I. ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES – 1973

1. INTRODUCTION

In 1973, Sri Lanka achieved a growth rate of 3·5 per cent in real terms, as against 2·6 per cent in the previous year and 1·0 per cent in 1971. On the basis of a rate of increase in population in 1973 of 1·76 per cent,[1] the increase in per capita product at constant prices is 1.7 per cent. This should be compared with the very low increase in per capita real product of 0·6 per cent in 1972 and a negative growth rate of 1·9 per cent in 1971. The increment in the real national product was below expectations because of a substantial fall in the output of coconut and tea and to a lesser extent of livestock products. On the other hand the production of rubber, subsidiary food crops and precious stones increased appreciably. The output of paddy, which is the largest domestic agricultural crop, did not show an increase in the year. The value added in manufacturing in real terms increased marginally, while the level of activity in construction improved with a slight increase in the availability of raw materials.

During the year, there was a very sharp increase in the money supply and this was mainly caused by the monetization of the increased foreign exchange holdings of the banking system. In the last four months of 1973, however, the monetary expansion continued at a slightly reduced pace. The continuation of the monetary expansion was primarily due to government having increased its borrowings from the banking system.

Very sharp price increases took place in 1973 and the rate at which prices rose was much higher than in 1971 and 1972. Import prices of essential commodities like rice, flour and sugar rose to levels which had not been previously reached in these commodity markets. Inflationary pressures and currency disturbances abroad affected the prices of imports and of locally produced goods. The measures taken by government in October also had an impact on domestic prices. The net result was a sharp increase in the cost of living index. The actual price increases of a wide range of goods were considerably in excess of the annual average increase in the Colombo Consumers' Price Index of 9·7 per cent.

Fiscal operations of the government in 1973 resulted in a net contraction of Rs. 53 million for the first time in many years. The sharp increase in revenue over 1971/72 and a substantial mobilization of domestic non-bank resources, enabled the government to reduce its indebtedness to the banking system. In addition, for the first time since 1968/69, the government was able to generate a surplus in its current account. There was a moderate increase in real capital expenditure over the previous year. Higher revenues accrued to the government largely from income tax, the Business Turnover Tax, export duties and revenue from the sale of FEECs.

In 1973, the deficit in the current account of the balance of payments was slightly lower than in 1972. Although there was a very large increase in the import bill, the higher prices for rubber and certain non-traditional and minor exports helped to increase foreign exchange earnings. Despite the latter and the

1. Please see page 12.

existence of stringent controls on foreign exchange, the end of the year saw a substantial increase in short-term liabilities. Furthermore, international currency realignments and the attendent depreciation of the Sri Lanka rupee imposed a continuing burden on servicing Sri Lanka's growing external debt.

In money terms gross fixed capital formation rose by 13 per cent in 1973, but when allowance is made for the sharp price increases the actual increase was only 2 per cent.

2. ECONOMIC PERFORMANCE

(a) Gross National Product

In 1973, the Gross National Product in real terms increased by 3·5 per cent, as compared to the growth rate of 2. 6 per cent in the preceding year. The average growth rate for 1972 and 1973 of 3·1 per cent is appreciably lower than the average for the 10 year period ending in 1971 which is 4·3 per cent. The Five Year Plan, which became operative in 1972, envisages a growth rate of 6 per cent on the average, and the rate of growth in 1973, therefore, falls far short of this target. However, the increase in per capita product at constant prices of 1·7 per cent in 1973 shows some improvement as against the increase of 0·6 per cent in 1972. This was not entirely due to a particularly better economic performance in 1973, but to an appreciable fall in the rate of population growth from 2·0 per cent in 1972 to 1·76 per cent in 1973. Although in money terms, the Gross National Product has increased by as much as 19·6 per cent, this figure is of no significance on account of the economic situation in 1973 when very large price increases occurred.

The economic performance in 1973 would have been better had there been no decline in production in two major export industries, tea and coconut. Coconut production fell sharply by 34·7 per cent while the output of tea declined by 1·1 per cent. In 1973, although coconut prices improved remarkably, that of tea remained almost static. Particularly with coconut, price increases were inadequate to compensate for the loss in export earnings from the severe short fall in production.

The terms of trade have consistently declined since 1960 and this fall was further intensified in 1972, when the decline was sharper than in any preceding year. In 1973, the terms of trade fell by 13 per cent contributing to a sharp weakening of the purchasing power of exports. The loss in the latter is estimated at Rs. 1170 million at constant (1959) prices. Import prices rose at a much faster rate than export prices and this is reflected in the extent to which the terms of trade have fallen.

Sectors which showed noteworthy gains in productivity and increased foreign exchange earnings in constant or SDR terms were, rubber, where output increased by 10 per cent and gems, where total production has been estimated at Rs.234·2 million. In the manufacturing sector as a whole, although value added increased marginally the value of gross output in real terms declined. The sectoral growth in the Gross Domestic Product is given in the table below.

TABLE 1 - 1

Sectoral Growth - Gross Domestic Product 1973

(at constant prices)

	1972 (Rupees Million)	1973 (Rupees Million)	Percentage change
1. Agriculture, Forestry, Hunting & Fishing ..	3,478·4	3,387·6	− 2.6
2. Mining & Quarrying	67·5	266·2	+294·4
3. Manufacturing	1,400·5	1,417·2	+ 1·2
4. Construction	505·0	516·2	+ 2·2
5. Electricity, Gas, Water & Sanitary Services ..	31·0	31·3	+ 1·0
6. Transport, Storage & Communication ..	987·6	1,018·7	+ 3·1
7. Wholesale & Retail Trade	1,327·2	1,383·2	+ 4·2
8. Banking, Insurance & Real Estate ..	135·6	141·9	+ 4·6
9. Ownership of Dwellings	312·6	318·1	+ 1·8
10. Public Administration & Defence ..	522·2	566·6	+ 8·5
11. Services	1,334·0	1,379·4	+ 3·4

Being the second year of the Five Year Plan when the rate of increase in private consumption expenditure should have actually decreased to enable more savings to be diverted to investment, the year 1973, stands out on account of the exceedingly high level of private consumption expenditure in money terms. Whereas in 1972 consumption expenditure went up by 10·4 per cent, in 1973 it increased by 24.9 per cent. Of this, expenditure on locally produced goods and services increased by 32·1 per cent, while expenditure on imports of goods and services decreased by 11·9 per cent as against an increase of 16·4 per cent in the preceding year. The latter could be attributed, at least in part, to the continuing stringent supervision exercised over the foreign exchange allocations for all imports.

(b) Fiscal and Monetary Developments in 1973

(i) Fiscal Operations

For the first time in many years, government fiscal operations resulted in a net contraction of Rs. 53 million. In the budget for the financial year 1973, it was expected that the government's fiscal operations would require bank borrowings to the extent of Rs. 100 million. On the contrary, a substantial increase in revenue together with a record borrowing from domestic non-bank sources enabled the government to reduce its indebtedness to the banking system by Rs. 116 million. During the year, borrowings from the Central Bank increased by Rs. 114 million and government's indebtedness to the commercial banks was reduced by Rs. 230 million while cash balances were drawn down by Rs 63 million.

The Approved Estimates for 1973 anticipated a total revenue of Rs. 3,880 million. Provisional data for 1973 shows that this estimate was exceeded by Rs. 154 million. When compared with the pro-rata revenue for 1971/72, there has been a sharp increase in revenue amounting to Rs. 752 million (or 23 per cent). Total expenditure in 1973 was Rs. 5,448 million of which recurrent expenditure (inclusive of net payments on "Advance Accounts") was Rs. 3,905 million. Consequently, there was a surplus in the government's current account for the first time since 1968/69. This surplus was Rs. 129 million in contrast to a deficit of Rs. 159 million (pro-rata) in 1971/72.

The sharp increase in revenue was brought about by increases in receipts from income tax, export levies, the Business Turnover Tax and revenue from the sale of FEECs. Income tax collections increased by Rs. 246 million, while business turnover tax collections increased by Rs. 142 million. The increase in income tax collections is partly accounted for by the carry over into 1973 of tax collections relating to 1972. The other increases in revenue were mostly the direct result of the budgetary measures aimed at mobilizing additional resources which were proposed in the budget speech for 1973. The increase in export duty collections was largely due to the high prices for exports, particularly rubber. On the other hand, there were slight decreases in revenue from import duties and profits from the sale of arrack.

The Approved Estimates for 1973 provided for a recurrent expenditure of Rs. 3,840 million and expenditure chargeable to capital votes of Rs. 1,691 million. In addition, supplementary estimates amounting to Rs. 196 million for recurrent expenditure and Rs. 113 million for capital expenditure were passed in the course of the year. Actual recurrent and capital expenditures in 1973 were Rs. 3,857 million and Rs. 1,110 million, respectively. While recurrent expenditure continued its normal rate of increase, in 1973 there was a moderate increase in capital expenditure in real terms in contrast to the experience in previous years. The extent of under-expenditure from capital votes was 19 per cent in 1973. This, however, is the normal level of expected under-expenditure.

The net impact of government fiscal operations in 1973 together with the comparable data for the two previous years is summarized in the following table.

TABLE 1 - 2

Financing of the Deficit 1970/71 to 1973

Rs. Million

	1970/71	1971/72		1973 Provisional
		12 months*	15 months	
1. Budget deficit	1,327	1,366	1,707	1,414
2. Less: Sinking Fund contributions, etc.	244	330	412	433
3. Net Cash Deficit	1,083	1,036	1,295	981
4. Financing				
(i) Total financing from non-bank sources	866	925	1,156	1,034
(a) Domestic non-market borrowing	140	199	249	251
(b) Domestic market borrowing from non-bank sources	492	442	552	623
(c) Foreign loans and grants	234	284	355	160
(ii) Domestic borrowing from the banking system	94	226	283	- 116
(iii) Use of government cash balances and Foregin Aid Counterpart Funds	123	- 115	- 144	63
(a) Cash balances	- 3	- 88	- 110	45
(b) Foreign Aid Counterpart Funds	126(a)	- 27	- 34	18
5. Adjustment for change in U.S. Aid Counterpart Funds	1	—	—	...
6. Net expansionary impact of government fiscal operations (4 ii, 4 iii & 5)	218	111	139	- 53

(a) The Central Bank Foreign Aid Counterpart Fund as at the end of September, 1971 was overdrawn by Rs. 112·8 million. This overdrawn position is the result of the delay in recording of commodity aid receipts. Also, please see footnote on page 155 of Annual Report 1971.

* on a pro-rata basis.

Domestic non-bank market borrowing in 1973 reached a record Rs. 623 million (net.) Resources mobilized through the issue of rupee securities was Rs. 760 million, the entirety of which came from non-bank sources. This is Rs. 240 million higher than the corresponding (pro-rata) amount for 1971/72. This successful mobilization of resources from the non-bank sector was largely aided by increased contributions from the National Savings Bank, sinking funds, the Employees' Provident Fund and the Insurance Corporation. In recent years, these captive sources have come to contribute almost 90 per cent of the total subscription to rupee securities. At a time when receipts of foreign finance have shown a tendency to decline, increased support from non-bank sources to the government loan programme, has helped the government in a large way, to sustain its investment programme. On the other hand, these increased borrowings have led to a sharp increase in the interest cost of the public debt. The interest bill on both foreign and local debt which was Rs. 206 million in 1968/69 is estimated to be Rs. 602 million in 1974. These interest payments now constitute a significant item of government recurrent expenditure, and is almost equal to the estimated gross food subsidy bill for 1974. It is imperative that if debt servicing is not to present a major problem to the government in the future, the return on investments made by the government should be adequately high to cover at least a substantial part of the cost of borrowing funds.

In October 1973, the government announced a package of proposals with a view to limiting the alarming rate of increase in the food subsidy bill. The issue of free rice to non-income tax payers was reduced from one measure to half a measure. The price charged from income tax payers was fixed at Re. 1/- per half measure. Distribution of wheat flour was brought under the ration and its price increased to 70 cents per pound. The weekly ration was fixed at one pound per person. The quantum of sugar issued under the ration monthly was reduced from one pound to three-fourth pound per person and the off-ration price of sugar was increased to Rs. 2/- per pound. All these measures were to have resulted in a substantial savings in the food subsidy bill, while at the same time enhancing the profits from their sale. The full budgetary impact of these measures was expected to be felt in 1974. Unfortunately escalating import prices of rice, flour and sugar are now expected to more than wipe off any gains that would have accrued from these measures. While this in a way reveals the vulnerability of the budget to circumstances beyond the country's control, it is nevertheless true that as long as transfer payments make a heavy claim on available resources, the development programmes of the government will suffer for lack of resources.

(ii) Money and Credit

In the twelve months ending in August 1973, money supply rose substantially by Rs. 327·7 million or by 15·2 per cent. This unprecedented increase occured mainly on account of an increase in the foreign exchange holdings of the banking system by Rs. 270·3 million. It was the outcome of current export earnings increasing in relation to the restricted outlays on imports as a result of which the banking system had larger foreign exchange holdings. In addition to this factor, the fall in time deposits in the banking system also contributed to the monetary expansion. Commercial bank loans to the private sector showed little change in this period, while government paid back loans to commercial banks. These loans had risen in 1972 and earlier in the current year, on account of the exigencies of the commercial bank strike at the end of 1972. Government operations which tended to moderate the money supply expansion were further strengthened when the government sector accumulated cash and deposit balances with the commercial banks.

In the twelve months ending in Augst 1973, a significant aspect of commercial banking was the fall in time deposits with the commercial banks and a modest increase in their savings deposits. As for time and savings deposits in the banking system, the reduction in commercial banks' holdings of time deposits was more than compensated by an increase in savings deposits with the National Savings Bank. The income tax exemptions given to its deposit holders and the simplified withdrawal procedures contributed to this.

In the period referred to above, the liquidity position of commercial banks as depicted by the ratio of their liquid assets to demand deposits fell due to the retirement of Treasury bills held by them, while there was an increase in demand deposits.

In the last four months of 1973, however, the rate at which the money supply rose tended to subside, but even so, the expansion at 11·9 per cent was high in relation to increases in the money supply in earlier years. In this period government's borrowing from the banking system which normally tends to increase with the close of the financial year, was the most important factor behind the expansion in the money supply, while the increase in external assets of the banking system assumed a secondary role. Transactions in the private sector were at a level comparable to that in the year ending August 1973. This was because the increase in bank credit to the private sector had a neutral effect on the money supply due to the increase in private sector savings deposits.

In the last four months of 1973, the liquidity ratio of the commercial banks increased, due to a sizeable increase in their cash holdings. Following the trend in the three preceding years in the calender year 1973, the portion of the money supply represented by demand deposits rose at a faster rate than that of currency.

In the year ending August 1973, credit to the private sector (including export bills) increased by Rs. 269·0 million or by 13·5 per cent compared to an increase of Rs. 233·6 million or by 13·2 per cent in the year ending August 1972. This expansion in commercial bank lending is mainly due to increased lending to government corporations and other private sector borrowers. Along with the slowing down of the increase in money supply in the last four months of 1973, commercial bank credit to the private sector also rose at a lower rate compared to the year ending August 1973. In this period, following the seasonal trend, credit to co-operative institutions declined with the repayment of a substantial amount of credit given for purchases under the Guaranteed Price Scheme. Throughout the year, as in 1972, credit for commercial purposes constituted the highest share in the total credit, while the share of credit for industrial purposes decreased slightly. In this period, the maturity pattern of advances shifted towards those of a shorter maturity.

Compared to the previous year, when the total volume of loans granted by state-sponsored savings and credit institutions declined by Rs. 7·3 million, in 1973, total loans given by these institutions increased by Rs. 12·9 million.

(c) Prices

The increase in the price level that took place in 1973 did not have a previous parallel. The Colombo Consumers' Price Index rose by 9·7 per cent during the year as against 6·3 per cent in 1972. Prices of consumer items outside the cost of living index increased at rates which were much higher than for the index as a whole. The extension of the coverage of the Business Turnover Tax and the increase in the price of Foreign Exchange Entitlement Certificates in late 1972, had their full impact on prices in the year under review. Prices of several essential items which were subject to price controls were revised upwards in the course of the year. In addition to this, the sharp increase in the money supply would have also exerted considerable pressure on the price level, although it is difficult to determine the significance of this factor.

In 1973, the more important factors bearing on the price level have originated externally. Sharp increases occurred in the prices of essential imported items notably, rice, wheat flour, fuel, textiles and milk foods. Freight costs also increased sharply and tended to push up the price level even further. An added factor was the goverment policy of containing food subsidies by passing on cost increases to the consumer. It was largely in pursuit of this decision that the October 1st measures were taken whereby the price of flour and sugar was raised sharply.

(d) The Balance of Payments - 1973[1]

The marked improvement in foreign exchange earnings in 1973 failed to fully offset the deficit in the current account of the balance of payments. These deficits have occurred since 1958 on a continuing basis, except in 1965 when there was a marginal surplus. During the year sharp price increases of essential imports did not provide adequate leeway to reduce import payments. However, as compared to the previous years, there was a substantial fall in the current account deficit from Rs. 196 million in 1972 to Rs. 161 million in 1973. Had it not been for the phenomenal increase in import prices and the adverse effects of the international currency disturbances, the deficit would have turned out to be lower. Import expenditure was cut down to the barest minimum by strict supervision over the allocation of foreign exchange.

Export prices which had remained depressed since the late fifties continued to improve throughout the year and progressively moved on to high levels towards the last quarter of 1973, adding strength to the merchandise account. In 1973, total export earnings rose to Rs. 2346 million from Rs. 1898 million in 1972 while the corresponding increase in import payments was from Rs. 2153 million to Rs. 2,644 million. The latter was not due to an increase in the physical quantity of imports, but largely, to the escalation of import prices and freight rates. This is reflected in the import price index for all commodities which rose from 158 in 1972 to 209 during the year.

1 Figures used in this section are on an exchange recorded basis.

The total resource gap which had to be financed in 1973 was Rs. 1518 million, as against Rs. 1291 million in 1972. The gap was financed by grants-in-aid, inflows of long term official capital and short term credits. Grants-in-aid declined marginally over the levels obtained in 1971 and 1972. Similarly, long term official capital also decreased from Rs. 415 million in 1972 to Rs. 335 million in 1973. With regard to the latter, the delays in finalising commodity aid agreements resulted in a decline in commodity aid by Rs. 94 million over the level in 1972. Since the flow of grants and long term capital was insufficient to finance the resource gap, the country had to rely on short term credits to a greater extent than hitherto. Short term credit thus obtained amounted to Rs. 1021 million. Repayments of short term credit were Rs. 739 million and the resultant increase in short term credit in 1973 was Rs. 282 million, as compared with a decrease of Rs. 9 million in 1972.

Drawings from the International Monetary Fund in 1973 were confined to facilities under the Compensatory Financing of Export Fluctuations as there was no standby arrangement or the allocation of Special Drawings Rights. Under the above facility, a sum of Rs. 137 million was drawn.

Foreign exchange receipts from the tourist trade continued to strengthen the services account in the balance of payments. Earnings from tourism are estimated to have more than doubled in 1973, while tourist traffic rose by 39 per cent.

3. ECONOMIC PROBLEMS AND ISSUES

(a) Economic Growth and the Plan

In 1973, the emphasis in economic policy was shifted increasingly to the production of food crops for domestic consumption. The main objective was to rapidly increase the production of rice, subsidiary food crops and other domestic substitutes for imported food. The government gave greater emphasis than before to food production because of the country's continuing heavy dependence on rice imports. The sharp increase in the world market prices of imported foodstufis such as rice, flour and sugar during the year implied that in the future too, the bulk of Sri Lanka's foreign exchange earnings will have to be earmarked for food imports than for economic development. This could appreciably reduce the amount of real resources available for investment and in turn retard growth.

The full impact of the food drive has not come within the estimate of the Gross National Product for the current year, because the output from the Maha crop 1973/74 and the bulk of the production of subsidiary crops will only be taken into account in the Gross National Product estimates for 1974. It has already been mentioned that while there was no difference in the level of paddy production between 1972 and 1973, the output of coconut and tea fell substantially. The sectors which showed appreciable increases in real output were subsidiary food crops, minor export crops and gem mining.

Making allowance for these factors, the increase in the Gross National Product in 1973 is disappointing when compared to the target rates laid down in the Five Year Plan. The Five Year Plan envisages a growth rate on the average of 6 per cent per year, whereas the growth rate in real terms in 1973 was only 3·5 per cent. This must also be compared with an average growth rate of 4·3 per cent in the decade preceding 1971; that is before the Plan became operative. The year 1973 was the second year of the Plan, and as already indicated, the average growth rate in 1972 and 1973 is 3·1 per cent.

Sri Lanka is now in the third year of the Five Year Plan. The level of economic achievement in the last two years makes it difficult for the country to work towards the targets that have been indicated in the Plan, unless, the pace of development is speeded up considerably in 1974 and the two years the reafter. As for the year 1974, the Maha crop has probably come up to expectations. But the prospects of a better Yala crop seems to be less certain, with the present scarcity of fertilizer, agro-chemicals and other inputs and the continuing tendency for these prices to go up. High yielding varieties of paddy, which have been extensively popularised, are dependent to a large extent on imported fertilizer and agro-chemicals, and shortages in these inputs are likely to create setbacks to production in the coming cultivation season. The tea and coconut industries which are also major productive sectors with considerable weightage in the national product, are likely to be affected in the same way. In addition, the uncertainties created in the plantation sector with the implementation of the land reform scheme are likely to aggravate the tendency for production to fall in this vital sector. The sharp increase in the prices of foodstuffs, crude oil and industrial raw materials is likely to reduce the availability of foreign exchange for the purchase of essential inputs which could make an effective contribution to increase productivity in agriculture.

The events in the year under review and in the preceding year show that the perspective within which the Plan was originally prepared, seems to have changed in many respects. Recent difficulties such as the scarcity in world food and raw material supplies, international currency disturbances and the oil price hike, have raised the import prices of foodstuffs, raw materials and manufactured goods, which are all essential for the development effort, to very high levels. At the same time, these inflationary pressures have weakened the purchasing power of the rupee and have resulted in the erosion of public and private real savings The Plan envisages a substantial and progressive increase in the level of savings so as to provide domestic resources for investment. In the Plan period savings were expected to increase from the pre plan level of 12·5 per cent per annum to 17 per cent. The actual level of savings in 1972 and 1973 have been about 12·8 per cent on the average, The factors that adversely affected the economy in 1973 were not anticipated in the Plan originally. Inflation and the increase in the cost of raw materials and capital goods have not only disturbed the pattern of investment and reduced the quantum of real resources but have also signified the need to re-orient the priorities and strategies in the Plan. These developments seem to indicate that it may be useful to re-examine the strategy and the priorities in the Plan according to current resource availability. A new set of investment priorities could be laid down taking into account the increasing shortages in food supplies and the need to diversify internal sources from which food can be obtained. A programme of work could be conceived with more modest and realistic objectives, and with a capacity to obtain quick results, particularly in the production of essential consumer items such as rice, sugar, cereals, livestock and fish products.

(b) Income Distribution

Some of the earlier Annual Reports have highlighted the deficiencies of the Gross National Product as an adequate measure of economic growth and the need to take into consideration other relevant social and economic indicators. In recent times, institutions like the World Bank and the International Monetary Fund have shown a great deal of interest in the distribution of income in the developing countries. Although in real Gross National Product terms, the present development effort may show inadequate progress, yet, if other socio-economic indicators are used, the impact of development could be evaluated in a more balanced manner. In one area at least, in the redistribution of income, Sri Lanka's achievement stands out among other countries in the Asian region.

Changes in income distribution have been analysed according to data available from the three Consumer Finance Surveys undertaken by the Central Bank in 1953, 1963 and 1973, respectively. The comparison of data in the 1953 and 1963 surveys does not show a significant shift towards greater equality in the size distribution of income. However, data from the latest Consumer Finance Survey, carried out in early 1973, gives a very encouraging picture of a marked shift in the distribution of income towards greater equality. The size distribution of income by each tenth of income receiver for the island as a whole is given below.

TABLE 1 - 3

Percentage of Total Income Received by each Tenth of Income Receivers (All Island)

Deciles	By each Tenth of Income Receivers		
	1953	1963	1973
Highest 10th	42·49	39·24	29·98
Second	14·16	16·01	15·91
Third	10·39	11·46	12·65
Fourth	7·94	8·98	10·56
Fifth	6·31	6·82	8·75
Sixth	5·71	5·55	7·10
Seventh	4·37	4·51	5 70
Eigth	3·56	3·56	4·38
Ninth	3·56	2·70	3·17
Lowest	1·51	1·17	1·80

Source: Reports of the Survey of Ceylon's Consumer Finances 1953, and 1963. The report on the 1973 survey has not yet been publis

The Gini concentration ratio, which is a commonly used index for the measurement of these income changes shows that, for the island as a whole, the ratio has fallen from 0.49 in 1963 to 0.41 in 1973. The 1973 data, also shows that this marked shift in the size distribution of income is evident in both the urban and rural sectors. In the estate sector, the distribution has been less equal, partly because wages have been relatively inflexible in the plantations as compared to the manufacturing and services sectors, and also, for a methodological reason that in the 1963 survey, management level staff on the estates were hardly represented in the sample, whereas in 1973 adequate representation was given to them. The concentrrtion ratios by sectors are given below.

TABLE 1 - 4

Concentration Ratios by Sectors (Income Receivers)

Year	Urban	Rural	Estate	All Island
1953	—	—	—	0·50
1963	0·49	0·44	0·27	0·49
1973	0·40	0·37	0·37	0·41

Source: Ceylon Consumer Finance Surveys
Central Bank of Ceylon

The use of a more comprehensive set of indicators to measure economic progress, thus tends to show that in Sri Lanka the impact of development has been more widespread than is generally conceived, and that the benefits have seeped down to those in the lower income brackets. Sri Lanka's efforts at development must also be compared with other developing countries with very high rates of economic growth but which tend to perpetuate inequalities in income distribution. It may be preferable to have a slightly lower rate of growth with a better distribution of income than the converse. The income distribution trends as depicted by the 1973 data are mainly the result of the deliberate policy of government in redistributing both income and wealth, through wage adjustments for workers receiving the lowest incomes, through the tax mechanism and other measures for redistributing wealth such as the present land reform scheme.

(c) Unemployment and Population

While greater equality in the size distribution of income is on the credit side of the economic balance sheet, a disquietening feature has been the increase in unemployment and under-employment in the country. According to the Survey of Labour Force Participation Rates undertaken by the Central Bank in the third quarter of 1973, the labour force including the unemployed and underemployed, but excluding housewives, was 35·5 per cent of the population. The survey data shows that 17·4 per cent of the labour force excluding housewives was unemployed. In terms of the mid-year population in 1973, the survey shows that there were 793,000 unemployed persons in the Island. The latter figure should be compared with the estimates of unemployment used in the World Employment Programme, ILO Mission Report entitled, "Matching Employment Opportunities and Expectations" which were from the Socio Economic Survey 1969/70. In that Report, the unemployed were estimated at 550,000 or 14 per cent of the total labour force, which consists of persons between the ages of 15 and 59. The increase in unemployment since the Socio Economic Survey of 1969/70 could be attributed to the greater numbers of young persons who are now entering the work force for the first time, as a result of high birth rates in the fifties and early sixties. The number of young persons who take up public examinations have also increased progressively in the last few years, and this in itself is a rough index of those who are likely to enter the labour market sooner or later.

In this background, a noteworthy feature has been the sudden decrease in the rate of population growth in 1973. In the last three years, the rate of population increase has remained around 2·0 per cent. But in 1973, the rate has fallen substantially to 1·76 per cent. There is insufficient information to explain this sudden drop in the rate of population increase with any degree of precision. However, it is reported that this change has been partly due to a fall in the birth rate, an increase in the death rate and to an increase in the repatriation of people of Indian origin.

The increase in unemployment and the relatively low rates of economic growth which were evidenced in the last three years signifies the need for a concerted and sustained effort towards reducing the rate of population increase. At the current average rate of population increase of about 2 per cent per annum, Sri Lanka's population is likely to double by the end of the century and food supplies will continue to be a major problem along with the inadequacy of foreign exchange and other real resources. In view of these problems, it will be easier to achieve the object of self-sufficiency in rice and other essential foodstuffs if a positive programme to further limit the rate of population increase is also undertaken. In this background, the more active participation of government in the population program may be desirable and a population policy should not be relegated to a second place. It should be part and parcel of the overall strategy for economic development.

(d) Agriculture

Domestic

The acreage brought under paddy in the Maha 1972/73 was about the same as in the five Maha seasons preceding the cultivation year 1970/71. In the Maha 1971/72 a slightly larger acreage was brought under cultivation, but the area harvested in the Maha 1972/73 was greater, on account of the lower incidence of crop failure. In the latter season yields on the whole were lower, falling from 48·1 bushels per acre in 1971/72 to 45·5 bushels in 1972/73. In Yala 1973, the extent sown was roughly half the area that was brought under paddy in the Maha season, 1972/73. But ultimately a slightly larger area of approximately 6 per cent, was harvested because crop failure was lower. The increased area harvested in Yala 1973 did not result in a corresponding increase in production because yields were lower by 4 per cent in relation to the previous Yala. This fall in yields took place despite the quantity of fertilizer issued for the Yala having nearly doubled. The higher fertilizer allocations should have ensured a much better Yala crop than in the previous year. The shortfall in the crop was not due to technical factors such as a shortage of vital inputs but to shortcomings in other forms, mainly the leakage of fertilizer from paddy to other crops and certain administrative difficulties associated with the timely release of credit to cultivators.

The lower rate of credit utilisation which was evident in the cultivation season preceding the Maha 1972/73 and Yala 1973 has been reversed thereafter. With the commencement of the Maha 1973/74, credit utilisation increased. sharply rising from Rs. 20·3 million granted in Maha 1972/73 to Rs. 60·9 million The increase has been due to the revision of credit limits from an average of Rs. 316 to Rs. 385 per acre, defaulting borrowers having become eligible once again for certain credit facilities and an increase in the number of cultivators seeking loans. The full impact of the higher rate of credit utilisation would be reflected in the crop figures for Maha 1973/74.

The paddy crop for the year 1973 as a whole has been estimated at 62·9 million bushels, which is the same as the crop in the previous year. During the year, there was a substantial decrease in the purchases made by the Paddy Marketing Board, from 26·2 million bushels or 41·6 per cent of the total crop in 1972 to 22·6 million bushels or 36 per cent in 1973. A major reason for the decline in purchases has been the increase in the free market price for paddy and the increasing divergence between the guaranteed price and market price. Until November 1972, the guaranteed price for paddy was Rs. 15 per bushel and thereafter it was raised to Rs. 18 per bushel in February 1973 and to Rs. 25 in October 1973. Towards the end of 1973, there was evidence that the gap between the guaranteed price and the free market price had widened even further, and the guaranteed price fixed in October 1973 was far lower than the free market price. The latter seems to have taken place with the increase in the demand for off ration rice as a result of the reduction in the quantity of rice given on the ration with effect from October 1973.

The situation that had emerged by the end of 1973, in the market for paddy, indicated that the Paddy Marketing Board would have to restructure its operations if it was to ensure that an increasing proportion of the paddy would be sold to it. Under the prevailing procurement policy there are a number of stipulations in regard to the quality of the paddy the Board would purchase and some of these conditions and other requirements were not insisted upon by the trader who bought the paddy direct from the cultivator. The Board does not provide all the facilities which the private trader gave the farmer such as credit, advance payments and transportation. It can however effectively replace the trader if it can purchase the paddy at the farmer's doorstep and pay him cash on the spot, thus obviating the need for the farmer to carry the paddy to the purchasing centre and often have the paddy rejected if it does not conform to specifications. The services of each cultivation committee or the newly set up productivity committees could be used to induce the farmer to sell a part of his crop to the Paddy Marketing Board. These committees have fairly reliable data on actual production in their cultivation registers and they would be in a position to assess the surplus for sale after making an allowance for the farmers' own requirements.

The guaranteed price of Rs. 25 per bushel prevailing at the end of the year was higher than the cost of production figures in the data that is currently available. These relate to the period before 1973. The cost of production data collected by the Central Bank for Maha 1966/67 showed that the average cost was Rs. 11·17 per bushel. A subsequent estimate made by the Agrarian Research and Training Institute for Yala 1972 which was confined to five districts showed that the cost of production varied from Rs. 9·80 to Rs. 14·43 per bushel. An estimate received from the Batticaloa district for the Maha 1973/74 shows that costs in that district have risen to Rs. 22·50 per bushel however the latter may not be representative for other paddy growing districts in the Island. With the sharp upward movements in prices in 1973, the cost of vital inputs for paddy including fertilizer, agro chemicals, fuel, tractors and spares, and labour have risen markedly. More accurate and representative cost of production data may have to be collected in order to ensure that the recent increases in the price of inputs have not unduly squeezed producer margins.

According to provisional estimates, there has been a sizeable increase in the production of subsidiary crops. As the food drive gathered momentum during the year the impetus to cultivate these increased. In 1972/73, the acreage under nine crops, including manioc, maize, and gingelly, has increased by 68·5 per cent. At the end of the year, the full impact of the drive to increase productivity in subsidiary crops was not evident because the major part of the harvest was expected to come in, in the early part of 1974. Despite these efforts, statistics show that the extents of land under important crops such as sorghum, soya beans and dhal are yet relatively small and appreciable increases in production could be achieved if a greater extent of land was brought under these crops.

Despite the efforts that have been made to develop the fishing industry the increase in fish production has not been appreciable. The surrounding oceans could virtually provide the country with an inexhaustible supply of high protein foods and this potential awaits to be fully exploited. In 1973 fish production has increased only by 0·9 per cent. The reason given for this poor performance was the lack of spare parts and fishing gear immobilising a large proportion of the mechanised fishing fleet. Even with the increasing investment in modern fishing equipment, imports of dried fish up to this date are now in the region of about Rs. 60 million per annum, while the wet fish catch has not increased appreciably.

Traditionally, the fishing industry has not been so dependent on costly imported equipment that requires a considerable amount of foreign exchange. Furthermore even today the traditional methods seem to bring in the bulk of the total catch. In 1973 fish produced by the private sector was 201 million pounds, and the bulk of this was by traditional methods, while the Fisheries Corporation which uses mainly mechanised methods produced only 5·3 million pounds or 2·1 per cent of the total catch. With population increasing at current rates, it may be increasingly difficult to provide all the food from the land. For one thing, the amount of land available for cultivation of food crops, would tend to diminish with increasing population pressure and in the context where world food supplies are expected to become increasingly critical, the country might have to look to the oceans as a major supplementary source for its requirements of food

Plantation.

Since 1965, when output reached the peak figure of 503 million pounds, tea production has continued to decline steadily; the only break in this trend occurred in 1968. In the earlier years the increase in production was achieved through a substantial rise in new investment and through technological improvements and with only a small increase in the planted area. As a result, Sri Lanka was able to sustain an increasing volume of exports and increase her share in world tea exports. Total production in 1973 was 466 million pounds; a fall of 5 million pounds or by 1·1 per cent. Exports recovered from 419 million pounds in 1972 to 454 million pounds in 1973. In 1972, exports were however at a lower level compared to the figure of 443 million pounds in 1971. Although rupee receipts from tea exports have risen from Rs. 1162 million in 1972 to Rs. 1261 million in 1973, in relatively constant SDR value terms, earnings have fallen from SDR 171·4 million in 1972 to SDR 165·3 million in 1973. The latter has been due to currency realignments in international markets and the depreciation of the Sri Lanka rupee. The drought that affected the hill country in the second successive year was a factor that contributed to the decline in production. Equally important was the increase in the cost of inputs which made substantial inroads into producer margins and weakened the incentive to maintain investment.

The commodity boom which pushed up prices of other beverages like coffee and cocoa and a wide range of commodities traded in international markets did not affect tea. The price of tea has remained virtually static throughout the year. The industry has had the unenviable position of having to absorb costs in the face of already critically low producer margins. To add to this factor, an atmosphere of uncertainty pervaded the tea industry with the implementation of the land reform scheme. As a consequence of this, some estates which traditionally maintained a high level of investment on technological improvement have reduced their level of expenditure. Lower expenditure on maintenance is also reflected in the reduced use of fertilizer. The fertilizer use fell from 118,000 tons in 1971 to 99,000 tons in 1972 and dropped sharply to 63,000 tons in 1973. Since tea yields are highly responsive to fertilizer application the progressive fall in fertilizer use has to be corrected if the industry is to achieve a higher level of output.

Sri Lanka has an export quota of 472 million pounds for 1973/74 (i. e. from 1st April, 1973 to 31st March, 1974) under the agreement reached by the Inter-Governmental Group on Tea. As against this quota, in 1973/74, the production of tea in this same period was only 448 million pounds[1] representing a shortfall of 24 million pounds in terms of the above export quota. The loss of foreign exchange on account of this shortfall amounts to Rs. 66 million at the 1973 f.o.b average price of Rs. 2·77 per pound.

In 1973, the coconut industry too was affected by most of the factors that caused a decline in the level of production in the tea industry. The severe drought in 1972 and the fall in fertilizer application contributed to produce one of the smallest coconut crops in the last two decades. Production fell very sharply from 2963 million nuts in 1972 to 1935 million nuts in 1973, or by 34·7 per cent. The use of fertilizer in the coconut industry fell sharply from 45,723 tons in 1972 to 30,539 tons in 1973. Since the bulk of the coconut properties are individual proprietorships and are not owned by broad based public companies a large extent of coconut land has come under the land reforms. The uncertainties created by the land reform programme resulted in some element of neglect in the larger estates which normally produced the major part of export supplies. Assuming that the 1972 level of production was maintained in 1973 as well, the loss in foreign exchange at 1973 prices from the reduced level of coconut production in 1973 would be Rs. 385 million. This latter figure must be compared with the gross foreign exchange earnings in 1973 of Rs. 487 million from non traditional exports, consisting of Rs. 141 million from gems and Rs. 346 million from other exports[2]. In other words, the loss of foreign exchange earnings from coconut has not even been offset by the gains in foreign exchange earnings from non-traditional exports other than gems.

Coconut prices also reached high levels during the year, but due to shortfalls in production, the industry could not fully take advantage of these high prices. The local market price of copra rose by 64 per cent to reach Rs. 323 per candy and the local market price of coconut oil rose by 79 per cent to reach Rs. 2032 per ton. Despite the recession in the industry, exports of all coconut by-products rose to Rs. 80·4 million which is Rs. 16·9 million above the level last year. In particular, coconut minor products seem to have responded well to the incentives given to the exporters through the Foreign Exchange Entitlement Scheme.

(e) Industry

The very sharp increase in import prices heavily affected the industrial sector as a whole on account of its excessive dependence on imported raw materials. With the increases in the cost of inputs, the resulting increases in the cost of production were passed on to the consumer. This was possible because the bulk of the industrial products do not come under price control. On account

1. The total production of tea from April, 1973 to February, 1974, according to the Tea Controller, was 419 million pounds and the production figure for March, 1974 is estimated to be 29 million pounds, a decline of 7 million pounds over the production figure in the corresponding month of 1973.

2. These exports, particularly manufactured goods have a very high import content, the net foreign exchange earnings are considerably less,

of these price increases, the industrial production figures for private and public sector industry given at current prices in this Report, are actually an overstatement of the real increase in production. In real terms value added increased only very marginally. Several industries, particularly in the metals and chemicals groups, were faced not only with very high raw material prices, but experienced difficulties in getting adequate supplies of raw materials. In some cases, industrialists refrained from placing orders on account of very high prices, because the limited foreign exchange allocations given would have enabled them to procure only a smaller quantity of raw material.

With regard to the public sector industries, the Central Bank continues to have difficulties in obtaining the most recent data from them and this has precluded a comprehensive analysis. The accompanying section on public enteprises shows that several important corporations have not responded to the questionnaire issued by the Central Bank.

Although the industrial corporations have shown an increase in output at current prices, in real terms it was negative; the decline was 2·1 per cent in 1973 as against an increase of 6·3 per cent in 1972. Several important corporations were affected by high import prices and relative scarcities of raw materials. Some had to curtail operations on account of machinery breakdowns and labour disputes. n 1973, as in the previous years, the capacity utilisation in industrial corporations was very low. For instance, the Steel Corporation had utilised only 40 per cent of installed capacity, while Tyre, Hardware, Leather and the Milk Board had very low rates of capacity utilisation. Along with low capacity utilisation there were shortages of goods produced by some of the industrial corporations that worked well below capacity, notable examples were tyres, cement and milk.

The overall performance of the corporations sector shows that as an economic entity it has not yet reached a viable position. In part, this is reflected in a low rate of economic return on the capital invested. Some of the weaknesses in the management, structure and operations of the corporations which have been present from the inception have not yet been corrected. These include excess machine capacity, a surplus workforce, absence of forward planning, deficient management, and excessive outlays on overheads. Despite these, some corporations tend to perpetuate these deficiencies by the continued recruitment of labour when there is a surplus already in the workforce, and by ad hoc management decisions.

In recent years there has been a steady increase in the number of state corporations. In 1973 thirteen new corporations were set up. A question that has to be considered in the context of the trend to set up new corporations to undertake a wide variety of activities is the limited resources currently available in the country. To successfully operate a large number of corporations a wide range of resources in the form of managerial skills, capital, know-how, knowledge of markets and technology are required. There is insufficient evidence that these pre-requisites for the efficient operation of public enterprise are available in adequate proportions.

As many corporations have functioned for more than a decade only an exhaustive review of their methods of operation and economic viability will give an insight into their deficiencies. Knowledge and information about these latter aspects will ultimately help to determine the guidelines for the operations of new corporations that are being set up.

(f) The Balance of Payments and the Exchange Rate

From the foreign exchange standpoint, a true picture of the gains from exports could be obtained only if increased export earnings are given in SDRs which have been relatively more stable than other currencies since 1970. This is relevant because in 1973, more than in other years, in rupee terms there was a substantial increase in foreign exchange earnings. The table below gives Sri Lanka's export volumes and earnings in rupees and SDRs.

TABLE I - 5

Sri Lanka's Export Volumes and Earnings

	Tea			Rubber			3 Major Coconut Products			Total Exports*	
	Vol. Mn. lbs.	Value		Vol. Mn. lbs.	Value		Vol. Mn. Nuts.	Value		Value	
		Rs. Mn.	SDR Mn.		Rs. Mn.	SDR Mn.		Rs. Mn.	SDR Mn.	Rs. Mn.	SDR Mn.
1963 ..	455·9	1140	239·5	209·5	257	54·0	1208	198	41·6	1731	363·7
1964 ..	455·7	1142	239·9	253·2	290	60·9	1681	273	57·4	1876	394·1
1965 ..	494·6	1210	254·2	266·8	304	63·9	1270	275	57·8	1949	409·5
1966 ..	441·3	1027	215·8	298·4	337	70·8	1017	196	41·2	1700	357·1
1967 ..	477·7	1061	222·9	290·9	282	59·2	940	167	35·1	1690	355·0
1968 ..	460·2	1162	195·4	328·3	331	55·6	1096	331	55·6	2035	342·0
1969 ..	444·5	1062	178·5	314·8	431	72·4	896	221	37·1	1916	322·0
1970 ..	459·7	1120	188·2	354·2	440	73·9	874	237	39·8	2033	341·5
1971 ..	443·1	1144	192·2	285·2	307	51·6	1010	276	46·4	1947	327·1
1972 ..	419·3	1162	171·4	285·7	265	39·1	1248	262	38·6	2009	296·3
1973 ..	453·6	1261	165·3	354·4	592	77·6	417	142	18·6	2617	343·0

Source: Ceylon Customs Returns

* Includes re-exports

Exchange Rates — 1950 - 67 : 1 SDR = Rs. 4·76 (Rupee devalued in November, 1967)
1968 - 71 : 1 SDR = Rs. 5·95
1972 : 1 SDR = Rs. 6·78
1973 : 1 SDR = Rs. 7·63

In 1973, in the case of tea, export volume increased by 34·3 million pounds while export earnings fell by SDR 6·1 million. In rupee terms, however, there was an increase of Rs. 99 million. Thus despite an increase in the volume of tea exports, foreign exchange earnings in real terms have actually fallen. Even over the last decade a similar trend is evident. For instance in 1963, Sri Lanka exported 456 million pounds of tea and earned SDR 239·5 million, while in 1973 exports were almost at the same level at 454 million pounds but earnings were only SDR 165·3 million, showing a fall in earnings by 31 per cent. In 1973, earnings from rubber went up by SDR 38·5 million or by nearly 98 per cent, while export volume rose by 24 per cent. Rupee receipts on the other hand have risen by 123 per cent. Of all the major products, rubber is the only commodity that has shown appreciable gains in foreign exchange earnings and this is because prices rose by more than 80 per cent in 1973. When all major exports are considered the effect of the progressive depreciation of the rupee is clearly seen. In 1963, foreign exchange earnings from these exports were SDR 363·7 million or Rs. 1,731 million. In 1973, however, although rupee receipts had risen to Rs. 2,617 the equivalent earnings in real terms were SDR 343 million which is less than the foreign earnings in 1963.

It is a matter of interest that after the devaluation of the rupee in 1967, rupee earning from exports rose from Rs. 1,690 million in 1967 to Rs. 2,035 million in 1968, but in SDR terms, earnings fell from SDR 355·0 million to SDR 342·0 million. Since the object of devaluation is to increase foreign exchange earnings, the devaluation of 1967 should have, in fact, brought in more foreign exchange. The pre-devaluation foreign exchange earnings of SDR 355·0 million have not been reached since then; not even in 1973 when commodity prices were at high levels.

Distortions in the Sri Lanka's export earnings in foreign exchange have arisen from succesive falls in the value of the Sri Lanka rupee in the last few years.[1] Before 1967, the exchange rate of the rupee had been stable for many years. Since then, the structure of exchange rates has undergone constant change and this has affected both import and export prices.

A note worthy development in 1973 has been the significant change in the pattern of exports. For decades, Sri Lanka's export trade had been dominated by the three primary commodities tea, rubber and coconut, which together accounted for more than 90 per cent of export earnings. This heavy commodity concentration of exports made export earnings particularly vulnerable to adverse price trends in international markets. Policies to diversify the export structure failed to show appreciable results until 1973. In 1973, however, the earlier

1. Since 1949 the first change in the exchange rate of the Sri Lanka rupee took place in November 1967, when the rupee was devalued by 20 per cent, following the devalaation of the pound sterling by 14 per cent. The resulting effective devaluation of the rupee was some 7 per cent in terms of sterling. In May 1968, a dual exchange rate system was established with the Foreign Exchange Entitlement Certificate Scheme. The official rate remained unchanged while the FEEC rate was a depreciated rate. The FEEC rate was initially fixed at 44 per cent and the resulting depreciation of the rupee was 31 per cent from the official rate. The price of FEECs was increased from 44 per cent to 55 per cent in July 1969 and further raised to 65 per cent in November 1972. The total depreciation in the certificate market thus amounted to 39 per cent. In November 1971 it was decided to abandon the par value as the basis for setting the official rupee rate and to peg the rupee to the US dollar. This action resulted in the depreciation of the Sri Lanka rupee against the SDR and an appreciation against the pound sterling. With the floating of the pound sterling in June 1972, Sri Lanka broke the link with the US dollar and the rupee was repegged to the pound sterling at Rs. 15·60 = £ 1, which was the rate operative in March 1972. As a result the rupee depreciated in terms of the pound sterling and the US dollar from the November 1967 level. By the end of 1972, as a result of the depreciation of the pound sterling in exchange markets, the value of the rupee fell further Throughout 1973, the rupee pound sterling rate remained unchanged, but with the devaluation of the US dollar in February 1973, the value of the rupee in terms of the dollar appreciated. The appreciation of the rupee was strengthened by the weakening of the US dollar. After August 1973 with the weakening of the pound sterling the value of the rupee started to fall once again

trend for certain non-traditional exports to emerge as major items in the country's export trade took a more concrete form. This was largely due to the sharp increase in gem exports through legal channels. In this respect, the year under review represents a distinct departure from tradition. On an exchange recorded basis, non-traditional exports accounted for 25·6 per cent of total exports in 1973, while the share of traditional exports fell to 74·4 per cent, which is an all time low. Although the latter figure could be partly explained in terms of the exceptionally low earnings from coconut products, nonetheless, total earnings from non-traditional exports have shown definite signs of progress towards diversification.

The success of the new export strategy could be primarily attributed to the positive measures that have been taken to promote exports. The incentives provided by the Convertible Account Scheme have infused dynamism into this sector. The leakage of foreign exchange in the earlier years, was to some extent, due to the inability of exporters, businessmen and others to purchase certain imported goods and to have access to foreign exchange legally for travel and other expenditure. This demand has to some extent been met through the operation of the Convertible Account Scheme and there are indications that the scheme is now being progressively broadened to extend the uses to which foreign exchange may be put. The success of this scheme is also seen in the progressivly increasing number of persons who are entitled to convertible accounts and the amount of money which is in deposit in these accounts.

The data given in various sections of this Report shows that consumption expenditure has gone up in 1973 and this has been only in part due to the increase in prices. In the case of some items such as wheat flour, there has been an appreciable increase in the quantity as well. As import prices have risen faster than export prices, as reflected in the terms of trade, import capacity has virtually stagnated. The latter emphasises the need for an overall strategy to reduce the share of consumption imports, whilst increasing the share of intermediate and capital goods, so as to provide the basic ingredients for development. This is all the more important, as the substitution potential between imported and domestically produced goods is much lower in the case of intermediate and capital goods, than in the case of consumption goods. But the emerging balance of payments situation in 1973 was pushing these prospects even further into the background because the limited resources were largely used to finance consumption imports.[1] It is in this light that the significance of the October 1st measures should be appraised. Although these measures were belated, in principal, they constituted a significant change in overall economic policy. In broad terms, the objective of the October 1st measures was to pass on increased prices of essential commodities to the consumer, while at the same time providing assistance to export sectors, such as the tea industry whose viability had weakened in the last few years. The net effect, once these and subsequent measures take full effect, should be to reduce the drain on food imports and stimulate domestic production.

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	Total food imports (Rs. Mn)	Percentage of total imports
1971	916	46·1
1972	960	46·5
1973	1308	48·2

In the above context, there is a close relationship between import capacity and the management of the foreign assets to the national advantage. Because the available foreign exchange resources are extremely limited, Sri Lanka is not in a position to always carry forward adequate stocks of essential foodstuffs such as rice, flour and sugar. The current policy is to buy these commodities at prevailing prices in quantities sufficient to meet requirements in the immediate future. Purchases in the futures markets hardly take place. In a situation where commodity prices have increased sharply and continue to fluctuate erratically at high levels, the purchasing procedures now adopted could result in an actual loss of foreign exchange if the decisions taken do not always ensure that purchases are made at the lowest prices. To make the best of the prevailing price and market situations, a continuing and thorough study of international markets, prices and their probable future trends may be necessary in order to get the maximum quantum of imports from the available foreign exchange by buying at the lowest prices. It is insufficient to work on certain notional trends in international commodity prices, or to make purchases in the expectation that prices will continue to rise because they have done so before. The management of the country's foreign exchange resources requires an expert knowledge of international markets and ad hoc decisions cannot always be to the best advantage of the country. In the management of the country's foreign exchange resources, the Foreign Exchange Budget Committee could play an important role in making the right decisions.

What has been said above applies equally to the management of the country's bilateral trading accounts. At the end of 1973, there was a balance of Rs. 54·8 million in the Sri Lanka's favour in these accounts. In the present situation where the available foreign exchange resources are very limited and the country has to increasingly resort to short term borrowings to finance its immediate payments, mainly foodstuffs, it is incongruous to permit the balances in Sri Lanka's favour in these accounts to increase. While no interest accrues on these balances, the interest rates at which short term credits have been available in in recent times have been around 8 per cent. The amounts owing to Sri Lanka could be reduced only if endeavours are made to ensure that purchases from these countries are increased rapidly. Apart from the role that Sri Lanka's foreign missions abroad could play in this connection, the closer supervision of these accounts at home could also make a contribution. Looking at the countries that owe Sri Lanka at present, it would appear that there is scope to increase imports which are now critically in short supply. For instance, some of these countries with which Sri Lanka has credit balances could supply Sri Lanka with crude oil, especially now, when the country finds it difficult to get supplies on favourable terms. Certain other Asian countries that have recently entered into bilateral trading arrangements have been able to obtain crude oil on concessionary terms.

The disadvantages of having to finance a substantial share of imports with short term and suppliers' credit facilities need not be overemphasised. It could expose the country to a potential liquidity crisis, should this source of finance suddenly dry up. It involves heavy costs in the form of high interest charges and the non-availability of usual trade discounts and conncessions. What is even more significant is that it restricts the freedom of shopping in the most competitive markets. While Sri Lanka, like most other less developed countries, has been a victim of economic forces beyond its control, there is nonetheless a paramount need to reduce the dependence on short term credits as a first step towards putting the external accounts position in order. The table below gives details of transactions in short term liabilities in 1970-73.

TABLE I-6

Short-term Liabilities (a)

(Rs. Million)

	1970		1971		1972		1973 (b)	
	Rece-ipts	Pay-ments	Rece-ipts	Pay-ments	Rece-ipts	Pay-ments	Rece-ipts	Pay-ments
1. Change in bilateral trade balances ..	—	75	—	57	—	11	1	—
2. Borrowings from foreign banks ..	123	—	—	81	12	—	—	112
3. Short-term credits ..	434	282	658	614	593	570	781	644
4. Suppliers' credits ..	85	80	58	65	53	84	240	95
5. Other (c) ..	31	7	21	14	88	38	36	111
Total ..	673	444	737	831	746	703	1,058	962

(a) Excludes transactions with the I. M. F.

(b) Provisional

(c) Includes changes in special account balances, commercial bank liabilities and China account balance when it was in favour of China.

A current account deficit in the balance of payments implies a shortfall in domestic savings over investment. In fact, it is only through a deficit in the current account that foreign resources are absorbed into the economy to supplement those available domestically. The gap can be covered in several ways. These include an inflow of long term private capital, the inflow of long term official capital, recourse to short term credits, the use of external assets or by increasing banking liabilities. The economic situation facing Sri Lanka dictates that long term capital inflows are the most desirable from of financing deficits. In practice, of course, trends in 1973 have not been in this direction The analysis of the capital account transactions in 1973 focusses attention on a basic weakness in the methods used to finance the current account deficit. Since 1968 heavy reliance has been placed on short and medium term credits as means of financing the external resource gap. Recurring short term indebtedness as shown in the table above has become a permanent mechanism of external financing in Sri Lanka.