.3	103,792
North Central	4.1	88,333
Northern	2.9	64,185

Source: Central Bank of Sri Lanka

However, it is important to note that the social indicators reveal a relatively lower gap among the provinces, in terms of education attainment and access to health facilities. Nevertheless, there is a need for making further improvements in these areas as well, to be compatible or at least closer to the levels that prevail in WP.

[1] These include the establishment of colonies, irrigation schemes such as Gal-oya, Walawe and Mahaweli etc., integrated rural development projects (IRDP), decentralised budget, District Development Councils and more importantly, the establishment of Provincial Councils in 1987. In addition, the government budget allocates a significant amount of funds annually for implementing various projects aimed at regional development.

Chart B 6.1 **Sectoral Composition of GDP - 2006**



Ongoing Efforts to Reduce Provincial Disparities

With about 70 per cent of the population living outside WP, there is a significant increase in demand for goods and services emanating from the rural areas. The government has embarked on an "inclusive growth strategy" in order to enhance the allocative efficiency of resources, and thereby, to ensure that the benefits of growth are trickled down to the masses in the villages of Sri Lanka.The government's policy on regional development has been enunciated in the "Ten Year Horizon Development Framework: 2006-2016" (*Ten-year-Vision*). In the *Ten-year Vision*, the government has indicated its committment to improving the socio-economic conditions of the entire island through a mixture of infrastructure development, human capital development, and enterprise development, while providing a safety-net to the needy segments. It intends to direct investments beyond the "centre", focusing on Public Private Partnerships (PPPs) and promoting the utilisation of resources in the provinces. This way, both the private sector and the public sector are expected to become the "combined engine of growth and development".

In addition to common development programmes at the national level, the government's key programmes to develop specific regions and areas include the Gama Neguma and Maga Neguma Programmes, Beyond the Palmyrah Grove, Eastern Revival, Senkadagala Revival, Rajarata Reawakening, North West Revival, Awakening of Wellassa and Krushi Navodaya. The *"Randora"* programme, the mega infrastructure initiative, is also aimed at developing infrastructure which is bound to have a favourable impact on regions.

These programmes are expected to address several priority areas including the reconstruction and rehabilitation of houses, resettlement of displaced families and establishment of government offices, development of rural infrastructure including regional roads and highways, telecommunications, electricity, irrigation and water supply. It also envisages facilitating the development of the fisheries sector at the regional level, providing effective financing facilities, developing health and education, training and skills development, establishing new industries and promoting the SME sector, resolving landlessness issues of the rural poor, re-training low skilled labour forces in rural areas, reducing the impact of natural disasters such as floods and droughts and promoting cooperation among communities as well as between government officials and the private sector.

The government has also provided a number of incentives and facilities through the national budget towards improving the regional economy. The provision of fiscal incentives to encourage investments in provinces outside the Western Province, the three hundred factories programme, the establishment of the Lanka Putra Development Bank, various tax incentives particularly to the agriculture, industry and fisheries sectors, and promotion of non traditional export agriculture are among them.

Role of Provincial Councils

The Provincial Councils (PCs) system could also make an effective contribution to the ongoing efforts aimed at balanced regional development. The PC system, which came into effect with the Thirteenth Amendment to the Constitution in 1987, has existed for about two decades now. A closer look at its performance reveals that one of the objectives of PCs, the achievement of 'balanced regional development', has not been realized yet, despite their existence for such a long period. As indicated above, regional economic disparities still prevail and seem to be increasing though the social indicators do not reflect a significant gap. Perhaps PCs have made some attempts, but no appreciable change has been shown in the provinces as yet. The WP still dominates as the main income earner and the key spending province of the country. Hence, PCs have to come up with a renewed effort to reduce regional economic disparities.[2]

One of the major avenues to increase the provincial output and reduce regional economic disparities is to increase the public investment in the Provinces. However, given the limited availability of government resources and

[2] The Central Bank, for the first time in history, initiated a seminar series to enable PCs to improve the awareness about the achievements of each PC compared to the other provinces and the overall development objectives of the country. Various initiatives that could be undertaken to improve their performance further in achieving balanced regional development were also proposed by the Central Bank at these seminars.

that the central government is already implementing a number of projects in the regions with a view to reducing regional disparities, the government faces difficulties in releasing sufficient funds to PCs for meeting all their development needs.

In such a situation, there is a need for all stakeholders, particularly PCs, to re think, re-organize and re-energize themselves to effectively contribute towards the challenge of reducing regional disparities. In this process, PCs need to assess their strengths and opportunities, and set themselves key targets on a macro basis for a specific period i.e. provincial GDP, provincial per capita GDP, sectoral output targets and investment targets. In setting macro targets for PCs, the probable rate of increase of GDP of WP can be used as the base. The provincial targets should be set to surpass that of WP, over the years, enabling the provinces to catch up with WP. Although this may be a tough goal, only such a strategy would lead to balanced regional development in the country. As the base for the provinces, other than WP, is relatively low, a higher growth can be realized, if PCs are well focused and persevering.

A number of methods/instruments could be used for this purpose. Obtaining private sector participation PPPs is a key area that needs to be promoted. In line with this, Build, Operate and Own (BOO) and Build, Operate and Transfer (BOT) projects in the respective areas need to be identified. New initiatives to obtain the involvement of eminent and successful businessmen by inviting them to participate in provincial investment activities are also to be introduced. In line with this, it is necessary to clear the barriers, if any, in creating PCs own institutions such as Investment Promotion and Tourist Promotion Authorities, entering into PPPs, obtaining foreign investors' collaboration and releasing government lands for investment.

A number of factors contribute towards generating growth and social progress in the provinces. The development of necessary infrastructure is a key requirement. The government is in the process of improving infrastructure. PCs can also enhance their efforts to further improve such facilities in their respective provinces through improved co-ordination of these infrastructure development initiatives. Enterprise activities in all three sectors i.e. agriculture (traditional crops, animal husbandry, fisheries, cash crops, export crops etc.), industry (processing industries, SMEs) and services (financial services, tourism etc.) are also to be developed within the provinces. In addition, human capital development, including vocational training, education in primary, secondary and tertiary levels, technology research and development, also contributes to the process.

In moving in this direction, it is important that PCs plan their activities well ahead. Identification of projects in the key areas, obtaining expertise, finding innovative ways to raise the finances without depending on the government all the time and getting private sector participation are the main areas that need attention.

Also, each province would need to develop its own Strategic Plan and strategies to increase provincial GDP and other social and development indicators. It is necessary that Chief Ministers of each Province assume the responsibility of such targets. The commitment from both, the government and opposition, should be obtained for the Way Forward Development Plan of each Province. Targets and plans should be announced along with projected outcomes. Also, PCs could implement a Results Based Monitoring and Evaluation System to evaluate their contribution to regional development. Such a system would cover a set of outcome indicators for policy areas, set targets, which are the quantifiable levels of achievement at a given period of time and performance targets that are needed to identify results. Assistance from other stakeholders is also to be obtained to monitor the implementation closely and to track the overall progress.

At the initial stage, PCs could at least identify two key development projects to be implemented in collaboration with the private sector on a PPP or joint venture basis to enhance economic activities, generate employment and increase income levels within their respective provinces to reduce regional imbalances. The Budget 2008, through the Finance Commission, has already allocated Rs. 150 million for each PC, totalling to Rs. 1,350 million, as the government's component for such key projects. These funds will be utilized to provide social and economic infrastructure facilities for these key projects. In this context, the best performing provinces can perhaps be recognized and rewarded by way of additional development allocations for the following year.