

**(H) BALANCE OF PAYMENTS AND EXTERNAL ASSETS<sup>1</sup>****1. General**

Stringent restriction of the quantity of imports helped, once again, to limit the adverse balance in commodity transactions to a level consistent with foreign exchange earnings and aid. The deficit in the merchandise account was Rs. 302 million. Grants from foreign governments helped to bring down the deficit in the current account to Rs. 269 million. The net inflow of long-term capital (mainly in the form of commodity and project aid) amounting to Rs. 294 million, was more than sufficient to offset the current account deficit. Consequently, there was, once again, a surplus of Rs. 25 million, in the "basic balance".<sup>2</sup>

As compared with the previous year, however, the performance of the balance of payments in 1972 was disappointing. In 1971, the surplus in the "basic balance" was as high as Rs. 188 million. The worsening of the basic balance was primarily the result of the reduced flow of aid. Grants fell by Rs. 24 million, while the net inflow of long-term aid declined by Rs. 111 million. As a result, unlike in 1971, it was not possible to achieve any reduction in the country's dependence on short-term credits for financing payments.

**TABLE II (H) 1**  
**Sri Lanka's Balance of Payments**

Year	Trade Balance	Net Invisibles including Transfer Payments	Balance on Current Account	Net Long-term Capital	Basic Balance
1957	- 95	- 100	- 195	- 18	- 213
1958	- 89	- 64	- 153	+ 8	- 145
1959	- 183	- 25	- 208	+ 32	- 176
1960	- 210	- 11	- 221	+ 22	- 199
1961	- 86	- 7	- 93	+ 11	- 82
1962	- 143	+ 3	- 140	+ 39	- 101
1963	- 161	- 7	- 168	+ 80	- 88
1964	- 193	+ 33	- 160	+ 8	- 152
1965	- 13	+ 72	+ 59	+ 58	+ 117
1966	- 344	- 53	- 290	+ 137	- 153
1967	- 335	+ 46	- 289	+ 161	- 128
1968	- 380	+ 25	- 355	+ 224	- 131
1969	- 746	- 51	- 797	+ 275	- 522
1970	- 315	- 35	- 350	+ 184	- 166
1971	- 287	+ 71	- 216	+ 404	+ 188
1972(a)	- 302	+ 33	- 269	+ 294	+ 25

(a) Provisional

Source: Central Bank of Ceylon.

Apart from the fact that the 1972 performance is less satisfactory than that of 1971, another disquieting feature is that the factors responsible for Sri Lanka's long-standing balance of payments weakness continue to manifest themselves. The prices of Sri Lanka's imports are rising inexorably, for reasons largely beyond her control. The contributory causes are:-

1. Owing to the prolonged strike in the commercial banks which took place in the last quarter of 1972, methods different to those of previous years have had to be adopted in estimating the balance of payments. In previous years, full details of the foreign exchange transactions of commercial banks were available for preparing the balance of payments estimates. At the time of writing this Report, such detailed information was available only for the first half of 1972. The gap in information has had to be filled by projections. The estimates for 1972 are therefore to be regarded as highly provisional.
2. The "Basic balance" is derived by setting off the current account balance against net long-term capital receipts.

- (i) The wage-price inflation in the advanced countries, which has raised the prices of Sri Lanka's manufactured imports,
- (ii) sharp increases in the prices of petroleum products, as a result of the successful pressure applied by the oil producing countries to obtain better prices for their petroleum exports,
- (iii) high prices of certain food items such as sugar, which was in short-supply throughout the year, and rice and wheat during the last quarter,
- (iv) Sri Lanka's increasing dependence on short-term and long-term credits for financing her imports, and the resultant weakening of her ability to make purchases from the cheapest source.

While the constant increase in import prices has imposed a considerable strain on Sri Lanka's external resources, new sources of pressure have emerged during the last few years. Interest payments on Sri Lanka's past borrowings claimed over 6 per cent of her export proceeds in 1972. Capital repayments on long-term debt required another 6 per cent. In addition, there is a large volume of short-term debts, which has to be re-cycled by borrowing afresh.

From a long-term point of view, more disturbing is the stagnation in export earnings observable during the last few years. In rupee terms, there was an increase in export earnings of 1.6 per cent in 1972, but this was very largely the result of the adjustments of exchange rates. In terms of foreign currency, there was in fact a slight drop in export receipts, the primary cause of which was a decline in the export quantum of tea. In 1971, the disruptions caused by insurgent activity, may have contributed to the fall in output, while, in 1972, adverse weather may have been partly responsible. There is, however, some evidence that the fall in the volume of tea and rubber exports is partly the result of efforts by producers to economise on their operating expenses. Considering that Sri Lanka is continuing to depend on these two industries for 73.1 per cent of export earnings this is clearly a disquieting trend.

A further reason for disappointment with the 1972 performance is that it was the first year of the new Five-Year Plan. Recognising the long-term limitations of a policy of exclusive reliance on import substitution for a country in Sri Lanka's circumstances, the Five-Year Plan places considerable emphasis on the rapid development of exports. Total export earnings are assumed to increase to Rs. 2,710 million by the end of the Plan period. Yearly targets for export earnings have not been fixed, but it is clear that with each year that passes without a noticeable increase in export earnings, the task of earning Rs. 2,710 million by the end of 1976 will become that much more difficult. Since the ability to finance the investment contemplated in the Five-Year Plan depends on the availability of the required foreign exchange, a short-fall in export targets can have serious repercussions on the success of the Plan.

Policy responses to this situation must inevitably centre on the further restriction of dispensable consumer imports, and on the provision of greater incentives for exports. The year 1972 witnessed some progress in both these areas. In August 1971, when the U.S. dollar was floated, the Government of

Sri Lanka had to decide whether to allow the exchange rate of the rupee to be determined in a fixed relationship to the Pound Sterling, as had been customary, or to forge a new link with the U.S. dollar. The main argument in favour of maintaining the link with the Pound was that Sri Lanka had a sizeable trade with the Sterling Area. A link with sterling would have helped to keep stable the rupee receipts of exports to and the rupee payments for imports from, the Sterling Area. At the same time, there were even more forceful arguments for establishing a link with the dollar. Since, after the float, the dollar had depreciated against Sterling, maintaining a fixed relationship between the rupee and the Pound, would have amounted to a revaluation of the rupee against the dollar. The consequences would then have been that Sri Lanka's exporters to the Dollar Area would have realized less rupees for their exports, while imports from the Dollar Area would have been cheaper in rupees. Neither of these consequences was desirable from the point of view of the balance of payments. Another important argument for a dollar-rupee link was that several countries which were in competition with Sri Lanka in export markets, had moved with the dollar. These matters were the subject of careful study by the Government, and in November 1971, the decision was taken to re-align the exchange rate with the dollar. When the float of the U.S. dollar ended with the Smithsonian Agreement, new exchange rates were fixed based on the previously existing relationship between the U.S. dollar and the rupee.

It soon became necessary to review those decisions when, in June 1972, the Pound Sterling was allowed to float. All the previous arguments for linking the rupee to the Pound Sterling still remained valid, while additionally, account had to be taken of the fact that failure to re-link the rupee to the Pound would adversely affect Sri Lanka's export trade with the Sterling Area. Accordingly, on 8th July 1972, exchange rates for the rupee were revised on the basis of a fixed relationship with the Pound Sterling. Since the balance of payments position of Sri Lanka did not warrant a revaluation of the rupee against a major currency, the implementation of these decisions indirectly resulted in a mild depreciation of the rupee against major currencies. This depreciation afforded some much-needed relief to domestic exports (particularly those exports which do not qualify for Foreign Exchange Entitlement Certificates), while also making some small contribution towards restraining the demand for imports.

Two important measures affecting the balance of payments were introduced in the new Budget. These were-

- (a) an increase in the rate for Foreign Exchange Entitlement Certificates from 55% to 65%, and
- (b) the subjection to Foreign Exchange Entitlement Certificates of a large variety of imports which were previously exempt.

These two measures should give a further fillip to non-traditional exports, while helping to keep in reasonable balance the demand for imports.

Detailed statistics of Sri Lanka's balance of payments and external assets are presented in Tables II (H) 2 and II (H) 3 and in Appendix II. The main items of the balance of payments are analysed in detail below:

## Balance of

	Rupees		
	1971		
	Credit	Debit	Net
<b>1. Merchandise Account</b>			
Exports (f.o.b.) ..	1,930		
Imports (c.i.f.) (own resources) ..		1,708	
(Aid Imports & Suppliers' Credits) ..		509	
Total Imports ..		2,217	
Trade balance (own resources) ..			(+ 222)
Trade balance (all imports) ..			- 287
<b>2. Services Account</b>			
Non-monetary gold ..	—	—	—
Port, transportation and insurance ..	139	43	+ 96
Foreign travel ..	20	15	+ 5
Investment income ..	13	134	- 121
(i) Profits & dividends ..	1	30	- 29
(ii) Other (interest) ..	12	104	- 92
Government Expenditure ..	35	24	+ 11
Miscellaneous services ..	106	111	- 5
Private transfers ..	20	40	- 20
Total Services ..	333	367	- 34
<b>3. Total Current Account (own resources)</b>	(2,263)	(2,075)	(+ 188)
<b>Total Current Account (all items)</b>	2,263	2,584	- 321
<b>4. Capital Payments</b>	—	1,051	-1,051
Loans ..	—	96	- 96
Suppliers' credits ..	—	65	- 65
Short-term credits ..	—	614	- 614
Oil compensation & ADB ..	—	10	- 10
Private capital ..	—	36	- 36
I. M. F. ..	—	145	- 145
Bank borrowings ..	—	81	- 81
Other ..	—	4	- 4
<b>Total Current &amp; Capital Payments (own resources)</b>			(- 863)
<b>Total Current &amp; Capital Payments (all items)</b>			-1,372
<b>5. Financing</b>			
IMF Drawings ..	83	—	+ 83
Bank borrowings ..	—	—	—
Bilateral balances ..	—	57	- 57
Suppliers' credits ..	58	—	+ 58
Short-term credits ..	658	—	+ 658
External Assets ..	—	96	- 96
Commodity Aid ..	260	—	+ 260
Project & Other Aid ..	86	—	+ 86
Other Aid ..	152	—	+ 152
Grants ..	105	—	+ 105
Private Capital ..	25	—	+ 25
Other ..	41	—	+ 41
Special Drawing Rights ..	63	—	+ 63
Errors & Omissions ..	—	6	- 6
<b>Total financing</b>	1,531	159	+1,372

(a) Provisional. Figures have been rounded off.

TABLE II (H) 2

## Payments 1971-1972

Million			U. S. Dollars Million					
1972 (a)			1971			1972 (a)		
Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
1,963	1,697 568 2,265	(+ 266) - 302	324	287 85 372	(+ 37) - 48	318	275 92 367	(+ 43) - 49
138	45	+ 93	23	7	+ 16	23	7	+ 16
32	13	+ 19	4	3	+ 1	5	2	+ 3
12	149	- 137	2	22	- 20	2	24	- 22
1	29	- 28	-	5	- 5	-	5	- 5
11	120	- 109	2	17	- 15	2	19	- 17
40	28	+ 12	6	4	+ 2	7	4	+ 3
126	128	- 2	18	19	- 1	20	21	- 1
25	59	- 34	3	7	- 4	4	10	- 6
373	422	- 49	56	62	- 6	61	68	- 7
(2,336)	(2,119)	(+ 217)	(380)	(349)	(+ 31)	(379)	(343)	(+ 36)
2,336	2,687	- 351	380	434	- 54	379	435	- 56
-	952	- 952	-	176	-176	-	155	-155
-	124	- 124	-	16	- 16	-	20	- 20
-	50	- 50	-	11	- 11	-	8	- 8
-	570	- 570	-	103	-103	-	93	- 93
-	-	-	-	2	- 2	-	-	-
-	38	- 38	-	6	- 6	-	6	- 6
-	170	- 170	-	24	- 24	-	28	- 28
-	-	-	-	14	- 14	-	-	-
-	-	(- 735)	-	-	(-145)	-	-	(-119)
-	-	-1,303	-	-	-230	-	-	-211
163	-	+ 163	14	-	+ 14	27	-	+ 27
12	-	+ 12	-	-	-	2	-	+ 2
-	11	- 11	-	10	- 10	-	2	- 2
72	-	+ 72	10	-	+ 10	12	-	+ 12
593	-	+ 593	111	-	+111	96	-	+ 96
-	229	- 229	-	16	- 16	-	37	- 37
317	-	+ 317	44	-	+ 44	51	-	+ 51
97	-	+ 97	14	-	+ 14	16	-	+ 16
-	-	-	25	-	+ 25	-	-	-
82	-	+ 82	18	-	+ 18	13	-	+ 13
51	-	+ 51	4	-	+ 4	8	-	+ 8
88	-	+ 88	7	-	+ 7	14	-	+ 14
62	-	+ 62	10	-	+ 10	10	-	+ 10
6	-	+ 6	-	1	- 1	1	-	+ 1
1,543	240	+1,303	257	27	+230	250	39	+211

Source: Central Bank of Ceylon.

TABLE II (H) 3

## External Resources and their Use

Item	Rupees Million				Percentage Share			
	1969	1970	1971	(a) 1972	1969	1970	1971	(a) 1972
<b>A. Resources</b>								
1. Merchandise exports f.o.b. ..	1,909	2,017	1,930	1,963	56	58	51	51
2. Services Account ..	269	234	333	373	8	7	9	10
3. Capital Inflow ..	417	382	628	547	12	11	16	14
of which:—								
(a) Loans <sup>1</sup> ..	362	299	346	414	11	9	9	11
(b) Other Aid <sup>2</sup> ..	—	—	152	—	—	—	4	—
(c) Grants <sup>1</sup> ..	46	75	105	82	1	2	3	2
(d) Private Capital ..	9	8	25	51	—	—	—	1
4. Short-term Liabilities ..	715	829	903	990	21	24	24	25
(a) Gross drawings from the International Monetary Fund ..	77	57	83	163	2	2	2	4
(b) Special Drawing Rights ..	—	78	63	62	—	2	2	2
(c) Increase in balances in Bilateral Payments Agreements ..	18	—	—	—	1	—	—	—
(d) Borrowings from Foreign Banks ..	227	123	—	12	7	4	—	—
(e) Short-term Credits ..	185	434	658	593	5	13	17	15
(f) Suppliers' Credits ..	176	85	58	72	5	2	2	2
(g) Other ..	32	52	41	88	1	1	1	2
5. Decline in External Assets (net of Sterling Loans Sinking Fund) ..	90	—	—	—	3	—	—	—
<b>Total</b> ..	<b>3,399</b>	<b>3,462</b>	<b>3,794</b>	<b>3,873</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>B. Use</b>								
6. Merchandise imports c.i.f. ..	2,655	2,332	2,217	2,265	78	67	58	58
of which Aid ..	581	459	509	568	17	13	13	15
7. Services Account ..	366	364	367	422	11	11	10	11
(a) Investment Income ..	120	152	134	149	4	4	3	4
(b) Migrants transfers ..	15	23	40	59	1	1	1	2
(c) Interest payments ..	10	100	104	120	2	3	3	3
8. Capital Amortization ..	87	126	132	162	2	3	3	4
(a) Official ..	77	113	96	124	2	3	2	3
(b) Private ..	10	13	36	38	—	—	1	1
9. Short-term Liabilities ..	305	605	976	801	9	18	26	21
(a) Repurchases from the IMF ..	87	161	145	170	3	5	4	4
(b) Decrease in balances in Bilateral Payments Agreements ..	—	75	57	11	—	2	2	—
(c) Bank borrowings ..	—	—	81	—	—	—	2	—
(d) Short-term Credits ..	147	282	614	570	4	8	16	15
(e) Suppliers' Credits ..	50	80	65	50	1	3	2	2
(f) Other ..	21	7	14	—	1	—	—	—
10. Increase in External Assets (net of Sterling Loans Sinking Fund) ..	—	39	77	183	—	1	2	5
11. Balancing item ..	- 14	- 4	25	40	—	—	1	1
<b>Total</b> ..	<b>3,399</b>	<b>3,462</b>	<b>3,794</b>	<b>3,873</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source: Central Bank of Ceylon.

(a) Provisional.

1. Includes assistance received in the form of Project and Commodity Aid.

2. Currency Loan from the Peoples' Republic of China.

Figures have been rounded off.

**(a) Merchandise Account**

The adverse balance of Rs. 287 million in the merchandise account in 1971 is estimated to have increased to Rs. 302 million in 1972. The larger deficit was caused by a rise in import expenditures, which increased by 2.1 per cent from Rs. 2,218 million in 1971 to an estimated Rs. 2,265 million in 1972, despite a reduction in quantity. As mentioned above, a part of the increased expenditure was due simply to the higher rupee valuation attached to imports as a result of the adjustment of exchange rates, but partly too, it was the result of a further rise in the foreign prices of imports.

Export earnings increased by 1.6 per cent from Rs. 1,930 million, to Rs. 1,963 million. In the case of exports, increased earnings were primarily due to exchange rate changes. In terms of foreign currency, however, export earnings declined by 1.9 per cent, mainly due to a lower volume.

**(b) Services and Transfers**

Table II (H) 4 sets out estimates on the services account. A sharp reduction in the deficit in the services account is observable in the last two years. In 1971, the deficit in the services account had reduced to Rs. 14 million, as compared with Rs. 102 million in the preceding year. In 1972, the deficit remained at the same level as in 1971.

Receipts from tourism, which received a minor set-back in 1971 due to the insurgency, show definite signs of revival. They are estimated to have increased from Rs. 20 million to Rs. 32 million. On the payments side, the large outflow through investment income is due principally to the larger interest payments due on Sri Lanka's growing foreign debt.

**TABLE II (H) 4**  
**Changes in Major Sectors in the Services Account**  
**1971 and 1972**

	Rupees Million							
	Credit			Debit			Balance	
	1971	<sup>(a)</sup> 1972	Change	1971	<sup>(a)</sup> 1972	Change	1971	<sup>(a)</sup> 1972
Port, Transportation and Insurance ..	139	138	- 1	43	45	2	+ 96	+ 93
Foreign travel ..	20	32	12	15	13	- 2	+ 5	+ 19
Investment Income ..	13	12	- 1	134	149	15	- 121	- 137
(i) Profits and Dividends ..	1	1	—	30	29	- 1	- 29	- 28
(ii) Interest ..	12	11	- 1	104	120	16	- 92	- 109
Government Expenditure ..	35	40	5	24	28	4	+ 11	+ 12
Miscellaneous Services ..	106	126	20	111	128	17	- 5	- 2
Private Transfers ..	20	25	5	40	59	19	- 20	- 34
<b>Total ..</b>	<b>333</b>	<b>373</b>	<b>40</b>	<b>367</b>	<b>422</b>	<b>55</b>	<b>- 34</b>	<b>- 49</b>

Source: Central Bank of Ceylon

(a) Provisional

In the case of transfer payments, the increased outflow on the private account can be attributed to the faster pace of repatriation under the Indo-Ceylon Agreement. Receipts from official transfer payments represent grants received from foreign countries and institutions, either in the form of cash or goods. They recorded a decline from Rs. 105 million to Rs. 82 million.

Taking services and transfer payments together, there was a surplus of Rs. 34 million, which helped to bring down the deficit on current account to Rs. 269 million.

### (c) Capital Account

The total resource gap which had to be financed in 1972 was Rs. 1,303 million, as compared with Rs. 1,372 million in 1971. The inflow of long-term official capital i.e. through commodity and project aid, fell from Rs. 498 million to Rs. 414 million. Repayments on account of such loans increased from Rs. 96 million to Rs. 124 million. As a result, the net inflow of official long-term capital declined from Rs. 402 million to Rs. 290 million.

The fall in the net inflow of long-term capital, made continued resort to short-term credits inevitable. During the year, the total amount of such credits obtained was Rs. 665 million, as compared to Rs. 716 million in 1971. Repayments made on such credits, however, fell from Rs. 679 million to Rs. 620 million. Thus, in 1972, the volume of short-term credits outstanding increased by Rs. 45 million, as compared with an increase of only Rs. 37 million in 1971.

TABLE II (H) 5

### Modes of Financing the External Resource Gap 1971-1972

	1971		1972(a)	
	Rs. Mn.	% Share	Rs. Mn.	% Share
Resource Gap .. .. .	- 1,372		- 1,303	
Financing:	+ 1,372	100	+ 1,303	100
1. External Assets .. .. .	96	7.0	229	17.5
2. Foreign Bank borrowings .. .. .	—	—	12	0.9
3. I. M. F. Drawings .. .. .	83	6.0	163	12.5
4. Bilateral trade balances .. .. .	57	4.1	11	0.8
5. Short-term trade credits .. .. .	658	48.0	593	45.6
6. Suppliers' Credits .. .. .	58	4.2	72	5.5
7. Commodity Aid .. .. .	260	18.9	317	24.4
8. Project Aid .. .. .	86	6.2	97	7.5
9. Other Loans & Lines of credit .. .. .	152	11.0	—	—
10. Grants .. .. .	105	7.6	82	6.3
11. Private Capital .. .. .	25	1.8	51	3.9
12. Other .. .. .	41	2.9	88	6.8
13. Special Drawing Rights .. .. .	63	4.5	62	4.8
14. Errors & Omissions .. .. .	6	—	6	0.1

Source: Central Bank of Ceylon.

(a) Provisional.



In 1972, a drawing of U.S.\$ 14.75 million, under the scheme for Compensatory Financing of Export Fluctuations, and drawings of U.S.\$ 10.5 million under the stand-by agreement of the previous year, resulted in receipts totalling Rs. 163 million. A further Rs. 19 million was credited to the I. M. F. as charges payable in rupees. Repayments on past drawings totalled Rs. 170 million. The net indebtedness to the I. M. F. thus increased by Rs. 12 million, in contrast to a reduction of Rs. 41 million in 1971.

Under the third annual instalment of the first allocation of Special Drawing Rights, Sri Lanka received such rights to the value of Rs. 62 million.

## 2. External Assets

Despite the adverse out-turn in the balance of payments, Sri Lanka's external assets increased in 1972 by Rs. 187 million.\* The assets of the Central Bank increased by Rs. 47 million, those of the commercial banks by Rs. 135 million, while Government's assets also increased by Rs. 5 million.

The increase in external assets, it should be emphasized, does not represent an improvement in the balance of payments. Rs. 62 million of the increase simply represents the allocation of Special Drawing Rights. Against the balance increase must be considered the increase in short-term liabilities of commercial banks of Rs. 68 million, and the increase in the Government's short-term liabilities of Rs. 46 million.

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\* See Appendix II, Table 48