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Unlocking Sri Lanka's economic success: Harnessing the power of economic complexity



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The economic success or stagnation of a country depends on factors such as strong institutions, effective governance, economic policies, education, infrastructure, and resource management. Geography plays a role, with resource-rich nations having an advantage, but mismanagement can lead to stagnation. Education and skill development create a productive workforce, while modern infrastructure and technology drive economic efficiency. Political stability and investor-friendly policies attract growth, whereas corruption and instability hinder progress. Colonial history also influences development, with some nations overcoming past disadvantages while others struggle with lingering economic disparities.

Sri Lanka's economy has been facing severe challenges, including a high debt burden, foreign exchange shortages, inflation, slow economic growth, and rising unemployment. The country's debt crisis led to a sovereign default in 2022, making debt restructuring a top priority. Foreign reserves remain low, limiting the ability to import essential goods such as food, fuel, and medicine. Inflation, although moderating, continues to impact the cost of living, reducing the purchasing power of ordinary citizens. Economic growth has been sluggish, with contractions in key sectors such as tourism, manufacturing, and agriculture. Additionally, structural weaknesses, including an oversized public sector and inefficient state-owned enterprises, have contributed to fiscal instability. Political and social unrest have further weakened investor confidence, making economic recovery even more challenging.

As of March 17, 2025, Sri Lanka is experiencing a period of economic stabilisation and growth following the severe crisis of 2022. The government has implemented significant reforms, leading to budgetary discipline, a bullish stock market, and improved credit conditions. The economy is projected to grow by 5% in 2025, with a primary budget surplus of 2.3% of GDP, aligning with International Monetary Fund (IMF) programme targets. Tourism has seen a resurgence, contributing to economic recovery. The government is also focusing on digital transformation, allocating LKR 3 billion towards digital investments and aiming to generate US \$15 billion in revenue through the digital economy by 2030. However, challenges remain, including the need to boost tax compliance, better target social welfare, and manage capital spending to maintain fiscal stability.

Given these economic struggles, one powerful yet often overlooked approach is economic complexity, which focuses on diversifying and upgrading a country's productive capabilities and exporting a diverse range of sophisticated and high-value-added products. Currently, Sri Lanka relies heavily on a few key exports, such as tea, garments, and rubber, which makes the economy vulnerable to global market fluctuations. By diversifying its production base and investing in advanced industries such as electronics, pharmaceuticals, and IT services, Sri Lanka can generate higher-value exports, attract foreign investment, and create well-paying jobs. A more complex economy also enhances global competitiveness and strengthens economic resilience against external shocks.

This article explores Sri Lanka's economic complexity, the challenges it faces, and essential lessons for achieving economic success.

Economic complexity is a key driver of long-term economic growth, as it is closely linked to higher wages, innovation, and resilience to global economic shocks. Nations with complex economies can adapt to technological advancements and shifting market demands, while those with low complexity remain vulnerable to commodity price fluctuations and economic crises. Countries that invest in education, technology, innovation, industrial diversification, and strong institutions develop high economic complexity, while those reliant on raw materials, low-tech industries, and weak governance remain less advanced. Japan, South Korea, and Germany have built highly complex economies by focusing on advanced manufacturing, R&D, and global trade integration, whereas developing countries like Sri Lanka struggle due to economic dependence on low-value exports and weak industrial policies.

The global standing of economic complexity varies significantly across countries, reflecting differences in industrial sophistication, technological capabilities, and diversification of exports. Economic complexity is measured by the Economic Complexity Index (ECI), which evaluates the diversity and sophistication of a nation's exports. Countries with high ECI scores, such as Japan (2.07), South Korea (1.85), and Germany (1.79), manufacture advanced products like semiconductors, pharmaceuticals, and automobiles, reflecting their strong technological capabilities and highly diversified economies. In contrast, countries with low economic complexity rely on agriculture, textiles, or raw material exports, limiting their ability to compete in high-tech global markets.

Sri Lanka has an Economic Complexity Index (ECI) of -0.35, indicating a relatively low level of industrial sophistication. The country's economy remains dependent on traditional exports such as tea, rubber, textiles, and apparel, which are low-value and labour-intensive industries. Global trends indicate that economic complexity is closely linked to long-term economic growth and resilience. Countries that focus on innovation, digital transformation, and high-tech industries tend to experience sustained economic expansion, while those reliant on resource-based economies remain vulnerable to external shocks. As global trade shifts toward knowledge-intensive and technologically advanced industries, nations with higher economic complexity are better positioned to adapt, compete, and achieve long-term prosperity.

Sri Lanka remains less advanced in economic complexity compared to other countries due to its continued reliance on low-value, traditional exports such as tea, rubber, and garments, rather than transitioning to high-tech and knowledge-intensive industries. Several factors have hindered its progress, including limited industrial diversification, low investment in technology and innovation, weak infrastructure, a skills gap due to brain drain, and political instability. Unlike countries that have successfully moved up the complexity ladder, Sri Lanka has struggled to develop high-tech manufacturing, advanced services, and a strong R&D ecosystem.

One of the key barriers is its over-reliance on low-value exports, with tea accounting for 11% of total exports, garments for 40%, and rubber making up a significant share. Unlike countries that have successfully transitioned into high-tech industries like electronics and pharmaceuticals, Sri Lanka remains dependent on traditional exports. Another major challenge is limited industrial diversification. While nations like South Korea and Malaysia have built strong technology-driven manufacturing sectors, Sri Lanka has struggled to expand beyond low-tech, labour-intensive industries.

Investment in research and development (R&D) and technology is also alarmingly low, with Sri Lanka spending just 0.1% of its GDP on R&D. This is in stark contrast to South Korea's 4.8% and Singapore's 2.2%, highlighting the country's weak commitment to innovation. The ongoing brain drain further exacerbates the problem, as thousands of highly skilled professionals leave annually due to limited opportunities, reducing the country's ability to transition into knowledge-based industries.

Additionally, weak infrastructure and policy instability discourage foreign direct investment (FDI) in high-tech sectors. Political instability, bureaucratic inefficiencies, and regulatory uncertainty have made Sri Lanka a less attractive destination for global investors. Compounding these issues is the country's high debt burden, with foreign debt exceeding \$50 billion, restricting the government's ability to allocate resources toward innovation and industrial expansion.

To improve its economic complexity and drive long-term growth, Sri Lanka must focus on industrial diversification, education reform, infrastructure development, and strategic trade policies.

Industrial diversification is critical, requiring a shift beyond traditional exports toward high-value industries such as electronics, pharmaceuticals, renewable energy, and IT services.

Expanding into these sectors will help Sri Lanka integrate into global value chains and reduce dependency on low-tech products. Equally important is education and skill development. The government must reform the education system to prioritise STEM (science, technology, engineering, and mathematics) and digital skills while expanding vocational training programmes to equip workers for advanced industries. Collaboration between universities and industries can drive innovation and entrepreneurship, fostering a startup ecosystem that promotes high-value industries.

Investment in R&D and innovation must increase significantly. Raising R&D expenditure from 0.1% to at least 1% of GDP would provide a much-needed boost to local startups, high-tech industries, and knowledge-intensive sectors. Establishing technology incubators and providing grants for startups in artificial intelligence, biotechnology, and robotics can accelerate innovation. Additionally, Sri Lanka must invest in both digital and physical infrastructure to support economic transformation. Expanding high-speed internet and digital connectivity will help grow the IT and digital services sector, while modernising roads, ports, and energy infrastructure will attract foreign investment in manufacturing and logistics. Encouraging high-tech foreign direct investment (FDI) is also crucial, which can be achieved by simplifying business regulations, offering tax incentives, and promoting technology transfer agreements to ensure knowledge diffusion into local industries. Supporting local innovation through government-backed R&D funds, business incubators, and grants for startups in emerging fields like artificial intelligence and biotechnology will further strengthen the economy.

A stable political and economic environment is crucial for attracting long-term investments. The government must ensure policy consistency, reduce bureaucratic inefficiencies, and strengthen institutions to foster investor confidence. Anti-corruption measures and transparent governance will further improve the business climate. Further, Sri Lanka should invest in renewable energy (solar, wind, and hydropower) to reduce dependency on fossil fuels, lower production costs, and attract green-tech investments. A green industrial policy will ensure that new industries align with global sustainability trends, making Sri Lankan exports more competitive.

To integrate into the global economy, Sri Lanka should negotiate free trade agreements (FTAs) with technology-driven countries like South Korea, Japan, and the European Union, improving access to advanced production techniques and supply chains. Furthermore, Sri Lanka should focus on policy stability, reducing bureaucracy, and enhancing the ease of doing business to attract foreign and domestic investments in high-tech and knowledge-driven industries. Leveraging its diaspora community to bring expertise, technology, and investments can also accelerate economic transformation. By implementing these measures, Sri Lanka can transition from a low-complexity, commodity-based economy to a diversified, high-tech, and knowledge-driven economy, ensuring long-term resilience and sustainable economic growth.

The Sri Lankan diaspora can play a significant role in enhancing the country's economic complexity by contributing to knowledge transfer, investment, entrepreneurship, technology and global networking. With over 3 million Sri Lankans living in countries like the United States, United Kingdom, Canada, Australia, and the Middle East, they have gained valuable experience in high-tech industries, entrepreneurship, finance, medicine, engineering, and

research & development (R&D), which can be leveraged to help Sri Lanka transition into more knowledge-intensive sectors.

One of the key ways the diaspora can support economic complexity is through investment in high-tech and innovation-driven industries. By channelling funds into startups, research centres, and advanced manufacturing, diaspora members can help Sri Lanka move beyond its traditional reliance on tea, garments, and tourism and diversify into sectors like information technology, pharmaceuticals, and renewable energy.

Additionally, the diaspora can act as a bridge to global markets, helping local businesses integrate into international supply chains and attract foreign direct investment (FDI). Through professional networks and collaborations, Sri Lankan professionals abroad can facilitate technology transfer, skill development, and knowledge-sharing programmes, ensuring that Sri Lanka's workforce gains expertise in complex industries.

Moreover, policies such as diaspora bonds, special investment zones, and business incentives can encourage skilled Sri Lankans abroad to return or remotely contribute to the country's economic development. By leveraging the talent, capital, and connections of the Sri Lankan diaspora, the country can accelerate innovation, industrial diversification, and economic resilience, ultimately boosting its economic complexity.

Technology is a key driver of economic growth, enhancing efficiency and adding complexity to goods and services, which shapes the development trajectory of nations like Sri Lanka. Increasing the export of technologically advanced and knowledge-intensive products presents a significant opportunity, particularly as the country navigates a post-pandemic recovery. By investing in innovation, research, and industrial diversification, Sri Lanka can reduce its dependence on traditional exports and transition toward a more sophisticated economic structure. Encouragingly, steps are already being taken to build a digital economy, which, if strategically developed, will play a vital role in enhancing economic complexity and global competitiveness. However, Sri Lanka's low economic complexity remains a major obstacle to long-term growth and global integration. To overcome this challenge, the country must prioritise innovation, industrial diversification, education, and infrastructure development. Implementing strategic reforms, attracting foreign investment, and leveraging the expertise of the Sri Lankan diaspora can accelerate this transformation, positioning Sri Lanka as a more competitive player in global markets.

With the right policies and a strong commitment to long-term economic development, Sri Lanka can move beyond its current limitations. By fostering a resilient, high-value, and technology-driven economy, the nation can ensure sustainable prosperity and a stronger global presence for future generations. The future of Sri Lanka's economy depends on strategic reforms that prioritise knowledge-based industries, governance improvements, and long-term economic resilience. Learning from global success stories and implementing data-driven policies will be crucial in transforming the nation's economic landscape.

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