

IMPACT ON SRI LANKA

Sri Lanka's economy still continues to be a largely dependent import-export economy. The world recession that has intensified in recent months has placed our economy in a very critical situation. All efforts towards self reliance and even modest structural changes are being frustrated by these external forces, giving the country little alternative but to fall back on the external "debt trap". The extreme deterioration in terms of trade, in recent years, has placed Sri Lanka among that group of countries which has come to be recognised as "most seriously affected" by the world commodity price inflation.

Rise in import prices

The table below relating to volume and prices of our imports shows clearly the effects of the deteriorating terms of trade over the last few years.

Year	Volume Index	Price Index
1969	108	134
1970	102	140
1971	90	150
1972	88	158
1973	79	209

Between 1969 and 1973, imports went down by approximately 29 per cent. While average prices rose by approximately 56 per cent. 1974 showed a further reduction in the volume of imports accompanied by a substantially higher upward movement in prices. The 1975 import programme allows for an increase in imports other than food, petroleum and fertilizer. But, as this increase is likely to be more than absorbed by price increases the volume of imports of investment and intermediate goods and raw materials, is therefore on present official forecasts likely to decline during 1975.

The recent sharp increases in import prices, particularly of rice, flour, sugar, petroleum and fertilizer (see page 11) have created serious problems for the country

by driving up the amount spent on food and increasing costs in all sectors of the economy. This has also resulted in the country having to make certain food purchases at unfavourable terms. Thus, the Food Commissioner's foreign borrowings which were chiefly short-term credits in the past had become, last year, mostly supplier's credit with 15 and 18 months' maturity.

Industry has been also severely hit by the rising prices of imported raw materials. The share of manufacturing in the country's Gross Domestic Product is reported to have declined since 1971, while the increase in industrial employment has been slight. In the private sector, for instance several of the 2000 industrial units registered with the Ministry of Industries were said to be operating far below capacity and some of them have laid off workers as a result. According to official data the level of capacity utilisation is estimated to be as low as 35 per cent. Unlike in a resource rich country like the U. S. which is working at 70% capacity because of the breakdown of economic relations, the industrial sector of Sri Lanka is operating at low capacity, not because of low demand but mainly because of lack of raw materials and other resources. The falling output in the manufacturing sector, specially of consumer goods, has added to the inflationary pressures created by the demand for these goods in the economy.

A directly felt effect of the international monetary instability is the import of inflation into this country. The rapid changes in both import and export prices has had its resultant impact on domestic prices at all levels. This has left the country chasing the mutually contradictory goals; of on the one hand having to curb mounting inflationary pressures; and on the other hand to compensate for the fall in real wages of fixed income earners.

Exports

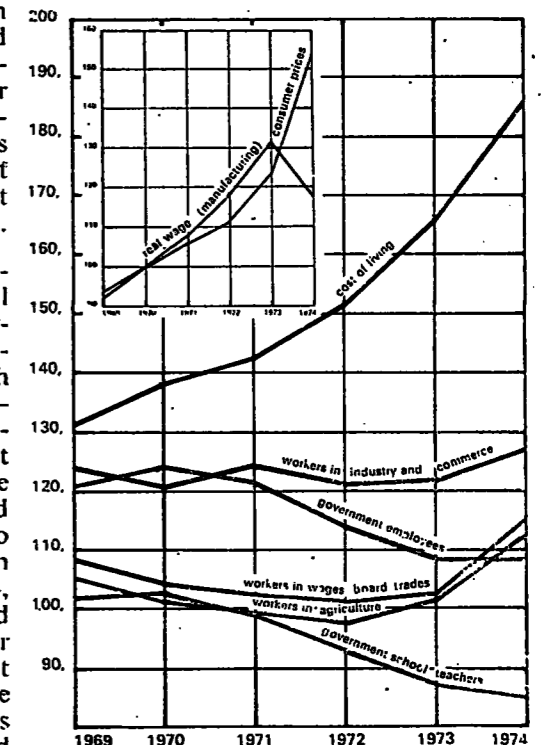
Whilst the effect of the rise in prices of imports has had an adverse effect on agriculture and industry the country has at the same time found it difficult to take full advantage of the rise in world commodity prices because of the difficulties faced in increasing the volume of exports of our traditional commodities. Although price increases were recorded for both tea and rubber the low level of production offset the advantages of price gains. In rubber, however, prices have continued on a downward trend in 1975 and the increase in volume of rubber exports may not help to offset falling prices unless there are spectacular developments for these commodities in the current year. The position is virtually the same for coconut products — earnings are not expected to go much above that of 1974, according to current trends.

The real growth of the non-traditional industrial export sector slowed down in 1974 because of the rapid increase in prices of the imported components of these products. The main factor contributing to the weakening of the country's manufactured export market, has no doubt been the world recession.

Because of the increased outlay on essential imports Government savings have also been comparatively negligible, with heavier public costs — the result is that expenditure on development projects in 1974 have been, and in 1975 would most probably have to be financed largely from borrowing. In 1974, borrowing is estimated to have risen to over Rs. 1,500 million, about 42 per cent above the 1973 figures. Of this 56% was borrowed domestically and the balance 44% abroad.

On these trends the 1975 borrowing forecast could be at least the 1974 figure of Rs. 1,500 million if not more of which almost half would have to be borrowings from abroad. One aspect of such a situation that is causing concern is the increasing costs of loan repayments, especially as many of the foreign loans have been relatively short-term ones.

In 1973 and 1974 the country experienced a sharp increase in prices and it was particularly sensitive to world wide inflation because of its dependent position. Attempts to place less reliance on imports is being nullified by its adverse terms of trade. The instability in the international monetary order has only hastened this process. The impact of imported inflation is seen in the falling real living standards of the country, except in the rural sector, since 1969, accompanied by the steep rise in the cost of living. (see accompanying diagram).



Cost of Living and Real Wage Rates in Sri Lanka (1952 = 100) compared with Japan (inset) for the same period.

Source: Central Bank of Ceylon and Bank of Tokyo.