ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES IN 1988

Introduction

In 1988, the Sri Lankan economy staged a modest recovery from the drought affected low growth performance in the previous year. In real terms, the Gross Domestic Product (GDP) is estimated to have risen by 2.7 per cent in 1988, compared with a growth rate of 1.5 per cent in 1987. Demonstrating a similar trend, the Gross National Product (GNP), which is derived by allowing for the flow of net factor income abroad, recorded a growth of 2.5 per cent in 1988, compared with a real GNP growth rate of 1.6 per cent in the previous year.

TABLE 1.1

National Income Statistics 1986 – 1988

Item	Amount (Rs. Million)			Growth Rate	
	1986	1987	1988*	1987	1988*
1. G.D.P. at Current Factor Cost Prices ..	163,713	177,731	203,516	8·6	14·5
2. G.D.P. at Constant (1982) Factor Cost Prices ..	114,261	115,922	119,050	1·5	2·7
3. G.N.P. at Current Factor Cost Prices ..	159,852	173,395	198,017	8·5	14·2
4. G.N.P. at Constant (1982) Factor Cost Prices ..	111,565	113,307	116,095	1·6	2·5
5. Mid year Population ('000) ..	16,117	16,361	16,586	1·5	1·4
6. G.N.P. Per Capita					
(i) At Current Prices (Rs.) ..	9,918	10,598	11,939	6·9	12·6
(ii) At Constant Prices (Rs.) ..	6,922	6,925	6,999	0·1	1·1

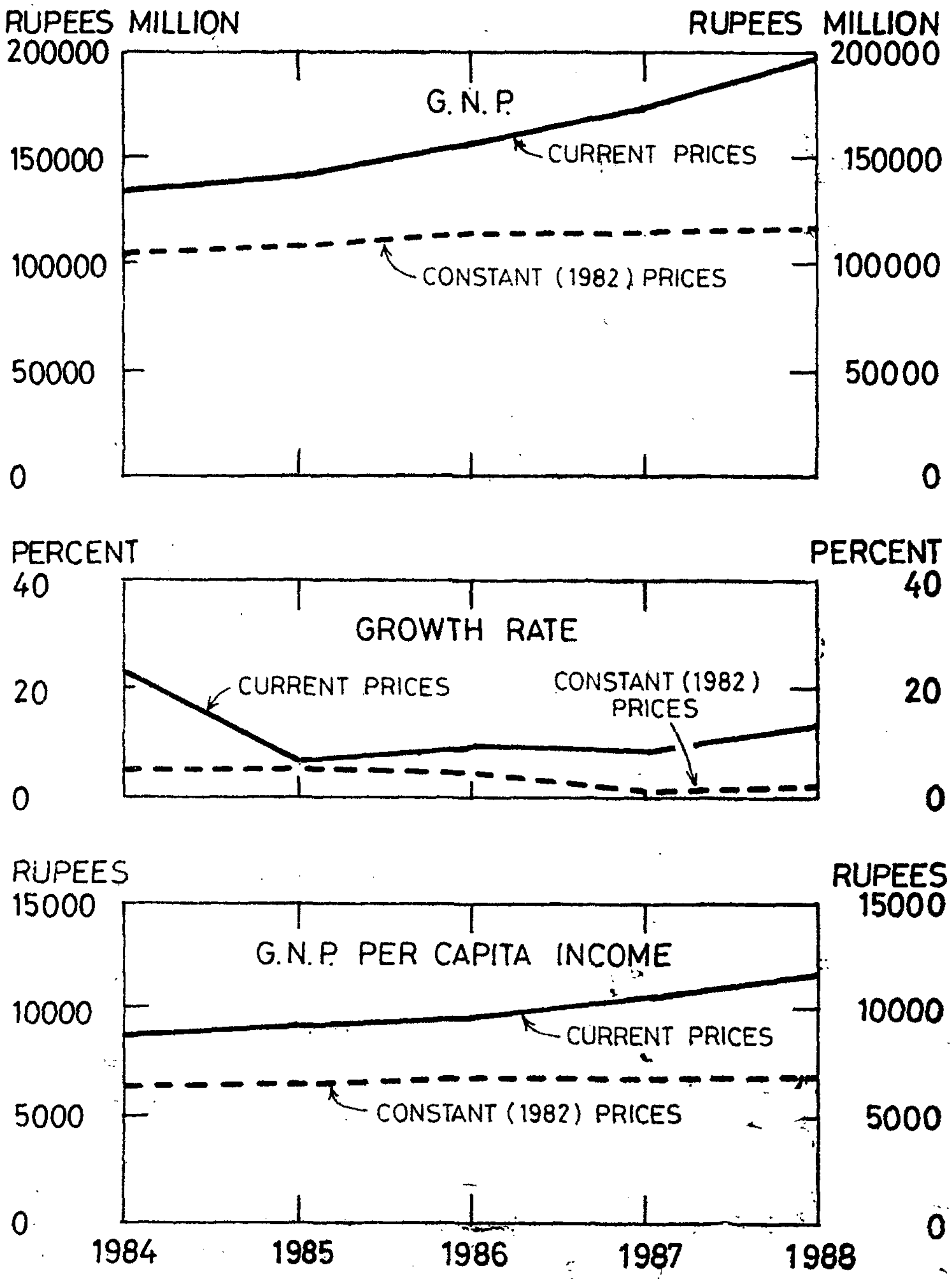
* Provisional

Source : Central Bank of Sri Lanka.

Considering the circumstances under which it had been achieved, viz., sporadic civil disturbances which adversely affected the production and distribution, the turn-around in the growth rate should be considered commendable. It underscores the resilience of an open economy with competition and market oriented incentives to withstand and overcome formidable adverse circumstances.

The GNP at current factor cost prices is estimated at Rs. 198 billion in 1988, registering a growth of 14.2 per cent over 1987. Meanwhile, the implicit GNP deflator, a measure of the overall price change of the economy, increased by 11.5 per cent in 1988, a rate significantly higher than the 6.8 per cent recorded in 1987. Accordingly, the GNP at constant (1982) prices in 1988 was estimated at Rs. 116 billion, recording an increase of 2.5 per cent. On the other hand, the real national income, which is derived by adjusting for the terms of trade effect, decreased marginally by 0.1 per cent, owing to a 7 per cent deterioration in the terms of trade during the year.

GROSS NATIONAL PRODUCT



Central Bank of Sri Lanka.

According to provisional estimates of the Registrar General, the mid-year population is estimated at 16.59 million, showing an increase of 1.4 per cent over 1987. Accordingly, the per capita GNP at current prices is estimated at Rs. 11,939 (US $ 375) in 1988, compared with Rs. 10,598 (US $ 360) in 1987. Thus, at current prices, the per capita income rose by 12.6 per cent in 1988, but in real terms the increase was only 1.1 per cent.

The recovery of the agriculture sector and the continuing growth in the manufacturing sector were the major contributory factors for the improved economic performance in 1988. The provisional estimates show that the agriculture sector, inclusive of forestry and fishing, has grown by 2.1 per cent. In the previous year, value-added in this sector decreased by 6 per cent under the impact of the drought. The improved performance of the agriculture sector in 1988 was the outcome of increased production of a number of commodities such as tea, paddy, sugar cane, minor export crops and minor food crops. Tea production rose by 6.4 per cent, while the overall growth in the paddy sub-sector was 16.4 per cent-the highest on record for any single year in recent times. Substantial increases in the output of minor export crops, minor food crops and sugar cane had also been recorded. On the other hand, coconut production recorded a sharp decrease of 15.7 per cent in 1988, largely due to the lagged effects of drought conditions prevalent in 1986 and early 1987.

Another sector which recorded impressive growth performance in 1988 was the mining and quarrying sector, where the value-added is estimated to have increased by 9 per cent, due mainly to the continued expansion in gem mining. The overall growth in the manufacturing sector in 1988 was estimated at 4.7 per cent. A major part of this growth occurred in factory industry, the output of which is estimated to have expanded by 7 per cent in 1988. Within the factory industries sub sector, the output of private sector industries increased by 10 per cent, while that of the state owned industries declined. Although the performance of the services sector was modest, it made a significant contribution to the overall growth of the economy in view of its relatively heavy weightage. Banking, insurance and real estate, which recorded a 6 per cent growth, was the leading growth sector within the broad services sector. The improvement in the water levels of hydro-reservoirs enabled the electricity, gas and sanitary services to post a growth rate of 3.5 per cent. In comparison, the growth performance in a number of other sectors had been fairly modest in 1988. Among these were the construction sector (1.5 per cent), the services sector (2.2 per cent) and the wholesale and retail trade sector (2.7 per cent).

Domestic savings are estimated to have increased from Rs. 25.2 billion in 1987 to Rs. 28.5 billion in 1988. However, the national savings ratio, defined as the ratio of national savings to GDP at market prices, declined from 15.3 per cent in 1987 to 14.8 per cent, in 1988, while the domestic savings ratio remained unchanged at 12.8 per cent between the two years.

TABLE 1.2

Composition and Growth of G.N.P. 1986—1988
At Constant (1982) Factor Cost Prices.

Sector	Amount (Rs. Million)			Growth Rate		
	1986	1987	1988*	1986	1987	1988*
1. Agriculture, Forestry and Fishing ..	29,106	27,409	27,984	2·6	- 5·8	2·1
of which						
1.1 Tea ..	2,723	2,750	2,926	- 1·3	1·0	6·4
1.2 Rubber ..	856	765	770	0·6	- 10·6	0·7
1.3 Coconut ..	3,935	2,967	2,501	2·8	- 24·6	- 15·7
1.4 Paddy ..	6,613	5,423	6,312	- 2·5	- 18·0	16·4
1.5 Other (Other Agriculture, Forestry and Fishing)	14,979	15,504	15,475	5·9	3·5	- 0·2
2. Mining and Quarrying ..	2,615	3,112	3,392	5·2	19·0	9·0
3. Manufacturing ..	17,558	18,748	19,622	8·4	6·8	4·7
3.1 Tree Crop Processing ..	3,225	3,340	3,273	0·1	3·6	- 2·0
3.2 Other ..	14,333	15,408	16,349	10·5	7·5	6·1
4. Construction ..	8,191	8,338	8,463	1·5	1·8	1·5
5. Services ..	56,791	58,315	59,589	4·3	2·7	2·2
6. G.D.P. ..	114,261	115,922	119,050	4·3	1·5	2·7
7. Net Factor Income from Abroad ..	- 2,696	- 2,615	- 2,955	—	—	—
8. G.N.P. ..	111,565	113,307	116,095	4·5	1·6	2·5

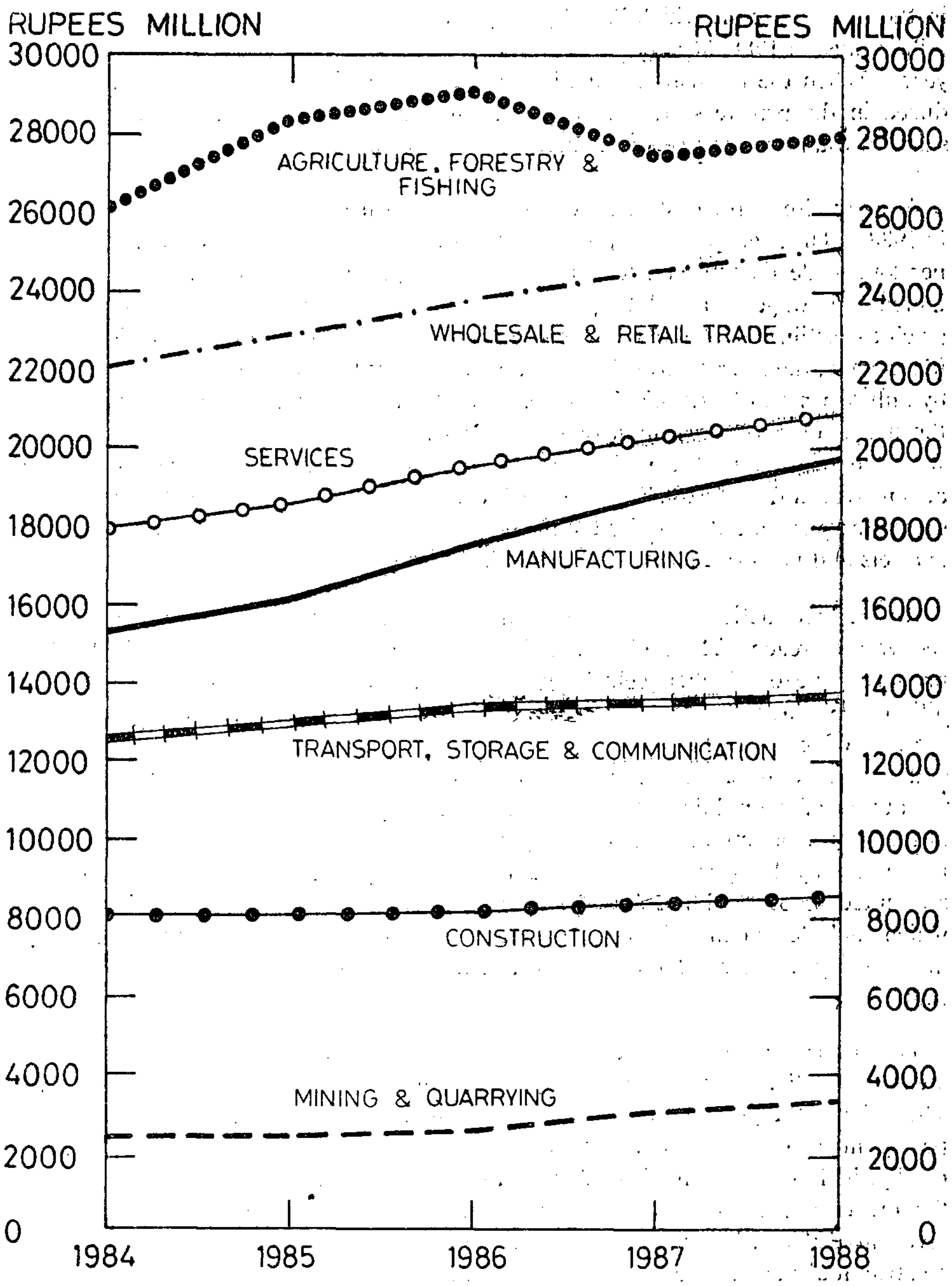
* Provisional. *Source* : Central Bank of Sri Lanka.

Gross Domestic Capital Formation (GDCF), inclusive of changes in stocks, increased by 12 per cent in 1988, compared with a rise of 8 per cent in 1987 and 10 per cent in 1986. As has been the pattern in recent years, the larger contribution to the capital formation came from the government sector, where the gross capital formation expanded by 25 per cent. The corresponding increases in 1987 and 1986 were 17 per cent and 23 per cent, respectively. Meanwhile, the combined capital formation of the private sector and public corporations increased by 7.8 per cent, as compared with a rise of 5.6 per cent in the previous year. As a ratio of GDP at market prices, GDCF declined marginally to 23.1 per cent in 1988, from 23.3 per cent in 1987.

Tea production rose by 6 per cent in 1988 to 226.9 million kgs.—the highest level of output reported since 1965. If not for the disruptions to production during the last quarter in the Southern and Uva regions owing to civil disturbances, the 1988 production performance would have been even better. The increase in production was reflected in all three elevational categories, with low grown teas recording the highest growth of 11 per cent. In comparison, the production of high grown and medium grown teas expanded by 5 per cent and 2 per cent, respectively. Unlike in the previous year when the growth in tea production came entirely from the private sector, in 1988 the production increase was shared between both the public and private sectors, but it was more heavily concentrated in the private sector, accounting for 74

GROSS DOMESTIC PRODUCT BY INDUSTRIAL ORIGIN

AT CONSTANT (1982) FACTOR COST PRICES



Central Bank of Sri Lanka.

per cent of the total increase. The tea production of the Janatha Estates Development Boards (JEDBs) and the Sri Lanka State Plantations Corporations (SLSPCs), including tea manufactured with bought leaf, increased by 3 per cent each to 74.4 million kgs. and 69.4 million kgs., respectively. Meanwhile, the production of tea in the private sector, which rose by 10 per cent in 1987, grew by 14 per cent to 83 million kgs. in 1988, accounting for 37 per cent of the total tea production during the year. When the tea manufactured by the JEDBs and SLSPCs with green leaf produced in the private sector are also reckoned under the private sector, its relative share in total production was as high as 45 per cent.

A sharp rise in the cost of production (COP) of tea was a worrisome development in 1988. The average cost of production of the JEDBs rose by 17 per cent to Rs. 46.92 per kg., while that of SLSPCs increased by 13 per cent to Rs. 44.42 per kg. The increase in wages granted to plantation workers and the higher prices for inputs (such as fertilizer) were among the principal factors contributing to the rise in COP. Meanwhile, the average gross price of all teas sold at the Colombo Auctions improved by only 9 per cent to Rs. 42.77 per kg. in 1988, from Rs. 39.30 per kg. in 1987. Thus the negative producer margin of the JEDBs rose from Rs. 4.12 per kg. in 1987 to Rs. 5.26 per kg. in 1988. Meanwhile, the negative producer margin of SLSPCs also increased from Re. 0.40 per kg. in 1987, to Rs. 2.69 per kg. in 1988. This underscores the paramount need for the tea industry to remain competitive in international markets and not price itself out by inordinate cost increases.

Rubber production, which suffered a severe setback in 1987, showed a marginal recovery to reach 122.4 million kgs. in 1988. The production increase in 1988 was primarily due to a higher yield brought about by relatively favourable weather conditions and intensive tapping of trees to take advantage of improved prices. As in the case of tea, the production increase in rubber too was shared between the public and private sectors,. Reversing the production performance in the previous year, the output of the public sector increased marginally accounting for about 33 per cent of the total production. The rubber production of the JEDBs and SLSPCs increased marginally by 2 per cent and 1 per cent, respectively, and their combined production amounted to 39.1 million kgs. Meanwhile, rubber production in the private sector, which includes small holdings, also increased marginally to 82.4 million kgs., thus maintaining its share of the total production at the previous year's level of 67 per cent.

The rubber sector too experienced a sharp rise in COP during the year. The increase in COP was brought about mainly by increased wages to plantation workers. The COP of the private sector moved up from Rs. 13.95 per kg. in 1987 to Rs. 15.55 per kg. in 1988. Meanwhile, the COP of the SLSPCs rose by 10 per cent to Rs. 23.50 per kg. in 1988 and that of the JEDBs by 21 per cent to Rs. 24.26 per kg. Despite the higher costs, the producer margins improved during the year owing to more favourable prices. The average export (f.o.b.) price of all grades of rubber recorded a substantial increase of 35 per cent to Rs. 37.33 per kg. in 1988. Accordingly, the JEDBs were able to raise their producer margin from Re. 0.26 per kg. in 1987 to Rs. 5.25 per kg. in 1988, while the SLSPCs recorded a producer margin of Rs. 3.83 per kg. in 1988, as against the negative margin of Rs. 1.40 per kg. in the previous year.

Under the impact of the prolonged drought that prevailed in the main coconut growing areas during 1986 and early 1987, coconut production suffered a setback for the second consecutive year in 1988. The total coconut production which declined to 2,292 million nuts in 1987, dropped further by 16 per cent to 1,933 million nuts in 1988, which is the lowest level of production since 1977. The reduced production resulted in a serious shortfall in the availability of nuts for the production of desiccated coconut and coconut oil in 1988. Consequently, the production of desiccated coconut decreased by 55 per cent and that of coconut oil by 52 per cent. Export volumes of copra and fresh nuts also declined by 43 per cent and 28 per cent, respectively.

Meanwhile, the prices of all three major coconut products increased substantially in international markets. The average f.o.b. price per nut rose from Rs. 2.64 in 1987 to Rs. 4.00 in 1988. However, the country was denied the maximum benefit of improved prices, as the availability of nuts for processing for export was very low. The total export volume of coconut kernel products declined substantially by 58 per cent, from 538 million nuts in 1987 to 224 million nuts in 1988. As in the case of tea and rubber, the average COP of coconut increased in 1988, and the cost per nut in 1988 was Rs. 1.21 per nut, compared with Re. 0.99 per nut estimated for 1987, recording an increase of 22 per cent.

A crop which recorded substantial production gains in 1988 was paddy. Paddy production in 1988 is provisionally estimated at 2.5 million metric tons (118 million bushels of paddy or 1.7 million metric tons of rice), showing an increase of 16 per cent. However, this was 7 per cent below the peak production of 2.7 million metric tons realised in 1985. After adjusting for wastage and seed paddy requirements, the availability of rice for consumption is estimated at 1.5 million metric tons. This was sufficient to meet around 88 per cent of the estimated annual consumption, as against 80 per cent achieved in 1987.

The increase in Paddy production was reflected in both Maha 1987/88 and Yala 1988. The production in Maha 1987/88, estimated at 1.52 million metric tons (73.1 million bushels), was an increase of 132,193 metric tons or 9 per cent over that of the previous Maha season. In comparison, the production in Yala 1988, estimated at 0.9 million metric tons (45 million bushels), was a substantial growth of 28 per cent compared with that of the previous Yala season. If not for the continued unsettled conditions in the Northern and Eastern provinces and the late release of water during the Maha season, which had a negative effect on production, the overall production performance in 1988 would have been considerably better.

The increase in paddy production in 1988 was primarily due to an expansion in the gross extent sown and harvested. The total extent sown increased by 84,096 hectares or 11 per cent, to 865,322 hectares. On the other hand, the average yield estimated at 3,419 kgs. recorded a decrease of 4 per cent over that of the previous year. The area sown in Maha season increased by 7 per cent to 544,628 hectares, while that in the Yala season rose markedly by 17 per cent to 320,694 hectares, largely reflecting improved weather conditions. Meanwhile, the total gross extent harvested during 1988 increased by 19 per cent to 811,034 hectares. The harvested area in Maha, 1987/88 rose by 15 per cent and in Yala, 1988 by 27 per cent. The extent of crop failure, which is the difference between the extent sown and the gross extent harvested, was considerably lower in 1988 than in the previous year.

In 1988, paddy purchased by the Paddy Marketing Board under the Guaranteed Price Scheme (GPS) amounted to 105,497 metric tons (5,055,000 bushels), showing a substantial increase of 65 per cent over the quantity purchased during 1987. Higher production in major paddy growing areas in both Maha and Yala seasons was the major contributory factor for this increase. Meanwhile, the guaranteed price of paddy was raised upwards from Rs. 70 to Rs. 80 per bushel in August, 1988 to cushion the adverse impact of the increase in fertilizer prices and provide a higher return to the paddy farmer. Despite the upward revision of the guaranteed price, open market prices of paddy continued to remain well above the guaranteed price during the year. In 1988, the average open market price of paddy was Rs. 93.45 per bushel, showing a 5 per cent increase over that of the previous year.

A crop which recorded very strong growth in 1988 was sugar. The total sugar production which declined by 15 per cent to 29,298 metric tons in 1987, rose to 53,522 metric tons in 1988, an increase of 83 per cent. The factories at Pelwatte and Sevanagala more than doubled their production to 29,972 metric tons and 11,039 metric tons, respectively. The Hingurana factory recorded an increase of 28 per cent in production to 11,084 metric tons. In contrast, sugar production at the Kantale factory suffered a severe setback, recording a 37 per cent decrease, mainly due to the reduced area harvested and the lower average yield resulting from reduced supply of water from the Kantale tank for cane cultivation. Sugar production in the private sector which came entirely from the Pelwatte factory accounted for 56 per cent of the total sugar production in 1988. If not for the labour shortage and breakdown of electricity supply during the fourth quarter following the escalation of civil disturbances, the overall production performance of the sugar sector would have been even more impressive.

The export growth of minor export crops indicates an improved production performance from the depressed levels in the previous year. Among the crops which have shown substantially improved performance in 1988 were coffee, cloves, nutmeg and mace. Significant increases in export volumes were also observed in the case of pepper, sesame seeds and cashew nuts, indicating corresponding output increases. Favourable weather conditions experienced in the major producing areas, coupled with enhanced fertilizer application, contributed to the increase in the output of most export crops in 1988. Judging by the decreases in export volumes, the production of three important crops, viz. cinnamon, cocoa and cardamoms, appeared to have declined in 1988. The unsettled conditions in the Southern province during the fourth quarter of 1988 affected cinnamon production.

Provisional estimates show that fish production in 1988 rose by 4 per cent, to reach 197,536 metric tons. The production increase was modest because of the slow recovery of fishing activities in the Northern and Eastern regions. The reduced production in the Southern province towards the end of the year, as a result of civil disturbances also had an adverse impact. As in the past, the private sector continued to account for a major share of total fish production and the Fisheries Corporation was engaged primarily in the purchasing of fish from the private sector. According to the provisional estimates of the Department of Census and Statistics, the total milk production (including buffalo milk) in 1988 is estimated at 226 million litres, recording a marginal increase of 2 per cent, while the total egg production, estimated at about 778 million, has registered a drop of 5 per cent when compared with the previous year.

In an uncertain atmosphere surrounded by sporadic civil disturbances, industrial growth slowed down in 1988. The value of industrial output expanded by 6 per cent in real terms during the year, compared with 8 per cent in 1987 and 12 per cent in 1986. As in the previous year, the expansion in industrial output came entirely from the private sector industries, where the value of production increased by 11 per cent. In contrast, for the second consecutive year, the value of output in public sector industries declined by 1 per cent. Disruptions to electricity supply, poor attendance at work places and interruptions to the distribution net-work in certain areas were among the major factors responsible for the lower growth in industrial output in 1988.

The industrial sub-sectors that recorded increases in production in 1988 were basic metal products (21 per cent), textile, wearing apparel and leather products (12 per cent), fabricated metal products (9 per cent), chemicals, petroleum and plastic products and non-metallic mineral products (5 per cent each). In contrast the output of the wood and wood products sector decreased by 17 per cent. The continued expansion of the wearing apparel industry, both within and outside the Investment Promotion Zones, was mainly responsible for the high level of output in the textile, wearing apparel and leather products industry. In the non-metallic mineral products sector, the improvement was largely the outcome of increased production by private sector industries manufacturing asbestos, glass products and ceramics.

The decline in the public sector industrial output in 1988 was the outcome of production shortfalls in a number of important public sector industrial enterprises. Among those recording decreases in output were the British Ceylon Corporation (60 per cent), Ceylon Mineral Sands (46 per cent), State Timber (43 per cent), Ceylon Oils & Fats (36 per cent), State Hardware (25 per cent), State Distilleries (23 per cent), National Paper (8 per cent), Sri Lanka Tyre (6 per cent))and National Textile (5 per cent) Corporations, and the State Rubber Manufacturing Company Ltd. (15 per cent). The disruptions caused to electricity supply, absenteeism and the interruption to the distribution programme during the latter half of the year were among the factors contributing to reduce the public sector industrial output. Industrial corporations which recorded increases in output during the year were Sri Lanka Sugar (47 per cent), Ceylon Steel (21 per cent) and Ceylon Petroleum (4 per cent) Corporations. Substantial increases in the output of the Sevanagala and Hingurana Factories, on account of an expansion in the harvesting area, contributed to the higher level of output in the Sri Lanka Sugar Corporation, while increased supply of raw material through imports was primarily responsible for the enhanced production of the Steel Corporation.

As in the previous two years, the budgetary transfers to industrial corporations remained modest in 1988. During the year, such transfers amounted to Rs. 435 million, compared with Rs. 291 million in 1987 and Rs. 489 million in 1986. Of the transfers made in 1988, Rs. 243 million or 56 per cent comprised capital transfers and Rs. 192 million or 44 per cent current transfers. For the fourth consecutive year, the Sri Lanka Sugar Corporation received the largest share of the budgetary transfers effected in 1988.

Despite the continuing uncertainties, there was continued interest shown by investors in the industrial sector, as reflected in the number of investment approvals sought in 1988. The Greater Colombo Economic Commission (GCEC) approved 31 projects in 1988, bringing the total number of projects approved to 283 by the end of 1988. The investment potential of the projects approved in 1988 was estimated at Rs. 1,727 million, with a foreign component of Rs. 1,120 million. Meanwhile, the Foreign Investment Advisory Committee (FIAC) approved 45 industrial projects in 1988, compared with 41 projects in the previous year. These projects envisaged a total investment of Rs. 954 million, with a foreign component of Rs. 225 million. The largest increase in industrial approvals in 1988 was by the Local Investment Advisory Committees (LIACs), which approved 608 projects during the year, compared with 364 projects in the previous year. The total envisaged investment in these projects amounted to Rs. 1,142 million, with an employment potential of approximately 19,000 persons.

The inflationary developments during 1988 were not reassuring. The Colombo Consumers' Price Index (CCPI) showed an increase of 14 per cent in 1988, over the average level in 1987. This was almost twice the increase recorded in 1987. On a point to point basis, *i. e.* December 1988 over December 1987, the annual increase in the CCPI was 15 per cent, suggesting an end year inflation rate of that magnitude. Consumer prices which rose sharply in January 1988, followed a more moderate path thereafter, but escalated considerably during the last two months of the year, largely due to supply shortages caused by the escalating civil disturbances. Meanwhile, prices on the primary market level, as measured by the Wholesale Price Index (WPI), also recorded a similar increase, indicating persistent and wide-spread price pressure in the economy.

During the period 1985-1987, the average rate of increase of the CCPI remained at a single digit level, suggesting the prevalence of more moderate inflationary pressures. Against this background, the re-emergence of double digit inflation in 1988 was a matter for considerable concern.

Several factors contributed towards the escalation of prices during 1988. The lagged effect of the drought, civil disturbances causing artificial supply shortages, higher tariffs on electricity and the revision of excise duty on tobacco and alcohol were the more notable among them. There was also considerable demand pressure on prices. The sharp increase in the money supply, as well as the substantial wage increases granted in several key sectors of the economy, contributed towards maintaining effective demand high during the greater part of the year. There was also the moderate nominal depreciation of the Rupee which pushed import prices up in terms of domestic currency. The escalation of civil disturbances during the last two months of the year and the resulting disruption to transport services led to supply shortages and consequent escalation in the prices of most consumer items during that period. The price pressure in the economy during 1988 was reflected more in food prices. The sub index for food, which has a weight of 62 per cent in the overall index, rose by 15 per cent compared to an increase of 9 per cent in the previous year.

In 1988, the producer prices rose at a slightly higher rate than consumer prices. The Wholesale Price Index (WPI) registered an annual growth rate of 17.8 per cent, compared with the 13.4 per cent increase recorded in 1987. On a point to point basis, *i.e.* December 1988 over December 1987, the index rose by 9.3 per cent. As in the case of consumer prices, the increase in producer prices was more reflected in the prices of food items. The sub index for food rose by 22 per cent during the year, compared with a rise of 19 per cent in 1987. Meanwhile, the sub index for consumer goods had risen by 20 per cent in 1988, compared with 18 per cent in 1987. On a sector-wise classification, the prices of export items rose by 28 per cent in 1988, compared to a 38 per cent increase in the previous year.

The year 1988 witnessed some major developments in the sphere of wages, following the implementation of the recommendations of the Administrative Reforms Committee on Salaries and Cadre in respect of government employees. While half the proposed increase was paid with effect from January, 1988, the balance was granted with effect from November, 1988. Following these revisions, the Average Wage Rate Index of all government employees increased sharply by 31 per cent during the year. Several public corporations and statutory boards revised their wage rates upwards in 1988, and in the private sector, several trades covered by Wages Boards also raised their minimum wages. Consequently, the Minimum Wage Rate Index of all employees covered by Wages Boards rose sharply by 21 per cent, compared to a 6 per cent increase in the previous year. As a result of a substantial wage hike in the plantation sector, the Minimum Wage Rate Index for workers in agriculture rose by 25 per cent in 1988.

According to available estimates, employment in both the public (government and semi-government) and private sectors increased marginally in 1988, compared with the levels in the previous year. In the public sector, employment in such activities as defence services, education, health, transport and provincial administration increased during the year, while employment in plantation, banking, trade, industry and construction declined.

According to provisional estimates of the Survey on Public Sector Employment conducted by the Central Bank, the number employed in the public sector increased marginally by 0.4 per cent, from its level at 1,222,000 at the end of 1987 to 1,227,400 at the end of 1988. Of this, 752,900 were employed in semi-government institutions, while the balance 474,500 were in government institutions. Although employment in semi-government institutions such as public corporations, authorities, statutory boards and other institutions increased only very marginally by 0.03 per cent, the increase has to be viewed against the background of a declining trend in employment in this sector observed in recent years. Regional Transport Boards, trading corporations, service based establishments and higher educational institutions were among the semi-government organisations that registered significant increases in employment in 1988.

Employment in government institutions, consisting of government ministries and departments, increased by 1.1 per cent to 474,500 employees as at the end of 1988. The largest increase was in the defence services.

Data on employment in the private sector are available only in respect of certain sub categories of the organised private sector. According to the Consumer Finance & Socio Economic Survey of 1986/87, the unorganised private sector accounted for about 78 per cent of total employment. The share of the organised private sector was approximately 7 per cent. The public sector, comprising the government public corporations, statutory boards and local government institutions, accounted for the balance 15 per cent. Meanwhile, employment in enterprises under the Greater Colombo Economic Commission (GCEC) continued to increase in the year under review. As at the end of 1988, the total number employed in GCEC enterprises stood at 54,626 ,recording an increase of 7.7 per cent.

It needs to be recognised that the growth in employment opportunities both in the public and private sectors in 1988 was very sluggish. The major reason for this was the continuing uncertainties created by the continuing civil disturbances and the slow-down in economic growth. In the private sector, the non traditional export industries such as textiles and garments continued to be the major source of labour absorption in 1988, which had been a phenomenon observed in recent years.

The developments in Sri Lanka's external trade sector were unfavourable in 1988. The value of exports increased only marginally by 2 per cent in SDR terms, as compared with 4 per cent growth in 1987. Meanwhile, the expenditure on imports, which had dropped by 4 per cent in 1987, rose by 5 per cent in 1988. Consequently, the trade deficit increased by 12 per cent during the year, in sharp contrast to a contraction of 18 per cent in the previous year. The trade deficit as a ratio of GDP rose from 5 to 6 per cent in 1988.

The slow growth of export earnings was primarily due to decreases in earnings from coconut, textiles and garments and petroleum products. Although the earnings from tea, rubber, minor agricultural products, gems and other industrial products increased, these were insufficient to offset sluggishness in other sectors. The higher expenditure on imports was the outcome of increases in both the prices and volumes of major import items. The prices of rice, sugar, wheat grain and fertilizer imports rose by significant margins over 1987, while the volumes of rice, wheat grain and fertilizer imports registered considerable increases.

According to adjusted Customs data, total earnings from exports amounted to SDR 1,097 million (Rs. 46,928 million) in 1988, as compared with SDR 1,080 million (Rs. 41,133 million) in 1987, recording an increase of 1.6 per cent in SDR terms. Individual commodity groups recorded varying export performances during 1988. While agricultural exports recovered to post a moderate growth of 3 per cent, industrial exports registered only a marginal increase of 1 per cent. In contrast, the growth in industrial exports in 1987 was 9 per cent. The most impressive growth in 1988 was that of mineral exports which recorded a 29 per cent increase over 1987.

Among agricultural exports, the value of tea exports recorded a 3 per cent increase, from SDR 280 million (Rs. 10,654 million) in 1987 to SDR 288 million (Rs. 12,299 million) in 1988. Against a decline of 6 per cent in price (in SDR terms) the increase in earnings was solely due to a rise in the export volume by 9 per cent to 220 million kgs. Meanwhile, the value of rubber exports increased by 13 per cent, from SDR 77 million (Rs. 2,929 million), in 1987 to SDR 87 million (Rs. 3,706 million), in 1988, due entirely to a rise in export price by 19 per cent. The volume of rubber exports which had declined by 4 per cent in 1987, dropped a further 6 per cent to 99 million kgs. in 1988. The earnings from coconut exports dropped sharply by 36 per cent, from SDR 56 million (Rs. 2,140 million), in 1987 to SDR 36 million (Rs. 1,538 million) in 1988, owing to a sharp decrease in the export volume caused by lower production. Meanwhile, there was a sharp improvement in the value of minor agricultural exports, which rose by as much as 33 per cent in SDR terms to SDR 60 million (Rs. 2,561 million). In comparison, the value of industrial exports recorded a marginal increase of 1 per cent, from SDR 525 million in 1987 to SDR 530 million in 1988. This was in sharp contrast to a 9 per cent growth posted in the previous year. As mentioned earlier, mineral exports recorded an impressive growth of 29 per cent, but from a lower base of SDR 47 million (Rs. 1,805 million) in 1987 to SDR 61 million (Rs. 2,614 million) in 1988. The large bulk of these consisted of gem exports, the value of which rose from SDR 38 million (Rs. 1,447 million) to SDR 48 million (Rs. 2,070 million).

In the context of a slow growth in export earnings, the export structure underwent marginal changes in 1988. Industrial exports continued to remain the major category of exports, a position achieved in 1986, accounting for 48 per cent of total exports. However, textile and garments exports recorded a marginal decline from 31 per cent of total exports in 1987 to 30 per cent in 1988. Despite this fall, the textile and garments category remained the single largest export item. Meanwhile the share of plantation crops—tea, rubber and coconut—which together accounted for 38 per cent of total exports in 1987, dropped to 37 per cent in 1988. On the other hand, the share of mineral exports increased from 4 per cent to 6 per cent between the two years.

According to adjusted customs data, the total expenditure on imports amounted to SDR 1,665 million (Rs. 71,200 million) in 1988, compared with SDR 1,589 million (Rs. 60,528 million) in 1987, recording increases of 5 per cent in SDR terms and 18 per cent in Rupee terms. The increase was reflected mainly in the consumer goods and intermediate goods categories. In sharp contrast to the experience in the previous year, when the outlay on consumer goods imports declined by 3 per cent in SDR terms, such outlays rose by 12 per cent, from SDR 363 million (Rs. 13,814 million) in 1987 to SDR 408 million (Rs. 17,425 million) in 1988. The increase was reflected in all categories of consumer goods imports. The expenditure on rice imports more than doubled, from SDR 18 million (Rs. 687 million) in 1987 to SDR 42 million (Rs. 1,795 million) in 1988. This was the combined outcome of increases in the volume by 86 per cent, to 210,000 metric tons, and in the price by 25 per cent. A sharp rise in the price of sugar by 29 per cent resulted in the value of sugar imports rising by 9 per cent to SDR 69 million (Rs. 2,927 million), despite a 15 per cent decline in the import volume. The value of milk and milk products also rose sharply by 35 per cent, from SDR 33 million in 1987 to SDR 45 million in 1988.

The import outlay on intermediate goods amounted to SDR 947 million (Rs. 40,508 million) in 1988, compared with SDR 909 million (Rs. 34,619 million) in 1987, recording an increase of 4 per cent in SDR terms. The increase was largely the outcome of increases in both the volume and prices of major import categories such as fertilizer, wheat grain and chemicals. The outlay on fertilizer imports increased sharply by 70 per cent to SDR 58 million (Rs. 2,476 million), owing to a substantial rise in quantity, from 373,000 metric tons to 556,000 metric tons, and a 14 per cent increase in price. Again, due to increases in the volume by 6 per cent and the price by 30 per cent, the outlay on wheat grain imports rose by 38 per cent, from SDR 51 million (Rs. 1,923 million) in 1987 to SDR 70 million (Rs. 2,983 million) in 1988. Meanwhile, the expenditure on chemical imports rose from SDR 41 million (Rs. 1,559 million) to SDR 44 million (Rs. 1,887 million). Despite these increases, the growth in the value of intermediate goods imports was moderated to some extent by a sharp drop in expenditure on petroleum imports, which declined by 20 per cent, owing entirely to a 21 per cent reduction in price, from SDR 14 to SDR 11 per barrel.

In contrast to consumer and intermediate goods imports, the expenditure on investment goods imports dropped by 5 per cent, from SDR 297 million (Rs. 11,334 million) in 1987 to SDR 283 million (Rs. 12,081 million) in 1988. This was a reflection of a slowing down of investment activities in an atmosphere of increasing uncertainties. The value of transport equipment imports dropped from SDR 37 million to SDR 33 million or by 12 per cent, while that of machinery fell from SDR 174 million to SDR 165 million or by 5 per cent.

TABLE 1.3

Summary of Balance of Payments 1985 - 1988

Rs. Million (SDR million in brackets)

Item	1985	1986	1987(a)	1988(b)
Merchandise (Net) ..	-19,801 (-711)	-21,390 (-649)	-20,005 (-525)	-24,512 (-574)
Non-Factor Services (Net) ..	-201 (-8)	255 (8)	74 (3)	96 (3)
Factor Services (Net) ..	- 3,445 (-125)	- 3,871 (-117)	- 4,699 (-124)	- 5,499 (-129)
Private Transfers (Net) ..	7,212 (262)	7,983 (242)	9,226 (242)	9,998 (234)
Official Transfers (Net) ..	4,828 (172)	5,114 (153)	5,311 (139)	6,076 (142)
Current Account Balance ..	-11,408 (-410)	-11,909 (-363)	-10,093 (-265)	-13,841 (-324)
Overall Balance ..	- 1,060 (-111)	- 2,124 (- 74)	- 1,801 (-72)	- 5,000 (-101)

Some Key Indicators

Terms of Trade (1981 = 100) ..	115	111	114	106
Net Petroleum Imports ..	7,109 (257)	3,935 (120)	6,124 (161)	5,574 (130)
Current Account Deficit as a Percentage of G.D.P. ..	6·9	6·7	5·1	6·2
Gross International Reserves ..	18,367 (611)	17,152 (492)	18,134 (415)	17,482 (393)
International Reserves in Months of Imports (*c*) ..	4·4	3·7	2·9	2·6

Source : Central Bank of Sri Lanka.

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

In terms of both trade and current account balances, Sri Lanka's balance of payments recorded considerable deterioration in 1988. The deficit in the merchandise account widened by 9 per cent, from SDR 525 million (Rs. 20,005 million) in 1987 to SDR 574 million (Rs. 24,512 million) in 1988. Following the same path, the current account deficit expanded by 22 per cent, from SDR 265 million (Rs. 10,093 million) in the previous year to SDR 324 million (Rs. 13,841 million) in 1988. Thus, the current account deficit to GDP ratio increased from 5.1 per cent in 1987 to 6.2 per cent in 1988, reflecting increased pressure on the balance of payments. Meanwhile, the net non-monetary capital inflow for financing the current account deficit, fell by 11 per cent in 1988, thus leaving an enlarged overall deficit of SDR 101 million to be met by drawing on the external assets of the country. This was the fourth consecutive year in which the overall balance was in deficit, and the cumulative deficit during the last 4 years was in the region of SDR 358 million.

The net outpayment on account of services rose from SDR 120 million (Rs. 4,625 million) in 1987 to SDR 126 million (Rs. 5,403 million) in 1988. This was largely due to an increased outflow on account of interest payments and a decline in earnings from tourism. Interest payments and other charges on external debt, inclusive of obligations to the IMF, rose from SDR 150 million (Rs. 5,721 million) in 1987 to SDR 165 million (Rs. 7,052 million) in 1988. The increase in interest payments was owing to both a rise in the external debt, as well as higher international interest rates. Meanwhile, the downward trend in tourist receipts which commenced in 1983 continued during 1988. Gross earnings from tourism declined from SDR 55 million (Rs. 2,107 million) in 1987 to SDR 46 million (Rs. 1,964 million) or by 16 per cent in 1988.

As in the previous year, the port, transportation and insurance category in the services account showed a positive development in 1988. The surplus in this category rose from SDR 2 million (Rs. 65 million) in 1987 to SDR 6 million (Rs. 219 million) in 1988. This larger surplus was attributable to increased receipts from port services and Air Lanka passenger fares and a reduction in foreign payments by Air Lanka.

In recent years, foreign exchange receipts on account of remittances by Sri Lankans working abroad had been a major source of balance of payments support in Sri Lanka. However, after reaching a peak in 1984, such remittances have continued to decline slowly thereafter, in real terms. The gross receipts from private transfers amounted to SDR 262 million in 1988, compared with SDR 270 million in 1987. However, in Rupee terms, these remittances showed an increase of 8 per cent, from Rs. 10,324 million in 1987 to Rs. 11,194 million in 1988. In 1988, official transfers, consisting of project and commodity grants, rose marginally from SDR 139 million (Rs. 5,311 million) to SDR 142 million (Rs. 6,077 million). Thus, the combined transfer receipts from private and official sources, taken together, recorded a marginal decline in SDR terms. In 1988, the net transfer payments were sufficient to meet only 54 per cent of the deficit on goods and services, as compared with 59 per cent in 1987, leaving a larger current account deficit amounting to SDR 324 million (Rs. 13,841 million), to be financed by capital flows. The current account deficit in 1987 was SDR 264 million. Thus after two years of improved performance, the current account balance in 1988 took a turn for the worse.

Usually, the current account deficit, which is by definition the gap between domestic investment and domestic savings, is expected to be financed by capital flows in the form of private foreign investment and official capital. However, such capital flows which had declined in 1987, suffered a further setback in 1988, falling by 11 per cent, from SDR 218 million (Rs. 8,408 million) in 1987 to SDR 193 million (Rs. 8,231 million) in 1988. The decline was primarily due to a sharp reduction in net capital flows to the private sector and increased amortization payments on official loans. Disbursements under long-term official loans increased from SDR 265 million (Rs. 10,162 million) in 1987 to SDR 286 million (Rs. 12,243 million) in 1988. However, on account of increased amortization payments on such loans amounting to SDR 122 million (Rs. 5,234 million), the net resource availability in the form of official capital flows was reduced to SDR 164 million (Rs. 7,009 million) during the year. At the same time, the net inflows of private capital declined sharply from SDR 65 million in 1987 to SDR 29 million in 1988.

Altogether, the net capital flows, both official and private, were sufficient to finance only 60 per cent of the widened current account deficit in 1988, leaving a large overall deficit to be financed by drawing on external reserves. The gross external assets declined by SDR 22 million or 5 per cent in 1988, and this was the fourth consecutive year when the country's external assets had to be utilised for financing the balance of payments deficit. The gross external assets at the end of December, 1988 stood at SDR 393 million (Rs. 17,482 million), compared with SDR 415 million (Rs. 18,134 million) at the end of 1987. The level of gross external assets at the end of 1988 was sufficient to finance only about 2 1/2 months imports projected for 1989, as compared with 3 months imports available at the end of 1987.

Since 1985, the Sri Lanka Rupee has been depreciating in nominal terms against all major currencies, largely due to the appreciation of most international currencies against the US Dollar. In 1988, however, the exchange rate movements had been mixed. During the year, the Sri Lanka Rupee appreciated vis-a-vis a number of currencies—10 per cent against the Indian Rupee, 4.3 per cent against the Deutsche Mark and 5.2 per cent against the French Franc. However, it continued to depreciate, in nominal terms, against a number of other currencies—3.2 per cent against the Pound Sterling and 5.3 per cent against the Japanese Yen. Against the US Dollar, the Rupee depreciated by 6.9 per cent and against the SDR at a lower rate of 2.3 per cent, reflecting the strengthening of the US Dollar against the SDR in 1988. The nominal effective exchange rate (NEER) of the Sri Lanka Rupee, defined as the trade weighted nominal exchange rate with respect to major trading partners, depreciated by 5.1 per cent in 1988. On the other hand, the real effective exchange rate (REER), *i.e.*, the nominal effective exchange rate adjusted for inflation differentials between Sri Lanka and her major trading partners, appreciated by 5.3 per cent, on a point to point basis.

The rapid accumulation of external debt had been a matter of concern in recent years. Sri Lanka's total outstanding external debt, including short-term loans, trade credits and Central Bank borrowings rose from SDR 3,372 million (Rs. 144,889 million) at the end of 1987 to SDR 3,679 million (Rs. 162,548 million) at the end of 1988. Thus, the external debt increased by 9 per cent in SDR terms and by 12 per cent in Rupee terms during the year. In the previous year, while the external debt decreased marginally in SDR terms, in Rupee terms it rose by 24 per cent. Reflecting the higher rate of increase in the external debt than the GDP, the external debt to GDP ratio increased from 65 per cent in 1987 to 70 per cent in 1988.

Even though the external debt increased during the year, a welcome development had been a reduction in the short-term debt which dropped by 11 per cent, from SDR 192 million (Rs. 8,348 million) in 1987 to SDR 170 million (Rs. 7,556 million) in 1988. This was primarily due to a decline in the Central Bank's foreign borrowings from SDR 41 million to SDR 5 million. Meanwhile, the outstanding level of private sector medium and long-term debt increased by SDR 26 million during the year. With these changes, there was some improvement in Sri Lanka's external debt profile in 1988. Owing to the conscious policy of discouraging commercial borrowings, the share of such borrowings in the total debt declined from 21 per cent to 19 per cent between 1987 and 1988.

The total service payments, which include amortization payments on medium and long-term loans and interest payments on all foreign loans, increased from SDR 383 million (Rs. 14,538 million) in 1987 to SDR 399 million (Rs. 17,018 million) in 1988. This reflected an increase of 4 per cent in SDR terms and 17 per cent in Rupee terms. The increase in the service payments in 1988 was solely due to a sharp increase in interest payments. Altogether, interest payments increased from SDR 130 million (Rs. 4,916 million) to SDR 149 million (Rs. 6,363 million) or by 14 per cent, largely due to a sharp rise in interest rates in overseas markets. Interest payments accounted for 37 per cent of the total debt service payments in 1988, compared with 34 per cent in 1987. In contrast, amortization payments dropped marginally from SDR 254 million to SDR 251 million. Reflecting the increase in interest payments, the debt service ratio, *i.e.* the total debt service payments as a ratio of exports of goods and services, rose from 27.7 per cent in 1987 to 28.8 per cent in 1988. The overall debt service ratio, *i. e.* total service payments as a ratio of current account receipts, excluding official transfers, also rose from 23.2 per cent to 24.2 per cent between the two years. The rise in the debt service ratio was the outcome of both higher debt service payments, as well as the sluggish growth in exports and other receipts.

The adverse developments in the balance of payments in 1988 were the outcome of several factors. First, the continued civil disturbances prevented the full potential of the export sector from being realised. Second, the prices of basic food items that Sri Lanka imports, such as rice, wheat grain and sugar, and of some intermediate goods such as fertilizer, recorded substantial increases in international markets. Third, the implementation of macro economic adjustment policies which sought to improve the balance of payments performance was interrupted by the heavy demands made on resources by the unsettled conditions in the country. Furthermore, these uncertainties also prevented the anticipated capital flows, both private and official, from being fully realised. Under the impact of these developments, the balance of payments position deteriorated sharply and the external assets position weakened to a critical level—the lowest since 1982.

The year 1988 also marked a sharp deterioration in the government's fiscal operations. According to provisional data, the current account of the Budget recorded a deficit of Rs. 6,031 million (2.7 per cent of GDP) in 1988, in sharp contrast to a surplus of Rs. 2,585 million (1.3 per cent of GDP) in 1987. Meanwhile, the overall budget deficit (before grants) in 1988 was Rs. 33,854 million (15.2 per cent of GDP), as compared with an anticipated deficit of Rs. 26,309 million (11.6 per cent of GDP) in the approved estimates. The overall deficit in 1987 was Rs. 21,749 million (11.1 per cent of GDP). The widened budget deficit in 1988 resulted in increased reliance on bank credit to finance the deficit. The resources so utilised from the banking system amounted to Rs. 9,078 million (4.1 per cent of GDP) in

1988, as compared with Rs. 3,541 million (1.8 per cent of GDP) in 1987. These developments indicate a sharp deterioration in the government's fiscal operations in 1988, as compared with the performance in 1987, as well as the anticipated performance in the original estimates.

TABLE 1.4

Summary of Government Fiscal Operations

Rs. Million

Item	1984	1985	1986	1987	1988 Estimates
Total Revenue and Grants	**37,354**	**39,556**	**40,991**	**46,822**	**47,877**
Total Revenue	**34,061**	**36,249**	**37,238**	**42,145**	**42,149**
Tax Revenue	29,939	30,442	31,272	35,119	35,691
Non Tax Revenue	4,122	5,807	5,966	7,026	6,458
Grants	**3,293**	**3,307**	**3,753**	**4,677**	**5,728**
Expenditure and Lending Minus Repayments	**47,837**	**55,234**	**59,193**	**63,894**	**76,003**
Current	24,630	32,645	33,966	39,560	48,180
Capital	19,915	21,530	23,236	22,816	21,212
Lending Minus Repayments	3,292	1,059	1,991	1,518	6,611
Current Account Surplus/Deficit(-)	**9,431**	**3,604**	**3,272**	**2,585**	**- 6,031**
Budget Deficit (before Grants)	**- 13,776**	**- 18,985**	**- 21,956**	**- 21,749**	**- 33,854**
Budget Deficit (after Grants)	**- 10,483**	**- 15,678**	**- 18,204**	**- 17,072**	**- 28,126**
Financing	**10,483**	**15,678**	**18,204**	**17,072**	**28,126**
Foreign Borrowings	**6,492**	**7,109**	**9,061**	**5,716**	**7,029**
Domestic Borrowings	**3,991**	**8,569**	**9,143**	**11,356**	**21,097**
Non Market Borrowings	951	- 1,801	- 669	1,415	2,703
Market Borrowings	3,040	10,370	9,812	9,941	18,394
Non Bank	5,135	5,659	6,765	6,400	9,316
Bank	- 2,095	4,711	3,047	3,541	9,078

(as a percentage of GDP)

Item	1984	1985	1986	1987	1988 Estimates
Total Revenue and Grants	**24·3**	**24·4**	**22·8**	**23·8**	**21·5**
Total Revenue	**22·2**	**22·3**	**20·8**	**21·4**	**18·9**
Tax Revenue	19·5	18·7	17·4	17·9	16·0
Non Tax Revenue	2·7	3·6	3·3	3·6	2·9
Grants	2·1	2·0	2·1	2·4	2·6
Expenditure and Lending Minus Repayments	**31·1**	**34·0**	**33·0**	**32·5**	**34·1**
Current	16·0	20·1	18·9	20·1	21·6
Capital	13·0	13·3	13·0	11·6	9·5
Lending Minus Repayments	2·1	0·7	1·1	0·8	3·0
Current Account Surplus/Deficit(-)	**6·1**	**2·2**	**1·8**	**1·3**	**- 2·7**
Budget Deficit (before grants)	**- 9·0**	**- 11·7**	**- 12·2**	**- 11·1**	**- 15·2**
Budget Deficit (after grants)	**- 6·8**	**- 9·7**	**- 10·1**	**- 8·7**	**- 12·6**
Financing	**6·8**	**9·7**	**10·1**	**8·7**	**12·6**
Foreign Borrowings	**4·2**	**4·4**	**5·1**	**2·9**	**3·2**
Domestic Borrowings	**2·6**	**5·3**	**5·1**	**5·8**	**9·5**
Non Market Borrowings	0·6	- 1·1	- 0·4	0·7	1·2
Market Borrowings	2·0	6·4	5·5	5·1	8·2
Non Bank	3·3	3·5	3·8	3·3	4·2
Bank	- 1·4	2·9	1·7	1·8	4·1

Source : Central Bank of Sri Lanka.

The deterioration in the fiscal outturn in 1988 was the outcome of several developments. First, the unsettled conditions in the country and the sporadic disturbances, resulted in a lower collection of revenue from several sources. Second, the increased commitments on account of personal emoluments, interest payments, food stamps, drought relief and security related outlays led to a substantial expansion in current expenditure. Third, the advance account operations under the food purchase and distribution account resulted in a considerable increase in outlays. Fourth, a large number of supplementary capital expenditure provisions had to be accommodated, as the year progressed. Under the combined effect of these factors, the budget deficit (before grants) increased from Rs. 21,749 million in 1987 to Rs. 33,854 million in 1988—an increase of 56 per cent.

Government revenue in 1988 amounted to Rs. 42,149 million, almost the same as in the previous year. However, in relation to GDP government revenue dropped from 21.4 per cent in 1987 to 18.9 per cent in 1988. Reflecting the poor revenue performance, the tax/GDP ratio declined from 17.9 per cent in 1987 to 16 per cent in 1988, while the non-tax revenue/GDP ratio also fell from 3.6 per cent to 2.9 per cent. Tax revenue at Rs. 35,691 million recorded a marginal growth of 2 per cent and accounted for 85 per cent of the total revenue in 1988, in comparison to 83 per cent contributed in the previous year. The decline in the tax revenue/GDP ratio indicates that the rate of growth in government revenue had failed to keep pace with the rate of growth of income in 1988.

On the expenditure side, total current expenditure in 1988 at Rs. 48,180 million registered an increase of 22 per cent over the previous year. As a ratio of GDP, the current expenditure rose from 20.1 per cent in 1987 to 21.6 per cent in 1988. The expenditure on goods and services amounting to Rs. 21,916 million accounted for 45 per cent of the total current expenditure, while transfer payments totalling Rs. 13,519 million formed 28 per cent. The total interest payment on government debt amounted to Rs. 12,745 million and represented 26 per cent of the total current expenditure in 1988.

In contrast to current expenditure, the capital expenditure recorded a decline, both in relation to approved estimates, as well as the level reached in 1987. During the year, capital expenditure totalled Rs. 21,212 million, as compared with Rs. 27,017 million provided for in the approved estimates. In the previous year, capital expenditure totalled Rs. 22,816 million, which reveals a decline of 7 per cent in 1988. Accordingly, government capital formation as a proportion of GDP dropped from 11.6 per cent in 1987 to 9.5 per cent in 1988.

The total budgetary resources mobilised by way of revenue and grants amounted to Rs. 47,877 million in 1988. On the other hand, on account of a sharp increase in current expenditure, the total expenditure escalated to Rs. 76,003 million or by 19 per cent. The resulting budget deficit (after grants) at Rs. 28,126 million was 65 per cent higher than the deficit in 1987. As a proportion of GDP, the deficit increased from 8.7 per cent in 1987 to 12. 6 per cent in 1988.

In the context of a sharply enlarged budget deficit, the mobilisation of resources for financing the deficit posed thorny problems in 1988. The resources available from foreign sources at Rs. 7,029 million, although an increase of 23 per cent over the amount available in the previous year, represented only a fourth of the resources required for financing the deficit. Accordingly, heavy domestic market borrowings had to be resorted to for the purpose. In 1988, market borrowings brought in Rs. 18,394 million, which was an increase of 85 per cent over the amount borrowed in the previous year. This comprised Rs. 9,316 million from non-bank sources and Rs. 9,078 million from banking sources. Of the latter, a sum of Rs. 926 million was through Central Bank's provisional advances and Rs. 10,363 million through the issue of Treasury bills. The resources utilized from the banking system in financing the budget deficit in 1988 at 4.1 per cent of GDP was one of the highest recorded for a single year in recent times.

The outstanding government debt stood at Rs. 223,002 million at the end of 1988. This was an increase of Rs. 32,193 million or 17 per cent over the debt outstanding at the end of 1987. Of the total debt, domestic debt rose by 25 per cent to Rs. 98,594 million, while the foreign debt increased by 11 per cent to Rs. 124,408 million. Medium and long-term debt accounted for 51 per cent of the outstanding domestic debt in 1988, falling from 57 per cent in the previous year. Correspondingly, the share of short-term debt rose from 43 per cent in 1987 to 49 per cent in 1988. The change in the debt structure towards short-term maturities was the inevitable outcome of heavy borrowings through Treasury bills during the year—a development to be taken note of in the interest of future fiscal stability.

The fiscal developments in 1988 resulted in further worsening macro economic imbalances in the economy, causing pressure on the money supply, prices, balance of payments and external reserves. In the context of a sharply expanded budget deficit requiring high bank financing with attendant adverse consequences, attempts were made to siphon-off excess liquidity in the economy by tightening monetary policy, particularly through intensified open market operations. Such action, however, even after allowing the yield on Treasury bills to move upto about 19 per cent per annum, was of limited success in neutralising the excessive liquidity creation through the budget deficit, underscoring the need for concerted action for consolidating the fiscal position, if the much needed macro economic stability is to be achieved.

The year 1988 witnessed considerable acceleration in the growth of money supply. The annual rate of growth of narrow money supply (M_1), which stood at 18 per cent at the end of 1987, increased sharply to 29 per cent by the end of 1988, while the annual rate of growth of broad money supply (M_2) also rose from 15 per cent to 16 per cent, between the two periods. As mentioned previously, the rate of inflation, as measured by the changes in the CCPI, was twice that of the previous year. Against this background, monetary policy had to take a rather restrictive stance in 1988. While the reserve requirements of commercial banks were considerably tightened, intensified open market operations were pursued for the major part of the year to siphon-off excess liquidity from the economy. The emphasis of the latter was more in the Treasury bills market, where there was greater market orientation in its operations. Following these developments, the short-term interest rates firmed up, but the overall changes in the interest rate structure were less pervasive than those warranted by the market developments. The Central Bank continued to provide refinance facilities, both for promoting activities in productive sectors of the economy, as well as for overcoming temporary liquidity problems faced by commercial banks.

TABLE 1.5

Monetary Magnitudes 1983 - 1988

Rs. Million

Item	1983	1984	1985	1986	1987	1988
Change in Domestic Credit ..	**6,895**	**633**	**9,300**	**4,883**	**11,457**	**21,302**
Increase in Net Credit to Govt. ..	383	-2,979	5,793	2,198	4,502	9,017
Increase in Credit to Govt. Corp. ..	-292	-237	290	301	2,627	3,421
Increase in Credit to Cooperatives ..	635	-255	-263	120	-301	195
Increase in Credit to other Private Sector ..	6,170	4,104	3,480	2,263	4,629	8,669
Change in Net External Banking Assets ..	**815**	**6,777**	**-691**	**-414**	**-443**	**-3,772**
Change in Total Assets/Liabilities ..	**7,710**	**7,410**	**8,609**	**4,468**	**11,014**	**17,530**
Increase in Broad Money Supply (M_2)	6,747	6,170	4,982	2,451	7,475	9,611
Increase in Other Liabilities (Net) ..	963	1,240	3,627	2,018	3,539	7,919
Percentage Increases in Monetary Magnitudes						
Percentage Increase in Total Domestic Credit ..	16·3	1·3	18·6	8·2	17·9	28·2
Percentage Increase in Total Assets and Liabilities ..	17·2	14·1	14·4	6·5	15·1	20·9
Govt. as a percentage of Total Domestic Credit Increase ..	5·6	-470·4	62·3	45·0	39·3	42·3
Non Govt. as a percentage of Total Domestic Credit Increase ..	94·4	570·4	37·7	55·0	60·7	57·7
Percentage increase in : -						
Broad Money Supply (M_2) ..	22·1	16·6	11·4	5·1	14·7	16·4
Narrow Money Supply (M_1) ..	25·4	14·1	11·5	12·9	18·4	29·1

Source : Central Bank of Sri Lanka.

The acceleration in the growth of money supply in 1988 was reflected more in the narrow monetary aggregate. The narrowly defined money supply (M_1), consisting of currency and demand deposits held by the public, rose by Rs. 7,296 million or 29 per cent, compared with an increase of Rs. 3,904 million or 18 per cent in 1987. In comparison, the broad money supply (M_2), defined to include M_1 plus time and savings deposits held by the public with commercial banks (quasi money), expanded by Rs. 9,611 million or 16 per cent. The corresponding increase in broad money in 1987 was Rs. 7,475 million or 15 per cent. The lower growth in broad money was due to a slowing down in the growth of time and savings deposits of the public held with commercial banks, which rose by Rs. 2,315 million or 7 per cent in 1988, compared with Rs. 3,571 million or 12 per cent in 1987.

In sharp contrast to the experience in the previous year when the expansion in M_1 was more evenly distributed between the currency component (Rs. 1,925 million) and the demand deposit component (Rs. 1,979 million), in 1988 the expansion in M_1 was heavily concentrated in the currency holdings of the public, which rose by Rs. 4,992 million or 37 per cent, Consequently, the share of the currency component in M_1 rose from 54 per cent in 1987 to 57 per cent in 1988. This unhealthy development was partly due to a disruption of normal banking services in some parts of the country and partly to the public's preference for liquid assets to meet unforeseen emergencies in the context of sporadic outbreaks of violence in the country. Alongside the sharp rise in the currency component of the money supply, there was also a considerable increase in the demand for currency notes of higher denominations viz. Rs. 500 and Rs. 1000. This reflects the increased use of high value notes for transaction purposes against a background of continuing inflationary pressures in the economy.

The slowing down in the growth of time and savings deposits of commercial banks (quasi money) was yet another adverse development experienced in 1988. In 1988, the growth in quasi money was only Rs. 2,315 million or 7 per cent, compared with an expansion of Rs. 3,571 million or 12 per cent in 1987. The deceleration in the growth of quasi money in 1988 was perhaps a reflection of a loss of attractiveness of bank deposits as an investment outlet in the context of rising inflationary tendencies in the economy. The growth in quasi money came mainly from other private sector constituents (OPSC), *i.e.* private sector proper, whose time and savings deposits rose by Rs. 2,100 million or 8 per cent. In comparison, time and savings deposits of government corporations recorded only a marginal increase, while those of co-operative institutions registered a decline.

The operations of the external sector were contractionary on the money supply for the fourth consecutive year in 1988. In all, external banking assets (net) declined by Rs. 3,772 million in 1988 or by 45 per cent. The decreases in these assets in 1985, 1986 and 1987 were Rs. 691 million or 7 per cent, Rs. 414 million or 4 per cent and Rs. 443 million or 5 per cent, respectively. The larger decline in net external assets of the banking system in 1988 reflects the worsening of the balance of payments position. The overall deficit in the balance of payments in 1988 was SDR 101 million, compared with the deficit of SDR 72 million in 1987 and SDR 73 million in 1986. The continued decline in net external assets of the banking system since 1984 and the worsening of the balance of payments position in 1988 reflects the increased pressures that Sri Lanka's external sector is exposed to in the context of widening macro economic instability in the country.

As the external sector exerted a contractionary impact on the money supply, a sharp growth in domestic credit was the main underlying factor for the acceleration in the growth of monetary aggregates in 1988. The domestic credit expansion (DCE) in 1988 was Rs. 21,302 million or 28 per cent, compared with Rs. 11,457 million or 18 per cent in 1987. The growth in domestic credit (DC) in 1988 consisted of an increase of Rs. 9,017 million or 33 per cent in net credit to government (NCG) from the banking system and an expansion of Rs. 12,285 million or 25 per cent in gross credit to private sector (GCPS) from commercial banks. The corresponding increases in the previous year were Rs. 4,502 million or 20 per cent and Rs. 6,955 million or 17 per cent, respectively.

The government's recourse to bank credit for budgetary purposes on a continuing basis had been a matter for considerable concern in recent years. In 1988, there was a further set-back on this score, when the net bank borrowings for budgetary purposes rose to an all time high of Rs. 9,017 million, amounting to 4 per cent of GDP. The need to resort to bank financing on this scale arose owing to a deterioration in the budgetary situation, which was due to both a short fall in revenue, as well as a considerable increase in expenditure. The latter was primarily the outcome of increased commitments on account of defence and the wage increases in the public sector.

In sharp contrast to the experiences in the previous year when the overwhelmingly large share of government's borrowings from the banking system came from commercial banks, the major share of such credit in 1988 was from the Central Bank. Altogether, NCG from the Central Bank rose by Rs. 8,316 million or 34 per cent during the year, while the NCG from commercial banks was Rs. 701 million or 8 per cent of total net bank borrowings. The need to borrow from the banking system was more marked during the closing months of 1988, reflecting both increased commitments, as well as the disruptions to revenue collection. During the last 2 months of 1988, the NCG rose by Rs. 5,259 million, exerting considerable pressure on the monetary aggregates.

The Central Bank's accommodation of government's borrowing requirements had been one of the major factors responsible for the expansion in the reserve money base, which increased by Rs. 2,468 million during the first half of 1988 and by a further Rs. 3,823 million during the second half. Thus, in all, the reserve money base increased by Rs. 6,291 million in 1988 as a composite outcome of a decline in net foreign assets (Rs. 2,977 million) and increases in net credit to government (Rs. 8,321 million), loans to commercial banks including refinance facilities (Rs. 358 million) and other items (net) (Rs.589 million). This large increase in the reserve money base no doubt exerted significant expansionary pressures on the monetary aggregates and prices.

In a parallel development to that of the Government, the private sector too resorted to heavy bank credit in 1988. Compared to an increase of Rs. 6,955 million or 17 per cent in the previous year, gross credit to private sector rose by Rs. 12,285 million or 25 per cent during 1988. The large bulk of this increase amounting to Rs. 8,689 million or 71 per cent, was in favour of other private sector constituents (OPSC). Credit utilized by this sector mainly took the form of loans and overdrafts, which recorded increases of Rs. 3,347 million and Rs. 2,761 million, respectively. The increased utilization of bank credit by the private sector is a reflection of the maintenance of a high level of commercial activity in that sector despite adverse circumstances.

During the year, commercial bank credit to government corporations increased by Rs. 3,421 million or 46 per cent, compared to a rise of Rs. 2,727 million or 55 per cent in the previous year. The sharp rise in credit to this sector reflected increased working capital requirements of certain key corporations such as the Ceylon Petroleum Corporation, State Plantations Corporation, Janatha Estates Development Board and the Co-operative Wholesale Establishment, owing to the unsettled conditions, on the one hand, and the rising costs, especially the enhanced wage bills, on the other.

In 1988, credit to co-operative institutions rose by Rs. 195 million or 17 per cent in contrast to a decline of Rs. 301 million or 21 per cent the previous year. The growth in credit to this sector was entirely reflected in the enhanced credit utilized for financing paddy purchases, the settlement of which had been delayed due to unsettled conditions during the last quarter of the year.

The year 1988 witnessed the emergence of a new concept of banking in Sri Lanka– agency banking. Under this scheme, which commenced in October, 1988, the two state banks enlisted the services of village money lenders to grant small loans to borrowers in the rural sector on more simplified and easy terms. The scheme involved the appointment of agents by the two state banks and granting loans to them for on-lending to prospective borrowers. Loans were available for the purposes of agriculture, industry (small scale), commerce, consumption and the purchase of consumer durable and for other miscellaneous purposes. By the end of 1988, 100 agents had been appointed by the Bank of Ceylon and 65 by the People's Bank under this scheme.

There was a general firming of interest rates in Sri Lanka during 1988, which was more pronounced at the short end of the market. Reflecting primarily the expanded demand for funds by the Government, which had to be satisfied through successive fresh issues of Treasury bills, the interest rates in this market rose to significantly high levels, particularly during the last four months of 1988. The weighted average interest rate on Treasury bills rose from 10.8 per cent per annum at the end of 1987 to 18.9 per cent by the end of 1988. The upward movement in rates in the primary Treasury bills market had its repercussions on the interest rates in the secondary Treasury bills market, where discount and rediscount rates underwent somewhat similar changes. Meanwhile, the coupon rate on Central Bank securities rose from 11 to 14 per cent in September and the yield on these securities rose to 16.20 per cent per annum at the auction held in September, from a range of 12.19 to 14.0 per cent per annum applicable to previous issues.

Reflecting the pressure generated by the upward movement of interest rates in the Treasury bill market and the increased demand for short-term funds within the commercial banking system, the interest rates in the inter-bank call money market recorded a significant increase during the year. The interest rates in this market rose from a range of 11-14 per cent per annum at the end of 1987 to a range of 16-21 per cent per annum by the end of 1988.

Although the short-term interest rates recorded somewhat sharper increases during 1988, the movement in the deposits rates of commercial banks was relatively modest. The maximum and minimum rates on 1 year deposits which ranged between 8.5 and 14.0 per cent per annum at the beginning of the year rose to a range between 9.0 and 15.5 per cent per annum by December, 1988. Meanwhile, interest rates offered by commercial banks on Certificates of Deposits rose from a range of 7 to 13 per cent per annum at the end of 1987 to a range between 8 and 14 per cent per annum by the end of 1988. The finance companies recorded a marginal increase in interest rates offered on Certificates of Deposits, from a range between 8 and 18 per cent per annum to a range between 10 and 18 per cent per annum during the year.

The slight upward movement in the rates offered on deposits was also reflected in the lending rates of commercial banks, where the rates were on a rising trend. The weighted average prime lending rate fluctuated between a range of 12.9 to 17.2 per cent per annum during 1988, compared with a range between 13.5 and 15.1 per cent per annum during the preceding year.

In view of the adverse developments in some finance companies in the recent past, the deposits rates of finance companies continued to be regulated by the Central Bank in 1988. In this regard, several directions were issued by the Bank under the Control of Finance Companies Act No. 27 of 1979, with a view to limiting the maximum interest rates offered on deposits and other instruments issued by finance companies. In terms of these directions, maximum rates which may be paid on 12 months deposits varied between 16.7 and 24 per cent per annum.

In the context of excessive growth in money supply and the continuing pressure on prices, the authorities were obliged to pursue an increasingly restrictive monetary policy in 1988. This was primarily aimed at siphoning-off excess liquidity in the economy through open market operations. The measures implemented included intensified sales of Treasury bills to non-Central Bank sources, particularly the commercial banks, the introduction of a re-purchase market for Treasury bills and the issue of Central Bank securities. Market forces were permitted to operate freely in the determination of interest rates on Treasury bills. Consequently, the weighted average interest rate on 3 months Treasury bills rose from 10.8 per cent at the end of 1987 to 18.9 per cent per annum at the end of 1988. The Central Bank also endeavoured to reduce its holdings of Treasury bills through intensified sales in the secondary Treasury bills market. However, in the face of heavy fresh issues of Treasury bills, the open market operations had only a limited success in reducing the share of Treasury bills held by the Central Bank. None-the-less, the total Treasury bill holdings of non-Central Bank sources rose from Rs. 8,223 million at the end of 1987 to Rs. 11,434 million by the end of 1988, representing 27 per cent of the total Treasury bills outstanding.

Another important monetary policy measure introduced during the year was the increase in the statutory reserves that commercial banks should maintain against their deposit liabilities. With effect from February, 1988, the statutory reserve ratio on all deposit liabilities was raised by 3 percentage points to 13 per cent. This was further raised by 2 percentage points to 15 per cent in September, 1988. However, in order to cushion the commercial banks of high intermediation costs, the increases on both occasions were permitted to be maintained in the form of government Treasury bills.

Although monetary conditions demanded the pursuance of a stringent monetary policy un-interrupted, two special relief measures had to be introduced in December for augmenting the liquidity of commercial banks to assist some industrialists affected by the civil disturbances. First, the Central Bank, in terms of Section 83(1)(*c*) of the Monetary Law Act provided assistance to affected commercial banks in the form of temporary accommodation at a special interest rate of 15 per cent per annum. Second, commercial banks were afforded an additional temporary facility under which the repayment period in respect of refinance granted by the commercial banks on account of pre-shipment advances to exporters was extended from the usual period of 3 months to 5 months.

The Central Bank continued to provide refinance facilities to commercial banks and certain other financial institutions for promoting short and medium-term lending to priority sectors of the economy. In addition, during 1988 refinance facilities also had to be provided to commercial banks to overcome liquidity problems caused by the escalation of civil disturbances in the last quarter of the year. Furthermore, refinance was also provided to certain finance companies experiencing serious liquidity problems. The total outstanding refinance provided by the Bank under different schemes expanded by Rs. 358 million in 1988, to reach Rs. 3,854 million by the end of the year. The Central Bank transferred Rs. 600 million to the Medium and Long-term Credit Fund (MLCF) from the general resources of the Bank in 1988, thus raising the refinance capacity to Rs.1,875 million.

The Central Bank continued to influence the direction of credit under the National Credit Plan. The Plan covered the lending by commercial banks, the National Savings Bank and other long-term credit institutions. However, the monitoring of the progress of the Plan for 1988 was made difficult by sporadic civil disturbances. Nonetheless, the Plan provided a valuable guideline for commercial banks and other lending institutions in channelling credit to different sectors of the economy.

During 1988, the capital market was dampened by the uncertainties surrounding an election year and the civil disturbances. It would appear that the level of activities in the capital market was influenced by the " wait and see " policy of investors. Although the number of new issues during the year was twice that of the previous year, the value of shares on offer amounted to only Rs. 202 million, as compared with Rs. 206 million worth of shares on offer in the previous year. The 10 new issues comprised, 5 for land and property development (Rs. 105 million), 4 for banks and finance (Rs. 94 million) and only one in the manufacturing category (Rs. 3 million). The total turnover in the secondary share market rose marginally to Rs. 380 million in 1988 from Rs. 336 million in 1987. The general price level in the market, as measured by the Colombo Securities Exchange (CSE) All Share Price Index, recorded a decline of 21 per cent between end 1987 and end 1988. Following a similar trend, the CSE Sensitive Price Index also recorded a decline of 19 per cent.

The resurgence of the Sri Lanka economy, despite adverse conditions in the world economy, which followed the economic reforms of 1977, suffered a setback following the outbreak of civil disturbances in 1983. The slow down of economic growth to 1.5 per cent in 1987, was also due to a severe and prolonged drought. The weather conditions improved in 1988, but sporadic civil disturbances continued to disrupt economic activity. Despite such setbacks, the economy showed signs of recovery in 1988, demonstrating its underlying strength and the capacity to adapt itself to changing circumstances. However, this small improvement should not be allowed to conceal the persistence of major disequilibrium linked to inadequacy of savings and excessive budget deficits.

In the background of growing imbalances in several sectors of the economy, the country adopted " A Medium-term Economic Policy Framework " for structural reforms, to be implemented during the period 1988 to 1991, which would once again give a stimulus for rapid and sustainable economic growth. This framework entailed a progressive moderation of the fiscal deficit, improvement of the balance of payments and containing inflationary pressures. However, most of the objectives earmarked for the first year of this programme could not be achieved, largely because the attainment of peaceful conditions proved to be more difficult than envisaged. On the other hand, under the stresses of an election year, government expenditure commitments recorded sharp increases, adding further pressure on the resources position.

Under the impact of these developments, the fiscal deficit widened considerably in 1988 and the balance of payments and the external reserve positions deteriorated. The rate of growth of money supply accelerated and inflation remained stubbornly at the double digit level of around 15 per cent. There was growing evidence of a gradual worsening of the employment situation and deterioration of incomes and nutritional levels of the poor. This resulted in an intense national dialogue which led to a growing consensus in the country that development programmes should receive due consideration for income distribution and alleviation of poverty.

Meanwhile , the country continues to face major structural and financial problems, including constraints on economic growth due to insufficient domestic savings and investment and a vulnerable external sector. In fact, the domestic savings rate has tended to stagnate over the last four years at around 12.4 per cent of GDP, because of the poor performance of the external sector, while the annual average rate of investment remained at 23.4 per cent over the same period. Meanwhile, as already mentioned, Sri Lanka was not able to achieve stable economic conditions which are a pre-requisite for sustained economic expansion. If these trends are allowed to continue, they would undermine confidence and jeopardise economic growth. For these reasons, while emphasizing the alleviation of extreme poverty, it is important to consolidate the country's fiscal position for sustaining the growth momentum of the economy, within a framework of an open and competitive economy.

The Annual Reports for 1986 and 1987 drew attention to the need for fiscal restraint as a pre-requisite for the maintenance of macro economic stability—a condition vital for sustained economic expansion. The 1988 fiscal developments represented a further setback on this score, when the overall budget deficit as a ratio of GNP rose to 14.8 per cent from 11.1 per cent in 1987, and the expansionary deficit (borrowings from the banking system) increased to 4.1 per cent, from 1.8 per cent in 1987. As a result, the balance of payments position deteriorated and inflationary pressures further intensified. The burgeoning fiscal deficit is posing major challenges for economic management. Although the monetary policy was considerably tightened, it had only limited success in siphoning-off excess liquidity in the economy, suggesting its limited usefulness in coping with fiscal excesses. Therefore, restoration of a better balance between government revenue and expenditure is essential for bringing about the desired improvement in fiscal position, which is a vital pre-requisite for enhancing prospects for future growth and stability.

Once the country gets used to large fiscal deficits, it becomes difficult to contain such deficits, falling further into a state of continuous instability, which harms long-term development. When such deficits have to be largely financed from expansionary sources, it will be the poorest members of society who would bear the greatest burden. The answer to growing fiscal deficits usually involves both raising revenue and cutting expenditure, while trying to minimise the social and economic costs of both. The 1988 fiscal developments point to a need for concerted action on two fronts to improve fiscal performance. The first is the need for consolidating the revenue raising effort, which has tended to slide in recent years. The government revenue as a ratio of GDP, which was 22.3 per cent in 1985, had declined to 18.9 per cent in 1988. In a similar development, the ratio of tax revenue to GDP had dropped from 19.5 per cent in 1984 to 16.0 per cent in 1988. The decreases in these ratios suggest a considerable erosion in the revenue collection effort of the government, which needs to be arrested if fiscal performance is to be improved. Second, there had been a notable change in the composition of expenditure in favour of consumption. For instance, while interest payments have been one of the fast growing components of government spending in recent years, capital expenditure appears to have been a category most prone to cutbacks. Consequently, while the total government expenditure as a ratio of GDP has increased the capital expenditure as a ratio of GDP has decreased from 13.3 per cent in 1985 to 9.5 per cent in 1988—a development which is not conducive to maintaining the tempo of future development. Therefore, the need of the hour is to raise more revenue through better tax effort and to divert a greater share of that revenue for investment, which would form the basis for future growth and employment creation.

A compression of the present scale of budget deficits is also essential for bringing about an improvement in the balance of payments, since large fiscal deficits tend to spill over and contribute to high current account deficits in the balance of payments, with accompanying implications on external reserves and the exchange rate. An improvement in the current account of the balance of payments requires a commensurate reduction in the overall savings—investments gap. Since the widening of the latter is largely attributable to a deterioration in budgetary savings, reduction in the fiscal imbalance will contribute substantially towards a sustained improvement in the balance of payments.

As there is some evidence of widespread malnutrition, anti-poverty programmes are receiving high priority in the government expenditure programmes of the immediate future. However, under existing constraints on financial resources, these programmes should be carefully targetted to the truly deserving. At the same time, it has to be recognised that the ultimate long-term solution for elimination of poverty lies in the rapid expansion of productive employment in all sectors of the economy. Investment plans during the coming years must therefore be suitably oriented to give adequate emphasis to productive employment generation. In order to achieve this, the economic policy in general should be so designed as to restore confidence through sound economic management.