9. TRADE, BALANCE OF PAYMENTS AND TOURISM

9.1 Overview

The growth of world trade continued to remain depressed although the worst of the effects on global demand that started with the Asian financial market crisis in mid-1997 had receded by mid-1999. The exchange markets in most of the affected economies reflected a gradual recovery. There was also a gradual build up of investor confidence after mid-1999. Consequently, foreign private capital which fled from emerging markets, particularly the Asian region, on a large scale during the last two years, began to return gradually after mid-1999, with a notable decline in risk premiums attached to emerging market bond issues. Meanwhile, commodity prices continued to decline with the exception of crude oil, which started climbing up as a result of a decision by the OPEC to cut back production and an improvement in demand in the East Asian economies. International trade remained subdued during most of the year.

Sri Lanka's external sector developments during 1999 reflected the lagged effect of depressed global demand and the resultant decline in commodity prices. Sri Lanka's international trade and balance of payments weakened somewhat during the year. The trade deficit widened owing to the importation of three aircraft by SriLankan Airlines during the year. The services account indicated a marginal improvement despite a rapid recovery in the tourism sector. The deficit in the income account widened further as a result of a large drop in interest income reflecting the drop in interest rates in international financial markets during most of 1999. Net current transfers registered a marginal increase of 1 per cent mainly due to an increase in net private transfers, which offset a decline in net official transfers during 1999. Consequently, the deficit in the current account widened from US dollars 226 million in 1998 to US dollars 495 million in 1999. The current account deficit as a percentage of GDP increased from 1.4 per cent in 1998 to 3.1 per cent in 1999. Despite increases in net long-term capital flows to the private sector, net capital and financial inflows declined from US dollars 413 million to US dollars 330 million due to a build up of assets held by commercial banks abroad and a decline in long-term borrowing by government. Consequently, the overall balance in the balance of payments registered a deficit of US dollars 263 million in 1999 compared with a surplus of US dollars 37 million in 1998.

The impact of declining global commodity prices on Sri Lanka's external trade moderated towards the latter part of the year bringing in improvements in both exports and imports. Exports, which declined by 11 per cent during the first eight months, reflected a significant recovery to register an overall decline of 4 per cent in 1999. Overall export prices declined by 10 per cent in 1999. Overall export volume increased by 6 per cent, mainly due to volume growth in the garments sector. Imports, excluding aircraft, declined by 5 per cent due both to lower international commodity prices and a decline in the volume of imports, the latter having a larger impact. Imports, including aircraft, increased by 0.2 per cent in 1999. Consequently, the trade deficit widened by 19 per cent to US dollars 1,299 million in 1999. The trade deficit as a percentage of GDP increased from 7.0 per cent in 1998 to 8.2 per cent in 1999.

The services account registered a marginal improvement from a surplus of US dollars 145 million to US dollars 147 million in 1999 despite of a rapid recovery in the tourism sector. Port related services, which contributed heavily to the services account in the past, remained somewhat stagnant due to competition from neighbouring countries. Net receipts from travel increased from US dollars 28 million to US dollars 55 million reflecting a 15 per cent increase in tourist arrivals during the year. Meanwhile, the deficit in the income account widened from US dollars 180 million to US dollars 253 million due to higher net interest payments resulting from a large drop (23 per cent) in interest income on investments and an increase (2 per cent) in interest payments on foreign debt. Private transfer receipts increased by 6 per cent to US dollars 1,056 million, which included compensation payments amounting to US dollars 112 million received by over 50,000 Sri Lankan workers in Kuwait who were displaced during the Gulf war. Net private transfers increased from US dollars 848 million to US dollars 887 million during the year. However, net current official transfers declined from US dollars 52 million to US dollars 24 million during 1999. With these developments in the trade, services, income and transfer accounts, the deficit in the current account expanded significantly from US dollars 226 million to US dollars 495 million during 1999.

The surplus in the capital and financial accounts declined during 1999 mainly due to a drop in financial flows. While net capital transfers decreased from US dollars 80 million to US dollars 75 million, the surplus in the financial account declined from US dollars 334 million in the previous year to US dollars 255 million in 1999. The latter was attributed to a reduction of foreign liabilities by commercial banks and a contraction in long-term borrowings by government. Net portfolio investment inflows and net short term credit to the private sector proper reflected some improvement during the year. Short-term private capital declined from an outflow of US dollars 64 million to an outflow of US dollars 142 million. The unfavourable

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				
	1995	1996	1997	1998	1999(b)	1995	1996	1997	1998	1999(b)
Trade Balance	-1,505	-1,344	-1,225	-1,092	-1,299	-77,109	-74,276	-71,833	-69,742	-91,754
Exports	3,807	4,095	4,639	4,798	4,600	195,092	226,801	274,194	310,401	324,429
Imports	5,311	5,439	5,864	5,889	5,899	272,201	301,077	346,026	380,142	416,183
Services (net)	152	105	159	145	147	7,796	5,805	9,386	9,300	10,337
Receipts	821	765	875	914	965	42,045	42,358	51,692	59,084	67,979
Payments	669	660	716	770	819	34,250	36,553	42,306	49,783	57,642
Income (net) (c)	-170	-197	-160	-180	-253	-8,717	-10,923	-9,417	-11,556	-17,813
Receipts	226	186	234	214	167	11,596	10,258	13,792	13,882	11,810
Payments	396	383	393	394	420	20,312	21,182	23,210	25,437	29,623
Goods, Services and Income (net)	-1,522	-1,436	-1,225	-1,127	-1,406	-78,030	-79,395	-71,864	-71,997	-99,231
Private Transfers (net)	675	710	788	848	887	34,593	39,230	46,494	54,843	62,472
Receipts (d)	790	832	922	999	1,056	40,482	46,003	54,445	64,585	74,356
Payments	115	122	135	151	169	5,889	6,773	7,951	9,742	11,884
Official Transfers (net)	61	49	44	52	24	3,114	2,709	2,625	3,359	1,690
Current Account	-786	-677	-393	-226	-495	-40,324	-37,456	-22,745	-13,795	-35,068
Capital and Financial Account	699	459	602	413	330	36,647	25,725	30,691	26,570	27,421
Capital Account	117	96	87	80	75	6,009	5,286	5,140	5,109	5,274
Capital Transfers(net)	117	96	87	80	75	6,009	5,286	5,140	5,109	5,274
Receipts	121	100	91	84	80	6,191	5,495	5,386	5,410	5,641
Payments	4	4	4	5	5	182	209	246	301	368
Financial Account	581	363	515	334	255	30,638	20,439	25,550	21,461	22,148
Long-term:	502	381	716	398	397	25,939	20,962	37,029	25,906	28,310
Direct Investment	53	120	430	193	177	2,931	6,606	25,504	12,379	12,449
Foreign Direct Investment (net)	16	86	129	137	177	1,011	4,756	7,587	8,846	12,449
Privatisation Proceeds	37	33	301	56		1,920	1,850	17,918	3,533	
Private Long-term (net),(c)	91	2	47	2	189	4,648	88	3,054	352	13,565
Inflows (e)	194	156	150	146	353	9,937	8,628	8,741	9,686	25,207
Outflows	103	155	102	145	165	5,289	8,539	5,687	9,334	11,641
Government, Long-term (net) (f)	358	259	239	203	32	18,359	14,268	8,471	13,175	2,296
Inflows	674	497	500	493	350	34,526	27,442	24,761	31,896	24,741
Outflows	315	238	262	290	319	16,166	13,174	16,291	18,721	22,445
Short-term:	79	-18	-201	-64	-142	4,699	-523	-11,479	-4,445	-6,162
Portfolio Investment (net)	-2	7	13	-24	-13	-90	353	749	-1,521	-886
Private Short-term (net),(c)	33	-44	-20	8	-10	1,702	-2,426	-1,195	414	-667
Commercial Bank Assets (net),(c)	14	59	-323	180	-19	-2,731	1,127	-23,384	5,035	-1,766
Commercial Bank Liabilities (net),(c)	35	-40	129	-228	-101	5,818	423	12,352	-8,374	-6,375
Government Short-term (net),(c)	-	-	-	-		-	-	-	-	
SDR Allocations										
Valuation Adjustments						6,394	4,213	-562	8,559	2,103
Errors and Omissions	139	150	-46	-151	-98	5,091	7,527	8,461	-7,534	-8,640
Overall Balance (g)	52	-68	163	37	-263	7,809	9	15,845	13,800	-14,184
Monetary Movements (g)	-52	68	-163	-37	263	-7,809	-9	-15,845	-13,800	14,184
Exchange Rate Rs/US$	-	-	-	-	-	51.25	55.27	58.99	64.59	70.39
Ratio to GDP as percentage										
Trade Account	-	-	-	-	-	-11.5	-9.7	-8.1	-6.9	-8.2
Current Account	-	-	-	-	-	-6.0	-4.9	-2.6	-1.4	-3.1
Current Account without Grants	-	-	-	-	-	-6.5	-5.2	-2.8	-1.7	-3.3

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.

(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.

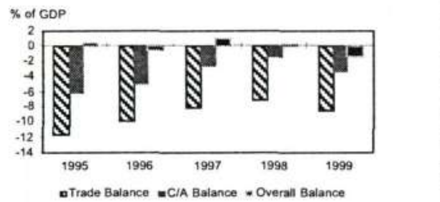
(d) Includes US dollars 64 mn, US dollars 78 mn and US dollars 85 mn. received in 1997, 1998 and 1999 as compensation of US dollars 2,500 per person to 26,101, 31,279 and 37,343 Sri Lankans, respectively, who lost employment in Kuwait due to the Gulf War in 1990. In addition US dollars 27 mn was also received as second round payments of US dollars 1,500 each to 18,244 Sri Lankans in 1999.

(e) Includes adjustment to capital inflows in 1995 and 1999 on account of the import of 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.

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 excluded from the overall balance

(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 (1997=100)			Ratios
	Exports	Imports	Exports	Imports	Terms of Trade(b)	Exports/ Imports
1997	13.3	7.6	100.0	100.0	100.0	0.79
1998 (c)	3.4	0.4	115.6	101.3	114.2	0.81
1999 (d)	-4.1	0.2	113.8	106.6	106.8	0.78

Sources: Sri Lanka Customs
Central Bank of Sri Lanka

(a) Growth rates are given in U.S. dollar terms.

(b) (Export unit value index / Import unit value index) * 100

(c) Revised

(d) Provisional.

Chart 9.2
External Trade

Chart 9.2.1
Trade Balance

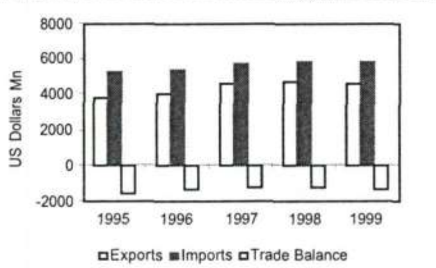
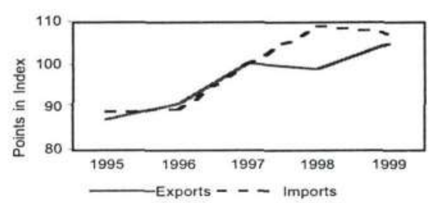
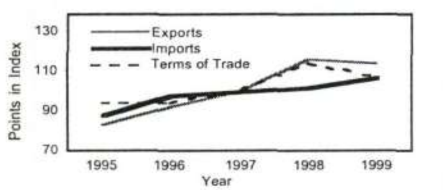


Chart 9.2.2
Export and Import Volume Indices (a)
(1997 = 100)



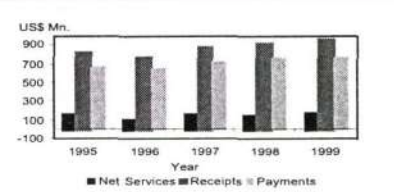
(a) Data for 1995 have been obtained by splicing the previous annual trade indices series.

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



(a) Data for 1995 have been obtained by 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 conditions in international capital markets forced Sri Lanka to postpone its inaugural sovereign issue, while receipts of long-term concessional loan capital to government declined temporarily due to both underutilisation of foreign loans and a general decline in resource availability from donor countries. Meanwhile, government repaid US dollars 34 million in respect of the Floating Rate Notes (FRN) issued in 1997 as some investors exercised the put option. As a result, net capital inflows to government declined significantly from US dollars 203 million to US dollars 32 million. In contrast, net long-term private capital flows increased significantly from US dollars 195 million to US dollars 366 million due to increased foreign direct investment and private loan capital.

The external debt stock of the country, the majority of which consists of concessional loans, increased by 3 per cent mainly reflecting the significant appreciation of the yen towards the latter part of the year. The debt/GDP ratio increased from 55.7 per cent to 57.4 per cent in 1999. Meanwhile, the debt service ratio increased from 11 per cent in 1998 to 12.5 per cent in 1999.

Exchange markets remained stable during the year in contrast to the high volatility in the previous year. The declining trend in inflation eased pressure on the exchange rate, particularly towards the latter part of the year. Reflecting this, the Sri Lanka rupee depreciated by 6 per cent against the US dollar during 1999. The real effective exchange rate of the Sri Lanka rupee against the 24 currency basket depreciated by 7 per cent in 1999.

Gross external assets of the country, at US dollars 2,582 million at the end of 1999, were sufficient to finance 5.3 months of imports for 1999, while gross official reserves, at US dollars 1,639 million, were sufficient to finance 3.3 months of imports for 1999.

9.2 Exports

Total export earnings, at US dollars 4,600 million in 1999 showed a 4 per cent decline over the previous year. This decline reflected the impact of lower export prices which offset the higher volume of exports. The unit price index in 1999 declined by 10 per cent while the volume index rose by 6 per cent. The lower commodity and input prices that prevailed in the world market in the early part of the year and the competition from the East Asian countries contributed to lower prices of the major export product, textiles and garments. Demand for tea and consequently the price of tea, declined due to the currency crisis in Russia. Natural rubber and rubber based products too were affected by competition from the East Asian countries.

TABLE 9.3
Composition of Exports

Category	US Dollars Million					Rs. Million				
	1995	1996	1997	1998	1999(a)	1995	1996	1997	1998	1999(a)
1. Agricultural Exports	829	961	1,060	1,088	947	42,478	53,206	62,667	70,225	66,751
Tea	481	615	719	780	621	24,638	34,067	42,533	50,280	43,728
Rubber	111	104	79	44	33	5,713	5,753	4,640	2,808	2,305
Coconut	103	110	118	94	129	5,270	6,091	6,939	6,110	9,119
Kernel Products	69	81	82	56	84	3,520	4,469	4,864	3,632	5,973
Other	34	29	35	38	45	1,750	1,622	2,075	2,478	3,146
Minor Agricultural Products	134	132	145	170	165	6,857	7,295	8,555	11,027	11,598
2. Industrial Exports (b) (c)	2,870	3,006	3,436	3,607	3,543	147,094	166,543	203,114	233,508	249,947
Food,Beverages and Tobacco	98	95	91	118	86	5,040	5,272	5,354	7,586	6,093
Textiles and Garments	1,853	1,902	2,274	2,460	2,425	94,946	105,341	134,455	159,303	171,068
Petroleum Products	85	104	97	73	74	4,374	5,740	5,743	4,662	5,210
Rubber Products	153	169	178	178	161	7,851	9,357	10,513	11,528	11,350
Ceramic Products	46	48	55	54	49	2,371	2,677	3,246	3,478	3,442
Leather and Footwear	118	139	183	214	201	6,054	7,690	10,812	13,855	14,140
Machinery and Equipment	124	154	204	182	201	6,348	8,572	12,076	11,811	14,155
Diamond and Jewellery (d)	196	192	142	131	163	10,023	10,643	8,384	8,491	11,472
Other Industrial Exports	197	202	212	197	183	10,087	11,251	12,531	12,794	13,018
3. Mineral Exports	87	96	90	60	64	4,447	5,292	5,271	3,863	4,540
Gems	78	86	84	56	61	3,972	4,771	4,899	3,577	4,326
Other Mineral Exports	9	10	6	4	3	475	521	372	286	214
4. Unclassified (c) (e)	21	32	53	43	46	1,073	1,760	3,141	2,802	3,215
Total Exports	3,807	4,095	4,639	4,798	4,600	195,092	226,801	274,193	310,398	324,453

(a) Provisional
(b) Revised
(c) Adjusted
(d) Diamond exports reported by the Customs in 1998 and 1999 were adjusted for data obtained from major exporters.
(e) Includes re-exports

Sources: Sri Lanka Customs
Ceylon Petroleum Corporation
Major exporters of diamonds
Central Bank of Sri Lanka

Sri Lanka's export earnings began to improve in the latter part of 1999. During the fourth quarter of 1999, export earnings increased by 3 per cent. This is attributable to robust economic growth in the USA and European economies who were the major importers of textiles and garments. The recovery in the East Asian economies from the currency crisis and the appreciation of their currencies improved Sri Lanka's competitiveness in rubber based products and garments towards the end of 1999. Meanwhile, lower production in major producing countries and the recovery in the East Asian countries improved rubber prices. Tea prices, which had been falling since August 1998, also showed a recovery in the last two months of 1999 due to lower production in major tea producing countries and active participation of the Commonwealth of Independent States (CIS) in the Colombo market. Following the recovery in economies in East Asia and Japan, the demand for gems and jewelley increased.

Export Structure

The export structure of the country has changed markedly with the diversification of exports since the introduction of economic liberalisation policies in late 1977. Industrial exports have expanded significantly since the early 1980's and as a result, the share of plantation agricultural commodities in total exports has declined from 74 per cent in 1977 to 21 per cent in 1999. Industrial exports continued to be the major contributor to exports earnings with their share increasing from 14 per cent in 1977 to 49 per cent in 1987. This ratio has remained around 75 per cent during the last 5 years. Within industrial exports, textiles and garments became Sri Lanka's largest single item of exports in 1986. In total exports, its share rose from 28 per cent in 1986 to 53 per cent in 1999. The sectors that have shown a significantly improved performance in the last decade are rubber based products, various spare parts including

Chart 9.3
Value of Exports by Major Categories

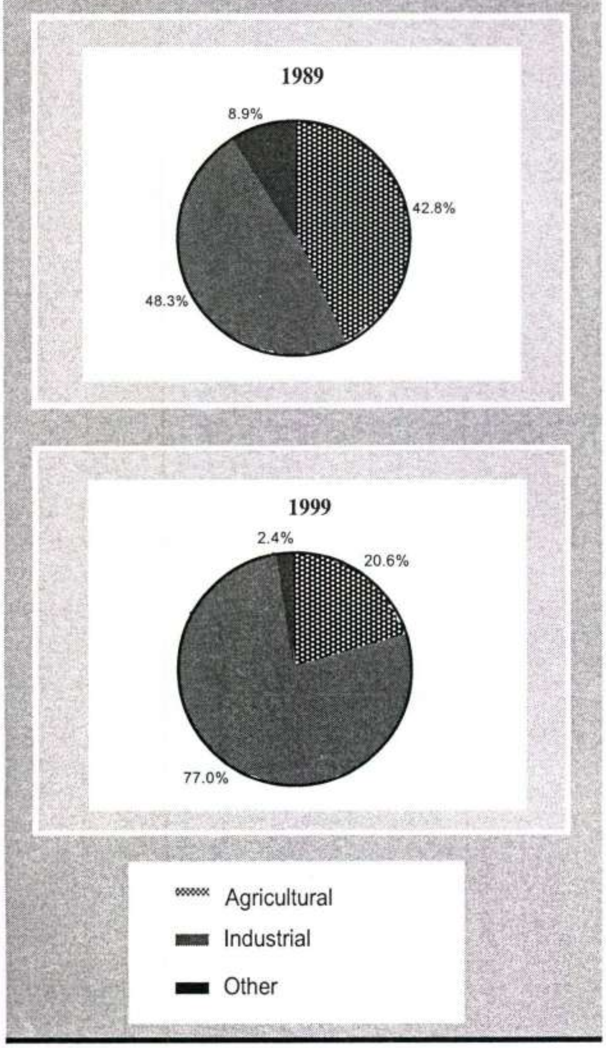
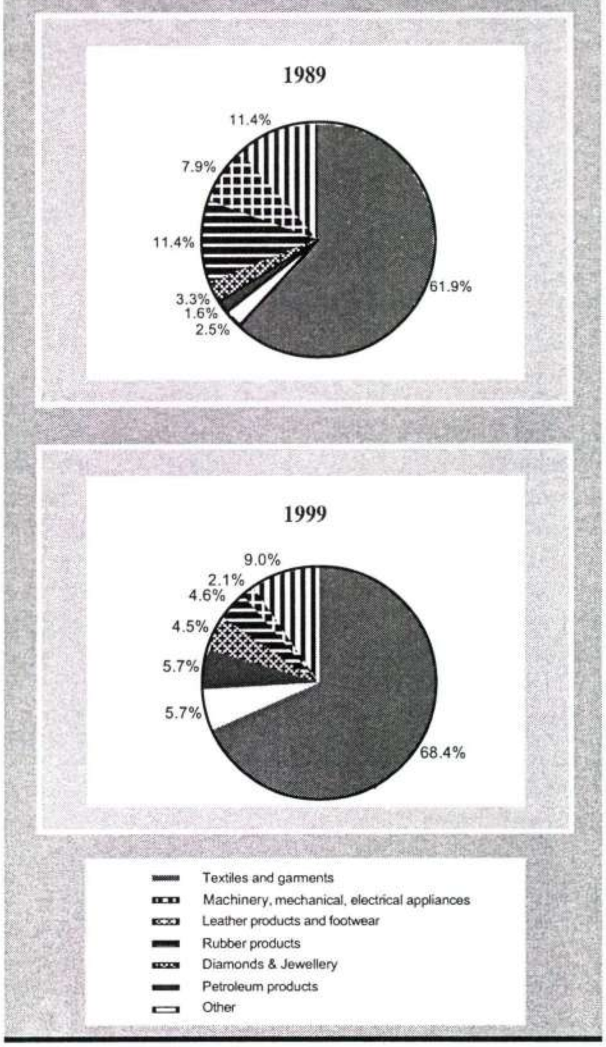


Chart 9.4
Value of Industrial Exports by Major Categories



electronics, leather products such as footwear and travel goods, diamonds, jewellery, petroleum products, canned food, fruits and fish products, ceramics, handicrafts and chemical products. Exports of mineral products, dominated by gems, too witnessed an improvement after 1977.

Textile and garments exports continued to be the leading sub-category of industrial exports, contributing 68 per cent to total industrial exports in 1999. The balance 32 per cent of industrial exports consisted of machinery and equipment (6 per cent), rubber based products (5 per cent), travel goods and diamonds (4 per cent each), petroleum products and footwear (2 per cent each), crustaceans and molluscs and ceramic products (1 per cent each) and other industrial products (7 per cent), showing an over concentration of industrial exports in a single product. Tea continued to be the leading sector under agricultural exports with a share of 65 per cent in 1999. Tea exports accounted for 13 per cent in total exports in 1999.

Industrial Exports

Earnings from industrial exports declined by 2 per cent in 1999 compared to a growth of 5 per cent in 1998. The value of textile and garment exports declined by 1 per cent in 1999 despite the increase in volume of 8 per cent due to a 9 per cent drop in unit price. Export of textiles declined by 11 per cent, while other made up textile articles and yarn declined by 21 per cent and 15 per cent respectively. Garment exports, which accounted for 90 per cent of the total earnings from the textiles and garments sub-sector, reported a marginal improvement of 0.2 per cent. Net foreign exchange earnings from garments increased by 9 per cent due to lower prices of raw material and higher domestic value addition. As in the previous years, more than 90 per cent of textiles and garments were exported by Board of Investment (BOI) companies. Export earnings of BOI enterprises declined by 1 per cent in comparison to a 10 per cent growth in 1998. Non-BOI enterprises, whose exports declined by 4 per cent in 1998, faced a further decline of 7 per cent in 1999, partly reflecting the adverse impact of the East Asian currency crisis on small scale exporters who produce for the lower end of the market. The USA (61 per cent) and the EU (35 per cent), led by UK (22 per cent), continued to be the main markets.

Exports of machinery, mechanical and electrical equipment increased by 10 per cent as against the decline of 11 per cent experienced in 1998. Major export items in 1999 were printed circuits, parts and accessories of sewing machines, office machines, data processing machines, electric motors, generators and motor tools.

Export earnings from rubber based products declined by 10 per cent in 1999 due to a substantial drop in the exports of gloves and tyres. Exports of examination gloves showed a recovery after September 1999 with the re-commencement of production by one of the major producers. Earnings from other rubber gloves and tyres too deteriorated in 1999 but at a slower rate in the latter half of the year. Rubber gloves alone accounted for 32 per cent of rubber based product exports in 1999. Exports of floor coverings and mats, plates, sheets and rubber bands performed well throughout 1999. Meanwhile, some new products including articles of apparel and clothing accessories, machine parts and floor tiles, emerged in 1999.

Exports of footwear increased by 5 per cent, led by exports of sports and other footwear to the USA, the UK, France and Canada. Owing to lower demand from the USA, Canada, Japan, France and Italy for hand bags and travel cases, the export of travel goods declined by 11 per cent. Exports of articles of leather and ceramic products were also lower during most of 1999 as a result of competition from the East Asian countries. However, all these categories showed an improvement towards the last quarter of 1999.

Export earnings from the food, beverages and tobacco sub category declined by 27 per cent in 1999, due to a sharp decline in the earnings from crustaceans and molluscs, which contributed 67 per cent to this sub category in 1998. The majority of prawn farms had suspended prawn cultivation temporarily after August 1998 with the out-break of the 'Yellow Head' and 'White Spot' diseases. Although farms recovered from these diseases, due to heavy rains, no new cultivation took place to make any significant impact on exports. In the last quarter of 1998, the downfall of the industry started with some farmers resorting to improper practices to obtain a larger harvest. The Ministry of Aquatic Resources Development issued instructions to regulate the cultivation and processing to prevent future disasters of this nature and closely monitored the situation to ensure that farmers adhered to the guidelines. In addition to the financial assistance of Rs.50,000 per acre introduced in 1998, provided to cover 50 per cent of the pond area for modernisation of farms, a relief package to reduce the interest burden of bank borrowings and a scheme to share the risk of bank loans granted for procurement of shrimp feed equally with the banks was introduced for a limited period. Import of shrimp feed remained duty free as a relief measure. Earnings from lobster and crab exports increased by 28 per cent, while earnings from fresh, frozen and salted fish and animal fodder exports increased by 42 per cent in 1999. This was due to the steps taken under the assistance of the Swedish International Development Co-operation Agency to improve the quality of fish products to meet European market requirements. Among other food items, coconut milk and cream, canned fruits, sweets, various food preparations and sauces showed an improvement over the previous year.

Diamond exports increased by 26 per cent in 1999, responding to increased demand from Belgium, Israel, Vietnam, the USA and Japan. The introduction of laboratory created synthetic moissanite as the latest diamond simulant attracted buyers. Diamond exports continued to increase after May 1999 following the recovery in the global economy.

The jewellery market, which suffered a setback due to the East Asian crisis, showed a recovery after May 1999 and indicated a 1 per cent increase for 1999. The USA continued to be the largest buyer of jewellery followed by Germany, Japan and the UK.

Earnings from the export of petroleum products increased by 2 per cent in 1999 despite the sharp decline (35 per cent) during the first half of 1999. The annual closure of the oil refinery for maintenance from 19 January to 20 March 1999 reduced production, thus resulting in a decline in petroleum exports during the first half of 1999. The higher international prices together with the resumption of normal operations of the refinery increased petroleum exports by 47 per cent during the second half of 1999.

Among other manufactured export categories, chemical products (10 per cent), tableware (11 per cent), wall tiles (22 per cent), articles of wood (8 per cent) and articles of leather (5 per cent) declined over the previous year. However, earnings from toys, articles of copper, quartz, brooms, brushes and stringed musical instruments were higher than in 1998 to meet increased demand from Western countries.

Plantation Crops

Earnings from plantation crops declined by 15 per cent. Tea and rubber exports declined, while coconut products exports showed an improvement. However, earnings from tea and rubber exports showed a recovery after November 1999. Tea prices, which continued to fall after August 1998 following the Russian currency crisis, improved during the second half, owing to the drop in production in major producing countries such as India and Kenya and the increased participation of the CIS countries at the Colombo auctions. Tea prices declined by 20 per cent from US dollars 2.87 per kg in 1998 to US dollars 2.30 per kg in 1999. The volume of tea exported declined by 1 per cent to 269 million kg in 1999, despite an increase in tea production by 2 per cent to reach a level of 259 million kg.

In the composition of Sri Lanka's tea exports, 64 per cent was in bulk form, while 30 per cent was in packed form. Higher value added forms of tea such as tea bags, Sri Lankan tea blended with foreign teas and instant and green teas accounted for the remainder, less than 6 per cent of the total. Orthodox tea accounted for more than 99 per cent of Sri Lankan teas, while Cut Tear and Curl (CTC) tea was produced in small quantities. Sri Lanka imported 1.9 million kg of tea, which was less than 1 per cent of the domestic production in 1999, for blending purposes. The United Arab Emirates (UAE) emerged as the largest buyer (15 per cent). Russia which had been the prime destination for Sri Lanka's tea since 1995 became the second largest buyer accounting for 14 per cent, while Turkey became the third largest buyer with a share of 9 per cent. The other major buyers were Syria (7 per cent), Saudi Arabia and Iran (4 per cent each).

Export earnings from rubber declined by 25 per cent due to lower international prices. Export volumes increased by 3 per cent, from 41.5 million kg in 1998 to 42.8 million kgs. in 1999 reflecting higher exports to Pakistan, the USA and Japan. Sheet rubber exports increased from 13 million kgs. to 17 million kg in 1999. The prices of all major grades of rubber products declined, resulting in a decline of 27 per cent in the average price of rubber exports. Accordingly, the average price fell from US dollars 1.05 per kg to US dollars 0.77 per kg. The average export prices of latex and other crepe rubber except sole crepe, declined by 25 per cent, while the average price of sheet rubber grades declined by 23 per cent in 1999. However, earnings from rubber exports accounted for less than 1 per cent of total exports.

World rubber prices, which continued to decline from mid 1997 owing to production surpluses in major producing countries such as Thailand, Indonesia and Malaysia coupled with sharp currency depreciations in those countries, showed an improvement towards the end of 1999. An increased demand for natural rubber, particularly from the USA, the Republic of Korea, China and the East Asian countries, and the production shortfall in major producing countries contributed to the improvement in prices. The increase in synthetic rubber prices in the wake of higher petroleum prices will also help in boosting natural rubber prices. In Sri Lanka, rubber production increased from 96 million kg in 1998 to 97 million kg in 1999. Local consumption of rubber remained around 54 million kg in 1999. In 1999, input quality requirements and attractive prices resulted in the import of 675,132 kg of natural rubber by the domestic manufacturing industry, compared to 259,869 kg in 1998.

Earnings from the three major coconut products showed a substantial recovery after April 1999 leading to an average growth of 51 per cent in 1999 attributable to higher prices of desiccated coconut and copra. The lagged effect of the long drought, resulting from the El-Nino conditions, affected the major coconut producers, the Philippines and Indonesia, increasing the international prices of major coconut products. However, the price of coconut oil has continued to decline since July 1999 due to increased supply of relatively cheaper substitutes such as palm oil and the reduction of the export tax on palm oil from 30 per cent to 10 per cent in July 1999 in Malaysia. Palm oil prices in the world market decreased by 35 per cent from US dollars 671 per metric ton to US dollars 436 per metric ton, whereas coconut oil prices remained as high as US dollars 737 per metric ton in 1999. World prices of soya oil and sunflower oil too declined by 30 per cent and 32 per cent, respectively.

Earnings from other coconut products increased by 17 per cent in 1999 attributable to higher demand for coir fibre mattresses, export of which increased by 67 per cent in volume terms. Except for coir yarn, prices of all other coir products were lower than in the pervious year. Meanwhile, exports of coconut shell charcoal and fresh nuts too showed an improvement over the previous year.

Other Agricultural Products

Earnings from other agricultural products declined by 3 per cent. Exports of cinnamon, un-manufactured tobacco, pepper, vegetables, cashew, essential oils, sesame seeds and coffee showed a decline. Some of these products were affected by the unusually high rainfall in the second half of the year while some were affected by poor demand. Exports of cinnamon declined marginally due to depressed international prices, which offset the impact of a higher volume of export. Earnings from pepper declined by 30 per cent due to lower demand from Egypt, India, Pakistan, UK and USA. Un-manufactured tobacco exports declined by 6 per cent, attributable to a 36 per cent drop in export volumes despite improved prices, due to lower demand from France, Italy and Spain. These three products together accounted for more than 64 per cent of total earnings from other agricultural products. Earnings from fresh and dry fruit increased substantially (194 per cent) due to a more than five fold growth in the volume of dried fruits largely exported to India. Exports of pineapple, tamarind and figs also increased. Fresh and dried fruits are exported largely to India, the Maldives, Pakistan, UAE, Germany and Malaysia. Exports of arecanuts, cloves, nutmeg and mace, cardamom and betel leaves too increased.

Mineral Products

Owing to higher earnings from gems, the export of all mineral products increased by 8 per cent. Mineral products contributed only about 2 per cent to the total export earnings in 1999. Gem exports, which suffered a major setback following the East Asian crisis and the subsequent depression in the Japanese market, have shown an improvement since April 1999, with higher exports to Japan, Hong Kong, Thailand and Singapore. Well trained labour and the use of advanced technology assisted Sri Lanka's gem cutting industry to maintain high standards, enabling Sri Lanka to attract the quality conscious US and European markets. France emerged as a major gem market with a high potential, while UK, Germany, Switzerland and Sweden continued to be the major buyers in the European market. Demand for calibrated stones, blue, pink and yellow sapphires showed a steady growth, while green tourmaline, citrene and pink tourmaline continued to be in good demand. The entry of new producing countries such as Tanzania, Vietnam and particularly, Madagascar, which produces all gem varieties found in Sri Lanka to the world market, has resulted in increased competition in this industry. Earnings from other mineral exports fell by 32 per cent due to lower earnings from natural graphite. However, earnings from metallic ores and iron pyrites and ilmenite grew six fold, containing the overall decline in the mineral sector.

9.3 Imports

Expenditure on imports, at US dollars 5,899 million, showed a marginal growth of 0.2 per cent in 1999. This is inclusive of three aircraft worth US dollars 298 million imported under the re-fleeting programme of Srilankan Airlines in 1999. Excluding aircraft, import expenditure declined by 5 per cent compared to the 8 per cent growth recorded in 1998. This negative growth was a result of drop in both the average import price (4 per cent) and the volume (1 per cent). Lower imports were seen in all three major import categories. The lower international prices of major agricultural and dairy products (sugar, wheat, rice and milk products) and major inputs (fertiliser and textiles) contributed to the fall in imports. Expenditure on consumer goods declined by 2 per cent while that on intermediate goods remained at previous year's level. Imports of investment goods grew by 6 per cent with the inclusion of the aircraft. Excluding the three aircraft, investment goods fell by 14 per cent in 1999. Expenditure on imports showed a significant improvement during the second half of the year, with a 14 per cent growth, as against a 13 per cent decline observed during the first half of 1999. A significant increase in investment goods (30 per cent) and in intermediate goods (11 per cent), particularly, textiles, crude oil and refined petroleum products and diamonds, contributed to this positive growth. The growth in investment goods imports during the second half of 1999 was entirely due to the import of the three aircraft.

Import Structure

A shift in the import structure in favour of intermediate and investment goods was observed during the last two decades following the economic liberalisation in 1977. An improvement in the domestic supply of rice and other food items may have helped to contain the food import bill. Meanwhile, expansion in the industrial sector resulted in higher imports of intermediate goods. Developments in infrastructure facilities, construction and the transport sector, combined with increased use of advanced technology, enhanced the imports of investment goods. Accordingly, the share of consumer goods in total imports declined from 42 per cent in 1977 to 21 per cent in 1999. The share of investment goods increased from 12 per cent to 27 per cent, while the share of intermediate goods increased from 44 per cent to 51 per cent over the same period.

Consumer goods

Positive growth in the consumer durable category was negated by the decline in food and drink imports, resulting in a decline of 2 per cent in expenditure on consumer goods. Lower international prices of major food items helped to reduce the expenditure on food and drink. Expenditure on sugar imports declined by 18 per cent, while wheat grain imports declined by 13 per cent due to lower quantity and depressed prices. Despite improved local paddy production

TABLE 9.4

End-Use Classification of Imports

Category	US Dollars Million					Rs. Million				
	1995	1996	1997	1998	1999(a)	1995	1996	1997	1998	1999(a)
1. Consumer Goods	1,181	1,234	1,223	1,255	1,236	60,508	68,372	72,062	80,956	87,060
Food and Drinks	720	801	781	723	655	36,901	44,377	45,996	46,543	46,116
Rice	2	91	73	42	46	122	5,118	4,331	2,621	3,290
Sugar	170	145	184	129	106	8,737	8,026	10,788	8,384	7,448
Wheat	198	204	139	127	111	10,155	11,267	8,128	8,133	7,792
Other	349	361	385	425	392	17,887	19,966	22,749	27,405	27,586
Other Consumer Goods	461	433	442	532	581	23,607	23,995	26,066	34,413	40,943
2. Intermediate Goods	2,702	2,767	3,096	2,982	2,983	138,475	153,117	182,754	192,494	210,439
Petroleum	387	479	539	345	426	19,827	26,525	31,828	22,275	30,124
Fertilizer (b)	86	76	66	62	66	4,406	4,189	3,916	3,969	4,690
Chemicals	143	134	136	143	136	7,310	7,402	8,024	9,241	9,590
Textiles and Clothing	1,159	1,168	1,386	1,397	1,320	59,375	64,601	81,816	90,099	93,105
Other Intermediate Goods (c)	928	910	969	1,035	1,034	47,557	50,400	57,170	66,890	72,929
3. Investment Goods	1,189	1,204	1,325	1,477	1,565	60,916	66,647	78,232	95,322	110,599
Machinery and Equipment	503	649	742	786	678	25,769	35,987	43,853	50,592	47,736
Transport Equipment (d)	304	179	208	264	523	15,564	9,885	12,276	17,098	37,191
Building Materials	272	263	272	303	260	13,956	14,540	16,030	19,590	18,296
Other Investment Goods	110	113	103	124	105	5,627	6,235	6,073	8,042	7,376
4. Unclassified Imports	240	234	220	176	115	12,301	12,940	12,978	11,367	8,126
Total Imports (e)	5,311	5,439	5,864	5,890	5,899	272,200	301,076	346,026	380,138	416,223

(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) Diamond imports reported by the Customs in 1998 and 1999 were adjusted for data obtained from major importers.
(d) Includes the value of 3 aircraft imported by SriLankan Airlines in 1999
(e) Adjusted.

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

(2,868,000 metric tons), imports of rice (214,200 metric tons) increased by 28 per cent. The government announced a 25 per cent duty waiver on rice during the period 22 October-31 December 1999, reducing duty on rice from 35 per cent to 10 per cent. More than 66 per cent of the total rice imports took place during this period. Wheat imports declined by 2 per cent to 659,000 metric tons, probably substituted for rice. Among the other food items, milk products, dried and other fish products, malt, sugar confectionery, garlic, peas and turmeric recorded decreases.

In the durable consumer goods category, imports of motor cars and motor cycles increased by 37 per cent, partly attributable to a partial duty waiver granted for public sector employees to import motor vehicles. Imports of radio receivers and television sets showed an increase of 66 per cent. The highest contributors to this improvement were colour television sets and sound recorders. Imports of medical and pharmaceutical products decreased by 9 per cent, reflecting both lower prices and a drop in quantity. Other consumer durable imports that increased in 1999 were plastic and wooden furniture, electrical home appliances, fluorescent lamps, light fittings and rubber tyres and tubes.

Intermediate Goods

The value of intermediate goods imports in 1999 remained more or less at the same level largely due to lower international prices which negated the positive growth in import volumes. Textile imports, which were responsible for over 44 per cent of intermediate good imports, declined by 6 per cent attributable to lower prices. Although the volume of crude oil imports declined from 2,156 thousand metric tons to 1,832 thousand metric tons, the value of crude oil imports increased by 19 per cent as the average price rose from US dollars 13.47 per barrel to US dollars 19.06 per barrel. The reason for the lower volume of crude oil imports was the routine closure of the refinery for maintenance. Other petroleum products increased by 31 per cent, attributable to the higher volume imported to meet the additional demand resulting from the temporary closure of the refinery. Lower prices of fertiliser too contributed to the decline in imports. Diamond imports increased by 28 per cent, reflecting the recovery in the diamond and jewellery industries. Other intermediate goods imports dropped by 4 per cent, largely attributable to lower imports of inputs for the soap, garments, livestock food and rubber based manufacturing industries. However, reflecting the recovery in the industrial sector of the economy towards the last quarter of 1999, intermediate goods imports recorded a much higher growth rate of 11 per cent during the second half of 1999.

TABLE 9.5
Volume of Major Imports (a)

'000 MT

Item	1995	1996	1997	1998	1999(b)
Rice	9	341	306	168	214
1st Quarter	8	1	104	136	24
2nd Quarter	...	23	9	12	13
3rd Quarter	...	117	12	2	31
4th Quarter	1	201	181	18	146
Wheat	1,057	913	789	880	859
1st Quarter	315	201	302	340	207
2nd Quarter	213	303	172	155	263
3rd Quarter	323	157	168	126	189
4th Quarter	206	252	147	259	200
Sugar	417	381	545	444	479
1st Quarter	133	94	176	79	152
2nd Quarter	76	84	163	129	64
3rd Quarter	95	58	83	99	138
4th Quarter	113	146	123	137	125
Petroleum (Crude Oil)	1,860	2,033	1,814	2,156	1,832
1st Quarter	332	566	299	567	244
2nd Quarter	452	493	389	431	503
3rd Quarter	584	466	606	662	548
4th Quarter	492	508	520	496	537
Fertiliser	452	361	391	440	539
1st Quarter	185	104	56	109	97
2nd Quarter	97	60	87	98	158
3rd Quarter	56	53	87	82	129
4th Quarter	115	144	161	151	155

(a) Adjusted.
(b) Provisional

Sources : Sri Lanka Customs
Co-operative Wholesale Establishment
Ceylon Petroleum Corporation

Investment Goods

The imports of investment goods increased by 6 per cent in 1999. However, expenditure on investment goods, excluding the aircraft, declined by 14 per cent reflecting declines in all major categories of imports. The drop in investment good imports was particularly due to lower volumes and reduced international prices. A lower growth in imports of investment goods was particularly evident during the first eight months of the year compared with higher imports in 1998 resulting from the immediate response to the generous incentive package provided in the 1998 Budget for the agriculture, transport, textile and garments and telecommunication sectors. During the year, imports of machinery and equipment, particularly in parts and accessories of industrial washing machines, telecommunications, tractors and construction related imports declined by 14 per cent. Similarly, imports of building materials and transport equipment (excluding aircraft), declined by 14 per cent and 15 per cent, respectively.

Direction of Trade

The USA continued to be the largest single buyer of Sri Lanka's exports in 1999. The market share of the USA (40 per cent) remained unchanged at the previous year's level. Garment exports to the USA accounted for 74 per cent of the total exports. However, garment exports to the USA declined by 6 per cent during the year. The UK, the second largest buyer, accounted for 13 per cent, while Germany which overtook Japan in 1998, continued to be 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 75 per cent of Sri Lanka's total exports in 1999 as against 74 per cent in 1998. However, increased exports to the East Asian countries (9 per cent) which have been recovering from the crisis situation in 1998, helped to maintain the market share of developing countries at 21 per cent as in the previous year, despite a decline of 14 per cent in exports to Middle East countries. Exports to CIS countries declined by 27 per cent due to lower tea exports to Russia. Western industrial countries, as a group, continued to be Sri Lanka's largest trading partner.

Japan maintained its position as the largest single exporter to Sri Lanka in 1999. Motor vehicles, spare parts, and woven fabrics were the major items imported from Japan. India was the second largest exporter, followed by Singapore, the Republic of Korea, Taiwan, the UK and the USA. Imports from Japan rose by 1 per cent due to higher imports of motor vehicles. Imports from the USA and the UK declined by 18 per cent and 6 per cent, respectively, thus reducing the industrialised countries' share from 37 per cent to 36 per cent. Reduced prices were the major contributory factor responsible for lower imports from those two countries. Wheat, gold, agricultural equipment, sugar and textiles were among the major items imported from the UK, while wheat accounted for 31 per cent of imports from the USA. Textiles, tools and accessories for the garment industry and fruits were the other major items imported from the USA.

Within the developing countries, the Asian countries experienced an increase in their market share from 84 per cent in 1998 to 85 per cent in 1999. However, expenditure on these imports declined marginally due to the substantial depreciation of the currencies in the East Asian countries in the early part of the year. Sri Lanka's imports from India consisted largely of food items such as lentils, rice, chillies and big onions, trishaws and other motor vehicles, sarees and beedi leaves. Sri Lanka imported electrical equipment largely from Singapore, The Republic of Korea and Taiwan. Imports from Middle Eastern countries declined by 6 per cent but their market share remained unchanged at the previous year's level.

9.4 Services and Income

The services account recorded a marginal improvement during the year. The net surplus in the services account increased by about 1 per cent to US dollars 147 million as a result of a high growth of 6 per cent in receipts and a similar increase in service payments. The growth in service receipts was reflected mainly in travel receipts, which increased by 19 per cent to US dollars 274 million, reflecting the significant improvement in tourist arrivals during 1999. The increase in service payments was mainly attributed to an increase in transportation payments by 7 per cent to US dollars 281million. Travel payments increased by 9 per cent during the period under consideration. Meanwhile, net inflows from port related services declined by 10 per cent to US dollars 131 million, contributing to an overall decrease of 13 per cent in net transportation services. Other business services and freight services continued to record net outflows during the period under review.

The deficit in the income account widened further to US dollars 253 million during 1999, mainly due to a drop in interest income as a result of low interest rates prevailing in the global financial markets and a lower asset base. Investment income receipts on foreign exchange reserves reflected a drop of 23 per cent to US dollars 153 million during the year while interest payments on foreign liabilities increased by 2 per cent. Net outflows on account of profits and dividend payments increased by 23 per cent to US dollars 109 million.

TABLE 9.6

Net Services, Income and Transfers (a)

ITEM	US Dollars Million		Rs. Million	
	1998	1999(b)	1998	1999(b)
1. Transportation	139	121	8,935	8,564
2. Travel	28	55	1,826	3,888
3. Insurance Services	16	17	1,011	1,206
4. Other Business Services	-29	-47	-1,889	-3,282
5. Government Expenditure n.i.e.	-9	-	-583	-38
Total Services	145	147	9,300	10,337
1. Compensation of Employees	-2	-2	-99	-112
2. Direct Investment	-89	-109	-5,747	-7,693
3. Interest and other charges (c)	-89	-143	-5,709	-10,008
Total Income	-180	-253	-11,556	-17,813
1. Private (d)	848	887	54,843	62,472
2. General Government	52	24	3,359	1,690
Total Current Transfers	901	911	58,202	64,162

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-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded.

(d) Includes US dollars 64 mn, US dollars 78 mn.and US dollars 85 mn. received in 1997, 1998 and 1999 as compensation of US dollars 2,500 per person to 26,101, 31,279 and 37,343 Sri Lankans, respectively, who lost employment in Kuwait due to the Gulf War in 1990. In addition US dollars 27 mn.was also received as second round payments of US dollars 1,500 each to 18,244 Sri Lankans in 1999.

9.5 Current Transfers

Net current transfers increased marginally by 1 per cent to US dollars 911 million during 1999. Private transfer receipts, at US dollars 1,056 million, reflected an improvement of 6 per cent entirely due to increased compensation payments of US dollars 112 million received by over 50,000 workers in Kuwait who were displaced during the Gulf war. In comparison, compensation payments received by this category during 1998 amounted to US dollars 78 million. Gross private transfers excluding this specific lump sum transfer from the United Nations indicate an increase of 2.5 per cent from US dollars 921 million to US dollars 943 million. Net private transfer receipts were sufficient to finance 63 per cent of the deficit in the goods, services and income accounts in 1999. Meanwhile, net inflows of official transfers consisting of food and commodity grants declined from US dollars 52 million to US dollars 24 million in 1999.

9.6 Capital Movements

Capital flows to Sri Lanka during 1999 reflected the general decline in capital flows to emerging market economies in the aftermath of the Asian crisis and the associated risk factors. This was aggravated by a cut in aid flows by major donor countries such as Japan in the wake of their own economic problems.

Net capital and financial flows registered a significant drop from US dollars 413 million in 1998 to US dollars 330 million in 1999 due to a decline in net capital transfers from US dollars 80 million to US dollars 75 million and a drop in net financial flows from US dollars 334 million to US dollars 255 million during the same period. As a result, the overall balance of the balance of payments reflected a deficit of US dollars 263 million in 1999 against a surplus of US dollars 37 million in 1998.

Capital Transfers

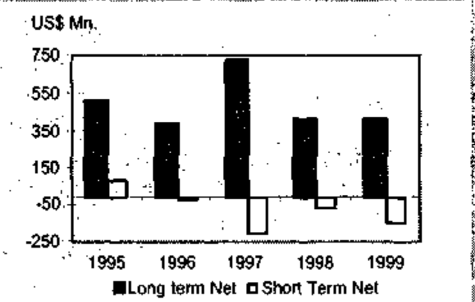
Net capital transfers decreased by 6 per cent to US dollars 75 million in 1999. Official project grants decreased by 3 per cent to US dollars 72 million, while private capital transfers decreased to US dollars 3 million. Japan continued to be the major donor contributing 50 per cent of total grants during the year.

Long-Term Capital

Despite the uncertain global economic and financial environment, net private long-term capital flows increased significantly from US dollars 195 million in 1998 to US dollars 366 million due to increased long-term borrowing by the private sector and higher foreign direct investment flows. The former was mainly reflected in the loan capital received by SriLankan Airlines, Sri Lanka Telecom and the DFCC Bank.

Loan capital to SriLankan Airlines amounting to US

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

dollars 290 million reflected the purchase of three aircraft under its medium term refleeting programme. The programme is expected to be expanded with the purchase of another six aircraft during the year 2000. Borrowing by Sri Lanka Telecom during the year amounted to US dollars 19 million for the continuation of the upgrading and expansion of its telecommunication network. Meanwhile, DFCC Bank received US dollars 5 million from the ADB to finance its small and medium enterprises project.

Foreign direct investment inflows registered a remarkable increase of 34 per cent to US dollars 202 million, a noteworthy development given the net outflow of foreign private capital from the Asian region during the year. The largest share of FDI flows during the year were to telecommunications (32 per cent), power (18 per cent), other industrial (17 per cent), garments (6 per cent) and port services (5 per cent). Meanwhile, FDI outflows increased from US dollars 13 million in 1998 to US dollars 24 million, mainly reflecting the investments by resident entrepreneurs in an oil palm plantation project in Indonesia, a hotel project in the Maldives and a manufacturing plant in the UAE.

Meanwhile, long-term capital inflows to the government declined significantly from US dollars 493 million in 1998 to US dollars 350 million in 1999 due to temporary delays in the implementation of some projects, a general decline in global aid flows to developing countries and a drop in non-concessional loan capital. The majority of the concessional aid disbursements during the year was for power generation, road development, water resources development, health, telecommunications and rural development. Major projects financed by multilateral agencies during the year included the second power system expansion project (US dollars 17 million), the plantation reform project (US dollars 16 million), the emergency rehabilitation of petroleum facilities (US dollars 9 million) and the third road development project (US dollars 8 million) funded by the ADB, the teacher education and teacher development project (US dollars 11 million) and the year 2000 emergency assistance project (US dollars 8 million) funded by the International Development Association (IDA). Meanwhile, projects financed by bilateral donors included the Regional telecommunications development project (US dollars 23 million), the Kukuleganga hydroelectric power project (US dollars 17 million), telecom network expansion project for Greater Colombo (US dollars 17 million), small and micro industrial leader and entrepreneur development project (US dollars 11 million) and the railway rehabilitation project (US dollars 10 million) funded by Japan and the Ampara-integrated water supply scheme (US dollars 13 million) with assistance from Australia. Gross outflows on account of capital repayments increased from US dollars 290 million to US dollars 319 million due to higher loan repayments, which includes the payment of US dollars 34 million in respect of the Floating Rate Note issued in 1997. As a result, net long-term capital inflows to the government dropped from US dollars 203 million to US dollars 32 million.

As in the past, the Asian Development Bank and the International Development Association continued to be the major multilateral donor agencies, extending US dollars 89 million and US dollars 51 million, respectively, under concessional project related lending in 1999. Aid disbursements from Japan amounted to US dollars 150 million in 1999, contributing 44 per cent of total aid receipts during the year.

Short-term Capital

Total net short-term private capital flows declined from a net outflow of US dollars 64 million to a net outflow of US dollars 142 million in 1999 mainly due to a build up of foreign assets abroad by US dollars 120 million by commercial banks and a net outflow of US dollars 13 million in portfolio investments.

Foreign investors continued to be net sellers in the Colombo Stock market, though on a smaller scale than in the previous year, due to continued uncertainties in the region. Portfolio investment inflows increased from US dollars 70 million to US dollars 72 million, while outflows declined from US dollars 93 million to US dollars 85 million, resulting in net outflows of US dollars 13 million through the share market. Short term capital flows to the private sector proper declined from a net inflow of US dollars 8 million to a net outflow of US dollars 10 million. The net outflow of US dollars 10 million was reflected entirely in repayments of short-term loans by the Ceylon Petroleum Corporation.

Commercial bank liabilities dropped by US dollars 101 million mainly due to a drop in borrowings from banks abroad by Foreign Currency Banking Units (FCBUs), while assets increased by US dollars 19 million reflecting an increase in deposits with banks abroad by domestic banking units. As a result, net foreign assets of commercial banks increased by US dollars 120 million in 1999.

9.7 Exchange Rate Movements

Exchange markets, particularly in the East Asian countries, reflected a recovery during 1999 from the high volatility experienced since the eruption of the East Asian crisis in July 1997. Relatively strong macro economic conditions in the United States in an uncertain global economic environment strengthened the dollar against all major currencies except the yen during 1999. Despite the successful launch, the euro could not hold on to its initial rate of euro 1.17 per US dollar. It depreciated by about 14 per cent against the dollar during the year against a background of a somewhat weak economy in the euro area. High volatility of key international currencies continued during the year. The Japanese yen appreciated by 8.8 per cent against the US dollar in response to signs of economic recovery reflected towards the latter part of the year. The pound sterling depreciated by 2 per cent, while the Indian rupee weakened by 2.3 per cent against the dollar during the year. Exchange markets in East Asia remained stable throughout the year. After a 31 per cent depreciation in the previous year the Indonesian rupiah appreciated by 12 per cent against the dollar while the Korean won appreciated by 2 per cent in 1999. The Singapore dollar remained stable with an appreciation of about 1 per cent against the dollar during the year. The Philippine peso (5 per cent) and the Thai baht (3 per cent) depreciated against the dollar. Meanwhile, Malaysia continued with its fixed exchange rate policy throughout the year. In Sri Lanka, the declining trend in the inflation rate throughout the year reduced pressure on the rupee. The Sri Lanka rupee depreciated by 6 per cent in 1999, compared with 9.6 per cent in 1998. It depreciated against the Japanese yen (16.2 per cent), the Indian rupee (3.7 per cent), and the pound sterling (3.5 per cent). Due to the sharp weakening of the euro, the rupee appreciated against the euro by 8.8 per cent. Against the composit unit of account, the SDR, the rupee depreciated by 3.5 per cent in 1999.

It is noteworthy that the real effective exchange rate of the Sri Lanka rupee against the twenty four currency basket depreciated by 7 per cent during 1999. The declining trend in Sri Lanka's inflation rate and the nominal depreciation of the rupee against the dollar helped to improve the country's external competitiveness.

9.8 External Assets

The unfavourable developments in the external environment particularly arising from the east Asian crisis had a profound impact on Sri Lanka's external assets position in 1999. While a slowdown in capital flows during the year meant a relatively larger use of official reserves for external payments, the declining interest rate differential and the slow growth in demand for credit by the private sector induced commercial banks to reduce their exposure to foreign banks.

In this backdrop, Sri Lanka's gross external assets declined by 11 per cent and stood at US dollars 2,582 million at the end of 1999, compared with US dollars 2,907 million at end 1998. This was a combined outcome of a drop in gross foreign assets of the Central Bank by 18 per cent to US dollars 1,619 million and an increase in gross external assets of commercial banks by 2 per cent to US dollars 942 million. While the former was reflected in a decline in its liquid balances, the latter was indicated in an increase in liquid balances of domestic banking units. Meanwhile, gross foreign liabilities of commercial banks declined by 12 per cent due to a drop in external borrowings by foreign

Chart 9.6
Effective Exchange Rate Indices

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

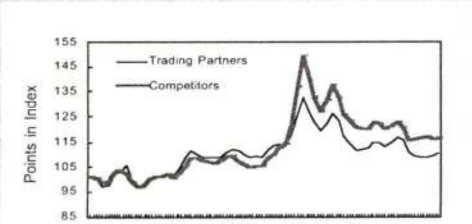


Chart 9.6.2
Nominal Effective Exchange Rate Indices
(1995 = 100)

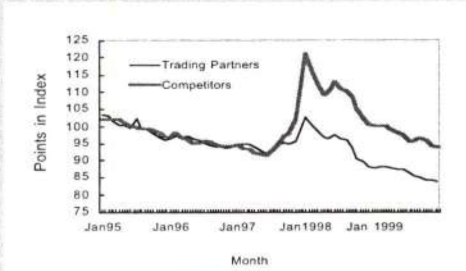


TABLE 9.7
Exchange Rate Movements

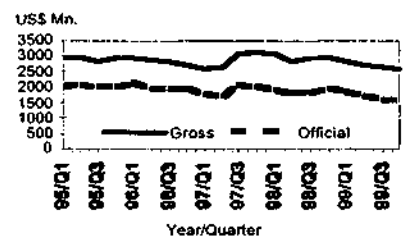
Currency	In Rupees per unit of Foreign Currency						Percentage Change over Previous Year(a)			
	End of Year Rates			Annual Average			Point to Point		Annual Average	
	1997	1998	1999	1997	1998	1999	1998/97	1999/98	1998/97	1999/98
Deutsche Mark	34.24	40.36	37.09	34.07	36.80	38.39	-15.2	8.8	-7.4	-4.1
French Franc	10.23	12.03	11.06	10.12	10.98	11.45	-14.9	8.8	-7.8	-4.1
Indian Rupee	1.56	1.59	1.66	1.63	1.57	1.64	-1.3	-4.3	3.8	-3.7
Japanese Yen	0.47	0.59	0.71	0.49	0.50	0.62	-20.3	-16.1	-1.6	-20.1
Pound Sterling	101.60	112.62	116.72	96.69	107.05	113.91	-9.8	-3.5	-9.7	-6.0
US Dollar	61.29	67.78	72.12	58.99	64.59	70.39	-9.6	-6.0	-8.7	-8.2
SDR	82.69	95.44	98.87	81.17	87.66	96.25	-13.4	-3.5	-7.4	-8.9

(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.

currency banking units. Accordingly, net foreign assets of commercial banks increased by US dollars 120 million in 1999. Gross official reserves, which consists of foreign assets held by the Central Bank and the government, declined by US dollars 345 million to US dollars 1,639 million at the end of 1999. Meanwhile, gross official liabilities declined by US dollars 81 million reflecting the repayments of US dollars 100 million to the IMF. The net outcome of this was a drop in net official reserves by US dollars 263 million which is reflected as a deficit in the balance of payments. Total external assets at the end of 1999 were sufficient to finance 5.3 months of imports for 1999, while gross official reserves were sufficient to finance 3.3 months of imports.

Chart 9.7
Quarterly External Assets



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

9.9 External Debt

TABLE 9.8
External Assets of Sri Lanka

Ownership	US Dollars Million(a)					Rupees Million				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
1. Government (b)	17	23	19	20	20	938	1,295	1,192	1,372	1,441
2. Government Agencies	-	-	-	-	-	-	-	-	-	-
3. Central Bank (c)	2,046	1,915	2,009	1,964	1,619	110,521	108,506	123,093	132,900	116,571
4. Total Official Assets	2,063	1,937	2,029	1,984	1,639	111,459	109,800	124,286	134,272	118,013
5. Commercial Banks (d)	839	780	1,103	923	942	45,338	44,211	67,596	62,561	67,946
6. Total External Assets	2,902	2,717	3,132	2,907	2,582	156,797	154,011	191,881	196,833	185,958
7 Gross Official Assets in Months of										
7.1 Merchandise Imports	4.7	4.3	4.2	4.0	3.3					
7.2 Import of Goods and Services	4.1	3.8	3.7	3.6	2.9					
8 Total Assets in Months of										
8.1 Merchandise Imports	6.6	6.0	6.4	5.9	5.3					
8.2 Import of Goods and Services	5.8	5.3	5.7	5.2	4.6					

(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	1995	1996	1997	1998	1999
Rs per US Dollar	54.05	56.71	61.29	67.78	72.12

(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) 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-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded.

Source: Central Bank of Sri Lanka.

Sri Lanka's total external debt increased from US dollars 8,749 million in 1998 to US dollars 9,049 million in 1999 indicating an increase of 3 per cent. The exchange rate variations, particularly the strengthening of the Japanese yen against the US dollar by about 9 per cent during the year, accounted for about 65 per cent of the increase in foreign debt. Medium and long-term debt consisting mainly of concessional assistance received from the ADB, Japan and the IDA accounted for 92 per cent of the total debt stock.

Total government debt at US dollars 7,088 million accounted for 78 per cent of the total debt stock. Government guaranteed debt of public corporations and the private sector increased by 31 per cent to US dollars 941 million reflecting the external borrowings by SriLankan Airlines to finance its refleeting programme. Consequently, the external debt to GDP ratio rose marginally from 55.5 per cent in 1998 to 57.4 per cent in 1999. Meanwhile, short-term debt outstanding, at US dollars 475 million, reflected

TABLE 9.9

Outstanding External Debt and Banking Sector External Liabilities (a)

Item	US Dollars Million					Rupees Million				
	1995	1996	1997	1998	1999(b)	1995	1996	1997	1998	1999(b)
1. Medium and Long-term Debt	8,152	7,988	7,719	8,264	8,574	440,570	452,944	473,043	557,530	617,504
1.1 Government (c)	6,637	6,554	6,346	6,902	7,088	358,710	371,648	388,925	467,798	511,152
1.2 Public Corporations and Private Sector with Government Guarantee (c)	640	637	670	718	941	34,582	36,098	41,061	48,673	67,839
1.3 Public Corporations and Private Sector without Government Guarantee (c)	279	267	270	277	288	15,066	15,144	16,521	18,789	20,747
1.4 IMF Drawings	596	530	433	367	258	32,212	30,054	26,536	22,271	17,766
2. Short-term Debt	542	498	478	484	475	29,309	28,262	29,323	32,833	34,240
2.1 Government	-	-	-	-		-	-	-	-	
2.2 Other(CPC and other trade credit) (c),(d)	542	498	478	484	475	29,309	28,262	29,323	32,833	34,240
3. Banking Sector External Liabilities (e)	1,078	1,047	1,202	958	885	58,287	59,356	73,638	64,926	63,838
3.1 Central Bank	1	1	1	-	-	27	43	65	24	7
3.2 Commercial Bank	1,004	964	1,094	865	765	54,256	54,678	67,030	58,656	55,142
3.3 ACU Liabilities	74	82	107	92	121	4,005	4,634	6,543	6,247	8,689
4. Total External Debt (1+2)	8,694	8,486	8,197	8,749	9,049	469,879	481,206	502,366	590,363	651,744
5. Total External Debt and Liabilities (1+2+3)	9,772	9,533	9,399	9,707	9,934	528,166	540,562	576,004	655,289	715,582
MEMORANDUM ITEMS										
Medium and Long-term Debt										
(1) Project Loans	4,594	4,654	4,530	5,150	5,453	248,296	263,918	277,637	349,043	393,249
(2) Non-Project Loans	1,871	1,724	1,612	1,656	1,578	101,137	97,745	98,788	112,237	113,819
(3) Suppliers' Credit	256	239	343	251	182	13,837	13,537	21,015	17,020	13,132
(4) IMF Drawings	596	530	433	367	258	32,212	30,054	26,536	22,271	17,766
(5) Other Loans (f)	834	841	801	840	1,103	45,088	47,690	49,067	56,960	79,539
Short-term Debt and Banking Sector Liabilities	1,621	1,545	1,680	1,442	1,360	87,597	87,618	102,961	97,759	98,078
Total External Debt as a percentage of GDP	66.7	61.1	54.3	55.5	57.4	70.4	62.6	56.4	58.0	58.7
Total Banking Sector External Liabilities as a percentage of GDP	8.3	7.5	8.0	6.1	5.6	8.7	7.7	8.3	6.4	5.7
Total External Debt and Liabilities as a percentage of GDP	75.0	68.6	62.3	61.6	63.0	79.1	70.4	64.7	64.4	64.4
Short-term Debt as a percentage of GDP	4.2	3.6	3.1	3.0	3.0	4.4	3.7	3.3	3.2	3.1
Short-term debt and banking sector external liabilities as a percentage of GDP	12.4	11.1	11.1	9.2	8.6	13.1	11.4	11.6	9.6	8.8
Short-term Debt as a percentage of Total Debt	5.5	5.2	5.1	5.0	4.8	5.5	5.2	5.1	5.0	4.8
Short-term liabilities as a percentage of Total Debt	11.0	11.0	12.8	9.9	8.9	11.0	11.0	12.8	9.9	8.9

Sources: Central Bank of Sri Lanka
External Resources Dept.

(a) 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-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded.
(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) ACU debits and foreign liabilities of commercial bank including those of FCBUs
(f) Includes long term loans of public corporations and private sector institutions.

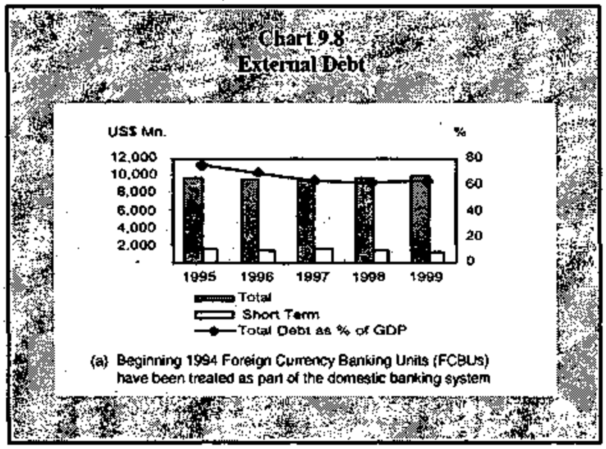


Chart 9.8
External Debt

a decline of 2 per cent due to a drop in borrowings by the Ceylon Petroleum Corporation in the form of suppliers credit. Total short-term debt accounted for nearly 5 per cent of the total debt stock.

Total foreign liabilities including banking sector external liabilities stood at US dollars 9,934 million as at end 1999. Total short-term external liabilities and the banking sector external liabilities accounted for 14 per cent of this total.

9.10 Debt Service Payments

Total debt service payments, which consist of both amortisation of long-term and medium-term debt and interest payments on all foreign debt, increased by 12 per cent to US dollars 846 million during the year due to increases in amortisation of foreign loans and interest payments. While amortisation of foreign loans increased by 17 per cent to US dollars 550 million, repayments to the IMF increased by 20 per cent to US dollars 100 million. Amortisation payments to the IMF were on account of the Structural Adjustment Facility (SAF) and the Enhanced SAF taken between 1988 - 1990 and 1991 - 1994, respectively while those to others comprised mainly debt repayments on government long-term concessional loans. Interest payments on foreign loans increased marginally by 2 per cent to US dollars 296 million in 1999 due to the combined effect of an increase in the debt stock and the declining trend in global interest rates. Interest payments to the IMF declined from US dollars 7 million to US dollars 5 million attributed to the decline in outstanding debt with the IMF. Debt service payments as a percentage

TABLE 9.10
External Debt Service Payments (a)

Item	US Dollars Million					Rupees Million				
	1995	1996	1997	1998	1999(b)	1995	1996	1997	1998	1999(b)
1. Debt Service Payments	764	746	733	759	846	38,652	40,953	42,645	48,773	59,304
1.1 Amortization	452	439	430	469	550	22,642	24,007	24,764	30,076	38,472
(i) To IMF	33	47	66	83	100	1,184	2,314	3,290	5,100	6,813
(ii) To Others (c)	419	392	364	387	451	21,458	21,693	21,475	24,975	31,658
1.2 Interest Payments	312	307	303	289	296	16,011	16,946	17,881	18,697	20,833
(i) To IMF	8	7	6	7	5	407	409	361	443	376
(ii) To Others (c)	304	300	297	282	290	15,604	16,537	17,520	18,254	20,457
2. Earnings From Merchandise Exports and Services	4,627	4,861	5,514	5,712	5,565	237,137	269,159	325,885	369,484	392,408
3. Receipts From Merchandise Exports, Services, Income and Private Transfers	5,644	5,878	6,670	6,925	6,788	289,215	325,420	394,122	447,951	478,574
4. Debt Service Ratio (d)										
4.1 As a percentage of 2 above										
(i) Overall Ratio	16.5	15.3	13.3	13.3	15.2	16.3	15.2	13.1	13.2	15.1
(ii) Excluding IMF Transactions	15.6	14.2	12.0	11.7	13.3	15.6	14.2	12.0	11.7	13.3
4.2 As a percentage of 3 above										
(i) Overall Ratio	13.5	12.7	11.0	11.0	12.5	13.4	12.6	10.8	10.9	12.4
(ii) Excluding IMF Transactions	12.8	11.8	9.9	9.7	10.9	12.8	11.7	9.9	9.7	10.9
5. Government Debt Service Payments										
5.1 Government Debt Service Payments (e)	342.2	378.5	393.4	419.5	449.0	17,888	20,947	24,060	27,126	31,613
5.2 As a percentage of 1 above	44.8	50.7	53.7	55.3	53.1	46.3	51.1	56.4	55.6	53.3

Source: Central Bank of Sri Lanka.

(a) 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-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded.
(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

of receipts from merchandise exports and services increased from 13.3 per cent to 15.2 per cent, while as a percentage of receipts from goods, services, income and private transfers, such payments increased from 11.0 per cent to 12.5 per cent in 1999.

9.11 External Trade Environment and Policy

Import and Export Controls

Sri Lanka's trade and tariff policy continued to facilitate the export led economic growth by creating an environment conducive to enhancing the competitiveness of the export sector while promoting a simple, broad based and transparent tariff system with lower tariff rates. Simplicity and the transparency of the trade and tariff policy were ensured further by minimising quantitative restrictions and removing specific duties, surcharges, hidden duty margins, cesses, ad-hoc duty waivers and exemptions.

The licensing requirements on foreign trade under the Import and Export (Control) Act No 1 of 1969 are now limited to a well defined narrow list considered necessary mainly for reasons of national security, public health, environmental protection and domestic producer protection. Imports of wheat and meslin and wheat and meslin flour continued to remain under licence control in 1999 in order to fulfil the contractual obligations between the government and the milling company, Prima Ceylon Ltd.,

The amendment made to the Import and Export (Control) Act on 17 November 1998 extending age limit of certain categories of motor vehicles used for goods transportation from 5 years to 7 years was in effect till 31 March 1999. In the past, under normal circumstances importers had been required to obtain licences for import of vehicles over 5 years old. This decision contradicted the present policy direction as it was an ad-hoc policy change, effected without considering the objective of environment protection. About 300 items of a total of about 6,000 items at 6 digit level of the Harmonised System Code (HSC) remained under import licence at end 1999.

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

Tariffs and Taxes on External Trade

The external trade policy underwent a clear directional change towards a simplified, more liberal and less protective regime. In line with the recommendations made by 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, the tariff system was replaced with a three band system with 5,10 and 30 per cent with effect from 6 November 1998. All industrial raw material and machinery not manufactured in Sri Lanka come under the 5 per cent band. 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, a few import items remained outside the three band system. Import duty on agricultural products remained at 35 per cent to allow the domestic agricultural sector to adjust to a lower tariff regime over the medium-term. Items considered to be essential for the maintenance of minimum living standards are kept at zero. Only a few items remained under the 20 per cent band for cost of living considerations. A limited number of items, namely sugar, tobacco and liquor, were under specific rates outside the three band system. Further consolidation of the tariff structure to a two band structure of 10 and 25 per cent was announced in the Budget 2000, keeping a few agricultural products under the 35 per cent rate. The concessionary rate of 5 per cent will be gradually eleminated.

There was no change in the number of items (39) under the list of exemptions which came into effect from 6 November 1998. 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 1999.

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. Except for the steps taken to accelerate the refunding process, no major changes with regard to the GST were implemented in 1999.

In line with present policy objectives, the granting of duty waivers on imports was gradually reduced limiting it to very essential items in the national interest. Although these duty waivers and exemptions are supported on the grounds of national interest, these ad hoc waivers created uncertainty and hindered the gradual process of achieving a simple and transparent tariff structure. However, commitment to minimise distortions can be seen in the changes that have taken place in the tariff structure in the recent past, although there have been a few exceptions.

Among the few duty waivers effective during 1999, the partial duty waivers of 20 per cent granted on copra and 30 per cent granted on edible oils other than coconut oil, which have continued since 13 January 1998 and 18 June 1998, remained unchanged. A partial duty waiver of 25 per cent on rice was introduced for the period of 22 October to 31 December 1999 aiming at maintaining domestic prices at a reasonably low level during the festive season by avoiding an expected supply variation. This decision created a surplus supply in the market as the Yala harvest was higher than

TABLE 9.11
Average Import Duty Collection Rate (a)

Item	1995	1996	1997	1998	1999(b)
Consumer Goods	10.7	10.3	11.8	12.7	12.8
Food and Drink	10.1	9.1	11.5	12.6	13.6
Rice	35.5	0.3	6.3	2.4	16.4
Flour	-	2.3	-	-	-
Sugar	14.6	15.9	17.8	20.8	21.3
Wheat and Meslin	-	-	-	-	0.3
Milk and Milk Products	11.5	11.5	11.8	11.5	11.6
Dried Fish	2	2.1	1.6	1.1	1.2
Other Fish Products	4.6	4.2	4.9	4.8	4.8
Other Food Items	18.7	19.0	17.9	20.5	19.9
Non-Food Consumer Goods	11.8	12.6	12.2	12.8	12.0
Motor Cars & Cycles	21.7	24.3	24.5	23.6	20.1
Radio Receivers-Television Sets	6.9	12.1	11.5	12.4	11.9
Rubber Tyres & Tubes	33.6	32.5	33.5	32.0	28.4
Medicinal & Pharmaceutical Products	1.5	1.5	1.3	0.9	0.6
Other Non-Food Items	11.1	10.6	9.4	10.1	9.1
Intermediate Goods	9.1	8.0	5.9	4.7	4.1
Fertiliser	-	-	0.1	-	-
Crude Oil	41.1	33.6	21.7	25.8	15.8
Other Petroleum Products	23.4	24.6	18.7	16.7	16.1
Chemical Elements and Compounds	9.8	7.6	7.6	5.8	3.6
Dyeing, Tanning and Colouring	8.8	8.2	7.1	7.5	5.3
Paper and Paper Boards	9.8	6.9	6.0	6.0	5.7
Textiles & Clothing	1	1.1	0.8	0.1	0.1
Other Intermediate Goods	9.2	5.7	5.2	4.8	4.1
Investment Goods	10.1	7.6	7.0	6.0	4.4
Building Materials	8.7	9.3	9.1	9.3	7.8
Transport Equipment	21.6	18.9	17.3	11.8	7.4
Machinery and Equipment	6.2	3.9	3.4	3.0	2.2
Other Investment Goods	10.1	6.7	6.3	4.4	3.4
Total	9.7	8.5	7.7	7.4	7.0

Sources: Sri Lanka Customs,
Co-operative Wholesale Establishment,
Ceylon Petroleum Corporation,
Central Bank of Sri Lanka

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

in the previous year (about 130,000 metric tons) while about 142,800 metric tons were imported during November and December 1999. For the same purpose, black gram, black gram flour, chickpeas, split chickpeas and thur dhal were also granted a full duty waiver for the period of 22 October-31 December 1999. A partial duty waiver of 6 per cent for diesel vehicles and 19 per cent for petrol vehicles was introduced on 22 February 1999 on imports made by public sector employees under a special scheme.

With regard to intermediate goods, a limited number of duty waivers were granted as relief measures. Full duty waivers introduced in 1998 for large scale manufacturers to import wheat flour and to state electronic media institutions to import media equipment continued in 1999. The latter concession was given in 1998 to enable state institutions to be competitive with private media institutions enjoying BOI status.

With the removal of duty waivers on whole and split lentils (35 per cent band), dried fish, dried sprats and dried prawns (10 per cent band), wheat grain (20 per cent band), live animals used for breeding purposes (10 per cent band), compact fluorescent lamps (10 per cent band), shrimp food, vitamins, coaches with 15 seats and above to provide transport facilities and buses for public transportation (10 per cent band) and partial waivers on canned fish (10 per cent band), milk powder (10 per cent band), effective since 1998, together with a reduction in waivers given on selected items to individuals, the revenue foregone due to duty waivers declined from Rs. 4,091 million in 1998 to Rs. 2,258 million in 1999.

The average import duty rate, i.e. the ratio of import duty collection to total adjusted imports, declined from 7.4 per cent in 1998 to 7.0 per cent in 1999, reflecting decreases in duty rates and dutiable imports. The share of dutiable imports in total imports declined from 35 per cent in 1998 to 34 per cent in 1999 reflecting the reduction in dutiable imports in the intermediate and investment goods categories. In the intermediate goods category, dutiable imports declined from 27 per cent to 24 per cent, while in the investment goods category, dutiable imports declined from 42 per cent to 39 per cent. The impact of the lower duty rates effective throughout 1999 was also reflected in all categories of investment and intermediate goods. The average duty rate on intermediate goods dropped from 4.7 per cent in 1998 to 4.1 per cent in 1999. The average duty rate on investment goods too declined to 4.4 per cent in 1999.

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 and rice. The full year impact of the removal of the duty waiver on sugar and the introduction of a specific rate from 16 January 1998, resulted in significantly higher average duty rates in 1999. The relatively higher duty rate on rice was due to the partial duty waiver on rice, which was effective for the period of nearly 10 weeks from 22 November 1999, as against full duty waiver effective in January 1998. A reduction in the average duty rate on non-food consumer goods was indicated in respect of motor cars partly due to the partial duty waiver granted for public sector employees in the 1999 Budget.

Textile and Garment Quota Allocation

The performance based quota system introduced in 1995 was continued in 1999. No major revisions in quota allocation took place in 1999. The Textile Quota Board (TQB) allocates Textile Quotas (TQs) each year primarily on the basis of past export performance. Allocation on the basis of past performances is referred to as 'Main Quota' or 'Performance Quota' allocation. In order to provide flexibility to the industry, exporters who holds Performance Quota are permitted to transfer unutilised quotas to another exporter through the TQB on a permanent or a temporary basis, but sale or purchase of quota is not permitted. About three per cent of quotas are allocated to small quota holders who have less than 4,000 dozens in all categories, on a pro-rata basis. The quotas that are available in a year on account of growth and flexibility provisions are earmarked for new investors and existing manufacturers who expand their capacities by investment in new machinery and equipment. Immediately after the allocation of performance quotas, the remaining quotas were allocated under the main pool quota scheme on a pro rata basis, on the number of employees. In the allocation, 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 should be made within seven working days.

Quota availability to USA, the EU and Canada rose by 4 per cent, 7 per cent and 1 per cent, respectively, under the flexibility provisions. Accordingly, overall quota availability increased by 4 per cent in 1999. The overall quota utilisation rate increased from 74 per cent in 1998 to 80 per cent in 1999 particularly due to increased utilisation of the US quota. The utilisation of the US quota increased from 78 per cent in 1998 to 85 per cent in 1999. The utilisation of quotas varied widely across different categories and countries. The under utilisation was partly due to insufficient demand for particular items as local producers used their capacity to produce high value added garments under other quota categories or to produce non-quota garments. This was evidenced by the increased exports in the non-quota garment categories and full utilisation of some popular categories. Quota allocated for certain popular categories to the USA and the EU such as lady's dresses, shirts and blouses, dressing gowns, men's and boys' shirts, men's and women's trousers and men's shorts and breeches, terry and other pile towels and shop towels, were used almost in full while some items, such as the trousers and shirts categories, were over utilised. This was partly due to the use of forged documents for exports to the USA.

Despite the increase in allocation of quota to the EU and Canada, quota utilisation rates in these countries was relatively lower than to the US market. However, utilisation rates were marginally higher than in the previous year. Except men's and women's trousers and men's shorts and breeches to the EU and trousers, overalls and shorts, women's shirts and blouses to Canada, all other quota categories to these countries were significantly underutilised. The garment and textile exports to the USA, highly concentrated in quota garments, declined by 6 per cent, contributing to the overall decline of 1 per cent in total earnings from textiles and garments. However, earnings from exports to the EU increased by 11 per cent, despite the lower rate of quota utilisation, indicating a move towards non-quota markets in the EU. Exports to non-quota countries too increased by 6 per cent in 1999 showing a positive move towards diversification of export markets and shifting from quota to non-quota categories.

A noteworthy development in 1999 was Sri Lanka's entry into the Electronic Visa Information System (ELVIS) which is designed to transmit key statistics on exports of textiles and garments directly to the US Customs through the electronic media. In a manner similar to visas issued in the case of travel by persons, the export of textiles and garments from Sri Lanka to the USA require a legal permit of entry, or visa. Visas for textile and garment products are issued by the BOI, TQB and the Ministry of Industrial Development. The exporters have to dispatch the document manually to importers in the USA, enabling them to clear the goods. This practice was vulnerable to counterfeiting, forging of signatures and illegal routing. An increasing number of visa forgeries that have taken place in recent years were identified by the TQB and as a way of overcoming those difficulties, Sri Lanka joined the ELVIS.

The ELVIS message, which is transmitted after the issuance of the visa, contains identification details such as visa number, date of issue, category, quantity and unit name and address of the manufacturer and his identification code and the name and address of the buyer as well as his identification code. When the TQB transmits the relevant information electronically to the US Customs services, the shipment is released, only if such information is matched with the data provided by the US buyer. At the initial stage of introduction of the ELVIS in Sri Lanka, there was a dual system with both paper visas and ELVIS messages. During this transitional period, matching of certain data with the manual system was required for Customs clearance. When the system is fully implemented, exporters, TQB and the US Customs will be linked through the ELVIS system allowing transmission of information from the exporter's office to the TQB and from the TQB to the US Customs.

In addition to the advantage of countering forgeries, the implementation of the ELVIS in Sri Lanka will enable a vital segment of the export industry to enter the electronic era. The ELVIS would minimise the delays involved in the process of exports by enabling exporters to obtain conformation of the visa registration and clearance of goods at the US Customs within a shorter period. After the full implementation exporters will receive this information directly at their offices. The TQB will be able to monitor quota utilisation right away and allocate the balance quota in a more efficient manner as all the information relating to utilisation of quota will be updated instantaneously. Overall, the full operation of the ELVIS will minimise the forgeries, simplify the export documentation, increase the efficiency in issuing visas and the accuracy, security and reliability of transmitted information and speed up the import clearance process in the USA.

Incentives to Exporters

During 1999, the government implemented various incentives proposed in the 1999 Budget targeting exporters and their skills requirements. BOI companies are provided with a preferential tax rate of 15 per cent and duty free facilities to establish training facilities. In order to further stimulate the private sector investor engagement in the provision of training facilities in priority sectors such as garments, gem and jewellery, electronics and computer software, the 1999 Budget announced the provision of a 5 year tax holiday to each training institute which undertakes training for a minimum of 300 persons.

In view of the encouraging response from investors for regional industrialisation, the 1999 Budget extended the BOI incentive package for another year. Thus, exporters who set up their industries before 31 December 1999 in backward areas will be granted BOI incentives such as tax holidays and import duty exemptions on capital goods and raw material and will also be exempted 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 requirement of a minimum investment under this scheme was eliminated in the 1999 Budget to provide benefits to small industries for importing machinery and equipment.

Institutional Support to Exporters

Exporters continued to receive institutional support from the Ministry of Plantation Industries (MPI), export development authorities, the Export Development Board (EDB) and the Sri Lanka Export Credit Insurance Corporation (SLECIC), other related ministries and government institutions. Support for developing traditional exports was provided by the MPI. The EDB played a major role in the development and promotion of non-traditional exports. In this regard, the EDB advised exporters on product development and diversification, quality improvement, improvement of technical capabilities and productivity, export packaging and attaining quality standards. It also assisted exporters to penetrate new and emerging markets, while maintaining market shares in existing markets.

The SLECIC granted credit insurance and guarantee services. Other relevant institutions, especially the Ministry of Foreign Affairs and the Ministry of Internal and International Commerce, continued to educate exporters on facilities available through bilateral, regional and multilateral organisations and were instrumental in establishing contacts between Sri Lankan entrepreneurs and their foreign counterparts. Private sector institutions such as Chambers of Commerce, also provided institutional support to exporters.

Under its technical and skills development programmes, the EDB conducted 111 programmes and workshops. The EDB organised the participation of Sri Lankan exporters in 35 product specific and general international trade fairs during the year 1999. In addition, buyer missions from the Philippines, Japan, Pakistan, Hungary, India and the Nordic region and a seller missions to Chile and other South American countries were organised. The EDB provided information to 43 trade inquiries from Pakistan, Maldives, Australia, Russia, India, Singapore, Japan, Middle East and Yugoslavia. The EDB also made a considerable effort to popularise e-commerce. The e-business section of the EDB, 'Cyber Trader', was opened in May 1999. Global Internet was accessed to obtain information on markets, trade regulations and trade opportunities. E- commerce centres were established in Galle, Matara and Hambantota. The Overseas Promotion Offices of the EDB in Rotterdam and Male promoted Sri Lankan products and services in the respective markets and also attracted investments from these regions.

The EDB continued to provide advice and assistance to exporters to resolve their various operational problems in relation to sea and air freight and entrepot trade. The EDB sponsored 24 small and medium scale enterprises (SMEs) for participation at the Jana Nipayum exhibition held in Colombo. A reverse exhibition was organised with the assistance of the Japanese External Trade Organisation (JETRO) for 5 Japanese companies who displayed products samples from Sri Lanka.

The SLECIC continued to assist exports of goods and services through support services of export credit insurance and guarantees for the development of exports in Sri Lanka. There were 224 policies in force at end 1999 and the total value of exports covered under insurance policies amounted to Rs.1,736 million by end December 1999. The number of policies issued during 1999 amounted to 37 with the value of Rs.262 million, as against 60 policies issued to the value of Rs.476 million in 1998. The drop in policies issued was largely attributable to increased premiums arising due to the Goods and Services Tax. Guarantees in force at end 1999 amounted to 1,392 with a total value of Rs.2,045 million as against 1,477 guarantees at end 1998 amounting to Rs.2,132 million. New business underwritten under bank guarantees increased by 32 per cent in number and 45 per cent in value. This was due to the underwriting of 190 new guarantees to the value of Rs.210 million in 1999 as against 144 new guarantees to the value of Rs.145 million underwritten in 1998. Claims paid under both insurance policies and guarantees amounted to Rs.6.4 million in 1999 as against Rs.8.6 million in 1998. During the year, the SLECIC issued direct guarantees to the value of Rs.9.2 million on behalf of 24 exporters. The SLECIC also issued seven export payments insurance policies for small scale exporters to the value of Rs.18 million in 1999. Further, it launched a

Box 5

Harnessing the Potential of E-Commerce

Electronic Commerce (e-commerce) is the general term applied to the use of the Internet to carry out normal business activities. A finer definition of e-commerce restricts it to trading activities conducted using the Internet. Thus, e-commerce is a subset of the broad activity of Internet based business (e-business).

Business enterprises use e-business for at least two purposes. They use it to market their products to consumers, and to manage the supply chain. Supply chain management is the computer based control of inventories; both material and finished goods. Consumers use e-business facilities to procure goods and services, pay bills and obtain information. The government could use e-business to cut down on the costs and extent of bureaucracy involved in facilitation and regulation. Thus, e-business branches out to e-commerce, e-banking, e-central banking and e-governance. The key features of e-business are ease, efficiency, simplicity and transparency. The success of e-business depends on an enterprise's ability to analyse, rationalise and integrate business activities.

The history of the development of the Internet and e-business reveals that they were the result of combined efforts of the government of the United States of America (USA), universities and private entrepreneurs. The initial demand for the technology and essential funding was generated by the US government. Human capital resources available in the universities, commercial interests and the entrepreneurship of the private sector fuelled the development process. As the Internet technology became easily accessible, and as it became a popular mode of business, the government withdrew itself from supplying the technology, but resorted to developing a suitable environment by bringing in necessary regulatory, supervisory and security mechanisms, and amending laws to facilitate e-business.

The origin of the Internet dates back to 1969, when the Advanced Research Projects Agency (ARPA) within the Department of Defence of the US government connected four major universities in the USA establishing the ARPANET. The contract for the development of the network was granted to a private firm, Bolt, Beranek and Newman (BBN), by ARPA in 1968. The theoretical foundations of the ARPANET were based on the research work of Leonard Kleinrock and J. C. R. Licklider of the Massachusetts Institute of Technology, USA, respectively, in 1961 and 1962.

Ray Thomson of BBN created the first e-mail program in 1972. In 1973 development work of a protocol to connect diverse computer networks began. The protocol was eventually called the Transmission Control Protocol/Internet Protocol (TCP/IP), and is the origin of the protocol used in the modern Internet. In 1979, IBM created BITNET (Because Its Time Network) to connect IBM mainframes around the educational community. In 1981, the National Science Foundation (NSF) created a network for non-commercial government and research uses. With these developments, by 1985, the Internet was already well established as a technology supporting a broad community of researchers and developers and was beginning to be used by other communities for daily computer communications. The NSF developed its network further, and in 1995 disallowed direct access to its network, and contracted out the access to four companies to be sold to the users. Thus, from the meager beginning of just 4 hosts of the Internet in 1969, the process of technological advancement, state sponsorship and commercialisation increased the number of hosts to well over 30 million by 1999. Commercialisation of the Internet became popular through constant dialogue between Internet users and developers, regular conferences, workshops etc. Commercialisation involved the development of private network services and commercial products implementing the Internet technology.

Countries outside USA rapidly embraced the new Internet technology and began preparing the environment to harness the potential of e-business. For example, neighboring India has established the Ministry of Information Technology, brought in amendments to various legislation, and made plans for providing Internet infrastructure facilities at low cost.

With the increasing use of e-business between countries, international organisations have stepped into provide standards and set up rules and regulations. Some of these are the World Trade Organization, United Nations Center for the Facilitation of Procedures and Practices for Administration, Commerce and Transport (UNCEFACT), and Center for Strategic and International Standards.[1]

In Sri Lanka some degree of e-commerce takes place in the private sector, but essential ingredients such as low cost telecommunication facilities, legislation and security

1. www.giic.org and United Nations; UN/EDIFACT is the standard

Box 5 (Contd.)

measures are yet to evolve fully. The predecessor of e-commerce, Electronic Data Interchange (EDI), is being used quite extensively by the financial sector in Sri Lanka. EDI does not use the Internet as the operating platform, it uses private platforms. Financial institutions in Sri Lanka use EDI predominantly for financial services. Those services are fund transfers using the system of the Society for Worldwide Interbank Financial Telecommunications (SWIFT), automated teller machine services and consumer banking.

The push for the development of information technology is carried out by the Council for Information Technology (CINTEC), an institution operating under the Ministry of Science and Technology. Promotion of e-business and e-commerce is undertaken by the Ministry of Internal and International Commerce and Food and its affiliated institute, the Sri Lanka Export Development Board.

Successful e-business involves coordination on several frontiers. Infrastructure facilities such as low-cost and widely available telecommunications facilities should be established. Measures relating to consumer protection, privacy and security of transactions need to be established. In the long-run, the quality of users and cognitive skills of the population need to be upgraded. Thus, the government has a major role to play in fostering e-business. Deregulation of the telecommunication industry may lead to increased competition and low-cost and widely available telecommunication facilities. There is a need to amend existing laws and bring in new legislation to facilitate e-business. The technology involved in providing security to Internet transactions is evolving (encryption technology) at present. Security also requires a 'trusted third party' or a 'certification agent' for Internet transactions. A government institution should provide such facilities. The government could re-engineer its processes and operations by using techniques of e-business. This will enhance the domestic demand for e-business and will generate a catalytic effect on private sector initiatives.

scheme to provide comprehensive services policies covering the export of services, in May 1999. The software, professional services and construction sectors are eligible for this facility. The policy covers non-payment or delayed payment by overseas buyers. During the year two such policies covering software were issued to the value of Rs.173 million.

During 1999, the Chambers of Commerce held a number of seminars and discussions on various issues such as the Free Trade Agreement between Sri Lanka and India, transport problems and possible solutions, negotiations skills for management excellence, environmental regulations and their impact on business, Y2K readiness, total quality management and documentary credit. Further, the Chambers participated in monthly meetings between the Treasury, exporters and the Department of Customs and settled many of the problems faced by its members. They maintained databases on overseas trade inquires with regard to export, import and joint venture opportunities. During 1999, the Chambers issued certificates of origin, entrepot certificates and miscellaneous commercial documents such as quality and weight certificates, agency agreements, radio activity certificates and shipping and agency certificates.

Freight Rates

During 1999, average freight rates for several destinations showed mixed changes. Generally, the average freight rates to the U.K., the USA, France and Egypt were higher than in 1998, while those to the Middle East and Asia were lower in 1999. Sharp increases were observed in the freight rates to the USA. The average freight rate for tea, rubber, garments and fibre to the U.K. increased while that for desiccated coconut decreased. The average rate for tea, rubber and desiccated coconut to the North Continent decreased while that for garments increased. The freight rates to Egypt and Saudi Arabia increased while those to Japan, Singapore, Dubai and Pakistan decreased. Thus, the rates had an adverse impact on exporters of commodities such as fibre which have a lower FOB value. This will lead to out-pricing of Sri Lankan fibre in the major fibre markets in the USA.

Shipping lines covering destinations in Asia have adopted the Freight of All Kind (FAK) system while those covering the U.K., the North Continent, the Mediterranean, France, Egypt, the USA and Canada adopted a commodity based freight system.

Freight rates are determined partly by the global demand and supply and 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.

The Terminal Handling Charge (THC), which was imposed by the shipping lines from September 1996, was increased in June 1997. While the shippers continued their protest against the imposition of the THC, some shipping lines increased the existing THC in the first quarter of 1999. During the later part of the year 1999, the Shippers' Council, Exporters Associations and Trade Chambers maintained that the shipping lines did not comply with the consultative procedure evolved to negotiate increases in freight rates and levying of other surcharges. The breakdown of this procedure was a set back to exporters in obtaining reasonable terms for their shipments.

The policies of the Central Freight Bureau (CFB) did not undergo any changes in 1999. However, the government is in the process of revising the shipping policy by proposing a new institution, the 'Maritime Authority'. The CFB will be given new functions after the formulation of the new institution.

9.12 Trade Relations, Trading and Clearing Arrangements

A fresh look was taken at Sri Lanka's trade relations in 1999 with the signing of the Indo-Lanka Free Trade Agreement (ILFTA), and the failure of the 3rd Ministerial Meeting of the World Trade Organization (WTO). There was an enhanced public inquiry into the nature of Sri Lanka's trade relations with the rest of the world and preparedness of Sri Lanka to face the challenges of liberal trade and globalisation in terms of legislation to prevent dumping in the domestic market, maintaining standards of imports, safeguarding national interests and providing infrastructure facilities in sharpening the national competitive edge.

The unilateral tariff reduction and implementation of the ILFTA came after the presentation of the Budget in February 2000. However, strengthening of the legal and institutional framework underlying international trade was a major focus in 1999. The Inter-Ministerial Sub Committee on Anti-Dumping and Countervailing duties prepared the first draft of Anti-Dumping and Countervailing Duties Legislation. Proposals for draft bills on the legislation on Customs Valuation and the legislation on Intellectual Property have been prepared by the Department of Customs and the National Intellectual Property Office in Sri Lanka, respectively.

Sri Lanka entered into several bilateral agreements in 1999. The agreement on Trade, Economic and Technical Co-operation signed with Ukraine will grant a 50 per cent reduction of import tariff on Sri Lanka's tea exports to Ukraine. An agreement was signed with the Czech Republic to strengthen trade relations. Sri Lanka held bilateral discussions with Iraq, and as a result, Iraq will import up to 6 million kg. of tea from Sri Lanka under the 6th phase of the 'Oil for Food Program', and would purchase 3 million kg. of vegetable ghee. Sri Lanka has offered to purchase 120 million metric tons of crude oil from Iraq. The continuation of negotiations at the Sri Lanka- European Commission (EC) Joint Commission resulted in receiving tariff concessions on imports of garments and fabrics manufactured with yarn imported from EC. Sri Lanka also had discussions with Norway on a trade and commercial partnership. Sri Lanka has proposed agreements on economic and technical co-operation with Russia, Georgia, Uzbekistan, Moldova, Armenia, Belarus, and Kazakstan.

The regional economic co-operation was fostered further in 1999 with continuing discussions with the South Asian Association for Regional Cooperation (SAARC), Bangkok Agreement, Bangladesh, India, Myanmar, Sri Lanka, Thailand-Economic Cooperation (BIMST-EC), and Indian Ocean Rim Association for Regional Cooperation (IOR-ARC).

The eleventh summit of the SAARC planned to be held in Katmandu could not be held in 1999 due to lack of consensus among member countries. The fourth round of negotiations under the South Asian Preferential Trading Arrangement (SAPTA) could not be held as planned due to the absence of representation from Pakistan. However, the value of Sri Lanka's exports to SAARC under SAPTA, given in Table 9.12, showed a significant improvement in 1999 although it did not grow in relation to total exports to each member country.

The work on the implementation of the South Asian Free Trade Agreement (SAFTA) progressed slowly in 1999. Plans for drafting a 'Comprehensive Treaty Regime' for SAFTA were made in 1999.

The annual BIMST-EC Ministerial Meeting was not held in 1999. Two Expert Group Meetings on Tourism, and Textiles and Clothing were held in Colombo to fullfil Sri Lanka's commitments made at BIMST-EC Ministerial Meeting held in 1998. At the IOR-ARC Ministerial meeting held in 1999, a committee, with Sri Lanka as a member, was appointed to develop an agenda for trade and investment policy.

Sri Lanka continued to receive tariff concessions from the participating developed countries of the Global System of Preferences (GSP), without any reciprocity. The direction of exports under this scheme did not show any significant change in 1999. Member countries of SAARC and the SAARC Secretariat are now negotiating with the EC to obtain special concessions for its members on the local content requirement under the 'cumulative rules of origin' criterion for the grouping. Under this criterion, material imported from SAARC member countries and used in production in any member country could be considered 'local material' in deciding the local content requirement.

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 1999, Sri Lanka exported goods to the value of Rs.268 million to Romania, Peru, Tunisia, Mexico and Chile.

Box 6

Indo Lanka Free Trade Agreement

The Indo Lanka Free Trade Agreement (ILFTA), officially titled the 'Free Trade Agreement Between the Democratic Socialist Republic of Sri Lanka and the Republic of India' was signed on 28 December 1998 by the Sri Lanka President, H. E. Chandrika Bandaranaike Kumaratunga and the Indian Prime Minister, Shri Atal Bihari Vajpayee. As was explained in the Annual Report of 1998 of the Central Bank, important details had not been finalised at the time of the signing of the agreement.[1] Subsequently, throughout 1999, both governments assessed the possible impact of the agreement under different scenarios of tariff reduction. On the basis of their findings, various tariff reductions have now been finalised. Tables 1 and 2 provide a description of tariff reductions.

A recent study done at the Central Bank assessed the possible short-run impact of the agreement on Sri Lanka's trade and industry.[2] The impact on Sri Lanka's exports was assessed by examining tariff reduction by India on goods produced and exported by Sri Lanka to the world. The tariff reduction was assumed to engender a market opening in India for Sri Lanka's products. Similarly, Sri Lanka's imports from India would increase in proportion to the market opening arising from the reduction of tariffs by Sri Lanka. Tables 3 and 4 give the existing trade and potential impact on trade.

The agreement will have an impact on domestic industries to the extent that the agreement lowers tariffs on the import of similar goods from India. However, the agreement does not remove tariffs in a very liberal manner. As seen in the Table 1, only 6 per cent of items are subject to 100 per cent tariff removal, whereas 25 per cent are subject to no tariff removal at all (negative list). Items subject to the phased out tariff removal will face a 35 per cent removal of tariffs in the first year and complete removal of tariffs in eight years.

The short-run impact of the industry is measured by assessing the impact on the profitability of domestic industries.[3] The Central Bank study included an assessment of the agreement on a sample of 475 firms. The study evaluated the profitability of a firm after and before imposing tariff concessions. A reduction in tariff is assumed to lower the market price of similar goods

TABLE 1
Broad Agreement on Tariff Concessions under ILFTA

Granting Country	Degree of Tariff Cut	Description of Items Receiving Tariff Cuts
India	0 per cent removal of tariff	for items in Annexure D of the agreement (Negative List)
	25 per cent removal of tariff	for items in Chapters 51-56, 58-60 and 63
	100 per cent removal of tariff	for items in Annexure E of the agreement
	50 per cent removal of tariff	Upto 15 Mn kg of Tea, 2 Mn. pieces of garments, and 6 Mn. pieces of garments using Indian fabrics (a)
	50 per cent removal followed by phased out removal of tariff	for remaining items (margin will be increased upto 100 per cent in two stages within three years)
Sri Lanka	0 per cent removal of tariff	for items in Annexure D of the agreement
	100 per cent removal of tariff	for items in Annexure F-I of the agreement
	50 per cent removal of tariff followed by phased out removal of tariff	for items in Annexure F-II of the agreement (the margin will be deepened to 70 per cent, 90 per cent and 100 per cent, respectively at the end of first, second and third year of the entry into force of the agreement)
	Phased out removal of tariff	for remaining items by not less than 35 per cent before the expiry of three years, 70 per cent before the expiry of sixth year and 100 per cent before the expiry of eighth year

(a) The quota of tea has been increased up to 15 Mn kg by the time of adapting the agreement.

produced by domestic industries. Thus, it will also reduce the profitability of a firm. Results of the study are given in Table 5. As seen in Table 5, only a marginal impact is expected on industries. There are several reasons for the marginal impact. Sri Lanka is

1 Central Bank of Sri Lanka, 1998, Annual Report, Colombo, Sri Lanka

2 Jayatissa R. A., and H. N. Thenuwara, Short-run Impact of Indo Lanka Free Trade Agreement on Sri Lanka's Trade and Industry, Staff Studies, Vols 25-26, 1995/96 (published in 2000)

3 Profitability is defined as the ratio between profits and income. Data on profitability of various domestic industries are published in Annual Reports of the Central Bank.

Box 6 (contd.)

generally a low tariff country. Most of the tariff reductions are imposed on items with already low tariff. High tariff items are in the negative list and as such do not face any immediate impact. Items in the phased out list are subject to only a 35 per cent tariff reduction in the first three years. Therefore, the short-run impact is minimal.

The long-run benefits from the agreement are expected through several channels. Continued tariff removal will enhance the competitiveness of domestic industries. Sri Lanka's exporters will have greater access to a large market. Sri Lanka will also be able to attract foreign investment into the country, if she can offer better physical and procedural infrastructure to firms who would operate in Sri Lanka and export to India.

TABLE 2
Summary of Tariff Concessions

Tariff Reduction (%)	Sri Lanka's Proposals		India's Proposals	
	Tariff Lines		Tariff Lines	
	No.	%	No.	%
100	319	6.2	1,441	28.1
50	893	17.4	2,510	49.0
50 with Quota:				
Tea			4	0.1
Garments			251	4.9
35	2,630	51.4		
25		-	527	10.3
0 (negative list)	1,279	25.0	388	7.6
Total	5,121	100.0	5,121	100.0

TABLE 3
Sri Lanka Exports in 1998 and Potential for Expansion

Tariff Reduction	To India			To World			Market Opening Factor (b)	New Export Level USD Mn
	Tariff Lines		Value USD Mn	Tariff Lines		Value USD Mn		
	No	% (a)		No	% (a)			
100	59	2.3	2.6	475	18.3	87	8	21
50	167	6.4	27.0	1,060	40.9	1,221	6	171
50 Tea	4	0.1	1.4	11	0.4	780	17	30
50 : Garments	48	1.9	0.1	373	14.4	2,460	480	48
25	28	1.1	0.8	304	11.7		11	9
0	79	3.1	2.6	367	14.2	1,576	1	3
Total	384	14.8	34.5	2,590	100,0	4,548	8	282

(a) The percentages shown are tariff lines as a percentage of Sri Lanka's total actively traded tariff lines, 2590.
(b) Market opening factor is derived as the ratio of number of tariff lines of active exports to the world and the number of tariff lines of exports to India.

Box 6 (contd.)

TABLE 4
Sri Lanka's Imports in 1998 and Potential for Expansion

Tariff Reduction	From India			From World			Market Opening Factor	New Export Level USD Mn
	Tariff Lines		Value USD Mn	Tariff Lines		Value USD Mn		
	No	% (a)		No	% (a)			
100	158	3.5	5	281	6.2	38	1.8	9
50	583	12.8	65	821	18.1	570	1.4	92
35	1,383	30.4	216	2,315	50.9	3,199	1.7	362
0	684	15.1	267	1,127	24.8	2,084	1.0	267
Total	2,808	61.8	553	4,544	100.0	5,891	1.6	729

(a) The percentages shown are tariff lines as a percentage of Sri Lanka's total actively traded tariff lines, 4544.

TABLE 5
Summary of Short-run Impact on Industries

Impact	Percentage of Firms
No impact	76
Moderate impact (a)	22
Heavy impact (b)	2
Total	100

Notes:
(a) Firms with profitability in the range above 10 per cent remaining above 10 per cent or in the range below 10 per cent remaining below 10 per cent.
(b) Firms with profitability in the range above 10 per cent falling below 10 per cent or in the range below 10 per cent falling below 0.

Sri Lanka continued to enjoy tariff concessions under the Bangkok Agreement (with the membership of India, Bangladesh, South Korea, Laos Republic and Sri Lanka). China is expected to become a member of the Agreement, and is currently negotiating tariff concessions with member countries. China completed its negotiations with Sri Lanka in 1999. 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. However, Fiji has not yet made a formal request to join the grouping.

TABLE 9.12
Exports from Sri Lanka under SAPTA

Country	Value (US dollars thousands)			Value as a percentage of exports to each country (%)		
	1997	1998	1999 (a)	1997	1998	1999 (a)
Bangladesh	-	15.6	47.0	-	0.15	1.06
Bhutan	-	-	-	-	-	-
India	1,408.3	7,338.3	18,132.0	3.22	19.47	10.83
Maldives	5.0	0.5	102.5	0.02	0.001	0.59
Nepal	588.7	65.2	23.5	36.94	5.93	28.35
Pakistan	99.1	342.6	740.7	0.26	1.27	0.80
Total	2,101.0	7,768.2	1,9049.9	1.77	6.84	6.77

(a) Provisional

Sources: Sri Lanka Customs, Central Bank of Sri Lanka

Sri Lanka decided to withdraw from the International Natural Rubber Agreement (INRA) in 1999. Malaysia and Thailand too have withdrawn from the agreement. This was a response to the failure of the price stabilising arm of INRA, the International Natural Rubber Organisation (INRO), in preventing the gradual deterioration of international rubber prices which affected all rubber producing countries including Sri Lanka. As a result of those withdrawals, INRA was terminated in 1999.

After chairing the Technical Group (the research arm) of the Intergovernmental Group of Twenty Four on International Monetary Affairs (G-24), Sri Lanka became the chairman of the G-24 group of countries in April 1999 for one year. The 1999 April meeting and the Annual Meeting of the Ministers of G-24 were held in Washington D.C. under the chairmanship of Sri Lanka. The Communiqué issued by the G-24 made a critical evaluation of the world economy in the wake of the unprecedented financial market crisis and called for, among other things, an international lender of last resort, more frequent use of SDRs to supplement international liquidity, a cautious approach to capital account liberalisation and a more co-ordinated approach by industrial countries in their macroeconomic management to reduce excessive volatility of exchange rates among key currencies and stressed the need to keep developed country markets always open for developing country exports. Sri Lanka participated in the G-15 summit held in 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 programs of co-operation. Under Sri Lanka's chairmanship, a link was established between G-24 and G-15 to improve interaction between the two groups. Thus, the deliberations at the meetings of the G-15 grouping were helpful in formulating Sri Lanka's position at the 3rd Ministerial Meeting of the WTO.

Sri Lanka's position and policy on issues pertaining to the WTO was in line with the common position of many developing economy groupings including SAARC. Sri Lanka held preparatory meetings with SAARC member countries and a group of 'Small and Vulnerable Economies' prior to the 3rd WTO Ministerial Meeting held in 1999 and formulated a common position. The common position called for proper implementation of the existing agreements and decisions arising from the Uruguay Round prior to the commencement of any new round of multilateral trade negotiations. It maintained that the Agreement on Agriculture and the Agreement on Textiles and Clothing do not allow a sufficient degree of market access in developed countries. The common position has further maintained the call for the non-implementation of anti-dumping provisions until the quota restrictions on textile exports from developing countries are fully phased out, and non-application of provisions under the Agreement of Sanitary and Phytosanitary and Technical Barriers to trade in a protectionist manner.

International differences on the above issues and other issues concerning the framing of multilateral trade related investment, competition policy, transparency in government procurement, labor standards and environment led to the failure of the 3rd Ministerial Meeting.

Sri Lanka progressed on fulfilling its commitments made to the WTO. The subcommittee on anti-dumping and countervailing duties set up under the Inter Ministerial Co-ordinating Committee for trade agreements, and in particular the WTO, is at the final stages of presenting to the Parliament. Sri Lanka signed the 5th Protocol under the Generalized Agreement on Trade in Services (GATS) in 1999. The Inter Ministerial Co-ordinating Committee on GATS held preliminary meetings with professional bodies in Sri Lanka on deciding the further liberalisation of professional services.

The Department of Commerce, which comes under the Ministry of Internal and International Commerce and Food, conducted several seminars to enhance the awareness among Sri Lanka's industrialists and policy makers of the impact of further liberalisation of trade in goods and services and evolving new concepts of competitiveness. General recommendations made at those seminars included further improvements in commercial diplomacy, institutional capacity building and trade policy research. Sri Lanka should be more concerned about consensus building among different sectors of the population prior to undertaking major policy changes. The lack of such consensus engenders investment risk and uncertainty and public unrest which are harmful for the policy efficacy.

The efficacy of the transmission of agreements reached at many bilateral, regional and multilateral discussions to serious action is also doubtful. Some contributory factors are budgetary problems, inadequate representation at discussions and mismatch of priorities of work undertaken by line ministries and work agreed at discussions by ministries attending such discussions.

9.13 Internal Trade and Institutional Arrangements

Internal trade grew by 2.1 per cent in real terms in 1999. Trade was conducted in a relatively free market environment with minor state intervention in price determination and controls, and major intervention in trade regulations. Interventions are deemed essential in preventing harmful effects arising from anti competitive practices such as collusive price fixing, dumping, predatory pricing and formation of monopolies as a result of large mergers. The government also intends to ensure consumer and producer welfare by minimising harmful effects of drastic price fluctuations. Those interventions are carried out by the Ministry of Internal and International Commerce and Food (MIICF) and its marketing organisations - the Co-operative Wholesale Establishment (CWE), Lanka Salu Sala Ltd., Lanka General Trading Company - the Ministry of Co-operative Development (MCD) and its affiliated Co-operative Development Department, the General Treasury, and the State Pharmaceutical Corporation of Sri Lanka (SPCSL). The two regulatory bodies attached to the MIICF, i.e., the Department of Internal Trade (DIT) and Fair Trading Commission (FTC), maintain price controls on pharmaceutical products and probe unfair trading practices. Since there exists a certain duplication of roles between the two institutions, and given the need to create a stronger institution probing trading practices, a proposal was made in 1997 to amalgamate the two institutions. The Bill for the proposed amalgamation is yet to be presented to Parliament.

The government's role in the supply of petroleum fuel and wheat flour continued in 1999. Throughout 1999, the Ceylon Petroleum Corporation was the sole authority for the production and supply of petroleum fuel, except LP gas which was monopolistically supplied by Shell Gas Lanka Ltd. The Food Commissioner's Department (FCD), attached to the MIICF, acted as the sole authority in the purchase and distribution of wheat flour, milled by Prima Ceylon Ltd. The importation of wheat flour was not liberalised until 2000. In February 2000, licensing requirements on the importation of wheat flour were removed. The FCD conducted its operations in collaboration with the CWE and the MCD outlets. The FCD also ensures that adequate quantities of rice and sugar are released to the market to avoid any supply shortages. This is done through the services of bonded warehouses and the CWE. Wheat flour imports were liberalised with the Budget 2000 while also allowing private sector participation in bunkering and aviation fuel sales.

The CWE is engaged in the increasingly difficult task of operating as a profit making institution while functioning as a welfare generating institution for both producers and consumers. For example, the CWE refrained from importing big onions, potatoes and dried chillies during the domestic crop seasons while private sector traders imported those goods. The CWE purchased those goods from domestic producers to maintain reasonable farm gate prices. Thus, in general the CWE's participation in domestic purchases was higher in 1999 than in 1998. In 1999 domestic purchases of big onions increased from 29 metric tons in 1998 to 2,625 metric tons in 1999. This was due to an increase in the domestic production of big onions and the need to stabilise farm gate prices. Domestic purchases of dried chillies also increased from 90 metric tons in 1998 to 299 metric tons in 1999. The CWE purchased 203 metric tons of potatoes from domestic producers. In 1999 there was considerable market intervention in paddy with the domestic purchase of 11,966 metric tons in 1999. The CWE purchased 1,400 metric tons of sugar in 1999.

Since the removal of the licensing requirement on important food items in 1996, and its commitment to establish minimum farm gate prices, the CWE's share of essential goods imports has continued to decline. In 1999 the imported quantities of potatoes and dried chillies were 772 and 97 metric tons, respectively in 1999 compared to 2,837 and 198 metric tons, respectively in 1998. Big onion imports showed an increase from 5,148 metric tons in 1998 to 6,280 metric tons in 1999. As a government directive to maintain buffer stocks, the CWE imported 20,000 metric tons of rice, and further 50,000 metric tons at a concessionery duty rate of 10 per cent. The CWE did not import any wheat flour in 1999.

In 1999, the CWE operated 149 retail shops and 42 wholesale shops, showing an increase of 2 retail shops over 1998. The total turnover was Rs. 6,836 million, an increase from Rs. 5,282 million reported in 1998. Franchise shops recorded a significant increase in turnover in 1999. Turnover was Rs. 1,689 million compared to the Rs. 613 million realised in 1998. This is a result of mobile sales introduced in 1998 where goods are supplied to the doorsteps of franchise dealers. The network of franchise dealers was expanded in 1999 by appointing 304 new local dealers and dealers in four more countries, i.e., Japan, the United States of America, Canada and France.

The other marketing institutions of the MIICF, namely Lanka Salu Sala Ltd., and Lanka General Trading Company, also engaged in providing standards for quality and prices of important consumer goods. They played a catalytic role in ensuring fair competition. The MCD also intervened in the market through the purchase of paddy during the harvesting period, and retail sales through co-operative societies. The Treasury influenced the supply of essential goods through duty waivers and tariff changes.

The State Pharmaceuticals Corporation of Sri Lanka (SPCSL) continued to be the sole supplier of pharmaceutical products to government health care institutions and a major supplier to the market. The SPCSL supplied pharmaceuticals at prices fixed by the FTC. All private sector imports of pharmaceuticals are subject to licensing and price controls. This is another area where elimination of the government monopoly is necessary to improve the efficiency of the pharmaceutical products trade with adequate safeguards to help reduce excessive medical costs.

Both the DIT and the FTC were engaged in ensuring the orderly conduct of traders in a 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). Only imported drugs and pharmaceuticals were subjected to price control in 1999. The DIT carried out 23 inspections under the PCA and offences were found in 11 of those. Under the CPA, 1,760 raids were conducted and 1,112 prosecutions were made. Investigations under the FRA resulted in uncovering 119 cases of fertiliser adulteration, non-conformity to standards, and violation of regulations on selling, distribution and storage.

The DIT continued with its consumer awareness program by conducting seminars and through its publications. It conducted a seminar and a public meeting to commemorate the World Consumer Day on 15 March 1999. The DIT also continued to be in the Steering Committee of the Asia and Pacific Region of Consumer International, an association collaborating with the UN Economic and Social Council.

The FTC continued to determine the prices of pharmaceuticals. It investigated two cases of collusive price fixing, several consumer complaints, and one merger of companies in 1999.

9.14 Tourism

The tourism sector, which has continued to recover since September 1998, improved further during 1999. The arrivals at 436,440, was the highest recorded so far and showed a 15 per cent growth over 1998, re-affirming the resilience of the industry. Moreover, the rate of growth in arrivals was also the highest in the South Asian region. Gross earnings from the sector grew from US dollars 230 million in 1998 to US dollars 274 million in 1999. The absence of any major incidents to disturb the security situation outside the North and East during most of the year was a major reason for the increase in arrivals. Promotional campaigns carried out by the government and the private sector, and increased flying frequencies of SriLankan Airlines and other airlines between Colombo and major sources of tourist traffic to the country also contributed to this favourable development. The improved global economic conditions, particularly the recovery of East Asian countries including Japan, was also contributory to the influx of tourists to the country.

Following the growth in arrivals, the foreign guest nights increased by 13 per cent while the overall occupancy rate grew by 9 per cent. Occupancy rates in all regions recorded increases with more pronounced growth rates reported from the south coast, hill country and ancient cities.

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 15 per cent increase. Higher arrivals from the UK, France, Italy and the Netherlands contributed significantly, while increases were also recorded from other countries in the region except Austria, Denmark, Spain and Switzerland. The UK led the arrivals, surpassing Germany, which was the highest source of arrivals in 1998.

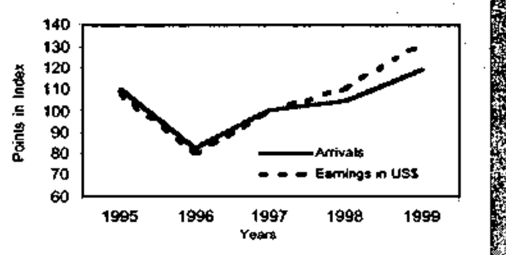
Arrivals from Asia also grew by 15 percent, with a high turnover from East Asia. Arrivals from the East Asia grew by 22 per cent led by 18 per cent increase in the arrivals from Japan. Arrivals from South Asia grew by 10 per cent dominated by arrivals from India. Arrivals from Australasia and North America grew by 25 and 5 per cent, respectively, while arrivals from Eastern Europe declined by 14 per cent, due to the civil crisis in their region.

The average duration of stay (ADS) of tourists in the country dropped marginally from 10.4 days in 1998 to 10.3 days in 1999. However, the impact of a reduced ADS on the earnings was more than offset by an increase in the average spending of a tourist per day from US dollars 59 to US dollars 61 in 1999. The slight drop in the ADS was mainly due to a decline in the share of arrivals of German tourists, who usually stay longer in Sri Lanka from 19 per cent in 1998 to 17 per cent in 1999. The average stay of German tourists was 14 days followed by tourists from the Netherlands (13.5 days), Austria (13 days) and the UK (12 days) in 1999.

Of total arrivals, 70 per cent travelled by regular inter-regional flights, 20 per cent arrived by regular intra- regional flights and the rest by charter flights. SriLankan Airlines brought in 47 per cent of the total number of tourists in 1999 compared to 42 per cent in 1998. The addition of three new aircraft to the fleet in 1999, especially during the peak season, has contributed to the increased share of the airline. The share of charter flights declined from 11 per cent in 1998 to 10 per cent in 1999.

Vacation continued to be the main purpose of arrivals in 1999, accounting for more than 93 per cent of total arrivals. The remainder was for business and visiting friends and relatives. Confirming Sri Lanka's potential for

Chart 9.9
Tourism Statistics
(1997 = 100)



developing new tourism products such as eco-tourism and culture tourism, the revenue from tourists visiting wild life parks, botanical gardens, zoological gardens and the cultural triangle continued to increase in 1999. The Sri Lanka Convention Bureau continued to promote meetings, incentive travel, conventions and exhibitions (MICE) tourism in 1999. The Bureau sponsored 7 conferences and exhibitions in 1999 and had 9,885 tourists visiting the country under the MICE category compared to 1,925 tourists visiting in 1998. The Bureau participated in several international campaigns, promoting Sri Lanka as a destination for MICE tourism in the Asia.

Following the recovery in the sector, direct employment grew by 5 per cent to 36,500 while the indirect employment increased from 48,692 to 51,100, according to the Ministry of Tourism and Civil Aviation (MTCA). Direct employment is considered as employment in hotels and restaurants, travel agencies, airlines, agencies providing recreational facilities, tourist shops and the Tourist Board. Indirect employment is generated by domestic producers and suppliers of inputs, manufacturers and suppliers of handicrafts etc.

The number of hotel units in the graded accommodation sector increased from 163 to 170, mainly in the hill country and south coast. With the increased number of hotel units, room capacity grew from 12,772 to 12,928. A new tourist hotel code was introduced in 1999, replacing the Hotels Code of 1973, with the main objective of ensuring and maintaining the standard required by the industry. Under the new code it is compulsory for all tourists hotels to register with the Ceylon Tourist Board (CTB). However, star classification of hotels remains optional.

The MTCA signed eight bilateral agreements on Air Traffic Rights with the UK, Italy, Germany, Pakistan, Malaysia, UAE, Nepal and Russia to increase the flying frequency per week in 1999. Operations of charter flights were at moderate level in 1999. The number of charters operated in 1999 was at 6 when compared with 9 in 1998. Sri Lanka's air traffic control system and procedures were modernised in 1999 to enhance the air safety. This may encourage international airlines to fly through the country's airspace, thereby enhancing tourist traffic and generating additional income to the country.

To counteract harassment of tourists and environment pollution the MTCA appointed a Ministerial Task Force Committee in 1999. A Ministerial Committee was also appointed to identify of places of scenic beauty to further develop tourism in the country. On the fiscal front, the government extended the scheme of granting duty free concessions for the refurbishment and upgrading of tourist hotels for more two months from 31 October, 1999 to 31 December, 1999.

International and regional associations play a vital role in promoting tourism. Sri Lanka was selected as the lead country in tourism in the BIMST-EC in 1998. Accordingly, Sri Lanka hosted the first expert group meeting on tourism in Colombo in 1999. Encouraging intra-regional travel, investigating tourism promotion opportunities, developing of new tourism products and developing projects for environmental management and cultural preservation were the areas earmarked for improvement by the BIMST-EC grouping.

TABLE 9.13
Tourism Statistics 1997-1999

Item	1997	1998(a)	1999(b)	Percentage Change	
				1998	1999
1. Tourist Arrivals	366,165	381,063	436,440	4.1	14.5
2. Tourist Guest Nights ('000)	3,680	3,944	4,478	7.3	13.4
3. Room Occupancy Rate (%)	49.1	52.8	57.6	7.5	9.1
4. Gross Tourist Receipts (Rs.Mn)	12,316	14,873	19,288	20.8	29.7
5. Per Capita Tourist Receipts (Rs.)	33,635	39,030	44,194	16.0	13.2
6. Total Employment	82,080	83,472	87,600	1.6	5.0
Direct	34,200	34,780	36,500	1.7	4.9
Indirect	47,880	48,692	51,100	1.6	5.0

(a) Revised
(b) Provisional

Sources: Ceylon Tourist Board, Central Bank of Sri Lanka.

Box 7

Eco-Tourism

Tourism contributes significantly to economic growth and development of a country. In Sri Lanka tourism is the fourth largest foreign exchange earner. Receipts from tourism in 1999 amounted to Rs.18,518 million. However, there has been continuing debate on the cost of tourism as it is alleged to have an adverse impact on the culture, society and natural environment of developing countries. Consequently, development of tourism in a sustainable manner is receiving increased attention worldwide.

Eco-Tourism (ET) is a new tourism product, which is considered to have no adverse impact on environmental, cultural and social features. ET is defined as "responsible travel to natural areas which conserves the environment and improves the welfare of the local people"[1]. ET includes travel to understand the cultural and natural history of countries and their environment, taking care not to alter the integrity of the eco-system, while producing economic opportunities that make the conservation of natural resources financially viable to local people.[2] Thus, ET helps in protecting the natural and cultural environs by providing revenues for preservation, while simultaneously promoting economic growth through tourism as an industry.

The ET is different from conventional tourism (CT) in several aspects. Among these are the differences in central activities, focus, nature of lodging and other facilities. In the case of CT, the activities are facility based and focus on relaxation and recreation. ET's main activities are enjoying nature through hiking, diving, wildlife viewing, bird watching and mountaineering. In the case of lodging, CT requires a high level of investment to supply luxurious lodges/hotels, whereas the lodges/hotels required for ET need less investment, may not be luxurious and are developed and designed in harmony with the natural and cultural environment. Moreover, an eco-tourist spends more time in a country than a conventional tourist does.[3]

Recognising the significance and importance of ET, the United Nations has proclaimed the year 2002 as the International Year of Eco-Tourism.[4] Enhanced global awareness for environmental conservation has also made ET a tourism product with a significant and increasing demand.[5]

The Tourism Master Plan of Sri Lanka (TMP), stresses the importance of development and marketing of tourism based on the county's religious traditions, cultural and historic attractions and natural beauty and diversity, thus recognising the importance of ET. Further, conservation and enhancement of natural, cultural and social heritages, community involvement in tourism and the planning and development of the industry as described in the TMP are very clearly based on the principles of ET.[6] Sri Lanka has also formed a society, viz., the Ecotourism Society of Sri Lanka (ESSL), recently. The ESSL is a non-profit organisation formed to assist in the development of ET in Sri Lanka.

Bio-diversity is considered most important element of ET. Thus, areas with an abundance and variety of flora and fauna are the primary attraction of an eco-tourist. Unique geography and cultural history are also among important factors that enhance a country's potential in harnessing gains from ET.

Sri Lanka is bestowed with a scenic natural environment and high bio-diversity, which are considered major attractions in ET. The ancient historical and cultural sites and wild life in national parks also enhance the country's resource base in ET. Further, the potential of Sri Lanka as an ET destination has been proved by the increased percentage of tourists visiting the wild life parks and botanical gardens during the past twelve years (Chart 1).

1 Definition given by the Eco Tourism Society (ETS); an organisation based in the USA.

2 An ecosystem is a unit of landscape, including its living and non-living components. The two components of the ecosystem are indispensably intermixed and intertwined. An ecosystem may be a pond, meadow, forest, sand dune, bog or even a small aquarium. In particular, it is the complex of interactions of all the organisms with their physical environment and with one another. The entire planet earth can be considered as an ecosystem. "*Encyclopedia Americana*"

3 According to Eco-tourism Statistical Fact Sheet – 1998 of ETS, an eco-tourists spend around US$ 1,000-1,500 per trip, whereas the conventional tourists spend around US$ 700-900 per trip.

4 The Economic and Social Council resolution 1998/40 of 30 July 1998 of the UN.

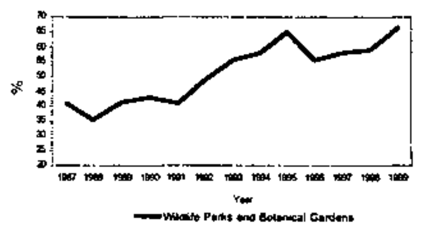
5 Of the total international tourist arrivals, about 40-60 per cent are eco-tourists. The tourist arrivals are expected to grow by an average of 4 per cent per annum during the next two decades while the arrivals based on the ET are expected to grow by 10-25 per cent. *Eco-tourism Statistical Fact Sheet 1998 of the Eco Tourism Society.*

6 UNDP/ WTO – Sri Lanka Tourism Master Plan, pg 82, State Printing Corporation of Sri Lanka.

Box 7 (contd.)

To promote Sri Lanka as an eco-tourism destination, attention should focused on developing the infrastructure facilities and re-focussing Sri Lanka's marketing strategy to promote it as an ET destination. It is also important for Sri Lanka to manage the rich resource base of ET carefully; too much growth can lead to diminishing social and economic returns and a threat to the very ecosystem and cultural assets on which they depend and seek to perpetuate.

Chart 1
Percentage of Tourists Visiting Wildlife Parks and Botanical Gardens of Total Arrivals (a)



Sources - Ceylon Tourist Board and The Royal Botanical Gardens, Peradeniya
(a) Visitors to the Peradeniya Royal Botanical Gardens only