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STABILIZATION AND ADJUSTMENT
POLICIES AND PROGRAMMES

COUNTRY STUDY

15

SRI LANKA

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STABILIZATION AND ADJUSTMENT
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COUNTRY STUDY: **SRI LANKA**

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PREFACE BY THE DIRECTOR

This monograph is part of a series being published by WIDER on the experience of developing countries with stabilization and adjustment programmes in the 1970s and 1980s. Each study analyzes the package of policies implemented by a specific country; its relations with the IMF and World Bank; the effects of the policies on production, employment, the balance of payments and social welfare; and what other policies might have been followed instead.

The intention of the series is to assist developing countries to devise adjustment policies that would, while accomplishing desirable adjustment and growth objectives, simultaneously remain politically viable in the particular country settings studied.

For this purpose it was thought desirable to explore policy alternatives to the adjustment programmes being implemented. Built into the design of the series, therefore - and constituting indeed its special feature - is the requirement that each study include a 'counterfactual' exercise to illustrate the effects of alternative policies. Utilizing econometric models adapted or specifically developed for each country, the probable effects of alternative policy packages are estimated; the object was to see how far the balance-of-payments adjustment and growth goals of a particular programme might have been achieved at a possibly lower social cost with a different policy mix.

Each country study is written by an independent scholar and expert in the relevant country. First drafts of the studies in this series were discussed at the WIDER conference on stabilization and adjustment policies in developing countries which was held 19-22 August, 1986 in Helsinki. Each study has been reviewed by WIDER's research advisers for the project, Professors Gerry Helleiner and Lance Taylor, and revised substantively by the author as necessary; subsequent editing has been conducted under the overall supervision of Mr Robert Pringle, Senior Fellow, who serves also as editorial adviser on WIDER publications.

A companion volume by Professor Taylor summarizing the experience of the countries surveyed will draw broader implications for the theory and practice of stabilization and adjustment policies; this volume will be published by Oxford University Press. The individual country studies in this series will subsequently be grouped into separate volumes, also for eventual publication by Oxford University Press.

Lal Jayawardena
Director
March 1987

EXECUTIVE SUMMARY

The adjustment experience of Sri Lanka has several special features. First, it followed a long period of relative stagnation of what was till late 1977, an inward looking economy afflicted with severe foreign exchange constraints. The adjustment process spread over the period of 1978-84 was remarkable for the manner in which co-ordination of policies between the International Monetary Fund and the World Bank together secured a steady flow of external resource inflows needed to underpin the adjustment effort. And what stands out clearly in the Sri Lankan experience is the emphasis on long term structural adjustment as distinct from short term policies which are characteristic of standard packages generally recommended by the International Monetary Fund.

Against a background of a progressive slowing down of the growth process till 1977 as well as the bottlenecks in the way of investment and output expansion, stabilisation and adjustment policies pursued during 1978-84 should be considered as having led to a mixed outcome. Viewed in balance of payments terms, the principal conclusion is that the policies did result in an underlying improvement in the balance of payments, which was, however, offset by a continuing deterioration in the terms of trade. There was also an increase in the growth rate. Official national accounts data indicate a growth in real GDP of 5.5 per cent per annum during the period of adjustment. However growth in real consumption turns out to be either too high or too low depending on the deflator employed. A variety of factors strengthen the suspicion that output growth as measured from the production side may have been overestimated. When GDP accounts are constructed from the expenditure side, real output growth falls to 4.4 per cent per annum. Still, output growth should be considered as a marked improvement compared to the period till 1977; over 1970-77 real GDP growth averaged just under 3 per cent per annum.

The evidence on household income growth from two Central Bank Consumer Finance Surveys is somewhat disquieting. The data on average income per spending unit during the periods 1978/79 and 1981/82 do not support any growth in real income in the three years. Significant nutritional deficiencies expressed as declines in per capita calorie consumption in the lower deciles of the population are also evident in the data. Aside from casting doubts on the official claims on output growth, the evidence on nutritional deficiencies among poorer sections of the population strengthens the view that some components of the adjustment policies, e.g., the withdrawal of the food subsidy, could have directly contributed to this result. Specifically the replacement of a physical ration by unindexed food stamps against a background of an overheated economy and the resulting inflation can be identified as the main factor. Subsidies fell from being 5 per cent of GDP in 1978 to 1 per cent in 1984.

Unemployment levels were on the decline during the period of stabilisation. But this need not have come about from stabilisation policies, since there was substantial emigration of labour to the Middle East as well as under the agreement with India on the repatriation of Estate labour.

The large inflow of external resources facilitated a high rate of investment. In terms of output growth, though, the implication is that of an extremely high capital output ratio at the economy wide level. A further feature of the investment programme is the tilt in favour of inflationary 'cost push', and bottleneck prone projects, as against quick yielding projects where policy changes rather than investment would have produced quick output gains. An example of the latter has been the experience of rice production where an average growth of nearly 4.5 per cent has eliminated import dependence compared to the situation in 1975 when one third of Sri Lanka's rice consumption was imported. This was the result of the exchange rate devaluation which permitted the introduction of a remunerative guaranteed price to the farmer.

Could an alternative strategy have been designed to realise the output, employment and balance of payments goals without having to sacrifice the nutritional standards of the poor? Prima facie it would appear that, had policies elsewhere sought to emulate the paddy production strategy of procuring output through improved incentives and diverted resources from bottleneck prone investment projects to maintaining minimum quality of life levels for lower income groups, it is possible that the adjustment objectives would have been realised without excessive social costs in terms of nutritional deprivation and inflation.

The main features of the adjustment programme during 1979-81 were the reduction in welfare related expenditures and the implementation of a massive public investment programme. The food subsidy scheme in 1979 was targetted to the poorer 35 per cent of the population. From 1980 this subsidy was replaced by the food stamp scheme which was not indexed to inflation. The replacement of the food subsidy by the non-indexed food stamps is seen to have resulted in a real fall in total consumption of food by 7.5 per cent in 1980 and this decrease originated from the poorer section of the population.

Simulations of alternative policy scenarios using a computable general equilibrium model for the Sri Lankan economy indicate that the goals of adjustment could have been realised without adversely affecting the nutritional standards of the poor. These alternative policy mixes include (1) a reduction in the investment programme while retaining the food subsidy; and (2) a raised tariff on consumer imports to yield resources for financing the food subsidy. The model findings illustrate the feasibility of alternative options in pursuing the objectives of adjustment.

I. INTRODUCTION

The year 1977 marked an important point of departure with fundamental changes in the direction of economic policies. The new Government of Prime Minister (later President) Jayewardene which assumed office in that year embarked on the implementation of a comprehensive policy package with the major objective of doing away with the controls and other restrictive features of what was until then an inward looking economy afflicted with severe foreign exchange constraints. The centre-piece of the new policy package was the exchange rate reform unifying the prevailing dual exchange rate system and bringing about an effective and substantial devaluation of the Sri Lankan Rupee. The trade restrictions and controls were eliminated to a large extent, and the domestic economy was for all practical purposes freed from the several regulatory instruments affecting production and distribution. Thus on the eve of 1978 the Sri Lankan economy came to acquire many of the features of a liberal open market system.

In an important sense the policy changes could be considered as the beginning of a stabilisation programme. The persistent foreign exchange shortage of the previous period had severely curtailed the country's import capacity which in turn had starved the productive sectors in agriculture and industry of much needed imported inputs. The result was under-utilisation of productive potential and consequently a slowing down of growth. For several years Sri Lanka had pursued policies designed to provide an extensive system of welfare measures. This included free education, free medical care and the provision of highly subsidised food items. The maintenance of these welfare measures entailed a heavy burden on the Government Budget and a situation had developed where the needs of recurrent and capital expenditure could not be met either from domestic resource mobilisation or through foreign inflows. Indeed, as indicated elsewhere in the paper, the year 1976 - i.e., just before the programme was launched - was characterised by a

previously unprecedented level of deficit financing in the budget.

It was against this background that the new Government embarked on liberalising the economy. The package of policy reforms evolved out of discussions with the major international financial institutions and was premised on a sustained programme of support from the countries constituting the Sri Lanka Aid Consortium. The International Monetary Fund and the World Bank were substantially involved in organising the aid programme and were to some extent instrumental in influencing the far-reaching changes in economic policies by the new Government; the programme was also viewed by domestic policy makers as the only way of relieving a backlog of excess demand pressures.

In chronological order, there were three major International Monetary Fund programmes for Sri Lanka between 1977 and 1984. All the three programmes entailed conditionalities. In general these conditionalities involved performance criteria with respect to:

- ceilings on the expansion of overall domestic credit or the rate of growth of new domestic assets of the banking system;
- ceilings on contracting new non-concessional short and medium terms foreign loans;
- the exchange rate;
- raising restrictions on trade and payments

Although the IMF relies on these criteria essentially to bring about short term adjustments, the longer term objective is to influence structural adjustments in the balance of payments and the economy more generally. The IMF programmes in Sri Lanka were in operation from the third quarter of 1977 through 1978; throughout 1979 and the first

quarter of 1980; and throughout 1983. Irrespective of whether the Government fully conformed to the performance criteria implied in the conditionalities - there is evidence of non-compliance a number of times - the policies pursued during the period 1978-84 could be considered as reflecting the general consensus among the Government, the IMF and the World Bank.

The analysis that follows seeks to assess the impact of Sri Lanka's adjustment programme on a variety of relevant economic magnitudes viz output, savings and investment, the price level, nutritional levels, equity and finally, on the balance of payments. The analysis bears in mind the consideration that the objective of the programme was to achieve a sustainable balance of payments position over the medium term which can for present purposes be defined as encompassing the period, 1978 to 1984. The analysis focusses on how far this medium term objective was achieved and what costs were incurred in respect of the other relevant economic and social magnitudes spelt out above in the process of achieving a sustainable balance of payments position.

It may be convenient, however, to begin by summarising the broad conclusions of the analysis which follows. Viewed in balance of payments terms, the principal conclusion is that had it not been for a continuing deterioration in her terms of trade, Sri Lanka would have considerably reduced the balance of payments gap. This result would have been achieved through a combination of import substitution as well as export promotion policies. However, in evaluating the costs of doing so, one is confronted by certain inconsistencies in the national accounts data which make it difficult to reach unambiguous conclusions. Nevertheless it is possible to shed some light on the probable costs involved.

The principal problem is as regards output growth over the period and may be simply stated. Given the growth of

Gross Domestic Product over the period as established from the production side of the accounts - 5.5 per cent - the paradox is that, depending on the deflator employed, real consumption turns out to be either too high or too low. If the Colombo Consumer Price Index is employed to estimate real consumption at 1978 prices, then per capita private consumption growing at 4.5 per cent annually exceeds the rate of growth of real per capita GDP of 3.8 per cent implying a marginal propensity to consume in excess of 100 per cent over the period - an unrealistic result. However, if the presumably more accurate Central Bank Cost of Living Index is used as the deflator, the growth in real consumption turns out to be too low. There are years when the marginal propensity to save is negative despite income growth. In particular there is an inexplicable fall in private consumption by 5.8 per cent in 1980 when GDP growth from the production side is also estimated at 5.8 per cent. It is unrealistic to expect this order of decline in real per capita private consumption, using presumably an accurate deflator over the period 1978 to 1984, when substantial GDP growth averaging 5.5 per cent is presumed to be taking place.

A variety of other factors strengthen the suspicion that GDP as measured from the production side may have been overestimated. First, commodity production grew relatively slowly at 4 per cent per annum, while services grew at the significantly higher rate of 6.7 per cent. The services sector is one where estimation procedures in the national accounts are relatively weak. A notable gain in commodity production was in paddy production. Construction declined in volume terms more or less continuously from 1981 after an initial spurt during 1978 to 1980, suggesting the emergence of major cost push bottlenecks. Secondly, the data on average income per spending unit in the two Central Bank Consumer surveys carried out during the periods 1978/79 and 1981/82 do not provide evidence of any growth in real income. Real income at 1978 prices in fact fell from Rs.806 to Rs.745 per spending unit. Thirdly, significant

nutritional deficiencies expressed as declines in per capita calorie consumption in the lower deciles can be identified in the data. This conclusion is common to data derived from the Central Bank surveys already mentioned and from the Department of Census and Statistics survey of 1980/81. The presumption that these considerations raise - that GDP growth as measured from the production side has been over-estimated - is further strengthened when GDP is constructed from the expenditure side using the Central Bank's data in 1978 prices, and the Central Bank's more accurate deflator. GDP as measured grew at an average of only 4.4 per cent during 1978-84.¹

This finding concerning relatively sluggish production growth has implications for the observed high rate of investment during the period. It suggests both an extremely high capital output ratio for investment overall, and a balance in economic policy that was tilted in favour of inflationary 'cost-push', and 'bottleneck' prone projects, as against quick yielding projects where policy changes rather than investment would have produced quick output gains. Certainly a notable example of the latter was the experience of rice production where an average growth of nearly 4.5 per cent eliminated import dependence compared to the situation in 1975 when one third of Sri Lanka's rice consumption was imported. This was the result, very crucially of the exchange rate devaluation which permitted the introduction of a remuneration guaranteed price to the farmer. Had, in other words, policies sought more generally to emulate the paddy production strategy and diverted resources from bottleneck prone investment projects to maintaining minimum quality of life levels for lower income deciles, it is entirely possible that higher output levels would have materialised without excessive social costs in terms of nutritional deprivation and inflation.

In particular, the country faced a critical policy choice in 1980 when confronted with a combination of cost-push inflation in construction and exogenous import

price shocks due to oil and other commodity price increases. The decision was then taken to incur expansionary Treasury bill financing that was as much as 10.8 per cent of GDP contrasted with 1.2 per cent in 1979. An alternative policy scenario might have been to rephase projects whose construction content was high thereby reducing cost-push inflation, while incurring a minimum expansionary deficit consistent with no more than accommodating the exogenous import price shock. A computable model that was developed for the purposes of this study simulates alternative scenarios that might have resulted given a different policy mix; the simulations indicate that 'lower cost' policy mixes were indeed available and that the balance of payments goals of the adjustment programme would just as easily have been realised by having recourse to one or other of these options.

II. THE ECONOMIC BACKGROUND TO THE ADJUSTMENT PROGRAMME OF 1977

There were two key elements in the pre-1977 picture which virtually predetermined the 1977 adjustment programme - both dominated by the concern of the then Government to be returned to office at the general elections of July 1977. The first of these was the revaluation by 20 per cent of the Sri Lanka Rupee on 12 March 1977 with the intention of bringing down import prices, and to that extent the cost of living, on account of imported goods. Sri Lanka had continued during the 1970s to maintain the dual exchange rate system first introduced in 1966. There were effectively two markets in foreign exchange - the 'A' and the 'B' market. This meant a relatively appreciated rate for exports of traditional tree crop commodities in inelastic demand, e.g., tea and rubber and the import of essential wage goods, e.g., rice (the so called 'A' market); and a more depreciated rate for non-traditional exports and imports of non-essentials expressed as a percentage premium in Rs per Dollar over the base rate (the so called 'feec' rate applicable to the 'B' market). The design was patterned after the ideas of Lord Kaldor first elaborated in 1965;² it was meant to maintain a dual exchange rate and therefore export competitiveness in the context of a strong trade union movement based in part on Britain's 1949 experience of devaluation of a unitary exchange rate. Nevertheless, an effective devaluation of the Rupee had over the years been achieved with this dual exchange rate system by (a) increasing the percentage premium in the 'B' market in terms of Rupees per Dollar of the 'feec' rate over the base rate, (b) by periodic small devaluations of the base rate itself and (c) by the shifting of items, e.g., books from the 'A' market to the 'B' market.

The decision in 1977 to revalue the Rupee was a dramatic reversal of this trend. It became publicly known that this decision was a controversial one at the level of the Monetary Board of the Central Bank and one to which at the

highest official level the Treasury had strenuously objected. Nevertheless, considerations of political expediency prevailed and the revaluation was endorsed by the Cabinet and the Government of the day.

As one wag put it at the time, about the only price which came down as a result of the revaluation, was the price of a bottle of whisky which was easy enough for the prevailing system of controls to police. The reason, of course, was the climate of excess demand against which the decision to revalue was made and it is this factor of excess demand which was the second element in the economic background leading up to the 1977 adjustment programme. Excess demand in Sri Lanka unfolded in two phases in 1976 and in 1977 for two quite separate reasons. If excess demand is denoted in proxy form by monetary expansion, then the money supply (narrow money M1) rose by almost 35 per cent - Rs.1,077 million - in 1976 as compared to an increase of 4.8 per cent in 1975 and 6 per cent in 1974. The expansionary gap in the budget amounting to Rs.605 million constituted the main factor behind the monetary expansion that year accounting for around half of that expansion. The other large element corresponded to the build up of reserves, (unfortunately unsterilized by appropriate monetary policies) that resulted from the mini tea-boom of that year. Credit to the private sector expanded by Rs.427 million and was not a determining factor in the picture.

The cause of the budget deficit, in turn, was the reduction in the price of flour brought about on 7 July 1976, again in anticipation of the 1977 elections. The Monetary Board of the Central Bank is obliged statutorily to report to the Minister of Finance whenever the money supply (narrow money M1) had increased by more than 15 per cent or the cost of living index by more than 10 per cent over their levels a year earlier. The first such report during 1976 was submitted to Government on 19 July 1976 covering the year April 1975 to 1976 during which a money supply expansion of 15.4 per cent had resulted primarily from deviations of the

Government budget from estimates. But by this time the reduction in the price of flour which was the decisive factor affecting the calendar year 1976 money supply expansion had occurred. It was possible through regression analysis of relevant variable being done in the Treasury to indicate how far the budget deficits expected for 1976 and for 1977 with or without the contemplated crash employment programmes then under consideration, would have a bearing on price inflation. The results are tabulated below.

| <u>1976</u> | <u>Deficit</u> | <u>Increase in money supply</u> | <u>Predicted increase in prices</u> |
|---|----------------|---|---|
| a) The Budget as it stood including the reduction in price of flour and increase in excise duties announced on 7.7.76 | Rs.500mn | 26% | 32% |
| b) The contemplated employment programme superimposed on (a) | Rs.633mn | 30% | 38% |
| <u>1977</u> | | | |
| c) The budget deficit then anticipated taking into account the effect of measures announced on 7.7.76 | Rs.900mn | 31% | 76% |
| d) Employment programme added to c) | Rs.1300mn | 40% | 96% |

It will be seen therefore that from the vantage point of policy makers of around the middle of 1976, levels of inflation of the order of 75-100 per cent - previously unknown in Sri Lanka - were seen to be likely if anticipated budget deficits were not bridged by appropriate taxation or market borrowings and if off-setting monetary policies were not put in place or if fiscal policies were not otherwise changed. Monetary policies would in any event have to be carefully devised taking into account their possible dampening impact on private sector activity. In the event the inflationary implications of the crash employment

programmes were such that this was resisted at the highest political level and the proposal was not even put up to Cabinet for decision. The programme had been intended to employ some 300,000 persons before elections. Nevertheless, the inflationary impact of the pre-existing budget deficit resulting largely from the flour price reduction had already been built into the economy and the policy problem had become one of generating the external resources needed to run the scale of import surpluses that would dampen inflation.

What was also crucial to determining the 1977 adjustment package introduced with the budget of November 1977 was the continued monetary expansion during 1977. Whereas the major impetus in 1976 came from the Government budget, the additional pressure on money supply came in 1977 from the private sector. In July 1976 the Monetary Board had proposed a set of monetary policies that included:

- a) a modification of the regulations governing till cash as part of the required reserves to be maintained by the commercial banks with the Central Bank.
- b) an increase in the reserve ratio on demand deposits.
- c) an upward revision of the bank rate from its level of 6.5 per cent and the removal of the higher penal rate at which banks would borrow from the Central Bank beyond defined credit limits.

While these proposals were not persisted with, the following measures were subsequently adopted:

- a) a gradual reduction in the proportion of required reserves that the banks were permitted to maintain in the form of Sri Lankan notes and coins, commencing 29 October 1976.
- b) a halving of bank credit for non essentials with effect from 4 October 1976.

c) an upward revision of the bank rate of 2 percentage points to 8.5 per cent effective from 26 January 1977 and the simultaneous removal of the penal rate.

However, these monetary policy measures had little impact on the growth of private sector credit as evidenced by the fact that it rose in gross terms by as much as Rs.1,057 million in the first 5 months on 1977 contributing to that extent to the expansion of money supply during the calendar year 1977 in an amount roughly equivalent to the total money supply expansion during 1976. Part of the increase was unavoidable amounting to Rs.377 million for the extension of credit for the financing of paddy (rice) purchases under the guaranteed price scheme. But commercial banks were not deterred by the higher bank rate from borrowing from the Central Bank and this is indicated by the fact that total commercial bank borrowings at that rate, amounted to Rs.380 million at the end of May 1977. Clearly the Monetary Board had erred in withdrawing a still higher penal rate because as it happened, even an enhanced bank rate did not prove deterrent enough.

In the event money supply during 1977 (narrow money M1) expanded by 29 per cent, the trend of commercial borrowing at bank rate being reinforced by the writing-off credit extended to paddy (rice) farmers.

To summarize then, Sri Lanka witnessed two successive years of monetary expansion in 1976 and 1977 which at around 35 per cent and 29 per cent annually was extremely large by previous standards and not much different from the 26 per cent and 31 per cent estimated for purposes of earlier regression analysis in 1976 as likely outcomes for these years. These increases would, when inserted into the regression equation, in use in the Treasury, have yielded a higher level of inflation than foreseen then. The only available policy alternative for reducing inflation was to run a sufficiently large import surplus by drawing down the reserves built up in 1976 and securing further additions to

external resources through a stabilization programme negotiated with the IMF and subsequently complemented by support from the World Bank and the Sri Lanka Aid Group. The fact that the excess demand problem was caught early meant that, during the period 1978-79, inflationary pressures were subsequently cushioned by a substantial influx of external resources resulting from the Fund/Bank programme. In addition compensating wage increases introduced as part of the stabilization package made possible a major increase in real wages. Both price and real wage movements were influenced during this period by the scale of import surpluses Sri Lanka was able to run under the Combined Bank/Fund programme amounting to 9.2 per cent of GDP in 1978 and 1979 as compared with 4.6 per cent of GDP in 1976-77

Given that the emerging excess demand situation predetermined the need for additional external resources which would have been unavailable without a Fund stabilization programme, the policy problem was that of negotiating what was essentially an inflation prevention exercise at minimum social cost. As is often the case, the choice lay between the raising of particular prices as part of the process of bridging an excessive budget deficit on the one hand and permitting on the other the generalized inflation at unprecedentedly high levels that would otherwise have supervened. In particular, both the Sri Lankan and the Fund negotiating teams focussed inevitably on the food subsidy as a major area for action in correcting the budget deficit.

Sri Lanka had long had a reputation for maintaining a subsidy on food of between 4 per cent and 5 per cent of gross domestic product from, in fact, the 1950's. Conventional wisdom had always sought to eliminate it in the belief and hope that the resulting shift to investment would have made for higher growth rates and thereby lower unemployment rates. The peculiar features of Sri Lanka's social matrix described elsewhere in this paper had hitherto, by-and large had the effect of resisting the

implementation of this conventional wisdom to any significant extent. Typically, an opposition party in Parliament expecting to win an election would campaign on the basis of enhancing rather than reducing the food subsidy and having again typically won, would usually succeed in implementing at least part of their campaign promises in the immediate aftermath of political victory. Then a process of education as to the limits of room for manoeuvre set by budget deficit considerations and their inflationary and balance of payments implications would set in. With alternate pulling and pushing by domestic officialdom and by Fund/Bank missions, some more or less feeble policy correction would occur mid-way during a Government's tenure of office.

This involved at times considerable ingenuity as evidenced by the decision in 1969, for example, to introduce free rice on the ration. This was not, in fact, as is sometimes assumed, an increase in the food subsidy, but a way of making a reduction in the subsidy politically palatable and therefore saleable towards the end of a Government's tenure. The pre-existing situation was one where four pounds of rice per person were provided, under the ration at a price of 25 cents for every two pounds, or 50 cents for the four. What the subsidy cut meant was a decision to grant on the ration the first two pounds free while the price of the balance two pounds was raised to 75 cents. The effect, of course, was to increase the average cost of rice and to that extent reduce the burden on the budget. Subsequent attempts at reducing the rice subsidy took the form of either increasing the price of the second two pounds of rice or of successively cutting the two pounds that were initially available free. By 1977 typically only one pound of rice was actually free on the ration supplementing amounts being available off ration in the open market. Thus what emerged in Sri Lanka under the political pressures stemming from its social matrix was a dual price regime for rice as well as for several other commodities, with minimum though not adequate basic rations forthcoming

at a subsidized price, and supplemented by consumers in the market place at the going rate. Such mid-course corrections would then, typically, be followed, at the very least by a policy vacuum pending the run up to the next election. Also, typically, some form of economic give-away would be implemented in the usually vain attempt to retain power at election time but which would have the effect of saddling the successor Government with an additional economic burden to be resolved.

The political cycle which brought in the new Government in 1977 ran true to previous form. It inherited the problem of coping with the 'give-aways' of the run up to elections. Moreover in the immediate aftermath of the election victory, the new Government itself felt obliged in implementation of election promises, to reduce the price of flour still further and this set the base line for the negotiations with the Fund and the Bank that followed.

The Bank in its 1978 report on Sri Lanka came up with a point of view that challenged the conventional wisdom on the need to have eliminated the food subsidy long ago. In an annex to the report prepared by Paul Isenman, the proposition was put forward that had Sri Lanka cut her food subsidy in the 1950s and re-invested its proceeds it would have reached a level of per capita income that would have been associated, (using the Bank's own country cross-section analyses), with lower levels of quality of life than in fact Sri Lanka had succeeded in enjoying by 1977 after having, in fact, followed throughout her policy of maintaining food subsidies with relatively marginal adjustments over time.

The problem for policy makers in 1977 was that of determining the extent to which the subsidy might be further tampered with in the interests of safeguarding the budget and preventing generalized inflation, while at the same time protecting basic needs and keeping Sri Lanka's quality of life unimpaired. It was at this point that recourse was had to nutritionists rather than economists and the results

simply turned over to the IMF for consideration.³ The nutritional data drew attention to a growing problem of malnutrition affecting the bottom 40 per cent of the population earning under Rs.200 per month during the 1970s as compared with the late 1960s. The technocratic instinct - in this case the IMF's - was to eliminate the food subsidy totally whenever a suitable opportunity presented itself. The bureaucratic or rather domestic policy makers' instinct was to ensure that any such process would go no further than was necessary to negotiate the external resources required without sacrificing social stability and throwing the bottom 40 per cent of income earners to the wolves.

An important element in the negotiation was the need to secure external funding for a major project package that would, in effect, seek to convert the subsidy into employment gains during the term of office of the Government. A key element in this package was the accelerated river-basin development of the Mahaweli, Sri Lanka's largest river involving both irrigation and electric power generating capacity and hence expected to contribute significantly to employment creation. This was funded in part by the domestic resources released by the subsidy cut and by external resources mobilized by the Sri Lankan Aid Group convened under World Bank auspices. The overall negotiation was therefore a composite one involving both international financial institutions.

The particular compromise negotiated with the International Monetary Fund in the first instance was to take away the free ration of rice from the top half of the population - some 7 million; to introduce a compensating wage increase; and to reverse the revaluation in crawling peg fashion ending up with an initial devaluation at a rate of Rs.16 per Dollar which was marginally below the going black market rate, and accelerate the inflow of externally financed supplies by a fairly thoroughgoing import liberalisation while managing the Rupee's float by keeping an eye on the level of reserves. The quid pro quo - obtained

from the Fund was a three tranche drawing on Sri Lanka's quota as an initial standby credit of SDR93 million in November 1977 followed by an Extended Fund facility drawing in 1979. Subsequently, Aid Group resources were obtained for the construction of three dams in the Mahaweli Basin, followed by a fourth in 1980.

The essential domestic policy elements evolved, however, out of negotiations with the IMF in November 1977 for the three tranche standby credit of SDR 93 million. The main points of the agreement between the Sri Lankan Government and the IMF were:

- (i) Immediate devaluation of the Rupee to a parity of Rs.16 to the U.S. Dollar, the adoption of a unified exchange rate system, and thereafter floating the Rupee which was to be tied to a basket of currencies.
- (ii) Liberalisation of many categories of imports and the replacement of controls by tariffs.
- (iii) The existing food subsidy system was to be replaced by one under which the only beneficiaries were to be households earning less than Rs.300 a month. In the case of the sugar ration, only the children of such families under the age of 12 would be eligible.
- (iv) A commitment to increase the price of flour at some stage (it had been reduced from Rs.1.10 to Rs.0.60 in the middle of 1977). Similarly, the price adjustments for fertilizer, petroleum, public transport and infants' milk were deferred for the time being.
- (v) A ceiling on the net domestic assets of the banking system, and a sub-ceiling on Government credit. Both these ceilings were to be binding

pre-conditions for making drawings, the timing of the 'trigger points' being the end of December 1977 and the middle of 1978.

- (vi) Increases in the interest rate on private savings deposits; from 7-8 per cent to 12-18 per cent on 6-18 month deposits.
- (vii) Constraint on the use of foreign exchange reserves. Annual loss was fixed at SDR 150 million; any excess over this figure was to be met by allowing the Rupee to depreciate downward.
- (viii) Limits on foreign borrowing: SDR 50 million for loans of one to five years' maturity and SDR 150 million for loans of one to 15 years' maturity.
- (ix) An across-the-board wage increase of 25 per cent, subject to a ceiling of Rs. 50 a month.
- (x) An increase in the procurement price for paddy from Rs.33 to Rs.40/bushel.

This was the initial policy framework. Over the following years, policies continued to conform to this general framework, though with varying degrees of emphasis on specific issues. The IMF and the World Bank continued to exercise some influence on Government policy; the former through two subsequent standby agreements including an Extended Fund Facility and the latter as the convenor of the Aid Consortium for Sri Lanka. The latest agreement with the IMF in 1983 stipulated that the Sri Lankan authorities will adjust the exchange rate of the Rupee at frequent intervals in order to at least maintain its competitiveness in real effective terms and that the changes will be made on the basis of a trade weighted exchange rate index deflated by relative monthly movements in wholesale prices for Sri Lanka and partner countries. The usual performance criteria in

terms of ceiling on domestic credit creation and limits on short term foreign borrowings were also part of the agreement.

In passing, it must be noted that the policy thrust in major essentials was well in line with the political and economic philosophy of the Government that assumed office in 1977. The principal area of difference initially was the extent of curtailment of the food subsidy, essentially on account of the politically unpalatable and nutritionally damaging task of doing away with a welfare measure, which had been in place for well over three decades and whose benefits had, as mentioned, begun to erode during the 1970s; and the policy compromise worked out in the negotiation was to retain the free rice ration for the poorer half of the population while eliminating it from richer half. Eventually the Government decided to bite the bullet and replaced the food subsidy through a means-tested non-indexed food stamps programme in late 1979, resulting in considerable savings in Government expenditure. The expectation of a spurt in employment creation flowing from the planned public investment programmes being negotiated with Aid Group support, providing a cushion to the subsidy cut, helped in this decision to further trim the subsidy. Hence, the Sri Lankan experience is not a clear case of the IMF and the World Bank coercing a Third World Government to adopt a set of unwelcome policies. It is more in the nature of a generally agreed programme, with the Government departing from essentials only under inevitable circumstances.

III. THE SOCIO-ECONOMIC MATRIX

Sri Lanka is essentially a rural society. Some 80 per cent of the population still reside in rural areas. In terms of conventional usage, as adopted in all socio-economic surveys conducted in Sri Lanka, households are classified into three groups. These are i) rural households, ii) estate households, and iii) urban households. According to the 1980/81 Socio-Economic Survey, 74 per cent of all households were in the rural sector, 7.3 per cent were in the estate sector, and the remaining 18.7 per cent in the urban sector.

The socio-economic characteristics of these household groupings are to a large extent derived from their principal occupations and partly from their ethnic origins. Most of the rural households are involved with the production, processing and trading of paddy. Except in the northern and parts of the eastern provinces, these households generally belong to the Sinhala-Buddhist community. Since there is relatively less of paddy cultivation in the north and east - the ethnic identification here is mainly that of Tamils and mostly belonging to the Hindu religion - occupations centre around a variety of subsidiary food crops cultivation. Estate households comprise landless labourers employed as workers in tea or rubber plantations. By and large they are Indian Tamils, whose forefathers had been brought in during the 19th century by the British. Urban households reflect the mix of public and private sector occupations in production and services. Here the ethnic composition is largely Sinhalese with a significant share of Sri Lankan Tamils and Muslims.

In terms of political strength, the Sinhala paddy farmers are undoubtedly the most significant group. Next come the urban trade unions with their capacity to disrupt activities in manufacturing and the white collar occupations. Since these unions are splintered in terms of their loyalties to different political parties, they have not been able to exert any influence on Government policy

apart from being of sporadic nuisance value. In recent years the Government has put down firmly all activities savouring of industrial unrest.

Of all the groups, it is the estate workers who have been the least effective in exercising any political influence. Though there are large trade unions to represent their interests, these are of no consequence, since most of these workers do not have the right to vote and do not count in the electoral arithmetic. A large number of the estate workers are awaiting repatriation to India under a bi-lateral agreement. Those remaining have either got the voting right very recently or are yet to be recognised as citizens with voting rights.

Successive Governments in Sri Lanka have accorded, in varying degrees, primacy to the interests of paddy farmers, which is a reflection of the political clout exercised by this group. Expansion of domestic paddy production was considered to be of high priority for the attainment of several goals, viz, rice self sufficiency; import substitution and improvement of the balance of payments; raising the incomes of paddy cultivators and promoting rural employment; and the gradual replacement of the imported wheat component of cereal consumption.

The principal instruments deployed for the realisation of the paddy sector objectives were i) a guaranteed price scheme; ii) the provision of fertiliser subsidies; iii) capital expenditures on major irrigation schemes; and iv) research and extension services. At the other end, the consumers were subsidised through rice rationing. Limited quantities of rice were given free to all consumers until 1977. This scheme was subsequently replaced through the provision of non-indexed food-stamps for families receiving income below a specified ceiling.

Production incentives to the paddy sector were somewhat boosted with the withdrawal of the subsidised food rations

and its replacement by food stamps. With a free market in rice trading, the guaranteed price came to be essentially the floor support price. Far more crucial as an incentive was the devaluation of 1977 which ensured that the domestic market price was generally in accord with world price levels. Hence the paddy farmers were able to gain a margin over the support price in addition to the input subsidies relating to fertiliser and irrigation.

The estate households constitute the work-force in the production of tea and rubber. It is this sector which has provided the bulk of the economic surplus available for deployment elsewhere in the system. The resources from this sector have financed the needs of the non-agricultural sector and to some extent even the paddy sector. Yet the development of the tree crop sector has lagged behind (tree crops are tea, rubber and coconut) since there has been little reinvestment or efforts to augment its production potential. As a result, the tree crop sector and particularly tea production has stagnated. And the estate households are virtually at the lower end of all the three groups of households in terms of living standards.

At another level, it is the estate sector which has generated the surplus for the financing of all the welfare services of the Government for several years. Net taxes collected from the plantations have generally exceeded the requirement of Government expenditure on food subsidies.⁴ In recent years, when the food subsidy has either been reduced or has been replaced by food stamps, the net revenue collected from plantations could be diverted to other heads of Government expenditure even after meeting the food stamp expenditure.

IV. IMPACT ON OUTPUT

The Sri Lankan economy reported impressive gains during the period 1978-84. Gross Domestic Product in real terms apparently increased at an annual rate of 5.5 per cent, as measured from the growth of production. This order of growth was made possible by agriculture growing at 4 per cent per annum, mining and manufacturing at 4.4 per cent, construction at 3 per cent and the services sector at 6.7 per cent. Among the principal agricultural crops, it was paddy that recorded the maximum gains. This is not surprising since the Government's investment policy and price policy favoured paddy cultivation. The abandonment of the rice ration scheme in 1979 resulted in all paddy transactions coming into the open market and consequently raising the producer price. Investments in major irrigation works contributed to increasing the proportion of land under irrigation, which in turn boosted yields. The price incentive served to increase the extent of the sown area and expanded irrigation facilities helped in the propagation of high yielding varieties and increased fertiliser application. In the event, paddy output increased significantly.⁵

The performance of the tree crop sector comprising tea, rubber and coconut was not satisfactory. Of these, output of tea and rubber declined. In the context of being the single major contributor of export earnings, the poor performance of this sector - and more particularly that of tea - had significant implications for balance of payments. The exchange rate reform did not result in higher returns to tea cultivation.⁶ Inadequate application of inputs, poor management, and absence of significant new investment all contributed to the situation. Thus, while the incentive package in the case of paddy did result in import substitution, the potential for increased exports of tea could not be realised due to poor production performance.⁷

Table 1: Annual Real Growth Rates of GDP and Selected Sector, 1978-84
(at constant 1970 factor prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | <u>1978-84</u> |
|-------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------|
| <u>Agriculture</u> | 5.4 | 2.0 | 3.1 | 6.9 | 2.6 | 5.3 | 2.1 | 4.0 |
| Paddy | 12.7 | 1.4 | 11.9 | 3.6 | -3.4 | 15.2 | -3.5 | 4.4 |
| Tea | -4.3 | 3.5 | -7.5 | 10.0 | -10.7 | -4.5 | 16.2 | -0.6 |
| Rubber | 5.6 | -0.9 | -13.0 | -6.7 | 0.6 | 12.3 | 3.7 | -1.5 |
| Coconut | 15.4 | 6.4 | -11.0 | 11.5 | 11.3 | -8.3 | -7.0 | 2.1 |
| Other Agriculture | 0.7 | 0.2 | 4.7 | 8.0 | 6.7 | 6.2 | 7.2 | 5.9 |
| <u>Manufacturing and Mining</u> | 10.0 | 4.8 | 1.6 | 5.9 | 4.6 | 2.2 | 9.2 | 4.4 |
| Export Processing | 2.1 | 4.4 | -9.8 | 7.6 | -5.3 | -4.6 | 9.0 | -0.9 |
| Factory Industry | 11.0 | 4.0 | 5.0 | 4.0 | 8.9 | 2.0 | 14.0 | 5.9 |
| Small Industry | 13.2 | 9.8 | 0.0 | 5.1 | 10.1 | 4.0 | 4.2 | 5.4 |
| <u>Construction</u> | 28.3 | 20.9 | 11.0 | -3.0 | -2.0 | 1.0 | -0.1 | 3.0 |
| <u>Services</u> | 7.6 | 7.8 | 8.0 | 6.4 | 7.0 | 6.6 | 5.8 | 6.7 |
| <u>GDP</u> | 8.2 | 6.3 | 5.8 | 5.8 | 5.1 | 5.0 | 5.0 | 5.5 |

Annual real growth rate over 1978-84 period using least squares method or estimating trend growth rate.

Source: Central Bank of Ceylon.

The overall growth in real GDP is partly attributable to the sharp rise in investment. Investment as a proportion of GDP increased substantially, ranging from 50 per cent to 90 per cent, as compared to the pre-1978 period. The incremental capital output ratio at 1978 constant market prices was of the order of 4.5, denoting the capital intensive nature of the growth attained. The growth in commodity production and the much larger rise in services output are presumably the result of the massive investment programme, largely financed by concessionary aid inflows. The resultant high level of imports, apart from contributing to the production-related activities, also led to a rise in import trade and hence to trade-related services. Hence, the high level of aid-financed investment could be seen as an important factor promoting growth during the period.

Analysis of the sources of growth shows that there have been declines in the shares of value added accruing to

agriculture and manufacturing activities. The share of agriculture declined from 26 per cent in 1978 to 23.4 per cent in 1984. Corresponding figures for manufacturing were 14.6 per cent and 13.8 per cent respectively. The share of the economy accounting for all commodity production fell from 45.1 per cent in 1978 to 41.8 per cent in 1984. However, in the case of services, the share of value added has risen from 50.3 per cent in 1978 to 53.9 per cent in 1984.

In most developing countries the process of structural change manifests itself initially in a larger growth of the industrial sector resulting in a rise in its share of the GDP. This did not happen in Sri Lanka during the period 1978-84. Given the fact that Sri Lanka is still in the early stages of development and has a low per capita income of around \$350, the falling share of commodity production is a cause for concern. This is particularly the case, since Sri Lanka has in no way reached the stage of satisfactorily meeting all the basic needs of food, clothing and housing, which depend a great deal on rapid expansion of commodity production. The need for closing the foreign exchange gap - which is of high priority in the case of Sri Lanka - will require the continued development and expansion of commodity production and specifically in the case of manufacturing activities. Viewed in this context, the structural change in favour of services could have contributed to a widening of the imbalance in the Sri Lankan economy. To the extent that the growth of services sectors like tourism augments foreign exchange earnings, there will be a positive effect on the balance of payments. However, the growth of the services sector with an elasticity of 1.5 in relation to that of commodity production will lead to further aggravation of the structural weakness in the economy. The evolution of the structural composition of the economy since 1978 is indicated in Table 2.

Table 2: Structural Composition of the Economy - 1978-1984 (percentages)

| <u>Sector of Origin</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Commodity production including utilities of which | 45.1 | 43.9 | 42.6 | 42.8 | 42.2 | 41.8 | 41.8 |
| Agriculture | 26.0 | 25.0 | 24.3 | 24.6 | 24.0 | 24.1 | 23.4 |
| Manufacturing | 14.6 | 14.4 | 13.7 | 13.6 | 13.6 | 13.0 | 13.8 |
| <u>Construction</u> | <u>4.6</u> | <u>5.2</u> | <u>5.4</u> | <u>5.0</u> | <u>4.7</u> | <u>4.5</u> | <u>4.3</u> |
| <u>Services</u> | <u>50.3</u> | <u>50.9</u> | <u>52.0</u> | <u>52.2</u> | <u>53.1</u> | <u>53.7</u> | <u>53.9</u> |

V. IMPACT ON SAVINGS AND INVESTMENT

A major objective of the policy changes introduced in 1977-78 was to drastically reduce the interventionist role of the Government and to let market forces be the determinant of economic activities. There was, however, one major exception. The role of the Government in undertaking direct investment activities assumed considerably increased significance during the period 1978-84. The Public Investment Programme of the Government pre-empted the larger share of resources and accounted for some 60-65 per cent of Gross Domestic Capital Formation (GDCF). The step-up in GDCF itself was steep from an average of 16 per cent of GDP at market prices during 1970-77 to 20 per cent in 1978 and 34 per cent in 1980. The composition of GDCF as a proportion of GDP at current market prices and the shares of the public and private sector are set out in Table 3.

Table 3: Composition of Gross Domestic Capital Formation
(percentage of GDP at market prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|-------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Total GDCF | 20.0 | 25.9 | 33.7 | 27.8 | 30.8 | 28.9 | 25.3 |
| Public Sector Share | 11.9 | 16.7 | 21.2 | 16.2 | 19.1 | 16.6 | 15.9 |
| Private Sector Share | 8.1 | 9.2 | 12.5 | 11.6 | 11.7 | 12.3 | 9.4 |

The core of the Public Sector Investment Programme⁸ was related to the development of the major river basin - the Mahaweli - through the construction of a number of hydro-electric projects and irrigation channels. Another important component was the housing and urban development programme. Both these schemes involved a substantial construction component. The core projects had the support of the international financial institutions like the IMF and the World Bank and had been formulated on assurances of foreign aid on concessionary terms. Given the nature of these projects in terms of high capital intensity and long

gestation periods, it was only to be expected that inflationary pressures on account of cost-push and demand-pull factors would be of a high order. The capital intensive nature of the programme is reflected in the sharp rise in capital-output relationships.

The financing of the investment programme was heavily dependent on the flow of external resources. The core part of the Public Investment Programme was largely tied to project related loans. Despite the impressive output growth during the period, there is little evidence of any significant mobilisation of domestic savings. Throughout most of the period, domestic savings as a percentage of GDP at current market prices fluctuated in the range of 11 to 14. Compared to earlier performance indicating an average of 12.7 per cent, there is very little improvement in the domestic savings rate. The foreign inward remittances by Sri Lankans employed abroad was an important element boosting net private transfers and consequently the volume of the nation's savings. It must be noted that these remittances helped in a fortuitous manner to buttress the balance of payments situation and to augment the resources available for GDCF; their magnitude, however, was clearly unrelated to domestic economic policies, except for the inducements of a high interest rate and some fiscal concessions.

Table 4: Savings and Investment Profile
(percentage of GDP at current market prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <u>Investment (GDCF)</u> financed by | 20.0 | 25.9 | 33.7 | 27.8 | 30.8 | 28.9 | 25.3 |
| Domestic Savings | 15.3 | 13.8 | 11.2 | 11.7 | 11.8 | 13.8 | 19.3 |
| Net Remittances* | 0.2 | 1.0 | 2.7 | 2.4 | 3.6 | 2.6 | 2.4 |
| Foreign Savings | 4.5 | 11.1 | 19.8 | 13.7 | 15.4 | 12.5 | 3.6 |

*This is the sum of net factor incomes earned abroad and net private transfers

A very substantial share of the investment was financed by foreign resources. In four out of the seven year period, domestic savings were less than even half of the financing requirements. This is essentially an example of a successful external resource mobilisation effort and, in part, highlights the advantages of pursuing policies supported by international financial institutions, which exercise considerable influence with donor countries. It is clear that the liberalised economy and the policies pursued by the Government did not yield any significant increase in domestic savings. And this is in spite of the reported impressive growth in GDP.

There was a general increase in interest rates during this period.⁹ Commercial bank interest rates on 12 month fixed deposits were raised from 14-15 per cent in 1978 to 20-22 per cent by 1980. Increases were also effected for deposits with savings institutions. These higher interest rates were, however, inadequate to compensate for the inflation during the earlier part of the period, and as a result, real interest rates became negative. In such a situation, mobilisation of savings became difficult. The unchanged rates of domestic savings during the years 1980-82 could be partly due to the fall in real interest rates.

The impact of the inflation and high interest rates was reflected in the cost of investment also. There is evidence to show that the costs of investment had risen at a higher rate than in the case of output. A comparison of the relationship between GDCF and GDP at current and constant market prices show that the higher cost of investment resulted in lower investment in real terms. The comparison is shown in Table 5.

Table 5: Impact of Price Inflation on Investment
(percentage of GDP at market prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| GDCF at Current Prices | 20.0 | 25.9 | 33.7 | 27.8 | 30.8 | 28.9 | 25.3 |
| GDCF at Constant 1978 Prices | 20.0 | 23.6 | 27.7 | 25.8 | 25.0 | 25.4 | 24.6 |

When adjusted for the effect of prices, GDCF as a proportion of GDP seems to be leveling off at around 25 per cent. The cost of investment was particularly high in 1980, 1982 and 1983. While 1980 has been a period of high prices, the effect in 1982 and 1983 must have come about as a result of substantial price increases for investment goods also.¹⁰

The high interest rates and the high cost of investment appear to have inhibited private investment activity. There is little evidence of any private sector investment of significance in manufacturing activities. Obviously the market-oriented policies succeeded neither in mobilising domestic savings nor in promoting private sector investment, other than in the services sectors. Viewed in this context, the adjustment policies apparently failed to create an impact on private sector commodity production activities, particularly in manufacturing.

Among the policy objectives outlined for the post-1977 period was the Government's intention to bring about a marked shift in the allocation of resources from consumption to investment. This in effect implied a curtailment of recurrent expenditures in the budget and the generation of current account surpluses for capital formation. An examination of the Government financing of its capital expenditures reveal the continued dependence on external and domestic borrowing for not only the entirety of capital expenditure needs but even to meet a part of the recurrent expenditures.

While Government tax revenue, as a proportion of GDP, declined through much of the period mainly as a result of reduction in export duties and a fall in export prices - the share of import duties also declined after 1980 - expenditure was curtailed through the reduction in subsidies and in the wages and salaries component.¹¹ The increase in the share of business turn-over taxes was not adequate to boost revenue over the requirements of meeting recurrent expenditure. The net result was that the current account surplus (indicating Government savings) did not reach any significant level until 1984. The financing of the Government's capital expenditure during 1978-84 is shown in Table 6.

Table 6: Financing of Government Capital Expenditure*
(percentage of GDP at current market prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <u>Capital expenditure</u> <u>financed by</u> | <u>12.8</u> | <u>14.8</u> | <u>18.6</u> | <u>13.8</u> | <u>16.2</u> | <u>13.6</u> | <u>12.8</u> |
| Government savings | -1.3 | 0.4 | -3.6 | -1.8 | -1.4 | 0.1 | 3.9 |
| Foreign grants | 1.5 | 2.6 | 4.0 | 3.2 | 3.4 | 2.8 | 2.2 |
| Foreign project loans | 3.5 | 1.3 | 1.5 | 2.3 | 3.0 | 4.0 | 4.2 |
| Foreign commodity loans | 2.4 | 2.1 | 1.6 | 1.6 | 1.0 | 0.8 | 0.4 |
| Foreign other loans | 1.8 | 1.1 | 2.1 | 1.9 | 0.8 | 0.4 | 0.4 |
| Domestic non-market borrowing | 1.8 | 1.1 | 2.1 | 1.9 | 0.8 | 0.4 | -0.4 |
| Domestic market borrowing | 0.7 | 1.7 | -0.7 | 0.4 | 1.7 | 1.8 | 0.5 |
| Expansionary financing (Domestic bank borrowing) | 3.8 | 4.4 | 3.1 | 1.7 | 4.0 | 3.3 | 3.4 |

*Excludes repayment of public debt.

On average, a fifth of the financing requirements of Government capital expenditure was met through foreign grants. Some 38 per cent was financed through foreign loans, most of which were on concessionary terms. Thus domestic resource mobilisation was required for only just over 40 per cent of the capital expenditures. But even for the financing of this somewhat modest share, the Government had to resort to varying doses of expansionary financing. Only a quarter of the total financing requirements could be found through non-expansionary domestic market borrowings - principally

through the use of captive savings like insurance, provident funds, etc. For the balance, borrowing from the banking system with its direct expansionary and inflationary implications, was the final resort. Obviously the revenue and expenditure policies were not attuned to the scale of capital expenditure envisaged. This was particularly evident in 1980, when expansionary financing was of the order of 10.6 per cent. During the next two years, the level came down to 4.5 per cent and 3.7 per cent respectively.

Given the reported output growth in the economy at a sustained rate of 5.5 per cent per annum, the inability of the Government to generate surpluses for the financing of its capital expenditure is note-worthy. The assured flow of foreign grants and concessionary aid did provide a sound basis for embarking on an ambitious investment programme. It was noted earlier that domestic savings had virtually remained stagnant despite the reported growth in GDP. The fiscal policies of the Government failed to generate even modest surpluses to finance part of investment financing. It would thus appear, that the output growth was substantially dissipated in consumption; or alternatively, that growth did not in fact attain the rates of expansion claimed in the national accounts.

VI. IMPACT ON PRICES

A crucial element in the analysis of the effect of adjustment policies is the behaviour of the price level. In the case of Sri Lanka, official data on prices are compiled by the Department of Census and Statistics and the Central Bank. The Colombo Consumers Price Index is published by the Department of Census and Statistics while the Central Bank is responsible for the Wholesale Price Index and the Cost of Living Index. Besides these, the implicit deflator derived from the constant and current price estimates of national income provides another indicator of price movements. However, some analysts¹² have recently expressed the view that the official Consumer Price Index does not reflect the actual price movements and has tended to under-state the extent of price increase. Some attempts have also been made to make adjustments for the defects and obtain a new set of price indices. The price increases as recorded by the official indices as well as in the adjusted series are set out in Table 7.

Table 7: Annual Average Price Increases from Year to Year - 1978-84
(percentages)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | <u>1978-84</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------|
| GDP Deflator | 7.8 | 15.7 | 18.2 | 20.5 | 9.9 | 15.7 | 17.3 | 145.7 |
| Colombo Consumer Price Index | 12.2 | 10.7 | 26.1 | 18.0 | 10.9 | 14.0 | 16.6 | 142.6 |
| Wholesale Price Index | 15.8 | 9.5 | 33.8 | 16.9 | 5.5 | 25.0 | 25.6 | 183.8 |
| Central Bank Cost of Living Index | 9.1 | 19.0 | 37.8 | 23.7 | 11.0 | 11.3 | 16.8 | 192.7 |
| Special Consumer Price Index (adjusted) | 9.4 | 13.7 | 45.6 | 24.1 | 11.2 | 11.5 | 17.0 | 198.1 |

Source:

1. Central Bank of Ceylon-Annual Reports.
2. Ministry of Finance and Planning, Public Investment 1985-89.
3. UNICEF-Social Impact of Economic Policies..., Sri Lanka, May 1985.

The annual increases in prices show considerable divergence among the different indices. While the GDP deflator and the wholesale price index are definitionally of a different type, the remaining three indices broadly conform to a similar basket of expenditure items. Of these the Colombo Consumer Price Index shows the least increase in prices. Even the GDP deflator is marginally higher than the Consumer Price Index. The Central Bank Cost of Living Index and the adjusted Special Consumer Price Index appear to be broadly in correspondence. All the indices - with the exception of the GDP deflator - show that the year 1980 witnessed the highest rise in prices. The extent of the increase ranges from a low of 26 per cent as recorded in the Colombo Cost of Living Index to almost 46 per cent as per the adjusted index.

To what extent were these price increases caused by external factors? The import component of the Colombo Consumer Price Index has a weight of 35 per cent. The behaviour of the import component of the index in relation to the total increase is shown in Table 8.

Table 8: Import Component of Colombo Consumer Price Increase
(percentage)

| Year | <u>Import Component Increase</u> | <u>Total Increase</u> |
|------|--------------------------------------|-----------------------|
| 1978 | 24.6 | 12.2 |
| 1979 | 16.4 | 10.7 |
| 1980 | 47.2 | 26.1 |
| 1981 | 18.0 | 18.0 |
| 1982 | 8.1 | 10.9 |
| 1983 | 9.5 | 14.0 |
| 1984 | 10.4 | 16.6 |

Imported inflation appears to have been a significant cause during the years 1978 to 1981. In other years, the domestic factors appear to have had a major influence on price behaviour. This is corroborated by the behaviour of the import component of the Wholesale Price Index also.¹³ Until 1981 the import component of the Wholesale Price Index (accounting for a weight of 27 per cent) was the dominant

factor influencing the behaviour of the overall price level. The major share of the increase was due to the increase in the price of the import component. However, in 1983 and 1984 the increase in the overall Wholesale Price Index was primarily caused by the price rise in the export component.

Another way of looking at the impact of imported inflation is to examine the import intensity of the GDP and then relate it to the rise in all import prices. Although this does not give a precise measure of the contribution of import prices to domestic overall price increase, it provides an indirect indication of the likely effect on overall prices. This is attempted below.

Table 9: Import Intensity of GDP and Import Prices
(percentages)

| | <u>All Imports (goods) as a percentage of GDP at market prices</u> | <u>Annual increase in import prices</u> | <u>Price effect</u> |
|------|--|---|-------------------------|
| 1978 | 0.34 | 85.2 | 29.0 |
| 1979 | 0.43 | 52.0 | 22.4 |
| 1980 | 0.51 | 18.5 | 9.4 |
| 1981 | 0.43 | 11.1 | 4.8 |
| 1982 | 0.42 | 7.0 | 2.9 |
| 1983 | 0.37 | 2.8 | 1.0 |
| 1984 | 0.31 | 8.2 | 2.5 |

The computations show that the induced effect of import prices was dominant during 1978 and 1979. In subsequent years, the impact of imported inflation appears to be moderate on the basis of the revised import price indices¹⁴ prepared by the Central Bank of Sri Lanka in 1985. This implies that domestic factors were the main cause of the price increase from 1980 onwards. These are analysed in Table 10.

The impact of each of these elements is difficult to estimate precisely, on account of the lags involved as well as the interaction between domestic expansion of demand and the imported supplies. Some conclusions can, however, be made. Expansionary financing effects were prominent in

1980-82. Money supply increased at a high rate in 1979 and 1980. Credit expansion was also very high in 1979 and 1980. Considering lags, these could have aggravated the price situation in 1980-82, which coincides with a period of high price increases.

Table 10: Domestic Factors Affecting Prices
(percentages)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Expansionary financing as a percent of GDP | 0.4 | 1.2 | 10.6 | 4.5 | 3.7 | 0.4 | -1.4 |
| Annual growth in money supply | | | | | | | |
| M1 | 10.6 | 29.1 | 22.9 | 6.3 | 17.3 | 25.4 | 14.0 |
| M2 | 24.9 | 38.2 | 31.9 | 23.1 | 24.8 | 22.1 | 16.6 |
| Increase in net domestic assets of the banking system | 25.2 | 39.8 | 78.4 | 23.7 | 21.9 | 17.2 | 1.7 |

VII. IMPACT ON PRIVATE CONSUMPTION EXPENDITURE

The accounting of Gross Domestic Expenditure shows a substantial rise in private consumption expenditure in nominal terms during the period 1978-84. As a percent of GDP at current market prices, private consumption increased from a level of 75.2 in 1978 to a high of 80.9 in 1981 and subsequently declined to 73.6 in 1984. This gives the impression of a rising trend in private consumption expenditure until 1981. However, in real terms the picture is somewhat different. The behaviour of real private consumption expenditure depends on the extent of the increase in consumer prices during the relevant period. It may also be more meaningful to examine the trend in the growth of real per capita private consumption.

Table 11: Increases in Real Per Capita Private Consumption
(percentages)

| <u>Deflator used</u> | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> | <u>1978-84</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------|
| Colombo Consumer Price Index | 5.4 | 11.29 | 2.9 | 7.4 | 2.6 | 3.6 | -0.7 | 29.8 |
| Central Bank Cost of Living Index | 8.4 | 3.6 | -5.8 | 2.4 | 2.5 | 6.1 | -0.9 | 7.6 |
| Special Consumer Price Index (adjusted) | 8.0 | 8.4 | -10.8 | 2.0 | 2.3 | 5.9 | -1.0 | 5.7 |

The Colombo Consumer Price Index reflects the minimum order of price increase and implies the maximum improvement in per capita consumption during the period 1978-84. In annual terms the rate comes to an average of 4.5 per cent. This appears to exceed even the growth observed in per capita GDP at constant market prices. The Central Bank of Ceylon estimates the growth of GDP at 1978 market prices at 38 per cent during 1978 to 1984. When adjusted for the population growth during the same period, the GDP per capita is seen to increase only by 25 per cent. If the Colombo Cost of Living Index is to be relied upon, the implication will be even a larger decline in average savings rate than what was revealed in the analysis of investment financing using

current price magnitudes. In a situation of steady growth in real GDP at a little over 5 per cent per annum, the order of consumption increases in excess of per capita income growth do not appear to be realistic.

A different picture emerges when current price magnitudes of private consumption are deflated by either the Central Bank Cost of Living Index or the Special Consumer Price Index. In both cases there is a steep decline in per capita private consumption during the years 1980 and 1984. If these are taken into account, the increase in per capita private consumption during the six year period is only of the order of 5.7 per cent to 7.6 per cent.

The fall in per capita private consumption and even in aggregate consumption during 1980 occurred despite a growth of 5.8 per cent in GDP at 1978 market prices as indicated by Central Bank estimates.¹⁵ However, it is interesting to note that commodity production recorded an increase of only 2.7 per cent during that year. And even this low growth was made up of an increase of 12 per cent in paddy production, 4.7 per cent in other agriculture (minor and subsidiary crops) and a 5 per cent growth in factory industry. The supply of domestically-made consumer goods suffered to some extent, with declines in coconut, tea, rubber and small industry. An examination of import volumes of consumer goods during the period shows that supplies in 1980 were marginally higher than in the previous year and mainly took the form of 'other' consumer goods. The volume indices compiled by the Central Bank (1985) are shown in Table 12.

Table 12: Import Volume Indices of Consumer Goods, 1978-84¹⁶
(1978 = 100)

| Year | Food & Drink | Textiles | Other Consumer Goods | Combined |
|------|-----------------|----------|-------------------------|----------|
| 1979 | 102 | 323 | 250 | 139 |
| 1980 | 86 | 331 | 345 | 141 |
| 1981 | 52 | 399 | 297 | 105 |
| 1982 | 40 | 331 | 368 | 97 |
| 1983 | 71 | 351 | 445 | 131 |
| 1984 | 70 | 379 | 336 | 122 |

The evidence presented above clearly establishes that domestic supplies were not significantly augmented by import volumes except of course in the first year of the programme, 1978, when the increase must have dampened excess demand pressures. The total of all consumer goods imports in terms of volume increased slightly in 1980 and declined in 1981. Given the low growth of commodity production in 1980, the possibility of a shortfall in consumption per capita cannot be ruled out. In this context, it may be of some relevance to note the argument that national accounts data in Sri Lanka yield an upwardly biased estimate of consumption.¹⁷ If that be the case, the consumption values have to be scaled down, though to what extent the rate of growth in consumption will be affected is not clear.

One possible explanation for the fall in real per capita private consumption in 1980 could be the revision of the food subsidy policy in the previous year. As explained elsewhere in the paper, Governments in Sri Lanka had always incurred an expenditure of 4-5 per cent of GDP on the provision of subsidised food. This situation underwent a change in 1980 when the Government replaced the food subsidy which was in quantity terms with the provision of food stamps, which was in value terms. This resulted in a sharp fall in the proportion of Government expenditure allocated to food subsidies. In addition to this, there were also some declines in expenditure on other social services like health and education.

Table 13: Major Social Expenditures as Percentage of GDP

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Education | 2.31 | 2.16 | 2.09 | 1.87 | 2.01 | 2.00 | 1.92 |
| Health | 1.22 | 1.21 | 1.11 | 1.00 | 0.95 | 1.02 | 1.09 |
| Net food subsidies, food stamps and kerosene stamps | 5.0 | 6.0 | 3.0 | 3.0 | 2.0 | 1.6 | 1.3 |

Source: For Education and Health, World Bank Mission Report 1985;
For Food Subsidies, Neville Edirisinghe, December 1985.

It is apparent that there was a sharp drop in Government recurrent expenditure on account of the food subsidy and its replacement by non-indexed food and kerosene stamps. Aside from the smaller declines in respect of recurrent expenditures on education and health, it is the withdrawal of the food subsidy that made the main contribution to substantial savings in Government spending. Under the food stamp scheme, households with annual incomes of less than Rs.3600, with some adjustments made for household size, became entitled to food stamps enabling them to purchase a stipulated set of goods at unsubsidised prices. By switching over to the food stamp scheme in place of the previous food subsidy, Government savings to the tune of 3-4 per cent of GDP were effected on annual recurrent expenditure from 1980 onwards. There is thus prima facie evidence to show that the purchasing power of households fell in 1980. And in a period of one year, the Government could not have introduced alternative income support plans by way of either wage increments or large-scale employment creation.

According to Alailima,¹⁸ "By 1980, increasing reliance on indirect taxes had virtually halved tax incidence on the rich, while substantially increasing the burden on the middle classes". Even for those with eligibility for food stamps, their purchasing power had fallen with price increases for rice, flour and sugar. All these indicators would suggest a deteriorating situation in regard to consumption levels in 1980.

The results of the Consumer Finance Surveys conducted by the Central Bank of Ceylon in 1978-79 and 1981-82 provide an indication of the change in levels of living during the three year period. The nominal income per spending unit during the two reference periods is shown together with the corresponding income levels in real terms using the Central Bank Cost of Living Index, in Table 14.

Table 14: Average One Month Income in Nominal
and Real Terms (Rupees)

| | Nominal Income | | Real Income (1978 prices) | |
|--------------------------------------|----------------|----------------|------------------------------|----------------|
| | <u>1978-79</u> | <u>1981-82</u> | <u>1978-79</u> | <u>1981-82</u> |
| Mean Income per Spending Unit | 921 | 1635 | 806 | 745 |
| Median Income per Spending Unit | 658 | 1159 | 576 | 528 |
| Central Bank Cost of Living Index | 114.3 | 219.5 | | |

- Note: 1. Spending unit represents the income of all income receivers in the unit.
2. The Cost of Living Index has been adjusted for the actual period of the survey spilling over from one year to another.
3. As per the cost of living index constructed by Neville Edirisinghe (December 1985), the increase in overall prices between 1978-79 and 1981-82 works out to 92 per cent. This tallies with the increase implied in the Central Bank Cost of Living Index.

If one is to determine the change in living standards in Sri Lanka as indicated by the results of the Consumer Finance Surveys, it seems clear that living standards did not rise between 1978-79 and 1981-82, even at the average income level or the median income level. The survey results, in fact, throw further doubt on the estimates of GDP increase, derived from the product side.

The behaviour of income growth in rural, urban and estate households between 1978-79 and 1981-82 survey periods show that rural and urban incomes increased by about 82 per cent. However, the estate sector recorded an increase of only 49 per cent. As shown earlier, the increases in all the three cases were not sufficient to neutralise the effect of the 92 per cent increase in prices during the inter-survey period. While the rural and urban sectors suffered a lesser decline in real income, the estate sector suffered a much larger decline of income in real terms. This is consistent

with expectations, since the introduction of the food stamps deprived the estate households of the pre-existing food subsidy, while at the same time excluding them from being entitled to food stamps on the basis of income eligibility criterion. The estate workers therefore sustained a cut in their real purchasing power.

It was expected that the withdrawal of the food subsidy and its replacement by a means-tested food stamps programme on the one hand and the abolition of subsidised prices for all food articles on the other, would have the twin effects of safeguarding the consumption standards of the less better off sections of the population and expanding employment and income generation opportunities through higher farmgate prices. The food subsidy was first withdrawn from almost half the population as a part of the initial package of adjustment policies, in 1978. This was subsequently replaced by the non-indexed food stamps in 1979. Thus, the effect of these actions came to be felt in 1980. The outcome of these policy measures did not turn out to be in accord with expectations.

When producers' prices are raised, the immediate direct result will be a gain to the large farmers with a marketable surplus. The small farmer, whose output is either entirely or substantially consumed by his own household, will not gain anything from the higher prices. And since the supply response to higher prices takes time, the only gainer is the large farmer. Even when supply responds to higher producers' prices, the small farmer is still not much of a beneficiary. True, second order effects of increased employment induced by higher labour demand in agriculture may materialise as a part of the supply response to higher farmgate prices. However, a large number of agricultural workers will be faced with an erosion in their purchasing power, which cannot be compensated either by the non-indexed food stamps or by the second order effects of expanded employment and incomes. This is the scenario that seems to have developed in Sri Lanka after 1978 and 1979.

The urban poor were also in distress. To the extent that their wage incomes were not fully insulated from the effect of the rise in prices, their real purchasing power was adversely affected. The data on real wage rates - which itself are understated since they are nothing but nominal wages deflated by the Colombo Consumer Price Index - show that incomes of large sections of employees did not keep pace with inflation during the period. All categories of employees in urban as well as rural sectors suffered real wage declines in 1980 and 1981. There was some improvement in 1982-84 for some sections, though clerical and skilled employees of the Government as well as workers in industry, commerce and services never got back to their 1978 wage levels. (See Table A). The situation with respect to the fall in real wages is even worse if nominal wages are deflated by the Central Bank Cost of Living Index, which appears to be a more accurate indicator of price increases. The outcome in this case will be continuous deterioration in real wages for all categories of employees.

To what extent have the policies led to an expansion of employment opportunities? The Consumer Finance Surveys conducted during 1978-79 and 1981-82 indicate that employment as a proportion of the labour force increased from 85.3 per cent to 88.3 per cent. The increase in urban areas was 6.5 per cent, in rural areas 2.6 per cent and in estate areas 0.6 per cent. The overall unemployment rate declined from 14.7 per cent in 1978-79 to 11.7 per cent in 1981-82. However, this outcome has to be seen in the context of (1) emigration of some 200,000 workers to West Asia (the Middle East) since 1977; (2) repatriation of 337,000 persons of Indian origin from the estate sector to India; and (3) demographic factors leading to a slight ageing of the population.¹⁹ The impact of these factors is to reduce participation rates and hence estimates of the labour force. Viewed against this background, the increase in employment creation seems to be of modest proportions. This, in turn, further supports the observed trend in real consumption behaviour.

VIII. IMPACT ON NUTRITION

The available data on calorie consumption after 1978-79 also support the declining trend in consumption, at least of the lower income groups. The Consumer Finance Surveys data have been used to estimate the apparent mean calorie consumption levels at the country level as well as the three household groupings. Neville Edirisinghe (December 1985) has made the following estimates of calorie consumption levels for 1978-79 and 1981-82.

Table 15: Apparent Mean Calorie Consumption
(per capita per day)

| | <u>1978-79</u> | <u>1981-82</u> |
|---------------|----------------|----------------|
| All Sector | 2,283 | 2,271 |
| Urban Sector | 2,240 | 2,229 |
| Rural Sector | 2,230 | 2,246 |
| Estate Sector | 2,763 | 2,639 |

There is a marginal fall in the aparent mean calorie consumption levels at the country level between the two periods. The fall is perceptible in the estate sector, while it is very small in the urban sector. The rural sector shows marginal improvement during the period. At the average level, the calorie intake is considered adequate in comparison with the 2,200 calories recommended for the average Sri Lankan. The estate households have definitely suffered in terms of their nutritional status during the period.

While the average serves to indicate the overall availability trends during the period, what is of importance, is to examine the changes in calorie consumption in each expenditure decile. Edirisinghe's estimates are shown in Table 16 for the two survey periods by different household groupings and expenditure decile categories.

Table 16: Apparent Per Capita Daily Calorie Consumption
by Expenditure 1978-79 and 1981-82

| Per Capita Expenditure Decile | 1978-79 | | | |
|-------------------------------------|---------|-------|-------|--------|
| | Total | Urban | Rural | Estate |
| 1 | 1,335 | 1,288 | 1,346 | 1,324 |
| 2 | 1,663 | 1,620 | 1,663 | 1,821 |
| 3 | 1,848 | 1,718 | 1,855 | 2,027 |
| 4 | 1,994 | 1,824 | 1,999 | 2,222 |
| 5 | 2,157 | 1,917 | 2,155 | 2,490 |
| 6 | 2,377 | 2,079 | 2,385 | 2,716 |
| 7 | 2,528 | 2,260 | 2,505 | 3,032 |
| 8 | 2,738 | 2,495 | 2,757 | 3,160 |
| 9 | 3,054 | 2,674 | 3,071 | 3,884 |
| 10 | 3,296 | 3,181 | 3,336 | 3,845 |

| Per Capita Expenditure Decile | 1981-82 | | | |
|-------------------------------------|---------|-------|-------|--------|
| | Total | Urban | Rural | Estate |
| 1 | 1,181 | 1,137 | 1,186 | 1,214 |
| 2 | 1,558 | 1,351 | 1,586 | 1,607 |
| 3 | 1,794 | 1,589 | 1,813 | 1,924 |
| 4 | 2,008 | 1,784 | 2,031 | 2,122 |
| 5 | 2,168 | 1,927 | 2,184 | 2,371 |
| 6 | 2,373 | 2,088 | 2,392 | 2,687 |
| 7 | 2,553 | 2,216 | 2,581 | 3,024 |
| 8 | 2,838 | 2,484 | 2,869 | 3,344 |
| 9 | 3,120 | 2,705 | 3,203 | 3,783 |
| 10 | 3,216 | 2,882 | 3,475 | 3,549 |

Source: Edirisinghe, December 1985, Table 4.3.

The changes during the period indicate a definite deterioration in the calorie consumption levels of the bottom 30 per cent of the expenditure classes. The deterioration is of the order of 12 per cent in the bottom decile, followed by 6 per cent in the next decile. The third decile from the bottom had a fall of 3 per cent. The middle classes from the fourth to the seventh deciles have largely maintained their calorie intake, while the top three deciles have recorded some increase, except the top-most decile, which recorded a marginal decline. It is obvious from this that the poorer 30 per cent of the population did suffer from perceptible declines in calorie consumption between 1978-79 and 1981-82.

In terms of household groupings, the rural sector seems to have suffered the least. The top 70 per cent of the rural population appear to have improved their calorie consumption levels. In the urban group, the calorie consumption has declined in seven expenditure deciles, with marginal improvements amounting to maintenance of the same levels in the remaining three. In the estate sector, the lower half of the households has suffered declines ranging from around 5 per cent to 12 per cent. In terms of overall inadequacy, this group seems to have been the worst affected.²⁰

The findings in regard to the overall situation for the country are also corroborated by the data analysed from the Socio Economic Survey conducted by the Department of Census and Statistics during 1980-81. The comparative position in terms of expenditure deciles for the three periods is set out in Table 17.

Table 17: Per Capita Daily Calorie Consumption by Expenditure Decile

| <u>Per Capita Expenditure (Deciles)</u> | <u>1978-79</u> | <u>1980-81</u> | <u>1981-82</u> |
|---|----------------|----------------|----------------|
| 1 | 1,335 | 1,221 | 1,181 |
| 2 | 1,663 | 1,590 | 1,558 |
| 3 | 1,848 | 1,788 | 1,794 |
| 4 | 1,994 | 1,904 | 2,008 |
| 5 | 2,157 | 2,113 | 2,168 |
| 6 | 2,377 | 2,303 | 2,373 |
| 7 | 2,528 | 2,519 | 2,553 |
| 8 | 2,738 | 2,666 | 2,838 |
| 9 | 3,054 | 2,971 | 3,120 |
| 10 | 3,296 | 3,261 | 3,216 |
| Total | 2,299 | 2,240 | 2,281 |

Source: David E. Sahn, December 1985, Table 7.

The continuous fall in the calorie consumption levels of the poorest 20 per cent is clearly evidenced in the data. The 1980-81 position shows that in all the expenditure deciles caloric consumption declined as compared to 1978-79. This would appear to be in line with the argument advanced

earlier about the short term implications of the abolition of subsidised prices for all food items.

Edirisinghe also finds that the "percentage of ultra-poor households, defined as households failing to achieve 80 per cent of the recommended calorie allowance ... increased from about 20 per cent in 1978-79 to 25 per cent in 1981-82 in the lowest quintile". Among these, it is the plantation and agricultural workers, who appear to have suffered the worst.

The analysis of data on calorie consumption reveal that (1) consumption levels have declined for all expenditure categories immediately after 1978-79; (2) the decline continued into 1981-82 with the lower 30 per cent bearing the brunt of these declines; (3) urban and estate households suffered a higher degree of deprivation; (4) the estate sector was the worst affected; and (5) the percentage of ultra-poor increased between 1978-79 and 1981-82. These findings are in accord with the trends in real consumption expenditure, the cost of living, and Government current expenditure policies in relation to social welfare including the abolition of food subsidies and removal of price control. The evidence on the movement of real wages and the inconclusive picture relating to employment creation raise the likelihood of a fall in consumption. It is difficult to reconcile these findings with the reported expansion of output at a high rate during the post 1977 period. This is examined further in Annex 1.

IX. IMPACT ON EQUITY

The egalitarian policies pursued by earlier Governments had succeeded in moving towards greater equality, as evidenced from the results of the Consumer Finance Surveys during the period 1953-73. This trend has now been reversed starting with 1978 and further in 1981-82, as measured from the distribution of incomes accruing to spending units. The share of income accruing to the bottom 40 per cent declined from 19.3 in 1973 to 16.1 in 1978-79 and to a still lower figure of 15.3 in 1981-82. The worsening of the Gini coefficient may have commenced even before 1978-79.

While the concentration in the distribution of incomes to income receivers did not change in the case of rural and estate sectors between 1978-79 and 1981-82, there was deterioration in the case of the urban sector. The open market policies have clearly benefitted the business class in the highest income decile, in urban areas. At the country level, the share of income accruing to the highest income decile increased by nearly 1.7 per cent between 1978-79 to 1981-82, while all other deciles suffered declines. The highest income decile in the urban sector has recorded the maximum rise in share with 4 per cent over 1978-79 level followed by the rural sector with 1.7 per cent.

If national accounts data are to be relied upon, there has been a spurt in income growth. Even if the distribution has become more skewed, average incomes would have risen in real terms. However, the survey evidence do not support this optimistic possibility, as average incomes are also seen as having declined in real terms. This again raises the question of the reliability of the high growth record implied in the national accounts.

X. EXTERNAL SECTOR POLICIES AND IMPACT ON EXPORTS

The external sector policies formed an integral component of the overall strategy to support the process of economic liberalisation and to contribute to the strengthening of the balance of payments over the medium term. The principal objectives were (1) to bring about self sufficiency in food grains and consequent import substitution; (2) improved productivity in the tree crop sector to facilitate increased export volumes; (3) growth in non-traditional exports; and (4) management of financing the external resource gap without aggravating debt servicing burdens.

The exchange rate reform bringing about an effective devaluation of the Sri Lankan Rupee was expected to promote both the traditional and the non-traditional components of Sri Lankan exports. Like almost all traditional primary commodity exporters, Sri Lanka had not succeeded in coping with the secular stagnation that had prevailed in the markets for its principal commodities of tea, rubber and coconut. Additionally, tea, which is still the mainstay of export earnings, has gone through a long period of falling productivity. Yield per hectare declined from 970 kilograms in 1964-66 to 856 kilograms in 1980-82.²¹ And Sri Lanka's share of world tea exports declined from around 35 per cent in 1964-66 to 21 per cent in 1980-82.

In the case of tea, the exchange rate reform would be effective as a producer incentive, only if tax policy adjusts to leave sufficient margins for the producer. Duties on tea have been a major source of revenue to the Government Budget and even after the exchange rate reforms, the policy of mopping up the maximum resources from the tea sector continued. The result was low or negative margins and a severe constraint on resources for reinvestment. Since some two thirds of tea production is in the public sector, resources could be transferred to the public sector corporations from the Government Budget. However, adequate

transfers do not seem to have taken place.

Almost similar reasons as in the case of tea seem to have affected the exports of rubber and rubber products also, which are entirely dependent on the export market. Admittedly, the world demand prospects for primary commodities like tea and rubber are unfavourable. However, this does not explain the falling share of Sri Lanka in world exports. These trends were in clear evidence long before 1977 and the exchange rate reform involving the depreciation of the Sri Lankan Rupee in a crawling peg fashion was touted as the main policy instrument to stimulate output growth and exports of tea, rubber and coconut - usually referred to as the tree crop sector. In the event, the outcome has certainly not matched expectations.

At current prices, total exports increased from 1978 to 1984 by 183 per cent (See Table 18). However, when adjusted for price increase during the period, exports at 1978 prices increased by just over 45 per cent during the six year period, denoting an annual growth rate of 6.45 per cent. The exports of the tree crop sector declined marginally in real terms, though there was a rise of 9 per cent in tea exports in 1984 as compared to 1978. In all the other years during the period, tea exports in real terms were falling continuously. The exchange rate correction does not seem to have helped in promoting exports of the tree crop sector to any significant extent.

There has been some change in the composition of exports. This has come about mainly as a result of the growth of industrial exports comprising textiles and the group of leather, rubber, wood and ceramics.²² The exports of these products have been impressive and partly reflects the trade liberalisation policies and perhaps the exchange rate correction. In the case of textiles and garments, the net earnings of foreign exchange would be minimal, since the product has a very high import component. The proportion of

Table 18: Percentage Composition of Exports
(at current and 1978 constant prices)

| | 1978 | | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | | 1984 | |
|------------------------|------|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| | A | B | A | B | A | B | A | B | A | B | A | B | A | B |
| 1. Tea | 48.5 | 48.5 | 37.4 | 44.3 | 35.1 | 41.9 | 30.6 | 37.4 | 29.6 | 36.5 | 33.0 | 33.9 | 42.1 | 36.4 |
| 2. Rubber | 15.3 | 15.3 | 16.3 | 13.6 | 14.7 | 12.1 | 13.7 | 11.8 | 10.8 | 11.5 | 11.4 | 11.9 | 8.8 | 9.8 |
| 3. Coconut products | 9.6 | 9.6 | 11.1 | 7.9 | 7.0 | 4.7 | 6.8 | 5.1 | 7.0 | 6.5 | 7.6 | 7.0 | 5.7 | 3.8 |
| 4. Minor crops | 5.5 | 5.5 | 5.8 | 5.5 | 5.0 | 4.6 | 6.6 | 6.1 | 7.0 | 5.8 | 5.9 | 5.2 | 3.6 | 3.8 |
| 5. Industrial products | 14.7 | 14.7 | 24.2 | 24.0 | 33.0 | 31.7 | 34.7 | 31.8 | 38.5 | 32.0 | 35.2 | 32.8 | 33.8 | 38.9 |
| 6. Gems | 4.0 | 4.0 | 3.2 | 2.8 | 3.8 | 3.6 | 3.0 | 3.3 | 3.2 | 3.7 | 3.7 | 6.1 | 1.6 | 3.3 |
| 7. Other exports | 2.4 | 2.4 | 2.0 | 1.9 | 1.4 | 1.4 | 4.6 | 4.5 | 3.9 | 4.0 | 3.2 | 3.1 | 4.4 | 4.8 |
| 8. Total | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 1000 | 100 |
| 9. Total export growth | A | 100 | 115.7 | | 133.2 | | 159.2 | | 162.4 | | 189.9 | | 282.7 | |
| | B | 100 | | 106.1 | | 113.7 | | 126.6 | | 128.8 | | 121.8 | | 145.7 |

Note: A - Current prices
B - Constant 1978 prices.

XI. IMPORT POLICIES

The Sri Lankan case for IMF support in late 1977 was partly premised on the contention that the economy at that point suffered from critical shortages of a wide range of non-food consumer goods, raw materials and other producer goods, against a backlog of 'excess' demand. The trade liberalisation policies were designed to achieve an immediate and substantial expansion of imports urgently required to augment supplies, dampen inflation and also stimulate domestic production. Implicitly, once the economy revived and strengthened, its import dependence could be, to an extent, reduced through efficient import substitution policies and also sustained in the medium term through measures to enlarge export earnings. The Government stated that the adjustment measures in the Sri Lankan context have to be viewed as a medium term effort for developing and strengthening the economy through necessary structural change. It is in this light that the performance in relation to imports has to be examined.

Sri Lanka's import dependence permeates almost every aspect of the economy's functioning. Its capital formation is dependent on imports for the entire equipment component. The manufacturing sector relies on imports for most of its raw materials. And a significant share of private consumption is also met out of imports. It is this high degree of import dependence that has made the economy vulnerable to the changes in the international market. The foreign exchange constraint was particularly severe during the seventies and subsequent to the first oil shock. Hence the support of the IMF and the World Bank had become crucial to increase the country's import capacity substantially.

The import trade volume indices (Table A.22) prepared by the Central Bank of Sri Lanka (1985) indicate that except in the case of food and drink, there were increases in real terms in all categories. The index for all imports shows an increase of 58 per cent between 1978 and 1984 in volume terms. However, the annual growth trend of the index is uneven and therefore it is difficult to draw any firm conclusions from its behaviour.

An alternative method of examining the behaviour of imports is to deflate the current import values using the Central Bank of Sri Lanka Trade Price Indices. These import price indices are prepared for each major category of imports. Using these indices the value of imports in 1978 prices can be obtained, and the growth trend of imports in real terms can be examined.

Table 20: Index of Value of Imports at 1978 Prices
(1978 = 100)

| Year | Food& Drink | Textiles | Consumer Goods | Inter- mediate Goods | Intermediate Goods Excl. Petrol | Invest- ment Goods | All Imports |
|------|----------------|----------|-------------------|----------------------------|---------------------------------------|--------------------------|----------------|
| 1979 | 106 | 173 | 161 | 83 | 59 | 112 | 104 |
| 1980 | 92 | 170 | 223 | 119 | 63 | 153 | 127 |
| 1981 | 57 | 194 | 204 | 131 | 67 | 147 | 120 |
| 1982 | 48 | 159 | 251 | 136 | 62 | 192 | 132 |
| 1983 | 78 | 165 | 308 | 132 | 70 | 190 | 142 |
| 1984 | 77 | 175 | 232 | 128 | 88 | 186 | 136 |

In overall terms imports increased until 1980, declined in 1981 and then increased until 1983. Import compression in real terms was achieved in 1981, but could not be sustained in subsequent years. In the food and drink category, imports fell from 1979 levels, particularly in 1981 and 1982. This was partly a reflection of the import substitution of rice. In all the rest of the groups, there was a general increase in imports. While the imports of all intermediate goods showed little growth after 1981, intermediates other than petroleum products increased by nearly 50 per cent during

1979 to 1984. The decline between 1978 and 1979 appears to be due to the splicing of two different indices. Petroleum imports, which accounted for half of the intermediate imports in most of the years, did not show any consistent trend during the period. Crude oil imports increased from 11.2 million barrels in 1978 to 13.6 in 1980 and 14.2 in 1982 and then declined to 12.7 (see Table A 19).

The fastest growing imports were those in the category of other consumer goods. Between 1979 and 1983, imports of other consumer goods increased by more than 90 per cent. This, while presumably in line with patterns of effective free market demand, might well have been held in check by appropriate tariffs in the interest of serious adjustment efforts; 'other consumer goods' being a category devoted largely for non-essential consumption and not related to influencing output or investment growth. Investment goods imports rose in line with the increasing import intensity of GDCF.

An examination of the composition of imports at current prices shows changes indicating the reduced weight of food and drink items. Textile imports were relatively stable, while the proportion of other consumer goods increased. All the components of the intermediate goods category excluding petroleum rose in terms of their weight composition. In the group of investment goods, the weight composition was fairly uniform among the components as well as over the period. A fourth of the imports was accounted by this group in most years (see Table A 17).

Table 21 shows the comparative changes in import composition at current and 1978 prices. At constant prices the share of food and drink do not show the same order of decline as in the case of current prices. Though the real value of imports in this category fell, it still had a high weight because of the slower growth in total real import values. The share of textile imports stabilised in real terms during 1982 to 1984. However, in the case of other

consumer goods, the share in real terms increased further, denoting rapid growth in real terms. In relation to other imports, real growth of intermediates was slower. Whether this was due to efficiency of use or falling growth-related demand, is not clear. The shares of investment goods rose both in current and constant price terms.

The analysis of the behaviour of imports shows that (1) there was import substitution in the food and drink group mainly through paddy output growth; (2) the public investment programme was an important factor in determining the import bill via its requirement for investment goods; (3) imports of other consumer goods grew faster than all the other categories in spite of its lower priority in the context of an adjustment policy framework; and (4) intermediate goods grew at a lower rate than either investment goods or non-essential consumer goods.

Table 21: Percentage Composition of Imports
(at current and 1978 constant prices)

| | 1978 | | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | | 1984 | |
|--------------------------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
| | A | B | A | B | A | B | A | B | A | B | A | B | A | B |
| 1. Food and Drink | 28.1 | 28.1 | 21.3 | 28.4 | 18.9 | 20.3 | 13.4 | 13.3 | 8.5 | 10.1 | 11.8 | 15.4 | 10.5 | 16.0 |
| 2. Textiles | 3.6 | 3.6 | 6.8 | 6.0 | 5.1 | 4.8 | 6.4 | 5.8 | 5.2 | 4.4 | 6.0 | 4.2 | 6.3 | 4.6 |
| 3. Other consumer goods | 6.5 | 6.5 | 6.6 | 10.1 | 6.0 | 11.4 | 5.5 | 11.1 | 6.9 | 12.4 | 7.8 | 14.1 | 6.5 | 11.1 |
| 4. Intermediates | 38.11 | 38.1 | 40.5 | 30.4 | 45.7 | 35.5 | 52.7 | 41.4 | 51.6 | 39.3 | 47.7 | 35.3 | 50.0 | 35.8 |
| 5. Investment goods | 22.9 | 22.9 | 24.2 | 24.5 | 24.0 | 27.6 | 21.7 | 27.9 | 27.6 | 33.4 | 26.5 | 30.6 | 25.6 | 31.4 |
| 6. Unclassified | 0.8 | 0.8 | 0.6 | 0.6 | 0.3 | 0.4 | 0.3 | 0.5 | 0.2 | 0.4 | 1.1 | 1.1 | | |
| 7. Total imports | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 8. Total imports growth | A | | 153 | | 231 | | 249 | | 286 | | 310 | | 324 | |
| | B | 100 | | 104 | | 127 | | 120 | | 132 | | 142 | | 136 |

Note: A - Current prices.
B - Constant 1978 prices.

XII. BALANCE OF PAYMENTS

In principle, adjustment policies are designed to bring about a sustainable balance of payments position within a period of time. The period depends on the type of balance of payments deficit experienced by the country in question. To the extent a country's demand for imports for supporting a minimum acceptable rate of economic growth is in excess of its export earnings, the deficit on balance of payments will be of a structural nature, and will need to be corrected over a longer period of time. Such correction will involve the shifting of resources among productive sectors to reduce import intensity or expand export capacity or do both. These efforts are further complicated by 'external shocks' which disrupt the achievement of a sustainable balance of payments position in the normal course. Under such circumstances the period of adjustment is further lengthened, and often domestic efforts turn out to be inadequate to cope with the external shocks.

The Sri Lankan situation corresponds to the category of a structural deficit in the balance of payments, needing to be corrected over a long term period. The efforts in this direction have been, to some extent, thwarted by (1) the increasing cost of financing the imports as a result of the price inflation in the international market; and (2) by the lack of buoyancy in export earnings partly flowing from the fall in prices for its primary commodity exports. In effect, the terms of trade have been continuously adverse to Sri Lanka for the past several years. The movements in terms of trade, as worked out by the Central Bank of Ceylon, are indicated in Table 22.

Table 22: Movements in Trade Indices and Terms of Trade

| Year | Volume | | Prices | | Terms of Trade |
|------|-------------|-------------|-------------|-------------|----------------|
| | All Exports | All Imports | All Exports | All Imports | |
| 1971 | 104 | 68 | 17 | 17 | 98 |
| 1972 | 102 | 67 | 17 | 18 | 94 |
| 1973 | 103 | 68 | 20 | 24 | 82 |
| 1974 | 89 | 42 | 31 | 42 | 72 |
| 1975 | 107 | 52 | 29 | 49 | 58 |
| 1976 | 102 | 57 | 34 | 44 | 78 |
| 1977 | 94 | 73 | 55 | 54 | 102 |
| 1978 | 100 | 100 | 100 | 100 | 100 |
| 1979 | 101 | 123 | 109 | 152 | 72 |
| 1980 | 106 | 155 | 119 | 180 | 66 |
| 1981 | 118 | 145 | 125 | 200 | 63 |
| 1982 | 124 | 142 | 123 | 214 | 57 |
| 1983 | 122 | 156 | 158 | 220 | 72 |
| 1984 | 141 | 158 | 206 | 238 | 87 |

Source: Central Bank of Ceylon.

But for a brief up-turn during 1976-77 and in 1983 and 1984, the terms of trade were unrelentingly adverse to Sri Lanka in the period covered. Between 1978 and 1982, the index fell from 100 to 57 leading to considerable erosion of Sri Lankan resources. Even the up-turn in 1983-84 still left the terms of trade 15 per cent worse than that prevailing in 1978. Hence Sri Lanka's balance of payments outcome during the period 1978-84 has to be examined after allowing for the terms of trade effect on its imports and exports. As noted earlier, the actual trade values deflated by the trade indices for each category of exports and imports, will provide an estimate of the trade accounts at constant 1978 (base year) prices. Since the overall trade indices may reflect the composition of imports and exports prevailing in the base year, the group price indices have been used to derive constant price estimates for each such group, and have been aggregated to obtain the total of merchandise exports and imports at constant 1978 prices. The comparative values for exports, imports and merchandise trade deficit are shown in Table 23.

Table 23: Merchandise Exports, Imports and Trade Deficit
at Current and 1978 Constant Prices
 (Rupees million)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Exports - current | 13206 | 15282 | 17595 | 21043 | 21454 | 25096 | 37347 |
| Imports - current | 14687 | 22541 | 33942 | 36582 | 41946 | 45558 | 47541 |
| Merchandise trade deficit | -1481 | -7259 | -16347 | -15539 | -20492 | -20462 | -10194 |
| As percentage of GDP at current market prices | 3.5 | 13.9 | 24.6 | 18.3 | 20.7 | 16.8 | 6.7 |
| Exports - constant | 13206 | 14012 | 15020 | 16724 | 17013 | 16094 | 19250 |
| Imports - constant | 14687 | 15331 | 18682 | 17673 | 19358 | 20852 | 20014 |
| Merchandise trade | -1481 | -1319 | -3662 | -949 | -2345 | -4758 | -764 |
| As percentage of GDP at constant market prices | 3.5 | 2.9 | 7.6 | 1.9 | 4.4 | 8.5 | 1.3 |

Note: The data on exports and imports are as in customs returns and may differ slightly from balance of payments accounts.

The analysis of the merchandise accounts show that if 1978 prices had prevailed, the balance of payments task would have been much less difficult. At constant 1978 prices, the gap would have been much lower than what was actually experienced at current prices. As a proportion of GDP at market prices, the merchandise deficit is seen to be very much lower when evaluated in constant 1978 prices. The magnitude of the shock as a consequence of the adverse terms of trade can be gauged from the erosion of resources each year as a percent of GDP at current market prices, the loss resulting from adverse terms of trade ranged from around 11 per cent in 1979 to 19 per cent during 1980-82. The impact of the oil shock in 1980 accounted for 4-5 per cent of the GDP at market prices during the years 1980 to 1983. Even after allowing for the effects of the oil price rise in 1980, some 14-15 per cent of the GDP equivalent was the order of losses sustained on account of the adverse terms of trade. Thus the terms of trade appear to be the single most important factor that has stood in the way of trade balance stabilisation.

The inability to cope with the fall in the terms of trade is best exemplified in terms of the financing task of the balance of payments deficit. The payments requirement in excess of the receipts on goods and services provides an indicator of the task involved. As a percentage of foreign exchange receipts the excess payments requirements increased from 29 per cent in 1978 to 86 per cent in 1982 and was 43 per cent in 1984. If aid imports are taken into account, the pressure is reduced to some extent. The payments requirements are shown in Table 24.

Table 24: Pressure on Balance of Payments 1978-84
(SDR million)

| | (1) | (2) | (3) | (4) | (5) | (6) |
|--------|----------|----------|----------------|---------------------------------|------------------------------------|---|
| | | | | Payments less Aid Imports | Index A (with Aid Imports)1/ | Index B (Adjusted for Aid Imports)2/ |
| Period | Receipts | Payments | Aid Imports | | | |
| 1978 | 805 | 1,035 | 170 | 865 | 29 | 7 |
| 1979 | 954 | 1,330 | 195 | 1,135 | 39 | 19 |
| 1980 | 1,149 | 2,013 | 198 | 1,815 | 75 | 58 |
| 1981 | 1,363 | 2,487 | 252 | 2,235 | 82 | 64 |
| 1982 | 1,485 | 2,763 | 293 | 2,470 | 86 | 66 |
| 1983 | 1,588 | 2,905 | 379 | 2,526 | 83 | 59 |
| 1984 | 2,050 | 2,929 | 447 | 2,482 | 43 | 21 |

Source: Central Bank of Ceylon.

$$1/: \text{Col}(5) = \frac{\text{Col}(2) - \text{Col}(1)}{\text{Col}(2)}$$

$$2/: \text{Col}(6) = \frac{\text{Col}(4) - \text{Col}(1)}{\text{Col}(4)}$$

The non-aid component of the payments liability averaged over 60 per cent between 1980 and 1983, and is a measure of the task involved in the process of attaining a sustainable balance of payments position. If resources could have been obtained on relatively easy terms, the situation could still have been sustainable. In the event, the outcome did show the difficulties involved in achieving a viable position.

In analysing the balance of payments account, it will be instructive to focus on the financing of the external resource gap, which is defined as the gap between payments for imports, services, private transfers and capital repayments on the one hand, and the receipts accruing from exports, services and private transfers. Table 25 sets out the details of the financing gap in terms of each resource element. The first group includes all transactions that will not have any effect on the current and future debt liabilities. These refer to grants and direct foreign investment. It is seen that on average 15-20 per cent of the gap was financed through these resources. The flow and availability of such resources is highly conducive to a sustainable balance of payments. Project aid, commodity aid, food aid and other long term financing are in the nature of concessionary aid, and to that extent impose limited obligations. In Sri Lanka's case, concessionary aid was a major element in 1978 and 1979. However, during the next four years, these averaged only a quarter of the financing requirements. There was a significant rise in 1984. But the period from 1980 to 1984 was conspicuous for short term credits. Such credits are usually resorted to in times of foreign exchange scarcity, and used to be a feature in Sri Lanka during the period prior to 1977. Recourse to this type of financing is an indication of difficulties in foreign resource mobilisation. And from 1981, Sri Lanka also had to resort to commercial borrowing, involving high interest costs.

Throughout the period 1978-84, drawings from the IMF have supported the financing requirements, and specifically in 1978, 1979 and 1981, when the drawings were large. And in 1980 the situation necessitated drawing down of reserves to finance the gap.

The pattern of financing the external resource gap indicates that in 1984 Sri Lanka had not yet attained a sustainable balance of payments position. The impact of the different adjustment policies on the balance of payments

outcome was minimal in the face of the adverse terms of trade. The most significant factor determining the current account deficit of the balance of payments was undoubtedly the terms of trade deterioration.

Table 25: Financing of the External Resource Gap*
(percentage)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Resource gap (SDR million) | 230 | 375 | 822 | 1,124 | 1,278 | 1,317 | 879 |
| Financed through (percentage share) | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Transactions not affecting debt position | 20.9 | 45.1 | 18.6 | 17.1 | 16.2 | 15.0 | 26.6 |
| Project aid | 27.0 | 11.2 | 6.6 | 7.5 | 13.0 | 16.2 | 32.4 |
| Commodity aid | 25.2 | 15.7 | 6.9 | 6.0 | 2.6 | 2.4 | 1.7 |
| Food aid | 12.2 | 3.5 | 1.7 | 1.4 | 1.2 | 1.6 | 3.1 |
| Other long term | 17.4 | 8.0 | 8.2 | 7.0 | 6.9 | 5.4 | 8.1 |
| Short term including supplies credit | 2.2 | 8.5 | 31.8 | 45.1 | 47.4 | 45.9 | 48.2 |
| Commercial borrowings by private sector | - | - | - | 6.0 | 5.8 | 6.8 | 4.8 |
| Bank borrowings | - | - | 2.1 | - | 5.3 | - | - |
| IMF drawings | 16.5 | 24.3 | 3.5 | 17.3 | 3.5 | 3.6 | 3.5 |
| Others | 3.5 | 6.9 | 1.8 | .4 | 3.6 | 3.1 | 1.5 |
| Reserves | -28.4 | -28.5 | -16.3 | -8.1 | -7.1 | -1.6 | -26.8 |
| Adjustments and errors | 3.5 | 5.3 | 2.5 | .1 | 1.6 | 1.6 | -3.1 |

* Defined as the gap between payments for imports and services and private transfers and capital repayments and receipts for exports and services and private transfers.

For 1978-80 - Private Capital treated as Direct Investment

The position of gross and net international reserves deteriorated during 1980-83. While gross reserves were less than adequate to finance two months import requirements, net reserves turned negligible and negative during 1981-83 (see Table A.23). Obviously the balance of payments situation was

becoming increasingly difficult. Another indicator of the unsatisfactory situation is the debt service ratio. Including IMF obligations, debt servicing as a ratio of export earnings reached 19 per cent in 1982, 22 per cent in 1983 and was estimated at 18 per cent for 1984. The rising debt service obligations will further constrain Sri Lanka's ability to contract new debt in the future.

The positive feature of Sri Lanka's external account is the financing of the Public Investment Programme. The foreign resources for this programme are mainly out of outright grants and concessionary loans. To that extent the impact of the Public Investment Programme on the balance of payments will be less onerous. Output growth in paddy is partly attributable to the Public Investment Programme and could thus have promoted import substitution.

XIII. ALTERNATIVE POLICY SCENARIOS AND THEIR IMPLICATIONS

What would have been the outcome if the Government had pursued a different set of policies? These counter-factual scenarios are sought to be explored through the construction and use of a model (Taylor, 1983) in which prices are determined as a Kaleckian mark-up over costs with the mark-up rate adjusting to capacity utilisation and to money supply pressures.

As discussed in earlier sections, the main features of the 1979-81 period were the reduction in welfare related expenditures and the implementation of a massive public investment programme. The food subsidy scheme in 1979 was targetted to the poorer 35 per cent of the population which accounted for an estimated 18.2 per cent of total budgetary expenditure. From 1980 this subsidy was replaced by the food stamp scheme which was not indexed to inflation. Although the stamps were intended for the same group, there was considerable leakage into higher income groups (Edirisinghe, 1985). The stamps can also be used as an income supplement and so can be spent on any good. Thus the effectiveness of food stamps to alleviate malnutrition is limited.

The replacement of the food subsidy by the food stamps is seen to have resulted in a real fall in total consumption of food by 7.5 per cent in 1980 and all of this decrease originated from the poorer 35 per cent of the population. The situation was not restored to 1979 levels in 1981. Could this have been avoided? It is in this context that the implications of some possible counter-factual scenarios have been examined.

The specific conclusions for the various policy simulations emerge as follows:

a) A continued price subsidy on rice in 1980 instead of food stamps raises food consumption by the poor by 15 per cent over the actual base year level. The current account

deficit worsens as more food is imported to meet demand. Increased domestic rice production to reduce imports must be accompanied by restraint of non-food imports in order to get an improvement in the current account.

b) If investment is reduced, the effect is predictably contractionary with GDP declining and improvements in the external account. The combined effect of a price subsidy on rice and lower investment is to lower prices which encourage consumption and exports. GDP growth is sustained by 1981 at the same level as in the base scenarios but food consumption by the poor is substantially increased.

c) Directed consumer tariffs can effectively remove the subsidy financing problems. They can also improve the current account by reducing inessential imports. They are better than deficit financing in that they keep prices low by reducing government credit rather than reducing reserves.

d) Subsidizing imported oil is expansionary but worsens the current account deficit and the government deficit.

The detailed description of the simulations corresponding to the different scenarios is discussed below.

The three years from 1979-81 are examined using the above model. The base runs come close to replicating what actually happened during the three years. They are used as a comparison for the counterfactual scenarios. The first alternative scenario, lower import price increases, is meant to demonstrate how less adverse terms of trade shocks have a strong impact on growth. Sri Lanka has been greatly affected by worsening terms of trade beyond her control.

The second scenario is to keep the food subsidy that was removed. This would continue a food policy that Sri Lanka has had for thirty years and which has contributed to high social indicators. The third scenario is to reduce the public investment programme in an attempt to keep the public

sector borrowing requirement down and to contain inflation. Inflation has often been cited as the reason why the poor are worse off today. The fourth scenario combines both the continued food subsidy and reduced investment to show the substantial improvement in the consumption of the poor. The final scenario has an oil price subsidy for a smoother adjustment to the oil shock of the late 1970s.

The results of the different scenarios are summarized below in terms of percentage deviations from the base runs.

Summary of Percent Deviations from Base Runs

| | <u>1a</u> | <u>1b</u> | <u>2a</u> | <u>2b</u> | <u>3a</u> | <u>3b</u> | <u>3c</u> | <u>4a</u> | <u>4b</u> | <u>4c</u> | <u>4d</u> | <u>5a</u> |
|------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | <u>1980</u> | <u>1981</u> | <u>1980</u> | <u>1980</u> | <u>1980</u> | <u>1980</u> | <u>1981</u> | <u>1980</u> | <u>1981</u> | <u>1980</u> | <u>1981</u> | <u>1980</u> |
| Real GDP | 5.1 | 2.9 | 0.1 | 0.8 | -1.3 | -0.9 | -0.2 | -0.9 | 0.4 | -1.1 | 0.2 | 1.4 |
| Food Consumption by the poor | 5.6 | 4.2 | 15.4 | 15.2 | -1.6 | -2.2 | -1.5 | 12.7 | 14.8 | 11.9 | 14.0 | 2.1 |
| Food Imports* | 143.1 | 87.9 | 162.9 | 126.2 | -36.7 | -41.7 | -22.0 | 114.8 | 138.2 | 100.6 | 124.4 | 49.4 |
| CA deficit | -11.6 | -17.6 | 11.6 | 11.6 | -17.7 | -19.7 | -13.8 | -8.6 | 7.1 | -23.7 | -16.7 | 11.7 |
| Total Inv | 4.3 | 3.5 | -0.7 | -0.2 | -11.3 | -14.8 | -10.0 | -15.4 | -10.7 | -15.7 | -11.2 | 2.3 |
| Money Supply | 12.2 | 25.9 | -2.5 | -2.9 | -3.5 | -16.6 | -17.1 | -19.1 | -20.8 | -19.5 | -21.7 | 5.9 |
| CPI | -0.9 | -0.7 | -5.2 | -4.2 | -0.9 | -1.9 | -2.4 | -7.1 | -6.9 | -6.0 | -5.3 | 0.0 |

* Percent deviations are large due to a small base

XIV. ALTERNATIVE TERMS OF TRADE EXPERIENCES

Sri Lanka has had a significant terms of trade deterioration since 1978:

Foreign Trade Price Indices

| | TT | Import Prices | Export Prices |
|------|-------|---------------|---------------|
| 1978 | 100.0 | 100.0 | 100.0 |
| 1978 | 68.9 | 154.9 | 106.8 |
| 1980 | 75.6 | 214.0 | 161.8 |
| 1981 | 65.7 | 263.6 | 173.1 |

Source: Department of Census and Statistics

This deterioration can be attributed to rising import costs from the 1978 oil shock and world inflation, both beyond Sri Lanka's control.

The Import prices used in the base simulation are:

Border Prices of Imports

| | Pinvestment | Pintermediate | Pconsumer |
|------|-------------|---------------|-----------|
| 1979 | .6591 | .5638 | .5779 |
| 1980 | .8367 | .9099 | .7263 |
| 1981 | 1.0000 | 1.0000 | 1.0000 |

Source: Department of Census and Statistics

Simulations 1a and 1b for 1980 and 1981 assume that these prices rise by 20 per cent a year starting from their 1979 values. This is lower than the actual increases, especially for intermediate imports for which the price rise is 61 per cent from 1979 to 1980.

The results of slower import price increases are substantial: real GDP is 5.1 per cent higher in 1980 and 2.9 per cent higher in 1981 than in the base scenarios. The effects are stronger in 1980 because the import price rise is much lower in that year compared to the base scenario.

The financial-real links are from the money supply to prices to real demands and from private credit to private investment. Here the lower import price reduces the current account deficit although the expansion tends to offset this. The result is higher reserves and so money supply rises, private credit rises and private investment expands.

The larger money supply also causes the markup rates in sectors 3 and 4 to increase directly. They are further increased by the higher capacity utilization due to demand pressures from the lowered prices. These increased markups show up in income of non-agricultural profit recipients. For example, in simulation 1b, sector 4 markup rates are 36 per cent as compared to 29 per cent in the base scenario and non-agricultural profits are 21 per cent higher.

These substantial markup increases affect the relative prices of manufacturing and service sectors. Sector 3 has prices kept down by lower import prices but sector 4 does not since its import-output coefficient is small. The price level in sector 4 rises much more than sector 3 price. These scenarios point out directions for monetary policy. Sterilization of larger reserves would prevent the large markup increases and the distortion in relative prices.

XV. CONTINUED FOOD PRICE SUBSIDY

The first policy alternative (scenario 2a) is to continue the 1979 subsidy of free rice rations to the lower 35 per cent of the population. The leakage of rice subsidies to the upper income groups is accounted for by reducing the subsidy to the poor and providing a small subsidy to the rich. With rice consumption about 30 per cent of the poor's food expenditure and with about 30 per cent not receiving their entitlement, free rice can be approximated by a 21 per cent price subsidy to that group. The upper income group receives a subsidy of 6 per cent. The food stamp scheme is not implemented and so transfers to households are reduced by Rs.1614 million. As expected, consumption of food by the poor rises dramatically from Rs.7644 million in the 1980 base run to Rs.8828 million in the current 1980 run. This is 0.6 per cent higher than in 1979 and is presumably what the trend would have been if the government had not switched from subsidies to transfers. Consumption of all other items by the poor also rises as they are able to achieve their base food necessities more easily. Food consumption by the upper 65 per cent rises but other consumption falls as they lose the benefit of the food stamp transfers.

Normally one would expect a price subsidy to be expansionary as it causes real incomes to rise. Here real GDP in 1980 is almost the same as the 1980 base. This is because the food subsidy is combined with a decrease in transfers to all households. Total consumption of food rises but total non-food consumption is unaffected due to the fall in income of the rich. Food supply is fixed in the short run and so the extra demand does not raise production. Secondly, the subsidy costs the government Rs.2502 million which results in a fall in government savings of Rs.925 million and thus an increase in government credit of the same amount. Increased real food imports raises the current account deficit by Rs.1079 million and so reserves are lower by this amount. Money supply is then lower, private credit is lower and so private investment falls. This offsets the

slightly higher exports.

In simulation 2a the net increase in food consumption results in a one to one increase in real food imports as output in food is fixed in the short run. Scenario 2b combines the food subsidy with an increase in producer food prices to provide incentive for increased domestic supplies. A supply elasticity of .5 is used, in line with the general success of the actual rice import substitution programme that Sri Lanka has been carrying out.²⁵

Simulation 2b combines the continued price subsidy with a price rise in food agriculture of 2 per cent and a food output increase of 1 per cent. GDP now rises 0.87 per cent from the base run due to food production rising and also due to increased demand on non-food sectors as agricultural incomes rise and non-agricultural prices are lower. Prices fall as markups fall due to the lower money supply outweighing the higher capacity utilization in the markup equation. Real food import requirements are Rs. 1828 million as opposed to Rs.2125 million in the above simulation. However, the current account deficit is the same as in scenario 2a because increased imports elsewhere, due to higher activity, counter the reduced rice imports.

The price subsidy scheme effectively increases consumption by the poor, especially on food. However, the procurement of the extra food is not so straightforward. Unless non-food imports can be curbed, increased domestic food production does not reduce the foreign savings required.

XVI. REDUCED INVESTMENT

Simulation 3a examines the effect of reducing investment by the public corporations (irrigation and housing projects) from Rs.7681 million to Rs.5681 million in 1980. As expected, the effect is contractionary and GDP falls by 1.4 per cent. Investment comes from the non-food sectors and from imports. The non-food sectors, being demand determined, suffer a loss in output. Consumption demands also fall as the effect of reduced incomes in nonagricultural wage and profit incomes outweighs the effects of reduced prices. Prices fall as markup rates fall with reduced capacity utilization and money supply. With no capital flow changes, there is an improvement in the current account deficit of Rs.1644 million as consumer imports, intermediate imports, capital imports and competitive imports all fall. Capital imports fall by Rs.777 million. This scenario is deflationary (the GDP deflator falls from .8434 to .8270) as the borrowing requirements of the government fall and the money supply falls.

Simulation 3b examines the effect of a fall in investment of Rs.2000 million combined with a fall in capital inflows by the same amount and a fall in government foreign borrowing of Rs.1000 million. This would occur if commercial bank and private foreign borrowing fell as a result of the lower investment.

This scenario results in a significant money supply fall as government credit and reserves fall. Government credit will fall since the borrowing requirement falls. Despite the significant improvement in the current account deficit as the economy contracts, reserves fall because the reduction in capital inflows is larger than the deficit improvement. On subsequent iterations sectoral prices in non-agriculture will fall as their mark-up rates adjust downward to reduced money supply. Also private credit falls and so private investment falls; private investment is crowded-in by government investment in this model. The reduced sectoral

prices increase real consumption demands and real manufacturing exports demand. These effects counter the reduced private and government investment and non-agricultural output is higher than in 3a. Real GDP is thus not as low as in scenario 3a with reduced investment alone. Also inflation is further contained due to the money supply effect on markup rates. The GDP deflator is .8084, down from the 1980 base run value of .8434. The CPI (which weights agriculture prices more heavily than the deflator) is .8176 down from .8334.

These reduced price levels are fed into a 1981 simulation (3c) where public investment is reduced by Rs.1000 million. Capital inflows are reduced by 1000 and government borrowing is reduced by Rs.500 million.

As in 1980 the money supply is lower than in the base year since government credit contracts due to the lowered borrowing requirement and reserves remain steady as the reduced capital inflow offsets the current account improvement. This, combined with a slightly lower capacity utilization, yields lower markup rates. The end result is that non-agricultural prices are reduced sufficiently that consumption demand and manufactured export demand offset the investment demand fall so that final real GDP is Rs.78989 million as compared to the base year Rs.79164 million.²⁶

The GDP deflator is .97, down from 1.000 in the base run. The CPI is now .97 down from 1.000. Over the two year period of lowered investment, real growth ends up 0.2 per cent lower and inflation has been improved. This shows that excessive public investment has been putting upward pressure on prices in the non-agriculture sectors. The lowered inflation would make the food stamp transfers, which were not indexed to the price level, worth more in real terms. However, because agricultural prices are controlled, they do not respond to the deflationary effect of reduced investment and so food consumption is not enhanced. This leads us to the next scenario.

XVII. FOOD SUBSIDY AND LOWER INVESTMENT

The fourth scenario combines simulations 2a and 3b by both continuing the food subsidy scheme and lowering investment levels and foreign inflows. For the years 1980 and 1981 there are food subsidies of 21 per cent to the poorer 35 per cent of the population and 6 per cent to the wealthier 65 per cent of the population (replacing the food stamp transfer of Rs.1614 million in 1980 and Rs.1321 million in 1981), investment is lowered by Rs.2000 million in 1980 and Rs.1000 million in 1981, and foreign inflows are reduced as in simulations 3b and 3c.²⁷

In 1980, the lowered investment and the reduced transfers decrease GDP whereas the subsidies tend to raise it. The resulting real GDP is down by 0.9 per cent from the base run. However the poorer segments of the population are better off as their food consumption rises from Rs.7644 million to Rs.8615 million. The GDP reduction is mainly due to lower investment: a reduction of Rs.2000 million in government investment, as well as a decline of Rs.1464 million in private investment as the money supply and then private credit fall significantly.

Prices are also lower: the GDP deflator is .8051, down from .8434 and the CPI is .7744, down from .8334 in the base run. Much of this is due to decreased money supply growth as central bank reserves fall by Rs.1203 million from the base run, due to the lowered capital inflows. Government credit remains about the same as in the base run; the lower investment and transfers are offset by the requirements of the subsidy (Rs.2457 million) and the lowered government foreign borrowing. The current account deficit is Rs.8490 million down from Rs.9287 million with the contraction of the economy countering the increased food imports.

These results are fed into a 1981 simulation retaining the price subsidy and decreasing government investment by Rs.1000 million. The results show real GDP as 0.5 per cent

higher than in the base case. The GDP deflator and CPI are .9544 and .9314 respectively instead of 1.0 as in the 1981 base. The lower prices cause real consumption and manufactured exports demand to rise sufficiently to counter the lowered investment.

Food consumption by the poor rises to Rs.9531 million, up from Rs.8301 million in the base run. The food subsidy costs the government Rs.3099 million and the net effect is that the change in government credit is higher than the 1981 base case by Rs.1272 million. However reserves fall by Rs.2809 more than the base due to both the larger current account deficit as food imports rise and the reduced capital inflows. The result is that the money supply level is greatly reduced from the 1981 base run. This leads to both the low prices and low private investment.

Financing difficulties occur as foreign capital inflows are assumed to fall as capital investment is decreased. The public sector borrowing requirement remains high because the reduced investment is outweighed by the cost of the subsidy. The government is forced to resort to expansionary bank financing.

Scenarios 4c and 4d solve the problem of financing the food subsidies by increasing the tariff on consumer imports. As reported by the Central Bank, consumer imports other than food and textiles rose faster in volume terms than any other category of imports. This makes consumer import tariffs an attractive revenue source. In runs 4c (1980) and 4d (1981) those tariffs are raised from .16 to .66 and from .17 to .67 respectively while keeping the same changes as in runs 4a and 4b.

Results are similar to scenarios 4a and 4b: the price subsidy and reduced investment lead to lower prices which encourage consumption and exports and so real GDP can be sustained at the base levels by 1981. Food consumption by the poor is greatly enhanced. But now the cost of the

subsidy programme is paid by consumer import tariff receipts of Rs.2159 million in 1980 and Rs.3222 million in 1981. Government savings are significantly improved from 4a and 4b and also from the base simulations. Consumer imports fall substantially, more than the increased imports of food, which gives the added benefit of a lower current account deficit in both years.

Government credit requirements are reduced due to the extra revenue and reserves are above their base levels. The result is that money supply is kept in line at similar rates as in 4a and 4b but now this is due to low government credit and high reserves, the opposite of 4a and 4b. Restrained money supply growth again leads to lower prices and increased real demands and the price subsidies encourage food consumption by the poor. Simulations 4c and 4d successfully continue the tradition of basic needs measures for promoting equity and demonstrate the usefulness of revenue policies that are directed towards certain goods.

XVIII. LOWER OIL PRICES

The fifth scenario is to study the effects of a lower input price for imported oil to ease the oil shock adjustment. This was examined by placing an input subsidy on petroleum products going into the manufacturing and services sectors. The manufacturing sector's input of petroleum is 22.6 per cent of its total input from manufacturing (refinement of crude oil is done by the petroleum industry). The service sector's input of petroleum is 45.7 per cent of total manufacturing inputs. The price of oil doubled from 1979 to 1980 and so a subsidy to manufacturing on the price of manufacturing inputs of 11 per cent and a subsidy of 23 per cent to the service sector would approximate a constant price of oil to these sectors.

The result is that prices in the manufacturing and service sectors in 1980 go from .7870 to .7846 and from .8197 to .8207 respectively. The subsidies reduce the prices but this effect is offset by the increased markups caused by the bigger government deficit. Real consumption rises due to higher incomes of profit recipients. The subsidies cost the government Rs.1675 million and this causes government credit to rise so the money supply rises, private credit rises and private investment then rises. This contributes to further expansion and the end result is that real GDP is 1.4 per cent higher than the base simulation.

The expansion worsens the current account deficit as more imports are demanded. The CPI falls, but only marginally. The GDP deflator rises because the calculation of real GDP involves fixed value added coefficient on capacity utilization. Details of the simulations show that real demand components of sector output are sensitive to the price. It then becomes important to keep prices under control to ensure growth. With the money supply link to prices the government must keep government credit under control and sterilize reserve increases when appropriate.

XIX. ADJUSTMENT POLICIES IN SRI LANKA

1. An overall assessment

In the light of the detailed analysis of policies and their impact in earlier sections of this paper, it is now possible to piece together a general assessment of their effectiveness in attaining the objectives of adjustment.

In an adjustment situation, fiscal policy seeks to curb excess demand by avoiding resort to borrowing from the banking system for the financing of the current and capital requirements of the Government Budget. It is therefore incumbent on the Government to pursue revenue and expenditure policies with a view to deriving a surplus on its current account to facilitate the financing of capital expenditures. The main features of fiscal policy in Sri Lanka from 1978 onwards were (1) increasing reliance on indirect taxes for raising revenue; (2) clamping down on the wages and salaries component of expenditures; and (3) sharp reduction in transfers and subsidies to households. But even these measures did not help in the generation of public savings. Until 1983 Government savings were negative in four out of six years and negligible in the remaining two. All that the belt tightening achieved, or perhaps contributed to, was a reduction in the consumption and nutrition levels of a large section of the population. The belt tightening efforts did not save the Government from resorting to substantial doses of expansionary financing during 1980-82, with its attendant effects on aggregate demand.

The question is, whether sacrifices in the consumption standards of the poor could have been avoided. As demonstrated elsewhere, there were policy options available to retain the expenditure on transfers and subsidies to households, and some curtailment of the very high public investment programme, which would have resulted in almost the same output growth and safeguarding of consumption. But, then, this would not have been in accord with the 'reform

package' and questions arise as to whether the IMF and the World Bank may have provided their support for mobilising external resources for such alternative packages.

The role of monetary policy is usually envisaged in terms of containing excess demand through the operation of interest rate policy and credit policy. A sufficiently high interest rate is expected to help in the mopping up of deposits from the public and hence constrain demand. Similarly, restraints on credit also have the same objectives. In the Sri Lankan case, interest rates were jacked up right from the beginning of 1978 and despite being still unattractive in comparison to the rate of inflation until 1982, were successful in promoting the growth of savings and time deposits. Yet, this did not help in raising domestic savings overall, perhaps partly on account of the negative real interest rate after accounting for inflation. A more worrisome aspect of the interest rate policy was that it may have been high enough to inhibit private entrepreneurs from borrowing for investment in activities involving relatively modest returns on capital invested. Given the uncertain nature of the market situation, it would have been imprudent for private investors to borrow funds at high rates of interest for long term investment and still hope to secure returns covering the interest obligations and risk premium. This seems to fit in with the Sri Lankan scenario, where private investment efforts have tended to concentrate on quick yielding activities like trading and other service oriented enterprises. Thus, while the effect of interest rate policy in containing excess demand was unclear, it was almost certainly an inhibiting factor for long term private investment, which would have had a high priority in terms of socio-economic developmental objectives.

The curtailment of bank credit, while putting the lid on expansion of aggregate demand, affects investment and working capital requirements also. However, net domestic assets of the banking system increased in 1979 and 1980.

Incidentally, 1980 corresponds to the period of highest expansionary financing resorted to in the Government Budget. The evidence on credit expansion supports the view that in practice the effect on growth of aggregate demand until 1982, could not have been negative. This is also in accord with the behaviour of prices during the relevant period, viz, 1978-81.

The centrepiece of the policy package was the exchange rate reform. Stated simply, the devaluation of the Sri Lankan Rupee was to be the lynchpin around which other policy measures cohered. In effect, it was expected to promote exports and discourage or rationalise import requirements. Additionally, the exchange rate policy - that is devaluation - was expected to set in motion the forces that were necessary to correct the overall price distortions in the economy. In the event, the dependence on tree crop exports still continues. In fact an upsurge in export earnings in 1984 was the direct result of a higher price for tea. Increases in export of industrial goods, and particularly garments, have to be viewed in the context of its low value added content. It is not clear that the export outcome would have been marketly different, at any rate in the tree crop sector had the devaluation of the Sri Lankan Rupee not taken place.

It was earlier shown that the only import substitution that took place was in respect of rice. Here the main factor was the price incentive, following the withdrawal of rice subsidies and the trading of rice in the open market. In this sense import substitution in rice could be considered a spin-off of the adjustment process. However, there was little import substitution in other areas. The achievement of some slowing down in the growth of intermediate imports is difficult to explain in the context of sustained growth of real output. There is a possibility that output growth may have been overstated.

The current account deficit of the balance of payments

was at high levels until 1983, and did not reveal any clear trend towards a sustainable position. The exchange rate reform did not bring about any significant change in this regard. However, the clamour for further devaluation of the Sri Lankan Rupee again became loud. The World Bank suggested that the 'appreciation' of the Sri Lankan Rupee after 1977 must be reversed. The argument here is that although the Rupee-Dollar parity shows a continuous depreciation of the Rupee, the Sri Lankan inflation rate is higher than those of its trading partners and hence the Rupee is overvalued. It may be noted that everytime the Rupee is devalued, imports become costlier and domestic prices are 'cost-pushed' to higher levels. To correct these higher prices, if the Rupee is to be devalued again, the process may become cumulative. And in the Sri Lankan basket of traditional exports, there are very few items that could gain from an exchange rate devaluation through high supply elasticities.

The financing of the balance of payments during the period 1978-84 does reveal the strains faced during 1980-83. However, the policies appear to have helped in the mobilisation of external resources for financing the Public Investment Programme.

2. Implications for the international financial institutions

The Sri Lanka adjustment experience overall emerges as a somewhat special case. A key element in this was the manner in which coordination of policies between the International Monetary Fund and the World Bank together, secured over a substantially long period - 1977 to 1986 - the external resource inflows needed to underpin the adjustment effort. As previously mentioned, the food subsidy cut, viewed formally as part of the IMF package of 1977, would not in the eyes of the Sri Lankan policy makers have been feasible without an assurance of support for a project package by the Bank and the Aid Group. The package comprised the Mahaveli

River Basin development together with associated 'lead' projects, and was aimed at creating the employment gains without which the entire subsidy cut operation would have been politically unviable. Consistently with this there is evidence, as time elapsed after the first 1977 standby, that IMF policy took into account the consideration that exchange rate corrections judged ordinarily desirable might have to await the resolution of key political issues, e.g., a presidential election, and, in more recent years, a resolution of the ethnic conflict.

This did not mean that leverage was absent; for example, the Minister of Finance went on record as saying that Sri Lanka had lost out on a drawing on the World Bank's structural adjustment facility. The reason he gave was that military expenditures in a country which had traditionally spent very little on defence had under the pressures of the domestic emergency risen sharply; and were in excess of a critical magnitude that might have been compatible with a Bank structural adjustment loan.

What the Sri Lanka experience makes clear, however, is that leverage by the Fund was never successfully applied to the point of forcing a devaluation on the country during a period when, as mentioned, the real exchange rate has appreciated; or for that matter, by the Bank to the point of substantially reducing external capital inflows from the Aid Group. In other words, the Sri Lanka policy situation can be contrasted with that of, say Ghana or Tanzania, where failure for a long period to come to terms with the Fund had the effect of drying up a large proportion of external capital inflows from the Bank and other donor sources, until such time as a satisfactory Fund negotiation was worked out.

In the Sri Lanka case, despite traditional Fund concerns over the maintenance of an overvalued exchange rate, external resource inflows from the Bank and the Sri Lanka Aid Group were never allowed to collapse, though they may not have measured up to the levels that might have been negotiated if, for example, a better accommodation with the

Fund were reached or if a solution to the ethnic problem was worked out. The Sri Lanka story, for all practical purposes, reads like one where the international financial institutions, i.e., the Fund and the World Bank worked in unison and alongside domestic policy makers to support the development effort once the initial breakthroughs had been made in 1977, despite growing obstacles to continuing external support which might, in other circumstances, have led to a substantial reduction in that support.

The principal policy issue that this raises is how similar country situations can be treated in like fashion in a systematic manner by the international financial institutions. What institutional processes might for example be introduced within the Fund/Bank complex to bring about as a rule the kind of particularly sensitive coordination of policies between these two institutions that has characterized their handling of the Sri Lanka case? Can we think, in other words, of a reform of these institutions that goes beyond what are, in effect, joint appraisals by their staffs of particular country situations?

Such a line of reform has been pinpointed by a Commonwealth Study Group on the Bretton Woods System which reported in 1983.²⁸

Joint appraisals by the staffs of the Fund and the Bank are necessary if the skills of each institution are to be best deployed in dealing with the common problem where the requirements of adjustment shade into development. A more desirable formal step in dealing with structural adjustment lending is for both institutions to assume, and declare, a joint responsibility for the relevant adjustment programmes. If this is done, countries would be expected to apply simultaneously for an EFF from the Fund and an SAL from the Bank; they would then negotiate the structural adjustment programme jointly with both institutions. The division of labour between the two would correspond to that of their traditional skills. The Fund would negotiate the conditions for prudent demand management policies while the Bank would deal with questions of investment priorities over the medium-term, and such issues as fiscal reform and institutional development.

A further stage of reform might over the longer-term be

implemented in the light of experience gathered with the working out of joint programmes of this sort. This reform could involve the merging of the IMF's EFF and the World Bank's SAL facility into a single separate lending entity under the direction of an Executive Board, where representation between developing and industrialised countries would be better balanced and free from weighted voting considerations. The new entity, standing mid-way between the Fund and the Bank, would be in a position to maintain, on a basis of periodic secondment, staff members from each institution whose energies would be specifically addressed to working out the conditions for structural adjustment programmes.

An alternative, even more heretical view which can be explored is the contention that there is no room for more than one international financial institution if adjustment/development efforts are to be coherently supported.

The Sri Lankan experience suggests three more desirable lines of reform. The first has to do with the exchange rate regime. As has been explained, both the Bank and the Fund accepted with equanimity a substantial period where the Sri Lankan Rupee was appreciating in real terms. An alternative strategy might have been to encourage a devaluation where it might really have been effective, viz, at the level of promoting those non-traditional exports with relatively high price elasticities and of curbing imports deemed 'inessential'. In other words, the question that arises is whether there would have been a gain in terms of balance of payments performance, by a reversion in Sri Lanka, to its long standing dual exchange rate regime, though better administered than before. Under such an arrangement the 'base' rate would apply to traditional exports such as tea that are in inelastic demand and to imports of 'essentials' such as wage goods, rice, flour, milk foods, pulses, etc., care being taken, of course, to pitch that 'base' rate at levels which would create a sufficiently large domestic price incentive to provide rapid import substitution of these 'essentials'.

The empirical evidence indeed suggests that the unitary 'base' exchange rate over the period 1978-84 was manifestly satisfactory in this regard, having underpinned an unprecedented import substitution effort in rice production to the point of making the country self-sufficient in rice. The alternative to a further devaluation of this 'base' rate conceived of a unitary rate would be to super-impose on it, as has been the case in the past an appropriately devalued second or 'feec' rate²⁹ that would apply to the export of non-traditionals which one would want to encourage, and to the import of anything classified as 'inessential' which one would want to discourage. In principle, the same thing could be approximated to by an equivalent combination of export subsidies and import duties in a single unitary exchange rate regime. The difference, however, is that the 'feec' rate is capable of being administered, as it has never been done in the past in Sri Lanka, as a genuinely floating rate. In contrast, import tariff and export subsidy adjustments have necessarily to be taken in discrete steps and be watched for a period, as was indeed the case with Sri Lanka's previous experience with a dual exchange rate regime where the 'feec' rate itself was only adjusted from time to time. But as explained, the alternative of a genuine floating and more depreciated second exchange rate accompanied by a fixed 'base' rate, has never been tried in the Sri Lankan context; and it is arguable that had that option been on offer from the IMF it might have been implemented, and might have produced a more viable balance of payments situation over the period 1978-84.

A second implication of the Sri Lankan experience concerns the relatively rapid phasing out of food subsidies after the initial cut. In the first phase (1977-78) the free rice ration was taken away, it will be recalled, only from the richer half of the population. It was the second phase, viz, the substitution of the rice subsidy by the food stamp scheme which saw the erosion of the nutritional levels of the bottom 40 per cent of the population. If the results of the counterfactual modelling exercise in this paper are to

be relied upon, the conclusion which follows is that this erosion in nutritional standards could have been prevented by not proceeding beyond the first phase of the subsidy cut, while simultaneously approximating to the relatively favourable balance of payments and growth rate outcomes actually attained in real terms. The major difference between the modelling exercise outcome and actual performance would have consisted in a higher consumption/investment mix than actually resulted and, of course, in a lower rate of inflation.

In brief, ways could have been found to adjust successfully while continuing to pursue a more 'basic needs' oriented strategy than actually occurred. The dilemma facing Sri Lankan policy makers has always been that of maintaining food subsidies without undue fiscal strain. What can be argued with the benefit of hindsight is that the international financial agencies and the Government need not have proceeded beyond the first phase of the subsidy cut on fiscal considerations alone; a reduced and phased out investment programme coupled with donor support for targeted protection of basic needs could have looked after the fiscal strains that would have resulted from not going beyond the first phase.

Indeed in a paper for the WIDER Food Strategies Conference³⁰ Kaushik Basu has argued, comparing Sri Lanka and Kerala, that the common features which make for a high level of basic needs satisfaction on a low per capita income, are the combination of a food subsidy policy affecting both rural and urban areas alike, and a high level of social services expenditure in the area of education and health care. Having analysed the debate between Surjit Bhalla, of the World Bank, and Professor Sen on the Sri Lanka case he concludes that Bhalla is in error in drawing the inference "that a larger social expenditure need not lead to higher living standards." What the Sri Lanka data establishes, in hindsight, is that it was the decision to lower social services expenditures beyond tolerable levels,

especially through the food stamp scheme, that led to the erosion of living standards of the bottom 40 per cent. No doubt the decision was made in the interest of stepping up the investment rate substantially in order to promote future growth and hence future living standards. But the evidence indicates that the time path of investment could have been more gradual, thereby avoiding the inflationary bottlenecks that also contributed to the erosion of living standards of the poorer 40 per cent, when superimposed upon the further subsidy cut implied in the food stamp scheme.

The final suggestion for international policy that emerges from Sri Lanka's experience is the extent to which the deterioration in her terms of trade has negated the adjustment effort underway. As Table 23 above indicates, the merchandise trade deficit at 1978 prices of both imports and exports, would by 1984 have been a fraction of the deficit that was actually registered in current prices, and of course, financed through flows on the services account and the current account. What this suggests is that the international community has still to find a satisfactory way of insulating a developing country engaged in an adjustment effort from the disruptive consequences of price movements that are entirely beyond the control of that country. It has been convincingly argued elsewhere, that the one facility which has been introduced into the IMF to look after short falls in export earnings, namely the compensatory financing facility has, in recent years been hedged about with so much conditionality that it can be described as a 'fifth tranche' of the IMF.³¹ What is required, and the Sri Lankan experience underlines this, is a reversion to the original philosophy of the compensatory financing facility where unconditional finance was being provided, and its further extension along lines that have been repeatedly canvassed in the past, namely to provide for compensation for import price increases as well. Such a genuine terms of trade facility funded through appropriate special drawing rights issues, for example, is something that in the light of the findings of the Sri Lanka country study at any rate should

be placed in the forefront of the international negotiating agenda.

FOOTNOTES

1. See Annex 1: Some Aspects and Implications of Sri Lanka's National Accounts, Table F, Row 3; and Table 7.
2. Nicholas Kaldor, ECLA Bulletin, 1965.
3. The prevailing situation is perhaps best captured in a report prepared for the Treasury by the chief nutritionist of the Medical Research Institute, Dr. Brightie De Mel, and the following extract is relevant. "Since 1973 the Government has imposed a ban on the import of certain foodstuffs. From 1972 to 1973 the importation of pulses fell from 30,600 MT to zero. In 1973 the importation of staple dried fish was reduced by nearly 50 per cent dropping from 35,300 MT in 1972 to 16,800 MT in 1973. In 1975 imports of dried fish fell to 15,300 MT and in 1976 this declined to 6,656 MT, a decrease of more than 60 per cent. The reduction of imports of pulses and fish, the principal protein staples of Sri Lanka, was initiated in 1972/73 concurrent with the world slump in grain production, and was an effort to conserve hard currencies for the purchase of wheat and rice, the prices of which achieved an all time high in that period.

Food Balance Sheet - G/CAPUT/DAY

| | <u>1969</u> | <u>1970</u> | <u>1971</u> | <u>1972</u> | <u>1973</u> | <u>1974</u> | <u>1975</u> |
|--------------------------|--------------|--------------|--------------|--------------|--------------|-------------|--------------|
| 1. Dried and salted fish | 9.32 | 8.63 | 8.63 | 8.74 | 4.55 | 4.85 | 4.69 |
| 2. Pulses | <u>18.52</u> | <u>16.20</u> | <u>7.91</u> | <u>7.32</u> | <u>3.97</u> | <u>2.15</u> | <u>5.40</u> |
| Total of 1 & 2 | <u>27.84</u> | <u>24.83</u> | <u>16.54</u> | <u>16.06</u> | <u>8.52</u> | <u>7.00</u> | <u>10.09</u> |
| 3. Whole milk powder | 2.55 | 2.74 | 2.22 | 1.40 | 2.14 | 1.89 | 2.32 |
| Total of 1, 2 & 3 | <u>30.39</u> | <u>27.57</u> | <u>18.76</u> | <u>17.46</u> | <u>10.66</u> | <u>8.89</u> | <u>12.41</u> |

Since then the ban has continued in effect as a means of stimulating domestic protein production. Although indigenous production of pulses and fish has increased, protein availabilities continue to lag behind national requirements. (All foods are produced locally now except for wheat, sugar, powdered whole milk and some rice). Sri Lanka, during the last few years, has also been adversely affected as a result of changes in the world economy. High prices and general shortage of foods have intensified the problem of malnutrition, particularly among the lowest 43 per cent of the population who earn less than Rs200/= a month. In 1969/70 the Socio-Economic Survey indicated that those earning less than Rs.200/= (about \$28) per month (43 per cent of population) were receiving 2,064 calories and 47 grams of protein daily while those under Rs.400/= (about \$55) per month were getting 2,272 calories and 54 grams of protein. The

National Nutritional requirements being 2,200 calories and 40 grams of protein per capita per day. By 1973 (Consumer Finance Survey 1973) these nutrition levels had fallen to 1931 calories and 34.5 grams of protein and 2,099 calories and 37.3 grams protein respectively, a fall of about 100 calories and 12.5 grams per caput per day for the lowest income group."

4. See Table 13 for expenditure on food subsidies and Table A 5 for revenue from export taxes (mainly from plantations).
5. For detailed analysis of the determinants of paddy production in Sri Lanka, see Thorbecke-Svejnar, November 1984.
6. See Table 7.05, World Bank, May 1985.
7. See Thorbecke-Svejnar, November 1984.
8. See Table A 6 for the distribution of Government capital expenditure.
9. See Table A 25.
10. See Table 7.
11. See Table 5 A.
12. For a detailed discussion of the shortcomings of the official price indices, see UNICEF, May 1985; Bhalla and Glewwe, May 1985.
13. See Table on Wholesale Price Index - Annual Reports - Central Bank of Ceylon.
14. The import price indices for the period 1979-84 are as in the Annual Report of Central Bank of Sri Lanka, 1985. The increase in import prices for 1978 and 1979 is based on import price indices published in the Central Bank Review of the Economy for 1984.
15. See Annex 1, Table 2.
16. 1981 base shifted and linked to 1978. See Table A 22.

17. Bhalla-Glewwe, May 1985.
18. P. Alailima, November 1984.
19. See UNICEF, 1985 and Korale, 1984.
20. In a recent analysis of Consumer Finance Survey data for 1978-79 and 1981-82, Sudhir Anand and Christopher Harris (WIDER, September 1987) have found that nutritional declines occurred in the bottom two deciles of the rural sector and all the deciles of the estate sector. The urban sector was found to have improved its nutritional status in all the deciles during the inter survey period. The findings about the urban and rural sectors are at variance to those by Edirisinghe (1985). However, the Anand-Harris analysis has considered per capita food expenditure to rank the individuals in the population as compared to per capita total expenditure in earlier analysis.
21. Thorbecke-Svejnar, November 1984.
22. See Tables A 14 and A 15.
23. See Table 26, Central Bank of Ceylon, Review of the Economy, 1982 and 1984.
24. See Table 22, Central Bank of Sri Lanka, Annual Report 1985.
25. Log regressions of domestic production on paddy fertilizer use, weighted producer prices, and a time trend yielded price elasticities of .1 to .41. However, this omits a rainfall variable. To the extent that rainfall is uncorrelated to the explanatory variables, the estimates are not biased. This can be argued since prices and fertilizer issues are controlled by the government and are set by budget considerations prior to the growing season. Thorbecke (1985) reports elasticities ranging from .155 to .530 for the area sown to the real weighted producer price of paddy. The higher elasticity of .5 is chosen because of the emphasis of government policy towards improved agricultural incentives and the success of these incentives.
26. It should be noted that an optimistic export elasticity of 1.5 was used. This can be justified by the large success of the textile industry which was well below its US imports quota at the time and accounted for a rapidly

increasing share of industrial exports. Refined petroleum is the other major share of industrial exports.

27. This scenario revives the debate of whether equity is better promoted by providing basic needs or by encouraging overall growth. To the extent that improved nutrition improves productivity, the argument becomes blurred. Basic needs can then be viewed as an investment in human capital which will promote growth as well as providing direct benefits toward equity.
28. Professor Gerald Helleiner, et al.
29. The foreign exchange entitlement certificate (FEEC) defined the depreciated dual rate in Sri Lanka's previous experience with the system. See above.
30. Kaushik Basu, May 1986.
31. Sidney Dell, February 1985.

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ANNEX 1

Some aspects and implications of Sri Lanka's national accounts

Tables 1 and 2 set out the current and constant price magnitudes of resources and its utilization as estimated by the Central Bank of Ceylon for the period 1978-84. The deflators implied in these magnitudes in respect of GDP, Imports, Exports, Consumption and Capital formation are set out in Table 3. Table 4 shows the Colombo Consumer price Index and the Central Bank Cost of Living Index. In what follows, the implications of these estimates for the behaviour of savings, consumption and capital formation are analysed.

1. Domestic Savings

By definition domestic savings can be derived as the difference between Gross Domestic Capital Formation (GDCF) and the net imports of goods and non-factor services. The difference expressed as a percentage of GDP indicates the rate of domestic savings. These are derived and shown below corresponding to current and constant price magnitudes.

Table A: Domestic Saving Rates
(Percentage of GDP at market prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|-------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. Current Price | 15.3 | 13.8 | 11.2 | 11.7 | 11.8 | 13.8 | 19.3 |
| 2. Constant Price | 15.3 | 10.8 | 9.1 | 7.4 | 8.3 | 8.6 | 11.7 |

It is clear that the domestic savings as implied in the constant price magnitudes are not only very much on the lower side as compared to current price magnitudes, but also have declined from the base year (1978) continuously and at the end of the period, are still 25 percent behind. The behaviour also implies a substantial fall in the marginal

propensity to save during the period. This is certainly unusual during a period of high growth rates of income.

2. Foreign Savings

Foreign savings magnitudes are represented by net imports of goods and non-factor services. Foreign savings will include remittances from Sri Lankan nationals abroad as well as the net inflow of foreign aid including grants, concessionary loans and commercial loans. The foreign savings component for financing the GDCF is derived below.

Table B: Foreign Savings as a Percentage of GDP at Market Prices

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| GDCF as current prices | 20.0 | 25.9 | 33.7 | 27.8 | 30.8 | 28.9 | 25.3 |
| Domestic savings | 15.3 | 13.8 | 11.2 | 11.7 | 11.8 | 13.8 | 19.3 |
| Foreign savings at current prices | 4.7 | 12.1 | 22.5 | 16.1 | 19.0 | 15.1 | 6.0 |
| GDCF at constant prices | 20.0 | 23.6 | 27.7 | 25.8 | 25.0 | 25.4 | 24.6 |
| Domestic savings | 15.3 | 10.8 | 9.1 | 7.4 | 8.3 | 8.6 | 11.7 |
| Foreign savings at constant prices | 4.7 | 12.8 | 18.6 | 18.4 | 16.7 | 16.8 | 12.9 |

The behaviour of foreign savings in terms of current and constant prices do not follow any uniform pattern. Whereas domestic saving rates at constant price terms were uniformly lower; foreign savings ratios are higher in constant price terms in four out of six years. Perhaps this reflects the deflation procedures adopted in the case of net imports of goods and services. However, the conclusion that foreign savings were the principal source of financing GDCF is further strengthened in constant price terms.

3. Consumption

Consumption out of GDP at current and constant prices is shown below. This refers to the total of Government and private consumption.

Table C: Consumption Proportions out of GDP at Market Prices
(percentage)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|-------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. Current Price | 84.7 | 86.2 | 88.8 | 88.3 | 88.2 | 86.2 | 80.7 |
| 2. Constant Price | 84.7 | 89.2 | 90.9 | 92.6 | 91.7 | 91.4 | 88.3 |

Expectedly, consumption behaviour is the opposite of domestic savings behaviour. What is of interest is to note the very high rate of the GDP that is being consumed during a period of high growth rates. There are years when the implied marginal propensity exceeds 100 per cent.

4. Private Consumption

The Central Bank does not provide constant price estimates of private consumption. However, this can be obtained by deflating the current price estimates either by the Consumer Price Index or by the Central Bank Cost of Living Index. The derived estimates are shown below.

Table D: Private Consumption as Percentage of GDP at Market Prices

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. Current Price | 75.2 | 77.1 | 80.3 | 80.9 | 79.9 | 78.1 | 73.6 |
| 2. Constant Price-1 | 75.2 | 80.3 | 79.7 | 82.2 | 81.3 | 81.4 | 78.6 |
| 3. Constant Price-2 | 75.2 | 74.8 | 67.9 | 66.8 | 65.9 | 67.6 | 65.2 |

Constant Price-1 reflects the price movements in the Colombo Consumer Price Index. This estimate differs from current price magnitudes and reflects a higher proportion of GDP being accounted for private consumption. Constant Price-2 shows a sharp fall in consumption through most of the period. While the current price and constant price-1 imply high propensity to consume and consequently of lower savings, estimates derived by using the Central Bank Cost of Living Index indicate the possibility of high savings.

5. Expenditure on Gross Domestic Product

In view of the somewhat contrary findings on consumption growth and proportions, it may be useful to work backwards to derive the GDP in terms of expenditure incurred on it. Assuming that the constant 1978 estimates of all components of expenditure except that relating to private consumption are in order (this is not a determination of their accuracy) the private consumption expenditure can be separately deflated by the Central Bank Cost of Living Index. The Colombo Consumer Price Index is not being used for this purpose on account of its well known limitations. The detailed arithmetic of working out the expenditure on GDP at 1978 prices is shown in Table 5. As a result the index of growth in GDP at constant prices comes out as follows.

Table E: Index of Growth of GDP by the Expenditure Method

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Expenditure on GDP at 1978 prices | 100 | 101.1 | 96.4 | 97.6 | 103.6 | 111.5 | 117.2 |

The computations indicate that output declined in 1980 and 1981 and over the period as a whole, GDP increased only by 17 per cent. However, this outcome is not in accord with normal expectations in the light of the high level of capital formation that is reported to have taken place in the economy, particularly during the years 1980 and 1981. At the same time the order of high consumption growth in the central Bank estimates in real terms also appear to be unreliable. This doubt arises on account of the implicit deflator in the Central Bank estimates of consumption being even lower than the Colombo Consumer Price Index, which admittedly suffers from under-estimation.

One possible source of discrepancy in the derivation attempted in Table 5 could be the procedure adopted for the deflation of 'Net imports of goods and non-factor services'. Although the precise method employed by the Central Bank of

Ceylon for deriving the estimates set out in Row-4 of Table 2 is not clear, it is possible to reconstruct these estimates using the trade price indices and the changing relationship between the Sri Lankan Rupee and the SDR. While the trade price indices can be used for deflating the goods component of the trade transactions, the Rupee-SDR relationship can be used as a deflator for the non-factor services component. The deflation is shown in Table 6. When the new estimates of 'Net imports of goods and non-factor services' are used for obtaining the GDP by the expenditure approach, the conclusions are somewhat different from that obtained in Table 5. The new estimates are shown in Table 7. While the overall growth of GDP during 1978-84 is now 34 per cent as against 17.2 per cent earlier the year to year changes in GDP are not comparable between the two expenditure estimates or with that of the product approach estimates. The comparison may be seen below.

Table F: Index of Growth of GDP by Alternative Estimation Procedures
(1978 prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. Product approach (Table-2) | 100 | 106.3 | 112.5 | 119.0 | 125.0 | 131.4 | 138.1 |
| 2. Expenditure - 1 (Table-5) | 100 | 101.1 | 96.4 | 97.6 | 103.6 | 111.5 | 117.2 |
| 3. Expenditure - 2 (Table-7) | 100 | 113.7 | 111.6 | 121.1 | 122.6 | 126.1 | 134.9 |

Both the expenditure approach estimates show a decline in GDP in 1980. In terms of the Expenditure-2 estimates, a spurt in growth took place in 1979 followed by a decline in 1980 and a slow-down between 1981 and 1983. The main conclusion is that the consistent growth implied in the product approach estimates is not substantiated by the expenditure approach.

6. Conclusion

The constant and current price estimates indicate

differing behaviour in relation to saving, consumption and capital formation. The deflators used for deriving constant price estimates do not appear to be in conformity with related independent indices. When independent price indices are used for deflating private consumption, the GDP derived through the expenditure approach shows a reduced growth as compared to the product approach. In the present state of the accounting, it is difficult to draw firm conclusions on the behaviour of the inter-related components of the product and expenditure accounts. If a high rate of real output growth did take place as indicated by the product account, the stagnant and often falling rate of domestic savings appear to denote abnormal behaviour. On the other hand, if the price signals implied in the Central Bank Cost of Living Index are right, private consumption expenditure in real terms is seen to have fallen during some years and had improved only marginally during the period as a whole. A related implication is the doubt cast on the output increase. The GDP deflator implicit in current and constant price estimates is not in accord with the large import component at high import prices, particularly during 1979-81. The current price estimates of GDP may not be reflecting the actual price increase. All these highlight the need to re-examine the national accounting procedures as well as the construction of inter-related price, cost of living and trade indices.

TABLE 1 - RESOURCES AND UTILIZATION (Rs. MILLION AT CURRENT MARKET PRICES)

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|-------|-------|-------|-------|--------|--------|--------|
| Gross domestic product | 42665 | 52387 | 66527 | 85005 | 99166 | 121571 | 152615 |
| Imports of goods and non-factor services | 16872 | 23969 | 36456 | 39558 | 45905 | 50381 | 53417 |
| Exports of goods and non-factor services | 14835 | 17660 | 21434 | 25892 | 27148 | 32016 | 44285 |
| Net imports of goods and non-factor services (2)-(3) | 2037 | 6309 | 15022 | 13666 | 18757 | 18365 | 9132 |
| Gross domestic expenditure (1)+(4) | 44702 | 58696 | 81549 | 98671 | 117923 | 139936 | 161747 |
| of which | | | | | | | |
| Consumption | 36148 | 45169 | 59084 | 75061 | 87468 | 104834 | 123170 |
| Gross domestic capital formation | 8554 | 13527 | 22465 | 23610 | 30455 | 35102 | 38577 |

Source - Central Bank of Ceylon - Review of the Economy - 1984. Table 5

TABLE 2 - RESOURCES AND UTILIZATION (Rs. MILLION AT 1978 PRICES)

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|-------|-------|-------|-------|-------|-------|-------|
| . G.D.P. at market prices | 42665 | 45353 | 47983 | 50766 | 53355 | 56049 | 58907 |
| . Imports of goods and non-factor services | 16872 | 20752 | 23617 | 24467 | 24973 | 25423 | 25601 |
| . Exports of goods and non-factor services | 14835 | 14983 | 14678 | 15118 | 16010 | 16058 | 18064 |
| . Net imports of goods and non-factor services (2)-(3) | 2037 | 5769 | 8939 | 9349 | 8963 | 9365 | 7537 |
| . Gross domestic expenditure (1)+(4) | 44702 | 51122 | 56922 | 60115 | 62318 | 65414 | 66444 |
| of which | | | | | | | |
| . Consumption | 36148 | 40430 | 43616 | 46967 | 48940 | 51191 | 51959 |
| . Gross domestic capital formation | 8554 | 10692 | 13306 | 13148 | 13378 | 14223 | 14485 |

Source - For 1978 and 1982-84, Central Bank for Ceylon, Review of the Economy, 1984. Table 1.4

For 1981, Central Bank of Ceylon - Review of Economy, 1983. Table 1.4

For 1979 and 1980, Central Bank of Ceylon, Annual Report 1981. Table 1.6

TABLE 3 - IMPLICIT DEFLATORS IN CENTRAL BANK CURRENT AND CONSTANT PRICE ESTIMATES

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|--|------|-------|-------|-------|-------|-------|-------|
| Gross domestic product | 100 | 115.5 | 138.6 | 167.4 | 185.9 | 216.9 | 259.1 |
| Imports of goods and non-factor services | 100 | 115.5 | 154.4 | 161.7 | 183.8 | 198.2 | 208.7 |
| Exports of goods and non-factor services | 100 | 117.9 | 146.0 | 171.3 | 169.6 | 199.4 | 245.2 |
| Consumption | 100 | 111.7 | 135.5 | 159.8 | 178.7 | 204.8 | 237.0 |
| Gross domestic capital formation | 100 | 126.5 | 168.8 | 179.6 | 227.6 | 246.8 | 266.3 |

TABLE 4 - COST OF LIVING AND CONSUMER PRICE INDEX

| | | | | | | | |
|-----------------------------------|-----|-------|-------|-------|-------|-------|-------|
| Central Bank Cost of Living Index | 100 | 119 | 164.0 | 202.8 | 225.2 | 250.6 | 292.7 |
| Colombo Consumer Price Index | 100 | 110.8 | 139.7 | 164.8 | 192.7 | 208.2 | 242.8 |

TABLE 5 - DERIVATION OF GDP BY EXPENDITURE INCURRED (Rs. MILLION)

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|-------|-------|-------|-------|-------|-------|--------|
| . Private consumption at current prices | 32105 | 40371 | 53399 | 68751 | 79226 | 94945 | 111235 |
| . Central Bank Cost of Living Index | 100 | 119 | 164 | 202.8 | 225.2 | 250.6 | 292.7 |
| . Private consumption at 1978 prices | 32105 | 33925 | 32560 | 33900 | 35180 | 37887 | 38003 |
| . Government consumption at 1978 prices (as implied in Central Bank estimates) | 4043 | 4295 | 4196 | 3949 | 4612 | 4829 | 5036 |
| . G.D.C.P. at 1978 prices | 8554 | 10692 | 13306 | 13148 | 13378 | 14223 | 14485 |
| . Gross domestic expenditure | 44702 | 48912 | 50062 | 50997 | 53170 | 56939 | 57524 |
| . Net imports of goods and non- factor services | 2037 | 5769 | 8939 | 9349 | 8963 | 9365 | 7537 |
| . Expenditure on G.D.P. at 1978 prices | 42665 | 43143 | 41123 | 41648 | 44207 | 47574 | 49987 |
| . Index of growth | 100 | 101.1 | 96.4 | 97.6 | 103.6 | 11.5 | 117.2 |

TABLE 6 - DEFLATION OF NET IMPORTS OF GOODS AND NON-FACTOR SERVICES (Rs. MILLION)

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|--|------|-------|-------|-------|-------|-------|-------|
| 1. Net imports of goods and non-factor service at current prices ^{1/} | 2037 | 6309 | 15022 | 13666 | 18757 | 18365 | 9132 |
| 2. Net goods at current prices ^{2/} | 1481 | 7259 | 16347 | 15539 | 20492 | 20462 | 10194 |
| 3. Net non-factor services (1-2) | 556 | -950 | -1325 | -1873 | -1735 | -2097 | -1062 |
| 4. S.L. Rupees for SDR-Index ^{3/} | 100 | 102.9 | 110.2 | 116.1 | 117.6 | 128.7 | 134.0 |
| 5. Net non-factor services at 1978 prices | 556 | -923 | -1202 | -1613 | -1475 | -1629 | -793 |
| 6. Net imports of goods at 1978 prices ^{4/} | 1481 | 1319 | 3662 | 949 | 2345 | 4758 | 764 |
| 7. Net imports of goods and non-factor services at 1978 prices | 2037 | 396 | 2460 | -664 | 870 | 3129 | -29 |

^{1/} Table 5, Annual Report, Central Bank of Ceylon, 1984.

^{2/} As in customs data in Central Bank of Ceylon Reports.

^{3/} World Bank, 1985.

^{4/} As derived in Table 23 in main text of this study.

TABLE 7 - REVISED ESTIMATE OF GDP BY EXPENDITURE INCURRED (Rs. MILLION AT 1978 PRICES)

| | | | | | | | |
|---|-------|-------|-------|-------|-------|-------|-------|
| 1. Gross domestic expenditure ^{1/} | 44702 | 48912 | 50062 | 50997 | 53170 | 56939 | 57524 |
| 2. Net imports of goods and non-factor services ^{2/} | 2037 | 396 | 2460 | -664 | 870 | 3129 | -29 |
| 3. Expenditure on GDP | 42665 | 48516 | 47602 | 51661 | 52399 | 53810 | 57553 |
| 4. Index of growth | 100 | 113.7 | 111.6 | 121.1 | 122.6 | 126.1 | 134.9 |

^{1/}See Table 5.

^{2/}See Table 6.

ANNEX 2

The Model

The model is adapted from one constructed by Taylor (1983) for India. It has been re-worked to fit the Sri Lankan economic structure. The agricultural sectors have fixed supply and the manufacturing and service sectors have demand determined output. In the latter sectors the model iterates until supply is equal to the calculated demand.

The model uses markup pricing and allows both a cost push inflation effect and the effect of inflationary money creation. Cost push comes through the producer variable costs which include labour and intermediate import costs. The markup rates in the manufacturing and service sectors are positively related to both capacity utilization and the money supply to capital ratio. This implies money supply has both an indirect and a direct effect on prices. Indirectly, increased money supply leads to increased private credit, private investment and capacity utilization which then raises markup rates.

The parameters for the markup equation are obtained from econometric regressions. These parameters suggest a monetarist story and reflect the concern shown in Sri Lanka for the inflationary effects of money growth. Each year that government borrowing has been high has been followed by stricter government borrowing in subsequent years. In particular, the Central Bank of Ceylon has a high degree of independence and has been known to refuse credit to the government.

In the short run markup rates absorb money supply increases and in the next year, wages increase as they are indexed to the CPI. This model thus implies that profit recipients are faster at protecting their income from monetary inflation than wage earners.

The detailed equations are listed in the end. The model consists of four sectors: 1) food agriculture and processing, 2) export agriculture, 3) manufacturing, mining and construction, and 4) services, trade and transports. There are four income classes: agriculture, estate wage earners, non-agriculture wage earners, and non-agricultural profit earners. Also there are two types of consumption classes: poor and rich.

Block I contains real supply-demand balances corresponding to the first four rows of the SAM. Competitive imports adjust to balance sector 1 (agriculture) and exports adjust in sector 2 (agricultural exports). The manufacturing and service sectors (sectors 3 and 4) are demand driven and so supply adjusts to meet demand. This generally follows the behaviour of the Sri Lankan economy.

Block II calculates this year's wages which are indexed to last year's change in the consumer price index.

Blocks III and IV define the price and supply structure of the four sectors. In the agricultural sectors (sectors 1 and 2) output is fixed since supply is generally inelastic in the short run. Final prices are fixed by the government and the markup rate adjusts to equal the excess of the fixed price over the variable costs. In sector 2 agricultural exports, the discrepancy between the world price and the domestic price accrues to the government which owns most of the tea estates. Taxes on the final good, input subsidies and intermediate import tariffs are accounted for.

In the non-agricultural sectors (sectors 3 and 4) output is demand determined. Domestic price determination is a Kaleckian markup over variable costs with the markup rate adjusting to capacity and money supply. An 'overall' markup is estimated as a function of capacity and money supply to capital ratio. The markup in sectors 3 and 4 are then adjusted to absorb the difference between markup levels as calculated by the overall rate and the sectoral rates. This

markup adjustment is one link from the monetary to the real sector as prices affect real consumption and real export of manufactures.

Block V contains income equations for the four income classes: agriculture, estate wage earners (sector 2), non-agricultural wage earners, and non-agricultural profits. Government corporation revenues are explicitly accounted for. Each income class can receive remittances from abroad and government transfers.

Block VI specifies the level of consumer spending for two classes: poor and rich. The government transfers to non-agricultural wage earners, which are the food stamp transfers, are divided between the poor and rich according to how much leakage is occurring to the upper income class.

Block VII gives consumer spending by the two classes for each of the four sectors' goods as well as for imports. The equations are based on the linear expenditure system which has two sets of parameters: base levels of consumption (ϕ_i) which are independent of price and income, and marginal propensities to consume (σ_i) out of income above the base income needed to attain the base consumption. Note that consumption subsidies and consumer import tariffs are accounted for as part of the consumer price.

Block VIII determines demand for manufacturing exports as a function of the relative world and domestic prices. The exchange rate and export subsidy rate are included in the relative price.

Blocks IX and X yield the government accounts and blocks XI and XII keep track of the foreign accounts. These blocks determine the government current surplus (SG) and the current account deficit (SFOR). To maintain consistency in the SAM, the government surplus here includes foreign grant receipts and all foreign interest payments (public corporations and the government hold most of the foreign

debt).

Block XIII gives the price of new investment for the private sector, the public corporations, and the government. Real and nominal GDP, the CPI and the GDP deflator are calculated.

Block XIV contains the monetary accounts. The change in the banking system government credit is the public sector borrowing requirement less the government domestic non-bank borrowing and government foreign borrowing. The change in reserves is the difference between capital inflows (net of amortization payments) and the current account deficit. The levels of central bank (CB) government credit and CB reserves is the difference between year-end total government credit and commercial bank government credit, and total reserves and commercial bank reserves, respectively. The money base is the sum of CB reserves, CB government credit, CB loans to commercial banks, less sundry liabilities. The money supply is a simple multiplier of the money base. Finally, private credit is the residual of the money supply less government credit and reserves, plus non-monetary commercial and CB liabilities.

Block XV contains equations for investment. Real private investment depends on real private credit thus establishing a second link between the monetary and real parts of the economy. Real private investment also depends on the change in real GDP as businessmen look at the current state of the economy for their investment decisions. Nominal public corporation investment and government investment are exogenous. The investment by destination is split between sectors 3 and 4 and imports according to the h -coefficients which are calculated to ensure that the investment by origin matches figures from the SAM.

Block XVIII yields the standard savings-investment identity and is used as a check of the model.

TABLE A1: MODEL EQUATIONS

I. SUPPLY-DEMAND BALANCES

$$\begin{aligned}
 M^C_j &= I_j [a_{1j} X_j] + C_1 + G_1 + E_1 + DS_1 - X_1 \\
 E_2 &= X_2 - I_j [a_{2j} X_j] - C_2 - G_2 - DS_2 + M^C_2 \\
 X_3 &= I_j [a_{3j} X_j] + C_3 + G_3 + E_3 + DS_3 + I_3 - M^C_3 \\
 X_4 &= I_j [a_{4j} X_j] + C_4 + G_4 + E_4 + DS_4 + I_4 - M^C_4
 \end{aligned}$$

I_j=summation over j
from 1 to 4

II. WAGES

$$w_{1t} = w_{1t-1} + \theta_1 (CPI_{1t-1} - CPI_{1t-2}) \quad i=2,3,4,G$$

III. AGRICULTURAL SECTOR

$$\begin{aligned}
 P_{j1} &= P_j (1-t_{j1}) & j=1,2,3,4 & & i=1,2 \\
 P_{51} &= e(1+t_{51})P^*_{51} & & & i=1,2 \\
 R_1 &= I_j [a_{j1} P_j] + w_1 b_1 + a_{51} P_{51} \\
 R_2 &= I_j [a_{j2} P_j] + w_2 b_2 + a_{52} P_{52} \\
 \tau_1 &= P_1 / [(1+t_1) R_1] - 1 \\
 \tau_2 &= P_2 / [(1+t_2) R_2] - 1 \\
 X_1 &= X_1 \text{ BAR} \\
 X_2 &= X_2 \text{ BAR}
 \end{aligned}$$

IV. NON-AGRICULTURAL SECTOR

$$\begin{aligned}
 P_{j1} &= P_j (1-t_{j1}) & j=1,2,3,4 & & i=3,4 \\
 P_{51} &= e(1+t_{51})P^*_{51} & & & i=3,4 \\
 P_3 &= \frac{(1+\tau_3)(1+t_3)}{1-(1+\tau_3)(1+t_3)a_{33}(1-t_{33})} [a_{13}P_1 + a_{23}P_2 + a_{43}P_4 + w_3 b_3 + a_{53}P_{53}] \\
 P_4 &= \frac{(1+\tau_4)(1+t_4)}{1-(1+\tau_4)(1+t_4)a_{44}(1-t_{44})} [a_{14}P_1 + a_{24}P_2 + a_{34}P_3 + w_4 b_4 + a_{54}P_{54}] \\
 R_3 &= I_j [a_{j3} P_j] + w_3 b_3 + a_{53} P_{53} \\
 R_4 &= I_j [a_{j4} P_j] + w_4 b_4 + a_{54} P_{54}
 \end{aligned}$$

Markup determination:

$$\begin{aligned}
 CU &= (GDPR - GDP\text{RTR}) / GDP\text{RTR} \\
 \text{TAU} &= \mu_1 + \mu_2 CU + \mu_3 \text{MS/K} \\
 \text{MARKUP} &= \text{TAU} * (I_j [b_j w_j X_j] + \text{INTIMP} + \text{INTTAR}) \\
 Q &= 1 / (\tau_3 R_3 X_3 + \tau_4 R_4 X_4) * (\text{MARKUP} - \tau_1 R_1 X_1 - \tau_2 R_2 X_2) \\
 \tau_3 &= Q\tau_3 \\
 \tau_4 &= Q\tau_4
 \end{aligned}$$

V. INCOME GENERATION

$$\begin{aligned}
Y_A &= w_1 b_1 X_1 + t_1 R_1 X_1 - GR_1 + TF_A + TG_A \\
Y_{EW} &= w_2 b_2 X_2 + TF_{EW} + TG_{EW} \\
Y_{NAW} &= w_3 b_3 X_3 + w_4 b_4 X_4 + TF_{NAW} + TG_{NAW} + w_6 L_G \\
Y_{NAP} &= t_1 R_1 X_1 + t_2 R_2 X_2 - GR_3 - GR_4 + TF_{NAP} + TG_{NAP} \\
GR_2 &= t_2 R_2 X_2
\end{aligned}$$

VI. DEMAND GENERATION

$$\begin{aligned}
D &= (1-s_A)(1-d_A)Y_A + (1-s_{EW})(1-d_{EW})Y_{EW} + (1-s_{NAW})(1-d_{NAW})Y_{NAW} \\
&\quad + (1-s_{NAP})(1-d_{NAP})Y_{NAP} + D_0 \\
NETTR &= (1-s_{NAW})(1-d_{NAW})TG_{NAW} \\
D_P &= \epsilon_1 (D - NETTR) + \epsilon_2 NETTR \\
D_R &= (1-\epsilon_1)(D - NETTR) + (1-\epsilon_2)NETTR
\end{aligned}$$

VII. CONSUMPTION BY SECTOR

$$\begin{aligned}
P_{IP} &= P_i (1 - V_{IP}) && i=1,2,3,4 \\
P_{IR} &= P_i (1 - V_{IR}) && i=1,2,3,4 \\
P_{5C} &= eP^* c (1 + t^* c) \\
D_{PHAT} &= I_j [\phi_{jP} P_{jP}] + \phi_{5P} P_{5C} \\
D_{RHAT} &= I_j [\phi_{jR} P_{jR}] + \phi_{5R} P_{5C} \\
C_{iJ} &= \phi_{iJ} + (\delta_{iJ} / P_{iJ}) (D_j - D_{jHAT}) && i=1,2,3,4 \quad j=P,R \\
C_{5J} &= \phi_{5J} + (\delta_{5J} / P_{5C}) (D_j - D_{jHAT}) && j=P,R \\
C_i &= C_{iP} + C_{iR} && i=1,2,3,4,5
\end{aligned}$$

VIII. MANUFACTURED EXPORTS

$$E_3 = E_3 \text{BAR} (eP^*_3 / [P_3 (1 - \Gamma_3)])^{n_{13}}$$

IX. GOVERNMENT INFLOWS

$$\begin{aligned}
INDTAX &= I_j [t_j (1 + t_j) R_j X_j] \\
PRTAX &= d_{NAP} Y_{NAP} \\
INCTAX &= d_A Y_A + d_{NAW} Y_{NAW} + d_{EW} Y_{EW} \\
GOVMON &= GR_1 + GR_2 + GR_3 + GR_4 \\
INTTAR &= eP^*_5 I_j [t_{5j} a_{5j} X_j] \\
CONTAR &= eP^* c C_5 t^* c \\
CAPTAR &= eP^*_1 I_5 t^*_1 \\
EXPPR &= (eP^*_2 - P_2) E_2 \\
FORTR &= TF_G \\
SUMIN &= INDTAX + PRTAX + INCTAX + GOVMON + INTTAR + CONTAR + CAPTAR + EXPPR + FORTR
\end{aligned}$$

X. GOVERNMENT OUTFLOWS

$$\begin{aligned}
CLIPUR &= I_j [P_j G_j] + eP^* c G_3 \\
GOVTR &= TG_A + TG_{EW} + TG_{NAP} + TG_{NAW} \\
GOVJ &= w_6 L_G \\
CONSUB &= I_j [P_j V_{jP} C_{jP}] + I_j [P_j V_{jR} C_{jR}] \\
EXPSUB &= \Gamma_3 P_3 E_3 \\
INPSUB &= I_j [P_j (t_{j1} a_{j1} X_1 + t_{j2} a_{j2} X_2 + t_{j3} a_{j3} X_3 + t_{j4} a_{j4} X_4)]
\end{aligned}$$

$$\begin{aligned} \text{SUMOUT} &= \text{CURPUR} + \text{GOVTR} + \text{GOVW} + \text{CONSUB} + \text{EXPSUB} + \text{INPSUB} \\ \text{SG} &= \text{SUMIN} - \text{SUMOUT} \end{aligned}$$

XI. FOREIGN INFLOWS

$$\begin{aligned} \text{AGREXP} &= eP^2 E_2 \\ \text{OTHEXP} &= P_1 E_1 + P_3 E_3 + P_4 E_4 \\ \text{TRANS} &= \text{TF}_A + \text{TF}_{EW} + \text{TF}_{NAW} + \text{TF}_{NAP} + \text{TF}_G \\ \text{SUMEXP} &= \text{AGREXP} + \text{OTHEXP} + \text{TRANS} \end{aligned}$$

XII. FOREIGN OUTFLOWS

$$\begin{aligned} \text{INTIMP} &= eP^3 (I_j [a_{5j} X_j]) \\ \text{CAPIMP} &= eP^4 I_5 \\ \text{CONIMP} &= eP^4 c C_5 \\ \text{COMPIM} &= I_j [P_j M^c_j] \\ \text{GOVIMP} &= eP^4 G_5 \\ \text{SUMIMP} &= \text{INTIMP} + \text{CAPIMP} + \text{CONIMP} + \text{COMPIM} + \text{GOVIMP} \\ \text{SFOR} &= \text{SUMIMP} - \text{SUMEXP} \end{aligned}$$

XIII. PRICE OF INVESTMENT AND INDICES

$$\begin{aligned} \text{PK}_G &= h_{3c} P_3 + (1 - h_{3c} - h_{3c}) P_4 + h_{3c} P^4 e (1 + t^* i) \\ \text{PK}_{Pc} &= h_{3pc} P_3 + (1 - h_{3pc} - h_{3pc}) P_4 + h_{3pc} P^4 e (1 + t^* i) \\ \text{PK}_{PR} &= h_{3PR} P_3 + (1 - h_{3PR} - h_{3PR}) P_4 + h_{3PR} P^4 e (1 + t^* i) \\ \text{GDPR} &= I_j [\text{VALAD}_j X_j] + L_G \\ \text{GDPNOM} &= I_j [b_j W_j X_j + r_j R_j X_j] + L_G W_G \\ C/I &= (a_1 P_{1R} + a_2 P_{2R} + a_3 P_{3R} + a_4 P_{4R} + a_5 P_{5c}) (1 - \varepsilon) + \\ &\quad (a_1 P_{1P} + a_2 P_{2P} + a_3 P_{3P} + a_4 P_{4P} + a_5 P_{5c}) \varepsilon \\ \text{GDPDEF} &= \text{GDPNOM} / \text{GDPR} \end{aligned}$$

XIV. MONETARY ACCOUNTING

$$\begin{aligned} \text{PSBR} &= \text{IGN} + \text{IPCN} - \text{SG} \\ \text{DGCR} &= \text{PSBR} - \text{GDOMNB} - \text{GFOR} \\ \text{DRES} &= \text{CAPINF} - \text{SFOR} \\ \text{GCR} &= \text{GCR}^0 + \text{DGCR} \\ \text{RES} &= \text{RES}^0 + \text{DRES} \\ \text{CBGCR} &= \text{GCR} - \text{BGCR} \\ \text{CBRES} &= \text{RES} - \text{BRES} \\ \text{MB} &= \text{CBRES} + \text{CBGCR} + \text{CBBGR} - \text{SUNLIA} \\ \text{MS} &= \Phi_0 + \Phi_1 \text{MB} \\ \text{PCR} &= \text{MS} - \text{GCR} - \text{RES} + \text{NMNET} \end{aligned}$$

XV. INVESTMENT DEMAND

$$\begin{aligned}
\delta\text{GDPR} &= \text{GDPR}_t - \text{GDPR}_{t-1} \\
\text{PCREAL} &= \text{PCR}/\text{GDPDEF} \\
\text{IPR} &= \beta_1 + \beta_2 \delta\text{GDPR} + \beta_3 \text{PCREAL} \\
\text{IPRN} &= \text{IPR} * \text{PK}_{PK} \\
\text{IPC} &= \text{IPCN}/\text{PK}_{PC} \\
\text{IG} &= \text{IGN}/\text{PK}_G \\
\text{I} &= \text{IPR} + \text{IPC} + \text{IG} \\
\text{I}_5 &= h_{5PK} \text{IPR} + h_{5PC} \text{IPC} + h_{5G} \text{IG} \\
\text{I}_3 &= h_{3PK} \text{IPR} + h_{3PC} \text{IPC} + h_{3G} \text{IG} \\
\text{I}_4 &= \text{I} - \text{I}_5 - \text{I}_3 \\
\text{K}_{t+1} &= (1-\text{DEP})\text{K}_t + \text{I}_t
\end{aligned}$$

XVI. SAVINGS-INVESTMENT

$$\begin{aligned}
\text{SPR} &= s_A(1-d_A)Y_A + s_{EW}(1-d_{EW})Y_{EW} + s_{KAW}(1-d_{KAW})Y_{KAW} + s_{NAP}(1-d_{NAP})Y_{NAP} - D_0 \\
\text{SAVTOT} &= \text{SPR} + \text{SG} + \text{SFOR} \\
\text{INVTOT} &= P_1 \text{DS}_1 + P_2 \text{DS}_2 + P_3 (\text{I}_3 + \text{DS}_3) + P_4 (\text{I}_4 + \text{DS}_4) + eP^*_1 (1+t^*_1) \text{I}_5
\end{aligned}$$

ESTIMATED EQUATIONS

$$\text{TAU} = .16615 + .925 \text{ CU} + .696 \text{ MS/K}$$

(4.10) (3.76) (4.18)

T=7 Adjusted R²=.830

$$\text{IPR} = 1755.3 + .35344 \delta\text{GDPR} + .51369 \text{ PCREAL}$$

(3.77) (2.10) (10.71)

T=15 Adjusted R²=.950

(Numbers in parentheses are absolute t-statistics)

TABLE A2: VARIABLE DEFINITIONSEndogenous Variables

| | |
|-------------------|---|
| MC ₁ | : Real competitive imports, sector 1 |
| X ₂ | : Real exports for sector 2 |
| X _i | : Real output, i=1,2,3,4 |
| W _{i,t} | : Wage rates for sector i in year t |
| P _{ji} | : Producer input prices from sector j to sector i |
| P _{si} | : Producer import price to sector i |
| P _i | : Market prices |
| R _i | : Producer variable costs |
| T _i | : Producer markup rates |
| CU | : Capacity utilization |
| TAU | : Economy-wide markup rate |
| MARKUP | : Economy-wide markup level |
| Q | : Adjustment parameter for sector 3 and 4 markup rates |
| Y _A | : Agricultural income |
| Y _{EW} | : Estate wage income |
| Y _{NAW} | : Non-agricultural wage income |
| Y _{NAP} | : Non-agricultural profit income |
| GR ₂ | : Government revenue from public corporations, sector 2 |
| D | : Total expenditure demand |
| NETTR | : Government transfers (mainly food stamps) net of saving and taxes |
| D _P | : Expenditure demand by the poor |
| D _R | : Expenditure demand by the rich |
| P _{1P} | : Consumer price for the poor |
| P _{1R} | : Consumer price for the rich |
| P _{5C} | : Consumer import price in domestic currency |
| D _{JHAT} | : Base consumption total cost for the poor and rich, j=P,R |
| C _{ij} | : Real consumption by good and class, i=1,...5, j=P,R |
| C _i | : Real consumption by good, i=1,...5 |
| E ₃ | : Real exports of manufacturing, sector 3 |
| INDTAX | : Indirect tax revenue |
| PRTAX | : Profit tax revenue |
| INCTAX | : Income tax revenue |
| GOVMON | : Government enterprise revenues |
| INTTAR | : Intermediate import tariff revenue |
| CONTAR | : Consumer import tariff revenue |
| CAPTAR | : Capital import tariff revenue |
| EXPPR | : Export profit from sector 2 |
| FORTR | : Foreign transfers to government |
| SUMIN | : Total government income |
| CURPUR | : Current purchases by government |
| GOVTR | : Total domestic government transfers |
| GOVW | : Government wage bill |
| CONSUB | : Consumer price subsidy cost |
| EXPSUB | : Export subsidy cost |
| INPSUB | : Input subsidy cost |
| SUMOUT | : Total government payments |

SG : Government savings
 AGREXP : Agricultural exports
 OTHEXP : Other exports
 TRANS : Foreign transfers from abroad
 SUMEXP : Total exports
 INTIMP : Intermediate imports
 CAPIMP : Capital imports
 CONIMP : Consumer imports
 COMPIM : Competitive imports
 GOVIMP : Government imports
 SUMIMP : Total imports
 SFOR : Foreign savings (CA deficit)
 PK_G : Price of capital to government
 PK_{PC} : Price of capital to public corporations
 PK_{PR} : Price of capital to private investors
 GDPR : Real GDP
 GDPNOM : Nominal GDP
 CPI : Consumer price index
 GDPDEF : GDP deflator
 PSBR : Public sector borrowing requirement
 DGCR : Change in total government credit
 DRES : Change in total reserves
 GCR : Government credit level, end of year
 RES : Reserves of banking system, end of year
 CBGCR : Central bank government credit, end of year
 CBRES : Central bank reserves, end of year
 MB : Money base, end of year
 MS : Money supply (M2), end of year
 PCR : Private credit (nominal), end of year
 ΔGDPR : GDP change from year t-1 to year t
 PCREAL : Real private credit
 IPR : Real private investment
 IPRN : Nominal private investment
 IPC : Real public corporation investment
 IG : Real government investment
 I : Total real investment
 I_i : Real investment by source, i=3,4,5
 K_t : Economy-wide capital stock at time t
 SPR : Total private savings
 SAVTOT : Total savings
 INVTOT : Total nominal investment

Exogenous variables

a_{ij} : Input-output coefficients
 G_i : Real government expenditure
 E_i : Real exports
 DS_i : Real change in stocks
 M^C_i : Real competitive imports, i=2,3,4
 θ_i : Wage indexation parameters, i=2,3,4,G
 t_{ij} : Input subsidy rates
 t_{5i} : Intermediate import tariff

P^*_5 : Border price of intermediate imports
 e : Exchange rate
 b_1 : Labour-output coefficients
 a_{3j} : Intermediate imports-output coefficient
 t_1 : Tax rates on final good
 P_i : Fixed market price, $i=1,2$
 $X_1 \text{ BAR}$: Fixed supply, $i=1,2$
 GDPTR : Trend real GDP
 μ_1 : Overall markup rate parameters
 GR_1 : Government revenue from public enterprises
 TF_j : Foreign transfers from abroad to income classes
 $j=A(\text{agriculture}), \text{EW}(\text{estate wages}),$
 $\text{NAW}(\text{non-agricultural wages}), \text{NAP}(\text{non-agric. profits})$
 TF_c : Foreign transfers (grants) to government
 TG_j : Government transfers to income classes
 L_c : Government employment
 s_j : Saving rates of each income class
 d_j : Direct tax rates of each income class
 D_0 : Intercept term in total demand equation
 ϵ_1 : Proportion of expenditure, excluding food stamp transfers,
by the poor
 ϵ_2 : Proportion of net food stamp transfers going to poor
 V_{1P} : Consumer subsidy rate to the poor
 V_{1R} : Consumer subsidy rate to the rich
 P^*_c : Border price of consumer imports
 t^*_c : Consumer import tariff rate
 ϕ_{1j} : Base-level consumption levels, $i=1,2,3,4,5$, $j=P,R$
 δ_{1j} : Marginal propensities to consume over the base levels
 $i=1,2,3,4,5$, $j=P,R$
 $E_3 \text{ BAR}$: Constant in manufacturing export equation
 P^*_3 : Foreign price for similar manufactures
 τ_3 : Export subsidy
 η_{13} : Elasticity of export demand for good 3
 P^*_1 : Border price of investment imports
 t^*_1 : Investment import tariff rate
 P^*_2 : World price of sector 2 exports
 P^*_g : Border price of government imports
 h_{1g} : Proportion of government investment coming from sector i
 h_{1PC} : Proportion of public corporation investment coming from
sector i
 h_{1PR} : Proportion of private investment coming from sector i
 VALAD_1 : Value added coefficient
 α_1 : Colombo consumer price index weights
 IGN : Nominal government investment
 IPCN : Nominal public corporation investment
 GDOMNB : Government domestic non-bank borrowing
 GFOR : Government foreign borrowing
 CAPINF : Capital inflows
 GCR^0 : Government credit at end of year 0
 RES^0 : Reserves at end of year 0
 BGCR : Bank government credit
 BRES : Bank reserves

SUNLIA : Central bank sundry liabilities
M₁ : Money multiplier parameters
S₁ : Real private investment parameters
DEP : Capital stock annual depreciation rate

Table A 1: GROWTH RATES OF GDP AND ITS COMPONENTS, 1978-84 a/
(Rs Million at Constant 1970 Factor Prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> <u>b/</u> | <u>1984</u> <u>b/</u> |
|--------------------------|-------------|-------------|-------------|-------------|-------------|-----------------------|-----------------------|
| Agriculture <u>c/</u> | 4,532 | 4,622 | 4,766 | 5,097 | 5,231 | 5,508 | 5,624 |
| Mining | 619 | 652 | 684 | 713 | 742 | 800 | 808 |
| Manufacturing | 2,541 | 2,659 | 2,681 | 2,820 | 2,955 | 2,979 | 3,319 |
| Construction | 794 | 960 | 1,066 | 1,034 | 1,013 | 1,023 | 1,023 |
| Services | 8,915 | 9,608 | 10,378 | 11,042 | 11,815 | 12,595 | 13,326 |
| Utilities | 158 | 190 | 209 | 234 | 257 | 274 | 282 |
| Transport/Communications | 1,607 | 1,716 | 1,838 | 1,957 | 2,079 | 2,173 | 2,282 |
| Commercial Services | 3,267 | 3,551 | 3,849 | 4,034 | 4,275 | 4,502 | 4,835 |
| Financial Services | 318 | 350 | 402 | 462 | 517 | 628 | 697 |
| Housing Services | 499 | 518 | 549 | 579 | 611 | 623 | 635 |
| Public Administration | 854 | 905 | 959 | 997 | 1,102 | 1,439 | 1,583 |
| Other Services | 2,212 | 2,378 | 2,572 | 2,779 | 2,974 | 2,965 | 2,995 |
| Gross Domestic Product | 17,401 | 18,501 | 19,575 | 20,706 | 21,756 | 22,844 | 23,986 |

Annual Growth Rate (%)

| | | | | | | | |
|--------------------------|------|------|------|------|------|------|------|
| Agriculture <u>c/</u> | 5.4 | 2.0 | 3.1 | 6.9 | 2.6 | 5.3 | 2.1 |
| Mining | 20.2 | 5.3 | 4.9 | 4.2 | 4.1 | 7.8 | 1.0 |
| Manufacturing | 7.8 | 4.6 | 0.8 | 5.2 | 4.8 | 0.8 | 11.4 |
| Construction | 28.3 | 20.9 | 11.0 | -3.0 | -2.0 | 1.0 | - |
| Services | 7.6 | 7.8 | 8.0 | 6.4 | 7.0 | 6.6 | 5.8 |
| Utilities | 20.6 | 20.3 | 10.0 | 12.0 | 9.8 | 6.6 | 3.0 |
| Transport/Communications | 7.3 | 6.8 | 7.1 | 6.5 | 6.2 | 4.5 | 5.0 |
| Commercial Services | 8.9 | 8.7 | 8.4 | 4.8 | 6.0 | 5.3 | 7.4 |
| Financial Services | 7.8 | 10.1 | 14.9 | 14.9 | 11.9 | 21.4 | 11.0 |
| Housing Services | 5.1 | 3.8 | 6.0 | 5.5 | 5.5 | 2.0 | 2.0 |
| Public Administration | 8.0 | 6.0 | 6.0 | 4.0 | 10.5 | 30.6 | 10.0 |
| Other Services | 5.4 | 7.5 | 8.1 | 8.0 | 7.0 | -0.3 | 1.0 |
| Gross Domestic Product | 8.2 | 6.3 | 5.8 | 5.8 | 5.1 | 5.0 | 5.0 |

a/ For 1983 and 1984, components do not add to total because new constant price series for 1982-84 has been linked with old series which is in constant 1970 prices.

b/ Provisional.

c/ Includes forestry and fishing.

Table A 2: Resources and their Utilization at Current Market Prices 1978-1984

| Rs. Million. | | | | | | | |
|--|--------|--------|---------|---------|---------|---------|---------|
| Item | 1978 | 1979 | 1980 | 1981 | 1982* | 1983* | 1984* |
| A. Resources | | | | | | | |
| Gross Domestic Product | 42,665 | 52,387 | 66,527 | 85,005 | 99,166 | 121,571 | 152,615 |
| Imports of Goods and Non-Factor Services | 16,872 | 23,969 | 36,456 | 39,558 | 45,905 | 50,381 | 53,417 |
| Total | 59,537 | 76,356 | 102,983 | 124,563 | 145,071 | 171,952 | 206,032 |
| B. Utilization | | | | | | | |
| Consumption | 36,148 | 45,169 | 59,084 | 75,061 | 87,468 | 104,834 | 123,170 |
| Gross Domestic Capital Formation | 8,554 | 13,527 | 22,465 | 23,610 | 30,455 | 35,102 | 38,577 |
| Exports of Goods and Non-Factor Services | 14,835 | 17,660 | 21,434 | 25,892 | 27,148 | 32,016 | 44,285 |
| Total | 59,537 | 76,356 | 102,983 | 124,563 | 145,071 | 171,952 | 206,032 |

* Provisional

Source: Central Bank of
Ceylon.

Table A 3: Gross National Expenditure at Current Market Prices 1978-1984

| | | Rs. Million. | | | | | | |
|---|---------|--------------|----------|---------|----------|----------|---------|--|
| Item | 1978 | 1979 | 1980 | 1981 | 1982* | 1983* | 1984* | |
| 1. Private Consumption | 32,105 | 40,371 | 53,399 | 68,751 | 79,226 | 94,945 | 111,235 | |
| 1.1 Imports of goods and non-factor services | 7,597 | 9,831 | 13,602 | 16,907 | 19,257 | 21,959 | 21,711 | |
| 1.2 Locally produced goods and services | 24,508 | 30,540 | 39,797 | 51,844 | 59,969 | 72,986 | 89,524 | |
| 2. Public Consumption | | | | | | | | |
| 2.1 Current expenditure on goods and services: Central Government | 4,043 | 4,798 | 5,685 | 6,310 | 8,242 | 9,889 | 11,935 | |
| 2.2 Current expenditure on goods and services: Local Government | 3,778 | 4,478 | 5,304 | 5,961 | 7,474 | 8,725 | 10,559 | |
| | 265 | 320 | 381 | 349 | 768 | 1,164 | 1,376 | |
| 3. Gross Domestic Fixed Capital Formation | 8,521 | 13,246 | 20,845 | 23,279 | 30,207 | 35,312 | 38,427 | |
| 3.1 Government and Public Enterprises | 3,077 | 3,809 | 4,709 | 4,126 | 4,866 | 5,963 | 5,982 | |
| 3.2 Public Corporation | 2,056 | 2,620 | 7,553 | 8,360 | 10,881 | }29,349 | 32,445 | |
| 3.3 Private Sector | 3,388 | 6,817 | 8,583 | 10,793 | 14,460 | | | |
| 4. Changes in Stocks | 33 | 281 | 1,620 | 331 | 248 | - 210 | 150 | |
| 4.1 Government and Public Enterprises | - 354 | -- 65 | 980 | - 120 | 78 | - 65 | -60 | |
| 4.2 Public Corporations and Private Sector | 387 | 346 | 640 | 451 | 170 | - 145 | 210 | |
| 5. Gross Domestic Expenditure(1+2+3+4) | 44,702 | 58,696 | 81,549 | 98,671 | 117,923 | 139,936 | 161,747 | |
| 6. Net Investment Abroad | - 1,032 | -- 3,556 | - 10,912 | - 8,498 | - 11,844 | - 11,122 | - 348 | |
| 7. Net Receipts of International Gifts and Transfers | 1,242 | 2,993 | 4,541 | 7,036 | 8,873 | 10,457 | 12,185 | |
| 8. Gross National Expenditure (5+6-7) | 42,428 | 52,147 | 66,096 | 83,137 | 97,206 | 118,357 | 149,214 | |

* Provisional

Source: Central Bank of Ceylon.

Item 4.1 - Changes in stocks in the following items only: imported rice, wheat flour and sugar, G.P.S.paddy and arrack.

Item 6 - Net Investment Abroad - The surplus to the nation on current account.

Table A 4: PERCENTAGE OF TOTAL INCOME RECEIVED BY EACH TENTH OF INCOME RECEIVERS, 1963, 1973, 1978/79, AND 1981/82

| Deciles | Urban | | | | Rural | | | | Estates | | | | All Island | | | |
|---------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 1963 | 1973 a/ | 1978/79 | 1981/82 | 1963 | 1973 a/ | 1978/79 | 1981/82 | 1963 | 1973 a/ | 1978/79 | 1981/82 | 1963 | 1973 a/ | 1978/79 | 1981/82 |
| Highest | 42.78 | 29.90 | 40.60 | 44.75 | 34.23 | 27.27 | 37.56 | 39.25 | 24.87 | 31.70 | 25.50 | 26.37 | 39.24 | 29.98 | 39.03 | 41.70 |
| Second | 15.64 | 15.42 | 15.07 | 14.24 | 16.51 | 15.44 | 15.42 | 14.86 | 13.31 | 13.51 | 14.58 | 14.60 | 16.01 | 15.91 | 15.27 | 14.82 |
| Third | 10.77 | 12.17 | 10.74 | 10.32 | 12.35 | 12.72 | 11.43 | 10.89 | 11.21 | 11.12 | 11.82 | 11.53 | 11.46 | 12.65 | 11.23 | 10.65 |
| Fourth | 8.31 | 10.25 | 8.52 | 7.83 | 9.96 | 10.68 | 9.39 | 9.01 | 10.42 | 9.53 | 10.41 | 10.12 | 8.98 | 10.56 | 9.12 | 8.56 |
| Fifth | 6.64 | 8.68 | 7.20 | 6.52 | 8.11 | 9.16 | 7.75 | 7.40 | 8.71 | 7.99 | 9.17 | 8.76 | 6.82 | 8.75 | 7.29 | 6.93 |
| Sixth | 5.13 | 7.45 | 6.04 | 5.11 | 6.45 | 7.79 | 6.36 | 6.10 | 8.71 | 6.91 | 7.58 | 7.75 | 5.55 | 7.10 | 5.93 | 5.57 |
| Seventh | 4.28 | 6.25 | 4.83 | 4.28 | 5.04 | 6.42 | 4.94 | 4.98 | 7.33 | 6.16 | 7.31 | 6.71 | 4.51 | 5.70 | 4.77 | 4.61 |
| Eighth | 3.16 | 4.75 | 3.66 | 3.38 | 3.73 | 5.18 | 3.66 | 3.80 | 6.86 | 5.58 | 5.90 | 5.92 | 3.56 | 4.38 | 3.60 | 3.46 |
| Ninth | 2.00 | 3.42 | 2.13 | 2.40 | 2.54 | 3.53 | 2.44 | 2.55 | 5.56 | 4.61 | 5.04 | 5.22 | 2.70 | 3.17 | 2.56 | 2.49 |
| Lowest | <u>1.29</u> | <u>1.70</u> | <u>1.21</u> | <u>1.17</u> | <u>1.08</u> | <u>1.81</u> | <u>1.05</u> | <u>1.16</u> | <u>3.02</u> | <u>2.89</u> | <u>2.69</u> | <u>3.02</u> | <u>1.17</u> | <u>1.80</u> | <u>1.20</u> | <u>1.21</u> |
| | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

a/ For a variety of reasons, 1973 data are not directly comparable with 1963.

Note: Totals may not add up due to rounding.

Source: Central Bank of Ceylon, Survey of Sri Lanka's Consumer Finances, 1963, 1973, 1978/79 and 1981/82.

Table A 5: SUMMARY OF BUDGETARY OPERATIONS, 1978-85 n/
(In percent of GDP)

| | 1978 | 1979 | 1980 | 1981 | 1982 | Provisional 1983 | Provisional 1984 | Budget 1985 |
|--|--------------|--------------|--------------|--------------|--------------|---------------------|---------------------|----------------|
| <u>Revenues</u> | <u>26.1</u> | <u>23.0</u> | <u>19.9</u> | <u>17.4</u> | <u>16.1</u> | <u>18.9</u> | <u>21.8</u> | <u>20.5</u> |
| Income Tax | 0.9 | 0.7 | 0.6 | 0.7 | 0.8 | 0.7 | 0.7 | 0.7 |
| Corporate Profit Tax | 1.7 | 1.9 | 2.6 | 1.7 | 2.1 | 2.0 | 2.5 | 2.4 |
| Export Taxes ^{a/} | 11.3 | 9.1 | 5.8 | 4.5 | 2.6 | 2.8 | 4.2 | 3.2 |
| Import Duties | 3.4 | 4.3 | 4.4 | 3.2 | 2.7 | 3.3 | 3.4 | 2.9 |
| Business Turnover Tax | 2.5 | 2.3 | 2.5 | 3.3 | 4.0 | 5.1 | 5.4 | 6.1 |
| Excise Tax | 3.1 | 2.5 | 2.5 | 2.2 | 2.1 | 1.9 | 1.8 | 1.8 |
| Other Taxes | 1.4 | 0.5 | 0.4 | 0.5 | 0.5 | 0.5 | 0.3 | 0.3 |
| Other Non-tax Revenue | 1.8 | 1.7 | 1.1 | 1.3 | 1.3 | 1.4 | 2.4 | 2.3 |
| Transfer of Central Bank Profits | - | - | - | - | - | 1.2 | 1.1 | 0.8 |
| <u>Current Expenditure</u> | <u>23.4</u> | <u>20.8</u> | <u>19.1</u> | <u>17.3</u> | <u>18.4</u> | <u>17.7</u> | <u>16.6</u> | <u>16.8</u> |
| Wages and Salaries | 5.4 | 5.5 | 4.8 | 4.3 | 4.4 | 4.1 | 3.7 | 3.9 |
| Goods and Services | 2.7 | 2.8 | 2.8 | 2.0 | 2.5 | 2.4 | 2.1 | 3.6 |
| Pensions | 1.1 | 1.1 | 1.1 | 1.1 | 1.4 | 1.5 | 1.4 | 1.3 |
| Transfers to Public Corporations | 2.5 | 1.8 | 2.4 | 1.6 | 1.7 | 1.6 | (| (|
| Transfers and Subsidies to Households and Other | 8.5 | 6.3 | 4.6 | 3.8 | 3.3 | 2.7 | (4.6 | (3.6 |
| Interest, Domestic | 2.5 | 2.6 | 2.8 | 3.7 | 4.2 | 4.4 | (| (|
| Interest, Foreign | 0.7 | 0.7 | 0.6 | 0.8 | 0.9 | 1.0 | 4.1 | 3.6 |
| Underexpenditure Provision | - | - | - | - | - | - | 1.1 | 1.1 |
| | | | | | | | -0.4 | -0.3 |
| <u>Advance Accounts</u> | <u>4.1</u> | <u>2.0</u> | <u>4.6</u> | <u>1.8</u> | <u>-0.9</u> | <u>0.9</u> | <u>1.6</u> | <u>0.1</u> |
| <u>Current Account Balance</u> | <u>-1.4</u> | <u>0.2</u> | <u>-3.8</u> | <u>-1.7</u> | <u>-1.4</u> | <u>0.3</u> | <u>3.6</u> | <u>3.6</u> |
| <u>Capital Expenditure</u> | <u>12.3</u> | <u>14.0</u> | <u>19.3</u> | <u>13.8</u> | <u>15.9</u> | <u>13.7</u> | <u>13.8</u> | <u>12.3</u> |
| <u>Overall Deficit</u> | <u>-13.7</u> | <u>-13.8</u> | <u>-23.1</u> | <u>-15.5</u> | <u>-17.3</u> | <u>-13.4</u> | <u>-10.2</u> | <u>-8.7</u> |
| <u>Foreign Finance (net)</u> | <u>9.0</u> | <u>7.1</u> | <u>9.2</u> | <u>8.9</u> | <u>8.1</u> | <u>8.0</u> | <u>8.5</u> | <u>7.0</u> |
| Net borrowing | 7.5 | 4.5 | 5.3 | 5.7 | 4.7 | 5.1 | 5.7 | 4.9 |
| (Gross commercial) | (-) | (-) | (1.4) | (2.0) | (1.2) | (1.1) | (-) | (0.3) |
| Grants | 1.5 | 2.6 | 3.9 | 3.2 | 3.4 | 2.9 | 2.8 | 2.1 |
| <u>Domestic Finance (net)</u> | <u>4.7</u> | <u>6.7</u> | <u>13.9</u> | <u>6.6</u> | <u>9.2</u> | <u>5.4</u> | <u>1.7</u> | <u>1.7</u> |
| Banking System | 0.4 | 1.2 | 10.6 | 4.5 | 3.7 | 0.4 | -1.7 | -0.6 |
| Other | 4.3 | 5.5 | 3.3 | 2.1 | 5.5 | 5.0 | 3.4 | 2.3 |

a/ Import duty rebates have been deducted from both revenues and current expenditures from 1981 onwards.

Source: Central Bank of Ceylon.

Table A 6: Government Capital Expenditure 1978-1984
(Summary - All Sectors)

| | Rs Million | | | | | | |
|---|------------|-------|--------|--------|--------|--------|--------|
| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
| Total Public Investment* Financing*/ | 4,725 | 6,619 | 13,370 | 12,565 | 15,896 | n.a. | n.a. |
| (i) Extra Budgetary Resources | - | - | 1,326 | 800 | - | - | - |
| (ii) Non-Expansionary Resources available to Government Budget | 5,333 | 7,147 | 4,938 | 7,880 | 12,066 | 15,540 | 22,281 |
| (iii) Supplementary Financing required for investment programme -/ | 116 | 662 | 7,106 | 3,885 | 3,990 | 1,168 | -2,760 |
| Total Capital Expenditure(Central Government) | 5,449 | 7,809 | 12,044 | 11,765 | 16,056 | 16,708 | 19,521 |
| 1. Agriculture | 962 | 2,464 | 5,184 | 5,462 | 8,879 | 8,256 | 8,566 |
| 1.1 Mahaveli | 507 | 1,497 | 3,416 | 3,851 | 7,141 | 6,073 | 5,568 |
| 1.2 Other Irrigation | 144 | 307 | 489 | 508 | 632 | 895 | 798 |
| 1.3 Field and Minor Export Crops | 114 | 291 | 498 | 562 | 429 | 499 | 871 |
| 1.4 Forestry and Land Settlement | 62 | 168 | 252 | 123 | 152 | 138 | 208 |
| 1.5 Plantation | 47 | 53 | 185 | 167 | 285 | 421 | 776 |
| 1.6 Animal Husbandry | 15 | 32 | 78 | 99 | 100 | 64 | 181 |
| 1.7 Fisheries | 73 | 116 | 266 | 152 | 140 | 166 | 164 |
| 2. Industry | 1,006 | 706 | 562 | 196 | 428 | 98 | 267 |
| 3. Housing, Water Supply and Urban Development | 286 | 1,235 | 2,074 | 2,028 | 1,562 | 1,945 | 1,844 |
| 4. Economic Overheads | 3,043 | 3,125 | 3,762 | 3,634 | 3,282 | 3,661 | 5,979 |
| 4.1 Transport | 474 | 1,071 | 1,186 | 848 | 1,036 | 787 | 1,124 |
| 4.2 Power | 229 | 214 | 613 | 872 | 409 | 481 | 1,508 |
| 4.3 Posts and Telecommunications | 49 | 236 | 418 | 399 | 388 | 401 | 838 |
| 4.4 Other Economic Overheads | 2,291 | 1,604 | 1,545 | 1,515 | 1,449 | 1,992 | 2,509 |
| 5. Social Overheads | 152 | 279 | 462 | 445 | 615 | 1,150 | 773 |
| 5.1 Education | 66 | 157 | 302 | 317 | 376 | 408 | 596 |
| 5.2 Health | 80 | 105 | 122 | 100 | 183 | 716 | 129 |
| 5.3 Other | 6 | 17 | 38 | 28 | 56 | 26 | 48 |
| 6. Miscellaneous | - | - | - | - | 1,290 | 1,598 | 2,092 |

* From National Account Statistics.

Source: General Treasury.

*/ Government Budget Figures.

-/ Net Borrowings from the Banking System.

Table A 7: MAJOR SOCIAL EXPENDITURES IN RELATION TO TOTAL CURRENT BUDGETARY EXPENDITURES

| Year | Total Current Expenditure Adjusted a/ (Rs. Million) | % of Total Current Expenditures Adjusted | | | | | % of GDP (current market price) | | | | |
|---------|---|--|--------------|--------------------------|--------------------|---|---------------------------------|--------------------|--------------------------|--------------------|--|
| | | Health b/ | Education b/ | Total Social Services b/ | Net Food Subsidies | Total Social Services and Net Food Subsidies b/ | Health Total b/ | Education Total b/ | Total Social Services b/ | Net Food Subsidies | Total Social Service and Net Food Subsidies b/ |
| 1978 | 10,491 | 4.95 | 9.37 | 14.89 | 20.33 | 35.21 | 1.22 | 2.31 | 3.66 | 5.00 | 8.66 |
| 1979 | 10,887 | 5.81 | 10.40 | 16.87 | 21.36 | 38.24 | 1.21 | 2.16 | 3.51 | 4.44 | 7.95 |
| 1980 | 12,730 | 5.81 | 10.90 | 17.42 | 2.40 | 19.82 | 1.11 | 2.09 | 3.33 | 0.46 | 3.79 |
| 1981 | 15,025 | 5.71 | 10.64 | 17.04 | 2.06 | 17.59 | 1.00 | 1.87 | 3.00 | 0.10 | 3.09 |
| 1982 c/ | 19,112 | 4.99 | 10.53 | 16.21 | 0.49 | 16.70 | 0.95 | 2.01 | 3.09 | 0.09 | 3.18 |
| 1983 c/ | 24,499 | 5.04 | 9.85 | 15.61 | 0.41 | 16.02 | 1.02 | 2.00 | 3.16 | 0.06 | 3.24 |
| 1984 c/ | 27,613 | 5.49 | 9.68 | 15.84 | 0.36 | 16.20 | 1.09 | 1.92 | 3.15 | 0.07 | 3.22 |

Total current expenditure adjusted = total current expenditure - gross food subsidy + net food subsidy.

Expenditures on current account only.

Not consistent with figures shown in the budget tables.

Table A 8: Trends in Money Supply 1975-1984.

| End of Period | Monetary Aggregates (Rs. Million) | | | Growth Rates (in %) of Money Supply | |
|---------------|-----------------------------------|--------------------|---------------------------|-------------------------------------|------|
| | Narrow Money Supply (a) | Quasi Money (b) | Broad Money Supply (c) | M1 | M2 |
| | M1 | | M2 | | |
| 1975 | 3,008.1 | 1,668.9 | 4,757.0 | 34.8 | 32.8 |
| 1976 | 4,165.6 | 2,155.3 | 6,320.9 | 38.4 | 32.9 |
| 1977 | 5,365.8 | 3,351.0 | 8,716.8 | 28.8 | 37.9 |
| 1978 | 5,936.4 | 4,955.7 | 10,892.1 | 10.6 | 24.9 |
| 1979 | 7,669.3 | 7,388.3 | 15,057.6 | 29.1 | 38.2 |
| 1980 | 9,428.2 | 10,432.0 | 19,860.2 | 22.9 | 31.9 |
| 1981 | 10,024.4 | 14,422.4 | 24,446.8 | 06.3 | 23.1 |
| 1982 | 11,759.8 | 18,750.1 | 30,509.9 | 17.3 | 24.8 |
| 1983 | 14,747.8 | 22,509.0 | 37,256.8 | 25.4 | 22.1 |
| 1984 | 16,823.8 | 26,603.5 | 43,427.3 | 14.0 | 16.6 |

Source: Central Bank of Ceylon

(a) Currency and demand deposits of the public.

(b) Time and savings deposits of private sector held with commercial banks.

(c) Total of Narrow Money and Quasi Money.

Table A 9: Colombo Consumers Price Index
1977 = 100

| Year | All Items | Food | Cloth- ing | Fuel & Light | Rent | Misc. | Average Annual Rate of Increase |
|---------------------------------|-----------|-------|---------------|-----------------|------|-------|---------------------------------------|
| 1977 | 100 | 100 | 100 | 100 | 100 | 100 | |
| 1978 | 112.1 | 116.8 | 101.1 | 101.8 | 100 | 107.9 | 12.1 |
| 1979 | 124.2 | 129.5 | 103.3 | 127.6 | 100 | 121.0 | 11 |
| 1980 | 156.6 | 167.1 | 107.2 | 219.0 | 100 | 141.0 | 26 |
| 1981 | 184.7 | 196.6 | 115.2 | 298.2 | 100 | 165.9 | 18 |
| 1982 | 204.8 | 221.5 | 122.3 | 317.0 | 100 | 181.0 | 11 |
| 1983 | 233.4 | 249.0 | 130.1 | 422.4 | 100 | 208.1 | 14 |
| 1984 | 272.2 | 294.1 | 137.4 | 498.1 | 100 | 238.4 | 17 |
| per cent change 1977-1984 | 172 | 194 | 37 | 398 | 0 | 138 | |

Source: Department of Census & Statistics.

Table A 10: PRICE INDICES FOR SURVEY YEARS (1978=100)

| | <u>1978-79</u> | <u>1980-81</u> | <u>1981-82</u> |
|--|----------------|----------------|----------------|
| 1. Colombo Consume Price Index | 108.0 | 154.7 | 178.1 |
| 2. Central Bank Cost of Living Index | 114.3 | 187.3 | 219.5 |
| 3. Special Consumer Price Index (adjusted) | 110.3 | 189.4 | 222.7 |
| 4. Wholesale Price Index | 107.1 | 161.4 | 178.4 |

- Note: 1. Consumer Finance Survey 1978-79 covered the last three months of 1978 and first nine months of 1979.
2. Socio-economic Survey 1980-81 covered 2/5th of 1980 and 3/5th of 1981.
3. Consumer Finance Survey 1981-82 covered the last three months of 1981 and first nine months of 1982.

Table A 11

Minimum Wage Rate Indices of Government Employees

1978 December = 100

| Period | Non Executive Officers (excluding minor employees) | | | | | | Minor Employees | | | | | | All Minor Employees | | Government School Teachers | |
|--------|---|-------------------------------|---|-------------------------------|----------------------------------|-------------------------------|----------------------------------|-------------------------------|----------------------------------|-------------------------------|----------------------------------|-------------------------------|----------------------------------|-------------------------------|----------------------------------|-------------------------------|
| | Clerical Employees | | Skilled Employees (other than clerical) | | Unskilled Employees | | All Non Executive Officers | | Skilled Employees | | Unskilled Employees | | | | | |
| | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index | Nominal Wage Rate Index | Real Wage Rate Index |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | |
| 1978 | - | - | - | - | - | - | 100.0 | 107.8 | - | - | - | - | 100.0 | 105.3 | 100.0 | 105.3 |
| 1979 | 112.4 | 106.7 | 113.3 | 107.3 | 117.9 | 111.9 | 115.6 | 109.7 | 116.1 | 110.2 | 120.1 | 105.1 | 118.7 | 112.6 | 112.3 | 106.6 |
| 1980 | 121.0 | 91.2 | 122.1 | 92.0 | 129.5 | 97.5 | 126.0 | 94.9 | 127.6 | 95.1 | 134.3 | 101.0 | 132.0 | 99.4 | 120.1 | 90.5 |
| 1981 | 133.4 | 85.1 | 135.2 | 86.2 | 146.2 | 93.2 | 140.9 | 89.9 | 144.2 | 92.0 | 154.8 | 98.7 | 151.1 | 96.4 | 133.1 | 84.9 |
| 1982 | 164.5 | 94.6 | 168.8 | 97.1 | 191.8 | 110.3 | 180.6 | 103.9 | 183.6 | 105.5 | 200.7 | 115.4 | 194.7 | 112.0 | 166.4 | 95.7 |
| 1983 | 184.3 | 93.2 | 189.8 | 95.9 | 218.2 | 110.6 | 204.6 | 103.4 | 211.2 | 106.7 | 232.2 | 188.3 | 226.2 | 114.2 | 188.1 | 95.1 |
| 1984 | 207.1 | 89.6 | 213.4 | 92.3 | 248.4 | 107.4 | 231.4 | 100.1 | 241.5 | 104.4 | 271.4 | 117.3 | 260.9 | 112.8 | 211.4 | 91.4 |

Source: Central Bank of Ceylon.

**Table A 12 : Minimum Wage Rate Indices Workers
In Wages Boards Trades
December 1978 = 100**

| Period | Workers in Agriculture | | Workers in Industry and Commerce | | Workers in Service | |
|--------|-------------------------|----------------------|----------------------------------|----------------------|-------------------------|----------------------|
| | (a) | | (b) | | (c) | |
| | Minimum Wage Rate Index | Real Wage Rate Index | Minimum Wage Rate Index | Real Wage Rate Index | Minimum Wage Rate Index | Real Wage Rate Index |
| | 1 | 2 | 3 | 4 | 5 | 6 |
| 1978 | 94.2 | 99.0 | 98.8 | 102.6 | - | - |
| 1979 | 123.1 | 116.0 | 111.3 | 105.2 | 113.9 | 107.8 |
| 1980 | 153.6 | 115.9 | 138.8 | 105.4 | 130.5 | 98.9 |
| 1981 | 153.9 | 98.3 | 151.0 | 96.2 | 146.4 | 93.2 |
| 1982 | 181.2 | 104.2 | 161.0 | 92.6 | 169.7 | 97.7 |
| 1983 | 198.7 | 100.4 | 163.1 | 82.5 | 177.8 | 89.7 |
| 1984 | 250.2 | 108.0 | 168.3 | 72.9 | 179.7 | 77.8 |

Source: Labour Department and Central Bank of Ceylon.

Note: The wage rates used in the calculation of Index are minimum wages for different rates fixed by the Wages Boards:

(a) The index refers to wage rates of tea growing and manufacturing, rubber growing and manufacturing, coconut growing and cocoa, cardamoms and pepper growing trades only.

(b) Includes baking, brick and tile manufacturing, coconut manufacturing, printing, textile, tyre and tube manufacturing, coir mattresses & bristol fibre export, hosiery manufacturing, engineering, garment manufacturing, match manufacturing, biscuit & confectionary, tea export and rubber export trades only.

(c) This includes cinema, motor transport and nursing home trades only.

Table A 13: SRI LANKA - BALANCE OF PAYMENTS
(Millions of US\$ at Current Prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| 1. EXPORTS (G+NFS) | 950 | 1,135 | 1,297 | 1,346 | 1,305 | 1,360 | 1,755 |
| 2. Merchandise (fob) | 846 | 982 | 1,065 | 1,066 | 1,014 | 1,062 | 1,475 |
| 3. Non-factor Services | 104 | 153 | 232 | 280 | 291 | 298 | 280 |
| 4. IMPORTS (G+NFS) | 1,081 | 1,540 | 2,205 | 2,055 | 2,205 | 2,138 | 2,121 |
| 5. Merchandise (cif) | 999 | 1,450 | 2,051 | 1,877 | 1,990 | 1,918 | 1,911 |
| 6. Non-factor Services | 82 | 90 | 154 | 178 | 215 | 220 | 210 |
| 7. RESOURCE BALANCE | -131 | -405 | -908 | -709 | -900 | -778 | -366 |
| 8. Net Factor Income | -15 | -15 | -26 | -97 | -98 | -138 | -131 |
| 9. Factor Receipts | 20 | 40 | 47 | 33 | 40 | 43 | 59 |
| 10. Factor Payments | 35 | 55 | 73 | 130 | 138 | 181 | 190 |
| 11. (M< Interest Paid) | (25) | (28) | (33) | (50) | (69) | (86) | (103) |
| 12. Net Current Transfers | 22 | 48 | 136 | 203 | 264 | 274 | 277 |
| 13. Transfer Receipts | 39 | 60 | 152 | 230 | 289 | 294 | 302 |
| 14. Transfer Payments | 17 | 12 | 16 | 27 | 25 | 20 | 25 |
| 15. CURRENT BALANCE | -124 | -372 | -798 | -603 | -734 | -642 | -220 |
| M< Capital Inflow | | | | | | | |
| 16. Net Direct Investment | 2 | 47 | 43 | 49 | 63 | 37 | 36 |
| 17. Official Grant Aid | 58 | 144 | 138 | 162 | 162 | 171 | 154 |
| 18. Net M< Loans (DRS) | 178 | 138 | 236 | 336 | 403 | 292 | 311 |
| 19. Disbursements | 242 | 187 | 286 | 380 | 472 | 373 | 410 |
| 20. Repayments | 64 | 49 | 50 | 44 | 69 | 81 | 99 |
| 21. Other M< (net) | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| 22. Net Short-Term Capital | -3 | - | 157 | 31 | 7 | 38 | -26 |
| 23. Capital Flows NEI and errors and omissions | -17 | 91 | 4 | -8 | 72 | 105 | 50 |
| 24. Change in Net Reserves (- indicates increase) | -94 | -48 | 220 | 33 | 27 | -1 | -305 |
| <u>Memo Items:</u> | | | | | | | |
| 25. Net Credit from IMF | +20 | +67 | -4 | +165 | -6 | -11 | +9 |
| 26. Disbursements | 48 | 105 | 39 | 229 | 43 | 38 | 32 |
| 27. Repayments | 28 | 38 | 43 | 64 | 49 | 49 | 23 |

Note: Underlying data from Central Bank of Ceylon except for lines 18-20 which are from World Bank's Debt Reporting System, and lines 25-27 from the IMF.

Table A 14: COMPOSITION OF EXPORTS, 1978-84

| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 a/ | 1984 a/ |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| <u>VALUE</u> (\$ Million) | | | | | | | |
| Tea | 411 | 367 | 373 | 335 | 305 | 353 | 620 |
| Rubber | 130 | 160 | 157 | 150 | 112 | 121 | 130 |
| Major Coconut Products | 62 | 83 | 46 | 53 | 48 | 60 | 61 |
| Copra | (1) | (1) | (...) | (3) | (3) | (3) | (3) |
| Coconut Oil | (21) | (33) | (3) | (10) | (17) | (18) | (12) |
| Desiccated Coconut | (41) | (50) | (42) | (40) | (28) | (38) | (46) |
| Sub-total | 603 | 610 | 576 | 538 | 465 | 534 | 814 |
| Other Exports b/ | 245 | 369 | 488 | 555 | 566 | 533 | 641 |
| of which: | | | | | | | |
| Precious & Semi-precious stones | (34) | (31) | (40) | (33) | (33) | (40) | (24) |
| Petroleum Products | (59) | (124) | (189) | (175) | (158) | (114) | (129) |
| TOTAL EXPORTS | 848 | 979 | 1,064 | 1,093 | 1,031 | 1,067 | 1,452 |
| (Percent of Total Export Value) | | | | | | | |
| Tea | 48.5 | 37.5 | 35.1 | 30.6 | 29.6 | 33.1 | 42.7 |
| Rubber | 15.3 | 16.3 | 14.8 | 13.7 | 10.9 | 11.4 | 8.9 |
| Major Coconut Products | <u>7.3</u> | <u>8.5</u> | <u>4.3</u> | <u>4.8</u> | <u>4.6</u> | <u>5.6</u> | <u>4.2</u> |
| Sub-total | 71.2 | 62.3 | 54.2 | 49.1 | 45.1 | 50.1 | 55.8 |
| Other Exports b/ | <u>28.9</u> | <u>37.7</u> | <u>45.8</u> | <u>50.9</u> | <u>54.9</u> | <u>49.9</u> | <u>44.2</u> |
| TOTAL EXPORTS | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| <u>VOLUME</u> | | | | | | | |
| Tea (million kg) | 193 | 188 | 185 | 183 | 181 | 158 | 204 |
| Rubber (million kg) | 138 | 128 | 121 | 133 | 131 | 125 | 126 |
| Major Coconut Products (million kg) c/ | 71 | 73 | 35 | 56 | 79 | 81 | 46 |
| Copra (million kg) | (1) | (1) | (...) | (2) | (3) | (4) | (2) |
| Coconut Oil (million kg) | (30) | (32) | (3) | (17) | (34) | (35) | (12) |
| Desiccated Coconut (million kg) | (40) | (40) | (31) | (37) | (42) | (42) | (32) |

a/ Provisional.

b/ Other exports include coconut by-products, spices, minor agricultural crops, precious and semi-precious stones, manufactured goods, minerals and petroleum re-exports.

c/ The approximate conversion ratios for nuts into kilograms for major coconut products are as follows: 4.93 nuts = 1 kg of copra, 13.33 nuts = 1 kg of coconut oil; and 6.80 nuts = 1 kg of desiccated coconut.

Note: Due to rounding off, components may not add up to totals. Data not necessarily consistent with exports data as compiled on payments basis (Table 3.01).

Source: Adjusted Sri Lanka Customs data as reported by the Central Bank of Ceylon.

Table A 15: ANALYSIS OF INDUSTRIAL EXPORTS

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Industrial exports (Rs. million at current prices) | 1891 | 2700 | 5814 | 7296 | 8271 | 8821 | 12815 |
| Trade price index (exports) | 100 | 110 | 122 | 137 | 152 | 167 | 168 |
| Industrial exports at constant prices (Rs. million) | 1891 | 3364 | 4766 | 5326 | 5441 | 5282 | 7628 |
| Textile and garment exports at current prices (Rs. million) | 481 | 1117 | 1826 | 3021 | 3502 | 4738 | 7535 |
| Price index (import price) | 100 | 168 | 191 | 227 | 257 | 311 | 320 |
| Textile and garment at constant prices (Rs. million) | 481 | 664 | 956 | 1331 | 1363 | 1523 | 2355 |
| Petroleum product exports at current prices (Rs. million) | 944 | 1928 | 3123 | 3375 | 3280 | 2682 | 3288 |
| Price index (import prices) | 100 | 140 | 175 | 192 | 217 | 215 | 246 |
| Petroleum product exports at constant prices (Rs. million) | 944 | 1377 | 1784 | 1758 | 1512 | 1247 | 1337 |
| Other industrial exports at current prices (Rs. million) | 466 | 655 | 865 | 900 | 1489 | 1401 | 1992 |
| Other industrial exports at constant prices (Rs. million) | 466 | 1323 | 2026 | 2237 | 22566 | 2512 | 3936 |

Table A 16: COMPOSITION OF INDUSTRIAL EXPORTS

| | 1978 | | 1979 | | 1980 | | 1981 | | 1982 | | 1983 | | 1984 | |
|-----------------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| | A | B | A | B | A | B | A | B | A | B | A | B | A | B |
| Industrial exports of which | 14.7 | 14.7 | 24.2 | 24.0 | 33.0 | 31.7 | 34.7 | 31.8 | 38.5 | 32.0 | 35.2 | 32.8 | 33.8 | 38.9 |
| Textile and garments | 3.6 | 3.6 | 7.3 | 4.7 | 10.4 | 6.4 | 14.4 | 8.0 | 16.3 | 8.0 | 18.9 | 9.5 | 20.0 | 12.2 |
| Petroleum products | 7.1 | 7.1 | 12.6 | 9.8 | 17.7 | 11.9 | 16.0 | 10.5 | 15.3 | 8.9 | 10.7 | 7.7 | 8.8 | 6.9 |
| Other products | 4.0 | 4.0 | 4.3 | 9.5 | 4.9 | 13.4 | 4.3 | 13.3 | 6.9 | 15.1 | 5.6 | 15.6 | 5.0 | 19.8 |

Table A 17: COMPOSITION OF IMPORTS, 1978-84 a/

| | (\$ million) | | | | | | |
|---------------------------------------|--------------|----------------|----------------|----------------|----------------|----------------|----------------|
| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 b/ | 1984 b/ |
| <u>CONSUMER GOODS</u> | <u>358.8</u> | <u>501.7</u> | <u>614.4</u> | <u>479.2</u> | <u>414.0</u> | <u>494.7</u> | <u>434.2</u> |
| of which: | | | | | | | |
| Food and Drink | 263.1 | 307.5 | 387.6 | 254.1 | 171.1 | 228.5 | 195.8 |
| Rice | 44.1 | 57.2 | 53.3 | 51.6 | 44.4 | 32.5 | 8.0 |
| Flour | 145.8 | 107.0 | 110.4 | 1.5 | 3.0 | 4.6 | 1.1 |
| Refined Sugar | 32.9 | 60.1 | 122.5 | 146.9 | 46.6 | 84.4 | 52.5 |
| Milk & Milk Products | 25.4 | 30.8 | 32.5 | 25.1 | 24.7 | 41.6 | 24.5 |
| Fish | 2.1 | 12.2 | 17.8 | 5.3 | 15.6 | 14.9 | 24.5 |
| Textiles (including clothing) | 34.0 | 98.7 | 104.1 | 121.3 | 104.1 | 115.8 | 117.0 |
| Other Consumer Goods | 49.8 | 78.9 | 107.1 | 93.8 | 121.7 | 133.0 | 101.6 |
| Medicinal & pharmaceutical products | 11.7 | 16.2 | 15.7 | 10.0 | 17.1 | 17.3 | 19.8 |
| <u>INTERMEDIATE GOODS</u> | <u>358.6</u> | <u>586.4</u> | <u>938.8</u> | <u>932.6</u> | <u>1,039.8</u> | <u>923.2</u> | <u>940.5</u> |
| of which: | | | | | | | |
| Wheat & Meslin | 8.7 | 19.0 | 34.8 | 98.2 | 85.9 | 99.5 | 104.1 |
| Fertilizer | 16.1 | 43.2 | 81.0 | 62.6 | 26.9 | 26.4 | 43.3 |
| Petroleum | 154.1 | 251.2 | 489.4 | 448.4 | 589.7 | 468.5 | 419.9 |
| Chemicals, elements & compounds | 28.6 | 32.2 | 32.9 | 34.5 | 35.0 | 35.4 | 40.4 |
| Dyeing, tanning & colouring materials | 7.7 | 9.6 | 12.3 | 12.0 | 11.8 | 9.4 | 11.5 |
| Paper & Paper board | 15.3 | 25.6 | 27.6 | 38.1 | 32.4 | 29.2 | 25.0 |
| <u>INVESTMENT GOODS</u> | <u>215.9</u> | <u>350.5</u> | <u>492.5</u> | <u>413.5</u> | <u>556.9</u> | <u>513.3</u> | <u>478.5</u> |
| of which: | | | | | | | |
| Building materials | 9.6 | 23.6 | 36.9 | 27.3 | 26.8 | 50.0 | 28.6 |
| Transport equipment | 63.3 | 103.7 | 146.5 | 115.9 | 265.7 | 162.6 | 119.2 |
| Machinery and equipment | 118.4 | 186.2 | 254.7 | 201.5 | 190.5 | 223.6 | 209.7 |
| <u>UNCLASSIFIED IMPORTS</u> | <u>7.6</u> | <u>8.6</u> | <u>7.1</u> | <u>6.9</u> | <u>4.8</u> | <u>4.9</u> | <u>22.4</u> |
| <u>TOTAL IMPORTS</u> | <u>940.9</u> | <u>1,447.2</u> | <u>2,052.8</u> | <u>1,832.2</u> | <u>2,015.4</u> | <u>1,936.1</u> | <u>1,875.6</u> |

a/ Based on customs data and, therefore, not necessarily consistent with balance of payments data in Table 3.

b/ Provisional.

Note: Due to rounding off, components may not add up to totals.

Source: Adjusted Sri Lanka Customs data as reported by the Central Bank of Ceylon.

Table A 18: COMPOSITION OF IMPORTS - (Percentages)

| Category | Percent composition | | | | | | |
|--|---------------------|-------|-------|-------|-------|-------|-------|
| | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
| 1. Consumer Goods of which | 38.3 | 34.7 | 29.9 | 25.2 | 20.5 | 25.6 | 23.2 |
| 1.1 Food and Drink | 28.1 | 21.1 | 18.9 | 13.4 | 8.5 | 11.8 | 10.5 |
| (i) Rice | 4.7 | 3.9 | 2.6 | 2.7 | 2.2 | 1.7 | 0.4 |
| (ii) Flour | 14.9 | 7.5 | 5.4 | 0.1 | 0.1 | 0.2 | 0.1 |
| (iii) Sugar | 4.2 | 4.1 | 6.0 | 7.7 | 2.3 | 4.4 | 2.8 |
| (iv) Milk & Milk Products | 2.7 | 2.1 | 1.6 | 1.4 | 1.2 | 2.2 | 1.6 |
| (v) (a) Fish dried (excluding Maldivian fish & including dried prawns) | 0.1 | 0.3 | 0.4 | 0.2 | 0.4 | 0.5 | 0.8 |
| (b) Fish other | 0.1 | 0.6 | 0.5 | 0.1 | 0.4 | 0.3 | 0.5 |
| (vi) Food other | 1.3 | 2.8 | 2.5 | 1.3 | 1.8 | 2.6 | 4.3 |
| 1.2 Textiles (including clothing) | 3.6 | 6.8 | 5.1 | 6.4 | 5.2 | 6.0 | 6.3 |
| 1.3 Other Consumer Goods of which | 6.5 | 6.6 | 6.0 | 5.5 | 6.9 | 7.8 | 6.5 |
| (i) Motor cars & cycles | 2.4 | 2.5 | 1.8 | 1.2 | 1.0 | 1.2 | 1.0 |
| (ii) Radio receivers | 0.3 | 0.6 | 0.5 | 0.8 | 1.8 | 1.5 | 0.9 |
| (iii) Rubber Tyres & Tubes | 0.4 | 0.2 | 0.1 | 0.4 | 0.4 | 0.4 | 0.4 |
| (iv) Medical & Pharmaceutical Products | 1.2 | 1.1 | 0.8 | 0.5 | 1.0 | 0.9 | 1.1 |
| (v) Other | 2.3 | 2.1 | 2.7 | 2.7 | 2.9 | 3.9 | 3.1 |
| 2. Intermediate Goods of which | 38.1 | 40.5 | 45.7 | 52.7 | 51.6 | 47.7 | 50.0 |
| (i) Fertilizer | 1.7 | 3.0 | 3.9 | 3.3 | 1.3 | 1.4 | 2.3 |
| (ii) Petroleum | 16.4 | 17.3 | 23.8 | 27.2 | 29.3 | 24.2 | 22.5 |
| (iii) Chemical elements & Compounds | 3.0 | 2.2 | 1.6 | 1.8 | 1.7 | 1.8 | 2.2 |
| (iv) Dyeing, tanning & colouring materials | 0.8 | 0.7 | 0.6 | 0.7 | 1.0 | 0.5 | 0.6 |
| (v) Paper & Paper boards | 1.6 | 1.8 | 1.3 | 2.0 | 1.6 | 1.5 | 1.3 |
| (vi) Wheat & Meslin | 0.9 | 1.3 | 1.7 | 4.6 | 4.3 | 5.1 | 5.2 |
| (vii) Other | 13.6 | 14.2 | 12.7 | 13.1 | 12.8 | 13.2 | 15.9 |
| 3. Investment Goods of which | 22.9 | 24.2 | 24.0 | 21.7 | 27.6 | 26.5 | 25.6 |
| (i) Building materials | 1.0 | 1.6 | 1.8 | 1.4 | 1.3 | 2.6 | 1.5 |
| (ii) Transport equipment | 6.7 | 7.2 | 7.1 | 6.1 | 13.2 | 8.4 | 6.4 |
| (iii) Machinery & Equipment | 12.6 | 12.9 | 12.4 | 10.6 | 9.5 | 11.6 | 11.2 |
| (iv) Other | 2.6 | 2.6 | 2.6 | 3.8 | 3.7 | 4.0 | 6.5 |
| 4. Total (items 1, 2 and 3) | 99.3 | 99.4 | 99.7 | 99.6 | 99.8 | 99.8 | 98.8 |
| 5. Unclassified Imports | 0.7 | 0.6 | 0.3 | 0.4 | 0.2 | 0.2 | 1.2 |
| 6. Total Imports (d) | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Central Bank of Ceylon.

Table A 19: PETROLEUM IMPORTS AND EXPORTS, 1978-84

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984 a/</u> |
|---------------------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------|
| <u>Value</u> (\$ million) | | | | | | | |
| Crude Oil | 143.7 | 201.6 | 435.8 | 448.4 | 488.9 | 332.9 | 372.4 |
| Gasoline | 0.6 | 1.2 | - | - | - | 4.4 | - |
| Avtur | 8.2 | 22.3 | 22.5 | 16.4 | 1.8 | 3.2 | - |
| Kerosene | 3.6 | 12.1 | - | - | 15.2 | 15.8 | 2.5 |
| Automotive Diesel | 10.7 | 51.9 | 14.8 | 35.5 | 56.6 | 102.0 | 33.7 |
| Other | <u>8.3</u> | <u>8.6</u> | <u>20.3</u> | <u>14.9</u> | <u>11.4</u> | <u>10.2</u> | <u>-</u> |
| TOTAL IMPORTS | 175.2 | 297.7 | 493.4 | 515.2 | 573.9 | 468.5 | 408.6 |
| TOTAL EXPORTS | 60.4 | 125.9 | 188.1 | 174.6 | 154.8 | 106.5 | 129.3 |
| NET IMPORTS | 114.8 | 171.8 | 305.3 | 340.6 | 419.1 | 362.0 | 279.3 |
| <u>Volume</u> ('000 tons) | | | | | | | |
| Crude Oil | 1,443.9 | 1,444.0 | 1,861.1 | 1,710.5 | 1,940.5 | 1,492.0 | 1,733.2 |
| Gasoline | 3.7 | 6.5 | - | - | - | 15.0 | - |
| Avtur | 55.7 | 65.3 | 58.4 | 45.0 | 5.4 | 10.9 | - |
| Kerosene | 25.4 | 41.9 | - | - | 43.4 | 55.8 | 8.8 |
| Automotive Diesel | 82.7 | 198.6 | 42.6 | 110.9 | 183.9 | 405.9 | 140.6 |

a/ Provisional.

Note: 1. Totals may not add up due to rounding.

2. Data may differ with Customs data used elsewhere in this report.

Source: Ceylon Petroleum Corporation.

Table A 20: IMPORT CONTENT OF GDCF (Rs. million at 1978 prices)

| | <u>1978</u> | <u>1979</u> | <u>1980</u> | <u>1981</u> | <u>1982</u> | <u>1983</u> | <u>1984</u> |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| GDCF at 1978 prices | 8554 | 10692 | 13306 | 13148 | 13378 | 14223 | 14485 |
| Imports of investment goods at current CIF prices | 3367 | 5459 | 8144 | 7956 | 11591 | 12077 | 12170 |
| Price index of imported investment goods | 100 | 145 | 158 | 161 | 179 | 189 | 194 |
| Imports of investment goods at 1978 prices | 3367 | 3765 | 5154 | 4942 | 6475 | 6390 | 6273 |
| Import content of GDCF at 1978 prices (1-4) | 39.4 | 35.2 | 38.7 | 37.6 | 48.4 | 44.9 | 43.3 |

Table A 21: CENTRAL BANK TRADE INDICES (a) (1978 = 100) = Exports

| Period | Export Volume | | | | | | | Export Price | | | | | | | | |
|--------|---------------|-------------------------------|------------------------------|-----------------------------------|-----------------------------|---------------------|-------------|--------------|-------------------------------|------------------------------|-----------------------------------|-----------------------------|---------------------|-------------|------------------------|-------------------|
| | Tea | Rubber including liquid latex | Three major coconut products | Precious and semi precious stones | Minor agricultural products | Industrial products | All exports | Tea | Rubber including liquid latex | Three major coconut products | Precious and semi precious stones | Minor agricultural products | Industrial products | All exports | All import price index | Terms of trade(b) |
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) | (12) | (13) | (14) | (15) | (16) |
| 1978 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 1979 | 97 | 93 | 98 | 69 | 136 | 105 | 101 | 92 | 132 | 152 | 128 | 116 | 110 | 109 | 152 | 72 |
| 1980 | 114 | 89 | 62 | 68 | 125 | 135 | 106 | 98 | 143 | 176 | 121 | 127 | 122 | 119 | 180 | 66 |
| 1981 | 114 | 96 | 75 | 47 | 179 | 182 | 118 | 103 | 147 | 169 | 115 | 137 | 137 | 125 | 200 | 63 |
| 1982 | 112 | 95 | 97 | 113 | 164 | 195 | 124 | 102 | 119 | 136 | 109 | 151 | 152 | 123 | 214 | 57 |
| 1983 | 100 | 94 | 99 | 176 | 145 | 224 | 122 | 152 | 149 | 171 | 95 | 178 | 167 | 158 | 220 | 72 |
| 1984 | 127 | 92 | 64 | 131 | 373 | 342 | 141 | 225 | 175 | 290 | 97 | 188 | 168 | 206 | 238 | 87 |

(a) Indices from 1979 are derived from the revised series (1981=100) in Tables 19-20 of the Annual Report of the Central Bank of Sri Lanka - 1985. Index for 1978 is spliced from data published earlier.

(b) Export price index

X 100

Import price index

Source: Central Bank of Sri Lanka, Annual Report, 1985.

Table A 22: CENTRAL BANK TRADE INDICES (a) (1978 = 100)

| | Import Volume | | | | | | | Import Price | | | | | | |
|------|---------------------|-----------------|-----------------------------|-----------------|---------------------------|-------------------------|--------------------|---------------------|-----------------|------------------------------|------------------|----------------------------|--------------------------|---------------------|
| | Consumer Goods | | | | Intermediate Goods (5) | Investment Goods (6) | All Imports (7) | Consumer Goods | | | | Intermediate Goods (12) | Investment Goods (13) | All Imports (14) |
| | Food & Drink (1) | Textiles (2) | Other Consumer Goods (3) | Combined (4) | | | | Food & Drink (8) | Textiles (9) | Other Consumer Goods (10) | Combined (11) | | | |
| 1978 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 1979 | 102 | 323 | 250 | 139 | 95 | 144 | 123 | 110 | 168 | 96 | 114 | 196 | 145 | 152 |
| 1980 | 86 | 331 | 345 | 141 | 131 | 205 | 155 | 169 | 191 | 95 | 143 | 234 | 158 | 180 |
| 1981 | 52 | 399 | 297 | 105 | 143 | 176 | 145 | 208 | 227 | 102 | 170 | 263 | 161 | 200 |
| 1982 | 40 | 331 | 368 | 97 | 142 | 181 | 142 | 181 | 257 | 120 | 170 | 284 | 179 | 214 |
| 1983 | 71 | 351 | 445 | 131 | 135 | 223 | 156 | 167 | 311 | 120 | 172 | 295 | 189 | 220 |
| 1984 | 70 | 379 | 336 | 122 | 147 | 220 | 158 | 156 | 320 | 139 | 177 | 332 | 194 | 238 |

(a) Indices from 1979 are derived from the revised series (1981=100) in Tables 22 and 23 of the Annual Report of the Central Bank of Sri Lanka, 1985. Index for 1978 is spliced from earlier data.

Source: Central Bank of Sri Lanka - Annual Report, 1985.

Table A 23: INTERNATIONAL LIQUIDITY, 1970-84
(\$ million)

| | End of Period | | | | | | | | | | | | | | |
|-----------------------------------|---------------|------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| | 1970 | 1971 | 1972 | 1973 | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
| Gross Official Reserves <u>a/</u> | 43 | 50 | 60 | 86 | 57 | 58 | 92 | 293 | 398 | 517 | 246 | 337 | 352 | 309 | 543 |
| Net International Reserves | -108 | -69 | -48 | -11 | -68 | -124 | -67 | 116 | 210 | 258 | 38 | 5 | -22 | -21 | 289 |
| <u>IMF Position</u> | | | | | | | | | | | | | | | |
| Use of IMF Credit | 79 | 78 | 81 | 89 | 125 | 146 | 156 | 206 | 242 | 309 | 269 | 404 | 377 | 347 | 335 |
| of which: | | | | | | | | | | | | | | | |
| Compensatory Drawings | 39 | 21 | 23 | 46 | 54 | 42 | 47 | 30 | 21 | 21 | 10 | 29 | 71 | 40 | 33 |
| Oil Facility Drawings | - | - | - | - | 42 | 76 | 90 | 93 | 87 | 63 | 37 | 12 | 1 | - | - |
| Extended Facility | - | - | - | - | - | - | - | - | - | 105 | 140 | 303 | 267 | 269 | 264 |
| Credit Tranche Drawings | 29 | 42 | 40 | 21 | 6 | 4 | - | 59 | 107 | 97 | 68 | 60 | 18 | - | - |
| Other | - | - | - | - | - | - | - | - | - | - | - | - | - | 32 | 33 |
| Buffer Stock | - | - | - | - | - | - | - | - | - | - | - | - | - | 6 | 5 |
| Trust Fund Loans Outstanding | - | - | - | - | - | - | - | - | 53 | 93 | 122 | 111 | 106 | 98 | 113 |

a/ Excluding international reserves held by commercial banks.

Source: IMF, International Financial Statistics.

Table A 24: Average Exchange Rates for Sri Lanka Rupee

| Foreign Currency | Exchange Rate on Nov. 15 | | | | | | | | Percentage Change since Nov. 1977 |
|---------------------|--------------------------------|-----------|----------|----------|---------|---------|---------|---------|--|
| | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 | |
| Per US \$ | 8.9990 | 15.611 | 15.5587 | 16.5344 | 19.2401 | 20.8124 | 23.5286 | 25.4380 | 182.68 |
| | | (73.47)* | (-0.34) | (6.27) | (16.36) | (8.17) | (13.12) | (8.12) | |
| Per UK £ | 15.5255 | 29.9165 | 33.0597 | 38.4784 | 38.9022 | 36.4282 | 35.6856 | 33.9621 | 118.75 |
| | | (92.69)* | (10.51) | (16.39) | (1.10) | (-6.36) | (-2.04) | (-4.83) | |
| Per Japanese Yen | 0.0341 | .07337 | .0659815 | .0734026 | .08741 | .08388 | .099139 | .107177 | 214.30 |
| | | (115.16)* | (-10.07) | (11.25) | (19.08) | (-4.04) | (18.19) | (8.11) | |
| Per SDR | 10.42 | 19.4706 | 20.1254 | 21.5166 | 22.6679 | 22.9762 | 25.1552 | 26.0781 | 150.27 |
| | | (86.86)* | (3.36) | (6.91) | (5.35) | (1.36) | (9.48) | (3.67) | |

Annual Percentage Change in brackets.

* Change between exchange rate prior to November 16, 1977 and Average Rate in 1979.

Source: Central Bank of Ceylon.

Table A 25: INTEREST RATES OF MAJOR CREDIT AND SAVINGS INSTITUTIONS, 1970-1984
(Percent per annum at end of period)

| | 1970 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 | 1983 | 1984 |
|---|---------------|-------------|------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------|
| Government Treasury Bills a/ | 4.75 | 5.00 | 5.00 | 9.00 | 9.00 | 9.00 | 13.00 | 13.00 | 13.50 | 12.00 | |
| Central Bank Rate b/ | 6.50 | 6.50 | 6.50 | 10.00 | 10.00 | 10.00 | 12.00 | 14.00 | 13.00 | 12.00 | |
| DEPOSIT RATES | | | | | | | | | | | |
| Commercial Banks | | | | | | | | | | | |
| 12 Months Fixed Deposits | 4.50-4.75 | 7.00-7.50 | 7.00-7.50 | 14.00-15.00 | 14.00-15.00 | 14.00-15.00 | 20.00 | 20.00-22.00 | 15.00-22.00 | 16.00-25.00 | 14.00- |
| Savings Deposits | 4.50 | 5.50 | 5.50 | 7.20 | 7.20 | 5.00-9.00 | 10.00-14.00 | 10.00-14.00 | 10.00-14.50 | 10.00-15.00 | 10.00- |
| Savings Institutions | | | | | | | | | | | |
| National Savings Bank | | | | | | | | | | | |
| Savings Deposits | 3.50-4.00c/ | 7.20 | 7.20 | 8.40 | 8.40 | 8.40 | 12.00 | 12.00 | 12.00 | 12.00 | |
| 12 Months Fixed Deposits | 4.50c/ | 7.50 | 7.50 | 15.00 | 15.00 | 15.00 | 20.00 | 20.00 | 20.00 | 20.00 | |
| 10-Year Savings Certificates | 5.00 | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 | 11.00 | |
| LENDING RATES | | | | | | | | | | | |
| Commercial Banks | | | | | | | | | | | |
| Secured | 6.50-12.00 | 6.50-13.00 | 6.50-14.00 | 10.00-20.00 | 10.00-20.00 | 10.00-20.00 | 11.00-23.00 | 11.00-30.00 | 11.00-30.00 | 11.00-30.00 | 12.00- |
| Unsecured | 8.50-12.00 | 9.50-14.00 | 9.50-14.00 | 18.00-20.00 | 18.00-20.00 | 18.00-21.00 | 19.00-30.00 | 19.00-32.00 | 14.00-32.00 | 11.00-30.00 | 13.80- |
| Long-Term Credit Institutions | | | | | | | | | | | |
| State Mortgage Bank d/ Agricultural and Industrial Credit Corporations d/ | 5.00-10.50 | 5.00-12.00 | 5.00-12.00 | 5.00-12.00 | 5.00-12.00 | 5.00-18.00 | 5.00-20.00 | 12.00-24.00 | 12.00-24.00 | 12.00-24.00 | 12.00- |
| Development Finance Corps. | 9.00-12.00 | 9.00-12.00 | 9.00-12.00 | 12.00-15.00 | 11.00-14.00 | d/ | d/ | d/ | d/ | d/ | |
| National Housing Department | 9.50-10.50 | 9.50-12.50 | 9.50-12.50 | 9.50-13.00 | 9.50-13.00 | 10.50-16.00 | 10.50-17.00 | 13.00-17.00 | 12.00-17.00 | 11.00-14.00 | 11.00- |
| National Savings Bank | 11.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00-9.00 | 6.00- |
| | 10.00-12.00c/ | 10.00-12.00 | 9.00-12.00 | 9.00-12.00 | 9.00-13.00 | 9.00-13.00 | 9.00-17.00 | 12.00-17.00 | 12.00-17.00 | 12.00-17.00 | 12.00- |

a/ Weighted average of bills issued on tender.

b/ Rate at which Central Bank provides advances to commercial banks secured by Government and Government guaranteed securities. Refinance facilities for productive purposes are currently available at rates ranging from 1.50-13.00%.

c/ Interest rates for the Ceylon Savings Bank, the Post Office Savings Bank, and the Savings Certificate Fund. These institutions were merged with the National Savings Bank on April 1, 1972.

d/ On January 1, 1979, the Agricultural and Industrial Credit Corporations were amalgamated into the State Mortgage Bank.

Source Central Bank of Ceylon.