SRI LANKA'S ECONOMY

A half yearly review

The economy in the first half of 1978 witnessed a process of adjustment to the package of economic reforms (Rupee devaluation and the liberal economic policy) introduced in the Budget of November 1977. After nearly two decades of economic controls and scarcities of imported goods, the economy has been opened to receive a liberal flow of imported goods, restrictions placed on private sector economic activity had been removed, and incentives in the form of a Free Trade Zone offered to attract local and foreign investment into export-oriented industries. The package of Rupee devaluation and the import liberalisation while removing scarcities in the economy by raising supplies both through higher imports and higher capacity utilisation in industry, required the evolution of a new (higher) set of price and wage levels as a part of the new economic picture that emerged. By mid 1978 there were signs that the economy was gradually approaching such a new price level with the rate of price increases slowing down in relation to the early months of the year. The prices that recorded the highest increases were those of imported goods and intermediates (which also have a high import content).

No estimates are available on the growth of overall production in this half year, but the official estimates project a growth rate of about 5.7 percent in the GNP for the year as a whole. If realized, this would be the highest annual growth recorded for the last decade. The estimated population in mid-1978 was about 14.2 million signifying an increase of about 1.7 percent over the level a year ago.

In contrast to 1977 when over half the increase in the GNP came from the agricultural sector, the manufacturing, construction and service sectors are expected to be the major contributors to the increase in the GNP this year. While the output of the agricultural sector is expected to increase by 5.7 per cent in 1978 as against 7.2 per cent in 1977, the corresponding increase in the manufacturing sector is expected to be 5.6 per cent in 1978 against an increase of only 1.1 per cent in 1977. The output of the construction sector is estimated to increase by 9.5 per cent in 1978, the trade and transport sectors by 5 per cent and the banking and finance sector by 21 per cent.

According to the provisional index of agricultural production computed by the *Economic Review* the overall production of principal agricultural crops (tea, rubber, coconut, and paddy) registered an increase of 7 percent over the first half of last year, and a 20 percent increase over the average level of 1975-76. This increase was largely a result of the substantial increase recorded in paddy production, the Maha harvest having reached a record level variously estimated at 59 million and 62 million bushels. The continued increase in paddy production since 1977 was a significant event carrying important economic consequences. For the first time it enabled the realisation of a substantial saving in the country's rice import bill and moreover, it also served to raise rural incomes in the paddy growing rural sector, thereby expanding the rural markets for what had been mainly urban consumer goods.

In the plantation sector only rubber production registered a sizeable increase. Coconut production, though showing an improvement over the 1977 slump, continued to remain below the past average levels, and tea failed to show an improvement over the last year's performance.

The production of many public sector industries recorded a distinct improvement over the half-yearly average levels of 1967-77. Sizeable production increases were recorded in cement, steel, ceramics, tyres, graphite and electricity. The greater availability of imported inputs enabled many private sector industries to raise thier production levels and capacity utilisation. However, liberal import flows and the higher cost of imported raw materials created a slump in the local textile industry and a reduced level of activity also characterised such small-scale industries as safety matches. There was also a decline in gem production (as reflected in exports).

There was an acceleration in construction activity compared to the previous years. The improved supply and availability of building materials and the initiaiton of large scale development projects by the government were contributory factors. Economic activity in the transport sector was boosted by the substantial increase in the imports of vehicles and transport equipment. The higher level of activity evidenced in both public and private sectors led to the generation of new employment, though the exact number of new jobs created is not known.

Under the new exchange rate system introduced in November 1977, the exchange rates of the Rupee were daily announced by the Central Bank presumably on the basis of market developments. During this half-year, while the Rupee-US Dollar rate remained relatively stable, there was a depreciation of the Rupee against the Yen by nearly 15 percent and against the Mark by nearly 6 percent.

When measured in SDR terms, while export earnings of the first half of this year remained virtually constant, the import expenditure showed an increase of 4 percent. The ability of the country to limit the increase in the overall import bill despite import liberalisation was largely a result of the substantial savings realized on rice imports which declined by over 70 percent. The highest increases in imports were recorded by vehicles, transport equipment machinery and mechanical/electrical equipment ,and the share of these imports in the overall import bill shot up to over 20 percent. There was also a sharp increase in the expenditure incurred by Sri Lankans on foreign travel. An increase of 380 percent has been registered in travel expenditure in the first half of this year when compared with the corresponding periods last year.

Despite the increase in the balance of trade deficit, the external assets registered an increase and the level of external assets at the end of June was almost equal to the total import bill of the first six months of the year. The commodity terms of trade of the first half of 1978 averaged 93.3 (1967-100) which was an improvement of about 15 percent over the average level of 1977, (which was 81).

PLANTATION PRODUCTION

The overall plantation production (as reflected in our index) showed a modest gain of 3 percent over the first half of 1977 but the production level was below the average level of 1975-76. While rubber production showed a distinct improvement over that of last year coconut production continued to remain below normal levels, with tea production showing a decline. Total export earnings from plantation produce during Jan.-June 1978 amounted to SDR 239 million which represented a decline of SDR 10 million or 4 percent when compared with the first half of 1977. As in the case of last year, export earnings from plantation crops continued to provide 74 percent of the total export income of the country.

The failure of the plantation output (in particular tea production) to show an improvement should be viewed against the background of the dislocations in management that resulted from the change-over of ownership from private to state hands under the Land Reform of 1975. There was a deliberate neglet of productivity by the former private owners in view of the Land Reform and a substantial decline in the quality of management characterised many organisations such as Cooperatives which managed a part of the plantations after the state take-over. The seriousness of such a management breakdown can be realized when it is noted that after the Land Reform, about two-thirds of the tea lands, nearly one-third of the rubber lands, and about one-tenth of the coconut lands are being owned and managed by the state. Since late last year, some significant steps have been taken by the government to improve the management of plantations. The institutional uncertainities that had surrounded the state-owned plantations have been removed by bringing the management of all estates under the umbrella of a single Ministry — the Ministry of Plantation Industries. Moreover, cooperative institutions which were ill-equipped and inexperienced to handle plantation management had been done away with, and the management of all state-owned plantations have been entrusted to two leading state agencies namely the State Plantations Corporation and the Janata Estate Development Board. Besides, some of the past management practices such as the visiting agents system and the role of superintendents have been restored with certain modifications.

A notable advance is also seen in the plantation sector. The sales of fertilizer to the plantations during Jan.-June 1978 amounted to 137,960 tons which was almost equal to the annual average fertilizer use in this sector during 1975-77. These developments and/or improvements in management and the increased fertilizer use, augur well for the future and should improve the production prospects in the plantation sector in the medium term. The production and export performance of each plantation crop during the first half of 1978 is briefly reviewed in the following section.

TABLE I INDICES OF AGRICULTURAL PRODUCTION — PRINCIPAL CROPS *

Crops	1975-76	1977	1978
Tea	100	103	99
Rubber	100	100.6	111
Coconut	100	74.3	87.6
Plantation Crops	100	96	99
Paddy	100	143	160
All Principal Crops	100	112	120

* *Computed by Economic Review (provisional).*

TABLE 2 TEA: PRODUCTION AND EXPORTS

	Production (Million kg)	Colombo Auction Sales Vol. (m.kg)	Colombo Auction Average Price (Rs)	Exports Vol. m.kg	Exports Value Rs. mn.	Exports Unit value per Kilo
1975 - 76						
First Half (avg.)	110.7	94.7	12.26	99.2	932.9	9.40
Second Half (avg.)	94.5	92.7	16.73	107.6	1082.5	10.06
1977						
First Half	114.0	95.9	14.57	92.7	1548.4	16.70
Second Half	94.6	90.8	18.60	92.9	1951.3	21.00
1978						
First Quarter	49.4	48.2	8.68	39.2	1261.8	32.26
Second Quarter	60.1	45.1	7.83	51.4	1786.7	34.94
Second Half	109.5	93.3	14.50	90.6	3048.5	33.64

Tea

Tea production in the first half of 1978 at 109.5 kg was lower than in the correspoding period of 1977 by 4.5 kg or nearly 4 percent. This decline was mainly reflected in the production of high and medium grown teas. The low growns have shown a modest increase in production. The quantity sold at the Colombo auctions also showed a decline of nearly 3 million kg. and the quantity exported declined by 2 million kg. The average auction price too declined when compared with the first half of 1977. The monthly average auction price having reached a peak level of s. 18.31 per kilo in February declined in the subsequent months. The average price in June stood at Rs. 11.08 which reflected a decline of 39 percent from the peak level recorded in February. On the other hand, the average export price (f.o.b.) showed an improvement throughout the first six months of this year rising from Rs. 27 per kg. in December 1977 to Rs. 36.36 per kg in June 1978, showing an increase of 35 percent. While in Rupee terms the average export price for tea in the first half of this year recorded an increase of about 100 percent over the corresponding period last year, in SDR terms there was a decline of about 5 percent. Thus, the higher rupee value was largely a reflection of the devaluation of the Rupee rather than an upward trend in prices in real terms.

Rubber

Unlike tea, the production of rubber in he firs half of 1978 showed a disinc improvemen when compared wih he corresponding periods of 1975-77. Production at 79.4 kilos represented an improvement of 11 percent over the corresponding figure of 1977, and the export volume registered an increase of nearly 5 million kilos or 6 percent. The export earnings in Rupee terms more than doubled but in SDR terms there was only a marginal increase of SDR 1 million. (SDR 60.3 million in 1978 compared with SDR 59.3 million in 1977). Rubber exports accounted for 18.6 percent of the total export earnings as against 17.5 percent last year. The average export value per ton at Rs. 13.75 represented a more than 100 percent increase compared to the level of the corresponding period last year, but there was a slight decline when measured in SDR units.

TABLE 3 RUBBER: PRODUCTION AND EXPORTS

	Production (Mn. Kilos)	Local Price RSS I (Rs. per kilo)	Local Price Crepe No. I (Rs. per kilo)	Volume Mn. Kilos	Total Value (Rs. millions)	Average Value Rs. per kilo
1975-76						
1st Half (avg)	75.4			78.1	355.9	4.56
2nd Half (avg)	80.1			70.6	415.2	5.88
1977						
1st Half	71.3	4.25	5.14	78.9	535.0	6.79
2nd Half	75.5	4.79	5.13	55.7	397.0	7.13
1978						
1st Quarter	38.2	5.84	6.06	42.1	590.3	13.92
2nd Quarter	41.2	6.56	6.88	41.6	560.3	13.54
1st Half	79.4	6.20	6.47	83.7	1150.6	13.75

Coconut

Coconut production showed a recovery from the worst ever slump recorded in 1977 but the production level continued to remain considerably below the past average level. The estimated production in the first half of 1978 was 1,004 million coconuts compared with an average production of 1,146 million nuts in the corresponding periods of 1975-76. (Both coconut oil and desiccated coconut production remained considerably below the average level of 1975-76. Though the export volume recovered relative to the 1977 level it was only about half the average level of of 1975-76). Coconut production in 1978 is now estimated to reach 2,250 million nuts as against an annual average of 2,458 million nuts in 1975-76.

Total earnings on the export of all coconut products during the first half of 1978 amounted to Rs. 516.2 million as compared to Rs. 200 million for the same period last

TABLE 4 COCONUT: PRODUCTION AND EXPORTS

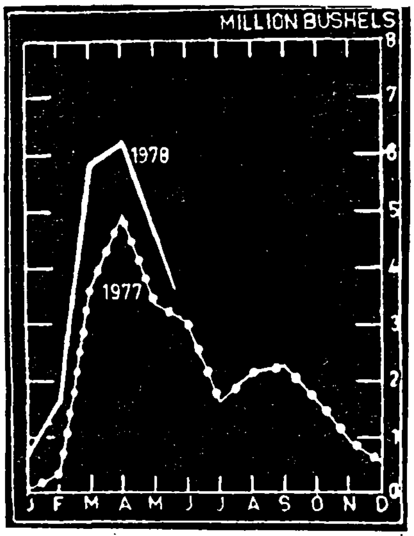
	Production Coconuts (mn. nuts)	Production Oil (tons)	Production D.C. (tons)	Exports Total Volume (mn. nuts) equivalents	Exports Total Value (Rs. mn)	Exports Unit Value per Rs.
First Half of:						
1975	1,154	20,242	51,252	386	199	0.52
1976	1,137	21,407	45,547	390	148	0.37
1977	851	11,324	18,376	107	126	1.18
1978	1,004	14,473	33,448	198	350	1.81

* *Provisional estimates.*

year. This reflects an increase, in rupee terms of about 158 percent in 1978 over that of 1977. The major share of these earnings came from D.C. exports which contributed about Rs. 230 million or 45 percent of the total earnings. Fibre exports brought in about Rs. 126 million or 25 percent and coconut oil exports around Rs. 123 million or 24 percent of the total.

Paddy Production

Among the principal agricultural crops, the most significant production increase was in paddy. The estimated Maha production at 61.6



the Guaranteed Price Schemt
Paddy purchases in 1977-78 under

million bushels represented an increase of 12 percent over the Maha of 1977 and 46 percent over the Maha of 1976. This higher production was largely a result of the higher harvested acreage estimated at 1.39 million acres, an increase of 11 percent over the previous Maha crop. The increased paddy production led to a sharp increase of 42 percent in the purchases of paddy under the G.P.S. The purchase volume at 21.9 million bushels was the highest so far recorded for a Maha season in recent history. The high GPS purchases of paddy, the decline in the ood Commissioner's requirements of rice to be issued under the ration scheme (as a result of the withdrawal of rice ration books from about half the population), and the availability of high stocks of imported rice (as shown by the high level of imports in 1977) led to a substantial drop in the rice imports. The import volume in the first half of 1978 (about 100,000 tons) was only about one third of the half yearly imports of rice during the year 175-77. The higher paddy production also served to raise rural incomes in the surplus paddy producing areas (notably in the Dry Zone districts) thereby expanding the market for urban goods in these areas. This high production should continue into the Yala season, with production estimated at over 30 million bushels, as against an annual average of about 23 million bushels for the last three years.

INDUSTRIAL PRODUCTION

In general, the industrial sector showed a higher production performance compared with the corresponding periods in the previous two years. In the public sector significant production increases were recorded by electricity, petroleum, cement, steel, ceramics, graphite, chemicals (caustic soda), and tyres. The enhanced availability of raw materials and other inputs as a result of the import liberalisation, and the relative industrial peace that characterised this period were among the factors contributing to the higher level of industiral production. There were, however, industries which recorded production declines in the face of the import liberalisation. The most important among them were the textiles and such small scale industries as toys, glassware, safety matches all of which had to face competition from better quality imported pro-

TABLE 6 PRODUCTION OF SELECTED INDUSTRIES

	1976 Full Year	1977 Full Year	1978 First Half	% Change in 1978 over 1976—77 average half-yearly level
1. Electricity (mn. kwt)	1133	1217	672	+ 14.2
2. Petroleum				
(a) Petrol (tons)	99508	103348	57568	+ 13.5
(b) Furnace oil (tons)	513678	545349	299399	+ 13.1
(c) Diesel oil (tons)	364454	368428	201621	+ 10.0
3. Steel (tons)	28295	24558	18867	+ 42.8
4. Cement (tons)	426449	356641	280708	+ 45.2
5. Chemicals (tons) (caustic soda)	1546	1516	854	+ 11.5
6. Tyres number)	180837	156474	113135	+ 34.2
7. Paper (tons)	17257	19429	10053	+ 9.6
8. Ceramics (tons) (Crockery)	2383	2909	1811	+ 37.6
9. Graphite (tons)	8007	8727	5031	+ 20.2
10. Ilmenite (tons)	54932	34092	10710	– 51.9
11. Salt (tons)	134749	47093	48732	+ 3.5
12. Sugar tons	23513	23316	11431	– 2.4
13. Hardware number) (mammoties)	199476	384720	149947	+ 2.7
14. Textiles (million metres)	107.8	106.2	51.79	– 3.2
15. Processed Milk (pints)	22202	28210	15019	+ 19.2
16. Plywood (sq. ft.)	47582	38613	16956	– 21.3
17. Gems (export value) SDR million	29.5	24.2	12.5	– 7.4

TABLE 5 PADDY PRODUCTION & RICE IMPORTS

	Maha Crop (million bushels)	Gross Harvested Area (Million acres)	GPS Purchases (million bushels)	Rice Imports (tons)
First Half of:				
1975	34.5	0.88	7.9	322,900
1976	42.3	1.05	10.2	244,800
1977	54.9	1.25	15.4	363,298
1978	61.6*	1.39	21.9	100,130

* *Also estimated as 59.08 million bushels*

ducts; and assembly industries such as radios, fans and electrical items. There was a tendency for some of these manufacturers to move towards trade or direct import and distribution of the items they previously assembled locally.

The textile industry, particularly the handlooms, suffered adversely as a result of import liberalisation and the institutional changes in the yarn import and distribution policy. While the price of yarn almost doubled, the final output could not be marketed owing to the competition from the better quality foreign products. On the otherhand, the export-oriented garments industry continued to record production increases. During the first half of 1978, nearly 4 million pieces of garments valued at Rs. 156 million were exported as against 5.2 million pieces valued at Rs. 94 for the whole of 1977. Among the projects approved for the Free Trade Zone are several garment manufacturing projects which should raise the garment export capacity of the country sharply in the coming year.

The production in the gem mining industry (as reflected in gem exports) showed no increase during the period under review. Although the value of gem exports in rupee terms (Rs. 238 million) rose by 85 percent over the first half of last year, when measured in SDR terms, there was a decline of about 13 percent.

CONSTRUCT ION

The implementation of a number of large scale development projects (accelerated Mahaveli project, Free Trade Zone, Greater Colombo development scheme and the five-year housing construction programme) and the increased economic activity in the private sector, led to an expansion in construction activity. The increased availabilities of key building materials such as cement (a 45 percent increase in production) was also an important factor in the higher level of construction activity. However, the prices of most building materials such as sand, timber, metal and bricks registered sizeable increases which raised the cost of construction; in particular the timber, shortage became a constraint on construction activity and this compelled the Government to permit the import of timber for more important projects planned for construction. Moreover, the large scale outflow of construction workers to Middle-eastern countries caused shortages of carpenters, masons and other skilled personnel and the local wages for such skills have recorded substantial increases in recent months. The construction activity in the public sector, though continued at a higher level than in 1977, showed a shortfall in relation to the targets. The average performance has been about 74 percent of the construction targets set for the first half 1978, as seen in table 7 below.

TABLE 7 CONSTRUCTION ACTIVITY IN THE PUBLIC SECTOR: The Performance of S elected Agencies

Agency	January-June 1978 Target (Rs. Millions)	Performance	% of the target achieved
1. Dept. of Buildings	62.6	46	73.5
2. State Engineering Corp.	58.9	36.4	61.8
3. Dept. of National Housing	26.4	19.8	74.8
4. River Valleys Dev. Board	27.9	25.4	90.6
5. State Development and Construction Corp.	24.6	15.0	61.2
6. Dept. of Highways	11.2	15.5	137.9
7. Irrigation Dept. (Major works)	25.6	16.2	63.5
8. Decentralized Budget for irrigation works & roads	31.0*	23.4	75.5
Total (1 to 8 above)	268.3	197.7	73.7

* *50% of 1978 allocation*

TRANSPORT AND TRAVEL

A substantial increase was recorded in the imports of vehicles and transport equipment and this led to higher output and employment in the transport sector. The vehicle population of the country (registered with the Commissioner of Motor Vehicles) rose from 203,771 in July 1977 to 213,678 in June 1978 which is an increase of nearly 10,000 vehicles. This was the highest increase recorded for a 12-month period in many years. The position as at June in the previous two years was 1975—193,054; and 1976 — 196,750. The greater part of the increase during the past one year took place in the first half of 1978. Of the total increase during the past one year over 3,000 were private cars, nearly 2,200 were tractors, and nearly 1,500 were lorries. Substantial increases which were recorded in lorry and tractor imports, in particular, would have led to enhanced employment opportunities in the transport sector. The public transport sector also recorded a higher level of activity as seen by the higher operated mileage of the CTB which rose by 14 percent over the first half of 1977 and the higher passenger mileage (which rose by 17 percent). The Port Cargo Corporation registered sizeable increases in the cargo handled, import cargo by 7 percent and export cargo by over 5 percent.

TABLE 8 TRANSPORT: SELECTED INDICATORS

	First Half 1977	First Haf 1978	Percentage Change
1. Vehicle Population: of which:	196,750	213,678	+ 8.6
Private Cars	91.559	94,621	+ 3.3
Lorries	35.077	36,514	+ 4.1
Tractors	21.378	23,535	+ 10.1
2. C.T.B. Operations:			
Operated Km. (millions)	194.4	220.8	– 13.6
Passenger km. (millions)	7,659	8,935	+ 16.7
3. Port Cargo Corporation Cargo handled (Thousand Tons)			
Import Cargo	1.047	1,120	+ 6.97
Export Cargo	508	535	+ 5.31

Tourism

An estimated 93,604 tourists visited the country during the first half of 1978, and this represented an increase of 22 percent over the

TABLE 9 FOREIGN TRAVEL: SELECTED INDICATORS

	First Half 1977	First Haf 1978	Percentage Change
1. Receipts from foreign travel			
Rs. millions ..	137	350	+ 155.5
SDR millions ..	15.2	18.3	+ 20.4
2. Payments for foreign travel			
Rs. millions ..	13.7	139	+ 914.6
SDR millions ..	1.5	7.3	+ 386.7
3. Net earnings from foreign travel (1-2):			
Rs. millions ..	123.3	211	+ 71.1
SDR millions ..	13.7	11.0	− 19.7
4. Tourist Arrivals (Number)	76,878	93,604	+ 21.8
5. Passport Issues (Number) ..	20,014	53,053	+ 165.1
6 Foreign Travel by Sri Lanka residents (Number)	30,710	57,313	+ 86.6

first half of 1977. The gross earnings from foreign travel thus registered an increase of 20 per cent. The visitor room strength of the country as at June 1978 was 4,900 and approval had been granted for nine more hotel projects with a room strength of 577. An important development in the first half of this year has been the substantial increase in the number of Sri Lankans travelling abroad on holidays, business, pilgrimage and for employment. Statistics on the number of Sri Lankans travelling abroad show that over the first six months of 1977 and 1978 there has been an almost 90 per cent increase. From 30,710 in 1977 it rose to 57,313 in 1978. A further indication is provided by the number of passport issues. 57,846 passports have been issued during the first half of 1978 and this number represents a considerable increase at 165 percent over the first half of 1977 and 39 percent over the second half. A good part of these new passport holders could be assumed to be prospective migrants to Middle Eastern countries. The expenditure of Sri Lankans for travel abroad amounted to Rs. 139 million (or 7.3 million SDR) and this represented an increase of 387 percent over the corresponding period last year. When allowance is made for the outflow of this expenditure, the net foreign exchange earnings from tourism amounted to only SDR 11 million which represented a decline of 20 percent from the net earnings of the corresponding period last year. However, the remittances from migrants to Middle Eastern countries are likely to show a significant increase this year. Rough estimates are that Rs. 25 to 30 million were being remitted per month by the Sri Lankans working abroad.

EXTERNAL TRADE AND PAYMENTS

In rupee terms, the value of exports and imports more than doubled but this was primarily a result of the devalued Rupee value. In SDR terms, the exports valued at SDR 327 million remained virtually unchanged from the level recorded in the first half of 1977, while the import value at SDR 360 million registered an increase of only 4 percent. The unchanged export earnings (in SDR terms) was a result of the increases in the earnings from rubber, coconut and industrial exports being offset by a decline in the earnings from tea, gems and minor agricultural crops. On the other hand,

BTN No.	Item	Increase in Rs. million	Increase in SDR million	Increase in %
86-89	Vehicles and Transport equipment	550.6	21.5	154.5
84-85	Machinery, Mechanical apparatus, and Electrical equipment	515.9	14.6	61.6
28-38	Chemical & Allied Products	790.5	10.2	17.3
16-24	Foodstuffs, Beverages and Tobacco	315.1	6.39	33.4
1-5	Animal Products	245.9	5.9	44.4
78-83	Base Metals & Products	163.8	5.1	75.6
68-70	Stone, Plaster, Cement Asbesto & Allied	218.9	3.02	18.9
90-92	Optical, Photographic and	45.9	1.42	76.8
	Scientific instruments	50.2	1.07	36.3
94-98	Miscellaneous Manufatures	19.4	0.8	163.8
	All Imports	3,755.8	14.73	4.3

TABLE 10 BALANCE OF MERCHANDISE TRADE

	Exports		Imports		Balance of Trade	
	Rs. million	SDR*	Rs. million	SDR*	Rs. million	SDR*
1st Half 1977	2937.1	326.5	3127.1	347.6	-190	-21.1
1st Half 1978	6244.7	327.2	6874.9	360.2	-630.2	33.0

* *SDR value was Rs. 8,9965 for the first half of 1977 and Rs. 19,0860 for the first half of 1978.*

TABLE 11 EXTERNAL ASSETS AND EXTERNAL DEBT

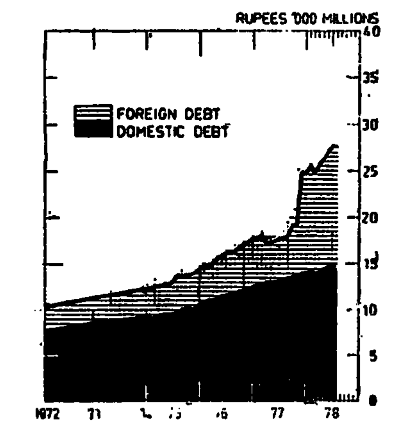
	External Assets Rs. Mn.	External Assets SDR Mn.	In terms of months imports	External Public Debt Rs. mn.	External Assets as % of Public External Debt
End June 1977	1602.7	189	3.5	4412	36.3
End Dec. 1977	5573.6	306	5.5	10,827	51.5
End March 1978	6356.0	329	6.0	11,359	56.0
End June 1978	6167.5	316	6.0	12,692	48.6

the modest increase recorded in the import bill (in SDR terms) despite the import liberalisation was a result of the large savings realized on rice imports which declined by as much as 72 percent in value and by 73 percent in volume. Foreign exchange savings on account of this reduced level of rice imports (relative to the first half of the previous year) was as much as SDR 45.4 million. This saving enabled the country to accommodate a good portion of the increases recorded in the rest of the import bill, and to contain the rise in the overall import bill to only SDR 15 million or 4 percent.

The import categories which showed the highest increases in previous year are seen in the table, at left, on page 8.

The import picture also showed some important structural changes. While the Food Commissioners imports (rice, flour and sugar) declined from 39.4 percent of the total import bill to 27 percent, the share of the major import categories covering machinery and vehicles and transport equipment (BTN nos. 84-89) rose from 11 percent to 20.4 percent. It was the category of vehicles and transport equipment which showed the highest absolute increase (an increase of as much as SDR 22 million) representing a percentage increase of 155 percent, followed by machinery and equipment (an increase of SDR 15 million) representing an increase of 62 percent. The highest percentage increase

TOTAL PUBLIC DEBT



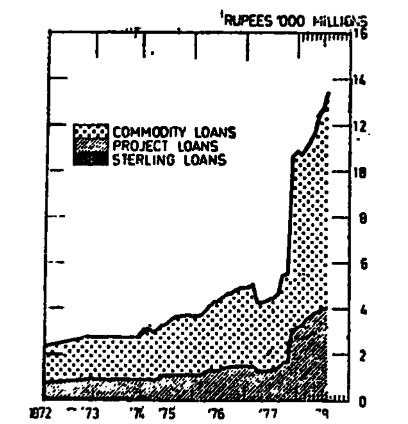
Source: *Central Bank of Ceylon*

was recorded by miscellaneous manufactures (164 percent increase) although the absolute increase was quite modest (being less than SDR 1 million).

The balance of merchandise trade showed a deficit of SDR 33 million which represents an increase in the trade deficit of over 50 percent in relation to the first half of 1977. The higher trade deficit was of course a result of the increased flow of imports while export earnings (in SDR terms) remained virtually constant.

Despite the higher balance of trade deficit, the external assets of the country rose by a significant amount. Compared with a level of SDR 189 million at the end of June 1977, the country's external assets at the end of June this year amounted to SDR 316 million, representing an increase of 67 percent. Compared with the position at the end of 1977, there was an improvement of nearly 10 percent by the end of March, which dropped to about 5 percent by end June. The external assets in June were almost equal to the first half of 1978 which represents a substantial build up of assets when it is noted that in most previous years of the 1970's, the external assets could finance only about two to three months of imports. Since the balance of trade was in deficit, the higher level of external assets was a result of an increased inflow of foreign capital and aid. It may be noted that the external public debt rose by 17 percent during the first six months of 1978. Measured in relation to the external debt, the level of the external assets throughout the first half of 1978, has been equivalent to about 50 percent of the external public debt, as against a picture of less than 30 percent that characterised the previous years of the 1970's.

THE FOREIGN DEBT



Source: *Central Bank of Ceylon*

Another healthy element in the foreign trade picture of the first half of 1978, was the noticeable improvement in the country's commodity terms of trade reflecting an increase in the import purchasing power of a unit of exports. The commodity terms of trade which have continuously dropped from 1967 (which is the base year, 1967-100), upto 1975 when they reached the lowest level at 46) showed some improvement in the subsequent two years, and by December 1977, they had recovered to the 1967 level of 100. During the first half of 1978, the monthly terms of trade fluctuated between a low of 78 and a high of 103, averaging 93.3 for the period as a whole and this represents a substantial improvement over 1977 when they averaged 81. The improved terms of trade largely reflects the rise in the export price index of tea.

TABLE 11 CHANGES IN THE COMMODITY TERMS OF TRADE
(1967-100)

	Export Price Index	Import Price Index	Terms of Trade
1967	100	100	100
1975	199	433	46
1976	239	383	62
1977	382	471	81
1978 Jan-March	684	748	92
1978 April-June	715	761	95
1978 1st half	701	757	93

Source: *Central Bank Trade Indices*

However, the trends in the first half of this year seem to indicate that the balance of payments would record a deficit of about SDR 122 million (Rs. 2,432 million) as compared with a surplus of SDR 121 million (Rs. 1,250 million) in 1977. This turnaround is primarily attributable to the larger inflow of non-food imports and also to an estimated decline of about 4 per cent in export earnings.

Making allowances for short-term capital repayments, the balance on the services account and private transfers, the balance of payments for the whole of 1978 is officially estimated to record an overall dificit of SDR 14 million.

EXCHANGE RATE MOVEMENTS

Since the exchange rate reform of mid-November 1977, the external value of the Sri Lanka Rupee has been announced daily by the Central Bank presumably on the basis of the supply and demand picture for various currencies in the local foreign exchange market. An analysis of the exchange

TABLE 12 THE VALUE OF RS. 100 IN FOREIGN CURRENCIES

	Rupees 100 is worth					
	Yen.	D.M.	£	Indian Rs.	U.S. $	SDR
End June 1977						
(a) Official Rate	3876	32.9	7.99	121.5	13.73	11.78
(b) FEEC inclusive	2349	19.9	4.84	73.6	8.32	7.14
End Dec. 1977	1538	13.4	3.34	53.9	6.41	5.30
End June 1978	1304	13.2	3.43	52.7	6.35	5.13
Percentage Change:						
(i) June '77 to June '78 at						
(a) Official Rate	-66.4	-59.9	-57.1	-56.7	-53.8	-56.5
(b) FEEC Rate	-44.5	-33.7	-29.1	-28.4	-23.7	-28.2
(ii) Dec. '77 to June '78	-14.8	-5.9	+2.7	- 2.4	- 0.9	- 3.2

rate changes during the first half of 1978 reveals that while the Rupee-US Dollar parity rate has changed only marginally, there has occurred a significant depreciation of the Rupee in relation to the Japanese Yen and a modest depreciation against the German Mark. The extent of the depreciation of the Rupee against the Yen has been nearly 15 percent and against the German Mark about 6 percent, while against the dollar the depreciation has been less than 1 percent. Thus, the outcome of the operation of the new system of exchange rate determination in the first half of this year has been the maintenance of a highly stable relationship with the US Dollar and a variable relationship with the Yen and Mark in particular. It may be noted in passing that this observed stability of the Dollar-Rupee rate has occurred during a period when the value of the Dollar has continuously declined, particularly against the Yen and the Mark, in world money markets. If we could assume that changes in the exchange rates have been announced by the Central Bank on the basis of the supply and demand for foreign currencies in the local market, then it could be said that the depreciation of the Rupee against the Yen essentially reflected a situation where the demand for Yen continuously outstripped the supply of Yen (meaning that imports from Japan were taking place far in excess of the exports to Japan) while stability of the dollar value reflected that the demand for dollars has remained roughly in line with the dollar supplies.

In relation to the official exchange rates that existed in June last year, the exchange rates prevailing at the end of June this year represented a depreciation of 66 percent against the Yen, 60 percent against the Mark, and 54 to 57 percent against the Pound Sterling, US Dollar and the Indian Rupee. However, when measured against the FEEC-inclusive exchange rates of June 1977 (which were the effective rates for most foreign trade transactions), the end June 1978 rates reflected a much lower degree of depreciation, namely 45 percent against the Yen, 34 percent against the Mark, 28 to 29 percent against the Pound and the Indian Rupee and 24 percent against the US Dollar. The depreciation of the Rupee against the SDR (the international monetary unit, the value of which is linked to a basket of key currencies) during the year ended June 1978 was nearly 57 percent (using the official rate of the Rupee a year ago) and 28 percent (using the FEEC-inclusive rate).

TABLE 13 MONEY SUPPLY (Rupees million)

	(1) Currency	(2) Demand Deposits	(3) Money Supply (M1=(1)+(2))	(4) Percent Change	(5) Savings & Time Deposits	(6) Money Supply (M2=(3)+(5))	(7) Percent Change
End of Period							
June 1977	2626	2322	4964	— 2.3	7116	12980	
December 1977	2792	2574	5301	+11.8	6716	12717	+15.8
March 1978	3042	2959	6066	+ 8.5	6037	11403	+11.5
June 1978	2938	2926	5847		4897	9844	+ 2.1

MONEY SUPPLY AND INTEREST RATES

The money supply, narrowly defined to include only currency and demand deposits (denoted by M1), stood at Rs. 5,864 million at the end of June 1978. This level represents an increase of 9.3 percent over the end of the December 1977 level. The increase in the money supply was confined to the period January — April when an increase of 12 percent was recorded. A decline set in during May which continued into June mainly due to a drop in the country's external assets.

The increase in the money supply during the first six months of 1978 was largely a result of (a) a rise in the external assets of the banking system and (b) an expansion of commercial bank credit to the private sector, public corporations, and co-operatives. The high level of bank credit to finance GPS purchases was an important factor in the commercial bank credit expansion. With a view to restraining the expansion in money supply, the Central Bank directed commercial banks not to increase the total of their advances to public corporations and boards over the levels of such advances outstanding as at June 28th. This ruling was marginally relaxed in mid-July to permit an increase in this overall ceiling; and was due to be further relaxed.

The money supply, broadly defined to include not only the currency and demand deposits but also savings and time deposits (denoted by M_2), stood at a level of Rs. 12,980 million at the end of June 1978. The level of this broad concept of money supply (M_2) was thus 121 percent higher than that of M_1 (narrow concept). Moreover, during the first half of 1978, M_2 increased at a faster rate (at 14 percent) than the increase recorded in M_1 (which was 9.3 percent). The reason for the higher rate of M_2 expansion was the continued increase in the savings and time deposits which recorded an increase of 18 percent during the first half of 1978.

The high level of savings and time deposits (at Rs. 7,116 million at the end June 1978) was an important source of secondary liquidity in the economy. High interest rates continued to attract funds into the savings and time deposits of the commercial banks and the National Savings Bank, and the increase in this flow of savings in the first half of 1978 amounted to Rs. 1,079 million.

The Central Bank rate on advances to commercial banks (Bank Rate) continued unchanged at 10 percent since August 1977. The market rate for Treasury Bills continued at 9 percent since November 1977. The commercial bank lending rates ranged from a minimum of 13 percent to a maximum of 20 percent. The banks and private finance companies continued to offer high rates for savings and time deposits. The National Savings Bank offered 8.4 percent for savings deposits and 12 to 18 percent for fixed deposits ranging from 6 months to 18 months.

The financial operations of the Government sector were a significant factor in that they helped to exert a contractionary influence on the money supply. Further, most of the factors that caused the money supply to increase during the first half of 1978 are expected to exert a negative influence during the second half. Thus, the Central Bank has estimated that the money supply would increase by about 12 percent in 1978, as against 35 percent in 1976 and 29 percent in 1977.

PRICES AND WAGES

The period under review witnessed significant price increases for many commodities, but there is no reliable index to measure the impact of these price changes on the cost of living. The Colombo Consumers Price Index is a defective barometer of consumer price changes and its shortcomings are well known. During the first half of this year, this 'defective' Index registered an increase of 11 percent. This increase was largely a result of the inclusion of the open market price of rice in the calculation of this index since February this year, when the rice and sugar rations were withdrawn from families earning Rs. 300 or more per month. As a result of this change, the food sub-index (which has a weight of 62 percent in the overall Index) registered a sharp increase of 13 percent in February. Apart from this, no other significant price changes are reflected in this Index. For example, clothing prices have remained constant, and the two groups fuel and light and miscellaneous commodities (which together have a weight of 23 percent in the Index) registered price increases of only about 1 percent. But this picture is hardly realistic since significant price changes did take place in each of these commodity groups.

A more realistic indicator of price change is provided by the Wholesale Price Index computed by the Central Bank. However, this index measures prices at the primary marketing level (that is, at the first commercial transaction in the chain of sales of the product) rather than at the retail level. Hence the prices covered by this index are mostly producers' prices (in the case of locally produced goods) and the import prices of imported goods. The Wholesale Price Index having shown an increase of 3.2 percent during January-March, declined by 3.5 percent during the next three months (April-June), so that for the six months as a whole there was no increase. Within the overall index, however, several important categories of commodities showed significant price increases. The price increases were highest in the case of imported goods (an increase of 26 percent) and intermediate goods (an increase of 14 percent). The subcategory of textiles and footwear (which is an important consumer item group) rose by as much as 23 percent and this stands sharply in contrast with the picture depicted by the Colombo Consumer Price Index where the Clothing index had remained constant for the first half of 1978. Among the intermediate products which showed relatively high price increases are paper products (+17%), non-metalic products (+ 13%), metal products (+ 15%) and fuel and light (+ 17%). However, the rate of price increase recorded for most commodity groups during April-June was much lower than in the first three months of the year. This may be an indication that by mid-1978 most prices having worked through the adjustment process necessitated by the devaluation, import liberalisation and other policy reforms were

TABLE 14 **CHANGES IN PRICES AND WAGES**

	June 1977	Dec. 1977	March 1978	June 1978	Percent Changes Dec. '77 to June '78	Percent Changes March '78 to June '78
1. Colombo Consumer Price Index 1952=100	203.9	204.6	221.6	227.0	+ 11.0	+ 2.4
of which Food Sub-index	205.3	203.1	230.1	238.3	+ 17.3	+ 3.6
2. Wholesale Price Index (1974=100)	142.8	153.2	158.1	152.6	— 0.4	— 3.5
of which:						
(a) Imported Goods	85.0	111.6	130.1	140.9	+ 26.3	+ 8.3
(b) Intermediate Goods	107.7	141.4	146.9	161.0	+ 13.9	+ 9.6
(c) Textiles and Footwear	155.1	196.4	228.1	240.5	+ 22.5	+ 5.4
(d) Paper Products	118.5	118.5	128.3	138.8	+ 17.1	+ 8.2
(e) Non-metallic Products	152.8	220.5	263.1	249.2	+ 13.0	— 5.3
(f) Metal Products	91.9	105.1	105.9	121.2	+ 15.3	+ 14.4
(g) Fuel & Light	173.1	215.5	232.6	251.2	+ 16.6	+ 8.0
3. Minimum Wage Rate Index Numbers 1952 = 100						
(a) Central Govt. Employees	237.2	275.2	275.2	275.2	— No Change —	
(b) Govt. School teachers	182.9	203.9	203.9	203.9	— No Change —	
(c) Workers in Wages Boards Trades	309.3	402.0	424.5	438.2	+ 9.0	+ 3.2

approaching their new equilibrium levels.

There was speculation, however, that the pressure on prices would continue for sometime in view of the excessive monetary expansion of the past two and a half years, since monetary expansion reacts on prices with a time lag; and the need for monetary restraint would persist for some time before pressure on prices could be relieved.

Beginning from around late 1977, there was a spectacular rise in urban land and property values, particularly in and around Colombo. In some parts of Colombo, the extent of the increase in land values has been as much as 100-300 percent. While a good part of the explanation of these price trends has to be sought in the activities of real estate specualtors, the inflationary trends, high interest rates and liquidity in private hands, and the increased business activity in the private sector were further factors that contributed to this land price inflation.

The wage increase of Rs. 50 (maximum) granted in December 1977 raised the minimum wage rate index of Central Government employees by 16 percent, and those of government school teachers by 11.5 percent and the workers of Wages Boards Trades by nearly 11 percent for the next six months. While the wage rates of all government employees remained constant those of the Wages Boards Trades recorded an increase of 9 percent. It could be assumed that the increase in the living costs that followed went to offset a substantial portion of these wage increases. The erosion of the real wages led to a demand by many trade unions for higher wages and the government was expected to make adjustments in wages and salaries in keeping with the living costs in the 1979 Budget to be introduced in mid-November.

MANPOWER AND EMPLOYMENT

The number of unemployed persons at the end of 1977 has been estimated to be over one million or over 20 percent of the labour force in the country. In view of this high rate of unemployment, the government has attached high priority to new employment generation. In the medium and long-term, the government expects to absorb the unemployed manpower by the implementation of major development projects such as the accelerated Mahaveli Development Scheme, Greater Colombo Development Scheme and the Investment Promotion Zone.

No data are available on the extent of employment creation during the first half of this year or on the number unemployed at the end of the period under review. However, scattered data available suggest a fair expansion of employment in this period. In the public sector the main course of new employment has been the filling up of vacancies in the existing cadres of various public sector institutions. The number of vacancies filled upto the end of June has been reported to be over 120,000 and the number of vacancies reported as available for filling as at the end June, according to the Ministry of Plan Implementation, was over 130,000. A new scheme for the placement of unmeployed persons in public sector jobs (called the Job Bank Scheme) was inaugurated and it is expected to provide 168,000 jobs (at the rate of 1,000 persons per electorate) under this Scheme during 1978. The government has also appealed to the private sector to increase its workforce by 10 percent, which it is anticipated would lead to the creation of about 50,000 jobs in this sector.

The enhanced level of economic activity in the private sector evidenced throughout this period would have led to a sizeable expansion in employment opportunities. Unofficial estimates suggest an increase of the order of about 20,000 during the first six months of this year. The number of jobs advertised in the daily papers (mainly skilled, managerial and technical jobs) was more than 8,000 during this period and this represents a considerable increse over the figures of the previous year. Liberalisation of the imports of raw materials, machinery and spares, by enabling the private sector industries to achieve a higher capacity utilization, would have led to some employment expansion. Moreover, the policy of import liberalisation would have had a direct effect on the employment generation in the import, wholesale and retail trade. Higher tourist traffic (outflow as well as inflow), substanaial increases in the imports of lorries, vans and tractors, and the higher level of construction activity were further factors that would have contributed to the employment expansion.

TABLE 15

REGISTRATION OF COMPANIES

Year	No of Companies Registered
1965	220
1961	181
1967	206
1968	215
1969	279
1970	240
1971	141
1972	261
1973	355
1974	349
1975	284
1976	265

Monthly Registrations Nos.

	1977	1978
Jan.	22	33
Feb.	23	12
March	49	43
April	18	36
May	17	45
June	29	56
July	15	59
Aug.	20	58
Sept.	27	58
	220	400

A further indication of the expanding business activity is evident from the numerous applications being received by the Registrar of Companies for the registration of new businesses. Some of these applications have even come from established businesses which were hoping to make use of the tax concessions granted to new companies set up after the budget of November 1977. The major part, however, are reported to be new concerns which in 1978 averaged 45 registrations per month as compared with a monthly average of 25 in previous years. The total number of new business registrations in 1978 was expected to exceed 500. (See table).

There were also signs of increased activity in the Investment Promotion Zone area and according to latest official information 46 projects had been approved with a total investment of Rs. 1,600 million on these projects and employment potential in them of 26,000. The construction of infrastructure facilities in this zone were underway and was providing diirect employment to considerable numbers. Several tube wells had been sunk and the internal roads relating to Phase I of the project were completed. The increased economic activity that has been stimulated through this project and several other major schemes, it is hoped, would ultimately generate the new employment opportunities which is expected to be the principal thrust of the government's future economic and social policy.