FOREIGN TRADE

Following two consecutive years of surplus, Sri Lanka's balance of trade (on the basis of Customs data) registered a deficit of Rs. 1,457 million (SDR 98 million) in 1978. When Customs data are adjusted for the imports and exports by certain government agencies which get recorded after some lag, the trade balance worsens to Rs. 2,173 million.

TABLE 1·8

Balance of Trade 1976 - 1978

Value in Rs. Million
SDR Million in brackets

Year	Imports		Exports		Balance of Trade	
	Customs	Adjusted	Customs	Adjusted	Customs	Adjusted
1976	4,645 (477)	4,946	4,815 (495)	4,840	+ 170 (+18)	- 106
1977	6,007 (630)	6,298	6,638 (659)	6,570	+ 631 (+29)	+ 271
1978	14,663 (774)	15,366	13,206 (676)	13,193	-1,457 (-98)	-2,173

Sources: Customs. Sri Lanka; Food Commissioner's Dept; Ceylon Fertilizer Corporation; Petroleum Corporation; State Gem Corporation.

A meaningful comparison of the customs trade data between 1978 and the years before is not possible because the data recorded in Sri Lanka Rupees includes the substantial changes in the value of the rupee since 1977. Hence, the analysis of trade data will be made in the relatively more stable Special Drawing Rights (SDRs) to facilitate comparison.

The trade deficit of 1978 was the result of a sharp rise of 23 per cent in import expenditure and a smaller increase in export earnings of 3 per cent Imports rose by SDR 144 million and exports were higher by SDR 17 million.

The rise in imports was a direct consequence of the relaxation of import controls in late 1977. The volume of imports, as measured by the Import Volume Index (1967=100) rose by 27 per cent, to the highest level since 1960. A major reason for the relatively poor performance of exports was that the world prices for tea, Sri Lanka's major export earner, fell from the peak levels of 1977. Coconut prices were also lower than their levels last year.

TABLE 1 · 9

Foreign Trade — 1969–78

Period	Rupees Million			Index Number 1967 = 100				Terms of Trade
				Volume		Prices		
	Exports[1] (f.o.b.)	Imports (c.i.f.)	Balanc of Trade	All Exports	All Imports	All Exports	All Imports	
1967	1,690	1,738	– 48	100	100	100	100	100
1968	2,035	2,173	– 138	103	101	117	126	93
1969	1,916	2,543	– 627	98	108	117	134	88
1970	2,033	2,313	– 280	102	102	118	140	84
1971	1,947	1,986	– 39	99	90	117	150	78
1972	2,039	2,064	– 55	97	88	118	157	75
1973	2,617	2,715	– 98	98	79	137	209	65
1974	3,471	4,554	–1,082	85	56	217	370	58
1975	3,933	5,251	–1,318	102	69	199	433	46
1976	4,815	4,645	+ 170	97	75	239	383	62
1977	6,638	6,007	+ 631	89	97	382	471	81
1978	13,206	14,662	–1,456	95	132	698	877	80

1. Including re-exports

Sources: Customs, Sri Lanka; Central Bank of Ceylon.

The 1977 economic reforms had a greater and more immediate impact on imports than on exports. A high rate of increase in imports would normally be expected following upon many years of licensing and controls, despite the higher cost of importation. In the case of exports, however, increases could only be expected in the medium and long term because of supply inelasticities in the short-run. Exports would normally be expected to rise after the lapse of sometime on account of the incentive extended by the depreciated exchange rate, especially in view of the fact that prior to the change, the three major traditional exports were not entitled to the premium exchange rate. However, a high percentage of the profits which would normally have accrued to producers of tea, rubber and coconut as a result of this exercise were siphoned off by the government. The export duties on tea, rubber and coconut were revised upward. thereby eroding producer margins at a time when costs of production were rising. Hence, as mentioned last year, the question of incentive for these major industries is of utmost importance and it is necessary to keep these taxes under constant review in order to ensure the viability of these major sectors of the economy.

Exports

As mentioned earlier, export earnings rose by barely 3 per cent in 1978 The poor performance in 1978 was in contrast to a growth of 33 per cent in 1977. Of the major export earners, the value of tea, gems and petroleum products fell while those of rubber and coconut products rose.

TABLE 1.10

Composition of Exports 1976 - 1978

Category	Value Rs. Million SDR Million in brackets			Percentage of Total Exports		
	1976	1977	1978	1976	1977	1978
Tea ..	2100 (216)	3503 (355)	6401 (327)	44	53	48
Rubber ..	890 (91)	931 (93)	2021 (103)	18	14	15
Coconut ..	382 (39)	335 (32)	972 (50)	8	5	8
Minor Agricultural crops*	231 (24)	378 (38)	658 (33)	5	6	5
Gems ..	261 (27)	298 (30)	531 (27)	5	4	4
Industrial Exports* ..	782 (80)	919 (86)	1891 (97)	16	14	14
Other Exports ..	170 (18)	275 (26)	733 (38)	4	4	6
Total Exports ..	4815 (495)	6638 (659)	13206 (676)	100	100	100

*Selected Items

Source: Customs, Sri Lanka.

In 1978, the value of tea exports fell by 8 per cent as a result of a drop in the export price from SDR 1·81 in 1977 to SDR 1·70 in 1978. The quantity of tea exports rose by 7 million kilos despite a drop in production. Although international tea prices fell from the peak levels of 1977, they have been rising during the past few years and the levels in 1978 have been well above those of 1976. It is, therefore, a matter for serious concern that Sri Lanka is the only major producing country in which tea production has been falling over the last decade. In fact, Sri Lanka has yet to exceed the production peak reached 14 years ago in 1965. Duties, taxes and other charges presently constitute as much as around 56 per cent of the export price of tea and this appears to be a serious constraint to increasing production.

On the other hand, the value of rubber exports rose appreciably, primarily on account of an increase in prices by around 14 per cent. The quantity of rubber exported rose only marginally. Earnings from coconut exports increased as a result of a rise in the quantity exported. This was made possible by a recovery in production from the depressed level of 1977. Export prices of coconut products, however, fell by around 18 per cent to SDR 0·09 per nut equivalent in 1978.

Earnings from gems and petroleum products dropped in 1978. Exports of petroleum products appear to have been somewhat reduced on account of higher domestic consumption. Industrial exports (excluding petroleum products and gems) increased this year by as much as 68 per cent to SDR 49 million in 1978. This increase was mainly in garments, glycerine, edible fats, crustaceans and molluscs, ceramics, machinery and mechanical appliances, graphite and ilmenite.

Exports of selected minor agricultural exports fell from SDR 38 million in 1977 to SDR 34 million in 1978. Prices of many items in this list have barely risen and the quantities exported of most of these commodities have fallen over a number of years. However, if account is taken of coffee and sesame seed exports which are excluded from the traditional list of minor agricultural exports, earnings from these items would have risen to around last year's level.

Imports

Following liberalization, the import pattern that emerged was encouraging. There was a sharp acceleration of investment goods imports reflecting the increase in the economy's growth rate. The volume of capital goods imports as measured by the Import Volume Index (1967=100) reached an all time high and rose by as much as 63 per cent. The upsurge in capital goods imports is an indication of a greater momentum in the future growth of the economy since such goods are generally influenced by long term considerations. The volume of intermediate goods imports appear to have risen by 10 per cent; and that of consumer goods, appear to have fallen purely because of a drop in rice imports which had more than offset an increase in other imports. Analysing SDR denominated trade data, the share of capital goods in total imports rose from 12 per cent in 1977 to 23 per cent in 1978 while the shares of intermediate goods

TABLE 1·11

Expenditure on Imports 1976 - 1978

Category	Value						Percentage of Total Imports		
	Rs. Million			SDR Million					
	1976	1977	1978*	1976	1977	1978*	1976	1977	1978
1. Consumer goods ..	**1,689**	**2,534**	**5,593**	**174**	**270**	**287**	**36**	**42**	**38**
1·1 Food and drinks ..	1,491	2,181	4,103	153	224	210	32	36	28
(i) Rice ..	602	917	689	62	94	35	13	15	8
(ii) Flour ..	683	925	2,274	70	96	117	15	15	16
(iii) Sugar ..	64	197	514	7	19	26	1	3	4
1·2 Textiles & clothing ..	49	150	531	5	15	27	1	3	4
1·3 Other ..	149	203	959	16	31	50			
2. Intermediate goods ..	**2,259**	**2,648**	**5,591**	**232**	**262**	**287**	**49**	**44**	**38**
2·1 Petroleum ..	1,164	1,441	2,402	120	141	123	25	24	16
2·2 Fertilizer ..	99	51	252	10	6	13	2	1	2
2·3 Chemicals ..	906	1,036	2,491	9	100	128			
3. Investment goods ..	**641**	**746**	**3,367**	**66**	**73**	**173**	**14**	**12**	**23**
3·1 Machinery & equipment	364	286	1,845	37	33	95	8	5	13
3·2 Transport epuipment ..	175	232	988	18	24	51	4	4	7
3·3 Building material ..	104	129	150	11	9	8	2	2	1
4. Unclassified .	**54**	**79**	**110**	**6**	**25†**	**29†**	1	1	**1**
5. Total ..	**4,645**	6,007	**14,662**	**477**	630	774	**100**	**100**	**100**

* Provisional Source: Customs, Sri Lanka.

† Includes adjustments for transactions effected after November 15, 1977 at rates prevailing prior to that date.

and consumer goods fell from around 44 per cent to 38 per cent each in 1978. Reduced imports of rice (which fell by 63 per cent) was a major factor contributing to the drop in the share of consumer goods.

In the capital goods category, the imports of machinery and equipment and transport equipment were more than twice their level in 1977, meeting the accumulated unfulfilled demand of several years. Registrations of lorries and vans, for instance, more than quadrupled in 1978.

Expenditure on consumer goods in 1978 rose by only about 6 per cent. All sub-categories of consumption goods, except rice, recorded increases in 1978. Imports of milk products, textiles, motor cars and miscellaneous food products rose substantially.

Among imports of intermediate goods, expenditure on chemicals, fertilizer, paper and paper board rose while expenditure on petroleum products and wheat fell on account of a drop in quantities.

Trade Policy

Trade policy in 1978 has been directed to promoting exports, further dismantling of licensing and reforming of the tariff structure and control procedures.

Duties on imports have been kept under continuous review and some modification of duties took place in the course of the year. Import duties were reduced for a number of commodities comprising items in short supply, essential consumer items, intermediate and capital goods. Duties were raised, sometimes to penal levels, on luxury consumer goods. For instances, duties on items such as perfumes, carpets and cigarettes were raised to 500 per cent in January. There were duty reductions on some consumer goods, such as condesned milk, infant and invalid milk food, frozen meat, biscuits, vegetable protein and yeast. Duties were also reduced on a number of intermediate goods such as barbed wire, articles of iron and steel, fertilizer and pesticides; as well as on capital goods such as engines and chassis for heavy diesel vehicles, roofing tiles and asbestos sheets.

In the case of exports, duties were halved in the case of instant tea, cinammon, cardamom, citronella oil and cocoa while pepper, cloves, coffee and nutmeg were exempted totally. The duty on block rubber was raised to re-establish the relationship with other rubber exports.

Schedule I of the Special Import Licence No. 1 of 1977 was further modified. Several items were deleted from the list of commodities subject to prior licensing, mainly coriander, sugar, fertilizer, safety matches, artificial resins and plastic materials, plywood sheets for tea chests, boxboard, certain base metals and internal combustion engines.

Many non-traditional exports were removed from export control. Need for prior export licensing was removed in all except for 21 items. These few items remain under licensing for purposes of conservation of non-renewable resources, local subsidization of essential consumer requirements, environmental protection and preservation of the fauna and flora of the country.

Various measures have been introduced in the course of the year to promote exports. Existing subsidy schemes for replanting and new planting of agricultural crops were generally revised upward. Grant of foreign exchange for business travel was considerably enhanced in 1978. The Greater Colombo Economic Commission was established to set up "Export Promotion Zones" with a view to attracting export oriented foreign investment. In the course of 1978, 52 approvals were granted for the establishment of such industries.

Another significant measure for promoting exports which was in the process of implementation (and introduced in 1979) was the establishment of an Export Credit Guarantee Corporation. This Corporation will assist exporters to obtain bank finance on a liberal basis and afford them a means of protection against the risks of non-payment or delayed payment by overseas buyers. Legislation was also in process of being enacted for the establishment of an Export Development Council of Ministers and an Export Development Board. The Board will be vested with the powers necessary for the development of exports.

BALANCE OF PAYMENTS[1]

The performance of the balance of payments during 1978 was influenced largely by the economic reforms of 1977. The immediate impact of these measures on the balance of payments was perceptible in 1978, when the current account shifted back to a deficit of Rs. 782 million (SDR 64 million) from a surplus of Rs 1,266 million (SDR 116 million) in 1977. External assets, however, increased further in 1978 and the end year reserves were sufficient to finance four months' imports anticipated for 1979. The growth in external assets arose from the surplus in the capital account generated by a heavy inflow of long-term capital and by drawings from the International Monetary Fund (IMF).

The impact of the exchange and trade liberalization on balance of payments was felt critically in the field of imports. In SDR terms,[2] payments on imports rose by 30 per cent; the import bill increased from Rs. 6,290 million (SDR 622 million) in 1977 to Rs. 15,350 million (SDR 808 million) in 1978. The increase in imports reflected the release of the pent-up demand built up over the years of controls. The rise in imports stemmed mainly from a speeding up of imports of investment and intermediate goods, while imports of consumer goods rose at a lower pace. A more than twofold increase in the import of capital goods in 1978 was partly a reflection of the bottlenecks that existed in domestic industries for a number of years, and partly a result of increased industrial activity. While the foreign exchange resource constraints and stringent import controls in the past served to limit the utilisation of external resources to certain essential imports, they inhibited the inflow of investment goods

1. The trade data used in the balance of payments are actual receipts and payments during the year. They differ from the external trade data given earlier, which reflect the physical movement of exports and imports. The difference is due to the time lag between receipts and payments on one side and the physical movement of goods, on the other.

2. The frequent changes in the exchange rate of Sri Lanka and also the instability of exchange rates between major international currencies since 1977 introduced a serious problem of comparison of time series data on balance of payments. In the absence of a stable monetary unit, the relatively more stable Special Drawing Rights (SDR) has been used as a unit of account for the purpose of comparison.