There was an expansion in the output of fabricated metal products, machinery and transport equipment in 1977. Production of a number of items including agricultural implements and motor spares rose appreciably. Exports of machinery and mechanical appliances too rose substantially in 1977.

As against increased production by the above mentioned groups, production of basic metal products and wood and wood products fell in 1977. This was accounted for partly by the decline in output of the Ceylon Steel Corporation and Ceylon Plywoods Corporation in 1977. Capacity utilization and value added in these industries dropped below the levels that prevailed in 1976.

A major constraint to increasing manufacturing output has been the small size of the domestic market. Heavy and continuing protection of local industries, lack of competition from imports and a widespread system of licensing and controls prevented these industries from improving product quality and reaching the levels of efficiency necessary for exporting their products. There were also the well known difficulties of gaining access to international markets. In this respect, the proposals of the 1977 Budget make a radical departure from earlier policies by liberalizing imports, freeing the majority of raw materials from licensing procedures and permitting imports of machinery in consignments not exceeding Rs. 700,000 without prior government approval. Also, export-oriented industries are to be fostered in a freer atmosphere of export processing zones which are to be established under the recently constituted authority – The Greater Colombo Economic Commission. A more dynamic growth in industry is anticipated by these proposals. In sum, 1977 witnessed a fundamental change in industrial policy in the form of a shift from import-substitution industry to export-led industrial development.

PRICES

The Colombo Consumers' Price Index, the only available published indicator of changes in the general price level until recently, showed an increase of 1.2 per cent in 1977, compared to an increase of 1.2 per cent in 1976 and 6.7 per cent in 1975. Serious shortcomings of this index, which have been commented upon in past issues of the Annual Report, have rendered it a very unrealistic measure of price changes.

In order to provide a more realistic indicator of price changes, the Central Bank computed a Wholesale Price Index in 1977 with 1974 as the base year. Although this index does not measure price movements at the retail level, it is more dependable in ascertaining the changes in prices than the Consumer Price Index. In sharp contrast to the estimated 1.2 per cent increase in Consumer Prices in 1977 as indicated by the Consumer Price Index, the Wholesale Price Index showed a rise in prices of 31 per cent in 1977. The corresponding increase in wholesale prices in 1976 was 8 per cent and in 1975, 3 per cent. On the other hand, the Implicit Price Index – which is the ratio of the Gross National Product at current prices to the Gross National Product at constant (1959) prices – indicated a rise in the price level of 16 per cent in 1977, as against 7 per cent in 1976 and 8 per cent in 1975. Of course, it is important to note that the Wholesale Price Index and the Implicit Price Index accord a high weightage to export prices, which rose substantially in 1977. If such indices are used to approximate the level of consumer prices, it will be necessary to discount this upward bias. On the whole, it may not be unreasonable to estimate that consumer prices rose by about 12 to 15 per cent in 1977.

The above estimates of price level changes in 1977 should be evaluated in the context of a 29 per cent increase in money supply, a 23 per cent rise in the Import Price Index in 1977, a 9 per cent rise in money wages and a general increase in interest rates; and the gradual depreciation of the Sri Lanka Rupee since August, 1977 culminating in the floating of the Rupee in November, 1977. Evidently, the immediate short-run effect on prices of the unification of the Rupee exchange rate and the trade liberalisation in November was an upward pressure on prices. This was expected because the accompanying trade liberalisation would take some time to work itself out, in the form of a substantial increase in imports and a reactivization of domestic production capacity. A moderation of prices could thus be only expected in the forthcoming year, when the economy would react more positively to the reforms of late 1977.

The increase in the Wholesale Price Index for 1977 was the result of the increase in the prices of food (42 per cent), textiles and footwear (40 per cent), fuel and light (35 per cent), non-metallic products (25 per cent), alcoholic drinks (7 per cent), paper products (4 per cent), machinery (6 per cent), transport equipment (7 per cent) and miscellaneous items (14 per cent). On the other hand, there was a decline in the prices of chemical products (27 per cent), petroleum products (2 per cent) and metal products (2 per cent).

As a device to regulate the availability of widely used consumer goods, rationing and price controls on a large number of commodities were continued during a greater part of 1977. Pharmaceutical products were the only new items brought under price control during the year. The controlled prices of sugar, wheat flour, bread, kerosene and paint were revised downward while the prices of sheet glass and electrical bulbs were revised upward. However, following the Budget proposals for liberalizing the economy, price controls were removed on November 15, 1977 except in the case of a few products - sugar, wheat flour, bread, gram dhal, coriander, beef, mutton and milk foods.

Partly in the hope of containing the growing inflation, the Government in March, 1977 revalued the Sri Lanka Rupee by about 20 per cent, although the long-term balance of payments prospects did not appear to warrant such a measure. Yet, prices tended to be sticky in a downward direction and administrative pressures were brought to bear on manufacturers to announce a reduction in prices of about 10 per cent. But this exercise proved rather abortive and ended with the decision of the new Government in August to allow the Sri Lanka Rupee to depreciate gradually to reflect its external value.