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SRI LANKA'S EXPORTS - OUT OF SYNC WITH GLOBAL DEMAND

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Abstract

A frequently cited reason for Sri Lanka's weak export performance is the heavy concentration of its export earnings in a few products and a few markets. Hence diversifying the product and market portfolio has emerged as a key solution to the problem. This paper investigates the merit of this diagnosis and the proposed solution by analysing the concentration of products and markets of the Asian countries that are among the top 25 exporters in the world and that account for nearly 20% of world's exports. The analysis finds that these countries demonstrate significantly high levels of concentration in a few markets and a few products in a manner similar to Sri Lanka. However, unlike in the case of Sri Lanka, the products and markets of the selected Asian countries demonstrate strong alignment with the trends in world market demand. Sri Lanka's markets and products show significant deviation from global demand, and the data reveals this to be more pronounced in products than in markets. The findings infer that, contrary to the popular belief, concentration is not necessarily a hindrance to export success. It can even be considered a strength and not a weakness if its alignment with the emerging global demand patterns is robust. The insights drawn from the analysis highlight the limitations of the current approach to fixing the export problem of Sri Lanka and the importance of revisiting strategies proposed to fix the problem.

Key Words: Exports, Trade Policy, Empirical Studies of Trade, Export Concentration, Sri Lanka

JEL Codes : F100, F130, F140

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INTRODUCTION

Reviving the export sector of the country has been a key policy objective of successive governments of Sri Lanka. However, sector performance has not lived up to expectations. As a percentage of GDP, the share of exports has declined from 33.3% in 2000 to 12.7% by 2016. The share of Sri Lanka's exports in the world market which has been a miniscule in 2000 at 0.08% has shrunk further to reach 0.06% by 2016. A frequently cited reason for this lackluster performance of the export sector has been heavy reliance of export revenue on a few markets and a few products (EDB 2014; MODSIT 2017)². Out of total export revenue in 2016, 37% is dependent on two markets (USA and UK) and 44% is dependent on two products (apparel - HS 61 and 62). Therefore, diversifying products and markets is widely believed to be the solution to this problem (EDB 2014; MODSIT 2017).

Reducing concentration of products to revive exports to some extent is in conflict with international trade theories that refer to product specialisation based on comparative and competitive advantages of countries, which are considered key factors driving international trade. Based on theory, it is expected that product specialisation will in fact be an important factor which determines the export success of a country. Further, product specialisation leads to a number of advantages such as efficiency gains and cost reductions arising from economies of scale. Further specialisation also enhances space for product and process innovation as well as brand creation in turn contributing to the competitive advantage of a country in the world market. There is, however, merit in promoting diversification of export products and markets as a means of reducing a country's vulnerability to external shocks. However, no theoretical argument based on international trade theory could be advanced to hypothesise that an exporting nation cannot be successful because its export earnings are concentrated in a few specialised products and a few export markets. The present research investigates the importance of having a diversified portfolio of products and markets to be successful in exports using empirical data on trade. It does so by analysing the product and market concentration of leading Asian exporters with the product and market concentration of the world and of Sri Lanka.

OBJECTIVES

The objective is to examine the validity of the diagnosis of Sri Lanka's key export problem as being the concentration of exports to a limited set of products and a narrow array of market destinations, and of the proposed solution to diversify its products and

² EDB – Export Development Board of Sri Lanka, MODSIT - Ministry of Development Strategies and International Trade of Sri Lanka

markets. The analysis compares the country's export basket concentration and its export performance against successful exporting nations, as well as to global market trends in both production and trade at a macro level to assess the merit of the diagnosis of the export problem and the proposed solution. The study also intended to draw lessons through the conclusions of this study, particularly with regard to the possible strategic focus Sri Lanka could set in view of overcoming the weak export performance of the country.

MATERIALS AND METHODS

This research examines the export statistics of leading exporting nations in the world, and world market demand- and production patterns in an attempt to map such performance against the diversity (or, in the contrary, the concentration) of their export basket and destinations. The patterns so perceived were compared with those of Sri Lanka, to understand similarities and differences.

This research takes, as a key measure of export success, the share of world exports of a country and its rank in the world export market. According to the international trade database maintained by the International Trade Centre (ITC), there are nearly 235 trading territories in the world.³ Together, they accounted for exports valued at USD 16 trillion in 2016. However, just ten of these countries accounted for 53% of total exports and 25 countries accounted for nearly 80% of total world exports. The high percentage of exports in the world accounted for by the top 25 exporters indicates that these countries have fared well in terms of exports in comparison with others. Ten out of the 25 leading exporting countries in the world were Asian, and together they accounted for 33% of total world exports. Excluding China, which is the largest exporter in the world, the rest of the Asian countries accounted for 20%.

The hypothesis that successful export performance would be associated with a broad array of products (i.e., lesser concentration of exportable items) and a widespread spectrum of market destinations (i.e., lesser degree of export market concentration) was thus examined against the basket of export products and markets of six Asian countries out of the ten leading Asian exporters in the world. The six countries selected to be examined in this analysis were Japan, South Korea, Singapore, Malaysia, Vietnam and Thailand. This group of countries were specifically selected because of the significant differences they display in terms of the size of their economies and levels of development. Three of the selected markets: South Korea, Singapore and Japan, are high-income countries; while

³ The number of trading territories exceed the number of countries in the world, because some territories which belongs to a single country, for the purpose of reporting international trade, are listed separately (e.g. Hong Kong, Taipei)

the other three are middle-income countries. Among these middle-income economies, Thailand and Malaysia are upper middle-income, and Vietnam is a lower middle-income country, like Sri Lanka (Abeyasinghe & Munas, 2017).

The analysis looked at the level of concentration of export earnings and their composition. The level of concentration is assessed by the percentage of export earnings generated from the three key markets and two key product categories. This analysis compares and contrasts the level of concentration as well as the composition of products with global trends to understand whether global market demand is a key determinant of the emerging patterns of products and markets among leading Asian exporters.

The analysis of product concentration is done using the product categorisation at two-digit level under the Harmonised System of Classification of products⁴. Compared to other research (UNCTAD5 2015) which calculates concentration or diversification at a more disaggregated level of 6 digit or above, the decision to select products at two-digit level was done purposely. As will be seen in the following sections, analysis of the level of product concentration at two digits bring out important insights at a macro level, which would not have been visible had the analysis taken place at a more micro level going beyond two digits. The aim of this research is not to undermine the merit of diversification and sophistication of products within broader categories of export products beyond two digits, but to highlight important factors which become visible only when analysis takes place at an aggregate level of two digits.

Data were sourced from the online international trade statistics database maintained by the International Trade Centre. As mentioned above, the annual export and import values of selected countries and of the world, as reported in the database, were used to calculate export concentration and to analyse the composition of products and markets. The research uses simple statistical comparisons of the concentration ratios at a macro level and graphical examinations of inter-country comparative patterns as analytical methods.

ANALYTICAL RESULTS

The leading Asian exporters of the world are a highly diverse group of countries

When making cross country comparisons, in any research, a key principle which is normally followed is to select countries that are comparable. To assess comparability of

⁴ The Harmonised System is an international nomenclature for the classification of products. It allows participating countries to classify traded goods on a common basis for customs purposes. At the international level, the Harmonised System (HS) for classifying goods is a six-digit code system. The HS comprises approximately 5,300 article/product descriptions that appear as headings and subheadings, arranged in 99 chapters (at HS02)

⁵ United Nations Conference on Trade and Development

countries, the frequently-used measures are GDP, per capita income (which is taken to assess level of development), population and land area (which at times can be proxies for market size and resource endowments – e.g. labour). This is done on the premise that these factors are important determinants of economic performance of a country. Therefore, it is only fair to expect that the leading exporters of the world display some level of similarity in terms of the size of their economies and the level of development. However, contrary to expectations, the ten Asian countries among the top 25 exporters in the world are a highly diverse group in terms of size of GDP, population, land mass, resource endowments and level of development (Table 1).

Table 1: World's Top 10 Asian Exporters – Selected Key Economic Indicators

Country	Share of world exports – 2016 (%)	GDP (US\$ Bn) 2016	Per Capita GDP (US\$) - 2016	Population (million) 2016	Land Area Sq km (000s)
China	13.0	11,199	8,123	1,379	9,388
Japan	4.1	4,939	38,894	127	365
Hong Kong	3.3	320	43,681	7	1
South Korea	3.1	1,411	27,539	51	97
Singapore	2.1	297	52,961	6	0.7
Taipei	1.8	N/A	N/A	23	32
India	1.6	2,263	1,709	1,324	2,973
Vietnam	1.4	203	2,186	93	310
Thailand	1.3	407	5,908	69	511
Malaysia	1.2	296	9,503	31	329

Source: International Trade Centre, World Bank

The fact that these countries which are incomparable by many economic yardsticks mentioned above are among the top 25, indicates that these factors are not necessarily hindrances to reaching the top. This provides a more optimistic view of the potential that a country like Sri Lanka has to perform well in exports, despite being a lower middle-income country, with a considerably small population of 20 million, GDP of USD 82 billion and a land area of 65,610 sq km.

Market concentration and composition of the selected Asian countries are strikingly similar

Since the economic size and level of development of the leading Asian exporters vary significantly, it is natural to expect a variation among them in terms of leading export

markets and products. However, the data reveals striking similarities in terms of both markets and products.

In terms of markets, all countries demonstrate a high degree of export concentration in three markets. The dependence of export revenue on three markets is over 30% for all selected countries (Figure 1). Vietnam, South Korea and Japan show greater levels of concentration of over 45%. In terms of market composition; China is among the top three export markets of all countries. USA is also among the top three for all countries except Singapore, where it is the fifth largest export market.

Figure 1: Market Concentration (%) and Composition - Selected Asian Countries

Source: International Trade Centre (www.trademap.org)

Further investigation as to the significance of these markets for a country which is faring well in exports reveals that they are the largest buyers of exports in the world. For example, USA, China, Japan, Hong Kong and South Korea are among the top three export markets of the selected countries and are in fact among the top ten importing countries of the world. They accounted for 34% of total world market demand in 2016. Out of these countries, USA and China are the two largest importing countries in the world and accounted for 24% of total global demand in 2016. The strong alignment between the export markets and global demand emerges as a key factor that leads to high levels of concentration in these markets for a significant portion of the export revenue.

Further, the data also reveal continuous re-alignment of exports by these countries with shifts in global demand. For example the concentration of export revenue has shifted to China in line with its emergence as a leading importer in the world. China became a key buyer in the world market since the turn of the century. The global import market share of China increased during 2001-2016 from 4% to 10%. The value of imports into China

increased over six-fold from US\$ 244 billion to US\$ 1589 billion during the same period. In line with this shift, exports of all Asian countries (except Vietnam) destined to China have more than doubled during the same period (Figure 2).

Figure 2: Share of Exports to China (as a % of total export value)

Source: International Trade Centre (www.trademap.org)

The product concentration and composition of selected Asian countries are strikingly similar as well

As mentioned before, the selected Asian countries also demonstrate striking similarities in terms of product concentration and composition, despite significant differences in their economic size and the level of development.

Figure 3 shows the level of export concentration and composition of the two largest product categories exported out of the 99 product categories (traded in the world at HS2 digit level) for the selected Asian countries. Similar to the market trends discussed in the previous section, data demonstrate a high degree of concentration of export earnings on two product categories across all the countries. For example, over 30% of export revenue of all countries, is concentrated in two product categories. For five countries out of the six, the level of concentration exceeds 40%.

Figure 3: Export Product Concentration and Composition - Selected Asian Countries

Source: International Trade Centre (www.trademap.org)

In terms of the product composition electrical products (HS 85) emerge as one of the two key export product categories for all countries except Japan. The other product category that is among the two key products for four countries out of the six is machinery (HS 84). The fact that all these countries are exporting somewhat similar products (with the exception of vehicles) that are considered ‘high tech’ regardless of the differences in the size of the economies and the level of development, challenges the conventional wisdom that considers the level of development as a key determinant of a country’s ability to produce ‘high tech’ products.

This is the result of the emergence of ‘Global Value Chains (GVCs)’ or ‘production networks’ over the last three decades. The GVCs refer to slicing production into small components and parts that are manufactured and assembled across different countries. These value chains have revolutionised development options facing poor nations enabling them to be part of the value chain of the so called ‘high tech’ products by producing/assembling parts and components rather than having to invest decades in building production chains of their own (Baldwin 2013).

For example, ‘No (single) country has a comparative advantage in making iPhones. What they do have is comparative advantage in generating elements of the iPhone GVC, in key services, components, and assembly’ (Spence 2017).

Research finds the fragmentation of production of electrical products and machinery into geographically separate stages to be a prominent feature of production and trade patterns in East Asia (Athukorala 2010).

The concentration of export earnings in electrical products and machinery among the selected Asian countries that are significantly different in the economic size and level of development is clearly the result of their alignment with the shift in global production trends during the last three decades. In addition to this, the analysis of global demand trends reveals that the key export products of these countries are key products demanded by the world. For example, the three product categories that are among the two key products; electronics (HS 85), machinery (HS 84) and vehicles (HS 87) are the three leading products demanded by the world, and accounted for 36% of the global demand in 2016.

Product and market concentration and composition of Sri Lanka is out of sync with global demand

This section analyses the degree of alignment of Sri Lanka's export products and markets with global demand in comparison to the selected Asian countries.

Figure 4: Concentration of Exports of Selected Asian Countries in the Worlds' Top Five Markets and Top Five Product Categories - 2016 (% of Exports)

Source: International Trade Centre (www.trademap.org)

Figure 4 compares the concentration of export revenue of the selected Asian countries including Sri Lanka in the five leading import markets that accounted for 38% of total global demand and the top five products traded that accounted for 43% of global demand in 2016.

The data reveals that, in terms of the level of market concentration, Sri Lanka to be on par with the other Asian countries. Out of total export earnings of the country, 45% is generated by selling to the leading markets in the world. However, the country fares poorly in terms of product concentration. Only 7% of the country's export earnings fall into the top five product categories that have the highest demand in the world. In contrast, over 40% of the export earnings of all leading Asian exporters selected for this analysis is generated by selling products that command the highest percentage of global demand. Japan shows the highest degree of concentration at 62%, followed by South Korea, Thailand and Singapore that show levels of concentration of over 50%.

Although Sri Lanka fares well in terms of market concentration, there is a key difference between the selected Asian countries and Sri Lanka in terms of market composition. This is the notable absence of China among the top five export markets of Sri Lanka. Almost 37% of exports of Sri Lanka are destined to U.S.A. and U.K. and China accounts for only 2% of the country's exports (CBSL 2016).⁶ In contrast over 10% of exports of all the selected Asian countries are destined to China.

In terms of product composition, Sri Lanka is clearly out of sync with global trends. The country depends on apparel exports (HS 62 and 63) for 44% of its export revenue. The apparel product categories are not even among the top ten product categories traded in the world and accounts for only 2% of total world market. While the world market share of apparel remains small, Sri Lanka's share in that market for apparel is even smaller. It accounts for only 1% of the total apparel import market in the world.

Another key insight that emerges from the analysis is that Sri Lanka's market composition is a reflection of its product composition. The data reveal Sri Lanka's over-reliance on markets in the West, especially on USA and UK which accounted for 37% of the country's exports, and its notable absence in China, to be the outcome of the country's current product composition.

USA and UK are among the top five leading importers in the world of apparel (HS 61 and 62) accounting for 27.4% of the world imports of apparel valued at US\$ 108 billion in 2016. USA which is the largest market for Sri Lankan apparel accounts for 21% of apparel imports in the world. The concentration of apparel is the key reason for USA and UK to emerge as the key export markets of Sri Lanka. Out of total exports from Sri Lanka

⁶ Central Bank of Sri Lanka

to USA in 2016, 75% comprised of apparel and out of total exports to UK 79% was apparel. These two markets accounted for two-thirds of total apparel exports of Sri Lanka during the same year. The data clearly shows that Sri Lanka's market concentration is the outcome of its product concentration. (Abeysinge & Munas 2017).

The data also indicates that the notable absence of China from the top five export markets of Sri Lanka can also be attributed to its product composition. Table 2 shows the import demand in China for key two products exported by the selected leading Asian exporters and Sri Lanka. China accounted for a mere 3% of total world imports of apparel in 2016 and the country was not even among the top ten importers of apparel in the world. In contrast, China was among the top five buyers of all key product categories exported by the other Asian countries. China was the largest buyer of electrical products in the world in 2016; accounting for 16.6% of total world demand.

Table 2: Demand in China for the Top Two Products Exported by the Selected Asian Countries and Sri Lanka - 2016

	Value of imports into China (USD Bn)	% Share of China in World Imports of the product	Rank of China in World Imports of the product
HS 85	140	16.60%	1
HS 84	196	7.60%	2
HS 87	71	5.30%	4
HS 62	4	1.80%	14
HS 61	2	1.20%	19

Source: International Trade Centre (www.trademap.org)

Analysis of exports from Vietnam to China further demonstrates the importance of aligning export products with demand as a key factor that determines the ability of a country to access a market. Vietnam is among the top five apparel exporters in the world accounting for 6% of total apparel exports. Apparel (HS 61 and 62) products are among the top five exports of Vietnam and accounts for 11% of total exports of the country. However, apparel accounts for only 3% of total exports of Vietnam to China. The key to export success of Vietnam to China has been the export of electrical products (HS 85) which accounted for 22% of its exports to China in 2016.

CONCLUSION

The analysis of export concentration and composition in terms of markets and product categories of leading Asian exporters provides useful insights that can guide policies and strategies of countries like Sri Lanka that are striving to revive exports.

First, the vast differences in terms of economic size and level of development of the Asian countries among leading 25 exporters indicate that these differences are not necessarily a constraint to reaching the top. Second, the significantly high levels concentration of export earnings to a few markets and a few product categories in these selected Asian countries indicate that export concentration is not necessarily a hindrance to become a leading exporter in the world. The Asian countries that have become world leaders in exports also demonstrate a high degree of reliance on a few markets and a few product categories to generate a significant portion of their export earnings (of over 40%).

Third, the world demand itself is significantly concentrated among a few markets and a few product categories. The level of concentration of products and markets of key Asian exporters is a reflection of world market demand. A striking similarity of the market and product concentration of the selected Asian countries is their strong alignment with trends in world market demand. This leads to the inference that the export concentration in a few markets and a few products may not necessarily be a weakness, but possibly a strength: particularly if export concentration is aligned with trends in global demand.

Fourth is the important role that the emergence of GVCs or the global production-sharing networks played in exports by enabling developed and developing countries to be part of the same value chain. Sri Lanka's failure to benefit from the emergence of GVCs or global production-sharing networks in electrical products and machinery seem to be a key opportunity missed in comparison with the selected Asian countries:

'Global production sharing opens up opportunities for countries to specialize in different slices (tasks) of the production process depending on their relative cost advantage and other relevant economic fundamentals' (Athukorala, 2010).

This seems to be a critical factor that contributed to the export product mix of middle-income countries among the six selected Asian countries in comparison with that of Sri Lanka. The research reveals the share of trade in Global Production Sharing (% of manufactured exports) of Sri Lanka to be as low as 6.2% compared to Malaysia at 73.2%, Thailand 69.7% and Vietnam 30.5% (Hewage & Ekanayake 2016). Research finds the lowering of barriers to trade in parts and components (both cost and time) and adopting a liberal and predictable investment regime to be key factors that contributed to the successful integration of East Asian countries into production networks (Athukorale, 2010).

Fifth, the over reliance of Sri Lankan exports in leading markets in the West and the notable absence of China among leading export markets of the country is the result of its product composition.

The five key insights drawn from the preceding analysis indicates that concentration of exports in a few products and a few markets per se is not necessarily the root cause of Sri Lanka's export problems. The weak alignment of the current products and markets with global demand patterns as well as with demand patterns of emerging Asian markets like China appears to be a more important factor that hinders country's export performance than concentration. The analysis found that the country has fared poorly in exporting to leading buyers in the world (most importantly those in Asia, and particularly to China) and in exporting products that are highly demanded by the world. Thus, it could be inferred that the country's currently adopted strategy of 'reducing reliance on a few markets and a few products' (in other words, increasing product and market diversification) as a key solution to its export problem, has its limitations and needs to be revisited. The trends in global demand, the changes taking place in investment and production in the world, and the alignment of the country's products with these are possibly more important factors to be strategically focused on to improve the export performance of the country. This analysis also demonstrates the importance of having a greater focus on products over markets. Investing in products that are aligned to global demand is important for the country to enter emerging import markets like China.

Finally, the analysis highlights the necessity to undertake further research into these aspects of the problem, so that more effective and insightful trade policies and strategies could be evolved in view of effectively addressing the export problem of the country.

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