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1975 CONSULTATIONS UNDER ARTICLE XVIII:12(b) WITH SRI LANKA[1]

Addendum

Supplementary Information on Sri Lanka's Balance of Payments, 1974[2]

In 1974 Sri Lanka's balance of payments was subject to greater stresses than ever before. On the one hand, there was a sharp increase in the import bill owing to a steep rise in the prices of foodstuffs, petroleum products and raw materials. On the other, although most of Sri Lanka's exports experienced price increases, not only were they lower than increases in respect of imports but also the full benefits of the increased prices could not be reaped by the country due to a reduction in the volume of output. Thus, while Sri Lanka's export earnings during 1974 increased considerably over the previous year's level, import payments rose by even a larger margin, resulting in a record trade deficit of Rs. 1,227 million. In comparison, the deficit in 1973 was only Rs. 299 million. In recent years, invisible transactions in the current account of the balance of payments have yielded surpluses thereby mitigating the adverse effects of the trade deficit. In 1974, the surplus on invisible transactions was even larger due very largely to a substantial increase in official grants. Consequently, the deficit on current account has been reduced to Rs. 899 million.

A deficit of this magnitude made it imperative that the sources of financing had to be more diverse than in previous years. Whereas during the last four years, the transactions in non-monetary sector of the capital account consisting mainly of long-term official capital and short-term and suppliers' credit arrangements were adequate to bridge the current account deficit, in 1974 as resources from these sources were inadequate, there were large monetary movements. These took the form of assistance from the IMF and oil exporting countries and use of facilities under bilateral trade and payments agreements. By preferring to incur monetary liabilities, rather than using accumulated reserves to finance the balance of the current account deficit, Sri Lanka was able to maintain and even slightly increase her external assets position; gross external assets increased from Rs. 851 million at the beginning of the year to Rs. 888 million at the end of the year.

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[1]Under simplified procedure L/3772/Rev.2

[2]Supplied by the Permanent Mission of Sri Lanka

Exports

The increasing trend in export earnings evidenced since 1972 was maintained with greater vigour during 1974. In 1974 total earnings were Rs. 3,376 million, compared with Rs. 2,398 million in 1973 and only Rs. 1,848 million in 1972. The higher earnings were the outcome of favourable prices for practically all exports. However, despite the higher level of prices, the output of tea and rubber declined appreciably.

The prices which remained depressed in the commodity boom in 1973 registered a significant increase in 1974. Rising production costs and higher freight charges due to the energy crisis contributed to the tightness of tea supplies in 1974, causing prices to rise by an average of 35 per cent at the Colombo Auctions, 25 per cent at Calcutta and 40 per cent in London over the comparable prices in 1973. As a result the average f.o.b. prices for Sri Lanka tea in 1974 at Rs. 3.52 per pound showed a 28 per cent improvement over the 1973 level. However, the volume of tea exported declined drastically from 454 million pounds in 1973 to 387 million pounds in 1974 owing to a reduction in the volume of production. Among the causes for lower production were reduced fertilizer application, fragmentation of estates, uncertainties arising from the Land Reform Law and unfavourable weather conditions. The improvement in export prices was more than sufficient to offset the reduction in export volume and the earnings from tea at Rs. 1,367 million registered a substantial increase over the previous year's level.

Rubber benefited from the boom in primary commodities from the early part of 1973. Prices improved further in early 1974 in the immediate aftermath of the abrupt rise in oil prices in 1974. From mid-1974 onwards, however, rubber prices have been on a declining trend, owing to a reduction in the demand for rubber due to the recessionary conditions in the industrial countries, especially the slow-down in the automobile industry. The price of RSS 1 in the London market fell from 52.27 pence per kg. in January 1974 to 26.24 cents per kg. in December 1974. Local market prices followed world market trends and declined continuously for the greater part of the year. The Colombo Market price of RSS 1 fell from Rs. 1.41 per pound in the first quarter of 1974 to Rs. 1.17 in the last quarter. Nonetheless, over the year as a whole the average rubber prices in 1974 were 56 per cent higher than in 1973. However, following the same pattern as tea, the volume of rubber exports fell considerably in 1974 despite higher prices. Uncertainties connected with Land Reform, adverse weather conditions, higher costs of production and the reduced application of fertilizer all combined to reduce rubber output by 40 million over the previous year's level. The 1974 output of 301 million pounds is the lowest on record since 1966. Despite the reduction in export volume, higher average prices resulted in total earnings from rubber increasing from Rs. 519 million in 1973 to Rs. 746 million in 1974.

Coconut output in 1974 is estimated to have registered an increase of 5 per cent over 1973. However, the output in 1974 was still a third below the level in 1972. The coconut industry which was severely affected in 1973 by such factors as the prolonged drought, lower application of fertilizer, disease in certain areas and the uncertainties created by the Land Reform Law failed to recover significantly in 1974 as these same factors continued to affect output. Consequently, the output of major coconut export products, i.e. corpa, oil and desiccated coconut, showed only marginal increases from the levels reached in 1973. Average f.o.b. price in terms of nut equivalent is estimated to have risen from Rs. 0.34 in 1973 to Rs. 0.85 in 1974, but the industry failed to benefit fully from these exceptionally favourable price trends. However, total earnings from coconuts rose from Rs. 146 million in 1973 to Rs. 451 million in 1974 - an increase of Rs. 305 million or 210 per cent.

Minor Exports

The boom conditions in commodity prices prevailing during the year enabled continuing advances to be made by a majority of minor export products. Earnings from minor exports reached Rs. 812 million - an increase of Rs. 155 million from the 1973 level. The main item in this increase was re-export of marine bunkers and aviation fuel, and exports of petroleum by-products like Naphtha. Export earnings from petroleum products was in the region of Rs. 350 million and was largely the result of the rise in the international price of crude oil. Earnings from coconut by-products, particularly fibre and shell charcoal also increased substantially. Out of the total earnings of Rs. 190 million ascribed to this group, fibre accounted for Rs. 140 million and shell charcoal for Rs. 48 million.

The advances made by petroleum products and coconut by-products were augmented by increases in earnings from exports of spices and manufactured industrial goods. In the latter category, notable increases were observed in exports of manufactured tobacco, wearing apparel, glycerol and glycerol lyes, travel goods, footwear, tableware, cement and machinery. Gains were recorded over most of the range of minor agricultural commodities. A notable exception to this general trend, however, had been the earnings from gems and precious stones which fell from Rs. 140 million in 1973 to Rs. 100 million in 1974. The initial setback to the surge in gem exports came in the aftermath of the abrupt rise in oil prices in early 1974 when the demand from the industrially rich countries started to fall off. Over the year as a whole although the volume exported was maintained, lower prices resulted in a fall in total earnings.

Imports

In 1974, Sri Lanka's import bill at Rs. 4,603 million rose by approximately 75 per cent over the 1973 level of Rs. 2,644 million. The whole of this increase has been due to higher prices largely resulting from the world scarcities of

agricultural food produce, boom in raw material prices and the inflationary conditions in the industrial countries. In fact, the volume imported of all commodities, other than a few miscellaneous items, has been noticeably lower. Between the two years, the all-imports volume index (1967 = 1,000) dropped from 79 to 56. Noticeable reductions were seen in the volume of rice, sugar, intermediate and investment goods imports.

The import price index (1967 = 100) increased from 209 in 1973 to 370 in 1974. Petroleum registered the steepest price increase, although as a broad group, the prices of foodstuffs also recorded a substantial increase. Consequently, the outlay on these commodities increased rather sharply, despite a considerable reduction in the quantities imported. The cost of rice, flour and sugar alone increased from Rs. 1,044 million in 1973 to Rs. 1,767 million in 1974.

The price increases and the resulting higher outlays on essential consumer goods and certain raw materials within a given import capacity inevitably affected the structure of imports. Whereas the total import bill increased by over 80 per cent over the year, the proportion spent on capital goods increased by only 20 per cent and its share in total imports fell from 17 per cent in 1973 to 10 per cent in 1974. On the other hand, while the share of consumer goods at 47 per cent of total imports registered a slight decline, the share of intermediate goods rose from 30 per cent in 1973 to 42 per cent in 1974. The latter had been largely due to sharp increases in the price of petroleum products and fertilizer.

The sharp increase in crude oil prices from US$2.50 per barrel in mid-1973 to US$10.65 per barrel (of light Arabian crude) in early 1974 resulted in Sri Lanka's import bill for petroleum and petroleum products rising from Rs. 293 million in 1973 to Rs. 905 million in 1974. Expenditure on petroleum alone absorbed over 20 per cent of the import bill in 1974.

Apart from a small amount spent on imports of refined products, the bulk of the payment in respect of petroleum is for crude oil which is refined locally. A part of this is re-exported as fuel for foreign ships and aircraft, and another part as by-products, for example, Naphtha. Such re-exports were valued at Rs. 350 million in 1974. On the basis of an approximation of 60 per cent of the crude oil imports being retained locally, and after adjustment for imports of refined products, the trade deficit resulting from the higher cost of crude oil is estimated at Rs. 560 million in 1974 as compared with Rs. 180 million for 1973. Together with the increase in outlay on fertilizer, whose prices were directly affected by the rise in crude oil prices, the oil induced deficit of Rs. 700 million is therefore seen to have accounted for more than half the deterioration in the merchandise trade deficit from Rs. 298 million in 1973 to Rs. 1.22 million in 1974.

Services and transfers

The services account which provided positive support for Sri Lanka's balance of payments in 1973 made an even greater contribution in 1974. The outturn on services account resulted in a surplus of Rs. 76 million, while the transfer payments provided a sum of Rs. 252 million. Thus, the invisible account as a whole, on a net basis, contributed resources amounting to Rs. 328 million. This favourable outcome helped, though moderately, to bring down the current account deficit to Rs. 889 million, after merchandise transactions alone had caused a deficit of Rs. 1,227 million.

The improved performance has been the outcome primarily of higher receipts from a variety of transactions. Receipts were higher from tourism and investment income abroad, while the receipts from official transfers registered over a three-fold increase accounting for about 75 per cent of the surplus in the service and transfers account.

Earnings from the tourist industry increase for the third year in succession in 1974. Total earnings during the year increased by about 60 per cent over the 1973 level to reach Rs. 94.8 million. As in the previous year, this has been the joint effect of a higher volume of tourist traffic and an increase in per head tourist expenditure in Sri Lanka. In 1974, the total number of tourists visiting the country reached 85,000 which is the highest figure recorded so far. The higher level of per capita expenditure by tourists is very largely due to the rise in cost of tourist services.

Receipts on account of investment income represents very largely the interest income from the investment of external assets in money markets abroad. These investments are mainly deposits of liquid balances in banks abroad and long-term securities. Such investments were made possible in 1974 because the gross external assets were maintained at a much higher level than the average for several preceding years which gave the Central Bank sufficient leeway to derive a foreign income from such assets. In 1974, receipts on account of investment income amounted to Rs. 36.8 million as compared with Rs. 17 in 1973.

Out payments on account of investment income consist both of remittances of profits abroad and of interest payments on foreign loans. The latter category of outpayments has become very significant today on account of the state of Sri Lanka's indebtedness abroad; interest payments have completely over-shadowed the remittances on account of private foreign capital. From a level of Rs. 52 million in 1969, the profits/dividend remittances abroad have dwindled to Rs. 13 million in 1974 while interest payments on foreign debt in the same period have risen sharply from Rs. 68 million to Rs. 134 million.

In 1974 grants from foreign governments valued at Rs. 254 million were considerably higher than in any previous year, but the sheer size of the trade deficit made the relative importance of grants in financing Sri Lanka's balance-of-payments deficit to decline. Whereas in the years 1971-1973 grants financed one third of the current account deficit, in 1974 this proportion had declined to one fifth. The major part of grants (90 per cent) was in the form of food aid and the principal donor country had been the People's Republic of China. Other important doners were Canada, Australia and the Federal Republic of Germany.

Capital account

The current account deficit of Rs. 899 million in Sri Lanka's balance of payments in 1974 is an all-time record and represents a considerable deterioration from the trend obtained during the last four years when the current account balance was progressively narrowed. In keeping with this development the method of financing the current account deficit also underwent considerable change. Current account deficits are normally financed by transactions in the non-monetary capital sector and through monetary movements. In Sri Lanka's context commodity and project aid from official sources and import credits under short-term and supplier's credit arrangements provide virtually the entirety of financing from the non-monetary capital sector. Monetary movements comprise changes in the assets and liabilities of the Central Bank and commercial banks in certain assets and liabilities of the Central Government which have monetary characteristics. This sector can provide finance for the current account deficit of the balance of payments either through a run down of assets, or through an increase of liabilities abroad or a combination of both. Since the very high current account deficit of 1969, close management of the balance of payments, which resulted in a steady and notable narrowing of the deficit, ensured that up to 1973 transactions in the non-monetary capital sector, i.e. long and short-term loans of the government and the private sector, not only covered the deficit in full but also enabled the country to build up external assets which increased steadily from Rs. 403 million in 1971 to Rs. 851 million in 1973. It is true that some of the types of financing, such as excessive resort to short-term and supplier's credits were not desirable, but on the other hand some of those credits helped to build up assets. The overall financing picture in the four-year period 1970-1973 therefore is that the current account deficit was financed wholly through transactions in the non-monetary capital sector.

These trends changed considerably in 1974 due mainly to the very large increase in the current account deficit arising from an increased import bill. Long-term loans, short-term and supplier's credits (all not of repayments) together contributed an inflow of Rs. 531 million during 1974. Although this is the highest ever recorded, being nearly double the average for the past few years, still it left a gap of Rs. 362 million, which was financed through monetary movements. These took the form of increased indebtedness to the IMF and increased recourse to credit from countries with which Sri Lanka has bilateral trade and payments agreements.

Assistance from the IMF came very largely through the Oil Facility set up in June 1974. Through two drawings during 1974, an aggregate amount of Rs. 260 million was available for balance of payments support. Other drawings from the IMF came through the Standby Arrangement negotiated in the early part of the year.

The contribution of the bilateral trade and payments agreements for balance of payments financing in 1974 amounted to Rs. 237 million, of which Rs. 70 million represented a reduction in amounts due to Sri Lanka from bilateral trading partners and Rs. 167 million by way of an increase in the amounts due from Sri Lanka to bilateral trading partners. The amount due to People's Republic of China under the Sri Lanka/China pact increased by Rs. 125 million during the year.

Assistance from the oil exporting countries is a new source of balance-of-payments financing which was available in 1974. Directly this consisted of a cash loan of US$21 million (Rs. 134 million) from the monetary authority of Kuwait to the Central Bank of Ceylon. Indirectly, such finances came from the IMF Sponsored Oil Facility.

Altogether non-monetary capital sector provided Rs. 520 million and the monetary movements Rs. 362 million (both on a net basis) towards financing the current account deficit.

External assets

On a calendar year basis, the gross external assets of Sri Lanka increased for the fifth successive year and at Rs. 889 million at the end of 1974 showed an improvement of Rs. 38 million over the level at the end of the previous year. This improvement occurred despite an unprecedented deficit in the current account of the balance of payments and was wholly due to the build-up of external liabilities on a very substantial scale. Thus the increase in assets does not represent any improvement in the balance of payments.

Although the Central Bank continued to be the major holder of external assets, commercial bank holdings rose markedly during the year due to the increase in the value of export bills discounted by commercial banks. Those amounted to Rs. 202 million in 1973 and increased to Rs. 304 million in 1974, accounting for over 75 per cent of the value of external assets held by commercial banks. This was very largely the result of higher prices for exports rather than a relaxation in the terms of credit for exports.

Measures to support the balance of payments

During 1974 the management of Sri Lanka's balance of payments was strictly within a given import programme. Two primary considerations that determined the import programme were the maintenance of a minimum level of consumption of essential commodities and the supply of intermediate goods to maintain a certain level of

economic activity. In a background of sharply increasing import prices the pursuit of those objectives caused a record trade deficit. Although no new measures were adopted restricting trade and payments or intensifying existing restrictions, the policy of limiting imports to availabilities of foreign resources caused a substantial reduction in import volumes.

Apart from this attempt to operate within a strict import programme there were no significant changes in the balance-of-payments policy during the year. The range of special incentives to encourage minor exports was maintained throughout the year with only slight modifications.

In the case of major exports a "Package Deal" of relief measures for the tea industry came into full effect from the beginning of 1974. These included changes in the Export Duty Rebate Scheme, the Tea Replanting Subsidy Scheme, the Tea Fertilizer Subsidy Scheme and the Tea-Chest Panel Subsidy Scheme and were largely designed to raise the overall production and increase the export volumes. Similarly, there were also certain modifications to the Rubber Replanting Subsidy Scheme with a view to promoting a higher rate of replanting. A subsidy scheme for Rubber Factory Development was also introduced in August 1974 with a view to increasing the manufacturing capacity of factories producing premium grade rubbers such as latex crepe and sole crepe, and new forms of rubber.

On the side of imports the policy of subjecting all imports (except those imported under the Convertible Rupee Scheme) to individual quota licensing continued to be in force throughout the year. In addition, there were numerous changes in the ration schemes for rice, flour and sugar largely with the objective of containing the import volumes within manageable limits. Consequent to the abrupt and sharp rise in crude oil prices, domestic prices of petroleum products, too, were increased in January 1974. The steep price increases caused a notable decline in the volume imported.

BALANCE OF PAYMENTS 1974*

Item	Goods and Services	Credit	Debit	Net
1.	Merchandise	3,375.7	4,603.1	- 1,227.4
2.	Non-monetary gold	-	-	-
3.	Freight and merchandise insurance	13.1	20.2	- 7.1
4.	Other Transportation	159.8	46.1	+ 113.7
5	4.1 Passenger fares	25.5	23.1	+ 2.4
	4.2 Port expenditures	125.6	15.9	+ 109.7
	4.3 Other	8.7	7.1	+ 1.6
5.	Travel	31.8	9.2	+ 85.6
6.	Investment income	38.8	147.9	- 111.1
	6.1 Direct investment	0.1	13.5	- 13.4
	6.2 Other	36.7	134.4	- 97.7
7.	Government expenditure n.i.e.	33.0	24.6	+ 8.4
8.	Other services	107.1	120.2	- 13.1
	8.1 Non-merchandise insurances	4.0	5.4	- 1.4
	8.2 Other	103.1	114.8	- 11.7
	Total goods and services	3,820.3	4,971.3	- 1,151.0
	Transfer Payments			
9.	Private	54.3	56.0	- 1.7
10.	Official	254.1	-	254.1
	Total Current Account	4,128.7	5,027.3	- 898.6
	Capital and Monetary Gold			
A.	Non-monetary Sector (items 11-14)	1,700.6	1,180.3	+ 520.3
11.	Direct investment	10.8	1.8	+ 9.0
12.	Other private long-term	1.2	2.5	- 1.3
13.	Other private short-term	-	15.0	- 15.0
14.	Central Government	1,688.6	1,161.0	+ 527.6
	14.1 Loans received	430.9	173.2	+ 257.7
	14.2 Short-term liabilities	1,257.7	984.3	+ 273.4
	14.3 Assets		3.5	- 3.5
B.	Monetary Sector (Items 15-21)	621.8	259.4	+ 362.4
13.	Commercial Banks - liabilities	-	-	-
16.	Commercial Banks - assets	-	97.2	- 97.2
17.	Central Bank - liabilities	178.6	-	+ 178.6
18.	Central Bank - assets	60.4	-	+ 60.4
19.	Net IMF position	111.4	162.2	- 50.8
20.	Oil facility	271.4	-	+ 271.4
21.	Special drawing rights	-	-	-
22.	Monetary gold	-	-	-
23.	Errors and omissions	15.9	-	+ 15.9

*Provisional
Exports mainly f.o.b.
Imports mainly c.i.f. figures are based mainly on exchange records.

Source: Central Bank of Ceylon