9. TRADE, BALANCE OF PAYMENTS AND TOURISM[1]

9.1 Overview

The balance of payments showed a significant improvement in 1997 mainly reflecting increased exports, services receipts, private transfers and higher capital and financial inflows. With the recovery of economic activities from the depressed conditions in the previous year, exports grew faster than imports thereby narrowing the trade deficit considerably. The services account registered a larger surplus mainly due to the growth of tourism and port services. Increased interest earnings reduced the net outflow on account of investment income. Reflecting an improvement in investor confidence there were higher capital inflows both in terms of privatisation proceeds and foreign direct investment. Meanwhile, the maintenance of some capital controls, the low exposure to short-term foreign debt, the flexibly managed exchange rate system, short-term monetary policy reform through a higher repurchase rate and enhanced surveillance of financial market activity helped to avoid the contagion effect of the East Asian crisis on Sri Lanka's financial markets. Accordingly, a lower trade deficit, a significantly lower current account deficit, a respectable surplus in the overall balance and a relatively stable foreign exchange market were the highlights of the external sector developments in 1997.

On the external policy front, Sri Lanka continued with further cautious liberalisation of the capital account and rationalisation of the trade regime. In January, commercial banks were permitted to grant foreign currency loans to all direct and indirect exporters either through their domestic or foreign currency banking units, subject to a limit on net foreign exposure of commercial banks. Hitherto, the foreign loan facility had been available mainly to BOI exporters for imported inputs. Further moves were also made in the tax and tariff system to remove anomalies and facilitate the shift to a Goods and Services Tax (GST) in 1998. The managed floating exchange rate regime was maintained, with a 2 per cent band between the Central Bank's buying and selling rates, allowing the currency to depreciate gradually keeping in mind the need to minimise erratic movements in the exchange rate. The annual average real effective exchange rate showed some appreciation in 1997 reflecting the sharp depreciation of East Asian currencies during the second half of 1997. This indicator alone may not reveal the complete picture with regard to the external competitiveness of Sri Lankan products, particularly given the inflationary impact of the large depreciation of East Asian currencies, which is yet to be seen.

The resilience displayed by the external sector in the previous year amidst difficult conditions was strengthened in 1997, with a rapid recovery in the economy. Exports increased by 13 per cent while imports grew by 8 per cent. Reflecting favourable prices for exports and declining prices on imports, the terms of trade improved by 4.2 per cent. As a result, the trade deficit narrowed, for the third consecutive year, from 10 per cent of GDP in 1996 to 8 per cent in 1997. The net service receipts increased by 51 per cent due to a strong recovery in the tourist industry and expansion of port related activities. Net factor income outflows declined by US dollars 38 million as there were higher inflows on account of interest earnings in respect of external assets invested abroad. Net current transfers increased by 10 per cent due to higher receipts from private transfers partly on account of compensation payments to Sri Lankan workers who were displaced from Kuwait by the Gulf war in 1990. The current account deficit of the balance of payments declined sharply to 2.5 per cent of GDP in 1997 or US dollars 387 million from 4.9 per cent of GDP or US dollars 683 million in 1996 continuing its downward trend for the third consecutive year.

Net private investment inflows increased substantially from US dollars 221 million to US dollars 341 million due mainly to privatisation proceeds. Foreign funds received by the National Development Bank (NDB) for its lending activities and foreign sale of NDB shares and 35 per cent of the shares of Sri Lanka Telecom, totalling US dollars 376 million, were the major sources of foreign private capital inflows to the country in 1997. Despite an increase in short-term trade credits of the private sector, net short-term liabilities declined as there was an increase in the net external assets of commercial banks in the context of declining domestic interest rates. The Government successfully raised US dollars 50 million through a Floating Rate Note issue in the international capital market after 15 years. However, net official capital inflows declined by about 35 per cent during the year due to weak utilisation of foreign aid and higher outpayments. Net capital transfers too declined by 9 per cent due to a reduction in project grants. The overall balance of the balance of payments registered a healthy surplus of US dollars 163 million according to the BPM5 during 1997. Gross official external assets at US

1 Presentation of this section is in US dollars and based on the IMF Balance of Payments Manual Fifth (1993) Edition (BPM5) format. For a review of the specifics under the new format please refer to Box 8.

TABLE 9.1

Balance of Payments-Analytic Presentation

Item	US Dollars Million 1993	1994	1995	1996	1997(a)	Rupees Million 1993	1994	1995	1996	1997(a)
Trade Balance	-1,147.6	-1,558.7	-1,504.5	-1,343.8	-1,212.5	-55,374.5	-77,022.2	-77,109.1	-74,276.1	-71,091.4
Exports	2,863.7	3,208.6	3,806.6	4,095.1	4,638.9	138,175.5	158,553.8	195,091.9	226,801.0	274,193.4
Imports	4,011.3	4,767.3	5,311.1	5,438.9	5,851.5	193,550.0	235,576.0	272,201.0	301,077.1	345,284.7
Services, net	163.6	179.8	152.1	105.1	159.1	7,846.5	8,883.6	7,795.5	5,804.9	9,385.6
Receipts	627.9	745.4	820.7	765.5	875.3	30,288.9	36,793.4	42,045.1	42,357.9	51,691.6
Payments	464.3	565.6	668.5	660.4	716.2	22,442.4	27,909.8	34,249.5	36,553.1	42,305.9
Income ,net	-124.2	-168.3	-137.3	-203.7	-165.5	-6,025.3	-8,363.8	-7,032.1	-11,232.1	-9,760.2
Receipts	119.0	152.3	223.3	175.1	218.7	5,760.9	7,569.4	11,441.7	9,694.8	12,939.0
Payments	243.2	320.6	360.6	378.8	384.2	11,786.2	15,933.2	18,473.8	20,926.9	22,699.2
Goods, Services and Income (net)	-1,108.3	-1,547.2	-1,489.6	-1,442.4	-1,219.0	-53,553.3	-76,502.4	-76,345.6	-79,703.3	-71,465.9
Private Transfers, (net)	556.5	622.1	675.2	710.0	787.4	26,889.3	30,765.8	34,592.9	39,230.0	46,493.7
Receipts(c)	626.9	707.1	790.2	832.2	922.1	30,285.6	34,991.6	40,482.3	46,002.7	54,445.0
Payments	70.4	85.1	115.0	122.2	134.7	3,396.3	4,225.8	5,889.4	6,772.7	7,951.3
Official Transfers net)	56.2	58.5	60.8	49.1	44.4	2,712.2	2,889.8	3,113.6	2,708.8	2,625.0
Current Account	-495.5	-866.6	-753.6	-683.3	-387.2	-23,951.8	-42,846.8	-38,639.0	-37,764.5	-22,347.2
Capital and Financial Account	1,108.3	1,045.2	838.8	535.2	569.8	53,374.9	52,036.0	42,719.1	29,946.4	36,821.5
Capital Account	108.6	113.1	117.3	95.9	87.0	5,237.7	5,589.5	6,009.2	5,285.9	5,140.2
Capital Transfers (net)	108.6	113.1	117.3	95.9	87.0	5,237.7	5,589.5	6,009.2	5,285.9	5,140.2
Receipts	110.8	115.7	120.8	99.7	91.2	5,342.8	5,720.2	6,191.4	5,495.3	5,386.1
Payments	2.2	2.6	3.6	3.8	4.2	105.0	130.7	182.1	209.4	245.9
Financial Account	999.7	932.1	721.5	439.3	482.7	48,137.2	46,446.5	36,709.8	24,660.5	31,681.3
Long-term:	639.9	714.1	581.0	341.1	632.5	30,684.1	35,647.9	28,997.4	18,795.3	37,875.3
Direct Investment	187.2	158.2	53.1	119.9	429.9	9,107.4	7,815.2	2,930.8	6,605.7	25,504.5
Foreign Direct Investment	187.2	158.2	15.6	86.5	128.7	9,107.4	7,815.2	1,010.6	4,756.1	7,586.7
Privatization Proceeds	0.0	0.0	37.5	33.5	301.1	0.0	0.0	1,920.2	1,849.6	17,917.8
Private Long-term (net)	187.9	309.8	74.9	3.2	60.9	8,997.8	15,628.4	2,856.3	202.2	4,044.0
Inflows (d)	303.2	402.6	221.9	180.4	175.6	14,585.6	20,202.8	10,305.0	10,000.4	10,601.7
Outflows	115.3	92.8	147.0	177.3	114.6	5,587.8	4,574.5	7,448.7	9,798.2	6,557.6
Government, Long-term (net)	264.8	246.1	453.0	218.0	141.7	12,578.9	12,204.4	23,210.3	11,987.4	8,326.8
Inflows	465.7	445.0	669.4	457.1	420.3	22,316.5	22,025.9	34,296.4	25,210.3	24,761.3
Outflows	200.9	198.9	216.4	239.1	278.6	9,737.6	9,821.5	11,086.2	13,222.9	16,434.5
Short-term:	359.7	218.0	140.5	98.3	-149.8	17,453.1	10,798.6	7,712.4	5,865.2	-6,194.1
Portfolio Investment	67.0	28.1	-2.3	6.6	13.1	3,271.5	1,334.3	-89.6	353.3	748.7
Private Short-term (net)	146.7	260.0	27.1	25.0	37.0	7,110.3	12,930.2	1,429.9	1,355.2	4,339.5
Commercial bank Assets (net)	54.3	-138.1	79.4	4.3	-289.5	904.5	-7,093.1	1,903.5	-1,103.2	-20,048.1
Commercial bank Liabilities (net)	91.7	68.0	36.3	62.3	89.7	6,166.8	3,627.2	4,468.6	5,259.9	8,765.9
Government Short-term (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
SDR Allocations										
Valuation Adjustments						-1,419.6	-1,379.8	6,394.4	4,212.8	-561.7
Errors and Omissions	48.2	61.1	-33.7	80.2	-19.7	3,216.7	5,890.7	-2,665.3	3,613.9	-1,932.1
Overall Balance (e)	660.9	239.7	51.5	-67.8	162.9	31,220.2	13,700.1	7,809.1	8.6	15,844.7
Monetary Movements (e)	-660.9	-239.7	-51.5	67.8	-162.9	-31,220.2	-13,700.1	-7,809.1	-8.6	-15,844.7
Exchange Rate Rs/US$						48.25	49.42	51.25	55.27	58.99
Ratio to GDP in percentages										
Trade Account						-11.1	-13.3	-11.5	-9.7	-8.0
Current Account						-4.8	-7.4	-5.8	-4.9	-2.5
Current Account without Grants						-5.3	-7.9	-6.3	-5.3	-2.8

Source: Central Bank of Sri Lanka.

(a) This presentation conforms as far as possible to the Balance of Payments Manual, 5th Edition (1993) of the International Monetary Fund.
(b) Provisional.
(c) Includes US dollars 64 million received in 1997 as compensation of US dollars 2,500 per person to about 26,000 Sri Lankans who lost employment in Kuwait due to the Gulf war in 1990.
(d) Includes adjustment to capital inflows in 1993,1994 and 1995 on account of import of five aircraft for which advance payments had been made in previous years.
(e) All transactions in the Monetary Sector are converted at the end of year exchange rates.

Box 8

Presentation of BOP Statistics according to the Fifth (1993) Edition of the IMF BOP Manual and External Sector Data in US Dollars

The Balance of Payments (BOP) statistics of Sri Lanka have hitherto been published according to the Fourth (1977) Edition format of the Balance of Payments Manual (BPM4) of the International Monetary Fund (IMF). Moreover, the BOP data as well as all other external sector data of Sri Lanka have been published by the Central Bank in Sri Lanka rupees and Special Drawing Rights (SDR). Henceforth, the Central Bank will i) publish the BOP statistics according to the Fifth (1993) Edition format of the Balance Payments Manual (BPM5); and ii) present external sector data in US dollars instead of SDRs. The rationale for this change as well as the major differences in presentation in the proposed new format are discussed in the remainder of this article.

I. Presentation of BOP Statistics According to BPM5

With the publication of the revised (Fifth Edition) Balance of Payments Manual by the IMF in 1993, all member countries are expected to publish their BOP statistics in accordance with the new format introduced in the manual. The salient features of the changes between the BPM4 and the BPM5 had been published in Box 9 of the Central Bank Annual Report of 1996. The major changes as they would appear in the text and Statistical Appendix tables of the Annual Report are as follows:-

1. The former Services account will be divided into two separate sectors , i.e. the Services sector consisting of trade in services and the Income sector which would consist of compensation of employees statistics and investment income (profits, dividends and interest). The Freight and Merchandise Insurance item shown in the old format will be disaggregated and Freight will be shown separately in the new format. Merchandise Insurance together with Non-merchandise Insurance, formerly shown under "Other Services", will be shown as Insurance Services in the new format.

2. Transfers will be divided into Current Transfers and Capital Transfers. Current transfers will consist of migrants' current transfers and non-project grants and will form part of the current account, while capital transfers consisting of project grants and migrants' capital transfers will be in the capital account.

3. The present Non-monetary sector will be redesignated as the Capital and Financial Account.

4. The commercial banks assets and liabilities which were hitherto included in the Monetary sector and were taken into consideration when computing the country's overall balance in the balance of payments will be shifted to the new Financial Account as part of short-term capital.

5. As a result of the shift of commercial bank assets and liabilities to the Financial Account mentioned in 4 above, the overall balance in the balance of payments will show the change in net official reserves (i.e. assets held by the Central Bank and the Government) only.

These changes in format are in keeping with changes that have taken place over time in the nature of international financial transactions and are therefore relevant and timely. Moreover, the changes will enable comparison of Sri Lanka's BOP statistics with the rest of the world in the future.

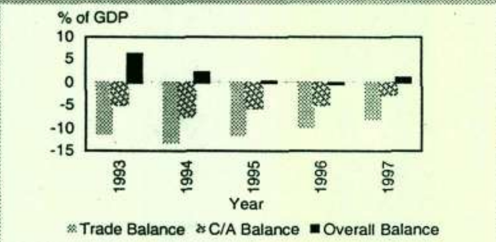
II. Publication of External Sector Data in US Dollars

During the sixties and early seventies external sector data were published, where necessary, in US dollars in addition to Sri Lanka rupees. Even after the establishment of the SDR in 1970 the same practice was continued as the US dollar and SDR were on par. However, with the de facto devaluation of the US dollar in 1971 and devaluation proper in 1973, the US dollar remained devalued in terms of the SDR. As the SDR, which represented a basket of major currencies, was considered to be a more stable unit of account and a reserve asset, the IMF expectation at that time was that the SDR would become one of the leading reserve assets in the world economy, in time.

Although the SDR is still used as the unit of account of the IMF, it has not received the prominence among reserve assets in the global economy as envisaged. In spite of the relatively high volatility of the US dollar compared to the SDR, the US dollar enjoys a prestigious position among the world's key currencies and accounts for the largest share of world trade and investment. In Sri Lanka too, US dollar denominated trade transactions account for about 75 per cent of the total. The IMF itself has reverted to presenting external sector data in US dollars. The IMF's Balance of Payments Year Book, which formerly presented individual country data in SDRs, now presents those data in US dollar terms. The data presented in US dollars are easily understood by most users.

Considering the above, it is advisable to publish external sector data in US dollars. Such a change for Sri Lanka would facilitate comparison of data with other countries of the world. However, it should be noted that the presentation of external sector data in a single currency would reflect the volatility of cross currency changes more than in a presentation in SDR which represents a basket of currencies that is far more stable against cross currency fluctuations. Nevertheless, it would be appropriate to follow world trends for data presentation and publishing. The 1997 Annual Report of the Central Bank will therefore present all external sector statistics in US dollars as a starting point to this change of presentation in the Annual Report.

Chart 9.1
Balance of Payments



(a) With the change in classification from BPM4 to BPM5 format, changes in commercial bank assets and liabilities are excluded from the overall balance

TABLE 9.2
External Trade Performance

Year	Growth Rates(a)		Price Indices (1990=100)			Ratios
	Exports	Imports	Exports	Imports	Terms of Trade(b)	Export/ Imports
1993	16.4	14.5	144.7	114.6	126.3	0.71
1994	12.0	18.8	151.2	121.0	125.0	0.67
1995	18.6	11.4	174.2	140.2	124.2	0.72
1996	7.6	2.4	196.3	154.9	126.7	0.75
1997(c)	13.3	7.6	212.3	160.8	132.0	0.79

Sources: Sri Lanka Customs
Central Bank of Sri Lanka

(a) Revised growth rates are given in US dollar terms.
(b) (Export price index / Import price index) x 100.
(c) Provisional.

Chart 9.2
External Trade

Chart 9.2.1
Trade Balance

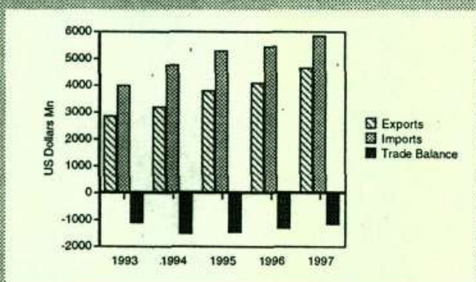


Chart 9.2.2
Export and Import Volume Indices
(1990 = 100)

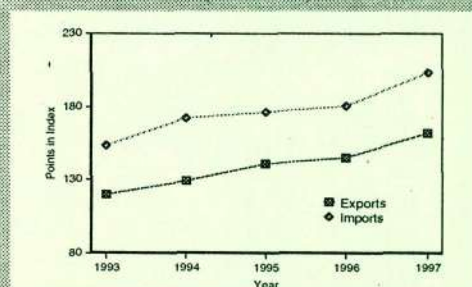


Chart 9.2.3
Trade Price Indices
(1990 = 100)

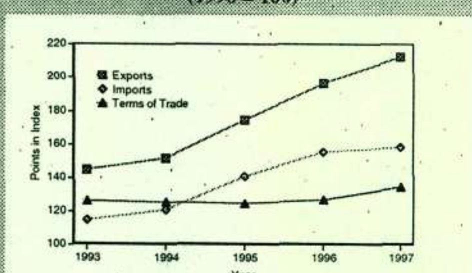
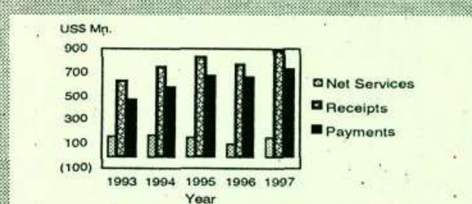


Chart 9.2.4
Trade in Services (a)



(a) With the change in classification from BPM4 to BPM5 format, Services exclude Income which now appears as a separate item in the Current Account

TABLE 9.3
Composition of Exports

Category	US Dollars Million					Rs. Million				
	1993	1994	1995	1996	1997(a)	1993	1994	1995	1996	1997(a)
1. Agricultural Exports	655	702	829	961	1,060	31,618	34,692	42,478	53,206	62,667
Tea	413	424	481	615	719	19,911	20,964	24,638	34,067	42,533
Rubber	64	72	111	104	79	3,086	3,582	5,713	5,753	4,640
Coconut	58	76	103	110	117	2,796	3,761	5,270	6,091	6,939
Kernel Products	38	50	69	81	82	1,847	2,476	3,520	4,469	4,864
Other	20	26	34	29	35	949	1,285	1,750	1,622	2,075
Minor Agricultural Products	121	129	134	132	145	5,825	6,385	6,857	7,295	8,555
2. Industrial Exports (b) (c)	2,102	2,399	2,870	3,006	3,436	101,437	118,544	147,069	166,543	203,114
Food,Beverages and Tobacco	63	86	98	95	91	3,054	4,262	5,040	5,272	5,354
Textiles and Garments	1,412	1,552	1,853	1,902	2,274	68,150	76,685	94,946	105,341	134,455
Petroleum Products	79	80	85	104	97	3,801	3,959	4,349	5,740	5,743
Rubber Products	71	102	153	169	178	3,445	5,026	7,851	9,357	10,513
Ceramic Products	35	39	46	48	55	1,711	1,920	2,371	2,677	3,246
Leather and Footwear	59	90	118	139	183	2,841	4,456	6,054	7,690	10,812
Machinery and Equipment	73	93	124	154	204	3,528	4,572	6,348	8,572	12,076
Diamond and Jewellery	154	170	196	192	142	7,449	8,419	10,023	10,643	8,384
Other Industrial Exports	155	187	197	202	212	7,458	9,245	10,087	11,251	12,531
3. Mineral Exports	76	87	87	96	90	3,653	4,292	4,447	5,292	5,271
Gems	71	79	78	86	84	3,402	3,917	3,972	4,771	4,899
Other Mineral Exports	5	8	9	10	6	251	375	475	521	372
4. Unclassified (c) (d) (e)	30	21	21	32	53	1,467	1,026	1,098	1,760	3,141
Total Exports	2,864	3,209	3,807	4,095	4,639	138,175	158,554	195,092	226,801	274,193

(a) Provisional.
(b) Adjusted.
(c) Revised.
(d) Includes re- exports.
(e) Includes US dollars 18.5 million (Rs.1,091million) of generators, US dollars 6.2 million (Rs. 366 million) of electric transformers and US dollars 26.5 million (Rs.1,563 million) of other items re-exported in 1997.

Sources : Sri Lanka Customs
Ceylon Petroleum Corporation
Central Bank of Sri Lanka

dollars 2,029 million were sufficient to finance 3.9 months of imports projected for 1998, compared to 4.0 months import cover at end 1996. Meanwhile, total assets, including those of commercial banks, had risen to 5.4 months imports cover from 5.0 months at end 1996.

9.2 Exports

Export growth recovered from 8 per cent in 1996 to 13 per cent in 1997. Most export items except natural rubber, petroleum products and mineral exports, contributed to this growth.

Industrial Products

Industrial exports, dominated by textiles and garments, have become far more important over the last two decades in the composition of Sri Lanka's exports. In 1997, industrial exports accounted for 74 per cent of total exports as against 14 per cent in 1977. Earnings grew sharply by 14 per cent in 1997 compared to a moderate 5 per cent in 1996. Textiles and garments grew by 20 per cent. The unit price of textiles and garments increased by 8 per cent, partly attributable to quality improvements. The volume of garment exports increased by 11 per cent in comparison to 4 per cent in 1996, reflecting mainly the recovery from the setback in 1996. Textile and garment exports continued to be the leading export sub-category, contributing 66 per cent to total industrial exports in 1997. Nearly 90 per cent of textile and garment exports were by BOI companies. Export earnings of BOI enterprises increased by 18 per cent, while those of non-BOI enterprises rose by 34 per cent partly reflecting the relatively higher adverse impact of last year's power cuts on the latter category. Net foreign exchange earnings from this sub sector increased by 21 per cent over the previous year reflecting higher domestic value addition. Of the earnings from this sub sector, garments, the major contributor, which accounted for 90 per cent, increased by 21 per cent, while textiles grew by over 11 per cent. The textile and garment industry benefited from the duty waiver granted on the import of yarn in March 1997 and the removal of turnover tax on yarn used in the handloom industry in April 1997. In addition, a package of incentives was introduced in the 1998 Budget announced in November 1997 making all intermediate and capital goods used in the textile and garment industry non-dutiable.

Chart 9.3
Value of Exports by Major Categories

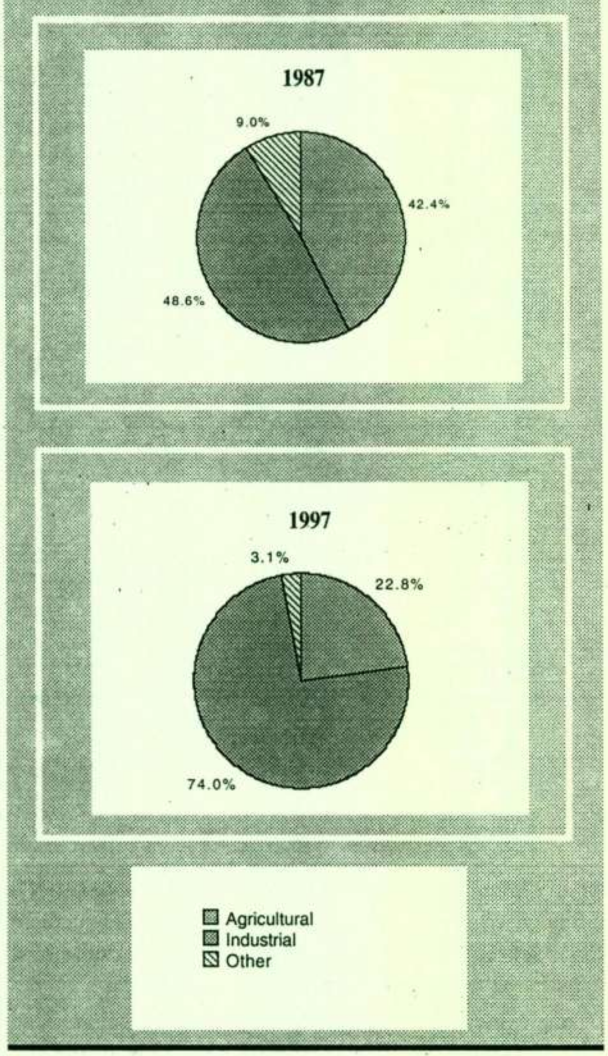
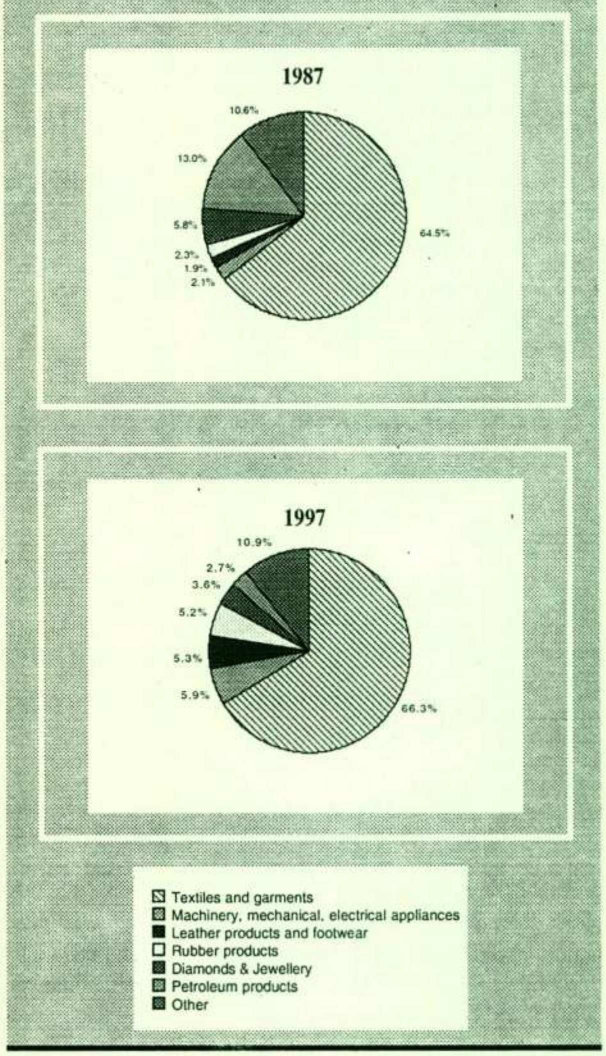


Chart 9.4
Value of Industrial Exports by Major Categories



The value of petroleum product exports declined by 7 per cent in 1997, with a 19 per cent decline in volume, due to the temporary closure of the refinery for maintenance purposes from 15 January to 2 March.

Reflecting further diversification of industrial exports, machinery, mechanical and electrical equipment exports increased by 32 per cent, mainly due to a growth in the exports of parts and accessories for office machines such as word processing and data processing machines and floppy disks, electrical transformers, static converters and parts, electric filament and discharge lamps, machine tools, weighing machines and electric generating sets. Export earnings of this category almost tripled during the last five years raising its sectoral share in total industrial exports to 6 per cent.

Rubber based products increased by 5 per cent despite the severe competition experienced in the international markets during the latter part of the year owing to the East Asian financial crisis, and accounted for about 5 per cent of total industrial exports. Export volumes of rubber based products such as tyres, non-surgical gloves, floor covering and mats, and some forms of vulcanised rubber increased substantially. Earnings from surgical gloves remained at the same level as in the previous year while exports of inner-tubes of tyres declined by 18 per cent. Within this sub sector, surgical and other gloves together accounted for 43 per cent, while tyres and tubes accounted for 41 per cent.

Export earnings from the food, beverages and tobacco sub sector declined by 5 per cent owing to an 11 per cent drop in the earnings from crustaceans and molluscs, which contributed 56 per cent to this sub category. The outbreak of the White Spot disease in major producing areas since late 1996 and increased salinity of water in prawn farms near the Negombo lagoon resulted in the closure of several prawn farms. However, a recovery of the industry was seen in the last quarter of 1997 after the disease was contained. Shrimp feed was made duty free with effect from August 1996 as a relief measure to shrimp farmers.

There was a marked reduction in jewellery (52 per cent) and diamond (20 per cent) exports due to lower demand. This was largely due to the major setback in the Japanese market resulting from the closure of two major jewellery companies in Japan. The increase in sales tax in Japan in 1997 and the financial crisis in East Asia, where major markets for diamonds and jewellery existed, were other factors responsible for this reduction. Diamond exports to Belgium, the largest market for Sri Lanka, declined by 18 per cent due to lower demand for their exports from the depressed Japanese and East Asian markets. In addition to the duty free facility granted in 1996 for precious metal for the manufacture of jewellery for export, the import of gems and gold was made duty free while the gem and jewellery industries were exempted from income tax and the national security levy from November 1997 with a view to encouraging the industry.

Other manufactured exports that showed increases were leather and footwear (32 per cent), table ware (9 per cent), wall tiles (14 per cent) and plastics (28 per cent). Earnings from chemical products declined marginally, while wood products dropped substantially with a significant decline in many categories, including wooden jewellery cases, due to lower demand.

Plantation Crops

Export of plantation crops increased by 10 per cent in 1997 and contributed to 20 per cent of the total as in 1996. In 1997, Sri Lanka regained its position as the world's largest tea exporter by overtaking Kenya. The export volume of tea increased by 10 per cent to 269 million kg. with tea production at a record level of 277 million kg. in 1997. Meanwhile tea prices increased by 6 per cent to US dollar 2.68 per kg. reflecting a supply shortage in the world tea market and a quality improvement in Sri Lanka's tea production. The value of tea exports rose by 17 per cent and contributed 15 per cent to total exports in 1997. Tea prices remained strong due to production shortfalls in Kenya, Indonesia, China and Bangladesh and increased world demand. Higher output in tea production in India and Sri Lanka was not sufficient to compensate for the sharp production drop in these countries. Rising demand from the Commonwealth of Independent States (CIS) and Turkey, coupled with the improvement in the quality of Sri Lanka's tea under private sector management contributed to higher tea prices throughout 1997 and this is likely to continue, reflecting one of the benefits of replacing state involvement by the private sector, in economic activities in which the private sector can perform better.

In the composition of Sri Lanka's tea exports, more than 49 per cent was in bulk form, while 36 per cent was in packed form. Tea bags, Sri Lanka tea blended with foreign teas and instant and green tea accounted for the remainder - less than 15 per cent of the total. As in the previous year, the CIS countries, which continued to be the prime destination for Sri Lanka's tea, accounted for 23 per cent of exports, while Turkey remained the second largest importer accounting for 13 per cent. The other major buyers were U.A.E (7 per cent), Syria (5 per cent), Egypt, Jordan and Libya (4 per cent each).

Export earnings from rubber declined by 24 per cent owing to lower prices (11 per cent) and a decline in exports volumes by 15 per cent. International rubber prices had already declined by 12 per cent between December 1996 and June 1997, even before the East Asian currency turmoil. Production surpluses in major producing countries, such as Thailand and Indonesia and the release of stocks led to lower prices. Sharp currency depreciations in Thailand (46 per cent), Indonesia (57 per cent) and Malaysia (35 per cent), which contribute more than 85 per cent of world rubber exports, also exerted downward pressure on international rubber prices during the latter part of the year. Rubber production was also adversely affected by heavy rains in the last quarter of 1997.

Being a small producer and exporter of rubber, accounting for only about 2 per cent of the world natural rubber market, Sri Lanka is a price taker in the international market for sheet rubber although it has a price advantage in certain grades of crepe rubber used in the manufacture of specialised articles such as surgical gloves, apparel and clothing accessories. The average export price of Ribbed Smoked Sheet (RSS) rubber, which accounted for about 43 per cent of total exports, declined by 20 per cent in 1997. However, the average price of latex natural rose by 5 per cent owing to the high quality of this product, while crepe grades too recorded higher prices. All other grades of rubber recorded lower prices. Relatively lower prices of rubber in the East Asian countries have made imported rubber more attractive recently for Sri Lanka's domestic manufacturing industry. The existing import duty of 10 per cent and turnover tax of 20 per cent with the upliftment of import value by 25 per cent for turnover tax and national security levy of 4.5 per cent together provided some degree of effective protection for domestic rubber producers. Imports of latex rubber increased from 63,690 kg. in 1996 to 270,891 kg. in 1997. However, it was only a small fraction (3 per cent) of local production.

Exports of coconut kernel products increased by 2 per cent. Higher production due to favourable weather conditions generated an exportable surplus of coconut kernel products. Exports of other coconut products (coir products, shell products etc.) also increased by 20 per cent in 1997. The average price of major coconut exports declined in 1997 by 4 per cent.

Other Agricultural Products

Exports of other agricultural products increased by 10 per cent and contributed to 3 per cent of total exports in 1997 despite a decline in export earnings from unmanufactured tobacco. Meanwhile, earnings from cinnamon exports rose by 34 per cent, benefiting from increased prices and higher volumes. These two products contributed 56 per cent to the total earnings from other agricultural products. Earnings from the fresh and dried fruit category declined by 32 per cent. Reduced earnings were due to low prices despite a four fold volume increase of tamarind exports, largely exported to Pakistan, which accounted for 70 per cent of the total volume of fresh and dried fruits. The volume of other fruit exports declined, contributing to the lower earnings from this category. Exports of all other agricultural products except betel leaves and other oil seeds, recorded increases. Export quantities of cinnamon, cloves, pepper, arecanuts and cardamoms grew significantly due to increased production resulting from favourable weather conditions. Prices of pepper, cinnamon, nutmeg and mace increased due mainly to improved demand from India, Pakistan, Nepal, and Saudi Arabia. Export prices of essential oils too rose substantially due to higher prices of cinnamon, pepper, nutmeg and mustard oil.

Mineral Products

The export earnings from all mineral products decreased by 6 per cent and contributed 2 per cent to exports in 1997 owing to lower earnings from precious and semi precious stones (3 per cent). Within this sector 'geuda' exports were adversely affected by the reduced participation of Thai buyers in the gem trade due to the financial crisis in Thailand. From the supply side, gem mining was adversely affected by the dispute between the Gem and Jewellery Authority and plantation companies, in respect of sharing proceeds from the auctioning of leases of lands under the plantation companies for mining. Since this dispute has not been settled, the reduction in legal mining in 1997 would be reflected in future gem exports. Precious stone export

TABLE 9.4

End-Use Classification of Imports

Category	US Dollars Million					Rs. Million				
	1993	1994	1995	1996	1997(a)	1993	1994	1995	1996	1997(a)
1. Consumer Goods	891	1,048	1,181	1,234	1,223	42,981	51,810	60,508	68,372	72,062
Food and Drinks	532	602	720	801	781	25,675	29,739	36,901	44,377	45,996
Rice	49	13	2	91	73	2,386	655	122	5,118	4,331
Sugar	116	180	170	145	184	5,621	8,875	8,737	8,026	10,788
Wheat	116	118	198	204	139	5,609	5,825	10,155	11,267	8,128
Other	250	291	349	361	385	12,059	14,384	17,887	19,966	22,749
Other Consumer Goods	359	447	461	433	442	17,306	22,071	23,607	23,995	26,066
2. Intermediate Goods	2,038	2,307	2,702	2,767	3,084	98,343	114,004	138,475	153,117	182,013
Petroleum	309	296	387	479	539	14,920	14,641	19,827	26,525	31,828
Fertiliser	64	63	86	76	54	3,108	3,097	4,406	4,189	3,175
Chemicals	109	121	143	134	136	5,244	5,975	7,310	7,402	8,024
Textiles and Clothing	865	1,038	1,159	1,168	1,386	41,740	51,299	59,375	64,601	81,816
Other Intermediate Goods	691	789	928	910	969	33,331	38,992	47,557	50,400	57,170
3. Investment Goods	1,047	1,366	1,189	1,204	1,325	50,508	67,524	60,916	66,647	78,232
Machinery and Equipment	464	559	503	649	742	22,377	27,635	25,769	35,987	43,853
Transport Equipment (b)	311	454	304	179	208	15,012	22,425	15,564	9,885	12,276
Building Materials	194	241	272	263	272	9,342	11,898	13,956	14,540	16,030
Other Invesment Goods	78	113	110	113	103	3,777	5,566	5,627	6,235	6,073
4. Unclassified Imports	36	45	240	234	220	1,718	2,238	12,301	12,940	12,976
Total Imports (c)	4,011	4,767	5,311	5,439	5,852	193,550	235,576	272,200	301,076	345,285

Sources : Sri Lanka Customs
Co-operative Wholesale Establishment
Ceylon Fertiliser Co. Ltd. and other major importers of fertiliser
Ceylon Petroleum Corporation
Central Bank of Sri Lanka

(a) Provisional.
(b) Includes the values of aircrafts imported by Air Lanka in 1993, 1993 and 1995
(c) Adjusted.

volumes declined, although marginally, in 1997, as against a 20 per cent increase in 1996. Earnings from other mineral exports fell by 33 per cent due to lower earnings from metallic ores and iron pyrites and other mineral product exports. However earnings from ilmenite and natural graphite grew, containing the decline in the mineral sector export earnings.

9.3 Imports

Total outlay on imports, at US dollars 5,852 million, registered a moderate growth of 8 per cent, compared with 3 per cent in 1996. Imports of intermediate goods grew by 11 per cent while those of investment goods grew by 10 per cent. Imports of consumer goods declined by 1 per cent, due to lower outlay on rice, wheat and milk imports. As in the case of the export structure, the import structure too has changed drastically over the last two decades shifting from the import of consumer goods to more development-oriented intermediate and investment goods. The share of investment and intermediate goods imports as a percentage of total imports had risen from 56 per cent in 1977 to 75 per cent in 1997.

Consumer Goods

Within the consumer goods category, imports of food and drink declined by 2 per cent reflecting mainly the partial recovery in rice production, while non-food consumer goods imports increased by 2 per cent reflecting improved domestic demand for consumer durable goods. Expenditure on rice imports dropped by 20 per cent in 1997 due to a reduction in the quantity as well as lower prices. The improved harvest in 1997 enabled a 10 per cent quantity reduction over 1996. During the year, 306,101 metric tons of rice were imported at a cost of US dollars 73 million to meet the additional demand not met by domestic production. Reduction in international prices by 11 per cent and the removal of the full duty waiver on rice on 30 January 1997, which had been effective for a nine and half month period from mid-April 1996, also contributed to lower the import outlay. The volume of wheat imports too declined by 14 per cent to 789,027 metric tons, while 10,674 metric tons of wheat flour were imported to meet a temporary shortage in the domestic market. The lower import of wheat reflected a drop in domestic demand due to the removal of the subsidy on wheat flour resulting in an increase in the retail price of wheat flour from Rs.13.95 per kg. to Rs.16.95 per kg. on 27 August 1996 and further to Rs.18.95 per kg. on 10 August 1997. The outlay on milk and milk products declined by 12 per cent due to lower prices. The quantity of sugar imports increased by 43 per cent to 545,000 metric tons to supplement the shortfall in domestic production, which fell

TABLE 9.5
Volumes of Major Imports (a)

'000 MT

Item	1993	1994	1995	1996	1997(b)
Rice	209	58	9	341	306
1st Quarter	48	37	8	1	104
2nd Quarter	47	12	...	23	9
3rd Quarter	17	5	...	117	12
4th Quarter	96	4	1	201	181
Wheat	771	826	1,057	913	725
1st Quarter	207	178	315	201	301
2nd Quarter	226	259	213	303	157
3rd Quarter	208	222	323	157	116
4th Quarter	130	168	206	252	151
Sugar	394	491	417	381	545
1st Quarter	146	127	133	94	176
2nd Quarter	129	147	76	84	163
3rd Quarter	78	134	95	58	83
4th Quarter	40	83	113	146	123
Petroleum (Crude Oil)	1,791	1,898	1,860	2,033	1,814
1st Quarter	369	503	332	566	299
2nd Quarter	553	547	452	493	389
3rd Quarter	370	364	584	466	606
4th Quarter	498	484	492	508	520
Fertilizer	465	427	452	361	332
1st Quarter	113	99	185	104	56
2nd Quarter	108	159	97	60	83
3rd Quarter	110	71	56	53	70
4th Quarter	134	97	115	144	123

(a) Adjusted.
(b) Provisional

Sources : Sri Lanka Customs
Co-operative Wholesale Establishment
Ceylon Fertiliser Co Ltd. & other major importers of fertiliser
Ceylon Petroleum Corporation

by 14 per cent, and to meet the increased demand. A duty waiver of 17 per cent, which came into effect from 27 November 1996 for ten months, and a 10 per cent duty waiver that was effective thereafter, together with the withdrawal of turnover tax on sugar with effect from 6 November 1996 contributed to higher imports. International prices of sugar declined by 11 per cent in 1997. All other food imports increased by 15 per cent, with substantial increases in imports of dried and other fish, potatoes and big onions. The increases in potato and big onion imports are attributable to the removal of the licensing requirement in July 1996 and duty waivers introduced from 4 December 1996 to 31 January 1997 when supply shortages occurred.

In the durable consumer goods category, imports of motor cars and motor cycles continued to decline in 1997, while imports of radio receivers and television sets showed an increase of 7 per cent. Medical and pharmaceutical products increased marginally due to higher prices, in spite of the drop in the import volume of medicaments indicating the higher utilisation of locally produced items. Other consumer durable imports that increased during 1997 were articles of plastic, printed matter, electrical home appliances, florescent lamps and clothing accessories.

Intermediate Goods

Imports of intermediate goods grew by 11 per cent, a growth similar to the average annual increase in imports during the previous three years, reflecting substantial increases in imports of refined petroleum products (58 per cent) and textiles (19 per cent). However, fertiliser imports declined sharply for the second consecutive year due to lower international prices and reduced application of fertiliser. The substantial increase in refined petroleum product imports was largely due to the higher volume that had to be imported for thermal power generation as well as to meet the supply shortfall resulting from the routine temporary closure of the refinery mentioned earlier. Crude oil imports declined by 10 per cent also due to the closure of the refinery. A partial duty waiver of 10 per cent was granted on crude oil, petrol and diesel and a full waiver on LP gas with effect from 15 January 1997 as a relief measure in the face of high international prices in the early part of the year. On average, however, annual crude oil prices declined from US dollars 20.19 per barrel in 1996 to US dollars 19.42 in 1997. In line with the growth in the textile and garment industry, textile imports increased by 19 per cent. Of the total textile imports, the BOI companies accounted for 86 per cent. Reflecting the setback in the diamond industry, diamond imports declined by 20 per cent in 1997. Among other intermediate goods, paper and paperboards (10 per cent), dyeing, tanning and colouring materials (14 per cent), unmanufactured tobacco (62 per cent) and palm oil (33 per cent) recorded increases.

Investment Goods

Imports of investment goods rose by 10 per cent in 1997 showing an improvement in the domestic investment climate. The growth in investment goods was largely due to increases in the import of machinery and equipment (14 per cent), transport equipment (17 per cent) and building materials (3 per cent). Increases in the import of machinery and equipment were observed in almost all sub-categories, with more pronounced growth recorded in the imports of telecommunication machinery, equipment and parts such as cellular telephones and other transmission apparatus for radio telephony and telegraphy reflecting a fast expansion in telecommunication services in the country. Higher imports were also seen of machines and parts used in the textile and garment industry for winding, weaving, knitting and sewing; industrial washing machines and tools; air and vacuum pumps; air conditioners; office equipment and parts, mainly for data processing; and machinery for filling, sealing, packing and labelling. The full duty waiver extended to diesel power generators in June 1996 was in effect till mid July 1997. There were further imports of 3,060 diesel power generators worth US dollars 32 million. However, generators and electrical transformers to the value of US dollars 18.5 million and US dollars 6.2 million were re-exported in 1997. Higher imports of transport equipment were reflected in imports of passenger buses and other goods transport vehicles such as lorries and bowsers largely due to the decline in duty on diesel engines and other parts and accessories of passenger and goods transport vehicles since November 1996.

9.4 Services and Income

The services account registered a significant improvement during 1997. Reflecting relatively larger growth of receipts vis-à-vis that of payments, the surplus in the services account rose by 51 per cent to US dollars 159 million in 1997. Service receipts increased by 14 per cent owing to a turnaround in receipts from tourism, which

TABLE 9.6
Net Services, Income and Transfers (a)

ITEM	US Dollars Million		Rs. Million	
	1996	1997(b)	1996	1997(b)
1. Transportation	138.3	155.7	7,641.7	9,193.7
2.Travel	-9.5	29.1	-517.3	1,728.2
3.Insurance Services	9.5	9.8	526.4	578.2
4 .Other business services	-26.7	-29.1	-1,483.6	-1,722.7
5. Government Expenditure n.i.e.	-6.6	-6.4	-362.3	-391.8
Total Services	**105.1**	**159.1**	**5,804.9**	**9,385.6**
1. Compensation of Employees	-1.2	-1.5	-77.9	-90.7
2. Direct Investment	-62.8	-74.8	-3,472.6	-4,424.2
3. Other	-139.7	-89.2	-7,681.6	-5,245.3
Total Income	**-203.7**	**-165.5**	**-11,232.1**	**-9,760.2**
1. Private (c)	710.0	787.4	39,230.0	46,493.7
2.General Government	49.1	44.4	2,708.8	2,625.0
Total Current Transfers	**759.1**	**831.8**	**41,938.8**	**49,118.7**

Source: Central Bank of Sri Lanka.

(a) This presentation conforms as far as possible to the Balance of Payments Manual, 5th Edition (1993) of the International Monetary Fund.

(b) Provisional (c) Includes US dollars 64 Mn. received in 1997 as compensation of US dollars 2,500 per person to about 26,000 Sri Lankans who lost employment in Kuwait due to the Gulf War in 1990.

registered a 25 per cent growth, and increased earnings from port services and passenger fares. The tourist industry recovered in 1997 to register a net receipt of about US dollars 29 million. Despite the terrorist attack in the Colombo city in October 1997 tourist arrivals increased by 21 per cent in 1997. Earnings from tourism grew by US dollars 42 million during the year.

The receipts from transportation services rose by 15 per cent reflecting the increases in receipts from passenger fares, freight and other port related services. Increase in air fares by the national carrier and a marked increase in tourist arrivals contributed to higher receipts from passenger fares while a record volume of trans-shipment cargo handled (26 per cent increase in volume) and growth in other cargo handling led to higher inflows from freight and other port related services.

The income category, which consists mainly of interest income, foreign direct investment income and compensation to employees according to the BPM5 presentation, grew by 25 per cent during the year, reversing the decline in 1996. Among the major contributory factors for the higher interest income inflows were the securities and foreign exchange trading profits of the Central Bank which more than doubled between 1996 and 1997. A drop in interest payments in US dollar terms by US dollars 5 million on account of medium and long-term loans of the Government, mainly as a result of the appreciation of the dollar against the yen and the SDR, also had a positive impact on the net income outflows during the year. Outflows on account of profits and dividends increased by 20 per cent during the year owing to the higher investment stock following high inflows in the recent past. In summary, net income outflows in dollars terms declined from US dollars 204 million to US dollar 166 million during 1997.

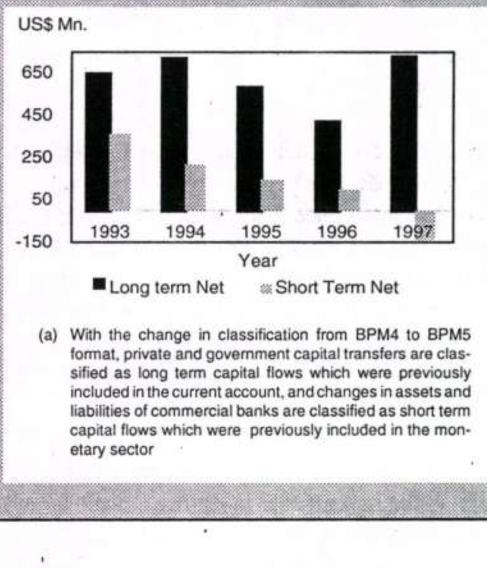
9.5 Current Transfers

Net current transfers rose by 10 per cent entirely due to private transfer receipts, which increased by 11 per cent during the year. The latter growth mainly reflected the receipt of US dollars 64 million as compensation payments to employees at the rate of US dollars 2,500 per worker received by 26,101 Sri Lankan workers who were displaced from Kuwait during the Gulf war in 1990. Meanwhile, private transfer payments grew by 10 per cent. As a result, net private transfers increased by 11 per cent to US dollars 787 million in 1997 which was sufficient to finance 65 per cent of the deficit in the goods, services and income account compared with 49 per cent coverage in 1996. Official current transfers, consisting mainly of food and commodity grants, declined by 10 per cent in 1997. Japan (31 per cent) continued to be the major donor, while the World Food Programme (15 per cent), Sweden (13 per cent) and Australia (10 per cent) also made noteworthy contributions during the year.

9.6 Capital Movements

In 1997, capital and financial flows increased by 6 per cent mainly due to privatisation proceeds of US dollars 301 million and increases in both private short-term and long-term investment inflows. Foreign direct investment and the Floating Rate Note (FRN) issues of the Government and a development bank also contributed to the capital inflows during the year. As a result, after netting out the increases in net foreign assets of commercial banks, the overall balance of the balance of payments reflected a surplus of US dollars 163 million in 1997 against a deficit of US dollars 68 million in the previous year, thereby improving the net official assets of the country.

Chart 9.5
Capital Flows (a)



(a) With the change in classification from BPM4 to BPM5 format, private and government capital transfers are classified as long term capital flows which were previously included in the current account, and changes in assets and liabilities of commercial banks are classified as short term capital flows which were previously included in the monetary sector

Capital Transfers

Net capital transfers declined by US dollars 9 million due to a 10 per cent drop in official project grants as a result of a lower utilisation of concessional assistance. Japan (48 per cent), Norway (26 per cent) and the United States of America (14 per cent) continued to be the major donors during the year.

Long-Term Capital

Long-term capital inflows almost doubled during 1997. With the decline in outflows due to a drop in amortisation payments in respect of private long-term loans, net long-term private capital inflows increased from US dollars 123 million to US dollars 491 million during the year largely due to privatisation proceeds. The divestiture of a 35 per cent government stake in Sri Lanka Telecom to Nippon Telegraph and Telephone Corporation (NTT) of Japan in August and the sale of debentures of the National Development Bank held by the Government, raised US dollars 225 million and US dollars 73 million, respectively.

Meanwhile, long-term loan capital to the private sector declined by 3 per cent. Major disbursements took place on account of long-term loan contracts by Sri Lanka Telecom (US dollars 37 million) to finance a series of projects for the installation of 150,000 new telephone lines and to the National Development Bank (NDB) (US dollars 28 million) along with the Floating Rate Notes, (guaranteed by the Asian Development Bank) issued by the NDB for US dollars 50 million in the international capital markets to expand their long-term lending activities in Sri Lanka. This was supported by lending to BOI enterprises by FCBUs and by non-FCBU sources during the year. The year also witnessed a decline in long-term capital outflows due to a decline in amortisation payments by US dollars 50 million following the extraordinary loan repayments in 1996 on account of two hotel projects and Air Lanka. This resulted in an increase in net long term private loan capital inflows by US dollars 58 million during the year.

The investment friendly macro-economic environment throughout the year appeared to have lent support to build foreign investor confidence. Foreign direct investment inflows are estimated at US dollars 133 million during the year which reflected an increase of 34 per cent over the previous year. Investment outflows of US dollars 5 million took place for four investment projects overseas approved on a case-by-case basis by the authorities in keeping with the cautious policy of liberalisation of the capital account.

At the disaggregated level, telecommunication (over US dollars 75 million), garments (over US dollars 17 million) and power generation (over US dollars 17 million) were the major sectors which attracted foreign investment through the BOI, through both equity and loans, in 1997.

Meanwhile, long-term capital inflows to the Government declined by 8 per cent due to the combined effect of a drop in long-term concessional assistance by 22 per cent to US dollars 333 million and an increase in long-term non-concessional borrowings to US dollars 88 million during the year. Japan (36 per cent), the Asian Development Bank (29 per cent), and the International Development Association (24 per cent) continued to be the major sources of concessional assistance to Sri Lanka during the year. The drop in concessional assistance to the Government as a result of lower utilisation, was partially offset by a successful launch of the Floating Rate Note issue for US dollars 50 million by the Government in the international capital market at a very attractive rate of LIBOR plus 1.5 per cent. This issue, which was meant to raise funds for infrastructure development, also aimed at establishing a bench mark rate for foreign borrowing and laying the foundation for a sovereign rating for Sri Lanka. This, together with a USAID funded Housing Guarantee Loan of US dollars 15 million resulted in a significant increase in total long-term non-concessional capital inflows to the Government. Despite higher repayments the outcome was a decline in net outflows of non-concessional long-term capital from US dollars 66 million in 1996 to US dollars 42 million in 1997.

Short-term Capital

Net short-term liabilities declined by US dollars 150 million during 1997 reflecting mainly the improvement in net foreign assets held by commercial banks (International transactions of commercial banks are treated as short-term financial transactions in the capital account of the balance of payments under the new BPM5 format. These had been treated as monetary sector transactions under the BPM4 format). The decline in interest rates on domestic assets and the uncertainty created by the East Asian currency turmoil prompted commercial banks to sharply reduce their external net liability position by portfolio adjustments towards foreign assets. Foreign assets held by commercial banks, mainly in the form of time deposits, rose by US dollars 290 million, which was US dollars 200 million more than the increase in foreign liabilities during 1997.

Net private short-term capital inflows increased by US dollars 12 million, reflecting higher trade credits to the export sector. The policy decision to allow commercial banks to lend in foreign currency to non-BOI exporters received only a moderate response with regard to FCBU lending, disbursements amounting to only US dollars 9 million during the year. However, as the interest rates on rupee loans continued to decline while the rupee continued to depreciate gradually, the relative attractiveness of foreign currency loans diminished. The Ceylon Petroleum Corporation (CPC) also did not increase its short term borrowings in 1997.

Reflecting the recovery in the economy in general, and the attractive stock prices, in particular, short-term capital inflows by way of portfolio investment registered an impressive overall growth of 82 per cent to US dollars 140 million. However, the regained foreign investor confidence was reflected in a continuous net inflow of foreign capital only throughout the period from February to July 1997 for investments in the Colombo Stock Exchange. A continuous net outflow was seen after August reflecting the impact of the East Asian currency turmoil which caused falls in most of the stock and currency markets in the region, and the resulting expectation of a large depreciation of the domestic currency. Although some of the early gains in net inflows were off-set by these outflows, the year as a whole registered a net inflow of US dollars 13 million in terms of portfolio investment, following US dollars 7 million in 1996.

9.7 Exchange Rate Movements

Foreign Exchange markets, the East Asian region in particular, faced severe uncertainty during the latter part of 1997, triggered by the currency crisis in the region. Countries that were most affected by the turmoil were Indonesia, Korea, Malaysia, the Philippines and Thailand, the currencies of which depreciated by 57 per cent, 50 per cent, 35 per cent, 35 per cent and 46 per cent, respectively, against the US dollar during the year.

The currency turbulence in East Asia had little impact on the Sri Lanka rupee mainly due to existing capital controls, very small exposure to short-term external debt and the continuous depreciation of the rupee under the flexibly managed exchange rate system. The exchange market and money market developments were closely monitored taking into account the need to maintain stability in the market. The Sri Lanka rupee depreciated by 7.5 per cent against the US dollar, the intervention currency. This, together with the significant appreciation of the US dollar against almost all major currencies during the year, resulted in a depreciation of the rupee against the SDR by 1.6 per cent.

Sri Lanka's Nominal Effective Exchange Rate (NEER) index with twenty four trading partners (1995=100) indicated an appreciation of 6 per cent from end December 1996 to end December 1997. The Real Effective Exchange Rate (REER) index based on the estimated inflation differentials appreciated by 14 per cent in 1997. However, the erratic behaviour of cross rates where the US dollar witnessed significant appreciation against most major currencies, particularly against the currencies of Sri Lanka's competitors in East Asia, following the East Asian currency crisis and the fact that the impact of currency depreciation on prices has not yet been fully reflected in their inflation indicators make the REER index a less reliable indicator of external competitiveness. This is particularly so when there are large changes in nominal exchange rates as seen in East Asia since mid 1997. Considering the time lag in the adjustments of cost of production and prices to exchange rate depreciation in those countries, it would be more appropriate to assess the changes in competitiveness in terms of a moving average of effective exchange rate indices. Such an index would smooth out some of the extreme volatility of day-to-day cross-rate changes and would also capture this lagged effect. The NEER calculated with trading partners on that basis depreciated by 0.7 per cent. The REER appreciated by 6 per cent. The managed float in Sri Lanka has the flexibility to capture these effects while also allowing exchange market conditions to be reflected in the exchange rate.

With the impact of other favourable developments in the real sector of the economy, the devalued Asian currencies had little short-run impact on Sri Lanka's external trade as seen by the high export growth and declining trade deficit. Highly import biased industries such as garments may even be in an advantageous position due to lower relative prices of imported raw materials from the Asian region. The competitive edge of the initial devaluation in Asian

TABLE 9.7
Exchange Rate Movements

Currency	In Rupees per unit of Foreign Currency						Percentage Changes over Previous Year(a)			
	End of Year Rates			Annual Average			Point to Point		Annual Average	
	1995	1996	1997	1995	1996	1997	1996/95	1997/96	1996/95	1997/96
Deutsche Mark	37.76	36.46	34.24	35.81	36.75	34.07	3.6	6.5	-2.5	7.8
French Franc	11.05	10.81	10.23	10.27	10.81	10.12	2.2	5.6	-5.0	6.8
Indian Rupee	1.54	1.58	1.56	1.58	1.56	1.63	-2.5	1.3	1.4	-4.5
Japanese Yen	0.53	0.49	0.47	0.55	0.51	0.49	7.6	3.6	7.7	4.1
Pound Sterling	84.25	95.86	101.60	80.88	86.34	96.69	-12.1	-5.6	-6.3	-10.7
US Dollar	54.05	56.71	61.29	51.25	55.27	58.99	-4.7	-7.5	-7.3	-6.3
SDR	80.39	81.38	82.69	77.74	80.23	81.17	-1.2	-1.6	-3.1	-1.2

Source: Central Bank of Sri Lanka.

(a) Changes computed on the basis of foreign currency equivalent of Sri Lanka Rupees.
A minus sign indicates depreciation.

Chart 9.6
Effective Exchange Rate Indices

Chart 9.6.1
Real Effective Exchange Rate Indices
(1995 = 100)

Chart 9.6.2
Nominal Effective Exchange Rate Indices
(1995 = 100)

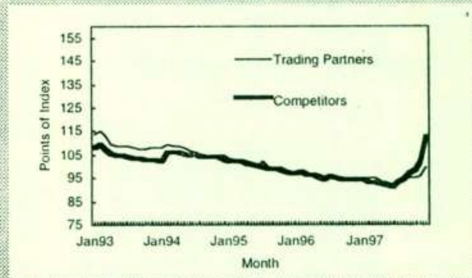


Chart 9.6.3
Real Effective Exchange Rate Indices
Twelve Month Moving Average (1995 = 100)

Chart 9.6.4
Nominal Effective Exchange Rate Indices
Twelve Month Moving Average (1995 = 100)

currencies after the crisis is expected to be partly offset by high domestic inflation, rising interest rates and other supply side constraints which are already seen in those economies. Sri Lanka's flexibly managed exchange rate policy in line with underlying macro economic fundamentals, cautious approach to liberalisation of capital transactions and the limited exposure to short-term external debt have helped to cushion the economy against possible adverse effects of the East Asian currency crisis. An improved performance in the balance of payments and external assets position, a manageable level of external debt and a relatively attractive stock market showed that the Sri Lankan economy was able to withstand the adverse implications of potentially lower export competitiveness and large capital outflows, at least in the short run. Under the flexibly managed exchange rate system, the exchange rate could depreciate faster, if that is necessary, to restore any long lasting adverse effects of large currency depreciations in East Asia on Sri Lanka's external competitiveness.

9.8 External Assets

Sri Lanka's gross external assets rose by 16 per cent to a new record level of US dollars 2,822 million at the end of 1997 turning around the declining trend recorded in the previous few years. External assets of the Central Bank grew by 5 per cent to US dollars 2,009 million and of the commercial banks by 57 per cent to US dollars 793 million. Gross official reserves, comprising foreign assets held by the Central Bank and the Government, rose by 5 per cent to US dollars 2,029 million during 1997. Gross external assets at the end of 1997 were sufficient to finance 5.4 months of imports projected for 1998, while gross official reserves were sufficient to finance 3.9 months of projected imports.

TABLE 9.8
External Assets of Sri Lanka

Ownership	US Dollars Million(a)					Rupees Million				
	1993	1994	1995	1996	1997	1993	1994	1995	1996	1997
1. Government (b)	32	23	17	23	19	1,597	1,132	938	1,295	1,192
2. Government Agencies	-	0	0	0	0	1	0	0	0	0
3. Central Bank (c)	1,642	1,999	2,046	1,915	2,009	81,404	99,859	110,521	108,506	123,093
4. Total Official Assets	1,675	2,022	2,063	1,937	2,029	83,002	100,991	111,459	109,800	124,286
5. Commercial Banks	449	587	508	504	793	22,256	29,349	27,446	28,549	48,596
6. Total External Assets	2,124	2,609	2,571	2,441	2,822	105,258	130,340	138,905	138,349	172,882
7 Gross Official Assets in Months of										
7.1 Merchandise Imports	5.0	5.1	4.7	4.3	4.2					
7 2 Import of Goods and Services	4.5	4.5	4.1	3.8	3.7					
8 Total Assets in Months of										
8.1 Merchandise Imports	6.4	6.6	5.8	5.4	5.8					
8 2 Import of Goods and Services	5.7	5.9	5.2	4.8	5.2					

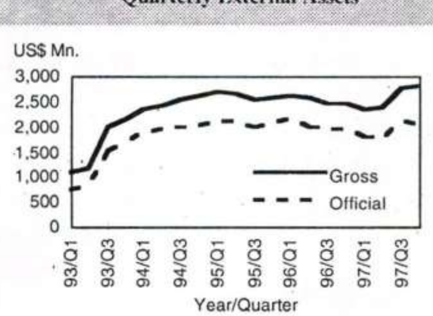
Source: Central Bank of Sri Lanka.

(a) Converted at the following end year rates except for certain items in the International Reserve of the Central Bank which were converted at the representative rate agreed with the IMF

Year	1993	1994	1995	1996	1997
Rs per US Dollar	49.56	49.98	54.05	56.71	61.29

(b) Figures since 1985 have been revised to include DST's Special Revolving Credit Balances
(c) Figures since 1993 have been revised to include foreign currency of commercial banks deposited with the Central Bank as reserve requirement on their foreign currency deposits.

Chart 9.7
Quarterly External Assets



9.9 External Debt

The developments in Sri Lanka's external debt in 1997 reflected the improvement in the balance of payments, particularly a sharp decline in the current account deficit and the changing composition of the capital account. Total external debt at around US dollars 8,397 million at the end of the year reflected a decline (about 3 per cent) for the second consecutive year. Of the total debt stock, loans in SDRs accounted for 38 per cent, while those in yen represented 26 per cent. US dollar loans accounted for another 22 per cent of the total debt outstanding, reflecting the impact of the appreciation of the US dollar against some of the major currencies. The external debt to GDP ratio, which declined from 72 per cent in 1995 to 62 per cent in 1996, declined further to 56 per cent improving the credit worthiness of the country. The net inflow of both long-term and short-term loan capital to the Government and the private sector was US dollars 240 million, most of which came in the form of long-term concessional assistance to the Government mainly from Japan, the Asian Development Bank (ADB) and the International Development Association (IDA).

The medium and long-term debt stock was US dollars 7,506 million, or 89 per cent of the total debt stock. Total debt outstanding to the IMF declined in US dollar terms by US dollars 97 million.

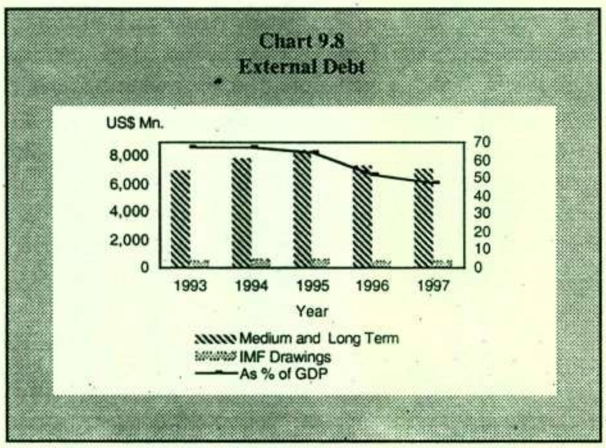
Government debt accounted for about 74 per cent of the total debt stock or 83 per cent of the medium and long-term debt of the country. Private sector debt without government guarantees represented about 2 per cent of total debt. Short-term debt outstanding at the end of the year reflected an increase of 4 per cent in US dollar terms mainly due to borrowings by BOI enterprises from FCBUs. Short term debt accounted for only 11 per cent of the total debt. They are largely suppliers' credits for raw materials supplied to the export processing industries and trade credits to the CPC.

TABLE 9.9
Disbursed and Outstanding External Debt

Item	US Dollars Million					Rupees Million				
	1993	1994	1995	1996	1997(a)	1993	1994	1995	1996	1997(a)
1 Medium and Long-term Debt	6,962	7,837	8,342	7,795	7,506	345,083	391,714	450,040	441.015	459,217
1.1 Government	5,673	6,135	6,582	6,454	6,217	281,142	306,615	355,736	365,993	380,989
1.2 Public Corporations with Government Guarantee	339	508	559	570	608	16,804	25,414	30,210	32,326	37,250
1.3 Private Sector with Government Guarantee	198	232	234	73	58	9,821	11,576	12,645	4,128	3,569
1.4Public Corporations without Government Guarantee	2	2	2	2	2	97	95	96	93	92
1.5 Private Sector without Government Guarantee	233	346	370	166	189	11,566	17,281	20,006	9,442	11,573
1.6 IMF Drawings	517	615	596	530	433	25,653	30,734	31,347	29,033	25,743
2. Short-term Debt	639	893	1,079	854	891	31,689	44,619	58,301	48,424	54,595
2.1 Government	0	0	0	0	0	0	0	0	0	0
2.2 Central Bank Borrowings	0	0	0	0	0	0	0	0	0	0
2.3 Other (b)	639	893	1,079	854	891	31,689	44,619	58,301	48,424	54,595
3. Total Debt (1+2)	7,601	8,730	9,421	8,649	8,397	376,772	436,333	508,341	489,439	513,812
MEMORANDUM ITEMS										
Medium and Long-term Debt										
(1) Project Loans	3,730	4,218	4,594	4,654	4,523	184,859	210,818	248,296	263,918	277,195
(2) Non-Project Loans	1,795	1,835	1,871	1,724	1,613	88,984	91,719	101,137	97,745	98,848
(3) Suppliers' Credits	163	161	256	239	207	8,087	8,051	13,837	13,537	12,690
(4) IMF Drawings	517	615	596	530	433	25,653	30,734	31,347	29,033	25,743
(5) Other Loans (c)	757	1,008	1,025	649	730	37,500	50,393	55,424	36,782	44,741

Sources: Central Bank of Sri Lanka
External Resources Dept.

(a) Provisional.
(b) Includes acceptance credits of Ceylon Petroleum Corporation, trade credits and short-term borrowings from FCBUs. Data revised from 1996.
(c) Includes long-term loans of public corporations and private sector institutions.



9.10 Debt Service Payments

Debt service payments, which consist of amortisation of medium and long-term loans and interest payments on all foreign loans, declined by 2 per cent to US dollar 754 million in 1997. Amortisation payments declined by US dollars 3 million and interest payments have declined by US dollars 8 million. Repayments to the IMF, entirely reflecting those on account of the Structural Adjustment Facility taken between 1988 and 1990, amounted to US dollars 66 million. Amortisation payments in respect of private debt were lower by US dollars 62 million while those in respect of government debt were higher by US dollars 40 million.

With the marginal decline in debt service payments and a higher growth in export earnings, the debt service ratio declined from 15.7 per cent in 1996 to 13.7 per cent in 1997. Similarly, debt service payments as a ratio of receipts from goods, services, income and private transfers declined from 13.0 per cent to 11.3 per cent.

9.11 External Trade Environment and Policy

Import and Export Controls

Sri Lanka's external trade policy continued to focus on achieving a liberalised trade regime by simplifying the tariff system while progressively reducing non-tariff barriers (NTBs). Quantitative restrictions on foreign trade are now limited to a well defined narrow list (a negative list) considered necessary mainly for reasons of national security, public health, environmental protection and domestic producer protection in a few selected areas. The import of

TABLE 9.10
External Debt Service Payments

Item	US Dollars Million					Rupees Million				
	1993	1994	1995	1996	1997(a)	1993	1994	1995	1996	1997(a)
1. Debt Service Payments	500	542	665	766	754	24,066	26,734	33,570	42,045	43,652
1.1 Amortisation	298	304	389	463	460	14,317	15,012	19,398	25,355	26,282
(i) To IMF	25	13	33	47	66	1,119	616	1,184	2,314	3,290
(ii) To Others	274	291	355	416	393	13,198	14,396	18,214	23,041	22,992
1.2 nterest Payments	202	237	276	302	294	9,750	11,723	14,172	16,691	17,371
(i) To IMF	7	7	8	7	6	363	348	407	409	361
(ii) To Others	195	230	269	296	288	9,387	11,374	13,765	16,282	17,010
2. Earnings from Merchandise Exports and Services	3,492	3,954	4,627	4,861	5,514	168,464	195,347	237,137	269,159	325,885
3. Receipts from Merchandise Exports, Services, Income and Private Transfers	4,237	4,813	5,641	5,868	6,655	204,511	237,908	289,061	324,856	393,269
4. Debt Service Ratio (b)										
4.1 As a percentage of 2 above										
(i) Overall Ratio	14.3	13.7	14.4	15.7	13.7	14.3	13.7	14.2	15.6	13.4
(ii) Excluding IMF Transactions	13.4	13.2	13.5	14.7	12.4	13.4	13.2	13.5	14.6	12.3
4.2 As a percentage of 3 above										
(i) Overall Ratio	11.8	11.2	11.8	13.0	11.3	11.8	11.2	11.6	12.9	11.1
(ii) Excluding IMF Transactions	11.0	10.8	11.1	12.1	10.2	11.0	10.8	11.1	12.1	10.2
5. Government Debt Service Payments	305	324	342	380	407	14,934	15,749	17,888	20,996	23,820
5.1 As a percentage of 1 above	61	60	51	50	54	62	59	53	50	55

Source: Central Bank of Sri Lanka.

(a) Provisional.
(b) Debt service ratios calculated in Rupee values and US dollar values differ due to variations in exchange rates during the year.
(c) Excludes IMF transactions.

maize remained under licence for reasons of domestic producer protection while paddy in husk remained under licence for phyto-sanitary reasons. Imports of wheat and meslin and wheat and meslin flour continued to remain under licence control in 1997 in order to fulfill the contractual obligations between the Government and Prima Ceylon Ltd., a milling company. During the year, ozone depleting substances such as carbon tetrachloride, methyl chloroform and methyl bromide were brought under import licences for environmental reasons, namely, the protection of the Ozone layer. In summary, about 300 items of a total of about 6000 items at 6 digit Harmonised System Code (HSC) level remained under import licence at end 1997.

Only four categories of exports, i.e. coral chunk and shells, wood and article of wood (ebony), ivory and ivory products and passenger motor vehicles first registered in Sri Lanka prior to 1945, remained under licence with the objectives of environmental protection and preservation of antiques.

Tariffs and Taxes on External Trade

The thrust of the tariff policy in the past was on the establishment of a simple and transparent tariff structure with lower rates and the improvement of Customs administration to create an environment conducive to promoting economic development. In this context, Customs duty has been rationalised to a three band tariff system with 10, 20 and 35 per cent rates for imports effective since February 1995. Only a few import items, namely tobacco, liquor and some categories of motor vehicles, remain outside the three band system.

The export sector has continued to be free from all export and ad-valorem sales taxes since end 1992, while export cesses and royalties on some items continued to remain in 1997.

Further consolidation of the tariff structure to a two band system with the primary focus on effective protection to local industries on a uniform basis remained a medium-term objective. The major emphasis on trade and tariff issues in the 1998 Budget was on improvements in the Customs administration, trade procedures and practices through the Customs modernisation programme. This programme envisages improvement of the automated data entry processing Automated System for Customs Data (ASYCUDA++) to a highly flexible and user friendly facility. This will also increase the effectiveness of Customs controls and the efficiency of the clearing process. The Customs administration will also expand into the field of trade promotion by establishing an investor facilitation unit. Improved surveillance, least inconvenience to exporters and importers and prevention of illicit traffic are the objectives of the proposed Cargo X -Ray system which is to be implemented in the Port of Colombo to examine containerised cargo using the most globally advanced system of cargo examination.

In 1997, the Government appointed a Presidential Commission of Inquiry of Trade and Tariff to study and recommend further appropriate changes to the tariff structure. The Government has also appointed a Committee to examine the implications of the proposed movement towards preferential trade arrangements leading to free trade among South Asian countries.

With a view to achieving high productivity, efficiency and expansion in economic activities by managing the trade and tariff policy in an effective manner, duty free facilities were made available by the 1998 Budget for several sectors to obtain raw material, plant and machinery. The textile and garment sector, which accounted for nearly 50 per cent of Sri Lanka's export earnings, spends more than 60 per cent of its earnings on importation of inputs. However, as more than 86 per cent of textile and garment imports hitherto were by the BOI enterprises on a duty free basis, the ratio of duty collection to total imports was as low as 0.8 per cent. The higher duty applicable to this sector was paid only by non-BOI, mainly medium and small scale, industries. Therefore, in line with the present policy direction of rationlisation of the tariff structure to simplify and minimise anomalies, imports of yarn, fabrics and all related intermediate and capital goods were made duty free with effect from 6 November 1997. The complete removal of duty on this sector will reduce the work load of the Customs, simplify Customs procedures and eliminate Customs delays, corruption and smuggling.

To provide necessary assistance to agriculture, the imports of NPK fertiliser and agro-chemicals were exempted from Customs duty. Meanwhile imports of seed cleaning, sorting and grading machines, seed testing equipment and seed packing machines were also made duty free. The tea manufacturing sector will also benefit by the removal of duty on tea packing machinery and colour separators. The transport sector was given high priority. In addition to the duty concessions provided in the 1997 Budget, importation of agricultural tractors, lorries and refrigerated trucks were made duty free to assist in marketing and goods transport. Items imported for manufacturing tractors and lorries were made duty free towards further strengthening this objective while encouraging local industries to produce these items in a competitive environment. Large commercial organisations were provided with a duty free facility to import buses and coaches for providing transportation to their employees. Furthermore, expenditure on account of these activities were deductible from taxable income. Private sector bus operators were allowed to import buses with a seating capacity over 40, free of duty. All these items were under the duty rate of 10 per cent until 6 November 1997.

The fisheries industry was provided with duty free imports of navigation equipment, spare parts for fishing boats, fish finding devices and raw material for fishing nets. These items were also at the 10 per cent rate earlier. Imports of computers, software and related components, telecommunication equipment and accessories were also made duty free with a view to reducing the cost of modern technology and communication facilities which are essentials for rapid economic development. To reduce the cost of medical services and to encourage private sector participation in health services, capital goods including medical and dental equipment and accessories, which were at 10 per cent duty earlier, were exempted from Customs duty. In addition to the duty free import of rough gemstones, tools, machinery and equipment for cutting and processing of gems provided in the 1996 Budget of November 1995, the gem and jewellery industry was provided with duty free imports of gold, gemstones and accessories used in manufacturing jewellery for exports in the 1998 Budget. Furthermore, the gem and jewellery industry was exempted from income tax and the national security levy. Import duty on rattans and bamboos were made duty free to assist the local cane industry and to safeguard the environment, while a programme to increase the supply of local raw material is envisaged.

The mark up of 25 per cent imposed on the computation of turnover tax on imports was also reduced to 10 per cent with effect from 6 November 1997. All items which were made duty free were also exempted from turnover tax.

In line with the present policy objectives, the granting of duty waivers on imports was limited to very essential items in the national interest. As a relief against the rising cost of living due to high food prices, full duty waivers on red split lentils (35 per cent), dried fish, dried sprats and dried prawns (10 per cent each) and partial waivers on full cream milk powder (10 per cent) and canned fish (5 per cent) continued throughout the year. A full duty waiver (20 per cent) was introduced on wheat with effect from 10 October 1997. A full duty waiver (35 per cent) on rice, which was introduced on 15 April 1996, was removed on 30 January 1997 following the successful Maha harvest. A partial duty waiver of 15 per cent, granted as a relief measure in the excess demand situation for onions, potatoes and dried chillies, which was effective from 4 December 1996, was withdrawn on 31 January 1997. A duty waiver of 17 per cent effective on sugar imports since 27 November

1996 was reduced to 10 per cent on 11 August 1997. A duty waiver of 30 per cent granted on edible oils and copra for a period of 7 months from 15 June 1996, to reduce the domestic edible oil prices and also to assist the local industries in the wake of high international prices of coconut kernel products, was reduced to 20 per cent with effect from 16 January 1997. However, these ad hoc duty waivers create uncertainty in the trade policy regime and hinder the development of efficient markets. The minimum protection that should be given to the non-plantation agricultural sector should be clearly defined and pre-announced for a given period of about five years with further phasing out plans in the long-run so that all producers, traders and consumers can function in a more predictable policy environment. This would lead to market efficiency which would improve welfare gains to all.

With regard to intermediate goods, a limited number of duty waivers were granted as relief measures. Duty waivers were granted on yarn and poultry feed to help local producers of textiles and to poultry farming. A full duty waiver was granted on shrimp food for the period 24 August 1996 to 24 February 1997 as a relief measure to shrimp cultivators. In the face of increased international prices of petroleum products, a full duty waiver (10 per cent) and partial duty waiver (10 per cent) were granted for LP gas and other petroleum products, respectively, from 15 January 1997 to 15 July 1997. To encourage the use of energy saving bulbs in order to conserve electricity, a full duty waiver (10 per cent) was granted on fluorescent lamps from 18 April 1997.

A full duty waiver on generators (10 per cent), which was granted on 1 June 1996 with a view to encouraging the use of generators by the private sector, was continued till 15 July 1997.

The effective import duty rate, the ratio of import duty collection to total adjusted imports, declined from 8.5 per cent in 1996 to 7.4 per cent in 1997, reflecting decreases in dutiable imports in relation to total imports, particularly in intermediate goods. The share of dutiable imports in total imports declined from 41 per cent in 1996 to 38.5 per cent in 1997 largely attributable to the increase in BOI imports, which amounted to 40 per cent of the total in 1997 in comparison to 35 per cent in 1996. In the intermediate good category, the effective duty rate dropped substantially, following the duty reductions granted on certain raw materials in the 1997 Budget and grant of duty waivers on LP gas and petroleum products from 15 January 1997 to 15 July 1997. Reflecting the impact of the duty waiver on petroleum products, effective duty rates for both crude oil and other petroleum categories dropped substantially. Although relatively high duty rates were applied (35 per cent) on textiles and clothing, effective duty rates were rather small (0.8 per cent), as 86 per cent of the total amount were imported duty free by BOI enterprises.

Effective duty rates on investment goods too declined in 1997, particularly on transport equipment. This was due to lower duty rates offered by the 1997 Budget for parts and accessories of transport equipment and passenger vehicles which showed substantial increases in import outlay during the year. A marginal reduction in the machinery and equipment category was partly due to a duty waiver on generators effective from June 1996 to July 1997.

In the consumer goods category the average effective import duty rate rose significantly for food and drink imports while that of non-food consumer goods declined marginally.

TABLE 9.11

Effective Import Duty Collection Rate (a)

Item	1995 (b)	1996 (b)	1997(c)
Consumer Goods	10.7	10.3	11.8
Food and Drink	10.1	9.1	11.5
Rice	38.5	0.3	6.3
Flour	0.0	2.3	0.0
Sugar	14.6	15.9	17.8
Wheat and Meslin	0.0	0.0	0.0
Milk and Milk Products	11.5	11.5	11.8
Dried Fish	2.0	2.1	1.6
Other Fish Products	4.6	4.2	4.9
Other Food Items	18.7	19.0	17.9
Non-Food Consumer Goods	11.8	12.6	12.2
Motor Cars & Cycles	21.7	24.3	24.5
Radio Receivers- Television Sets	6.9	12.1	11.5
Rubber Tyres & Tubes	33.6	32.5	33.5
Medicinal & Pharmaceutical Products	1.5	1.5	1.3
Other Non-Food Items	11.1	10.6	9.4
Intermediate Goods	9.0	8.0	5.9
Fertiliser	0.0	0.0	0.1
Crude Oil	41.1	33.6	21.7
Other Petroleum Products	23.4	24.6	18.7
Chemical Elements and Compounds	9.8	7.6	7.6
Dyeing , Tanning and Colouring	8.8	8.2	7.1
Paper and Paper Boards	9.8	6.9	6.0
Textiles & Clothing	1.0	1.1	0.8
Other Intermediate Goods	9.2	5.7	5.2
Investment Goods	10.1	7.6	7.0
Building Materials	8.7	9.3	9.1
Transport Equipment	21.6	18.9	17.3
Machinery and Equipment	6.2	3.9	3.4
Other Investment Goods	10.1	6.7	6.3
Other Imports	2.2	4.1	2.3
Total	9.7	8.5	7.4

Source: Sri Lanka Customs, Co-operative Wholesale Establishment, Ceylon Petroleum Corporation.

(a) Actual import duty collection as a percentage of total adjusted import values (c. i. f).
(b) Revised
(c) Provisional

The increase in the effective import duty rate of the food and drink category mainly reflects imports of rice and sugar. The impact of removal of a full duty waiver of 35 per cent on rice which was enjoyed for eight and a half months in 1996 and reduction of the duty waiver on sugar from 17 per cent to 10 per cent on 11 August 1997 were reflected in significantly higher duty rates in 1997. Only a very marginal change can be seen in the effective rate of non-food consumer goods.

Textile and Garment Quota Allocation

The performance based quota system continued in 1997 with priority given to new exporters and those who expanded their existing capacities, in allocating pool quotas. No major revisions in quota allocation took place in 1997. Quota availability to the USA, the EU and Canada rose by 5.6 per cent, 11.4 per cent and 0.9 per cent, respectively. As a result, overall quota availability increased by 6.2 per cent in comparison to the 13.5 per cent increase recorded in 1996. However, the overall quota utilisation rate declined to 65 per cent from 70 per cent in 1996 mainly due to weak demand for some quota categories. Meanwhile, a shift was also seen from low value added to high value added items. The utilisation of quotas varied widely across different categories and countries. To the USA market, quota availability and utilisation both increased significantly for certain items such as coats, trousers and play suits. To the same market, for other items such as night-wear, fabrics and suits for women, utilisation was higher than that in 1997 despite a lower quota allocation. Even though the quota availability was raised for items such as gloves, knitted blouses, shirts and shop towels, utilisation was much lower for those items. The quota utilsation rates for all items to the EU declined despite the rise in the available quota. With regard to the Canadian quota, only a few categories indicated satisfactory quota utilisation. The above performance was partly due to insufficient demand for some items which come under quota, indicating that an increase in quota availability also needed to be supported by demand for those items in those specific markets.

Incentives to Exporters

The Government introduced several policy measures during 1997, with a view to improving the competitiveness and profitability of the export sector. In order to reduce administrative delays and cumbersome procedures, implementation of existing schemes such as the Duty Rebate Scheme, the Inward Processing Scheme, Bonded Warehouse Scheme and Exemptions on Fiscal Levies Scheme through the Committee on Exemption of Fiscal Levies was abandoned in 1997. These schemes were thereafter implemented directly by the Sri Lanka Customs and the Ministry of Finance. As proposed in the 1997 Budget, the scheme for exemption of fiscal levies on capital and intermediate goods for export processing was amended. Under this scheme, a 100 per cent exemption of duty and taxes was granted on imports of capital and intermediate goods by exporters who export over 50 per cent of their production. A 50 per cent exemption was granted to those who export between 25 per cent and 50 per cent. The extension of the coverage of this scheme reduced the up-front cost of investment, especially of small and medium scale exporters (SMEs) in undertaking new investments, upgrading existing machinery and increasing productivity. With a view to reducing interest rates and making more funds available to private sector investors, non-BOI exporters were permitted to borrow in foreign currencies from FCBUs as well as domestic banking units. In order to stimulate investment, the depreciation allowance on plant, machinery and equipment which was hitherto recovered at 33 1/3 per cent per annum was increased to 50 per cent allowing investors to recover their investment expenditure within two years. In addition, with a view to reducing the up-front cost of investment, the national security levy on imports of machinery and equipment which was reduced from 4.5 per cent to 2 per cent in 1995, was further reduced to 0.5 per cent in January 1997.

Exporters are able to take advantage of the fiscal incentives provided by the 1998 Budget to promote computer technology and train computer personnel, and the reduction of the minimum investment requirement for advanced technology from Rs.2.5 million to Rs.1 million for existing companies and from Rs.10 million to Rs.4 million for new companies. This helped SMEs to become eligible under this scheme and encouraged adoption of new technology. As an incentive to encourage further expansion of the garment industry, a three year extension of the existing tax holiday, proposed in the 1997 Budget, was granted to garment factories in difficult and most difficult areas, subject to creation of 150 extra jobs. A 100 per cent rebate was granted on the quoted freight rates for foliage, cut flowers, fruits and vegetables exports with effect from August 1997.

In the 1998 Budget, various incentives were proposed to promote small and medium scale agricultural products, fresh and processed fruits and vegetables, the gem and jewellery industry and the textile and garment industry. Existing and new companies engaged in the export of fresh and processed fruits and vegetables which undertake the cultivation of a minimum area of 5 hectares, were granted a 10 year tax holiday together with duty free imports of machinery and equipment. In addition to duty free imports of gold, gem stones and accessories, the gem and jewellery industry was exempted from income tax and the national security levy. With the complete duty free status given to the textile industry, the manufacture-in-bond scheme for textiles was eliminated.

Institutional Support to Exporters

The Export Development Board (EDB) continued to provide a wide range of services to further develop and promote exports and to assist in improving the policy climate for exports. With a view to developing and promoting mainly non-traditional exports, the EDB advised exporters in various aspects such as supply development, quality improvement, productivity, export packaging and penetration of new markets. Under technical and skills development programmes, the EDB conducted several programmes and workshops to assist exporters. Under market promotion, several product specific fairs and general trade fairs were conducted in addition to contact promotion programmes and inward/outward buying missions for a wide range of products including jewellery, garments, wooden handicrafts, handloom products, footwear, coir products, spices, ceramic giftware, floriculture and aquarium fish. The EDB provided assistance to develop export oriented SMEs in the provinces through its provincial offices in Kandy, Kurunegala and Galle and organised the participation of SMEs at the 'Jana Nipayum' trade exhibition organised by People's Bank. Under the Export Processing Village (EPV) programme, a delegation from the European Fair Trade Association (EFTA), which buys a major share of production, visited Sri Lanka to explore the possibilities of diversifying the product range.

Expo'97 held in November 1997 helped to generate new orders worth US dollars 3 million. In addition, a single country exhibition was organised by the EDB in Belgrade in association with the Sri Lanka Tea Board, Ceylon Tourist Board, Bank of Ceylon and Air Lanka to promote business and trade relationships in Yugoslavia. The EDB, in collaboration with the International Trade Centre (ITC), organised a conference of all Trade Promotional Organisations (TPOs) in the South Asian Association for Regional Co-operation (SAARC), with the objective of enhancing regional trade linkages and opportunities for technical co-operation in trade among TPOs in the SAARC region.

During 1997, the Sri Lanka Export Credit Insurance Corporation (SLECIC) continued to assist exporters by providing support services of export credit insurance and guarantees for the development and diversification of exports. During 1997, there were 214 policies in force for a value of Rs.1,289 million in addition to 1,436 guarantees in force for a value of Rs.2,195 million. However, SLECIC's business activities indicated a setback in 1997 following the temporary closure of some export-oriented industries due to losses carried forward from the end of the preceding year following power cuts and labour unrest. Furthermore, the cost of export credit insurance and guarantee services remained high when turnover tax and the national security levy were added to the premium. The existing small scale insurance policy of the SLECIC was amended in February 1997, in order to make it more attractive to small scale exporters and perform competitively in the international market.

Freight Rates

During 1997, shipping freight rates for several destinations moved further downwards due to competition among shipping lines following the continuation of the liberalised shipping trade policy adopted in 1996. Shipping lines covering nearly all destinations have adopted the Freight of All Kind (FAK) system except to the USA and East Canada, which have commodity based freight systems. The average freight rates for all commodities shipped to the UK, the North Continent, the Mediterranean, France, Egypt, Syria, the Far East, Kuwait, Pakistan and Australia dropped.

The Ceylon Association of Ships' Agents (CASA) imposed a mandatory Terminal Handling Charge (THC) on exports in March 1997. Exporters strongly opposed this charge on the grounds that the THC would make Sri Lanka's exports less competitive. After several unsuccessful negotiations with the relevant authorities exporters made a complaint through the Ceylon Chamber of Commerce to the Fair Trading Commission (FTC) against alleged anti-competitive practice by the CASA of imposing a THC on export shipments. The FTC is investigating the complaint and an order will be issued after the investigations are completed.

9.12 Trade Relations, Trading and Clearing Arrangements

Sri Lanka has gradually removed all non-tariff barriers, except for the import of wheat and wheat flour which are still under licensing requirements, and a few other goods which require licensing for non-economic reasons. Tariffs have been reduced to a three rates band, consisting of 10, 20 and 35 per cent. Thus, Sri Lanka has the most liberal trade and payments policy regime in the South Asian region.

To facilitate its commitments to the World Trade Organisation (WTO), sub-committees set up under the Inter-Ministerial Co-ordinating Committee (IMCC) were strengthened with participation from the private sector and trade chambers. Sub-committees prepared draft legislation to

Box 9

Sri Lanka Submits Offers to WTO on Financial Services

The General Agreement on Trade in Services (GATS) which covered 155 service sectors including financial services, was one of the Agreements negotiated in the Uruguay Round. At the end of the Uruguay Round, the negotiations on financial services as with a few other service sectors did not achieve a satisfactory outcome. Hence, it was decided to continue the negotiations in this sector after the conclusion of the Uruguay Round. The World Trade Organisation (WTO) was established on 1 January 1995 as an outcome of the General Agreement on Trade and Tariff (GATT) negotiations with the objective of promoting globalisation of trade in goods and services. At the Singapore Ministerial Conference of the WTO held in December 1996, it was agreed that the members would conclude the negotiations on the financial services sector by December 1997. Accordingly, a time frame was agreed upon and the first phase of negotiations commenced in Geneva in April 1997.

Sri Lanka's commitments under GATS were, until recently, limited to just a few horizontal commitments on 'commercial presence' (foreign investment) and 'presence of natural persons' (employment) and some specific commitments in tourism and travel related services. In February 1997, Sri Lanka submitted its commitments in the telecommunication sector.

Under the GATS, schedules of horizontal (applicable to all sectors) commitments or specific (applicable to a specific sector) commitments are to be submitted by WTO members to be used as the basis for bilateral or multilateral negotiations towards the global liberalisation of services. For each sector, such commitments apply to 4 modes of supply (cross border supply, consumption abroad, commercial presence and presence of natural persons) and 2 categories of limitations (on market access and on national treatment). While the term 'market access' is self explanatory, the national treatment obligation is to accord to the services and service suppliers of any other member, treatment no less favourable than is accorded to domestic services and service suppliers. A member wishing to maintain any limitation must indicate these limitations in the schedule of commitments.

In the schedules of commitments, domestic regulations which do not discriminate between the home country suppliers of the service and other service suppliers, either in terms of market access or national treatment, need not be included. In the case of financial services, such commitments are not expected to include measures taken by authorities for prudential purposes. Further, the use of temporary non-discriminatory restrictions in payments and transfers in the event of serious balance of payments and external financial difficulties is permitted. In addition, the management of monetary and exchange rate policy falls outside the scope of the GATS.

In terms of Article II of the GATS, with respect to any measure covered by the Agreement, each member should immediately and unconditionally accord to services and service suppliers of any other member, treatment no less favourable than it accords to like services and service suppliers of any other country. This is known as Most Favoured Nation (MFN) Treatment. If any member maintains a measure inconsistent with MFN Treatment, such a measure has to be listed as an exemption.

Once a specific commitment is filed by a country under the GATS, it would be difficult to withdraw such a commitment, although specific commitments would not bar further liberalisation.

During the Uruguay Round, the following activities were listed as financial services under two broad categories, namely, (1) insurance and related services and (2) banking and other financial services (excluding insurance). Life and non-life insurance services, re-insurance and retrocession, insurance intermediation such as broking and agency services and services auxiliary to insurance were categorised under the former. Banking and other financial services (excluding insurance) included acceptance of deposits; lending of all types including consumer credit, mortgage credit, factoring and financing of commercial transactions; financial leasing; all payment and money transmission services; guarantees and commitments; trading in money market instruments; foreign exchange, derivatives, exchange rate and interest rate instruments such as swaps and forward rate agreements, securities, other negotiable instruments, and other assets such as gold; participation in issues of new securities; money broking; asset management such as portfolio management or pension fund management; settlement and clearing services for financial assets; provision and transfer of financial information and financial data processing, advisory and other auxiliary financial services.

Sri Lanka's policies in the area of financial services have been more liberal than many countries. At present, Sri Lanka is not a major exporter of financial services.

Box 9 (contd.)

but has great potential and expects to grow in the future. Thus, it was felt that the inclusion of a schedule of specific commitments by Sri Lanka based on existing policies would enhance international recognition of the liberal policies in place in Sri Lanka's financial sector.

Accordingly, Sri Lanka submitted its draft conditional offers on insurance and banking and other financial services in December 1997. In the insurance sector, offers were made in 3 sub sectors, i.e. (a) Life insurance, (b) Non-life insurance and (c) Re-insurance and Retrocession. In the case of both Life and Non-life insurance sub sectors, under market access, new establishments are subject to licences approved by the Government of Sri Lanka while there will be no limitations on national treatment. In both sub sectors, foreign equity participation is determined by the horizontal commitments made earlier (i.e. the country's general laws relating to foreign investment).

Regarding banking and other financial services, the liberalised policies already in place were given as offers. However, there were two important measures which deserve specific mention. In terms of a decision taken by the Monetary Board with the approval of the Cabinet in 1987, commercial banks incorporated outside Sri Lanka were permitted to have only up to 10 branches in Sri Lanka. With the approval of the Cabinet, this restriction was waived prior to the submission of offers. Second, in terms of the Banking Act, non-nationals are permitted to hold only up to 49 per cent equity of a commercial bank incorporated in Sri Lanka. Foreign investment in shares of other financial institutions were considered on a case by case basis by the Central Bank under the Exchange Control Act. However, it was decided to permit non-nationals to invest in any institution providing financial services up to 49 per cent of its share capital.

Sri Lanka retains the right to subject approval, registration and licensing relating to banks and other financial institutions to an economic needs test.

World financial markets are becoming increasingly integrated as a result of innovations in information technology. In such an environment, progressive liberalisation of existing restrictions on trade in financial services will become inevitable. The GATS provides a mechanism to support and accelerate the process of liberalisation in trade in financial services. While acknowledging the importance of international competition in banking, securities and insurance markets, the critical need for preserving prudential policies to safeguard financial systems for the benefit of both investors and consumers should never be underestimated.

enact national anti-dumping and countervailing legislation, and towards submission of Sri Lanka's offers to the WTO in respect of telecommunications and financial services, and resumption of GATT Article XXVIII.

Sri Lanka continued to negotiate concessions under the South Asian Preferential Trading Arrangement (SAPTA). The concessions received in 1996 were made effective from 15 July 1997 by a Gazette notification. The third round of trade negotiations began in July 1997 in Kathmandu. Sri Lanka's objective was to expand the list of products covered under SAPTA and to deepen the tariff concessions already received. Sri Lanka submitted its request list at the first meeting. The negotiations under the third round are expected to be concluded by April 1998. Meanwhile, at the SAARC summit held in Male in May 1997, Heads of SAARC member countries agreed to advance the South Asia Free Trade Area (SAFTA) by the year 2001. However, this seems too ambitious when the very modest results obtained at SAPTA negotiations over the last two years are considered. The major contributory factor to slow progress in SAPTA negotiations is the reluctance to abolish non-tariff barriers by other member countries.

Sri Lanka also completed its commitments under Phase II of the Multi-Fibre Arrangement phasing out procedures by submitting a list of items to the Textile Monitoring Body of the WTO. With this list, Sri Lanka has completed 17 per cent of the phasing-out requirement, due to be completed by December 2004.

The Global System of Trade Preferences (GSTP) among the Group of 77 made further efforts to expand the GSTP membership, product coverage and the depth of tariff reductions. However, the results of negotiations remained insignificant in 1997.

The Bangkok Agreement which was signed in 1975 is expected to be one of the important regional trade agreements in Asia once China accedes to it. China has concluded bilateral meetings to exchange tariff concessions with a majority of the members including Sri Lanka. During the negotiations China agreed to offer concessional tariffs for over 40 products covering almost all the items currently exported by Sri Lanka to China.

The International Natural Rubber Agreement III that came into force in December 1995 remained in force during 1997. However, there have been no significant developments under this Agreement during 1997. Sri Lanka maintained its position of not acceding to the International Coffee Agreement in 1997 as well.

On a bilateral level, Sri Lanka had discussions with four joint commissions for economic and technical co-operation from India, Kuwait, Iran and the European Union in 1997. Lowering tariffs and removing non-tariff barriers for products of export interest to Sri Lanka were discussed at bilateral meetings with India. India offered to extend concessions on a unilateral basis for at least 70 products. Sri Lanka prioritised 84 products from the list of 182 products originally submitted to India for trade concessions. A response to this has not yet been received.

At the first session of the Sri Lanka-Kuwait joint commission, possibilities for joint marketing arrangements between Sri Lanka and Kuwait companies to promote Sri Lankan products in the countries of the Gulf Co-operation Council (GCC) were explored. The two countries agreed to encourage companies in both countries to establish joint ventures with the aim of undertaking business ventures in the two countries, the rest of the GCC and SAARC. Sri Lanka also sought the assistance of the Government of Kuwait to encourage the Kuwait Investment Authority to invest in public quoted companies and infrastructure projects in Sri Lanka.

The Sri Lanka-Iran joint commission held its fifth session in Colombo in 1997. At the session the possibilities of establishing joint ventures for the manufacture of melamineware, chandeliers and machine made carpets were discussed.

The 13th Session of the Sri Lanka-European Union joint commission was also held in Colombo in 1997. The session focused on the development of economic, trade and commercial co-operation.

The joint commissions with Egypt, China and Cyprus did not meet in 1997. The next set of meetings of those commissions is scheduled to take place in 1998.

9.13 Internal Trade and Institutional Arrangements

The internal trade policy of the country is to allow the market mechanism to determine prices and quantities and to intervene in the market only to avoid harmful price and quantity fluctuations of selected important goods. The Ministry of Internal and International Commerce and Food, the Ministry of Agriculture, the Treasury and affiliated departments had given due consideration to avoid excessively low prices that could affect local producers and to avoid too high prices that may affect consumers. Bonded warehousing systems, guaranteed price schemes, tariffs and the use of public sector agencies such as the Co-operative Wholesale Establishment (CWE), Ceylon Petroleum Corporation (CPC) and State Pharmaceuticals Corporation (SPC) were employed in the procurement, import and distribution of these items.

The Co-operative Wholesale Establishment (CWE) continued local purchases of important agricultural products as a relief measure to local producers and to supply their retail outlets. Big onion purchases increased from 1,088 metric tons in 1996 to 1,570 metric tons in 1997 recording a 44 per cent increase. The local purchases of dried chillies decreased marginally from 1,849 metric tons in 1996 to 1,797 metric tons in 1997. Local purchases of sugar showed a drastic decline from 4,608 metric tons in 1996 to 290 metric tons in 1997 due to lower domestic production.

The Government uses the CWE to control imports of important food items, when such items are under import licence. The removal of licensing on dried chillies, big onions and potatoes in July 1996 resulted in the CWE importing no dried chillies at all, because of heavy private sector imports. However, 5,863 metric tons of big onions were imported by the CWE, to supply their retail outlets. Reflecting a movement in the right direction, a market take-over of imports as a result of removing the licensing requirement is seen in the declining share of imports by the CWE. The share of rice imports by the CWE fell from 11 per cent in 1996 to 8 per cent in 1997. The share of big onions dropped from 7 per cent in 1996 to 5 per cent in 1997, while dried chillies dropped from 5 per cent to no imports at all in 1997.

Wheat flour production is still monopolised by Prima Ceylon Ltd. The wheat grain is imported by the CWE and processed by the Prima mill. However, when milling is not sufficient or if there is a scarcity, the CWE imports wheat flour. The distribution of wheat flour was liberalised and the entire consumer subsidy was removed by August 1997. The price per kilogram of wheat flour rose to Rs.18.15 on 10 August 1997 from Rs.16.15 per kilogram that had prevailed since December 1996.

The number of retail shops operated by the CWE increased to 147 in 1997 from 145 in 1996. The total number of wholesale shops remained at 35. The combined turnover of wholesale and retail shops increased from

Rs.4,680 million in 1996 to Rs.5,392 million in 1997. However, the franchise shops reported a low turnover in 1997. Sales dropped from Rs.698 million in 1996 to Rs.432 million in 1997. The CWE has appointed 14 field officers to look into the causes of the reduction in sales. The number of operating franchise shops was 3,500 in 1997.

The other wing of the Government's food distribution network, the Co-operative Movement, has also shown a development since 1996. The total number of primary co-operative societies grew from 12,283 in 1996 to 12,410 in 1997. The membership of the societies grew from 5 million members in 1996 to 5.1 million members in 1997.

Maintenance of the free market system necessitates probing into unfair trading practices, violations of product quality standards and consumer welfare measures stipulated by the Government. This function is carried out by the Department of Internal Trade (DIT) and the Fair Trading Commission (FTC), affiliated to the Ministry of Internal and International Commerce and Food.

The DIT, formerly the Price Control Department, maintained price controls on imported pharmaceuticals, on which price orders are drawn by the FTC, and entered into an agreement on the maximum prices of beef and mutton with traders of beef and mutton in 18 districts with effect from 26 September 1997. Penal sections of the Price Control Act were enforced on imported drugs, and pharmaceuticals during 1997. A total of 151 inspections were carried out, in the course of which 73 offences were detected.

The DIT also conducted 2,262 raids on business enterprises to inspect their adherence to the conditions laid down by the Consumer Protection Act. The DIT assisted the Agricultural Development Ministry to investigate fertiliser adulteration and non-conformity to the standards set forth with formula categorisation, and violation of regulations in the context of selling, distribution and storage. The successful number of raids was 1,965 out of which 1,404 offenders were prosecuted in 1997.

The DIT conducted several programmes to enhance consumer protection and awareness, and improve the quality of the market place. The DIT intervened to resolve disputes due to sale of substandard goods, and non-availability of after-sales services. Several programmes have been launched to create awareness among consumers on consumer rights. The DIT also issued two directions to enhance consumer protection. Direction 100 requires all cigarette packs to contain one of the two health warnings given by the Government in all three languages. Direction 101 requires all milk powder packs to contain the date of manufacture, date of packing and the date of expiration in a conspicuously legible manner.

The DIT is also a member of Consumers International (CI), an organisation closely collaborating with the UN Economic and Social Council (UNECOSOC). Sri Lanka, represented by the DIT, has been in the steering committee of the Asia and Pacific Region of the CI.

The Fair Trading Commission (FTC) determined the prices of pharmaceuticals, investigated seven anti-competitive practices and was also involved in food security matters and consumer awareness activities. The FTC investigated anti-competitive practices against firms engaged in the poultry industry, supply and distribution of liquor, importation of glass bottles, importation of lubricants, production of plastic water bottles, cargo handling at the port and ground handling at the Bandaranaike International Airport. A draft Bill was introduced in 1997 to amalgamate the activities of the DIT and FTC, in order that one unified institution would be able to carry out probing activities more effectively in the future.

9.14 Tourism

The tourism sector, recovered further during 1997 reflecting the resilience in the industry. Tourist arrivals in 1997 grew by 21 per cent to 366,165. The gross earnings from the tourist industry rose at an even higher rate of 26 per cent reflecting an increase in the average income earned per tourist. The bomb attack which occurred in Colombo at the start of the peak season in November affected the industry somewhat in 1997.

Following the recovery in arrivals, foreign guest nights grew by 31 per cent, while the overall occupancy rate rose to 49 per cent, compared with 40 per cent in 1996. On a region wise basis, all regions recorded growth, with more pronounced increases in the South coast followed by the hill country. The improvement in the ancient cities was mainly attributed to a rise in the occupancy rates of the hotels at Habarana, Sigiriya and Dambulla. The increase in local guest nights by more than 20 per cent brought further relief to the industry which has suffered due to the country's security situation over the past few years.

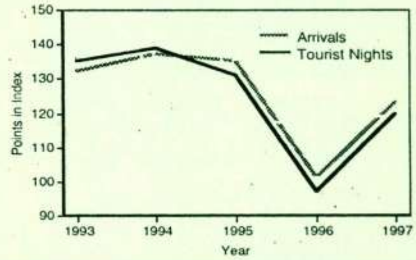
The number of hotel units in the graded accommodation sector increased from 144 to 158, mainly in the South coast and in the ancient cities. With the increased number of hotel units, room capacity grew from 11,600 to 12,370.

Employment in the sector also showed an improvement. Direct employment grew from 31,963 to 34,200 persons, while indirect employment increased from 44, 748 to 47, 880 persons.

Tourist arrivals from all major regions showed increases over 1996. Western Europe, which continued to be the leading source of tourist traffic to the country, accounting for 58 per cent of the total arrivals, recorded a 27 per cent increase. Higher arrivals were recorded from all countries in Western Europe. The UK, which became the main single source of arrivals outnumbering Germany in 1996, continued to maintain its position in 1997. The substantial appreciation of the sterling pound against the Sri Lankan rupee which lowered the cost of vacationing in Sri Lanka for UK nationals may have led to this turnaround. Arrivals from Asia, the second largest source grew by 10 per cent. A growth in arrivals from most countries in the Asian region except Indonesia, Thailand and Pakistan, was seen. The lower arrivals from Indonesia and Thailand may be partly a reflection of the financial crisis in these countries. Arrivals from Australasia, North America and Eastern Europe too increased by 34 per cent, 28 per cent and 41 per cent, respectively, increasing the diversification of tourist arrivals.

As in the past, vacation was the main purpose of arrivals in 1997, accounting for about 95 per cent of total arrivals. The remainder were for purposes such as business and visiting friends and relatives. Reflecting the potential for the promotion of novel aspects of pleasure tourism such as eco-tourism and culture tourism, the revenue from foreign visitors who visited wild life parks, botanical gardens, zoological gardens and the cultural triangle continued to increase in 1997. The number of tourists who visited the zoological gardens grew by 35 per cent and earnings increased by 53 per cent in US dollar terms. Revenue received from visits to botanical gardens and wild life parks rose by 22 per cent and 16 per cent, respectively. The number of tourists visiting the cultural triangle grew by 40 per cent while the income from sale of tickets showed a 43 per cent increase, also due to an upward revision in prices of tickets by US dollars 2.50 to US dollars 32.50. The Sri Lanka Convention Bureau continued to promote meetings, incentive travel, conventions and exhibitions (MICE) tourism in 1997. The number of tourists who visited under the MICE category grew by more than four fold over 1996 as the number of conferences and exhibitions held in 1997 had doubled.

Chart 9.9
Tourism Statistics
(1990 = 100)



Of the total arrivals, 69 per cent travelled by scheduled inter-regional flights, while another 25 per cent arrived by intra-regional flights. Air Lanka flights brought in 46 per cent of the total number of tourists in 1997 compared with 48 per cent in 1996. Charter flights brought in 6 per cent of the total and recorded an increase of 48 per cent over 1996. As charters play a vital role in developing leisure destinations, the industry will benefit immensely by increased charter operations.

In the 1998 Budget, the Government granted a series of concessions to the tourism industry in order to promote Sri Lanka as a tourist destination and to exploit its full potential for national economic development. Turnover tax (1 per cent) on hotel accommodation charges has been removed. Imports of goods for refurbishment and upgrading of hotels and import of vehicles for transport of tourists were exempted from import duty for a period of one year with a view to improving the quality of facilities in tourist hotels and expanding transport facilities in the tourist sector. Moreover, corporate income tax on the tourist industry has been reduced from 35 per cent to 15 per cent to ensure a reasonable after tax rate of return for the investor in the tourist hotel industry.

TABLE 9.12
Tourism Statistics 1995-1997

Item	1995	1996(a)	1997(b)	Percentage Change	
				1996	1997
1. Tourist Arrivals	403,101	302,265	366,165	-25.0	21.1
2. Tourist Guest Nights ('000)	4,024	2,974	3,680	-26.8	24.9
3. Room Occupancy Rate (%)	52.6	40.3	49.1	-23.4	21.8
4. Gross Tourist Receipts (Rs.Mn)	11,569	9,195	12,316	-20.5	33.9
5. Per Capita Tourist Receipts (Rs.)	28,700	30,420	33,635	6.0	10.6
6. Total Employment	87,360	76,711	82,080	-12.2	7.0
Direct	36,260	31,963	34,200	-11.9	7.0
Indirect	51,100	44,748	47,880	-12.4	7.0

(a) Revised
(b) Provisional

Sources: Ceylon Tourist Board
Central Bank of Sri Lanka