The main state trading organizations continued to operate in competition with the private sector. Yet, in the trading of certain items like textiles and dried fish which were subject to licensing, these organizations remained a favoured sector. It appeared that the principal role of these organizations was, to assist the government in its attempts to reduce the cost of living, particularly, of the low income groups, and also to stabilize prices of essential commodities.

Government's intentions of further liberalization of trade became apparent when the import of sugar was liberalized. However, no private commercial import of sugar could be expected, as the government declared its intention of stabilizing sugar prices during the year. Also, despite liberalization, sugar continued to remain a commodity subject to price control, which probably deterred prospective private importers from entering the trade. Once the import of a commodity is liberalized, the need for price control of that commodity should not arise.

The Governments' concern for the consumer interests sometimes resulted in certain ad hoc decisions and short term measures being taken which would have discouraged domestic production in the long run. For instance. the import of chicken and its sale at very low prices by the state at one time disrupted market incentives and created much uncertainty in the local poultry industry. Such decisions could adversely affect long term investment.

As a means of stabilizing prices and ensuring regular supplies, "buffer stock schemes" were in operation for a number of commodities such as dried chillies, safety matches, milk foods, dried yeast, corriander, fish etc. Some of these schemes did not appear to have been well worked out. Stocking of dried yeast, for instance, resulted in unsold stocks being piled up in warehouses. In the case of dried chillies, there was no proper co-ordination between the two main organizations, the C.W.E. and the Marketing Department.

There is an urgent need for greater rationality to be brought into state trading policies. In keeping with the overall liberal policy framework, they ought to bring in greater competition and efficiency in the public sector trade, if that sector is to engage in trade in a big way at all. Adequate protection and incentives to local producers should be ensured through an appropriate long-term tariff policy. Frequent revisions of tariffs create uncertainties, and thereby act as constraints to long-term business decision making. Pricing of commodities by the state trading organizations should give more consideration to producer incentives. Buffer stock management would need to be more carefully worked out, both to avoid over stocking, and also not to over-supply the market, especially in the case of locally produced minor foods stuff like chillies; onions and potatoes.

BALANCE OF PAYMENTS [1]

The balance of payments developments in 1979 were largely the outcome of the economic reforms since 1977. Imports were liberalized with a view to raising domestic productivity, and to achieve an export-led economic growth in the long-term. As a result of the immediate increase in demand for imports, arising from increased domestic economic activity, along with a sharp rise in import prices, the

---

1 The trade data used in the balance of payments are actual receipts and payments during the year. They differ from the external trade data given earlier, which reflect the physical movement of exports and imports. The difference is due to the time lag between receipts and payments on one side and the physical movement of goods, on the other.

trade deficit more than doubled from Rs. 2,393 million (SDR 144 million) in 1978 to Rs. 7,288 million (SDR 362 million) in 1979. This larger trade deficit was the primary factor which determined the balance of payments out-turn in the year.

Despite substantial increases in the services account surplus and in net transfers from abroad, the higher trade gap led to an unprecedented current account deficit of Rs. 3,556 million (SDR 177 million) in 1979. Nevertheless, the large scale inflow of long-term capital, drawings from the International Monetary Fund (IMF) and the allocation of Special Drawing Rights (SDRs) enabled Sri Lanka not only to bridge the deficit, but also generate a small overall surplus of Rs. 793 million (SDR 35 million) in 1979. This resulted in an increase in the gross external assets at the end of the year by 28 per cent to Rs. 9,652 million (SDR 475 million), which was adequate to finance about 3½ months' imports projected for 1980.

In 1979, import payments increased sharply by 37 per cent, to Rs. 22,570 million (SDR 1,121 million), as compared with 30 per cent in the preceding year. As in 1978, the increase in import payments was mostly in respect of intermediate and investment goods. Importation of investment goods, such as machinery and equipment, transport equipment and building materials, increased considerably, to meet the domestic demand created by new investments. The increase in the import bill on intermediate goods was largely attributable to higher prices for petroleum imports and larger import volume of other intermediate goods. The demand for investment and intermediate goods imports is likely to gather momentum in the years ahead. Therefore, a sharp expansion in exports would be necessary to sustain the development effort in the future.

Export earnings, in SDR terms, increased moderately by 12 per cent from Rs. 13,207 million (SDR 675 million) in 1978 to Rs. 15,282 million (SDR 759 million) in 1979. This slow growth was mainly due to the disappointing performance by the traditional export crops. There was, however, a big increase in non-traditional exports such as garments, textiles and petroleum products, but these products have a high import content, and hence, the net earning of foreign exchange is rather limited. Therefore, Sri Lanka will have to continue to depend on the traditional export crops as a major source of foreign exchange for some time ahead.

In contrast to the performance in the previous year, the surplus in the services account rose sharply from Rs. 119 million (SDR 6 million) in 1978 to Rs. 739 million (SDR 37 million) in 1979. As observed in the recent years, tourism has emerged as a major source of the surplus generated in this account. Gross earnings from tourism increased by 40 per cent from Rs. 750 million (SDR 38 million) in 1978 to Rs. 1,053 million (SDR 53 million) in 1979, partly on account of a 30 per cent increase in the number of tourist arrivals. Payments on travel abroad increased marginally to Rs. 458 million (SDR 23 million) in 1979 as compared to a steep rise in the previous year. Increases in interest earnings on foreign investments and earnings from port services also contributed to the surplus in the services account. With the growth of external assets, interest earnings on the investment of such assets in foreign money markets nearly doubled from Rs. 314 million (SDR 16 million) in 1978 to Rs. 614 million (SDR 30 million) in 1979. On the other hand, interest payments on foreign borrowings rose from Rs. 458 million (SDR 25 million) to Rs. 756 million (SDR 37 million), or by 48 per cent.

Another noteworthy development in 1979 was the very sharp increase in net transfers to Sri Lanka . The amount of such transfers more than doubled from Rs. 1,242 million (SDR 63 million) in 1978 to Rs. 2,993 million (SDR 148 million)

TABLE 1.21

Balance of Payments — Analytic Presentation from 1975 - 1979

Items	Rs. Million					SDR Million				
	1975	1976	1977	1978	1979*	1975	1976	1977	1978	1979*
1. Merchandise	-1,421	- 709	+ 350	- 2,393	- 7,288	- 168	- 73	+ 29	- 144	- 362
Exports (f.o.b.)	3,913	4,707	6,640	13,207	15,282	464	484	651	675	759
Imports (c.i.f.)	-5,334	-5,416	-6,290	-15,600	-22,570	- 632	- 557	- 622	- 819	-1,121
2. Services	+ 89	+ 112	+ 304	+ 119	+ 739	+ 11	+ 12	+ 29	+ 6	+ 37
Receipts	565	643	923	1,942	2,992	67	66	89	99	149
Payments	476	531	619	1,823	2,253	56	54	60	93	112
3. Goods & Services (1+2)	-1,332	- 597	+ 654	- 2,274	- 6,549	- 157	- 61	+ 58	- 138	- 325
4. Transfers	560	547	612	1,242	2,993	66	56	59	63	148
Private	19	56	122	342	754	2	6	12	17	37
Official	541	491	490	900	2,239	64	50	47	46	111
5. Current Account Balance	- 772	- 50	+ 1,266	- 1,032	- 3,556	- 91	- 5	+ 117	- 75	- 177
6. Non-Monetary Capital	404	591	326	2,600	3,306	48	61	32	133	164
Private sector	- 32	- 109	- 127	145	874	- 4	- 11	- 12	8	43
Public sector	436	700	453	2,455	2,432	52	72	44	125	121
Long-Term (Net)	560	659	602	2,609	2,432	67	68	58	133	121
Receipts	(1,254)	(1,244)	(1,319)	(3,680)	(3,351)	(149)	(128)	(127)	(188)	(167)
Amortization	(- 694)	(- 585)	(- 717)	(-1,071)	(- 919)	(- 82)	(- 60)	(- 69)	(- 55)	(- 46)
Short-Term (Net)	- 124	41	- 149	- 154	—	- 15	4	- 14	- 8	—
7. Valuation adjustments	—	—	1,680	344	- 18	—	—	—	—	—
8. Errors and Omissions	- 32	- 10	+ 41	- 50	+ 820	- 8	- 7	4	7	36
9. SDR Allocation	—	—	—	—	241	—	—	—	—	12
10. Overall Balance	- 400	531	3,313	1,861	793	- 51	49	153	65	35
11. Monetary Movements (-Surplus) ..	+ 400	- 531	-3,313	- 1,861	- 793	+ 51	- 49	- 153	- 65	- 35+
Rate of Conversion-SL Rs./SDR (Annual Average) ..	—	—	—	—	—	8.44	9.73	10.42	19.58	20.13

Source: Central Bank of Ceylon.

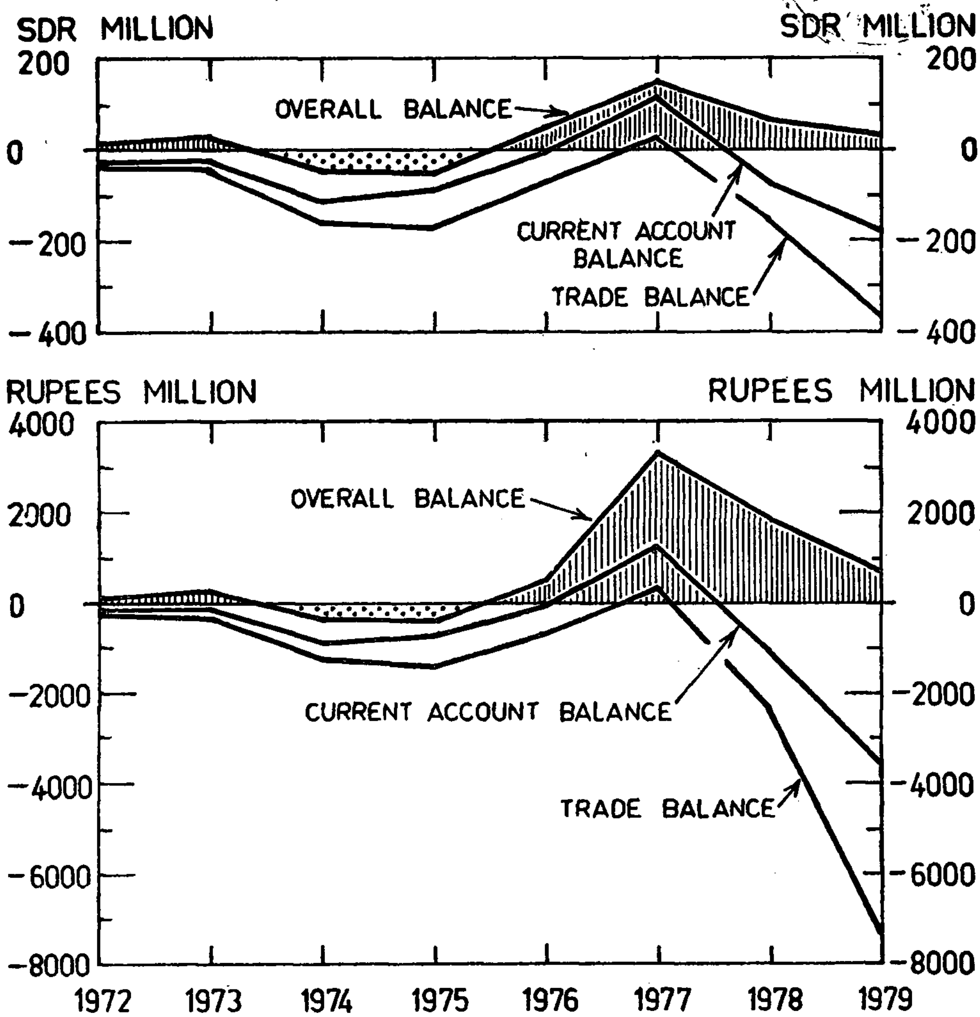
* Provisional

Note: 1. The table on Balance of Payments in previous reports is replaced by this analytic presentation which covers the period from 1975.

2. Rates of conversion for all transactions "above the line" are converted at annual average rates. Monetary movements are converted at end of period rates. From 1977 onwards all conversions of service sector and non-monetary sector transactions represent the sum of conversion for the four quarters, and may not coincide with the conversions at average annual rates.

BALANCE OF PAYMENTS

ANNUALLY

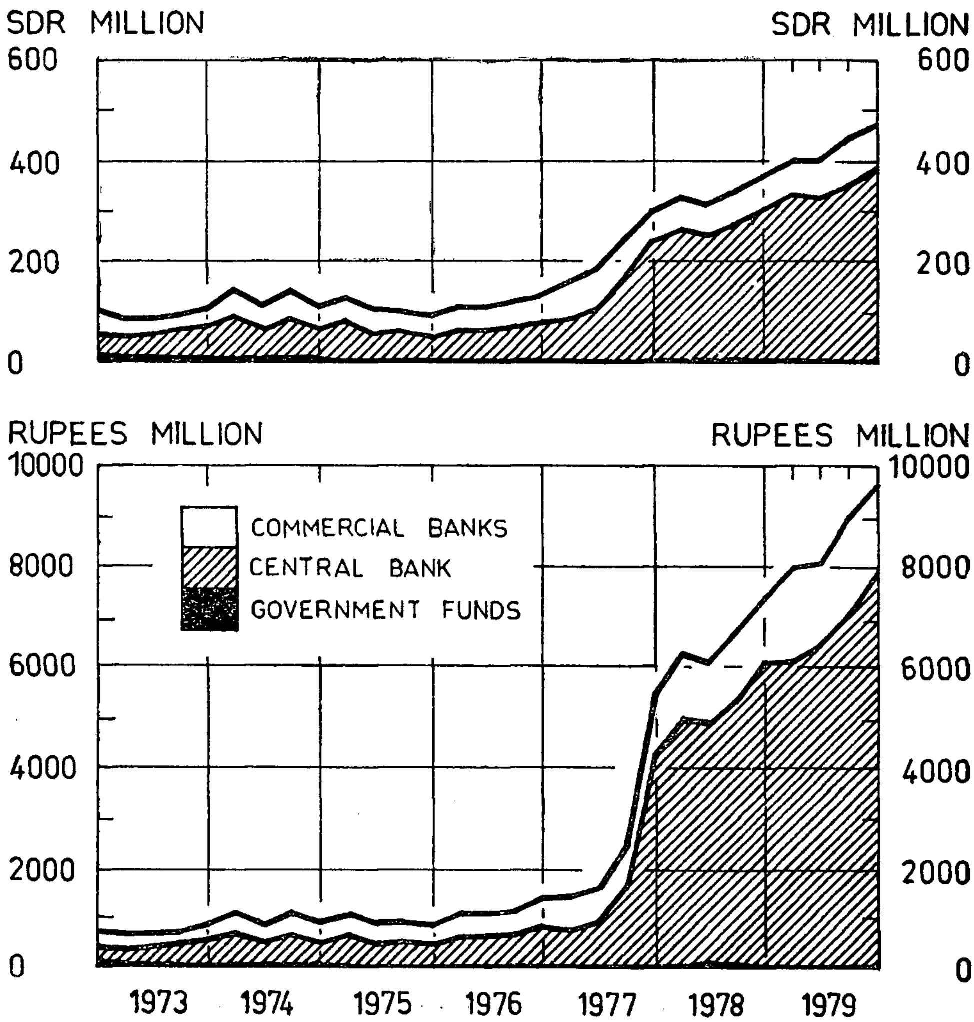


Dept. of Economic Research

Source: Central Bank of Ceylon.

EXTERNAL ASSETS

QUARTERLY



Dept. of Economic Research

Source: Central Bank of Ceylon

in 1979, owing to a rise in both official and private transfers. The bulk of the private transfers comprised inward remittances made by Sri Lankans working abroad. Such transfers have been estimated to have increased by 48 per cent from Rs. 610 million (SDR 31 million) in the previous year to Rs 935 million (SDR 46 million). It could be estimated that approximately 70 per cent of these inward remittances were received from the Sri Lankans employed in the Middle Eastern countries. Official transfers, consisting largely of project and commodity grants from foreign governments and international organisations, more than doubled from Rs. 900 million (SDR 46 million) in 1978, to Rs. 2,239 million (SDR 111 million) in 1979.

The utilization of foreign resources is presented in Table 1-22. In SDR terms, total foreign payments (uses) rose by 28 per cent, whereas foreign earnings (sources) increased only by 18 per cent, resulting in a widening of the external resource gap from Rs. 4,048 million (SDR 230 million) in 1978 to Rs. 7,554 million (SDR 376 million) in 1979. As pointed out before, the high level of import payments was the major source of the widening resource gap. Capital repayments, which accounted for a large proportion of the total payments prior to 1977, declined further in 1979, reflecting some important changes in the modes of financing of the external resource gap in recent years.

Since 1977, outright grants, long-term official borrowings, private direct investments and the drawings from the IMF have become more important in financing of the resource gap than short-term credits and bank borrowings. Long-term loans consisted of commodity aid of Rs. 1,464 million (SDR 72 million), project aid of Rs. 840 million (SDR 42 million) and a loan of Rs. 599 million (SDR 30 million) from the Trust Fund of the IMF. Although the disbursements of long-term official loans have declined from Rs. 3,680 million (SDR 188 million) in 1978 to Rs. 2,903 million (SDR 144 million) in 1979, this decline was more than offset by the substantial increase in outright grants. Thus, the relative importance of outright grants in financing the external resource gap has increased considerably. These included commodity grants of Rs. 1,167 million (SDR 58 million), project grants of Rs. 998 million (SDR 49 million) and profits distributed by the IMF under it's gold sales programme of Rs. 74 million (SDR 4 million). Suppliers' credits which dipped sharply in 1978, rose substantially to Rs. 609 million (SDR 31 million) in 1979.

The other striking feature in the non-monetary capital movements was the considerable increase in the net inflow of private foreign capital, largely as investments in the Industrial Promotion Zone of the GCEC. Private direct investments rose from Rs. 23 million (SDR 1 million) in 1978 to Rs. 769 million (SDR 38 million) in 1979.

Drawings from the IMF have also increased very sharply since 1977. The IMF provided Rs. 1,592 million (SDR 80 million) in two equal instalments in 1979 under the Extended Fund Facility (EFF). The EFF arrangement for Sri Lanka was approved in January, 1979 permitting Sri Lanka to borrow up to SDR 260.3 million (Rs. 5,206 million, approximately) during the three years from 1979 to 1981 for the purpose of providing medium-term balance of payments assistance needed to effect structural adjustments in the economy, subject to periodic negotiation and mutual agreement on Sri Lanka's overall economic policies. In addition, the IMF allocated SDR 12.4 million (Rs. 241 million) to Sri Lanka in January, 1979. This was the first SDR allocation made under a resolution adopted by the IMF in December, 1978 which provided for a total allocation of about SDR 4 billion to all the participants in the SDR Department of the IMF in each of the three years 1979, 1980 and 1981.

TABLE 1.22

Financing of the External Resource Gap - 1977-1979

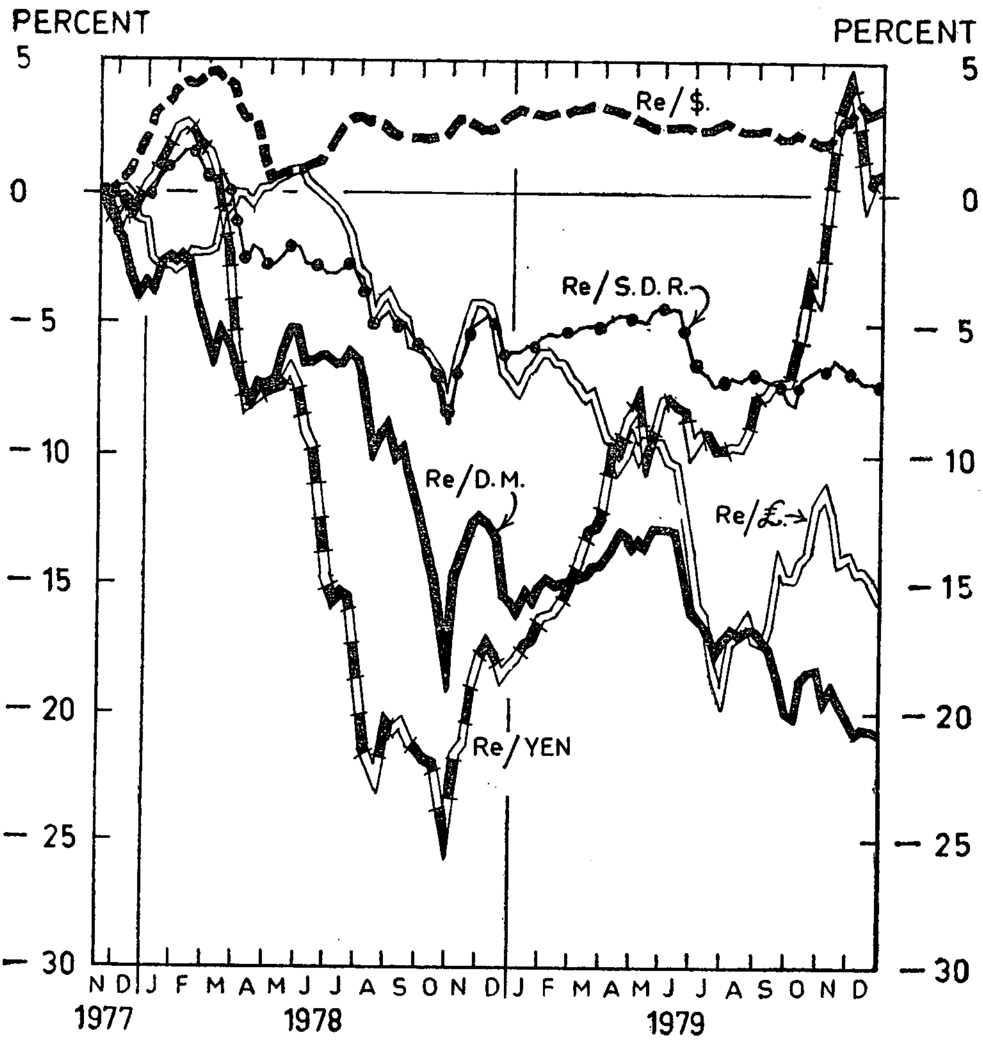
Category	Rupees Million 1977	Rupees Million 1978	Rupees Million 1979	SDR Million 1977	SDR Million 1978	SDR Million 1979
1. Foreign Earnings	**7,753**	**15,759**	**19,210**	**758**	**805**	**954**
1.1 Exports	6,640	13,207	15,282	651	675	759
1.2 Services	923	1,942	2,993	89	99	149
1.3 Private transfers	190	610	935	18	31	46
2. Foreign Payments	**8,613**	**19,807**	**26,764**	**845**	**1,035**	**1,330**
2.1 Imports	6,290	15,600	22,570	622	819	1,121
2.2 Services	620	1,823	2,253	60	93	112
2.3 Private transfers	67	268	181	6	14	9
2.4 Capital repayments ..	1,636	2,116	1,760	157	109	88
3. External Resource Gap ..	**— 860**	**—4,048**	**—7,554**	**—87**	**—230**	**— 376**
4. Financing of the Resource Gap	**+ 860**	**+4,048**	**+7,554**	+87	+230	**+ 376**
4.1 Long-term loans (*a*) ..	1,184	3,680	2,903	114	188	144
4.2 Grants	490	900	2,239	47	46	111
4.3 Suppliers' credits	135	8	609	13	—	31
4.4 Short-term credits	225	114	41	22	6	2
4.5 Bank borrowings	222	—	—	—	—	—
4.6 Bilateral balances	—	—	413	—	—	20
4.7 IMF Drawings	935	756	1,592	55	38	80
4.8 Direct investment	4	23	769	—	1	38
4.9 External assets	—4,171	—1,904	—2,175	—169	— 65	— 104
4.10 SDR allocation	—	—	241	—	—	12
4.11 Other	115	177	120	11	9	6
5. Valuation Adjustment(*b*).. ..	**1,680**	**344**	**— 18**	—	—	—
6. Errors and Omissions	**+ 41**	**— 50**	**+ 820**	**— 6**	**+ 7**	**+ 36**

Source: Central Bank of Ceylon.

(*a*) Consists of project aid, commodity aid and Trust Fund drawings.
(*b*) Estimated increased value of external assets consequent on the changes in the exchange rate.

EXCHANGE RATES

CUMULATIVE PERCENTAGE CHANGES
FROM NOVEMBER 16, 1977



Dept. of Economic Research

Source: Central Bank of Ceylon.

The inflow of long-term official loans, drawings from the IMF, private direct investments and the allocation of SDRs generated a surplus in the capital account. This surplus was more than sufficient to finance the current account deficit and the external resource gap and, therefore, additional resources spilled over to external assets.

The considerable improvement in Sri Lanka's external assets during the last 4 years has strengthened the country's credit worthiness in international capital markets. In June, the government negotiated an eight year US $ 50 million (Rs. 781 million) Eurodollar loan on attractive terms of 7/8 of one per cent per annum over LIBOR (London Inter-bank Offered Rate) during the first 4 years, and at 1 per cent over LIBOR, thereafter. However, as the country's asset position was strong, this loan was not drawn during 1979.

The changing pattern of the modes of financing of the external resource gap in recent years is partly responsible for the decline in the debt service ratio (i.e. capital repayments and interest on foreign loans including IMF transactions and bank borrowings, as a percentage of earnings from merchandise exports and services) from 15 per cent in 1978 to 13 per cent in 1979. Excluding IMF transactions, the debt service ratio fell from 12 per cent in 1978 to 8 per cent in 1979. The actual debt service payments declined by 16 per cent from Rs. 1,862 million (SDR 95 million) in 1978 to Rs. 1,620 million (SDR 80 million) in 1979, owing to the changes in the maturity structure of the debt contracted in the recent past. The easing in debt service burden is explained partly by the increase in earnings from exports and services in 1979 and partly by the more favourable terms on which recent borrowings have been made. For instance, about 70 per cent of the total number of long-term loans amounting to 74 per cent of the total value contracted in 1979, carried a grace period of 10 years or more. The outstanding level of external debt rose from Rs. 17,506 million (SDR 865 million) at the end of 1978 to Rs. 18,447 million (SDR 906 million) at the end of 1979, as a result of a higher utilization of project and commodity loans, and drawings from the IMF under the EFF and the Trust Fund.

The cumulative changes of exchange rates since 16th November, 1977 when the Sri Lanka Rupee was allowed to float, showed that by the end of 1979, the Rupee appreciated by 4 per cent against the U.S. Dollar and 1 per cent against the Japanese Yen. On the other hand, the Rupee depreciated by 16 per cent against the Pound Sterling, 21 per cent against the Deutsche Mark and 7 per cent against the SDR.

GOVERNMENT FISCAL OPERATIONS

The provisional data of government revenue and expenditure in 1979 revealed a current account surplus of Rs. 200 million, in sharp contrast to the original budgeted surplus of Rs. 895 million. The deterioration of the current account has been largely on account of increase in the recurrent expenditure and a heavy underestimation of payments under advance accounts. Provsional capital expendiure, including sinking fund contributions and repayments, amounted to Rs. 8,991 million, and with a current account surplus of Rs. 200 million, the overall budget deficit was Rs. 8,791 million. This was financed to a great extent from domestic resources amounting to Rs. 4,589 million, and a sum of Rs. 4,229 million obtained from foreign sources. The final expansionary impact of the government fiscal operations was Rs. 634 million.

The total government expenditure in 1979 was Rs. 21,521 million, when compared with the preceding year's total expenditure of Rs. 18,853 million, showing a 14 per cent increase. Recurrent expenditure, including expenditure under