

2. NATIONAL INCOME AND EXPENDITURE

2.1. Overall Trends

In 1997, the Gross Domestic Product (GDP) grew by 6.4 per cent in real terms, recovering strongly from the previous year's modest economic performance. The GDP growth in 1997 was notably higher than the average growth rate of 5.2 per cent during the past five year period 1992-96. Following the setback during the first half of 1996, the economy recovered during the second half. This growth process accelerated in 1997. The Agriculture sector, which was adversely affected by the prolonged drought in 1996, recovered in 1997. The Manufacturing, Construction and Services sectors also performed well in 1997 contributing to faster economic growth.

The Gross National Product (GNP), defined as the GDP adjusted for net factor income from abroad, grew by a higher 6.9 per cent. The net factor income from abroad increased due to an increase in investment income receipts reflecting interest income on a higher level of foreign assets invested abroad and a decline in interest payments on foreign debt.

The GDP at current market prices was estimated at Rs.890 billion. The mid year population was estimated to have increased by 1.3 per cent to 18.6 million in 1997. Accordingly, the per capita GDP rose to Rs.47,999 (US dollars 814) in 1997. Sri Lanka is gradually approaching the income level of a middle income country and therefore, access to concessional and foreign funds for further development work would diminish gradually. Hence, in the future, a growing share of funds for development projects will have to be raised in foreign capital markets. The Government successfully launched a Floating Rate Notes issue for US dollars 50 million in the international capital market in March 1997 with a view to establishing a benchmark interest rate for Sri Lanka in international markets.

The domestic investment climate became more favourable in 1997. The reduction of interest rates, moderation of inflation and improved fiscal discipline helped to maintain the domestic financial markets relatively stable in the context of highly volatile international financial markets. The improved economic fundamentals have fostered greater investor confidence. These had a favourable impact on economic growth in 1997. The higher growth rate also reflected the recovery of economic activities from depressed conditions in the previous year. There was a slight upturn in the stock market and corporate profits improved during the year. There was also an increase in the inflow of foreign direct investment but the inflows from the East Asian region

were below the anticipated levels as the pledged foreign investment from some of these countries was held back due to their currency crisis. There was also an easing of labour unrest in 1997. However, rigidities, particularly in labour markets and insufficient infrastructure facilities, continued as obstacles to faster growth in private investment, while high security expenditure also absorbed resources away from productive investment. Despite these, Gross Domestic Capital Formation (GDCF) increased to maintain its ratio to GDP at a slightly higher level than in 1996.

The Agriculture sector recorded a growth rate of 3.1 per cent in real terms, contributing 8.4 per cent to the growth in real GDP in 1997. The output of three major agricultural crops, tea, coconut and paddy, increased while rubber production declined. Tea production recorded a further growth of 7.2 per cent over the previous year and reached a new peak production level of 277 million kilograms. The continuous growth in tea production since 1993 is a noteworthy feature. Tea producers also gained by the continued increase in international tea prices in 1996 and 1997. The paddy output in 1997 increased by 8.6 per cent and this helped to reduce the outlay on rice imports. The recovery in the coconut sub-sector was slow since the production responds to weather conditions with a time lag of about one year. The fisheries sub-sector, which experienced a setback in 1996, also recovered during the year, recording an increase in the output of marine fish and fresh water fish.

The Manufacturing sector grew by 9.3 per cent in 1997, compared to 6.5 per cent in 1996 and contributed 29 per cent of the overall economic growth. The export oriented industries continued to provide an impetus to economic growth. Industrial exports account for about two thirds of industrial production and are the most important sub-sector in the Manufacturing sector. The export value of industrial products increased by 14.3 per cent from US dollars 3,006 million in 1996, to US dollars 3,436 million in 1997. The export volume index of manufactured goods increased by 11.1 per cent in 1997 when compared to 4.7 per cent in 1996. In addition to the growth in export demand, the major factors which contributed to improving the performance of the Manufacturing sector in 1997 were the enhancement of the electricity generating capacity, easing of industrial labour unrest and the incentives for the industrial sector offered in the last two Budgets.

Despite a decline in the hydro power generation during the first half of the year, increased thermal power generation

TABLE 2.1
Sectoral Composition and Increase in Gross National Product at Constant (1982) Prices

Sector	Rate of Increase (%)		Percentage Share of Increase in GNP(%)		Percentage Share of GNP(%)	
	1996(a)	1997(a)	1996(a)	1997(a)	1996(a)	1997(a)
1. Agriculture, Forestry and Fishing	-4.6	3.1	-29.4	8.4	18.8	18.1
Agriculture	-5.1	3.0	-27.7	6.9	15.8	15.2
Tea	5.1	7.2	3.0	2.0	1.9	1.9
Rubber	6.3	-5.8	0.8	-0.4	0.4	0.4
Coconut	-7.6	3.3	-5.1	0.9	1.9	1.9
Paddy	-26.7	8.6	-35.7	3.8	3.0	3.1
Other	3.5	0.4	9.3	0.6	8.5	8.0
Forestry	1.3	1.3	0.5	0.2	1.3	1.2
Fishing	-3.9	5.0	-2.2	1.2	1.7	1.6
2. Mining and Quarrying	8.9	3.4	6.8	1.3	2.6	2.5
3. Manufacturing	6.5	9.3	42.5	28.9	21.3	21.8
Processing of Tea, Rubber & Coconut Kernel Products	1.0	3.0	0.7	1.0	2.2	2.1
Factory Industry	7.3	10.3	38.9	26.4	17.7	18.2
Small Industry	6.3	7.0	2.9	1.5	1.5	1.5
4. Construction	3.4	5.4	7.4	5.5	7.0	6.9
5. Electricity, Gas, Water and Sanitary Services	-2.0	8.0	-1.0	1.7	1.5	1.5
of which : Electricity	-3.8	8.0	-1.7	1.5		
6. Transport, Storage and Communication	7.5	7.8	26.7	13.4	11.8	11.9
of which: Communication	25.2	33.1	8.7	6.4		
7. Wholesale and Retail Trade	5.2	6.5	35.2	21.0	22.1	22.0
Imports	7.4	9.0	21.0	12.3	9.4	9.6
Exports	8.2	11.6	8.3	5.7	3.4	3.5
Domestic	2.0	2.2	5.9	3.0	9.3	8.9
8. Banking, Insurance and Real Estate	10.1	9.8	18.6	8.9	6.2	6.4
9. Ownership of Dwellings	1.3	1.2	1.0	0.4	2.3	2.2
10. Public Administration and Defence	5.0	4.4	6.8	2.8	4.4	4.3
11. Services (n.e.s.)	4.0	5.8	4.7	3.2	3.8	3.8
12. G.D.P.	3.8	6.4	119.5	95.5	101.8	101.4
13. Net Factor Income from Abroad			-19.5	4.5	-1.8	-1.4
14. G.N.P.	3.2	6.9	100.0	100.0	100.0	100.0

(a) Provisional

Source: Central Bank of Sri Lanka

by the Ceylon Electricity Board and the private sector helped to avoid interruptions to the power supply in 1997. The installed generation capacity of electricity supplied through the national grid increased by 12 per cent with the commissioning of three new thermal electricity supply stations. The supply mix of 65 per cent of hydro electricity and 35 per cent thermal electricity reduced the over dependence on hydro electricity resulting in a more reliable power supply. The capacity of power generation by the Ceylon Electricity Board was increased in 1997 for the first time after the commissioning of the Samanalawewa hydro power project in 1992. The Services sector performed better than last year, reflecting the growth in demand for services that accompanied the expansion of the Agriculture, Manufacturing and Construction sectors and the recovery in tourism. Moreover, the modernisation and expansion programmes that took place in the sub-sectors of finance,

port and dockyard services and communications have contributed to enhancing the output of the Services sector. The Services sector grew by 7 per cent in 1997 contributing to 56 per cent of the increase in real GNP. This sector accounted for 51 per cent of GNP in 1997.

GDP at current factor cost prices increased by 15.5 per cent to Rs.804 billion in 1997. Accordingly, the implicit GDP price deflator, a measure of the overall price level in the economy, increased by 8.5 per cent, compared to an increase of 12.1 per cent in 1996. This reflected the trends in other aggregate price indicators in 1997.

Gross Domestic Expenditure at current market prices was estimated to be Rs.953 billion in 1997, reflecting an increase of 13.9 per cent. Consumption expenditure, which represents the largest share in overall expenditure, rose by

13.2 per cent in 1997. When viewed in relation to the increase in the consumer prices of 7-10 per cent in 1997, this indicates an increase in real consumption. However, it is noteworthy that consumption as a percentage of GDP declined reflecting an increase in the marginal propensity to save with increasing per capita income, despite a reduction in real interest rates. This increase needs to be sustained by maintaining real interest rates at a positive level and reasonably attractive to depositors. Private consumption expenditure at current prices increased at a rate of 13.1 per cent in 1997 when compared to 16.4 per cent in 1996. The increase in consumption expenditure is reflected by various indicators such as the increase in the volume of imports of consumption goods, a rise in the collection of sales and services taxes and an increase in new registration of passenger cars and motorcycles. Household demand for services including transport, telecommunication and electricity, also expanded in 1997. Public consumption expenditure, comprising salaries and wages and outlay on goods and services in Government institutions, registered an increase of 13.8 per cent in 1997, in comparison to 5.8 per cent in 1996.

Gross Domestic Capital Formation was estimated to have risen by 16.6 per cent to Rs.217 billion in 1997. The ratio of Gross Domestic Capital Formation to GDP increased from 24.2 per cent in 1996 to 24.4 per cent in 1997. Private investment increased from 18 per cent of GDP to 18.9 per cent of GDP. Public investment however declined from 6.2 per cent in 1996 to 5.5 per cent. The expansion in capital formation was reflected through a number of indicators including a rise in the imports of capital goods, an increase in the sales volume of major construction materials, a growth in loans and advances granted by the banking system and an increase in foreign direct investment. The core-programmes within public investments were human resource development, transport and economic infrastructure. These accounted for 53 per cent of the overall public investment expenditure. The Gross Domestic Savings ratio increased from 15.3 per cent in 1996 to 17.3 per cent in 1997. A decline in the Government's dis-savings, mainly through rationalisation and economising of public spending and an increase in private sector savings, mainly due to higher corporate savings, have resulted in a higher savings rate in 1997 when compared to 1996. The national savings ratio increased from 19.0 per cent in 1996 to 21.4 per cent in 1997.

2.2 Sectoral Performance

The Agriculture sector, which includes forestry and fishing, grew by 3.1 per cent in 1997 mainly due to the growth in tea and the recovery in the paddy, coconut and

fisheries sub-sectors. The combined output of paddy in the 1996/97 Maha season and the 1997 Yala season is estimated at 2.24 million metric tons, an increase of 8.6 per cent when compared to the output in 1996. The plantation sector as a whole performed well during 1997, with tea production increasing by 7.2 per cent mainly due to improved management under the private sector and a moderate recovery of 3.3 per cent in coconut production. The Colombo Auction average price for tea during 1997 was Rs.119.40 per kg; an increase of 14.5 per cent when compared with the average price in 1996. The higher prices were largely due to the tight world supply situation and increased demand for Sri Lanka tea from the CIS countries. The high prices augur well for the tea sub-sector as rising producer margins will enable investment in tea plantations and factories. Rubber production in 1997 declined by 5.8 per cent as the production during the last quarter was affected by heavy rains. In addition, the decline in the producer prices also led to an erosion of producer margins while there was upward pressure on cost of production due to continuing labour shortages.

Other agriculture, which accounts for 52 per cent of the value added in the total Agriculture sector, increased marginally by 0.5 per cent in 1997. In this sub-sector, increases in production were recorded in vegetables, minor export crops and animal husbandry products, while the output of subsidiary food crops, fruits and sugarcane declined. The slow growth in this sub-sector is reflected by a decline in fertilizer use (by 5 per cent) and higher imports of chillies, onions, potatoes and vegetables during the year when compared to 1996.

The fisheries sub-sector, which suffered a setback in 1996, also recovered with both marine and fresh water fish production recording increases. Accordingly, the output in the fisheries sub-sector has grown by 5 per cent with total fish production increasing from 228,550 MT in 1996 to 240,000 MT in 1997.

The Mining and Quarrying sector grew by 3.4 per cent in 1997, reflecting the growth of output of the major quarrying products and aggregate stones and clay for bricks and tiles as a result of the expansion in construction activities. However, this growth rate was lower than in 1996. The export demand for gems and geuda slackened during the second half of the year due to the financial market and currency crisis in East Asia and the drop in demand from Japan. The extraction of mineral sands and graphite also declined in 1997. Export earnings from minerals in 1997 remained at US dollars 90 million as in 1996, while the volume of minerals exported declined by 4 per cent in 1997.

The Manufacturing sector, which includes factory industry, processing of tea, rubber and coconut kernel products and small industries, grew by 9.3 per cent in 1997, when compared to 6.5 per cent in 1996. The factory industry sub-sector, which represents more than 80 per cent of the overall manufacturing sector, registered a growth of 10.3 per cent, in real terms, against a background of reduced labour unrest, a robust external demand for industrial products and further incentives offered in the 1997 Budget for export oriented industrial production. In 1997, industrial exports grew by 11 per cent in volume, with exports of garments continuing to lead with an export volume growth of 11.8 per cent. A substantial rise in exports of leather and rubber goods was also recorded. Industrial exports at Rs.203 billion accounted for 74 per cent of Sri Lanka's export earnings in 1997. An increase in the output of tea and coconut kernel products led to a higher growth rate (3 per cent) in the agro-processing industry, when compared to 1.0 per cent in 1996.

A growth rate of 7.0 per cent was recorded in the small industries sub-sector. Recovery in agriculture, expansion in construction activity and an up-turn in tourism led to a better performance in the small industries sub-sector in 1997, when compared to the previous year. Paddy milling, the agro-processing industry of other non-plantation crops, manufacture of bricks, wood-work and metal fabrication work related to the construction industry and the handicraft industry catering largely to the tourist industry, expanded during the year. Small industries play an important role in the context of employment generation, dispersion of industrial production into rural areas and developing inter-sectoral linkages in production. Recognising these aspects, the Government through the 1997 Budget extended to the small industries which export their products, some of the incentives which were in place for the large scale industrial enterprises, such as tax holidays, turnover tax and duty waivers. A noteworthy development in recent years which is taking place within the small industries sub-sector is assembling of computers, communication equipment and other electronic equipment which are increasingly undertaken in small scale enterprises. This movement to higher technology industries augurs well, especially in the context of providing employment avenues to the educated and the technically skilled work force.

The Construction sector grew by 5.4 per cent in 1997 compared to a lower growth rate of 3.4 per cent in 1996. The expansion in construction was mainly due to an increase in the construction of buildings for residential and commercial purposes, road construction and rehabilitation and maintenance of irrigation. This trend was consistent with the increase in the sales of basic inputs to construction such as cement, roofing materials and steel.

The Transport, storage and communication sector grew by 7.8 per cent in 1997. Within this sector, the communication sub-sector maintained a high growth momentum benefiting from the infrastructure expansion under both Sri Lanka Telecom and private sector companies. Port services, which grew by 16 per cent in 1996, performed even better in 1997. The growth of port services was seen in the areas of cargo handling, container throughput and transshipment cargo handling. These activities recorded growth rates of 18 per cent, 24 per cent and 16 per cent, respectively. The number of ships calling at the Colombo Port increased by 5 per cent. With these developments, the Port of Colombo also indicated improvements in efficiency by increasing the net gantry moves from 23 in 1996 to 26 in 1997. However, cargo handling at the Ports of Trincomalee and Galle recorded declines. Despite these developments, there are areas of concern for the future development of port activities. The Port of Colombo encountered difficulties in handling cargo due to capacity limitations resulting in a significant increase in the turn-around time of cargo vessels. An expansion in dockyard services contributed to a better performance in the port services sub-sector during the year under review.

The number of subscribers under Sri Lanka Telecom and private companies recorded significant increases during 1997 compared to 1996. The number of new subscribers under Sri Lanka Telecom was 28,300 at end 1997 compared to 22,800 at end 1996. The new subscribers under private sector telecommunication services were 35,616 at end 1997 compared to 21,928 at end 1996. The services improved further in the second half of the year with the expansion projects of the two newcomers i.e., Suntel and Lanka Bell in supplying telecommunication services. Meanwhile, the acquisition of a 35 per cent share of Sri Lanka Telecom by Nippon Telegraph and Telephone Corporation (NTT) of Japan and its expansion projects with production and management efficiency through the use of modern techniques also contributed to raise the value addition in this sector. With the developments in the telecommunication sector, the telephone density, which is the number of persons per telephone, improved from 72 in 1996 to 58 in 1997. The expansion of the telecommunication sector was accompanied by improvements in quality and efficiency with the introduction of new services such as telephone hunting facilities, abbreviated dialling, absentee services, call waiting, call forwarding and conference calls.

The transport sub-sector, which includes road, rail and air transport services, grew by 4.7 per cent in 1997. The expansion in the road transport services is largely the outcome of the expansion in the Agriculture, Manufacturing and Construction sectors leading to an increase in the demand for goods transportation. The growth in the tourist

industry enabled a recovery in air transport services. The number of passenger kilometers flown by Air Lanka increased to 4,304 million in 1997 from 3,809 million in 1996.

TABLE 2.2
Composition of the Other Agriculture Sub Sector

Sector	Value Added (1982) Constant Prices (Rs.Mn.)			
	1994	1995	1996	1997(a)
Vegetables	5,181	5,541	5,765	5,800
Subsidiary Food Crops (b)	3,602	3,673	3,687	3,466
Minor Export Crops (c)	1,603	1,462	1,543	1,666
Sugar Cane	257	287	279	254
Tobacco	210	175	169	176
Animal Husbandry (d)	1,117	1,248	1,344	1,359
Other	1,697	1,635	1,725	1,856
Total	13,667	14,021	14,512	14,577

Source: Central Bank of Sri Lanka

- (a) Provisional
 (b) Subsidiary food crops mainly include potatoes, chillies, red onions, big onions, green gram, cowpea and kurakkan.
 (c) Minor export crops mainly include coffee, pepper, cinnamon, cloves, cashew nuts and betel leaves.
 (d) Animal Husbandry comprises milk, eggs, poultry and other meats.

The impetus to the growth in Wholesale and retail trade was mainly from the expansion in external trade. In real terms, imports rose by 10.5 per cent and exports by 11.6 per cent in 1997. The share of Wholesale and retail trade in total GDP increased to 22 per cent in 1997 while its contribution to the overall GDP growth during the year was 22.4 per cent.

The Banking, real estate and financial services sector recorded a growth rate of 9.8 per cent in 1997. With the reduction in the Statutory Reserve Requirement (SRR) and

the increased inflow of foreign funds into the financial system, the availability of liquidity in commercial banks increased. The reduction in the SRR also reduced the effective cost of funds of commercial banks. Although commercial banks reduced their lending rates somewhat, they decreased their deposit rates even more, thus resulting in a widening of the margin between lending rates and deposit rates. This, together with the increase in economic activity, had a positive impact on the profitability of the commercial banking sector in 1997.

The tourism sector recovered with tourist arrivals increasing by 21 per cent over 1996, to reach 366.165 in 1997. Gross earnings from tourism increased from US dollars 166 million in 1996 to US dollars 209 million in 1997, an increase of 26 per cent. With the growth in tourist arrivals, the room occupancy rate in graded hotels rose from 39 per cent in 1996 to 48 per cent in 1997, leading to an expansion of hotel services.

2.3 Expenditure

Gross Domestic Expenditure (GDE), the sum of consumption expenditure and Gross Domestic Capital Formation, was estimated at Rs.953 billion, showing an increase of 13.9 per cent in 1997.

Consumption expenditure was estimated at Rs.736 billion in 1997, a 13.2 per cent increase over the Rs.650 billion in 1996. Private consumption expenditure, which represents about 87 per cent of the overall consumption expenditure, registered a growth of 13.1 per cent, increasing from Rs.569 billion in 1996 to Rs.644 billion in 1997. Private consumption expenditure on imported goods and non-

TABLE 2.3
Total Resources and Their Uses at Constant 1982 Prices

Item	Percentage Share				Percentage Growth	
	1982	1995(a)	1996(a)	1997(a)	1996	1997
1. Total Resources	100	100	100	100	3.2	7.7
GDP at Market Prices	68	67	67	66	3.8	6.4
Imports of Goods & Non-Factor Services	32	33	33	34	2.1	10.5
2. Utilisation	100	100	100	100	3.2	7.7
Consumption	60	59	59	59	3.4	7.2
Gross Domestic Fixed Capital Formation	21	17	16	16	2.3	4.8
Government	3	2	2	2	-7.6	13.6
Private Sector & Public Corporations	18	15	15	14	3.7	3.7
Changes in Stocks	0	0	0	0	150.0	-92.4
Exports of Goods & Non-Factor Services	19	24	24	25	3.2	11.6

(a) Provisional.

Source: Central Bank of Sri Lanka

factor services rose at a higher rate due to a rise in consumption expenditure on consumer durables, including motor cars and motor cycles, and services, namely in foreign travel. Within the domestically produced goods and services, consumption expenditure on food items and manufactured products recorded a significant growth, contributing to more than 69 per cent of the overall increase in Private Consumption Expenditure.

Gross Domestic Capital Formation (GDCF) is estimated to have increased by 16.6 per cent to Rs.217 billion in 1997. Private investment amounted to Rs.169 billion, while its share to overall GDCF was 78 per cent. The increase in private investment is mainly attributed to an improvement in the investment climate. Foreign Direct Investment (FDI) of Rs.7,873 million (US dollars 134 million) and gross inflows of long-term foreign capital to the private sector of Rs.10,602 million (US dollars 176 million) together financed 11 per cent of total private investment in 1997 as in 1996. Capital formation in the government sector, which reflects its acquisition of real assets to enhance the capital stock of government ministries and departments under the Public Investment Programme (PIP), increased by 27.4 per cent to Rs.30,000 million. Meanwhile investments by public enterprises and corporations increased by a marginal 2.3 per cent, to Rs. 49 billion in 1997, when compared to a decline of 10 per cent in 1996.

TABLE 2.4
National Savings at Current Market Prices

Category	Rs. Mn			
	1982	1995(a)	1996(a)	1997(a)
1 Gross Domestic Product at Market Prices	99,238	667,772	768,128	890,485
2 Domestic Savings	11,770	102,111	117,691	154,450
3 Net Factor Income from Abroad	-1959	-6958	-11258	-9934
4 Net Private Transfers from Abroad	5,494	34,820	39,242	46,449
5 National Savings	15,305	129,973	145,674	190,965
6 Domestic Savings Ratio (2 as a % of 1)	11.9	15.3	15.3	17.3
7 National Savings Ratio (5 as a % of 1)	15.4	19.5	19.0	21.4

(a) Provisional

Source: Central Bank of Sri Lanka

Increased capital formation was also reflected in the increase in the volume of imports of investment goods by 6 per cent. The imported goods content of domestic investment in 1997 remained at 36 per cent as in 1996. Within investment goods, substantial increases were recorded in machinery and equipment (5.3 per cent), transport equipment (10.9 per cent) and building materials (9.5 per cent). The composition of investment goods in 1997 shows that capital formation was mainly in the Manufacturing and Transport, Storage and Communication sectors. Within the Manufacturing sector, a higher proportion was absorbed in the industries of food and beverages and textiles and wearing apparel.

2.4 Availability and Utilisation of Resources

The total resources available to the economy, comprising Gross Domestic Product and imports of goods and non-factor services (foreign resources) increased to Rs.1,278 billion in 1997 from Rs.1,105 billion in 1996. This increase of Rs.173 billion was generated by a Rs.122 billion increase in GDP at current market prices and a Rs.51 billion increase in foreign resources. Of the total resources, 59 per cent was spent on consumption and 16 per cent on capital formation, while the balance 25 per cent was reflected in exports of goods and non-factor services.

The availability of resources valued at constant (1982) prices rose by 7.7 per cent in 1997, compared with an increase of 3.2 per cent in 1996. In real terms, consumption expenditure grew by 4.1 per cent in 1997 compared to an increase of 3.5 per cent in 1996. Meanwhile, GDFCF grew by 4.8 per cent, compared to 2.3 per cent in 1996. Led by industrial exports, which grew by 11.0 per cent, and an expansion in agricultural exports (by 9 per cent), exports of goods and non-factor services grew by 11.6 per cent.

2.5 National Savings

Domestic savings in 1997 have been estimated at Rs.154,450 million, which was an improvement of 31 per cent over the previous year. The ratio of domestic savings to GDP rose to 17.3 per cent in 1997 when compared to 15.3 per cent in 1996. The reduction in government dis-savings and the higher level of corporate sector savings mainly contributed to increase domestic savings in 1997. National savings, which is defined as the sum of domestic savings and net foreign income, rose to Rs.190,965 million, which was 21.4 per cent of GDP.