9. TRADE, BALANCE OF PAYMENTS AND TOURISM

9.1 Overview

Sri Lanka's balance of payments showed a further reduction in the trade and current account deficits and a surplus in the overall balance in 1998. In line with a sharp contraction of world exports, the growth rate of Sri Lanka's exports also decelerated to 2 per cent. Despite an increase in the import volume, the value of imports increased marginally (0.5 per cent) as prices of major import commodities such as crude oil, wheat, fertiliser and sugar declined sharply under depressed world market conditions. Thus, the trade deficit declined in 1998. The services account continued to register a surplus, though somewhat lower than in the previous year. In addition to the compensation payments of US dollars 78 million, received on account of the Sri Lankan workers displaced from Kuwait by the Gulf war in 1990, private transfers continued to increase, making a positive contribution to the balance of payments. Consequently, there was a further significant reduction in the current account deficit in 1998. Foreign long-term private capital inflows continued to increase while there was a net outflow of short-term capital through the share market. Meanwhile, the rupee depreciated by nearly 10 per cent against the US dollar, a faster rate compared to the previous five-year average of around 6 per cent. Sri Lanka's exchange and money markets remained relatively stable, as domestic monetary and exchange rate policy was effective in maintaining financial market stability. A lower trade deficit, a considerably lower current account deficit, a surplus in the balance of payments and a stable foreign exchange market were the highlights of external sector developments in 1998.

The external sector developments displayed Sri Lanka's ability to withstand external shocks to a certain extent, but the adverse impact of the depressed world market conditions was being felt seriously during the second half of 1998. Export growth, which was around 8 per cent during the first half, declined to 2 per cent by the end of the year. Imports increased by one half of one per cent in 1998. The slow down in imports was mainly the outcome of low world commodity prices. The noteworthy increases in the volume of imports, particularly in investment goods, during the first few months of 1998, reflected the response by investors to fiscal incentives proposed in the 1998 Budget. However, a gradual slow down has been noticed since then. Meanwhile, the terms of trade improved by 14 per cent due both to higher export prices and lower import prices. Consequent to these developments in external trade, the trade deficit narrowed from 8.1 per cent of GDP in 1997 to 7.2 per cent in 1998.

The services account registered a surplus of US dollars 143 million in 1998. Net factor income outflows, which consist of interest payments and profits and dividends, increased by 12 per cent. Net current transfers increased by 8 per cent owing to aggressive promotional campaigns by commercial banks to increase their market share of such funds, as well as compensation payments to 31,279 Sri Lankan workers who were displaced from Kuwait by the Gulf War in 1990. Consequently, the current account deficit of the balance of payments improved considerably from 2.6 per cent of GDP in 1997 to 1.8 per cent in 1998, continuing its downward trend for the fourth consecutive year.

Net inflows in the financial account were lower in 1998, reflecting the fact that inflows in 1997 included a large volume of privatisation proceeds amounting to US dollars 301 million, compared to US dollars 56 million in 1998. In view of the uncertainty in the capital markets, a further sale of Telecom shares was deferred until 1999. Net short-term private capital outflows showed a reduction in net short-term liabilities of commercial banks by US dollars 48 million, an outflow of US dollars 24 million through the share market and a small increase in other short-term private capital inflows. It is noteworthy that long-term private capital inflows, including foreign direct investment, continued to increase in 1998, reflecting the growing foreign investor confidence in Sri Lanka's medium-term development strategy. Over half the FDI inflows of US dollars 150 million were to the telecommunication sector, with significant inflows to the energy and manufacturing sectors as well. Investment outflows to approved projects amounted to around US dollars 13 million. Long-term concessional capital inflows to the government increased during the year. Net capital inflows to government declined by 17 per cent as a result of a drop in non-concessional capital inflows and somewhat higher amortisation payments.

Long-term capital flows to the private sector included a Floating Rate Notes (FRN) issue by DFCC Bank for US dollars 65 million in international capital markets and loans amounting to US dollars 43 million raised by Sri Lanka Telecom. Net long-term capital flows to this sector however, declined due to higher outflows arising mainly from an advance payment of US dollars 48 million by Air Lanka Ltd. towards its refleeting programme.

Sri Lanka's stock of external debt increased by more than the net increase in debt creating capital flows, mainly due to the impact of the appreciation of the yen, raising the debt to GDP ratio by 1 per cent in 1998. The appreciation of the yen alone increased the debt stock by around US dollars 200 million. The debt/GDP ratio stood at 56 per cent. The stock of short-term debt accounts for only 6 per cent of total debt. Sri Lanka's debt service ratio in 1998 was estimated at 11 per cent, the same as in 1997.

TABLE 9.1
Balance of Payments-Analytic Presentation
(Incorporating FCBUS of Commercial Banks as Part of the Domestic Banking System)(a)

Item	US Dollars Million					Rupees Million				
	1994	1995	1996	1997	1998(b)	1994	1995	1996	1997	1998(b)
Trade Balance	-1,559	-1,505	-1,344	-1,225	-1,157	-77,022	-77,109	-74,276	-71,833	-73,945
Exports	3,209	3,807	4,095	4,639	4,735	158,554	195,092	226,801	274,194	306,329
Imports	4,767	5,311	5,439	5,864	5,891	235,576	272,201	301,077	346,026	380,274
Services, net	180	152	105	159	143	8,884	7,796	5,805	9,386	9,201
Receipts	745	821	765	875	913	36,793	42,045	42,358	51,692	58,986
Payments	566	669	660	716	770	27,910	34,250	36,553	42,306	49,786
Income, net (c)	-162	-170	-197	-160	-179	-8,068	-8,717	-10,923	-9,417	-11,468
Receipts	171	226	186	234	214	8,473	11,596	10,258	13,792	13,882
Payments	333	396	383	393	392	16,541	20,312	21,182	23,210	25,350
Goods, Services and Income (net)	-1,541	-1,522	-1,436	-1,225	-1,192	-76,207	-78,030	-79,395	-71,864	-76,212
Private Transfers, net	622	675	710	788	848	30,766	34,593	39,230	46,494	54,843
Receipts (d)	707	790	832	922	999	34,992	40,462	46,003	54,445	64,585
Payments	85	115	122	135	151	4,226	5,889	6,773	7,951	9,742
Official Transfers (net)	58	61	49	44	55	2,890	3,114	2,709	2,625	3,490
Current Account	-860	-786	-677	-393	-289	-42,551	-40,324	-37,456	-22,745	-17,880
Capital and Financial Account	943	699	459	602	395	46,569	36,647	25,725	30,691	25,321
Capital Account	113	117	96	87	61	5,589	6,009	5,286	5,140	3,862
Capital Transfers(net)	113	117	96	87	61	5,589	6,009	5,286	5,140	3,862
Receipts	116	121	100	91	65	5,720	6,191	5,495	5,386	4,164
Payments	3	4	4	4	5	131	182	209	246	301
Financial Account	830	581	363	515	334	40,979	30,638	20,439	25,550	21,459
Long-term:	705	502	381	716	398	34,849	25,939	20,962	37,029	25,904
Direct Investment	158	53	120	430	193	7,815	2,931	6,606	25,504	12,379
Foreign Direct Investment	158	16	86	129	137	7,815	1,011	4,756	7,587	8,846
Privatisation Proceeds	0	37	33	301	56	0	1,920	1,850	17,918	3,533
Private Long-term (net),(c)	295	91	2	47	7	14,554	4,648	88	3,054	711
Inflows (e)	384	194	156	150	149	18,992	9,937	8,628	8,741	9,873
Outflows	90	103	155	102	142	4,438	5,289	8,539	5,687	9,162
Government, Long-term (net) (f)	253	358	259	239	198	12,479	18,359	14,268	8,471	12,814
Inflows	440	674	497	500	487	21,757	34,526	27,442	24,761	31,525
Outflows	187	315	238	262	290	9,278	16,166	13,174	16,291	18,711
Short-term:	124	79	-18	-201	-64	6,131	4,699	-523	-11,479	-4,445
Portfolio Investment	28	-2	7	13	-24	1,334	-90	353	749	-1521
Private Short-term (net),(c)	172	33	-44	-20	8	8,495	1,702	-2426	-1195	414
Commercial Bank Assets (net),(c)	-158	14	59	-323	180	-8160	-2731	1,127	-23384	5,035
Commercial Bank Liabilities (net),(c)	82	35	-40	129	-228	4,461	5,818	423	12,352	-8374
Government Short-term (net),(c)	-	-	-	-	-	-	-	-	-	-
SDR Allocations										
Valuation Adjustments						-1380	6,394	4,213	-562	8,559
Errors and Omissions	157	139	150	-46	-69	11,062	5,091	7,527	8,461	-2,201
Overall Balance (g)	240	52	-68	163	37	13,700	7,809	9	15,845	13,800
Monetary Movements (g)	-240	-52	68	-163	-37	-13700	-7809	-9	-15845	-13,800
Exchange Rate Rs/US$	-	-	-	-	-	49.42	51.25	55.27	58.99	64.59
Ratio to GDP in percentages										
Trade Account	-	-	-	-	-	-13.3	-11.5	-9.7	-8.1	-7.3
Current Account	-	-	-	-	-	-7.3	-6.0	-4.9	-2.6	-1.8
Current Account without Grants	-	-	-	-	-	-7.8	-6.5	-5.2	-2.8	-2.1

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. In addition, beginning 1994, Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system. (see technical note in Box 8)

(b) Provisional

(c) From 1994 onwards Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system in the compilation of balance of payments statistics. Accordingly, transactions involving FCBUs and non-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded. For details please see the technical note on "Redefining FCBU Transactions in the Compilation of Balance of Payments Statistics" in Box 8.

(d) Includes US dollars 64 mn. and US dollars 78 mn. received in 1997 and 1998 as compensation of US dollars 2,500 per person to 26,101 and 31,279 Sri Lankans, respectively, who lost employment in Kuwait due to the Gulf War in 1990.

(e) Includes adjustment to capital inflows in 1993,1994 and 1995 on account of the import of five aircraft for which advance payments had been made in previous years.

(f) Data since 1994 have been revised to incorporate additional information.

(g) All transactions in the Monetary Sector are converted at the end of year exchange rates.

Box 8

Redefining FCBU Transactions in the Compilation of Balance of Payments Statistics

The Balance of Payments is a summary statistical statement of all economic transactions (those relating to goods, services, transfers, financial assets and liabilities and capital) of an economy with the rest of the world. In the compilation of balance of payments statistics, the relevant transactions are identified as those between residents and non-residents. Individuals who are in a country for more than one year are generally treated as residents. Business enterprises, including foreign financial institutions operating in a country, even if they are incorporated elsewhere, are treated as residents because it is the location of the enterprise engaged in economic activity that matters for balance of payments purposes.

Countries have been applying the resident/non-resident distinction flexibly in the compilation of balance of payments statistics. This has made the international comparison of balance of payments statistics difficult. Similarly, in Sri Lanka in the past, foreign currency banking units (FCBUs) of commercial banks operating in Sri Lanka were treated as non-residents or pure off-shore units in the compilation of both monetary and balance of payments statistics, although conceptually, they should have been treated as residents. This was because FCBUs were expected to undertake mainly off-shore transactions, while also catering to companies operating in Export Processing Zones under Section 17 of the Board of Investment (BOI) Law, which were predominantly foreign owned, at that time. This treatment was reconsidered in the context of increasing transactions over time between FCBUs and the domestic economy. It was felt that it was timely to treat FCBUs as resident enterprises and make the corresponding changes to the monetary and balance of payments statistics.

Accordingly, as a first step in treating FCBUs as resident enterprises, in 1996, FCBU transactions were incorporated in the monetary aggregates, generating a broader concept of money supply (M2b) (Box 10 of the Central Bank's Annual Report of 1996). The treatment of FCBUs as resident enterprises in the compilation of balance of payments statistics is the next step. External data have now been adjusted to treat FCBUs as resident enterprises. Under this revised definition, transactions involving FCBUs and non-residents, i.e., banks and other institutions abroad, are included in the compilation of balance of payments statistics. Transactions involving FCBUs and residents are excluded, as those are domestic transactions denominated in foreign currency. This technical note explains the justification for the definitional change and its implications on the balance of payments and other external sector indicators.

The justification for the treatment of FCBUs as resident entities in the balance of payments and monetary statistics is as follows:

(a) This treatment will make the balance of payments statistics conform to the standard international classification of external sector transactions as laid down in the Balance of Payments Manual and the UN System of National Accounts (SNA), which would be a step forward in further improving Sri Lanka's economic statistics.

(b) FCBUs have become an integral part of the domestic banking system, catering largely to resident enterprises, mainly BOI enterprises approved under Section 17 of the BOI Law. (It should be noted that BOI enterprises have always been treated as residents in the compilation of balance of payments statistics). Nearly 70 per cent of the assets of FCBUs at end 1998 represented their claims on resident enterprises, as compared with about 30 per cent on non-resident enterprises. This is in contrast to the situation in the early 1980s. In 1985, 62 per cent of the assets of FCBUs were claims on non-residents.

(c) Most FCBU transactions are undertaken by domestic commercial banks. Accordingly, at end 1998, 66 per cent of the assets, representing their lending to resident enterprises, were held by the FCBUs of domestic banks while the balance 34 per cent were held by the FCBUs of foreign banks operating in Sri Lanka.

(d) FCBUs mobilise a larger part of their resources from the domestic economic system, in the form of domestic banking unit (DBU) placements of their foreign currency deposits in FCBUs and deposits belonging to other resident enterprises, mainly BOI firms. Placements of foreign exchange funds by DBUs, mainly funds in Non-Resident Foreign Currency (NRFC) accounts, provide nearly 30 per cent of FCBU resources. (Over 50 per cent of NRFC accounts, themselves are held by residents.) A larger part of the remaining FCBU resources was in the form of deposits belonging to BOI enterprises.

Box 8 (contd.)

(e) Increasingly, a large number of domestically owned enterprises or domestic-foreign collaborations are registering as BOI enterprises and are becoming eligible for FCBU facilities, thus leading to increased integration of FCBUs with the domestic economy. FCBU dealings with non-residents accounted for only about 30 per cent of total FCBU transactions at end 1998.

In view of the foregoing, it is appropriate to include only the transactions of FCBUs with non-residents in the balance of payments statistics, and to exclude transactions of FCBUs with residents. The following are the implications of this definitional change on the balance of payments and other external sector economic indicators (Table 1).

(a) Income Account: Changes stem from changes in interest receipts and payments by commercial banks and the private sector. Interest receipts and interest payments by commercial banks rise, as both foreign assets and foreign liabilities of commercial banks increase when FCBUs and DBUs are amalgamated. Interest receipts and payments by the non-bank private sector decrease as interest payments on borrowings from FCBUs by non-bank residents, mainly BOI enterprises, and interest receipts on deposits held with FCBUs by such residents are excluded. The net outcome of these changes is a reduction in the deficit in the income account in 1998, and a corresponding decline in the current account deficit.

(b) Financial Account: Changes stem mainly from the borrowings by BOI and non-BOI enterprises and the government from FCBUs being excluded and the new definition of the assets and liabilities of commercial banks to include both FCBUs and DBUs.

- Private Long-term Capital: There is no change in the net position due to the definitional change in 1998 in private long-term capital inflows. This is a coincidence.
- Private Short-term Capital: Private short-term capital inflows and outflows decline considerably, as FCBU transactions with the domestic private sector, in particular BOI enterprises, as well as certain public corporations, in particular the Ceylon Petroleum Corporation, are now treated as transactions between residents and are not included as short-term foreign capital inflows, unlike in the old definition. The outcome is a change in net private short-term capital from a deficit in the old presentation, to a small surplus in the revised presentation, in 1998.
- Government Long-term Capital: Government borrowings from and repayments to FCBUs are excluded and are reflected under domestic sources of financing. The syndicated loan from FCBUs to the government of US dollars 100 million raised in November 1998 has been classified under the new definition as a domestic borrowing.
- Commercial Banks: Assets are redefined to exclude placements of DBU balances in the FCBUs, while balances held by FCBUs and DBUs with non-residents are included as foreign assets. Liabilities exclude all foreign currency deposits of residents, but include those of non-residents in both FCBUs and DBUs. Under the revised presentation, both gross foreign assets and gross foreign liabilities of commercial banks are considerably higher. Gross foreign assets are higher because the assets held abroad by FCBUs are added to assets held abroad by DBUs. Foreign liabilities of FCBUs are added to the foreign liabilities of DBUs. However, as explained in Box 10 of the Annual Report of the Central Bank for 1996, the increase in foreign liabilities under the revised presentation is less because foreign currency deposits of residents are treated as domestic liabilities of DBUs denominated in foreign currency.

The net outcome of these changes in the financial account is a substantial drop in net financial flows in 1998 under the new definition.

(c) Overall Balance: It should be noted that this treatment of FCBUs as residents in the compilation of balance of payments statistics does not affect the overall balance.

(d) External Debt and Debt Service Payments: As FCBU lending to domestic enterprises is considered as debt to the domestic banking system, the overall external debt stock declines by 5 per cent of GDP. The debt service ratio also declines by 1 percentage point, as interest payments on borrowings from FCBUs by domestic entities are treated as resident to resident transactions (with a corresponding increase in domestic debt obligations and domestic debt service payments of the government and the private sector to the banking sector).

Box 8 (contd.)

TABLE 1
Balance of Payments - 1998 (a)

Previous Presentation (FCBUs being treated as off-shore units)

Item	US Dollar Million		
	Credit	Debit	Net
A GOODS	4,735	5,891	-1,157
B SERVICES	913	770	143
Transportation	400	263	137
Passenger Fares	139	124	15
Freight	34	57	-23
Other	227	82	145
Travel	230	202	28
Insurance Services	34	18	16
Other Business Services	224	253	-29
Government Expenditure n.i.e.	25	34	-9
C INCOME	214	423	-209
Compensation of Employees	12	13	-2
Direct Investment	2	91	-89
Other	200	319	-119
D CURRENT TRANSFERS	1,054	151	903
Private	999	151	848
General Government	55	0	55
CURRENT ACCOUNT	6,915	7,235	-320
CAPITAL AND FINANCIAL ACCOUNT	1,918	1,291	627
A CAPITAL ACCOUNT	65	5	61
Capital Transfers	65	5	61
General Government (Other)	55	0	55
Other Sectors (Migrant Transfers)	10	5	5
B FINANCIAL ACCOUNTS	1,853	1,287	566
Private Investment	1,266	989	276
Long - Term	373	174	200
Direct Investment	150	13	137
Privatisation Proceeds	56	0	56
Other Private Long-term	167	160	7
Short - Term	893	816	77
Portfolio Investment	70	93	-24
Other Private Short-term	452	460	-7
Commercial Bank - Assets	141	219	-78
Commercial Bank - Liabilities	229	44	186
Central Government	587	297	290
Long-Term	466	157	308
Other Long-Term	121	140	-18
Short - Term	0	0	0
MONETARY SECTOR	607	644	-37
Government - Assets	12	13	-1
Government - Liabilities	0	0	0
Central Bank - Assets	302	257	46
Central Bank - Liabilities	293	291	1
Transactions with IMF	0	83	-83
Allocation of SDRs	0	0	0
Valuation Adjustments	0	0	0
Monetary Gold	0	0	0
Errors & Omissions	0	-270	-270

New Presentation (FCBUs being treated as part of the domestic banking system)

Item	US Dollar Million		
	Credit	Debit	Net
A GOODS	4,735	5,891	-1157
B SERVICES	913	770	143
Transportation	400	263	137
Passenger Fares	139	124	15
Freight	34	57	-23
Other	227	82	145
Travel	230	202	28
Insurance Services	34	18	16
Other Business Services	224	253	-29
Government Expenditure n.i.e.	25	34	-9
C INCOME	214	392	-179
Compensation of Employees	12	13	-2
Direct Investment	2	91	-89
Other	200	288	-88
D CURRENT TRANSFERS	1,054	151	903
Private	999	151	848
General Government	55	0	55
CURRENT ACCOUNT	6,915	7,204	-289
CAPITAL AND FINANCIAL ACCOUNT	1,676	1,282	395
A CAPITAL ACCOUNT	65	5	61
Capital Transfers	65	5	61
General Government (Other)	55	0	55
Other Sectors (Migrant Transfers)	10	5	5
B FINANCIAL ACCOUNTS	1,611	1,277	334
Private Investment	1,124	988	136
Long - Term	355	155	200
Direct Investment	150	13	137
Privatisation Proceeds	56	0	56
Other Private Long-term	149	142	7
Short - Term	768	832	-64
Portfolio Investment	70	93	-24
Other Private Short-term	183	175	8
Commercial Bank - Assets	386	206	180
Commercial Bank - Liabilities	130	358	-228
Central Government	487	290	198
Long-Term	466	157	308
Other Long-Term	22	132	-110
Short - Term	0	0	0
MONETARY SECTOR	607	644	-37
Government - Assets	12	13	-1
Government - Liabilities	0	0	0
Central Bank - Assets	302	257	46
Central Bank - Liabilities	293	291	1
Transactions with IMF	0	83	-83
Allocation of SDRs	0	0	0
Valuation Adjustments	0	0	0
Monetary Gold	0	0	0
Errors & Omissions	0	-69	-69

Disbursed and Outstanding External Debt (a)

Item	Old 1998	New 1998
1.Total Debt	9,615	8,753
1.1 Government	7,000	6,897
1.2 Private Long-term	1,119	1,002
1.3 Private Short-term	1,129	487
1.4 IMF Drawings	367	367
2.Total Debt as a % of GDP	61.1	55.6

(a) Provisional

External Debt Service Payments(a)

Item	Old 1998	New 1998
1.Debt Service Payments	811	754
1.1 Amortization	492	467
1.2 Interest Payments	319	288
2. Debt Service Ratio		
2.1 Overall Ratio	14.4	13.4

Box 9

Monthly Trade Indices

Monthly trade indices provide useful information on the changes in the economy and are an important input to decision making, research and other policy studies on the economy. Monthly trade indices provide an understanding of the seasonal variations in trade, provide inputs for the estimation of national income on a more frequent basis than annually and help understand terms of trade pass-through on monthly inflation in the economy.

The Central Bank of Sri Lanka (CBSL) first introduced trade indices in 1953 in its publications, and continued to publish these indices until 1969. The indices were presented on both monthly and annual bases, and were published in the Monthly Bulletins and the Annual Reports of the CBSL. In 1969 the classification of exports and imports was changed from the Standard International Trade Classification to the Brussels Tariff Nomenclature (BTN) which was introduced at that time[1]. This resulted in a delay in releasing the detailed data on exports and imports on monthly basis by the Sri Lanka Customs, and publication of the monthly indices was abandoned[2]. Since 1969, only the annual trade indices have been published.

In view of the usefulness of monthly trade indices, the CBSL embarked on compilation of monthly trade indices in 1997. This endeavor was facilitated by the innovations in information technology which enabled timely processing of large volumes of monthly data by the Sri Lanka Customs. Monthly indices have been compiled from January 1996 up to December 1998, and are given in the Statistical Appendix tables 70, 71 and 72 of this report[3].

Coverage of Indices

The CBSL monthly series comprises six indices, namely, value, volume and unit value indices for both exports and imports. The total number of Harmonized Commodity Description and Coding System (H.S.) items at 8 digit level classified under exports and imports were 5,229 and 8,624, respectively, as at end 1997. Export items were sub-divided into three major categories, Agricultural, Industrial and Mineral. The three main categories were further sub divided into 16 major sub categories and 70 sub-sub categories. Import items were divided into three major categories, Consumer Goods, Intermediate Goods and Investment Goods. These three categories were further divided into 18 major sub categories and 16 sub-sub categories. Value, volume and unit value indices were computed for each major category, sub category and sub-sub category. Indices of the major categories and some important sub categories are published in this report.

Currently, the sub categories and sub-sub categories cover 97 per cent of exports and 68 per cent of imports based on 1997 values. The base year and index coverage are expected to be reviewed and revised, as necessary, every three years. The coverage of imports is expected to be expanded in the future.

Computation of Indices

The base values for calculating monthly indices were taken as the average monthly values and volumes of 1997[4]. Average monthly value shares in 1997 were used as weights. The number of Customs entries in the base year data for exports and imports were 204,382 and 279,592 respectively.

In each category, the value index was computed as a simple index of the ratio of values between the current month and the base period. The index was defined as $\frac{\sum_i P_{it} Q_{it}}{\sum_i P_{i0} Q_{i0}}$, where P_{it} and Q_{it} are price and quantity of the i^{th} good at time t, respectively, and P_{i0} and Q_{i0} are the price and quantity of the i^{th} good in the base period.

The volume index was calculated as a Laspeyres index. Operationally, weights (value shares of the base period) were multiplied by the ratio of the quantities between the current month and the base period, i.e., the volume index for the sub category, was the weighted

1. In 1989 the Customs classification underwent a further change from the BTN to the Harmonized Commodity Description and Coding System (H.S).
2. As discussed in the Central Bank of Sri Lanka, Annual Report, 1969 - Appendix Table 49 / Foot note No.2
3. The recording system of units of exports and imports was changed after 1995 by the Customs. To avoid complications that would arise in calculating volume indices due to this change, computation of past indices was limited to 1996.
4. The year 1996 was not used as a base year since the trade patterns (especially exports) were abnormal in that year due to the prolonged drought that prevailed.

Box 9 (contd.)

average of the volume indices of sub-sub categories. The volume index for the major category, was the weighted average of the volume indices of the sub categories. The volume index was defined as

$$\sum_i w_i \frac{Q_{it}}{Q_{io}} = \sum_i \left(\frac{P_{io} Q_{io}}{\sum_i P_{io} Q_{io}} \right) \frac{Q_{it}}{Q_{io}}$$

where w_i is the value share in the base year, This simplifies to the Laspeyres index given by

$$\frac{\sum_i P_{io} Q_{it}}{\sum_i P_{io} Q_{io}}$$

For homogeneous categories, monthly volumes were divided by respective base volumes to obtain indices. Difficulties arise in calculating volume indices for categories consisting of heterogeneous goods. For those categories, indices were calculated as the weighted averages of the volume indices of the individual items in the category. However, in certain categories, where the number of items was very extensive with considerable price variation, volume indices were based on samples of H.S. items in the categories selected on the basis of value shares as well as a clear identification of such H.S. items. The monthly volume indices of those selected H.S. items weighted by their value shares were used to calculate the volume indices for each category.

The unit value index was calculated effectively as a Paasche index by dividing the value index by the volume index[5].

Quarterly and Annual series were calculated on the same basis.

Main Trends Observed Using the Index

Monthly export value indices given in Figure 1 reflect clear seasonal increases in summer and winter months in Sri Lanka's exports, attributable mainly to increases in volumes of garment exports. Monthly import value indices given in Figure 2 show increases just preceding the festival seasons in April and December due mainly to increases in the volume of food and other consumer goods imports. The peak in the import volume in October 1996 shows the importation of a large volume of rice towards the end of the period during which import duties on rice were completely waived[6]. Importation of a large number of machinery parts is reflected in the second peak in import volume in May 1998 which resulted in a slump in the unit value. As seen in the two figures, the value indices of both exports and imports move closely with volume indices, while unit value indices did not vary greatly.

Figure 1
Monthly Export Indices

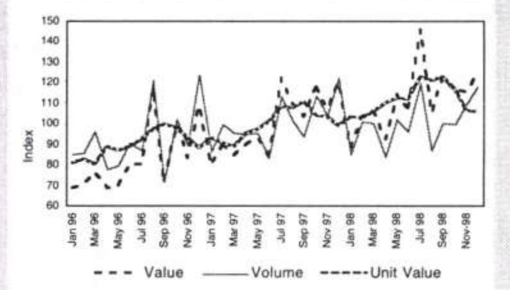
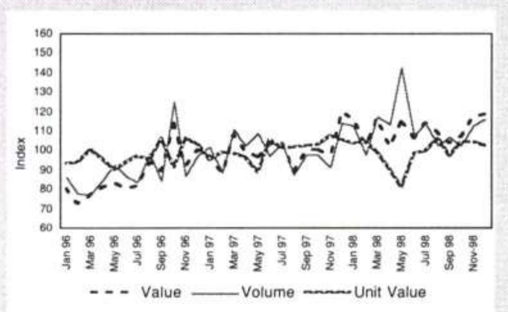


Figure 2
Monthly Import Indices

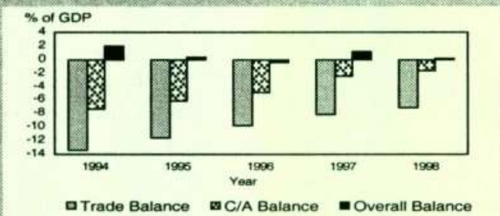


5. The unit value index is computed as the ratio between the value index and the volume index, thus becoming the Paasche index given by the formula

$$\frac{\sum_i P_{it} Q_{it}}{\sum_i P_{io} Q_{it}}$$

6. The duty waiver on rice was first granted for a six months period from 15.4.96 to 15.10.96 and was further extended for another two months later.

Chart 9.1
Balance of Payments



(a) With the change in classification from BPM4 to BPM5 format changes in commercial banks assets and liabilities are treated as short-term capital
(b) Beginning 1994, Foreign Currency Banking Units (FCBUs) have been treated as part of the domestic banking system

TABLE 9.2
External Trade Performance

Year	Growth Rates(a)		Price Indices (b) (1997=100)			Ratios
	Exports	Imports	Exports	Imports	Terms of Trade(c)	Exports/ Imports
1996	7.6	2.4	91.5	97.7	93.6	0.79
1997	13.3	7.6	100.0	100.0	100.0	0.79
1998 (d)	2.1	0.5	111.6	97.8	114.2	0.80

Sources: Sri Lanka Customs
Central Bank of Sri Lanka

(a) Growth rates are given in U.S. dollar terms.
(b) A new trade indices series has been introduced from 1998. Please refer Box 9 and footnote (a) in the Statistical Appendix Table 73 for a detailed description on the change of the methodology.
(c) (Export unit value index / Import unit value index) * 100
(d) Provisional.

Chart 9.2
External Trade

Chart 9.2.1
Trade Balance

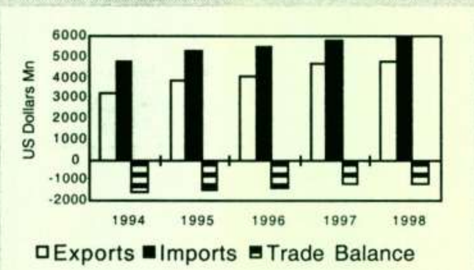
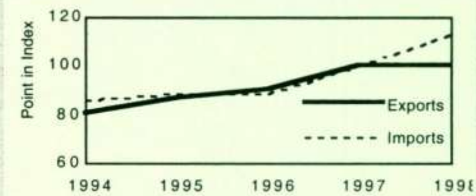
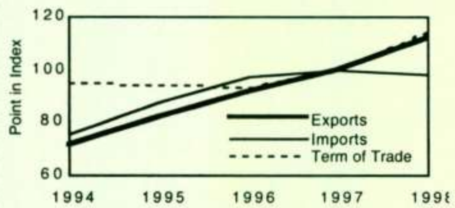


Chart 9.2.2
Export and Import Volume Indices (a)
(1997 = 100)



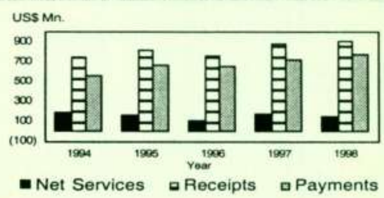
(a) Data for 1994 and 1995 have been obtained b splicing the previous annual trade indices series.

Chart 9.2.3
Trade Price Indices (a)
(1997 = 100)



(a) Data for 1994 and 1995 have been obtained I splicing the previous annual trade indices series.

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

Exchange rates among key currencies continued to be highly volatile in the international exchange markets. Although this posed a challenge in the management of exchange rates for developing countries, with the flexibly managed exchange rate system in place, Sri Lanka was able to maintain relative stability in the domestic exchange market. The rupee depreciated by 9.6 per cent against the dollar. The real effective exchange rate of the Sri Lanka rupee against the 24 currency basket depreciated by 12 per cent in 1998, offsetting the appreciation that was seen in 1997 due to the large depreciation of some of the East Asian currencies.

The overall balance of the balance of payments registered a surplus of US dollars 37 million in 1998. Gross official assets were sufficient to finance 4.0 months of imports of the same year. Total gross external assets at US dollars 2,907 million, which include official assets and those of commercial banks, were sufficient for 5.9 months of import cover.

9.2 Exports

The export growth in 1998 was 2.1 per cent compared to the 13 per cent growth experienced in 1997. Export earnings recorded an 8 per cent growth in the first half of 1998 but slowed down in the second half, recording a negative growth of 3 per cent. This situation was the result of slow growth in textiles and garments and tea, and the negative growth in natural rubber and some of the rubber based products, coconut products, gems, diamonds and jewellery. These sectors were affected by the lower global aggregate demand and the increased competition from the East Asian countries. Earnings from the single largest export item, i.e., textile and garments, which began to slow down in late 1997, showed a recovery towards July 1998 but again slowed down thereafter. Tea prices, which remained buoyant till July 1998, came down during the last quarter of the year mainly due to world production surpluses and the Russian crisis that began in mid August. Although slowed down, textiles and garments, tea, minor agricultural products, food beverages and tobacco and travel goods showed positive growth, but their impact on overall export performance was negated by the negative growth in earnings from rubber, coconut products, gems, diamonds and jewellery.

Industrial Products

Industrial exports led by textiles and garments continued to be the largest contributor to export earnings, accounting for 75 per cent of total exports. Earnings from this sector grew by 3 per cent in 1998 compared to 14 per cent in 1997. Textiles and garments, the largest category in the sector,

TABLE 9.3
Composition of Exports

Category	US Dollars Million					Rs. Million				
	1994	1995	1996	1997	1998(a)	1994	1995	1996	1997	1998(a)
1. Agricultural Exports	702	829	961	1,060	1,068	34,692	42,478	53,206	62,667	70,225
Tea	424	481	615	719	780	20,964	24,638	34,067	42,533	50,280
Rubber	72	111	104	79	44	3,582	5,713	5,753	4,640	2,808
Coconut	76	103	110	117	94	3,761	5,270	6,091	6,939	6,110
Kernel Products	50	69	81	82	56	2,476	3,520	4,469	4,864	3,632
Other	26	34	29	35	38	1,285	1,750	1,622	2,075	2,478
Minor Agricultural Products	129	134	132	145	170	6,385	6,857	7,295	8,555	11,027
2. Industrial Exports (b) (c)	2,399	2,870	3,006	3,436	3,544	118,544	147,094	166,543	203,114	229,437
Food,Beverages and Tobacco	86	98	95	91	118	4,262	5,040	5,272	5,354	7,586
Textiles and Garments	1,552	1,853	1,902	2,274	2,460	76,685	94,946	105,341	134,455	159,303
Petroleum Products	80	85	104	97	73	3,959	4,374	5,740	5,743	4,662
Rubber Products	102	153	169	178	176	5,026	7,851	9,357	10,513	11,528
Ceramic Products	39	46	48	55	54	1,920	2,371	2,677	3,246	3,478
Leather and Footwear	90	118	139	183	214	4,456	6,054	7,690	10,812	13,855
Machinery and Equipment	93	124	154	204	182	4,572	6,348	8,572	12,076	11,811
Diamonds and Jewellery	170	196	192	142	68	8,419	10,023	10,643	8,384	4,421
Other Industrial Exports	187	197	202	212	197	9,245	10,087	11,251	12,531	12,793
3. Mineral Exports	87	87	96	90	60	4,292	4,447	5,292	5,271	3,863
Gems	79	78	86	84	56	3,917	3,972	4,771	4,899	3,577
Other Mineral Exports	8	9	10	6	4	375	475	521	372	286
4. Unclassified (c) (d)	21	21	32	53	43	1,026	1,073	1,760	3,141	2,803
Total Exports	3,209	3,807	4,095	4,639	4,735	158,554	195,092	226,801	274,193	306,328

(a) Provisional.
(b) Adjusted.
(c) Revised.
(d) Includes re-exports

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

Box 10

Indo-Lanka Free Trade Agreement

The Indo-Lanka Free Trade Agreement (FTA), officially titled the Free Trade Agreement Between the Democratic Socialist Republic of Sri Lanka and the Republic of India, was signed on 28 December1998 by the Sri Lankan President Chandrika Bandaranaike Kumaratunga and the Indian Prime Minister Shri Atal Bihari Vajpayee.

A bilateral free trade agreement is an agreement between two countries on the reduction of border tariffs and other non-tariff and para-tariff measures for a specified set of goods. The primary objective is the promotion of long-run economic growth and development of a country by removing barriers to trade with the preferred trading partner. The removal could take place immediately or gradually over a period of time. An agreement could exclude some tradable products on the basis of concerns such as the potential injury to important domestic industries due to the removal of trade barriers, and also for national security reasons. Lists of those excluded items are called 'negative lists'. Those items on negative lists do not receive concessions but are traded subject to normal terms of trade. Since the purpose of a preferential trade agreement is the promotion of the countries' own products, the agreement specifies rules of origin criteria. Thus, to receive concessions, a product should either be wholly obtained in a country or go through a substantial transformation within a country if it contains any material imported from a third party country. The required degree of transformation is specified under the rules of origin criteria in the agreement.

There are several justifications for choosing India as Sri Lanka's first partner of free trade. India is Sri Lanka's closest geographic neighbour, as well as a close economic neighbour. India has been among Sri Lanka's most important import suppliers during the last several years, reaching the top in the last three years. This proximity and low border tariff facilitate trade and investment between the two countries, as well as investment by any third country in Sri Lanka aiming for the Indian market.

Proponents of the FTA believe that countries like Sri Lanka and India can no longer achieve higher growth by emulating experiences of newly industrialised countries. Some of the important factors include the deceleration of the developed economy markets, increased protectionism in those countries, increased competition among developing and emerging economy exporters, emergence of trading blocs centred around economically powerful countries and stagnant or declining net foreign aid. Thus, developing countries should seek each others co-operation in promoting exports and economic growth. India, being a large economy and a market with a significantly large group of middle income earners, could provide opportunities for the expansion of Sri Lanka's exports by offering preferential tariffs to Sri Lanka.

The FTA demonstrated the political commitment of the two countries, at the highest level, to promote free trade. It signals the manufacturing and business ties of the two countries, the need for improving their competitive edge to face challenges posed by the intensifying process of globalisation. The FTA does not remove all tariffs on all goods at once. As in the North American Free Trade Agreement (NAFTA), it removes tariffs on a phased out schedule. India will remove tariffs entirely on some goods immediately, while partial concessions will be granted to some selected products. The tariffs on those products will be removed gradually over a period of three years. Sri Lanka will also fully remove tariffs immediately for some products, and will grant partial concessions on some other products. Sri Lanka will gradually remove tariffs on those products over a period of eight years.

The FTA provides protection to some industrialists by establishing negative lists. The negative lists contain products on which no tariff concession will be granted. Though such negative lists hinder the effectiveness of the FTA, it has become obvious that they are an unavoidable component of the agreement at this stage. These could avoid destabilising effects by providing an opportunity to delay the exposure of some of the domestic industries to foreign competition. Therefore, the next best option would be to minimise the negative lists. The negative lists of the two countries were to be finalised.

Among other important criteria, the FTA has adopted the principles of national treatment criteria enshrined in Article III of GATT 1994. State trading enterprises may be established and maintained as understood in Article XVII of GATT 1994. The agreement allows safeguard measures that could result in provisionally suspending the preferential treatment if they cause or threaten to cause a serious injury to the economy of the importing country, or in view of balance of payment difficulties. The domestic legislation too may be applied to counteract any unfair trade practices such as subsidies or dumping. The FTA has a provision to set up a Joint Committee at ministerial level to review at least annually the progress made in the implementation of the FTA, and to set up a working group on Customs related issues including harmonisation of tariff headings between the two countries. The agreement has provision for the settlement of disputes. The agreement can be terminated by either country by giving six months written notice to the other of its intention to terminate the agreement. Any amendment to the agreement may be made through mutual agreement of the two countries.

The FTA does not preferentially lift any para-tariff or non-tariff barriers. Thus, lifting those barriers would be a focal point of the Joint Committee. If the barriers are asymmetric between Sri Lanka and India, the Joint Committee should negotiate to even out differences, or to address it through 'tariffication', thereby imposing suitably high tariffs to negate effects of para-tariff and non-tariff barriers.

Any trade agreement or a change in trade policy affects consumers, exporters and importers and producers in contracting countries. It also affects countries in the rest of the world to the extent of trade diversion caused by the preferential trade agreement. In contracting countries, in the short-run, a reduction in tariffs will lower the price faced by domestic consumers, thus enhancing their welfare. Exporters and importers may experience larger volumes of trade, thus enhancing their income levels. Industrialists and producers catering to the export market may realise the benefits of freer

Box 10 (contd.)

trade, while industrialists and producers catering to the domestic market may face competition and loss of market share. The government too may lose tariff related fiscal revenue. However, this may not be a serious issue, as the generation of fiscal revenue through trade causes unhealthy trade distortions.

It is impossible to avoid trade diversion resulting from preferential trade agreements. The preferentially lower tariff could make some Indian products cheaper for Sri Lankans even though the price before tariff for similar products may be lower in other countries. This distorts global resource allocation, global welfare, and welfare of Sri Lankan consumers if there exists a sufficiently large quality difference in those products between India and the rest of the world.

In the long-run freer trade promotes efficiency, foreign investment, technology flows and knowledge spillovers; the ingredients of higher long-run growth. The growth will further be accelerated due to agglomeration effects, i.e., benefits accruing via larger markets, greater specialisation and economies of scale. Industries with comparative advantage or competitive advantage over their rivals in contracting countries will realise benefits of larger markets. Even in the absence of any comparative advantage, removal of trade barriers and restrictions on transportation may enable greater intra-industry trade, i.e., trade in semi-finished goods similar to the trade patterns observed in the European Union.

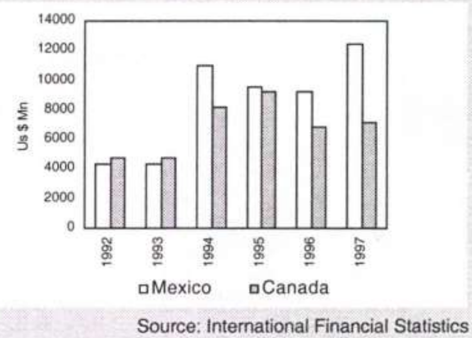
Sri Lanka expects to benefit through enhanced investment from India and other countries resulting from the FTA. The ability to derive the benefits depends on the relative efficiency of procedures relating to trade and investment in Sri Lanka, the degree of infrastructure development including port services and road networks, and India's willingness to accept and facilitate raw material imports and finished goods exports by Sri Lanka. The lower tariff structure in Sri Lanka and non-existence of para-tariff and non-tariff barriers will be advantageous. However, infrastructure facilities will have to be further developed for Sri Lanka to remain competitive and efficient to attract foreign investment. In this regard government institutions could play a larger role together with private sector participation. Many infrastructure products such as roads are public goods. They play an eminent role in the acceleration of long-run growth. Public goods, similar to private goods, should also be planned, produced and delivered efficiently and on time, and this process requires entrepreneurial capabilities.

Potential investors in Sri Lanka motivated by the FTA would also like to see Sri Lanka's plans for infrastructure development. Therefore, Sri Lanka should prepare a realistic comprehensive plan for infrastructure development so that the FTA could play its catalytic role in economic development.

The impact of the FTA on Sri Lanka in the long run could be assessed using similar historical events. Sri Lanka underwent a drastic policy change in 1977 that eliminated a substantial volume of tariff and non-tariff barriers. In the subsequent span of two decades Sri Lanka experienced greater volumes of foreign investment, higher volumes of both exports and imports, and faster economic growth. All this was achieved while facing the constraint of civil strife.

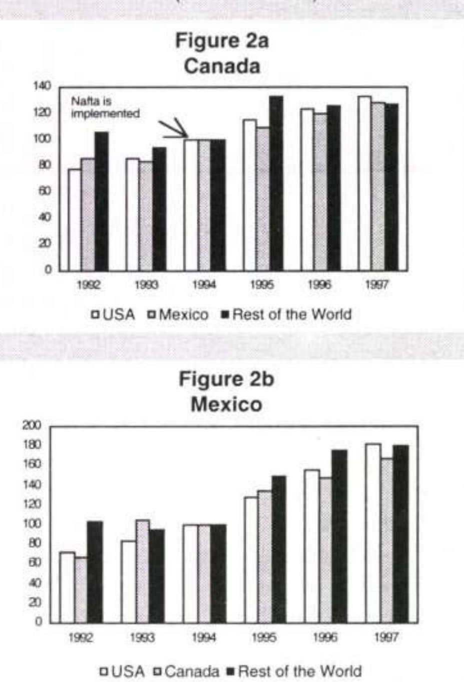
The impressive export performance of Sri Lanka illustrates its capability to compete with any country in the world successfully in winning shares of the world market. The evidence of NAFTA indicates that both Canada and Mexico experienced higher volumes of exports and direct investment after the signing of the agreement in 1994. Thus, if effectively implemented, Sri Lanka could benefit from the FTA in the years to come.

Figure 1
Development in Foreign Direct Investment in Mexico and Canada before and after Implementing NAFTA in 1994



Source: International Financial Statistics

Figure 2
Indices of Export Value in US Dollar Terms and Direction of Exports before and after Implementing NAFTA in 1994 (Index 1994=100)



Source: International Financial Statistics

Chart 9.3
Value of Exports by Major Categories

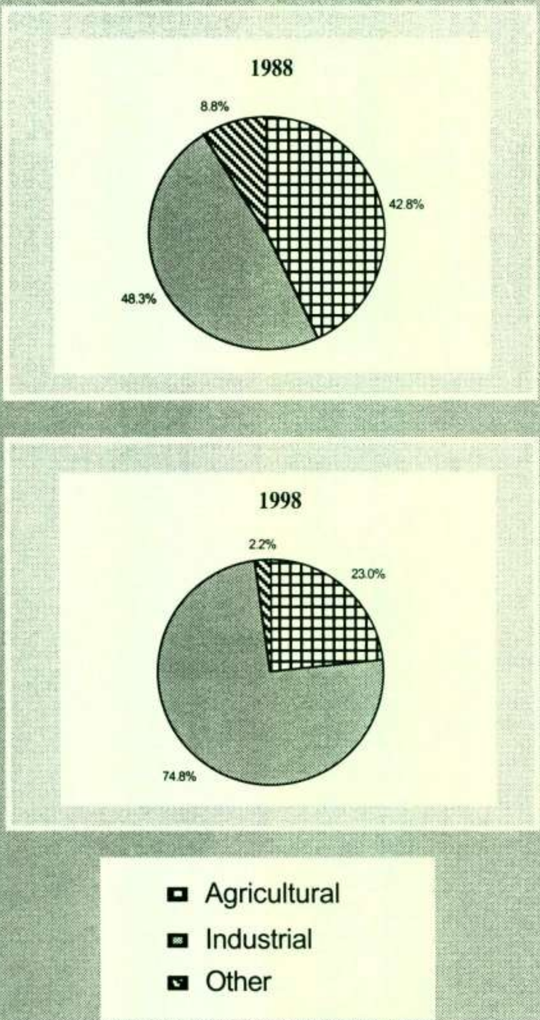
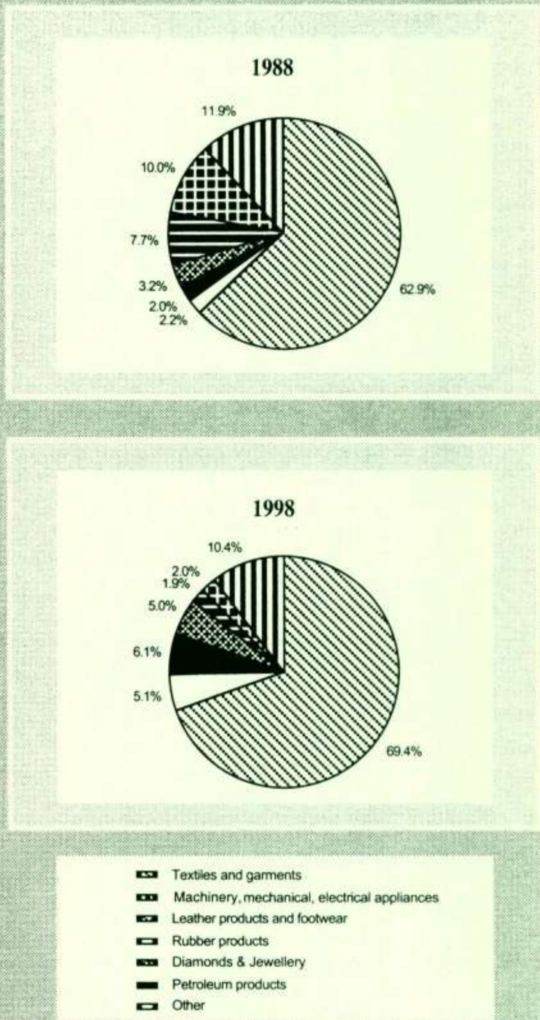


Chart 9.4
Value of Industrial Exports by Major Categories



grew by 8 per cent. However, high product prices, coupled with lower input prices, resulted in an increase in net foreign exchange earnings by 20 per cent over the previous year. The unit value of textiles and garments increased by 5 per cent, while volumes increased by 3 per cent in comparison to 8 per cent and 11 per cent, respectively, in 1997. As seen in the monthly volume indices, seasonal fluctuations were clearly seen in garment exports. Exports were higher before the summer and winter seasons in the USA and European markets. More than 90 per cent of textile and garment exports were by BOI companies. Export earnings of BOI enterprises increased by 10 per cent in comparison to 18 per cent in 1997. Those of non-BOI enterprises, which rose by 34 per cent in 1997, declined by 4 per cent, partly reflecting the adverse impact of the East Asian currency crisis on small - scale exporters of these products who produced for the lower end of the market. Of the earnings from this sub sector, garments, the major contributor, which accounted for 90 per cent, increased by 7 per cent, while textiles grew by over 11 per cent. The textile and garment industry benefited from the package of incentives introduced in the 1998 Budget, which made all intermediate and capital goods used in the industry non-dutiable. Textile and garment exports continued to be the leading export sub category, contributing 69 per cent to total industrial exports in 1998.

Within the leather and footwear category, travel goods increased by 40 per cent largely attributable to increased demand from the USA for handbags and travel cases. Earnings from footwear declined by 7 per cent due to lower exports of sports items and non-exclusive footwear. This sector suffered due to a productivity drop by a major manufacturer following strikes among its workforce, as well as a decline in competitiveness with China and South and East Asian countries. Other articles of leather exports declined by 28 per cent largely due to the drop in exports of sports goods to the USA and UK markets.

Earnings from machinery, mechanical and electrical equipment exports declined by 11 per cent, mainly due to lower exports of ferrous waste and scrap metal and parts and accessories of electrical equipment and electronic office equipment such as word processing and data processing machines. However, export earnings of this category have almost doubled during the last five years, raising its sectoral share in total industrial exports to 5 per cent.

Export earnings from rubber based products, which accounted for about 5 per cent of total industrial exports, remained virtually unchanged in 1998. The main reason for this was the substantial drop in exports of surgical gloves, which accounted for 22 per cent of rubber based products in 1997. This share dropped to 12 per cent in 1998 due to a temporary interruption to production of examination gloves in a single firm that underwent a transition in production technology. The production of examination gloves recommenced with the operation of new machines in November 1998. However, earnings from other rubber based products collectively increased by 13 per cent due to higher earnings from tyres and tubes, non-surgical gloves, floor covering and mats, rubber bands and other rubber products. Satisfactory performance in tyre exports was due to the expansion of production capacity in the industry and the re-commencement of operations by one of the pioneer tyre manufacturers, in December 1997, after a lapse of nine months.

Export earnings from the food, beverage and tobacco sub category increased by 30 per cent owing to a 55 per cent increase in the earnings from crustaceans and molluscs, which contributed 67 per cent to this sub-category. The industry has been recovering since the last quarter of 1997 from the white spot disease in major shrimp producing areas. Shrimp feed was made duty free, with effect from August 1996, for two years as a relief measure to shrimp farmers. The growth in this sub sector slowed down somewhat in the last quarter of 1998 due to a sharp decline in lobster and prawn exports. Some prawn farms ceased prawn cultivation temporarily in August 1998 due to the spread of the yellow head disease in those farms.

Earnings from the export of petroleum products declined by 25 per cent in 1998. This was mainly due to the increased local consumption of fuel oil for thermal power generation. The export volume of petroleum products declined only by 12 per cent, while prices declined by 15 per cent in line with lower international oil prices that prevailed during the year.

There was a marked reduction in diamond (54 per cent) and jewellery (41 per cent) exports due to lower demand. Diamond exports continued to fall due to lower demand from Belgium, Japan, and Thailand, whose share was about 89 per cent of total diamond exports. Diamond exports to Belgium, the largest market for Sri Lanka, declined by 58 per cent due to lower demand from the depressed Japanese and East Asian markets. Under the present depressed market conditions, Belgium, which is the major diamond centre, purchased less and also maintained lower stocks than usual due to uncertainty in the market. Exporters were badly affected by the loss of the Japanese market that purchased high quality products. Large diamond manufacturers in the country have found it difficult to maintain their normal production levels and as a result they have cut down their production to a considerable extent. Possible improvements in this market were undermined by the depressed gem and jewellery industry. The jewellery market, which suffered similarly due to the East Asian crisis, lost its markets in Singapore, Japan and Hong Kong. With a view to encouraging the jewellery industry, the import of gems and gold was made duty free, while gem and jewellery industries were exempted from the National Security Levy (NSL) from November 1997 and from income tax from 24 August 1998.

Among other manufactured export categories, exports of chemical products increased by 11 per cent. However, earnings from tableware, tiles, ceramic statuettes and ornamental articles and plastics were lower in 1998 largely due to increased competition from East Asian countries.

It was evident that sectors catering to the lower end of the market were the most affected. Hardly any effect was seen on products of high quality and special designs for niche markets. Therefore, a gradual move to high quality products, new and efficient technology that can respond to fast changes in patterns and styles, use of qualified designers and use of a trained workforce are essential if industries are to improve productivity to survive in the present competitive global environment.

Plantation Crops

Earnings from plantation crops remained at the previous year's level due to negative growth in rubber and coconut exports, which offset the improved earnings from tea. The export volume of tea increased by 1 per cent to 272 million kgs. with tea production at a record high level of 280 million kgs, which was one per cent higher than in the previous year. Mseanwhile, tea prices increased by 7 per cent to US dollar 2.87 per kg. in 1998. Tea prices remained strong during the first five months of the year and then increased at a slower rate till August 1998. The continued high demand for tea from the Commonwealth of Independent States (CIS) and Turkey, improvement in the quality and tight supply conditions in the other major auction centres, mainly Kenya and India, contributed to this development. However, tea prices fell after August 1998 following the Russian currency crisis which began in mid-August and also due to production surpluses in major producing countries. The Russian rouble had depreciated by 70 per cent by end 1998. Russia being the largest single tea importer from Sri

Lanka, earnings from tea exports slowed down from July 1998, lowering the cumulative growth to 8 per cent during 1998. In the first half of 1998 tea exports increased by 33 per cent.

In the composition of Sri Lanka's tea exports, more than 58 per cent was in bulk form, while 34 per cent was in packed form. Higher value added forms of tea such as tea bags, Sri Lanka tea blended with foreign teas and instant and green teas accounted for the remainder, less than 8 per cent of the total. Sri Lanka imported 4.3 million kgs. of tea, which was less than 2 per cent of the domestic production in 1998. As in the previous year, Russia, which continued to be the prime destination for Sri Lanka's tea, accounted for 16 per cent of exports. The UAE emerged as the second largest buyer (12 per cent), while Turkey became the third largest buyer, accounting for 11 per cent. The other major buyers were Syria (6 per cent), Libya (5 per cent) and Saudi Arabia (4 per cent).

A significant decline was recorded in the earnings from rubber (45 per cent). The decline in rubber exports was due to both volume (33 per cent) and price (18 per cent). The average export prices of latex and other crepe rubber, except sole crepe, which accounted for about 50 per cent of total exports, declined by 23 per cent, while the average price of sheet rubber grades declined by 31 per cent in 1998. However, the average price of sole crepe used in the manufacture of sanitary and pharmaceutical items increased by 6 per cent in 1998. Export prices and quantities of rubber had started to slow down even before the East Asian currency turmoil. Production surpluses in major producing countries such as Thailand and Indonesia led to lower prices. Sharp currency depreciations in Thailand, Indonesia and Malaysia, which contribute more than 88 per cent to world rubber exports, have also affected international rubber prices since the latter part of 1997. Global supply trends and price forecasts show increased world supply and lower prices in 1999 and 2000. The industry does not show any evidence of a price turnaround in the near future.

Local consumption of rubber increased by 20 per cent to 53 million kgs., reflecting the expansion of the rubber based products sub-sector. The import volume of natural rubber declined to 259,869 kgs. in 1998 from 270,891 kgs. in 1997. Rubber imports are exempted from GST but are liable for an import duty of 10 per cent and NSL of 5.5 per cent (until November 1998, 4.5 per cent), thereby providing protection to domestic rubber producers.

The export volume of desiccated coconut, which accounts for about 80 per cent of total kernel product exports, fell by 29 per cent, as major producers, the Philippines and Indonesia, offered attractive prices. Local producers were unable to compete with these prices, as their cost of production was relatively higher. The use of coconuts for the manufacture of coconut oil rose due to high international prices resulting from the ban on palm oil exports by Indonesia. Export prices of coconut oil increased by 31 per cent in 1998, to US dollars 1.15 per kg. Export earnings of coir fibre based products, mainly coir fibre mattresses, increased by 13 per cent in 1998. However, local coir producers faced difficulties, as raw material prices were much higher than those of competing countries. Since Sri Lanka produces the finest coir in the world market, producers were able to maintain their export levels, but at a lower profit margin.

Other Agricultural Products

Earnings from other agricultural products increased by 18 per cent mainly due to a substantial increase in prices (18 per cent). Earnings from pepper increased by 94 per cent, benefiting from higher prices and volumes. Demand for pepper from Egypt, India, Pakistan, the UK and USA increased substantially. Cinnamon exports rose by 8 per cent, attributable to a 23 per cent increase in prices, despite the decline in volumes. The volume of un-manufactured tobacco rose by 43 per cent despite depressed prices, due to higher demand from the UK, Italy and Spain. These three products together contributed 68 per cent of the total earnings from other agricultural products. Earnings from fresh and dry fruit declined by 41 per cent. Reduced earnings were due to a more than 87 per cent decline in the volume of tamarind, largely exported to Pakistan, which accounted for 67 per cent of the total volume of fresh and dried fruits exported in 1997. Exports of all other agricultural products, except betel leaves, cashew nuts and cloves, recorded increases.

Mineral Products

The export earnings from all mineral products decreased by 33 per cent and contributed only 1 per cent to exports in 1998 owing to lower earnings from precious and semi-precious stones (34 per cent). The demand for gems was adversely affected by the continued depression in the Japanese gem and jewellery market. Gems exported to Thailand, Taiwan, Singapore and Malaysia too declined substantially. Accordingly, export volumes of precious stones declined by 24 per cent in 1998, as against a marginal drop in 1997. The USA and UK markets for precious and semi-precious stones have been stable for low value products. On the supply side, the problems that the Gem and Jewellery Authority had with the plantation companies relating to sharing proceeds from auctions of the leases of land for gem mining were resolved in March 1998. As a result, legal mining increased. However, illegal mining was still high due to the problems associated with leasing state lands for mining. The entry of new producing countries such as Tanzania, Vietnam and Madagascar to the world market may also have increased the competition in this industry. These new entrants may have taken some of the major buyers away from Sri Lanka, particularly Thai merchants from the 'Geuda' market. Earnings from other mineral exports fell by 30 per cent due to lower earnings from metallic ores and iron pyrites, ilmenite and other mineral products. However earnings from natural graphite grew, containing the decline in the mineral sector export earnings.

9.3 Imports

Total outlay on imports increased marginally by 0.5 per cent compared to the 8 per cent growth recorded in 1997. This slow growth was a result of an 11 per cent drop in average import prices and a 12 per cent growth in volumes. The falling international commodity prices (sugar, wheat, fertiliser and crude oil) and many intermediate and investment good prices contributed to the fall in import prices. Outlay on of food and drinks declined by 7 per cent reflecting mainly the partial recovery in rice production, lower international prices of wheat and sugar, a lower volume of sugar imports in comparison to the exceptionally high volume of imports in 1997 following the generous duty waivers and tax exemptions enjoyed by this commodity at that time. The duty waiver on sugar was reduced from 17 per cent to 10 per cent for a period of five months from 11 August 1997, and this was changed to a duty waiver based on a specific duty rate of Rs. 3.50 per kg. from 16 January 1998. Outlay on wheat declined by 8 per cent entirely due to lower international prices. The volume of wheat imports increased

TABLE 9.4
End-Use Classification of Imports

Category	US Dollars Million					Rs. Million				
	1994	1995	1996	1997	1998(a)	1994	1995	1996	1997	1998(a)
1. Consumer Goods	1,048	1,181	1,234	1,223	1,255	51,810	60,508	68,372	72,062	80,956
Food and Drinks	602	720	801	781	723	29,739	36,901	44,377	45,996	46,543
Rice	13	2	91	73	42	655	122	5,118	4,331	2,621
Sugar	180	170	145	184	129	8,875	8,737	8,026	10,788	8,384
Wheat	118	198	204	139	127	5,825	10,155	11,267	8,128	8,133
Other	291	349	361	385	425	14,384	17,887	19,966	22,749	27,405
Other Consumer Goods	447	461	433	442	532	22,071	23,607	23,995	26,066	34,413
2. Intermediate Goods	2,307	2,702	2,767	3,096	2,977	114,004	138,475	153,117	182,754	192,240
Petroleum	296	387	479	539	345	14,641	19,827	26,525	31,828	22,275
Fertiliser (b)	63	86	76	66	62	3,097	4,406	4,189	3,916	3,989
Chemicals	121	143	134	136	143	5,975	7,310	7,402	8,024	9,241
Textiles and Clothing	1,038	1,159	1,168	1,386	1,397	51,299	59,375	64,601	81,816	90,099
Other Intermediate Goods	789	928	910	969	1,030	38,992	47,557	50,400	57,170	66,636
3. Investment Goods	1,366	1,189	1,204	1,325	1,477	67,524	60,916	66,647	78,232	95,322
Machinery and Equipment	559	503	649	742	786	27,635	25,769	35,987	43,853	50,592
Transport Equipment	454	304	179	208	264	22,425	15,564	9,885	12,276	17,098
Building Materials	241	272	263	272	303	11,898	13,956	14,540	16,030	19,590
Other Investment Goods	113	110	113	103	124	5,566	5,627	6,235	6,073	8,042
4. Unclassified Imports	45	240	234	220	182	2,238	12,301	12,940	12,978	11,757
Total Imports (c)	4,767	5,311	5,439	5,864	5,891	235,576	272,200	301,076	346,026	380,275

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) From 1997 onwards Customs data on fertiliser have been used instead of data obtained from Ceylon Fertiliser Co. Ltd. & other major importers of fertiliser.
(c) Adjusted.

consumer goods grew by 4 per cent while intermediate goods declined by 4 per cent, due to lower outlay on fertiliser, petroleum products and diamond imports. However, excluding petroleum products, intermediate good imports grew by 3 per cent. Import of investment goods grew by 11.5 per cent largely due to growth in machinery and equipment and transport equipment. Monthly import volumes fluctuated within the year showing seasonal increases just preceding the festival seasons in April and December due mainly to increases in volumes of food and consumer durables.

Consumer Goods

Positive growth in the consumer goods category was entirely due to the significant increase in durables. Outlay on imports by 11.5 per cent to 879,500 metric tons, while 46,283 metric tons of wheat flour were imported too. Expenditure on rice imports declined by 42 per cent entirely due to the lower quantity imported following the improved harvest in Maha 1998. Of the 167,600 metric tons of rice imported during the period under review, 125,200 metric tons were imported in January 1998, when the full duty waiver was effective, signifying the reaction of the market to duty waivers. The full duty waiver on rice was available for the period 20 November 1997 to 31 January 1998. All other food imports increased by 10 per cent, with substantial increases in milk products, wheat flour, dried and other fish, chillies and potatoes.

In the durable consumer goods category, imports of motor cars and motor cycles increased by 55 per cent, while imports of rubber tyres and tubes declined by 2 per cent reflecting the higher utilisation of locally produced goods. Imports of radio receivers and television sets grew by 2 per cent. Medical and pharmaceutical products imports rose by 17 per cent due to higher prices. Other consumer durable imports that increased in 1998 were printed books, electrical home appliances and clothing accessories.

TABLE 9.5

Volumes of Major Imports (a)

'000 MT

Item	1994	1995	1996	1997	1998(b)
Rice	58	9	341	306	168
1st Quarter	37	8	1	104	136
2nd Quarter	12	...	23	9	12
3rd Quarter	5	...	117	12	2
4th Quarter	4	1	201	181	18
Wheat	826	1,057	913	789	880
1st Quarter	178	315	201	302	340
2nd Quarter	259	213	303	172	155
3rd Quarter	222	323	157	168	126
4th Quarter	168	206	252	147	259
Sugar	491	417	381	545	444
1st Quarter	127	133	94	176	79
2nd Quarter	147	76	84	163	129
3rd Quarter	134	95	58	83	99
4th Quarter	83	113	146	123	137
Petroleum (Crude Oil)	1,898	1,860	2,033	1,814	2,156
1st Quarter	503	332	566	299	567
2nd Quarter	547	452	493	389	431
3rd Quarter	364	584	466	606	662
4th Quarter	484	492	508	520	496
Fertiliser	427	452	361	391	440
1st Quarter	99	185	104	56	109
2nd Quarter	159	97	60	87	98
3rd Quarter	71	56	53	87	82
4th Quarter	97	115	144	161	151

(a) Adjusted.
(b) Provisional

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

Intermediate Goods

Expenditure on intermediate goods declined by 4 per cent, largely due to lower international prices which negated the positive growth in import volumes. Outlay on fertiliser imports decreased by 7 per cent entirely due to lower prices. Lower prices and the build up of domestic stocks contributed to high volumes imported in 1998. The volume of textile imports grew by 10 per cent but lower prices helped to slow down the growth in outlays on such imports. Hence, the import bill on textiles increased by only 1 per cent. Outlay on crude oil dropped by 18 per cent in contrast to the higher volume of imports. Prices of crude oil declined from US dollar 19.42 per barrel to US dollar 13.63 per barrel between the two periods. Other petroleum products declined by 53 per cent attributable to lower prices as well as the lower quantity of imports as against higher volumes of refined petroleum products imported in early 1997 to meet the additional demand due to the temporary routine closure of the refinery. Non-petroleum intermediate goods imports increased by 3 per cent. Diamond imports declined substantially reflecting the setback in the diamond industry. Chemicals increased by 5 per cent. Other intermediate goods imports increased by 6 per cent, largely attributable to imports of inputs for the food, soap, livestock and rubber based manufacturing industries.

Investment Goods

Import outlays on investment goods increased by 12 per cent in 1998 in comparison to 10 per cent in 1997. These imports increased at a higher rate during the first five months of 1998 but slowed down thereafter. The average growth rate for the first five months was 23 per cent. Reflecting an immediate response to the generous incentive package provided by the 1998 Budget for the agriculture, transport, textile and garments and telecommunication sectors, imports of machinery and equipment and transport equipment increased during the first two months by 44 per cent and 20 per cent, respectively. A duty waiver too was available for large commercial organisations to import buses and coaches for providing transportation to their employees.

Investment goods imports also continued to benefit from lower international prices, reflected in an 8 per cent drop in the unit value index. Accordingly, the volume growth in the investment good category was as high as 21 per cent. This growth was predominantly in garment and textile machinery, data processing machines, tractors, telecommunication equipment and construction related imports, signifying the continuation of the momentum of investment growth seen since 1997 in those sectors. Transport equipment imports increased by 27 per cent, attributable to higher imports of passenger transport vans and buses, particularly buses with a seating capacity of 30 or more, refrigerated trucks, chassis and other parts and accessories for motor vehicles. Building material imports increased by 12 per cent, reflecting continued growth in the construction industry related to expansion of commercial infrastructure as well as real estate development.

Direction of Trade

The USA continued to be the largest single buyer of Sri Lanka's exports in 1998. Its market share increased from 36 per cent in 1997 to 40 per cent in 1998, largely due to increased garment exports. Garment exports to the USA increased by 12 per cent during the year. The UK, the second largest buyer, accounted for 11 per cent, while Germany over took Japan and became the third largest buyer, accounting for 5 per cent of Sri Lanka's exports, mainly due to higher garment exports. As a result, the industrialised countries, taken together as a group, accounted for 74 per cent of the total exports in 1998 as against 73 per cent in 1997. Exports to East Asian countries declined by 23 per cent in 1998. However, increased exports to Middle East countries offset this decline to maintain the market share of developing countries at 21 per cent as in the previous year. Exports to CIS countries declined by 13 per cent due to lower tea exports to Russia. The heavy concentration of Sri Lanka's exports to Western industrial countries made them, as a group, Sri Lanka's largest trading partner.

Japan regained its position as the largest single supplier of imports to Sri Lanka, displacing India, which had been the largest supplier since 1996. Imports from Japan rose by 16 per cent, while those from the USA and UK increased by 23 per cent and 8 per cent, respectively, enhancing the industrialised countries' share from 35 per cent to 37 per cent. Imports from Middle East countries declined by 29 per cent, reducing their market share from 9 per cent to 6 per cent, largely due to the price effect of petroleum imports. However, imports from East Asian countries increased by 7 per cent, broadening the trade deficit with these countries.

9.4 Services and Income

The services account registered a surplus of US dollars 143 million in 1998. This was a lower surplus compared to US dollars 159 million 1998, and reflected the slowing down in the port-related services. Net receipts from transportation services dropped by 12 per cent in 1998 owing to a marginal increase in receipts (3 per cent) against a faster growth (13 per cent) in payments. Slow growth in import and export trade and a decline in transshipment cargo handled led to a slower growth in receipts from port related services, while increased freight charges were partly responsible for higher payments in transportation services. Tourist arrivals during the early months of 1998 were affected due to both the uncertain security situation arising from terrorist attacks in February and March and the depressed global economic conditions, particularly in the East Asian region. Competition from countries in the East Asian region also had an impact on tourist arrivals during the year. However, tourist arrivals reflected a recovery in the last quarter of the year with a significant increase of 16 per cent. This contributed to an overall growth of 4 per cent in 1998, resulting in a 10 per cent growth in receipts from travel. Travel payments rose by 12 per cent, leading to a marginal drop in net travel receipts. This was due to an increased number of Sri Lankans travelling to cheaper destinations in the Asian region for pleasure, as well as business purposes.

The income account, which consists of interest income, foreign direct investment income and compensation payments to employees (according to the BPM5 presentation), showed a larger deficit of US dollars 179 million in 1998 in comparison to US dollars 160 million in 1997. This was entirely due to lower foreign investment income of the Central Bank owing to a reduction in foreign exchange trading activities abroad in a volatile international investment climate and a reduction of international interest rates. Total outflows in the income account remained around the same level as last year.

TABLE 9.6

Net Services, Income and Transfers (a)

ITEM	US Dollars Million		Rs. Million	
	1997	1998(b)	1997	1998(b)
1. Transportation	156	137	9,194	8,836
2. Travel	29	28	1,728	1,826
3. Insurance Services	10	16	578	1,011
4. Other Business Services	-29	-29	-1,723	-1,889
5. Government Expenditure n.i.e.	-6	-9	-392	-583
Total Services	159	143	9,386	9,201
1. Compensation of Employees	-2	-2	-91	-99
2. Direct Investment	-75	-89	-4,424	-5,747
3. Other (c)	-83	-88	-4,902	-5,621
Total Income	-160	-179	-9,417	-11,468
1. Private (d)	788	848	46,494	54,843
2. General Government	44	55	2,625	3,490
Total Current Transfers	832	903	49,119	58,333

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) From 1994 onwards Foreign Currency Banking Units (FCBUs) of commercial banks have been treated as a part of the domestic banking system in the compilation of balance of payments statistics. Accordingly, transactions involving FCBUs and non-resi dents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded. For details please see the technical note on "Redefining FCBU Transactions in the Compilation of Balance of Payments Statistics" in Box 8

(d) Includes US dollars 64 mn. and US dollar 78 mn. received in 1997 and 1998 as compensation of US dollars 2,500 per person to 26,101 and 31,279 Sri Lankans, respectively, who lost employment in Kuwait due to the Gulf War in 1990

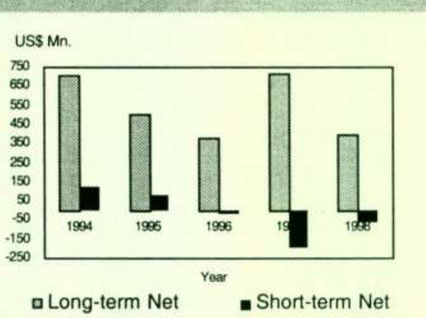
9.5 Current Transfers

Following the same upward trend seen in the previous year, net current transfers further rose significantly by 8 per cent entirely due to private transfer receipts, which increased by 8 per cent during 1998. Both worker remittances and compensation payments rose. A sum of US dollars 78 million was received as compensation payments, at the rate of US dollars 2,500 per worker, by 31,279 Sri Lankan employees who were displaced from Kuwait during the Gulf War in 1990. Net transfer receipts increased by 8 per cent to US dollars 848 million in 1998, which was sufficient to finance 70 per cent of the deficit in the goods, services and income account in 1998, compared with a 64 per cent coverage in 1997. Official current transfers, which consist mainly of food and commodity grants, increased by 25 per cent to US dollars 55 million in 1998. In 1998, India also contributed US dollars 25 million as a special cash grant for budgetary purposes.

9.6 Capital Movements

The capital and financial account registered a net inflow of US dollars 395 million, reflecting a decline of 34 per cent compared with the 6 per cent increase recorded in 1997. As a result, the surplus in the overall balance declined to US dollars 37 million in 1998 from US dollars 163 million in 1997.

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

(b) Beginning 1994 Foreign Currency Banking Units (FCBUs) have been treated as part of the domestic banking system

Capital Transfers

Net capital transfers declined to US dollars 65 million in 1998 from US dollars 91 million in 1997. Reflecting the general reduction in the flow of concessional aid to developing countries, the grant component of foreign aid has been declining in the case of Sri Lanka too. Official project grants declined by 34 per cent. Japan continued to be the major donor, contributing 67 per cent of total grants during the year.

Long-Term Capital

Net inflows of private long-term investment recorded a 58 per cent decline to US dollars 200 million, mainly due to lower privatisation proceeds and increased outflows of other private long-term funds. Efforts to reform public enterprises with private sector participation continued and inflows of foreign exchange through this programme in 1998 were US dollars 56 million, compared with US dollars 301 million in 1997. The proceeds in 1998 were from the sale of the government's duty free shop, Orient Lanka Ltd. (US dollars 11 million) and the sale of a 26 per cent equity stake in Air Lanka Ltd. (US dollars 45 million) to Emirates. Long-term outflows increased by 39 per cent, partly due to advance payments by Air Lanka Ltd towards purchase of aircraft in 1999 and 2000 under its proposed refleeting programme. The expansion plan for the national carrier includes more destinations and greater frequency of flights. This is to be facilitated by the medium-term refleeting programme. Plans are underway to purchase 6 aircraft over the next two year period. Other large inflows during the year were US dollars 65 million raised by DFCC Bank through the Floating Rate Notes issue (for which the principal amount is guaranteed by the Asian Development Bank and the interest payments guaranteed by the Government of Sri Lanka) and several loans, totalling US dollars 43 million, raised by Sri Lanka Telecom Ltd. for financing their development projects. Foreign direct investment flows were somewhat higher than in 1997. The largest share of FDI flows during the year were to the telecommunication (55 per cent), power (19 per cent) and rubber manufacturing (6 per cent) sectors. Investment outflows were mainly in respect of a tourism project in the Maldives.

The net inflows of long-term capital to the government decreased by 17 per cent due both to higher loan repayments and lower disbursements of non-concessional loans during the year. Inflows of concessional loans to the government from both multilateral and bilateral sources increased by 40 per cent to US dollars 466 million. Sectors which received significant concessional financial flows during the year were power generation, water resources development, health, telecommunications and rural development. The major multilateral donors were the Asian Development Bank (ADB) and the International Development Association (IDA), which extended US dollars 117 million and US dollars 91 million, respectively, of concessional assistance during 1998, indicating a growth over 1997 of 23 per cent and 16 per cent, respectively. Japan continued to be the major aid donor to Sri Lanka. Aid disbursements from Japan increased to US dollars 189 million in 1998 from 118 million in 1997. Aid from Japan accounted for 41 per cent of the total aid receipts in 1998 compared to 36 per cent in 1997.

Short-Term Capital

Short-term private capital inflows increased by 54 per cent to US dollars 768 million in 1998, mainly due to a decline in commercial bank assets abroad, while payments rose by 19 per cent to US dollars 832 million.

Inflows of portfolio investment declined by 50 per cent to US dollars 70 million in 1998. Depressed global stock markets and particularly the impact of the Asian crisis affected the Colombo stock market, resulting in a net sale by foreign participants. The stock market performance was further dampened after the nuclear testing by India and Pakistan in May 1998 further raising uncertainties about the Asian region among international investors. Consequently, a net outflow was recorded in portfolio investment in 1998, compared with a net inflow in 1997. Other private short-term flows turned to a net inflow in 1998 in contrast to the net outflow recorded in 1997, mainly due to lower repayments by the Ceylon Petroleum Corporation to non-FCBU foreign sources of short-term financing.

Changes in assets and liabilities of commercial banks in the financial account were largely influenced by the changes in deposits and advances of their Foreign Currency Banking Units (FCBUs). A decline in the external borrowings of FCBUs resulted in a decline in commercial bank liabilities by US dollars 228 million, while assets of commercial banks also declined by US dollars 180 million, mainly due to a drop in FCBU deposits with banks abroad.

9.7 Exchange Rate Movements

The uncertain and volatile conditions observed in international exchange markets during the latter part of 1997 continued in early 1998, with a tendency to stabilise towards the latter part of the year. Except for the Indonesian rupiah, all other currencies in the region that were severely affected by the currency turbulence in East Asia in 1997 recovered during 1998. The rupiah continued to depreciate, by 31 per cent, against the US dollar during the year against a backdrop of both economic and political uncertainties. With the regaining of some market confidence following stringent reform efforts, other currencies appreciated; the Korean won (42 per cent), the Thai baht (29 per cent), the Philippine peso (3 per cent), the Malaysian ringgit (2 per cent) and the Singapore dollar (1 per cent). Meanwhile, the Japanese yen appreciated against the dollar by 13 per cent in response to initiatives undertaken to address issues in the financial sector. The uncertainties in the international exchange markets were renewed with the rouble crisis in the Russian Federation and the financial sector problems in Brazil during the latter part of the year.

Chart 9.6
Effective Exchange Rate Indices

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

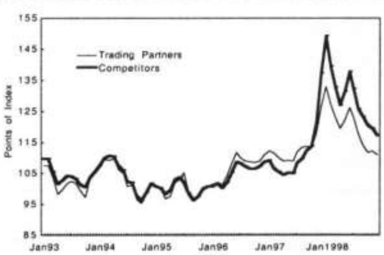


Chart 9.6.2
Nominal Effective Exchange Rate Indices
(1995 = 100)

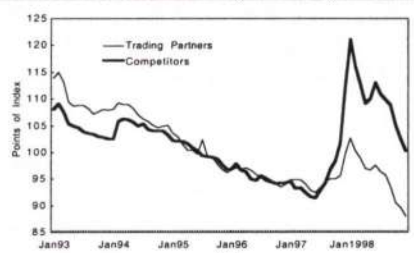


TABLE 9.7
Exchange Rate Movements

Currency	In Rupees per unit of Foreign Currency						Percentage Change over Previous Year(a)			
	End of Year Rates			Annual Average			Point to Point		Annual Average	
	1996	1997	1998	1996	1997	1998	1997/96	1998/97	1997/96	1998/97
Deutsche Mark	36.46	34.24	40.36	36.75	34.07	36.80	6.5	-15.2	7.8	-7.4
French Franc	10.81	10.23	12.03	10.81	10.12	10.98	5.6	-14.9	6.8	-7.8
Indian Rupee	1.58	1.56	1.59	1.56	1.63	1.57	1.3	-1.3	-4.5	3.8
Japanese Yen	0.49	0.47	0.59	0.51	0.49	0.50	3.6	-20.3	4.1	-1.6
Pound Sterling	95.86	101.60	112.62	86.34	96.69	107.05	-5.6	-9.8	-10.7	-9.7
US Dollar	56.71	61.29	67.78	55.27	58.99	64.59	-7.5	-9.6	-6.3	-8.7
SDR	81.38	82.69	95.44	80.23	81.17	87.66	-1.6	-13.4	-1.2	-7.4

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

Source: Central Bank of Sri Lanka.

Sri Lanka continued to manage its exchange rate flexibly. The exchange rate policy adopted by Sri Lanka has proven to be effective in helping the export sector and maintaining exchange market stability. The Sri Lanka rupee depreciated by 9.6 per cent against the US dollar, reflecting a faster depreciation during 1998 than in the previous year. Meanwhile, the Sri Lanka rupee depreciated by 13.4 per cent against the SDR reflecting the significant depreciation of the US dollar against most major currencies during the year. Overall, the Sri Lanka rupee had depreciated by 13 per cent against the US dollar since the currency turmoil in East Asia erupted in early July 1997. This compares with depreciation of the Indonesian rupiah by 69 per cent, the Malaysian ringgit by 34 per cent, the Philippines peso by 33 per cent, the Thai baht by 30 per cent, the Korean won by 25 per cent and the Singapore dollar by 14 per cent during the same period.

The Nominal Effective Exchange Rate (NEER) index for Sri Lanka with a basket of 24 currencies representing both trading partners and competitors reflected a depreciation of 12 per cent during 1998. Meanwhile, the Real Effective Exchange Rate (REER) index, i.e., the NEER adjusted for estimated inflation differentials between Sri Lanka and its trading partners and competitors, depreciated by 12 per cent.

9.8 External Assets

Sri Lanka's gross external assets at the end of 1998 stood at US dollars 2,907 million, compared with US dollars 3,132 million at the end of 1997. Gross foreign assets of the Central Bank declined by 2 per cent at end 1998. Gross external assets of commercial banks declined from US dollars 1,103 million in 1997 to US dollars 923 million, indicating a reduction of investments abroad by FCBUs. Their gross foreign liabilities also declined by a larger amount (US dollars 228 million) as external borrowings by FCBUs declined. Hence, there was an improvement in net foreign assets of the commercial banks by US dollars 48 million. Gross official reserves, comprising foreign assets held by the Central Bank and the government, declined by US dollars 45 million to US dollars 1,984 million during 1998. However, there was a larger decline in gross official short-term liabilities which include the repayments to the IMF of US dollars 83 million and the settlement of ACU

Chart 9.7
Quarterly External Assets

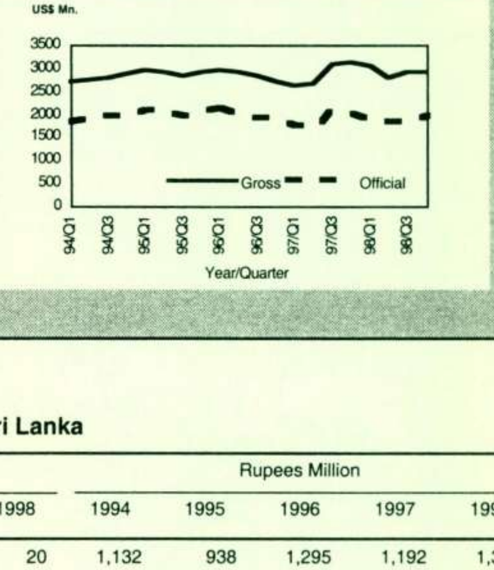


TABLE 9.8
External Assets of Sri Lanka

Ownership	US Dollars Million(a)					Rupees Million				
	1994	1995	1996	1997	1998	1994	1995	1996	1997	1998
1. Government (b)	23	17	23	19	20	1,132	938	1,295	1,192	1,372
2. Government Agencies	0	0	0	0	0	0	0	0	0	0
3. Central Bank (c)	1,999	2,046	1,915	2,009	1,964	99,859	110,521	108,506	123,093	132,900
4. Total Official Assets	2,022	2,063	1,937	2,029	1,984	100,991	111,459	109,800	124,286	134,272
5. Commercial Banks (d)	853	839	780	1,103	923	42,607	45,338	44,211	67,596	62,561
6. Total External Assets	2,874	2,902	2,717	3,132	2,907	143,598	156,797	154,011	191,881	196,833
7 Gross Official Assets in Months of										
7.1 Merchandise Imports	5.1	4.7	4.3	4.2	4.0					
7 2 Import of Goods and Services	4.5	4.1	3.8	3.7	3.6					
8 Total Assets in Months of										
8.1 Merchandise Imports	7.2	6.6	6.0	6.4	5.9					
8 2 Import of Goods and Services	6.5	5.8	5.3	5.7	5.2					

(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	1994	1995	1996	1997	1998
Rs per US Dollar	49.98	54.05	56.71	61.29	67.78

Source: Central Bank of Sri Lanka.

(b) Figures since 1985 have been revised to include the DST's Special Revolving Credit Balances

(c) Figures since 1993 have been revised to include foreign currency deposits of commercial banks maintained with the Central Bank as reserve requirement on their foreign currency deposits.

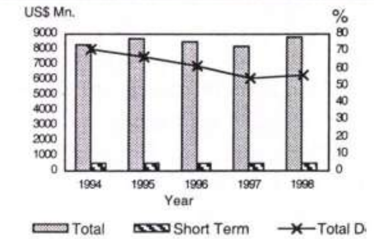
(d) Since 1994 Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system, rather than as off-shore units, in the compilation of balance of payments statistics. Accordingly, external assets of commercial banks have been revised to include balances held by FCBUs with non-residents and to exclude placements by domestic commercial banks with FCBUs. (see technical note on "Redefining FCBU Transactions in the Compilation of Balance of Payments Statistics in Box 8) balances. As a result, the net official reserves improved by US dollars 37 million, resulting in an overall surplus in the balance of payments by that amount. Total external assets at the end of 1998 were sufficient to finance 5.9 months of imports for 1998, while gross official reserves were sufficient to finance 4 months of the same year imports.

9.9 External Debt

The total external debt of Sri Lanka increased to US dollars 8,753 million at the end of 1998 from US dollars 8,197 million in 1997. Over 85 per cent of the increase was due to exchange rate variations, in particular, the strengthening of the Japanese yen against the US dollar. Medium and long-term debt accounted for 94 per cent of the total debt stock, consisting mainly of concessional assistance received from the ADB, Japan and the International Development Association (IDA). Total debt outstanding to the IMF declined by 15 per cent in dollar terms during the year to US dollars 367 million.

Government debt accounted for about 79 per cent of the total debt stock. The outstanding government guaranteed debt of public corporations and the private sector rose by 8 per cent to US dollars 724 million in 1998, mainly due to the US dollars 65 million Floating Rate Note issue raised by DFCC Bank. The external debt to GDP ratio rose to 56 per cent in 1998 from 54 per cent in 1997. Short-term debt outstanding at the end of the year reflected an increase of

Chart 9.8
External Debt



(a) Beginning 1994 Foreign Currency Banking Units (FCBUs) have been treated as part of the domestic banking system

TABLE 9.9
Disbursed and Outstanding External Debt (a)

Item	US Dollars Million					Rupees Million				
	1994	1995	1996	1997	1998(b)	1994	1995	1996	1997	1998(b)
1. Medium and Long-term Debt	7,788	8,152	7,988	7,719	8,266	389,232	440,570	452,944	473,043	560,279
1.1 Government (c)	6,216	6,637	6,554	6,346	6,897	310,665	358,710	371,648	388,925	467,477
1.2 Public Corporations and Private Sector with Government Guarantee (c)	696	640	637	670	724	34,802	34,582	36,098	41,061	49,052
1.3 Public Corporations and Private Sector without Government Guarantee (c)	261	279	267	270	278	13,027	15,066	15,144	16,521	18,854
1.4 IMF Drawings	615	596	530	433	367	30,738	32,212	30,054	26,536	24,896
2. Short-term Debt	510	542	498	478	487	25,487	29,309	28,262	29,323	33,001
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 (c),(d)	510	542	498	478	487	25,487	29,309	28,262	29,323	33,001
3. Total Debt(1+2)	8,298	8,694	8,486	8,197	8,753	414,719	469,879	481,206	502,366	593,280
MEMORANDUM ITEMS										
Medium and Long-term Debt										
(1) Project Loans	4,218	4,594	4,654	4,530	5,160	210,818	248,296	263,918	277,637	349,738
(2) Non-Project Loans	1,835	1,871	1,724	1,612	1,641	91,719	101,137	97,745	98,788	111,221
(3) Suppliers' Credits	161	256	239	343	251	8,051	13,837	13,537	21,015	17,020
(4) IMF Drawings	615	596	530	433	367	30,738	32,212	30,054	26,536	24,896
(5) Other Loans (e)	959	834	841	801	847	47,907	45,088	47,690	49,067	57,405
Total Debt as a percentage of GDP	70.8	66.7	61.1	54.3	55.6	71.6	70.4	62.6	56.4	58.4
Short-term Debt as a percentage of GDP	4.4	4.2	3.6	3.2	3.1	4.4	4.4	3.7	3.3	3.2
Short-term Debt as a percentage of Total Debt	6.1	6.2	5.9	5.8	5.6	6.1	6.2	5.9	5.8	5.6

Sources: Central Bank of Sri Lanka
External Resources Dept.

(a) Since 1994 Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system, rather than as off-shore units, in the compilation of balance of payments statistics. Accordingly, disbursed and outstanding external debt data have been revised to exclude FCBU loans to domestic entities as they are considered as domestic transactions under the new definition. Please see the technical note on "Redefining FCBU Transaction in the compilation of Balance of Payments Statistics" in Box 8.

(b) Provisional

(c) Data since 1994 have been revised to incorporate additional information.

(d) Includes acceptance credits of Ceylon Petroleum Corporation and other trade credits.

(e) Includes long-term loans of public corporations and private sector institutions.

2 per cent in US dollar terms, mainly due to borrowings by BOI enterprises and accounted for only 6 per cent of the total debt. These are largely suppliers' credits for raw materials supplied to the export processing industries and trade credits to the Ceylon Petroleum Corporation.

9.10 Debt Service Payments

Total debt service payments, which consist of amortisation of long and medium-term debt and interest payments on all foreign debt, increased marginally by 3 per cent to US dollars 754 million in 1998 due to the combined effect of an increase in amortisation of foreign loans by US dollars 37 million and a drop in interest payments by US dollars 15 million. The increase in amortisation payments was reflected in payments made to the IMF, which rose to US dollars 83 million on account of the Structural Adjustment Facility (SAF) taken between 1988 and 1990 and the Enhanced SAF taken between 1991 and 1994, and to others, which increased to US dollars 384 million. The drop in interest payments could be attributed to a declining global trend in interest rates.

The debt service ratio increased marginally from 13.3 per cent in 1997 to 13.4 per cent in 1998 due to the combined effect of reduced interest payments and a slower growth in export earnings during the year. Debt service payments as a ratio of receipts from goods, services, income and private transfers remained unchanged at 11.0 per cent during the period under review.

9.11 External Trade Environment and Policy

Import and Export Controls

Sri Lanka's external trade and tariff policy has continued to focus on rationalising the trade and tariff system through lowering and simplifying the tariff structure, while progressively reducing quantitative restrictions and removing distortions associated with ad hoc duty waivers and exemptions. The licensing requirements on exports and imports have been limited to a well defined narrow list considered necessary mainly for reasons of national security, public health, environmental protection and domestic producer protection. The import of maize remained under license for reasons of domestic producer protection, while

TABLE 9.10
External Debt Service Payments (a)

Item	US Dollars Million					Rupees Million				
	1994	1995	1996	1997	1998(b)	1994	1995	1996	1997	1998(b)
1. Debt Service Payments	540	764	746	733	754	26,644	38,652	40,953	42,645	48,504
1.1 Amortization	290	452	439	430	467	14,313	22,642	24,007	24,764	29,895
(i) To IMF	13	33	47	66	83	616	1,184	2,314	3,290	5,100
(ii) To Others (c)	277	419	392	364	384	13,697	21,458	21,693	21,475	24,794
1.2 Interest Payments	250	312	307	303	288	12,330	16,011	16,946	17,881	18,609
(i) To IMF	7	8	7	6	6	348	407	409	361	376
(ii) To Others (c)	242	304	300	297	282	11,982	15,604	16,537	17,520	18,233
2. Earnings From Merchandise Exports and Services	3,954	4,627	4,861	5,514	5,648	195,347	237,137	269,159	325,885	365,316
3. Receipts From Merchandise Exports, Services, Income and Private Transfers	4,833	5,644	5,878	6,670	6,861	238,812	289,215	325,420	394,122	443,782
4. Debt Service Ratio (d)										
4.1 As a percentage of 2 above										
(i) Overall Ratio	13.7	16.5	15.3	13.3	13.4	13.6	16.3	15.2	13.1	13.3
(ii) Excluding IMF Transactions	13.1	15.6	14.2	12.0	11.6	13.1	15.6	14.2	12.0	11.8
4.2 As a percentage of 3 above										
(i) Overall Ratio	11.2	13.5	12.7	11.0	11.0	11.2	13.4	12.6	10.8	10.9
(ii) Excluding IMF Transactions	10.8	12.8	11.8	9.9	9.7	10.8	12.8	11.7	9.9	9.7
5. Government Debt Service Payments										
5.1 Government Debt Service Payments (e)	324.1	342.2	378.5	393.4	417.0	15,749	17,888	20,947	24,060	26,063
5.2 As a percentage of 1 above	60	45	51	54	55	59	46	51	56	54

Source: Central Bank of Sri Lanka.

(a) Since 1994 Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system, rather than as off-shore units, in the compilation of balance of payments statistics. Accordingly, external debt service payments have been revised to exclude those payments by domestic entities to FCBUs as they are considered as domestic transactions under the new definition. Please see the technical note on " Redefining FCBU Transactions in the Compilation of Balance of Payments Statistics" in Box 8
(b) Provisional
(c) Data since 1994 have been revised to incorporate additional information.
(d) Debt service ratios calculated in rupee values and US dollar values differ due to variations in exchange rates during the year.
(e) Excludes IMF transactions

rice 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 1998 in order to fulfil the contractual obligations between the government and Prima Ceylon Ltd., a milling company. Some restrictions that had existed hitherto were relaxed, including the enhancement of the upper limit on advance payment for imports, from US dollars 3,000 to US dollars 7,500, by way of amendments made to the Import and Export Control Act No. 1 of 1969, with effect from 8 April 1998. During the year, selected parts of motor vehicles were brought under import licence. The licence requirement on three year of age diesel engines of cubic capacity less than 3,250 was revised to five year old engines. Importers had been required to obtain licences for imports of vehicles over 5 years old in the past. However, certain categories of motor vehicles less than 7 years of age, used for goods transportation, were permitted to be imported without licence requirement for a period of four and a half months from 17 November 1998. This decision is not in keeping with the present policy direction as it amounts to an ad hoc policy change. In summary, about 300 items out of about 6,000 items at the 6 digit level of the Harmonised System Code (HSC) remained under import licence at end 1998.

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, continued to remain under licence with the objectives of environmental protection and preservation of antiques.

Tariffs and Taxes on External Trade

Sri Lanka's tariff policy continued to focus on stimulating export led growth by implementing measures conducive to enhancing the competitiveness of exports within the framework of a simple and transparent tariff structure with lower rates and to improve the Customs administration with a commitment to reform the prevailing system to facilitate international trade and commerce to meet the challenges in the next millennium. In this context, the Presidential Trade and Tariff Commission (PTTC), which was appointed by the government in 1997 to study and recommend appropriate changes to the tariff structure, made its recommendations in July 1998. The PTTC recommended reduction of the prevailing tariffs and a move towards a two band tariff system in two stages. In line with these recommendations, the three band tariff system with 10, 20 and 35 per cent rates for imports, which had been effective since February 1995, was replaced with a three band tariff system of 5, 10 and 30 per cent with effect from 6 November 1998. All industrial raw material and machinery not manufactured in Sri Lanka are classified under the 5 per cent band. Further consolidation of the tariff structure to a two band system is expected to commence in the year 2000.

A few items remained outside the three-band tariff system. In line with the present policy direction of rationlisation of the tariff structure to simplify and minimise anomalies, duty on imports of motor cars and jeeps, which were under the duty range of 50-100 per cent, was reduced and unified at 30 per cent. However, to safeguard government revenue targets, an excise duty of 10 per cent was levied. Import duty on crude oil and petroleum products, which had remained outside the three band system since 6 November 1997, was increased from 25 per cent to the upper rate of 30 per cent. To simplify the procedures involved, concessions extended to transport, communication and medical equipment were classified under a zero rate of duty. Import duty on sports items too was removed with the objective of facilitating sports activities in Sri Lanka towards reaching international standards. Import duty on agricultural

TABLE 9.11

Effective Import Duty Collection Rate (a)

tem	1995	1996	1997	1998(b)
Consumer Goods	10.7	10.3	11.7	12.7
Food and Drink	10.1	9.1	11.4	12.6
Rice	38.5	0.3	6.3	2.4
Flour	0.0	2.3	0.0	0.0
Sugar	14.6	15.9	17.8	20.8
Wheat and Meslin	0.0	0.0	0.0	0.0
Milk and Milk Products	11.5	11.5	11.8	11.5
Dried Fish	2.0	2.1	1.6	1.1
Other Fish Products	4.6	4.2	4.9	4.8
Other Food Items	18.7	19.0	17.9	20.5
Non-Food Consumer Goods	11.8	12.6	12.2	12.8
Motor Cars & Cycles	21.7	24.3	24.5	23.6
Radio Receivers- Television Sets	6.9	12.1	11.5	12.4
Rubber Tyres & Tubes	33.6	32.5	33.5	32.0
Medicinal & Pharmaceutical Products	1.5	1.5	1.3	0.9
Other Non-Food Items	11.1	10.6	9.4	10.1
Intermediate Goods	9.1	8.1	5.9	4.7
Fertiliser	0.0	0.0	0.1	0.0
Crude Oil	41.1	33.5	21.7	26.4
Other Petroleum Products	23.4	24.6	18.7	16.7
Chemical Elements and Compounds	9.8	7.6	7.6	5.8
Dyeing, Tanning and Colouring	8.8	8.2	7.1	7.5
Paper and Paper Boards	9.8	6.9	6.0	6.0
Textiles & Clothing	1.0	1.1	0.8	0.1
Other Intermediate Goods	9.2	5.7	5.2	4.8
Investment Goods	10.1	7.6	7.0	6.0
Building Materials	8.7	9.3	9.1	9.3
Transport Equipment	21.6	18.9	17.3	11.8
Machinery and Equipment	6.2	3.9	3.4	3.0
Other Investment Goods	10.1	6.7	6.3	4.4
Total	9.7	8.5	7.7	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

products remained at the present level of 35 per cent to allow the domestic agricultural sector to adjust to a lower tariff regime over the medium term. However, import duty on agricultural seeds and planting material was maintained at a zero level. Only a few items remain under the 20 per cent band, while a limited number of items, namely sugar, tobacco and liquor, were under specific rates outside the three band system.

The number of items on the list of exemptions was increased from 26 to 39 in November 1997 and revised again by removing seeds, fruits, spores and plants imported for planting purposes and gold, rough stones of diamond and diamond powder imported for the jewellery industry from the schedule and introducing certain pharmaceutical products and packing materials used for packing milk, vegetable and fruit juices to the schedule with effect from 6 November 1998. The number of items under the list of exemptions remained at 39. The export sector has continued to be free from all export and ad valorem sales taxes since late 1992, while export cesses and royalties on some items continued to remain in 1998.

The three band turnover tax system, with 8,12 and 18 per cent rates on imports, was replaced by a Goods and Services Tax (GST) with a single moderate rate of 12.5 per cent with effect from 1 April 1998. Under the GST, all exports are zero rated, while exemptions were granted for selected import items including essential food imports. Other than items included in the exemption schedule or under the zero rate of GST, all imports, whether duty free or not, were liable for GST.

In line with the present policy objectives, granting of duty waivers on imports was limited to items essential in the national interest. Towards achieving the objective of minimising distortions in the tariff structure, items on full duty waivers, namely, whole and split lentils (35 per cent band), dried fish, dried sprats and dried prawns, live animals used for breeding purposes and compact fluorescent lamps (10 per cent band) and one item on a partial waiver, canned fish (10 per cent band), were made duty free with effect from 6 November 1998. A partial duty waiver of 10 per cent on milk powder (20 per cent band) too was removed by reclassifying it under the 10 per cent in the tariff schedule itself. A full duty waiver had been provided to vitamins to rectify an anomaly in the tariff schedule and this was included in the exemption list with effect from 6 November 1998.

A full duty waiver (35 per cent band) on rice, which was introduced on 20 November 1997, was removed on 31 January 1998 following the successful Maha harvest. A partial duty waiver of 15 per cent was granted on onions and potatoes for the period of 27 November 1997 to 31 January 1998. A duty waiver of 10 per cent on sugar imports, effective since 11 August 1997, was changed to a specific duty rate of Rs. 3.50 per kg. with effect from 16 January 1998. A partial duty waiver of 20 per cent granted on edible oils other than coconut oil for a period of 18 months from 13 January 1997, was increased to 30 per cent with effect from 18 June 1998. The partial duty waiver of 20 per cent on copra , which had continued since 13 January 1997, remained unchanged. In order to mitigate the effects of a rising cost of living due to high food prices, a full duty waiver on wheat grain (20 per cent) continued throughout the year.

With regard to intermediate goods, a limited number of duty waivers were granted as relief measures. To ensure the availability of raw material for flour based products at reasonable prices, large scale manufacturers are allowed to import wheat flour and a full duty waiver was granted with effect from 21 January 1998. A full duty waiver was granted on shrimp food for the period 24 August 1996 to 23 August 1998, while a full duty waiver was provided for buses with 30 seats or above for a period of one year from 1 January 1998. Coaches with 15 seats and above were provided with a full duty waiver for one year from 16 March 1998 to encourage employers to provide transport facilities to workers. Since 7 May 1997, state electronic media institutions have been provided with a full duty waiver for media equipment in order to enable them to be competitive with private media institutions enjoying BOI status.

All these revisions, together with the removal of duty waivers on power generators, LP gas, petroleum products, cotton yarn in hunk form and live goats, operating in 1997, enabled the government to reduce the revenue foregone due to duty waivers from Rs. 11,550 million in 1997 to Rs. 6,245 million in 1998. The reduction in waivers given on various items to individuals too contributed towards this development. Although these duty waivers and exemptions are supported by objectives of national interest, these ad hoc waivers create uncertainty and hinder the development of an efficient market. Nevertheless, a clear indication of the policy path in the trade and tariff regime towards minimising distortions can be seen in the recent past.

The average import duty rate, i.e., the ratio of import duty collection to total adjusted imports, declined from 7.7 per cent in 1997 to 7.4 per cent in 1998, reflecting decreases in duty rates and dutiable imports. The share of dutiable imports in total imports declined from 37.0 per cent in 1997 to 35.4 per cent in 1998, reflecting the reduction in dutiable imports in the intermediate and investment goods categories. In the intermediate goods category, the average duty rate dropped from 5.9 per cent in 1997 to 4.7 per cent owing to the effect of the duty concessions granted on certain raw materials in the 1998 Budget.

Average duty rates on investment goods too declined in 1998, particularly with regard to transport equipment. This was due to a series of duty concessions offered by the 1998 Budget for the importation of tractors, lorries, prime movers, refrigerated trucks and items for manufacturing tractors, and duty waivers provided to large commercial organisations to import buses and coaches for providing transportation to their employees. As a result, the average duty rate on transport equipment declined from 17.3 per cent in 1997 to 11.8 per cent in 1998.

In the consumer goods category, the average import duty rate rose for both food and drink and non-food consumer goods categories. The increase in the average import duty rate of the food and drink category was mainly reflected in imports of sugar. The impact of the duty waiver reduction on sugar from 17 per cent to 10 per cent on 11 August 1997, which was changed to a specific rate from 16 January 1998, was reflected in significantly higher average duty rates in 1998. Only a very marginal change was seen in the effective rate of non-food consumer goods.

Textile and Garment Quota Allocation

The performance based quota system, introduced in 1995, was continued in 1998. Shipment of products under quota categories is allowed only on proof of payment of EPF and ETF contributions. Priority was given to exporters who made new investments or expanded their existing capacities, in allocating new quota. Immediately after the allocation of performance quota, the remaining quota were allocated under the main pool quota scheme on a pro rata basis of number of employees, and preference was given to exporters to non quota countries and exporters of non quota items to quota countries. The under-utilised categories in the previous year were declared as 'cold' categories and allocated on the condition that shipment would be made within seven working days. The various schemes that have evolved under pool quota systems reflect cumbersome procedures that require close supervision and monitoring to achieve maximum utilisation. Quota administration had been in some disarray in 1998 as quotas to the USA for some items such as men's and boys' jackets and shirts were over utilised and the Textile Quota Board had to take action to avoid the possible imposition of an embargo by the USA government.

Quota availability to the USA, the EU and Canada rose by 3 per cent, 13 per cent and 8 per cent, respectively, under the flexibility provisions. Accordingly, overall quota availability increased by 5 per cent in 1998. The overall quota utilisation rate remained at around 74 per cent as in the previous year. The utilisation of quotas varied widely across different categories and countries. The under utilisation was partly due to insufficient demand for particular items and local producers used their capacity to produce high value added garments under other quota categories or to produce non quota garments. This was evident from the increased garment exports by the non-quota garment sector, and over utilisation of some popular categories to the USA and Canadian markets. Quota utilisation increased significantly for certain items such as men's and boys' jackets, men's and boys' shirts, women's and girls' coats and dresses, shirt and blouses, women's and girls' suits, and shirts, nightwear, dressing gowns, coats and trousers. To the same market, allocation and utilisation were higher than in 1997 for other items such as skirts and towels. At the same time, even though the quota availability was raised for certain items, 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. In spite of the 9 per cent growth recorded in garment exports to quota countries, the share of garment exports under the quota system declined from 63 per cent in 1996 to 62 per cent in 1997. Exports under quota to the USA declined from 88 per cent in 1996 to 83 per cent in 1997, while quota shares to the EU and Canada remained at 28 per cent and 87 per cent, respectively.

Quotas continued to be an important regulator of trade in textiles and garments. Until quotas are fully phased out in 2005 under the Uruguay Round Agreement on Textiles and Clothing, optimal utilisation of quotas needs to be ensured to reap the full potential benefits under the existing framework. Hence, the quota administration needs to be done efficiently. Although market based quota distribution through auctioning of quotas would have produced better results in terms of quota utilisation, various other objectives, such as the need to promote new investments, regionalise industries and generate more employment, have entered into the quota administration in Sri Lanka. Although a fundamental change in the quota allocation system may not be necessary, it should be the responsibility of quota administrators to ensure the smooth functioning of the system, so that the growth of the textiles and garments industry and trade will not be interrupted. This is all the more important as the global competition among suppliers has intensified in the context of depressed world market conditions and there needs to be smooth transition to face more intense competition in a quota-free trading environment after 2005.

Incentives to Exporters

During the year 1998, the government implemented various incentives proposed in the 1998 Budget targeting exporters as well as other industrialists. Accordingly, goods needed for the modernisation of agriculture, such as green houses, planting material, packaging material, refrigerated trucks, and requirements for the gem and jewellery industry, such as machinery and equipment and raw material, were exempted from customs duty and the GST.

A BOI incentive structure was provided to encourage investors to set up industries in difficult and most difficult areas by end 1998 to encourage regional industrialisation. In view of the encouraging response from investors, this facility was extended for another year in the 1999 Budget. Thus, exporters who set up their industries before 31 December

1999 in backward areas will be granted BOI incentives such as tax holidays, import duty exemptions on capital goods and raw material and will also be exempt from the provisions of the Exchange Control Act.

The fiscal incentive scheme introduced in the 1996 Budget to encourage investment in new and existing industries to acquire advanced technology was extended for a further period of two years by the 1998 Budget. This scheme allowed duty free imports for new companies investing over Rs 4 million and for existing companies investing over Rs.1 million. The minimum investment requirement for this scheme was eliminated in the 1999 Budget to provide benefits to small industries for importing machinery and equipment. However, the concession on income tax is applicable only to those with a minimum investment of Rs.4 million.

Institutional Support to Exporters

Exporters received institutional support from various traditional export product development authorities, the Export Development Board (EDB), the Sri Lanka Export Credit Insurance Corporation (SLECIC) and other related government institutions. The EDB played a major role in promoting non-traditional exports through its programmes on entrepreneur development, product development, market promotion, providing trade related information, granting financial assistance and making recommendations on related economic policy issues to the government. Institutional support for traditional exports such as tea, rubber and coconut was provided by the development authorities of the respective products. The SLECIC granted credit insurance and guarantee services. Other relevant institutions, especially the Ministry of Internal and International Commerce and Food (MIICF) and the Ministry of Foreign Affairs, educated exporters on facilities available through bilateral, regional and multilateral organisations and were instrumental in establishing contacts between Sri Lankan exporters and foreign counterparts. Business organisations in Sri Lanka, such as Chambers of Commerce, also provided institutional support to exporters.

Under its technical and skills development programmes the EDB conducted 63 programmes including product specific seminars and general workshops. The EDB provided assistance to exporters to participate in several international trade fairs for products such as coir goods, gems and jewellery, organic tea, spices, essential oils, herbs, cashew nuts, garments, footwear, fruits, vegetables, floriculture, light engineering goods and handicrafts. Confirmed orders to the value of Rs.241 million (0.1 per cent of exports in 1998) were secured by the exporters as those trade fairs. Under the Export Processing Village (EPV) programme, the EDB continued to assist the Dambadeniya, Polgahawela and Tissamaharama EPVs. The EDB provided financial assistance totalling Rs.216 million to 270 exporters under three development programmes, namely, the 200 garment factory programme, the incentive scheme for the handloom textile industry and the agricultural products and rubber products rebate scheme.

To develop export oriented small and medium scale enterprises (SME), the EDB launched several programmes in the Southern, North Western and Central provinces. An exhibition in the Central and North Western provinces organised by the EDB helped SMEs to generate export orders for Rs.2 million. The EDB facilitated the participation of SMEs at other exhibitions such as the 'Jana Nipayum' trade exhibition organised by People's Bank and 'Sri Lanka Intrad '98' an industrial trade and investment exhibition. In addition, the EDB assisted the Federation of Chambers of Commerce and Industry of Sri Lanka to organise the SAARC Trade Fair held in Colombo in September 1998 where more than 300 exhibitors from all SARRC countries participated. In November 1998, the EDB participated in the trade mission to Iraq and organised Sri Lanka's participation at the 31st session of the Baghdad International Trade Fair with the objective of re-introducing Sri Lankan products to the Iraqi market.

The Sri Lanka Export Credit Insurance Corporation (SLECIC) continued to provide export insurance and guarantee services for the development of exports. During 1998, 60 insurance policies were issued for a value of US dollars 7.4 million, which was only 0.15 per cent of total export value. The year 1998 was a particularly difficult year for Sri Lankan exporters as they were hit by the East Asian and Russian currency crises. The SLECIC launched a special insurance policy covering tea exports to Russia on 15 October 1998, at the request of the Ministry of Finance and at the initiative of the Sri Lanka Tea Board. The special cover was for a period of 4 months and was limited to 75 per cent of the loss with a maximum limit of US dollar 15 million. However, the SLECIC issued only 4 policies for a total value of US dollar 2.7 million under this scheme. The SLECIC provided several schemes of guarantees to commercial banks against default risk on financial facilities granted to exporters. Those schemes helped exporters to obtain necessary financing on time. In 1998, the SLECIC issued a total of 66 guarantees for a total value of Rs.142.8 million for pre-shipment credit, post-shipment credit, export production credit and export performance guarantees. The SLECIC continued to issue direct guarantees to assist gems and jewellery exporters participating in trade fairs and exhibitions abroad, under the "Admission Temporarie Admission"(ATA Carnet) system. Under this scheme, exporters were assisted to obtain a standard certificate, which is a temporary admission permit issued by the Sri Lanka National Council of the International Chamber of Commerce (ICC) without any collateral security, which permitted duty free access to foreign exhibitions.

During 1998, the Chambers of Commerce held a number of seminars to enhance awareness on challenges faced by exporters and facilitated business meetings between local entrepreneurs and their foreign counterparts. Further, the Chambers participated in monthly meetings between the Treasury, exporters and Customs and settled many of the problems faced by its members. They maintained data bases on overseas trade inquiries, potential foreign buyers, sellers and agents. During 1998, they issued export documents such as certificates of origin, invoices and phytosanitary certificates. In addition, miscellaneous commercial documents such as quality and weight certificates, agency agreements, radio activity certificates and entrepot certificates of origin were also issued. The Chambers held industrial, trade and investment exhibitions with the aim of creating awareness about Sri Lanka's manufacturing and trading capacity and investment potential.

Freight Rates

Shipping lines covering destinations in Asia such as Singapore, the Arabian Gulf, Dubai, Kuwait and Pakistan have adopted the Freight of All Kind (FAK) system. However, most of the shipping lines covering the UK, North Continent (North European destinations), the Mediterranean, France, Egypt, the USA and Canada adopted a commodity based freight rate system.

During 1998, average shipping freight rates changed significantly. For destinations such as the UK, the North Continent, the Mediterranean, France, Egypt and Syria, average freight rates were higher than in 1997, while for destinations in the Middle East (Dubai, Kuwait, Jeddah), Pakistan and Australia, freight rates were lower.

During the latter part of the year, certain major shipping lines had revised their proposed shipping charges on shipments to Europe and the USA, which they expect to implement with effect from 1 January 1999. According to the proposed rates, an increase of US dollars 1,000 for 40 foot containers to the USA was reported for many shipping lines. To destinations in Europe, an increase of US dollar 400 per container from January 1999 and a further increase of US dollar 300 from April 1999 were proposed.

Freight rates are determined partly by the global demand and supply forces and the degree of competition among shipping lines. In Sri Lanka, local agents implement rates given to them by their principal shipping companies, which mostly operate abroad. Thus, the rates may have an adverse impact on small scale exporters in Sri Lanka. In this light, the Exporters' Association of Sri Lanka (EASL) is strongly opposing rate hikes because of the fear of further erosion of competitiveness. Thus, the situation needs careful study before the negative impact on small scale exporters' competitiveness, as expected by the EASL, is felt.

The controversial Terminal Handling Charges (THC) levied in 1997 continued to generate further distress among exporters. In response to a complaint made by the EASL on this in 1997, the Fair Trading Commission (FTC) made investigations into the matter. The FTC decided that the THC was anti-competitive and the Ceylon Association of Ships' Agents (CASA) was asked to remove the charge. The CASA appealed against the FTC ruling and the case has not been settled yet. Meanwhile, the CASA expects to increase the THC in 1999.

It should be noted that in the affairs of freight, the role of the Central Freight Bureau (CFB) is not clearly defined. Although the CFB provides statistical notes on freight charges, they do not provide any policy guidelines or regulatory services. Clearly, the manpower resources of the CFB could be utilised to address controversial issues on freight.

9.12 Trade Relations, Trading and Clearing Arrangements

With the objective of increasing the degree of integration into the global economy, Sri Lanka took several major steps to reduce tariffs on a unilateral, bilateral and multilateral basis and to strengthen regional, bilateral and multilateral relations in 1998.

Sri Lanka unilaterally reduced tariff levels and also dis-invoked Article XVIII B of GATT'94 in 1998, which was invoked in 1971 due to the country's balance of payment difficulties. Under the provisions of this Article, Sri Lanka could impose restrictions on imports until the balance of payment situation eases. Thus, Sri Lanka has removed the possibility of imposing non-tariff barriers under any future balance of payment difficulties. At present, Sri Lanka does not maintain any non-tariff barriers for economic reasons, but maintains para-tariff measures to raise funds for national defence and to maintain port services.

During the year, Sri Lanka's trading relations with India achieved new heights with India's unilateral removal of quantitative restrictions on 2000 items benefiting the region, and the signing of the Indo-Lanka Free Trade Agreement (ILFTA) in December. However, of the 2000 listed items, Sri Lanka exports only a few to India. The ILFTA is Sri Lanka's first ever free trade agreement. It was an outcome of the fourth round of negotiations under the Indo-Lanka Joint Commission. The effectiveness of the ILFTA could be affected by the exclusions to be imposed by the two countries under the 'Negative Lists'. Nevertheless, the ILFTA signals the willingness of the two countries to adopt a free trade environment and gradually remove the protection granted to local industries.

Tariffs will be removed under ILFTA immediately for some items by the two countries. The remaining items, excluding those in the negative lists, will receive a 25 to 50 per cent tariff cut immediately. The two countries will remove the rest of the tariff on those items, except for a few select items, over a period of three to eight years. Removal of non-tariff barriers seems to be taking place at a very slow pace both under the South Asian Preferential Trading

Arrangement (SAPTA) negotiations and under the ILFTA. This is disadvantageous, as Sri Lanka has already removed all non-tariff barriers, except for a few maintained for national security and health reasons.

Sri Lanka regularly holds meetings of its Joint Commissions with several countries. In 1998, the Sri Lanka-Pakistan Joint Commission meeting was held and issues dealing with trade expansion, market access, credit lines and technical co-operation were discussed. The fourth session of the annual consultations with Norway was held in 1998 and the need for a specific program was discussed.

Sri Lanka initiated bilateral discussions with Iraq, and as a result, Iraq resumed importing tea from Sri Lanka with an enhanced allocation of 2.3 million kilograms under the 5th phase of the Oil for Food Program.

Sri Lanka also entered into bilateral discussions with several economically important countries where Joint Commissions do not exist. Considering the importance of shipping, a bilateral agreement is planned with Italy. Similarly, for tea exports, Sri Lanka had bilateral discussions with the Russian Federation and several East European countries in the Commonwealth of Independent States (CIS). The discussions resulted in exchanging draft agreements on trade and economic and technical co-operation with Russia, Uzbekistan, Ukraine, the Czech Republic, the Slovak Republic and Hungary. A trade agreement with Romania has been cleared and verified on both sides and will be initialised at the next Joint Committee meeting to be held in Bucharest.

The tenth Summit of the South Asian Association for Regional Co-operation (SAARC) was held in Colombo in 1998. At this meeting, the Heads of Government decided to accelerate and complete the third round of trade negotiations under SAPTA, to consider reductions in the domestic content requirement under the rules of origin criteria, and to constitute a committee of experts with specific terms of reference to work on drafting a comprehensive treaty regime for creating a future free trade area in the region, the South Asian Free Trade Area (SAFTA).

The third round of negotiations under SAPTA concluded in November 1998. At this round Sri Lanka obtained several tariff concessions from other SAARC members ranging from 10 per cent to 20 per cent, and all non-tariff barriers on the items receiving tariff concessions were removed. Bangladesh and Bhutan each granted tariff concessions for 7 products. India granted tariff concessions for 25 products and Pakistan granted concessions for 6 products. The Maldives offered tariff concessions and removed non-tariff barriers for 358 items for all members, of which only a part may be useful to Sri Lanka.

The concessions are subject to the exporting country contributing a significant share to the processing of products, as laid down in the local content requirement of the rules of origin criteria. A proposal to revise this requirement down from 50 per cent to 40 per cent received approval at the conclusion of the third round. This requirement is higher than the requirement imposed on trade under the ILFTA. However, having any such requirement is an impediment to the trading process as a bureaucratic process is involved in granting certificates on fulfilling the local content requirement.

The 14th session of the Sri Lanka-EC Joint Commission was held in 1998. At the meeting, Sri Lanka negotiated concessionary tariffs under the Generalized System of Preferences (GSP) for knitted garments and fabrics by obtaining a revision on the rules of origin criteria.

Sri Lanka continued to receive tariff concessions from the participating developed countries of the GSP. Those countries grant tariff concessions to all developing countries without expecting any reciprocity. The share of exports receiving concessions from various countries is in the range of 7 per cent to 42 per cent. Exports to the USA received the lowest concessions, while exports to Canada received the highest concessions. This generally low share of exports receiving concessions may be due to various safeguard measures adopted by importing countries and the lack of awareness by Sri Lankan exporters of the GSP scheme. Sri Lanka could improve the share of exports receiving preferential treatment under the GSP by obtaining further concessions on the local content requirement in the rules of origin criteria. In this connection, SAARC as a grouping could lobby to receive special concessions for its members on the local content requirement under the 'cumulative rules of origin' criteria for the grouping. Under these criteria, material imported from SAARC member countries and used in production in any other member country could be considered 'local material' in deciding the local content requirement. The Commerce Department of Sri Lanka has already taken initiatives on obtaining the cumulative rules of origin concessions and popularising the scheme among exporters.

Sri Lanka made further progress in receiving concessions from the participating developing countries of the Global System of Tariff Preferences (GSTP). Under this system a group of developing countries exchange tariff concessions with reciprocity. In 1998 Sri Lanka confirmed its offer for the second round of negotiations.

Sri Lanka continued to enjoy tariff concessions under the Bangkok Agreement (with the membership of India, Bangladesh, South Korea, the Republic of Laos and Sri Lanka). China is expected to become a member of the agreement, and is currently negotiating tariff concessions with member countries. Member countries attribute the modest performance under this agreement to the limited territorial coverage. Hence they are making attempts to encourage Fiji to join the group. Sri Lanka's exports to Fiji amounted to Rs.68 million and imports amounted to Rs.1 million in 1998.

The International Natural Rubber Agreement (INRA) faced new challenges as one prominent member, Malaysia, withdrew from the agreement. It may face further setbacks if Thailand too withdraws, as speculated. The price stabilising arm of INRA, the International Natural Rubber Organisation (INRO), could not prevent the gradual deterioration of international rubber prices which affected all rubber producing countries including Sri Lanka. Sri Lanka will have to closely follow developments and re-evaluate the costs and benefits of being in the organisation.

Sri Lanka also participated in meetings of two regional groupings, BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, Thailand-Economic Co-operation), incorporating countries situated along the rim of the Bay of Bengal and IOR-ARC (Indian Ocean Rim Association for Regional Co-operation). The membership of the IOR-ARC includes countries of the Indian Ocean spanning the continents of Africa, Asia and Oceania. Sri Lanka currently holds the vice-chairmanship of the IOR-ARC.

Sri Lanka is a member of the G-24 group of countries and was admitted to the G-15 group of countries in 1998. Both are groupings of developing countries. The purpose of the G-24 is to raise their voice and find common solutions to asymmetric effects of the international economic and financial system. Sri Lanka was the first vice-chairman of the group in 1998 and will assume the chairmanship in April 1999. The objective of the G-15 is to tackle mutual global issues from a South-South perspective. It was designed to serve as a forum for regular consultations among developing countries, with the aim of co-ordinating policies and action at the global level, and to help develop and implement programmes of co-operation.

The Sub-committee on Agriculture set up under the Inter Ministerial Co-ordinating Committee for trade agreements, and in particular the WTO, is conducting research on the implications of the WTO agreement on agriculture in Sri Lanka. The draft legislation prepared in consultation with the Sub-committee on Anti-Dumping and Countervailing Duties is being considered by the concerned parties in Sri Lanka.

9.13 Internal Trade and Institutional Arrangements

Internal trade in Sri Lanka is conducted in a free market environment with minimum intervention. The state intervenes to ensure price competition, stabilise prices and ensure the availability of a few essential goods, where large fluctuations in the quality supplied or in prices could have harmful effects on consumer and producer welfare. Those interventions are carried out by the Ministry of Internal and International Commerce and Food (MIICF) and its marketing organisations, viz., the Co-operative Wholesale Establishment (CWE), Salusala, Lanka General Trading Company, Kiriya Milk Industries of Lanka Company (Pvt) Ltd., the Ministry of Co-operative Development and its affiliated Co-operative Development Department, the General Treasury and the State Pharmaceutical Corporation. The two regulatory bodies attached to the MIICF, viz., the Department of Internal Trade (DIT) and Fair Trading Commission (FTC), maintain price controls on pharmaceutical products and probe into unfair trading practices. Since there exists a certain duplication of roles between the two institutions, and to create a stronger institution probing into trading practices, a proposal was made in 1997 to amalgamate the two institutions. The Bill for the proposed amalgamation is being prepared by the Legal Draftsman's Department.

In order to ensure the availability and price stability of essential consumer goods and goods that affect producer welfare, the CWE continued to purchase bulk quantities locally and to import goods. The CWE has to play the role of market stabiliser, while ensuring its own financial viability. Local purchases of big onions dropped in 1998 to a very low level of 30 metric tons compared to 1,570 metric tons purchased in 1997. This drop was due to the favorable prices that prevailed in 1998 for big onions. Thus, the CWE did not have to intervene to support producers. Local purchases of dried chillies too declined in 1998 due to a poor harvest and reasonably high prices realised by the farmers. The quantity purchased in 1998 was 90 metric tons compared to 1,797 metric tons in 1997. The lower local purchases resulted from the lower domestic production of sugar. In 1998, the CWE purchased 650 metric tons of sugar due mainly to low domestic production. Though this is higher than the purchase of 290 metric tons in 1997, it is substantially lower than the 4,608 metric tons purchased in 1996.

Since the removal of the licensing requirement on essential food items in 1996, the CWE's share of essential goods imports declined drastically in 1997 and 1998. Thus, the CWE imported those goods only to supply its retail shops when local purchases were not sufficient. In 1998, the quantities imported were comparable to the quantities imported in 1997, after providing allowances for the better local rice harvest, and restrictions imposed by major exporting countries (India and Pakistan) on big onion exports due to poor harvests in those countries. In 1998, the CWE imported 5,148 metric tons of big onions (7 per cent of total imports), 198 metric tons of dried chillies (1 per cent of total imports), and 14,953 metric tons of rice (9 per cent of total imports). However, the importation of wheat flour, the only good under licence, increased from 5,213 metric tons to 46,283 metric tons due to a production disturbance at Prima Ceylon Ltd., the sole local miller of wheat grain in Sri Lanka.

The number of CWE shops operating in 1998 amounted to 147 retail shops and 42 wholesale shops, showing an increase of 7 wholesale shops in 1998. The total turnover was Rs.5,282 million, a drop from Rs.5,392 million reported in 1997. Franchise shops recorded an increased turnover in 1998, a reversal of the decline observed in 1997. The total franchise sales in 1998 were Rs.613 million, a significant increase from the Rs.432 million recorded in 1997, but still lower than the turnover of Rs.698 million recorded in 1996. The satisfactory performance could be attributed to the introduction of mobile sales to franchise shops and the appointment of 260 new dealers and 18 super franchise dealers in 1998. The CWE ventured into opening franchise shops abroad in 1998 to popularise Sri Lankan produce and as a part of their profit making strategy. The first dealer has been appointed in Australia, and appointment of dealers in a few selected countries will follow in 1999.

The other marketing institutions of the MIICF, viz., Salusala, Lanka General Trading Company, and Kiriya Milk Industries of Lanka Company (Pvt) Ltd., engaged in providing anchors for quality and prices of important consumer goods. They played an effective role in ensuring fair competition. The State Pharmaceuticals Corporation and the Co-operative Development Department too played similar roles. The Treasury influenced the supply of essential goods through duty waivers and tariff changes.

Both the DIT and the FTC were engaged in ensuring the orderly conduct of trade in the free market environment. The two institutions made considerable efforts to enhance consumer awareness of consumers' rights, promote the formation of consumer groups, take measures to protect consumers, establish fair trading practices, regulate internal trade and maintain price controls where required.

The DIT acted under the provisions of the Price Control Act (PCA), the Consumer Protection Act (CPA), and the Fertiliser Regulation Act (FRA). Imported drugs and pharmaceuticals were subject to price control in 1998. The DIT carried out 175 inspections under the PCA and in 53 of those, offences were found. Under the CPA, 2,275 raids were conducted, and 1,507 prosecutions were made. Investigations under the FRA resulted in revealing 82 cases of fertiliser adulteration, non-conformity to standards and violation of regulations on selling, distribution and storage. The DIT also received and investigated consumer complaints on the irregular imposition of the Goods and Services Tax (GST).

The DIT continued with its consumer awareness programme by conducting seminars and through its publications. It issued one directive requiring all mosquito coils to conform to the specification SLS 453. The DIT also continued to be in the Steering Committee of the Asia and Pacific Region of the Consumer International, an association collaborating with the UN Economic and Social Council.

The FTC continued to determine the prices of pharmaceuticals. For the first time, maximum retail prices were fixed for pharmaceuticals, manufactured or packaged locally. It investigated six anti-competitive practices, four consumer complaints and one merger of companies. There were no anti-dumping charges brought before the FTC and no investigations were done in 1998.

9.14 Tourism

The tourism sector continued to recover in 1998 from the major slowdown experienced in 1996. In 1996 the arrivals plummeted to 302,265 from 403,101 arrivals in 1995. Subsequently, in 1997, arrivals grew by 21 per cent to 366,165. In 1998 they grew by 4 per cent to 381,063, almost reaching the target of 388,000 set by the Ceylon Tourist Board, despite the two major terrorist attacks that occurred in early 1998. The competition from the East Asian countries

Chart 9.9
Tourism Statistics
(1997 = 100)

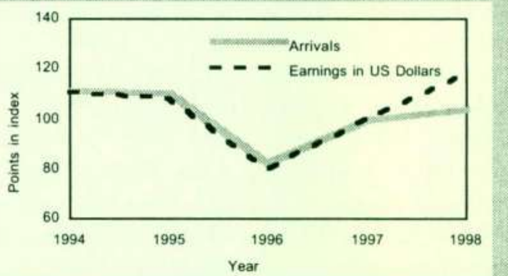


TABLE 9.12
Tourism Statistics 1996-1998

Item	1996	1997	1998(a)	Percentage Change 1997	Percentage Change 1998
1. Tourist Arrivals	302,265	366,165	381,063	21.1	4.1
2. Tourist Guest Nights ('000)	2,974	3,680	3,950	23.7	7.3
3. Room Occupancy Rate (%)	40.3	49.1	52.8	21.8	7.5
4. Gross Tourist Receipts (Rs.Mn)	9,195	12,316	14,873	33.9	20.8
5. Per Capita Tourist Receipts (Rs.)	30,420	33,635	41,584	10.6	23.6
6. Total Employment	76,711	82,080	83,427	7.0	-1.6
Direct	31,963	34,200	34,780	7.0	-1.7
Indirect	44,748	47,880	48,647	7.0	-1.6

(a) Revised
(b) Provisional

Sources: Ceylon Tourist Board
Central Bank of Sri Lanka

as a result of currency depreciation, and the impact of the global economic slowdown were also contributory factors to the slow growth. The gross earnings from tourism grew by 21 per cent in 1998, more than the growth in arrivals, reflecting higher income earnings per tourist. This was due to the increased share of tourists arriving from high income European countries, with a longer average duration of stay.

Following the growth in arrivals, both the foreign guest nights and the overall occupancy rate showed increases of 7 per cent each. On a regionwise basis, occupancy rates in all regions, other than the Colombo City and the hill country, recorded increases. Higher growth rates were recorded in the South coast, Greater Colombo area and the ancient cities.

The number of hotel units in the graded accommodation sector increased from 158 to 163, mainly in the hill country and the South coast. With the increased number of hotel units, room capacity grew from 12,370 to 12,772.

Western Europe continued to be the major source of tourists to the country, accounting for 63 per cent of the arrivals. The number of arrivals from this region recorded a 13 per cent increase and the share of arrivals grew from 58 per cent to 63 per cent. Higher arrivals from Germany and the Netherlands contributed significantly, while increases were also recorded from all other countries in the region, except Sweden and Belgium. Germany led the arrivals, surpassing the UK, which had been the highest source of arrivals during the last two years.

The decline in arrivals from Asia was 12 per cent, largely due to the low turnover from India, Thailand and Malaysia. The East Asian crisis may have had an impact on arrivals from the Asian region. Arrivals from Eastern Europe, North America and Australasia grew by 13, 10 and 4 per cent, respectively.

Of the total arrivals, 69 per cent travelled by regular inter-regional flights, while 20 per cent arrived by regular intra-regional flights. Air Lanka flights brought in 42 per cent of the total number of tourists in 1998 compared to 46 per cent in 1997. The arrivals from charter flights continued to grow in 1998. Charter flights brought in 11 per cent of the total (42,755 arrivals) compared to 5 per cent (19,555 arrivals) in 1997, an increase of 119 percent. The increase is partly due to the suspension of its activities in Sri Lanka by British Airways in March 1998, as evidenced by a doubling of arrivals from the UK by charters. Arrivals by charters from other countries, accounting for 66 per cent of the total charter arrivals in 1998, also grew by 101 per cent. As charters play a vital role in developing leisure destinations, efforts should be taken to increase charter flights into Sri Lanka.

The average duration of stay of tourists in the country grew marginally from 10.1 days in 1997 to 10.4 days in 1998. It was observed that the tourists coming by charter flights tended to stay longer in the country. In 1998, tourists arriving by charter flights stayed an average of 3 days more than other tourists. On a country wise basis, the highest stay was recorded by German tourists who stayed an average 15 days, followed by tourists from Austria (13 days), the Netherlands (12.5 days) and the UK (12 days) in 1998. In 1997 too, the highest stay of 14 days was recorded by German tourists.

The Department of Civil Aviation plays an important role in the travel trade through the management of the use of Sri Lanka's air space. In 1998, the Department signed seven bilateral agreements including those with the UK, Australia and France, to increase the frequency of flights per week and the seating capacity. Two charters were registered with the Department in 1998, one from Italy and the other from France, thus increasing the number of charters operated as at end 1998 to nine. The increase in flying capacity, particularly from Western European countries, will be favourable for the industry. The expected fleet expansion of Air Lanka Ltd in 1999 will also have a beneficial effect on tourist arrivals.

Vacation continued to be the main purpose of arrivals, accounting for more than 93 per cent of total arrivals in 1998. The remainder was for purposes of business and visiting friends and relatives. Re-enforcing the potential for 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 1998. The Department of National Zoological Gardens commenced preliminary work in 1998 on the proposed open modern zoo, which is to be established adjacent to the Pinnawala Elephant Orphanage on an extent of 38 acres, at an estimated cost of Rs.30 million. In order to provide tourists with greater access to Sri Lanka's culture and arts, the Tourist Board commenced work on the establishment of a National Arts and Cultural Centre in Colombo Fort in 1998. The Sri Lanka Convention Bureau continued to promote Meetings, Incentive travel, Conventions and Exhibitions (MICE) tourism in 1998. The Bureau sponsored 8 conferences and exhibitions in 1998 and had 1,925 tourists visiting the country under the MICE category. The Bureau participated in several international campaigns to promote Sri Lanka as the latest destination for MICE tourism in the Asia. However, incidents of crime, tourist harrassment and pollution of beaches will seriously undermine the efforts of these ambitious projects.