

CHAPTER II

THE ECONOMY OF SRILANKA

Statement of the Problem

The developing economy of Srilanka has a unique position in South Asia region. She has a shared legacy of colonial dominance in the past with India; and attained the political independence in 1948 from the British rule. At that time her per-capita income was the highest among the other South Asian Countries and was the third highest in whole Asia just after Japan and Malayasia¹. Srilankan economy was export-biased and remained open for the first phase after independence from 1948 to 1960. Her exports were specialised in three main crops, viz. tea, rubber and coconuts. The UNP govt. in power from 1947 to 1956 adopted the policy of export-led growth with minimal intervention and was committed to pursuing policies to exploit fully its comparative advantage. She was able to continue a Neutral Trade Regime until 1960. During 1948-1960 period her average growth rate of GDP was 5 percent and in 1960 she maintained a per capita income of \$152 which was almost double than that of India in that particular year.² While Srilanka was specialised on traditional agro-based exports, she concentrated her imports specially on food items and industrial products.

Srilanka was in an interventionist period from 1960 to 1977 when the Neutral Trade Regime was drastically revised

specially from 1956 after the assumption of power by SLFP dominated coalition government. In contrast to the previous open economy, an inward oriented restrictive and import substitution led industrial economy got favour from the ruling party. Result was that Srilanka had trade deficits from 1956 to 1976 period. Her export share in total world exports during 1960 to 1977 declined from 0.36 percent to only 0.07 percent. Her average propensity to export (export to GDP) declined from 28 percent to 19 percent over the same period. Average GDP growth rate over 1970-1977 period stood at only 2.9 percent consequently, about 24 percent of labour force became unemployed by 1977. The economy was then characterised by stagnant manufacturing sector, excess capacity, food shortages and inflation rates in the range of 15 percent to 20 percent.³

From 1974 she had been listed by the UNO as the Most Seriously Affected Country (MSA).⁴

In 1977, the UNP government returned to power in Srilanka and pledged to adopt again a Trade Liberalisation Regimes. This government tried to adopt the previous policy of liberalisation. She got her special encouragement from the impressive performance of the NICs like Korea, Hongkong, Taiwan and Singapore. She implemented a Trade liberalisation package in 1977 including the following :-

1. Liberalisation of trade and exchange policies, accompanied by an exchange rate and tariff reform.

- ii. Removal of some price controls.
- iii. Adoption of measures to encourage foreign private direct investment, thereby adding to scarce domestic capital, technology and managerial skills.
- iv. Domestic bank interest rates were permitted to increase sharply.⁵

Some Structural Aspects of Srilankan Economy:

The basic characteristics of the Srilankan economy during 1977 to 1987 may be viewed from the Sectoral distribution of GDP as depicted in Table-2.1. It shows the share of primary Sector⁶ as 26.9 percent on average. The range of the shares for this particular sector over years of reference being 23.9 percent to 30.2 percent. But this shows somewhat declining trend over the period.

Unlike other developing countries Srilanka's share of Secondary Sector⁷ in the GDP is almost the same at 26.7 percent on average for the same reference period. It indicates the importance of industrial base of the economy. This is nearly equal to the agricultural sector. This peculiar position of the primary and secondary sectors - placed Srilanka in an unique position vis-a-vis other developing economies.

On the other hand, the service(Tertiary) Sector⁸ in Srilanka has been flourishing as the dominant sector in the economy. Its over all share on average is as high as 46.3 percent with somewhat increasing trend.

Table-2.1

Sectoral Distribution of GDP in Srilanka(in.%)

<u>Year</u>	<u>Sectors</u>	<u>Primary</u>	<u>Secondary</u>	<u>Tertiary(service)</u>
1977		30.2	30.2	39.6
1978		28.5	28.5	43.0
1979		28.8	27.3	43.9
1980		27.6	28.5	43.9
1981		28.2	27.3	44.5
1982		27.1	25.5	47.4
1983		26.8	24.7	48.5
1984		26.1	25.9	48.0
1985		25.2	26.0	48.8
1986		23.9	25.0	51.1
1987		24.0	25.1	50.9
Annual Average		26.9	26.7	46.3

Source: UN Statistical year book for Asia and the Pacific - 1988 & 1991.

However, the intersectoral relationship established in Srilankan economy may be analysed from Table-2-2. To understand the relationship, the elasticities of tertiary Sector output with respect to primary(or secondary) sector outputs are calculated as follows.⁹

$$E \text{ or } e = \frac{\text{Annual growth rate in Tertiary Sector}}{\text{Annual growth rate in Primary(or Secondary)Sector}}$$

The value 'E', i.e., the elasticity of tertiary sector output in respect of primary sector output stands at 1.6, which indicates that a 1% increase in primary sector is followed by the increase of 1.6 percent in the tertiary sector. Similarly, the value of 'e', i.e., the elasticity in tertiary sector output in respect of Secondary Sector out put stands at 1.6. So, it also indicates a 1 percent increase in the Secondary Sector is accompanised to the same 1.6 percent increase in the tertiary sector.

Elasticity of Tertiary Sector : 1977-1987

year	Value in Billion Rupees			Annual growth Rate in %			E(7/5)	e(7/6)
	Primary	Secondary	Tertiary	Primary	Secondary	Tertiary		
1	2	3	4	5	6	7	8	9
1977	11.1	11.2	14.6	n.a	n.a	n.a	-	-
1978	12.6	12.7	19.2	13.6	13.4	31.5	2.3	2.4
1979	15.8	14.9	24.1	25.4	17.3	25.5	1.0	1.5
1980	18.8	19.5	30.0	19.0	30.9	24.5	1.3	0.8
1981	23.9	23.0	37.6	27.1	17.9	25.3	0.9	1.4
1982	26.4	24.8	46.3	10.5	07.8	23.1	2.2	2.9
1983	38.9	29.4	57.9	47.3	18.5	25.0	0.5	1.4
1984	38.5	38.1	70.0	-01.0	29.6	20.9	-	0.7
1985	39.7	41.1	76.9	03.1	07.9	09.9	3.2	1.3
1986	41.2	43.0	88.0	03.8	04.6	14.4	3.8	3.1
1987	45.4	47.4	96.1	10.2	10.2	09.2	0.9	0.9
		Annual Average		15.9	15.8	20.9	1.6	1.6

Source: UN Statistical year Book for Asia and the Pacific 1988 & 1991

Note: n.a.= not available.

Though both the primary and secondary sectors in Srilankan economy have got same importance, the developing nature of the economy stresses more importance on primary sector as the key to development strategy. So to have an overview on the agriculture in Srilanka Table-2.3 and Table-2.4 may be analysed. Table-2.3 shows the land use in Srilanka during 1977 to 1987. It is evident the lion's share of total land area under agricudlture is about 49.2 percent. The land reforms of 1972 and 1975¹⁰ thus have some visible impacts on the use of acreage as is visible upto 1985. Of the agricultural land are "Arable land and land under permanent crops" have a total acreage of 24.6 percent on an average.

An important feature in Srilankan agriculture is that only 6.3 percent agricultural land came under irrigation system during the reference period. Inspite of Mahaweli Ganga Development Programme a total 18.3 percent agricultural and land remain unirrigated .

"Forest and woodland" has covered 26.3 percent of land area in Srilanka, whereas the average shasre of "permanent medows and pastures" and "other land" constituted, on average, 5.1 percent and 19.3 percent land area in Srilanka.

The Srilankan agriculture is earmarked for its plantation and rice cultivation. From table 2.4 it is evident that 17 percent of total agricultural land area, for the period 1977 to 1987 was covered by rice cultivation. For plantation of tea and rubber (the main exportables of Srilanka) use 5.7 percent and 4.9 percent of total agricultural land. Other

principal crops, viz, "Cassava", "Maize", "Millet" and "Sweet Potatoe" cover 1.4 percent , 0.6 percent, 0.5 percent and 0.4 percent agricultural land area in Srilanka.

As regards to foreign trade sector in Srilankan economy the share of total turnover in GDP for the reference period of 1977 to 1987 is about 28 percent. It is evident from Table-2.5 such shares were the highest at 36.4 percent both in 1979 and 1980, the lowest being 21.2 percent in 1986. So, more than ¼th percent of the GDP in Srilanka is represented by her foreign trade during that period indicating some positive impact of her trade liberalisation policy.

Table-2.3

Land use in Sri Lanka (in %) : 1977-1987

Land Description	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	Av.
1. Agricultural area												
a. Arable land & land under permanent Crops.	24.8	24.9	24.9	24.9	25.0	25.2	25.3	25.4	25.4	22.6	22.6	24.6
b. Irrigated Land.	5.6	6.2	6.1	6.1	6.3	6.0	6.2	6.3	6.7	7.3	6.3	6.3
c. Unirrigated land.	19.1	18.7	18.8	18.8	18.7	19.1	19.0	19.0	18.7	15.3	16.3	18.3
	49.5	49.8	49.8	49.8	50.0	50.3	50.5	50.7	50.8	45.2	45.2	49.2
2. Permanent meadows & pastures.	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.2	5.2	5.1
3. Forest & Wood land.	27.7	27.6	27.6	27.6	27.6	27.5	27.5	27.5	27.4	20.9	20.9	26.3
4. Other Land.	17.7	17.5	17.5	17.4	17.3	17.1	16.9	16.7	16.7	28.7	28.7	19.3

Source: UN Statistical year Book for Asia and the Pacific 1988 & 1991 .

Table-2.4

Share of area under principal crops in total agricultural area(in %).

Principal Crops	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986	1987	AV.
Rice	15.6	16.9	16.3	16.9	17.2	15.2	15.8	17.9	17.4	19.6	18.0	17.0
Maize	.6	.6	.4	.4	.6	.6	.6	.7	.7	.9	.9	.6
Millet	.9	.8	.6	.6	.5	.5	.5	.4	.3	.6	.3	.5
Cassava	2.2	1.7	1.3	1.2	1.3	1.4	1.3	1.3	1.2	1.4	1.2	1.4
Sweet Potatoes	.6	.5	.4	.3	.4	.4	.3	.4	.3	.4	.3	.4
Tea	5.7	5.7	5.7	5.7	5.7	5.6	5.5	5.2	5.3	6.7	5.9	5.7
Rubber	n.a.	n.a.	n.a.	5.2	4.8	4.7	4.7	4.7	4.6	5.4	5.3	4.9

Source: UN Statistical year Book for Asia and the Pacific and 1988 and 1991.

Note: N.a.= not available.

To have a better look into the openness of her economy it is seen from Table-2.6 that as high as 16.6 percent (on average) of her GDP during the same reference period is represented by her imports alone. Such shares of imports in GDP during the period have shown the highest and lowest values at 24.1 percent and 12.9 percent in 1980 and 1984 respectively. It shows her high average propensity to import.

On the other hand, Srilanka's share of exports in her GDP as shown in Table-2.7 during the same reference period from 1977 to 1987 stood at 10.6 percent (on average) varying between the highest and lowest values of 17.6 percent and 8.2 percent in 1977 and 1986 respectively.

Table-2.5

Share of Srilanka's Trade turnover in G.D.P.

<u>Year</u>	<u>Share in %</u>
1977	33.6
1978	35.4
1979	36.4
1980	36.4
1981	27.0
1982	26.2
1983	23.1
1984	23.0
1985	23.3
1986	21.2
1987	22.9
<u>Average</u>	<u>28.0</u>

Source: (1) IMF - Direction of Trade Statistics Year Book (various issues)
(2) IMF - Exchange Arrangements and Exchange Restrictions, Annual Report - 1989.

Table-2.6

Share of Srilanka's Imports in GDP.

<u>Year</u>	<u>Share in %</u>
1977	16.0
1978	18.6
1979	21.7
1980	24.1
1981	17.4
1982	16.7
1983	14.6
1984	12.9
1985	13.8
1986	13.0
1987	13.9
<hr/> Average	<hr/> 16.6

Sources: (i) IMF - Direction of Trade Statistics Year Book
(various issues)

(ii) IMF - Exchange Arrangements and Exchange Restrictions; Annual Report - 1989.

Table-2.7

Share of Srilanka's Exports in GDP.

<u>Year</u>	<u>Share in %</u>
1977	17.6
1978	16.8
1979	14.7
1980	12.3
1981	9.6
1982	9.5
1983	8.5
1984	10.1
1985	9.5
1986	8.2
1987	9.0
<u>Average</u>	<u>10.6</u>

Sources: 1. IMF-direction of Trade Statistics Year Book
(Various issues)

2. IMF - Exchange Arrangements and Exchange Restrictions,
(Annual Report-1989).

The export and import performances in Srilanka during the reference period, therefore, have created some structural imbalance in the foreign trade sector. These imbalances coupled with most ambitious developmental programmes during the period invited a large amount of foreign capital in the form of foreign aids representing Srilanaka's external debts. The available data as presented in Table-2.8 shows that US \$ 114.3 million of interests were made during the period between 1980 to 1987. During the same period the average principal and down payment stood due at US \$ 100.4 million resulting into the total debt - service, on average, at US \$ 214.6 million. During the same period the average export earnings of Srilanka was US \$1151.6 million. So the debt service ratio during the reference period stood at 18.4 percent (on average) indicating a moderate degree of debt - service burden for Srilanka as per World Bank Standard. But the future danger lies in the high compound growth rates in respect of interest payments, amortisations and total debt service burdens which have been round at 10.7 percent, 19.0 percent and 14.76 percent respectively, whereas growth rate for export earnings was only 2.8 percent with such a low rate of growth in export earnings, it is not possible to meet the debt burden for Srilanka.

Table-2.8

Debt Service Burden of Srilanka(1980-87)

Year	Interest (million US \$)	Principal & Down Payment (million US\$)	Total Debt Service (million US \$)	Total Export Earning (million US \$)	Debt Ser- vice Ratio (in %)
1980	69.0	51.2	120.2	1042	11.5
1981	85.0	46.5	131.5	1044	12.6
1982	96.0	75.1	171.1	1015	16.8
1983	116.0	74.0	190.0	1066	17.8
1984	125.0	91.0	216.0	1454	14.8
1985	132.0	111.0	243.0	1191	20.4
1986	135.0	148.0	283.0	1099	25.7
1987	156.0	206.0	362.0	1302	27.8
Average	<u>114.3</u>	<u>100.4</u>	<u>214.6</u>	<u>1151.6</u>	<u>18.4</u>
Compound growth rate over 8 years.	10.7	19.0	14.76	2.8	

- Sources: 1) Asian Development Bank - Key Indicators of Developing and Pacific Countries.
2) UN Statistical Year Book for Asia and the Pacific-1991.

SUMMARY :

After independence, Srilanka has gone through three major trade policy phases. In the first, after 1948, the economy was relatively open. In the Second, which commenced in 1960, a Neutral Trade Regime biased against export was initiated. And in the third since 1977 a strong Liberalisation efforts were made.

During the first phase after independence her exports were specialised in three main crops, viz, tea, rubber and coconuts. Srilanka was able to continue a neutral trade regime until 1960. The per-capita income of Srilanka was double than that of India while she specialised on traditional agro-based exports and concentrated her imports on food items and industrial products.

In the Second phase, Srilanka was in an interventionist period from 1960 to 1977, when the neutral trade regime was drastically revised. As a result, her exports during this period declined from 0.36 percent to only 0.07 percent and her average propensity to export declined from 28 percent to 19 percent over the same period. Average GDP growth rate stood at only 2.9 percent and about 24 percent of labour force became unemployed. The economy was then characterised by a stagnant manufacturing sector, excess capacity, food shortages and high inflation. Srilanka has been listed as one of the most seriously affected country (MSA) by the UNO.

And in the third phase, Srilanka again adopted a Trade Liberalisation Regimes to return to the previous open economy. Liberalisation of Trade and exchange policies, removal of price controls, encourage foreign investment, technology and managerial skills and slightly increased the domestic bank interest rates were the characteristics of this period.

In Sectoral distribution of GDP, the share of primary sector was 26.9 percent (on average) and the share of Secondary Sector was almost the same at 26.7 percent (on average). It indicates the importance of industrial base of the economy to the same equal level as the agricultural sector. On the other hand, the service(tertiary) sector has been flourishing as the dominant sector of the economy and its overall share on average was 46.3 percent with an increasing trend. The elasticity of primary and Secondary Sectors output in respect of tertiary sector output are 1 and 1.6.

The developing nature of the economy of Srilanka stresses more importance on the primary sector as basic source of development. The agricultural land was 49.2 percent of the total land area during the reference period. Of the agricultural land area Arable land and land under permanent Crops' have a total acreage of 24.6 percent on an average. The Srilankan agriculture is earmarked for its plantation and rice cultivation. About 17 percent land was covered by rice cultivation, 5.7 percent and 4.9 percent of total agricultural land were under tea and rubber plantation.

The foreign trade sector in Srilankan economy is very important. But it has a slow rate of growth. As regards to debt - service there are various dangerous trends. It seems that if Srilanka fails to improve her performance in the export sector, she might face the problem of what is generally known as 'debt traf'.

NOTES AND REFERENCES :

1. Raja Patirana, Sarath - Foreign Trade and Economic Development: Srilanka' Experience - World Development, vol.16, No. 10, pp.1143-1157, 1988, Oxford, U.K.
2. Ibid.
3. Ibid.
4. Poorest of the poor: A Glossary Third World Quarterly - Vol.4, No.1, p.144, January 1982, London.
5. Raja Patirana, Sarath - op.cit.
6. Primary Sector includes - agriculture, hunting, forest tree & fishing; mining & querrying.
7. Secondary Sector includes - Manufacturing; Electricity, gas & water, and construction.
8. Tertiary(Service) Sector includes - wholesale & retail trade, restaurants & hotels, transport, storage & communication; finance, insurance, real estate & business services; and community, social & personal services.
9. Kuznets,C.F.Simon; Modern Economic Growth, Yale University Press, 1966.
10. Maheshwari, B.B. - India and Srilanka Economic Relation; p.14, Agam Prakashan - Delhi, 1987.

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