

# The Outlook for Sri Lanka's Economy

## — an ADB view

The Asian Development Bank in its annual survey of the Sri Lanka's economy comes to the conclusion that by the end of 1988 the country faced a very difficult economic situation. In the ADB's view the major constraints to economic growth were a high debt service ratio, high unemployment, large interest payments on government debt, a growing current account deficit, and low domestic savings. It saw two other unfavourable prospects for the economy, namely, that the earlier heavy flows of external assistance could not be maintained at the same pace and the productivity of the massive investment programme undertaken over the past decade had fallen far below expectations.

The ADB also warned that though the pursuit of very drastic austerity programmes would be difficult for Sri Lanka, in view of the already difficult political situation, there was a need to bring down

TABLE 1.  
CHANGES IN MONEY SUPPLY (M1)  
(percent per annum)

	1986	1987	1988
<b>Newly Industrializing</b>			
<b>Economies</b>			
Hong Kong	23.9	46.0	8.5
Korea Rep. of	16.6	14.7	20.2
Singapore	11.8	12.3	8.4
Taipei, China	51.4	37.8	24.4
<b>Southeast Asia</b>			
Indonesia	15.6	8.6	7.9
Lao People's Democratic Rep.	69.9	80.5	77.3
Malaysia	2.8	13.0	8.8
Philippines	19.1	22.1	14.4
Thailand	20.5	28.0	12.2
Viet Nam, Socialist Rep. of	215.9	472.5	
<b>South Asia</b>			
Bangladesh	15.1	20.9	8.2
Burma	41.3	-40.8	18.4
India	16.1	13.8	12.6
Nepal	23.8	24.9	12.7
Pakistan	18.0	19.1	11.2
Sri Lanka	12.9	18.4	29.1
<b>China, People's Rep. of</b>	25.3	25.2	13.0
<b>South Pacific</b>			
Fiji	22.6	-3.4	61.6
Papua New Guinea	4.7	8.8	3.7

the budgetary and external payments deficits, through sustained efforts at fiscal cut backs and export promotion.

The survey records how since 1985 economic growth had slowed down as both direct and indirect repercussions of the civil disturbances in the North and East of the country percolated through the economy. These disturbances only

TABLE 2.  
CHANGES IN MONEY SUPPLY (M2)  
(percent per annum)

	1986	1987	1988
<b>Newly Industrializing</b>			
<b>Economies</b>			
Hong Kong	32.8	30.7	21.8
Korea Rep. of	18.4	19.1	21.5
Singapore	10.9	19.8	13.5
Taipei, China	25.3	26.6	17.9
<b>Southeast Asia</b>			
Indonesia	19.5	22.5	25.2
Lao People's Democratic Rep.	70.0	79.0	90.1
Malaysia	11.1	5.0	5.7
Philippines	9.6	14.2	24.0
Thailand	13.4	20.2	6.0
Viet Nam, Socialist Rep. of	212.1	482.0	
<b>South Asia</b>			
Bangladesh	16.6	22.0	15.7
Burma	31.3	-23.9	15.9
India	18.1	16.4	16.3
Nepal	19.4	22.4	21.5
Pakistan	16.1	16.3	8.6
Sri Lanka	5.1	14.7	16.5
<b>China, People's Rep. of</b>	28.2	25.6	15.3
<b>South Pacific</b>			
Fiji	16.7	3.8	20.6
Papua New Guinea	16.0	8.3	12.6

aggravated the domestic and external pressures on the economy. The escalating expenditures on defence and internal security hampered attempts of the government to stabilise the economy and effect structural adjustments. While the 1987 economic performance was seriously effected by a severe drought, which reduced agricultural production to low levels, the modest recovery recorded in 1988 did not have a significant impact on economic performance. Some of the ADB's comparative performance indicators (see diagram on Page 3) show that in at least four of these

TABLE 3.  
GOVERNMENT EXPENDITURE  
(percent of GDP)

	1986	1987	1988
<b>Newly Industrializing</b>			
<b>Economies</b>			
Hong Kong	13.3	12.0	11.7
Korea Rep. of	17.3	17.0	16.6
Singapore	43.3	45.5	34.7
Taipei, China	14.4	13.0	13.6
<b>Southeast Asia</b>			
Indonesia	22.8	23.5	22.5
Lao People's Democratic Rep.	36.8	36.9	
Malaysia	38.0	36.1	29.8
Philippines	14.9	17.4	16.7
Thailand	15.7	17.2	15.4
Viet Nam, Socialist Rep. of	17.8	19.6	
<b>South Asia</b>			
Bangladesh	11.3	14.5	13.8
Burma	14.3	14.3	13.6
India	17.5	16.7	
Nepal	18.3	19.1	19.5
Pakistan	24.6	25.7	25.2
Sri Lanka	34.3	34.1	35.2
<b>China, People's Rep. of</b>	32.7	28.2	
<b>South Pacific</b>			
Fiji	38.5	31.9	30.6
Papua New Guinea	33.5	31.1	29.3

economic indicators Sri Lanka was near the bottom of the league. With regard to changes in Money Supply (M1) there were only 2 countries namely, Laos 77.3% and Fiji 61.6% that had higher rates of money supply change in 1988 than Sri Lanka's 29.1% (In terms of M2, however, there were nearly 7 countries of the 19 ADB members ahead of Sri Lanka) See Tables 1 and 2.

In Sri Lanka, Money Supply (M1), increased by 29 percent in 1988. The ADB survey states that this excessive growth in liquidity, together with the decline in domestic availability of some basic goods after the sharp drop in agricultural production in 1987, and the upward adjustments in business turnover taxes, wage increase and higher incomes earned from improved prices of exports, have contributed to the acceleration in inflation during 1988.

Another important indicator was Government expenditure as percent of GDP and here Sri Lanka headed the list for 1988 with 35.2%, closely followed by 34.7% of Singapore. (See Table 3).

**TABLE 4.**  
**GOVERNMENT TAX REVENUE**  
(percent of GDP)

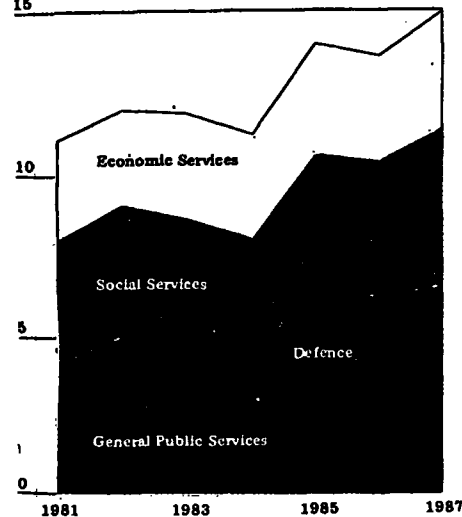
	1986	1987	1988
<b>Newly Industrializing Economies</b>			
Hong Kong	10.6	11.2	9.4
Korea Rep. of	16.0	16.7	15.2
Singapore	13.6	13.1	13.1
Taipei, China	7.5	7.6	9.1
<b>Southeast Asia</b>			
Indonesia	15.6	16.4	15.9
Lao People's Democratic Rep.	2.4	2.6	
Malaysia	20.6	15.5	15.9
Philippines	10.5	11.7	11.6
Thailand	14.1	15.0	16.6
Viet Nam, Socialist Rep. of	2.7	3.1	
<b>South Asia</b>			
Bangladesh	7.0	7.0	5.9
Burma	7.4	7.5	7.3
India	8.3	8.6	
Nepal	7.1	7.5	8.5
Pakistan	11.5	10.2	11.4
Sri Lanka	16.1	16.6	15.7
<b>China, People's Rep. of</b>			
	22.1	19.3	
<b>South Pacific</b>			
Fiji	18.6	18.5	16.3
Papua New Guinea	17.9	18.1	18.6

In terms of Government tax revenue as percent of GDP Sri Lanka's 16.7% was only second to Papua New Guinea's 18.6%. (See Table 4).

Sri Lanka's budget deficit was also about the highest for the 19 ADB member Asian countries, (apart from the exceptional Laos 49.1%). In spite of the high tax

**Government Expenditure by Function**

Per Cent of GDP



Source: ADB, Key Indicators (July 1988).

revenue and GDP ratio of 19% in 1987, the highest for Asia in that year, and 16.7% in 1988 (second only to 18.7% of Papua New Guinea), Sri Lanka's overall budget deficit has continued to be a relatively high 15.7% in 1988. The main reason was that while the ratio of capital expenditure to the GDP was reduced there has been

**TABLE 5.**  
**OVERALL BUDGET SURPLUS/DEFICIT OF CENTRAL GOVERNMENT**  
(percent of GDP)

	1986	1987	1988
<b>Newly Industrializing Economies</b>			
Hong Kong	1.3	3.2	0.0
Korea Rep. of	-0.1	0.5	-1.1
Singapore	3.1	-2.9	9.0
Taipei, China	-0.9	0.1	-6.2
<b>Southeast Asia</b>			
Indonesia	-6.0	-5.4	-5.6
Lao People's Democratic Rep.	-11.3	-12.5	-49.1
Malaysia	-10.6	-7.6	-6.0
Philippines	-5.0	-3.0	-2.6
Thailand	-3.9	-0.7	2.3
Viet Nam, Socialist Rep. of	-5.1	-4.5	
<b>South Asia</b>			
Bangladesh	-7.0	-6.4	-5.6
Burma	-2.6	-2.3	-4.6
India	-5.4	-4.5	
Nepal	-9.3	-8.9	-8.8
Pakistan	-7.6	-8.0	-7.7
Sri Lanka	-12.7	-11.7	-15.7
<b>China, People's Rep. of</b>			
	-0.7	-0.7	
<b>South Pacific</b>			
Fiji	-5.7	-6.8	-7.4
Papua New Guinea	-11.3	-7.9	-6.3

a rapid growth in current expenditure. Defence expenditure has continued to take up an increasingly large amount of total expenditure since 1984. (See diagram). Mainly because of defence and external security associated with the disturbed civil conditions the fiscal position has continued to deteriorate. Throughout 1986, 1987 and 1988 Sri Lanka's overall budget deficit as a percent of GDP has been one of the highest for the Asian countries. (See Table 5).

The survey emphasises that a wide resource gap is a key structural weakness which poses some difficult problems for macroeconomic management in Sri Lanka. Even though the investment rate declined to about 22-23 percent in 1987 and 1988, the resource gap remained large because domestic saving, despite some increase, fell far short of investment.

## FINANCE

### Commercial Bank Deposits

In 1988 the total resources of Commercial Banks increased by nearly Rs 19 bn or 25 percent over that of the previous year. As much as 42 percent of this resource growth was by way of deposit mobilisation. The growth in bank deposits consisted of increases in time and savings deposits of Rs 3.5 bn and demand deposits of Rs 4.5 bn. In 1988 substantial increases in other liabilities, and paid up capital and reserves also contributed to the increasing resource base of Commercial Banks.

The Central Bank's latest quarterly Survey of Bank Deposits and Advances shows that total bank deposits stood at Rs 42.3 bn by the end of June 1988; and of these deposits the indigenous banks held 77 percent and the foreign banks 23 percent. Of the total deposits the States Banks held 66 per cent and the other indigenous banks 11 percent; while of the 23 percent held by the foreign banks the old foreign banks and the new foreign banks each held approximately 11.5 percent.

The total number of deposit accounts with the Commercial Banks at the end of June 1988 stood at 5,888,683 indicating a decline of 173,379 during the first six months of 1988.

However, the total number of accounts held by foreign banks increased by 5,144 during the period under review.

In the case of indigenous banks, the average balance of an account increased slightly by Rs 284 to reach Rs 5,639 as at the end of June. Meanwhile, the average balance of an account with foreign banks stood at Rs 94,870 as at the end of June, reflecting an increase of Rs 2,093 during the first half of 1988. Following the trend observed in recent years, these changes indicated that the indigenous banks were more oriented towards retail banking through their large network of branches, while the foreign banks were mostly concentrated in wholesale banking.

Amount in Rupees Million.

	1988 June			
	No. of Accounts	% of Total	Amount	% of Total
1. Indigenous Banks	5,786,962	98.3	32,630.3	77.1
1.1 State Banks	5,494,357	93.3	28,004.9	66.2
1.2 Other indigenous Banks	292,605	5.0	4,625.4	10.9
2. Foreign Banks	101,721	1.7	9,676.8	22.9
2.1 Old Foreign Banks	79,670	1.4	4,849.6	11.5
2.2 New Foreign Banks	22,051	0.4	4,827.2	11.4
	5,888,683	100.0	42,307.1	100.0

Source: Central Bank of Sri Lanka