THE AID SITUATION FOR SRI LANKA

Sri Lanka was among the group of non-oil exporting developing countries that had suffered from an inadequacy of resources, both local and foreign, to implement its development programmes and also had to operate under the strain of an increasing debt burden.

After World War 11, Sri Lanka was in the fortunate position of reapong the benefits of an export boom with its absolute values of exports showing a continuous expansion in each succeeding year upto 1952. In 1950 the external assets of Sri Lanka were sufficient to meet 92 percent of her annual requirements. External assets went on to reach record levels of Rs.1,276 million in 1956. Thereafter the decline set in and by 1960 the external assets were sufficient to finance only 21 percent of the country's annual import bill.

Strength of the country's external assets seem to have been taken for granted and there was no concerted effort to increase domestic production or curtail imports. Despite an increase in the volume of exports, in the absence of price increases in imports, and with the increasing volume of imports, external assets continued to be depleted during the 1957–60 period.

A conspicuous feature of Sri Lanka's economy over the past three decades has been the problems associated with managing the external assets situation, mainly due to the recurring deficit of current account of the balance of payments. Since 1957 payments on current account have exceeded current receipts, almost every year, leading to a severe depletion of Sri Lanka's foreign exchange resources. Among the factors responsible for this situation were the adverse movements in the terms of trade and the difficulty of containing imports to a level compatible with the level of external assets available to the country. The gravity of the balance of payments situation began to be felt with the severity of payments and import controls introduced in the 1960's and carried on more intensively into the 1970's.

Sri Lanka's major exports of tea, rubber and coconut suffered from world market price declines over the 1960's. The country's heavy dependence on foreign trade was apparent at this stage and levels of real national income fluctuated with the variations in the terms of trade. The terms of trade rose from 100 in 1948 to 150 in 1956 and fell to 115 in 1963. These adverse movements reduced seriously the amounts of imports that export earnings could buy and lowered the real national income. Purchasing power in the mid 1960's was rising faster than the real national income and imports in excess of export earnings were drawn in to fill the gap. This became possible for a time by running down accumulated foreign reserves, but it only resulted in aggravating the supply situation and a deterioration in the country's capital stock. Import restrictions had therefore to be tightened. In 1965 the foreign exchange allocation for food stuffs and other basic goods had to be reduced by Rs.200 million (a considerable slice of the foreign exchange budget at that time) below the 1964 levels.

There appeared to be little choice for Sri Lanka at this juncture other than resorting to foreign aid. The problem of the scarcity of foreign exchange was aggravated as a result of the mismanagement of resources in the past. Had a concerted effort been made to curtail imports, with a suitable import substitution programme at an earlier stage, as occured for example in India when the external assets were still available, perhaps the situation could have been averted, when import prices started increasing

Export reserves at this stage were depleted and exchange earnings were no longer sufficient to meet basic consumption requirements and provide the inputs necessary for the country's development efforts and long term economic growth. It was in this environment of crisis and threat of economic stagnation that in 1965 the "Aid Group" was formed to deal with the crisis which confronted the country's economy.

Sri Lanka entered into a standby agreement with the IMF in 1965, which was originally for an 18 month period. However, the problems associated with the trade deficit continued and further access to the IMF facilities was necessary. Sri Lanka's problems were seen as something more than of a short-term nature and the Sri Lanka "Aid Group" which was formed at this stage, under the auspices of the World Bank, was expected to bring relief.

The Government made an urgent request for aid from the World Bank. An IBRD and IDA team visited the country in 1965 and reported "it will not be possible for Ceylon to set about the task of restoring its economy to a level where it can function smoothly and where the stage is set for accelerating growth, without a large amount of additional foreign aid. This task will be an emergency operation. It will require flexibility on the part of potential donors in tailoring their assistance to the most urgent needs of Ceylon's economy. For 1965 and 1966, these needs will be mainly in the form of maintenance imports, not of financing specific investment projects"

At the time the Sri Lanka Aid Group was formed the external resource requirements of Sri Lanka were estimated to be around US $ 100 million. This was based on projections which expected that a growth in the export volume would offset the price decline. This was not realised and Sri Lanka received less aid from the Aid Group which eventually necessitated other short-term finances from the IMF and other funds as well as from the foreign commercial banks. The $ 100 million target was not met by the Aid Group countries but from project loans, mainly from the World Bank and the Asian Development Bank

The decade of the 1960's witnessed the growth of a manufacturing industrial sector in the country. A large part of the impetus in these initial stages of industrialization came from the protection given to the local market through the forced imposition of import controls, due to the lack of foreign exchange. One benefit found to have accrued from the exchange "crisis" situation was the encouragement that local production, both industrial and agricultural, received during this period. More evident, however, was the stagnation in many sectors of the economy which resulted from the import and exchange controls. Export earnings remained stagnant, while prices of imports kept rising, which only further aggravated the situation created by the foreign exchange shortages. This situation brought into sharper focus the need for external assistance.

During the period from 1960–1970 a total of approximately Rs.2,559 million was committed in the form of external assistance for Sri Lanka. (See table 3) Canada, USA, UK and the West European countries pledged nearly 60 percent while the share of the Socialist Bloc countries during this period was about 25 percent. A large part of the aid flow was in the second half of the decade, mainly as a result of the "Programme" assistance that began to come in during the late 1960's.

In 1969 and 1970 the external resource gap (the difference between total foreign exchange earnings and total foreign exchange payments) exceeded Rs. 1,100 million, which was about 50 percent of the country's total foreign exchange earnings. This was in sharp contrast to the situation in the earlier half of the decade when the external resource gap ranged between Rs 125 million and Rs 350 million.

The growing foreign exchange gap was financed by resort to external borrowings. As the balance of payments crisis deepened and the external resources gap increased, government had greater recourse to short-term borrowing adding further immediate burdens on account of debt servicing. The foreign debt increased from Rs.374 million in 1964 to Rs 1,551 million in 1970. In each of the years 1969 and 1970 the external resource gap of over Rs 1,000 million was financed to the extent of over Rs 600 million by short-term borrowings. In 1970 the situation was such that more than 65 percent of the gross borrowings of Rs.1,124 million was required for servicing repayment of debts.

Table 4 above right indicates that out of the country's foreign exchange earnings in 1970 nothing was left for investment in development.

Table 3 Economic Assistance Pledged by Source as at 1970*

Source	Volume of Assistance pledged (Rs. Million)	As % of total
U.S.A.	585,241,646	22.9
Canada	119,835,245	4.7
U.K.	294,464,337	11.5
'Other' Western European	419,232,456	16.4
Socialist bloc	638,097,367	24.9
Japan	148,809,600	5.8
India	79,364,622	3.1
International Institutions (Multi-lateral sources)	274,084,540	10.7
Total	2,559,129,813	100.0

* Excludes Grants received

Source: *Staff Studies–Central Bank of Ceylon P.97. Vol. 3. No.1, April 1973.*

The Government's Five Year Plan 1972–76 quoting the above figures argued that "after servicing the foreign debt the foreign exchange remaining was insufficient to buy the essential requirements listed above, let alone import the machinery and other capital goods necessary for economic development. This is at the heart of the economis crisis confronting the country.

In this situation it is not possible for the country to continue with the policies of the past - to spend more than it is earning and to continue indefinitely increasing the foreign debt. The crippling burden of debt repayments together with the existing imbalance between imports and exports must necessarily exercise a dominating influence on the choice of a strategy for the Plan"

Table 4 Foreign Exchange Earnings and Expenditure on Selected Items 1970

		Rs. mn
1.	Total foreign exchange earnings	2,264
2.	Imports –	
	(a) Food	1,069
	(b) Textiles	124
	(c) Drugs	29
	(d) Other consumer goods	72
	(e) Intermediate goods	451
3.	Debt servicing (Capital repayments and interest on all foreign debt)	757
4.	Total of items (2) to (3)	2,502

Source: *The Five Year Plan, 1972–76*

The government that came into office in May 1970 found that it was confronted with a short term unfunded debt of over Rs. 700 million. This debt was showing a tendency to grow rapidly as the short term foreign liabilities (with a maturity of less than 12 months) were close to Rs130 million by mid 1970. Dr.Buddhadasa Hewavitharana, who became Economic Advisor to the Ministry of Finance after May 1970, described the critical situation in a paper as follows: "The reserves of the Central Bank were fast declining towards zero level and the lines of credit negotiated with foreign banks in the past, which had served in effect as its working balances were almost all drawn. The total external assets were at a critically low level and only a fraction of these were available in liquid form. A bunching of capital repayments was due to occur soon, due to the ending of the grace periods of a large number of loans taken in the mid and later sixties (implying that capital repayments would begin) and the maturing of suppliers' credits taken in the late sixties. Large purchases were due to be made from the IMF and repurchases were continuing to be in excess of the purchases. Settlement had to be reached with the German Kreditanstalt on the repayment of the loan of Rs.50 million in which the country was in default. A situation in which amortization of the official debt together with interest on short-term credits would pre-empt 25 percent of the exchange earnings or as much as 33 percent including the capital repayment on short-term credits (at the pack in 1972) also had to be faced".

The Government therefore decided to resort to drastic measures which included: (1) the scrapping of the OGL System and placing all imports under licensing and quota allocations; (2) reducing heavily the allocation of foreign exchange to private sector industries; (3) tightening up on the entire import programme. With the severe import restrictions the merchandise and current accounts showed a marked improvement and there was even an overall surplus of Rs 46 million in the following year. The scaling down of the current account deficit and improvement in the foreign exchange resources position may have provided temporary relief but did not in any way represent a fundamental improvement in the balance of payments or in the general performance of the economy. The basic problems of the adverse terms of trade, falling export performance, heavy external indebtedness and economic stagnation still remained.

There was no doubt that the relief was only temporary and the cutting down on imports and current account deficit would not help the economy in the long run.

The foreign exchange reserves position seems to have been improving in the early 1970's but it was clear that these short term improvements in the situation were due to a slack demand for imports arising from economic stagnation. The compulsion to confine the limit of foreign expenditures to the level of external resources available worked in direct opposition to fostering economic growth.

The Government attempted to eliminate the need for short term overseas loans by repaying the Central Bank borrowings and reaching agreement with the foreign banks whereby loans with maturity of less than 12 months (Rs 120 million) were to be repaid over the five year period beginning in 1972. After 1970 no new lines of credit were negotiated with the foreign banks and for a time they disappeared as a method of financing the resource gap. This was made possible largely through a long term loan from China. Supplier's credits (which are also costly loans) were deliberately limited and very few credits of one to two years maturity were approved. This resulted in a rise in share of long and medium term loan capital from 43 percent in 1970 to 54 percent in 1972, although it fell to a low level of 31 percent in 1973.

In the early 1970's a significant feature of the foreign debt situation, particularly drawings from the IMF, was that the Fund was not a net supplier of foreign exchange since Sri Lanka's re-purchases were in excess of its purchases. The overall credit picture that emerged in the early 1970's however, was the rapid increase in short term credit in both their relative share as well as volume. They increased from 15 percent in 1969, (Rs 185 million); to 48 percent (Rs 658 million) in 1971; and 69 percent (Rs 875 million) in 1973. Although Sri Lanka's reliance on suppliers' credit and costly short term debts had declined in these years, it was still necessary to continue borrowing short term in order to pay off outstanding obligations. There was a progressive improvement in the deficit payment due to debts incurred in the past. Only 41.6 percent of the foreign resources raised in 1970 could be utilised to meet the deficit in current account, while the balance 58.4 percent had to be used to meet capital payment.

The Government was not able to keep to its intention of eliminating supplier credits and in 1973 and 1974 it once again resorted to this form of credit to finance imports of wheat flour and grain from Australia, France and the United States. These credits had short maturities and caused tremendous repayment burdens.

There was also a build up in the use of short term trade credits from 1970 as seen in the table below

Debt Burden

The former Director of the External Resources Division of the Ministry of Finance and Planning and Economic Affairs Nihal Kappagoda, in a paper on the "External Debt Problem" presented the following table.

It is seen that the debt service ratio increased from 3.5 percent to over 22 percent in 1973 and was reduced to 17.9 percent due to the higher level of export earnings in rupee terms realised next year. The repayment of short-term trade credits which are rolled over has been left out of this computation. However, the repayment of suppliers credits and IMF repurchases accounted for 68 percent of total amortization payments, clearly illustrating the greater debt service burden caused by shorter term borrowings.

Table 5 **Debt Service Payments**

(Rs. Million)

	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
1. Debt Service Payments										
(a) Amortization	52	84	84	174	214	354	387	379	512	549
(b) Interest	22	25	33	42	68	100	104	102	108	134
Total	74	109	117	216	282	454	491	481	620	683
11. Earnings on exports of goods and services	2108	1878	1860	2223	2163	2253	2243	2206	2735	3821
111. Debt Service Ratio	3.5	5.8	6.2	9.7	13.0	20.2	21.9	21.8	22.7	17.9
1V. Breakdown of 1 (a)										
IMF Repayments	36	54	18	48	87	161	145	170	169	162
Official Loans	16	30	45	61	77	113	96	125	148	173
Suppliers Credits	–	–	21	35	50	80	65	84	95	214
Bank borrowings from Abroad (net)	–	–	–	29	–	–	81	–	112	–
Total	52	84	84	174	214	354	387	179	512	549

Source: *Marga Institute, Quarterly Journal Vol. 3 No.1, 1976.*

The disadvantage in this form of credit was that a particular volume of short term trade credits would result in a diminished volume of imports

The reliance on the International Monetary Fund as a major source of financing for imports began in 1965, with the negotiation of the first Standby Agreement with the Fund. Subsequent agreements were entered into with the Fund to finance stabilisation programmes of the Government, including one that was approved at the time the dual exchange rate system was introduced. In addition to drawings made under successive Standby Agreements, financing was also made available during the ten – year period under the Compensatory Finance Scheme for export fluctuations, the allocation of Special Drawings Rights over the three year period 1970 – 72 and the drawings made available by the IMF under its Oil Facility.

Striking a warning note he stated that increasing the levels of official assistance on favourable terms would not add substantially to the debt burden over the next 5–10 years due to the built-in grace period, but a continuation of borrowings of shorter maturities compounded with the high reliance on short-term trade credits and bank borrowings, which have been increasing at the rate illustrated in the table, would undoubtedly create a critical debt service situation over the next few years. In other words, due to the accumulation of short-term debts, a continuation of extensive borrowings at this end of the maturity scale could place the country's credit worthiness in the future seriously in doubt.

During the seven year period 1970–1977 the economic environment and policies persued at that time failed to promote growth in most sectors of the economy. Production failures occured in both the agricultural and industrial sectors. The manufacturing sector, particularly, suffered for the want of raw materials, intemediary goods, spares and components, Throughout the period, with the exception of 1977, the balance of payments continued to be under severe pressure with declines in export earnings from tea, rubber and coconut, and increases in the import prices of food, oil and fertilisers. In the wake of mounting balance of payments deficits, the Government had resorted to a policy of stringent import and exchange controls and resources to short-term credits. This had further pushed up the cost of imports. Meanwhile, the mounting debt service burden aggravated the foreign exchange problem, especially in the aftermath of the increasing oil prices.

This prolonged period of stagnation in the agricultural, industrial and services sectors, combined with inadequate levels of savings and investment had reduced the economy to a run-down condition. From July 1977 the new government decided on a programme in which one of the basic objectives was to reduce the pressure on the country's balance of payments. This programme which introduced a more liberal exchange and trade system from November 1977 needed to fall back heavily on external resources for its implementation. To meet basic supply and demand requirements of the economy and a minimum level of investment a continued inflow of foreign resources was required. Thus, although there was a considerable trade deficit in 1978 this was offset by a continued high level of official transfers and sharply increased aid and other net non-monetary capital receipts from abroad. These movements in the net international reserves, resulted in an overall surplus of about SDR 65 million in the balance of payments. The basis of the new programme was a shift from import substitution to export oriented policies. The intention was to increase significantly the export of non-traditional goods in order to reduce the economy's vulnerability to fluctuation in prices of primary commodities. The rationale was that until exports become a dynamic sector, the balance of payments situation will have to be safeguarded through the mobilization of foreign resources. According to an official statement the strategy for the realization of these objectives was to be based on the resource endownments domestically available, and support that could be mobilized from the international community. "Sri Lanka's economic growth is critically dependent on the capacity to import the raw materials for the productive sectors and the capital goods necessary for the expansion of production capacities. The investment and growth possibilities will, therefore, depend on adopting policies aimed at investment and production incentives and on the extent of foreign and domestic resources that could be mobilized during the medium – term".

Unfortunately Sri Lanka's balance of payments has continued to deteriorate. The deterioration in terms of trade has been a major contributory cause; particularly the poor performance of exports, mainly tea, rubber and coconut. The result is that the picture presented in the balance of payments situation over the last five years is one of a sharp increase in the value of imports and payments on the invisibles account, a very slow growth in the value of exports and large increases in private inward remittances. The balance on the current account had deteriorated from a deficit of SDR 121 million in 1978 to a deficit of SDR 622 million in 1982. This gap has arisen almost entirely due to the adverse trade account.

Favourable Terms and Heavy Commitments

Sri Lanka was fortunate in obtaining very advantageous terms for external fianancing of its development expenditure. During the five years from 1978 the major part of this external financing has come in the form of official grants and concessionary loans. The Government's call for large commitments of aid to finance its major development projects, particularly the Accelerated Mahaweli Development Programme, met with very favourable response. The result was a heavy increase in aid commitments. The table below shows how the level of financial capital increased at a high rate during this period; the greater availability of foreign recourses being an important contributory factor for this trend.

Table 6

Financing of Imports*

(Rs. Million)

	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973	1974
1. Imports	1960	1922	2018	1985	2356	2655	2332	2218	2153	2644	4603
11. Sources of foreign financing											
(a) Official aid											
Loans	78	77	173	212	295	362	299	498	415	335	462
Grants	76	65	51	46	23	46	75	105	100	94	282
(b) Suppliers credits	–	–	–	38	86	176	85	58	52	240	429
(c) Short-term trade credits	n.a.	n.a.	n.a.	n.a.	84	185	434	658	593	769	836
(d) Bank borrowings (net increase)	–	–	–	57	–	227	123	–	12	–	16
(e) IMF drawings *	–	109	144	123	213	77	135	146	225	137	377
Total	154	251	368	476	701	1073	1151	1465	1397	1575	2402
111. Foreign financing as a percentage of imports	8.0	13.1	18.2	24.0	29.8	40.4	49.4	66.1	64.9	59.6	52.2

* Including SDR allocations and oil facility drawings

(Over the six year period 1977–1982 the value of one SDR averaged US $1.22)

Source: *Marga Institute, Quarterly Journal. Vol. 3 No. 1 1976*

With a large programme of public investment on its hands, in a period where domestic resources have continued to be scarce and the demand for imports rising, the Government has seen no alternative to seeking foreign exchange on a substantial scale in the medium term. But financing gaps have emerged in the Government's Investment Programme, from 1980 onwards. The scale of the programme has therefore been reduced in response to increasing resource limitations. It has also become necessary to resort to foreign borrowings on commercial terms. Of the total amount of disbursed external debt outstanding in 1982, about 73 percent is in respect of borrowings from foreign governments and international organisations. with only about 25 percent in the form of commercial borrowings. It is expected that a small amount in respect of borrowings of the latter category will be required even in the future. However, the structure of debt ownership is unlikely to change appreciably. The table at right shows the debt service payments as projected by the Finance Ministry, for the period 1983 to 1995.

Table 8 Projected Debt Service Payments 1983–1995 on External Debt*

(US $ Millions)

	1983	1985	1990	1995
1. Debt serving on debts incurred upto end of 1982*				
(a) Amortization	72.8	130.2	105.9	80.5
(b) Interest	101.6	107.5	47.4	33.6
2. Debt servicing on debts incurred during 1983–1987				
(a) Amortization	–	45.4	114.4	68.4
(b) Interest	7.2	48.9	78.8	45.1
3. Total debt servicing on debts incurred upto end of 1987				
(a) Amortization	72.8	175.6	220.3	148.9
(b) Interest	108.8	156.4	126.2	78.7
4. Projected earnings on exports of goods and services	1506	1874	3320	6116
5. Debt service ratio:percent	12.1	17.7	10.4	3.7

* Medium and Long Term debt only , excluding IMF transactions.
** Upto September end 1982, Source C Bank

Source: *Public Investment Programme 1983–1987*

Table 7. Foreign Aid Commitments/Disbursements and Fixed Capital Formation 1977–1982

US$ Million

	1977	1978	1979	1980	1981	1982
1. Foreign Aid						
(i) Commitments	254	400	569	628	815	577
(ii) Disbursements	254	261	268	326	437	415
2. Fixed capital formation						
(i) Public sector 2 3	185	329	413	742	688	853
(ii) Total 3	386	546	851	1261	1210	1414

1. Include non-aid Group Assistance
2. Public Sector including extra Budgetary investment.
3. FEEC rate (Rs US S) for 1977 and respective nonfixed rates for other years.

Source: *Public Investment Programme 1983 - 1987*

Foreign aid disbursements in the period 1982–1986 will depend to a large extent on the rate of implementation of the aided projects in the Public Investment Programme. A large proportion of the Budgetary Public Investment Programme (about 66 percent in 1983) is financed through foreign aid. Of the already commited aid, disbursements on the various Mahaweli Projects are expected to reach a peak of about US $ 200 million in 1984. For purposes of making a projection of aid disbursements for the period 1983–1987, it has been assumed that total gross foreign aid disbursements expressed as a percentage of GDP will decline from 11 percent in 1983 to about 8 percent in 1987.The aid disbursements on the Mahaweli Projects have been related to the actual implementation schedules and the aid commitments already made. Any disbursements from new commitments for Mahaweli Projects made in and after 1983 would therefore alter the allocation of toal aid between Mahaweli and non-Mahaweli

The implications of this reliance on foreign aid, and projected levels of foreign borrowing, on the future debt servicing commitments have been closely considered. Present projections for the period 1983–1987 indicate that, on the average a net borrowing of about US S 523 million per annum will have to be made. This corresponds to a gross borrowing of approximately US S 700 million of which 69 percent is expected to be on concessionary terms.

The bulge in the mid 1980s is the consequence of commercial loans obtained by the Central Government, same Public Corporations and the national airline. The two latter loans were for purposes of acquiring capital assets which are expected to yield sufficient foreign exchange to meet their respective debt servicing commitments.

The picture that emerges from the resulting debt service commitments shows that amortization and interest payments on foreign long and medium term debt (excluding IMF transactions) should reach a peak of about US $ 472 million in 1988. This represents a debt service ratio of 18.2 percent. It is expected that the debt service payments will taper off after 1987 and by 1995, the ratio is expected to be below 10 percent.

FOREIGN DEBT AID AT END OF 1982

Debt Outstanding

The total foreign debt outstanding as at the end of 1982 amounted to Rs 34,597 million, recording an increase of Rs 5,425 million or 19 per cent over 1981. This compares with an increase of 31 per cent in 1981 over the previous year. The share of foreign debt in gross public debt decreased marginally from 45 per cent to 43 per cent in 1982. Foreign loans continued to be an important source of budgetary finance accounting for about 28 per cent of the net cash deficit. The gross receipts of foreign loans in the form of project, commodity and cash and other loans in 1982, amounted to Rs 5,701 million, registering an increase of 4 per cent over the previous year. Project loans' amounted to Rs 3,256 million (57 per cent), while commodity loans and cash loans amounted to Rs 1,355 million (24 per cent), and Rs 1,090 million (19 percent) respectively.

Foreign Assistance 1978–1982

Rs. Million

	Item	1978	1979	1980	1981	1982 Provisional
1.	Gross Receipts	3,716.6	2,878.4	4,115.8	5,486.7	5,701.3
2.	Repayments	501.4	499.2	599.8	606.6	673.6
3,	Net Receipts	3,215.3	2,379.2	3,516.0	4,880.1	5,027.7
4.	Change in liability due to exchange rate variations	773.0	316.6	2,921.3	2,162.6	440.2
5.	Liability as at end of period*	14,582.3	15,840.8	22,276.8	29,172.1	34,597.4

Source: *Central Bank of Ceylon.*

* *Adjusted to include Rs.0.5 million, Rs. 804.4 million, Rs. 1.3 million and Rs. 42.7 million being written off balances in 1978, 1979, 1980, 1981 and 1982 respectively.*

Summary of Utilization Rates of Foreign Loans Contracted by Sri Lanka 1970–1982

Year	Amount contracted during the year Rs. Mn *	Amount utilized upto 31st Dec. 1982 Rs. Mn *	Amount utilized upto 31st Dec. 1982 Rs. Mn *	Utilization rate upto 31st Dec. 1982 (percentage)
1970	1,083.0	1,026.8	56.2	95
1971	1,619.4	1,586.9	32.5	98
1972	2,288.7	1,327.4	961.3	58
1973	1,412.7	1,387.1	25.6	98
1974	1,791.8	1,662.5	129.3	93
1975	5,309.1	3,956.0	1,353.1	74
1976	2,572.8	2,261.5	311.3	88
1977	2,822.1	2,356.3	465.8	85
1978	6,943.0	5,638.5	1,304.5	81
1979	7,231.6	4,852.1	2,379.5	67
1980	11,060.2	3,648.1	7,412.1	33
1981	14,561.0	3,917.6	10,643.4	27
1982	9,762.8	1,968.2	7,794.6	20
1070–1082	68,458.2	35,589.0	32,869.2	52

Source: *Central Bank of Ceylon.*

* *Converted into Sri Lanka Rupees using exchange rates (middle) as at 31.12.1982.*

Repayments

Repayments of foreign loans during 1982 amounted to Rs 674 million, of which Rs 402 million (60 percent) was on commodity loans, Rs 204 million (30 percent) on projected loans and the balance Rs 68 million (10 percent) on cash and other loans. When adjusted for repayments, net disbursements under foreign borrowings during the year amounted to Rs 5,027 million in comparison to the previous year's Rs 4,880 million. The amount outstanding increased by Rs 440 million due to the depreciation of the Sri Lanka rupee with respect to other currencies. This compares with an increase of Rs 2,163 million in the previous year.

New Loans

Twenty six new loan agreements were signed in 1982 comprising 18 for project loans, 6 for commodity loans and 2 for cash and other loans. The total value of these loans as at 31 December, 1982 amounted to Rs 9,763 million. In comparison, agreements were signed in 1981 for 25 loans amounting to Rs 14,464 million.

Utilization

As at the end of 1982, the aggregate utilization rate for loans contracted since 1970 was 52 percent in comparison to 50 percent in 1981. While the level of utilization of project loans was 32 percent, commodity loans and cash and other loans recorded a very much higher rate of 83 percent and 85 percent, respectively. It was significant that the relatively more expensive cash loans which were fully utilized in the previous years were not utilized in 1982. Of a Euro-Currency Commercial loan of US $ 100 million contracted in 1982, only US $ 40 million was utilized during the year. Among the loans contracted in 1981, there were 5 loans amounting to Rs 1,544 million on which withdrawals did not commence until the end of 1982.

Central Bank of Ceylon, Review of the Economy, 1982.

Sources and Forms of Foreign Resource Flows

During the 1966–70 period when Sri Lanka's external resource needs came into greater focus, there was a tendency to accept more and more commodity Aid, as it was the easiest and quickest form of aid to disburse. By the early 1970's Sri Lanka had about 25 donors both bilateral and multilateral.

As Sri Lanka became more dependent on the Aid Group, it became necessary to follow the usual prescriptions of the World Bank. The necessity for diverting resources towards growth with less emphasis on welfare and consumption was the key policy requirement. Sri Lanka had no option but to follow this path; though it should be noted, this policy has not been entirely without its beneficial results and Sri Lanka experienced higher rates of overall growth than several other developing countries in the region.

Furthermore, the rate of Sri Lanka's debt service repayments were comparatively lower than most other countries in the region which had debt service ratios of between 20–30 percent. According to World Bank data the debt service ratios as a percentage of export earnings in 1970 was 20.9% for India, 23.6% for Pakistan and 22.1% for Burma; while Sri Lanka's ratio was 10.3%.

In the 20 years upto 1969 Sri Lanka had received external assistance from 17 countries, which amounted to Rs.1,888. The grant element was just over one quarter of the total aid received, as seen in table 9. The grant element in the multilateral aid was only 15 percent while in bilateral aid it was close to 30 percent of the total. The interest rates on the two types of aid were 5.1% for multilateral and 3.0% for bilateral.

It was unfortunate that over the 1950's and 60's the share of grants in total external assistance received by Sri Lanka kept declining, with increasingly adverse implications on her balance of payments. Countries such as Australia, New Zealand and Sweden and the UN agencies gave aid in 100 percent grant form, while others provided almost the entirety in the form of loans; and terms varied considerably according to source and purpose; while most of the loans had to be paid back in convertible currency. One Central Bank study in 1975, found that in these two decades the terms of assistance for Sri Lanka appeared to be less favourable than those applicable to global aid flows.

Table 9 Sources, Magnitudes and Forms of Aid Received by Sri Lanka, 1950–1969*

Rank	Source	Total	Grants (Rs.million)	Loans	Grants as % of Total
1	U.S.A.	417	84	333	20.1
2	Canada	255	180	75	70.6
3	U.K.	225	18	207	8.0
4	I.B.R.D.	178	–	178	–
5	F.R.G.	170	15	155	8.8
6	People's Republic of China	126	70	56	55.6
7	Japan	101	2	99	2.0
8	U.S.S.R.	95	–	95	–
9	G.D.R.	89	–	89	–
10	Australia	69	69	–	100.0
11	France	60	5	55	8.3
12	India	37	–	37	–
13	United Nations	30	30	–	100.0
14	New Zealand	12	12	–	100.0
15	Yugoslavia	9	–	9	–
16	Sweden	9	9	–	100.0
17	Poland	6	–	6	–
18	Others	7	3	4	42.9
	Total	1,895	497	1,398	26.2

* *Upto September, 1969.*

Source: *Staff Studies, Vol.5 No.1, April 1975.*

After 1970 the balance of payments problem increased with greater intensity and there was more need for resort to external assistance in these years. The number of donors exceeded thirty, with nearly seven multilateral groups among them. As seen in table 10, the quantum of aid over the seven years from 1970–77 was Rs 1,428 million of which 73 percent was in the form of loans, and 27 percent came in as grants. Among the countries whose assistance came in as 100 percent grants were Sweden, Australia, Yugoslavia, Italy, Norway, Switzerland, GDR and Saudi Arabia; while the multilateral agencies giving 100 percent grants were the UN group and the EEC. The Aid Group package of assistance was now stabilised and almost 75 percent of the aid to Sri Lanka came in through this channel in the 1970/77 period. Over the next six years almost 90 percent of official development assistance came in through this channel as seen in table 11.

Table 10, **Commitments of ODA 1970–77 (US $ Millions)**

	Donor	Total 70–77	Of which Loans	Grants	Percentage Loans	Grants
A						
1.	U.S.A.	176.2	148.93	27.27	84.52	15.48
2.	World Bank	134.5	134.5	–	100.00	–
3.	China	132.24	112.13	20.11	84.79	15.21
4.	Japan	107.4	90.92	16.48	84.66	15.34
5.	USSR	90.37	87.71	2.66	97.06	2.94
6.	FRG	86.6	62.39	24.21	72.04	27.96
7.	ADB	81.3	81.3	–	100.00	–
8.	Canada	81.3	51.17	30.13	62.94	37.06
9.	UK	73.5	32.43	41.07	44.12	55.88
10,	UN Group	72.0	–	72.0	–	100.00
	Sub Total (A)	1035.41	801.48	233.93	77.41	22.59
	A/B (%)	(72.50)	(77.25)	(59.89)		
B						
11	Sweden	57.6	–	57.6	–	100.00
12.	France	43.5	38.92	4.58	89.47	10.53
13.	India	42.5	40.55	1.95	95.41	4.59
14.	Netherlands	41.0	25.07	15.93	61.15	38.85
15,	Iran	32.0	32.0	–	100,00	–
16.	E.E.C.	28.8	–	28.8	–	100.00
17.	Kuwait Fund	25.72	25.47	0.25	99.03	0.97
18.	Australia	22.1	–	22.1	–	100.00
19.	UAE	17.2	17.2	–	100.00	–
20.	Libya	16.0	15.0	1.0	93.75	6,25
21	OPEC Fund	11.3	11.3	–	100,00	–
22.	Hungary	10.36	10.36	–	100.00	–
23.	Czechoslovakya	7.86	7.86	–	100.00	–
24.	Denmark	7.0	6.5	0.5	92.86	7.14
25.	Saudi Fund	6.7	–	6.7	–	100,00
26.	Bulgaria	4.80	4.80	–	100.00	–
27.	Yugoslavia	4.15	–	4.15	–	100.00
28.	Italy	3.4	–	3.4	–	100.00
29.	Norway	2.8	–	2.8	–	100.00
30.	DPR Korea	1.76	1.0	0.76	56.82	43.18
31.	Switzerland	1.0	–	1.0	–	100.00
32.	GDR	0.47	–	0.47	–	100.00
33.	Others	4.65	–	4.65	–	100.00
	Total A + B	1428.08	1037.51	390.57	72.65	27.35

Source: *External Resource Division, Ministry of Finance and Planning*

Issues

Although aid. inclusive of loans, has increased tremendously during the last few years, there are certain factors which are worthy of consideration. One is the wide variety of aid sources. There was aid from about 30 individual countries and from about 10 international agencies. The other aspect of increasing aid is that the country has launched an unprecedented development programme. At a time when such massive development programmes are going on in a country it is difficult to make a proper assessment of the value of aid. Much depends on the results that could be obtained. The justification for the massive loans is yet to come by way of results in these programmes. It is generally accepted that there is no danger to an economy from a high level of borrowing, even on 'hard' terms, provided these funds have been used to build up the capacity to repay such debts.

In the year 1981, Japan has emerged as the most generous donor towards Sri Lanka. Out of the total receipts, 15.29 percent of aid in 1981 was from Japan. Netherlands, UK and USA followed with 11.73% 11.43% and 10.32% respectively. However, aid should be considered together with trade especially the trade balance with the different countries.

The options available to Sri Lanka are clear. Export growth has not been sufficient to compensate for the growing debt situation. It is of paramount importance to launch a vigorous food substitution programme .together with an export promotion programme.

Over the long term PL 480 programme aid has probably had an adverse effect on Sri Lanka's food production programme. The people have developed a preferential taste for wheat flour, which is supplied through this aid line, and which is available freely. It has been observed that in 1974–75, at a time when the rice harvest was expected to be much less than the target the government launched a major food programme, which could not be carried out as planned owing to the release of PL 480 stocks. In March 1975 the USA offered 100,000 tons of wheat flour,

Table 11 Disbursements of ODA 1978–83* (US $ Millions)

	Donor	Total	Of which		Percentage	
	78–83*	Loans	Grants	Loans		Grants
A						
1.	U.S.A.	295.97	245.74	50.23	83.03	16.97
2	Japan	246.75	145,19	101.56	58.84	41.16
3.	U.K.	220.1	–	220.1	–	100.00
4.	World Bank	183.3	183.3	–	100,00	–
5.	Canada	144.31	105.22	39.09	72.91	27.09
6.	Sweden	134.19	–	134.19	–	100.00
7.	Netherlands	112.66	81.45	38.21	68.07	31.93
8.	FRG	110.95	94.31	16.64	85.00	15.00
9.	ADB	85.96	85.96	–	100.00	–
10.	UN Agencies	68.71	–	68.71	–	100.00
	Sub Total (A)	1,609.9	941.17	668.73	58.46	41.54
	A/B (%)	(89.07)	(83.24)	(82.82)		
B						
11.	France	56.73	52.50	4.23	92.54	7.46
12.	Norway	50.73	–	50.73	–	100.00
13.	E.E.C.	45.45	7.25	38.20	15.95	84.05
14.	India	41.80	39.58	2.22	94.69	5.31
15.	Australia	31.21	–	31.21	–	100.00
16.	China	26.25	26.25	–	100.00	–
17.	OPEC Fund	19.11	19.11	–	100.00	–
18.	Kuwait Fund	14.6	14.6	–	100.0	–
19.	Denmark	10.39	7.67	2.72	73.82	26.18
20.	IFAD	9.07	9.07	–	100.0	–
21.	Finland	7.45	–	7.45	–	100.00
22.	Iraq	5.52	5.52	–	100.00	–
23.	USSR	3.02	2.97	0.05	98.34	1.66
24.	UAE	2.515	2.515	–	100.00	–
25.	Saudi Fund	2.19	2.19	–	100.00	–
26.	Switzerland	0.89	0.18	0.71	20.22	79.78
27.	Romania	0.34	–	0.34	–	100.00
28.	Hungary	0.06	0.06	–	100.00	–
29.	Belgium	0.03	–	0.03	–	100.00
30.	GDR	0.025	0.003	0.022	88.0	12.0
31.	Libya	0.10	–	0.10	–	100.0
32.	Others	0.66	–	0.66	–	100.00
	Total A + B	1,938.04	1,130.638	807.402	58.34	41.66

* January to September 1983.

Source: *External Resource Division, Ministry of Finance and Planning.*

making it conditional that this stock should be imported before the end of June 1975. The Sri Lanka government accepted this offer, and anticipating these imports started releasing flour stocks from April onwards, this had an adverse impact on the local food production programme. The harvest of food crops was due at this time and the farmers were unable to sell their produce at the expected price. This turned out to be a major distincentive to the producers of subsidiary food crops. A major extension drive that had been launched by the Department of Agriculture also received a setback as it had taken considerable persuasion by the Department to get farmers' to start growing these subsidiary food crops, which also caused serious damage to the country's long-term development prospects.

Conclusion – Foreign Aid – Sri Lanka

Despite the very high investment levels (as seen in table 7), almost half of it financed through foreign aid in certain years, the current deficits in the government budget, the balance of payments deficits and growing debt service obligations have all contributed to the fundamental imbalances in the economy. Investment levels appear to have risen far above the absorptive capacity of the economy; and productivity levels have failed to keep pace with investment resulting in a situation where financial inputs have continued to increase much faster than real incomes. In 1982, for instance, while real national income increased by 3.5 percent capital formation (at constant prices) increased by 5.8 percent.

Meanwhile, the inability to generate sufficient domestic resources has meant an increasing resort to foreign finances. Much of the achievements in the economy in the six years upto 1983 have been possible mainly due to this external assistance. The objective in recourse to 'aid' from outside was that the international resource transfers would act as a device to complement the domestic resource mobilization programme; but rather the tendency has been for foreign resources to substitute for the domestic. The danger in such a situation is that foreign aid which was meant to act as a galvanising factor for developing domestic capabilities over a period can become the medium of perpetuating foreign dependence indefinitely

C.G. S.G. C.D.