ECONOMIC PERFORMANCE, PROBLEMS AND POLICIES IN 1990

A significant upsurge in economic growth, noteworthy turn-around in the balance of payments and a further consolidation of the fiscal position were among the highlights of Sri Lanka's economic performance in 1990. In real terms, Gross National Product (GNP) is estimated to have increased by 6.6 per cent, the highest rate of growth for over a decade. In the balance of payments, there was an overall surplus of SDR 130 million, the first year to record a surplus after a period of five years. The budget deficit as a ratio of GDP which declined from 15.7 per cent in 1988 to 11.2 per cent in 1989 dropped further to 9.9 per cent in 1990. However, monetary and price developments continued to be adverse and remained areas of concern during the year.

Despite the adverse circumstances facing the country, displaying a remarkable degree of resilience and flexibility, the Sri Lankan economy staged a sharp recovery in economic performance in 1990. The estimated 6.6 per cent increase in Gross National Product (GNP) in real terms was a significant improvement from the depressed GNP growth of 2.3 per cent achieved in 1989. Meanwhile, the Gross Domestic Product (GDP) which excludes factor income from abroad has registered a growth rate of 6.2 per cent in real terms as compared with 2.3 per cent in 1989. The higher rate of growth in the GNP in comparison to the GDP growth in 1990 was due to a significant increase in factor income flows from abroad, following the improvement in the country's external assets position.

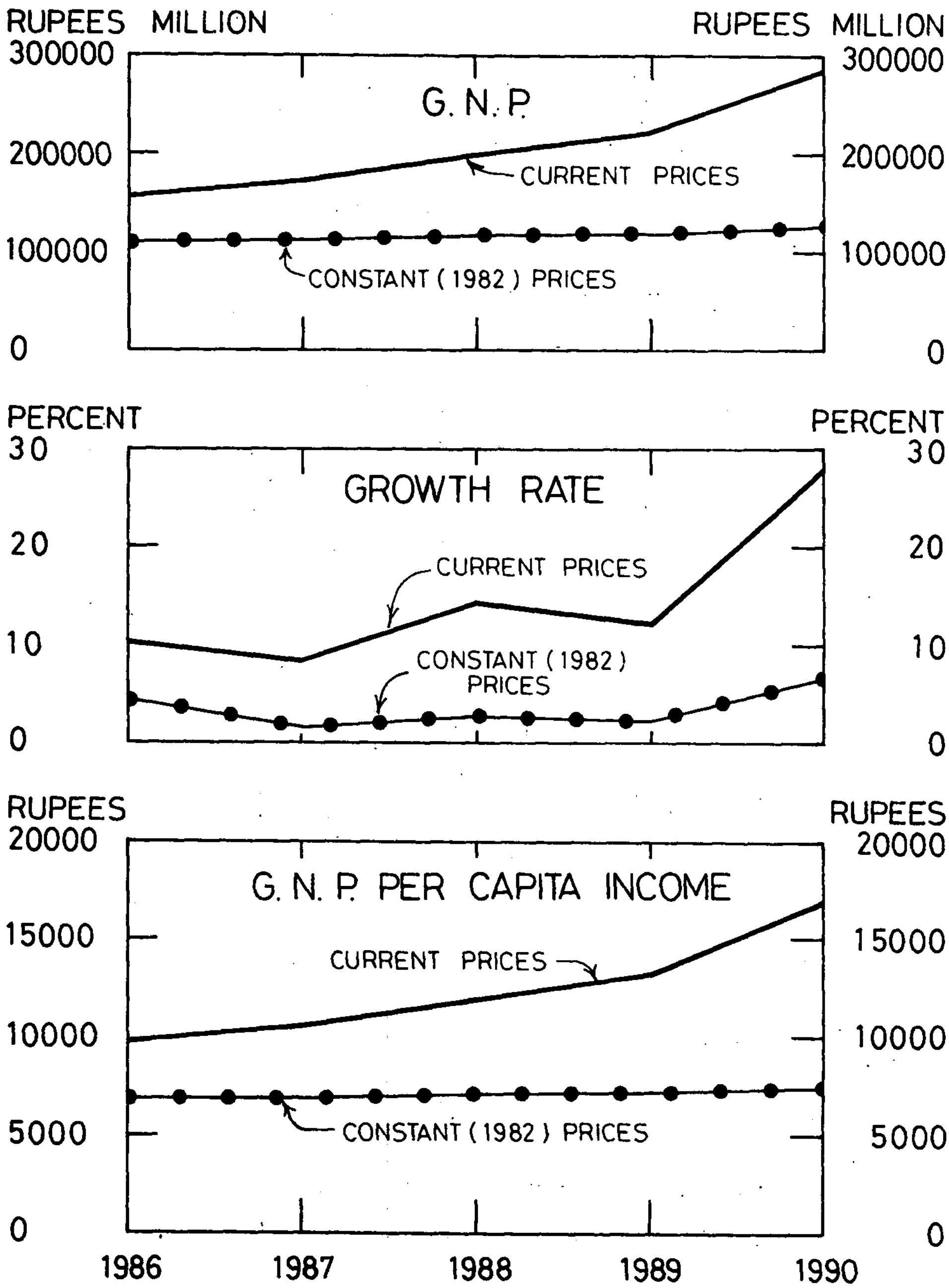
TABLE 1.1
National Income Statistics 1988 – 1990

Item	Amount (Rs. Million)			Growth Rate	
	1988	1989*	1990*	1989*	1990*
1. GDP at Current Factor Cost Prices	203,516	228,138	290,495	12.1	27.3
2. GDP at Constant (1982) Factor Cost Prices	119,050	121,729	129,256	2.3	6.2
3. GNP at Current Factor Cost Prices	198,250	222,399	284,553	12.2	27.9
4. GNP at Constant (1982) Factor Cost Prices	116,214	118,874	126,747	2.3	6.6
5. Mid Year Population ('000)	16,586	16,806	16,993	1.3	1.1
6. GNP Per Capita					
i. At Current Prices (Rs.)	11,952	13,293	16,745	11.2	26.0
ii. At Constant Prices (Rs.)	7,007	7,073	7,457	0.9	5.4

* Provisional

Source: Central Bank of Sri Lanka

GROSS NATIONAL PRODUCT



Central Bank of Sri Lanka.

Considered against the relatively poor growth performance over the past five years when the annual GNP growth rate averaged 2.7 per cent, the 1990 growth performance is very admirable. It is reminiscent of the high growth rates experienced during the period 1978-1982 immediately following the introduction of liberalised economic policies when the annual GNP growth averaged 6.0 per cent. It reflects the resilience of the economy and its growth potential, provided right conditions and appropriate policies are in place.

The GNP at current factor cost prices is estimated at Rs.285 billion in 1990 representing an increase of 27.9 per cent over the previous year. The implicit GNP deflator, an indicator of overall price changes in the economy, has risen by 20.0 per cent in 1990, a rate considerably higher than 9.7 per cent recorded in 1989. Accordingly, the GNP at constant (1982) prices was estimated at Rs.127 billion showing an increase of 6.6 per cent - the highest observed for over a decade.

According to provisional estimates of the Registrar General, Sri Lanka's mid-year population in 1990 was 17 million, an increase of 1.1 per cent over 1989. Accordingly, the per capita GNP at current prices in 1990 was estimated at Rs.16,745 (US.$ 418). While per capita income at current prices rose by 26.0 per cent, the increase in real terms was 5.4 per cent.

Domestic savings are estimated to have increased from Rs.30.8 billion in 1989 to Rs.47.4 billion in 1990 and as a ratio of GDP at market prices, domestic savings rose from 12.2 per cent to 14.8 per cent. Meanwhile, the national savings, which include net factor income and remittances from abroad, as a ratio of GNP rose from 14.6 per cent to 17.5 per cent over the two years. The rise in the savings rate though marginal can be considered an encouraging development considering the fact that it occurred at a time when considerable inflationary pressures were present in the economy.

TABLE 1.2
Composition and Growth Rate of GNP 1988 – 1990 at Constant (1982) Factor Cost Prices

Item	Amount (Rs. Million)			Growth Rate		
	1988	1989*	1990*	1988*	1989*	1990*
1. Agriculture, Forestry & Fishing	27,984	27,666	30,100	2.1	-1.1	8.8
of which						
1.1 Tea	2,926	2,668	3,004	6.4	-8.9	12.6
1.2 Rubber	770	697	718	0.7	-9.5	3.0
1.3 Coconut	2,501	3,210	3,261	-15.7	28.3	1.6
1.4 Paddy	6,312	5,258	6,467	16.4	-16.7	23.0
1.5 Other (other Agriculture, Forestry & Fishing)	15,475	15,833	16,650	-0.2	2.3	5.2
2. Mining & Quarrying	3,392	3,576	3,901	9.0	5.4	9.1
3. Manufacturing	19,622	20,488	22,427	4.7	4.4	9.4
3.1 Tree Crop Processing	3,273	3,257	3,530	-2.0	-0.5	8.4
3.2 Other	16,349	17,231	18,897	6.1	5.4	9.7
4. Construction	8,463	8,514	8,684	1.5	0.6	2.0
5. Services	59,589	61,485	64,144	2.2	3.2	4.3
6. G.D.P.	119,050	121,729	129,256	2.7	2.3	6.2
7. Net Factor Income from Abroad	-2,836	-2,855	-2,509	–	–	–
8. G.N.P.	116,214	118,874	126,747	2.6	2.3	6.6

* Provisional

Source: Central Bank of Sri Lanka

The rate of capital formation increased considerably in 1990 thereby improving the future growth prospects of the economy. The Gross Domestic Capital Formation (GDCF), inclusive of changes in stocks, recorded an increase of 33 per cent in 1990, as compared with an expansion of only 8 per cent in 1989. Consequently, the ratio of GDCF to GDP at market prices rose from 21.7 per cent in 1989 to 22.6 per cent in 1990. Following the trend in the previous year, the larger contribution to capital formation came from the private sector. The combined capital formation of the private sector and public corporations increased by 32 per cent as compared with a rise of 16 per cent in 1989. In contrast, the GDCF of the government declined by 5 per cent closely on the heels of the decrease of 15 per cent recorded in the previous year.

It was the outstanding performance of the agriculture sector which provided the major impetus to high economic growth in 1990. The value added in the agriculture sector, including forestry and fishing, showed an impressive growth of 8.8 per cent, in contrast to a decline of 1.1 per cent recorded in the previous year. Within the agriculture sector, the growth performance was mixed. Among the plantation crops, the contribution by the tea sub-sector was most striking. Tea production in 1990 reached the highest level on record causing this sector's value added to be increased by 12.6 per cent in real terms. Meanwhile, value added in the rubber and coconut sub-sectors rose by 3 per cent and 1.6 per cent, respectively, in 1990. However, the crop which displayed the highest resilience in 1990 was paddy, recording a production increase of 23 per cent over the depressed level in 1989, mainly on account of the impetus coming from favourable weather conditions in the major paddy producing districts. Meanwhile, the value added in the 'other agriculture' sub-sector which includes forestry and fishing, grew by an impressive 5.2 per cent in 1990, as compared to a growth of only 2 per cent in the preceding year. Overall, on account of the high weightage of the agriculture sector in the total GDP, the impressive performance of this sector helped in large measure to raise the overall growth of the economy in 1990.

Another sector which showed improved performance in 1990 was the mining and quarrying sector, the value added of which increased by 9.1 per cent. Within this sector, the activities connected with gem mining and quarrying expanded, while the output of ilmenite, rutile and other mineral sands declined due to the renewed civil disturbances in the North and East.

As has been the general trend in recent years, the manufacturing sector made a significant contribution towards maintaining the growth momentum of the economy in 1990. The increase in value added in the manufacturing sector, which included processing of agricultural commodities, factory industries and small industries, was an impressive 9.4 per cent in 1990. The output of the factory industry sub-sector which contributes around two-thirds of the total production in the manufacturing sector expanded by 10.2 per cent in real terms. When the output of petroleum products is excluded, the large bulk of this growth occurred in the private sector, demonstrating its dynamism in responding to economic incentives. The industrial categories which recorded improved performance in 1990 were textiles, wearing apparel and leather products; chemicals, petroleum and plastic products; and fabricated metal products, machinery and transport equipment. Meanwhile, in contrast to a decline of 0.5 per cent in 1989, the value added in the processing of tea, rubber and coconut kernel products increased by an impressive 8.4 per cent, due largely to the increased volume of tea production during the year.

Among the other sectors which contributed to the growth performance in 1990 was the services sector. The services sector which grew by 3.2 per cent in 1989 recorded a higher rate of growth of 4.3 per cent in 1990. In view of the heavy weightage of this sector in the overall GNP, the expansion in this sector accounted for 34 per cent of the total increase in GNP during the year. Within the services sector, value added in electricity, gas, water and sanitary services rose by 10.2 per cent, while the stimulus from the higher level of economic activity enabled the trade and transport services and the banking and financial services to post higher rates of growth in 1990. The long-awaited improvement in the tourism industry resulted in raising the value added in hotel services by 20 per cent in real terms during the year.

The agriculture sector which suffered a severe setback in 1989 staged a remarkable recovery during 1990. Favourable weather conditions, attractive prices and easing of civil disturbances in most parts of the country were among the factors contributing to the recovery of the agriculture sector. While almost all crop sectors contributed to this improvement, the performance of tea, paddy and minor food crops were particularly outstanding.

Tea production at 233 million kgs. in 1990 was the highest level ever achieved. This was a 13 per cent increase over the previous year. All three elevational categories contributed to this improved performance. The major share, however, came from Low grown teas, the output of which increased by 27 per cent to reach 105 million kgs., the highest production level ever on record for this category. Tea production in the High and Medium grown areas increased by 3 per cent and 4 per cent, respectively. The remarkable improvement in the tea sector was primarily attributed to favourable weather conditions, attractive prices and the easing of civil disturbances in most parts of the country.

The overwhelmingly larger share of the increase in tea production in 1990 came from the private sector. The combined production (including tea manufactured with bought leaf) of the Janatha Estate Development Boards (JEDBs) and the Sri Lanka State Plantation Corporations (SLSPCs) increased only by about 5 per cent to 139 million kgs. thereby lowering their relative share in the total tea production from 64 per cent in 1989 to 60 per cent in 1990. Tea production of the estates managed by the JEDBs increased by 4 per cent to 72 million kgs., while that of the SLSPCs expanded by 5 per cent to 67 million kgs. Meanwhile, tea production of the private sector rose significantly by 27 per cent to 94 million kgs. in 1990.When the green leaf produced by the private sector and processed in the factories owned by the two state sector plantation corporations is included, the share of the private sector in the total tea production rose from 44 per cent to 49 per cent.

The quantity of tea sold at the Colombo Auctions increased by 12 per cent in 1990 to 216.9 million kgs. compared to 193.7 million kgs. sold during 1989. As in the previous year, the reduced world supplies coupled with increased demand pushed the tea prices up at the Colombo Auctions during 1990. The average gross price of all teas at the Colombo Auctions increased significantly by 30 per cent to Rs.70.97 per kg. in 1990 from Rs.54.61 per kg. in 1989. The average export (f.o.b.) price of tea also rose by 37 per cent to Rs.91.78 per kg. in 1990.

The average cost of production (COP) of the JEDB at the corporate level rose from Rs.52.68 per kg. in 1989 to Rs.57.87 per kg.in 1990 while that of the SLSPC increased from Rs.54.03 per kg. to Rs.61.89 per kg. Meanwhile, the average COP for the sector as a whole is estimated to have increased from Rs.49.70 per kg. in 1989 to Rs.57.65 per kg.in 1990. The increase was largely due to high fertilizer prices and wage costs.

Rubber production is estimated to have increased by 3 per cent to 114 million kgs. in 1990. In the context of a marginal decline in the area under tapping, the increase was entirely due to a higher average yield achieved during the year. Increased number of tapping days on account of the favourable weather conditions and the easing of civil disturbances were among the factors contributing to this improvement. The entire increase in output came from the JEDBs and the SLSPCs which accounted for 34 per cent of the total rubber production. Meanwhile, the private sector recorded a decline of 2 per cent in production to 75 million kgs. during the year.

The cost of production (COP) of rubber during 1990 increased both in the private and public sectors mainly due to increased prices of fertilizer and chemicals and the higher wage costs. In the private sector, the COP is estimated to have increased by 19 per cent, from Rs.15.06 per kg. in 1989 to Rs.17.96 per kg. in 1990.

As in the previous year, the rubber prices in the international market failed to improve during 1990. Reduced demand by the major consuming countries and the increased world supplies exerted downward pressure on rubber prices. The average price of RSS 1 at the Colombo Auctions rose very marginally from Rs.22.63 per kg. to Rs.22.93 per kg. in 1990. In contrast, the average prices of RSS 2 and latex crepe 1X declined marginally to Rs.21.36 per kg. and Rs.28.88 per kg., respectively over the prices prevailing in the previous year. The average export f.o.b. price of all varieties of rubber declined marginally by 2 per cent to Rs.35.50 per kg. in 1990.

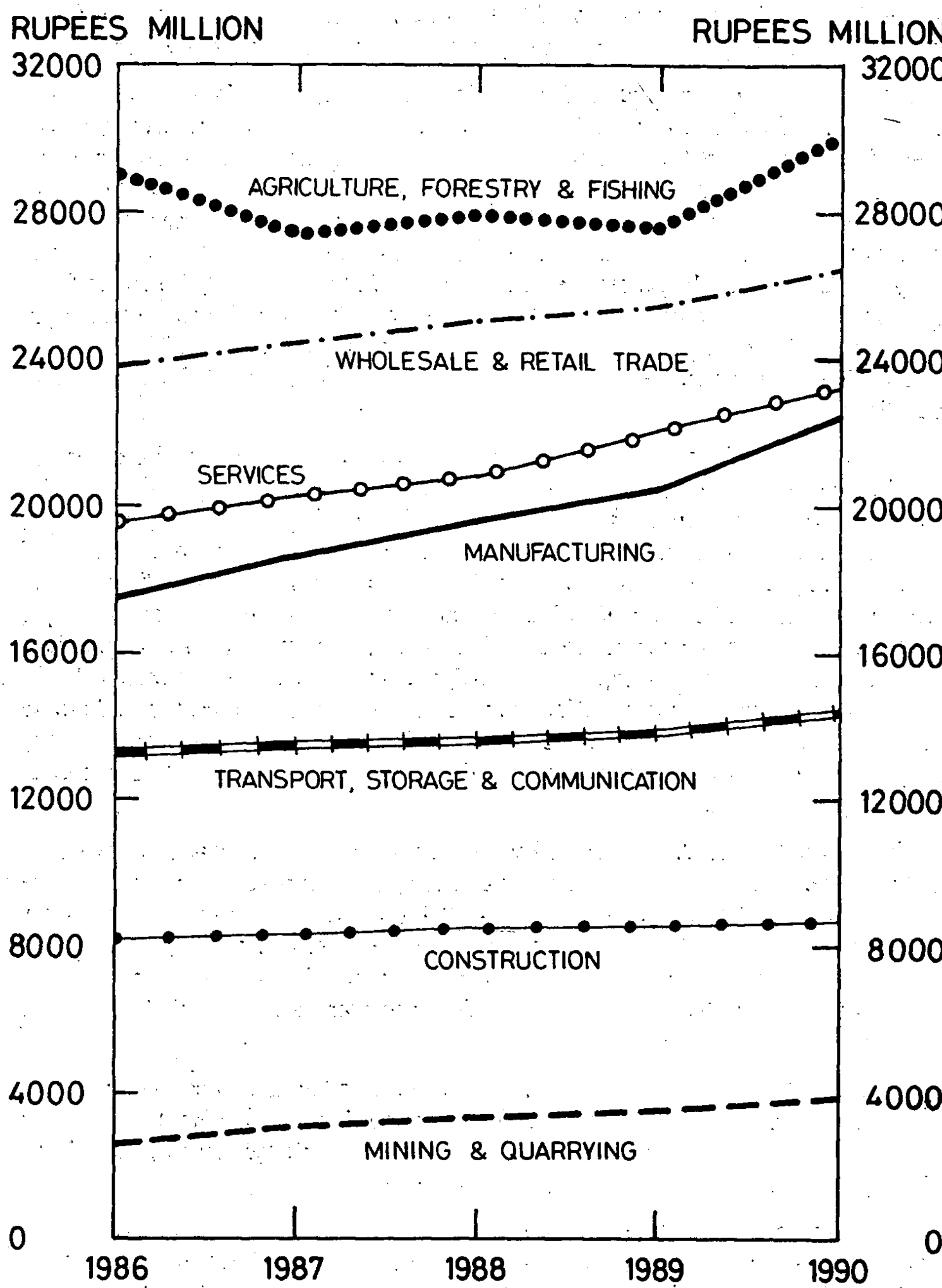
Coconut production which rose by 28 per cent in 1989 recorded a marginal increase of 2 per cent to 2,523 million nuts in 1990. The disappointing performance of the coconut sector was primarily an outcome of the severe drought conditions which affected the Northern part of the coconut triangle adversely during the year.

Desiccated coconut (DC) production which recorded a more than two-fold increase during 1989 showed a further 17 per cent growth in 1990. This was mainly due to higher international demand for Sri Lankan DC. In contrast, the other two major kernel products which increased substantially in 1989 performed poorly during 1990. The oil production increased only marginally while the nut equivalent of copra exports declined by 24 per cent to 31 million nuts. The average export (f.o.b) price of the three major kernel products increased by 8 per cent to Rs.3.63 per nut on account of the higher prices fetched by DC during the year. Meanwhile, the average cost of production in 1990 estimated at Rs.1.11 per nut showed a significant rise of about 31 per cent as compared with Re.0.85 per nut reported in 1989, mainly due to higher fertilizer prices and increased wage costs. The estimated domestic consumption of fresh nuts accounted for 59 per cent of the total nut output.

Paddy production which suffered a severe setback in 1989 recorded an impressive 23 per cent growth in 1990. The output of paddy in 1990 provisionally estimated at 2.54 million metric tons was however 5 per cent lower than the peak production of 2.66 million metric tons recorded in 1985. The increase in production was reflected in both Maha, 1989/90 and Yala, 1990 seasons. The improvement in production was primarily a result of favourable weather conditions and improved security conditions in the country which led to a substantial expansion of area sown as well as harvested and a marginal increase in the average yield. The availability of domestically produced rice during 1990 accounted for about 88 per cent of the domestic requirement compared to the 73 per cent covered during the previous year.

GROSS DOMESTIC PRODUCT BY INDUSTRIAL ORIGIN

AT CONSTANT (1982) FACTOR COST PRICES



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Paddy purchases by the Paddy Marketing Board (PMB) which declined by 95 per cent during 1989 showed a six-fold increase to 31,000 metric tons in 1990 on account of the 28,000 metric tons of paddy purchased at market prices, above the guaranteed price, from 23rd March, 1990 to 7th May, 1990. The guaranteed price of paddy was revised upwards from Rs.80 per bushel to Rs. 110 per bushel in February, 1990. As in 1989, the open market prices of paddy remained well above the guaranteed price throughout 1990.

Sugar production which recorded a marginal improvement in 1989 increased by 6 per cent to 57,171 metric tons in 1990. This increased level of output was largely due to improved security conditions, adequate rainfall, and the expansion in planting activities of the outgrowers. The factories at Kantale, Sevanagala and Pelwatte contributed to the improvement in production. Kantale which recorded a 62 per cent increase in the previous year recorded a further 3 per cent increase to 2,364 metric tons in 1990. Sevanagala factory which reported a 19 per cent decrease in production during 1989, showed an 8 per cent increase to 9,648 metric tons in 1990. The Pelwatte factory which recorded a 5 per cent drop in production during 1989, reported a 16 per cent increase to 33,020 metric tons in 1990. The output of the Pelwatte factory accounted for 58 per cent of the total sugar production in 1990.

The production of most of the minor food crops recorded a substantial improvement in 1990 compared with the depressed production levels in the previous year. Substantial increases were recorded in the production of soyabeans, gingelly, black-gram, maize, green-gram and cowpea. In the category of high value minor food crops, output of chillies and big onions recorded substantial increases of 75 per cent and 70 per cent, respectively in 1990. On the basis of the export data, most of the minor export crops, except cloves and cocoa, appeared to have fared poorly as compared with the previous year. The quantity of cloves exported showed a more than six-fold increase to 2,137 metric tons, while cocoa exports during the year increased by 39 per cent to 168 metric tons. The export volumes of pepper, coffee and cardamoms which declined substantially during 1989 recorded further decreases by 17 per cent, 28 per cent and 73 per cent, respectively during 1990.

Fish production of the marine fishery sector in 1990 provisionally estimated at 145,798 metric tons was a 12 per cent decrease over the previous year. Production in the coastal fishery sub-sector which accounted for 92 per cent of the total marine fishery production declined by 15 per cent mainly due to the unsettled conditions which restricted fisheries activities in the Northern and Eastern provinces in the second half of 1990. As in the past, the private sector continued to account for almost the total fish production in 1990.

According to estimates of the Department of Census and Statistics, the total milk production (including buffalo milk) in 1990 was 288 million litres, an increase of 21 per cent over the previous year, while the total egg production was estimated at 818 million indicating a decrease of 2 per cent over the preceding year.

The industrial sector recorded a significant improvement as reflected in higher levels of production and value added in 1990. This was largely a result of a revival in industrial activities with the easing of civil disturbances in most parts of the country. The value of industrial output which grew by 6 per cent in real terms during the last two years, increased by 14 per cent in 1990, the highest rate of growth recorded since 1984. Unlike in the recent past, the impressive growth in industrial output originated both from the continued expansion of private sector industries and better performance of the public sector industries. The industrial output of the private sector and the public sector increased by 14 per cent each.

Industrial sub-sectors that recorded production increases in 1990 were chemicals, petroleum and plastic products (37 per cent), basic metal products (24 per cent), fabricated metal products (12 per cent), textile wearing apparel and leather products (13 per cent), paper and paper products (9 per cent), and food, beverages and tobacco (7 per cent).

The substantial increase in the output of the chemicals, petroleum and plastic products category was primarily due to a sharp increase in the production of the Ceylon Petroleum Corporation and a substantial improvement in the output of private sector industries engaged in the manufacture of products such as paints, varnishes, soaps, cosmetics and rubber products. The continued expansion of the wearing apparel industry both within and outside the investment promotion zones was the major contributory factor for the increased level of output in the textile, wearing apparel and leather products category. In the fabricated metal products sector, improvement was largely due to the increased production in a number of private sector industries such as fabricated metal, machinery and equipment and structural metal products. Increased production in the Steel Corporation was responsible for the higher output level of the basic metal products category. In the food, beverages and tobacco category, increased output levels were recorded mainly in the private sector industries engaged in the manufacture of tobacco, sugar, tea packeting, soft drinks and carbonated water, liquor products and confectionery. The increased output level of the paper and paper products category was attributed to the National Paper Corporation as well as private sector industries.

The substantial increase in public sector industrial output was largely due to the higher production level of the Ceylon Petroleum Corporation. Among the public sector enterprises recording increases in output were Distilleries Company (158 per cent), Ceylon Petroleum (49 per cent), Ceylon Leather Products (35 per cent), State Mining and Mineral Development (29 per cent), State Rubber Manufacturing (22 per cent), Lanka Ceramics (17 per cent), Kelani Tyres (10 per cent), Ceylon Steel (5 per cent) and Lankaloha Hardware (4 per cent).

Public sector industrial enterprises which recorded decreases in output during the year were National Salt (64 per cent), National Textile (45 per cent), Ceylon Plywood (42 per cent), Ceylon Mineral Sands (35 per cent), Oils and Fats (16 per cent) and Sri Lanka Cement (5 per cent). The decline in the output of the National Salt Corporation was mainly due to production shortfalls in salterns in the northern regions as a result of unsatisfactory security conditions. The sharp decrease in the output of the National Textile Corporation was largely due to the transfer of ownership of two textile mills to the private sector during the year. The inadequate supply of "clinker" had an adverse impact on the Sri Lanka Cement Corporation. Output of the Oils and Fats Company Limited declined due to marketing problems.

Budgetary transfers to public sector industrial enterprises during the year amounted to Rs.111 million which was a decrease of 71 per cent compared with the previous year. The Sri Lanka Sugar Corporation and the National Textile Corporation received Rs.69 million and Rs.42 million, respectively as capital transfers during the year.

Investment activities in the industrial sector continued to expand in 1990. The Greater Colombo Economic Commission (GCEC) which became a "one stop centre" to service foreign investors after merging with the Foreign Investment Advisory Committee (FIAC) in January 1990 approved 30 projects with "GCEC status" in 1990, bringing the total number of projects approved to 337 by the end of 1990. The investment potential of the projects approved in 1990 was estimated at Rs.2,075 million with a foreign component of Rs.1,630 million.

Subsequent to the establishment of the one stop center, the GCEC has approved 47 projects with "FIAC status" which do not enjoy GCEC concessions. The total envisaged investments in these projects amounted to Rs.1,089 million of which the foreign investment component was Rs.280 million.

A considerable acceleration in the rate of increase in prices was one of the most worrisome developments on the economic scene during 1990. The Colombo Consumers' Price Index (CCPI) recorded an annual average increase of 21.5 per cent in 1990, the highest ever rise since 1980 and a very near doubling of the rate of increase in 1989. The annual increase on a point-to-point basis (December, 1990 over December, 1989) at 19.6 per cent was slightly lower. At the primary market level too, there was increased price pressure in 1990 with the annual average of the Wholesale Price Index (WPI) rising by 22.2 per cent. The corresponding increase in 1989 was only 9.0 per cent.

Several factors contributed to maintain continuing price pressure in the economy during 1990. First, corrective adjustments in administered prices caused the prices of some important consumer items such as wheat flour and bread to rise during the first half of the year. Second, such price adjustments, in-turn, had an important bearing on the prices of other food items such as rice and pulses due to the substitution effect. Third, the removal of the fertilizer subsidy in January, 1990 led to higher production costs which in-turn impacted on prices. Fourth, substantial price increases were recorded in respect of major food items such as fish, beef, vegetables, potatoes and red onions due to temporary supply shortages. Fifth, the revision of fuel prices following the Gulf crisis had both a direct and an indirect effect on prices, particularly during the closing months of the year. Sixth, electricity tariffs and postal rates were revised upward in 1990.

While the above factors contributed to push prices up during 1990, it needs to be recognised that the demand pressure created by excessive monetary expansion too contributed in no small measure to support the inflationary pressures in the economy. The growth of the broad monetary aggregate remained consistently high - the annual rate ranging between 13.1 per cent and 19.1 per cent. A rate of monetary expansion far exceeding the rate of real growth in the economy should necessarily impact on prices in the absence of a sufficient import surplus to meet the gap in demand.

The price pressure was prevalent on a wide front in 1990. In the Colombo Consumers' Price Index, the sub-index for food rose by 23 per cent on an average and was responsible for 74.4 per cent of the total increase in the index. The series of corrective price adjustments affected the food prices during the year to push the index to an all-time high. Clothing prices too rose sharply by 18 per cent in 1990 on top of a 17 per cent increase recorded in 1989. Meanwhile, prices of fuel and light items advanced by 24 per cent, which was double that of the increase recorded in the previous year. The sub-index for the miscellaneous group rose by 19 per cent surpassing the 16 per cent increase registered in 1989. The contribution of this sub-group towards the overall increase in the index was 14 per cent, the second highest contribution.

The Wholesale Price Index (WPI), which measures the price movements at the primary market level, also showed incipient price pressure in the economy during 1990.

This index recorded an annual average increase of 22 per cent as compared with a 9 per cent rise observed in 1989. On a point-to-point basis (December, 1990 over December, 1989), the index registered an increase of 17 per cent. As in the case of the CCPI, higher food prices contributed significantly to the rise in the WPI during the year. The improvement in the average export price of tea also had a significant impact on the movement of the WPI during the year. Another notable contributory item was petroleum products, the average price of which rose by 23 per cent during the year in the wake of the Gulf crisis.

In 1990, average nominal wages of government employees, as measured by their nominal wage rate index, rose somewhat sharply by 13 per cent. This was due to two special allowances granted to public sector employees drawing middle and low level salaries, to compensate for inflation. However, despite the substantial increase in nominal wages, the real wages declined by 7.1 per cent in the overall public sector owing to high price pressure prevailing in the economy during the year. In the organised private sector, overall nominal wages as measured by the minimum wage rate index for workers in trades covered by Wages Boards advanced by 16.9 per cent, while their real wages deteriorated by 3.9 per cent in 1990.

According to provisional estimates, employment in the private sector increased considerably in 1990 while that in the government sector decreased. Within the public sector, employment in semi-government institutions decreased significantly. The employment in the overall public sector is estimated to have decreased by 1.5 per cent to 1,318,150 persons as at the end of 1990. Under the impact of the public service restructuring programme, employment in all categories of the public sector, except the Service Worker category which includes defence personnel, decreased or remained unchanged in 1990. Meanwhile, employment in semi-government institutions decreased substantially by 5.5 per cent during the year.

Owing to non-availability of an annual series of data on employment in the private sector, other indicators are used to assess the changes in employment in that sector. The number of employees registered with the Employees' Provident Fund (EPF) rose by 4.3 per cent in 1990 while the total number of private sector employees in approved provident funds recorded an increase of 44.6 per cent. Meanwhile, the total number of employees in enterprises operating under the Greater Colombo Economic Commission (GCEC) expanded by 16.5 per cent to 71,585 persons in 1990. These, together with a vast number of self-employment opportunities created through poverty alleviation programmes and institutional funding programmes seemed to suggest a significant expansion of employment opportunities in the private sector during the year.

Despite the tension on the international scene, the developments in Sri Lanka's external trade sector were more favourable in 1990 than in the previous year. The value of merchandise exports grew impressively by 20 per cent, to SDR 1,461 million (Rs.79,481 million) as compared with an 11 per cent growth in 1989. This was the highest annual growth in exports experienced during the past 5 years. On the other hand, the outlay on imports rose by 14 per cent to SDR 1,980 million (Rs.107,729 million) as against a 5 per cent increase in 1989. Consequently, the trade deficit was contained at SDR 519 million (Rs.28,248 million), almost the same level as in 1989. Meanwhile, the ratio of export earnings to import payments rose significantly from 70 per cent in 1989 to 74 per cent in 1990. However, the overall price movements of Sri Lanka's exports and imports continued to be unfavourable. Accordingly, despite a substantial improvement in export prices, particularly that of tea, the terms of trade deteriorated by 10 per cent in

1990. This was the result of a sharp increase in import prices of major items such as petroleum, fertilizer and sugar.

Among exports, all major categories, viz. agriculture, excluding rubber and coconut, industrial and mineral products, recorded significant increases in 1990. The earnings from agricultural exports increased by 11 per cent as against a marginal growth of 1 per cent in the previous year. Industrial exports recorded an impressive growth of 24 per cent as compared with a 16 per cent increase in 1989. Meanwhile, mineral exports which indicated a decrease of 5 per cent in 1989 grew by 10 per cent in 1990. In general, non-traditional exports appeared to have shown significant dynamism in 1990 responding positively to the adjustment measures undertaken since 1989.

On the basis of Customs data, the value of tea exports rose substantially by 23 per cent, from SDR 296 million (Rs. 13,664 million) in 1989 to SDR 364 million (Rs.19,823 million) in 1990, due to increases in both the export volume and prices. While the export volume rose by 6 per cent, from 204 million kgs. in 1989 to 216 million kgs. in 1990, the average export price improved by 17 per cent, from SDR 1.45 per kg. (Rs.66.91 per kg.) to SDR 1.69 per kg. (Rs.91.78 per kg.) over the two years. However, value of rubber exports fell further by 15 per cent, from SDR 67 million (Rs.3,112 million) in 1989 to SDR 57 million (Rs.3,080 million) in 1990, due entirely to a drop in the export price by 17 per cent, from SDR 0.78 per kg. (Rs.36.17 per kg.) to SDR 0.65 per kg. (Rs.35.50 per kg.). The volume of rubber exports recovered marginally from 86 million kgs. in 1989 to 87 million kgs. in 1990. Earnings from coconut exports too dropped by 18 per cent, from SDR 62 million (Rs.2,865 million) in 1989 to SDR 51 million (Rs.2,783 million) in 1990, owing to an 11 per cent drop in the export volume from 572 million nuts to 508 million nuts. As the average export price remained unchanged at SDR 0.07 per nut, there was no compensatory price effect to offset the loss due to the shortfall in export volume. The value of minor agricultural exports rose from SDR 52 million (Rs.2,408 million) in 1989 to SDR 58 million (Rs.3,165 million) in 1990. Substantial increases in earnings were recorded in vegetables, cloves, tobacco, sesame seeds and cashew nuts. Earnings from industrial exports expanded from SDR 616 million (Rs.28,470 million) in 1989 to SDR 763 million (Rs.41,510 million) in 1990. This was the outcome of impressive growth rates recorded in all categories of industrial products, namely, textiles and garments (21 per cent), petroleum products (49 per cent) and other industrial products (22 per cent). Mineral exports which suffered a setback in the previous year expanded by 10 per cent, from SDR 58 million (Rs.2,693 million) to SDR 64 million (Rs.3,484 million), entirely due to a 13 per cent increase in earnings from gem exports.

With these developments, the composition of exports underwent further changes in 1990. The industrial exports category further consolidated its position as the principal category of exports, its share rising from 51 per cent to 52 per cent between the two years. Conversely, the share of plantation agricultural crops, which together accounted for three-fourths of total export earnings in 1977, dropped further to 32 per cent in 1990 from 35 per cent in 1989. At the same time, the share of mineral exports too fell from 5 per cent to 4 per cent. As a single item, textiles and garments, which became the largest export item in 1986 continued to maintain the lead position, increasing its share further from 31 per cent in 1989 to 32 per cent in 1990.

According to adjusted Customs data, the total outlay on imports amounted to SDR 1,980 million (Rs.107,729 million) in 1990 compared with SDR 1,737 million (Rs.80,225 million) in 1989, showing an increase of 14 per cent. The increase was reflected in all categories of imports. The expenditure on consumer goods rose by 13 per cent, from SDR 454 million (Rs.20,962 million) in 1989 to SDR 515 million (Rs.28,004 million) in 1990 largely owing to increased outlays on wheat flour and durable consumer goods such as motorcars and motorcycles. The value of rice imports fell sharply by 56 per cent, from SDR 74 million (Rs.3,397 million) to SDR 32 million (Rs.1,758 million) between the two years due to a reduction in volume from 316 thousand metric tons to 172 thousand metric tons.

TABLE 1.3

Summary of Balance of Payments 1987 – 1990

Rs. Million (SDR Million in brackets)

Item	1987	1988	1989(a)	1990(b)
Merchandise (Net)	-20,005	-24,260	-24,050	-28,124
	(-525)	(-568)	(-530)	(-518)
Non-Factor Services (Net)	74	382	129	2,902
	(2)	(8)	(1)	(53)
Factor Services (Net)	-4,699	-5,266	-5,738	-5,942
	(123)	(-122)	(-124)	(-109)
Private Transfers (Net)	9,226	10,187	11,840	14,813
	(242)	(238)	(258)	(274)
Official Transfers (Net)	5,311	6,588	6,751	6,698
	(139)	(154)	(147)	(123)
Current Account Balance	-10,093	-12,377	-11,069	-9,653
	(-265)	(-290)	(-248)	(-177)
Overall Balance	-1,224	-3,339	-1,905	6,998
	(-62)	(-64)	(-67)	(130)
Some Key Indicators				
Terms of Trade	114	106	99	89
Net Petroleum Imports	6,124	5,574	6,134	10,393
	(161)	(130)	(133)	(191)
Current Account Deficit as a percentage of G.D.P	5.1	5.6	4.4	3.0
Gross International Reserves	18,479	19,025	23,390	34,271
	(423)	(426)	(447)	(599)
International Reserves in Months of Imports	3.2	3.1	3.1	3.6

(a) Revised (b) Provisional *Source*: Central Bank of Sri Lanka

The expenditure on intermediate goods rose to SDR 1,078 million (Rs.58,672 million) in 1990, from SDR 980 million (Rs.45,255 million) in 1989, reflecting a growth of 10 per cent between the two years. The increase was largely due to higher outlays on petroleum, fertilizer, chemicals and paper products. The commitments on petroleum imports rose sharply by 46 per cent, from SDR 181 million (Rs.8,376 million) to SDR 264 million (Rs.14,367 million), due mainly to price increases following the Gulf crisis. The outlay on fertilizer also rose by 43 per cent largely due to an increase in the volume of imports from 355 thousand metric tons to 505 thousand metric tons. However, import payments on wheat grain and textiles fell in 1990. Expenditure on wheat grain dropped by 35 per cent to SDR 70 million (Rs.3,791 million) in 1990 due to a 21 per cent drop in the volume and an 18 per cent drop in the price. The value of textiles and clothing imports dropped by 6 per cent in 1990.

The outlay on investment goods increased by 35 per cent, from SDR 260 million (Rs.12,018 million) in 1989 to SDR 352 million (Rs.19,129 million) in 1990, largely due to a rise in the importation of transport equipment and machinery. The value of the imports of building materials, however, declined during the year.

A significant improvement in the country's balance of payments position was a noteworthy feature of Sri Lanka's economic performance in 1990. Under the impact of a series of favourable factors such as continued buoyancy in tea prices, recovery of the tourism sector, greater utilization of foreign assistance and the recovery in economic activities in general following improvements in the security situation, there was a significant turn-around in the balance of payments position. In 1990, the overall balance recorded a surplus of SDR 130 million (Rs.6,998 million), in contrast to large deficits recorded in each of the preceding five years. The improved balance of payments performance in 1990 was inspite of the adverse impact of the Gulf crisis, in particular the higher commitments on petroleum imports.

According to the balance of payments data, the deficit in the services account registered a substantial reduction, from SDR 123 million (Rs.5,609 million) in 1989 to SDR 56 million (Rs.3,040 million) in 1990. The improved performance of the services account in 1990 was attributable to increased net foreign exchange earnings from travel, port transportation and insurance and investment income categories. The gross foreign exchange receipts on account of travel rose from SDR 59 million in 1989 to SDR 102 million in 1990 recording an increase of 73 per cent. This was mainly due to a substantial recovery in tourism as reflected in a 60 per cent increase in tourist arrivals in 1990. Net receipts from tourism showed more than a seven-fold increase, from SDR 6 million in 1989 to SDR 44 million in 1990. The port, transportation and insurance category recorded a surplus of SDR 8 million in 1990 as against a deficit of SDR 8 million in 1989, owing to increased passenger fare collections. Despite an increase in the repatriation of profits and dividends to SDR 20 million from SDR 14 million in 1989, the net outflow of foreign exchange on account of investment income declined by 12 per cent, from SDR 124 million in 1989 to SDR 109 million in 1990. This was due to a considerable increase in interest receipts from portfolio investments following the improvement in the country's external assets position and a significant reduction in interest payments due to a reduction in the short-term external debt.

Total net receipts on account of transfers decreased marginally in 1990 to SDR 397 million (Rs.18,591 million) from SDR 405 million (Rs.21,511 million) in 1989 owing to a reduction in official transfers. Net private transfers increased by 6 per cent to SDR 274 million (Rs.14,813 million) in 1990. Worker remittances which account for the major share of private transfers recorded a significant increase, rising from SDR 279 million (Rs.12,830 million) in 1989 to SDR 297 million (Rs.16,071 million) in 1990, thus disproving the initial fears of a sharp reduction in remittances, following the Iraqi occupation of Kuwait. The improvement was partly due to the accelerated repatriation of earnings by workers in the Middle East, as a reaction to the crisis situation. Official transfers, however, decreased from SDR 147 million (Rs.6,751 million) in 1989 to SDR 123 million (Rs.6,698 million) in 1990.

The deficit on current account was contained at SDR 177 million (Rs.9,653 million) in 1990 compared to a deficit of SDR 248 million (Rs.11,069 million) in 1989. This was the lowest deficit recorded during the past six years. As a ratio to GDP, the deficit declined from 4.4 per cent in the previous year to 3.0 per cent in 1990 reaching the lowest level on record since the tea boom of 1984. This ratio, excluding official grants, declined by two percentage points to 5.1 per cent in 1990. This significant narrowing of the current account deficit was an outstanding feature of balance of payments developments in 1990.

The developments in the capital account of the balance of payments were also more favourable in 1990 than in 1989. The net non-monetary capital inflows increased by 38 per cent to SDR 297 million in 1990, mainly due to increased utilization of foreign loans by the central government. Net capital inflows in the form of private direct investment rose marginally from SDR 14 million in 1989 to SDR 15 million during 1990. As in the previous year, there was a net outflow on account of loan capital in the private sector due to settlement of past loans. The net utilization of short term credits by the private sector decreased from SDR 72 million in 1989 to SDR 49 million in 1990 owing to a reduction in the utilization of normal trade credits by the private sector exlcuding the Ceylon Petroleum Corporation.

Inflow of net non-monetary capital to the government increased by 56 per cent to SDR 264 million (Rs.14,498 million) in 1990 due to larger disbursements of foreign loans as well as a reduction in amortization payments. While gross disbursements increased by 22 per cent to SDR 356 million (Rs.19,545 million) in 1990, amortization payments decreased by 25 per cent to SDR 92 million between the two years, mainly due to a reduction in the repayment of non-concessional loans. Total disbursements included a sum of SDR 66 million received for structural adjustment purposes from the ADB and IDA as balance of payments support loans.

The improvements in the balance of payments position in 1990 helped in bolstering the country's foreign exchange reserves. In all, gross official reserves rose by SDR 79 million (Rs.5,645 million) in 1990, as compared with an increase of SDR 17 million (Rs.2,494 million) in 1989. Similarly, the country's total gross external assets increased by SDR 152 million (Rs.10,881 million), from SDR 447 million (Rs.23,390 million) at the end of 1989 to SDR 599 million (Rs.34,271 million) at the end of 1990. This level of gross reserves was sufficient to finance 3.6 months of imports projected for 1991.

The Sri Lanka Rupee depreciated against all major currencies in 1990. The Sri Lanka Rupee depreciated against the Japanese Yen, Deutsche Mark, French Franc, and Pound Sterling, by 4.3 per cent, 9.4 per cent, 10.1 per cent and 14.0 per cent, respectively, while appreciating by 5.7 per cent against the Indian Rupee. It depreciated marginally by 0.6 per cent against the intervention currency, the US Dollar. Against the SDR, the Rupee depreciated by 7.5 per cent during 1990 on top of a 16.3 per cent depreciation in the previous year.

Sri Lanka's total outstanding foreign debt was estimated at SDR 4,162 million at the end of 1990 reflecting an increase of SDR 203 million during the year. The medium and long term debt accounted for 92 per cent of the total debt. Total outstanding debt to the IMF at the end of 1990 was SDR 288 million as compared to SDR 275 million at the end of the previous year. This included the third and final disbursement of SDR 44.5 million under the Structural Adjustment Facility (SAF) arrangement. The outstanding level of short term debt recorded a marginal decrease in 1990.

One of the most welcome developments in the balance of payments front in 1990 was a sharp reduction in the debt service burden. Debt service payments, which include amortization of medium and long term loans and interest payments on all foreign loans, decreased by SDR 69 million to SDR 306 million in 1990. The debt service payments as a ratio of receipts from exports of goods and services declined from 24.6 per cent in 1989 to 16.5 per cent in 1990 reflecting both a reduction in debt service payments and an increase in export earnings. The debt service payments as a ratio of receipts from exports of goods and services and private transfers was 14.2 per cent in 1990 as against 20.8 per cent in 1989.

Fiscal operations in 1990 reflected continuing adjustment efforts in maintaining a sustainable budget deficit. The overall budget deficit was contained within 10 per cent of GDP as targetted under the on-going stabilization programme. New fiscal measures aimed at strengthening revenue mobilisation efforts and reducing expenditure outlays were of substantial assistance in realising deficit targets in 1990. The revenue/GDP ratio at 21.2 per cent in 1990, reflected the efforts made in recent years to maintain high revenue targets. While sustaining enhanced revenue effort, the government was able to reduce the current expenditure/GDP ratio to 22.4 per cent in 1990 from the previous year's level of 22.6 per cent.

Reflecting further adjustments in public investment, the capital expenditure and net lending in relation to GDP dropped further, from 10.0 per cent in 1989 to 8.8 per cent in 1990. Accordingly, the overall government expenditure/GDP ratio in 1990 declined to 31.1 per cent from 32.6 per cent in 1989. Apart from the revenue and expenditure adjustments made towards achieving a reduced budget deficit, there were also favourable trends on the financing side of the deficit, in that domestic financing requirements were met almost entirely from domestic non-bank sources thereby eliminating the need for resorting to expansionary bank financing.

Government revenue in 1990 amounting to Rs.67,964 million recorded an increase of 26 per cent. However, revenue in relation to GDP declined marginally from 21.4 per cent in 1989 to 21.2 per cent in 1990. Reflecting enhanced buoyancy in major revenue sources, the tax revenue/GDP ratio rose from 18.9 per cent to 19.1 per cent. Tax revenue from domestic goods and services at Rs.28,770 million which accounted for nearly half the total tax revenue, increased by 38 per cent over the previous year. Meanwhile, international trade oriented taxes generating Rs.19,341 million, accounted for a further 32 per cent of tax revenue in 1990. Revenue receipts from income taxes and taxes on property transactions at Rs.10,477 million marked an increase of 34 per cent in comparison to a growth of 22 per cent in 1989.

On the expenditure side, interest payments, household transfers and outlays on account of other goods and services at Rs.50,959 million continued to maintain upward pressure in 1990. Interest payments on government debt at Rs.20,668 million comprising about 30 per cent of total current expenditure, grew by 44 per cent. Similarly, transfer payments in 1990 rose by 23 per cent to Rs.20,936 million, of which a sum of Rs.15,872 million was on account of household transfers. Despite only a moderate increase in the government's wage bill by 9 per cent to Rs.15,749 million, total expenditure on goods and services at Rs.30,167 million marked an increase of 18 per cent. This was due to a 30 per cent expansion in outlays on other goods and services which included defence related purchases. Reflecting these developments, the current expenditure at Rs.71,771 million registered an increase of 26 per cent, slightly lower than the rate of increase in nominal GDP. Accordingly, the current expenditure/GDP ratio declined marginally from 22.6 per cent in 1989 to 22.4 per cent in 1990.

The adjustments in capital expenditure were much sharper than adjustments in current expenditure. Capital expenditure and net lending at Rs.28,043 million showed a nominal increase of 11 per cent. Accordingly, the capital expenditure/GDP ratio fell from 10.0 per cent in 1989 to 8.8 per cent in 1990. The decline in capital expenditure

TABLE 1.4
Summary of Government Fiscal Operations

Rs. Million

Item	1986	1987	1988	1989	1990 Approved Estimate	1990 Provi-sional	1991 Approved Estimate
Total Revenue and Grants	40,991	46,822	48,337	60,386	68,062	74,662	79,529
Total Revenue	37,238	42,145	41,749	53,979	61,262	67,964	71,529
Tax Revenue	31,272	35,119	35,946	47,513	55,920	61,206	64,899
Non-Tax Revenue	5,966	7,026	5,803	6,466	5,342	6,758	6,630
Grants	3,753	4,677	6,588	6,407	6,800	6,697	8,000
Expenditure and Lending minus Repaymets	59,193	63,894	76,532	82,164	89,861	99,814	107,551
Current	33,966	39,560	46,132	56,884	63,561	71,771	72,962
Capital	23,236	22,816	22,878	20,750	21,653	19,161	28,118
Lending minus Repayments	1,991	1,518	7,522	4,530	4,647	8,882	6,471
Current Account Surplus/Deficit (-)	3,272	2,585	-4,383	-2,905	-2,299	-3,807	-1,433
Budget Deficit (before grants)	-21,956	-21,749	-34,783	-28,185	-28,599	-31,850	-36,022
Budget Deficit (after grants)	-18,203	-17,072	-28,195	-21,778	-21,799	-25,153	-28,022
Financing	18,203	17,072	28,195	21,778	21,799	25,152	28,022
Foreign Borrowings	9,061	5,716	7,128	5,926	10,558	11,644	19,883
Domestic Borrowings	9,142	11,356	21,067	15,852	11,241	13,509	8,139
Non-Market Borrowings (a)	-669	1,415	1,687	5,300	0	60	0
Market Borrowings	9,811	9,941	19,380	10,551	11,241	13,448	8,139
Non Bank	6,765	6,400	9,227	13,838	10,199	13,074	12,639
Bank	3,047	3,541	10,153	-3,286	1,042	374	-4,500
(as a percentage of GDP)							
Total Revenue and Grants	22.8	23.8	21.8	24.0	24.0	23.3	21.7
Total Revenue	20.7	21.4	18.8	21.4	21.6	21.2	19.5
Tax Revenue	17.4	17.9	16.2	18.9	19.7	19.1	17.7
Non-Tax Revenue	3.3	3.6	2.6	2.6	1.9	2.1	1.8
Grants	2.1	2.4	3.0	2.5	2.4	2.1	2.2
Expenditure and Lending minus Repayments	33.0	32.5	34.5	32.6	31.7	31.1	29.3
Current	18.9	20.1	20.8	22.6	22.4	22.4	19.9
Capital	12.9	11.6	10.3	8.2	7.6	6.0	7.7
Lending minus Repayments	1.1	0.8	3.4	1.8	1.6	2.8	1.8
Current Account Surplus/Deficit (-)	1.8	1.3	-2.0	-1.2	-0.8	-1.2	-0.4
Budget Deficit (before grants)	-12.2	-11.1	-15.7	-11.2	-10.1	-9.9	-9.8
Budget Deficit (after grants)	-10.1	-8.7	-12.7	-8.6	-7.7	-7.8	-7.6
Financing	10.1	8.7	12.7	8.6	7.7	7.8	7.6
Foreign Borrowings	5.0	2.9	3.2	2.4	3.7	3.6	5.4
Domestic Borrowings	5.1	5.8	9.5	6.3	4.0	4.2	2.2
Non-Market Borrowings	-0.4	0.7	0.8	2.1	0.0	0.0	0.0
Market Borrowings	5.5	5.1	8.7	4.2	4.0	4.2	2.2
Non Bank	3.8	3.3	4.2	5.5	3.6	4.1	3.4
Bank	1.7	1.8	4.6	-1.3	0.4	0.1	-1.2

Source: Central Bank of Sri Lanka

(a) Adjusted for Rs. 3,478 Million increases of arrears in expenditure in 1989 and Rs. 2,107 Million decreases of arrears in expenditure in 1990.

was also attributable to implementational problems largely of foreign funded development projects.

The overall revenue and expenditure flows of government fiscal operations in 1990 resulted in a budget deficit (before grants) of Rs.31,850 million which was 13 per cent higher than the deficit of Rs.28,185 million recorded in the previous year. The funds available from foreign sources by way of loans and grants at Rs.18,341 million represented nearly 60 per cent of the resources required for financing the deficit as compared to 44 per cent in the previous year. However, total domestic borrowings at Rs.15,616 million registered an increase of 26 per cent in 1990 largely due to commitments amounting to Rs.2,107 million spilling over from the previous year. In relation to GDP, domestic borrowings remained at 4.9 per cent as in the previous year. An important feature of deficit financing in 1990 was that almost the entire domestic borrowing requirement was mobilized from domestic non-bank sources. Accordingly, the budgetary operations in 1990 did not result in exerting pressure on monetary expansion as borrowings from the banking system were at a minimal level of Rs.374 million.

The outstanding government debt at the end of 1990 stood at Rs.310,780 million. This was an increase of 13 per cent over the outstanding debt at the end of the previous year. Of the total debt, domestic debt rose by 14 per cent to Rs.133,897 million while the foreign debt at Rs.176,883 million also recorded an increase of 13 per cent. At the end of 1990, medium and long term domestic debt totalled Rs.59,454 million and registered an increase of 9 per cent, while short term debt at Rs.74,444 million marked a growth of 18 per cent. Reflecting these changes in the government debt structure, the share of short term debt in total domestic debt rose to 56 per cent in 1990 from 54 per cent in 1989.

Total resources mobilized through the issue of Treasury bills amounted to Rs.10,437 million, of which Rs.7,401 million came from non-bank sources. The outstanding Treasury bills as at end 1990 were Rs.67,968 million in comparison to Rs.57,246 million at end 1989. While the outstanding liability on Treasury bills increased, the Treasury bills held by the Central Bank declined from Rs.34,098 million at the end of 1989 to Rs.30,654 million at the end of 1990. Accordingly, the share of Treasury bills held by the Central Bank declined sharply from 60 per cent to 45 per cent over the two years. The Rupee Loan Programme raised a total sum of Rs.8,314 million for budgetary purposes in 1990. However, the outstanding debt on account of Rupee Securities rose only by Rs.460 million as there were repayments totalling Rs.8,212 million during the year. Meanwhile, National Defence Bonds which were introduced in 1990 raised Rs.4,532 million. The major subscribers to Treasury bills, Rupee Securities and National Defence Bonds were the Employees' Provident Fund, the National Savings Bank, Employees' Trust Fund and the Insurance Corporation of Sri Lanka.

The outstanding foreign debt stood at Rs.176,883 million at the end of 1990 in comparison to Rs.156,298 million, a year ago. Although the net foreign borrowings for budgetary purposes during the year amounted to Rs.11,644 million, the outstanding foreign debt at the end of the year recorded an increase of Rs.20,585 million owing to an additional rupee liability of Rs.8,508 million arising from exchange rate variations during the year. The total foreign debt at the end of the year comprised Rs.106,676 million on account of bilateral loans and Rs.59,526 million on account of multilateral loans.

The government debt service payments consisting of amortization and interest payments totalled Rs.32,878 million in 1990, an increase of 38 per cent over the previous year. Reflecting this high growth, the debt service payments as a ratio of GDP increased from 9.5 per cent in 1989 to 10.2 per cent in 1990.

A significant acceleration in the rate of growth of money supply was one of the less favourable features of macro-economic developments in 1990. The annual rate of growth of narrow money supply (M1) was 13 per cent at the end of 1990 as compared with 9 per cent at the end of 1989. Depicting a much sharper increase, the annual rate of growth of broad money supply (M2) rose to 19 per cent at the end of 1990 from 12 per cent at the end of 1989. The monetary developments in 1990 were in sharp contrast to the experience in 1989 when the rate of growth of both monetary aggregates decelerated considerably in line with the macro-economic stabilisation programme that was in progress. This reversal of the macro-economic targets on the monetary front constituted one adverse feature of an otherwise satisfactory macro-economic milieu that emerged during the year.

TABLE 1.5

MONETARY MAGNITUDES 1984 – 1990

Rs. Million

Item	1984	1985	1986	1987	1988	1989	1990
Change in Domestic Credit	633	9,300	4,883	11,457	21,302	5,454	17,543
Increase in Net Credit to Govt.	-2,979	5,793	2,198	4,502	9,017	54	3,078
Increase in Credit to Govt Corp.	-237	290	301	2,627	3,421	3075	1,774
Increase in Credit to Co-operatives	-255	-263	120	-301	195	-140	418
Increase in Credit to otherPrivate Sector	4,104	3,480	2,263	4,629	8,669	2,465	12,273
Change in Net External Banking Assets	6,796	-768	-3	111	-2,233	-2,326	5,474
Change in Total Assets/Liabilities	7,429	8,532	4,880	11,568	19,069	3,128	23,017
Increase in Broad Money Supply (M_2)	6,170	4,982	2,451	7,475	9,611	8,487	14,584
Increase in other Liabilities (Net)	1,259	3,551	2,428	4,093	9,458	-5,359	8,433
Percentage Increases in Monetary Magnitudes							
Percentage Increase in Total Domestic Credit	1.3	18.6	8.2	17.9	28.2	5.6	17.1
Percentage Increase in Total Assets and Liabilities	14.2	14.2	7.1	15.8	22.4	3.0	17.7
Govt. as a percentage of Total Domestic Credit Increase	-470.4	62.3	45.0	39.3	42.3	1.0	17.5
Non Govt. as a percentage of Total Domestic Credit Increase	570.4	37.7	55.0	60.7	57.7	99.0	82.5
Percentage Increase in:							
Broad Money Supply (M_2)	16.6	11.4	5.1	14.7	16.4	12.4	19.1
Narrow Money Supply (M_1)	14.1	11.5	12.9	18.4	29.1	9.1	12.8

Source: Central Bank of Sri Lanka

The acceleration in the growth of money supply in 1990 was more pronounced in the broad monetary aggregate. This was due to a significant improvement in the growth of quasi money. Quasi money which showed a considerable growth of Rs.5,528 million or 16 per cent in 1989 recorded a very substantial increase of Rs.10,044 million or 24 per cent in 1990. The increase was very largely reflected in the time and savings deposits of other private sector constituents which rose by Rs.9,578 million or 27 per cent during the year. This phenomenal growth in quasi money despite adverse inflationary pressures pervading the economy can be singled out as one of the most reassuring macro-economic developments observed during the year.

Meanwhile, the monetary base (or reserve money) recorded an increase of Rs.4,789 million or 18 per cent in 1990 as compared with a much smaller growth of Rs.1,227 million or 5 per cent in the previous year. On the source side, this increase was largely caused by a considerable expansion in net foreign assets of the Central Bank amounting to Rs. 2,997 million. In comparison, the net domestic assets (NDA) of the Bank rose by Rs. 1,792 million. The sharp increase in net foreign assets of the Central Bank partly explains the high growth of quasi money during the year.

A substantial rise in the growth of domestic credit was the major underlying factor for the acceleration in the rate of growth of money supply in 1990. In contrast to a moderate increase of Rs.5,454 million or 6 per cent in 1989, domestic credit expanded sharply by Rs.17,543 million or 17 per cent in 1990. Both the government sector and the private sector shared in the growth of domestic credit during the year but the overwhelmingly larger share was utilised by the private sector. In all, gross credit to private sector rose by Rs.14,465 million or 22 per cent in 1990 compared with an increase of Rs.5,400 million or 9 per cent in 1989. Meanwhile, as compared with a meagre increase of Rs.54 million in 1989, net credit to government (NCG) from the banking system expanded by Rs.3,078 million or 9 per cent in 1990.

The rather large growth in credit to private sector in 1990 can be attributed to sucn factors as the recovery in economic activity following the improvement in the business climate and favourable weather conditions, and enhanced working capital requirements as a consequence of upward revisions in electricity and petroleum prices. Within the private sector, credit utilisation by all three sub-sectors enhanced during the year. Credit extended by commercial banks to other private sector constituents (private sector proper) increased by Rs.12,273 million or 24 per cent in 1990, as compared with Rs.2,465 million or 5 per cent in 1989. The high level of credit utilised by the private sector despite a very tight monetary policy in operation was reflective of the buoyancy in economic activity that was prevalent during the year.

Meanwhile, commercial bank credit to public corporations expanded by Rs.1,774 million or 13 per cent which was considerably lower than the increase of Rs.3,075 million or 29 per cent recorded in 1989. The major borrowers were the Co-operative Wholesale Establishment (CWE), the Janatha Estate Development Board (JEDB) and the Sri Lanka State Plantations Corporation (SLSPC). Altogether, the level of outstanding bank credit of the CWE rose by Rs.1,224 million. The enhanced role of the CWE as an importer and buffer-stock holder of essential foodstuffs, following the transfer of food import responsibilities from the Food Commissioner to the CWE, resulted in the latter making further heavy demands on the banking system. Meanwhile, bank credit to the co-operative sector which dropped by Rs.140 million or 11 per cent in 1989, expanded by Rs.419 million or 36 per cent in 1990 suggesting increased channelling of bank credit through this sector to the rural sector of the economy.

In 1990, net bank credit to government (NCG) expanded by Rs.3,078 million or 9 per cent largely due to a rapid utilisation of bank credit during the closing months of the year. The increases in Treasury bill holdings of commercial banks by Rs.5,124 million and provisional advances from the Central Bank by Rs.3,563 million were the major items contributing to the growth in bank credit to the government during the year.

However, the latter included a special loan of Rs.3,055 million arising from revaluation adjustments of the liabilities to the IMF which cannot be attributed to the budgetary operations during the year and, hence the growth of NCG resulting from budgetary operations can be considered very small.

Meanwhile, the developments in the external sector constituted the single largest expansionary factor on the money supply in 1990. In contrast to a decline of Rs.2,326 million or 33 per cent in 1989, the net foreign assets (NFA) of the banking system increased by Rs.5,474 million or 116 per cent in 1990. The NFA of the banking system rose sharply during the first quarter, nearly doubling to reach Rs.9,342 million by the end of March and further improved to reach Rs.10,206 million by the end of December with fluctuations in between. A favourable balance of payments out-turn together with increased availability of lines of credit caused the foreign assets position of the banking system to improve during the year.

The overall liquidity position of commercial banks improved during 1990. While demand deposits rose by Rs.5,441 million, liquid assets increased by Rs.12,079 million thereby raising the ratio of liquid assets to demand deposits from 131 per cent at the end of 1989 to 149 per cent at the end of 1990. The expansion in liquid assets was mainly reflected in the Treasury bill holdings of commercial banks which rose by Rs.5,124 million or 84 per cent during the year. Both the improvement in the balance of payments position and the enhanced flow of Central Bank refinance would have contributed to improve the liquidity of the commercial banking system. However, although the overall liquidity position of the banking system improved in 1990, the volume of transactions in the call money market showed an increasing trend, especially during the first three quarters of the year, reflecting an imbalance as between banks with respect to the availability of resources. Meanwhile, reflecting the increased level of economic activity, the continuing high rates of inflation and the enhanced working capital requirements following the upward revisions of electricity tariffs and fuel prices, commercial bank credit to private sector rose sharply during the year, by Rs.14,465 million or 22 per cent, as compared with a growth of Rs.5,400 million or 9 per cent in 1989.

After a few years of moderate growth, the year 1990 witnessed a sharp increase in the bank branch network in the country. Raising the banking density in the country considerably, 48 new bank branches were opened during the year. These included 30 branches established by commercial banks, 11 RRDB branches and 7 National Savings Bank branches. This considerable expansion in the branch network reflected the enhanced competition among banks to provide banking facilities, following the improvement in the security situation in most parts of the country.

The year 1990 witnessed a relatively sharp increase in the total assets/liabilities of the Central Bank which rose by Rs.14,692 million or 23 per cent. On the assets side, both foreign assets and domestic assets recorded significant increases. The International Reserve (gross) of the Central Bank increased substantially by Rs.6,436 million or 65 per cent in 1990 following the increase of Rs.2,346 million or 31 per cent recorded in 1989. Meanwhile, compared to a marginal growth of Rs.761 million or 2 per cent in 1989, the domestic assets of the Bank (excluding other assets and accounts) expanded by Rs.4,483 million or 11 per cent in 1990. A notable item among domestic assets is the loans and advances to commercial banks and other financial institutions which rose by Rs.3,018 million or 70 per cent, mainly due to the growth in short-term refinance loans during the year.

On the liabilities side, monetary liabilities consisting of currency in circulation and deposits grew by Rs.11,661 million or 32 per cent in 1990 as compared with an increase of only Rs.2,532 million or 8 per cent in 1989. Currency in circulation rose by Rs.2,774 million and deposit liabilities by Rs.8,887 million. The sharp increase in monetary liabilities is a reflection of the pressures under which the monetary system functioned in 1990. A noteworthy favourable development, however, was a sharp reduction in the Bank's outstanding liabilities on account of short-term borrowings from abroad. In the wake of a favourable balance of payments out-turn, such borrowings declined significantly by Rs.2,631 million during 1990 in contrast to an increase of Rs.2,401 million in 1989.

In the context of unabated inflationary pressures, the general level of interest rates continued to remain high in 1990 for the second consecutive year. Reflecting increased recourse to raising funds through Treasury bill issues on the part of the government, the interest rates in the Primary Treasury bill market remained high, ending the year at a range of 17.4-18.4 per cent per annum. Interest rates in the Secondary Market for Treasury bills generally responded to variations in rates in the primary market.

In contrast to the Treasury bill market where the variations in rates were moderate, interest rates in the interbank call money market showed substantial fluctuations during the year. This reflected the relatively lower degree of arbitrage that existed between the two markets. The minimum and maximum rates on one year fixed deposits of commercial banks which stood at a range of 11.0-20.5 per cent at the end of 1989 remained at a range of 11.0-21.0 per cent at the end of 1990. Within this broad range, there was a general upward movement of rates during the year. In response to such changes, the National Savings Bank (NSB) revised its rates upward on savings and fixed deposits by around 2 percentage points per annum in July, 1990 to preserve its competitiveness. Meanwhile, following the movement of deposit rates the Average Weighted Prime Lending Rate (AWPR) of commercial banks rose to 18.6 per cent in December - its highest level for the year.

In May, 1990 the Central Bank announced the issue of Treasury Certificates of Deposits (TCDs) on behalf of the government. The yield rate on TCDs increased from a range of 14.6-16.5 per cent per annum in May, 1990 to a range of 17.1-19.0 per cent per annum in October and remained at that level for the rest of the year. Reflecting the changes in short-term rates, the long-term interest rates too tended to rise marginally during the year. For instance, the rate of interest on government securities rose from a range of 11-12 per cent per annum to 13 per cent while the lending rates applicable to certain categories of MLCF loans also increased marginally. The lending rates of long-term credit institutions such as the National Development Bank and the Development Finance Corporation of Ceylon also moved up marginally during the year.

Against a background of sustained expansion in liquidity and continuing inflationary pressures, the monetary policy remained tight throughout 1990. In the previous year, monetary policy tended to become increasingly restrictive to cope with growing inflationary pressures and balance of payments difficulties. Among the policy measures implemented in that year were an upward revision of Bank Rate from 10 to 14 per cent, partial ceiling on commercial bank credit to private sector, a 100 per cent margin requirement against Letters of Credit on non-essential imports and a further intensification of activities in the Treasury bill market. The restrictive monetary policy stance was further tightened in 1990. First, Bank Rate was raised by 1 percentage point to 15 per cent in July, 1990. Second, the interest rates applicable to Central Bank refinance were revised upward in respect of a number of facilities during the year.

Meanwhile, the Central Bank continued its thrust on open market operations with a view to moderating the rate of growth of its domestic assets which had been a major factor contributing to excessive liquidity creation in the economy. However, in order to maintain the momentum in economic activity, the Bank was obliged to continue to provide refinance facilities to priority and pioneering sectors of the economy. Towards this end, the resources available under the Medium and Long-Term Credit Fund (MLCF) were raised by Rs.625 million in June 1990 and further by Rs.750 million in October, 1990 to reach Rs.3,250 million by the end of the year.

In general, interest rates in Treasury bill markets were allowed to be determined by market conditions. In the Primary market for Treasury bills, weekly auctions were held thereby providing a regular investment outlet for liquid funds of commercial banks and other investors. The availability of Treasury bills with varying maturities, i.e. 3-months, 6-months and 12-months, provided a better portfolio option to investors. The sale of Treasury bills under the "Tap System" was further expanded in 1990 by making it open to investors from Colombo as well. The continued activities in the Secondary Treasury bill market provided an investment outlet for temporary surplus funds, particularly of financial institutions. During the year, the total sales of Treasury bills in this market amounted to Rs.67.2 billion and purchases to Rs.21.1 billion, resulting in a total gross turnover of Rs.88.3 billion.

In response to intensified activities both in the Primary market and the Secondary market, the holdings of Treasury bills by the non-bank sector further increased from Rs.15.5 billion at the end of 1989 to Rs.22.9 billion at end 1990. Consequently, the share of Treasury bills held by the non-bank sector in the total outstanding increased from 31 per cent to 37 per cent between the two years. Meanwhile, despite an increase in total Treasury bill issues by Rs.10.4 billion (book value) during 1990, the share of the Central Bank's holdings in the total declined from 57 per cent to 44 per cent reflecting the effectiveness of open market operations activities.

Sri Lanka launched a three year Structural Adjustment Programme in 1988 with assistance from international institutions in order to improve economic performance. The third year programme which commenced in 1990 was designed to develop and strengthen the on-going adjustment effort and to lay a firmer basis for sustained economic growth with price and balance of payments stability. Structural reforms covered a wide range of areas in 1990. In rationalising public expenditure, the government eliminated a number of subsidies notably those on wheat flour, rice and fertilizer resulting in a budgetary saving of about 1 per cent of GDP. In the area of public enterprise reforms, several public enterprises were peoplised. Considerable progress was also made in reducing the budgetary commitments to the transport sector through fair revisions. Welfare expenditure on Janasaviya and the Mid-Day Meal Programe was contained within manageable levels through better targetting. Meanwhile, with a view to improving the business environment and the private sector confidence, the government lifted restrictions on foreign equity participation, except in specific areas, whilst also eliminating the 100 per cent transfer tax on share transactions by foreigners. As a further step towards trade liberalization, the country's tariff system was simplified and maximum nominal tariff rates were brought down to 50 per cent.

In response to this policy thrust the economy appears to have reacted very favourably. The real GNP growth accelerated to 6.6 per cent, following five years of mediocre performance. There was further consolidation of fiscal performance, the budget deficit/

GDP ratio falling from 11.2 per cent in 1989 to 9.9 per cent in 1990. The balance of payments displayed considerable dynamism with the current account showing a lower deficit and the overall balance recording a surplus of SDR 130 million. These achievements could be considered formidable, considering the circumstances under which they were achieved. However, in the midst of these favourable developments certain disquieting trends emerged, which if allowed to continue unarrested would jeopardise growth and economic performance in the future. The most formidable of these was the persistent inflationary pressure in the economy. During most parts of 1990 the price increases were sharp with the average inflation rate, as measured by the increases in CCPI, remaining at around 21 per cent. This resurgence of inflationary pressures was threatening to undermine the gains made in economic management whilst also endangering the prospects for consolidating growth performance in the coming years under reasonable price stability. Needless to say that uncontrolled inflation can undermine the confidence that underlies the hard-won economic recovery and would risk dissipating the flow of badly needed foreign capital into the country.

Inflation can affect the economy and economic performance in many different ways. First, it distorts the price structure which in turn adversely affects the allocation of resources among competing claims within the economy. Second, it can seriously undermine the financial intermediation process through an erosion of the real value of financial assets thereby penalising those who are thrifty and generate financial savings while bestowing benefits on those who live on borrowed funds. Third, continuing inflation can undermine export competitiveness while encouraging the import flow, the two together contributing to exert pressure on the country's balance of payments with adverse implications on the exchange rate and external reserves. Fourth, persistent inflation will discourage inflow of foreign capital and encourage capital outflow, a process disastrous for a capital deficient economy. Fifth, inflationary periods are characterised by faster increases in government expenditure than government revenue leading to unmanageable fiscal deficits, which if financed from expansionary sources contribute to further fuel inflation. Sixth, a rapid upsurge in the cost of living will lead to demands for higher wages which the employers will find difficult to resist, leading to a wage-price spiral. Seventh, the uncertainty and instability in relative prices and interest rates that surfaces during an inflationary situation make long-term investment riskier and more difficult to finance.

Above all, the most disturbing aspect of inflation is its adverse social impact. As a rule, the negative effects of inflation are distributed more unevenly; the poor and the weaker sections of the community having to face the larger brunt of it, as against those who are more affluent and better placed to weather such adverse developments; some really standing to gain from it, as profits tend to rise disproportionately at the expense of wages. In Sri Lanka, a substantial proportion of the population still remains below the poverty line. Accordingly, programmes aimed at poverty alleviation have received highest priority in the government's economic policy in recent years. Within the constraints of resource availability, well-targetted poverty alleviation programmes have been designed to protect the vulnerable sections of the population until adequate growth and normal productive employment in agriculture, industry and elsewhere emerge. Continuous and uncontrolled inflation would not only undermine the hard-earned gains against poverty but could also throw such programmes completely off-course.

While many factors contributed to maintain price pressure in the economy, the high level of aggregate demand as reflected in the growth of monetary aggregates contributed in no small measure in sustaining inflationary pressures in the economy during 1990.

Strong growth in commercial bank lending to private sector, partly supported by refinance credit from the Central Bank, maintained aggregate demand at a higher level than was warranted by the supply situation. Altogether, commercial bank credit to private sector which had increased by 9 per cent during 1989 rose by 22 per cent in 1990 and by the year's end there was a clear need for further tightening of monetary policy with a view to easing demand pressure in the economy. A reduction in the underlying rate of inflation in the medium term is likely to require a significant reduction in the average rate of growth of money supply, which in turn will entail considerable restraint in the growth of bank credit and refinance from the Central Bank.

It needs to be recognised that controlling inflation is no easy task, particularly when an unduly heavy burden is placed on monetary policy. To begin with, while a tight monetary policy, if it stays sufficiently long, can contribute to softening inflation, its side effects can be as harmful as the original ailment. Then, considerations of resource allocation efficiency demands that the operation of monetary policy should be based largely on market-based instruments of monetary policy. However, in the context of the still formative state of Sri Lanka's money and capital markets and the distortions in such markets, the prospects for effective implementation of market-based monetary instruments are limited, implying that a combination of both direct and indirect instruments of monetary control will have to be continued. At Sri Lanka's current stage of development, undue reliance on market-based instruments is also fraught with problems. For instance, the freedom of action in the area of interest rate policy is somewhat limited if the incentives for investment and production are not to be thwarted. Entrepreneurs generally look for cheaper credit and frown upon increases in interest rates, even during times of high inflation. Movements to higher interest rates are generally identified as entering periods of recession or down-turn in economic activity. This is particularly important at a time when the business climate has improved with prospects of creating a large number of new jobs. The saving public, on the other hand, would require them to be protected against the loss of capital value of their financial assets, which invariably happens during times of inflation. Resolving this dichotomy and performing a complicated balancing act is indeed a major challenge faced by economic policy makers in an inflationary situation. The general public, and more particularly the entrepreneurial classes, have to be convinced that temporary high rates of interest are better than extra-high rates of inflation, which can undermine business confidence and export competitiveness. Therefore, judicious use of monetary policy is necessary so as to generate the required degree of monetary stability while also maintaining adequate production incentives. In other words, the economy should not be allowed to get overheated, but it should not be choked off either, and this constituted a policy challenge of great significance by the end of 1990.