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ANALYSIS OF BALANCE OF TRADE: SRI LANKAN CONTEXT

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Abstract

International trade among the countries are motivated by theories and governments all over the world due to the self-insufficiency of producing goods and services. The aim of this study is to analyze the balance of trade and its relationship with current account of balance of payment of Sri Lanka. For this purpose, data from various Annual Reports of Central Bank of Sri Lanka were collected for a sample period of ten years from 2008 to 2017. Trend analysis is used as the analytical technique of this study. The finding of this study shows that the annual trade deficit of Sri Lanka is between 9 and 15 percent of its annual GDP during the period of 2008-20017. More than one fourth of all exports of Sri Lanka is to United States of America where as more than 80 percent of exports are dominated by India, China, Middle East, Asia-other and European Union to Sri Lanka. During the last decade, Sri Lanka was experiencing continuous trade deficit, which in turn depends on the behavioral pattern of exports and imports of Sri Lanka. The finding of this study further concluded that the deficit of current account balance is less than that of trade balance in Sri Lanka and as an average, the trade account balance is more than 400 times the current account balance during the last ten years and in 2009 it was 1,480 times.

Keywords: *Trade Volume, Trade deficit, Current Account, Balance of Payment, Sri Lanka*

Introduction

In the globalized world, there is no country self-sufficient in the sense of producing all the goods and services it needs. According to the theory of comparative advantage, the imperfect market theory and the product life cycle theory firms worldwide became motivated to expand their business internationally. Further to this, the development of international trade is the result of numerous efforts by governments to remove cross-border restrictions among the countries. As a result, every country imports from other countries, the goods that cannot be produced at all in the country or can be produced only at an unduly high cost as compared to the foreign supplies.

The balance of payments (BOPs) of a country is a summary of transactions between domestic and foreign residents of a specific country over a period, usually a quarter or a year. It represents an accounting of a country's international transactions by business, individuals and the government. A BOPs statement can be broken down into various components. Those that receive the most attention are current account, the capital account and the financial accounts. The current account represents a summary of the flow of funds between one specified country and all other countries due to purchases of goods and services or to the cash flows generated by income-producing financial assets. The difference between total exports and imports is referred to as the balance of trade. When the countries' import exceeds its export then it will cause trade deficit and opposite the case is the trade surplus (Madura, 2015). The trade deficit is referred to as a negative balance of trade and represents an outflow of domestic currency to foreign markets.

Objective of the Study

The main objectives of this study is to analyze the balance of trade and its relationship with current account of balance of payment of Sri Lanka. These main objectives can be subdivided into the following sub objectives.

i. To understand the trade volume of Sri Lanka.
ii. To analyze the trend of exports, imports and balance of trade of Sri Lanka.
iii. To evaluate the relationship between the balance of trade and current account of balance of payment of Sri Lanka.

Literature Review

Srivastava, Sinha and Yadav (2016) investigated a trend analysis of trade imbalance of Indian balance of payment. The finding of their study indicates that the execution of liberalization policies i.e. from1990-91 until 2012-13, where the import exceeds the exports. This creates greater trade imbalance and burden on the BOP accounts of the country. They further emphasized that the causes of these variations are the factors like exchange rate, interest rate, domestic currency devaluation, and export and import opportunities for the business.

Behera (2016) examined the trend in India's balance of payments since 1990-91 to 2014-2015. The conclusion of this study indicates that given the liberal imports, the trade deficit remains a matter of concern in India. Investment, both foreign direct investment (FDI) and foreign portfolio investment (FPI), may result in reversals taking the economy into payments and currency crisis. This study further suggests that it is prudent to rely on short term selective controls on trade and capital flows for moderating short term volatility when the market mechanism fails to assist.

Mathew (2013) examined the trends and challenges of India's balance of payments. He concluded that the current account deficit got wider due to financial crisis and fluctuation in exchange rate.

Raschen (2014) in his study of the problem of balance of payment imbalances based on some countries such as China, Japan, oil exporting countries and United States pointed out the effect of crisis on balance of payment imbalances. The conclusion of this study indicates that external economic imbalances should not be demonized per se, but to be more alert to negative developments and correct them at an earlier stage, so that in future too the greatest possible benefit can be gained from cross-border trade and financial flows.

Vijayakumar (2014) investigated the effects of exchange rate on the trade balance in the Sri Lankan context after post liberalization. The result of this study indicates that the real exchange rate has significant positive influence on the trade balance of Sri Lanka, both in the short- run and the long-run. However, evidence of J-curve effect is non- existence for trade between Sri Lanka and USA. The finding further elaborates that the devaluation improving the trade balance in the short- run has repetitive tendency in the long-run.

Boaten and Ayentim (2013) analyzed the Balance of Payment in Ghana using the Monetary Approach. The study shows that the balance of payment disequilibrium in Ghana is significantly influenced by domestic credit, GDP growth, and interest rate. Their finding further suggest that government expenditure and public debt may influence the balance of payment in Ghana.

Monokroussos and Thomakos (2012) did a technical study on the determinants of Greece's current account position. Their empirical results document a number of key drivers contributing to the significant deterioration in the country's current account position in recent years, with two of the most important ones including: (i) accumulated loss of economic competitiveness against main trade-partner economies; and (ii) pronounced fiscal policy relaxation following the euro adoption.

Methodology

As the aim of this study is to analyze the balance of trade and its relationship with current account balance of BOP of Sri Lanka, it adopted a descriptive approach. This paper is based on secondary data, which is collected from Central Bank Annual Reports for a period of ten years from 2008 to 2017.

Data Analysis and Interpretations

Trade Volume of Sri Lanka

This section is devoted to analyze the trade volume of Sri Lanka as a percentage of Gross Domestic Product (GDP) and the trade volume between Sri Lanka and other countries.

Some countries rely more heavily on international trade than do others. The annual dollar amount in millions of exports, imports and trade deficit are presented as a percentage of annual dollar amount in millions of gross domestic products (GDP) of Sri Lanka, during the period from 2008 to 2017 is presented in table 1 below.

The annual exports of Sri Lanka is typically between 12 and 17 percentage of its annual GDP. The exports as percentage of GDP shows a decrease since 2008 and starts increases gradually in 2017. The annual imports of Sri Lanka is in between 23 and 31 percentage of its annual GDP. The imports as a percentage of GDP is seen to decrease from 2008 which is reflected in the constant behavioral pattern in imports since 2013 as approximately 24 percentage in GDP. The highest trade deficit as percentage of GDP is in 2011 and the next is in 2012. This is represented by the highest volume of imports during this period.

The proportion of Sri Lanka's exports to various countries is shown in table – 2. More than 20 percent of Sri Lanka's exports to United States of America (U.S.A) specifically in 2015 and 2016 it is 27% and 2017 there is slight decline as 26%. About 15 percentage of Sri Lankan exports has been to Asia and European Union countries and 10 percent are to Middle East. In 2008, Sri Lanka exported 14 percent of all its export to United Kingdom (U.K) however it declined to 9 percent in 2017.

The proportion of total imports from various countries during the period from 2008-2007 are shown in table -3. India, China, Middle East, Asia-other and European Union are the key exporters to Sri Lanka; together, they account for about 80 percent value of all Sri Lanka imports. From year 2016 onwards United Arabic Emirates also exports to Sri Lanka and it is 8 percent of all Sri Lanka's imports in 2017.

Table 1. Exports, Imports and Trade deficit as a percentage of GDP in Sri Lanka

	2008	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Exports as % of GDP	17.4	14.7	14.6	16.2	14.3	14	14.0	13.1	12.7	13.1
Imports as % of GDP	30.2	21.2	23.8	31.1	28.0	24.2	24.5	23.5	24	24.1
Trade deficit as % of GDP	12.8	6.5	9.2	14.9	13.7	10.2	10.4	10.5	11.2	11.0

Source: Central Bank Annual Reports, 2008-2017

Table 2. Distribution of Sri Lanka's Exports by Country

Year / Country	2008 %	2009 %	2010 %	2011 %	2012 %	2013 %	2014 %	2015 %	2016 %	2017 %
USA	23	22	21	20	22	24	24	27	27	26
UK	14	14	12	11	11	10	09	10	10	9
Germany	05	5	5	5	5	05	-	04	05	05
Asia	15	13	16	16	15	14	15	17	16	15
Other	13	16	16	19	20	20	16	17	17	14
EU-Other	13	14	13	13	12	12	13		12	15
Middle East	11	11	12	11	10	11	10	10	10	10
Belgium	06	5	5	5	05	04	03	03	-	-
India		-	-	-	-	-	-	-	-	06
Italy		-	-	-	-	-	-	-	04	-

Source: Central Bank Annual Reports

Table 3. Distribution of Sri Lanka Imports by Country, 2008-2017

Year / Country	2008%	2009%	2010%	2011%	2012%	2013%	2014%	2015%	2016%	2017%
India	25	18	19	23	19	18	21	23	20	22
China	08	10	9	10	14	16	18	20	22	19
Asia-other	18	20	18	17	19	18	18	17	19	23
EU	12	13	11	9	9	9	08	9	9	8
Middle East	14	15	14	14	15	13	14	8	8	10
Other	11	11	16	16	14	15	12	15	10	4
Singapore	09	10	12	10	09	09	06	6	6	6
UAE	-		-	-	-	-	-	-	6	8
USA	03	03	01	01	01	02	03	2	-	-

Source: Central Bank Annual Reports

Trend in Sri Lanka export, import and trade balances

This section is devoted to describe the trend of exports, imports and trade balances of Sri Lanka for the ten years period from 2008-2017.

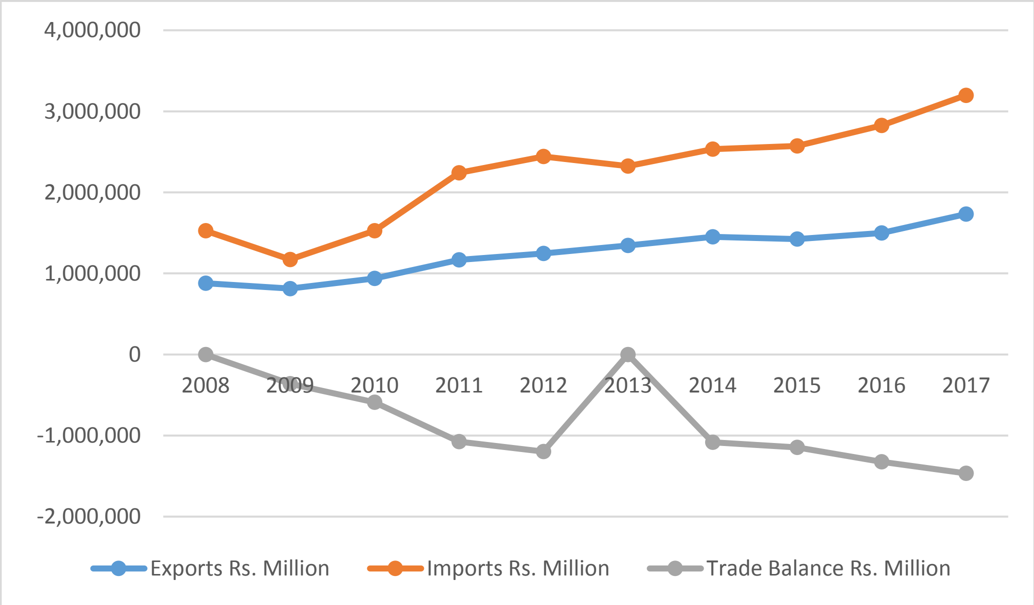
The annual trend between 2008 - 2017 in Sri Lanka's exports, imports and balance of trade in terms of million rupees is shown in table -3 and figure 3. The important matter that is observed here is that the trend of trade account balance depends upon the trend of both exports and imports of Sri Lanka. In other words, the deficit of trade account balance has been determined by the excess of exports over the imports during the last ten years period. Sri Lanka's balance of trade deficit increased substantially from 2008 to 2012.

Nevertheless, there have been occasional improvement in the trade account balance in Sri Lanka more specifically in year 2013. During 2013, global economy had moderate recovery and as a result exports of Sri Lanka also recovered. Earning from exports recorded a positive growth from mid-2013 following 15 months of contractions. Export earnings grew by 6.4 percent in 2013 in contrast to a decline of 7.4 percent in 2012. The largest contribution to the growth in export earnings came from industrial exports, which accounts for around three fourths of total export earnings. Earning from industrial exports increased by 5.1 percent in 2013 mainly due to the better performance in textiles and garments, which contributed 43.4 percent to total export earnings in 2013.

Table 4. Trend in Sri Lanka's Exports, Imports and Balance of Trade : 2008-2017

Year	Exports Rs. Million	Imports Rs. Million	Trade Balance Rs. Million
2008	878,499	1,525,705	- 647,207
2009	813,911	1,172,618	-358,707
2010	937,737	1,526,604	-588,867
2011	1,167,588	2,241,488	-1,073,900
2012	1,245,531	2,440,899	-1,195,368
2013	1,344,054	2,323,128	-979,074
2014	1,453,176	2,535,163	-1,081,987
2015	1,425,791	2,572,467	-1,146,676
2016	1,500,766	2,826,260	-1,325,495
2017	1,732,440	3,198,572	-1,466,133

Source: Central Bank Annual Reports



Source: Central Bank Annual Reports

Figure 1. Trend of Export, Imports and Trade account Balance of Sri Lanka: 2008-2017

Earnings from textiles and garments increased by 13 percent in 2013. In addition to this, earnings from agricultural products increased by 10.7 percent in 2013. From 2014 onwards, the exports performance was seen to increase due to the improved external demand along with stable macro-economic environment.

Expenditure on imports, which declined continuously from early part of 2012, on a year-on-year basis continued to contract during most of 2013. Expenditure on imports in 2013 declined by 6.2 percent from the previous year. This is due to the impact of policy measures adopted in 2012 to rationalize imports, lower expenditure on fuel imports as well as subdued commodity prices in international markets. The largest contribution to the decline in overall expenditure came from deduction in expenditure on imports of investment goods which declined by 7.3 percent and imports of intermediate good which declined by 3.2 percent. Expenditure on imports increased moderately from 2014 compared to the contraction in both 2012 and 2013. The major reason for the increase in import expenditure was due to higher imports of motor vehicles for personal use due to reduction tariff and larger depreciation of Japanese Yen.

Relationship between Balance of Trade and Current Account

Based on the data found in terms of million rupees, table – 2 and figure 2 clearly show the trends of trade and current accounts balance of Sri Lanka for the periods from 2008 to 2017. What is observable here is that the deficit of current account balance is less than that of trade balance in Sri Lanka. The percentage relationship between trade and current account balances is also shown in table – 2. According to this table, it can be seen that as an average, the trade account balance is more than 400 times the current account balance and in 2009 it was 1,480 times. The reason for the lower deficit of current account compared to trade balance is the open economic system that came in to operation after 1977 have had favorable private and government transfer. In other words, the transfer payment in Sri Lanka is always favorable but after trade liberalization and open economy, it has more injection of private transfer into Sri Lankan economy. Further, the current account deficit in 2015 broadly remained unchanged from 2014 and it continues till 2016. However, during the last decade, Sri Lanka has experienced balance-of trade deficit owing to strong Sri Lanka's demand for imported consumer products that are produced at a lower cost than similar products can be produced in Sri Lanka and intermediate goods.

Conclusion

The paper has analyzed the trade volume of Sri Lanka, trend of exports, imports, trade balance and current account balance and the relationship among them. Based on the observations in the data presented and analysis of Central Bank Annual Reports (2008-20017) following conclusions can be drawn. The annual trade deficit of Sri Lanka is between 9 and 15 percent of its annual GDP during the period of 2008-20017. More than one fourth of all exports of Sri Lanka is to United States of America where as more than 80 percent of exports are dominated by India, China, Middle East, Asia-other and European Union to Sri Lanka.

The trend of trade account balance depends on the behavioral pattern of exports and imports of Sri Lanka during the period from 2008-20017. During the last decade Sri Lanka was experiencing continuous trade deficit. However, there has been a slight improvement during the year 2013. It is notable that during the year 2013 earnings from exports recorded a positive growth and the imports expenditure declined compared to the previous years. Efforts had been made to strengthen the access to overseas markets for Sri Lankan products together with encouragement of investment. The implementation of certain policy measures has contributed to rationalize imports in order to protect selected domestic industries.

It can also be concluded that as an average the trade account balance is more than 400 times of current account balance during the last ten years and in 2009 it was 1,480 times. The open economic system that came in to operation after 1977 have had favorable private and government transfers which in turn have positively contributed to lower current account deficit compared to trade deficit.

Finally, the finding of this study is consistent with the previous studies described in the literature review in a manner that Sri Lanka is experiencing continuous trade and current account deficits.

Limitations and Directions for Further Research

This study is limited by its nature of being descriptive and a limited sample period of ten years. The use of trend analysis had been used as a technique of data analysis. Further, there are various factors such as cost of labour, inflation, national income, credit conditions, government policies and exchange rates affecting the international trade flows of a country. The effect of these factors were not within the scope of this study.

The use of long term time series data since 1977 and the introduction of trade liberalization in Sri Lanka with appropriate econometric model to analyze and to evaluate the effect of various factors affecting international trade flows could be used in future research.

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