

SRI LANKA'S ECONOMY IN 1985

Sri Lanka's economy recorded an overall growth rate of 5.5 percent in 1985 with sources of this growth being mainly agriculture and manufacturing. This position is reported in the Annual Report of the Central Bank for 1985 in its review of the country's economic performance during last year. The report considers this a "remarkable achievement" in the face of an unfavourable external economic environment and internal unrest in some parts of the country. The report maintains that another achievement was that despite various adverse factors there was also a deceleration of prices in 1985, with consumer prices (as measured by the Colombo Consumer's Price Index) rising only 1.5 percent over the year.

What mitigated the adverse factors was the continuous expansion in the agricultural sector which accounts for about one fourth of the country's GDP. Paddy production, which fell in 1984 due to transitory adverse weather conditions, returned to its high growth path of recent years to record a 10 percent growth in 1985. Coconut production increased sharply by 52 percent. Tea production, which increased by 16 percent in the previous year moved up a further 3 percent. These developments in both domestic agriculture and plantation crops together with their consequential impact on agro-processing and trade were largely responsible for the maintenance of a 5.5 percent growth rate.

In many respects, however, the Report appears to have surfaced unfavourable developments for the economy. Among these developments were the decline in commodity prices, particularly of tea and coconut; the continuing drop in tourist traffic and consequent

decrease in tourism related services; the need for increased expenditure on defence activities; a slowing down of foreign investment; and the general disruption of economic activities in the Northern and Eastern parts of the country. The substantial deterioration in Sri Lanka's balance of payments in 1985 is regarded as one of the most serious adverse developments. There was also a reversal in government fiscal operations compared to the previous two years, with budgetary operations in 1985 getting more expansionary. Meanwhile, Sri Lanka recorded an unfavourable trade performance in 1985, with export earnings declining for the first time since 1972.

Overall Trends

In 1985, real GDP is estimated to have increased by 5.0 percent compared with 5.1 percent in 1984. A favourable development in 1985 was the decreased net outflow of factor income in real terms which resulted in the real Gross National Product (GNP) increasing by 5.3 percent, as against an increase of 5.1 percent in 1984.

Gross National Product at current factor cost prices is estimated at Rs. 147 billion in 1985; 6.5 percent higher than the estimated value for 1984. When account is taken of the real increase in GNP, the implicit price deflator is estimated to have increased by only 1.5 percent, in contrast to the increase of 17.4 percent in the previous year. This marked decline in the rate of increase of GNP deflator is attributed mainly to the decrease in export prices of major agricultural products.

Sri Lanka's mid year population in 1985 has been provisionally estimated by the Registrar General's

Department at 15.8 million; a 1.5 per cent growth over the 1984 estimate. Therefore, per capita GNP amounted to Rs. 9,219 (US Dollars 339). In real terms, per capita income is estimated to have increased by 3.7 percent, which is marginally less than the 4 percent increase in 1984.

The deterioration of Sri Lanka's terms of trade by 22.5 percent in 1985 resulted in the real GNP decreasing marginally by 0.4 percent in 1985. This is in contrast to an increase in real GNP by 8.6 percent in 1983 and 9.9 percent in 1984 owing to an improvement in the terms of trade.

In 1985, the main contributions to economic growth, however, were from agriculture, manufacturing and trade, while transport and banking also made significant contributions. But agriculture was the most prominent source of growth, recovering from its decline in the previous year.

Sectoral Performance

The sectoral growth rates for the period 1983 - 1985 are given in Table 1. The agriculture, forestry and fisheries sector, which declined marginally in 1984, grew by as much as 8.6 percent in 1985. This growth was sustained despite a slower growth of the tea sub-sector and a negative growth in the rubber sub-sector. The overall growth in agriculture was mainly the result of a growth of 52.3 percent in the coconut sub-sector which is unparalleled in recent years; and also the 10 percent growth in the paddy sector in 1985 which contrasts with the marginal decline in 1984. The growth in other agriculture has been slower than growth in the previous year. The fisheries sub-sector performed marginally better than in the previous year.

The overall growth in the manufacturing sector decreased from 12.3 percent in 1984 to 5.2 percent in 1985, mainly as a result of the

TABLE 1

Composition and Growth of GNP 1983 - 1985 at Constant (1982) Factor Cost Prices

Sector	Amount (Rs. Million)			Growth Rate	
	1983(a)	1984(a)	1985(a)	1984	1985
1. Agriculture, Forestry and Fishing of which:	26,212	26,113	28,366	0.4	8.6
1.1 Tea	2,309	2,681	2,759	16.1	2.9
1.2 Rubber	865	878	851	1.5	3.1
1.3 Coconut	2,992	2,513	3,828	-16.0	52.3
1.4 Paddy	6,318	6,166	6,783	2.4	10.0
1.5 Other (including subsidiary food corps, forestry & fishing)	13,728	13,875	14,145	1.1	1.9
2. Mining and Quarrying	2,413	2,449	2,486	1.5	1.5
3. Manufacturing	13,710	15,390	16,193	12.3	5.2
3.1 Tree Crop Processing	2,715	2,983	3,222	9.9	8.0
3.2 Other	10,995	12,407	12,971	12.8	4.5
4. Construction	8,039	8,030	8,070	-0.1	0.5
5. Services	49,001	52,413	54,455	7.0	3.9
6. G.D.P.	99,375	104,395	109,570	5.1	5.0
7. Net Factor Income from Abroad	- 2,936	- 2,996	- 2,837	-	-
8. G.N.P.	96,439	101,399	106,733	5.1	5.3

(a) Provisional

Source: Central Bank of Sri Lanka.

sharp drop in factory industry growth from 15.0 percent to 5.0 percent.

The mining and quarrying sector maintained a 1.5 percent growth rate in 1985. Slow growth in construction and a decline in gem exports mainly account for this low rate of growth.

The construction sector grew by 0.5 percent in 1985, as against a marginal decline of 0.1 percent in the previous year. Value added in electricity, gas, water and sanitary services, increased at a similar rate as that in 1984, and electricity generation grew by about 9 percent in 1985.

The transport, storage and communication sector recorded a reduced growth rate of 4.2 percent in 1985. Value added in wholesale and retail trade grew at a lower rate than in the preceding year, mainly as a result of negative growth in the exports sub-sector. The growth of the imports sub-sector was higher than in the previous year. Value added in the banking, insurance and real estate

sector recorded a growth rate of 9.9 percent in 1985.

Expenditure Pattern

The rate of expansion of Gross Domestic Expenditure (GDE) continued to slow down. The GDE growth rate in 1985 was 10.0 percent compared with growth rates of 16.4 percent in 1984 and 18.6 percent in 1983. See Table 2.

The GDE at current market prices in 1985 is estimated at Rs. 179 billion, which is an increase of Rs. 16.3 billion over the previous year. Private consumption expenditure increased by 10.7 percent to reach Rs. 123.2 billion in 1985. Of this figure, the expenditure on foreign goods and non-factor

services was Rs. 27 billion—an increase of 24.3 percent over the previous year. The expenditure on locally produced goods at Rs. 96.2 billion was an increase of 7.4 percent over that of the previous year.

Gross Domestic Fixed Capital Formation (GDFCF) increased by 3.9 percent in 1985 compared to an increase of 11.9 percent in the previous year. The total value of imported investment goods decreased by 17.1 percent in 1985 as compared with an increase of 5.0 percent in 1984; while the imports of capital goods, excluding ships and aircrafts decreased by 25.1 percent. The import content of Gross Domestic Fixed Capital Formation was 23.1 percent in 1985 and 28.9 percent in 1984.

This sharp decrease in imported investment goods is in contrast to an increase of 5 percent in 1984. The lower import content of capital expenditure was particularly due to the completion of head-works of the Mahaweli scheme which resulted in a large reduction in capital goods imports.

Availability and Utilization of Resources

Of the total resources of Rs. 221.3 billion available to the Sri Lankan economy in 1985, Rs 159.8 billion (72.2 percent) was from domestic sources and Rs. 61.5 billion (27.8 percent) was from imports.

While 18.7 percent of resources was expended on capital formation, 62.3 percent was spent on consumption and 19.0 percent on the

TABLE 2

Item	Import Content of Capital Expenditure		
	1983	1984	1985
1. Gross Domestic Fixed Capital Formation	35,342	39,558	41,106
2. Imports of Investment Goods (c.i.f. value)	10,900	11,443	9,488
3. Imports of Investment Goods excluding ships and aircrafts (c.i.f. value)	9,298	10,512	7,877
4. Import Content (2 as a percentage of 1)	30.8	28.9	23.1

Sources: Customs Sri Lanka, Central Bank of Sri Lanka.

TABLE 3 National Savings 1983 - 1985 (At Current Market Prices)

Category	1983(a)	1984(a)	1985(a)
1. G.D.P. at Market Prices	121,601	153,746	159,787
2. Domestic Savings	16,767	30,576	21,915
3. Net Factor Income from Abroad	-3,214	-3,401	-3,410
4. Net Private Transfers	6,441	7,031	7,298
5. National Savings	19,994	34,206	25,803
6. Domestic Savings Ratio (2 as a percentage of 1)	13.8	19.9	13.7
7. National Savings Ratio (5 as a percentage of 1)	16.4	22.2	16.1

(a) Provisional

Source: Central Bank of Sri Lanka

exports of goods and non factor services. The comparable figures for 1984 were 19 per cent on capital formation, 59.5 percent on consumption and 21.4 percent on exports of goods and non-factor services.

Domestic savings declined by 28.3 percent in the current year from Rs. 30.6 billion in 1984 to Rs.21.9 billion in 1985. This is in contrast to both 1983 and 1984, when significant increases were observed in domestic savings which were 13.7 percent in 1985 in contrast to the 1984 ratio of 19.9 percent. Total national savings to GDP ratio fell from 22.2 percent in 1984 to 16.1 percent in 1985. See Table 3.

AGRICULTURE

Tea

In 1985, tea production increased by 3 percent. This production increase of 6.1 million kgs. in 1985 followed a substantial increase of 28.7 million kgs. in 1984. These increases in production in the two successive years resulted in the 1985 production of 214.1 million kgs. being the highest level of production since 1971.

The increase in production in 1985 was mainly due to the combined effect of favourable weather conditions and increased fertilizer application. This increase was largely confined to low grown areas whose

production increased by about 6 million kgs. or 98 percent of the total increase in production. Medium grown tea production increased by only 0.6 million kgs. or 1 per cent, while high grown tea production fell marginally by 0.5 million kgs. or 0.6 per cent.

A noteworthy feature in tea production during 1985 was that for the first time in the history of tea production in Sri Lanka, low grown areas accounted for the highest share in total tea output. The higher production in low grown areas was achieved by an increase in the area under cultivation and higher yields obtained through better cultural practices including increased fertilizer application by small holders in these areas. These improvements were made possible by booming tea prices which prevailed throughout 1984 and early in 1985.

The registered extent under tea cultivation is estimated to have increased marginally by 3,650 hectares in 1985. This was largely due to the increase in the area under new plantings particularly in low grown areas as a direct consequence of the boom in tea prices in 1984.

TABLE 4 Statistics on Tea Sector 1983 - 1985

Item	Unit	1983	1984(a)	1985(b)
1. Production	Mn.Kgs.	179.3	208.0	214.1
1.1 High Grown	Mn.Kgs.	67.8	79.3	78.8
1.2 Medium Grown	" "	48.4	54.6	55.2
1.3 Low Grown	" "	63.1	74.1	80.1
2. Registered extent under tea	'000 ha.	230	228	231
3. Fertilizer issues	'000 Mt.tons	115.5	137.2	149.9
4. Replanting	Hectares	1367	n.a.	n.a.
5. Prices				
5.1 Colombo net	Rs./kg.	36.96	46.45	35.39
5.2 Export f.o.b.	" "	52.52	77.20	60.31
6. Cost of production	" "	26.37	34.00	35.00
7. Exports	Mn.Kgs.	157.8	204.0	198.0
8. Export earnings	Rs. Mn.	8295.0	15764.0	12002.8
	(SDR Mn)	(330)	(605)	(434)
9. Value added as % of GDP(c)		5.0	7.4	5.6

(a) Revised

(b) Provisional

(c) In growing and processing only

Note: Data on average yield per hectare are not available

Sources: Sri Lanka Tea Board, National Fertilizer Secretariat; Central Bank of Sri Lanka

The average cost of production (COP) per kg. of made tea in 1985 was estimated at around Rs.35 per kg. which was marginally higher than that of 1984. The average export (f.o.b.) price fell by 22 per cent from Rs. 77.20 per kg. in 1984 to Rs. 60.31 per kg. in 1985. Following this trend, the net sale average fell by 24 percent and as a consequence the average producer margin is estimated to have fallen by 97 percent from Rs.12.45 per kg. in 1984 to Rs. 0.39 per kg. in 1985. The average producer margins in the public sector estates have varied from a negative producer margin of Rs. 3.11 per kg. in the JEDBs to a positive producer margin of Rs. 0.17 per kg. in the SLSP's estates.

A reduction in the export duty was

announced in the budget as an immediate measure of relief to tea producers who were faced with steadily declining tea prices. The export duties on bulk tea, green tea, packeted and instant tea was reduced by Rs. 2.00 per kg. and tea bags by Rs. 1.00 per kg. These rates were made applicable from 14th November, 1985. As a further measure of relief the threshold price of the advalorem sales tax was increased from Rs. 32 to Rs. 40 per kg. with effect from 1st November, 1985. The rate of tax remained at 50 percent.

If tea prices remain depressed at present levels, the two public sector corporations will not be in position to generate their own funds for the envisaged development expenditure under the proposed Medium Term Investment Programme (MTIP). In this context the report emphasises that it may be worthwhile considering the restoration of subsidies paid out of the cess fund to which the two public sector corporations also contribute.

Considering the massive contribution still made by the tea sector to the economy of the country, in terms of revenue, employment generated and foreign exchange earned etc. the Central Bank has suggested that the tea industry should also be in a position to receive assistance when it is in distress. In addition to the tax reliefs granted to the sector, the proposed MTI Programme meant for the public sector estates and the Stabilization Fund for Tea which was established in 1985 could provide some measure of relief to tea producers. A scheme of assistance to the public as well as private sector producers under the Stabilization Fund for Tea is expected in 1986; and every attempt would need to be made to ensure that the objectives of these scheme are realized.

Rubber

Rubber production has been provisionally estimated at 138 million

TABLE 5

Statistics on Rubber Sector 1983 - 1985

Item	Unit	1983	1984*	1985*
1. Production	Mn. Kgs.	140	142	138
2. Area				
2.1 Under cultivation	'000 hectares	205.6	205.6	205.6
2.2 Under tapping	" "	170.5	169.0	168.2
3. Yield	Kg./hectare	818	840	838
4. Fertilizer issues	'000 Mt. tons	18.6	23.5	24.2
5. Replanting	Hectares	4,862	5,530	6,694
6. Prices				
6.1 Export f.o.b.	Rs/Kg.	22.77	26.16	21.33
6.2 Colombo RSSI	" "	13.95	14.94	16.17
7. Cost of production (a)	" "	9.90	12.06	13.67
8. Exports	Mn. Kgs.	125.2	126.2	120.2
9. Domestic consumption	Rs. Mn.	2,852.0	3,301.0	2,566.0
10. Export earnings	(SDR. Mn.)	(114)	(127)	(93)
11. Value added as % of GDP (b)		1.7	1.6	1.4

* Revised and Provisional.

(a) Weighted average cost of production of public sector estates, private sector estates and small holdings.

(b) In growing and processing only.

Sources: Rubber Control Department; National Fertilizer Secretariat; Central Bank of Sri Lanka

kgs. in 1985. This decrease of 4.4 million kgs. is three percent less than the production in 1984. As in the previous year, the entire drop in production occurred in the public sector estates. Rubber production in the private sector estates remained more or less at the same level as in 1984. Consequently, the relative share of the private sector in total production increased from 67 percent in 1984 to 70 percent in 1985.

Small private estate owners and small holders were able to contain cost increases by keeping wages low. In the case of small holders only a marginal increase is observed in the cost of production (COP) from Rs. 10.28 per kg. in 1984 to Rs. 10.85 per kg. in 1985. In contrast the COP of large private sector estates increased by 19 percent from Rs. 13.83 per kg. in 1984 to Rs. 16.48 per kg. in 1985. Of the public sector estates, the COP of the SLSPCs increased by 11 percent from Rs. 14.00 per kg. in 1984 to Rs. 15.58 per kg. in 1985, while

that of the JEDBs increased by 29 per cent from Rs. 13.01 per kg. in 1984 to Rs. 16.72 per kg. in 1985. The COP of the public sector estates and large private sector estates remained at a higher level than that of the small holders and small private estates because of the wage increases granted to the public sector workers in 1984. The COP of the large estates in the private sector would have increased as they may have found it difficult to obtain labour without paying a wage comparable to that of the public sector estates.

In spite of a fall in export (f.o.b.) price of all grades of rubber by 18 percent the Colombo market price of RSS 1 increased by 8 percent. The small holders and private small estates may have benefitted from this price increase to some extent but in the case of public sector estates the increase was not sufficient to offset the increase in their C.O.P.

The Central Bank concludes that

rubber production has approached a plateau in terms of production, yield per hectare and extent in bearing. In view of the limited scope for expansion of the area under cultivation, the future prospects for increasing production would depend, to a greater extent, on increasing productivity, while maintaining an effective level of replanting. To this end, the expansion in the use of high yielding varieties and the maintenance of cultural practices including fertilizer application at desired levels are vital. However, the low incomes of a small holder dominated rubber sector precludes a more widespread adoption of better cultural practices.

Small holders are also constrained by insufficient processing facilities and are sometimes made to carry latex for processing over long distances. Crudely processed latex, in the absence of better processing facilities, fetches low prices making their plight even worse. Hence, some incentives are necessary to revive this vital sector of the economy.

Coconut

In, 1985 coconut production reached a record level of 2,958 million nuts. This was an increase of 52 percent over the previous year and is the highest level of production since 1972. This pheno-

menal increase in coconut production may be attributed mainly to the lagged effect of favourable weather conditions of previous years and increased fertilizer application. There were widespread rains in the main coconut producing areas in most of 1984 and a considerable increase in fertilizer application was also observed during the last few years. The largest increase was observed in the second half of 1985 with the production peak being September-October. The increase in nut production led to a more than three-fold increase in coconut oil production and a 64 percent increase in desiccated coconut production. During 1985, copra exports rose more than three-fold while fresh nut exports increased more than two-fold. The availability of nuts in abundance and cheaper prices resulted in the diversion of larger volumes of nuts for processing and very large increases in coconut product exports. The removal of certain export restrictions on coconut products also enabled higher copra and fresh nut exports inspite of these products not being very competitive in world markets during 1985.

Inspite of various concessions granted to the coconut export sector, the domestic producers continued to be effected by falling nut prices. The average price of a coconut in the Colombo market at Rs. 2.18 was almost half of what it was in 1984. The experience in 1985 aptly demonstrated the plight of producers in the event of a glut in the market. The processing sector which took advantage of the depressed nut prices carried large stocks and at times had to be provided with financial assistance to enable the purchasing of nuts. Reduced fertilizer application when nut prices fall could lead to depressed production in future affecting the consumers. Therefore the proposed Coconut Stabilization Fund may be in the interest of producers as well as consumers.

The coconut processing industry

TABLE 6

Statistic on Coconut Sector 1983 - 1985

Item	Unit	1983	1984	1985(a)
1. Production(b)	Mn. nuts	2,312	1,942	2,958
1.1 Desiccated coconut	Mn. nuts(c)	295	221	362
1.2 Coconut oil	Mn. nuts(c)	663	295	1,039
1.3 Copra exports	Mn. nuts(c)	18	12	37
1.4 Fresh nut exports	Mn. nuts	6	4	10
1.5 Domestic nut consumption(d)	Mn. nuts	1,373	1,404	1,421
2. Average Price				
2.1 Colombo	Rs/nut	2.42	4.07	2.18
2.2 Export f.o.b.	Rs/nuts	3.66	6.48	3.59
3. Fertilizer issues	'000 Mt.tons	35.7	50.0	41.0
4. Cost of production	Rs/nuts	0.60	0.63	0.64
5. Replanting/under planting(e)	Hectares	2,641	2,553	4,102
6. New planting(c)	Hectares	3,394	1,580	1,561
7. Export earnings	Rs. Mn.	1,921	2,118	3,093
	(SDR.Mn)	(76)	(81)	(112)
7.1 kernel products	Rs.Mn.	1,409	1,553	2,383
	(SDR.Mn)	(56)	(60)	(86)
7.2 Other products	Rs. Mn.	512	566	710
	(SDR.Mn)	(20)	(22)	(26)
8. Value added as % of GDP(f)		4.2	3.5	3.5

Sources: Coconut Cultivation Board; Coconut Development Authority; National Fertilizer Secretariat; Central Bank of Sri Lanka

(a) Provisional.

(b) Estimate (break down does not add to total production due to adjustment for changes in Copra stock).

(c) In nut equivalent converted at 1 Mt.ton DC = 6,8000 nuts
1 Mt.ton oil = 8,000 nuts and
1.Mt.ton Copra = 4,925 nuts.

(d) Estimated on the basis of per capita household consumption of 90 nuts. Excludes industrial use

(e) This excludes planting activities undertaken on holdings less than 0.4 hectares in size owing to lack of detailed data.

(f) in production and processing only.

continues to be affected by obsolete machines and out-dated techniques of production. In view of the stiff competition faced from other substitute edible oils, upgrading the quality of our coconut products is essential if Sri Lanka is to be able to compete in world markets, and towards this end a package of incentives to manufacturers seems essential.

Minor Export Crops

Minor export crops are grown as mixed crops, mostly in homestead gardens; hence, data on either the extent in bearing or production are scanty. Therefore, a direct assessment of this important sector's performance is not possible. Changes in export volumes are therefore used as a proxy to ascertain the movements in production as a very large proportion of these products is exported.

On the basis of export data, the production of most minor export crops except coffee, cardamom, sesame and cocoa fell during 1985. The production of pepper, cloves, nutmeg, betel leaves, arecanuts and essential oils fell substantially. The export volumes of vegetables and fruits too showed large decreases. Cinnamon production fell marginally, while the decline in the production of other oil seeds was moderate. However, the domestic demand for most of these products was good.

The production of sesame seeds increased more than three-fold while cocoa and cardamom production almost doubled. Coffee production rose by about 43 percent. However, some of these estimates of production increases in 1985 are in comparison with the low level of production in the previous year.

(The domestic agricultural sector covering paddy and other subsidiary good crops is dealt with separately in a column on Agriculture in our next issue.)

BALANCE OF PAYMENTS

Among the most serious adverse developments in the economy last year was the deteriorating balance of payments situation. Sri Lanka's balance of payments deteriorated substantially in 1985 both in terms of the current account and the overall balance. Deficits in the merchandise and services accounts widened, net private transfers decreased marginally and official transfers indicated a substantial drop during the year. Consequently, deficit in the current account increased from Rs. 1,400 million (SDR 51 million) in 1984 to Rs. 11,532 million (SDR 417 million) in 1985 and, as a ratio of GDP, from 0.8 per cent in 1984 to 7.2 per cent in 1985. The current account deficit excluding official transfers increased to Rs. 15,528 million (SDR 559 million) from Rs. 6,554 million (SDR 249 million) in 1984; and its ratio to GDP increased from 4.2 per cent to 9.6 per cent between these two years.

The deterioration of primary commodity prices, the poor performance of most non-traditional agricultural exports and the increase in import volumes resulted in a much larger trade deficit in 1985. The deficit in the merchandise account in 1985 was Rs. 19,328 million (SDR 697 million) compared with Rs. 11,850 million (SDR 453 million) in 1984. While exports, in SDR terms, dropped by 10 per cent, imports increased by 5.3 per cent.

Earnings from merchandise exports decreased from Rs. 37,198 million (SDR 1,427 million) in 1984 to Rs. 35,382 million (SDR 1,284 million) in 1985. The fall in export earnings from the three major plantation products by Rs. 3,667 million or 22 per cent in SDR terms was the main reason for this decrease in 1985. Export earnings from minor agricultural products declined by 8 per cent due to a drop in both volume and price. Export of textiles and readymade garments, which had shown a continuous

increase since 1977, declined by 1.0 per cent in 1985, while exports of petroleum products increased by 11.1 per cent during the year. Exports of other industrial products declined by 4.4 per cent. The combined export earnings from all non-traditional exports increased by 7.2 per cent in 1985.

The expenditure on merchandise imports increased to Rs. 49,710 million (SDR 1,981 million) in 1985. Import outlay on consumer goods increased while those on investment goods declined during the year. Expenditure on food items increased mainly due to higher imports of rice, sugar and wheat. Increased fertilizer imports was the main reason for the larger outlay on imports of intermediate goods.

The deficit in the services account nearly doubled in SDR terms during the year. This deficit is estimated at Rs. 3,498 million (SDR 127 million) in 1985 compared to Rs. 1,735 million (SDR 66 million) in 1984. Increases in the net outflows of foreign exchange on account of port, transportation and insurance, a decline in net foreign exchange earnings from tourism and the increase in net outflows on account of other miscellaneous services were the main reasons for the enlarged deficit in the services account.

Gross earnings from tourism declined from Rs. 2,587 million (SDR 99 million) in 1984 to Rs. 2,197 million (SDR 80 million) in 1985. Interest payments on foreign loans including those on drawings from the IMF increased from Rs. 4,588 million (SDR 170 million) to Rs. 5,388 million (SDR 196 million) during these two years. Interest earnings also increased from Rs. 1,478 million (SDR 57 million) in 1984 to Rs. 2,256 million (SDR 82 million) in 1985. Interest payments continued to be the largest debit item in the services account in 1985, though the net outflow was marginally lower than in 1984.

Net outflow of foreign exchange through the services account amounted to 30 percent of the current deficit in 1985.

Although foreign exchange inflows of private remittances increased by 5 percent in rupee terms, they decreased marginally in SDR terms; Rs. 8,020 million (SDR 291 million) in 1985 compared with Rs. 7,653 million (SDR 294 million) in the previous year. Net receipts of private transfers declined by 2 percent and amounted to Rs. 7,298 million (SDR 265 million) in 1985. Next to tea, private transfers constituted the largest single credit item in the current account of the balance of payments during last year.

Official transfers, which include project and commodity grants, decreased from Rs. 5,154 million (SDR 198 million) in 1984 to Rs. 3,996 million (SDR 142 million) in 1985. Project grants at Rs. 2,620 million (SDR 94 million) in 1985, compared with Rs. 2,701 million (SDR 104 million) in the previous year, declining by 9.6 percent in SDR terms.

Total foreign exchange receipts from exports, services and private transfers indicated a 7.4 percent drop in SDR terms. Total foreign exchange outflows in terms of imports, services, private transfers and capital repayments indicated a marginal drop in SDR terms. As a result, the external resource gap increased from Rs. 24,009 million (SDR 919 million) in 1984 to Rs. 28,863 million (SDR 1,043 million) in 1985. The external resource gap was financed through foreign borrowings and use of reserves to an extent of 86 percent while the balance was financed out of non-debt creating capital flows. In 1985 direct foreign investments in GCEC and other enterprises amounted to Rs. 810 million (SDR 29 million) as compared with Rs. 830 million (SDR 32 million) in 1984. Non-monetary capital to the private sector in the form of long term capital increased substan-

TABLE 7

External Debt Outstanding 1984 - 1985 (Disbursed)

Item	Rs. Million		SDR Million	
	1984(a)	1985(b)	1984(a)	1985(b)
A: Long & Medium Term	64,649.4	80,744.7	2,509.7	2,682.1
1. Government	54,191.8	68,315.3	2,103.7	2,269.2
2. Public Corporations with Government Guarantee	9,181.3	9,211.4	356.4	305.9
3. Private Sector with Government Guarantee	98.0	419.3	3.9	14.0
4. Public Corporations without Government Guarantee	—	—	—	—
5. Private Sector without Government Guarantee	1,178.3	2,798.7	45.7	93.0
B: Short Term and Other	13,736.6	13,558.6	527.0	480.0
1. IMF Drawings	8,643.6	7,913.5	328.3	292.5
2. Bank Borrowings	3.3	6.0	0.1	0.2
3. Other(c)	5,116.7	5,639.1	198.6	187.3
C: Total Outstanding (A+B)	78,413.0	94,303.3	3,036.7	3,162.1

(a) Revised

(b) Provisional

Source: Central Bank of Sri Lanka

tially in 1985. Disbursement of foreign loans by the private sector, excluding Air Lanka Ltd., increased from Rs. 362 million (SDR 14 million) in 1984 to Rs. 2,223 million (SDR 81 million) in 1985. Large increases in foreign loan disbursements were resorted to by the Ceylon Shipping Corporation, Hotel Hilton and Pelwette Sugar Co. Ltd. Total foreign loan disbursements by these three enterprises amounted to Rs. 1,775 million (SDR 65 million) in 1985. Air Lanka Ltd. indicated a net outpayment of Rs. 885 million (SDR 33 million) in 1985. Short-term capital inflows to the private sector also increased by Rs. 414 million (SDR 14 million) in 1985 as compared with a decrease of Rs. 648 million (SDR 25 million) in the previous year. As in 1984 acceptance credits of the Ceylon Petroleum Corporation indicated a decrease during this year. Short-term loans taken by GCEC enterprises and Dry Docks Ltd., increased by Rs. 546 million (SDR 20 million) during the year while the level of short-term trade credits increased by Rs. 195 million (SDR 7 million).

The reduction in the gross inflows of non-monetary capital to the

public sector was mainly due to a decline in the disbursements of project loans and the absence of euro-currency drawings in 1985. Project loan disbursements in 1985 amounted to Rs. 7,365 million (SDR 273 million) as compared with Rs. 7,427 million (SDR 285 million) in 1984. Commodity loan disbursements in 1985 increased to Rs. 1,269 million (SDR 47 million) from Rs. 1,103 million (SDR 42 million) in 1984. Disbursements of other loans, consisting of mainly commercial loans for the on-going development projects amounted to Rs. 588 million (SDR 22 million) as compared to Rs. 1,857 million (SDR 71 million) in 1984. Total amortization payments on public sector foreign loans increased from Rs. 1,694 million (SDR 65 million) in 1984 to Rs. 1,992 million (SDR 72 million) in 1985.

External Assets

In 1985 Sri Lanka's gross external assets declined to Rs. 18,367 million (SDR 611 million) from Rs. 18,942 million (SDR 735 million) in 1984. This was a 17 percent decrease in SDR terms. Reflecting the sharp deterioration

in the overall out-turn of the balance of payments the net external assets declined by 39 percent during the year to reach Rs. 6,068 million (SDR 173 million) at the end of 1985. Rs.

At the end of 1985 the gross official reserves, consisting of gross external assets of the government and the Central Bank amounted to Rs. 12,642 million (SDR 421 million) compared with Rs.13,724 million (SDR 533 million) at the end of 1984. This is a 21 percent decrease in SDR terms compared with the level of gross official reserves at the end of the previous year. The decrease was mainly in the Central Bank's liquid balances abroad and investments in foreign securities. Gross external assets of commercial banks also decreased in SDR terms to Rs. 5,726 million (SDR 190 million) in 1985 compared with Rs.5,218 million (SDR 202 million) in 1984.

The level of gross external assets at the end of 1985 was sufficient to finance 3.8 months imports projected for 1985.

Exchange Rate Movements

The Sri Lanka Rupee depreciated against all major currencies during 1985. The rupee depreciated by 25 percent each against the Deutsche Mark and the French Franc, while depreciating by 23 percent each against the Japanese Yen and the U.K.Pound. It also depreciated by 6 percent against the Indian Rupee. The Sri Lanka Rupee, depreciated against the U.S.Dollar by 4.1 percent in 1985. The depreciation of the U.S. Dollar against the SDR and the depreciation of the Sri Lanka Rupee against the U.S.Dollar resulted in the Rupee depreciating against the SDR by 14.1 percent during the year.

The cumulative changes since 16th November, 1977 indicate that the Rupee depreciated by 41.6 percent against the U.S.Dollar; 26.6 percent against Pound Sterling; 36.0 percent against the Deutsche Mark;

52.1 percent against the Japanese Yen; 9.1 percent against the French Franc; and 18.0 percent against the Indian Rupee. The depreciation of the Rupee against the SDR since November 16, 1977 to the end of 1985 was 37.1 percent.

External Debt

Sri Lanka's total outstanding debt including short-term loans and trade credits increased from Rs. 78,413 million (SDR 3,037 million) at the end of 1984 to Rs. 94,303 million (SDR 3,162 million) at the end of 1985. While this indicates an increase of 4 percent in SDR terms, ratio of outstanding debt to GDP increased from 52 percent to 54 percent during these two years.

Long-term and medium-term loans of the government including suppliers credits increased from Rs. 192 million (SDR 2,104 million) to Rs. 68,315 million (SDR 2,269 million) between these two years. Multilateral and bilateral loans to government increased by Rs.3,381 million (SDR 22 million) and Rs.9,894 million (SDR 160 million), respectively. Loans from foreign financial markets decreased by SDR 14 million during the year. Of the total outstanding government sector loans, project loans and non-project loans excluding IMF Trust Fund loans accounted for 53.7 percent and 42.5 percent, respectively. Outstanding long and medium-term loans of the public corporations decreased in SDR terms from SDR 356 million in 1984 to SDR 306 million in 1985.

Debt Service Payments

The total debt service payments to export earnings from goods and services (in SDRs) increased from 17.5 percent in 1984 to 22.4 percent in 1985. This sharp increase was due to the combined effect of the reduction in export earnings and increases in debt service payments. The Debt Service Ratio excluding IMF transactions too revealed an increase from 14.5 per

cent in 1984 to 18.5 percent in 1985. The overall debt service payments as a ratio of the receipts from merchandise exports, services and private transfers increased from 15.0 percent to 19.0 percent between 1984 and 1985.

TRADE AND TOURISM

Overall Trade Balance

The unfavourable performance of Sri Lanka's external trade was a major cause for the deterioration in the balance of payments situation. While in SDR terms export earnings declined by 8 percent expenditure on imports increased by 5 percent. Consequently the trade deficit increased sharply. This is in sharp contrast to 1984 when export earnings increased by 44 percent while import expenditure increased only marginally by 0.6 percent.

The decrease in export earnings in 1985 was mainly due to a substantial drop in tea and rubber prices. The increase in imports reflected the higher outlay on import of ships, aircraft, defence equipment, consumer goods, wheat grain and fertilizer.

The unfavourable movements in prices of both exports and imports resulted in a deterioration of Sri Lanka's terms of trade in 1985 after its considerable improvement in the previous two years. Export prices, measured by the export price index, decreased by 14 percent in 1985 as compared with an increase of 31 percent in 1984. Conversely, import prices increased by 11 percent in 1985 compared with an increase of 8 percent in 1984. These relative movements in prices resulted in a decrease of 23 percent in Sri Lanka's terms of trade in 1985 as compared with an improvement of 22 percent in 1984.

Exports

According to adjusted data, earnings from exports in 1985 was

TABLE 8

Foreign Trade 1979 - 1985

Year	Rupees Million			Index Numbers 1981=100				
				Volume		Prices		Terms of Trade
	Exports (f.o.b.)	Imports (c.i.f.)	Balance of Trade	All Export	All Imports	All Exports	All Imports	
1979	15,273	22,560	- 7,287	85	85	87	76	116
1980	17,595	33,942	-16,347	90	107	95	90	106
1981	21,043	36,582	-15,539	100	100	100	100	100
1982	21,454	41,946	-20,492	105	98	98	107	92
1983	25,096	45,558	-20,461	104	108	126	110	114
1984	37,347	47,541	-10,194	120	109	165	119	139
1985(a)	36,207	52,917	-16,710	126	102	141	132	107

(a) Provisional Adjusted from 1980 onwards. Sources: *Customs Sri Lanka; Central Bank of Sri Lanka.*

Rs.36,207 million (SDR 1,311 million) compared to Rs. 37,347 million (SDR 1,432 million) in 1984. This decline of 3 percent in rupee terms or 8 percent in SDR terms is in contrast to increases of 49 percent and 43 percent, respectively, in 1984. The decline of exports in 1985 was mainly due to the reduced earnings from agricultural exports from Rs. 22,575 million (SDR 866 million) in 1984 to Rs.19,026 million (SDR 689 million) in 1985. As a result, the share of agricultural exports in total exports declined from 60 percent in 1984 to 52 percent in 1985. Earnings from mineral exports increased by 27 percent (20 percent in SDR terms) from Rs.923 million (SDR 35 million) to Rs.1,177 million (SDR 43 million), while those from industrial exports increased by 9 percent (3 percent in SDR terms) from Rs 12,815 million (SDR 491 million) to Rs. 13,980 million (SDR 506 million). The share of industrial exports in total exports increased from 34 percent in 1984 to 39 percent in 1985 due mainly to the decline in the share of agricultural exports.

The value of industrial exports increased in 1985 to Rs.13,980 million (SDR 506 million) compared to Rs. 12,815 million (SDR 491 million) in 1984. Earnings from textiles and garment exports declined by 1 percent in SDR terms from Rs.7,535 million

(SDR 289 million) in 1984 to Rs. 7,899 million (SDR 286 million) in 1985, while those from other industrial products increased by 11 percent (4 percent in SDR terms) from Rs.1,993 million (SDR 76 million) to Rs. 2,204 million (SDR 80 million). However, the slow growth in these exports was compensated by an increase in the export of petroleum products which rose by 18 percent (11 percent in SDR terms) from Rs.3876 million (SDR 140 million) in 1985.

In 1985, minor agricultural exports and gems continued to decline further while industrial exports showed only a marginal increase compared to the previous year.

Imports

The total outlay on imports (adjusted data) amounted to Rs. 52,917 million (SDR 1,915 million) in 1985 compared to Rs.47,541 million (SDR 1,823 million) in 1984. This is an increase of 11 percent in Rupee terms and 5 percent in SDR terms. The increase was largely due to increased imports of consumer goods, ships, aircraft, defence equipment, wheat grain and fertilizer.

The composition of imports changed notably in 1985. The share of consumer goods increased from 23 percent to 27 percent, while that of investment goods declined to 26 percent. The share of

intermediate goods, however, charged marginally from 50 percent to 48 percent. The higher outlay on imports of rice, sugar, flour, textiles and motor cars and cycles was responsible for the increase in consumer goods. The value of imports of rice, wheat and sugar increased over 100 percent, going up from Rs. 1,571 million in 1984 to Rs. 3,280 million in 1985.

The outlay on the import of investment goods in 1985 amounted to Rs.10,387 million (SDR 376 million). This is a decrease of 19 percent in SDR terms over the previous year. When import of ships and aircraft are excluded, the decline in the value of investment goods is greater. The decrease in investment imports in SDR terms was mainly due to decreased imports of transport equipment (22 percent) and machinery & equipment (16 percent), over the previous year. However the import of building materials, which had declined by 40 percent (in SDR terms) in 1984, increased by 16 percent in 1985.

Expenditure on import of intermediate goods amounted to Rs.25,532 million (SDR 924 million) in 1985 compared to Rs.23,749 million (SDR 911 million) in 1984 showing an increase of 8 percent (2 percent in SDR terms). However, the import outlays on wheat grain increased by 12 percent (6 percent in SDR terms) while those on fertilizer rose by 43 percent (35 percent in SDR terms). The import of chemical elements and compounds, which had increased by 24 percent (19 percent in SDR terms) in the previous year, dropped by 12 percent (17 percent in SDR terms) in 1985. The outlay on import of petroleum, which had declined by 3 percent in rupee terms (7 percent in SDR terms) in 1984, decreased further by 3 percent in SDR terms in 1985. In rupee terms, however there was an increase of 3 percent. The share of petroleum in total intermediate goods declined marginally over the previous year mainly due to the

decline in prices of petroleum products in the international market.

Total import outlay on consumer goods which declined by 5 percent (8 percent in SDR terms) in 1984, increased sharply by 29 percent (22 percent in SDR terms) in 1985. This increase was reflected in all categories of consumer goods, namely food & drink, textile & clothing and other consumer goods; which increased by 12 percent and 39 percent respectively, in SDR terms over the previous years in the category of food & drink. Expenditure on rice imports registered a more than four-fold increase from Rs. 197 million (SDR 7.5 million) to Rs. 1,089 million (SDR 39 million), while sugar imports rose by 48 percent (39 percent in SDR terms). The total volume of imports of rice, flour and sugar increased almost 50 percent by about 400,000 tons going up from a total of 873,005 tons in 1984 to 1,264,134 tons in 1985. Rice imports were up from 38,448 tons

TABLE 9

Volume of Major Imports in 1985

Month	Metric Tons				
	Rice	Wheat	Sugar	Petroleum (crude oil)	Fertilizer
January	45	68,964	25,600	29,816	20,970
February	23,946	85,764	31,463	31,823	20,260
March	20,126	35,069	33,300	237,591	18,380
April	20,227	52,500	45,079	157,201	33,125
May	18,344	52,500	36,000	170,648	28,339
June	6,860	52,500	16,420	124,424	32,387
July	27,265	68,330	18,500	154,748	40,677
August	20,077	51,618	770	63,911	42,213
September	20,525	35,945	25,322	187,224	28,600
October	14,907	58,512	19,223	186,117	94,817
November	10,002	—	68,494	158,287	42,907
December	29,004	103,444	67,448	155,679	31,100
Total (a)(b)	211,367	571,146	387,621	1,657,469	433,865
Total 1984	38,448	571,190	263,367	1,733,557	327,625

Sources: Customs, Sri Lanka; Central Bank of Sri Lanka.

(a) Adjusted

(b) Monthly data may not add up to the annual total due to subsequent adjustments

Composition of Exports

TABLE 10

Category	Value Rs. Million			SDR Million			Percentage of Total Exports		
	1983	1984	1985(d)	1983	1984	1985	1983	1984	1985
1. Agricultural Exports	14,554	22,575	19,026	579	866	689	58.0	60.4	52.5
1.1 Tea	8,295	15,764	12,003	330	605	434	33.1	42.2	33.2
1.2 Rubber	2,852	3,301	2,566	114	127	93	11.4	8.8	7.1
1.3 Coconut	1,921	2,118	3,093	76	81	112	7.6	5.7	8.5
1.3.1 Kernel Products	1,409	1,553	2,383	56	60	86	5.6	4.2	6.6
1.3.2 Other	512	566	720	20	22	26	2.0	1.5	2.0
1.4 Minor Agricultural Products(a)	1,486	1,391	1,365	59	53	49	5.9	3.7	3.8
2. Industrial Exports(a)(b)	8,821	12,815	13,980	351	491	506	35.1	34.3	38.6
2.1 Textile and Garments	4,738	7,535	7,899	188	289	286	18.9	20.2	21.8
2.2 Petroleum Products	2,682	3,288	3,877	107	126	140	10.7	8.3	10.7
2.3 Other	1,401	1,993	2,204	56	76	80	5.6	5.3	6.1
3. Mineral Exports	1,132	923	1,177	45	35	43	4.5	2.5	3.2
3.1 Gems(f)	940	706	874	37	27	32	3.7	1.9	2.4
3.2 Other	192	217	303	8	8	11	0.8	0.6	0.8
4. Unclassified(c)	589	1,033(e)	2,024(c)	23	40	73	2.3	2.8	5.6
Total Exports(b)	25,096	37,347	36,207	998	1,432	1,311	100.0	100.0	100.0

(a) Selected Items

(b) Adjusted

(c) Includes re-exports

(d) Provisional

(e) Includes export of aircraft

(f) Includes diamonds

Conversion

1983 - 1 SDR = Rs. 25.16

1984 - 1 SDR = Rs. 26.08

1985 - 1 SDR = Rs. 27.63

Sources: Customs, Sri Lanka; Ceylon Petroleum Corporation

to 211,367 tons; wheat from 571,190 tons to 665,146 tons; while sugar increased from 263,367 tons to 387,621 tons. (Total amount sugar consumption in the country is estimated at around 300,000 tons). In the category of other consumer goods, the import of motor cars and cycles increased markedly while that of radio receivers and television sets increased by 8 percent in SDR terms.

Foreign Trade Policy

Liberalised trade policies instituted in November, 1977 were continued during 1985 with modifications to increase their effectiveness. In particular, restrictions on textile imports were removed. Selective import licences were for food commodities

whose local production had increased, export licences were required for some exports to ensure their quality and export duties of tea and coconut were reduced to provide relief to producers facing diminished export prices.

In spite of numerous incentives that have been provided in the recent past such as tax concessions, import duty rebates, concessionary financing and export credit insurance etc., the performance of the non-traditional export sector was not very encouraging. The export performance was sustained by only petroleum products and some industrial goods in 1985. In other areas such as minor agricultural products, gem exports and several agro-based industries, there were export declines. The reduction of interest rates and the more

realistic exchange rate that came into operation towards the end of 1985 should have provided some impetus to revitalise this sector. It is however, quite premature to judge the effectiveness of these changes.

Tourism

The level of activity in the tourist industry declined further in 1985. The main indicators of tourism such as the number of tourist arrivals, number of tourist nights, room occupancy and exchange earnings depicted a decreased performance of the industry despite promotional measures taken in anticipation of a recovery. The disappointing performance can largely be attributed to the impact of adverse publicity of the security situation in major markets.

End-Use Classification of Imports

TABLE 11

Category	Value in Rs. Million			SDR Million			Percentage of Total		
	1983	1984(a)	1985(b)	1983	1984	1985	1983	1984	1985
1. Consumer goods	11,639	11,052	14,261	462.7	423.8	516.2	25.5	23.2	27.0
1.1 Food and drink	5,375	4,986	5,908	213.7	191.2	213.8	11.8	10.5	11.2
1.1.1 Rice	765	197	1,089	30.4	7.5	39.4	1.7	0.4	2.1
1.1.2 Flour	108	28	206	4.3	1.1	7.5	0.2	0.1	0.4
1.1.3 Sugar	1,985	1,346	1,985	78.9	51.6	71.8	4.4	2.8	3.7
1.2 Textile & Clothing	2,724	2,974	3,799	108.3	114.0	137.5	6.0	6.2	7.2
1.3 Other	3,540	3,092	4,556	140.7	118.6	164.9	7.8	6.5	8.6
2. Intermediate goods	21,727	23,749	25,532	863.7	910.7	924.2	47.7	50.0	48.2
2.1 Petroleum	11,024	10,681	10,986	438.2	409.6	397.6	24.2	22.5	20.8
2.2 Fertilizer	625	1,103	1,579	14.8	24.3	57.2	1.4	2.3	3.0
2.3 Chemicals	832	1,028	902	33.1	39.4	32.6	1.8	2.2	1.7
2.4 Wheat	2,340	2,471	2,765	93.0	94.8	100.1	5.1	5.2	5.2
3. Investment goods	12,077	12,170	10,387	480.1	466.7	376.0	26.5	25.6	19.6
3.1 Machinery and Equipment	5,261	5,335	4,769	209.1	204.6	172.6	11.6	11.2	9.0
3.2 Transport Equipment(c)	3,826	3,031	2,499	152.1	116.2	90.5	8.4	6.4	4.7
3.3 Building Materials	1,177	727	899	46.8	27.9	32.5	2.6	1.5	1.7
4. Unclassified	115	570	2,737	4.6	21.8	99.0	0.3	1.2	5.2
Total Imports (d)	45,558	47,541	52,917	1,811.1	1,823.0	1,915.4	100.0	100.0	100.0

(a) Revised

(b) Provisional

(c) Includes values of ships and aircraft which have not been recorded in the Customs Returns

(d) Adjusted

Sources: Customs, Sri Lanka; Food Commissioner's Department, Ceylon Fertilizer Corporation and other major importers, Ceylon Petroleum Corporation, Air Lanka Limited, Ceylon Shipping Corporation