

318 (548.7)

cost of other sub-sectors. It is not surprising therefore that the rate of growth of the Gross Domestic Product (GDP) came down to 4.9 percent, the lowest reached since 1977. (See table 1.) Intertwined with these problems and further aggravating the situation were an unstable balance of payments, and an unprecedented monetary expansion towards the latter part of the year.

The annual growth rate in the GDP reached its highest point of 8.2 percent in 1978 but declined gradually thereafter. However, the growth rate over the six year period, 1978-1983, averaged 6 percent per annum, which is considered impressive in view of the series of adverse external factors during this period and also by virtue of the fact that the average growth rate exceeded not only that of the pre-1977 period but also the government's medium term target of 5.5 percent per annum set at the beginning of 1978.

Considering growth in the domestic product among countries of the region, however, Sri Lanka's performance in 1983 lagged behind nearly two-thirds of the other Asian countries. Of 15 developing countries in the Asian region, selected by the Asian Development Bank from among its member countries, Sri Lanka was placed in tenth position on a comparison of real growth rates in 1983. (See box on page 6).

Agriculture

The Central Bank's sector-wise analysis of the Gross Domestic Product in 1983 has revealed that the real growth rate of 4.9 percent was achieved mainly due to the increases in production in the agricultural sector, which includes forestry and fishing. The 1983 growth rate of 5.1 percent in this sector was twice as much as that recorded in the previous year. The high growth rate in this sector was largely the result of a 14.7 percent increase in the volume of paddy production in 1983. A Maha crop of about 85 million bushels of paddy was harvested and total production for the year reached 118 million bushels.

SRI LANKA'S ECONOMY

Sri Lanka's economic performance in 1983 is difficult to compare with that of the previous years as this was in many ways an unusual year for the economy. Against the backdrop of a fading recession that had effected the developed countries and precipitated the decline in Sri Lanka's terms of trade was witnessed (locally) a few events of far reaching consequence, beginning with the new term of office of the government and the mini general election in the first part of 1983. Also, drought conditions early in the year resulted in a lower rate of growth in the agricultural sector. But most

unsettling for the economy, however, was the civil disturbances of the last week of July when several factories, shops, dwellings, warehouses and vehicles in the suburban areas were destroyed. This was followed by a period of short working hours and general disruption of normal activities which lasted a few more weeks. There was also a temporary decline in the transport sector and a general slowing down of construction activity. The service sector, particularly the tourist trade, was a noteworthy casualty; while public expenditure on defence and relief activities had to be increased at the

Table 1 Sri Lanka's Production Indicators 1974 - 1983

Year	GDP at Constant 1970 factor Cost Prices		GNP at Constant 1970 factor Cost Prices		GNP per Capita Constant Prices	
	Rs million	% rate of growth	Rs million	% rate of growth	Rupees	% rate of growth
1974	14,585	3.2	14,449	3.2	1,088	1.8
1975	14,987	2.8	14,837	2.7	1,099	1.0
1976	15,431	3.0	15,258	2.8	1,112	1.2
1977	16,078	4.2	15,934	4.4	1,143	2.8
1978	17,401	8.2	17,329	8.8	1,221	6.8
1979	18,501	6.3	18,430	6.4	1,274	4.3
1980	19,575	5.8	19,456	5.6	1,320	3.6
1981	20,706	5.8	20,257	4.1	1,356	2.7
1982	21,756	5.1	21,232	4.8	1,398	3.1
1983	22,824	4.9	22,076	4.0	1,432	2.4

Source: *Central Bank Review of the Economy 1982 and Annual Report 1983*

Some of the comparatively smaller areas in the agricultural sector such as sugar, milk and fisheries made no noteworthy contribution in 1983 despite the producer subsidies and attractive market prices offered to them. Sugar production in 1983 was estimated at 21,508 metric tons, a decrease of 6 percent when compared with production in 1982. Despite a tariff policy geared to maintaining producer incentives as a measure of protecting the local industry and inducing additional investment in the sector the domestic industry was unable to produce more than 10 percent of local consumption requirements last year. Estimates of milk production in 1983 were 419 million litres (including buffalo milk) and increase of 4 percent over the previous year. Although the National Milk Board increased producer prices payable for milk in March 1983 the amount of milk collected by the Board dropped by 2 percent to 54 million litres during the year. Fish production provisionally estimated at 218,500 metric tons in 1983, showed only a marginal increase of 2 percent over that of the previous year. Coastal fish production in 1983 was 16 percent below that envisaged in the Five Year Fisheries Master Plan.

Other agricultural sectors, however, consisting of subsidiary food

crops, minor export crops and other live stock products made a substantial contribution to the overall growth of the sector in 1983.

The growth rates in various sectors for the period 1982 to 1983 are given in Table 2. Value added in agro-processing industries of tea, rubber and coconut declined by 4.6 percent in 1983, as against a 5.3 percent decline in the previous year. Value added in factory industries increased only by 2 percent in 1983 compared with 8.9 percent in the previous year. This is the net result of a 15 percent decline in production in the state owned industries and a 26 percent increase in the private sector industries. In the small industries subsector, a 4.1 percent growth rate has been observed in 1983, compared with a 10.1 percent growth rate in 1982. The manufacturing sector as a whole increased marginally, by 0.8 percent in 1983, compared with a 4.8 percent expansion in 1982.

Construction

In the construction sector, there has been only a marginal growth of 1 percent in 1983. The building construction activities of the private sector seem to have declined in 1983

for the third consecutive year. The reason for the increase in value added in this sector was mainly because of the high level of expenditure in the Accelerated Mahaweli Scheme; with the completion of Headworks at Maduru Oya and increased construction work on the Victoria Dam and Randenigala Projects.

Value added in electricity, gas, water and sanitary services increased by 6.6 percent in 1983. Electricity generation in 1983 increased by only about 2.3 percent over the previous year. However, the production of gas products increased by about 20 percent.

In the transport, storage and communication sector, there has been a 4.5 percent expansion in 1983, compared with the 6.2 percent expansion in the previous year. The slower growth in imports has been primarily responsible for this slow growth rate.

Value added in the wholesale and retail trade sector increased by 5.3 percent in 1983, against the 6 percent growth in 1982. Here too, the value added contribution from import based trade increased much less than in the previous year.

The banking, insurance and real estate sector grew by 21.4 percent as against a 11.9 percent increase in 1982. Value added in ownership of dwellings increased by 2.3 percent compared with a 5.5 percent increase in 1982.

In public administration and defence, a large increase in value added has taken place in 1983.

The other services sector suffered a marginal decline in 1983 compared with a 7 percent growth rate in 1982, largely because of the decline in the tourist sub-sector. The total number of tourist arrivals declined by 17.2 percent in 1983 over the previous year.

The Central Bank has concluded from an analysis of the sectoral performance in 1983 that the Sri Lanka

economy's real output levels are below its potential. This is so in state owned plantation agriculture, particularly in tea, and in public corporation where overall production declined by about 15 percent. Corrective measures in these sectors could greatly enhance the production potential of the economy to achieve a higher real growth rate.

The agricultural sector still accounts for more than one quarter of the Gross Domestic Product, although its share in exports has declined in the last six years from a level of 72 percent to 58 percent. The area that has lagged behind most in this sector has been that of tree crops.

The potential for expansion of output, employment and exports in this sector has been recognised and the associated problem areas are now beginning to receive the attention of authorities concerned.

Manufacturing

In the manufacturing sector value added has grown at an average rate of 4.2 percent over the period 1978-83. Here too overall growth in the last six years has been adversely affected as a result of stagnation of output in the plantations with processing of tea, rubber and coconut constituting one third of the value added.

During 1983 output in the manufacturing industry sector increased by only 2 percent; compared with a 9

percent increase in 1982 this drop in output is significant. The industrial sector has to face several difficulties mainly on account of developments outside its control. Growth of industries such as garments and leather goods, in which Sri Lanka has a comparative advantage viz-a-viz the industrialised countries, has been inhibited by the protective tariff and non-tariff barriers in the markets abroad.

The ethnic disturbances in July 1983 also affected production in the industrial sector. Another reason for drop in output was the power shortage as a result of drought.

Energy

Energy supplies continued to be a problem in 1983. Although world oil

Table 2 Sectoral Composition and Increase in Gross National Product at Constant (1982) Prices 1982 - 1983

Sector	Value Added (Rs Million)		Percent Share of GNP		Increase/decrease over previous year (Rs Million)
	1982*	1983*	1982	1983	1983
1. Agriculture, Forestry and Fishing	24,964	26,237	27.7	27.9	1,273
1.1 Agriculture	20,771	21,810	23.0	23.2	1,039
1.1.1 Tea	2,418	2,309	2.7	2.5	- 109
1.1.2 Rubber	770	833	0.9	0.9	63
1.1.3 Coconut	3,263	2,995	3.6	3.2	- 268
1.1.4 Paddy	5,484	6,252	6.1	6.6	768
1.1.5 Other	8,836	9,421	9.8	10.0	585
1.2 Forestry	1,710	1,816	1.9	1.9	106
1.3 Fishing	2,483	2,611	2.7	2.8	128
2. Mining & Quarrying	2,238	2,413	2.5	2.6	175
3. Manufacturing	13,604	13,710	15.1	14.6	109
3.1 Export Processing	2,846	2,715	3.1	2.9	- 131
3.2 Factory Industry	8,777	8,953	9.7	9.5	176
3.3 Small and other Industry	1,978	2,042	2.2	2.2	64
4. Construction	7,959	8,039	8.8	8.6	80
5. Electricity, Gas, Water & Sanitary Services	1,089	1,61	1.2	1.2	72
6. Transport & Communication	8,536	8,920	9.4	9.5	384
7. Wholesale & Retail Trade	16,059	16,910	17.8	18.0	851
7.1 Imports	4,167	4,242	4.6	4.5	75
7.2 Exports	2,861	2,870	3.2	3.1	9
7.3 Domestic	9,031	9,798	10.0	10.4	767
8. Banking, Insurance & Real Estate	3,192	3,876	3.5	4.1	684
9. Ownership of Dwelling	3,250	3,315	3.6	3.5	65
10. Public Administration & Defence	2,812	3,673	3.1	3.9	861
11. Services (not elsewhere stated)	8,698	8,672	9.6	9.2	-
12. Gross Domestic Product	92,398	96,926	102.3	103.1	4,528
13. Net Factor Income from Abroad	-2,034	- 2,889	- 2.3	- 3.1	-855
14. Gross National Product	90,364	94,037	100.0	100.0	3,673

*Provisional

Source: Central Bank of Ceylon Annual Report 1983

prices came down for the first time in ten years Sri Lanka was not able to enjoy the full benefits of this favourable trend as unprecedented drought conditions restricted hydro electricity generation and imported oil had to be used in larger quantities to generate thermal power. Hydro electricity generation declined by 24 percent while thermal power generation increased by 96 percent over the 1982 levels.

Trade

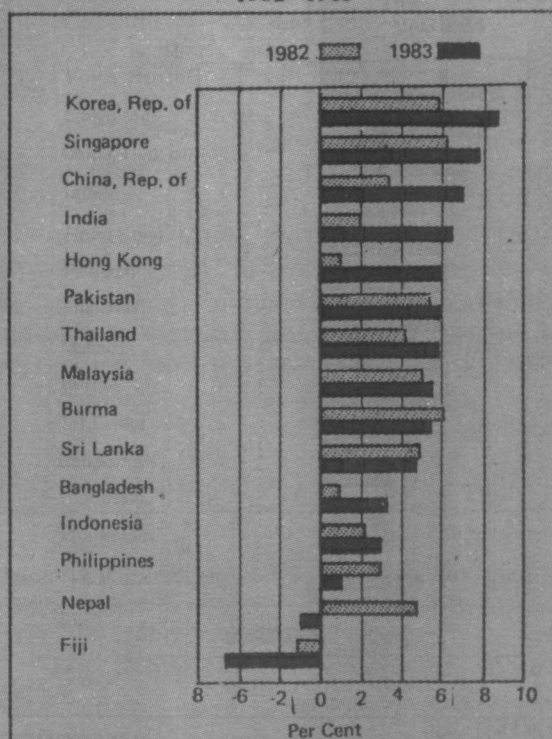
Sri Lanka's external trade performance began to show an improvement towards the end of 1983. For the first time since 1977 exports grew by 7 percent (see table 3) and import values also declined (see table 4). The balance of trade deficit, however, continued into 1983 too. According to Customs data, total expenditure on imports in 1983 was Rs. 42,021 million (SDR 1,671 million) and total earnings from exports Rs. 25,183 million (SDR 1,001 million) resulting in a trade deficit of Rs. 16,838 million (SDR 669 million); which is a decrease of 2 percent in SDR terms over the previous year's deficit of Rs. 15,751 million (SDR 686 million).

As a result of the relative price movements of exports and imports in 1983 the country's terms of trade improved by 16 percent. This improvement was a significant development because the country's terms of trade had been deteriorating continuously since 1977.

Balance of Payments

A viable balance of payments position has eluded the country because of the inherent weaknesses in the external trade structure. Although for the first time since 1977 the terms of trade for Sri Lanka improved in 1983, the deficit on the service account increased. This unfavourable movement in the services account began around 1980, mainly due to an increase in the payment of interest on foreign loans and this situation was accelerated in 1983 with last year's significant drop in earnings from tourism. The excess of receipts over payments in the services account which

ESTIMATED RATE OF REAL GROWTH OF SELECTED DMCs, 1982 - 1983



GROWTH IN DOMESTIC PRODUCT

A majority of the countries in the Asian region experienced increases in their GDP growth rates in 1982. An Asian Development Bank review of performance in 1983 indicates that in the cases of four newly industrialised developing countries, namely, the Republic of Korea, Singapore, Hong Kong and Republic of China; and also India, increases were particularly pronounced, whereas growth rates declined in Burma, Sri Lanka, Fiji, Philippines and Nepal.

The countries which recorded substantially higher GDP growth rates in 1983, than in 1982 were able to take advantage of the export opportunities presented by the reviving economic activity in the industrialised

countries. This growth however, was not only export led, it also contained elements of buoyant domestic demand. GDP growth in the Republic of Korea therefore went up to 8.7 percent in 1983 from a growth rate of 5.8 percent in 1982. Hong Kong's 1983 GDP grew up to 5.9 percent compared with a 1982 GDP growth rate of 1.1 percent.

Four South East Asian Countries, Indonesia, Malaysia, Philippines and Thailand had varying rates of GDP growth. Because of high debt burdens and only modest improvements in their exports, most of them pursued stringent fiscal and monetary policy.

The economic performance of six south Asian countries (Bangladesh, Burma, India, Nepal, Pakistan and Sri Lanka) was mixed. Pakistan sustained a high level of economic growth, with GDP increasing by 5.8 percent during Fiscal Year (FY) 1983. India experienced robust recovery in its GDP growth - from 2 percent in FY 1982 to 6.5 percent in FY 1983 - due to production increases on a wide front, particularly in agriculture. Bangladesh made a significant recovery from the less than one percent GDP growth of FY 1982, although 1983 growth of 3.3 percent still remained somewhat depressed. Burma's FY GDP growth rate declined to 5.5 percent from 6.0 percent in FY 1982; Nepal's GDP declined by 0.9 percent during 1983; and Sri Lanka experienced a deterioration in GDP growth from 5.1 percent in 1982 to 4.9 percent in 1983.

was SDR 38 million in 1979 reached a peak of SDR 40 million in 1980, but in 1981 the surplus came down to only SDR 10 million and by 1982 there was a deficit of SDR 16 million, and in 1983 a deficit of SDR 52 million.

The rate of increase in private remittances also slowed down in 1983, although the total value of remittances in 1983 was higher than in

the previous year. The imbalance between foreign earnings and payments continued into 1983. In SDR terms, the trade deficit was SDR 808 million and the total deficit of Goods and Services SDR 860 million. Private transfers of SDR 255 million brought down the Current Account Balance deficit to SDR 605 million as seen in table 4 on page 7.

Table 3 Balance of Trade 1978 - 1983

Rs. Million (SDR Mn in brackets)

Year	Exports (a) F.O.B.	Imports (b) C.I.F.	Balance of Trade
1978	13,206 (674)	14,687 (750)	- 1,481 (- 76)
1979	15,273 (759)	22,560 (1,121)	- 7,287 (- 362)
1980(c)	17,273 (803)	33,637 (1,563)	-16,364 (-760)
1981	20,199 (891)	35,530 (1,567)	-15,331 (-676)
1982	21,124 (919)	36,876 (1,605)	-15,751 (-686)
1983	25,183 (1,001)	42,021 (1,671)	-16,838 (-669)

(a) Includes value of re-exports

(b) Excluding bullion & Specie

(c) Revised from 1980-onwards

Source: *Customs Sri Lanka;*
Central Bank of Ceylon.

Conversion

1977 - 1 SDR = 10.42

1978 - 1 SDR = 19.58

1979 - 1 SDR = 20.12

1980 - 1 SDR = 21.52

1981 - 1 SDR = 22.67

1982 - 1 SDR = 22.98

1983 - 1 SDR = 25.76

1983, also influenced to a large degree the drop in rate of growth of real per capita income from 3.1 percent in 1982 to 2.4 percent in 1983.

Total debt service payments, including IMF transactions, as a ratio of the earnings from merchandise exports

and services increased from 18.9 percent in 1982 to 21.6 percent in 1983; while the ratio excluding IMF transactions increased from 12.9 percent to 16.0 percent between these two years. The overall debt service payments as a percentage of the receipts from merchandise exports, services and workers remittances from abroad in 1983 was 17.9 percent as against 15.5 percent in 1982. Details of debt service payments are given in table 5.

It is seen that the increased volume of borrowing on concessionary and non-concessionary terms have over this period invariably led to substantial increases in interest payments; and resulted in the share of interest on public debt increasing from 3.2 percent of GDP in 1978 to 5.4 percent of GDP in 1983. In value terms, interest payments on public debt in 1983 consisted of Rs. 5,314 million on domestic debt and Rs. 1,279 million on foreign debt; with the percentage increases during the year being 27 percent on domestic debt and 40 percent on foreign debt.

The total foreign debt outstanding as at the end of 1983, amounted to Rs. 46,025 million, recording an in-

Table 4 Balance of Payments 1978 - 1983 (SDR Million)

	1978	1979	1980	1981	1982	1983
Exports *	675	759	818	903	918	988
Imports *	819	1121	1576	1596	1808	1796
Trade Balance *	-144	-362	-752	-693	-890	-808
Services	6	37	40	10	-16	-52
Receipts	99	149	214	261	303	317
Payments	93	112	174	251	319	369
Goods & Services	-138	-325	-718	-683	-906	-860
Private Transfers	17	37	105	172	240	255
Current Account Balance	-121	-288	-613	-511	-666	-605
Financing						
Grants	46	111	106	136	147	160
Direct Investment	1	36	33	42	58	35
Other Private Long Term(net)	7	7	33	66	182	69
Central Govt. (Net)	125	121	125	225	231	292
Short Term (Net)	-	-	115	8	-	32
SDR Allocation	-	12	12	12	-	-
Errors & Omissions	7	36	23	-4	24	17
Overall Balance	65	35	-166	-26	-24	-
Monetary Movements	-65	-35	166	26	24	-

Source: *Public Investment 1984-88; Ministry of Finance and Planning.*

*Customs data is adjusted and therefore differs from the figures in Table 3.

A notable feature in the production indicators (seen in Table 1) is the wide disparity between the real growth rates of the GDP and GNP in 1983. This difference of almost .9 percentage points in growth rates has drawn attention to the size of the net outflow of factor income. This increase in outflow of net factor income abroad was caused more as a result of interest payments on foreign loan capital than on repatriation of dividends and profits accruing to private foreign capital. Interest payments on foreign loans went up in 1983 by as much as 34 percent over the 1982 figure. Debt service payments made up of amortization of long and medium-term loans and interest payments relating to long, medium and short-term foreign loans increased from Rs. 5,292 million (SDR 231 million) in 1982 to Rs. 7,094 million (SDR 285 million) in 1983. This increased outflow of net factor income, during the course of

crease of 33 percent as compared with the 19 percent increase in the previous year. The depreciation of the Sri Lanka rupee viz-a-viz other currencies led to an increase in the outstanding liability by Rs. 5,254 million in 1983, as compared to an increase of Rs. 440 million in 1982.

It was evident that the country was living beyond its means and incurring heavy debts to meet its requirements. The debt burden which is

the amount of external assets, inclusive of private transfers, set aside for the payment of capital and interest for foreign debts had gone upto 18 percent from an estimated 11.2 percent in 1980. The growth in external debt as a result of the persistingly large current account deficit in the balance of payments has therefore been the subject of serious concern in recent years. The mounting external liabilities, especially those of short maturity have severely handicapped

the management of the balance of payments and the exchange rates. This weakening in the management of the balance of payments has even threatened the very foundation on which Sri Lanka's liberalised trade and payments system rests. The observations of the Central Bank in this regard are worthy of note: "notwithstanding the flexibility given to resident enterprises in conducting business with non-residents, careful and adequate monitoring of financial transactions is a

Table 5 Debt Service Payments
Rs Million (SDR million in Brackets)

Item	1979	1980	1981(a)	1982(a)	1983(b)
1. Debt Service Payments	2,383.1 (118.0)	2,762.8 (137.0)	4,449.7 (197.4)	5,291.7 (230.7)	7,093.8 (285.3)
1.1 Amortization	1,627.4 (80.8)	1,781.5 (91.4)	2,084.1 (93.8)	2,563.3 (112.0)	3,131.3 (126.9)
(i) To I.M.F.	622.6 (30.9)	748.5 (43.4)	1,289.2 (59.1)	1,146.3 (49.9)	1,097.3 (46.2)
(ii) To Others (c)	1,004.8 (49.9)	1,033.0 (48.0)	794.9 (34.7)	1,417.0 (62.1)	2,034.0 (80.7)
1.2 Interest Payments	755.7 (37.2)	981.3 (45.6)	2,365.6 (103.6)	2,728.4 (118.7)	3,962.5 (158.4)
(i) To I.M.F.	170.00 (8.4)	345.6 (12.4)	487.6 (21.7)	519.5 (22.4)	749.3 (30.8)
(ii) To Others	585.7	635.7	1,878.0	2,208.9	(127.6)
2. Earnings from Merchandise Export and Services	18,274.7 (907.7)	22,207.8 (1,032.0)	26,526.1 (1,168.2)	28,059.8 (1,221.7)	32,875.1 (1,305.2)
3. Receipts from Merchandise Exports, Services and Private Transfers	19,210.1 (954.0)	24,725.8 (1,149.0)	30,955.9 (1,363.3)	34,083.5 (1,484.1)	39,732.0 (1,578.0)
4. Debt Service Ratios * (as a percentage of 2)					
(i) Overall Ratio	13.0	12.4	16.8	18.9	21.6
(ii) Excluding IMF Transactions	8.7	7.5	10.1	12.9	16.0
5. Debt Service Ratios * (as a percentage of 3)					
(i) Overall Ratio	12.4	11.2	14.4	15.5	17.9
(ii) Excluding IMF Transactions	8.3	6.7	8.6	10.6	13.2

Source: Central Bank of Ceylon

(a) Revised

(b) Provisional

(c) Does not include amortization payments in respect of FCBU loans to GCEC enterprises and some of the FCBU loans to other approved enterprises as information is not available.

* Calculated using rupee values. Debt Service Ratios calculated on SDR values may differ from these rates due to variations in exchange rates during the year.

sine qua non to ensure that obligations to non-residents do not overtake Balance of Payment realities”.

The Central Bank in its Annual Report for 1983 reveals the seriousness of the deterioration in the debt profile and causal factors behind it when it observes: “In previous years the debt ratio excluded certain types of debt mainly due to difficulties in estimating those arising from offshore units. These omissions relate to lendings by the Foreign Currency Banking Units to GCEC enterprises and certain State Corporations and Ceylon Petroleum Corporation borrowings abroad. Given the general tightness of credit in the local market and its high cost, the temptation to borrow abroad was strong, especially as interest rates in the principal money markets were much lower than in Sri Lanka. Bank borrowings and commercial credit which formed a negligible proportion of total External Debt in 1979 had by end of 1983 climbed to 33 percent. Between these two years long-term concessional debt increased by SDR 1,051 million while short maturity high cost credit from commercial sources increased by SDR 577 million. In consequence there was a significant deterioration of the debt profile. Another, and more worrying feature, was that the debt service to export ratio had by 1983 increased to nearly 22 percent. If workers remittances are aggregated to exports, the ratio declines to 18 percent. On the other hand, if the gains from terms of trade are excluded, the debt ratio would have been at least 24.4 percent or 19.8 percent depending on whether or not worker remittances are added to export earnings. (Debt service ratios appearing here are still considered slightly understated as not all FCBU lendings to GCEC enterprises have been identified.)”

Monetary Expansion

The heavy increase in private sector credit, in 1983, also caused much concern to the authorities and resulted in a tightening of monetary policy measures. Narrow money supply, M1, increased by 25 percent in 1983 as against 17 percent in 1982; going up from Rs.11,759.8 million

Table 6

Money Supply and Price Level

End of	Money Supply (Rs. Mn.)		Colombo Consumer Price Index (1952 = 100)	Central Bank Wholesale Price Index (1974 = 100)
	Narrow Money Supply (M1)	Broad Money Supply (M2)		
1978	5,936.4	10,892.1	227.8	156.7
1979	7,669.3	15,057.6	252.3	171.6
1980	9,428.2	19,860.2	318.2	229.5
1981	10,024.4	24,446.8	397.7	289.7
1982	11,759.8	30,509.9	423.7	291.5
1983	14,747.9	37,256.9	517.8	418.4
1984 Jan	14,964.3	38,277.2	523.7	454.4

Source: Central Bank of Ceylon

in December 1982 to Rs. 14,747.9 million in December 1983. But this increase took place mainly in the last quarter of 1983 as a result of excess liquidity in the economy due to the tea boom, increasing domestic credit and cumulative effect of budget deficits.

Certain unforeseen and extraneous factors like the July disturbances: speculative activity in the foreign exchange market and delays in the repatriation of export proceeds further complicated monetary management in 1983. The expansion in credit in the latter part of last year, had also resulted in increased inflationary pressures in the economy. Credit restrictions were therefore introduced by the Central Bank, as high levels of spending continued to chase prices beyond tolerable limits. The situation resulted in a credit ceiling on Commercial Bank advances with effect from November 1, 1983. The credit ceiling was withdrawn at the end of November and instead more traditional types of policy instruments were introduced for restricting credit: the reserve requirement of the deposits on Commercial Bank advances was increased by introducing a reserve ratio on unutilised balances of overdrafts allowed to the private sector by Commercial Banks, and by reducing the availability of accommodation under the penal rate for grant of advances; while commercial banks were required not to exceed quotas allocated to them under the bank rate for temporary liquidity requirements.

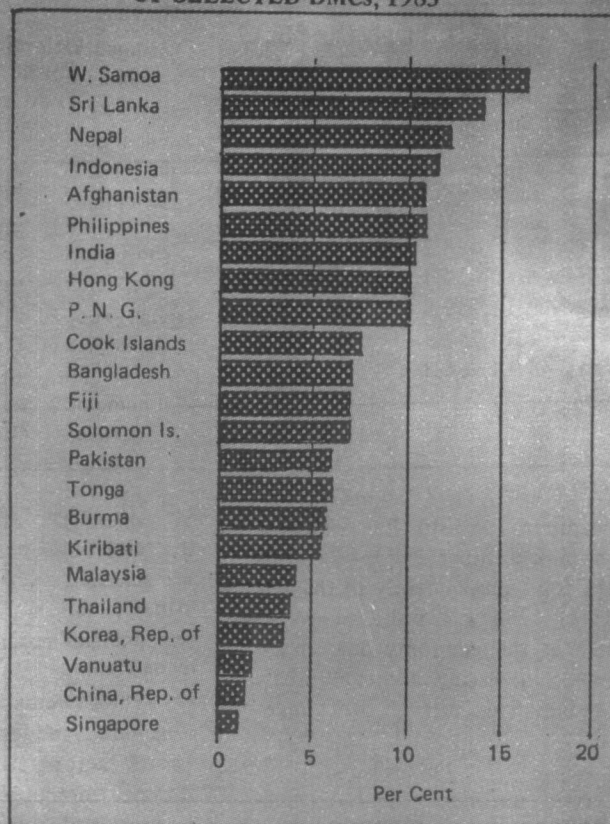
Monetary expansion, was held at the level of 22 percent with the policy measures affected in the latter half of 1983 which slowed down the rapid expansion of credit.

The increase in the money supply is generally dependent on three main casual factors, namely, domestic credit; net foreign assets of the banking system; and “other items”. In 1983 Sri Lanka’s monetary expansion was influenced mainly by the unprecedented increase in credit to the private sector and also the sharp rise in the country’s external assets during the last two months of the year.

The net foreign assets of the banking system have been an important factor in influencing the money supply in Sri Lanka. When there is an increase in net foreign assets an expansion in money supply takes place and this is what happened in the last two months of 1983 and at the beginning of 1984, when external assets (net) of the banking system increased by nearly 34 percent as compared with a decline of 19 percent at the same time one year earlier.

In November 1983, for instance, purchases of foreign exchange by the Central Bank from Commercial Banks (arising from high export proceeds) was almost Rs. 4,000 million, while drawings under an IMF Stand-by Arrangement, utilisation of a Japanese Yen loan and part proceeds of an Euro Currency loan raised the holding of cash and balances in the Central Bank

CHANGES IN CONSUMER PRICES OF SELECTED DMCs, 1983



PRICE TRENDS

The 1983 weighted average increase in consumer prices in the member countries of the Asian Development Bank - 7.8 percent - was lower than the 8.0 percent in 1982. Inflation rates declined in a majority of Asian countries. Republic of China, Republic of Korea, Malaysia, Singapore, Thailand and Vanuatu showed the lowest rates of inflation, with price increases ranging between 1 and 4 percent. The stable prices of foodgrains and oil, combined with domestic stabilization policies tenaciously maintained by Asian countries, helped control inflation. Inflation rates increased significantly or remained at relatively high levels in Afghanistan, Hong Kong, India, Indonesia, Nepal, Papua New Guinea, Philippines, Sri Lanka and Western Samoa. Depreciations of their currencies in relation to the US dollar were an important factor in the large price increases experienced by these Asian countries.

Source: Asian Development Bank Annual Report

by a further Rs 1,500 million. All these factors helped to increase the country's foreign assets considerably during this period. But when there is an increase in foreign earnings the Central Bank has to issue additional money through the banking system to settle the domestic part of these transactions. This pushes up the money supply.

The more influential factor, however, in the rise of money supply was an increase in domestic credit. In this regard, the Central Bank had to adapt various measures to hold the increase in money supply at a "desired" rate or level. The Central Bank's intention in adapting such restrictive policy

measures was also intended to achieve a degree of price stability. In Sri Lanka, particularly, it has been observed that the years which experienced the largest increases in money supply had also recorded a steep rise in the price index. A comparison of these two parameters brings out this position more clearly.

By early 1984 it was apparent that monetary policy alone, without supporting measures, would not be adequate in promoting growth and development under conditions of reasonable price stability within a free market atmosphere. Inflation, as measured by the available price indicators, accelerated, particularly

towards the end of the year. The Colombo Consumer's Price Index, which increased 10.8 percent in 1982, registered an increase of 14 percent in 1983; while the official estimate of the rate of inflation was 10 percent in 1982, 14 percent in 1983 and 20 percent in the first few months of 1984.

Prices

Although the relative degree of price stability achieved in 1982 (see box) continued into the first few months of 1983, by the middle of the year prices had started a steep climb. As already observed an important influencing factor was the rapid expansion of credit to the private sector and co-operative sector in the latter half of 1983, in order to meet the extra need for credit for rehabilitation after the ethnic disturbances and the increased response to bridging finance for export and trade financing. By December 1983, on a point to point basis, the Colombo Consumer's Cost of Living Index was observed to have increased by 21 percent. The average rate of price increase in 1983 as a whole was 14 percent, as compared with 10.8 percent in 1982. The Central Bank in analysing the factors responsible for the increases in the Cost of Living Index has pointed out that it was mainly the increases on items in the food basket, (which has a weight of 67 percent in the Index) that was instrumental in bringing about this situation. Two notable items were tea, which went up as a result of the upsurge in export prices, while coconut prices also rose to unprecedented levels. In addition the prices of flour and bread, bus fares and kerosene, were revised upwards.

The depreciation of the exchange rate and falling value of the rupee as a result of world exchange movements and the need to maintain a "real effective rate" of exchange was another important factor influencing the price situation. The changes in Sri Lanka's consumer prices were about the highest among the country's, in the Asian region according to the Asian Development Bank. (See diagram) In many of these Asian count-

rics which registered a high level of inflation, the depreciation of their currencies in relation to the US Dollar was an important factor in the heavy price increases they experienced. Except for the French franc, the Sri Lanka rupee depreciated against all major currencies in 1983. The depreciation of the rupee against the US dollar was nearly 15 percent, making it a cumulative depreciation of 36 percent against the dollar since November 16, 1977. Exchange rate movements show that the rupee value of the US dollar which was Rs. 21.32 at the end of 1982 had fallen to Rs. 25.00 by the end of 1983. The Asian Development Bank commenting on these trends in its annual report for 1983 states that "to improve the competitiveness of the economy the Government devalued the currency by about 10 percent in March 1983 and again by about 5 percent in July, while domestic administered prices of imported goods were adjusted in line with world prices and the new exchange rates."

Wages

The movements of real wage rates were limited with the acceleration in the rate of increase in prices and the slower rate of increase in nominal wages. While the Colombo Cost of Living Index for all items moved up from 416.1 points in 1982 to 474.2 points in 1983 and the Central Bank's Wholesale Price Index moved up from 283.3 points in 1982 to 354.1 points in 1983 the real wage rates for all grades of workers in wages boards and trades and government school teachers registered a fall during this period.

In the government sector money wages moved up slightly while in the organised private sector they increased 7 percent as against 16 percent in 1982.

In the unorganised private sector, however, the gains were more significant and according to Central Bank estimates nominal wages in the paddy and rubber growing sectors increased 18-19 percent.

Employment

The employment situation in the government, semi-government and

DOMESTIC PRICE MOVEMENTS

In the six year period 1978-83 the average annual rate of increase in consumer prices was about 15.1 percent. Among the causes for this sharp increase were the increasing international prices of essential commodities such as petroleum, the major revision of the exchange rate in 1977 followed by a further gradual depreciation of the currency in the last six years, and the periodic revision of the administered prices of basic consumer goods and services. A major contributory factor was the presence of excess demand conditions throughout the period caused mainly by heavy public investment outlays.

In 1983 domestic prices increased at a rate higher than in the previous year. However, the rates indicated by the Colombo Consumer's Price Index and the implicit GDP deflator are slightly lower in 1983 than the average for the previous five year period. The sharp increase shown by the wholesale price index reflects mainly the favourable price movements of the main export commodities.

Annual Average Price Increases 1978-1983 (Percent per annum)

	1978	1979	1980	1981	1982	1983
1. Colombo Consumers' Price Index	12.1	10.8	26.1	18.0	10.8	14.0
2. Central Bank Cost of Living Index	9.1	19.0	37.8	23.7	11.0	(n.a.)
3. Central Bank Wholesale Price Index	15.8	9.5	33.7	17.0	10.0	25.0
4. GDP deflator	8.3	15.3	20.0	21.4	11.0	15.0

Among the consumer goods, the fuel and light group, recorded the highest rate of price increase. This reflects mainly the increased prices of firewood and kerosene. The prices in the food and miscellaneous groups also increased due to upward adjustments of administered prices such as those of wheat flour and passenger transport fares. The international prices of Sri Lanka's main imports recorded a lower rate of increase in general in 1983 compared to the previous years. The rupee prices of these imports, however, increased due to currency depreciation and revision of several import duty rates.

Source: *Public Investment 1984 - 1988 pp. 26 - 27*

organised private sector appeared to be one of stability, although there were no appreciable gains. However, the restraint on government expenditure, particularly capital expenditure, and the policy of not admitting new projects into investment plans were deciding factors in narrowing down new employment opportunities in the government sector. The Central Bank reveals in its annual report that the semi government sector (corporations etc.) "under the imperatives of economic realities and financial discipline evidenced several instances of actual retrenchment. Increased employment in other corporations was

barely adequate to compensate for retrenchment. It is only in the case of enterprises based on foreign collaboration, namely the GCEC and FIAC, that some new employment creation was evident".

Capital Formation

The situation that the Sri Lanka economy underwent in the post liberalised period, though compounded by unfavourable international developments, arose basically in the attempt to force the pace of development through a heavy investment programme much in excess of available resources. Without much leeway

to draw on external assets dependence on concessional aid and commercial borrowings to finance Gross Domestic Fixed Capital Formation has been very high. The growth of Gross Domestic Fixed Capital Formation in 1983 increased by only 16 percent as compared to a 30 percent growth in 1982. This was partly due to the cessation of new investment projects in the public sector and also uncertainty in the private sector after the disturbances in July.

Fiscal Operations

The overall performance of the government's fiscal operations showed a considerable improvement during the year 1983 not only in comparison to the previous year but also when compared with the budgetary performance since the fiscal year in 1980. In recent years the fiscal imbalance and its method of financing has been a major source of instability for prices, the balance of payments and the exchange rate. The 1983 picture on the contrary reflected a concerted attempt to enforce fiscal discipline. The "austerity" Budget of 1983 focussed special attention on the savings effort of the Government in raising the level of domestic savings. This Budget not only emphasized the inevitability of drastic reductions in public spending but also pointed out the necessity to enhance the revenue base of the Government. In February 1983, several revenue augmenting measures were taken. These included the raising of basic BTT rates, imposition of duties on hitherto exempt imports and transfer of a part of the profits of the Central Bank to the Treasury. Further, tax concessions were limited to areas of highest development priority, which essentially covered the non-traditional exports sector. In 1983 the Government was therefore able to generate a Current Account surplus; also recourse to inflationary bank credit dropped to just one percent of GDP from over 4 percent earlier. Another important feature in fiscal operations was the improved revenue performance which was the main contributory factor influencing the final budgetary outcome.

Trends in 1984

The budget of 1984 was formu-

Table 7 Estimated Capital Investment 1984 - 1988

	(Rs billion)			
	1983	1984	1988	Total 1984-1988
Total Investment	35.5	37.5	43.8	202.9
of which				
Private	16.5	16.6	23.2	96.6
Public	19.0	20.9	20.6	106.3

Source: *Public Investment 1984 - 1988: Ministry of Finance & Planning.*

lated in the backdrop of the 1983-87 medium-term investment programme, which aims at a viable budgetary outcome and balance of payments. Budgetary management is regarded in the programme as a crucial step towards the reduction of the pressure on the balance of payments.

With favourable developments in the prices of plantation crops, it has been possible to revise expectations about likely government revenue. It is expected that in 1984 approximately an additional Rs. 1,500 million could be collected from the ad valorem tea tax. Present export price trends indicate that this is a realizable target. In the case of the export duty on rubber, an increase of about Rs. 350 million is expected in 1984. Import duties are expected to yield an increment to earlier budgeted figures amounting to over Rs. 300 million. A further inflow of Rs. 350 million is expected as contributions from the surplus of public corporations in accordance with a recent government decision. These and other factors are expected to increase government revenues by over Rs 2,300 million in 1984. Total current receipts are projected to be around 22 percent of GDP.

Between 1984 and 1988, the Government expects to achieve a structural transformation in resource utilization. Since restraints on public capital expenditures are expected to release resources for private sector development, the relative share of private resources for private sector development, the relative share of

private sector investment is projected to increase. Of a total investment of Rs. 202.9 billion envisaged over the period 1984-1988 the estimated share of public sector investment is Rs. 106.3 billion and private investment Rs. 96.6 billion. The private sector's relative share however, is projected to increase and finally overtake public sector capital spending by 1987-88. As seen in table 7 below, the private sector is expected to contribute Rs. 23.2 billion to the public sectors Rs. 20.6 billion by 1988.

In order to achieve the desired levels and structure of total investment, it is assumed that domestic savings will play a greater role than in the past. Both the public and private sectors are projected to contribute positively to this end. In fact, private savings are projected to grow faster and reach a level of 15.7 percent of GDP by 1988 as against an estimated 11 percent in 1984. Net external inflows of funds are projected to decline (see table 8) and this slack is expected to be taken up by the private sector.

The increase in the money supply by nearly 25 percent continued upto May 1984 and the Central Bank once again had to adopt measures to limit credit expansion. The increase in the money supply was also having its impact on prices with rate of inflation running at 20 percent by May 1984. The Central Bank was compelled to act as inflation kept going up and interest rates could not be brought

down despite the high level of liquidity. The Central Bank's present strategy is one of keeping down both inflation and interest rates not so much by changes in monetary policy as the attempt to promote stable prices and improve economic conditions. There have also been fears that pressure would build up on the country's balance of payments through higher prices. As observed from what took place earlier in the year, rising inflation together with the deterioration in the balance of payments caused heavy speculation on the exchange rates and it was in order to minimise the adverse effects of this trend on the economy that the Central Bank decided to restrict expansion of credit. The commercial banks were required to limit their credit expansion to the private sector only to 5 percent above the level of loans and advances reached on May 11. Earlier in the year too the Central Bank had prohibited commercial banks from expanding credit beyond their March levels for non-essential imports. The intention of the Central Bank has been to discourage

imports on non essentials while providing finance for exports and agriculture, including plantations. The Government, through the Central Bank, has been trying to improve the quality of credit flows and bring them in line with its development priorities.

In introducing these credit restrictions the hope of the Central Bank was that the market would adjust itself to importing of non essential goods using its own funds or borrowing from the korb market or from finance companies; but since the costs of such borrowed funds are high it was expected that a decline in non-essential imports would take place after a time. But it has been found that at times of credit restrictions the demand for this type of funds keeps increasing; and some non-essential imports continue to be financed by non-banking institutions at very high costs, which include interest charges, management fees and commissions that vary between 50 and 70 percent of the costs, but still there is a demand for such funds.

Inflationary pressures have built up, over the ten months since July 1983 and have resulted in pressures for higher wages from nearly all sectors, with plantation workers, government teachers and other sectors of government service forcing their demands.

In the first few months of 1984 it may be seen that inflationary pressures have been induced by two factors, namely, a steep increase in the money supply and scarcity/shortages of important food items that occupy a significant position in the cost of living index.

The weather, once again, has played a major role in creation of crop and food scarcities. In recent years, it has invariably been conditions of drought but in the early months of 1984 the position was reversed to one of excess rains and floods. Vital items in the food basket such as rice, vegetables, onions, chillies and fish have been affected as a result and prices of many of these items have

MEASURES TO CURB MONETARY EXPANSION

The Central Bank decided, in March 1984, to implement a series of monetary policy measures against the background of the emerging economic and financial situation. In the twelve months ended January 1984, the monetary expansion recorded 24 percent. This was the combined outcome of the rise in central banking assets and domestic credit. External assets rose on account of enhanced export proceeds resulting mainly from high tea prices which prevailed in the latter part of 1983. The expansion in domestic credit largely arose due to delay in repayments of bank advances arising from July disturbances and the extension of fresh loans to the private sector.

In order to restrain credit, the Bank resorted to selective credit controls with a view to limiting credit, on non priority imports and siphoning off excess liquidity. At the same time, there was an increased demand for working capital requirements of the tea sector following the tea boom and the Central Bank enhanced the refinance facilities under the pre-shipment export credit refinance scheme. With a view to reduc-

ing the cost of borrowing on exports the Central Bank introduced an interest rebate

scheme and linked the refinance facility with forward purchases of export proceeds.

The policy measures were:

- (1) Enhancing the export credit refinance facility from Rs 1.3 to Rs. 1.7 billion.
- (2) Implementing an interest rebate scheme enabling the exporters to receive an interest subsidy of 4 percent under the existing refinance scheme.
- (3) Reducing the maturity period of the pre-shipment refinance from 120 to 90 days.
- (4) Compelling exporters to forward sell their export proceeds to the commercial banks (exporters whose exports are below Rs. 500,000 at any one time will be exempted).
- (5) Requesting the banks not to afford cover on the importation of goods other than food, raw materials oil and oil products and pharmaceuticals.
- (6) Requesting banks not to expand credit beyond the level outstanding as at 23.3.84 for the importation of goods other than those specified and not to discount usance bills on other imports without permission from the Central Bank.
- (7) Requesting the banks not to extend credit to single importers beyond the level reached on 23.3.84 for the importation of non essential goods.
- (8) Withdrawing the general accommodation facility of Rs 108 million at Bank rate.
- (9) Informing the PNB to reduce the marketing refinance facility, and keep at any moment the outstanding facility to be less than Rs 400 million.
- (10) Imposing on finance companies a liquidity ratio of 10 percent of their total deposits.
- (11) Requiring the finance companies to maintain assets in the form of Sri Lanka Government Treasury bills and securities equivalent to 3 percent of the average of their end month deposit liabilities during the 12 months of the last financial year. This measure is to be made effective from 1st June, 1984.
- (12) Activating the open market operations through the secondary Treasury bills market with a view to absorbing the excess liquidity.

stayed at unprecedented levels for a considerable period. Unless there is a check on the rise of food prices it will not be easy bringing current inflationary trends under control, in 1984. The other factor is the money supply and excess liquidity to which the Central Bank has turned its attention.

tion of restrictions on credit over a prolonged period could cause a major slow down in the economy. At the same time the changes in monetary policy have to be so made that expectations of continued inflation are not encouraged.

The government would have to carefully evaluate the limits of possible policy choices that are now available

helped to keep the balance of payments situation within control. Private transfers, which have acquired significance in recent years are expected to increase by less than 4 percent per annum in the coming years. As a result of the tapering off effects in the Middle East job market. By 1988, however, improvement is anticipated in the trade balance (See table 8). The prospects for foreign aid, however, are much less propitious than they have been in the past and there are doubts as to whether Sri Lanka would in the future receive foreign aid on the same scale as before. It means that the country will have to rely far more on its internal resources and own internal efforts to correct the serious imbalances in the economy.

The period from 1978 to 1983 is characterised by high investment levels which were largely introduced by government policy. This period has witnessed a substantial increase in the flow of foreign investment and also in national savings which has enabled the country's gross domestic investment to rise from an average of 16 percent of GDP in the preceding seven year period to an average of 27 percent of GDP during this period.

The sustained expansion in government spending and increased activities in the private sector have, as we observed, led to a general expansion in the monetary system which was further aggravated through the developments of the last months of 1983. While production and investment levels increased a number of adverse features have also emerged in the economy. To sum up in the words of the Minister of Finance and Planning, Mr Ronnie de Mel, in the course of an address to Government Agents this year: "while we have made very substantial gains, massive economic problems still remain. I have never tried to conceal the very serious nature of the financial and economic problems which we still face and the many difficult and painful decisions which the Government must take if we are to overcome them."

The Central Bank of Ceylon Annual Report for 1983; and the Finance Ministry's Public Investment Programme 1984/88, as sources, are duly acknowledged.

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Table 8 Balance of Payments 1983, 1984 & 1988 (1)
(U S \$ Million)

	1983	1984	1988
1. Merchandise			
(a) Exports	1056	1324	1679
(b) Imports	1920	2058	2361
2. Trade balance	-864	-734	-682
3. Non factor services (Net)	80	75	178
4. Factor services (Net)	-136	-168	-232
5. Private transfers (Net)	273	281	330
6. Current account balance	-647	-526	-408
7. Net aid disbursements	423	408	382
8. Directo foreign investments	38	43	50
9. Other MLT loans Government	77	13	30
10. Other MLT loans: Private Sector and Public Corporations	74	111	20
11. Progress/Advance Payments	-71	-16	-17
12. Other financing items(2)	52	-33	-59

Source: *The Central Bank of Ceylon Annual Report for 1983*

Note: 1 Figures for 1983 and 1984 are at current market prices while those after 1984 are at 1984 constant prices.

2 Includes short-term borrowing, errors & omissions valuation adjustments and changes in reserves.

The Central Bank has been devising various measures to influence the liquidity position in the financial system, and was attempting to bring down money supply from its current growth rate of 25 percent to 15 percent by the end of 1984. The Central Bank in its attempt to siphon off part of the excess liquidity has engaged in open market operations on a limited scale and is also as a further measure issuing its own securities by auction. Caution, however, would have to be exercised when attempting to reduce the demand for funds; it could compel businesses to use their own funds but could also lead to decline in production or employment. Furthermore, continua-

in order to coordinate short-term stabilization policies with medium-term structural adjustments of the economy. Resources have to be diverted to the productive sectors but in doing so it is necessary that the government budget does not also preempt large resources from the private sector. This may be avoided by generating a surplus in the budget and curtailing capital expenditures.

In recent years, the foreign trade position has been completely out of balance and it has been mainly private transfers (from remittances abroad) and official aid transfers that have