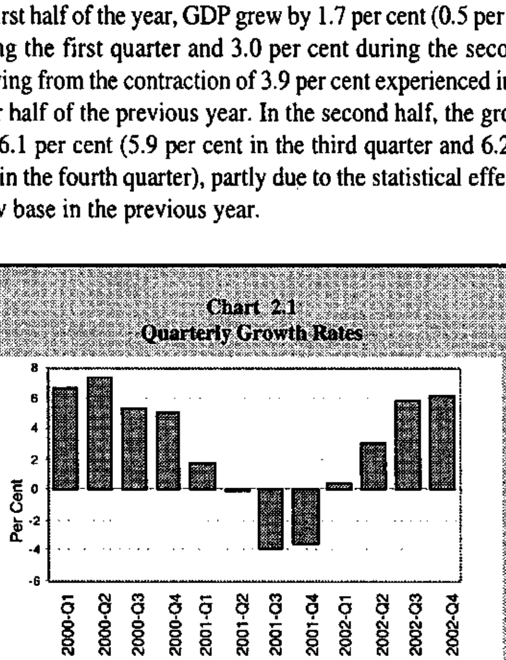
Chapter 2

NATIONAL INCOME AND EXPENDITURE

2.1 Overall Trends

In 2002, Gross Domestic Product (GDP) grew by 4.0 per cent, recovering convincingly from the contraction of 1.5 per cent reported in 2001. The recovery was a gradual process. During the first half of the year, GDP grew by 1.7 per cent (0.5 per cent during the first quarter and 3.0 per cent during the second), reviving from the contraction of 3.9 per cent experienced in the latter half of the previous year. In the second half, the growth was 6.1 per cent (5.9 per cent in the third quarter and 6.2 per cent in the fourth quarter), partly due to the statistical effect of a low base in the previous year.

Chart 2.1
Quarterly Growth Rates



The growth in 2002, over a performance that plummeted in the previous year, was driven by several factors. The security situation, which improved with the uninterrupted continuation of the cease-fire that came into effect in late February, boosted consumer demand, as well as the shift to positive perceptions and attitudes, both domestically and internationally. The world economy that experienced difficulties in the previous year, regained some of its growth momentum in 2002, though at a slower pace than earlier projected. The partial recovery in markets that are of major importance to Sri Lanka, namely, USA, Europe and the Middle East, was particularly important for recovery in the domestic economy. Benign weather conditions after a severe drought that had prevailed in 2000/2001 supported the recovery in agriculture, while the discontinuation of power cuts impacted positively on industry and services. Meanwhile, the removal of the war risk insurance surcharge on sea and air travel improved external trade and tourist activities. Further, a decline in interest rates, commensurate with the deceleration in inflation, and improved fiscal discipline that minimized expansionary government borrowing, created a conducive macro economic environment for growth in 2002. However, under-performance of the world economy, and the wait and see attitude of investors watching the political cohabitation between the Parliament and the Executive Presidency and the progress of the peace process initiated early in the year dampened the potential for economic growth beyond the long term average of 5.0 per cent per annum.

Meanwhile, Gross National Product (GNP), defined as GDP adjusted for net factor income from abroad (NFIA), grew by 4.1 per cent in real terms, in 2002, compared to a contraction of 1.3 per cent in 2001. The growth in GNP was higher than that in GDP due to the better performance of NFIA. NFIA, though continuously negative, improved in US dollar terms in 2002 owing to the decline in factor payments and increases in factor receipts. Interest earnings improved in 2002 owing to the increase in gross reserves, while interest payments on foreign borrowings fell due to the decline in interest rates in international markets.

Though economic activity turned around from negative to positive growth which was encouraging, the recovery was not adequately broad based. The Agriculture sector, recovered significantly, but not completely, with the improvement in weather conditions. The growth in the Agriculture sector was 2.5 per cent in 2002, compared to a contraction of 3.4 per cent in the previous year. The industry sector continued to shrink during the first half of 2002, but regained some growth momentum during the latter half, recording a 1.0 per cent growth in 2002, due to both domestic and global factors, compared to a contraction of 2.1 per cent in 2001. The comparatively low performance in the Industry sector raises concerns, as this sector is crucial for the creation of employment opportunities and influences activities in the Services sector, as well as future economic growth. The Services sector, which contracted marginally by 0.5 per cent in the previous year, thrived in 2002, with a growth of 6.0 per cent, responding well to the increased demand for services such as trade, transport, communication, financial services and tourism, arising mainly from the improved security situation both locally and internationally. The overall recovery reported in 2002 was clearly centered on the performance in the Services sector which contributed 80 per cent of the GDP growth, claiming 53.6 per cent of total GDP in 2002, compared to 52.5 per cent in 2001. The demand for services arose mainly from

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 (%)	
	2001(a)	2002(b)	2001(a)	2002(b)	2001(a)	2002(b)
1. Agriculture	-3.4	2.5	-44.9	12.6	20.1	19.8
1.1 Agriculture, forestry and fishing	-3.4	2.5	-44.9	12.6	20.1	19.8
Agriculture	-4.3	1.9	-43.8	7.3	15.5	15.1
Tea	-3.5	5.0	-3.2	1.8	1.4	1.4
Rubber	-1.5	5.0	-0.4	0.5	0.4	0.4
Coconut	-13.5	-13.6	-15.4	-5.3	1.5	1.3
Paddy	-5.7	6.1	-12.0	4.8	3.1	3.2
Other	-2.2	2.5	-12.9	5.6	9.0	8.9
Forestry	5.0	2.7	5.9	1.3	1.9	1.9
Fishing	-3.9	5.9	-6.9	4.0	2.7	2.7
2. Industry	-2.1	1.0	-37.7	7.1	27.4	26.6
2.1 Mining and quarrying	0.7	-1.1	0.7	-0.5	1.8	1.7
2.2. Manufacturing	-4.2	2.2	-46.9	9.5	16.9	16.7
Processing of tea, rubber & coconut kernel products	-6.7	-1.0	-9.0	-0.5	2.0	1.9
Factory industry	-3.9	2.8	-35.0	9.7	13.7	13.5
Small industry	-3.5	0.9	-2.9	0.3	1.3	1.2
2.3. Construction	2.5	-0.8	11.2	-1.5	7.3	6.9
2.4. Electricity, gas, water and sanitary services	-2.9	-1.3	-2.8	-0.5	1.4	1.4
3. Services	-0.5	6.0	-17.4	80.3	52.5	53.6
3.1. Transport, storage and communication	3.8	7.7	28.7	24.1	12.4	12.8
3.2. Wholesale and retail trade	-6.7	5.5	-95.2	29.1	20.9	21.3
Imports	-10.7	8.6	-68.9	19.8	9.0	9.4
Exports	-8.0	2.0	-13.9	1.3	2.5	2.5
Domestic	-2.0	3.4	-12.4	8.0	9.4	9.4
3.3. Banking, insurance and real estate	7.9	11.0	38.8	23.2	8.3	8.9
3.4. Ownership of dwellings	1.4	1.4	1.6	0.6	1.8	1.8
3.5. Public adminlnstration and defence	1.0	0.0	3.1	0.0	5.0	4.8
3.6. Services (n.e.s.)	2.2	3.2	5.5	3.4	4.1	4.1
4. Gross domestic product (1+2+3)	-1.5	4.0	-100.0	100.0	100.0	100.0

(a) Revised
(b) Provisional

Source : Central Bank of Sri Lanka

domestic consumers. Suppliers who had excess capacity responded quickly to this increase in demand. In contrast, activities in the industry sector took a comparatively longer time to regain their growth momentum owing to the inherent nature of such activities. For example, generally, the recovery in export manufacturing and in the construction industry take relatively longer, as the decision making process and obtaining required material inputs take more time. Slower recovery in the Industry sector will hinder longer term growth prospects which are dependent on construction sector activity and manufacturing.

On the expenditure front, GDP at current market prices was estimated at Rs. 1,585 billion compared with Rs. 1,407 billion in 2001, recording an increase of 12.6 per cent in nominal terms. This increase was explained to a lesser extent by increases in real economic activity and, to a larger extent, by the increase in the general price level. The overall inflation as measured by the GDP deflator was 8.3 per cent, in comparison to 12.4 per cent recorded in 2001. The comparatively lower inflation was mainly induced by the increase in local production to meet demand and improved macro economic stability. Accordingly, GDP per capita for 2002 is estimated at Rs. 83,382, an increase of 11.0 per cent over the previous year's Rs. 75,133, which surpasses the combined increase in inflation and population growth, indicating an overall improvement in living standards, on average. In US dollar terms, per capita GDP increased by 3.7 per cent, from US dollars 841 to US dollars 872.

GDP at market prices, when estimated by the expenditure approach, also reflects the total demand in the economy comprising both domestic and external demand. Domestic demand, (consumption plus investment demand) rose by 13.1 per cent at current market prices. Total consumption expenditure, which includes both private and government consumption expenditure, increased in current terms, by 14.2 per cent. This increase was solely due to the 16.6 per cent

Box 9

A Preliminary Estimation of Regional Gross Domestic Product (RGDP)

Introduction

Region specific development strategies for Sri Lanka have received increasing attention in recent times, largely due to the widely accepted view that certain expanding economic activities are mainly concentrated in a few regions, thereby generating significant economic disparities among regions. This has led policy makers and researchers to emphasise the need for compiling region specific databases on various macro economic variables that are available at the national level. The estimation of regional GDP (RGDP) was undertaken essentially towards fulfilling this task.

The compilation of RGDP would allow policy makers to obtain key economic indicators such as economic growth, labour productivity and per capita income at the regional level. This would help to identify major gaps in the economic and social development of various regions in the country, which are essential for enhancing the efficiency of the policy making and resource allocation process. Hence, the estimation of provincial GDP (PGDP) not only fulfils a long felt demand of policy makers in the country, but also widens the frontiers of statistical analysis by providing a comprehensive data base for researchers in academia and business as well.

Recent Statistical Developments

The Central Bank of Sri Lanka (CBSL) has recently begun compilation of PGDP on a provisional basis[1]. Analysis of these data for the period 1996 to 2001 brings out some striking observations on the level and the distribution of regional economic activities in the country as measured by the standard indicator of aggregate economic activity, GDP, the monetary value of goods and services produced in a region/province in a year. In compiling PGDP, the national GDP was apportioned to the respective provinces by using both direct and indirect methods depending on the availability and the reliability of the relevant regional level data on production, expenditure and income.

The compilation of PGDP utilised a large number of data sources, around 4000, both primary and secondary. Data were mostly gathered from central government organisations, provincial authorities, local government authorities, financial sector institutions, censuses and sample surveys of the Department of Census and Statistics (DCS) and the CBSL and other private sector institutions. Currently, the estimates are compiled with a lag of one year. However, it is hoped that with further improvements in the availability of disaggregated statistics and their timeliness this lag can be reduced.

The estimation of regional GDP by apportioning the national GDP to regions is not an ideal method of estimating sub national accounts. The lack of adequate disaggregated data, especially information on inter-province and intra-province transactions, has compelled use of this methodology for the moment. Further, the limited information from the Northern and Eastern provinces due to the security situation that prevailed during the period of analysis, also adds an element of uncertainty to those estimates. The estimates have been compiled at current factor cost prices. Again, lack of adequate data to compile appropriate provincial price deflators prevent derivation of constant estimates of GDP which are necessary for studying real changes in output. Despite these limitations, the

TABLE 1
GDP Shares by Province[1]

Province/Year	1996	1997	1998	1999	2000	2001	Annual Average GDP Share
Western(WP)	43.7	44.3	45.3	46.7	49.6	47.3	46.5
N.Western(NWP)	11.3	12.1	12.0	10.4	10.4	10.9	11.2
Central(CP)	10.0	10.5	9.8	9.2	9.4	9.8	9.8
Southern(SP)	9.0	8.8	9.3	9.6	9.4	9.9	9.3
Sabaragamuwa(SaP)	9.0	7.6	6.7	6.4	6.7	6.3	7.1
Eastern(EP)	4.8	5.0	5.5	5.0	4.5	5.0	5.0
Uva(UP)	5.1	5.0	4.9	4.1	3.9	4.5	4.6
N.Central(NCP)	4.6	4.0	3.6	4.1	3.9	3.8	4.0
Northern(NP)	2.4	2.8	2.9	2.5	2.2	2.5	2.5
National GDP	100	100	100	100	100	100	100

1 Provisional

Source: Central Bank of Sri Lanka

1 A Provisional Estimation and Analysis of Regional Economic Activity in Sri Lanka (1996-2000) (published in Staff Studies of CBSL Vol. 31 & 32, 2001 & 2002) and update of the same study for 2001 (unpublished mimeo).

Box 9 (contd.)

provisional estimates provide very useful regionally disaggregated information on the Sri Lankan economy.

It was seen that, while the Western Province (WP) dominated PGDP with a share of nearly half, 4 other provinces, comprising the Central Province (CP), North Western Province (NWP), Sabaragamuwa Province (SaP) and Southern Province (SP), each contributed a share of greater than 5 per cent, while the remaining 4 provinces, comprising the Eastern Province (EP), North Central Province (NCP), Northern Province (NP) and Uva Province (UP), each contributed less than 5 per cent (Table 1). Consequently, for simplicity of analysis, the nine provinces were grouped into 3 regions, namely Region H (high economic activity), comprising the WP, Region M (moderate economic activity) comprising the CP, NWP, SaP and SP and Region L (low economic activity) comprising the EP, NCP, NP and UP.

Major Findings

◆ The analysis clearly indicates an uneven distribution of GDP among provinces. Of the national GDP, Region H was responsible for an average 46 per cent, whereas 37 per cent was contributed by Region M in the period 1996 - 2001. Region L was responsible for only 16 per cent of national GDP during this period (Table 2). This trend emphasises the vital role that could be played by minimising existing disparities and optimising on relative advantages in the availability and exploitation of infrastructure facilities, natural resources and human resources among the 3 regions.

◆ There is an imbalance in the distribution of sectoral economic activities as well (Chart 1). As expected, the share of the agriculture sector in the Western Province GDP was the lowest (5 per cent of the province's GDP) whereas the

Chart I
Average Share of Economic Sectors within Regions 1996-2001

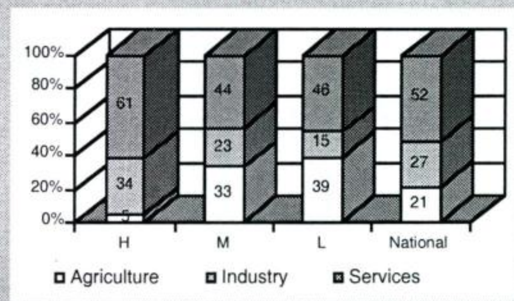
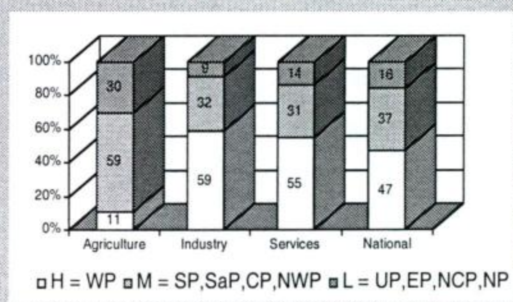


Chart II
Average Share of Regions within Economic Sectors 1996-2001



services sector contributed the highest (61 per cent). The Industry sector contributed the balance 34 per cent to the GDP. Both Region M and Region L also had the highest share in the services sector (44 and 46 per cent, respectively) and the lowest shares (23 and 15 per cent) in industrial sector

TABLE 2

Regional Gross Domestic Product and Shares at Current Factor Cost Prices (Rs. Mn.)[1,2]

Region/Year	1996	1997	1998	1999	2000	2001	Growth Rate[3]	
							1996-2000	1996-2001
H	304,377	356,073	413,401	484,714	558,157	589,478	16.4	14.2
	(43.7)	(44.3)	(45.3)	(48.7)	(49.6)	(47.3)	(46.3)	(46.5)
M	274,083	313,623	345,113	353,275	404,114	458,684	10.3	10.9
	(39.4)	(39.0)	(37.8)	(35.5)	(35.9)	(36.8)	(37.5)	(37.4)
L	117,476	134,001	154,324	156,743	162,988	197,541	8.7	11.2
	(16.9)	(16.7)	(16.9)	(15.8)	(14.5)	(15.9)	(16.1)	(16.3)
National GDP	695,936	803,697	912,837	994,732	1,125,259	1,245,703	12.8	12.4

1 Provisional
2 Average proportion of Regional GDP to National GDP
3 Average Annual Nominal Growth Rate
H = High Contributor(WP), M = Medium Contributor(SP, SaP, CP, NWP)
L = Low Contributor(UP,EP, NCP, NP)

Source: Central Bank of Sri Lanka

Box 9 (contd.)

activities. Agriculture accounted for around a third of GDP in both regions.

◆ When economic sectors were disaggregated by regions, it was seen that the Agriculture Sector was dominated by Region M (59 per cent) consistent with major agricultural areas of the CP and NWP being in Region M along with plantation areas of the SaP and SP (Chart 2). Meanwhile, both the Industry and Services Sectors where dominated by Region H (59 and 55 per cent). The international seaport and airport, along with superior access to road and rail facilities in Region H have provided the necessary infrastructure for Region H to dominate in both these sectors of economic activity in the recent past, particularly manufacturing, construction, trading and commerce.

◆ During the 5 year period of positive economic growth from 1996 to 2000, the average annual growth in current terms in the 3 regions varied considerably (Table 2). Region H grew by over 16 per cent, Region M by 10 per cent and Region L by just below 9 per cent, thereby further widening the existing disparities. The average GDP deflator during this period was about 8 per cent. Thus, a simple estimation of real growth indicates that Region H grew at over 8 per cent, Region M at around 2 per cent and Region L at below 1 per cent, to achieve an average annual growth of around 5 per cent for the country as a whole. Replication in other regions, of the success in achieving this high growth in one region during this period would enable Sri Lanka to achieve her targeted higher long-term growth path.

◆ The overall contraction in the economy in 2001 changed the relative contribution of the regions. Although GDP at current factor cost prices grew in all provinces in 2001, the growth was moderate in the CP, SP, UP, EP, NWP and NP, while it slowed down in the WP, SaP, and NCP compared to the growth registered in 2000. The growth rates of the latter three provinces were estimated to be negative[2] in real terms in 2001. When combined with the fact that the WP is responsible for nearly fifty per cent of the country's GDP, it can be concluded that the contraction in economic activities in the WP was the single most important factor that led to the negative overall growth in 2001.

◆ When the population distribution of 2001[3] was considered, it was clearly seen that the share distribution of income was skewed towards the high income region. Nearly 50 per cent of the GDP was shared by only 29 per cent of the population in Region H. At the other extreme, while 37 per cent of the GDP was distributed among nearly half the population in Region M, 15 per cent of the GDP was shared by a quarter of the population in Region L (Table 3).

TABLE 3

Per Capita Income by Region in 2001

Region	Population Share(%)	GDP Share (%)	Per Capita Income	
			Rupees	US Dollars
H	29	47	109,953	1,230
M	46	37	53,102	594
L	25	16	41,734	467

◆ Consequently, the levels of per capita income showed considerable disparities among these three regions. The per capita income in Region H was Rs 109,953 (US Dollars 1,230), thereby emphasising that Region H had a per capita income well above the standard cut-off level for developing countries of US Dollars 1,000, whereas in the other two regions, the per capita income was less than half this amount.

◆ The estimates provide a comprehensive overview of the existing disparities between provinces and emphasise the importance of productivity enhancement, particularly in agriculture, encouragement of private sector participation in services such as education, health, transport and trading activities and expansion of IT and in infrastructure development at the regional level towards narrowing down the existing disparities in economic well-being among the provinces.

Conclusion

Being a developing country with a per capita income of less than US Dollars 1,000 per annum, Sri Lanka is today facing the challenge of raising her per capita income at a rapid pace to a desirable level that would provide for a reasonable international standard of living and quality of life for all her citizens. The high concentration of economic activities in certain provinces, thereby generating considerable disparity in economic opportunities, would be an additional constraint to achieving this task, even with an efficient fiscal and monetary policy framework, unless policies are also geared towards overcoming barriers and exploiting opportunities for economic development at the regional level, as well. Early attention to this issue is critical, as widening regional economic disparities not only affect the achievement of a sustainable high overall economic growth directly, but also indirectly, through their potential impact on social and political stability in the country.

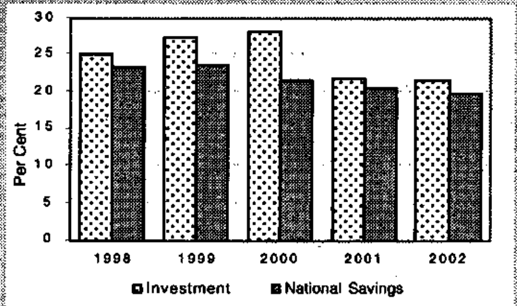
2 In terms of both the growth in overall GDP deflator (12.4%) and the CCPI (14.2%).

3 Taken from the Census of Population and Housing 2001 conducted by the Department of Census and Statistics.

expansion in private consumption expenditure (PCE), which represented around 90 per cent of the total consumption expenditure. Government consumption expenditure declined, by 3.6 per cent, due to fiscal consolidation efforts. The expansion in consumption expenditure was nearly equal to the increase in GDP at market prices, signifying that marginal propensity to consume (MPC), which is usually lower than one, was nearly equal to one. The MPC which ranged between 0.75 and 0.90 for the period of 1996-2001 rose to 0.95 in 2002. This unusual increase in consumption expenditure was explained by two factors. First there was an increase in demand, particularly in the Northern and Eastern provinces, which had been suppressed for many years due to the security situation that prevailed throughout the country. The demand for consumer goods, especially for imported consumer goods, rose significantly during the year. This was reflected in imports of consumer goods that showed a 22 per cent volume increase during the period. Second, the continuous decline in interest rates discouraged financial savings, further encouraging consumption. In real terms, PCE grew by 8 per cent, indicating an improvement in living standards.

Investment expenditure (Gross Domestic Capital Formation) at current market prices, which declined by 12.2 per cent in 2001, is estimated at Rs. 338 billion, an increase of 9.1 per cent over 2001. However, the Investment/GDP ratio, which dropped to 22.0 per cent in 2001 from the peak level of 28.0 per cent in 2000, declined to 21.3 per cent. Several factors contributed to this inadequate performance in capital formation. There was already excess capacity in the economy so that growth could be achieved without considerable improvement in capital stock in 2002. Though capital inflows grew rapidly, the commencement of several large-scale infrastructure projects that were earmarked did not materialize during the year. Most private investors preferred to follow a wait and see policy, due to uncertainties that prevailed on the political front, including their close monitoring of progress made on the peace process initiated at the beginning of the year. This curtailed the expansion of private capital formation. The poor performance of government investment under severe budgetary constraints, also contributed to the low level of total investment expenditure. Government investment expenditure, which increased by 3.0 per cent in 2001, deteriorated by 24.7 per cent in 2002. A notable fact was that, despite the decline in the investment ratio, capital formation rose in 2002, in real terms by 3.1 per cent, compared with a 17.5 per cent decline in 2001. The increase in capital stock was significant towards the very end of 2002, indicating an accumulation of stocks for use in the following year and that the growth achieved in 2002 was predominantly based on efficient use of the prevailing capital stock. However, the decline in the investment ratio will not augur well for future economic growth. This emphasises the fact that the future economic growth will ultimately depend on the speedy implementation of structural reforms and finding a lasting solution to the civil conflict that will crucially affect future capital formation.

Chart 2.2
Investment and Savings Ratio



Net external demand (viz. exports less imports) continued to be negative, as imports of goods and non-factor services, such as passenger and freight transportation, travel, insurance and business services, was higher than the export of goods and such non-factor services. In 2002, while both exports and imports grew, imports grew at a much higher rate than exports, thereby further widening the gap in net external demand.

On the resources side, domestic savings, the sum of private and government savings, were estimated at Rs. 231 billion, an increase of 4.3 per cent, in nominal terms. However, the increase in savings was lower than the increase in disposable income. Accordingly, the domestic savings/GDP ratio, which was 15.8 per cent in 2001, declined to 14.6 per cent in 2002. Although private savings increased by 3.2 per cent in 2002, the private savings/GDP ratio dropped from 20.7 per cent to 19.0 per cent with the higher rate of growth of nominal GDP. The increase in consumption expenditure, as reflected by an MPC almost equal to one, and a sharp decline in interest rates eroded the propensity to save. On the positive side, government dis-savings, which had risen drastically during the previous two years, improved marginally due to the prudent budgetary policies that were followed. The national savings ratio also declined, but at a lower rate, from 20.3 to 19.7 per cent due to the improvement in net foreign private transfers which grew by 19.4 per cent. The resource gap, the investment- national savings gap as a ratio of GDP, stood at 1.6 per cent compared to 1.7 per cent recorded in 2001 and 6.6 per cent in 2000. However, the decline in the gap was a consequence of a faster decline in the private investment/GDP ratio, rather than an improvement in the national savings/GDP ratio. This is not a healthy development as it lowers the potential for future expansion of output.

2.2 Sectoral Performance

In 2002, value added, in real terms, increased in Agriculture (2.5 per cent), Industry (1.0 per cent) and Services (6.0 per cent). The increase in the value added in the Services sector contributed 80 per cent of the overall economic growth. The contributions to growth from the Agriculture and Industry sectors were 13 per cent and 7 per cent, respectively.

Agriculture Sector

The Agriculture sector, which contracted by 3.4 per cent in the previous year, grew by 2.5 per cent in 2002 under favourable weather conditions. However, the relative importance of the Agriculture sector continued to decline from 20.1 per cent in 2001 to 19.8 per cent. While fluctuating in the short run with changing weather patterns, the long run problem in the Agriculture sector has been its low level of productivity and lack of policy direction. A comprehensive, consistent policy package compatible with the overall market oriented economic policy framework is urgently needed to prioritise the required reforms, enhance productivity and thereby revitalise the growth in this sector in the long run.

In 2002, the production of most major crops such as tea, rubber and paddy, improved under favourable weather conditions. However, coconut production continued to drop due to the lagged effect of the drought in 2001.

Tea production at 310 million kg for the year 2002 bettered the previous all time record of 305.8 million kg established in 2000. This was mainly due to good weather and higher productivity against the background of the collective wage agreement between employees and workers that was smoothly renegotiated in mid 2002. Production for 2002 recorded a substantial increase of 14.9 million kg (or 5 per cent) over 2001, with the highest growth of 11.9 million kg from the high grown sector. This, incidentally, is the highest production from the high grown sector in the recent past. Low grown tea, which is dominated by smallholders, also recorded an increase of 2.9 million kg, or 1.8 per cent, while medium grown tea recorded a marginal increase of 0.4 per cent. Despite the high production, tea auction prices improved by 3.7 per cent.

Rubber production, which had declined continuously due to the low prices that had prevailed, increased in 2002 by 5.0 per cent, mainly owing to the satisfactory improvement in prices. The annual average price recorded a growth of 26 per cent, while export earnings from rubber rose. The recovery in prices is attributed to production cutbacks by major South East Asian producers and a revival in demand for natural rubber, especially from tyre manufacturers. It is expected that prices will remain attractive in the near term.

Coconut production in 2002 went down further, recording a 13.6 per cent decline. The drop in output was attributed to the lagged effect of the reduced rainfall received during the latter half of 2000, and in 2001. High costs of production, reduction in application of fertiliser, poor yields and less inducement for planting and replanting have worsened the problem. In the wake of the drop in output, the producer price of nuts increased sharply by 76 per cent during the year.

Paddy production in 2002 was 2.86 million metric tons, an increase of 6.1 per cent over the previous year. The production in the Maha season recorded a notable growth of 9.9 per cent owing to the increase in extent sown and harvested. Yala production achieved a marginal increase. Replacing the 35 per cent import duty on imported rice with a specific duty of Rs. 7 per kg in January 2002 and removal of the licencing requirement in March 2002, coupled with the depleted stock position at the beginning of the year, led to an increase in rice imports in 2002. However, due to high demand, coupled with the increase in input costs such as fertiliser, fuel, electricity and other accessories, rice prices continued to increase, further aggravated by drought conditions that prevailed at the beginning of the season during the latter half of 2002.

TABLE 2.2

Composition of the Other Agriculture Sub Sector

Sector	Value Added (1996) Constant Prices (Rs.Mn.)		
	2000	2001(a)	2002(b)
Total	**77,913**	**76,205**	**78,085**
Vegetables	36,426	35,166	34,350
Subsidiary food crops(c)	16,032	15,312	17,053
Minor export crops (d)	6,960	6,297	7,116
Sugarcane	1,345	1,048	1,058
Tobacco	1,325	1,297	1,487
Animal husbandry(e)	6,630	7,377	7,303
Other	9,195	9,708	9,718

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

Source: Central Bank of Sri Lanka

Value added in the other agriculture sub sector, which consists of vegetables, fruits, subsidiary food crops, minor export crops, animal husbandry, sugarcane and tobacco, increased by 2.5 per cent in 2002. In this category, vegetable production declined by 2.3 per cent. This decline was a consequence of the combined effect of the 0.3 per cent growth in the Maha season and 5.6 per cent drop in the Yala season. Almost all varieties of up country vegetables showed downward production trends, while the production levels of low country vegetables showed mixed performances. The subsidiary food crops category recorded a growth of 11.4 per cent. This growth was mainly because production of potatoes increased by 53 per cent owing to the protection provided through a high tariff on imported potatoes since March 2001. Production of big onions dropped by 11 per cent compensated for by the increase in imports by 18 per cent. Production in the minor export crops category increased by 13 per cent as reflected by the growth in export earnings from these crops. Export volumes of arecanuts, coffee, pepper and cloves recorded over 100 per cent growth, while production of nutmeg and mace, cardamoms, betel leaves and essential oils also increased significantly.

The animal husbandry sub-sector recorded a marginal decline during the year. Poultry meat production grew slowly by 4.7 per cent during 2002 compared to the high growth of 7.3 per cent in 2001. This was due to the difficulties faced by the tourist industry, power cuts and subsequent difficulties such as stock accumulation and resultant drop in farmgate prices of poultry products that the industry faced during 2001. The uncertainty that prevailed in the domestic market stimulated the export of chicken and chicken products, which grew by 32 per cent. These products were exported mainly to the Maldives, India and Bangladesh. A government decision to grant a rebate on chicken exports which was implemented in October 2002, contributed to this growth. Exports in 2003 are expected to increase further owing to this scheme. Though such rebates could contribute to promote exports in the short-run, it is necessary for the industry to improve productivity and cut down the cost of production in order to sustain this rate of growth in the long run in a competitive world. As a result of a poultry disease that prevailed in the first half of the year, production of eggs declined marginally during the year. Meanwhile, milk production also dropped by 6.0 per cent, due to the adverse effects of high input costs, particularly the price of cattle feed.

Fish production during 2002 recorded a growth of 5.9 per cent when compared to 2001. Due to the improved security situation in the Northern and Eastern areas, the marine sector recorded an increase of 7.2 per cent, contributing significantly to this growth.

Industry Sector

The Industry sector, which comprises Manufacturing, Construction, Mining and quarrying and, Electricity, gas and water supply, grew by 1.0 per cent in 2002, compared with a decline of 2.1 per cent in 2001. The slow recovery in the Industry sector delayed a full recovery in the overall economy. Except the Manufacturing sector, the largest sub-sector in Industry, all the other sub-sectors continued to contract in 2002.

In the Manufacturing sector, the factory industry sub-sector, the largest sector in terms of value added, employment generation and foreign exchange earnings, recorded a growth of 2.8 per cent, compared with a contraction of 3.9 per cent in 2001. During the decade prior to 2001, the factory industry sub-sector grew by over 8 per cent annually and provided the impetus to the overall growth in the Industry sector. The under-performance in this sub-sector was due to the dismal performance of the textiles, wearing apparel and leather products category, which grew over 10 per cent per year in the previous decade. Internationally, the competition in the global apparel market has intensified in recent years with the entrance of new and low-cost manufacturing countries, the gradual improvements in modern technology and the expansion of preferential trade. Domestically, the increase in utility costs such as fuel, electricity, telephone and other charges has affected the competitiveness of local manufacturers and has reduced the value added in the industry. Amidst these difficulties, the apparel industry managed to record a marginal growth of 1.2 per cent, compared with an 8.5 per cent decline in the previous year. However, domestic market oriented manufacturing industries performed well due to increased demand and contributed to the overall growth in factory industry. Apart from factory industry, processing of plantation crops contracted marginally by 1 per cent. The processing of tea and rubber grew, while that of coconut fell due to the decline in coconut production. Meanwhile, the small industry sub-sector improved by 0.9 per cent.

The dismal performance of the Construction sector experienced from the latter half of 2001 continued during 2002. There was a considerable increase in small-scale construction activities, mostly in housing construction and related activities, with the peace initiatives. Nevertheless, the low investment by both private and public sectors in major infrastructure projects completely offset the favourable performance in the housing construction sector. Low investment by the private sector and budgetary constraints in the public sector were mainly responsible for this development. It was unfortunate that major construction projects for which funding arrangements were in place, such as the Southern highway and Kotmale power projects, were unable to commence work during the year. These delays not only hinder the growth performance in the Construction sector but also the capacity for expansion in the overall economy in the future.

The Mining and quarrying sector contracted by 1.1 per cent in 2002. The gem mining sector, the largest mining sector in terms of value added, continued to suffer from the reduced demand from major buyers during the first half, but recovered strongly during the second half. However, other mining activities such as mining of graphite, phosphate and mineral sands contracted during the year. The quarrying sub-sector contracted in 2002 due to the dismal performance of the construction industry.

The Electricity, gas and water sector contracted by 1.3 per cent in 2002, when compared with the 2.9 per cent contraction in the previous year. Electricity generation during the first half of the year declined by 5.9 per cent due to the continuation till mid May 2002 of power cuts begun in mid 2001. In the second half of the year the generation rose by 15.3 per cent, resulting in an annual increase of 4.4 per cent. The demand for electricity grew by 5.3 per cent during the year, mainly due to growth in the manufacturing and commercial sectors. The hydropower generated by the CEB declined by 15 per cent due to the drought conditions that prevailed during the first half of the year and lower utilisation of hydropower with the greater usage of hired thermal power. Value added in the electricity sub sector declined by 2.1 per cent as a result of higher dependence on thermal power, which has high generation costs. In 2002, 60 per cent of the total electricity was generated thermally, in comparison to 52 per cent in 2001. In April 2002, the CEB removed the 25 per cent fuel adjustment charge imposed on electricity consumption but increased the electricity tariff by around 37 per cent effective from 1 April 2002 to cushion against the high costs involved in thermal power generation and use of hired power plants. Rising dependence on thermal power is a key area of concern as it has an adverse impact, not only on value added in the power sector, but also critically on the long term growth prospects of the economy through its impact on the costs of production. Meanwhile, water distribution, which was curtailed due to power cuts and drought from 2001 to mid 2002, recorded a growth of 3.8 per cent in 2002 compared with a 2.1 per cent growth in the previous year.

Services Sector

The growth in the Services sector provided the major impetus for growth in 2002. The recovery in economic activity and the more peaceful environment that followed the cessation of hostilities since late February 2002, created a demand for services such as trade, transport, leisure activities, financial services and telecommunication services. Overall, the growth of the Services sector in 2002 was 6.0 per cent compared with a contraction of 0.5 per cent in 2001.

Value added in the Transport, storage and communication sector increased by 7.7 per cent in 2002, largely due to the expansion in the telecommunication sub sector by 19.3 per cent. However this was a deceleration from the previous year's growth of 23.1 per cent. The growth in the telecommunication sector in 2002 was also partly due to the new demand arising from the North and East. The number of subscribers to cellular telephones increased by 36 per cent, while inter-net and email users recorded a growth of 12.8 per cent. The profits of Sri Lanka Telecom (SLT) recorded a notable increase of 33 per cent. This profit growth was attributed to the savings the SLT made as it was not required to pay any management fee following the expiration of the management agreement it had with NTT of Japan and increase in tariff charges by 15 per cent. The disconnection of 1,700 illegally used lines also contributed. At present, SLT has 760,000 subscribers and has provided 60,000 new connections during the year.

Port services recorded a growth of 2.4 per cent in 2002 as against zero growth in the previous year. Although the first half of the year recorded a negative growth, the third and fourth quarters of 2002 reported high growth rates. Colombo Port, including the South Asia Gateway Terminals (SAGT), handled 1.76 million twenty foot equivalent units (TEUs) of container throughput in 2002, a growth of 42,000 TEUs over 2001, the greatest volume in the region, in terms of container handling. This success was attributed to the improved management strategies and drastic improvements in the Navigation and Operational divisions of the Colombo Port. The removal of the war risk insurance surcharges on sea and air transport in March 2002 and smooth operations uninterrupted by labour issues also contributed positively to this growth. Sri Lanka's first and only private terminal operator, the SAGT, handled a record throughput of 558,000 TEUs last year, up 69 per cent over the volumes handled in 2001.

The combined growth rate of the transport sub sector (roads, rail and air), which includes passenger and freight transport, was 3.7 per cent when compared to the decline of 1.8 per cent in the previous year. This relatively high growth was consequent to the increased goods and passenger transport activities to and from the Northern and Eastern provinces following the ceasefire, which also supported the domestic trading sub sector. However, the number of passenger kilometers run by the Regional (Cluster) Bus Companies declined by 0.7 per cent. Passenger kilometers run by the Sri Lanka Railways (SLR) increased by 2.5 per cent. Due to enhanced economic activity and improved goods distribution in the island, freight ton kilometers of the SLR increased by 20.2 per cent. However, owing to the increase in current expenditure and delays in fare increases, the profitability of the SLR declined by 8.0 per cent. The adverse impact of the September 11 attack on air travel and its reduced flight capacity resulting from the terrorist attack on its aircraft in July 2001 were reflected in the decline in the number of passenger kilometers flown by SriLankan Airlines by 5.7 per cent in 2002. Nevertheless, the services account of the balance of payments indicated a substantial increase in receipts from travel related services stimulated by the increased tourists arrivals and visits by Sri Lankans domiciled abroad that also contributed to the demand for such services. Meanwhile, three domestic airlines began operating services between Colombo and Jaffna, exploring new markets in domestic travel.

In 2002, the Trade sector rebounded with a growth of 5.5 per cent, compared with the contraction of 6.7 per cent in the previous year. Trading of imported goods grew by 8.6 per cent, due to the removal of the war risk insurance surcharge on sea and air transport, increase in demand for goods following the improved security situation, recovery in economic activity, comparatively low prices that prevailed in the international markets and reduction in the import duty surcharge from 40 per cent to 20 per cent. Importation of consumer goods increased by 21.7 per cent, while that of intermediate goods and investment goods increased by 7.0 per cent and 12.3 per cent, respectively. Meanwhile, the average price of imported goods declined by 7.9 per cent in US dollar terms. The recovery in the export trade sector, however, was slow, due to a slow recovery in export demand. The export trade sub-sector grew by 2.0 per cent compared with a contraction of 8.0 per cent in the previous year. Enhanced activities between the North and the other parts of the country stimulated the domestic trade sector.

The Banking, insurance and real estate sector performed well, recording the highest sectoral growth of 11.0 per cent, while it also contributed significantly to the overall GDP growth. The growth in the commercial banking sub-sector was mainly responsible for this growth. With the decline in interest rates, net interest income in the commercial banking sector grew, as the decline in deposit rates was greater than that in lending rates. The removal of the national security levy and turnover tax, and their increased efficiency through the use of cost effective methods also contributed to this growth. In addition to the banking sector, unit trusts and share-brokers performed well in 2002 due to the resurgence of activities in the Colombo Stock Exchange. The insurance sector as a whole contracted, although many individual companies did well during the year.

The output of the public administration and defence sector remained constant in real terms, in 2002. As a result of efforts to rationalise employment in the public sector, a decline was observed in public sector employees, especially among clerical and minor staff, but this decline in employment was offset by a commensurate increase in productivity and the value added in this sector remained at the same level as in the previous year.

The Services (n.e.s.) category, which includes all other unclassified services, grew by 3.2 per cent in 2002. Enhanced activities in the sub sectors of advertising, private education, janitorial services, television and broadcasting, and lotteries contributed to this growth. The demand for private education continued with the healthy competition created in recent years among institutional service providers for academic as well as professional courses. More private sector participation in road cleaning and garbage collection activities contributed to the growth in janitorial services. In 2002, tourist arrivals increased by 16.7 per cent to 393,171. This was largely due to the peaceful environment that prevailed in the country, particularly in relation to other competitor tourist destinations such as Bali that suffered setbacks in the aftermath of terrorist attacks, and the global promotional campaign spearheaded by the Ceylon Tourist Board. Arrivals from the Asian region increased by 59 per cent or by 53,332 partly due to a package of incentives to tourists from those regions till July 2002. Arrivals from India showed an increase of 106 per cent to 69,960. However, arrivals from Western Europe dropped by 1.8 per cent compared to 2001 due to lower arrivals from Germany in the first half of the year. Accordingly, the market share of the Asian region increased from 27 to 36 per cent, while the market share of Western Europe dropped from 61 per cent to 51 per cent in 2002. These factors have affected the foreign guest nights in graded hotels, which declined by 0.9 per cent in 2002. Hotels were able to improve occupancy levels to some extent from local guests nights, which showed an increase of 23 per cent. However, total guest nights in all graded hotels recorded an increase of only 4.2 per cent. Consequently hotel services, which suffered a severe setback in 2001 were not able to recover commensurate with the increase in tourist arrivals, and recorded a decline of 2.5 per cent in real terms in 2002.

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 2002, GDE, or total domestic demand, was estimated at Rs. 1,691 billion at current market prices, reflecting an increase of 13.1 per cent over 2001. Of the total expenditure, consumption expenditure accounted for 80 per cent. GDP at market prices, the sum of GDE and net imports, was estimated at Rs. 1,585 billion, an increase of 12.6 per cent over the previous year.

Consumption expenditure at current market prices was estimated at Rs. 1,353 billion, an increase of 14.2 per cent over the previous year. In 2001, consumption expenditure moved up by the same percentage essentially due to the inflationary pressure experienced during the year. There was no real growth in consumption in 2001 when the economy experienced a contraction. In contrast, the increase in consumption expenditure in 2002 was due to inflation and higher real consumption. Of the total consumption, private consumption rose by 16.6 per cent, while government consumption declined by 3.6 per cent in current terms. Consequently, the share of PCE increased to 90 per cent of total consumption expenditure from 88 per cent recorded in the previous year. In PCE, expenditure on imported goods and non-factor services increased by 14.1 per cent. Merchandise imports, which had declined in volume terms in 2001, increased sharply in 2002 due to the significant increase in demand. Imports of services too rose sharply in 2002.

Appendix Table 7 which has been reconstructed this year, gives a detailed, purpose-wise breakdown of PCE, based on the System of National Accounts - 1993 (SNA 93) - Classification of Individual Consumption by Purpose (COICOP) (See Box 10). Food and non-alcoholic beverages emerged as the most important category in PCE, but the gradual decline in importance of this category was evident in 2002 too. The increase in PCE on food by 15 per cent, in current terms, was partly due to the increase in prices of food items such as rice, wheat flour, meat, fish and coconuts. The increase in PCE on the clothing and footwear category was due to the increase in purchase of clothing materials and ready-made garments. The price hikes in gas and other liquid fuels during 2002 have led to higher expenditure on utility services, while the increase in the number of subscribers by 20 per cent and the overall price increases in communication equipment and services has raised the expenditure in the communication category by 34 per cent, in current terms. The PCE on transport, which recorded a decrease of 10 per cent in 2001, grew by 38 per cent in 2002. The higher demand for passenger and goods transport, increase in fuel prices and purchasing of new vehicles for private consumption, as reflected in import statistics, contributed to the unusual increase. PCE on health increased by 28 per cent, mainly due to the increase in prices of pharmaceuticals and charges on medical services. PCE on miscellaneous goods and services, which includes financial services, insurance, personal care, personal effects and social protection, grew by 19 per cent. However, within this sub sector, the PCE on financial services fell mainly due to the fall in interest costs resulting from the low interest rates that prevailed in 2002.

Investment expenditure at current market prices, which declined by 12.2 per cent in 2001, is estimated at Rs. 338 billion, an increase of 9.1 per cent over the previous year. The increase was solely due to the higher investment by the private sector and public corporations, by 14.4 per cent. Public investment contracted by 24.7 per cent, in current terms. On a sectoral basis, investment on transport equipment increased by 26.7 per cent. This was due to the greater demand for transport

Box 10

Restructuring of Private Consumption Expenditure (PCE)

The Gross Domestic Product (GDP), a measure of aggregate economic activity, comprises the sum of consumption and investment expenditure of the private and public sectors of the economy and the net exports. In Sri Lanka, the composition of the GDP is such that consumption is responsible for 85 per cent, while the remaining 15 per cent are investment and net exports of goods and non-factor services. Of the total consumption expenditure, Private Consumption Expenditure (PCE) accounts for about 90 per cent, while public consumption accounts for the balance. Thus, it is important to understand the composition of and changes in the private consumption component. In general, the change in PCE drives aggregate demand.

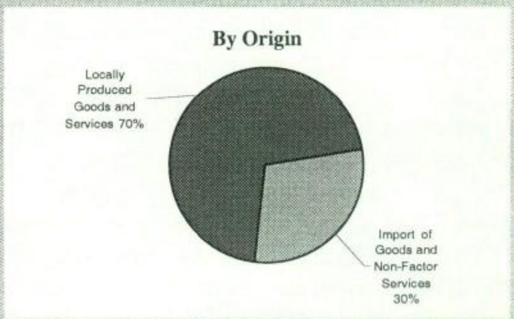
PCE constitutes the total expenditure incurred by individuals (including both household and non-household sectors) on goods and services consumed. The expenditure incurred by private sector producers is not a part of the PCE, since, in the final analysis, the obligation of the organized private sector is to produce goods and services for individual consumption or investment. The key determinants of the long-term behaviour of the PCE are national income, distribution of income and wealth, population, age structure of the population, availability of goods and services, habits and attitudes of the consumers, openness of the economy, and relative prices.

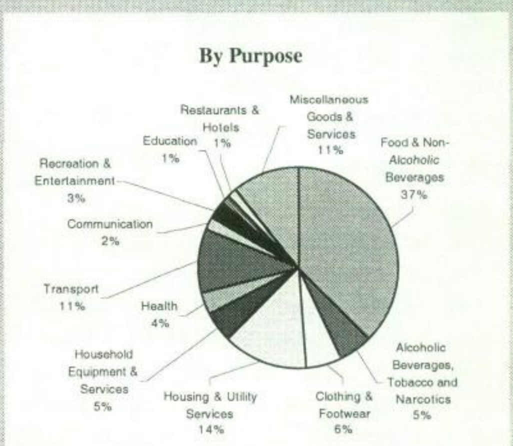
The Central Bank of Sri Lanka (CBSL) has been compiling National Accounts, and PCE since 1959. The initial classification used in 1959 to estimate PCE, which had been in use till 2001, was based on 'imported goods' and 'locally produced goods' (Appendix Table 7 of CBSL Annual Report 2001) and not by purpose of such consumption (eg. food, clothing, health). This classification was first published in the 1961 Annual Report. It appears that this classification by origin of goods consumed was developed to meet the requirements of that time within the limitations of available information. During the late 1950s, these estimates were solely dependent on the information available from existing databases and the most practical use of methodology for computation. At the onset of the PCE estimates, indicators for consumption of imported goods were obtained from Customs data, while consumption of locally produced goods was taken from production data. In the absence of direct production statistics, consumption estimates would have been based on information from Consumer Finance Surveys.

This classification by origin of goods did not comply with any international standard and therefore did not permit international comparison. It also did not provide sufficient information for a detailed expenditure side economic analysis. Furthermore, when revisions were made to the base years for compilation of national accounts, in 1970, 1982 and 1996, the PCE classification had not been revised. Thus, the system of estimating PCE did not provide a standard classification that reflects the long term changes in consumption patterns commensurate with the economic changes that have taken place during the past 40 years.

At the international level, the United Nations, in collaboration with OECD, IMF, World Bank and Commission of European Communities, introduced the System of National Accounts 1993 (SNA 1993) in 1993. The SNA 1993 provides a comprehensive manual which elaborates on the methodologies to be adopted in the compilation of national income estimates, and recommends

Chart I
Structure of PCE in 2002





Box 10 (contd.)

that member states comply with the specified international standards in the compilation of their national accounts statistics. The SNA 1993 further developed the existing international standard for PCE, the Classification of Individuals Consumption by Purpose (COICOP). This classification provides a more informative structure of PCE while it also facilitates international comparison of national accounts. The COICOP has also been adopted by the Department of Census and Statistics in its newly compiled Sri Lanka Consumer Price Index (SLCPI). Since the CBSL expects to comply with SNA 1993 in the future, the adoption of this international system of classification was a necessity.

In this context, the estimation of PCE under COICOP was done in two stages. At the first stage, a base year was chosen for the initial estimates and at the second stage, a series was developed for the following years using the base year estimates. Usually, the basis for the PCE estimates is provided by family budget surveys, since these surveys cover household expenditure extensively. The latest survey in this regard is the Consumer Finance and Socio-Economic Survey 1996/97 (CFS) conducted by the CBSL. Concepts and definitions used in the CFS are based on international standards. The CFS provides total expenditure of the sample households on each food and non-food item and consumer durable. Therefore, the base year selected for the estimates under the new classification was 1997.

From the CFS data, monthly per capita expenditure for each item was estimated as the foundation for estimating PCE under the new classification. The per capita expenditure so derived was then annualized and blown up by the population to obtain a value on national basis for the year. These items were then grouped and summed according to the new classification (COICOP) to obtain an aggregate value for PCE for the year 1997. There were two exclusions to the above procedure where, owing to well-recognised under-estimation of expenditure by households for these sectors in the CFS, alternative estimation methods were applied using alternative sources of data[1].

Once the aggregate PCE estimate was so derived, it was observed that a statistical discrepancy existed between this estimate and the one that had already been published under the former classification. As there was no specific information regarding the statistical discrepancy that would enable a quantitative revision, there was no justification for revising the published data series that has been in existence since 1959. Accordingly, a more realistic approach was adopted to smooth out this discrepancy. The difference in the two expenditure values was proportionately allocated among the items in the new classification to arrive at a total estimate for PCE for the base year (1997) that was consistent with the published estimate under the existing classification. In this allocation, however, three sub sectors were excluded from this proportional distribution due to specific technical reasons[2].

Once the 1997 estimate was compiled, the following data sources and types of data were used in the prescribed manner to derive rates of growth for each category of PCE for succeeding years.

- Production data and production volume indices were used in instances where information was directly available from individual sources (eg. paddy, fish etc.).
- Retail prices of commodities available at the CBSL and index values from the Sri Lanka Consumer Price Index (SLCPI) and Colombo Consumer Price Index (CCPI) were used to derive current estimates.
- Where consumption patterns were not depicted by production data alone, import data from the Customs Department were pooled with the production data.
- Where production and/or import/export data did not represent the actual consumption, per capita expenditure was adopted to obtain a more rational estimate. (eg. tea, coconut, sugar etc.)
- In some instances, where all the above methods appeared unrealistic, commodity flows were applied to obtain estimates.
- In services like electricity, water and telecommunication, domestic sales information of the supplying institutions were considered.

The rates of growth so derived were then applied to each previous year's estimates to obtain estimates for subsequent years. The same methodology used for the 1997 estimates was applied to smooth any statistical discrepancy that arose between the published and revised estimates for the subsequent years as well.

Appendix Table 7 of this report provides the new classification and corresponding estimates from 1997 onwards. In brief, a revision from the old PCE classification to the COICOP has the following advantages:

1 Domestic sales information was used to estimate consumption of tobacco products, since this category is known to be underestimated in household surveys and an estimate for consumption of financial services was constructed from GDP data for this sector, since it is not captured in family budget surveys, including the CFS.

2 Rice and related products, wheat and related prodproducts, beedi and cigarettes.

Box 10 (contd.)

- The COICOP updates the old classification, which is outdated and does not reflect necessary information on the structure of current consumption, to a standard classification.
- The new COICOP structure facilitates international comparison and long term analysis of PCE data.
- The new classification will disseminate more relevant information on PCE to the user.
- As the CBSL expects to compile national accounts according to the SNA 1993, this revision becomes compulsory.
- The CBSL currently compiles quarterly national accounts by the Production approach, but plans to compile the same by the Expenditure approach as well. The estimation of the PCE by the new classification would enhance the accuracy of such estimates.
- Users of the existing classification will continue to receive origin-wise information on PCE in broad terms. Appendix Table 5 of the Annual Report will continue to provide information on PCE by the two broad categories of imports of goods and non-factor services and locally produced goods and services.
- It allows for refinement of the data series once in five years. Since the CBSL conducts the Consumer Finance Survey every five years, it will permit the revision of the PCE series on each such occasion. This regular revision will capture the variations in consumption patterns during that period, thereby providing for more accurate and updated estimation of PCE on a regular basis.

Table 1 which provides the percentage distribution of PCE by the major categories of COICOP, indicates the following:

- The highest expenditure category was food and non-alcoholic beverages. The expenditure on this category accounted for around 37-40 per cent of total expenditure during the period 1997-2002. Of all food items, rice remained the most important.
- Though food was the most important category, the data show that its relative share had declined, but at a slow pace.
- Household expenditure on tobacco and narcotics was relatively high, around 5 per cent of the total expenditure.
- The expenditure on education was very low, around 1 per cent. Free education and provision of free school books and uniforms might be the reason for this. Another reason would be that education related expenses may have been classified under other categories. e.g. expenditure on school vans under transportation.
- Expenditure on health was also comparatively low, around 2 per cent of the total expenditure (considerably less than the expenditure on tobacco and narcotics). Presumably, the reason is free health care facilities provided by the state.
- The expenditure on communication, though as low as 0.6 per cent of the total expenditure in 1997, had grown over 150 per cent during the next five years. This reflects the expansion of telephone facilities during these five years.

The above findings serve to emphasize the relevance of the new classification in comparison to the former one in terms of providing information to the user.

TABLE 1
Percentage Distribution of PCE among major categories of COICOP

COICOP No.	Category	Percentage Share					
		1997	1998	1999	2000	2001	2002
01	Food & Non-Alcoholic Beverages	40.4	39.0	38.7	37.1	37.8	37.4
02	Alcoholic Beverages, Tobacco and Narcotics	5.8	6.0	5.9	6.1	5.9	5.3
03	Clothing & Footwear	6.3	6.1	6.0	6.7	6.3	5.9
04	Housing & Utility Services	15.0	14.2	13.8	14.2	14.8	14.0
05	Household Equipment & Services	5.0	5.5	5.4	4.4	4.7	4.7
06	Health	2.4	2.9	2.8	3.1	3.3	3.6
07	Transport	7.9	8.9	10.1	11.3	8.9	10.5
08	Communication	0.6	0.9	1.1	1.3	1.6	1.9
09	Recreation & Entertainment	3.6	3.6	3.6	3.5	3.4	3.2
10	Education	1.2	1.2	1.2	1.3	1.3	1.3
11	Restaurants & Hotels	1.4	1.4	1.4	1.3	1.3	1.3
12	Miscellaneous Goods & Services	10.2	10.2	10.1	9.7	10.7	10.9
	Total Expenditure	100.0	100.0	100.0	100.0	100.0	100.0

TABLE 2.3
Aggregate Demand

Rs. Mn.

	Current Market Prices			Constant (1996) Prices		
	2000	2001(a)	2002(b)	2000	2001(a)	2002(b)
A. Domestic Demand						
Consumption	1,038,377	1,185,482	1,353,428	824,760	826,552	888,706
(% Change)	16.6	14.2	14.2	5.0	0.2	7.5
Gross Domestic Capital Formation	352,632	309,684	337,782	260,186	214,731	221,415
(% Change)	16.8	-12.2	9.1	9.9	-17.5	3.1
Total Domestic Demand	**1,391,009**	**1,495,166**	**1,691,210**	**1,084,946**	**1,041,283**	**1,110,121**
(% Change)	**16.7**	**7.5**	**13.1**	**6.2**	**-4.0**	**6.6**
B. External Demand						
Exports of Goods & Non-Factor Services (c)	490,676	525,398	573,072	371,663	352,064	371,636
(% Change)	25.0	7.1	9.1	18.0	-5.3	5.6
Imports of Goods and Non-Factor Services (c)	624,048	613,167	679,438	510,563	461,917	513,496
(% Change)	30.4	-1.7	10.8	14.9	-9.5	11.2
Net External Demand	-133,373	-87,768	-106,365	-138,900	-109,853	-141,860
C. Total Demand	**1,257,636**	**1,407,398**	**1,584,845**	**946,046**	**931,430**	**968,261**
(% Change)	**13.7**	**11.9**	**12.6**	**6.0**	**-1.5**	**4.0**

(a) Revised
(b) Provisional
(c) 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 those aircraft, included in the BOP service account as a balancing item was not considered as a non-factor service for the year 2001.

Source : Central Bank of Sri Lanka

facilities during the year following the improved security situation. However, investment in building and other construction, and plant and machinery increased by lower amounts of 10.1 per cent and 13.0 per cent, respectively. Meanwhile, investment in other capital goods also increased by 24.3 per cent. Of the total private investment, a considerable share was assigned to infrastructure development in port services, telecommunications, information technology and energy. Public investment was mainly concentrated on road construction, energy and water supply. Monthly import statistics showed that capital formation increased sharply at the very end of the year. This increase in stocks at end 2002 will impact positively on the real growth in 2003. Reflecting the increase in stock accumulation, gross capital formation (investment expenditure), which is inclusive of stocks, increased in 2002 by 9.1 per cent, in current terms, while gross fixed capital formation, which is exclusive of stocks increased by 7.7 per cent.

2.4 Availability and Utilization of the Resources

The total resources available in the economy, consisting of GDP and imports of goods non-factor services (foreign resources), at current market prices, increased by 12.1 per cent to Rs. 2,264 billion in 2002. This increase was generated by the increase of Rs. 177 billion (12.6 per cent) in GDP at current market prices and an increase of Rs. 66 billion (10.8 per cent) in foreign resources. In 2001, the availability of resources valued at (1996) constant prices contracted due to the contraction in economic activity while it increased by 6.3 per cent in 2002. The increase in resource availability, in real terms, in 2002 was the combined outcome of an economic growth of 4.0 per cent and a rise in the imports of goods and services by 11.2 per cent.

With regard to utilisation of these resources, consumption grew by 7.5 per cent in real terms, while investment and exports of goods and non-factor services also increased by 3.1 per cent and 5.6 per cent, respectively, in real terms. The share of consumption grew from 59 per cent to 60 per cent. The share of investment remained at 15 per cent, while that of exports of goods and non-factor services remained constant at 25 per cent.

Changes in the availability and utilisation of resources clearly indicate that economic activity in 2002 was mainly in response to the recovery and growth in domestic consumer demand. The growth in external demand of 5.6 per cent was driven by the growth in the export of services, as the export of goods grew by only 2.0 per cent. Investment demand continued to suffer from the slow recovery in the global economy and the cautious approach adopted by potential investors at the still early, albeit encouraging, stages of the peace process to end the decades-long civil conflict in the country. A full recovery in investor confidence is essential for the long term growth performance in the economy.

2.5 Domestic Savings and National Savings

Domestic savings, which include private savings and government savings, were estimated at Rs. 231 billion, an increase of 4.3 per cent over the previous year. The increase in domestic savings was mainly due to the improvement in private

TABLE 2.4

Total Resources and Their Uses at Constant (1996) Prices

Item	Percentage Share			Percentage Growth	
	2000	2001(a)	2002(b)	2001	2002
1. Total Resources	100	100	100	-4.3	6.3
GDP at Market Prices	65	67	65	-1.5	4.0
Imports of Goods and Non-Factor Services (c)	35	33	35	-9.5	11.2
2. Utilization	100	100	100	-4.3	6.3
Consumption	57	59	60	0.2	7.5
Gross Domestic Fixed Capital Formation	18	15	15	-17.5	1.7
Private Sector and Public Corporations	16	13	13	-19.0	6.3
Government	2	2	1	-5.9	-27.6
Changes in Stocks	0	0	0	-12.1	10,441.4
Exports of Goods and Non-Factor Services (c)	26	25	25	-5.3	5.6

Source : Central Bank of Sri Lanka

(a) Revised
(b) Provisional
(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.

TABLE 2.5

National Savings at Current Market Prices

Rs. Mn.

Category	2000	2001(a)	2002(b)
1. Gross Domestic Product at Market Prices	1,257,636	1,407,398	1,584,845
2. Domestic Savings	219,259	221,916	231,417
3. Net Factor Income from Abroad	-23,083	-23,830	-24,064
4. Net Private Transfers from Abroad	73,810	87,902	104,938
5. National Savings	269,986	285,988	312,291
8. Domestic Savings Ratio (2 as a % of 1)	17.4	15.8	14.6
9. National Savings Ratio (5 as a % of 1)	21.5	20.3	19.7

(a) Revised
(b) Provisional

Source : Central Bank of Sri Lanka

savings. Government savings, which is defined as the current account balance of the government budget, although remaining in deficit, improved slightly by way of a reduction in the deficit in 2002 due to the prudent budgetary policies followed to curtail such deficit. The domestic savings/GDP ratio deteriorated, however, from 15.8 per cent to 14.6 per cent in 2002. The decline in the domestic savings ratio was due to the increase in private consumption expenditure. This decline does not augur well for future capital formation as it indicates a reduction in available resources from domestic sources for investment.

National savings, the sum of domestic savings, net foreign private transfers and net factor income from abroad, were estimated at Rs. 312 billion in 2002 recording an improvement of 9.2 per cent over the previous year. The improvement in national savings was mainly due to the increase in net foreign private transfers by 19.4 per cent. Net foreign private transfers, which consists mainly of workers' remittances from the Middle East, accounted for 34 per cent of national savings in 2002. In 2001, the corresponding ratio was 31 per cent.