

## Chapter 2

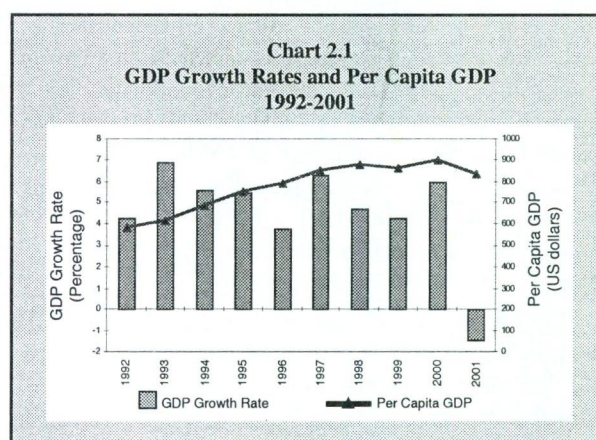
# NATIONAL INCOME AND EXPENDITURE

### 2.1 Overall Trends

In 2001, Gross Domestic Product (GDP), in real terms, contracted by 1.4 per cent. This is the first negative growth reported since Independence in 1948. The lowest growth recorded earlier was 0.2 per cent in 1971, a year in which economic activities were crippled by a youth insurrection. The temporary deviation of the economy in 2001 from its long-term growth trend of around 5 per cent per annum reflected the negative outcome of several factors that affected both the aggregate supply and aggregate demand sides of the overall economy. On the supply side, the production of goods and services contracted or decelerated during the year and, consequently, the profitability of economic activities was hindered considerably. On the demand side, the real growth in private consumption expenditure, the major source of overall demand, moved away from its historical rising trend under depressed economic conditions and rising prices, and remained almost stable. In 2000, the growth in real private consumption expenditure was 5 per cent. In 2001, investment expenditure declined by 17.1 per cent, in real terms, as the private sector remained cautious and the government curtailed its capital expenditure under growing fiscal constraints. Resources available for investment also decelerated considerably as the contraction in economic growth reduced the capacity for domestic savings, which fell from 17.4 per cent to 15.3 per cent of GDP. Furthermore, the unemployment rate recorded a marginal increase reflecting the loss of job opportunities in the economy.

Although the economy had performed well in 2000 and grew by 6 per cent, the signs of deceleration were visible from the second half of the year. During the first half of 2000, the economy grew by 6.9 per cent, while the growth in the second half decelerated to 5.2 per cent. In the first half of 2001, the growth decelerated further to 0.9 per cent, largely due to a slowing down of economic activity in industrial countries, which reduced the demand for manufactured exports, and the dismal performance in agriculture owing to adverse weather conditions. The contraction itself occurred during the second half, under extremely difficult internal and external circumstances. The continuation of the drought, which also resulted in prolonged power cuts, the terrorist attack at the airport in July with the subsequent imposition of insurance surcharges on sea and air travel and the general political uncertainty

that prevailed, especially after the prorogation of Parliament in August, impacted adversely on investor and business confidence during the latter half of the year. In another adverse development, the expected recovery of the US economy, the largest market for Sri Lankan exports, was delayed due to the terrorist attacks on key economic and military targets in USA on September 11 and their aftermath. Under these hostile conditions, a contraction of the economy during the second half of the year was inevitable. The contraction was 3.5 per cent. Consequently, the annual GDP contracted by 1.4 per cent.



Meanwhile, Gross National Product (GNP), defined as GDP adjusted for Net Factor Income from Abroad (NFIA), contracted by 1.3 per cent in real terms, in 2001, compared to an increase of 5.8 per cent in 2000. The contraction in GNP was lower than that in GDP due to the better performance of NFIA. The NFIA, though continuously negative, improved in 2001 owing to the decline in factor payments. This was mainly due to the considerable decline in international interest rates, which resulted in lower interest payments on foreign borrowing.

In 2001, on the external front, the global economy itself faced difficulties. While most countries experienced a slowing down of economic activity, some others also encountered contractions in economic growth. The rise in world oil prices during 2000, weaker equity markets, a slump in the high-tech sector especially in the United States, the continued difficulties in the financial and corporate sectors in Japan and the resultant weakening of domestic demand in OECD countries were among the many

factors that dampened world economic growth in 2001. Delayed recovery in the US economy, downturn in Europe and a continuing slump in Japan triggered the global slowing down during the first half of the year. This trend, which was earlier expected to reverse during the second half of 2001, was exacerbated by the terrorist attacks in USA during the latter part of the year. The slowing down of OECD countries' economies extended to the rest of the world, with declines in information technology spending affecting East Asian countries and deteriorating financing conditions affecting a number of emerging markets, especially in Latin America. Short-term economic forecasts were revised downward repeatedly for virtually all the major economies. Slower growth prospects translated into lower demand for developing country exports and lower prices for many primary commodities. With the exception of a few countries such as China, India, Russia and Vietnam, most others were badly affected by the slowing down of the world economy. Global output growth for 2001 is estimated at 2.4 per cent, sharply lower than the previous projection of 4.2 per cent, and well below last year's growth of 4.8 per cent and the average growth in the last decade of 3 per cent. This was also reflected in the growth of world trade. In 2000, the volume of world trade grew by over 10 per cent, while in 2001 it slumped to less than 1 per cent. The Sri Lankan economy, which thrived in 2000 with a global boom, shrank in 2001 with global gloom. The contraction of the Sri Lankan economy, however, was relatively sharper owing to difficulties experienced on the domestic front.

The Industry sector<sup>1</sup> contracted by 2 per cent in 2001. Within Industry, the Manufacturing sector which contributes more than sixty per cent of the value added in the sector, declined by 4 per cent in 2001. This sector recorded a negative growth of 0.6 per cent in 1977, and since then grew strongly by over 7 per cent per annum on average, and provided the impetus to economic growth after liberalisation. This growth accomplishment was largely due to the performance of the export oriented industrial sector throughout the period. This sector had concentrated on the apparel and garments industry, which contains a high component of imported inputs and faces highly competitive markets. In 2001, the apparel industry faced a crisis situation due to several factors. Over supply in the world

market, which caused a reduction in prices, intense competition from low cost producing countries such as China, Cambodia and Vietnam, entrance to the market of transition economies, which enjoy the advantage of geographical proximity to the European market, and slowing down of the economies of major buyers such as USA and the European Union, combined to create the crisis in the apparel and garments industry. In addition, quota free and concessionary access granted by USA to the Caribbean and Sub-Saharan countries also adversely affected the competitiveness of Sri Lankan textile and garment exports to USA. The experiences in 2001 indicate that, to remain in the market, Sri Lanka has to be more competitive and has to explore non-traditional markets away from the major buyer, USA. Also, the most important lesson learnt was that the export oriented industrial sector urgently needs a structural change and a broader diversification from the apparel and garment industry. Increases in cost of production also caused a decline in value addition in the Manufacturing sector, in general. Prices of utilities such as electricity, water and telecommunications and of fuel increased considerably in 2001 compared with the previous year. In addition, the continuing power cuts during the latter half of the year negatively affected performance and profitability in the Manufacturing sector.

In 2001, value added in the Agriculture sector declined by 3 per cent. The contraction was largely due to the adverse weather conditions that prevailed throughout the year. Unlike in the other two sectors, i.e., Industry and Services, the Agriculture sector had experienced fluctuations over the years, as the performance in this sector is heavily dependent on weather conditions. Recently, in 1992 and 1996, too, the Agriculture sector suffered contractions under adverse weather conditions. However, the long run problem in the Agriculture sector, which has hindered its growth capability, has been the low level of productivity. In recent years, productivity improvements were observed in some areas of plantation agriculture and domestic agriculture. Of the plantation agriculture, productivity in tea cultivation improved due to better management and cultivation practices followed by the private management companies. In the domestic agriculture sector, productivity in paddy cultivation improved during the last decade owing to several factors. The improved seed paddy available to farmers through the private sector following the removal of the government monopoly in this field and the adoption of the technology package introduced by the Yaya demonstration programme of the Department of Agriculture, improved yields especially in the irrigated paddy lands. The abandoning of cultivation in marginal rain fed lands where the productivity was low also enhanced the overall efficiency in paddy cultivation. Against this background, the decline in value addition in Agriculture in 2001 can be treated as a cyclical one that will recover with normal weather patterns.

<sup>1</sup> The sectoral classification used in this analysis has been changed in accordance with the classification used in the World Bank publication, World Development Indicators, which classifies the International Standard Industrial Classification (ISIC) - Revision 3 as follows: The new sectoral classification is Agriculture (ISIC division 1-5), Industry (ISIC division 10-45) and Services (ISIC division 50-99). Accordingly Agriculture includes the Forestry & Fishing sub sectors and Industry comprises the Mining and Quarrying, Manufacturing, Electricity, Gas & Water Supply and Construction sub sectors. All other sub sectors are classified under Services.

The Services sector encompasses services such as transportation, communication, wholesale and retail trade, financial services, public administration and all other services not classified elsewhere, and consists of 52.5 per cent of the total GDP. Value added in the Services sector declined by 0.5 per cent in 2001. The contraction was the result of the shrinkage in international trade and the overall slowing down of the main producing sectors, Agriculture and Industry.

On the expenditure front, GDP at current market prices was estimated at Rs 1,400 billion compared with Rs 1,258 billion in 2000. This increase following on the contraction in real economic growth, was solely due to the increase in the general price level. The overall price inflation as measured by the GDP deflator was 13 per cent, in comparison to 6.7 per cent recorded in 2000. The higher inflation was mainly induced by the lower supply of goods and services during the year. Accordingly, GDP per capita

for 2001 is estimated at Rs 74,760, an increase of 9.8 per cent, over the previous year's Rs 68,102.<sup>1</sup> The increase in the per capita income was not sufficient to offset the impact of the overall price inflation and per capita GDP deteriorated, in real terms, during the period under review. In US dollar terms, per capita GDP declined by 6.9 per cent, from 899 dollars to 837 dollars, following a 15.1 per cent average depreciation of the Sri Lankan rupee in 2001 over the previous year. The contraction in economic activities also impacted on the level of employment. The unemployment rate, which had dropped continuously from 13.8 per cent in 1993 to 7.6 per cent in 2000, increased marginally to 7.8 per cent in 2001. Also, the labour force

<sup>1</sup> The per capita GDP series was revised on the basis of provisional population estimates by the Department of Census and Statistics following on the Census of Population and Housing - 2001.

**TABLE 2.1**  
**Sectoral Composition and Increase in Gross Domestic Product at Constant (1996) Prices**

Sector	Rate of Increase (%)		Contribution to Change in GDP (%)		Percentage Share of GDP (%)	
	2000(a)	2001(a)	2000(a)	2001(a)	2000(a)	2001(a)
<b>1. Agriculture, forestry &amp; fishing</b>	<b>1.8</b>	<b>-3.0</b>	<b>6.3</b>	<b>-42.2</b>	<b>20.5</b>	<b>20.1</b>
Agriculture	1.7	-3.7	4.6	-41.0	15.9	15.5
Tea	7.8	-3.4	1.8	-3.4	1.4	1.4
Rubber	-9.7	-1.8	-0.7	-0.5	0.4	0.4
Coconut	8.0	-9.7	2.3	-11.8	1.8	1.6
Paddy	-0.3	-5.7	-0.2	-12.8	3.2	3.1
Other	0.9	-2.0	1.4	-12.5	9.1	9.0
Forestry	1.6	5.0	0.5	6.3	1.8	1.9
Fishing	2.5	-4.0	1.2	-7.5	2.7	2.7
<b>2. Mining &amp; quarrying</b>	<b>4.8</b>	<b>0.7</b>	<b>1.4</b>	<b>0.8</b>	<b>1.7</b>	<b>1.8</b>
<b>3. Manufacturing</b>	<b>9.2</b>	<b>-4.0</b>	<b>25.9</b>	<b>-48.0</b>	<b>17.4</b>	<b>16.9</b>
Processing of tea, rubber & coconut kernel products	4.2	-5.3	1.5	-7.6	2.1	2.0
Factory industry	10.4	-3.9	23.2	-37.3	14.0	13.7
Small industry	5.5	-3.5	1.2	-3.1	1.3	1.3
<b>4. Construction</b>	<b>4.8</b>	<b>2.5</b>	<b>5.6</b>	<b>11.9</b>	<b>7.0</b>	<b>7.3</b>
<b>5. Electricity, water and gas</b>	<b>4.5</b>	<b>-2.9</b>	<b>1.1</b>	<b>-2.9</b>	<b>1.5</b>	<b>1.4</b>
<b>6. Transport, storage and communication</b>	<b>7.8</b>	<b>5.2</b>	<b>14.9</b>	<b>42.0</b>	<b>11.8</b>	<b>12.5</b>
<b>7. Wholesale and retail trade</b>	<b>8.7</b>	<b>-6.5</b>	<b>31.2</b>	<b>-98.8</b>	<b>22.1</b>	<b>21.0</b>
Imports	12.9	-10.7	20.0	-73.5	10.0	9.0
Exports	18.3	-8.0	7.3	-14.8	2.7	2.5
Domestic	2.4	-1.6	3.9	-10.6	9.5	9.4
<b>8. Banking, insurance and real estate</b>	<b>6.4</b>	<b>5.0</b>	<b>8.0</b>	<b>26.3</b>	<b>7.6</b>	<b>8.1</b>
<b>9. Ownership of dwellings</b>	<b>1.7</b>	<b>1.4</b>	<b>0.5</b>	<b>1.7</b>	<b>1.8</b>	<b>1.8</b>
<b>10. Public administration and defence</b>	<b>4.2</b>	<b>1.0</b>	<b>3.4</b>	<b>3.3</b>	<b>4.8</b>	<b>5.0</b>
<b>11. Services (n.e.s.)</b>	<b>2.3</b>	<b>2.2</b>	<b>1.6</b>	<b>6.0</b>	<b>4.0</b>	<b>4.1</b>
<b>12. Gross domestic product</b>	<b>6.0</b>	<b>-1.4</b>	<b>100.0</b>	<b>-100.0</b>	<b>100.0</b>	<b>100.0</b>

(a) Provisional

Source : Central Bank of Sri Lanka



participation rate declined from 49.2 per cent in 2000 to 48.3 per cent by the end of the third quarter of 2001. Due to the rigidities in the labour market that prevent retrenchment, it is believed that the full impact of the contraction was not reflected in employment statistics.

Investment expenditure (Gross Domestic Capital Formation) at current market prices, which has continuously grown by over 15 per cent per annum in the recent past, is estimated at Rs. 308 billion, a decline of 12.5 per cent over 2000. Accordingly, the Investment/GDP ratio, which peaked at 28 per cent in 2000, dropped in 2001 to 22 per cent. The decline in investment was entirely an outcome of a decline in private investment by 14.5 per cent. Government investment, which could have mitigated the negative impact of falling private investment, remained below the desired level due to budgetary constraints. The growth of government investment, in 2001, was limited to 2.1 per cent. The downturn in private sector investment can be attributed to a host of factors including the contraction in real GDP growth, decline in corporate savings and the excess capacity available in industries due to the sluggish local and international demand. In addition, uncertainty on the political front and inconsistent policy signals also had a negative impact on business confidence and consequently on private sector investment. The decline in investment expenditure was reflected in imports where the importation of capital goods fell by 38 per cent in US dollar terms during the year. However, in 2000, SriLankan Airlines had invested US dollars 297 million to purchase three aircraft. When this one time occurrence is excluded, the decline in overall investment in 2001 falls to 6.5 per cent and the decline in capital goods imports falls to 25 per cent. The decline in investment expenditure does not augur well for the economy, as investment plays a key role in the future growth potential of a country.

Total consumption expenditure, which includes both government consumption expenditure and private consumption expenditure, increased in 2001, in current terms, by 14.2 per cent. However, in real terms, this was an improvement of only 0.4 per cent, considerably lower than the increases recorded in the recent past. When adjusted for population growth, the level of per capita consumption in 2001 remained almost unchanged at the level of the previous year. On the resources side, domestic savings were estimated at Rs. 215 billion. This was a decline of 2.1 per cent in nominal terms. Private savings increased at a higher rate of 8.2 per cent. This was wholly offset by government dis-savings, which worsened during the year by 60 per cent in nominal terms. The domestic savings/GDP ratio, which was 17.4 per cent in 2000, declined to 15.3 per cent in 2001. The private savings/GDP ratio also dropped, from 20.9 per cent in 2000 to 20.3 per cent. National savings, meanwhile, deteriorated by a lower margin from 21.5 per cent to 19.5 per cent. The resource

gap, namely the national savings-investment gap as a ratio of GDP, fell to 2.5 per cent in 2001. In 2000, the gap was 6.5 per cent. The decline in investment expenditure was instrumental in this decline.

## 2.2 Sectoral Performance

In 2001, value added, in real terms, declined in Agriculture (3.0 per cent), Industry (2.0 per cent), and Services (0.5 per cent). The decline in value added in the Industry sector contributed 38.3 per cent of the overall contraction in economic growth. The contributions to the contraction by the Agriculture sector and the Services sector were 42.2 per cent and 19.5 per cent, respectively. Of Services activities, the decline in value added of the Wholesale and retail trade sector was instrumental in the decline in the overall value added in this sector and contributed almost 100 per cent of the total contraction in GDP growth.

### Industry Sector

According to the revised classification, the Industry sector consists of four sub sectors namely Manufacturing, Construction, Mining and quarrying and Electricity, gas and water supply. They contributed 61.8 per cent, 26.5 per cent, 6.5 per cent and 5.2 per cent, respectively, to the total Industry value addition.

The Manufacturing sector, which recorded a significant growth of 9.2 per cent in 2000, contracted by 4 per cent in 2001. The value addition in all the sub sectors of Manufacturing declined in 2001. The factory industry sub sector, the largest sub sector in Manufacturing in terms of value addition, export earnings and employment generation, declined in 2001 by 3.9 per cent over the previous year. The textiles, wearing apparel and leather products category, which represents over 40 per cent of factory industry in terms of value addition, declined by 8.2 per cent mainly due to the depressed demand from major buyers in USA and EU countries. In addition to the above category, the other export oriented categories such as rubber and related products, diamond processing and ceramic products also faced a lack of demand and consequently recorded negative growth rates in 2001. In comparison, the domestic market oriented industries performed satisfactorily and were able to partly offset the negative impact created by the export oriented industries. These industries, which include food processing, beverages, building materials, pharmaceuticals and detergents, milk products, animal feed, PVC, and plastics and metal products, blossomed during the first half of the year with increased domestic demand following numerous sales promotion activities such as aggressive advertising, discounts, free offers, incentive gift vouchers, and price discrimination. However, during the second half of the year, these industries also faced difficulties due to the overall economic downturn resulting in a negative annual growth for most of the sectors.

The value added by processing of plantation crops dropped by 5.3 per cent, in 2001. The decline was due to the shortfall in the production of all three major plantation crops, tea, rubber and coconut, during the year. Meanwhile, the small industry sub-sector also contracted by 3.5 per cent in 2001. The contraction of economic activities and downturn in the tourism industry reduced the demand for goods manufactured by the small scale industrial sector. The decline in the activities of large scale industries, which had backward linkage with small industries, also negatively affected this sub sector.

In 2001, the Construction sector recorded a growth of 2.5 per cent compared with the 4.8 per cent growth reported during the previous year. Though it showed a deceleration when compared with the previous year, the positive performance of this sector contributed to mitigate the magnitude of the overall negative economic growth. The deceleration recorded was largely due to the contraction in investment expenditure, which led to a lower number of large-scale construction projects. The growth of this sector, despite the overall economic downturn, was attributed to the increase in housing and other building construction activities as reflected in the indicators of sales of housing construction materials. Evidencing this trend, the Greater Colombo Housing Approval Index rose by 4.1 per cent in 2001 over the previous year, while the All Building Approval Index increased by 4.9 per cent.

The Mining and quarrying sector, which grew by 4.8 per cent in 2000, recorded a marginal increase of 0.7 per cent in 2001. The growth in this sector was solely due to the expansion in the quarrying sub sector by 2.5 per cent. This growth was mainly due to the expansion in construction activities in which quarrying products are the major inputs. Meanwhile, the mining sub sector declined by 4.1 per cent largely owing to depressed performance in gem mining activities. The value of gem exports declined in 2001 by 10 per cent, attributed to sluggish demand for precious stones in the depressed world market. However, other mining activities such as phosphate and graphite indicated an improvement in production.

The Electricity, gas and water sector experienced a contraction of 2.9 per cent in 2001 when compared with a 4.5 per cent growth in the previous year. The major contributory factor to this decline was the crisis situation in electricity that prevailed during the latter half of the year resulting in a 3.7 per cent decline in value added in the electricity sub sector in 2001. In early 2001, the Ceylon Electricity Board (CEB) imposed a surcharge of 25 per cent on electricity consumption and restriction on usage of electricity from the national grid for air conditioners, neon lamps etc. as a temporary measure to mitigate the impact of the sharp increase in the cost of production due to high fuel prices. In the second half, CEB had to impose power

cuts, as demand could not be met by the supply. Electricity generation during the first half of the year rose by 3 per cent but declined by 7.7 per cent in the second half, resulting in an annual decline of 2.5 per cent. Due to prolonged drought conditions, hydropower generated by the CEB recorded a decline of 3.5 per cent during the year, while the thermal power generated by the CEB also dropped by 14.1 per cent mainly due to a breakdown of one thermal power plant and the termination of the use of all emergency hired power plants by end June 2001 due to the high cost to the CEB. Although the private power producers, both thermal and hydro, were able to increase their generation by 28.7 per cent (or 276 GWh) during the year, additional demand could not be met by these sources. The water sub sector, which includes collection, purification and distribution of pipe borne water, recorded a growth of 2.1 per cent compared with 5.3 per cent growth in the previous year. Water distribution was also curtailed due to power cuts during the latter half of the year.

### Agriculture Sector

The value addition in agriculture declined by 3 per cent in 2001. This was mainly attributed to the failure of both the North-East and the South-West monsoons. Production of all major crops, tea, rubber, coconut, paddy and other food crops, declined under these adverse weather conditions. The negative impact of the decline in the crop sector was partly offset by the performance of the livestock sector, where the production of all major categories, poultry, milk and eggs, improved. The achievement of the forestry sector was also favourable and contributed to mitigate the impact of the drought on the overall Agriculture sector.

The value addition of the plantation crops declined by 6.4 per cent. The steady upward trend experienced in tea production since 1993 was reversed in 2001. The output, which exceeded 300 million kg. in 2000, declined by 3.4

**TABLE 2.2**  
**Composition of the Other Agriculture Sub Sector**

Sector	Value Added (1996) Constant Prices (Rs.mn)		
	1999	2000(a)	2001(a)
Total	77,236	77,913	76,355
Vegetables	35,235	36,426	35,166
Subsidiary food crops(b)	15,781	16,032	15,312
Minor export crops (c)	7,666	6,960	6,299
Sugar Cane	1,281	1,345	1,039
Tobacco	1,484	1,325	1,460
Animal husbandry(d)	6,597	6,630	7,371
Other	9,192	9,195	9,708

Source : Central Bank of Sri Lanka

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

per cent to 295 million kg. this year. Output in low grown teas, which is dominated by smallholders, increased marginally and accounted for over 56 per cent of the total output. In contrast, the output of high and medium grown teas declined significantly. The estate workers' strike, which continued for nearly a month during the first quarter of the year, was another contributory factor to lower production volumes. The drought also adversely affected the activities of replanting and new planting. Further aggravating the situation, tea prices in international markets declined by 3.5 per cent, in US dollar terms, due to an over supply in the world market.

Coconut production in 2001, estimated at 2,796 million nuts, was 9.7 per cent less than the peak output recorded in the previous year. The drop in output was attributed to the lagged effect of the reduced rainfall received during the latter half of 2000, and in 2001. Reduction in the application of fertiliser during both 2000 and 2001 also had a negative impact on the output in 2001. In the wake of a drop in output, the price of nuts increased sharply during the latter part of the year.

Paddy production in 2001 was 2.69 million metric tons, a decline of 5.7 per cent over the previous year. The decline in production was solely attributed to the drop in production in the Maha season by 9.4 per cent. Yala production achieved a marginal increase, despite the drought, mainly owing to higher yields from irrigated lands. Due to this factor, as well as the elimination of rain fed marginal lands from cultivation, the average yield increased in 2001, in both seasons. Meanwhile, the drop in paddy production, coupled with restrictions imposed on the import of rice, resulted in higher producer prices for paddy farmers.

The other agriculture sub sector, which consists of vegetables, fruits, subsidiary food crops, minor export crops and animal husbandry, declined by 2 per cent during the year. In this category, vegetable production declined by 3.5 per cent. Almost all varieties of low country vegetables showed downward production trends, while the production levels of most up country vegetables and tubers increased. The drought that prevailed throughout the year adversely affected the production of low country vegetables. Subsidiary food crops recorded a drop of 4.5 per cent. This was another adverse outcome of the failure of both the North-East as well as the South-West monsoons. Production volumes of all varieties of subsidiary food crops other than potatoes declined. Potato production showed a sharp increase of 19 per cent, which was an outcome of the very heavy protection provided to potato farmers through the specific duty imposed on imported potatoes.

A notable production increase of 11 per cent was observed in the animal husbandry category. Although poultry meat production recorded a growth of 12 per cent

during the year, the industry faced a setback during the second half of the year resulting from the lack of demand mainly from the beleaguered tourist industry. As a consequence, large quantities of poultry meat accumulated in cold stores and farmgate prices of poultry products dropped even below the cost of production. The power cuts that prevailed during the latter part of the year worsened this problem. However increased production of meat coupled with the fall in domestic demand stimulated the industry towards the export market. This was evident from the export volume of chicken and processed products of 209 metric tons in 2001 as against 50 metric tons in 2000. The bulk of these were exported to the Maldives and Middle East countries during the last quarter of the year.

Meanwhile, the forestry sub sector, which had lagged behind over the years, recorded an improved growth of 5 per cent in 2001. New long term investments in forestry by the private sector for future consumption enhanced the value addition of the forestry sub sector. This trend will be beneficial to increase potential value addition from the forestry sector in the future as well.

### Services Sector

The Services sector declined by 0.5 per cent during the year. The decline in the Wholesale and retail trade sector had the most severe impact on overall economic growth in 2001. The value addition in the trade sector declined by Rs 12,280 million, which was almost similar to the overall contraction of GDP, valued at Rs 12,423 million. The value added by import trade declined by 10.7 per cent in 2001, as reflected by the drop in the volume of imports, partly due to the impact of policy measures implemented since early 2001 for macroeconomic stabilisation and also the general slowing down of economic activities during the year. The export trade sub sector also suffered a setback of 8 per cent, owing to the lower demand for exported goods. The value of imports and exports in 2001 declined by 18.4 per cent and 12.8 per cent, respectively, in US dollar terms, evidencing the decline in value addition in these sub sectors. The decline in the domestic trade sub sector, by 1.6 per cent, indicates the overall decline in production of agricultural and manufactured goods which serve the domestic market.

Despite the overall economic downturn, the transport, storage and communication sector was able to record a growth of 5.2 per cent in 2001. The telecommunication sub sector, which has been growing vigorously and continuously since 1996, provided further impetus to the growth in the overall sector, by expanding by 25.5 per cent over the previous year. The corresponding growth rate in 2000 was 25.1 per cent. This growth performance was largely due to the expansion in cellular telephones by 55 per cent during the year. Heavy investment, aggressive advertising campaigns, introduction of new facilities and competitive

prices contributed to this growth in the cellular phone industry. Meanwhile, the number of Internet and e-mail users also recorded a healthy growth of 52 per cent during 2001. However, due to the fact that the previous pent up demand for fixed telephone lines had been met, the increase in new connections of fixed telephone lines was limited to 8 per cent.

In an unsatisfactory economic climate, especially in the external trading sector, the port services sub sector maintained a zero growth position. During the first half of the year, this sub sector performed well and indicated that it was moving away from the stagnation it had suffered during the previous three years. This was in spite of the deceleration recorded in external trading activities during the first half, partly due to the increased efficiency of port activities in the field of cargo handling and transshipment activities. However, the imposition of war risk insurance charges on sea travel and the subsequent contraction of external trade during the second half, wiped out the positive first half performance. Labour unrest at the Sri Lanka Ports Authority in August, which almost crippled port activities for a period of one week, also contributed adversely.

The transport sub sector, which includes passenger and freight transport, has three different segments, namely, roads, rail and air. The combined contraction rate of these sectors was 0.5 per cent in 2001 when compared with a 4.1 per cent growth during the previous year. The negative growth was mainly due to the decline in value added in road haulage, which was associated with the contraction in domestic production as well as external trade. However, the passenger transport sector performed well and partly mitigated the negative impact of the freight transport sub sector. Improvements in the public transport sector contributed to this development. The number of buses operated per day by the Regional (Cluster) Bus Companies increased in 2001 to 5,722 from 5,496 in 2000. The value addition by Sri Lanka Railways (SLR) also rose in 2001, as shown by the increase in the number of operated trains and passengers transported and volume of cargo handled. The 15 new power sets added to the rolling stock of power sets of the SLR in 2000, were instrumental in improving the railway services. Meanwhile, the air transport sub sector also experienced difficulties following the terrorist attacks on the Katunayake airport and USA in the third quarter of the year. The number of passenger kilometers flown by SriLankan Airlines declined to 6,556 million in 2001 from 6,860 million in 2000.

Despite gloomy economic conditions, the banking and insurance sector displayed a healthy growth of 5 per cent during 2001. The insurance sector performed well, attributed to uncertain economic conditions, and maintained a robust growth during the year. The commercial banking sector also performed comparatively well and grew by 4.8 per cent in

real terms. This was largely due to the increase in net interest income in the commercial banking sector. Also, the reduction of the statutory reserve requirement on foreign currency deposits in the latter half of the previous year reduced the effective cost of funds of the commercial banking sub sector.

The Services (n.e.s) sector, which includes all other services not classified elsewhere, grew by 2.2 per cent in 2001. The performance of private health services, private educational services, advertising services and repair services of all types, ranging from household appliances to vehicles, contributed to this growth. However, the hotel services sub sector, which depends mainly on foreign tourist arrivals, contracted in 2001 owing to the decline in tourist arrivals during the latter half of the year. Tourist arrivals declined by 44 per cent in the latter half, compared to an increase of 10.5 per cent in the first 6 months of the year. The hotel industry was virtually crippled as a result of the terrorist attacks at the airport as well as in USA. The industry kept afloat, largely depending on local tourists in the latter half of the year.

### 2.3 Expenditure

The aggregate demand generated by domestic economic activity is measured by Gross Domestic Expenditure (GDE), which is the sum of consumption and investment expenditure of the private and public sectors of the economy. In 2001, GDE was estimated at Rs 1,494 billion at current market prices, reflecting an increase of 7.4 per cent over 2000. Of the total expenditure, consumption expenditure accounted for 79 per cent. GDP at market prices, the sum of GDE and net imports of goods and services, was estimated at Rs, 1,400 billion, an increase of 11.3 per cent over the previous year.

Consumption expenditure at current market prices is estimated at Rs 1,185 billion, an increase of 14.2 per cent over the previous year. This increase was mainly due to the inflationary pressure that prevailed during the year. The real increase of consumption expenditure was 0.4 per cent, whereas in the previous year the corresponding increase was 5 per cent. Private Consumption Expenditure (PCE), which represents almost 88 per cent of consumption expenditure, recorded a growth of 15.2 per cent, in nominal terms, from Rs 906 billion in 2000 to Rs 1,044 billion in 2001. Of the PCE, expenditure on imported goods and non-factor services increased by 6.4 per cent in nominal terms. Importation of most basic food items declined in volume terms during the year. Of the imported non-food category, a notable decline of 46 per cent in US dollar terms was recorded by imports of motor vehicles and cycles, over the previous year. This decline was mainly due to the discontinuation of import duty concessions offered to certain public sector employees. In the domestically produced

goods category, the expenditure on rice, coconut products and fish increased considerably, despite the decline in local production, solely due to the increase in prices. Expenditure on industrial goods recorded an increase of 13.0 per cent, in nominal terms, over the previous year, with the consumption of processed foods and clothing displaying noteworthy increases.

Investment expenditure at current market prices is estimated at Rs 308 billion in 2001, reflecting a 12.5 per cent decline over the previous year. The decline was solely due to the decline in private investment by 14.5 per cent. In the private sector, large scale investment projects on which work had started continued. However, with the exception of the commencement of the Katunayake Highway, there were no new large-scale projects on which work commenced during the year. On a sectoral basis, private sector investment in transportation declined by 71.2 per cent in current terms, followed by investment in planting, replanting and land development (20 per cent) and plant and machinery (8.7 per cent) and other capital goods (5.0 per cent). Meanwhile, investment in building and other construction materials increased by 14.3 per cent. Of the total private investment, a considerable share was assigned to infrastructure development in port services, telecommunication and energy. Public investment expenditure however, increased by 2.1 per cent. Public investment was mainly concentrated in road construction, energy and water supply.

## 2.4 Availability and Utilisation of Resources

The total resources available to the economy, consisting of GDP and import of goods and non-factor services (foreign resources), at current market prices, increased to Rs 2,011 billion in 2001 from Rs 1,882 billion in 2000. This increase was generated by an increase of Rs 143 billion (11.3 per

cent) in GDP at current market prices and a decline of Rs 13 billion (2 per cent) in foreign resources.

The availability of resources valued at constant (1996) prices declined by 4.5 per cent in 2001. The contraction in economic growth by 1.4 per cent and in imports of goods and non-factor services, by 10.1 per cent, were responsible for the decline. In 2000, the availability of resources, in constant terms, grew by 9.0 per cent. With regard to utilisation of these resources, consumption grew marginally, by 0.4 per cent in real terms, while investment and exports of goods and non-factor services declined by 17.1 per cent and 6.5 per cent, respectively. Of the utilisation, the share of consumption grew from 57 per cent to 60 per cent and the share of investment declined from 18 per cent to 15 per cent, while the share of exports of goods and non factor services changed marginally.

## 2.5 Domestic and National Savings

According to the UN System of National Accounts 1993 (SNA 1993), savings is a balancing item that arises as a residual of disposable income, which is not used in final consumption. However, the existing system of National Accounts in Sri Lanka estimates savings through the investment approach, a methodology widely accepted and broadly followed. Accordingly, domestic savings are estimated as a residual, the difference between investment and external resources (defined as the net imports of goods and non-factor services). Domestic savings, which include private savings and government savings, were estimated at Rs 215 billion for 2001, a decline of 2.1 per cent over the previous year. The decline in domestic savings in 2001 was solely due to the 60 per cent deterioration in government savings, which is defined as the current account balance of the government budget. Government dis-savings worsened during the year due to the shortfall in government revenue and increased current expenditure. The contraction of

TABLE 2.3  
Total Resources and Their Uses at Constant (1996) Prices

Item	Percentage Share			Percentage Growth	
	1999	2000(a)	2001(a)	2000	2001
1. Total resources	100	100	100	9.0	-4.5
GDP at market prices	67	65	67	6.0	-1.4
Imports of Goods and Non-Factor Services(b)	33	35	33	14.9	-10.1
2. Utilization	100	100	100	9.0	-4.5
Consumption	59	57	60	5.0	0.4
Gross Domestic Fixed Capital Formation	18	18	15	10.0	-17.1
Government	2	2	2	6.4	-6.1
Private sector and Public corporations	16	16	13	10.5	-18.6
Changes in Stocks	0	0	0	-58.2	-12.1
Exports of Goods and Non-Factor Services(b)	24	26	25	18.0	-6.5

(a) Provisional

Source : Central Bank of Sri Lanka

(b) The repayment of loans, taken for the purchase of aircraft, of US\$ 292.8 million, from the receipts of insurance payments, against the destruction of these aircraft, included in the BOP service account as a balancing item was not considered as a non factor service for the year 2001.



economic activities, decline in volume of imports, tax incentives granted during the latter half of the year and the poor financial performance of certain public sector enterprises were mainly responsible for the shortfall in government revenue, while enhanced welfare expenditure and expansion in interest payments largely accounted for the increase in current expenditure. Private savings, which include household savings and corporate savings, increased in 2001 by 8.2 per cent, to Rs 284 billion. In 2000, the corresponding growth was 15.5 per cent. The deceleration was due to the contraction in real income, increase in the general price level and decline in corporate profits during the year. The domestic savings ratio (domestic savings as a percentage of GDP), which was 17.4 per cent in 2000, dropped in 2001 to 15.3 per cent, while the private savings ratio also declined, from 20.9 per cent to 20.3 per cent.

National savings, the sum of domestic savings, net foreign private transfers and net factor income from abroad, were estimated at Rs 273 billion in 2001. The national savings ratio deteriorated by a lower margin when compared with the domestic savings ratio, from 21.5 per cent to 19.5 per cent. This was solely due to the increase in net foreign

**TABLE 2.4**  
**National Savings at Current Market Prices**

Category	Rs. mn			
	1998	1999	2000(a)	2001(a)
1. Gross Domestic Product at Market Prices	1,017,986	1,105,963	1,257,634	1,400,180
2. Domestic Savings	194,735	215,733	219,259	214,699
3. Net Factor Income from Abroad	-11,556	-17,831	-23,083	-25,048
4. Net Private Transfers from Abroad	54,785	62,438	73,810	83,802
5. National Savings	237,965	260,340	269,986	273,453
8. Domestic Savings Ratio (2 as a % of 1)	19.1	19.5	17.4	15.3
9. National Savings Ratio (5 as a % of 1)	23.4	23.5	21.5	19.5

(a) Provisional

Source : Central Bank of Sri Lanka

private transfers by 13.5 per cent. Net foreign private transfers, which consists mainly of workers' remittances from the Middle East, accounted for around 31 per cent of national savings in 2001. In 2000, the corresponding ratio was 27 per cent.