PART 1

WEIGHTS AND MEASURES

Conversion Factors

British to Metric Units

1 acre	=	0.405 hectares (ha)
1 pound (lb)	=	0.454 kilogrammes (kgs)
1 long ton (2240 lbs)	=	1.016 metric tons (mt. ton)
1 hundred weight (cwt)	=	50.802 kgs.
1 mile	=	1.609 kilometres (kms)
1 long ton mile	=	1.635 mt. ton kms
1 lb/acre	=	1.121 kgs./ha
1 cwt/acre	=	125.536 kgs./ha
1 pint	=	0.75 litres
1 imperial gallon	=	4.55 litres

Metric to British Units

1 hectare	=	2.471 acres
1 kilogramme	=	2.205 lbs
1 mt. ton (1000 kgs.)	=	0.984 long ton
1 metre	=	3.281 feet
1 kilometre	=	0.621 mile
1 mt. ton kilometre	=	0.612 long ton mile
1 litre	=	1.76 pints=0.219 imp. gallons
1 kg/ha	=	0.892 lb/acre

Paddy/Rice Conversions

1 bushel of paddy (46 lbs)	=	20.87 kgs.
1 mt. ton paddy	=	47.92 bushels paddy
	=	0.7 mt. ton rice
1 mt. ton rice	=	68.46 bushels paddy
	=	1.43 mt. ton paddy
1 bushel paddy/acre	=	51.55 kgs. paddy/ha

ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES IN 1983

INTRODUCTION

In 1983 real Gross Domestic Product (GDP) in Sri Lanka is estimated to have increased by 4.9 per cent.* This compares with a real growth rate of 5.1 per cent recorded for 1982. When account is taken of Net Factor Income the Gross National Product (GNP) at constant (1982) Factor Cost Prices showed a growth rate of only 4.1 per cent in 1983. This notable difference between the growth rate of GDP on the one hand and the GNP on the other once again draws attention to the size of the net outflow of factor income. The previous occasion when the GNP growth rate was similarly affected was in 1981 although in that year real growth of the GDP itself was nearly one percentage point higher than in 1983. The increase in outflow of net factor income abroad was more in respect of interest payments on foreign loan capital than on account of repatriation of dividends and profits accruing to private foreign capital.

Gross National Product in 1983 at current factor cost prices is estimated at Rs. 109,009 million and at Rs. 94,037 million at constant (1982) factor cost prices. The implicit change in the GNP deflator in 1983 is estimated at 16 per cent. This is a marked increase over the 10.2 per cent average change in prices registered for 1982. According to tentative estimates made by the Registrar General's Department, Sri Lanka's population rose by 1.5 per cent. When allowance is made for this increase in the population, real per capita income increased by 2.5 per cent as against the increase of 3.3 per cent in 1982. This drop was influenced to a much larger degree by the increased outflow of net factor income during the course of 1983. Per capita GNP at current prices was Rs. 7,071 or U.S. $ 301.

An analysis of the sectoral composition of the GDP in 1983 indicates that the real growth rate of 4.9 per cent was sustained mainly by the increase in value added in the agricultural sector, which includes forestry and fishing. The 1983 growth rate of 5.1 per cent in this sector was double that recorded for the previous year. The services sector, whose growth rates over the last five years consistently exceeded that of the growth rate of the GDP as a whole, once again maintained a relatively high growth tempo averaging 6.6 per cent. However, the other two major sectors, manufacturing and construction performed poorly. The manufacturing sector grew by less than one per cent and the construction sector by one per cent.

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* The growth rate is based on a New Series of National Accounts with 1982 as the base year. The selection of 1982 as the base year was influenced by two main considerations. First, the structural changes in the economy flowing from the radical changes in economic and financial policies adopted in 1977 had stabilised by 1982. Secondly, by 1982 a more upto date and qualitatively superior primary data base was available for certain production estimates, eg. the results of the Central Bank Survey of Consumer Finances and Socio Economic Conditions, 1981/82.

TABLE 1.1

National Income Statistics 1980—1983

Item	Amount (Rs. Mn.) 1980 (a)	1981 (a)	1982 (a)	1983 (a)	Growth Rate % 1980	1981	1982	1983
1. G.D.P. at Current Factor Cost Prices	62,246	79,337	91,643	111,335	25·0	27·5	15·5	21·5
2. G.D.P. at Constant (1970) Factor Cost Prices	19,575	20,706	21,756	22,824	5·8	5·8	5·1	4·9
3. G.N.P. at Current Factor Cost Prices	61,814	77,469	89,609	108,171	24·8	25·3	15·7	20·7
4. G.N.P. at Constant (1970) Factor Cost Prices	19,456	20,216	21,229	22,076	5·6	3·9	5·0	4·0
5. G.D.P. at Current Factor Cost Prices (New Series)			92,398	112,173				21·4
6. G.D.P. at Constant (1982) Factor Cost Prices (New Series) ..			92,398	96,926				4·9
7. G.N.P. at Current Factor Cost Prices (New Series)			90,364	109,009				20·6
8. G.N.P. at Constant (1982) Factor Cost Prices (New Series) ..			90,364	94,037				4·1
9. Mid Year Population ('000)	14,685	14,935	15,189	15,416	1·7	1·7	1·7	1·5
10. G.N.P. per capita (Old Series)								
i. At Current Prices	4,194	5,187	5,900	7,017	22·5	23·7	13·7	18·9
ii. At Constant (1970) Prices	1,320	1,353	1,398	1,432	3·6	2·5	3·3	2·4
11. G.N.P. per capita (New Series)								
i. At Current Prices			5,949	7,071				18·9
ii. At Constant (1982) Prices			5,949	6,100				2·5

(a) Provisional

Source: Central Bank of Ceylon.

TABLE 1.2

Composition and Growth of GNP 1982 - 1983 at (1982) Constant Factor Cost Prices

Sector	Amount (Rs. Mn.)		Growth Rate
	1982 (a)	1983 (a)	1983 (a)
1. Agriculture, Forestry & Fishing of which:	24,964	26,237	5·1
1·1 Tea	2,418	2,309	−4·5
1·2 Rubber	770	833	8·2
1·3 Coconut	3,263	2,995	−8·2
1·4 Paddy	5,484	6,290	14·7
1·5 Other (including subsidiary food crops, forestry & fishing)	13,029	13,810	6·0
2. Mining & Quarrying	2,238	2,413	7·8
3. Manufacturing	13,601	13,710	0·8
3·1 Tree Crop Processing	2,846	2,715	−4·6
3·2 Other	10,755	10,995	2·2
4. Construction	7,959	8,039	1·0
5. Services	43,636	46,527	6·6
6. G. D. P.	92,398	96,926	4·9
7. Net Factor Income from Abroad	−2,034	−2,889	—
8. G. N. P.	90,364	94,037	4·1

(a) Provisional

Source : Central Bank of Ceylon.

Within the various sectors there were wide disparities in the performance of sub-sectors. The increase in value added in paddy growing by 14.7 per cent is the highest recorded for any single year. Whilst rubber showed a growth of 8.2 per cent, the decline in tea and coconut output caused by adverse weather conditions had a very unfavourable impact on the growth rate. The rise in the growth rate of the subsidiary food crops above the GDP growth rate has been consistently maintained over the past few years. In the case of the manufacturing sector, the low growth rate of one per cent in 1983 was due to the decline in output of tea and coconut. Factory industry and small industry however showed a 2.2 per cent growth as against a nine per cent growth for the previous year.

In contrast to negative growth rates in the previous two years, the construction sector increased its value added contribution to the GDP by one per cent over that for 1982. This was primarily the outcome of a high level of expenditure in the Accelerated Mahaweli Scheme. The completion of the headworks in the Maduru Oya Project, rapid construction of the Victoria Dam with a view to its completion in early 1984 and commencement of work in the Randenigala Project provided a major impetus to construction activity. Private sector activity in house construction, however, declined for the third consecutive year.* In the services sector, while the level and composition of imports continued to be an important factor in inducing higher activity in wholesale and retail trade and in transport, the disturbances in July provided a check to growth. It is however, tourism and its ancillary services sub sectors which can be singled out as having been the most severely affected by the July disturbances. The decline in tourist traffic by 17 per cent caused a negative growth rate in 1983 whereas in the previous year the value added increased by seven per cent.

Tea production in 1983 at 179 million kgs. was the lowest recorded since 1956. Unprecedented drought conditions that prevailed in the first half of 1983 and significantly reduced application of fertilizer during the drought period caused a drop in the output of tea. The decline in production was reflected in reduced average yields per hectare. The coconut sub sector suffered even more due to adverse weather conditions. Compared with a decline in tea output by 4.5 per cent, coconut production declined by 8.2 per cent. As the weightage of coconut is as important as tea and rubber combined, the fall in output of coconut is identified as an important factor affecting the sectoral growth rate.

Given the widespread prevalence of the drought, the significant growth rates for rubber, paddy and subsidiary food crops output are noteworthy. In the case of rubber the growth of eight per cent has occurred after a long period of decline. The subsidiary food crop sector had a growth rate comparable with its historical average, while in the case of paddy the growth of 14.7 per cent was the highest recorded in any year.

The increased output of rubber came from the private sector holdings which comprised three quarters of the area under tapping. Considerably better prices during 1983 are perceived as having induced intensive tapping. This is evidenced by the improvement in the average yield. Although such practices could reduce the productive lifespan of trees, the increased use of fertilizer observed in this sector could mitigate the long term adverse consequences of intensive tapping. The output of paddy, governed principally by the Maha harvest, was not affected by the drought as cultivation activities occurred in the closing stages of the previous year. However, drought conditions and low water levels in the major tanks caused the acreage under cultivation to be reduced and for the Yala harvest to decline in consequence by 13 per cent over 1982. Though adverse to paddy cultivation, this situation encouraged farmers to bring under alternative crops lands previously cultivated in paddy as subsidiary food crops cultivation requires much less water than paddy. Hence, the notable increase in subsidiary food crops production.

In the case of sugar, even with a tremendous local market potential, price incentives and a tariff policy aimed at maintaining producer incentives, production dropped yet again. The decrease of six per cent in 1983 follows a decrease of four per cent in the previous year. Though egg production increased by nine per cent,

* This is based on data on permits issued by local authorities.

neither milk production nor fisheries, both of which enjoyed government producer subsidies and attractive market prices, could make any noteworthy contribution in 1983.

Excluding tree crop processing, output in manufacturing industry increased by only two per cent in 1983. The drop, when compared with 1982 (nine per cent) is substantial. The industrial sector had to face several difficulties on account of developments outside their control. Protective tariff and non tariff barriers in markets abroad, especially in industrial countries, continued to inhibit growth of such industries as garments and leather products, in the production of which Sri Lanka has a comparative advantage vis-a-vis industrial countries. Ethnic disturbances in July took its toll on industry, directly on account of a number of industrial units especially in garments/textiles being destroyed or damaged and, indirectly, through the effect of shorter working hours during July/August on production. The third reason was the islandwide power shortage as a result of the drought induced decline in hydro power generation. Despite the unfavourable environment and events in 1983, private sector industry recorded a commendable increase in real growth by 26 per cent. This is an improvement even over the 1982 growth rate of 18 per cent.

Public sector production, which accounts for about 60 per cent of the total industrial output, however declined in real terms by 15 per cent. This is in contrast to the five per cent growth in 1982. A factor worthy of note in developments in the state industrial sector over the past few years has been the decisive influence of the operations of the Petroleum Refinery on overall industrial output. In 1983, a prolonged shut-down largely explains the 15 per cent decline. Excluding this the decline was seven per cent. In the previous year an uninterrupted operation of the refinery accounted for two-thirds of the increase. In fact, some of the industries in the state industrial sector showed stagnation and were seemingly lacking in a growth potential. The suspension of operations of certain large unviable state sector projects such as Nylon Six Project and the Urea Plant during 1983 were thus inevitable.

Industrial exports have made steady progress. From a share of one-seventh in 1978, industrial exports in 1983 accounted for a third of total exports. Although its contribution to the economy in general and balance of payments in particular seems appreciable, the concentration of such exports in petroleum by-products and made-up garments has implications for policy. The expansion of petroleum exports is limited to the refinery capacity net of domestic needs. These petroleum exports are not the outcome either of Sri Lanka's comparative cost advantage or of exploration of overseas market opportunities. Exports of made-up garments are likely to continue to be affected by protectionist policies abroad. If continued growth in these areas is constrained, future growth would depend very much on a more diversified development of industrial exports.

Steady growth in the longer term therefore, will be greatly facilitated by industrial growth on a more diversified basis taking into account the maximum contribution to Sri Lanka on the basis of value added. The increasing involvement of foreign enterprise in Sri Lankan industry through the auspices of the Foreign Investment Advisory Committee (FIAC) and the Greater Colombo Economic Commission (GCEC) therefore provides an opportunity for Sri Lankan industrial products to penetrate into foreign markets with the initiative and support of foreign collaborating firms.

The relative degree of price stability that was achieved in 1982, after the high price levels obtaining in 1980/81, continued well into the first half of 1983. The decelerating price tendencies in industrial countries had a moderating influence on the price situation in Sri Lanka. Moreover, oil prices which for nearly ten years played a major role in international price developments, actually declined in 1983. Yet, in Sri Lanka, by the middle of the year prices started climbing until by December, on a point to point basis the Colombo Consumers' Cost of Living Index was observed to have increased by 21 per cent. The average rate of price increase for the year as a whole was 14 per cent. This compares with 10.8 per cent for 1982.

Many factors were instrumental in bringing about this price situation. Most items in the food basket, which has a weight of 67 per cent in the Index, went up in price. Notable items were tea, as a direct result of the upsurge in export prices, and coconut, reflecting the deep inroads of a prolonged drought into production. Flour/ bread, bus fares and kerosene, the only remaining items in the " administered prices " category whose prices were out of line with costs were revised upwards by substantial amounts. The depreciation of the exchange rate resulting from world exchange rate movements and maintenance of a real effective rate was another reason for these changes. A further factor was the higher rates and increased coverage of Turnover Taxes prescribed by the March budget. Finally, a rapid expansion of credit to the private sector and the co-operative sector in the latter half of the year to meet extra credit needs of rehabilitation after ethnic disturbances and the increased recourse to bridging finance for export and trade financing helped accelerate the rising trend of prices as the year drew to a close.

The acceleration in the rate of increase in prices and the slower rate of increase in nominal wages set narrow limits for movements in real wage rates. Money wages, when deflated by the Colombo Consumer's Price Index to estimate real wages, have moved up slightly as far as the Government sector (including school teachers) is concerned. Money wages in the organised private sector increased seven per cent compared to the 16 per cent for 1982. In contrast, the unorganised private sector appears to have made significant gains. This is particularly true of paddy and rubber growing where nominal wages have increased 18-19 per cent. Besides this observed fact, an assessment of the real wage situation here should also take into account the fact that the Colombo Consumer's Price Index does not have the same relevance to rural and estate labour as it has for Colombo working classes. Another characteristic of note in wage developments in the unorganised sector is that female wage rates in cultivation activities increased by a larger proportion than male wage rates.

The employment situation in the Government, semi-government and organised private sector was one of stability with no appreciable gains in any one of these sectors which are the ones covered by systematic data collection. The restraint on government expenditure, particularly capital expenditures, the continuation of the policy of not admitting new projects into investment plans were deciding factors in narrowing down new employment opportunities in the government sector. The semi-government sector (corporations etc.), under the imperatives of economic realities and financial discipline evidenced several instances of actual retrenchment. Increased employment in other corporations was barely adequate to compensate for retrenchment. It is only in the case of enterprises based on *foreign collaboration*, namely the GCEC and FIAC projects, that some new employment creation is evident.

An indicator of recent trends in the employment situation, derived from Central Bank's Consumer Finance and Socio-Economic Surveys, is that the unemployment rate declined from 14.8 per cent of the labour force in 1978/79 to 11.7 per cent in 1981/82. Underemployment, too has declined very significantly. There was a significant expansion of employment in the private sector in 1982 and 1983. With the labour force swelling annually at an estimated rate of 2.3 per cent, the level of unemployment in 1983 would at least have remained at the 1981/82 level. A factor that supports this observation is the continued high level of migration of workers abroad, especially to West Asia and Middle East which helped reduce pressure of unemployment in Sri Lanka.

The situation that the Sri Lanka economy underwent in the post liberalization period, though compounded by unfavourable international developments, arose basically in the attempt to force the pace of development through a heavy investment programme greatly in excess of available resources. Without much leeway to draw on external assets, dependence on foreign savings (i.e. concessional aid, commercial borrowings etc.) to finance Gross Domestic Fixed Capital Formation has been very high.

There was a marked slow-down in the growth of Gross Domestic Fixed Capital Formation in 1983 when it increased by 16 per cent in comparison with 30 per cent for 1982. This was due in part to the cessation of new investment projects in the public sector. In part, too, this may have been influenced by private sector uncertainty in the wake of the ethnic disturbances in July. As a ratio of GDP at market prices, Gross Domestic Fixed Capital Formation declined from 30.6 per cent in 1982 to 28.6 per cent in 1983. In another favourable development, consumption, that hitherto had outstripped or at best kept pace with the GDP (at market prices), increased in 1983 only by 19.7 per cent as against the growth of GDP by 22.2 per cent. Hence, the ratio of Domestic Savings in relation to GDP rose from 11.8 per cent to 13.6 per cent. Gross National Savings, which is computed after including private transfers from abroad, increased to 16.2 per cent of the GDP. In an overall sense, therefore, the combination of decelerating investment and a higher level of National Savings reduced the reliance on Foreign Savings to 43 per cent of the total required for financing investment. It is necessary to go back to 1979 to come across a comparable situation.

TABLE 1.3

Investments—Savings 1979-1983

Category	1979		1980		1981		1982		1983 (*a*)	
	Rs. Mn.	%	Rs. Mn.	%	Rs. Mn.	%	Rs. Mn.	%	Rs. Mn.	%
1. **Investment-Savings(local &foreign)**	13,527	100.0	22,465	100.0	23,610	100.0	30,608	100.0	35,036	100.0
Less : Goods and Non-Factor Services (Net) ..	- 6,309	- 46.6	- 15,022	- 66.9	- 13,667	- 57.9	- 18,757	- 61.3	- 18,437	- 52.6
2. **Gross Domestic Savings** ..	7,218	53.4	7,443	33.1	9,943	42.1	11,851	38.7	16,599	47.4
Add : Factor Services net ..	- 239	- 1.8	- 432	- 1.9	- 1,868	- 7.9	- 2,034	- 6.6	- 3,164	- 9.0
Private Transfers, net ..	754	5.6	2,260	10.1	3,918	16.6	5,494	17.9	6,400	18.2
3. **Gross National Savings** ..	7,733	57.2	9,271	41.3	11,993	50.8	15,311	50.0	19,835	56.6
4. **Foreign Savings (1—3)** ..	5,794	42.8	13,194	58.7	11,617	49.2	15,297	50.0	15,201	43.4
Official Transfers, net ..	2,239	16.6	2,281	10.1	3,118	13.2	3,379	11.0	4,016	11.5
Concessionary Loans, net (*b*) ..	2,365	17.5	2,712	12.1	3,279	13.9	4,291	14.0	5,796	16.5
Commercial Borrowings, net ..	209	1.5	3,164	14.1	3,465	14.7	5,198	17.0	4,108	11.7
Direct Investment ..	731	5.4	710	3.2	947	4.0	1,323	4.3	893	2.5
Use of Net External Assets ..	- 793	- 5.9	2,967	13.2	406	1.7	1,149	3.8	- 296	- 0.8
Other, net (*c*) ..	1,043	7.7	1,360	6.0	402	1.7	- 43	- 0.1	684	2.0
5. **As a percentage of GDP at Market Prices**										
(i) Investments ..		25.8		33.8		27.8		30.6		28.6
(ii) Gross Domestic Savings ..		13.8		11.2		11.7		11.8		13.6
(iii) Gross National Savings ..		14.8		13.9		14.1		15.3		16.2
(iv) Foreign Savings ..		11.0		19.9		13.7		15.3		12.4

Source : Central Bank of Ceylon.

(*a*) Provisional.
(*b*) Net foreign loan receipts of the Central Government excluding commercial borrowings.
(*c*) Comprises of SDR Allocations, Valuation Adjustments and Errors & Omissions in the Balance of Payments.

Welcome as these developments are, there is no occasion for complacency. Gross Domestic Savings had risen, but the volume of exports had stagnated during the year. When the cyclical upturn in commodity prices wears off and the terms of trade gain erased, pressures will mount for increasing reliance on foreign savings or drastic curtailment of government and private sector investment. The prospects for concessional aid are uncertain. Further large scale commercial borrowing is imprudent in view of the dire consequences for debt servicing. Future investment outlays would, therefore, perforce be determined by national savings. In this context, the need for policies that continue to attract an increasing level of foreign worker remittances and for policies to contain consumption and increase savings cannot be overemphasised.

Narrow money supply, M_1 increased by 25 per cent in 1983 as against 17 per cent in 1982. But this increase took place mainly in the last quarter of 1983 as a result of excess liquidity in the economy due to the tea boom and cumulative effect of budget deficits.

Certain unforeseen and extraneous factors like the July disturbances, speculative activity in the foreign exchange market and delays in the repatriation of export proceeds complicated monetary management in 1983. Monetary policy alone without supporting measures would not be adequate in promoting growth and development under conditions of reasonable price stability within a free market atmosphere. Inflation, as measured by the available price indicators, accelerated, particularly towards the end of the year. The Colombo Consumer's Price Index, which increased 10.8 per cent in 1982, registered an increase of 14 per cent in 1983.

Domestic Credit Expansion (DCE) which increased by 16 per cent in 1983 was much lower than the 25 per cent registered in 1982. Yet, the change in Net External Banking Assets, which for three successive years exerted a contractionary influence on Money Supply, in 1983 provided an expansionary impetus in the last quarter of the year. Also, the moderating influence of the behaviour of 'Other liabilities (net)' of the banking system was much lower in 1983 than in any of the years dating back to 1977.

The key to understanding how a lower rate of increase in Domestic Credit Expansion can co-exist with accelerating prices lies in a decomposition of the aggregate figure into its component elements. A salutary feature of Domestic Credit Expansion in 1983 was the virtual absence of government demand for credit. Net Credit to Government increased by only two per cent as against 42 per cent and 34 per cent in 1981 and 1982 respectively. Even more striking was that only five per cent of Domestic Credit Expansion was on account of accommodating government demands.

Several reasons explain the greatly reduced reliance of the government on the banking system. Government revenue increased very substantially: Central Bank profits amounting to Rs. 1,500 million were transferred to the Treasury; higher import duties and turnover taxes and increased collections from the tea ad-valorem tax added substantial amounts to revenue. On the financing side,

TABLE 1.4

Monetary Magnitudes 1978—1983

(Rs. Million)

	1978	1979	1980	1981	1982	1983
Changes in Domestic Credit	**1,900**	**4,296**	**10,832**	**8,163**	**8,431**	**6,895**
Increase in Net Credit to Government ..	- 1,126	1,057	6,052	3,817	4,361	383
Increase in Credit to Government Corporations ..	693	984	776	365	190	- 292
Increase in Credit to Co-operatives	443	233	- 540	- 74	- 106	635
Increase in Credit to other Private Sector ..	1,890	2,022	4,544	4,055	3,986	6,170
Change in Net External Banking Assets	**1,884**	**1,218**	**- 3,177**	**- 690**	**- 568**	**815**
Change in Total Assets and Liabilities	**3,784**	**5,514**	**7,655**	**7,473**	**7,863**	**7,710**
Increase in Broad Money Supply (M_2)	2,175	4,166	4,803	4,587	6,063	6,747
Increase in Other Liabilities (Net)	1,609	1,348	2,852	2,886	1,800	963

Percentage increases in Monetary Magnitudes

	1978	1979	1980	1981	1982	1983
Percentage increase in total Domestic Credit ..	21.7	40.2	72.4	31.6	24.8	16.3
Percentage increase in total Assets and Liabilities ..	30.3	33.9	35.2	25.4	21.3	17.2
Government as percentage of total Domestic Credit Increase	- 59.3	24.6	55.9	46.8	51.7	5.6
Non-Government as percentage of total Domestic Credit Increase	159.3	75.4	44.1	53.2	48.3	94.4
Percentage increase in Broad Money Supply (M_2) ..	25.0	38.3	31.9	23.1	24.8	22.1
Narrow Money Supply (M_1) ..	10.6	29.2	22.9	6.3	17.3	25.4

Source: Central Bank of Ceylon.

increased subscriptions to Rupee Securities by non-bank sources, and the utilisation of foreign commercial borrowings minimised recourse to domestic banks. So, too, did the reduction in overall budget deficit, the outcome of firm restraint over expenditures, particularly of capital expenditure.

Credit to government corporations in fact declined in 1983. The ability of the Plantation Corporations, riding on the crest of the tea price boom, to reduce their indebtedness to the banking system was a positive development. The National Textile Corporation is another important case where an outstanding liability to the banking system was eliminated, although through government assistance. But many other features behind the reduction of corporation sector reliance on bank credit cause much disquiet. Several corporations reached over the domestic banking system into the offshore and foreign sector to satisfy their liquidity needs, thus posing a threat to the effectiveness of monetary policy. Though the pressure on domestic banks was reduced, the inflationary potential of such borrowings is very real. In particular, the continued access of the Ceylon Petroleum Corporation (CPC) to large amounts of Acceptance Credits abroad, alongside high operational profits and a strong cashflow enabled the CPC to prop up other corporations experiencing acute shortages of working capital.

Recent Annual Reports have voiced much disquiet about extensive government recourse to the banking system in that it crowds out the private sector from the credit market. This was inconsistent with the policy stance of encouraging private sector enterprise. If so, 1983 provides us with an about turn. Nearly 90 per cent of Domestic Credit Expansion in 1983 was in respect of the private sector. On an year-on-year basis, credit expansion to the private sector was 32 per cent compared with 26 per cent for 1982. What is important is total credit and not credit to just one sector. In that respect there was a decline in the rate of expansion of overall credit from 24.8 per cent in 1982 to 16.3 per cent in 1983. Though overall credit expansion was lower in 1983, it was accompanied by a sharp increase in net external banking assets which caused excess liquidity towards the last quarter of 1983.

Several reasons underlie credit expansion of a magnitude larger in 1983 than in 1982 even though the GDP growth rate was much lower. Total credit to private sector increased by a larger percentage in 1983 than in 1982 despite a lower growth rate in GDP and lower private sector investment. It was clear that the demand for credit was more consumer led than investment induced. Accordingly in October the Central Bank imposed quantitative controls on credit expansion as a temporary measure in order to reduce credit expansion to tolerable levels. This was removed in November. But at this time, terms of trade swung in favour of Sri Lanka because of higher tea and coconut prices pushing up the level of reserves to more comfortable levels. The build-up of external assets should have reduced the need for recourse to Bank finance. But the exporters needed bridging finance at higher levels in a situation of higher prices. The Central Bank Export Refinance Scheme was widened and increased by Rs. 1.07 billion to accommodate exports. This had the effect of releasing funds to finance the demand for credit by non-export oriented sectors. The July disturbances brought forth further demands on bank credit. Breakdown of the kerb market both with respect to short term financing and trade financing, delay in repayments of loans and advances by enterprises affected directly or indirectly, a delay in repatriation of export proceeds due to exchange market uncertainty and fresh credit to damaged enterprises resulted in credit expansion being maintained at a high level.

Credit to public sector, which has been to finance capital expenditures as evidenced by data for previous years, is less of a threat to domestic monetary stability as the proportion likely to leak out as imports appears to be much higher than in the case of credit to private sector. Since the large increase in credit to the private sector was mostly for the purpose of stocking imported goods, holding on to export stocks to gain from currency fluctuations and expected price increases, and for financing of enterprises that were destroyed by July disturbances, the repercussions were reflected on domestic prices.

If one transaction should be singled out for special mention as having contributed to Domestic Credit Expansion, it was the refinance marketing loan for purchases by the Paddy Marketing Board. A high level of purchases coupled with an inability to dispose of stocks kept outstanding credit high and well beyond desirable limits. The expansionary impact of the increase in Net External Banking Assets due to an improved Balance of Payments situation and the cumulative effect of successive budget deficits was felt towards the closing months of the year.

Monetary policy response to restore order and stability took the form of a freeze on credit to the private sector at end October levels. This was replaced at end -November by increased statutory requirements on Demand and Time/Savings deposits and a complete cessation of accommodation at the penal rate. Reserve ratios were increased from 14 to 16 per cent for demand deposits and from six to eight per cent for time and savings deposits. Further a reserve ratio of 16 per cent on unused overdraft balances was imposed in December.

The degree of relaxation of the hitherto tight monetary policy after a period of moderate increase in prices was a response to the special needs of the export and other priority sectors which were perceived to have taken the brunt of quantitative credit controls. It was a problem both of availability and cost of credit. While the Bank rate was reduced by one percentage point, the cost of concessionary refinance for exports declined by three percentage points. Meanwhile, the quantum of refinance for traditional exports was more than doubled while a new Supplementary Facility was introduced to cater to selected non-traditional exports. The increased liquidity in the banking system was accompanied by a lowering of savings mobilisation rates.

The narrowing of positive real rates of return through a reduction of nominal rates and of increasing prices had its inevitable consequence in reducing the public's holdings of real savings in the banking system.

Since the nadir of cultivation loans consequent on withdrawal of the government guarantee in 1978 on account of mounting defaults, progress in meeting the credit needs of the agricultural sector has been slow. The 16 per cent increase in bank loans in 1983 under the Comprehensive Rural Credit Scheme (CRCS), the bulk of which was for paddy cultivation, though a marked improvement is still inadequate when compared with the credit requirements in the agricultural sector. Although the quantum of paddy loans granted to eligible farmers (Rs. 3,300 - Rs. 5,600) is considered adequate, the poor coverage of credit needy farmers remains an unsatisfactory feature of the CRCS. On a more positive note, there was a marked improvement in the recovery rate in 1983. On the average 70 per cent of the loans was recovered. Given the high risk of default, any steady improvement in recovery rates is desirable for the expansion of agricultural credit. The type of operational measures to contain default therefore merits equal attention of policy formulating bodies like the Rural Credit Advisory Board as the present thrust of bank policy is to wean farmers away from expensive sources of non-institutional credit and into the banking system.

During the year the transactions in the Capital Market increased substantially when compared with the previous year. In the primary market the number of new share issues increased to 37 when compared with 19 such issues in the previous year. Accordingly the nominal value of new shares rose from Rs. 371 million in 1982 to Rs. 1,004 million in 1983. As against the previous year, the highest number of new shares was issued in respect of investments in the Engineering, Motor and Industry categories. New issues in respect of the hotel and travel industry were a close second. For the purpose of claiming tax relief as in the previous year, peak activities in the primary market took place during the first quarter of the calendar year coinciding with the last quarter of the income tax year of assessment. Moreover, there was a bunching of new share issues to take advantage of tax holidays available to Public Quoted Companies in specified fields of investments only till 31st March, 1983. Transactions in the Secondary market, however, continued to be at low key.

The overall performance of the government fiscal operation showed a considerable improvement during the year not only in comparison to the previous year but also when compared with the budgetary performance since the 1980 fiscal year. At one time or the other during the recent past, fiscal imbalance and its method of financing was a major source of instability for prices, the balance of payments and the exchange rate. The 1983 picture on the contrary reflects a concerted attempt to enforce fiscal discipline.

First, Government was able to generate a current account surplus and thus make a contribution to Gross Domestic Savings. Consequently, borrowings from local and foreign sources were used solely to finance investment outlays. Second, Government recourse to inflationary bank credit dropped to just one per cent of GDP from the four per cent plus levels of the recent past. In fact, once adjusted for holdings of cash balances, the expansionary impact of the 1983 budget as measured by the relevant GDP ratios was the lowest for the entire period since the economic and financial reforms of 1977. While all major fiscal variables contributed to this relatively favourable fiscal situation, revenue performance should be singled out as the main contributory factor that influenced the final budgetary outturn.

A major effort at gathering additional revenue through wider coverage and increased rates on imported and domestically produced articles, fortuitous gains from a cyclical upturn for commodity prices and more effective collection efforts increased tax revenues much faster in 1983 (34 per cent) than in 1982 (nine per cent). The tax effort brought in 17 per cent of GDP to government. The comparable ratio for 1982 was 15 per cent. Adding up the profits transfer from the Central Bank, the increase in total revenue of 42 per cent was well ahead of the increase in total expenditures of 23 per cent in 1983.

TABLE 1.5

Fiscal Magnitudes 1978—1983

(Rs. Million)

	1978	1979	1980	1981	1982*	1983*
Revenue	11,688	12,730	14,068	16,228	17,809	25,210
Expenditure ..	18,853	21,521	30,343	31,094	37,900	46,772
Recurrent Expenditure including Advance Accounts (—) ..	12,239	12,531	16,489	17,729	19,231	25,078
Current Account Deficit (-)/ Surplus (+) ..	- 551	+ 200	- 2,421	- 1,493	- 1,422	+ 132
Capital Expenditure ..	6,614	8,991	13,854	13,373	18,669	21,694
Overall Budget Deficit ..	7,165	8,791	16,274	14,861	20,091	21,562
Financing—						
Foreign ..	4,454	4,237	6,735	8,208	8,794	10,902
Domestic Non-Bank ..	2,486	3,902	2,484	2,779	7,607	10,151
Domestic Bank ..	167	680	7,126	3,917	4,006	1,203
Use of Cash Balances ..	58	- 28	- 72	- 38	- 315	- 694

(As a Percentage of G.D.P.)

	1978	1979	1980	1981	1982*	1983*
Revenue ..	27.4	24.3	21.1	19.1	17.8	20.6
Expenditure ..	44.2	41.1	45.6	36.6	38.0	38.2
Recurrent Expenditure including Advance Accounts ..	28.7	23.9	24.8	20.8	19.2	20.5
Current Account Deficit (-)/ Surplus(+) ..	- 1.3	+ 0.4	- 3.6	- 1.8	- 1.4	+ 0.1
Capital Expenditure ..	15.5	17.2	20.8	15.7	18.6	17.7
Overall Budget Deficit ..	16.8	16.8	24.5	17.5	20.0	17.6
Financing—						
Foreign ..	10.4	8.1	10.1	9.7	8.8	8.9
Domestic Non-Bank ..	5.8	7.4	3.7	3.3	7.5	8.3
Domestic Bank ..	0.4	1.3	10.7	4.6	4.0	1.0
Use of Cash Balances ..	0.1	- 0.1	- 0.1	- ...	- 0.3	- 0.6

* Provisional

Sources : General Treasury
Central Bank of Ceylon.

The continuing concern with the unsustainable level of government expenditure in relation to resource availability helped limit the increase in Recurrent Expenditure to 19 per cent in 1983, down from the 26 per cent for 1982. If there had not been a poor showing of Advance Account operations, merely ensuring the original target (even then an anticipated net outpayment) would have yielded a current account surplus of Rs. 727 million, equivalent to 0.7 per cent of the GDP.

A continuation of the policy of concentrating on on-going projects and the non-admission of new projects slowed down nominal growth of the capital budget from 40 per cent in 1982 to 16 per cent in 1983. Deflated by 1970 prices, in real terms capital expenditure had declined over 1982 by eight per cent. This reduction in real terms had a dampening effect on economic activity.

As a result of the adjustment effort yielding greatly increased revenue and slowing down growth of expenditures, the overall budget deficit as a share of the GDP at market prices declined to 17.6 per cent from 20 per cent for the previous year. Viewed against the 1982 trends, efforts at mobilising foreign finance and increasing disbursement made a greater impact on financing the overall budget deficit than did domestic non-bank borrowings. The share of foreign financing in total financing increased from 44 per cent to 51 per cent between 1982 and 1983.

Developments in the world economy held out moderate promise of support for Sri Lanka's Balance of Payments in 1983 after several years of damaging consequences. After the most prolonged global recession in the post-war period, and the world economy led by a strong recovery of economic activity in the United States, finally emerged out of the recession in 1983. Though inflation was brought under control, widespread high rates of unemployment evoked further protectionism - a major cause hindering effective transmission of recovery in industrial countries to the rest of the world. The recovery in industrial countries was accompanied by an increased demand for developing countries' exports, and a consequent upturn in commodity prices. Many non-oil developing countries experienced a turnaround in their terms of trade.

With oil prices declining in real as well as nominal terms, and export prices for Sri Lanka's principal commodities substantially higher, the terms of trade improved by 16 per cent. The significance of this improvement lies in the fact that the country's terms of trade was on a deteriorating trend since 1977. Real National Income of Sri Lanka, as a result of the favourable terms of trade effect, increased 5.7 per cent in 1983 over the previous year.

Measured in terms of the SDR, tea export prices increased by 38 per cent, while rubber and coconut products registered price increases averaging 18 per cent. Yet total export earnings valued in SDRs have increased only 7.5 per cent. The high export prices and the consequent relief on the balance of payments front, however, contained some very unfavourable underlying trends. The export volume of tea, rubber and of many minor agricultural and industrial products declined. The volume of tea exported was the lowest since 1956. While the unprecedented drought undoubtedly depressed output, inadequacies in management in the State Plantations sector continued to afflict the tea and rubber industries. Little progress was evident in 1983 that efforts to tackle the problem were yielding tangible benefits. Hence, Sri Lanka was not able to reap the full benefits of higher export prices, particularly for tea, due to the decline in production.

TABLE 1.6

Summary of Balance of Payments-1981—1983

Rs. Million (SDR Million in brackets)

Item	1981*(a)*	1982*(a)*	1983*(b)*
Merchandise Exports ..	20,507 (903)	21,098 (918)	24,917 (988)
Merchandise Imports ..	36,123 (1,596)	41,501 (1,808)	45,221 (1,796)
Non-Factor Services (Net) ..	1,950 (85)	1,645 (72)	1,867 (75)
Factor Services (Net) ..	—1,868 (— 81)	—2,034 (— 88)	—3,164 (—127)
Private Transfers (Net) ..	3,918 (172)	5,494 (240)	6,400 (255)
Official Transfers (Net) ..	3,118 (136)	3,379 (147)	4,016 (160)
Current Account Balance ..	—8,498 (— 381)	—11,919 (—519)	—11,185 (—445)
Overall Balance ..	— 406 (— 26)	—1,149 (— 24)	+ 296 (0·5)

Some Key Indicators

Item	1981*(a)*	1982*(a)*	1983*(b)*
Terms of Trade (1978=100) ..	46	38	44
Net Petroleum Imports ..	6,592 (291)	8,994 (391)	8,342 (331)
Current Account deficit as a percentage of GDP ..	10	12	9
Gross International Reserves ..	9,222 (387)	11,094 (472)	12,840 (491)
Import Capacity of Gross International Reserves (in months of imports) *(c)* ..	2·6	3·2	3·1

Source: Central Bank of Ceylon

(a) Revised.
(b) Provisional.
(c) Projected for the following year's imports in SDR terms.

Outlays on imports, which have been growing steadily in recent years, actually declined in 1983 though only marginally (one per cent) in SDR terms. Even then, he underlying trends are unfavourable for the Balance of Payments. Oil, ships and aircraft excluded, imports have maintained their steady increase. Though no distinct category of imports can be singled out as having engineered import growth, small increases over a broad range of products have caused the aggregate outlay to remain high. The share of aid related imports, which are mainly of capital equipment, has increased to 21 per cent in 1983 from the previous year's level of 19 per cent. In the face of the continuing high levels of intermediate goods imports, which are nearly equal to all of export earnings, and of capital goods, the outlook for Balance of Payments will remain bleak without dramatic gains in import substitution, especially of agricultural products and, equally important, reversal of the declining trend of production of export commodities.

Thanks, however, to the sharp rise in export prices, the deficit in the Merchandise Account of the Balance of Payments dropped by 10 per cent in 1983. The deficit in the Services Account widened much further than in 1982 due to a fall in earnings from tourism and a sharp rise in interest payments abroad on outstanding borrowings. The uncertainties in the period following the July disturbances, adversely affected activity in the tourist sub sector.

The receipt of official grants-in-aid and remittances by Sri Lankans working abroad contributed substantially to moderate the Current Account deficit in the Balance of Payments. However, the momentum of these flows, especially worker remittances, seems to have slowed down in 1983. Largely on the strength of an improved trade balance, the Current Account deficit, too, in 1983 (SDR 415 million) was lower than the record level for 1982 (SDR 519 million).

As a ratio of Gross Domestic Product, the Current Account deficit declined from 12 per cent in 1982 to nine per cent in 1983. When official transfers amounting to Rs. 4,016 million (SDR 160 million) are excluded, the ratio in 1983 was 13 per cent compared with 15 per cent in the previous year.*

As in 1982, despite the large Current Account deficit, the overall deficit in the Balance of Payments in 1983, was maintained at a relatively low level due mainly to net inflows of Non-Monetary Capital in the form of direct investment and long-term foreign loans. Net inflows of Non-Monetary Capital in 1983, amounted to Rs. 10,797 million (SDR 428 million) while net inflows in 1982 were Rs. 10,813 million (SDR 471 million).

Net inflows of Non-Monetary Capital in 1983 declined by nine per cent in SDR terms. This was due solely to the decline of private foreign direct investment, the inflow of Non-Monetary Capital to the public sector having increased by 26.4 per cent. Net inflows of Non-Monetary Capital in 1983, were able to finance almost the entire amount of the Current Account deficit. The level of gross external assets increased by five per cent in 1983 and stood at Rs. 12,840 million (SDR 491 million). This was sufficient to finance 3 months' imports, projected for 1984.

* In the computation of this ratio, it is assumed that even without the benefit of grants, imports would have taken place.

The level and rapid growth of external debt in consequence of the persistently large Current Account deficits in the Balance of Payments have been the subject of grave concern in previous Reports. The build up of external liabilities, especially those of short maturity, severely handicaps the management of the Balance of Payments and the exchange rate. A weakening in the management of the Balance of Payments will put at risk the very foundations on which Sri Lanka's liberalized trade and payments system rests. Hence, notwithstanding the flexibility given to resident enterprises in conducting business with non-residents, careful and adequate monitoring of financial transactions is a *sine qua non* to ensure that obligations to non-residents do not overtake Balance of Payments realities.

In previous years the debt ratio excluded certain types of debt mainly due to difficulties in estimating those arising from offshore units. These omissions relate to lendings by the Foreign Currency Banking Units to GCEC enterprises and certain State Corporations and Ceylon Petroleum Corporation borrowings abroad. Given the general tightness of credit in the local market and its high cost, the temptation to borrow abroad was strong especially as interest rates in the principal money markets were much lower than in Sri Lanka. Bank borrowings and commercial credit which formed a negligible proportion of total External Debt in 1979 had by end 1983 climbed to 33 per cent. Between these two years long-term concessional debt increased by SDR 1,051 million while short maturity high cost credit from commercial sources increased by SDR 577 million. In consequence there was a significant deterioration of the debt profile. Another, and more worrying feature, was that the debt service to exports ratio had by 1983 increased to nearly 22 per cent. If workers remittances are aggregated to exports, the ratio declines to 18 per cent. On the other hand, if the gains from terms of trade are excluded, the debt ratio would have been at least 24.4 per cent or 19.8 per cent depending on whether or not worker remittances are added to export earnings.*

The year under review was also noteworthy for a severe energy crisis. Though energy consumption in the world has been on a declining trend, Sri Lanka's development imperatives have required a sustained increase in energy consumption. Consequently, the fall in prices of oil, both in real as well as nominal terms, was a welcome relief. Yet, Sri Lanka could not reap the full benefits of the price decline as hydro-power generation was curtailed by drought conditions. Hence, to maintain supplies, high cost thermal generation with the use of imported heavy diesel, was resorted to. This meant a near two per cent addition to the total import bill.

It is six years since a major reform exercise which placed greater reliance on free market forces for the efficient allocation of limited resources. Whilst recognising some dramatic gains in the production of the staple crop (paddy), a few subsidiary

* Debt Service ratios appearing here are still considered slightly understated as not all FCBU lendings to GCEC enterprises have been identified.

crops and in the sphere of employment, deep rooted weaknesses in the structure of the economy and in its management persist. The Balance of Payments of this open economy, though benefitting from import saving gains in agriculture, remained still weak in 1983. Export surpluses are lower within a stagnant or falling production curve. Diversification gains of the export structure, the key to medium term Balance of Payments viability, are unclear in the case of minor agricultural crops and fragile in the case of industrial products. The dramatic swing in the terms of trade in Sri Lanka's favour in 1983 and its promise for 1984 should not reduce the commitment and the sense of urgency to keep policies on course and targets within sight.

Sri Lanka is on the brink of self sufficiency in rice production. The dramatic gain in production has been the outcome more of higher yields than of a larger acreage harvested. With considerably larger extents of irrigated land becoming available as downstream operations of the Accelerated Mahaweli Programme gather momentum, and with vagaries of weather affecting a relatively reduced acreage, further large production gains are imminent. Translating these into a Balance of Payments advantage require a critical appraisal of the possibilities of progressively substituting locally produced rice in place of expensive imported wheat flour. In 1983 five per cent of the total import outlay was on account of imports of wheat grain. Overcoming the deeply ingrained dietary habits call for a substantial change in relative pricing between rice and flour within a framework of incentives to generate investment in manufacturing processes that facilitate the substitution of rice in place of wheat flour. A parallel development should be the diversion of lands where paddy yield is presently low into other subsidiary food crops. Equally important is rendering the production surplus suitable for the export market. Strict quality control and an ability to enter into and fulfil long term contracts are pre-requisites to venture into the export market. In fact, progress on all these fronts would stand in eloquent justification of downstream investments of the Mahaweli programme.

With the reduced profile of operations for the Paddy Marketing Board (PMB) and with its surplus modern milling capacity and its own research and development activities, it would seem that the PMB is at a comparative advantage to meet this challenge. Given past experience and involvement in local procurement and sale of paddy/rice, it would be a wasteful duplication of effort for the PMB to attempt anything more than upholding the Guaranteed Price Scheme. Within a co-ordinated strategy under which the Food Commissioner will hold a buffer stock of rice, the PMB should be geared to enter the export market. A very desirable incidental benefit would be the reduced need for the marketing refinance facility, whose high level and prolonged use in 1983 complicated the conduct of monetary policy and contributed to inflation.

The response of paddy agriculture to a carefully orchestrated policy and the lack of dynamism in production of subsidiary food crops seem to suggest that policy initiatives in the latter area still lack coherence. Production has continued to be beset by inadequate extension, marketing and storage facilities and seasonal price fluctuations. Inconsistencies in certain policies remain unresolved, e.g. the competitive prices of coconut products in the local market directed at consumers (fresh nuts and oil) and the Dairy Industry (poonac) have undermined producer incentives to produce substitutes like oilseeds, soya bean, etc. It required a severe drought in 1983 and resultant scarcity prices for coconuts, to make soya an attractive substitute. Even then, the restoration of export licensing for coconut products followed as an insurance device to protect consumers from excessive exports. What is called into question here is not an isolated event, but the commitment to policy.

The potential for diversification in agriculture will be examined in the sections to follow. Skilful intercropping policies are equally important. Returns from intercropping are striking in smallholder dominated coconut lands. As a monocrop, coconut planting/replanting is not attractive. Yet, if intercropped with perennial crops, private returns rise dramatically, while from a national angle, both subsidiary food production and coconut output would have been augmented.

Previous Annual Reports have repeatedly drawn attention to the need to restructure management of the state sector plantation corporations. A Report by Management Consultants dealing with accountability, production norms, delegation of decision-making and responsibility has been completed. Implementation should be undertaken with speed, thankful that the tea and rubber price boom will facilitate rather than impede implementation. Meanwhile, the industry can also look forward to finalization of the World Bank assisted Estate by Estate Medium Term Investment Programme, to strengthen the long-term viability of tea and rubber properties.

Notwithstanding the critical dependence of long-term balance of payments viability on the growth of industrial exports on a broad front, concerted policy action to force the pace has been lacking. Incentives related to exchange rate developments, especially in 1983, were in the right direction, but complementary action is lagging behind. Outside of re-exports of petroleum by-products, state sector manufacturing enterprises' contribution to exports of industrial products is negligible.

The progression from a secure market sheltered by highly protective tariff and non-tariff barriers to a market in competition with imported substitutes and thence to the export market necessarily implies painful choices in the process of readjustment. Within a broad spectrum of incentives like exchange rate, tax concessions and export grants, the essential rationalization of industry has depended on tariff reform to identify the efficient from the inefficient. The recommendations of the

Presidential Tariff Commission should be available during the course of 1984. It may be considered necessary to establish a structure of duties that will discriminate most in favour of those units where value added is greatest and which are unassisted in other ways such as subsidies on inputs and licensing to limit import competition. In the particular case of state sector concerns, some of which have social objectives, it would be defeatist to ignore the cost of readjustment. The option to close down those enterprises which cannot cover even operating costs in the future should not be ignored. Government's determination in this respect observed in 1983 is an encouraging sign.

Policies directed at particular sectors, however, depend on the macro-economic setting for the full realization of their objectives. Given the close link between economic growth and development and government initiatives, it is imperative that fiscal policies place public finances on a sustained sound footing. Given the huge imbalance between savings and investment, a pre-condition to good management is the ability of government to contribute to domestic savings through a current account surplus.

In fact in 1983 this was achieved, albeit on a small scale. But it was the product partly of a major tax effort from existing sources and partly of fortuitous gains related to high prices for some export commodities. The potential for a large disequilibrium inherent in the underlying weakness of the budget underscores the urgency for rehabilitating the tax yielding commodity base of the economy. Possibilities for major cut-backs in recurrent expenditure are slow to materialise. Interest on public debt and the subsidy to the National Savings Bank absorbed 32 per cent of recurrent expenditures in 1983. Budgetary management that avoids recourse to the banking system in Sri Lanka and abroad would help contain expansion of recurrent expenditures through a reduced liability for interest payments. A further consideration is the inevitable additions to recurrent expenditure on account of maintenance expenditures as major projects under the high level of investment are completed and commissioned.

In this context a contribution to government revenue by direct beneficiarie of the large investments in infrastructure projects should be forthcoming. Equally important is to ensure that Public Enterprises should be compelled to declare dividends to Government as a return on government's stake in their equity and loan portfolio. The reorganisation of Public Enterprises on the basis of efficiency criteria is the only way to make them pay their way. Even the limited possibilities that existed to make a beginning in this direction have suffered as a result of many financially viable ventures over-stepping their mandate and venturing into unrelated activities that reduced cash flows and undermined their viability.

In the light of budgetary constraints, prospects for medium term public investment therefore are for a continuation of the policy of non-admission of new projects, except in a few limited cases identified as critical to the economy. In this connection, availability of concessional aid for a project, even if fully financed by donors, is of secondary relevance, the first condition being the dictates of a national scale of priorities. That scale should limit new projects to those which are quick yielding, provides reasonable financial and economic returns and strengthens the balance of payments through export expansion or import substitution.

A policy of containing capital investment in the context of a high burden of public debt may involve 'captive sources' of finance like the National Savings Bank looking for other investment outlets. The development of the capital market and other avenues of investment are aspects that Government should address its mind to.

The lessons of 1983 should stand in good stead for the management and conduct of monetary policy in 1984. Monetary policy continued to be restrictive but flexibility was maintained as far as interest rates were concerned. Demands of the export sector for concessional finance were met by increased refinance limits to priority sectors. However, towards the last quarter monetary policy measures had to be tightened further because of a large increase in private sector credit. The commodity boom should further improve the liquidity in the banking system. The use of such resources to uplift growth, development and incomes require qualitative credit control policies and effective monitoring mechanisms to ensure compliance. The objective of controlling inflation and protecting the balance of payments by limiting the leakage abroad (imports) of high export incomes indicate a continuing need for regular review of monetary policy measures whilst ensuring a flexible approach. A thorough re-appraisal of the policy relating to borrowings by resident enterprises from banks abroad and a tailoring of the paddy marketing refinance loan in accordance with the reduced role of the Paddy Marketing Board in paddy procurement are specific features that merit mention.

Sectoral policies aimed at increasing output can strengthen the balance of payments through higher exports and reduced reliance on imports. Monetary and fiscal policies provide the essential macro-economic background to facilitate production and ensure consequential benefits to the balance of payments. It is necessary to make continued adjustments so as not to allow a slippage that may threaten price stability.

In the sections that follow, developments during 1983 are discussed and analysed in greater detail.