The Relationship between Economic Growth and International Trade in Sri Lanka: A Review

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Abstract

International trade is the exchange of capital, goods and services across the international borders or territories which could involve the activities the government and individual. There are three main facts aware in international trade. They are supply of productive factors, Method of productive technology and efficiency of productive factors. Economic growth means an increase in real gross domestic product (GDP). This increase in the value of national output. According to the Smith's absolute theory, specialization in the production of only few goods by nations will lead to increase the efficient and production. That means autarky level price differences will lead to international trade. Because of this theory the international trade is a reason for economic growth. The theory of comparative advantage was present by David Ricardo, the theory is known as the main principle of the international trade that explains mutually beneficial trading relationship between countries. Because of this theory we can said, the international trade help to the country's economic growth. Any economy can reach to the economic growth by connecting with an open economy. Therefore, to appearance economic growth mainly important thing is international trade. When it is consider about the theoretical facts of international trade and the economic growth, the method of analyzing international trade and economic growth by Heckscher Ohlin theory (HO theory) and the idea of the capitalist economist are analyze by this article. Before the 1977, Sri Lanka referred enclosed economy and after the 1977 Sri Lanka referred, the open economy and they used international trade after that period. This is the reason of economic growth in Sri Lanka. This article explain the relationship between economic growth and international trade in view of economic performance of Sri Lanka.

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Introduction

International trade and economic growth are the most important concepts in modern economy. World economic activities are mainly based on the international trade. Most countries desired to reach the economic growth through the international trade. Therefore they followed most actions to success their goals. Under this situation, identification of international trade and economic growth are very important. Foreign trade is exchange of capital, goods, and services across international borders or territories. Like that economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. Sri Lanka also try to reach the higher economic growth through the international trade.

International Trade

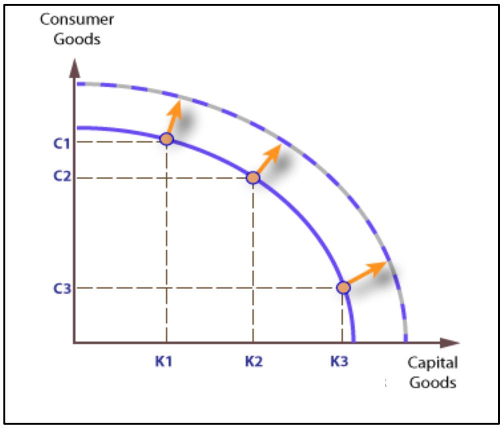
Foreign trade is exchange of capital, goods, and services across international borders or territories. In most countries, it represents a significant share of gross domestic product (GDP). While international trade has been present throughout many of history, its economic, social, and political importance has been on the rise in recent centuries. All countries need goods and services to satisfy wants of their people. Production of goods and services requires resources. Every country has only limited resources. No country can produce all the goods and services that it requires. It has to buy from other countries what it cannot produce or can produce less than its requirements. Similarly, it sells to other countries the goods which it has in surplus quantities. India too, buys from and sells to other countries various types of goods and services. Generally no country is self-sufficient. It has to depend upon other countries for importing the goods which are either non-available with it or are available in insufficient quantities. Similarly, it can export goods, which are in excess quantity with it and are in high demand outside. International trade means trade between the two or more countries. International trade involves different currencies of different countries and is regulated by laws, rules and regulations of the concerned countries. Thus, International trade is more complex. According to Wasserman and Haltman, “International trade consists of transaction between residents of different countries”. Like that according to Anatol Marad, “International trade is a trade between nations”. Eugeworth said that “International trade means trade between nations”.

Industrialization, advanced transportation, globalization, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalization. Without international trade, nations would be limited to the goods and services produced within their own borders.

International trade is in principle not different from domestic trade as the motivation and the behavior of parties involved in a trade do not change fundamentally regardless of whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or culture. International trade consists of ‘export trade’ and ‘import trade’. Export involves sale of goods and services to other countries. Import consists of purchases from other countries. International or Foreign trade is recognized as the most significant determinants of economic development of a country, all over the world. The foreign trade of a country consists of inward (import) and outward (export) movement of goods and services, which results into. Outflow and inflow of foreign exchange. Thus it is also called EXIM Trade. For providing, regulating and creating necessary environment for its orderly growth, several Acts have been put in place. The foreign trade of India is governed by the Foreign Trade (Development & Regulation) Act, 1992 and the rules and orders issued there under. Payments for import and export transactions are governed by Foreign Exchange Management Act, 1999. Customs Act, 1962 governs the physical movement of goods and services through various modes of transportation. To make India a quality producer and exporter of goods and services, apart from projecting such image, an important Act – Exports (Quality control & inspection) Act, 1963 has been in vogue. Developmental pace of foreign trade is dependent on the Export-Import Policy adopted by the country too. Even the EXIM Policy 2002-2007 lays its stress to simplify procedures, sharply, to further reduce transaction costs.

Economic Growth

Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. It is conventionally measured as the percent rate of increase in real gross domestic product, or real GDP. Of more importance is the growth of the ratio of GDP to population (GDP per capita, which is also called per capita income). An increase in growth caused by more efficient use of inputs (such as labor, physical capital, energy or materials) is referred to as intensive growth. GDP growth caused only by increases in the amount of inputs available for use (increased population, new territory) is called extensive growth. In economics, "economic growth" or "economic growth theory" typically refers to growth of potential output, i.e., production at "full employment". As an area of study, economic growth is generally distinguished from development economics. The former is primarily the study of how countries can advance their economies. The latter is the study of the economic development process particularly in low-income countries. Growth is usually calculated in real terms, i.e., inflation adjusted terms to eliminate the distorting effect of inflation on the price of goods produced. Measurement of economic growth uses national income accounting. Since economic growth is measured as the annual percent change of gross domestic product (GDP), it has all the advantages and drawbacks of that measure. The simplest way to show economic growth is to bundle all goods into two basic categories, *consumer* and *capital* goods. An outward shift of a PPF means that an economy has increased its capacity to produce.



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When using a PPF, growth is defined as an increase in potential output over time, and illustrated by an outward shift in the curve. An outward shift of a PPF means that an economy has increased its capacity to produce all goods. This can occur when the economy undertakes some or all of the following:

- Employs new technology
- Employs a division of labour, allowing specialization
- Employs new production methods
- Increases its labour force
- Discovers new raw materials

Relationship between International Trade and Economic Growth

International trade and economic growth are two concepts that go together, because international trade contributes to the growth of a country's economy in several ways. Some of these ways include the effects of import and export, specialization, increased productivity and improved infrastructure. The exportation of goods to other countries can contribute to the growth of the exporting country by increasing the earnings of that country. The national economies of some countries are even dependent on and sustained by their exports. For instance, some oil-producing countries depend on the income from the export of crude oil and its derivatives to sustain their nations. Some of these countries actually plan their national budgets based on projections or calculations of expected income from the export of oil. Apart from crude oil, other countries also partially base their national budget on the income from items like agricultural products, precious stones and even technology. This represents one way in which international trade and economic growth are linked. Apart from commodities, the international trade in labor is also an offshoot of globalization. Immigrants take much-needed skills to countries in which these skills are needed. Most immigrants from less-developed nations send money to relatives in their country of origin, contributing to the economic growth of those countries. They also help increase the growth of the economies of the countries where they live by contributing to productivity. For instance, migrant workers often work on farms where they supply labor to help prepare food items for sale locally and internationally. More skilled immigrants like engineers, doctors and nurses contribute to the growth of the economy of their chosen country. Another factor establishing a link between international trade and economic growth is the increase in productivity. When there is a high demand for a product, the countries that produce such a product will automatically increase production in order to meet up with the demand for the product. This increase translates to more revenue and an improvement in the economy of the country. A vibrant culture of international trade also contributes to the building of an infrastructural framework in order to sustain the trade. For instance, the demand for groundnuts from a country may lead to the building of roads and an improved transportation system to support the production. If the groundnuts are cultivated in farms located in villages that previously had a poor network of roads, the government or other corporate interests might build better roads.

Economic Growth and Trade Evidence of Sri Lanka, Trends

The Sri Lanka economy has achieved the 5 percentage growth level approximately for recent four decades. Due to that, we should have responsibility to answer the question like weather these achievements are in the effective or not? When we answer this type question in the economical perspective. We should focused on the other macro-economic variables as money supply, unemployment rate, exchange rate, price stability etc. Even though, 5 percentage growth level is the sati factionary one in the South Asian region (Velnampy and Achchuthan, 2013). Further, in the Asian Region, China and India have already achieved the 8 percentage growth level. And also output gap between advanced and emerging economies has been narrowing over the past decade and is expected to narrow even further going forward (Sri Lanka economic outlook,2012). In this context, export growth is recognized as the main determinant of the production and employment growth of and capital goods which, in turn, increase the production potential of an economy. Export growth is important because of its effect on internal trade and economic stability. Even more, the rate of economic growth and the distribution of income and wealth in a country are closely related to export growth. Growth of economy is directly related to exports. If exports increase at a faster pace as compared to imports, nothing can stop an economy from begin a developed one. On the other hand, the instability in exports can adversely affects the process of economic development. With an economy worth $80.591 billion (2015) and a per capita GDP of about $11,068.996 (PPP), Sri Lanka has mostly had strong growth rates in recent years. The Sri Lanka economy has seen robust annual growth at 6.4 percent over the course of 2003 to 2012, well above its regional peers. In GDP per capita terms, it is ahead of others countries in South Asian region. Since the end of the three-decade civil conflict, Sri Lanka is now focusing on long-term strategic and structural development challenges as it strives to transition to an upper middle income country. Export to the United States, Sri Lanka's most important market, were valued at $1.8 billion in 2002, or 38% of total exports. For many years, the United States has been Sri Lanka's biggest market for garments, receiving more than 63% of the country's total garment exports. India is Sri Lanka's largest supplier, with imports worth $835 million in 2002. Japan, traditionally Sri Lanka's largest supplier, was its fourth-largest in 2002 with exports of $355 million. Other important suppliers include Hong Kong, Singapore, Taiwan and South Korea. The United States is the 10th-largest supplier to Sri Lanka; US imports amounted to $218 million in 2002, according to central bank trade data. A new port is begin built in Hambanthota in Southern Sri Lanka, funded by the Chinese government as a part of the Chinese aid to Sri Lanka. This will easy the congestion in Sri Lanka ports, particularly in Colombo. In 2009, 4456 ships visited Sri Lankan ports.

Table 01: selected exports in Sri Lanka

Item	2008	2009
Agricultural commodities		
Tea, MT'000	320	290
Rubber, MT'000	49	56
Coconut, MN. Nuts	380	384
Fruits	14,362	13,032
Coffee	86	60
Cinnamon	12,459	12,234
Unmanufactured Tobacco	1,278	686
Betel Leaves	3,002	2,591
Selected Other Commodities, MT		
Mineral Exports	5,176	3,018
Gems, '000 Carats	7,531	7,445
Textiles and Garments, MN. KGS	828	720

Source: Central Bank of Sri Lanka

Table 02: Selected Imports In Sri Lanka

Item	Unit	2008	2009	2010	2011	2012	2013
Rice	MT'000	84	52	126	28	36	23
Wheat Grain	MT'000	919	1,026	1,051	1,242	1,084	895
Sugar	MT'000	571	466	548	606	569	548
Milk And Milk Food (b)	MT'000	66	65	76	88	84	69
Infant Milk Food	MT'000	1,343	1,442	911	1,756	1,446	1,545
Fish - Dried (c)	MT'000	48	49	49	50	41	39
Pharmaceutical Products (d)	MT'000	18	16	50	20	32	17
Fertilizer	MT'000	773	462	649	801	640	600
Crude oil	MT'000	1,853	2,066	1,819	2,070	1,486	1,743
Cement	MT'000	2,004	1,702	2,012	2,584	3,796	4,123
Motor Vehicles (e)	NO.	19,525	3,767	37,522	68,763	103,182	32,321
Motor cycles	NO.	153,657	112,307	226,426	252,036	186,372	160,524
Tractors	NO.	28,575	12,860	18,617	26,870	18,967	13,701

Source: Central Bank of Sri Lanka

How International trade influence to Sri Lankan Economic Growth

We can identify many factors influence to economic growth of Sri Lanka under international trade. Some of them are Export, Import, Investment, Tourist Arrivals, Textiles and etc. We can discuss about economic growth of

Sri Lanka under these factors. In the export earning of the Sri Lanka, industrial goods have the great share comparing with agricultural outputs. In the industrial goods, textile sector is viewed as the potential one. Meantime, in the agricultural sector, tea is recognized as the potential one. Sri Lanka's export performance since 2000 has not been sati factionary one. Expanding trade deficit in 2011 and 2012 is partly explained by the unimpressive performance of the export sector. Further, global economic downturn is not the only reason for the low export growth in Sri Lanka. In the Sri Lankan context, Sri Lankan government introduced the 2013 as the development oriented fiscal year, in which, the small medium enterprises are nourished through the incentives and tax holidays. In this context, in the 2013 Budget, some tax incentives and holidays have been included, Such as (1) profit and income from both export and local sales by manufactures of garment and ceramic products are taxed at 12%, (2) Manufacturing, distribution and marketing of organic fertilizer and pesticides are exempted from all direct and indirect taxes. And SMEs with annual liable turnover/supplies below Rs.12Mn are liable to pay NBT, (3) Any supply of goods manufactured in Sri Lanka or provision of services, to foreign ships for payments in foreign currency are 148 treated as deemed export and the profit and income there from are taxed subject to the concessionary rate of 12%, (4) The sale of goods manufactured in Sri Lanka by an export oriented BOI registered enterprise enjoying tax holiday and which is permitted to import project related goods or raw materials on duty free basis under the provisions of that BOI agreement, during the project implementation periods. Based on the above arguments, researchers should check the influence of the export and import on the economic growth in the Sri Lankan context. The Sri Lankan government has taken the strategic policies to rise up the economic growth through the export oriented business development in the Sri Lanka especially in the year of 2013. Therefore this study is viewed as the fruitful one in the developing or emerging countries context to take the cues about the influence of the export and import on the economic growth. Sri Lanka was a contracting party to the General Agreement on Tariffs and Trade (GATT) and also became the founding member of the World Trade Organization (WTO). For decades, the country assumed a proactive role as a driving force to trigger trade liberalization in the region. Sri Lanka is also a member of South Asian Free Trade Area (SAFTA). Sri Lanka shares healthy trade relations with India after the two countries signed a free trade agreement (FTA). By 2004, trade between the two nations rose by 128% and reached USD 2.6 billion by 2006.Sri Lanka also leverages on "GSP+" trade preferences of the European Union. Australia has strong trade ties with Sri Lanka. In the financial year 2008-09, the two-way trade between these two countries amounted to $329 million. Sri Lanka trade benefits a lot from its modern ports that were built by the British before leaving they left the island. In 2009, the country's exports stood at $7 billion as compared to $8.137 billion in 2008. The imports also fell to $9.6 billion 2009 from $14.08 billion 2008. Under the international trade Sri Lanka exports various commodities. The major export commodities of Sri Lanka are Textiles and apparel, Tea and spices, Diamonds, Emeralds, Rubies, Coconut products, Rubber manufactures, Fish and etc. Like that Sri Lanka imports various commodities under the international trade. The major import commodities of Sri Lanka are Textile fabrics, Mineral products, Petroleum, Foodstuffs, Machinery and transportation equipment and etc.

Tourism is also a major factor of economic growth. In Sri Lanka, this field is very important factor in economic growth. Over the years, tourism has been identified as one of fastest growing economic sectors in the World. According to the UNWTO, international tourist arrivals expanded at an annual rate of 6.2%, growing from 25 million to 980 million from 1950 to 2011. As a result, many developing countries have given prominent precedence to the industry in pursuing economic growth and development. Tourism is considered as the industry which not only generates foreign exchange income to the host country, but also creates employment opportunities in various sectors, stimulates the development of services and economic growth and development. Moreover, benefits of tourism are spread over a wide section of society comparatively to other sectors of the economy. Sri Lanka is one of major tourist attraction destinations in South Asian region. The country has unique opportunities for various kinds of tourism including traditional tourism, adventure tourism, coastal tourism, eco-tourism and safari tourism, cruise tourism and medical tourism etc. Its geographical location, natural beauty and historical and heritage values have made additional potential for promoting tourism in the country. After the economic reforms in 1977, the successive governments have implemented various attractive policies and programs to promote tourism in pursuing economic growth and development. In particular, the country witnessed a strong upsurge in tourism after the end of the civil war in 2009. According to Tourism Development Authority of Sri Lanka, 654447 and 855975 tourist arrivals have been recorded in 2010 and 2011 respectively. The annual growth rates of the arrival in last two years were 46% and 23% respectively. Recent past, the government of Sri Lanka has taken some of initiatives such as income tax exceptions, interest subsidiary, import tax release and other subsidiaries for the firms and entrepreneurs those who involve in the industry. Moreover, the government has employed a number of initiatives to encourage and attract Foreign Direct Investment (FDI) to the hospitality and tourism industry. Although an extensive body of literature has been dealt with international tourism and economic growth, the link between two variables is ambiguous.

Investment is also a major factor of economic growth. In Sri Lanka this field is very important factor in economic growth. In Sri Lanka, before the government implemented the economic liberalization policy, economy followed the inward looking policies, which had limitations for foreign investors and free flow of FDI. Later, implementation of the economic liberalization in Sri Lanka created the friendly economic climate. And also, Sri Lanka was one of the longest democratic traditions in the region and over the years, governments have followed free market policies and continued to liberalize the economy. Further, Sri Lanka creates better economic environment to attract the FDI through the monetary and fiscal policy framework in South Asian region. In the Sri Lankan Perspective, in Sri Lanka, the period between 1960–1976 has been considered as the period which had the poor economic performance in terms of lower average economic growth rate. Especially, Period from 1970–1976 has been viewed as period which had economic recession. This period is especially well known as the most trade restricted period of the economy. After that, the liberalization policy was adopted to the economy. As results of the liberalization policy, the economic growth rate was increased dramatically. Further, in the period of 1987–89, economic growth rate was affected by the political instability. Later, in 2001, negative growth level has been faced by the economy. Again the Political instability was the reason for the particular economic recession. . However as a whole, country has performed well after 1977 with compared to the period before 1977. Meantime, Sri Lankan economy has achieved the 5 percentage growth level approximately for recent four decades. This level is the satisfactory one in the South Asian Region. Growth rate has been steadily increased for last decade (2000–2010). Further, in the Asian region, china and India have already achieved the 8 percentage growth level. And also output gap between advanced and emerging economies has been narrowing over the past decade and is expected to narrow even further going forward. Therefore, it is important to empirically examine the impact of FDI on economic growth and unemployment in the Sri Lankan perspective. Such understanding or finding will help to policy makers to establish the better policy framework in the foreign direct investment in the developing or emerging economy like Sri Lanka. We can identify these facts in studying about Economic growth of Sri Lanka under International trade. According to above information we can identify international trade mainly effect to the economic growth of a country.

Conclusion

Sri Lankan economy has achieved 5 percentage growth level approximately for recent four decades. It means that GDP growth rate in Sri Lanka average

6.22 percent from 2003 until 2015.In the present day society Sri Lankan women go to middle estate countries to earn money. It is a main income sector in Sri Lankan budget. Because of this most of the foreign exchange come to Sri Lankan income. Tourism, tea export, apparel, rice production and other agricultural products are the main economic sectors of Sri Lankan economy. Tourist arrivals of Sri Lanka exceeded 1.5 million in 2014 and is expected to exceed 2.5 million by 2016. Tea production is one of the main sources of foreign exchange for Sri Lanka and accounts for 2% of GDP contributing over US $ 1.5 billion in 2013 to the Sri Lankan economy. Kenya is the main tea export partner in Sri Lanka. The apparel industry of Sri Lanka employs about 15% of the country's workforce. In the present day society most of the youth girls and boys engage with the apparel companies to earn money. United State is the main importer of textile goods from Sri Lanka. According for 76% in total. United State, United Kingdom, Germany are the main export partners of Sri Lanka. India, China, Iran are the main import partners in Sri Lanka. Because of the international trade that country can consume variety of goods available, consumers can consume goods and services with cheaper cost, anyone can engage with foreign companies. From these facts increase the earning of that country. These facts influence to economic growth. Therefore this study is viewed as the fruitful one in the developing countries context to take the cause about the influence of the export and import on the economic growth.

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