ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES - 1976

INTRODUCTION

The rate of growth of Sri Lanka's economy in 1976 was of the same order of magnitude as in the four years immediately preceding. The moderate growth of this period was largely due to the sub-normal performance of the agricultural sector. The outcome of external trade turned out to be favourable for the country, after many years. Export prices continued to improve mainly as a result of the economic recovery of the industrial countries. Unlike in previous years when there was an escalation of import prices, the country's trading position was strengthened by decreases in import prices in 1976. Food imports, mainly consisting of rice, wheat, wheat flour and sugar, experienced substantial price reductions due to increased world production of these commodities. However, the upward trend in the prices of intermediate and investment goods, which reflected the inflationary conditions in the industrial countries, as well as the increase in petroleum prices, continued. Overall movements of export and import prices were such that, for the first time in 15 years, the trend of rapidly declining terms of trade was reversed. This improvement in the terms of trade resulted in a minimal deficit in the merchandise trade. In the fiscal sector there was substantial financing of the budget deficit from expansionary sources of finance. This combined with the increase in net foreign assets resulted in an unprecedented increase in money supply.

In 1976, the Gross National Product at current prices estimated at Rs. 24,081 million increased by 9.8 per cent. In real terms, the increase in GNP was 3.0 per cent. With the increase in population remaining at 1.6 per cent the real product per capita rose by 1.3 per cent. This compares with the growth of the Gross National Product in 1975 of 3.6 per cent and an increase in real product per capita of 2.0 per cent. Capital formation increased by 7.3 per cent while the rate of domestic savings increased from 11.2 per cent in 1975 to 14.2 per cent in 1976.

The moderate economic growth in the last few years has been largely due to the erratic performance of the agricultural sector. Agriculture remains the single largest sector and accounts for about one-third of the Gross National Product. Since a substantial proportion of the services is ancillary to the agricultural sector and the industrial output as computed also includes value added in the processing of agricultural commodities, the real importance of this sector is even larger. Furthermore, the output in agriculture is highly dependent on a few crops notably tea, rubber, coconut and paddy. The first three of these crops account for the major proportion of foreign exchange earnings and consequently their performance is an important determinant of the country's import capacity. In the case of paddy its volume of production has an important bearing on the volume of cereal imports.

Prolonged drought conditions in the coconut growing areas were the primary cause of the nearly 13 per cent drop in coconut production during the year. The low levels of fertilizer application in coconut lands in 1974 and 1975, which had their lagged effects on production in the following year, were partly due to difficulties of fertilizer application under drought conditions and partly to high fertilizer prices. The rainfall figures for 1976 in the main tea growing area were the worst during the last decade. The low and uneven distribution of rainfall combined with the reduced level of fertilizer application were responsible to a considerable extent for the 8.1 per cent decline in tea production. On the other hand, rubber, confined to the Wet Zone, registered a 2.2 per cent increase in 1976. The performance in paddy production, with an increase of 5 million bushels, would have been better but for the adverse weather conditions that prevailed in the Yala season.

Two developments which would have an important impact on agricultural production in the long run were the diversion of the Mahaweli river to the Dry Zone and the conclusion of a contract to set up a urea fertilizer plant. While the former would enhance the country's double-cropped area and reduce crop failures, the latter would produce locally one of the most important agricultural inputs.

As a matter of policy, diversification of exports has been pursued to increase economic resilience. Recent developments in this direction are the increased export earnings from tourism, precious stones, minor agricultural products and some light industrial products. Of an increase of nearly Rs. 900 million in the merchandise exports, almost Rs. 500 million accrued to the non-traditional sector. Foreign exchange earnings from the tourist industry continued to increase and were Rs. 74 million more in 1976 than in 1975.

Heavy dependence of domestic industry on imported raw materials constitutes a burden on the balance of payments. This in turn has kept the capacity utilization in industries below desired levels. Various incentives have been given to stimulate industrial exports and liberal foreign exchange allocations have been granted to industries manufacturing for export. Industrial exports, (including petroleum products) which accounted for 9 per cent of the total value of industrial production in 1975, rose to 12 per cent in 1976.

The terms of trade which declined continuously from 142 in 1962 to 46 in 1975, improved to 62 in 1976. This reversal in trend was the consequence of a number of favourable factors. Industrial countries, which had been under the grip of recession and inflation, increased their production and were able to reduce their rates of inflation. The resulting rise in income levels, in real as well as nominal terms, was favourable for Sri Lanka's exports which are income elastic. Higher demand led to better tea prices. High crude oil prices increased synthetic rubber prices while the recovery of the motor vehicle industry increased the demand for rubber. These factors kept rubber prices buoyant. Tea and rubber price increases were in spite of increased world production of these commodities. Even though Sri Lanka's exports declined in volume, the increased prices helped to obtain substantially higher export earnings. The complementary developments in imports were a higher volume of imports and a lower import bill. The food imports of Sri Lanka, the value of which in 1975 formed 48 per cent of the total import bill, declined substantially to 33 per cent due to lower prices consequent on good harvests in the exporting countries. These developments were responsible for a remarkably small trade deficit of Rs. 105 million and a current account deficit of only Rs. 49.8 million in the balance of payments.

The expansion of the money supply in 1976 was exceptionally large. During the year, the money supply increased by Rs. 1,077 million, an increase of 34.9 per cent compared to an increase of 4.8 per cent in 1975. The principal factors responsible for the expansion were the financial operations of the Government and the increase in net external banking assets. The increase resulting from the former was Rs. 540 million, while the contribution made by the latter was Rs. 470 million.

ECONOMIC GROWTH

Overall Performance

The 1976 Gross National Product at current factor cost prices is provisionally estimated at Rs. 24,087.8 million. This is an increase of 9.8 per cent from the corresponding estimate for 1975. When allowance is made for price increases, the Gross National Product at constant (1959) prices, increased by 3.0 per cent in 1976, compared to 3.6 per cent in 1975.

The provisional estimate of the mid-year (1976) population of Sri Lanka is 13.7 million indicating an increase of 1.6 per cent. The GNP per capita at constant (1959) prices increased by only 1.3 per cent, compared to an increase of 2.0 per cent in 1975. The 1976 GNP per capita in real terms was Rs. 833 compared to Rs. 822 in 1975. The GNP and GNP per capita at constant prices and their annual growth rates for the past decade are given in Table 1.

Owing to the importance of foreign trade in the economy of Sri Lanka, changes in the terms of trade have an important bearing on the real national income. An improvement in the terms of trade increases the quantum of imports which could be obtained with a given quantum of exports and thereby increases the exchange value of the goods and services produced. The real Gross National Product when adjusted for the changes in the terms of trade provides estimates of the real national income.

Since the terms of trade improved by 35 per cent in 1976, the real national income increased by 4.0 per cent while the real national product increased by only 3.0 per cent. The per capita real income increased by 2.4 per cent, although the GNP per capita increased by only 1.3 per cent.

In other words, due to the improvement in the terms of trade in 1976, real national income increased by more than the real national product. Increases in real national income provide a measure of the increase in real resources available through production as well as through international exchange. The improvement in 1976 is in contrast to the position in 1975 when there was a decline in the terms of trade by 20.6 per cent. In that year the real national product increase of 3.6 per cent was reduced to a real national income increase of only 1.7 per cent.