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Sri Lanka: Recent Economic and Policy Developments

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SRI LANKA

Recent Economic and Policy Developments

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Approved by the Asia and Pacific Department

November 12, 1999

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I. Introduction and Summary

1. **Despite the slowdown in world trade and economic growth, Sri Lanka's economy grew in 1998 at close to its historic average rate.** The recorded 4¾ percent growth in real GDP was lower than 1997 when the economy was recovering after a bad harvest. In the first twelve months following the outbreak of the Southeast Asian crisis, Sri Lanka was helped by reduced export competition and lower commodity prices. But by the middle of 1998, growth in Sri Lanka started to slow markedly, and GDP growth dropped sharply to 3 percent in the first half of 1999. Increased price competition from Southeast Asia, especially in garments and textiles, the end of a two-year boom in tea prices, and slower world economic growth all had an adverse impact.

2. **Inflationary pressures abated in 1998, as prices for imported commodities came down and the economy started slowing in the middle of the year; the monetary tightening in early 1998 also contributed.** Through August 1999 annual average inflation was 5 percent and inflation on a 12-month basis was 4¾ percent. The limited wage data available suggest the presence of still substantial cost pressures and inflationary expectations remain high, as reflected in nominal interest rates.

3. **In 1998 public finances experienced a serious interruption of the medium-term consolidation strategy that had been set in motion by the present government.** The gains of 1997 were reversed when the overall budget deficit rose to 9¼ percent in 1998, from just under 8 percent of GDP in 1997. This was in excess of the originally targeted deficit (6½ percent of GDP) with half of the deviation due to revenue shortfalls—split evenly between the Goods and Services Tax (GST) and other taxes except the National Security Levy (NSL)—and the remainder because of expenditure (mostly defense) overruns. The revenue/GDP ratio declined from 20½ percent in 1995 to 17¼ percent in 1998. Declining interest payments permitted a shift from current to capital spending within unchanged overall expenditures in relation to GDP. The increased deficit was largely financed domestically, putting pressure on interest rates.

4. **The 1999 Budget originally aimed for an overall deficit of 6 percent of GDP.** But because of the extent of slippage in 1998 and the changed economic prospects, the Ministry of Finance published revised projections in June 1999. Assuming expenditures will be as budgeted—implying a cut in defense expenditures of 1 percent of GDP—the lower revenue projections would result in an overall budget deficit in 1999 of 7¾ percent of GDP.

5. **The monetary stance has shifted over the past 18 months. In late 1997 and early 1998, the Central Bank tightened its monetary policy to resist downward pressures on the rupee exchange rate emanating from the Southeast Asian currency crises.** During this period it also intervened substantially in the foreign exchange market. By October 1998 the Bank was comfortable with the trend of the exchange rate, and encouraged by the easing of inflation. To address the slowdown in economic growth, the official overnight repo rate

was steadily reduced from 12 percent in October to 9½ percent in August 1999 considering the downward trend in inflation. The reduction of reserve requirements in August 1999 by 1 percentage point as a further step moving towards market-oriented monetary management, announced in 1999 by the Central Bank, also led to a relaxation of monetary conditions.

6. **Sri Lanka's balance of payments benefitted in 1998 from an improvement in the terms of trade**. Import values were almost unchanged thanks to a sharp drop in prices and this more than offset the slowdown in export value growth as competition from Southeast Asia intensified in an overall weaker global market place. The current account improved from a deficit of 3 percent of GDP in 1997 to 2¼ percent in 1998. Compared to 1997, the capital and financial account recorded less official assistance from abroad and much reduced privatization proceeds, but a slight increase in foreign direct investment.

7. **This paper provides background information on economic developments and key policy issues**. The main economic developments in 1998 and the first half of 1999 are discussed in Chapter II. Background information on key structural policy issues facing the authorities are elaborated in Chapter III and throughout the paper in the form of text boxes and more detailed annexes. These topics include reform of the tax structure, inflation targeting, the pension system, and banking system soundness. Detailed tables on all sectors are provided in the Appendix.

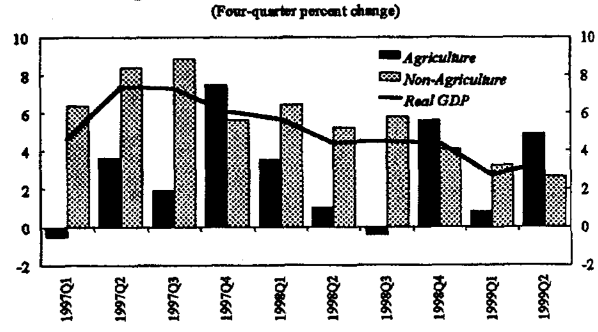
II. Recent Economic Developments, 1998–99

A. Real Sector[1]

Growth, saving, and investment

8. **The Asian crisis, and the resulting global economic slowdown, has hit Sri Lanka with a delay**. Growth slowed significantly to 4¾ percent in 1998, from 6¼ percent in 1997 (Figure 1). The demand for exports of rubber, coconut products, gems, jewelry, and ceramics was depressed. Also, increased competition led to lower growth in the export oriented industrial sector, particularly the garments and textiles sector. The depressed conditions have persisted into 1999, and may be spreading to domestic market oriented

Figure 1. Sri Lanka: Real GDP Growth, 1997-99
(Four-quarter percent change)



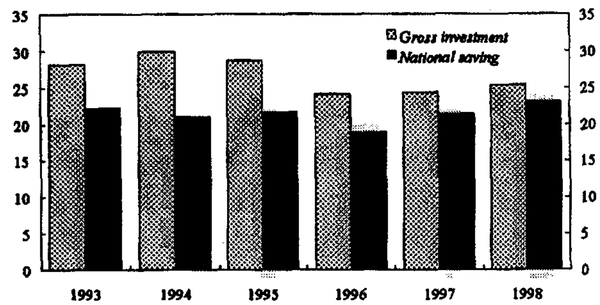
Source: Data provided by Sri Lanka authorities.

[1]See Appendix Tables 1 to 13, and Figures 1–4.

activities as well. In the first half of 1999, real GDP was 3 percent above the same period last year. Quarterly GDP growth has displayed a downward trend since the third quarter of 1997.

9. **National savings continued to increase faster than gross investment, causing the savings-investment gap to narrow to 2¼ percent of GDP in 1998, down from 3 percent of GDP in 1997.** Gross domestic savings increased to 19 percent of GDP in 1998, from 17¼ percent in 1997. This was due to a higher private sector savings rate resulting from increased per capita incomes, and increased corporate savings. Gross investment as a share of GDP increased to 25½ percent in 1998, from 24½ percent in 1997 (Figure 2). Private investment increased because of time-bound tax concessions including the removal of duty on capital goods which increased imports of investment goods by 12 percent, and an increase in corporate profits. Public investment increased as a result of investment in infrastructure. Given Sri Lanka's desire to substantially increase growth, the relatively lower growth of investment compared to savings is a cause for concern.

Figure 2. Sri Lanka: Saving and Investment, 1993-98
(In percent of GDP)



Source: Data provided by Sri Lanka authorities.

Sectoral developments

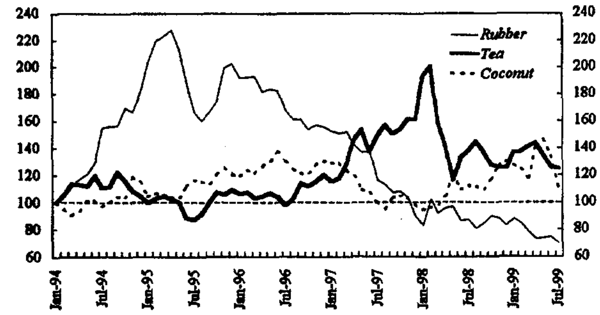
Agriculture

10. **Agricultural output has consistently registered annual growth rates that are well below GDP growth, leading to a steadily declining share of agriculture in GDP in recent years**. In 1998, agricultural output grew by 2½ percent. This was largely due to increased paddy and fish production and a record high tea output. Low rubber prices caused a 9 percent decline in rubber production, while the lagged effect of adverse weather in 1997 caused a 3 percent decline in coconut production. First quarter growth in 1999 was ¾ percent, compared to 3½ percent for the corresponding period in 1998 though there was a rebound in the second quarter. However, quarterly agricultural growth rates for Sri Lanka are rather variable, and have shown no discernible trend or systematic intra-year variation, making it difficult to predict agricultural output growth for 1999.

11. **Attractive prices in the first half of 1998 and good weather in the low elevation areas caused Sri Lankan tea production to increase by 1 percent, to a new record high**. The increase in production in the low elevation areas offset declines in the high and mid elevation areas. On average, tea prices rose in 1998. The average Colombo auction price rose by 12½ percent in 1998, following a 15 percent increase in 1997. In dollar terms, the price increase was less pronounced. The average export price in dollar terms rose by 7 percent,

following a 6 percent increase in 1997. Starting from mid-1998, however, tea prices fell significantly as a result of substantial increases in tea production in Kenya, and India, and a fall in the demand for tea caused by the Russian rouble crisis. The global excess supply conditions have continued, and tea prices are likely to remain low (Figure 3).

Figure 3. Sri Lanka: Key International Commodity Prices, 1994-99
(January 1994=100; U.S. dollar terms)



Source: IMF, Commodity Price System Database.

12. **The sharp fall in rubber prices on the international market has created a crisis in Sri Lanka's rubber industry**. Rubber production has continued to decline; by 9 percent in 1998, following a 6 percent decline in 1997. Producers profit margins have also fallen sharply over the past 2 years. Preliminary indications are that crepe rubber prices fell below cost of production in early 1999. As a result, some producers have resorted to practices which are detrimental to the long term health of the industry, including reducing the application of fertilizer, and failing to replant. Some smallholders have also resorted to felling rubber trees for sale as firewood.

13. **Paddy and fish production recorded strong growth, but coconut production declined in 1998**. Paddy production increased sharply by 20 percent, as a result of a 16 percent increase in the area under cultivation due to favorable weather, and an increase in the average yield for the Yala season. Fish production increased by 8 percent, as a result of increased sea fishing in the North and East, increased inland fishing, and improvements in facilities and management in the fisheries sector. Coconut production declined by 3 percent in 1998, due to the lagged effect of the El Niño weather phenomenon in 1997.

14. **The production of other agricultural crops was mixed**. Production of export crops such as pepper, cinnamon leaf oil, cocoa, coffee, and cardaman increased significantly. However, the production of potatoes, onions and chillies declined as a result of increased import competition resulting from the removal of import restrictions in 1996. Production of legumes such as soya, black gram, green gram, and cowpea increased.

Industry

15. **In the industrial sector, export oriented activities generally saw declining growth, while domestic market oriented activities typically continued to register high growth rates**. Recession in Japan, one of the largest markets for gems, and the Asian crisis, caused a sharp drop in the demand for Sri Lankan gems—exports declined by 46 percent in dollar terms in 1998. However, output of quarrying products increased as a result of growth

in the construction sector. First half 1999 growth in the mining and quarrying sector was 4¼ percent, suggesting a slight recovery in this sector.

16. **The sharp slowdown of world trade and intensified competition caused by the Asian crisis significantly reduced growth in the export oriented industries**. As a result, growth in manufacturing output declined to 6 percent in 1998, from 9 percent in 1997. Growth in output of textiles, wearing apparel, and leather products fell sharply to 4½ percent in 1998, from 18¾ percent in 1997. However, high growth rates were recorded in domestic market oriented industries such as refined petroleum products, cement, building materials, wheat flour, animal feed, liquor, milk products, pharmaceuticals, beverages and chemicals. First half 1999 growth in manufacturing output was 4 percent, significantly lower than first half 1998 growth, suggesting continued depressed growth in this sector.

17. **The construction sector continued to do well in 1998**. Growth increased to 7 percent in 1998, up from 5 percent in 1997. This was partly due to fiscal incentives in the 1998 budget to encourage private sector participation in housing construction and other infrastructure development. Also, the public sector housing programme, managed by the National Housing Development Authority, showed significant progress in 1998. In the first nine months of 1998, net advances by commercial banks for housing and property development increased sharply by 20 percent, compared to the same period in 1997. However, first half 1999 growth for construction was only 5¼ percent, which could be the first signs of the adverse effects of the global economic crisis on the sector.

Services

18. **The services sector saw a mixture of outstanding growth in some activities, and substantial declines in growth in others**. Overall services sector output grew at 5 percent in 1998, down from 7 percent in 1997. The outstanding performers in the sector were electricity generation, and telecommunications, which grew at 10 percent and 46 percent respectively in 1998. However, growth in the ports sector fell sharply to 2½ percent in 1998, down from 17 percent in 1997, as a result of regional economic conditions and new competition from Oman. First half 1999 growth for services was 2½ percent, significantly lower than first half 1998 growth.

19. **In the power sector, output of electricity increased by 10 percent in 1998**. The increase was due to the expansion of thermal power generation, and plentiful water supplies, which sustained a high level of hydropower generation and was sufficient to maintain an uninterrupted power supply although demand has been rising at an average rate of 10 percent per annum. The installed capacity of power generation increased to 1636 MW in 1998, from 1575 MW in 1997. The telecommunications sector continued to grow rapidly, by a record 46 percent in 1998, from 32 percent in 1997. This was largely due to substantial increases in capacity of both Sri Lanka Telecom and private sector participants, which then led to a

substantial increase in subscribers. Telephone density improved from one phone per 59 persons in 1997 to one phone per 41 persons in 1998.

20. **Tourist arrivals increased by a modest 4 percent in 1998, fueled largely by a substantial increase in arrivals from Western Europe, which offset a decline in arrivals from Asia**. The annual occupancy rate for graded accommodation rose from 49 percent to 53 percent in 1998. Growth in the ports sector declined to 2½ percent in 1998, down from 16¾ percent in 1997, largely as a result of a reduction in transshipment cargo handling. This was the result of the adverse effects of the Asian crisis on trade, and intensifying competition from a new port, the Mina Raysut at Salalah, Oman. Preliminary indications in 1999 are that losses of business to the Mina Raysut port are likely to be substantial, as two major shipping lines have announced that they will be shifting a large portion of their transshipment volume from the Colombo harbor to Salalah. Plans for the addition of a new container terminal, the Queen Elizabeth Quay, to the Colombo harbor were finalized in August 1999. The new quay is under private management, and will have the capacity to handle 750,000 containers per year, bringing the total capacity of the harbor to 3 million containers per year.

Prices, wages and employment

Prices

21. **All price indices indicate that inflation fell slightly in 1998 on an annual average basis**. Annual average inflation as measured by the Colombo Consumer Price Index (CCPI), which is the official measure of inflation compiled by the Department of Census and Statistics (DCS), was 9½ percent in 1998, down slightly in 1997.[2] The Greater Colombo Consumer Price Index (GCPI), also compiled by the DCS, indicated that annual average inflation in 1998 was 7 percent, down from 1997. The higher inflation rate indicated by the CCPI could be attributed to differences in coverage, and the larger weight given to some types of food, such as vegetables (which registered sharp increases in 1998), in the CCPI. The Wholesale Price Index (WPI), which is compiled by the Central Bank of Sri Lanka (CBSL), increased by 6 percent in 1998, down from a 7 percent increase in 1997, reflecting a drop in paddy prices, lower import prices for wheat grain and rice, the decline in rubber prices, lower rate of increase in tea prices, and unchanged prices for petroleum products. Consistent with the other price indices, the GDP deflator, which is also compiled by the CBSL, increased 8½ percent in 1998, a pace slightly less than in 1997.

22. The decline in average inflation was entirely due to lower increases in prices for non-food items, since, on average, food prices increased at the same rate in 1998 as in 1997. On a twelve month basis, there was a significant increase in inflation in the first half of the year, with CCPI measured inflation for June 1998 being 14 percent (Figure 4). This was attributed

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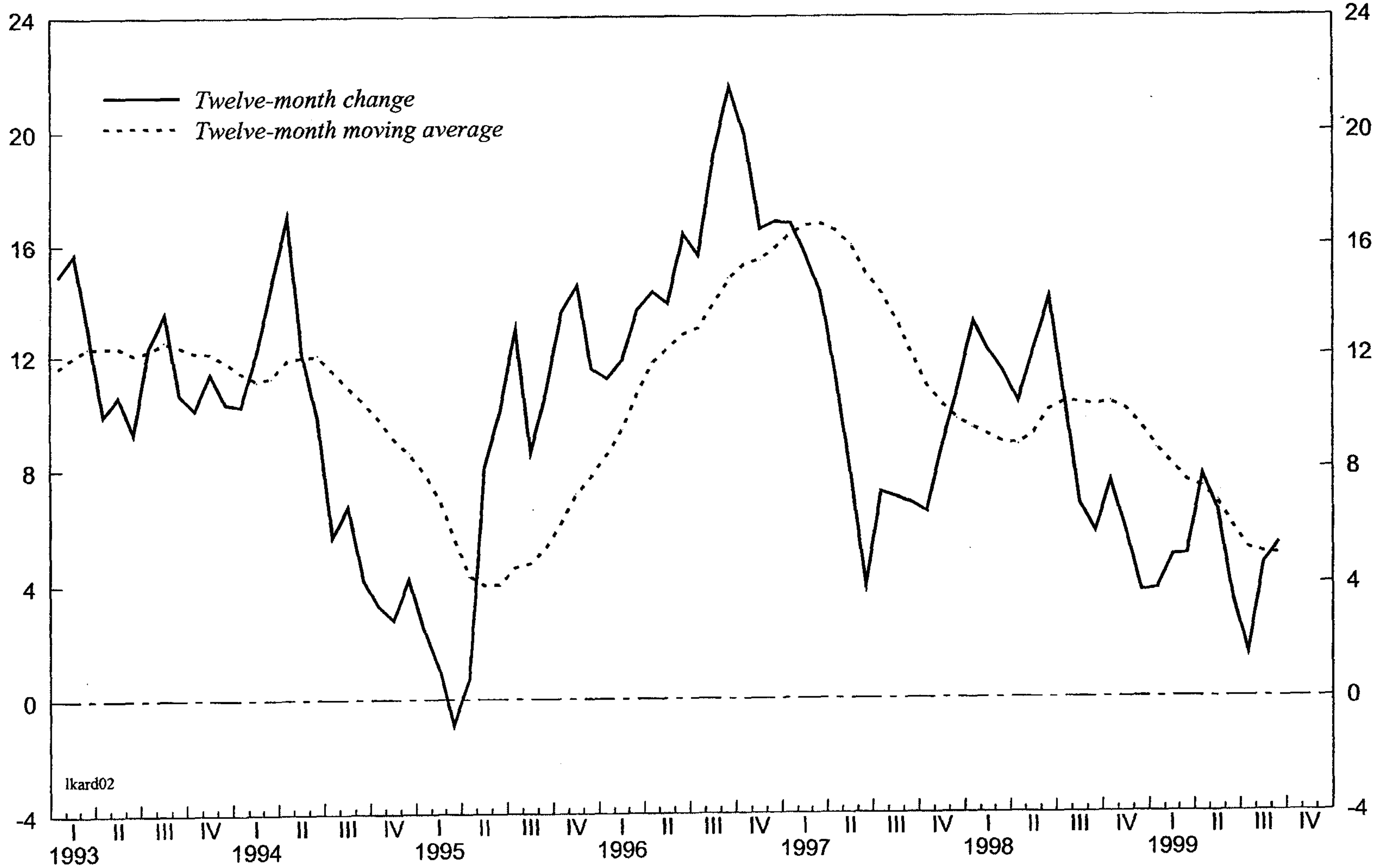
[2]Box 1 discusses the deficiencies in the available price indices.

Figure 4. Sri Lanka: Inflation, 1993-99 1/

(In percent)



Source: Data provided by Sri Lanka authorities.

1/ Colombo Consumer Price Index.

Box 1. Price Indices and the Measurement of Inflation[1]

The Colombo Consumer Price Index (CCPI), the official measure of inflation, is deficient and badly in need of updating. Two alternative series are now being published, namely the Greater Colombo Consumer Price Index (GCCPI) and the Colombo District Consumer Price Index (CDCPI). These are more up-to-date but suffer some of the same deficiencies as the CCPI. Compilation of a new consumer price index addressing the existing deficiencies is crucial in improving public confidence in inflation measurement. The Department of Census and Statistics has been working on the compilation of a new consumer price index.

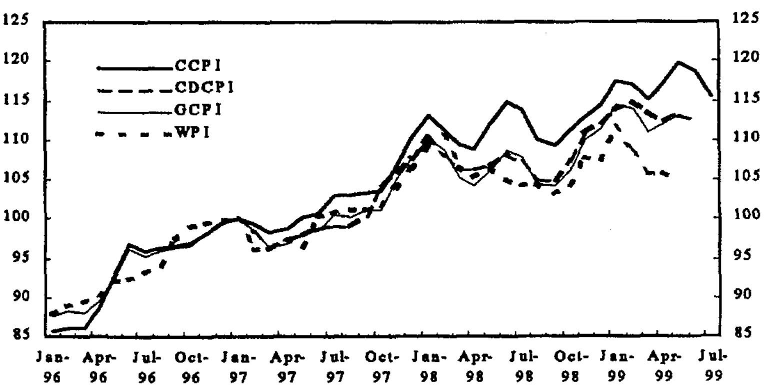
A general measure of inflation should cover the whole country, the whole population and all consumer goods and services. **However, all three consumer price indices limit their geographical coverage to Colombo and its surrounding area and cover only working class households.**

Critically, the CCPI uses weights based on an expenditure survey from 1949/50. Some adjustments were made but attempts to replace the basket have not been successful (the CCPI is used to determine cost of living adjustments). The GCCPI is based on 1985/86 expenditure data, and the CDCPI, first published by the central bank in 1998 is based on the 1996/97 Consumer Finance Survey.

The GCCPI covers Colombo city and its suburbs, whereas the CCPI covers only Colombo city. It also covers some consumer durables. The CDCPI has the widest geographical coverage, Colombo district, but has gaps in its coverage of durables and communications.

As a general measure of inflation, the CPI should measure price increases experienced by the ***average Sri Lankan household.*** This would entail a much wider geographical and population coverage (including the middle and a substantial proportion of the upper income groups). To satisfy the needs of various types of users, sub-indices of the overall CPI could be published.

Sri Lanka: Measures of Inflation
(January 1997 = 100)



Source: Central Bank of Sri Lanka.

Neither the wholesale price index (WPI) nor the GDP deflator are particularly well suited for the measurement of inflation as experienced by the household, as they are not based on the household's consumption basket.

The WPI, in practice, resembles a producer price index since it actually measures producer prices rather than wholesale prices. It is weighted using 1974 production data, and its purpose and uses are unclear. It is generally not used for deflating output in the national accounts, nor is it seen as an important inflation indicator or widely used for cost of living and inflation adjustments in contracts. The CBSL plans to improve the WPI and turn it into a genuine producer price index (PPI).

[1] Source: Sri Lanka: Report on the Consumer Price Statistics Mission, October 1–14, 1998, IMF Statistics Department.

to continued excess liquidity in the banking system, and to the introduction of the Goods and Services Tax (GST) which is estimated to have increased consumer prices by about 2–3 percent. This situation however improved in the latter half of the year, with twelve month CCPI inflation falling to 3¾ percent in December 1998. This was the result of a reduction in the growth of money supply (consolidated broad money (M2b) grew by 13 percent compared with a growth rate of 16 percent in 1997), improved domestic supply and the worsening external environment which reduced demand pressures on prices.

23. On a twelve month basis, CCPI measured inflation increased to 7¾ percent by April 1999, but has since declined to 4¾ percent in August 1999 due to a fall in food prices. Food production, especially vegetables, fish and coconuts, has been plentiful so far, in 1999, as a result of good weather. This suggests that inflationary pressures may be abating. However, informal responses by private sector agents suggest that inflationary pressures and expectations are significantly higher. Also, the rate at which interest rates have been declining is significantly lower than that for prices.

Wages

24. **Real wages increased for most workers in 1998**. The implementation of the second phase of the B.C. Perera Salary Review Committee proposals led to a 10½ percent increase in nominal wages of public sector employees. Given CCPI inflation of 9½ percent, this translates to a 1 percent increase in real wages for the public sector. All categories of employees in the public sector received wage increases.

25. Wages in the organized private sector also increased. The daily wage of those plantation workers covered by a collective agreement, made to settle an industrial dispute, was increased from Rs 83 to Rs 95. Tea sector workers covered by the agreement received an additional price share supplement of Rs 6 per day, which however is subject to review within 18 months if tea prices suffer a serious downturn. Rubber sector workers also received an additional price share supplement of 30 cents for each one rupee increase in the price of rubber (RSS No.1) over the threshold price of Rs 65. For plantation workers not covered by the collective agreement, minimum wages were also increased from Rs 83 to Rs 95. There were also revisions in the minimum wages of a large number of Wages Boards. The Minimum Wage Rate Index of all workers covered by Wages Boards increased by 12¼ percent in 1998, which was significantly higher than the 3 percent increase registered in 1997.

26. Nominal wages also increased in the informal sector for most activities. Provisional data from the Countrywide Data Collection System of the CBSL shows that daily wages increased for carpenters and masons in small scale construction, skilled helpers in carpentry and masonry, and unskilled workers in building construction. Real wages increased in most activities related to paddy cultivation, including ploughing, spraying, weeding, harvesting and threshing. Similarly real wages increased for the preparation of land, and for female pluckers, in the small scale tea plantations. In coconut cultivation, real wages increased for digging of

pits and for plucking. However, nominal wages for tapping in rubber smallholdings declined slightly as a result of the deterioration in rubber prices.

Employment [3]

27. **The unemployment rate declined from 10½ percent in 1997 to 9½ percent in 1998**. Key generators of employment were the manufacturing, construction, trade, hotels, insurance, real estate and personal services sectors. Board of Investment (BOI) enterprises generated about 36,200 new employment opportunities, a substantial share of total domestic employment generation. The number of people leaving for foreign employment is estimated to have risen by 7 percent in 1998, after declining in 1996 and 1997. Public sector employment as a share of total employment continued to decline (from 25 percent in 1993 to 18 percent in 1998). The decline is most pronounced in the quasi-government sector where public enterprise reforms and privatization have transferred substantial numbers of employees to the private sector. In absolute terms, public sector employment was 1.1 million persons in 1998, a 1 percent increase over 1997.

28. Unemployment rates for those with higher academic qualifications (especially those with GCE A Levels and above) are consistently significantly higher than those for the population as a whole. This appears to be the result of a mismatch between the skills being taught by the educational system, which are more suitable for white collar jobs, and the professional and technical skills, such as management, marketing, computer studies, accounting, finance and English language, that are in demand in the private sector. Current educational reforms underway seek to address this deficiency by revising school curricula and improving school infrastructure and teacher training.

29. **Labor market laws, especially the Termination of Employed Workmen Act, continue to be a major structural impediment to growth**. The Act makes it exceedingly difficult to lay workers off for nondisciplinary reasons. Moreover, existing labor tribunals, which arbitrate disputes between management and workers, have large and growing backlogs of unresolved cases. Thus, the constant entry and exit from industries that is a feature of modern dynamic market driven economies, is significantly impeded in Sri Lanka. The laws also discourage foreign investors from setting up enterprises in Sri Lanka, as costs associated with closing down unsuccessful businesses are perceived to be excessively high.[4]

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[3]Labor force and employment estimates for 1998 are not strictly comparable to those in previous years. The quarterly Sri Lanka Labor Force Survey was amended slightly in the third quarter 1998 to include unpaid female family workers such as housewives engaging in supporting family income generating activities, especially in the agricultural sector, in the labor force. Previously, they were counted as "not in the labor force." This contributed to the large increase in the labor force and employment observed for 1998.

[4]For an analysis of the labor market, see IMF Staff Country Report No. 98/118.

B. Public Finances[5]

Overview

30. **Though declining, the public sector in Sri Lanka remains large, representing about 13 percent of gross national expenditure and 18 percent of total formal employment**. The public sector comprises the central government; provincial, municipal, urban, and local councils; public enterprises and statutory boards; and a wide range of public institutions.[6] The central government budget covers the revenues, expenditures, and financing of the presidency, the judiciary, parliament, 28 line ministries, and several departments and agencies. The eight Provincial Councils (PCs) operate under a separate budgetary arrangement (Box 2). The government is considering amendments to the Constitution that would allow for a radical regional devolution of power.

31. **Following over two decades of persistently large budget deficits, in 1994 the government began to take steps toward achieving a low and sustainable budget deficit over the medium-term** (Figure 5). In particular, the government started to reduce the size of the public sector, improve the efficiency of its operations, and retreat from the production and distribution of marketable goods and services. On the revenue side, a start was made at rationalizing the tax structure, improving the efficiency of tax administration, and introducing cost recovery mechanisms in the form of administrative fees and charges.[7] On the expenditure side, budget execution and cash management were improved, operational expenses, subsidies, and transfers to public enterprises were reduced, welfare expenditures were rationalized and better targeted, and privatization proceeds and a more rational public debt management system were used to limit the interest burden. Though these improvements in the structure of the public sector and its operations have been overshadowed by developments in defense spending, a number of monitoring and control mechanisms were introduced in early 1999, designed to permit much tighter control over military expenditures.

Fiscal developments in 1998

32. **The progress in fiscal consolidation achieved over the last several years was interrupted in 1998**. The 1998 budget sought to extend the process of fiscal consolidation begun in 1994 and consolidate the gains of improved macroeconomic performance in 1997 by targeting a further reduction in the overall fiscal deficit of the central government to 6½ percent of GDP. This would help reduce inflationary pressures and contain the build-up

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[5]See Appendix Tables 14–21 and Figures 5–7.

[6]See IMF Staff Country Report No. 98/118 for summary measures of the relative size of the public sector (Annex II), and for a list of public enterprises and statutory boards (Annex III).

[7]See Annex I of this report for an overview of tax and nontax revenue structures.

Box 2. Provincial Councils—Devolution and Fiscal Operations

Provincial Councils and Devolution

A system of local government has existed in Sri Lanka since ancient times. Initially, these units took the form of village councils, but they were subsequently extended to urban, municipal, and district levels. During the colonial period, local government became more dependent on central government, especially for revenue. In 1987, significant powers were devolved to the regions in an attempt to satisfy demands for autonomy in the Tamil-dominated North and East. The Thirteenth Amendment to the Constitution formalized the relationship between central and local government and introduced a new unit of administration in each of the eight Provinces. These Provincial Councils (PCs) were given jurisdiction over public order and the provision of certain services (e.g., housing, roads, education and health), and vested with some specific revenue collection powers. The provisions were subsequently strengthened in the Provincial Councils Act of 1987, and extended by the Administrative Reform Committee of 1988.

The devolution system that resulted has been marked by ambiguities in responsibilities between central government and PCs, the absence on the part of PCs of adequate control, accountability and transparency of their fiscal operations; and the failure of the PCs to deliver quality services. The government unveiled new devolution proposals in 1996, which address some of these weaknesses, but they have yet to be adopted by Parliament. However, the proposals do not specify detailed intergovernmental financial relations. Therefore, it remains uncertain whether the proposals will correct long-standing problems of weak expenditure management and control, and provide the right incentives for proper financial management.

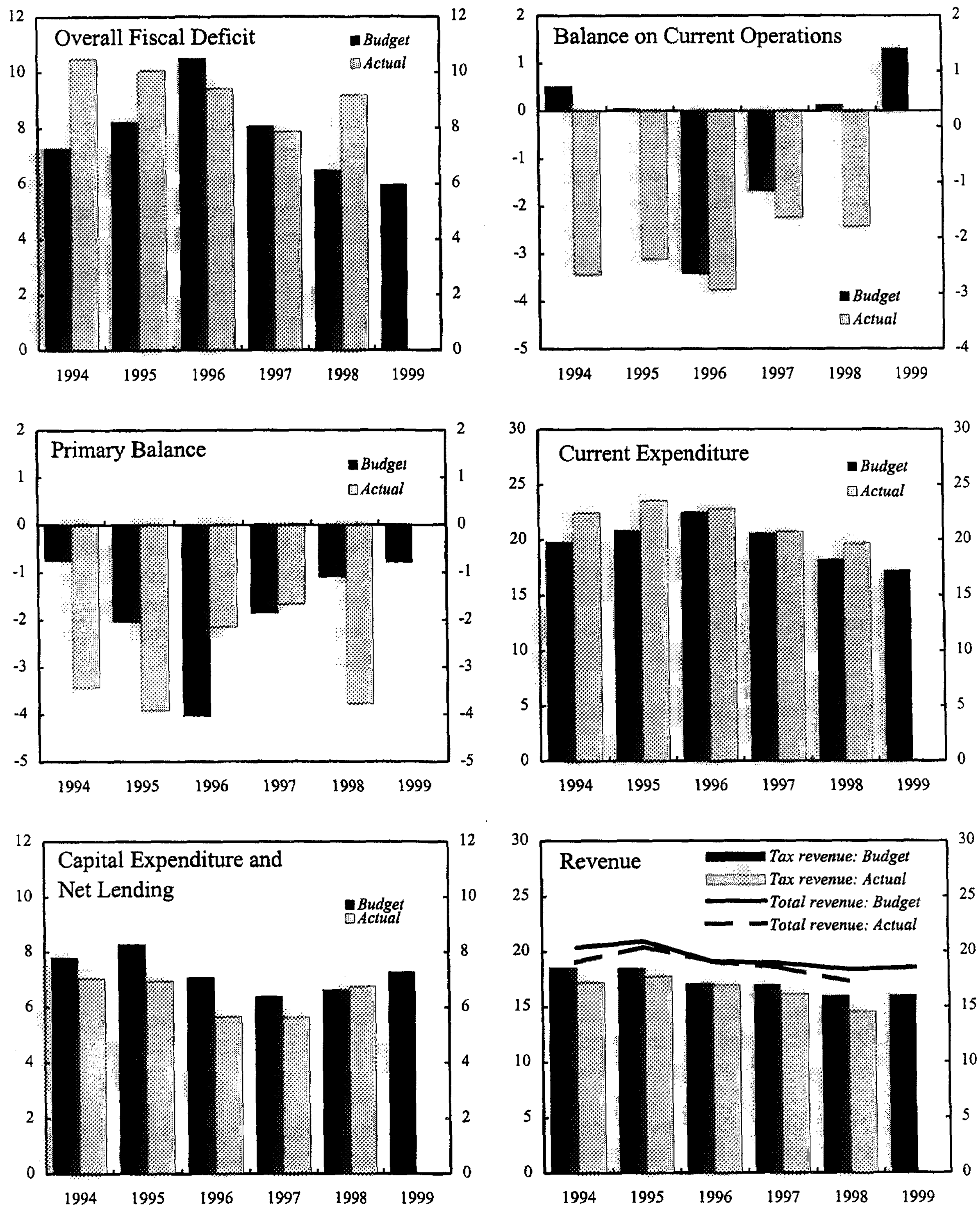
Fiscal Operations of Provincial Councils

The major revenue sources of PCs comprise turnover taxes on wholesale and retail businesses; license fees on motor vehicle registration; stamp duties on property transactions; and various fees and charges. The Western PC (which includes Colombo) accounts for two-thirds of total PC revenues. In 1998, the Rs 6 billion (½ percent of GDP) in revenues collected by PCs covered less than a quarter of their total expenditures.

The bulk of PCs expenditure is spent on personal emoluments in the provision of social services, principally education (68 percent) and health (19 percent). The Western PCs accounts for a quarter of total PCs current expenditure. Capital expenditure by PCs are small, and mostly related to line ministry projects funded through the Medium-Term Investment Program (MTIP). In 1998, total expenditure amounted to Rs 26.7 billion (2½ percent of GDP), of which Rs 25.2 billion (94 percent) were for current expenditure.

The bulk of the combined overall deficit of PCs (95 percent) is financed by block grants from the central government. The remainder is financed through matching criteria-based grants.

Figure 5. Sri Lanka: Fiscal Developments, 1994-99
(In percent of GDP)



Source: Data provided by the Sri Lanka authorities.

of domestic debt.[8] In the event, the deficit rose sharply, to 9¼ percent of GDP. This setback was due to both higher-than-budgeted defense expenditures and weaker revenues, especially from the newly introduced Goods and Services Tax (GST). As a result, the current account deficit widened to 2½ percent of GDP, compared with the small surplus budgeted, while bank financing was 2 percentage points of GDP higher than budgeted.

Revenue

33. **The trend decline in total domestic revenue continued in 1998**. Total receipts fell to 17¼ percent of GDP, from a peak of over 20 percent of GDP in 1995. The decline during the year was due entirely to weaker than expected tax revenues reflecting a sharp decline in taxes on goods and services, lower income tax receipts, and weak buoyancy of import duties. As a result, the tax-to-GDP ratio fell to 14½ percent—the lowest level since 1950. In contrast, ***nontax revenues*** rose to 2¾ percent of GDP, spurred by higher property income. ***Foreign grants*** continued to decline, to under 1 percent of GDP.

34. ***Income tax*** receipts, which account for 12 percent of total tax revenue (Figure 6), declined to 2 percent of GDP because of lower corporate tax receipts. ***Personal income tax receipts*** increased marginally in nominal terms reflecting the unification of the tax threshold at Rs 144,000 for all tax payers, the widening of the brackets to Rs 100,000, and the full year effect of the reduction, in 1997, in the withholding tax rate on interest income from 15 percent to 10 percent. ***Corporate tax revenues*** declined in nominal terms owing to reductions in rates applicable to priority sectors such as agriculture, fisheries, livestock and tourism (to 15 percent), investment tax allowances to manufacturing enterprises, and tax incentives to Board of Investment (BOI) enterprises, regional industrialization industries and computer software companies.

35. ***Taxes on goods and services***, declined by about 1 percentage point of GDP to 9 percent of GDP. This setback reflected the combination of the introduction of the GST at a less than revenue-neutral rate, the exclusion of the retail and large sub-sectors from its base (e.g., petroleum), and weaker than anticipated receipts from excise duties, despite some rate increases. The ***GST*** was introduced on April 1, 1998 at the rate of 12½ percent on imports, the manufacturing sector and most services, except financial services which remain subject to the turnover tax (TT).[9] As a result of the low rate, numerous exemptions, and implementation problems, including with the refund system,[10] receipts from the GST were 17 percent lower

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[8]See IMF Staff Country Report No. 98/118, p. 24, for 1998 budget details.

[9]See Annex I and IMF Staff Country Report No. 98/118, Box 1, for details on the GST and turnover tax.

[10]The level of refunds claimed by exporters was substantially higher than projected by the (continued...)

than budgeted in nominal terms, and just under 10 percent lower than the previous year's receipts from turnover taxes (see Box 3).[11] ***Excise duty receipts*** fell short of the budgeted target and failed to compensate fully for the expected decline in TT/GST revenues, rising by 14 percent in nominal terms over 1997, despite rate increases on liquor and petroleum and the imposition of excise duty on all imported private motor vehicles. Though total imports increased by 10 percent in local currency terms, revenues from ***import duties*** grew only by 4 percent, because of the removal of import duties on yarn, fabric, intermediate and capital goods for the textile industry, and exemptions granted to priority sectors, including telecommunications. Lower international prices of major dutiable imports (e.g., petroleum) and a further rationalization of the tariff structure in November 1998 to 5, 10, and 30 percent also contributed. As a result, the average effective import duty rate fell slightly to 7½ percent. Revenues from the ***National Security Levy*** (NSL) rose sharply following the inclusion of the telecommunications sector to the base (in April) and an increase in the rate by 1 percentage point to 5½ percent (in November) to help offset higher-than-budgeted defense spending.

36. ***Nontax revenues*** were buoyed by rising rents from plantations; higher profit transfers and dividends (from the Central Bank of Sri Lanka (CBSL), the Ports Authority, the Ceylon Petroleum Corporation (CPC), and Air Lanka); higher social security contributions following the increase in contribution rates (from 4 to 6 percent); and buoyant revenues from non-industrial (i.e., government department) sales and services.

Expenditure

37. **In 1998 the government extended the progress in further reducing current expenditure and reversed the recent decline in capital spending**. Thus, ***total expenditure and net lending*** remained unchanged over 1997 at 26½ percent of GDP, as a 1 percentage point of GDP reduction in current expenditure was entirely offset by increases in capital spending and net lending.

38. ***Current expenditure*** continued to decline, to just under 20 percent of GDP, although 1½ percentage points of GDP higher than budgeted. In nominal terms, ***wages and salaries*** were budgeted to rise by 7 percent, reflecting the increase recommended by the 1995 Salaries Commission. In the event, wages and salaries rose by over 20 percent, because of a sharp rise in allowances paid to defense personnel. Expenditures on ***other goods and services*** (excluding defense) also rose sharply, although this was partially offset by lower interest payments and

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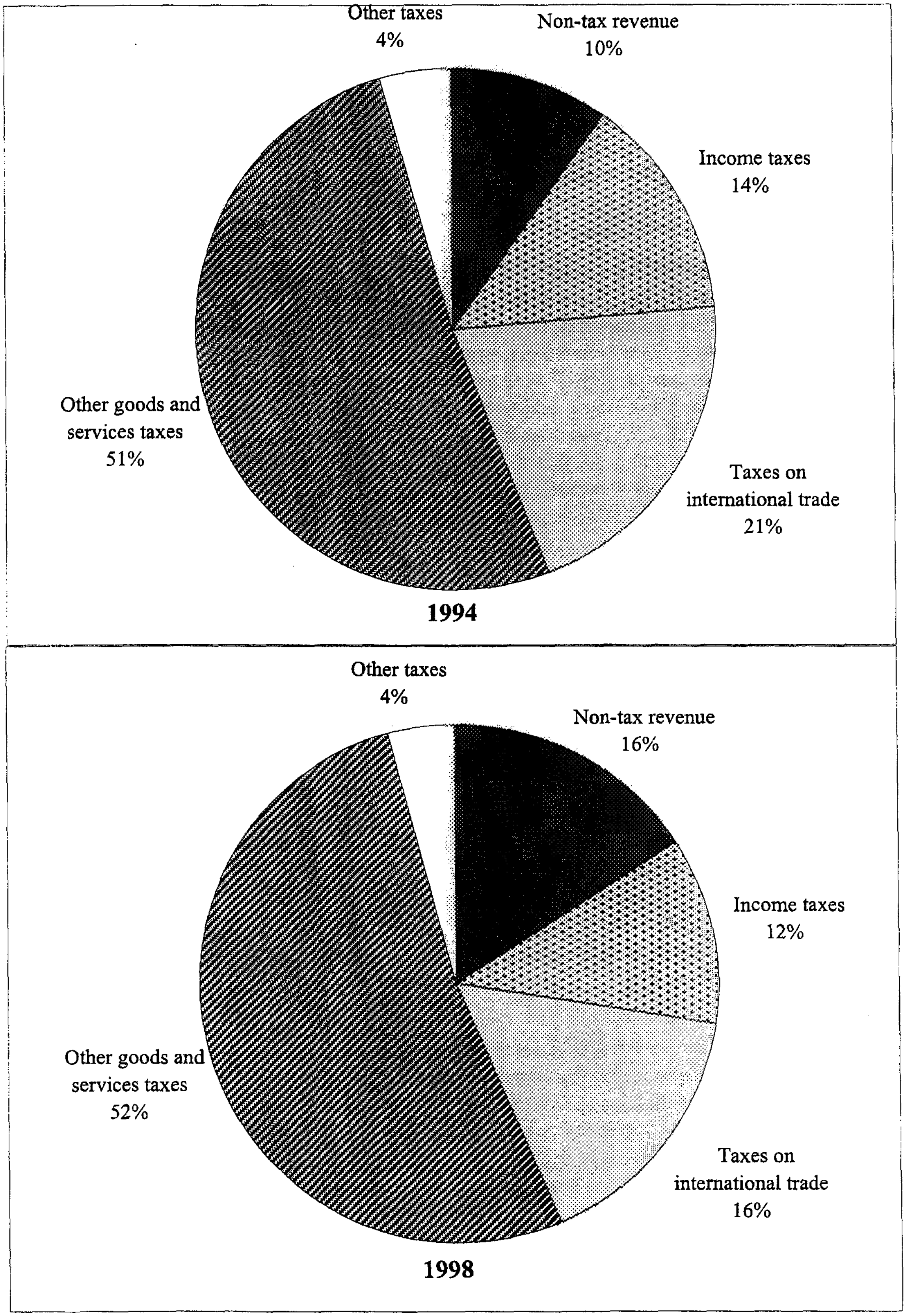
[10](...continued)
Ministry of Finance and continued in 1999. To limit cash flow problems, a system of vouchers was introduced from mid-1999 whereby refund claims could be set off against taxes due rather than settled in cash.

[11]The full impact of halving the turnover tax rate on financial services to 1 percent in 1997 was felt in 1998, further eroding GST/TT revenues.

Figure 6. Sri Lanka: Composition of Revenue, 1994 and 1998
(In percent of total revenue)



Source: Data provided by the Sri Lanka authorities.

Box 3. Issues in the Implementation and Revenue Yield of the GST

Since its introduction on April 1, 1998, the yield of the GST has been below what was hoped. For 1998 as a whole, combined receipts from the GST and the turnover tax were, in nominal terms, 17 percent lower than budgeted and 9½ percent lower than turnover tax receipts the previous year. As the government intends to rely on the GST as the main revenue raising instrument, the following issues in the implementation and revenue yield of the GST will need to be addressed:

The low rate and narrow base

At 12½ percent, the GST rate in Sri Lanka is lower than the average standard rate in many regions of the world, including Europe, Latin America, and the Baltic states and Russia. On the one hand, the single rate structure is an important strength, making implementation more transparent and administration easier. On the other hand, a rate of 12½ percent was never likely to be revenue-neutral without a significant broadening of the tax base. Though inclusion of the retail sector in the base would have required constitutional reform and revenue sharing with Provincial Councils, the base of the tax was narrowed at the outset due to a fairly extensive list of exemptions, including on health care, education, public transport, financial services, primary agricultural products, horticulture, fisheries, animal husbandry and poultry, certain foodstuffs, and a number of major commodities, including petroleum products, sugar, cement, gold, and precious stones.

The low registration threshold

At Rs 1.8 million (US$27,000), the annual turnover threshold for registering for the GST is low compared to other countries (Indonesia: US$51,200; Singapore: US$709,000; Tunisia: US$102,700; Uganda: US$50,000; UK: US$75,400). The low threshold adds an unnecessary administrative burden from processing returns of a large number of small-scale taxpaying entities which contribute little to total GST collections.

The deferral period

Since the introduction of the GST, additional amendments to the GST Law were passed during 1998, extending the period for which GST tax liabilities can be deferred. Under the current system, exporters who are registered and carry out their import activities under the Board of Investment (BOI) as well as exporters who import goods through customs, may defer payment of GST on all imports for a period of up to 60 days. This is twice as long as the initial deferral period. Moreover, there is some evidence that non-exporters are abusing the system by seeking deferral of GST liability on their imports.

The refund system

In the six months to June 1999, GST refunds amounted to just under 40 percent of gross collections. Such a proportion seems higher than warranted. In particular, the fact that exporters can defer payment for 60 days while refunds have to be issued within 30 days, complicates the control of refunds, and probably reduces revenue collected through customs. In addition, procedures for verifying refund claims (particularly from BOI exporters) and preventing credit mechanism abuse are inadequate. From mid-1999 the refund system was amended so that exporters receive vouchers, not cash, redeemable against future tax liabilities.

the containment of total current transfers. In particular, ***interest payments*** on domestic debt declined, reflecting lower average interest rates and the retirement of Rs 10 billion in Treasury bills. Nevertheless, interest payments continued to be a burden on the government, representing over a quarter of current expenditure (Figure 7) and taking up almost a third of total revenue. The growth of ***current transfers and subsidies to households*** was contained in nominal terms by efforts to improve the screening process for Samurdhi recipients, which led to a reduction of 44,700 in the number of beneficiaries and helped offset higher pension outlays as a result of the decision to clear costs of living allowance arrears. Compared with 1997, ***current and capital transfers to public corporations and institutions*** increased by ¼ percent of GDP to 2¾ percent, reflecting revised salary structures of some corporations and institutions, additional transfers to the Mahaweli Authority, and further budgetary support to cover continued operational losses of the railways and the Postal Department. Against this, lower international prices enabled the complete removal of the wheat subsidy to the Cooperative Wholesale Establishment (CWE).

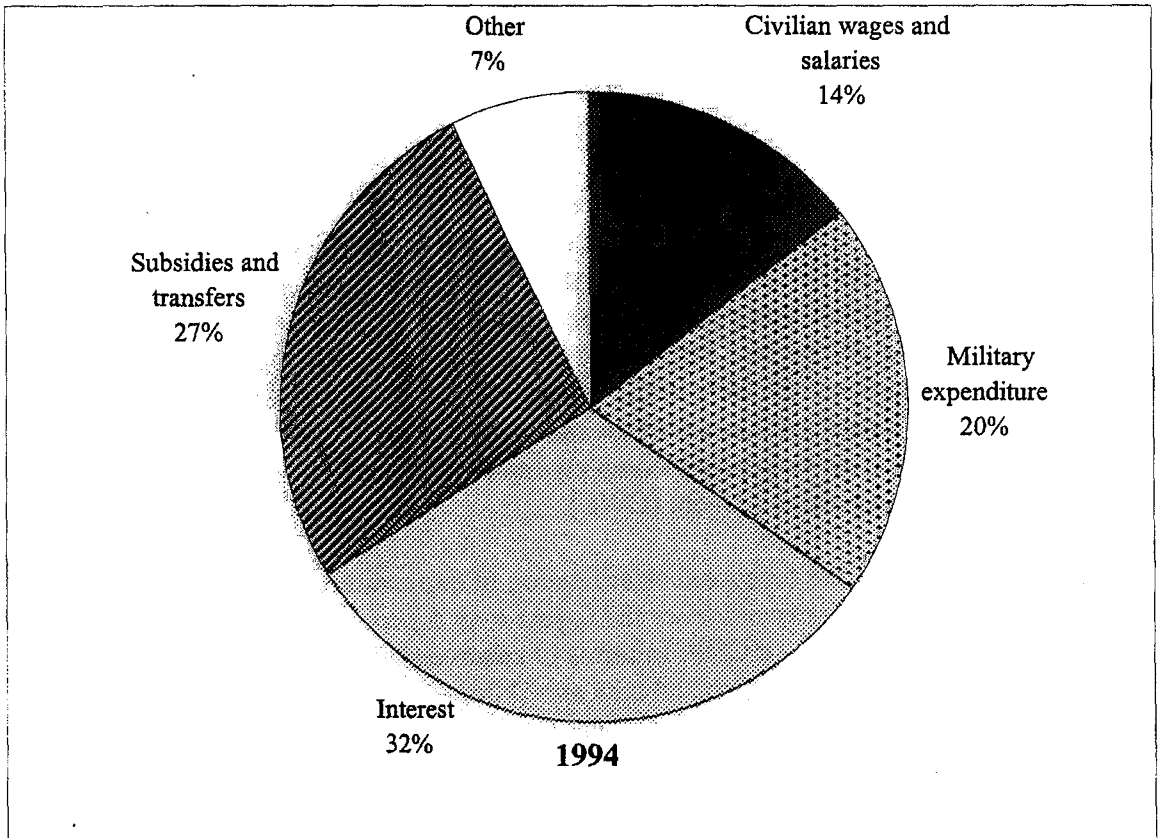
39. With respect to the functional classification of expenditure, from a peak of 6½ percent of GDP in 1995, ***military expenditures*** fell to just over 5 percent of GDP in 1997, but rose again in 1998 to 5¼ percent of GDP. In terms of relative shares in total expenditure, spending on ***social services*** (including health and education) has fallen every year since 1994 to just under 30 percent. However, though the share of expenditure on ***health services*** has remained constant at about 5½ percent, that of ***education*** has risen from 9 percent in 1995 to 10 percent in 1998. The share of spending on ***general public services*** has edged up gradually each year to 27 percent, of which 16 percent is accounted for by defense spending. The shares of ***economic services*** and ***interest*** each represented just over a fifth of total expenditure.

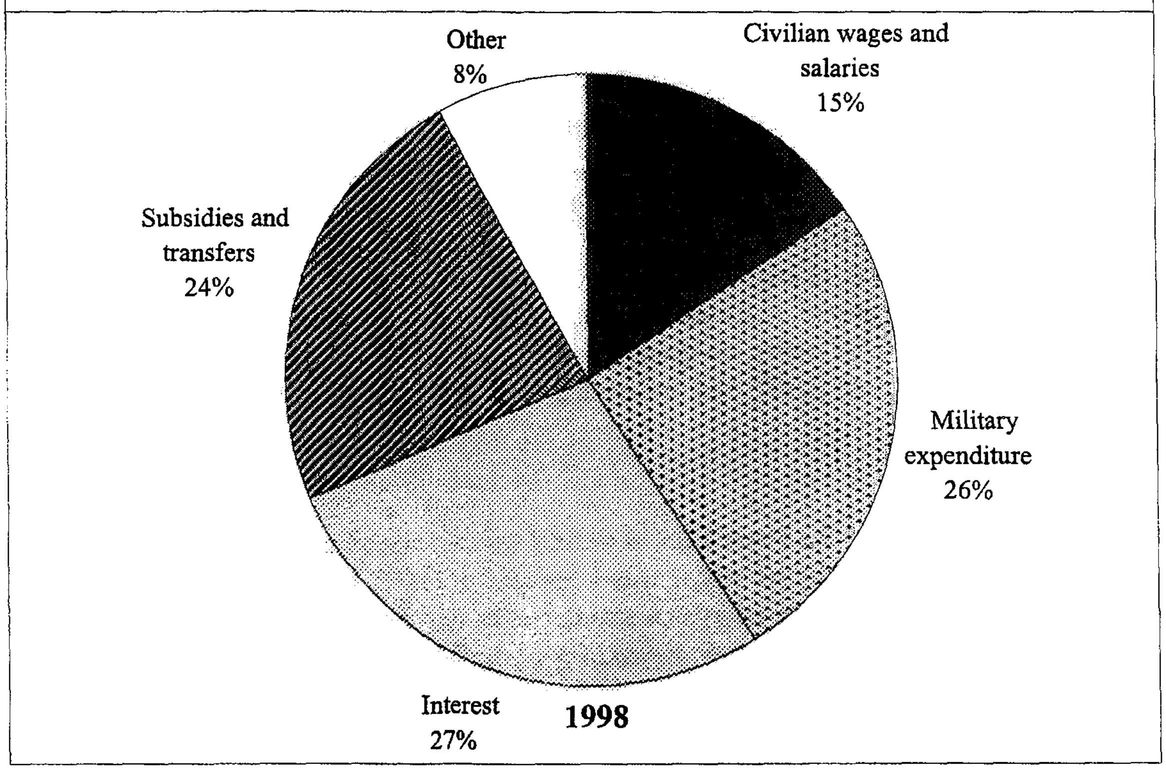
40. ***Capital expenditure and net lending*** increased to just under 7 percent of GDP, in line with budget targets. In a reversal of the previous year's experience, ***capital expenditure*** increased by 22½ percent following sharp improvements in project implementation and the availability of adequate counterpart funds. In particular, capital spending was targeted to the development of agriculture and irrigation, transport and communications, energy and water supply, and the provision of education and health services. ***Net lending*** increased by more than the budget target reflecting on-going power generation and transmission projects of the Ceylon Electricity Board (CEB) and on-lending to the Ports Authority.

Financing and debt

41. **The increase in the overall fiscal deficit was financed domestically.** ***Net external financing*** of the overall budget deficit was 1 percent of GDP, half a percentage point of GDP less than budgeted, while ***foreign grants*** amounted to ¾ percent of GDP, slightly less than budgeted. As a result, total ***domestic financing*** of the budget rose sharply, to Rs 75¾ billion (7½ percent of GDP). Of this amount, ***bank financing*** amounted to Rs 19 billion (2 percent of GDP), including Rs 5½ billion from the Central Bank and a (US$100 million foreign currency) loan from FCBUs (Rs 6¾ billion) towards the end of the year. ***Privatization***

Figure 7. Sri Lanka: Composition of Expenditure, 1994 and 1998
(In percent of total expenditure)





Source: Data provided by the Sri Lanka authorities.

receipts brought in only just under Rs 4½ billion, against the budgeted Rs 8 billion (see below).

42. **Total central government debt rose to Rs 907 billion at end-1998, equivalent to 89 percent of GDP, up from 86 percent of GDP a year earlier**. The stock of ***foreign debt*** rose to 45 percent of GDP, reflecting a substantial increase in liabilities stemming from depreciation of the exchange rate, principally against the Japanese yen. However, 97 percent of the foreign debt, owed for the most part to the Asian Development Bank, the International Development Association, the International Fund for Agricultural Development, and the Japanese, Korean, and German governments, is concessional. As a result of the sharp increase in domestic financing, total central government ***domestic debt*** increased to 44 percent of GDP, up from 43 percent of GDP at end-1997. The share of short-term domestic debt, consisting of Treasury bills, provisional advances, and borrowing from FCBUs, declined slightly to 33 percent. The government continued its policy of extending the maturity structure of government debt, and improving the market orientation in government domestic borrowings with a view to gradually replacing the use of rupee loans with more market-based instruments. With this aim in mind, the stock of Treasury bonds, with maturities of 2, 3, and 4 years, rose from Rs 10 billion to just under Rs 49 billion. In the event, the stock of rupee securities held with captive sources (mainly the government pension funds and the NSB) with maturities of between 4 and 10 years, continued to rise, reaching Rs 251 billion.

The 1999 budget

43. **Against a backdrop of an adverse international environment, the 1999 budget sought to resume the progress in fiscal consolidation and extend economic reforms to help increase production, generate employment, and encourage the development of the debt and capital markets**. Specifically, the budget targeted a further reduction in the overall deficit to 6 percent of GDP through revenue enhancing and expenditure control measures, further tariff reform and reviews of tax laws and customs administration procedures, and various tax incentive schemes in priority sectors (see Annex I).

44. ***Total domestic revenue*** was budgeted to remain at 18½ percent of GDP, the same as in the 1998 budget. Revenue raising measures included an increase in the National Security Levy to 5½ percent (effective November 1998), a new excise duty on all imported vehicles (to compensate for unifying the customs duty at 30 percent), higher excises on liquor and cigarettes, a Rs 750 million levy on the Ports Authority, and increases in various administrative fees and charges for government services. ***Current expenditure*** was budgeted to fall by a full percentage point of GDP below the 1998 budget target to just over 17 percent. This was to be achieved through tighter control on all recurrent expenditures. Wages and salaries were budgeted to increase in line with nominal GDP, while pension payments were projected to decline by Rs ½ billion in nominal terms. Interest payments were budgeted to rise to Rs 51¾ billion in light of the increase in stock of domestic debt during 1998. ***Capital***

expenditure was budgeted to rise to just under 6 percent of GDP, while ***net lending*** was projected to increase slightly to 1¼ percent of GDP.

45. **The magnitude of the fiscal consolidation in 1999 is projected to be less than originally budgeted**. In light of the worse-than-anticipated outturn in 1998, compared to the projections made at the time the 1999 budget was prepared, and actual fiscal performance in the first few months of 1999, the Ministry of Finance and Planning revised its budgetary targets for 1999.[12] Total revenue is now projected to rise to only 17¾ percent of GDP, while current expenditure is anticipated to decline to only 18 percent of GDP. As a result, the current balance is projected to remain in deficit compared with the 1½ percent of GDP surplus originally budgeted, and the overall fiscal deficit is projected to decline only to 7¾ percent of GDP, 1¾ percent of GDP higher than originally budgeted.

Public enterprises and privatization

46. **In 1998, the recent progress in reducing the overall burden of public enterprises on the budget was interrupted**. In particular, while current transfers to public corporations and institutions declined by almost half to Rs 5½ billion (½ percent of GDP) between 1995 and 1997, they rose again to Rs 7¼ billion (¾ percent of GDP) in 1998. Similarly, capital transfers fell by Rs 1 billion to Rs 17 billion (2½ percent of GDP) in 1997, but rose to Rs 20 billion (2¾ percent of GDP) in 1998. The absence of transfers to the CWE and the Shipping Corporation and the reduction, in nominal terms, in transfers to CEB and the Water Supply and Drainage Board was more than offset by higher transfers to the Mahaweli Authority, the Transport Board (for the railways), the Road Development Authority, and the Housing Development Authority. In addition, though the declines in the international prices of wheat and petroleum and adjustments in administered prices in the last couple of years have eliminated the need for subsidies, a flexible pricing mechanism has yet to be adopted for either product and the potential for renewed subsidies remains. In the case of CPC, the lower oil costs enabled a significant improvement in the profitability of petroleum sales, while allowing the continuation of the cross-subsidy for kerosene and diesel. Moreover, the CPC continues to benefit from import duty waivers on petroleum products. Finally, though several public enterprises, institutions, and statutory bodies have been closed or are no longer operating (including the Paddy Marketing Board), their workforce has not been reduced due to difficulties in finding required resources for compensation and remains a burden on the public sector's payroll.

47. **In 1998, receipts from sales of government-owned assets brought in just under Rs 4½ billion in receipts, compared to Rs 8 billion budgeted**. While the government initially targeted the sale of 40 percent of its shares in Air Lanka for US$70 million, only 26 percent of its shares were sold for Rs 2¾ billion (US$45 million). The remainder is to be transferred before end-2000. The government also continued its policy, begun in late 1995, of

[12] Details were published in June 1999 in the Ministry's *Trends in Public Finance 1998.*

disengaging from the plantations sector, divesting itself of 19–39 percent of its shares in seven plantation companies, for a total of Rs ¾ billion. The divestiture of 37 percent of government shares in Orient Lanka brought in Rs ¾ billion in privatization receipts. The intended sale of an additional 10 percent of government shares in Sri Lanka Telecom (for about Rs 3½ billion) was delayed because of a dispute with the joint-partner which has since been settled. The government plans to sell a further 10½ percent stake in Telecom as part of its Rs 8 billion 1999 privatization program.

C. Monetary Developments [13, 14]

48. **Monetary policy has several objectives**. The Monetary Law Act (MLA) assigns the following objectives to monetary policy: (i) the maintenance of the stability of the general level of domestic prices; (ii) the promotion of the stability of the exchange rate of the Sri Lankan rupee in relation to foreign currencies; (iii) the promotion of a competitive, sound and progressive financial system; and (iv) the encouragement and promotion of the full development of the productive resources of Sri Lanka. However, because no clear prioritization is assigned to these objectives and these sometimes conflict, the precise aim of monetary policy in Sri Lanka is sometimes unclear and the policy stance of the CBSL at any given time remains less transparent. As a result, although inflation has fallen over the last eighteen months or so, inflationary expectations remain high. The government has approved amendments to the MLA to make price stability the main objective of the Central Bank and to improve the flexibility of its policy instruments for monetary management.[15]

49. **In its conduct of monetary policy, the CBSL has continued its gradual move toward indirect instruments of monetary control**. In a bid to influence call (interbank) interest rates and broad money growth in line with projected money demand, the CBSL uses as its primary instruments of monetary policy, the overnight repurchase (repo) and reverse repo rates, the discount and rediscount rates in the secondary market for 3-month Treasury bills, and open-market type operations in the primary market for domestic government securities (3-, 6-, and 12-month Treasury bills and 2–5 year Treasury bonds). In addition, the CBSL affects the level of reserve money through the amount of Treasury bills it takes into its own portfolio at the weekly auctions. Because the stock of Treasury bills in the Central Bank was sufficient, the CBSL's own 7-day securities were not used to mop up liquidity in 1998.

50. **Against the backdrop of an uncertain international environment and a weakening fiscal position, monetary policy was moderately tight in 1998**. In the first

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[13]See Appendix Tables 22–27, and Figures 8–10.

[14]For an overview of the financial system, see IMF Staff Country Report No. 98/118, Box 4.

[15]Annex II of this report discusses the advantages and some of the requirements in moving to an inflation targeting framework in Sri Lanka.

quarter, monetary policy remained restrictive owing to pressures on the exchange rate stemming from the uncertainty that had swept across regional financial and foreign exchange markets in the second half of 1997. At the beginning of the second quarter, the monetary policy stance was relaxed somewhat as exchange rate pressures abated and inflation declined, but subsequently was tightened again following renewed uncertainty in the domestic foreign exchange market. In the last quarter, a further easing of inflationary pressures, relative stability in the domestic foreign exchange market, and some concern about the dampening effect that relatively high interest rates were exerting on economic activity, prompted a slight relaxation of the monetary policy stance. However, the extent of the lowering of interest rates was restricted by a weakening fiscal position.

51. **Reserve money growth resumed in 1998–99, fueled by a sharp increase in credit to government** (Figure 8). In contrast to 1997 when it had fallen by 2 percent as a result of the repayment of government debt to the CBSL, reserve money grew by Rs 9¼ billion (11 percent) in 1998 to Rs 93 billion, spurred by an increase in net credit to government of Rs 5½ billion and a build-up in net foreign assets. On the liabilities side, currency in circulation jumped by Rs 7 billion to Rs 60 billion. In the first half of 1999, reserve money growth slowed to 9½ percent on an annual basis, but net credit to government rose by Rs 7¼ billion, through a rise in holdings of Treasury bills and CBSL advances. Since 1997, the money multiplier has remained relatively stable in the 3.9–4.1 range, but jumped to 4.3 in June 1999.

52. **Broad money grew by 13¼ percent in 1998 to Rs 378 billion, in line with the growth of nominal income**. Two thirds of the growth in broad money was caused by growth in net domestic assets. Net foreign assets of the banking system rose by Rs 15 billion through the continued build-up of net foreign assets of commercial banks and as valuation effects from the depreciation of the exchange rate more than offset the decline in the US dollar value of net international reserves of the monetary authorities. As a consequence of the deteriorating fiscal position, net claims on government rose by Rs 19 billion (2 percent of GDP), including a Rs 6¾ billion (US$100 million) loan from foreign currency banking units in December. In contrast, total claims on government corporations declined by Rs 4 billion to Rs 10¾ billion. In particular, despite the absence of any direct budgetary support, loans to the CWE declined slightly, as a result of lower international wheat prices, and lending to the CPC fell by Rs 1¼ billion, as a result of lower international fuel prices and rising profit margins. Loans to Sri Lanka Telecom rose by Rs ¾ billion as part of its development program. Credit to the private sector grew by a modest 11¾ percent, reflecting tighter bank supervision and weaker economic activity, particularly in the export sector.[16]

53. **Broad money growth picked-up in the first half of 1999**. Broad money grew by 14 percent in the year through end-June 1999, fueled in large part by a surge in net credit to

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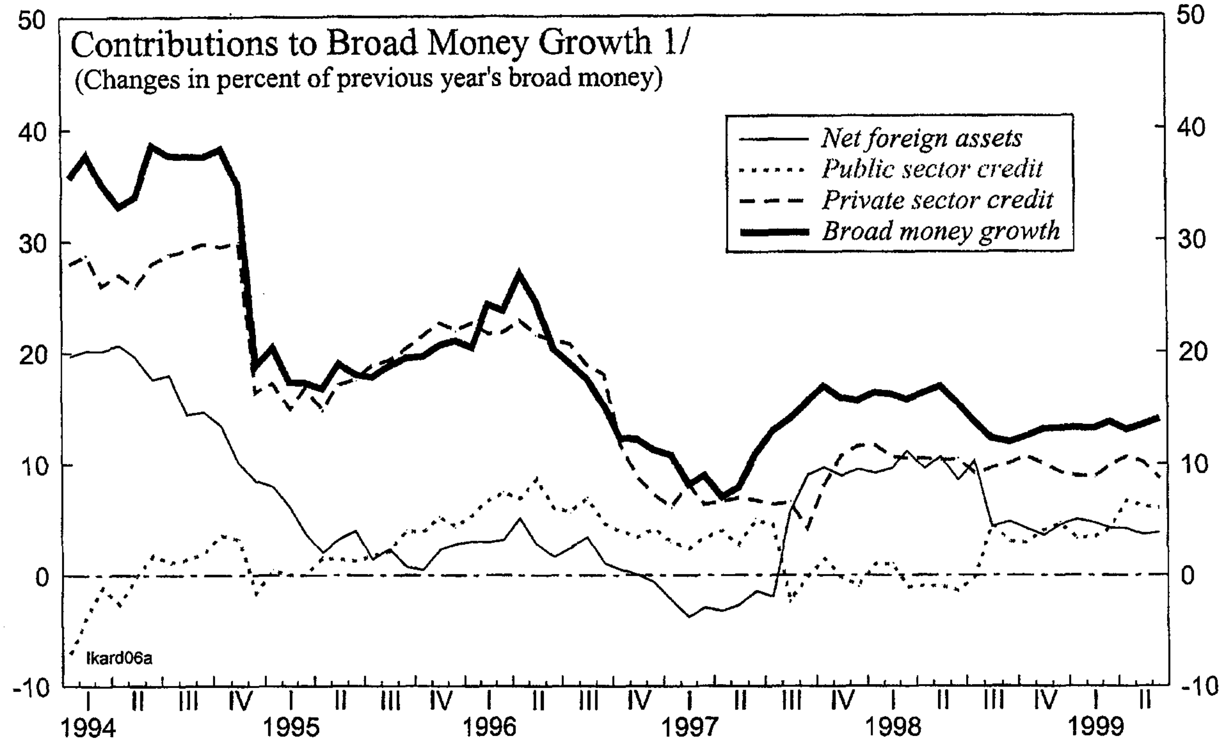
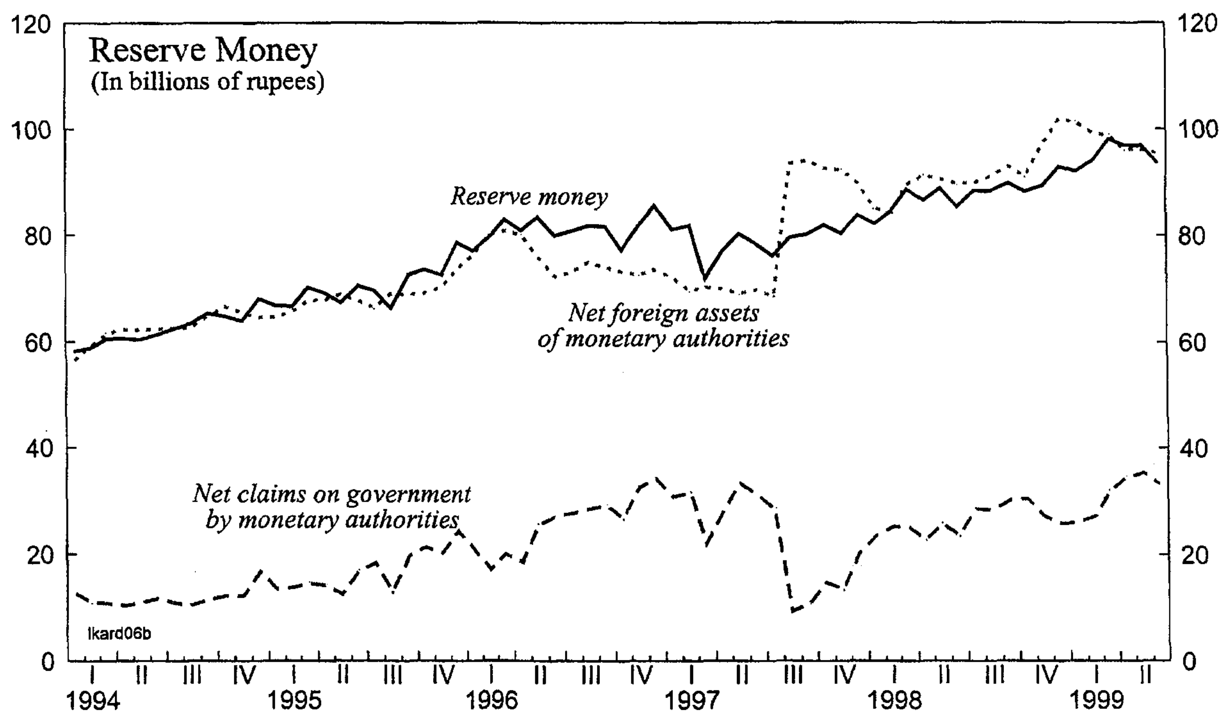
[16]Credit extended by Foreign Currency Banking Units, mainly for trade-related activities, grew by only 7 percent.

Figure 8. Sri Lanka: Monetary Aggregates, 1994-99





Source: Data provided by Sri Lanka authorities.

1/ Broad money includes foreign currency banking units (FCBUs).

government and higher private sector credit (from domestic banking units). During the period, claims on government corporations continued to decline, by Rs 2 billion, mostly the result of sharply lower lending to the CPC. Net foreign assets of the banking system fell by Rs 4¼ billion as the build-up in net foreign assets of commercial banks was insufficient to offset the decline in net international reserves of the monetary authorities.

Interest rates

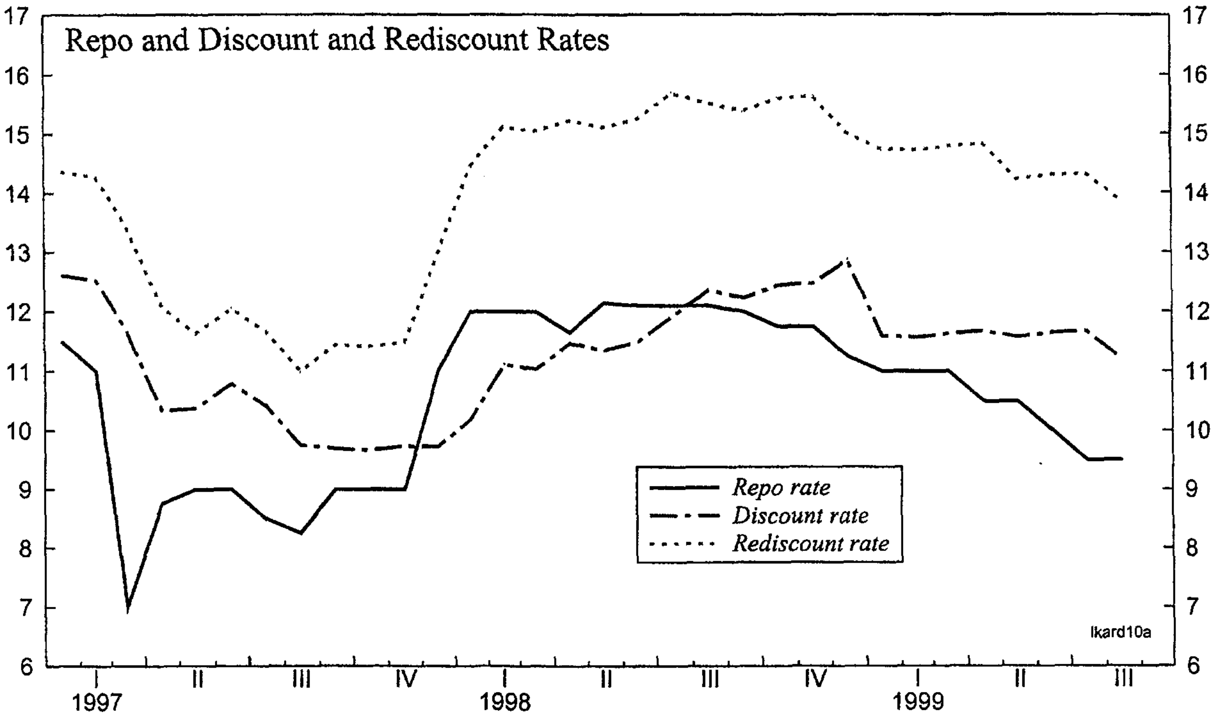
54. **Short-term interest rates firmed during 1998 as a result of the CBSL's somewhat tighter monetary policy stance.** In a bid to raise the minimum interbank call rate and deter any speculative buying of foreign exchange at a time of uncertainty in regional foreign exchange markets, the CBSL raised the overnight repo rate by 300 basis points between December 1997 and January 1998 to 12 percent, and increased the spread between the discount and rediscount rates in the secondary market by 1 percent to 4¼ percent (Figure 9). As speculative pressures eased in response to higher borrowing costs, and inflation continued to fall, the repo rate and the spread were reduced to just under 11¾ percent and 3¾ percent, respectively, by end-April. However, renewed speculative activity thereafter prompted the CBSL to again raise its key interest rate in May, and the repo rate was maintained at or just above 12 percent until October. In the last quarter, following several months of declining inflation and reduced uncertainty in the domestic foreign exchange market, the repo rate was gradually reduced to 11¼ percent by end-December. While the minimum interbank call rate moved in line with the repo rate, the maximum call rate experienced much greater volatility during the year, reflecting temporary bouts of liquidity shortages, peaking at 28 percent in July. In a bid to stabilize the upper end of the interbank call rate, the CBSL re-introduced the overnight reverse repo facility in November, at a rate equivalent to the discount rate at the secondary window (just under 15½ percent). The yield on 3-month treasury bills in the primary market rose in most months, from just under 10 percent at end-1997 to over 12½ percent in November, before falling to 12 percent in December (Figure 10).

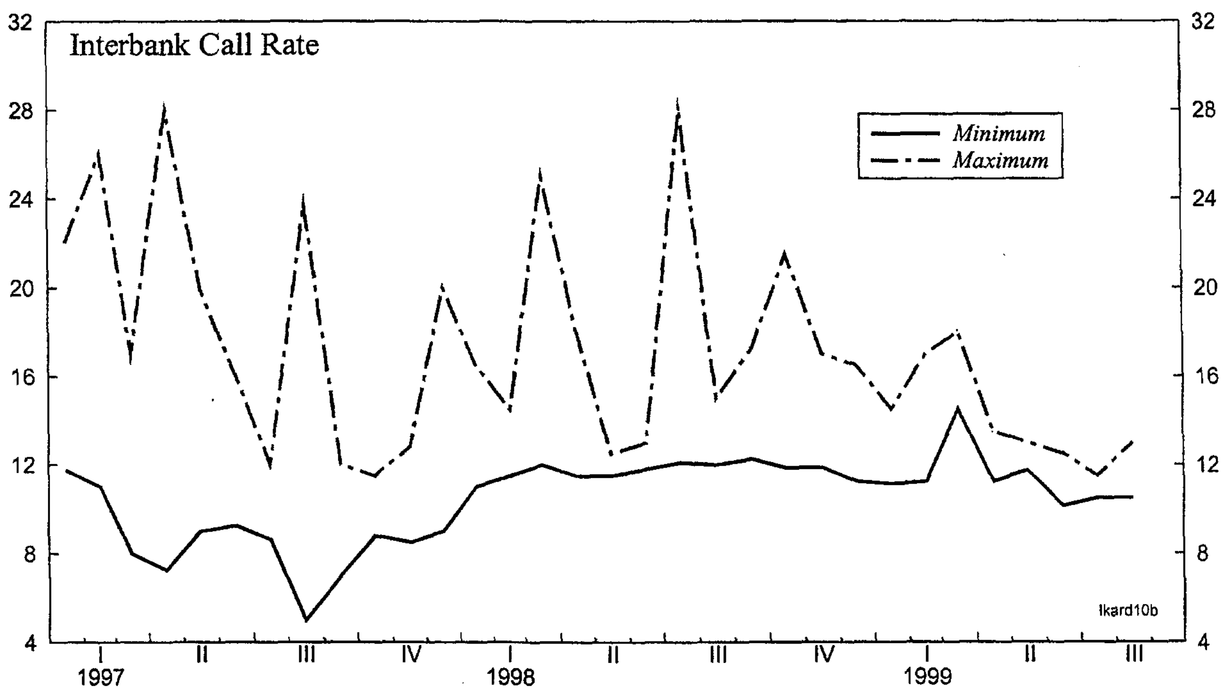
55. **In the first half of 1999 short-term interest rates declined.** Reassured by a return of stability in the domestic foreign exchange market and a continued decline in the average rate of inflation in the first half of 1999, the CBSL gradually reduced the repo rate to 9½ percent and the spread between the discount and rediscount rates to 2.65 percent (in July). Through August 1999, the yield on 3-month Treasury bills declined by only ¼ percent, however, in response to the government's need to finance its operations.

56. **The increase in the spread between commercial banks' average lending and deposits rates in 1998, as a result of lower yields on deposits, was partly reversed in the first half of 1999.** Partly in response to bouts of tighter liquidity in the market as well as concerns regarding the quality of loan portfolios, the average weighted prime lending rate (AWPR), which commercial banks offer their best customers, rose from just under 14¼ percent in December 1997 to 15½ percent in April 1998. After a temporary peak of over

Figure 9. Sri Lanka: Short-term Interest Rates, 1997-99

(In percent)

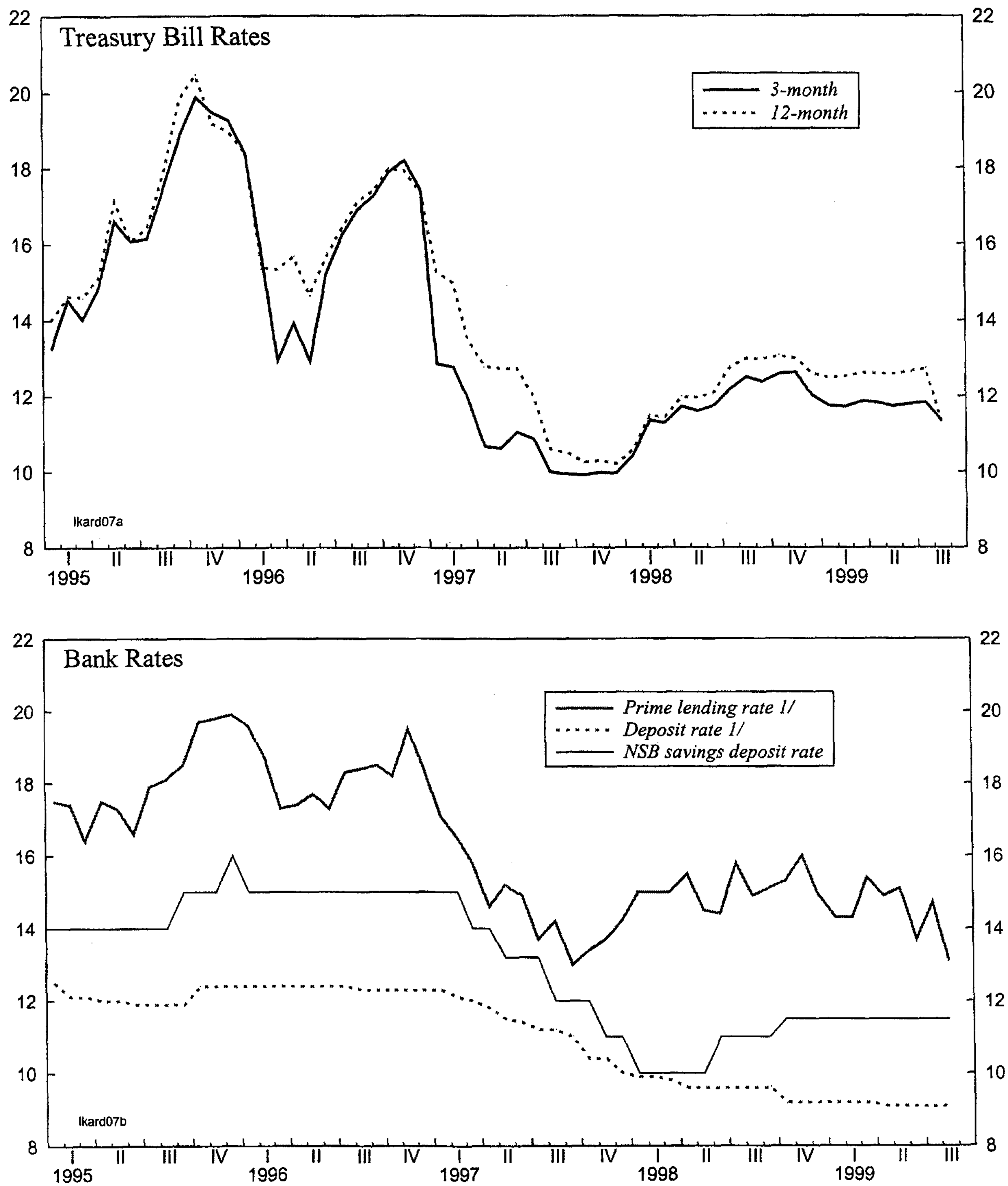




Source: Data provided by Sri Lanka authorities.

Figure 10. Sri Lanka: Other Interest Rates, 1995-99

(In percent)



Source: Data provided by Sri Lanka authorities.
1/ Weighted average.

15¾ percent in July 1998, following a severe bout of liquidity shortage, the AWPR hovered at around 15 percent until the end of the year. In contrast, partly as a result of the decline in deposit rates offered by the NSB, the weighted average fixed deposit rate of commercial banks (AWFDR) decreased gradually from 11½ percent to just under 10¾ percent at end-1998, and banks' profits increased. However, despite declining inflation, the average real deposit rate remained negative before turning positive in August 1998. In the first half of 1999, the spread narrowed as lending rates declined by just under 1½ percent, while average real short-term deposit rates rose.

57. **Long-term interest rates on government securities moved upward during 1998, while rates charged by long-term credit institutions declined**. Long-term interest rates include those on rupee loans, Treasury bonds, and loans of long-term credit institutions. In response to the widening fiscal deficit, interest yields on both rupee loans and Treasury bonds increased during the year. In particular, interest rates on rupee securities rose from 11–11¼ percent at the beginning of 1998 to 12–12¼ percent in the latter part of the year. Weighted average yields on 2-, 3-, and 4-year bonds issues during the year rose to 10¾–14 percent, 12½–14 percent, and 13–14 percent, respectively. In contrast to yields on government securities, interest rates on loans by the all long-term credit institutions decreased by 1–2 percent during the year.[17] Average annual yields on long-term government bonds were steady in the first half of 1999; those on 3-year bonds firmed to just under 13½ percent, while those on 4 year issues declined slightly to just over 13½ percent.

D. Banking System Soundness

58. **The financial condition of the banking sector is a cause for concern**. The results of portfolio analyses on the two state-owned commercial banks—accounting for more than half of the banking system—show them to be weak, and options are now being considered to improve their financial condition. The private domestic commercial banks as a group are in better financial shape, but a sharp drop in provisions relative to non-performing loans suggests increasing fragility. Steady improvements are being made in banking supervision and regulation, and in public disclosure of banking sector performance.

Regulation and Supervision

59. **Banking regulation and supervision have been much strengthened in recent years**. The 1995 amendments to the Banking Act strengthened the regulatory powers of the Central Bank of Sri Lanka (CBSL) and extended its mandate beyond commercial banks to specialized banks, foreign currency banking units, and rural development banks. In 1997, the

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[17]The State Mortgage and Investment Bank (SMIB), the Development Finance Corporation of Ceylon (DFCC), the National Development Bank (NDB), the National Housing Development Authority (NHDA), and the National Savings Bank (NSB).

CBSL's Bank Supervision Department (BSD) issued, for the first time, directives with respect to loan classification, suspension of interest, provisioning, investments in equity, and the acquisition of immovable property; and it tightened its directives with respect to capital adequacy and single borrowers. Subsequently, the BSD expanded its reporting system to be able to monitor compliance, which has generally been good. With the exception of classification and provisioning, all directives are up to international standards.

60. **Despite recent progress, a number of weaknesses remain, both in the regulatory environment and in the capacity of the BSD to effectively supervise the banking system.** As noted, provisioning requirements are not up to international standards.[18] Plans for raising them are facing strong resistance from banks which anticipate problems in making the additional provisions. Also the Domestic Banking Units (DBUs) and Foreign Currency Banking Units (FCBUs) of the commercial banks are not supervised on a consolidated basis. FCBUs are exempt from almost all requirements under the Banking Act, including capital adequacy rules, other prudential regulations, and reserve and liquidity requirements.[19] Furthermore, bank supervision so far concentrates on credit risks and neglects important market risks, such as foreign exchange exposure and maturity risks. BSD is in the process of surveying the banks' foreign exchange exposures in preparation of setting appropriate limits. Finally, the CBSL's authority in dealing with errant institutions is rather limited, a weakness that is being addressed with amendments to the Banking Act.

61. The capacity of the BSD to competently supervise the banking sector is constrained by an inadequate number of qualified bank supervisors. It also needs to improve its computer systems to more effectively process and analyze data it regularly collects from the banks. In both areas, staff training and computerization, BSD is receiving technical assistance but progress is slow. In 1998, BSD focused its efforts on bringing the specialized banks and

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[18]The CBSL allows loans that are past due for up to 89 days to be classified as *performing*; loans that are 90–179 days past due must be classified as *non-performing* but provisions are not required; loans that are 180–359 days past due are *sub-standard* with 20 percent provision, 360–540 days past due are *doubtful* with a 50 percent provision, and more than 540 days past due are *loss* requiring a 100 percent provision. This contrasts with international best practice—as promulgated by the World Bank, among others—which considers only loans that are fully current as *performing*, and classifies loans that are 0–89 days past due as *special mention* with a 2 percent provision, loans that are 90–170 days past due as *sub-standard* with a 20 percent provision, loans that are 180–359 days past due as *doubtful* with a 50 percent provision, and loans over 360 days past due as *loss* with a 100 percent provision.

[19]Conceived in the 1980s as *offshore* institutions, and therefore not subject to foreign exchange controls, the FCBUs are in practice deeply integrated in the domestic economy, borrowing from the DBUs and lending to local non-resident companies, be it only in foreign currency. Besides freedom from regulation, they enjoy tax concessions.

FCBUs within its reporting system. Given the large number of institutions BSD must now cover, prioritization of its activities according to risk has become a major imperative.

62. Standards for the public disclosure of banking sector data were raised considerably over the past year. In May 1998, BSD issued guidelines to external auditors to solicit their support in verifying banks' compliance with prudential regulations. BSD has the sanction of removing a particular auditor from its short list of qualified auditors from which banks must choose. A major step forward in financial disclosure was that the new Sri Lanka Accounting Standards (SLAS) and Sri Lanka Auditing Standards (SLAuS) became law in December 1998. Both sets of standards are solidly based on international standards.[20] Starting with the

Box 4. Financial Sector Regulation and Supervision

Regulation and supervision of Sri Lanka's banking system is the responsibility of the Bank Supervision Department (BSD) of the Central Bank. The legal framework consists of the Monetary Law Act and the Banking Act (both last amended in 1995). BSD subscribes to the Core Principles for Effective Banking Supervision issued by the Basel Committee in 1997. The basic objective of bank supervision in Sri Lanka is to ensure the safety and soundness of the banking system and thereby safeguard the interests of depositors. The CBSL is empowered to issue detailed directives to the country's commercial banks (two state banks; seven private domestic banks; and seventeen foreign banks, all branch offices); the specialized banks (savings banks and long-term lending institutions), the Foreign Currency Banking Units (FCBUs), and the Regional Development Banks (RDBs). The BSD has about 50 examiners for its off-site supervision and on-site inspections. On-site inspections must take place at least once every two years.

The banking system is open to foreign competition in that there is no limit to the number of branches a foreign bank may open. However, foreign ownership of domestically incorporated banks is limited to 40 percent.

Insurance companies are currently regulated by the Controller of the Insurance situated in the Ministry of Finance. According to a pending Regulation of Insurance Industry Bill, that function will be vested in an independent Insurance Board. The Securities and Exchange Commission regulates and supervises all companies listed on the Colombo Stock Exchange, including six commercial and specialized banks and some 20 other financial institutions.

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[20] They are based on the International Accounting Standards and the International Standards on Auditing, respectively, with slight modifications to meet local conditions and needs. The Sri Lanka Accounting and Auditing Standards Act of 1995 vested standard setting with a professional body, the Institute of Chartered Accountants. Monitoring is by the government appointed and funded Sri Lanka Accounting and Auditing Standards Monitoring Board.

1999 accounts, SLAS and SLAuS apply to all large companies, all financial companies and all public corporations engaged in commercial activities.[21] Already BSD had introduced new financial reporting standards for banks based on SLAS 23 that take effect with their 1998 accounts. The new format provides much more information on the banks' risk profile, profitability and available capital, and highlights movements in loan loss provisions, the volume of loans on which interest is suspended, and sectoral concentration of credit risks. Finally, as of January 1999, all banks, including foreign bank branches, must publish their half-yearly financial accounts and audited annual accounts by means of newspaper advertisements.

63. The CBSL expects the banking system to be Y2K compliant well before 2000. Banks are required to disclose their level of compliance. Contingency plans for meeting the likely excessive demand for currency at year-end are being drawn up. In addition, the news media are being used to heighten public awareness.

Financial Condition of the Banks

64. **The financial condition of the banking system has not significantly improved over the past year**. Banks have been adversely affected by the economic slowdown, the disruption of the tea trade, and intensified competition, especially between the private domestic banks. Table 1 presents banking sector indicators, based on quarterly reports by banks to the BSD, averaged for the three categories of banks, namely the state banks, the private domestic banks and the foreign bank branches.[22] To some extent the worsening trends reflect the stricter enforcement of prudential regulations.

65. **The ratio of non-performing loans (NPLs) to total advances continues to be high for all three categories of banks**. The state banks are the worst off, with a ratio of 19¼ percent, followed by the private domestic banks and foreign branches with ratios of 14¾ percent and 11¼ percent respectively.[23] Over the past year the state banks recorded a slight improvement, thanks to government guarantees for some NPLs, but for the private banks the ratio deteriorated. For the foreign banks it deteriorated and then improved thanks to significant write-offs and recoveries. The ratio of net non-performing loans (NNPLs) to total

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[21]In 1997, the Colombo Stock Exchange already imposed SLAS on all listed companies, including banks.

[22]Information prior to 1996 was destroyed in the 1996 bombing of the central bank building.

[23]Bank of Ceylon does not include suspended interest among it non-performing assets, recording it as a memorandum item instead, which reduces its NPL ratio.

Table 1. Sri Lanka: Indicators of Banking System Soundness, 1996–99

	96Q4	97Q1	97Q2	97Q3	97Q4	98Q1	98Q2	98Q3	98Q4	99Q1
Capital adequacy ratios 1/					(In percent; risk weighted)					
Core capital (minimum 4 percent)										
State commercial banks	9.1	9.0	8.7	8.3	8.7	8.1	8.0	8.9	7.6	7.4
Private domestic banks	10.6	9.9	10.3	10.3	10.1	9.6	9.7	9.4	9.9	9.6
Foreign banks	11.4	11.5	12.7	11.6	13.0	12.4	13.0	12.8	14.8	15.1
All banks	9.8	9.6	9.7	9.4	9.7	9.1	9.1	9.5	9.2	9.0
Total capital (minimum 8 percent)										
State commercial banks	10.7	9.2	9.0	9.1	9.2	8.6	8.5	9.4	8.2	7.7
Private domestic banks	11.8	10.7	11.2	11.2	10.9	10.6	10.6	11.4	12.3	11.9
Foreign banks	13.8	11.5	13.2	13.6	13.9	12.6	14.3	14.5	13.9	14.7
All banks	11.5	10.0	10.2	10.4	10.4	9.7	9.9	10.6	10.2	9.9
Liquid assets ratio 1/					(In percent)					
State commercial banks	23.3	25.0	25.4	25.0	26.9	26.6	27.6	27.3	28.5	30.6
Private domestic banks	26.2	25.1	25.7	27.6	24.9	22.9	23.7	23.0	25.1	25.7
Foreign banks	26.9	32.4	34.4	29.2	33.6	40.2	33.2	35.7	36.6	38.8
All banks	24.6	26.1	26.6	26.4	27.1	27.0	27.0	26.8	28.3	29.8
Nonperforming loans					(In percent)					
Nonperforming loans/total advances										
State commercial banks	18.9	18.4	18.5	21.1	20.2	20.7	19.6	20.2	19.5	19.3
Private domestic banks	12.0	12.3	12.8	13.7	12.4	12.8	12.9	13.2	13.4	14.7
Foreign banks	8.3	8.6	10.4	9.2	10.4	11.6	10.6	12.7	12.7	11.3
All banks	15.4	15.2	15.7	17.2	16.4	16.9	16.3	17.0	16.6	16.8
Net-nonperforming loans/total advances 2/										
State commercial banks	7.2	6.9	7.5	9.7	10.0	10.5	9.9	10.2	9.1	9.8
Private domestic banks	7.2	6.6	6.9	7.6	6.4	6.5	7.1	6.5	6.9	8.1
Foreign banks	3.7	3.2	3.9	2.6	4.0	3.7	3.0	4.6	4.8	2.7
All banks	6.7	6.3	6.8	8.0	8.1	8.3	8.2	8.3	7.9	8.4
Net-nonperforming loans/capital 2/										
State commercial banks	116.2	115.7	109.7	127.4	142.4	147.2	116.0	125.7	109.8	117.0
Private domestic banks	80.0	78.4	83.1	87.9	75.1	76.9	82.5	84.2	84.9	98.1
Foreign banks	16.4	17.2	19.9	12.0	21.7	8.1	8.4	21.1	28.6	18.0
All banks	91.7	90.7	90.2	99.2	105.1	106.9	92.1	99.7	92.0	99.7
Provisions/nonperforming loans 3/										
State commercial banks	...	...	61.2	57.8	53.7	52.2	53.8	52.0	58.8	52.8
Private domestic banks	...	...	101.7	61.1	64.9	62.4	71.7	68.9	52.5	49.7
Foreign banks	...	...	74.0	81.4	73.2	75.6	71.0	64.0	90.1	104.9
All banks	...	...	75.1	62.1	59.9	58.5	61.8	59.1	60.2	57.3
Total advances					(In percent of total)					
State commercial banks	56.6	55.7	56.9	55.3	54.8	54.4	54.9	54.6	54.2	54.0
Private domestic banks	29.6	30.3	30.4	30.9	32.1	33.7	33.2	34.1	34.5	35.2
Foreign banks	13.8	13.9	12.6	13.9	13.0	11.9	11.9	11.4	11.3	10.8
All banks	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(Percent annual growth)										
State commercial banks	...	-2.7	0.0	-7.9	9.7	7.7	9.0	14.7	13.0	14.7
Private domestic banks	...	27.6	25.9	16.2	23.0	22.6	23.1	28.2	22.8	20.7
Foreign banks	...	19.3	12.8	15.2	6.7	-5.5	6.0	-4.9	-0.3	4.9
All banks	...	7.9	8.3	1.4	13.2	10.4	12.9	16.1	14.4	15.5
(Percent quarterly growth)										
State commercial banks	-10.4	2.1	4.1	-3.2	6.6	0.3	5.3	1.9	5.1	1.7
Private domestic banks	5.8	6.3	2.3	1.0	11.9	6.0	2.7	5.2	7.2	4.2
Foreign banks	9.0	4.5	-7.5	9.3	0.9	-7.4	3.8	-1.9	5.8	-2.7
All banks	-3.7	3.7	1.9	-0.3	7.5	1.1	4.3	2.5	5.9	2.1
Memorandum items:										
All banks (In percent)										
Nonperforming loans/total assets	8.7	8.3	8.1	8.3	8.7	8.6	8.6	8.6	8.8	8.8
Net nonperforming loans/total assets	2.7	3.6	3.4	3.6	4.1	4.2	4.2	4.3	4.3	4.2
Nonperforming loans/GDP	4.4	4.2	4.1	4.2	4.4	4.4	4.4	4.3	4.4	4.5
Net nonperforming loans/GDP	1.4	1.8	1.7	1.8	2.1	2.2	2.2	2.2	2.2	2.1

Source: Central Bank of Sri Lanka; based on quarterly bank reporting.

1/ Weighted by total advances.
2/ Net nonperforming loans are defined as nonperforming loans *less* provisions and accrued interest.
3/ Specific provisions plus accrued interest over total non-performing loans.

advances also increased for the private banks.[24] NNPLs continue to exceed capital for the state banks, and now equal capital, for the private domestic banks—presenting a risk to solvency and suggesting an urgent need for an infusion of new capital.

66. **Domestic banks are provisioning at about half the rate of foreign banks, as shown by the ratio of provisions to NPLs.** This ratio has dropped steeply since 1997, indicating increasing problems in absorbing loan losses. Assuming that foreign banks face the same losses on their NPLs as domestic banks, and that their provisioning is in line with international best practice, this large difference in ratios suggests that the domestic banks are seriously under provisioned.[25] Most foreign branches, at the insistence of their home supervisors, make general provisions against performing loans, while Sri Lankan banks do not.[26]

67. Domestic banks, both state and private, are experiencing an erosion of their capital base. Their risk-weighted capital adequacy ratio (CAR) based on core capital has been declining since 1996. For the state banks it reached 7¾ percent on average by 1999Q1. One state bank, with a ratio of 6 percent, is well below the minimum of 8 percent mandated by the CBSL, whereas the other state bank, with a ratio of 9 percent, is still above, but for both the trend is down. Retained profits are clearly insufficient to offset loan loss provisions. For the private domestic banks the ratio was 12 percent in early 1999. The foreign banks strengthened their capital adequacy and reached a CAR of 14¾ percent. So far reliance on tier-two capital is very small and consequently the core and total CARs follow largely similar patterns. But in 1998, several private domestic banks took the novel step of raising tier-two capital by issuing subordinated debt, increasing their CAR based on total capital.[27] The CBSL has proposed to the banks an increase in the minimum capital adequacy standards, to 5 percent for core and 10 percent for total capital, but the timetable is unclear.

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[24]Net non-performing loans are defined as NPLs minus provisions and accrued interest.

[25]If, as is suggested, domestic banks lend more against collateral than do foreign banks, this could explain part of the difference in ratios, but not the trend.

[26]In addition to *host* country supervision by the CBSL, foreign bank branches are subject to *home* country supervision. Some 85 percent of foreign branches in Sri Lanka (weighted by assets) have their head office in an industrial country.

[27]To be eligible for tier-two capital, subordinated debt must be of at least five-year maturity. In fact, all debt issued was for exactly five years, and BSD is amortizing the amount by one-fifth every year for capital adequacy purposes. Since the subordinated debt is tradeable, the differential prices quoted offer a market assessment of the soundness of the banks in question.

State Commercial Banks

68. **Despite a gradual loss in market share, the two state commercial banks, the Bank of Ceylon (BOC) and the People's Bank (PB), continue to dominate banking, making up a little over half of all assets and liabilities.** It is clear from the analysis above that they are considerably weaker than the banking system on average. Much of that is due to past government interference, especially with board and management appointments, dividend policy, credit activities, investments, recruitment and remuneration.

69. Twice in recent years these two banks have benefited from official support operations. In 1993, they were recapitalized at a cost of 3½ percent of GDP in order to meet the new capital adequacy requirement. Unfortunately, lending practices did not improve, and, especially in 1994 there was an upsurge in politically motivated lending, sometimes with explicit government guarantee. The guaranteed lending turned non-performing, forcing the government in 1996 to support the banks by placing interest earning bonds equivalent to 1¾ percent of GDP.

70. Concerned that losses might again be accumulating, the government asked the banks in 1998 to carry out diagnostic reviews. Two teams of international auditors were engaged for this purpose—financed by a World Bank loan—who submitted their reports in June 1999. After a thorough examination of the loan portfolios—reviewing all large loans individually and smaller loans on a sample basis, and applying international standards for classification and provisioning—the auditors concluded that as of end-1998 both banks were seriously under provisioned.

71. Privatization of the state banks, widely recommended as the preferred approach to restoring commercial viability, is not politically feasible at present. Instead the Government tightened in 1998 the performance agreements that were put in place at the time of the 1993 recapitalization. The new State Bank Agreements signed in July 1998, by the Secretary to the Treasury on behalf of the Government, and by the members of the Supervisory Boards and Senior Management on behalf of the banks, spelt out reciprocal commitments.[28] The banks' management teams agreed to aim for specific operational targets, and the Government agreed to respect the banks' operational autonomy.

72. The Agreements required the banks to report regularly to the CBSL which is in charge of monitoring implementation. According to a first appraisal carried out in early 1999, the Agreements had scored little success. The banks failed to reach five out of six specific operational targets, namely return on assets, return on equity, staff costs to average assets, total overhead costs to average assets, and rationalization of branch network; the only target

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[28]The Agreements are often referred to as Memoranda of Understandings (MOUs)

met was recoveries of nonperforming advances.[29] BOC performed much better than PB, and only narrowly missed the targets for staff costs to average assets and total overhead costs to average assets. The 1999 targets were relaxed in light of the 1998 outcomes. The Government continues to consider its options as to how best to improve the financial condition and operating efficiency of the state banks. It has publicly raised the possibilities of privatizing management, and selling a portion of the shares to the public.

E. Balance of Payments and External Debt[30]

Overall developments

73. Sri Lanka's overall balance of payments in 1998 recorded a surplus—albeit smaller than in 1997 (¼ percent of GDP in 1998 versus 1 percent of GDP in 1997) (Figure 11). The worsening of the surplus was mainly a result of the decline in the capital and financial accounts surplus (from 4.0 percent of GDP in 1997 to 2½ percent of GDP in 1998), which more than offset the improvement in the current account deficit (from 3 percent of GDP in 1997 to 2¼ percent of GDP in 1998). Gross international reserves fell by US$45 million. Total external debt rose from US$8.2 billion to US$8.8 billion during 1998, with the bulk of the remaining of a concessional nature.[31]

Current account transactions

74. **The current account deficit fell from US$438 million in 1997 to US$345 million in 1998**. The decrease in the deficit was mainly due to a continuing decline in the trade deficit and an increase in private transfers (mostly from U.N. compensation offered to migrant workers displaced by the Gulf War), though this was partially offset by a fall in service and income balances.

75. **The trade deficit shrank from US$1.2 billion in 1997 (8 percent of GDP) to US$1.16 billion in 1998 (7½ percent of GDP)**. Although export growth outpaced import growth, the rate of growth in value terms in 1998 (2 percent in export and ½ percent in

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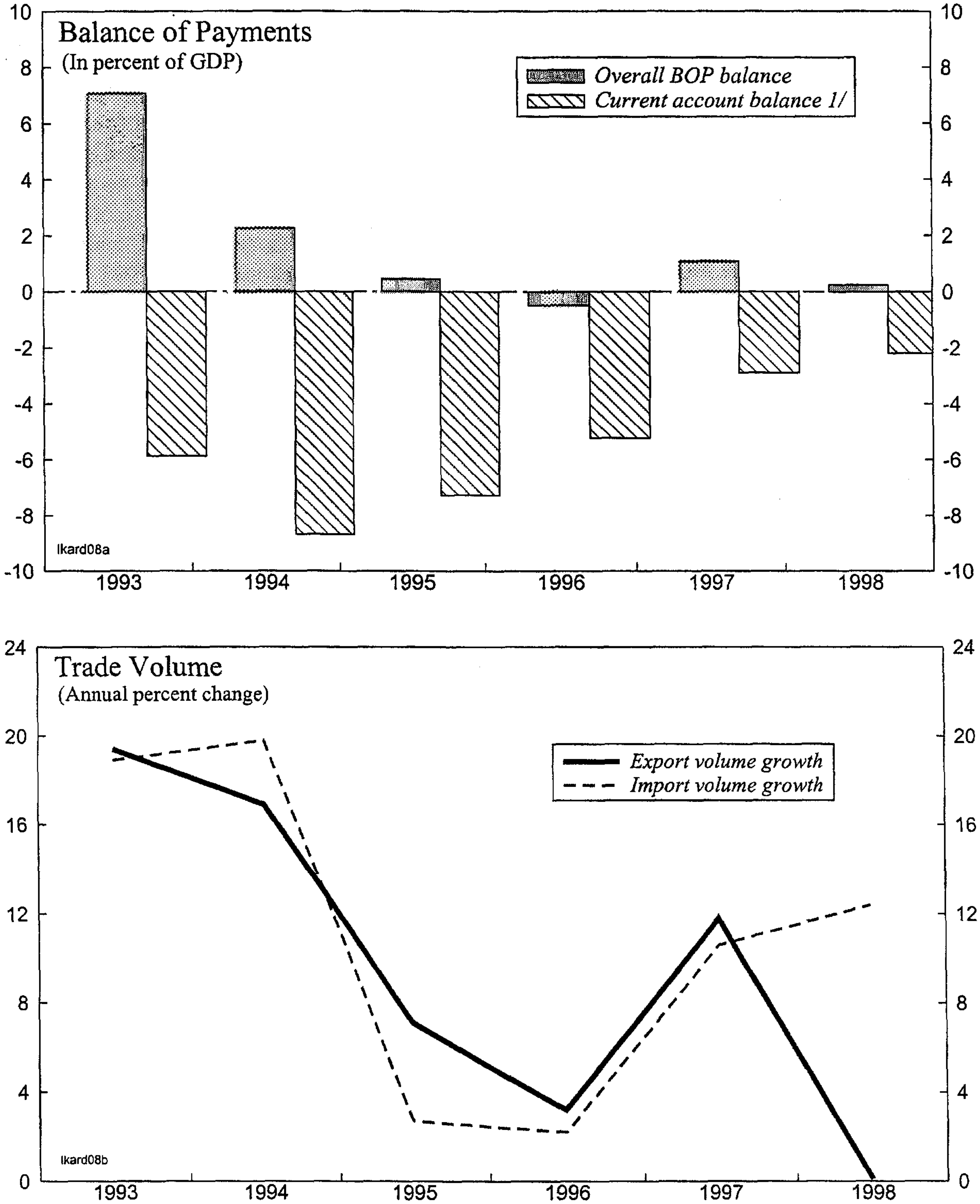
[29]In 1998, BOC recovered Rs 1.9 billion and PB Rs 2.8 billion; this included loans to textile companies, which the Government decided to guarantee.

[30]See Appendix Tables 28 to 40 and Figures 11 and 12.

[31]In the published balance of payments for this report, data reflect the change in the treatment of the Foreign Currency Banking Units (FCBUs). Previously, FCBUs were treated as nonresidents or off-shore units. From 1994 onwards, FCBUs have been treated as a part of the domestic banking system. Therefore, transactions between the FCBUs and residents have not been included in the statistics of the balance of payments.

Figure 11. Sri Lanka: External Sector Indicators, 1993-98



Source: Data provided by Sri Lanka authorities.
1/ Excluding official transfers.

import) was much lower than in 1997 (13 percent in export and 8 percent in import). Low export performance in 1998 was the result of slow growth in textiles and garments and tea and the negative growth in traditional exports other than tea (rubber, coconut and gems), which were affected by lower global aggregate demand and enhanced competition from South and East Asian countries. Textiles and garments, the largest export sector, which began to slow down in late 1997, showed a recovery in the first half of 1998 but slowed down again in the second half of that year. Tea, the second largest export sector, performed well in the first half of 1998 with a record high production and price hikes. After August 1998, however, tea prices fell due to the Russian currency crisis (Russia being the largest tea importers from Sri Lanka) and a worldwide production surplus. Cumulative growth in tea exports, which reached 33 percent in the first half of 1998, fell to 8 percent during the second half of 1998.

76. Growth of import values was only ½ percent in 1998, as a 12 percent growth in import volumes was offset by an 11 percent drop in import prices. Consumer goods imports slightly increased owing to an expansion in the durable goods sector (mainly motor cars and motor cycles), which were more than offset by the declines in rice, wheat and sugar. (These declines reflect a recovery in rice production, the lower international price of wheat and sugar and the termination of a preferential duty treatment granted on sugar in 1997.) Intermediate goods imports—such as petroleum and fertilizers—declined as a result of a substantial reduction in international prices that negated the growth of import volumes. Investment goods increased by more than 10 percent while benefitting from lower international prices. (Growth in this area was mainly in the garment and textile machinery sector, data processing machines, tractors, telecommunication equipments, transport van/buses and building materials.)

77. Trade with the European Union and the United States—Sri Lanka's main partners—remained basically unchanged, although reliance on exports to the latter increased. Exports to East Asian countries declined, but this was offset by an increase in exports to Middle Eastern countries. The sources of imports continue to be diversified, with Asia (including Japan), accounting for about 60 percent of total imports in 1998.

78. **The service account surplus deteriorated from US$159 million in 1997 to US$143 million in 1998, mainly due to a slowing down in port-related services**. Receipts from port-related services grew slowly due to a sluggish increase in import and export transactions and a decline in transhipment trade handled by ports, while payments in transportation services increased due to increased freight charges.

79. **Income accounts have been in a deficit since 1993, growing from US$160 million in 1997 to US$179 million in 1998**. This was as a direct result of the lower foreign investment income of the Central Bank due to a volatile investment climate and lower international interest rates. **Private transfers rose by 8 percent in 1998**. Worker remittances as well as compensation payments, grew. In the latter case, US$78 million came from United Nations compensation payments to migrant workers employed in Kuwait for losses incurred during the Gulf War.

Capital and financial account transactions

80. **Capital transfers fell over the last three years, with an inflow of US$61 million in 1998**. The decline reflects a reduction in the flow of concessional assistance.

81. **The financial account declined significantly (by US$182 million) to US$333 million in 1998**. This was mainly due to lower privatization proceeds (US$45 million from the sale of a 26 percent stake of Air Lanka in 1998 compared to US$300 million in 1997) and increased outflows of private and government long-term payments (advance payments by Air Lanka toward purchase of aircraft in 1999 and 2000 under its refleeting programme). Foreign direct investments (FDI) slightly increased to US$137 million in 1998. FDI flows were for telecommunication (the share within FDI is 55 percent), power (19 percent) and rubber manufacturing (6 percent).

82. Portfolio investments recorded a net outflow of US$24 million in 1998 from a net inflow of US$13 million in 1997, reflecting more sales in the Colombo Stock Exchange (influenced by the Asian crisis and more specifically, dampened by the nuclear testing of India and Pakistan in May 1998).

External debt

83. **Sri Lanka's outstanding external debt increased from 54 percent of GDP in 1997 to 56 percent of GDP in 1998**.[32] Medium and long-term debt (including the IMF) also increased from 51 to 53 percent of GDP during this period. In terms of exports of goods and services, the external debt rose from 148 to 155 percent while debt service payments changed only marginally from 13¼ –13½ percent.

84. Much of the increase in this ratio is a result of exchange rate movements during this period, in particular—the strengthening of the Japanese yen against the U.S. dollar. In nominal terms, government debt, which comprised about 80 percent of the total outstanding debt, increased by 8¾ percent while government guaranteed debt of the public and private sector rose by 8 percent. The increase in the latter was due to a floating rate note issue (US$65 million) raised by DFCC Bank.

85. Short-term debt relative to GDP marginally declined from 3¼ to 3 percent. In U.S. dollar nominal terms, it increased by 2 percent mainly due to borrowing by BOI

[32]Since the treatment for the Foreign Currency Banking Units (FCBUs) was changed from off-shore banking units to the domestic banking system, the outstanding external debt declined by 5 percent of GDP in 1998 under the new definition.

enterprises. These borrowings are largely suppliers' credits to the export processing industries and trade credits to the CPC.

Exchange and trade system

86. Sri Lanka's exchange system changed little in 1998. Sri Lanka accepted the obligations of Article VIII, Section 2, 3, and 4 on March 15, 1994, and maintains an exchange system free of restrictions on current international transactions. Capital inflows are largely unrestricted.

87. For most of 1998, the Central Bank of Sri Lanka pursued an exchange rate policy aimed at recapturing most of the competitiveness lost during the sharp devaluations of the Asian crisis countries in 1997 (Box 5 describes the authorities' exchange rate policy), and the rupee depreciated by 12 percent in real effective terms during the year (Figure 12). Nevertheless, in the eighteen months to mid-1999, the commercial banks' spot rate repeatedly bumped against the selling rate despite sales by the CBSL amounting to over US$200 million.

88. **Substantial steps were taken in the trade policy regime in Sri Lanka in 1998.** The Presidential Trade and Tariff Commission (PTTC) recommended in July 1998 that prevailing tariffs should be reduced and a two-band tariff system be introduced in two stages. Three non-zero rates of 10, 20 and 35 percent which were introduced in 1996, were replaced by a new three-band system of 5, 10 and 30 percent in November 1998. Further consolidation towards a two band system is expected to commence in 2000. A few items such as sugar, tobacco and liquor remain outside the three-band tariff system. The number of items on the list of duty exemptions was increased from 26 to 39—some of the new items being pharmaceutical products, vegetable and fruit juices. To establish a simple and transparent tariff structure, duty waivers on imports were limited (e.g., a duty waiver on items as rice, power generators, LP gas and petroleum products was removed). The effective import duty collection rate continued to fall from 7¾ percent in 1997 to 7½ percent in 1998, reflecting decreases in duty rates and dutiable imports in relation to total imports, especially in intermediate and investment goods.

89. Licensing requirements on imports and exports remained basically unchanged in 1998.[33] The licensing requirements on wheat and meslin and wheat and meslin flour remained, due to the Government's contractual obligation to supply grain to a particular flour mill company. Some restrictions relating to import transactions were relaxed, including the enhancement of the upper limit on advance payment for imports, from US$3,000 to US$7,500. (Sri Lanka also maintains export quotas on textile and apparel used to implement bilateral quotas under the Multi-Fiber Arrangement.)

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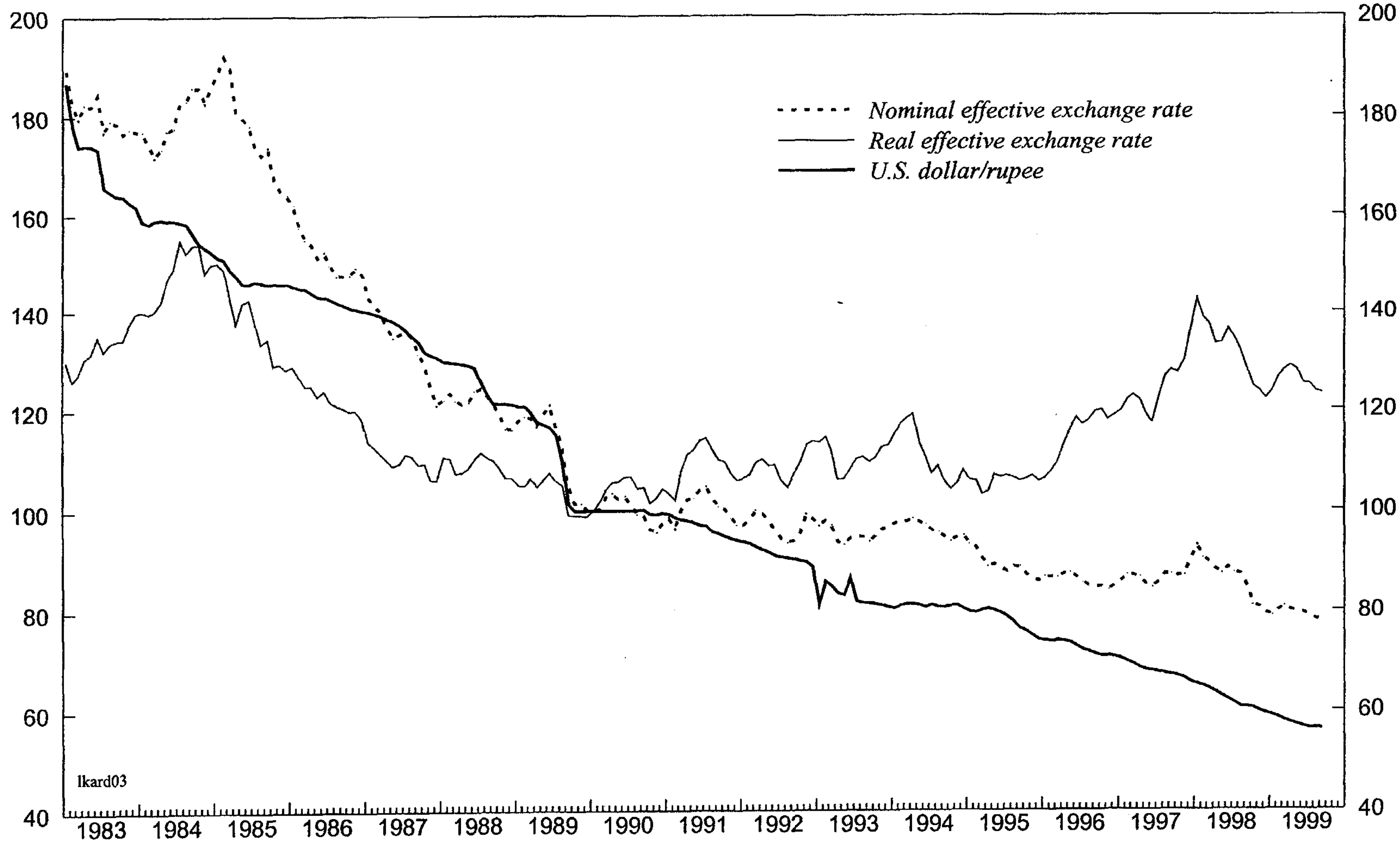
[33]With the objective of environmental protection and preservation of antiques, there are four minor export licensing requirements on: (i) ivory; (ii) coral; (iii) certain wood and wood products; and (iv) passenger motor vehicles first registered in Sri Lanka before 1945.

Figure 12. Sri Lanka: Exchange Rate Indices, 1983-99 1/

(Indices: January 1990=100)



Sources: IMF, International Financial Statistics; Information Notice System; and staff estimates.

Box 5. Exchange Rate Policy—How the Float is Managed

Sri Lanka's exchange rate regime falls in the category of *managed floats*. The Sri Lankan rupee has been floating since 1977. The rupee exchange rate is basically determined by demand and supply in the foreign exchange market, but the Central Bank of Sri Lanka (CBSL) attempts to guide and smooth it on a path towards a medium-term target that maintains export competitiveness. The Bank does not provide forward exchange cover.

At the beginning of each trading day, the CBSL announces the rupee rates at which it is prepared to buy or sell US dollars, which is its only intervention currency. Since 1995 these rates have been two percentage points apart. Banks are free to trade at any rate but will usually turn to the CBSL when they find the intervention rates advantageous. Thus, the *intervention band* limits intra-day volatility to two percentage points.

The CBSL intervenes only passively; it responds to bids or offers but does not initiate trades. While officially banks may only buy from or sell to the CBSL for trade-related purposes, this is not strictly enforced nor enforceable. On occasion banks will prefer to trade in the market at rates outside the band. Daily information on CBSL *interventions* is being published.

The intervention band is neither preannounced nor predetermined. The way it is adjusted from day to day is the crux of the managed float. In deciding on its medium-term path, one important input for the CBSL is an internally produced *real effective exchange rate* (REER) index for 24 trading partner countries—published in graph form in the Annual Report—which reflects competitiveness. The policy is to avoid any large trend appreciations, but just as important in judging competitiveness is the actual *performance of the export sector*. Meanwhile the daily setting of the intervention band is guided by an alternative REER index, for a smaller group of countries but kept up-to-date with inflation projections. The daily changes in the dollar-rupee rate necessary to keep this REER index stable are dominated by movements in the *dollar-yen cross rate*, the two currencies with the largest weights. Finally, the way the CBSL pursues its *medium-term target* is by routinely depreciating more and appreciating less than those daily calculations indicate. How much more or less depends, among other things, on behavior of the market exchange rate.

Given the shallowness of the market, the best measure of the *market exchange rate* is a rate the CBSL computes daily, namely the weighted-average rate for all transactions on the previous day. The position of this rate within the intervention band is an indicator of market pressures. In practice, the market rate tends to lie very close to the CBSL's selling rate for extended periods, suggesting that the market is often guided by the intervention band.

90. The Indo-Lanka Free Trade Agreement (ILFTA) was signed in December 1998. The ILFTA is Sri Lanka's first ever free trade agreement under which tariffs on some items will be removed immediately and those remaining, with the exception of those in the 'negative list,' being subject to a 25–50 percent tariff reduction. ILFTA will be implemented once the negotiation over the 'negative list' can be finalized.[34] Sri Lanka is a participant in a number of regional trading arrangements—the most important of which is the South Asian Preferential Trading Arrangement (SAPTA). The third round of negotiations under the SAPTA concluded in November 1998, and Sri Lanka obtained several tariff concessions from other member countries from 10–20 percent and the removal of the nontariff barriers on the items receiving tariff concessions. A summit meeting of South Asian Association for Regional Cooperation (SAARC) which was held in Colombo in 1998—decided to request the special committee to work on drafting a comprehensive treaty regime for creating the South Asia Free Trade Area (SAFTA).

III. Structural and Social Issues

A. Public Administration Reform

Issues

91. There is an urgent need to redefine the role of government, to one that is consistent with the open liberalized market oriented economy that Sri Lanka has been moving towards in recent years. There is still a strong government presence in a number of economic activities, and the government is a very significant provider of employment. This situation is no longer appropriate in the new liberalized economy, where it is envisaged that the private sector should be the primary source of economic activity, and employment. Redefining the role of government involves deciding what role the government should now play, and how government departments, boards, and public enterprises should be organized and structured to efficiently perform this role.

92. There is a need to reassess the level of employment in the public sector and identify government agencies, boards, and public enterprises that are no longer required, or that must be restructured in order to improve efficiency. Retraining staff will also make them better able to deliver the services required in a more liberalized economy. There is a general consensus that overstaffing in the public sector constitutes a significant burden on the government budget.

93. Salaries and wages should also be restructured to provide incentives for improving performance, and procedures for appraising performance strengthened and more firmly linked to incentives. Since the current civil service pension scheme is an important part of the compensation of workers, salary and wage reform should be consistent with pension reform.

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[34]As of June 1999, Sri Lanka and India continue discussions relating to the 'negative list'—especially on whether tea and rubber products should be included.

Entrance and exit policies should also be reviewed to ensure continued improvements in the efficiency of the civil service. Current regulations generally do not allow entry into permanent senior level positions in the civil service. Almost everyone comes in at the bottom and works their way up. Thus the entry of talented senior level personnel from outside is negligible, which could adversely affect the efficiency of the civil service.

94. There is also a need to rationalize the relationship between the central and provincial governments. For example, in many districts there are two management structures, one central and one provincial, existing side by side. This has created ambiguities in power and management that have undermined the delivery of some government services to those districts. Thus, the government's agenda for the devolution of power from the center to the provinces will need to be implemented in a manner that enhances the efficiency with which government services are provided.

Current Status of Reforms

95. Progress in reforming the public sector has been slow. Existing labor laws make it difficult and costly to reduce employment levels in the public sector. Excess public sector employment has typically been addressed by attrition, though a number of retrenchment schemes have been carried out. In spite of the need to reduce public sector employment, there continues to be extensive recruitment into public service: The Samurdhi Authority, a public corporation, gave permanent positions to 30,000 new staff as animators; the Ministry of Education recruited 12,000 new teachers; and the Ministry of Finance recruited 8,000 recent graduates as new staff.

96. Over the past year, some government agencies and public corporations have been restructured. 5,700 staff of the Mahaweli Authority were retrenched in 1998, at a cost of Rs 1.3 billion. 460 staff of the Sri Lanka Central Transport Board were retrenched in 1998, and another 1,500 have agreed to leave, though there are no funds to finance their separation packages. 457 staff of the Sri Lanka Broadcasting Corporation were retrenched in 1998 at a cost of Rs 157 million, and retrenchment of a further 817 staff is being considered. 147 staff of the Film Corporation were retrenched at a cost of Rs 31 million, and retrenchment of a further 200 staff is being considered. Finally, 121 staff of the National Development Trust Fund were retrenched at a cost of Rs 15 million.

97. The National Administrative Reform Council (NARC), comprising the president, senior government politicians, senior public servants, and a private sector representative, has been set up with a mandate to determine what reforms are necessary and how they will be implemented. Significant progress is not expected until after the presidential and general elections. In addition, the Management Services Department (MSD) was created in May 1999. It will act as the secretariat for NARC, and has a mandate to spearhead institutional reforms across government. Its functions will include: management of the entire public sector workforce; undertaking organizational reforms of state agencies, including public enterprises, to improve efficiency and performance; and managing public sector salaries, incentives, welfare schemes, and other remuneration packages.

Outlook

98. The staff at the MSD appear to be highly motivated to institute reform in the public sector, which is encouraging. However, they will require substantial resources and assistance in order to successfully complete their task. This would include the provision of financing for retrenchment and separation packages that would be necessary as employment in the public sector is reduced, and training of MSD staff to improve their ability to evaluate and design appropriate structures for government institutions.

99. The success of the MSD will clearly depend on the political situation and commitment provided by NARC. As noted above, the current political situation suggests that NARC is unlikely to propose substantial reforms before the next general elections. Since the date for the next elections is uncertain, there is the risk that the momentum for reform will be dissipated. Also, the high recent recruitment into the public sector has reduced the credibility of proposals for public administration reform.

B. Pension System Reform

Current pension schemes

100. The key pension and provident fund schemes in Sri Lanka are the Public Service Pension Scheme (PSPS) for the public sector; the Employees Provident Fund (EPF), the Employees Trust Fund (ETF), and a number of Approved Private Provident Funds (APPF's) for the formal private sector; and 3 voluntary contributory (though heavily subsidized) schemes recently introduced by the Government covering farmers, fishermen, and the self employed (Table 2). There are also about 7 small market based contributory provident funds run by a number of banks and insurance companies. In all, only about 50 percent of the labor force is covered by some kind of pension scheme.

101. The PSPS covers some 600,000 active civil servants and 350,000 retirees. The PSPS is not funded and benefits are paid from current tax revenue. Benefits are generally regarded as the most generous in Sri Lanka, averaging about US$60 per month. However, benefits are not portable, and thus represent a significant impediment to the movement of labor from the public to the private sector. Current expenditures on the PSPS represent about 10 percent of government tax revenue and 2 percent of GDP. The rapidly ageing population means that, under current policies, the PSPS is expected to become a significant and growing fiscal burden over the next three decades. Even using conservative assumptions about interest rates, wage growth and mortality rates, current estimates suggest that the PSPS represents an unfunded liability which may exceed 50 percent of GDP.

102. The EPF is funded by employee and employer contributions (8 percent and 12 percent, respectively) with Rs 161 billion in assets. The EPF pays a lump sum benefit upon retirement which is substantially lower than the benefits received under the PSPS. Also, unlike the PSPS pension, EPF benefits are taxable. Participation is compulsory and there is no cap on contributions as income increases. In addition, government restrictions on the types of

Table 2. Sri Lanka: Pension and Provident Funds

Wage Employees (3.1 million)		Self employed (3 million)
Government sector	**Private sector (including corporation sector)**	**Voluntary**
Mandatory noncontributory unfunded • Public Sector Pension Scheme (PSPS)	*Mandatory contributory funded* • Employees Provident Fund (EPF) • Employees' Trust Fund (ETF) • Private sector Approved Provident Funds (APPFs)	*Contributory funded* • Farmers' Pension Scheme • Fishermen's Pension Scheme • Self-Employed Pension Scheme.
Mandatory contributory • Public Service Provident Fund (PSPF)		*Market based contributory* • 2 by Private Banks • 1 by National Savings Bank • 2 by Government Insurance Companies, 2 by Private Insurance Companies
Survivors pension schemes • Widows' and orphans pension schemes (W & OP) • Teachers pension schemes		

Coverage, Funding and Benefits of the Existing Pension Schemes/Provident Funds

Government sector	Coverage	Funding mechanism	Benefits
Mandatory noncontributory unfunded • Public Service Pension Scheme (PSPS)	This presently covers civil servants, armed services, provincial government employees, government teachers, local government employees.	Unfunded (government revenues)	80–85 percent depending on the last drawn salary if 30 years of service (YOS) completed and 2 percent reduction for each year short of 30 YOS. 24 months lump sum in exchange for 5–10 percent reduction of pension for ten years after which full pension entitlement is granted.
Mandatory contributory • Public Service Provident Fund (PSPF)	Government employees who are not covered under the PSPF.	Funded • 8 percent by the employee, • 12 percent by the employer	Lump sump payment at retirement
Survivors pension schemes • Widows and orphans • Teachers	Government employees, including teachers	Unfunded • 4–7 percent by the employee	Widowed spouses continue to receive benefits until they are remarried; children receive benefits up to the age of 18.
Private sector (including Government Corporations and Boards)			
Mandatory contributory funded			
Employees Provident Fund (EPF)	All private sector and government corporation and statutory board employees.	• Funded, • 8 percent by the employee 12 percent by the employer (minimum)	• Lump sum payment on retirement; withdrawal possible for reasons specified by the Act. • Housing loan, (pledging 75 percent of the total contribution)
Employees Trust Fund (ETF)	All private sector and government corporation and statutory board employees, and Private Approved Provident Fund members	• Funded • 3 percent by the employer	• Lump sum payment at the cessation of service • Pre retirement benefits viz. life insurance, medical insurance, scholarships for children
Private Approved Provident Funds (APPFs)	Comply with specific provident and pension funds approved by the Commissioner of Labor	• Funded • 8 percent by the employee • 12 percent by the employer (minimum)	• Lump sum payment at cessation of service and • Pre retirement benefits viz. low interest Housing Loan.
Contributory funded			
Farmers' Pension Scheme/ Fishermen's Pension scheme	Funded; The member contributes premium, rest from government revenue	Nominal premium by the member	• Monthly pension depends on the age of enrolment • Range from RS. 1,000 – 4,167 per month, on reaching the age of 60.

Source: World Bank.

investments that these funds can engage in (primarily imposed to create captive funds to finance the budget deficit), taxation of investment income, and poor managerial ability, have meant that the funds have had very low returns on their investments. The average after-tax real rate of return on EPF investments for 1972–98 was ¼ percent. Accounts are not portable between various employers in the formal private sector, which has led to multiple accounts for single individuals. The ETF is financed by a 3 percent employer contribution and has about Rs 22 billion in assets. In practice, the main difference between it and the EPF is that it allows payment of benefits upon cessation of employment rather than upon retirement, and also provides limited medical insurance. Both funds are not efficiently managed and adequately regulated, which has significantly dampened their popularity with the labor force.

103. In 1996, legislation was passed prohibiting the establishment of any new APPF's, creating uncertainty about the legal standing of the 200 existing ones, and their ability to accept new participants. Total assets amount to about Rs 20 billion. There is a perception that APPF's are very poorly managed and regulated. Returns on APPF investments are low, and accounts in the APPF's are not portable.

104. The subsidized contributory voluntary schemes for the informal private sector pay monthly pensions of up to US$60 upon reaching the age of 60, as well as a death and disability allowance. The scheme for the self-employed is not popular and participation remains low. However there are about 470,000 participants in the fishermen and farmers schemes.

Possible Options for Reform

105. **Change the PSPS to a fully funded defined contribution scheme for existing public sector workers**. However, since this is unlikely to be politically feasible at this time, changes could be imposed on new entrants, and the scheme could be made more attractive for younger existing workers to encourage a switch to the new system. Since the contributions would represent a cut in wages for participants, it would be necessary to restructure salaries to take this into account. The optimal approach would be an integrated approach in which PSPS reform is part of a comprehensive reform of the entire civil service structure. The authorities are working with the World Bank to develop a pension reform strategy.

106. **Improve the administration and regulation of the EPF, ETF, and APPF's**. This could be achieved by setting up a small regulatory body to oversee the governance and investment strategies of private provident funds, including the ETF, EPF, and APPF's. Also, since they have similar functions and serve essentially the same group, consideration could be given to merging the EPF and ETF.

107. **Improve the investment returns of the ETF and EPF, develop investment management skills through training and recruitment, and progressively remove most restrictions on the types of investments they can engage in as managerial ability improves.**

108. **Repeal legal restrictions on setting up new APPF's and clarify their legal standing**. To improve labor mobility, accounts in the APPF's, ETF, and EPF could be made portable between employers, so that private sector provident funds are not employer-based, but are generic. This would encourage market discipline as employees move accounts to the better performing funds. Eventually, the private provident fund industry could be fully liberalized and consideration could be given to making accounts in (a reformed) PSPS portable as well.

109. **Liberalize entry into annuities markets** to provide a means for provident funds beneficiaries to convert their lump sum benefits into annuities.

110. **Evaluate the fiscal burden implied by the substantial government subsidy component in the self employed, fishermen, and farmers pensions schemes, and take steps to keep this burden manageable.**

C. Poverty and the Environment

Poverty

111. **Sri Lanka has done well in reducing poverty and maintaining low levels of income inequality.** The incidence of poverty fell from 30 percent in 1985 to about 19 percent in the mid-1990s. Continuing government emphasis on protecting minimum consumption levels and promoting social development has ensured that: (i) there is virtually no starvation or destitution; (ii) existing poverty is not age or gender biased; and (iii) the poor are well protected through free health, education, and income support programs. As indicated below, strong state investment in the social sectors has resulted in favorable social development indicators.

112. **However, relatively large pockets of poverty persist, especially in conflict and rural areas, and about a fifth of the population lives below the poverty line.**[35] In the conflict areas in the Northeastern Province, the quality of life has deteriorated sharply; over a half million people have been displaced, while a large proportion of social and physical infrastructure has been destroyed. Outside the conflict areas, rural poverty accounts for over 75 percent of the poor people in the country; the majority of the rural poor are landless agricultural laborers and farmers operating miniature plots. The deepest poverty is observed in geographically isolated areas, principally jungles and mountain tops.

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[35]The poverty line, last calculated in 1991, is Rs. 471 per person per month, based on a daily nutritional threshold of 2,500 calories. The government is currently updating the poverty line threshold.

Social and Demographic Indicators

	Units	15–20 years ago	Most recent estimate	Same region income group South Asia	Same region income group Low income	Next higher income group
General						
GNP per capita	U.S. dollars	370	823	350	430	1,670
Income distribution						
Highest quintile	Percent of income	43	39	...	...	...
Lowest quintile	Percent of income	7	9	...	...	...
Population characteristics						
Population	Millions	16	19	...	...	...
Rate of growth	Percent per anum	1.5	1.0	1.8	1.6	1.3
Life expectancy at birth	Years	69	72	62	63	67
Age dependency ratio[1]	Percent	70	54	70	67	63
Urban population	Percent	21	23	27	29	56
Labor force						
Labor force participation rate[2]	Percent	39	42	43	50	44
Health and nutrition						
Population per physician	Persons	5,516	6,843	...	...	3,064
Population per hospital bed	Persons	340	415	1,889	1,152	402
Immunization from measles	Percent of under 12s	2.0	88.0	79.8	77.2	87.4
Access to safe water	Percent of population	37	64	77	53	...
Infant mortality rate	Per thousand live births	30	16	71	58	36
Education						
Adult illiteracy	Percent of population[3]	13	10	50	35	...
Primary school enrollment	Percent of school-age population	103	113	99	105	105

Sources: Central Bank of Sri Lanka, Annual Report (1998); and *World Bank, World Development Indicators,* 1999.

[1]Ratio of dependents (total number of individuals aged less than 15 years and greater than 64 years) to working age population (number of individuals aged between 15 and 64).
[2]Total labor force as a ratio of population.
[3]Fifteen years or older.

113. **The government is currently developing a poverty policy framework with World Bank and UNDP assistance**. Part of this framework is based on analysis of the latest available household survey data from the Department of Census and Statistics (1995/96) and the *Report of Consumer Finances and Socio Economic Survey, 1996/97* of the CBSL (1999). In addition, the World Bank is supporting a country-wide integrated survey to obtain information on household, community and market variables, to analyze the coverage of poverty programs and measure living standards. The survey also covers the Northeastern Province, which has not been adequately covered since 1981/82.

Environment

114. **The main environmental problems are degradation of coastal areas, deforestation, and pollution of water resources**. The government, with donor assistance, is implementing several programs to mitigate their negative impacts, and improve management and enforcement of environmental regulations through institutional strengthening. The Coastal Conservation Department, which has the responsibility managing coastal resources, is overseeing the implementation of the Coastal Zone Management Plan (CZMP). The CZMP outlines an overall strategy and contains specific programs and measures to reduce coastal erosion and pollution (from the discharge of industrial pollutants and raw sewage), and minimize degradation of coastal habitats, including historical, cultural and recreational sites. Deforestation, caused by shifting cultivation, timber exploitation, fuelwood use, and encroachment of agriculture on forests, has led, in turn, to flooding and erosion of rainfed agricultural areas, siltation of reservoirs, and lower land productivity. As part of the government's remedial strategy, a substantial effort has been placed on reforestation through the Forestry Sector Master Plan, and forest coverage has increased in recent years. Measures are also being taken to improve management of both natural forests and replanted areas. The greatest negative impact of pollution is on water resources. Increases in fertilizer use has accelerated eutrophication of water bodies, while wastewater discharges, particularly in the Colombo area, are further deteriorating water quality. The government, with the assistance of the Asian Development Bank (AsDB), is taking steps to strengthen water resource management through the recently established Water Resources Council and Secretariat.

An Overview of the Tax Structure in Sri Lanka[1]

I. Tax System in General

1. The level of taxation in Sri Lanka has been relatively high (tax revenue/GDP is 17 percent) compared with those of other countries at a similar stage of development.[2] This high level of taxation could be explained most explicitly by the scale of expenditure. As shown below, tax/GDP in each country is correlated with expenditure /GDP and Sri Lanka has recorded a high level of expenditure compared with other low and middle income countries.[3]

Tax Revenues and Expenditure in Selected Countries

Countries	Per Capita GDP (US$)	Tax Revenues (Percent of GDP)	Expenditure (Percent of GDP)
Low Income			
India (1997)	370	9.8	14.9
Nepal (1997)	220	8.9	17.0
Pakistan (1994)	500	13.2	24.3
Lower-Middle Income			
Sri Lanka (1996)	**800**	**17.0**	**27.7**
Bolivia (1997)	970	15.3	22.1
Indonesia (1996)	1,110	14.7	14.6
Philippines (1997)	1,200	17.0	19.3
Thailand (1997)	2,740	16.1	18.7
Upper-Middle Income			
Malaysia (1997)	4,530	19.4	20.1
High Income			
Korea (1997)	10,550	18.6	18.8
Japan (1993)	38,160	17.6	23.7
United States (1997)	29,080	19.1	20.9
United Kingdom (1995)	20,870	33.3	41.6
Germany (1997)	28,280	26.7	33.3
France (1997)	26,300	39.2	46.6

Sources: IMF, *Government Finance Statistics, International Financial Statistics*; World Bank, *World Development Indicators, 1999.*

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[1]Basic information on the tax and nontax structures is provided in Attachment I.

[2]Sri Lanka is classified as a lower middle income country with per capita income of about $800 dollars (1997). The general positive relationship between the level of tax receipts and per capita income—an index of development—has been observed in developing countries (Tanzi (1990)). Other factors explaining the level of taxation include: urbanization, monetization, dominance of the agricultural sector, importance of foreign trade, ability of tax administration, and policy objectives and accompanying expenditure scale.

[3]Over the period 1977–98, government expenditure rose at an annual average rate of 17 percent, slightly faster than that of revenue. Of note, defense spending has significantly increased—from 1½ percent of GDP in the mid-1980s to 5–6 percent in the mid- and late-1990s as the civil conflict intensified.

2. The tax system in Sri Lanka changed in 1977.[4] Before 1977, income tax was designed for redistribution of income with higher tax rates and lower exemptions. Turnover tax and import/export duties were the main sources of revenue mobilization. From 1977 onward, the main objectives of income taxes shifted to resource allocation, i.e., encouraging investments through expanding tax holidays/tax exemptions, which narrowed the income tax base. Export duties declined as the government shifted to an outward looking trade policy.

3. The tax system, as such, has gradually evolved toward a relatively high dependence on consumption taxes (Turnover Tax/Goods and Service Tax, Excise Tax and National Security Levy) while the dependence on taxes on international trade has been significantly reduced. Meanwhile, the share of income tax has gradually declined (Figures 13). In recent years about 60 percent of tax revenue has been generated by consumption taxes, 20 percent by taxes on international trade, and 15 percent by income taxes.

4. Estimates of tax elasticity—the measurement of the automatic built-in response of tax revenue to changes in economic growth, assuming an unchanged tax system—showed that Sri Lankan tax revenue would not have expanded as much as economic growth without frequent discretionary changes to the tax system. Jayasundera (1990) estimated the overall tax elasticity to be 0.7, among which only personal income tax has an elasticity over unity (1.2) showing a higher growth rate of revenue than that of GDP. Establishing an elastic tax system, as most industrial countries have, is an important revenue objective. It should be attained through: broadening tax base, realizing the appropriate progressivity in tax system, and making tax administration more efficient and stronger.

II. Taxes on Income

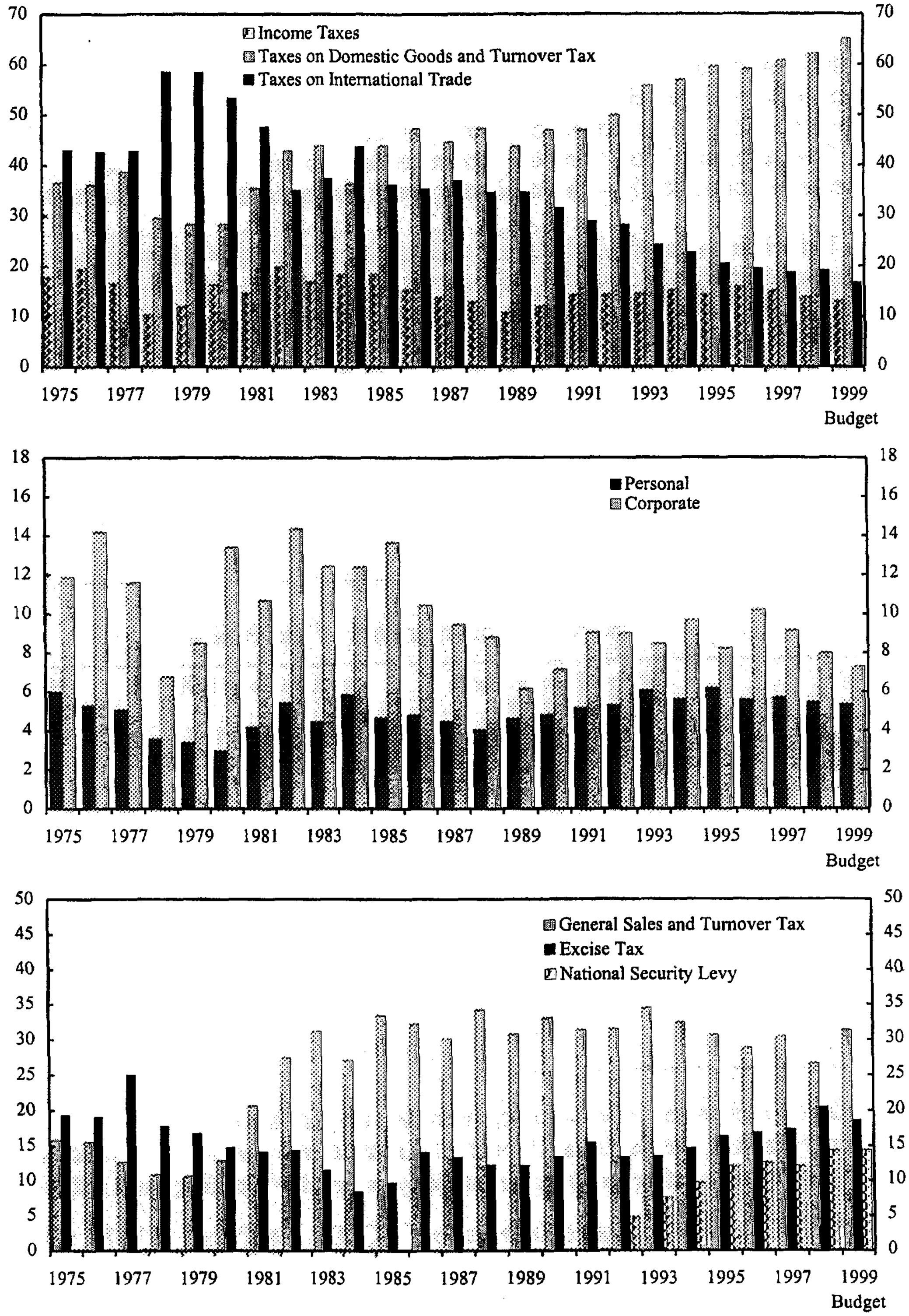
Corporate Income Tax and Tax Incentives

5. The rate of the corporate income tax (CIT) is relatively modest (35 percent flat rate) and the definition of the tax base is standard except for generous rates of depreciation. Nevertheless, the actual scope of CIT is very much limited. Cross-country comparisons show that the yield of CIT in Sri Lanka is low within the grouping of low–middle income countries. This is mainly due to tax incentives such as tax holidays and exemptions given as investment incentives.

6. Sri Lanka has expanded tax incentives in wider areas in economy since 1977 such as agriculture, housing, non-traditional exports, tourism and the gem industry. Generous

[4]1977 was an turning point in the economy of Sri Lanka. In that year, a new government drastically changed economic policy from a highly interventionist stance with priority on economic and social equality, to a liberalized and market-oriented stance aimed at higher economic growth. A new policy programme included the shift from quantitative restrictions on trade and payments, a relaxation of interest rate control, the adoption of a realistic exchange rate, and the lifting of price controls.

Figure 13. Sri Lanka: Central Government Tax Revenues, 1975-99
(In percent of total)



Source: Data provided by Sri Lanka authorities.

tax incentives are given through two stages: (i) the standard Inland Revenue Act and (ii) special Board of Investment (BOI) Law (Attachments II and III).[5,6]

7. The influence of tax incentives on investment decision is very controversial. Moreover, as pointed out in the Taxation Commission Report (1990), tax incentives create problems of economic distortion, erosion of tax base, tax avoidance, and complexity. In addition, tax incentives are likely to be extended by strong political pressures, even though initially time bound. The authorities, following the recommendations of the Commission, have tried to limit tax incentives concurrently with establishing low rates and a broad-based tax structure.

8. Notwithstanding the authorities' efforts, tax incentives still remain in a wide area. For example, in 1994, full 5-year tax holidays for BOI export companies were abolished and replaced with a concessional tax rate of 15 percent for a 20–year period for all export companies. The latter represents a *de facto* tax holiday of 43 percent for 20 years and is applied uniformly to export sectors. As a result, the revenue loss has increased.

9. Comprehensive data on revenue losses from these tax incentives are not available. An indication is provided by comparing the number of approvals of tax holidays with the number of tax files. As indicated below, roughly 15 percent of the corporate tax base is excluded from the scope of corporate income tax.

The Number of Approvals of Tax Holidays

	Approvals under Inland Revenue Act (new approvals)	Approval under BOI Law (cumulative base)	Number of tax files by resident companies
1997	88	1,713	10,784
1996	43	1,743	11,070
1995	6	1,572	9,497
1994	8	1,470	9,678
1993	7	1,241	9,249

Sources: Administration Report of Commissioner General, 1993–1997, and data from BOI.

[5]Under the current Inland Revenue Act, incentives (5-year tax holidays, tax-free dividends, import duty waivers, concessional 15 percent tax rates) are given to the broad categories of industry and services using advanced technology or involved in direct and indirect exports.

[6]The Greater Colombo Economic Commission (GCEC), established in 1978, was reconstituted in 1992 as the BOI under the BOI Law. The BOI facilitates private investment through granting incentives including tax holidays, concessional tax rates, and exemptions from import duty and exchange control. More than 1,000 companies operating under a signed agreement with the BOI, account for 60 percent of Sri Lanka's total exports and 80 percent of industrial exports.

Personal Income Tax

10. The personal income tax (PIT) generates only about 1 percent of GDP in revenues. Although the low yield from PIT is typical of lower income countries, the yield from PIT in Sri Lanka is relatively low compared with other countries at the same development stage.[7] The low profile of PIT is the historical result of Sri Lanka's dependence on taxes on international trade and goods and services. This is due to several elements, such as the economy's reliance on agricultural sector, small industry, low level of income, low level of tax compliance and inefficient tax administrations.

11. PIT is currently not levied on the emoluments earned by government officials and lawmakers. PIT's tax base could be expanded to include those emoluments, although such taxation might produce little tax revenue as the level of those emoluments is low and any extra revenue could be offset by salary increases to maintain net public sector wages and salaries.[8] Nevertheless, the main objective of such inclusion would be to enhance compliance among other potential taxpayers.

Personal Income Tax—Tax Base and Rate

The rate schedule under the PIT applies to net income with four brackets ranging from 10 percent to 35 percent. The base of the tax includes all sources of income such as wages and salaries, pensions, interest income and dividends, capital gains and business income of self employed. There is a tax-free allowance of Rs 144,000. There are no other special deductions. The tax unit is the individual—every person is required to pay income tax in instalments on a self-assessment basis.

12. PIT in Sri Lanka is characterized by a relatively high threshold and a low level of income at which the highest marginal rate applies. However, revenue from PIT is highly dependent on high income individuals (70 percent of PIT paid by residents comes from only 5 percent of taxpayers). Reducing the threshold and pushing up the applicable level of the highest marginal rate might cause substantial revenue loss.

13. The Minister of Finance announced the compendium of the Income Tax Act and its 23 amendments in the 1999 Budget Speech. A new streamlined law, as well as fewer exemptions, will improve tax administration. The introduction of Goods and Service Tax (GST) could also be of assistance in administering the PIT (and CIT) by providing more information on taxpayers. The computer systems installed for GST should be used to facilitate information flows across several tax items and different tax departments.

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[7] As the economy evolves and the tax system matures, the importance of the PIT tends to rise (Hinrichs (1966)).

[8] In 1998, average salaries of public servants were Rs 49,628 (US$770) per year. Average income (1996/97) was estimated at Rs 69,120 (US$1,170) per income receiver, according to the socio-economic survey conducted by the CBSL in 1999.

III. TAXES ON GOODS AND SERVICES

Goods and Service Tax

14. The Goods and Services Tax (GST) was introduced in April 1998, replacing the Turnover Tax (TT), which had existed since 1964. The GST is levied on a value added basis at a single standard rate of 12.5 percent with full credit given for all inputs. In Sri Lanka, the wholesale and retail trading sectors are outside of the scope of the GST unless such activities are carried on as a part of the business of an importer or manufacturer.[9] This is due to the

Turnover Tax

The turnover tax (TT) was introduced in 1964 (originally called the business turnover tax). It was a multi-stage tax levied on gross receipts, with a broad coverage including manufacturing, wholesale and retail trade, services, and imports (services were incorporated in the TT coverage in 1968, as were imports in 1981). Despite a multiplicity of tax rates, 80 percent of TT revenue was collected from four basic rates (5, 12.5, 15 and 20 percent) levied on a few items—sugar, diesel, petrol, liquor, and tobacco. In 1992, the TT structure was rationalized to a three band system of 5, 10 and 20 percent. TT remains applicable to banking and financial services, which are not liable to GST.

TT had serious defects:

- the multiplicity of rates had become complicated and administratively cumbersome;
- with the exception of input credits to domestic manufactures, TT had a cascading effect (cumulative effects of tax extended on the sale prices of commodities); and
- economic distortions were caused by the input credit system (e.g., input tax paid at the import stage was not deducted from the final tax due on the sale of imported goods, if not subjected to a manufacturing process).

provision of Sri Lanka's Constitution (13th amendment), which prescribed the devolution of turnover tax on wholesale and retail sales to the Provincial Councils. Although the wording of the 13th amendment does not seem to prohibit the central government from including the trading sector in the coverage of GST, political considerations mean the government refrains from doing so. With respect to the expansion of the tax base and prevention of tax-evasive transactions, wholesale and retail sectors should be subject to the GST.[10] Moreover, GST taxes paid by traders should be allocated to each province on revenue-sharing arrangements between central government and Provincial Councils, although these arrangements also face the interpretation problems of the 13th amendment.

15. To minimize the regressive effect of the GST, a fairly extensive list of exemptions (35 different categories, including the basic food basket of mass consumption and supplies

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[9] Wholesale and retail activities comprises about 22.5 percent of GDP.

[10] Among countries which introduced VAT (more than 110 countries to date), a limited number of countries have not extended VAT to the retail stage. Algeria, Cote d'Ivoire, Kenya and Malawi implemented VAT up to the manufacturing stage, while Indonesia, Mauritius, and Morocco have VAT up to the wholesale stage (Zee (1992)).

considered essential for economic development) was formulated. This list has narrowed the scope and coverage of GST.[11]

16. GST was introduced with a standard tax rate of 12.5 percent, which is lower than the estimated revenue-neutral rate, as a result of political considerations to reduce the tax burden on the consumer.[12] The main objective was to put the GST firmly in place without causing any distortions. Toward this end, a moderate tax rate and generous tax exemptions were considered vital. On the other hand, a relatively low registration threshold (Rs 1.8 million) put a heavy burden on the administration (Table 3). As the GST is expected to be the key element of the tax system in Sri Lanka, consideration should be given to increasing the tax rate, expanding the tax base and improving the administration of the tax.

17. Even one year after the introduction of the tax, public understanding and awareness of GST is still inadequate, and confusion about which companies and what activities are subject to GST remains. This confusion is likely lead to the public misconception that the GST is being widely evaded or not transferred to the tax office. At this juncture, efforts to improve public relations are required. Steps have been taken to improve implementation and public awareness of the GST system.

National Security Levy

18. The National Security Levy (NSL), which was introduced as an interim measure, has gained an important position in the total tax structure.[13] Since the NSL has the same tax structure as the turnover tax, it has the same weakness, e.g., a cascading effect on the sales price. With respect to simplifying the tax system and to increasing economic efficiency, and assuming the abolishment of NSL is not feasible given the current level of defense outlays, consideration should be given to the harmonization of NSL with the permanent tax system, e.g., in the form of a surcharge for security purposes in the GST.

Excise duty

19. The present system of excise duties, which is a combination of *ad valorem* duties (based on value) and specific duties (based on quantity), works well in terms of revenue stability and administrative efficiency. There are only a limited number of excises (hard and malt liquor, cigarettes, pipe tobacco, petrol, diesel, and motor vehicle), yielding revenue of

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[11]At the drafting stage of the GST law, the Fund's Fiscal Affairs Department (FAD) had recommended that some items be dropped from the exemption list (Silvani et al (1996)). The following items, however, remained in the final version of the law: noninfant milk foods, pharmaceutical products, books, cement, fertilizer, and tractors.

[12]FAD estimated a tax-neutral revenue rate of about 19–20 percent, assuming a noncompliance level of 20–40 percent (Zee et al (1992)). A more recent estimate of the revenue-neutral rate, calculated by an FAD advisor, was 17 percent.

[13]NSL receipts were the equivalent of 2 percent of GDP in 1998, more than revenue from income taxes.

3 percent of GDP and fulfilling the social objectives of restricting consumption of products harmful to health.

History of National Security Levy and Save the Nation Contribution

The NSL was introduced in 1991 at a rate of 1 percent, raised to 3 percent in the same year, to 3.5 percent in 1994, to 4.5 percent in 1995, and to 5.5 percent in 1999. Manufactures, imports, insurance, banking, finance, and telecommunication are subject to NSL. The tax is very buoyant because of the limited exemptions (e.g., exports, re-exports, import and manufacture of gems and jewelry). Furthermore, the effective tax burden is higher since a portion (currently 2/9) is not deductible for income tax purposes.

In line with the increased expenditure for defense, the Save the Nation Contribution (SNC) was introduced in 1996. The SNC is a type of income tax surcharge, and levied on all employees, including self employed persons and pensioners at the progressive rates of 2 and 3 percent.

20. However, there is some room to enhance the revenue from excise duties. Compared with other countries, excises on diesel and kerosene are low. Adjusting for purchasing power parities, the price of diesel and kerosene in Sri Lanka is about a half the average of OECD countries.

IV. Taxes on International Trade

Import Duty

21. In conjunction with trade liberalization, major tariff reforms began in the late 1980s, characterized by rationalization and simplification of tariff structure, lowering of high tariff rates, removal of quantitative restrictions and reduction of exemptions. After a gradual process of reducing the number of tariff bands to four in 1991 (10, 20, 35 and 50 percent) and to three in 1995 (10, 20 and 25 percent), Sri Lanka now proposes to adopt a two band tariff structure in the year 2000.[14] In the interim, a three-band tariff of 10, 20 and 35 percent was replaced with 5, 10 and 30 percent in November 1998.[15] A few items remain outside the 3-band tariff system, e.g., the agriculture tariff remained at 35 percent to allow the domestic agricultural sector to adjust to a lower tariff regime. As a result, the interim regime comprises five rates (5, 10, 20, 30 and 35 percent).

[14]The Trade and Tariff Commission recommended in July 1998 to move to a 2 band tariff system from 2000 onwards with rates of 10 and 25 percent (plus zero percent).

[15]A rate of 5 percent applies to all raw materials and machinery not manufactured in Sri Lanka; a 10 percent rate to processed items and fully finished items not produced in Sri Lanka, and 30 percent rate to everything else. There is also a zero rate for items entitled to duty free importation under government agreements and international conventions.

Table 3. Sri Lanka: VAT/GST in Asian and Pacific Countries

Countries		Current rates 1/	Rates at Introduction	Introduction year	Registration Threshold 2/	VAT Revenue/ Total tax revenue	VAT revenue/ GDP	Per capita Income
					(U.S. dollars)	(In percent)	(In percent)	(U.S. dollars, 1997)
Sri Lanka	**1998**	12.5	12.5	(1998)	28,000	26.9	3.9	800
Bangladesh	1997	15	15	(1991)	17,000	47.9	3.6	360
Indonesia	1995	5, **10**, 20, 35	10	(1985)	53,000 (Goods) 27,000 (Services)	28.5	4.1	1,110
Japan	1998	4, 5, **5**	3, 6	(1989)	229,000	20.3	2.1	38,160
Korea	1996	2, 3.5, **10**	13	(1977)	45,000	23.2	4.3	10,550
Nepal	1998	10	10	(1997)	46,000	27.2	2.4	220
New Zealand	1998	12.5	10	(1990)	56,000	24.3	8.2	15,830
Pakistan	1997	15	12.5	(1988)	61,000 (Manufacturing) 122,000 (Retail)	17.3	2.3	500
Philippines	1997	10	10	(1994)	19,000	10.9	1.7	1,200
Singapore	1995	3	3	(1994)	700,000	8.0	1.3	32,810
Thailand	1997	7	7	(1992)	24,000	17.9	2.9	2,740

Sources: Data from Fiscal Affairs Department, IMF; *Taxes and Investment in Asia and the Pacific*, International Bureau of Fiscal Documentation; *World Development Indicators 1999*, World Bank.

1/ Bold figures are standard VAT rate for each country.
2/ Registration Threshold is rounded to the nearest $1,000 calculated by period average exchange rate. From 1992, Indonesia expanded the scope of VAT to include the retailers with an annual turnover of 1 billion rupiah ($445,000).

22. As tariff reform has progressed, the effective rate of import duty has substantially decreased, from 15.9 percent in 1990 to 9.7 percent in 1995 and further to 7.4 percent in 1998. Although this level is lower than neighboring countries such as India and Pakistan, there still remains room for further liberalization compared with South-East Asian countries like Indonesia, Malaysia and Korea.

Export Duty

Export duties were originally introduced in 1915 and were an important revenue source for a long time. In 1980, export duties represented 30 percent of total tax revenue —the single largest tax revenue source. Through the 1980s, however, the scope and role of export duties (on tea, rubber and coconut products) decreased substantially (from 8 percent of total revenue in 1985 to 4 percent in 1990). This change was aimed at ensuring reasonable profit margins for exporters of crops. As they had faced fierce competition from counterparts in other Asian countries which had no or very small taxes on exports, they could not shift their tax burden fully to export prices. International agreements applying the destination principle to taxes on trade also militated against export duties. Though export duties were recognized at times as substitutes for income taxes in hard-to-tax sectors, such duties were totally removed in 1992.

V. CONCLUSION

23. The current Sri Lankan tax system depends heavily (more than 80 percent) on indirect taxes. This is due to the usefulness of indirect taxes as a practical method for encompassing hard-to-tax economic sectors including agriculture, small industry and "footloose" companies and individuals. Thus:

- After raising the rate and reducing exemptions, the GST is expected to be the mainstay of tax revenues;
- Import duties will inevitably decrease in accordance with trade liberalization;
- Excise duties are expected to continue as a stable source of revenue;
- The status of the NSL in the tax structure needs to be reviewed.

24. On the other hand, in order to construct a more balanced and buoyant tax structure, direct taxes should have a higher share. This can be attained by:

- Overhauling existing tax incentives and removing/scaling down tax concessions;
- Strengthening tax administration through more efficient human allocation and continuous training with the help of computerization;
- Enhancing the taxpayers' compliance by including salaries of public servants into the income tax base, and fostering better public relations regarding tax and fiscal issues.

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TAX AND NONTAX REVENUE STRUCTURES IN SRI LANKA—1999

TAX STRUCTURE

I. Income Tax

Legislation
Inland Revenue Act No. 28 of 1979 as amended from time to time.

Implementing Agency
Department of Inland Revenue.

I.1 Personal Income Tax

Legislation
Income tax is charged annually. A resident person is liable to tax on his income arising both in and outside Sri Lanka. A nonresident is liable to tax only on his income arising in Sri Lanka.

Residence Rule
A person who resides in Sri Lanka for a period exceeding 183 days in aggregate in any year of assessment is treated as a resident.

Rate Structure

- Tax free threshold - Rs 144,000 for residents
- Tax unit - Individual
- Tax Rates -

Taxable income	*Rate*
First Rs 100,000	10 percent
Next Rs 100,000	15 percent
Next Rs 100,000	25 percent
Balance	35 percent

- Non-Citizen employees - 15 percent

Terminal Benefits on Retirement

First Rs 500.000	Exempt
Next Rs 150,000	5 percent
Next Rs 150,000	10 percent
Balance	15 percent

I.2 Corporate Tax

A Company means any company incorporated or registered under any law in force in Sri Lanka or elsewhere and includes a public corporation.

Residence Rule
A company is deemed to be resident if its registered or principal office is in Sri Lanka or if it is controlled and managed from Sri Lanka.

Rate Structure

Category	*Tax rate*
Resident and nonresident companies	35 percent
Export, agriculture, tourism, and construction	15 percent
Provident funds and charities	10 percent

Capital Gains

Period of ownership of Property

Years	*Rate (percent)*	*Years*	*Rate (percent)*
Over 25	0		
20–25	5	05–15	17.5
15–20	12.5	02–05	25
Less than 2 years			

Capital gain on sale of Quoted Company shares is fully exempt

Rates of Depreciation

Type of asset	
Plant, machinery and fixtures, computer software	50 percent
Motor vehicles and office furniture	25 percent
Qualified buildings	6⅔ percent
Motor coach used for employee transport	100 percent

II. Save the Nation Contribution

Legislation

Save The Nation Contribution Act of 1996 as amended from time to time.

Implementing Agency

Department of Inland Revenue.

Tax Liability

All employees including self employed persons and pensioners excluding the members of armed forces and police.

Applicable Rates

Emoluments: Rs 15,000 to Rs 30,000 per month 2 percent.[1]

Emoluments: Rs 30,000 and above per month 3 percent[1]

III. Customs Duty

Legislation

Customs Ordinance No.17 of 1869 as amended from time to time.

Implementing Agency

Department of Customs

Tax Liability

Customs duty is levied on all goods, wares, and merchandise imported into Sri Lanka.

Duty Structure

Zero duty -	Wheat, lentils, dried fish, fertilizer, seeds, pharmaceuticals, yarn, textiles, tractors, lorries, timber computers, sports equipment.	
Standard rate bands	- 5 percent	- raw material
	- 10 percent	- intermediate goods
	- 30 percent	- finished products
Special rate band	- 35 percent	- agricultural products
Specific duty	- Tobacco, cigarettes, liquor, and sugar	

Date of Payments

At the point of import.

Computation of Duty

Duty rate is applied on Cost, Insurance and Freight (CIF) value.

IV. Goods and Services Tax (GST)

Legislation

Goods and Services Tax Act No. 34 of 1996 and amendment Act No. 11 of 1998.

Implementing Agency

Department of Inland Revenue.

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[1]Emoluments—total income excluding arrears.

Tax Liability
Domestic supply or imports of goods and services.

GST Threshold
Turnover in excess of Rs 500, 000 in any quarter or in excess of Rs 1,800,000 in four successive quarters.

Applicable Rates

i. Exempt
   - Essential food items i.e., rice, flour, sugar, milk and milk powder, bread
   - Pharmaceuticals
   - Petroleum products, fertilizer
   - Cement, timber
   - Financial services

ii. Zero Rate
   - Export of goods
   - International transportation (including transhipment) of goods and passengers
   - Services directly connected with any movable or immovable property outside Sri Lanka

iii. Standard rate of 12.5 per cent on domestic supply or imports.

iv. Refunds
   - GST on inputs for zero rated and taxable goods and services are recoverable.

Computation of Duty
On Manufacturing:
Wholesale price (WSP) excluding GST and National Security Levy (NSL) multiplied by the GST rate.

On Services:
Final consumer price excluding GST and NSL multiplied by the GST rate.

On Imports:
CIF with all fiscal levies excluding GST and NSL multiplied by the GST rate.

Date of payment
Monthly return if the value of taxable supplies exceeds Rs 30 million per annum, otherwise quarterly.

V. **Excise (Special Provisions) Duty**

Legislation
Excise (Special Provisions) Act No. 13 of 1989 and Amendments Act No. 40 of 1990 and Act No. 8 of 1994.

Implementing Agency
Excise (Special Provisions) unit of Department of Customs.

Tax liability
On the following articles manufactured locally or imported:

- Cigarettes
  > 60 mm in length Rs 1,468 per 1000 sticks
  60 mm – 67 mm Rs 2,362 per 1000 sticks
  67 mm – 72 mm Rs 3,392 per 1000 slicks
  72 mm – 84 mm Rs 3,526 per 1000 sticks
  84 mm < Rs 4,042 per 1000 sticks
- Pipe tobacco Rs 250/- per Kg
- Malt Liquor 10 percent
- Hard Liquor 30 percent
- Diesel 15 percent
- Petrol 50 percent
- Motor vehicle
  Petrol cars 10 percent
  Diesel cars 60 percent
  Vans 30 percent

Computation of Duty

Domestic

Wholesale price excluding Excise (Special Provisions) duty multiplied by the Excise (Special Provisions) duty rate.

Imports

105 percent of CIF with all fiscal levies excluding Excise (Special Provisions) Duty, multiplied by the Excise (Special Provisions) Duty rate.

Date of payment

Cigarettes and Petroleum products – monthly payment
Liquor – quarterly payment
Motor vehicles – at the point of import

VI. Excise (Ordinance) Duty

Legislation

Excise Ordinance No. 8 of 1912 and subsequent amendments.

Implementing Agency

Department of Excise

Liability

Domestically produced hard and soft liquor only.

Duty structure

• Coconut and processed arrack	Rs 200.80 per proof liter[2]
• Country made foreign liquor	Rs 234.80 per proof liter[2]
• Molasses and palmyrah arrack	Rs 184.80 per proof liter[2]
• Malt liquor above 5 percent in strength	Rs 25 per liter[2]
• Malt liquor less than 5 percent in strength	Rs 15 per liter[2]

Date of payment

Monthly

VII. National Security Levy

Legislation

The National Security Levy (NSL) is imposed under the National Security Levy Act No.52 of 1991 as amended from lime to time.

Implementing Agency

Department of Inland Revenue

Liability

Manufacture and imports and selected services such as insurance, banking, finance and telecommunication.

Exempted

Exports, re-exports, imports and manufacture of gems and jewelry and electricity.

Duty structure

Standard rate	5.5 percent
Concessionary rate for plant and machinery	0.5 percent

[2]Standard proof is 57.1 percent in alcohol.

Computation of Duty
Domestic:
Wholesale price (WSP) excluding Excise (Special Provisions) duty, multiplied by the NSL rate.

Imports:
The aggregate of CIF, Customs Duty (CD), 25 percent mark-up of CIF and CD to be multiplied by the NSL rate. [(CIF + CD) 1.25] x NSL Rate.

Date of payment
Monthly payment if the turnover exceeds Rs 5m per month, otherwise quarterly.

VIII. Turnover Tax

Legislation
Turnover Tax Act No. 69 of 1981 as amended from time to time.

Implementing Agency
Department of Inland Revenue

Tax Liability
TT is applicable to banking and financial services which are not liable to GST.

IX. Stamp Duty

Legislation
Stamp Duty Act No. 43 of 1982 as amended from time to time.

Liability
Section 2 of the Stamp Duty Act imposes the duty to be paid and specifies the documents and instruments in respect of which the duty is chargeable.

Following are the main instruments liable for Stamp Duty:
(a) Debt acknowledgments.
(b) Letters of credit, bills of exchange, promissory notes.
(c) Bonds, pledges, mortgages, share certificates, bank guarantees.
(d) Deed or instruments for the exchange of any property, lease or hire agreements.
(e) Documents filed in civil proceedings and other court documents affidavits, affirmations.

Rates
Rates of duty as fixed by Regulations made under Section 69 of this Act.

	For every Rs 7,000 or part thereof
• Letter of Credit	
Imports	Rs 20.00
Re-exports and sale in duty free shops	Rs 0.50
• Agreements relating to mortgages, transfers, pawning, pledges	Rs 2.00

X. Motor Vehicle Tax

Legislation
The motor vehicle levy was introduced in Sri Lanka by the Finance Act No. 16 of 1995 and implemented from April 1, 1995.

Implementing Agency
Department of Motor Traffic

Tax liability
An annual levy of Rs 5,000 is levied on diesel motor vehicles.

Luxury motor vehicles as classified below are also liable to a levy which is imposed on an annual depreciation over a period of 7 years.

Vehicle	*Type / Capacity*	*Levy in the first year*
Luxury	Diesel - exceeding 2,500cc Petrol - exceeding 2,000cc	Rs 50,000/-
Semi luxury	Diesel - 2,200cc–2,500cc Petrol - 1,800cc–2,000cc	Rs 25,000/-
Semi luxury dual purpose Excluding vans	Diesel - exceeding 2500 cc Petrol - exceeding 2000 cc	Rs 10,000/-

NONTAX STRUCTURE

I. RAILWAY

Legislation

Railway Ordinance No. 9 of 1902

Basis of Liability

Passengers and freight

- **Passenger fares per km**
  1st Class: 0.984 cts
  2nd Class: 0.564 cts
  3rd Class: 0.204 cts
- **Freight fares per tonne kilometer**

Class	*Below Rambukkana (Rs)*	*Above Rambukkana (Rs)*
1	0.60	0.90
2	0.80	1.20
3	1.20	1.80
4	2.00	3.00

II. POSTAL

Legislation

Ceylon Post Office Ordinance No. 11 of 1908

Basis of Liability

Letters	Rs 3.50 for 30 gms
Post cards	Rs 2.00
Registration fees	Rs 10.00
Aerogrammes	Rs 12.00
Printed matter	Rs 2.00 for 30 gms

III. RENT

- **Government quarters**

  A fixed rate of Rs 1000/- per month for summit flats

  Economical rent decided by the Ministry of Public Administration. The rate depends on the area and the facilities provided.

  Rents are imposed on government buildings in terms of the schemes stipulated in chapter XVIII–XX of the Establishments Code.

Base

Government officers quarters	Married	– 12½ percent of basic salary
	Unmarried	– 7½ percent of basic salary
Circuit bungalows:	Nuwara Eliya and Diyatalawa	– Rs 50.00 per day
	Diyatalawa and Bandarawela	– Rs 35.00 per day

Rent for office space depends on the floor area

- **Lease Rental from Regional Plantation Companies:**

  Revenue Base for Lease Rental –
  The base lease rental value is adjusted each year by the GDP deflator of the preceding year.

IV. INTEREST
Interest levied on lending to commercial enterprises. Interest rate is determined in terms of the provisions of the respective sub-loan agreements.

V. PROFITS AND DIVIDENDS
- Profit received from public enterprises
- Dividend received on the Government share of public companies
- Levies imposed

VI. SALES AND CHARGES
Legislation
Under Relevant Legislation
- Administrative Fees and Charges e.g., Passport fees, examination fees etc.
- Sales by Government Departments e.g., sale of publications by the Government Press Sale of used goods, scrap and waste by the Government Departments.
- Fines and Forfeits - Fines, penalties and forfeits.

VII. SOCIAL SECURITY CONTRIBUTION
Legislation
Widows and Orphans Ordinance No. 1 of 1898.

Base
- On salary

up to Rs 45,600 per annum	— 4.6 percent
Rs 45,601 - 70,260 per annum	— 6 percent
Rs 70,261 and above per annum	— 7 percent

- The W and OP scheme for female officers who joined the public service prior to 1983 was optional.
- The following officers serving in the police and armed services are exempt.

* Police	— Home Guards Policy Security Assistants
* Army, Navy, Air Force	— Volunteers and all female staff

VIII. CENTRAL BANK PROFIT TRANSFERS
Monetary Law Act No. 58 of 1949–Chapter 2 Section 39 (C)
In terms of Section 39 of the Monetary Law Act, any net profit after liquidation of the Monetary Adjustment Account and maintaining at least 15 percent of the difference between total assets and assets in gold and in foreign currencies, can be used to liquidate any outstanding government obligations to the Central Bank of Sri Lanka or be credited to the Consolidated Fund in consultation with the Minister of Finance.

IX. CAPITAL REVENUE
- **Divestiture Proceeds**
  Public Enterprises Reform Commission Act No. 1 of 1996. All divestiture proceeds are to be credited to the Consolidated Fund.
- **Repayment of Loans**
  Principal amount received by the Government on lending to commercial enterprises.

Tax Incentives Under Inland Revenue Act

Category	Incentives
Agriculture and animal husbandry	▪ Tax holidays (10 years). ▪ Exemption of dividends. ▪ Exemption of certain subsidy or grant. ▪ Deduction of certain expenses (e.g., agricultural research expenses, expenses incurred in opening up land). ▪ 15 percent concessionary tax rate
Fishing	▪ Tax holidays (5 years). ▪ Exemption of dividends. ▪ Exemption of certain subsidy or grant. ▪ Deduction of certain expenses (e.g., research expenses, purchase of equipment for fishing, purchase of fish for rearing).
Tourism and construction	▪ 15 percent concessionary tax rate
New and existing company utilizing advanced technology: ▪ employing at least 50 people; ▪ investing a minimum of Rs 4 million on machinery; ▪ with approval of MOF.	▪ Tax holidays (5 years).* ▪ Exemption of dividends.* *Package to expire March 31, 2000.
Exports	▪ Profits sourced from export of nontraditional goods are subject to 15 percent concessionary tax rate for 20 years. ▪ Dividends out of qualified export profits are subject to 15 percent tax rate. ▪ Companies that supply to export operations also benefit from 15 percent tax rate for 20 years. Dividends are also taxed at 15 percent. ▪ Zero rated for GST.
Housing	Tax Exemptions: ▪ Net annual value of owned house is exempt from income tax; ▪ Rent is exempt from income tax for 7 year period including the year when construction is completed; ▪ Capital gains arising from change of ownership are exempt or taxable at reduced rates (5–25 percent); ▪ 75 percent of profits from construction and sale of houses is exempt from income tax; ▪ Dividends paid by a company for construction and sale of houses are exempt from income tax.
	Relief for Investment Following expenses are deductible from income as 'qualifying payments': ▪ investment on a construction/sales company; ▪ repayment of housing loans; ▪ amount spent by individual in construction of a house; ▪ amount spent by individual on certain lease of residence.
Gem and jewelry trade	▪ Companies that export gems and jewelry receive an open-ended exemption from income tax. ▪ Exemption of dividends.

Tax Incentives Under Section 17 of BOI Law

Category	Incentives
Thrust Industries (electronics, ceramic, rubber, engineering, pioneering):	
1. **New and existing BOI companies** ▪ Minimum investment of Rs50 million. ▪ Exporting at least 90 percent of output. ▪ Employing minimum 50 persons (existing companies only).	▪ Tax holidays (10-20 years, depending on investment scale). ▪ Concessionary tax at 15 percent after tax holidays and up to cumulative period of 20 years. ▪ Import duty exemption.
2. **Existing nonBOI companies**	▪ 5 year tax holidays (if company reaches a 50 percent export level within 5 years). ▪ 10 year tax holiday (if company reaches a 90 percent export level within 10 years). ▪ Concessionary tax at 15 percent after tax holiday and up to cumulative period of 20 years. ▪ Import duty exemption.
Nontraditional export oriented manufacturing: ▪ Minimum investment of Rs 12.5 million; ▪ Exporting at least 90 percent of output.	▪ Concessionary tax at 15 percent (20 years). ▪ Import duty exemption. ▪ Excise duty exemption.
Export-oriented services: ▪ Minimum indirect export of 70 percent of output.	▪ Concessionary tax at 15 percent (20 years). ▪ Import duty exemption. ▪ Excise duty exemption.
Large scale projects: ▪ Total project cost is not less than Rs 500 million; ▪ Exporting at least 90 percent of output; ▪ Employing minimum 100 persons.	▪ Tax holidays (10–20 years). ▪ Concessionary tax at 15 percent after tax holidays and up to cumulative period of 20 years. ▪ Import duty exemption. ▪ Excise duty exemption.
Projects locating in designated industrial zones: ▪ Exporting at least 50 percent of its output (in the case of apparel, the criterion is 90 percent); ▪ Employing minimum 150 persons.	▪ Tax holidays (5, 8 years, depending on zones). ▪ Concessionary tax rate at 15 percent after tax holidays and up to cumulative period of 20 years.

Note: There are more tax incentive under BOI law which apply to: (i) exports of textiles, software, gems, and jewelry, and agricultural products; (ii) export trading, regional operating headquarters; (iii) expansion of existing and new companies outside Colombo district; (iv) nonexport oriented projects (tourism, housing, and small scale infrastructure); (v) existing enterprises undertaking large scale investments; and (vi) training institutions, worker transport.

INFLATION TARGETING IN SRI LANKA—PRELIMINARY CONSIDERATIONS

I. INTRODUCTION

1. In the two decades since liberalization reforms began in Sri Lanka in the late 1970s, inflation in Sri Lanka has been moderate (10–30 percent) but sustained, and thereby exacted a high cost on the economy. The principal reasons for the persistence of inflation include the lack of transparency in the precise goal of monetary policy within a framework of monetary and exchange rate anchors, the conduct of a generally accommodative monetary policy, the authorities' backward-looking approach to inflation, and the apparent instability of money demand. As a result, despite declining average inflation over the last year or so (to 5 percent by August 1999), inflationary expectations remain two to three times higher. One method of permanently reducing inflationary expectations that has been adopted by an increasing number of countries with moderate levels of inflation, including some developing countries, is to target the inflation rate directly rather than through some intermediate target. This paper outlines the main issues that would need to be considered by the Sri Lanka authorities in the move to an inflation targeting (IT) framework.

2. Section II reviews the main developments in inflation in Sri Lanka over the last two decades, and assesses the costs of sustained inflation on the economy. Section III describes the current monetary policy operations, highlights the principal advantages for Sri Lanka of moving to an IT framework, and reviews the main requirements and constraints of such a shift. Section IV draws together the conclusions of the analysis.

II. INFLATION DEVELOPMENTS

A. Measures and Trends

3. **There are several measures of inflation in Sri Lanka**, including three separate indices for consumer prices, a wholesale price index (WPI), and the GDP deflator. As explained in Box 1 of Chapter II, each of the three measures of consumer price inflation suffer from a number of deficiencies. Briefly, despite its narrow coverage and outdated weights, the Colombo CPI (CCPI) is the official measure of inflation in the economy since it is used to determine wage adjustments for many employees. The Greater Colombo CPI (GCPI) has wider coverage than the CCPI, both geographically and in the number of goods and services included in the basket, and is based on more recent expenditure weights. The Colombo District CPI (CDCPI) has the widest geographical coverage, is based on very recent expenditure weights, but suffers from gaps in its coverage of consumer durables and communications. The WPI is closer to a producer price index since it measures producer rather than wholesale prices, but its weights are outdated. Finally, the GDP deflator is heavily influenced by the terms of trade (as are the CPIs) but is compiled only quarterly.

4. **Over the last two decades, all measures show that the average annual rate of inflation in Sri Lanka has been moderate (10–30 percent), persistent, and exhibited relatively wide cyclical variance.** From 1978 through 1998, the average of all inflation measures was 12 percent but the average rate was never been kept below 8 percent for longer than 3 years (Figure 14). Through the mid-1980s, the cyclical variance of each measure was relatively wide, as was the dispersion between the measures. Though all measures have moved closer together recently, and oscillated less, the variance of each inflation measure remained relatively wide, ranging between 7–22 percent. According to the official index, average inflation was 12.3 percent over the period (Figure 15). However, the variance of annual consumer price inflation has been quite large, and the post-reform era has been subject to four distinct episodes (1978–81; 1983–84; 1988–90; and in 1996) during which average inflation rose above 15 percent.

5. Inspection of the main components of the CCPI reveals differences in their cyclical patterns (Figure 16). Price inflation of food items (weight: 62 percent) exhibited regular oscillation, mostly reflecting weather patterns, rising above 30 percent in 1981, 1991 and 1997, and turning negative in 1985 and 1995. Price inflation of clothing (weight: 9 percent) was relatively stable except for 1987 and 1990 when price increases surged above 20 percent. The price of fuel and light (weight: 4 percent) surged twice in the early 1980s and again in the early- and mid-1990s. The price of rent (weight: 6 percent) was not adjusted during the period. Finally, price inflation of the miscellaneous category (weight: 19 percent) remained relatively stable. The CCPI contains several items, including kerosene, bread, wheat flour, tobacco, alcohol, electricity, and some transport fees, whose prices have long been administered by the government and adjusted only periodically.[1]

6. Administrative price changes were relatively large in 1981, 1984, 1990, and 1997. Excluding the effect of all administered price changes, "free" or "uncontrolled" consumer price inflation averaged 12 percent over the period, virtually the same rate as indicated by the overall index and the "Miscellaneous" items category, which excludes most administratively-set prices and volatile food prices.

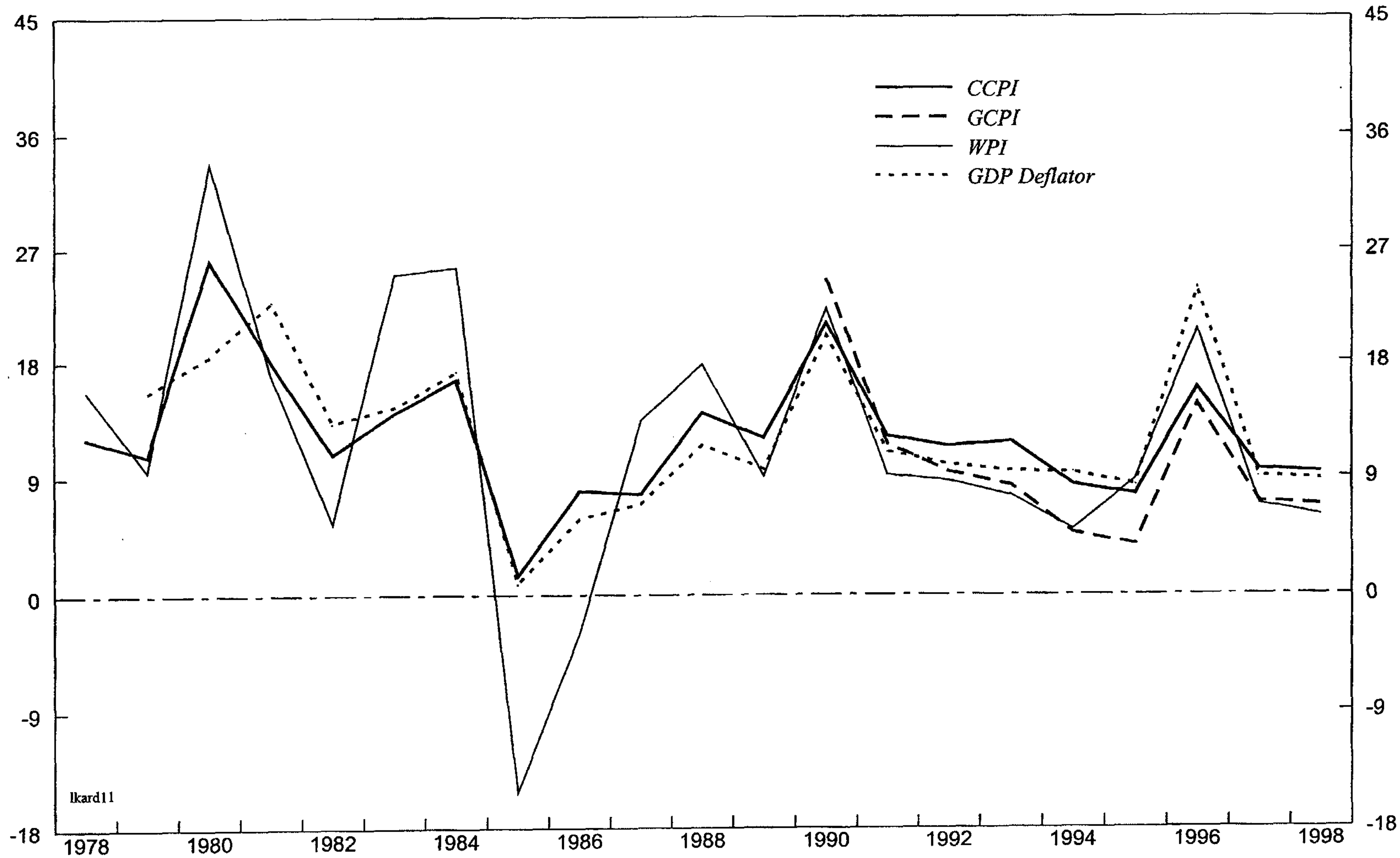
B. Determinants

7. **In Sri Lanka, import costs, weather-related supply factors, and excessive liquidity growth have been the main causes of inflation.** As Sri Lanka is a small open economy still moderately dependent on agricultural output, a priori one would expect that in addition to the usual demand-pull factors (bank financing of fiscal deficit, wage and monetary growth pressures), cost-push factors such as movements in the terms of trade and vagaries in the weather would exert a strong influence on inflationary developments. Indeed, a 1994 staff study found that between 1977 and 1993, i.e, including the first three periods of accelerating price increases referred to above, overall, inflation in Sri Lanka was predominantly caused by

[1]Administratively priced items have a combined weight of about 20 percent in the index.

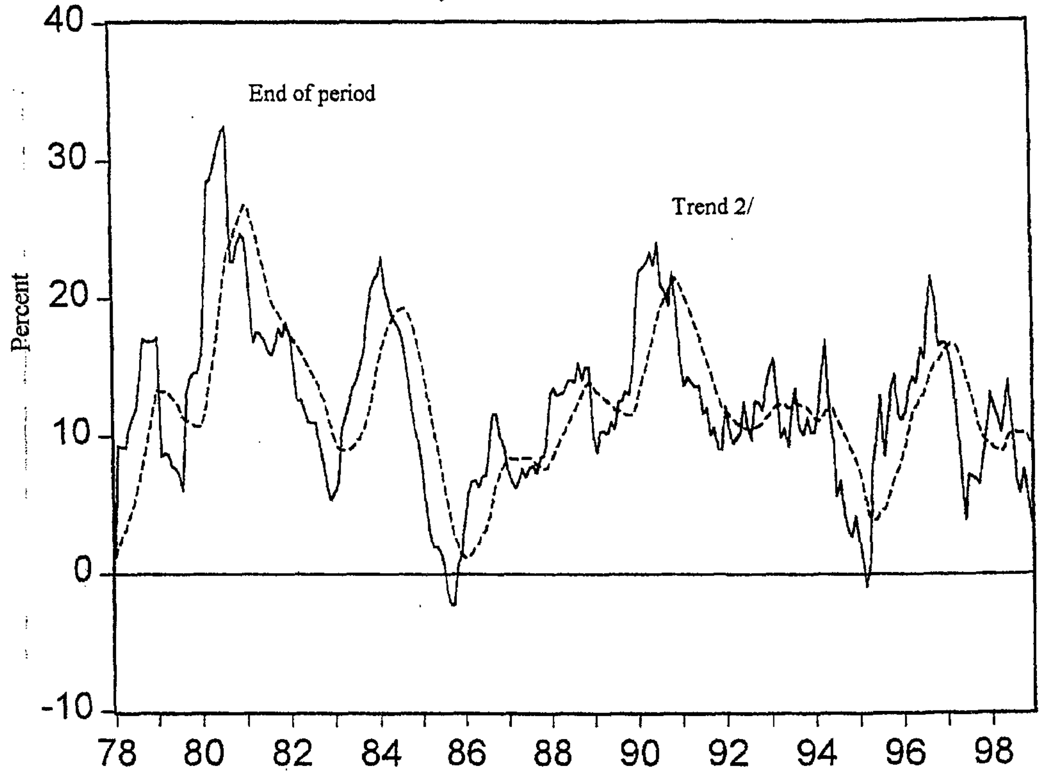
Figure 14. Sri Lanka: Annual Average Inflation, 1978-98

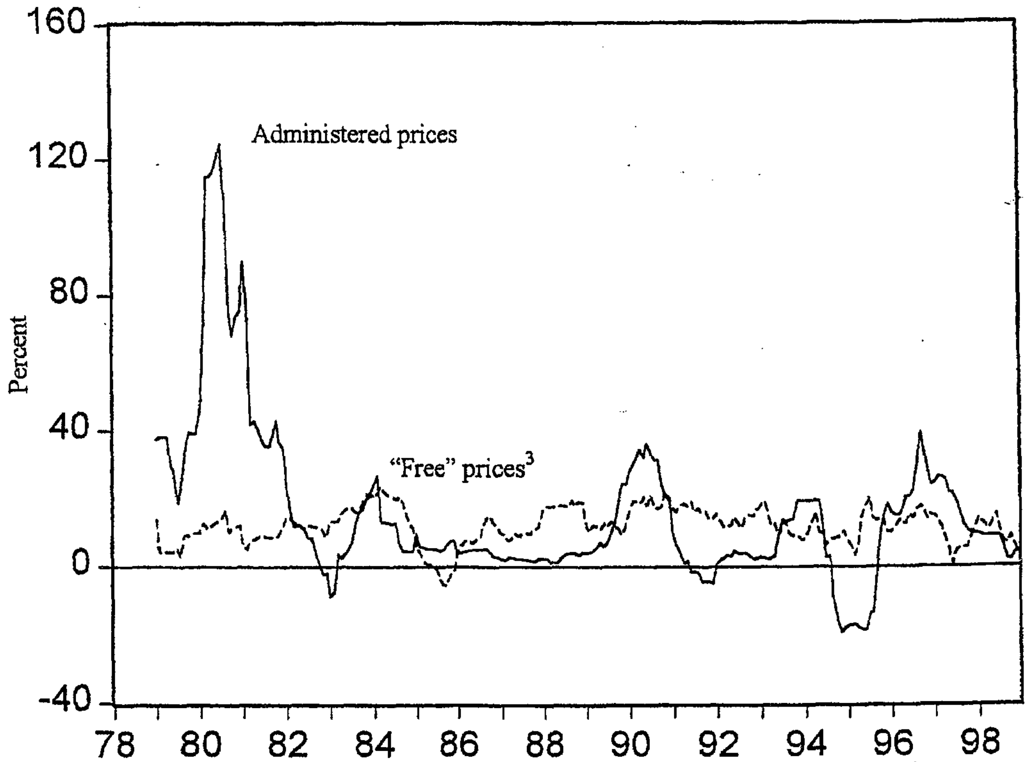
(In percent)



Source: Data provided by Sri Lanka authorities.

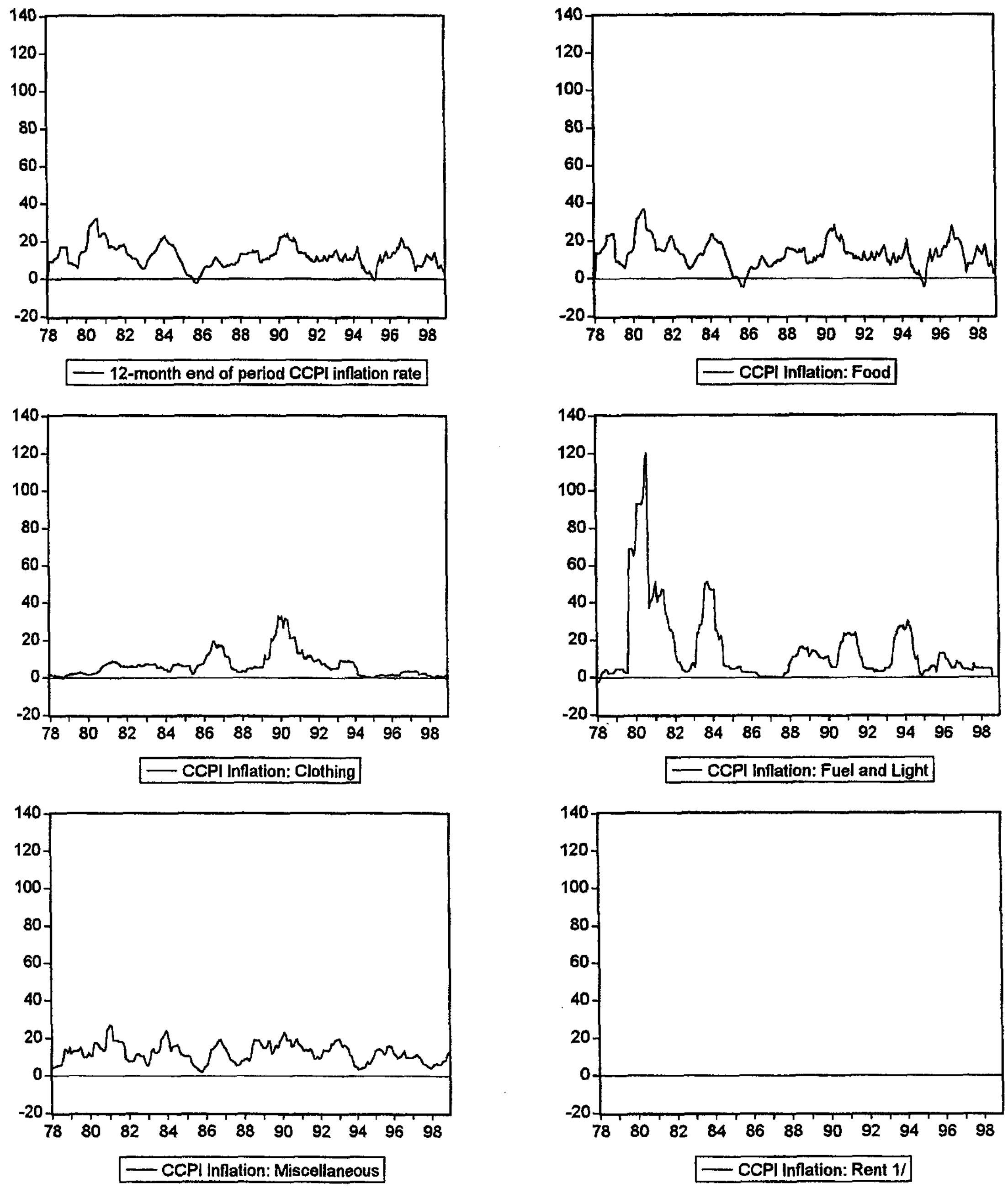
Figure 15. Sri Lanka. Consumer Price Inflation
January 1978–December 1998 1/





Source: Data provided by the CBSL.
1/ As measured by overall CPI.
2/ Twelve-month moving average.
3/ "Free" prices inflation refers to the change in the overall CCPI excluding changes in administered prices.

Figure 16. Sri Lanka: Consumer Price Inflation by Main Component
January 1978 - December 1998



Source: Data provided by the CBSL.

1/ Rent prices remained unchanged during the period.

increases in international import prices and, to a lesser extent, excessive domestic liquidity growth originating, in large part, from rising fiscal deficits.[2] Weather-related supply shortages, discrete upward adjustments in administered prices, and a generally accommodative monetary policy were also contributing factors to overall inflation in all four episodes. In addition, it is possible that the high variability in relative price movements added impetus to overall inflation through so-called menu effects.[3]

8. **Imported and domestically-generated inflationary pressures in Sri Lanka have followed different cyclical patterns**. Following a steep spike in inflation in the late 1970s, after the second oil shock and the initial liberalization of the economy, inflation declined in the first few years of the 1980s in response to the appreciation of the real effective exchange rate, lower US dollar import prices, and lower growth of public sector credit from a tightening of fiscal policy. This progress was reversed in the mid- and late-1980s, as a result of expansionary policies and worsening terms of trade. After a period of declining or steady inflation after 1991, prices accelerated again in 1996 following rapid monetary expansion, higher food prices stemming from the drought, and further adjustments in administered prices. Since then, lower import prices, favorable weather, and contained monetary expansion led to a reduction in trend inflation, to around 10 percent by end-1998.

C. Effects

9. **Though moderate, sustained inflation has exerted a number of negative impacts on the Sri Lanka economy**. First, inflation has created and perpetuated a vicious-cycle of currency depreciation-wage and price inflation-currency depreciation. This has not only increased domestic costs, which have offset temporary gains in competitiveness, but also resulted in permanent and uneven inflationary expectations. Second, uncertain inflationary expectations have, in turn, acted as a break on domestic resource mobilization by discouraging savings and making ex post returns on financial instruments riskier, and raised ex ante lending rates which have discouraged domestic investment. Third, inflation has increased income inequality by exerting a disproportionate adverse effect on people with fixed-incomes, including pensioners, welfare recipients, and the poor. Fourth, even moderate inflation has probably resulted in lower economic growth over the period. In particular, while the theoretical and empirical evidence on the detrimental effect of high inflation on economic growth have long been established, recent empirical evidence also points to the existence of a

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[2] *Inflation Determination in Sri Lanka*, prepared by Paul J. Heytens, "Sri Lanka: Background Papers", SM/94/67; March 16, 1994; IMF (unpublished).

[3] Spikes in the costs of a few items are likely to be passed on in the form of higher prices, while small declines in the costs of other items are rarely fully translated into lower prices for these items. Evidence of this ratchet effect on inflation, through large increases in administered prices, has been found for Poland. See Pujol and Griffiths (1996) and Wozniak (1998).

statistically significant negative (nonlinear) relationship between growth and moderate- to low-inflation, all the way down to the single-digit range.[4]

III. Inflation Targeting

10. **The implementation of monetary and exchange rate nominal anchors has failed to bring about a permanent reduction in the rate of inflation in Sri Lanka.** Three principal reasons for this can be identified. First, the main objectives of monetary policy of stabilization and development have been given varying priority and have, in some instances, conflicted.[5] For example, in the 1980s, the policy of low interest rates stemming from concerns about the rate of economic growth resulted, at times, in excessive liquidity growth and/or exchange rate depreciation, which in turn, contributed to inflation. Second, neither the nominal monetary anchor system nor, since 1983, the dual nominal anchor system of money and exchange rate targets, has been successful in permanently reducing inflation, in large part because monetary and exchange rate policies have been passive (based on a backward-looking inflation path). In particular, though the CBSL uses short-term interest rates and open-market type operations in domestic government securities in a bid to influence interbank call rates and broad money growth in line with the (unannounced) indicative monthly monetary growth targets, the targets are based on projected inflation as determined by a two-year moving average of past inflation. Third, recent studies have raised doubts about the stability of the relationship between the intermediate monetary target and the final objective of price stability. In particular, Op de Beke and Kochhar (1997) found no predictable relationship for narrow or broad money including foreign currency deposits, and only weak evidence of a stable demand for broad money excluding foreign currency deposits, with parameter instability more acute in the early 1990s.[6] More recently, Weliwita and Ekanayake (1998) confirmed the absence of a stable demand for broad money but found some evidence of a stable demand for narrow money.[7]

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[4]For example, see A. Ghosh and S. Phillips, *Warning: Inflation May Be Harmful to your Growth*, IMF Staff Papers, Vol. 45, No. 4 (December 1998), and M. Sarel *Nonlinear Effects of Inflation on Economic Growth*, IMF Staff Papers, Vol. 42, No.1 (March 1996).

[5]The Monetary Law Act refers to the stabilization of the general level of domestic prices and the exchange rate, and the development of the productive resources of the country.

[6] *Money Demand and Monetary Policy in Sri Lanka*, prepared by A. Op de Beke and K. Kochhar in "Sri Lanka: Selected Issues", IMF Staff Country Report No. 97/95, IMF, Washington, D.C. (October 1997).

[7]A. Weliwita and E.M. Ekanayake, *Demand for Money in Sri Lanka During the Post-1977 Period: A Cointegration and Error Correction Analysis*, Applied Economics, Vol. 30 (1998).

11. **Inflation targeting offers a potential alternative nominal anchor**. Inflation targeting (IT) has gained increased attention over the last decade or so, including recently in some developing countries.[8] In principle, IT is relatively straightforward and involves the following four basic steps: (i) the inflation target is set by the government (in agreement with the central bank) and publicly announced; (ii) the central bank forecasts the future path of inflation; (iii) the forecast is compared with the targeted inflation rate; and (iv) the difference between the forecast and the target determines how much monetary policy has to be adjusted.

A. Advantages

12. **The shift to IT framework in Sri Lanka would offer many advantages over the current dual nominal anchor framework.** Most importantly, it would: (i) enable the CBSL to focus on the *primary* objective of reducing inflation by giving it the mandate to tighten monetary policy *before* inflationary pressures rise too high; and (ii) lock-in inflation at a low single digit rate to permanently reduce inflationary expectations, which remain high, and help end the cycle of inflation-depreciation. In addition, public agreement between the CBSL and the Ministry of Finance and Planning on the inflation target is likely to enhance the credibility, accountability, and transparency of the monetary framework and may improve the efficiency of the transmission mechanism.[9]

B. Requirements

13. **Successful implementation of an IT policy would require firm political commitment.** First, at a policy level, adoption of an IT framework would require public agreement between the CBSL and the government on the inflation target. This would imply implicit acknowledgment that there exists no long-run trade-off between inflation and unemployment, and that notwithstanding the possibility of a short-run Phillips curve, the best way the CBSL can help generate higher growth in the long-run is to maintain a low rate of inflation. Thus, the inflation target must be given priority over all other objectives such as wages, employment, or the exchange rate, unless other policy goals are consistent with the inflation target.[10] Second, the CBSL should have a sufficient degree of independence in

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[8] Inflation targeting frameworks have been adopted in Australia, Canada, Finland, New Zealand, Spain, Sweden, and the U.K. In developing countries, recent cases include Chile, the Czech Republic, Israel, and Poland.

[9] For example, in New Zealand, the inflation target is publicly agreed between the Reserve Bank and the government in the Policy Target Agreement (PTA). The PTA may be overridden by the government for a period of six months, but the reasons must be made public. See Debelle (1997) and Masson, Savastano, and Sharma (1997).

[10] In Chile, Israel, and Poland, an inflation target coexists with a crawling exchange rate band.

(continued...)

conducting monetary policy. This does not imply that the CBSL needs to be independent in a statutory sense, although there are advantages, but the CBSL must be free to use all the instruments of monetary policy at its disposal without government interference.[11] In case disagreement does arise over the required policies to achieve the inflation target, the reasons for the disagreements should be made public. Third, and related to the first point, fiscal policy needs to be supportive of the inflation target so as not to create expectations of future inflation, either through excessive bank financing of the budget deficit or an unsustainable accumulation of public debt.[12] In that connection, it would be important to resume the progress in fiscal consolidation by publicly re-asserting a path for the reduction of the fiscal deficit, and ensuring that the domestic financial market is able to absorb placements of public debt. Such a renewed commitment to a supportive fiscal policy would enhance the credibility of the IT framework and thereby help to reduce inflationary expectations.

14. **Adoption of an IT framework would also require a forward-looking approach to inflation and meeting technical and operational requirements**. In principle, the operating framework under an IT regime would not be that different from the current one, except in two important ways. First, key short-term interest rates under the control of the CBSL (repo and rediscount rates) would be adjusted to affect future inflation (and not as a reaction to past and current inflation as in the present framework). Second, the exchange rate should be fully flexible to absorb temporary external shocks, leaving the primary task of reducing inflation to monetary policy. Management of the exchange rate to limit the rate of depreciation, would only be possible to the extent that the level of the exchange rate chosen or targeted is consistent with the inflation objective.

15. In addition, several technical requirements would need to be met. First, the authorities would need to develop an accurate and reliable measure of underlying or core inflation, which abstracts from temporary influences. Second, the CBSL must be able to accurately forecast inflation on a monthly basis over a policy-relevant time horizon. This implies that a reliable relationship can be modeled from looking at historical data, and that it will remain sufficiently stable under the new regime. Third, the CBSL must be able devise a reliable forward-looking

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[10](...continued)
However, the pursuit of other objectives is likely to reduce the credibility of the authorities' commitment to make the inflation target the priority in case of conflict.

[11]Debelle and Fischer (1994) and Debelle (1997) distinguish between "goal" and "instrument" independence. In practice, if the inflation target is not endorsed by the government, and the government can remove the Governor of the Central Bank, "instrument" independence may have little effect.

[12]A 1995 staff study found that the fiscal position as at end-1994 was not sustainable. That assessment was recently confirmed by Cashin, Haque, and Olekalns (1999) based on the stock of public sector liabilities at end-1997.

operational procedure to adjust monetary policy instruments, in relation to its assessment of future inflation, to hit the chosen target. In other words, pre-emptive strikes against inflation in the form of changes in the instrument(s) of monetary policy would be necessary *before* the inflation rate begins to rise. Such a proactive monetary policy would, in turn, require the CBSL to acquire a firm understanding of the dynamics, including lag lengths, involved between a change in the policy instrument and its impact on the inflation target. The results from such an exercise would provide crucial input into several other aspects of IT, including the horizon over which the target should be specified, its level, and whether it should be a point estimate or a band. However, as discussed in the next section, further work is required before these technical and operational requirements could be met.

C. Constraints

16. **Preliminary results on the search for leading indicators of inflation, which could be used to model and forecast inflation, and on the transmission mechanism, are mixed.** Results of recent work undertaken by the CBSL indicate that changes in its monetary conditions index (MCI), which measures the pressure on inflation arising from changes in the interest rate and exchange rate, are broadly consistent with changes in inflationary pressures 9 months ahead.[13] In addition, preliminary analysis undertaken by Fund staff suggests that a statistical relationship can be found between broad money (including foreign currency deposits) and two measures of inflation (overall CCPI inflation and CCPI inflation excluding administrative prices changes, or "free" price inflation), although the relationships are not strong (see Box 6 and Figure 17). In particular, neither the import price variable nor any exchange rate measure appears statistically significant as a leading indicator of inflation. This may be because temporary or exceptional price movements are increasing the volatility of both inflation measures used. As hinted above, better results might be obtained by constructing an "underlying" or "core" rate; i.e., one that excludes not only the effect of changes in administered prices but also the impact of changes in subsidies and indirect taxes, supply shocks (e.g., weather-related), and items whose prices are subject to high volatility (e.g., certain food items).[14] Finally, with regard to the transmission mechanism, preliminary work at the CBSL has found that the impact of short-term interest rates on inflation is statistically significant after a lag of about 2 years. However, as discussed below, the relationships and

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[13] The MCI measures the weighted pressure of interest and exchange rate deviations (three-month Treasury bill and real effective exchange rate, respectively) on the deviation of inflation, compared to levels that prevailed in a base period (January 1993). See *Central Bank of Sri Lanka Annual Report, 1998*; Box 2, p.17.

[14] Partly in response to recent Fund technical assistance, the CBSL is working on expanding the CD–CPI, and plans to compute an island-wide consumer price index, including various sub-indices, sometime next year. A monthly production price index is also being prepared.

Box 6. The Search for Leading Indicators of Inflation in Sri Lanka

A necessary condition for adopting an inflation targeting framework is the ability to forecast inflation over a policy-relevant time horizon. A common approach to building a forecasting equation when underlying structural economic relationships are changing and/or not well understood is to use leading indicators. Typically, the approach uses vector autoregressions (VARs) to help identify leading indicators which have predictive information (in this case on inflation) on the basis of three following sequential tests: Granger-causality tests provide information on the indicator properties of selected variables; variance decomposition tests measure the proportion of the variance of inflation that is explained by the variance of the indicator variable; and impulse response tests assess whether the indicator variable contains information sufficiently far ahead in the future to be operationally useful.

The Data

Prices were measured using the overall CCPI, the overall CCPI excluding administered prices (i.e., "free" prices), and the index of "miscellaneous" items in the overall CCPI. The set of leading indicator variables used comprised reserve and narrow money, broad money (including and excluding foreign currency deposits, FCD), net credit to government, credit to the private sector, three-month LIBOR, three- and twelve-month T-bill rates, overnight repurchase (repo) rate, nominal and real effective exchange rate indices, bilateral exchange rate of the rupee against the US dollar, nominal and real wage rate indices of central government employees, administered prices, import unit values (converted to local currency), the US price index, and the All Share index of the Colombo Stock Exchange. The sample period starts in January 1978 and ends in December 1998, except for the following series for which start dates are (in parenthesis): the effective exchange rate indices (February 1979), the 12-month T-Bill rate (March 1989), the stock exchange index (January 1991), broad money including FCD (January 1992), and the repo rate (November 1993). All variables are seasonally adjusted, except interest rates and the stock exchange index, and in natural logarithms, except interest rates. ADF and Phillip-Perron tests show that the levels of all variables are I(1). Therefore, first differences of inflation and the indicator variables are assumed to be stationary.

Initial Results

The initial results of the search for leading indicators of inflation are only partially encouraging. The results of the likelihood-ratio tests for the null hypothesis that the indicator variable does not Granger-cause inflation show that monetary aggregates, both the nominal and real wage rate indices, the US and world inflation rates, the nominal effective exchange rate, and interest rates have some degree of predictive content for three measures of inflation selected.[1] However, neither the import price index nor any exchange rate measure showed any predictive content, although both are known to be important determinants of inflation. The variance decomposition results only (and weakly) support the Granger-causality findings that broad money including FCD is a leading indicator of inflation. The variance of broad money including FCD explains, within 12 months, about 20 percent of the variance in overall CCPI inflation and 16 percent of the variance in "free" price inflation. Finally, the impulse-response functions from broad money including FCD to both measures of inflation are statistically significant for short lags (Figure 17); more so for "free" price inflation. However, in both cases, an impulse to broad money is shown to cause an initial *decline* in inflation. This counter-intuitive result could be explained by a temporary shock to consumption, which would exert downward pressure on prices, and increase both deposits and lending.

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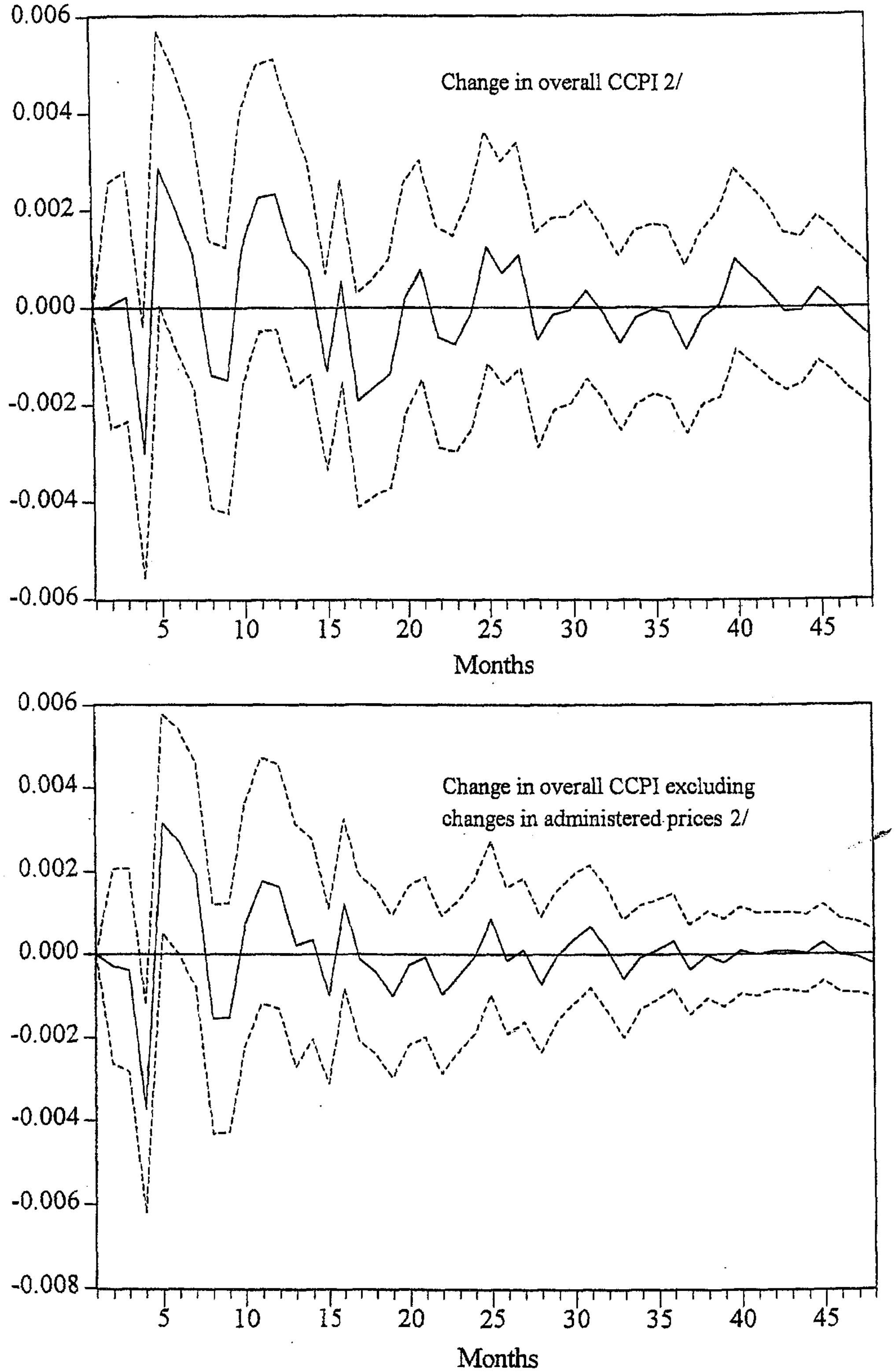
[1]The results are available from the author at esidgwick@imf.org.

Figure 17. Sri Lanka. Inflation Responses to Impulses in Broad Money 1/



Source: Data provided by the CBSL.

1/ Broad money includes foreign currency deposits.
2/ Dotted lines denote standard errors.

dynamics between the whole structure of interest rates and inflation are distorted by government interference in the market determination of interest rates in the financial system.[15]

17. **Problems of financial repression, a shallow capital market, and a fragile banking system need to be addressed**. Though interest rates are in principle market-based, the government retains a strong influence on their determination. In particular, the compulsory placements of public debt ("rupee loans") with the National Savings Bank, the insurance companies, and the two government-sponsored pension funds, reduces the government's borrowing cost and prevents the development of a secondary market in government debt. Moreover, the fragile banking system, dominated by two state banks in poor condition, also interferes with the market-determined interest rate structure. Until interest rates are completely free to respond to market forces, the transmission mechanism between a change in the instruments of monetary policy (e.g., a change in the repo rate) and its effect on the policy target (e.g., inflation) is unlikely to operate effectively.

IV. Conclusions

18. Sustained inflation has exerted a number of negative impacts on the Sri Lankan economy over the last two decades, including the persistence of high inflationary expectations and, possibly, lower economic growth. The persistence of inflation has been caused, in part, by the lack of transparency in the precise goal of monetary policy, within a framework of monetary and exchange rate anchors, and the authorities' backward-looking approach.

19. The adoption of an IT framework in Sri Lanka would: (i) force the Central Bank to focus on the primary objective of reducing inflation and give it the opportunity to tighten policies *before* inflationary pressures rise too high; and (ii) lock-in inflation at a low single digit rate to permanently reduce inflationary expectations. Public agreement between the CBSL and the Ministry of Finance and Planning on the inflation target is likely to enhance the credibility, accountability, and transparency of the monetary framework and may improve the efficiency of the transmission mechanism.

20. Preliminary results suggest that broad money (including foreign currency deposits) and the monetary conditions index could be used as leading indicators to help model and forecast inflation, but further work is required in constructing an "underlying" or "core" measure of inflation. Finally, the relationships and dynamics of the monetary transmission mechanism between short-term interest rates and inflation are distorted by government interference in the market-determination of interest rates.

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[15] *The Scope for Inflationary Targeting in Sri Lanka*, prepared by H.N. Thenuwara; Central Bank of Sri Lanka, December 1998 (unpublished). By comparison, estimates for industrial countries indicate that the average lag between inflation determinants and their full effect on inflation ranges between 18–24 months.

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Table 1. Sri Lanka: Gross Domestic Product and Expenditure Components, 1994–98 1/

	1994	1995	1996	1997	1998
	(In billions of Sri Lanka rupees at current market prices)				
Consumption	490.9	565.7	650.4	736.0	822.6
Private	434.9	489.1	569.4	643.8	723.5
Public	56.0	76.6	81.0	92.2	99.1
Gross investment	156.5	171.8	186.3	217.1	257.3
Private 2/	116.1	119.0	138.5	162.8	195.5
Public 3/	40.4	52.8	47.7	54.3	61.8
Domestic demand	647.4	737.5	836.7	953.1	1,080.0
Exports of goods and nonfactor services	195.8	237.7	268.6	325.3	364.8
Aggregate demand	843.3	975.2	1,105.3	1,278.4	1,444.7
Imports of goods and nonfactor services	264.2	307.4	337.2	388.2	430.2
Expenditure on gross domestic product	579.1	667.8	768.1	890.3	1,014.5
Net factor income from abroad	-8.3	-7.0	-11.3	-9.4	-11.5
Gross national income	570.8	660.8	756.9	880.9	1,003.0
Net current transfers from abroad	31.0	34.8	39.2	46.5	54.8
National disposable income	601.8	695.6	796.1	927.3	1,057.8
	(In percent of GDP)				
Consumption	84.8	84.7	84.7	82.7	81.1
Gross fixed investment	27.0	25.7	24.2	24.4	25.4
Private 2/	20.0	17.8	18.0	18.3	19.3
Public 3/	7.0	7.9	6.2	6.1	6.1
	(In billions of Sri Lanka rupees at constant 1996 prices) 4/				
Consumption	...	...	650.4	696.8	745.6
Gross investment	...	...	186.3	193.1	222.5
Domestic demand	...	...	836.7	889.9	968.1
Exports of goods and nonfactor services	...	...	268.6	299.9	302.9
Aggregate demand	...	...	1,105.3	1,189.7	1,271.0
Imports of goods and nonfactor services	...	...	337.2	372.5	415.3
Resource gap	...	...	-68.7	-72.6	-112.4
Expenditure on gross domestic product	...	...	768.1	817.3	855.7
Gross domestic product at factor cost	...	...	695.9	739.8	774.8
	(Annual percentage change, constant prices) 5/				
Consumption	6.4	5.4	3.4	7.1	7.0
Gross investment	9.2	0.5	2.8	3.6	15.3
Domestic demand	7.0	4.3	3.3	6.4	8.8
Exports of goods and nonfactor services	13.0	2.9	3.2	11.6	1.0
Aggregate demand	8.4	4.0	3.2	7.6	6.8
Imports of goods and nonfactor services	14.2	1.0	2.1	10.5	11.5
Gross domestic product	5.6	5.5	3.8	6.3	4.7
Memorandum items:					
Population (midyear, in millions)	17.9	18.1	18.3	18.5	18.8
Gross national income per capita, in thousands of Rs	32.2	36.4	41.3	47.4	53.1
Gross national income per capita, in dollars	646.5	710.9	747.7	804.9	827.1

Sources: Data provided by the Sri Lanka authorities; and staff estimates.

1/ At market prices.

2/ Includes investment by public corporations not financed through the government budget.

3/ Capital expenditure and net lending by the central government, excluding privatization proceeds.

4/ New series of GDP estimates, with 1996 as the base year. Estimates for 1995 and before have not been compiled on the new basis.

5/ Growth rates for 1994–96 are based on the accounts at 1982 constant prices. See SM/98/183 for details.

Table 2. Sri Lanka: Saving, Investment, and the Current Account, 1994–98

	1994	1995	1996	1997	1998
	(In billions of Sri Lanka rupees at current prices)				
Gross investment	156.5	171.8	186.3	217.1	257.3
Current account balance 1/	-45.7	-41.9	-40.6	-25.8	-22.2
National saving	110.8	128.0	146.0	191.3	235.3
Net factor income from abroad	-8.1	-8.7	-10.9	-9.4	-11.5
Net private transfers	30.8	34.6	39.2	46.5	54.8
Domestic saving	88.1	102.1	117.7	154.2	191.9
Private	105.2	120.0	146.6	174.0	216.5
Public	-17.0	-17.9	-28.9	-19.7	-24.6
	(In percent of GDP)				
Domestic saving	15.2	15.3	15.3	17.3	18.9
Private	18.2	18.0	19.1	19.6	21.3
Public 2/	-2.9	-2.7	-3.8	-2.2	-2.4
Gross investment	27.0	25.7	24.2	24.4	25.4
Private 3/	20.0	17.8	18.0	18.3	19.3
Public 4/	7.0	7.9	6.2	6.1	6.1
National saving	19.1	19.2	19.0	21.5	23.2
Of which: Private 5/	22.1	21.8	22.8	23.7	25.6
Balance of payments current account	-7.8	-6.5	-5.2	-2.9	-2.2
Private sector saving minus investment	2.0	4.0	4.8	5.4	6.3
Public sector saving minus investment	-9.9	-10.6	-9.9	-8.3	-8.5

Sources: Data provided by the Sri Lanka authorities; and staff estimates.

1/ Data on the current account balance and national saving reflect the treatment of FCBU's as part of the domestic banking system.

2/ Current revenue minus current expenditure.

3/ Includes investment by public corporations not financed through the government budget.

4/ Capital expenditure and net lending by the central government, excluding privatization proceeds.

5/ Includes net factor income and transfers from abroad.

Table 3. Sri Lanka: Gross Domestic Product by Industrial Origin at Current Prices, 1994–98

	1994	1995	1996	1997	1998
	(In billions of Sri Lanka rupees at current prices)				
Agriculture 1/	124.4	137.7	156.1	175.8	192.7
Plantation crops 2/	19.2	20.6	27.2	30.8	32.5
Paddy	21.2	21.6	19.9	24.5	26.8
Fishing	14.4	16.6	18.8	21.4	23.7
Other	69.5	78.9	90.3	99.1	109.7
Mining and quarrying	10.5	11.5	13.9	16.6	17.4
Manufacturing	80.5	94.1	112.7	131.9	151.0
Plantation crop processing	10.0	11.9	16.2	19.5	23.2
Other	70.5	82.2	96.5	112.4	127.8
Construction	38.3	44.5	48.2	56.4	69.3
Services	269.7	310.6	364.9	423.0	482.4
Gross domestic product at factor cost	523.3	598.3	695.9	803.7	912.8
Net factor income from abroad	-8.3	-7.0	-11.3	-9.4	-11.5
Gross national product	515.0	591.4	684.7	794.3	901.3
	(In percent of GDP)				
Agriculture 1/	23.8	23.0	22.4	21.9	21.1
Plantation crops 2/	3.7	3.4	3.9	3.8	3.6
Paddy	4.1	3.6	2.9	3.0	2.9
Fishing	2.7	2.8	2.7	2.7	2.6
Other	13.3	13.2	13.0	12.3	12.0
Mining and quarrying	2.0	1.9	2.0	2.1	1.9
Manufacturing	15.4	15.7	16.2	16.4	16.5
Plantation crop processing	1.9	2.0	2.3	2.4	2.5
Other	13.5	13.7	13.9	14.0	14.0
Construction	7.3	7.4	6.9	7.0	7.6
Services	51.5	51.9	52.4	52.6	52.9
Gross domestic product	100.0	100.0	100.0	100.0	100.0
Memorandum items:					
Annual percentage increase in implicit GDP deflator 3/	9.3	8.4	12.1	8.5	8.4
CPI Inflation	8.4	7.7	15.9	9.6	9.4

Sources: Data provided by the Sri Lanka authorities; and staff estimates.

1/ Including forestry and fishing.
2/ Tea, rubber, and coconuts.
3/ Based on factor costs.

Table 4. Sri Lanka: Gross Domestic Product by Industrial Origin at Constant Prices, 1994–98 1/

	1994	1995	1996	1997	1998
			(In billions of Sri Lanka rupees at 1996 factor costs)		
Agriculture 2/	...	...	156.1	160.8	164.8
Plantation crops 3/	...	...	27.2	28.1	27.5
Paddy	...	...	19.9	22.1	26.2
Fishing	...	...	18.8	19.7	21.3
Other	...	...	90.3	90.8	89.8
Mining and quarrying	...	...	13.9	14.5	13.7
Manufacturing	...	...	112.7	122.9	130.7
Plantation crop processing	...	...	16.2	16.8	16.6
Other	...	...	96.5	106.2	114.1
Construction	...	...	48.2	50.8	54.5
Services	...	...	364.9	390.8	411.2
Of which:	...	...			
Public administration and defense	...	...	35.2	37.1	38.2
Wholesale and retail trade	...	...	155.3	165.1	172.5
Gross domestic product	...	...	695.9	739.8	774.8
Net factor income from abroad	...	...	-11.3	-8.8	-9.9
Gross national product	...	...	684.7	730.9	764.9
			(Annual percentage change)		
Agriculture 2/	3.3	3.3	-4.6	3.0	2.5
Plantation crops 3/	11.1	3.2	-0.9	3.5	-2.3
Paddy	4.7	4.7	-26.7	11.2	18.3
Fishing	1.4	4.9	-3.9	5.0	8.3
Other	-0.1	2.4	3.2	0.6	-1.1
Mining and quarrying	6.0	3.4	8.9	3.8	-5.4
Manufacturing	9.1	9.2	6.5	9.1	6.3
Plantation crop processing	13.0	4.4	1.0	3.5	-1.2
Other	8.6	9.8	7.2	10.0	7.5
Construction	6.0	4.9	3.4	5.4	7.1
Services	5.2	5.1	5.8	7.1	5.2
Of which:					
Wholesale and retail trade	6.4	3.6	5.2	6.3	4.5
Gross domestic product	5.6	5.5	3.8	6.3	4.7

Sources: Data provided by the Sri Lanka authorities;and staff estimates.

1/ New series of GDP estimates, with 1996 as the base year. Estimates for 1995 and before have not been compiled on the new basis. Growth rates for 1994–96 are based on the accounts at 1982 constant prices. See SM/98/183 for details.

2/ Including forestry and fishing.

3/ Tea, rubber, and coconuts.

Table 5. Sri Lanka: Basic Data on the Tea Sector, 1994–98

	1994	1995	1996	1997	1998 1/
	(Area in thousands of hectares and volume in millions of kilograms)				
Production, yield and exports					
Planted area	187	189	189	194	195
Production	242	246	258	277	280
By type:					
High grown	77	74	72	84	76
Medium grown	47	51	48	57	54
Low grown	118	122	138	136	150
Exports	230	241	244	269	272
Yield per hectare	1,295	1,302	1,365	1,428	1,559
Replanting area	1.22	1.21	0.94	0.93	1.24
	(In Sri Lanka rupees per kilogram)				
Prices and costs					
Average f.o.b. export price	91.32	102.31	139.56	158.39	184.94
Average Colombo auction price (net)	65.12	72.21	103.88	119.4	134.35
Cost of production 2/	75.67	76.74	87.04	93.47	106.72
Producer's margin 3/	-10.55	-4.53	16.86	25.93	27.63

Source: Data provided by the Sri Lanka authorities.

1/ Provisional.

2/ Estimated weighted average cost of production of the privatised plantation companies and the public sector estates.

3/ Average Colombo auction price minus cost of production.

Table 6. Sri Lanka: Basic Data on the Rubber Sector, 1994–98

	1994	1995	1996	1997	1998 1/
	(Area in thousands of hectares and volume in millions of kilograms)				
Production, yield, and exports					
Area under cultivation	161	162	162	163	158
Area under tapping	121	124	122	129	125
Production	105	106	113	106	96
Exports	69	68	72	62	41
Domestic use	36	37	40	44	54
Yield (kg/ha)	870	853	927	823	768
Fertilizer use (in '000 metric tons)	17	15	17	12	15
Replanting area	1.62	3.24	3.44	1.03	2.54
	(In Sri Lanka rupees per kilogram)				
Prices and costs					
Average f.o.b. export price 2/	51.81	83.69	79.78	75.42	67.72
Average Colombo auction price 2/	50.36	72.04	67.85	56.62	49.76
Cost of production	30.85	33.37	36.70	40.37	44.41
Producer's margin 3/	19.51	38.67	31.15	16.25	5.35

Source: Data provided by the Sri Lanka authorities.

1/ Provisional.

2/ For RSS No.1 category of rubber.

3/ Average Colombo auction price for RSS No.1 minus cost of production.

Table 7. Sri Lanka: Basic Data on the Coconut Sector, 1994–98

	1994	1995	1996	1997	1998 1/
	(Area in thousands of hectares and volume in millions of kilograms)				
Production, yield, and exports					
Planted area	412	416	417	417	439
Production	2,622	2,755	2,546	2,631	2,547
By type:					
Desiccated coconut 2/	380	465	425	524	362
Coconut oil 2/	480	516	328	289	334
Copra 2/	32	50	39	42	52
Fresh nut exports	25	27	17	18	18
Domestic nut consumption 3/	1,687	1,716	1,720	1,744	1,762
By sector:					
Yield (nuts/ha)	6,364	6,623	6,106	6,309	5,802
Exports	437	579	475	505	435
Fertilizer use (in '000 metric tons)	31	34	39	35	36
Replanting area	0.84	0.99	0.58	1.22	0.60
Replanting subsidy (in SL Rs per ha)	25,000	25,000	38,750	38,750	38,750
	(In Sri Lanka rupees per thousand nuts)				
Prices and costs					
Average f.o.b. export price	5,672	6,080	9,420	9,630	9,730
Average Colombo market price (fresh nuts)	6,300	5,450	9,410	11,850	11,150
Cost of production (private sector)	1,840	2,020	2,180	2,260	2,400
Producer margin 4/	4,460	3,430	7,220	9,590	8,750

Source: Data provided by the Sri Lanka authorities.

1/ Provisional.

2/ In nut equivalent per metric ton; dessicated coconut = 6,800 nuts; oil = 8,000 nuts; and copra = 4,925 nuts.

3/ Estimated on the basis of per capita consumption of 94.8 nuts per year; excluding industrial use.

4/ Average Colombo market price minus cost of production.

Table 8. Sri Lanka: Paddy and Other Agricultural Production, 1994–98

	1994	1995	1996	1997	1998 1/
	(Volume in thousands of metric tons, area in thousands of hectares and yield in kilograms per hectare)				
Paddy production	2,684	2,810	2,061	2,239	2,692
Gross area sown	930	915	749	730	848
Net area harvested	798	795	587	619	740
Yield on net area harvested	3,363	3,535	3,513	3,603	3,634
Fertilizer use (in '000 metric tons)	270	257	238	224	228
Of which : Maha 2/					
Production	1,670	1,761	1,331	1,457	1,781
Net area harvested	499	489	377	397	501
Yield on net area harvested	3,345	3,603	3,534	3,670	3,555
Of which : Yala 3/					
Production	1,014	1,049	730	782	910
Net area harvested	299	306	210	222	239
Yield on net area harvested	3,393	3,427	3,477	3,529	3,802
Memorandum items :					
Paddy wholesale (market) price 4/	168	163	213	231	215
Guaranteed price scheme 4/	155	155	155	155	155
Purchases under Guaranteed Price Scheme (in percent of total production)	4.4	10.0	0.05	0.00	0.00
Rice imports (in '000 metric tons)	58	9	341	306	168
Other agricultural products:					
Sugarcane	874	858	862	773	729
Tobacco 5/	12	11	11	11	9
Fish	224	238	229	240	260

Source: Data provided by the Sri Lanka authorities.

1/ Provisional.

2/ October-April season.

3/ April-October season.

4/ In rupees per bushel. One bushel is 20.9 kilograms.

5/ Includes beedi/cigar tobacco and cigarette tobacco.

Table 9. Sri Lanka: Consumption and Prices of Petroleum and Electricity, 1994–98

	1994	1995	1996	1997	1998
Gross consumption of selected petroleum products ('000 MT)					
Kerosene	206	222	228	225	235
Gasoline	183	190	197	193	203
Auto diesel	725	789	1,045	1,295	1,181
Heavy diesel	53	80	87	...	...
Furnace oil	228	241	336	372	551
Consumption of electricity 1/	3,587	3,932	3,740	4,039	4,509
(In '000 metric tons oil equivalent)	891	979	899	1,051	1,163
			(In percent)		
Composition of electricity generation					
Hydro power	93.2	94	71.7	67.5	68.9
Thermal power	6.3	5.6	21.5	20.6	22.0
Private power	...	...	3.4	8.1	7.2
Self generation	0.5	0.4	3.4	4.6	1.9
			(In Sri Lanka rupees per liter)		
Prices of petroleum products 2/ 3/					
Kerosene	11.8	9.5	10.4	10.4	10.4
Gasoline	35.0	40.0	50.0	50.0	50.0
Auto diesel	12.0	12.4	13.2	13.2	13.2
Heavy diesel	11.4	11.7	11.7	...	...
Fuel oil	6.8	6.8	7.5	7.5	7.5
Cost price of petroleum products 4/ 5/					
Kerosene	12.1	11.7	12.5	13.0	9.8
Gasoline	21.5	25.8	32.2	30.3	28.4
Auto diesel	11.1	13.1	14.0	14.5	11.5
Heavy diesel	11.5	12.1	...	...	...
Fuel oil	6.5	7.0	7.5	8.8	6.6
Crude oil (c.i.f., in US$ per barrel)	16.4	17.6	20.2	19.4	13.6
Price of electricity 2/ 6/	3.7	3.7	4.0	4.2	4.5
Price of electricity for domestic units >150 Kwh 2/	3.0	3.0	3.5	3.6	...

Source: Data provided by the Sri Lanka authorities; Ceylon Petroleum Corporation; and Ceylon Electricity Board.

1/ Including use for electricity generation.

2/ End of period.

3/ Price includes taxes. From December 1995, taxes consist of a 20 percent turnover tax on gasoline, a 6 percent turnover tax on all other petroleum products, and a 4.5 percent National Security Levy on all products. There are also excise duties of SL Rs 7 per liter.

4/ Period average.

5/ Unit cost of production including customs duty (all customs duties are charged to domestic sales), turnover taxes, and all other expenses.

6/ Basic rate on household consumption of electricity between 50 and 500 kilowatt hours per month, excluding fuel surcharge levied on all users of electricity exceeding 150 kwh per month, in SL Rs per Kwh.

Table 10. Sri Lanka: Price Indicators, 1994–98

	1994	1995	1996	1997	1998
			(Annual average percentage change)		
GDP deflator 1/	9.3	8.4	12.1	8.6	8.4
Colombo consumer price index	8.4	7.7	15.9	9.6	9.4
Of which:					
Food (61.9 percent) 2/	8.9	6.9	19.2	10.9	10.9
Rice (6.4 percent)	0.3	2.1	25.8	7.7	-0.9
Bread, wheat flour (9.4 percent)	2.7	20.4	59.7	30.5	8.0
Clothing (9.4 percent)	1.7	1.0	2.2	2.7	1.0
Fuel and light (4.3 percent)	14.9	6.1	8.1	4.5	3.2
Kerosene (4.0 percent)	7.3	15.4	2.4	6.9	0.0
Rent (5.7 percent) 3/	0.0	0.0	0.0	0.0	0.0
Miscellaneous (18.7 percent)	5.9	14.1	10.8	8.2	7.5
Wholesale price index	5.0	8.8	20.5	6.9	6.1
Domestic goods	13.0	6.8	11.7	6.5	5.0
Imports	4.5	10.1	11.6	8.2	0.1
Exports	-5.4	11.0	40.4	6.7	10.9
			(Annual percentage change)		
Colombo consumer price index (end-period)	4.2	11.5	16.8	10.7	3.7
Wholesale price index	1.8	16.2	18.1	6.6	0.9

Source: Data provided by the Sri Lanka authorities.

1/ Based on market prices.

2/ Data between brackets represent the weight in the overall index.

3/ Low-income housing is under rent control.

Table 11. Sri Lanka: Selected Wage and Employment Developments, 1994–98

	1994	1995	1996	1997	1998
	(Index, December 1978 = 100)				
Nominal wages					
Minimum wage 1/	712	740	825	849	953
Agriculture	822	831	940	972	1,098
Industry and commerce	556	652	697	711	808
Services	431	457	487	487	506
Government employees 2/	736	793	862	907	1,001
Real wages					
Minimum wage	112	108	99	97	100
Agriculture	129	121	113	111	115
Industry and commerce	87	95	84	81	85
Services	68	67	59	56	53
Government employees	115	115	104	104	105
	(Annual average percentage change)				
Real wages					
Minimum wage	-4.2	-3.5	-8.2	-1.7	2.7
Agriculture	-5.7	-6.0	-6.9	-1.2	3.2
Industry and commerce	-3.0	8.7	-11.7	-2.7	3.9
Services	8.7	-1.6	-11.9	-4.6	-5.2
Government employees	0.5	0.0	-10.3	0.5	0.9
	(In thousands of persons)				
Employment in the public sector 3/	1,325	1,307	1,161	1,080	1,091
Central government 4/	700	738	752	762	790
Quasi-governmental institutions 5/	625	569	409	310	301
Employment in formal private sector	3,956	4,050	4,376	4,500	4,994
Board of Investment (BOI) companies	206	233	242	258	294
Other	3,750	3,817	4,134	4,242	4,700 6/

Source: Data provided by the Sri Lanka authorities.

1/ Weighted average nominal wage for workers covered by Wage Boards; weights are based on the number employed in each trade as of end-December 1978.

2/ Average of initial salary grades for non-executive and minor employees, skilled and non-skilled; excludes school teachers.

3/ Changes reflect principally the Government's privatization program.

4/ Includes employees of government ministries, school teachers, and defense personnel.

5/ Includes universities, public corporations, boards, and state-owned banks.

6/ The large increase in 1998 was partly due to the increase in coverage of female unpaid family workers in the agricultural sector. This is shown in the private sector 'other' category.

Table 12. Sri Lanka: Labor Force, Employment, and Unemployment, 1994–98 1/

	1994	1995	1996	1997	1998 3/
	(In millions of persons)				
Total labor force	6.08	6.11	6.24	6.23	6.57
Male	4.18	4.11	4.19	4.17	4.30
Female	1.99	1.95	2.03	2.06	2.27
Urban	1.07	1.20	0.80	0.90	0.84
Rural	5.01	4.86	5.41	5.33	5.73
Total employed	5.36	5.36	5.54	5.58	5.95
Male	3.80	3.75	3.85	3.87	4.02
Female	1.56	1.59	1.65	1.72	1.93
Urban	0.90	1.04	0.71	0.80	0.76
Rural	4.46	4.30	4.79	4.79	5.19
Total unemployed	0.80	0.75	0.71	0.65	0.62
Male	0.38	0.36	0.34	0.30	0.28
Female	0.42	0.36	0.38	0.34	0.34
Urban	0.17	0.16	0.09	0.09	0.08
Rural	0.63	0.56	0.62	0.54	0.54
	(In percent of labor force)				
Unemployment rate	13.1	12.3	11.3	10.4	9.5
Male	9.7	8.8	8.5	7.6	6.6
Female	20.1	18.8	18.0	16.2	14.9
Urban	16.0	13.7	11.7	10.4	9.7
Rural	12.4	11.5	11.5	10.2	9.5
	(In percent of unemployed)				
Male	47.6	50.3	46.9	47.3	45.7
Female	52.4	49.7	53.1	52.7	54.3
Urban	21.3	22.8	13.1	14.6	13.0
Rural	78.7	77.2	86.9	85.4	87.0
Age 24 years or younger	67.0	61.6	64.5	60.8	60.9
Less than 9 years of schooling 2/	49.6	49.7	54.5	51.9	47.4

Source: Department of Census and Statistics, Labor Force Survey.

1/ Annual data as of April, excluding northern and eastern provinces.

2/ Less than General Certificate of Education (Ordinary Level).

3/ Second quarter.

Table 13. Sri Lanka: Employment by Economic Sectors, 1994–98

	1994	1995	1996	1997	1998 1/
	(In millions of persons)				
Total employed	5.36	5.36	5.54	5.58	6.09
By economic sector:					
Agriculture	2.19	1.97	2.07	2.07	2.39
Mining and quarrying	0.04	0.09	0.09	0.08	0.08
Manufacturing	0.72	0.79	0.81	0.87	0.93
Utilities	0.03	0.02	0.03	0.03	0.04
Construction	0.26	0.29	0.30	0.30	0.30
Trade and hotels	0.56	0.65	0.66	0.72	0.71
Transportation, communications, storage	0.25	0.25	0.27	0.27	0.28
Insurance and real estate	0.13	0.08	0.11	0.09	0.12
Personal services	0.97	0.95	1.00	1.00	1.12
Other	0.20	0.32	0.18	0.16	0.23
	(In percent of total employment)				
Agriculture	40.9	36.7	37.4	37.1	38.1
Mining and quarrying	0.7	1.7	1.6	1.4	1.3
Manufacturing	13.4	14.7	14.6	15.6	15.3
Utilities	0.6	0.5	0.5	0.5	0.7
Construction	4.9	5.3	5.4	5.4	4.9
Trade and hotels	10.4	12.2	11.9	12.9	11.7
Transportation, communications, storage	4.7	4.7	4.9	4.8	4.3
Insurance and real estate	2.4	1.5	2.0	1.6	2.0
Personal services	18.1	17.7	18.1	17.9	18.4
Other	3.7	6.0	3.2	2.9	3.8

Source: Department of Census and Statistics, Labor Force Survey.

1/ Third Quarter.

Table 14. Sri Lanka: Summary of Central Government Operations, 1994–99

	1994	1995	1996	1997	1998 Budget	1998 Outturn	1999 Budget
	(In billions of Sri Lanka rupees)						
Total revenue	110.0	136.3	146.3	164.9	188.4	175.0	214.3
Tax	99.4	118.5	130.2	143.5	164.0	147.4	185.4
Nontax	10.6	17.7	16.1	21.4	24.4	27.7	28.9
Total expenditure and net lending	170.8	203.5	218.7	234.9	255.1	268.2	283.3
Current expenditure	130.0	157.1	175.1	184.7	187.1	199.7	199.2
Capital expenditure	30.4	39.3	37.6	44.2	57.3	54.2	68.7
Net lending	10.4	7.1	5.9	6.0	10.7	14.4	15.3
Overall deficit (before grants)	-60.7	-67.2	-72.4	-70.0	-66.6	-93.2	-68.9
Grants	8.3	9.0	7.7	7.5	9.0	7.2	8.0
Net foreign borrowing	11.8	21.2	10.2	9.7	16.4	10.2	12.3
Net domestic borrowing	40.7	37.0	54.5	52.8	41.2	75.8	48.7
Of which: Banking system	1.2	7.1	13.1	-2.2	0.0	19.0	0.0
Asset sales 1/	3.0	3.0	4.7	22.5	8.0	4.4	8.0
	(In percent of GDP)						
Total revenue	19.0	20.4	19.0	18.5	18.4	17.3	18.5
Tax	17.2	17.8	16.9	16.1	16.0	14.5	16.0
Nontax	1.8	2.7	2.1	2.4	2.4	2.7	2.5
Total expenditure and net lending	29.5	30.5	28.4	26.4	24.9	26.4	24.5
Current expenditure	22.4	23.5	22.8	20.8	18.2	19.7	17.2
Capital expenditure	5.2	5.9	4.9	5.0	5.6	5.3	5.9
Net lending	1.8	1.1	0.8	0.7	1.0	1.4	1.3
Current account balance	-3.4	-3.1	-3.8	-2.2	0.1	-2.4	1.3
Overall deficit (before grants)	-10.5	-10.1	-9.4	-7.9	-6.5	-9.2	-6.0
Grants	1.4	1.4	1.0	0.8	0.9	0.7	0.7
Net foreign borrowing	2.0	3.2	1.3	1.1	1.6	1.0	1.1
Net domestic borrowing	7.0	5.5	7.0	5.9	4.0	7.5	4.2
Of which: Banking system	0.2	1.1	1.7	-0.2	0.0	1.9	0.0
Asset sales 1/	0.5	0.4	0.6	2.5	0.8	0.4	0.7
Memorandum items:							
GDP (billions of rupees)	579.1	667.8	768.9	890.3	1,026.5	1,014.5	1,156.1

Sources: Data provided by the Ministry of Finance; and Fund staff estimates.

1/ Asset sales are treated here as a component of financing.

Table 15. Sri Lanka: Summary of Central Government Revenue by Component, 1994–99

	1994	1995	1996	1997	1998 Budget	1998 Outturn	1999 Budget
	(In billions of Sri Lanka rupees)						
Tax revenue	99.4	118.5	130.2	143.5	164.0	147.4	185.4
Income tax	15.3	17.1	20.8	20.8	24.1	20.4	24.2
Personal	5.6	7.4	7.4	8.3	9.2	8.6	10.6
Corporate	9.7	9.8	13.3	12.6	14.9	11.8	13.5
Stamp duty and taxes on property	4.4	5.2	5.3	6.4	8.1	7.1	9.3
Tax on Central Bank holdings of treasury bills	0.5	1.1	1.6	1.1	0.0	0.0	0.0
Taxes on goods and services	56.7	70.8	77.1	88.2	101.0	91.7	120.8
Turnover tax/GST	32.3	36.4	37.6	43.3	47.1	39.3	58.1
Excises	14.6	19.4	22.1	26.6	31.5	30.3	34.5
Of which : Liquor	4.7	6.2	5.8	6.2	8.4	7.7	9.2
Tobacco	7.9	9.5	12.8	14.8	16.3	15.1	17.0
License fees	0.1	0.6	1.0	1.1	1.9	1.0	1.4
National security levy	9.7	14.4	16.4	17.3	20.5	21.1	26.7
Taxes on international trade	22.6	24.4	25.5	27.0	31.0	28.2	31.1
Of which : Imports	22.6	24.4	25.5	27.0	31.0	28.2	31.1
Nontax revenue	10.6	17.7	16.1	21.4	24.4	27.7	28.9
Property income	7.6	13.1	10.1	14.3	15.2	18.0	18.9
Fees and charges	1.4	1.8	2.8	2.7	2.9	2.9	3.3
Other	1.6	2.9	3.2	4.3	6.4	6.7	6.7
Total revenue	110.0	136.3	146.3	164.9	188.4	175.0	214.3
	(In percent of GDP)						
Tax revenue	17.2	17.8	16.9	16.1	16.0	14.5	16.0
Income tax	2.6	2.6	2.7	2.3	2.3	2.0	2.1
Taxes on property	0.8	0.8	0.7	0.7	0.8	0.7	0.8
Taxes on goods and services	9.8	10.6	10.0	9.9	9.8	9.0	10.5
Taxes on international trade	3.9	3.6	3.3	3.0	3.0	2.8	2.7
Nontax revenue	1.8	2.7	2.1	2.4	2.4	2.7	2.5
Total revenue	19.0	20.4	19.0	18.5	18.4	17.3	18.5

Source: Data provided by the Ministry of Finance.

Table 16. Sri Lanka: Economic Classification of Expenditure, 1994–99

	1994	1995	1996	1997	1998 Budget 1/	1998 Outturn	1999 Budget 1/
	(In billions of Sri Lanka rupees)						
Current expenditure	130.0	157.1	175.1	184.7	187.1	199.7	199.2
Expenditure on goods and services	54.7	75.4	80.0	83.8	85.6	97.8	92.0
Salaries and wages	29.3	34.9	38.3	44.7	47.9	53.9	54.3
Other goods and services	25.4	40.5	41.7	39.2	37.7	43.9	37.7
Interest payments	40.9	41.1	48.9	55.2	55.4	54.9	59.8
Foreign	5.5	6.2	6.7	6.7	7.4	7.3	8.1
Domestic	35.4	35.0	42.2	48.6	48.0	47.6	51.7
Subsidies and current transfers	34.4	40.5	46.2	45.7	45.4	47.0	47.7
To public corporations	2.6	7.8	8.2	2.7	2.4	3.0	2.5
To public institutions	2.0	2.2	2.3	2.7	5.4	4.3	6.0
To other levels of government	1.3	1.2	1.6	1.9	1.5	2.0	2.1
To households	28.3	29.1	32.1	37.1	35.4	37.1	36.1
To private institutions and abroad	0.2	0.2	2.0	1.3	0.7	0.6	1.0
Capital expenditure	30.4	39.3	37.6	44.2	57.3	54.2	68.7
Acquisition of capital assets	16.6	22.6	20.9	25.7	35.2	32.2	36.3
Capital transfers	13.8	16.7	16.7	18.5	22.2	21.9	32.4
To public corporations	4.2	5.2	6.0	5.9	6.4	6.8	9.4
To public institutions	8.4	10.4	9.6	11.0	14.0	13.3	18.5
To other levels of government	1.1	1.1	1.0	1.5	1.7	1.8	2.0
To abroad/other	0.1	0.0	0.0	0.1	0.0	0.1	2.5
Lending minus repayments	10.4	7.1	5.9	6.0	10.7	14.4	15.3
Total expenditure and net lending	170.8	203.5	218.7	234.9	255.1	268.2	283.3
	(In percent of GDP)						
Current expenditure	22.4	23.5	22.8	20.8	18.2	19.7	16.8
Subsidies and current transfers	5.9	6.1	6.0	5.1	4.4	4.6	4.1
Capital expenditure	5.2	5.9	4.9	5.0	5.6	5.3	5.9
Net lending	1.8	1.1	0.8	0.7	1.0	1.4	1.3
Total expenditure and net lending	29.5	30.5	28.4	26.4	24.9	26.4	24.5
	(In percent of total expenditure)						
Current expenditure	76.5	77.3	80.1	79.4	73.8	75.5	71.6
Subsidies and current transfers	20.2	19.9	21.1	19.6	17.9	17.8	17.6
Capital expenditure	17.8	19.3	17.2	18.8	22.5	20.2	24.3
Net lending	6.1	3.5	2.7	2.5	4.2	5.4	5.4
Memorandum items:							
Military expenditure (bill.of rupees)	26.4	42.5	44.9	45.0	43.1	54.0	50.7
In percent of GDP	4.6	6.4	5.8	5.1	4.2	5.3	4.4

Sources: Data provided by the Ministry of Finance; and Fund staff estimates.

1/ Budget estimates include unallocated expenditure as a contingency of Rs 700 million in 1998 and minus Rs 300 million in 1999.

Table 17. Sri Lanka: Functional Classification of Expenditure, 1994–99

	1994	1995	1996	1997	1998 Budget	1998 Outturn	1999 Budget
	(In billions of Sri Lanka rupees)						
General Public Services	32.8	53.7	57.1	62.6	64.5	72.4	66.2
Civil Administration	6.4	10.5	12.1	17.6	20.1	21.4	22.9
Defense 1/	19.4	35.2	38.1	37.1	36.5	42.5	35.6
Public Order and Safety	7.0	8.0	6.8	7.9	7.9	8.5	7.7
Social services	55.3	67.5	69.6	71.3	79.4	79.1	83.7
Education	17.7	18.9	20.4	22.3	27.9	26.7	29.5
Health	9.2	11.0	11.8	12.1	14.6	14.4	15.4
Welfare	26.2	33.8	33.7	32.0	31.3	32.4	31.3
Housing	0.8	1.6	1.2	0.8	1.6	1.3	1.5
Community services	1.4	2.2	2.6	4.0	4.1	4.3	5.9
Economic services	35.5	44.2	40.2	39.9	57.4	55.2	67.4
Agriculture and irrigation	7.7	9.9	8.6	7.5	11.7	11.5	14.7
Fisheries	0.5	0.5	0.5	0.6	1.1	0.7	1.1
Manufacturing and mining	0.4	0.5	0.6	2.0	2.9	2.5	1.3
Energy and water supply	6.0	6.0	6.6	7.3	11.1	9.6	13.5
Transport and communication	16.5	20.9	15.1	14.6	23.2	21.8	25.1
Trade and commerce	0.3	0.2	1.0	0.3	1.2	0.4	0.7
Other	4.1	6.2	7.8	7.5	6.2	8.7	11.1
Other	43.9	41.6	54.2	62.6	56.8	61.2	66.4
Of which: interest	38.0	38.7	48.9	55.2	55.4	54.9	59.8
Total expenditure and net lending 1/	167.5	207.0	221.1	236.4	258.1	267.9	283.8
	(In percent of GDP)						
General Public Services	5.7	8.0	7.4	7.0	6.3	7.1	5.7
Of which: Defense 1/	3.4	5.3	5.0	4.2	3.6	4.2	3.1
Social services	9.6	10.1	9.1	8.0	7.7	7.8	7.2
Of which: Education	3.1	2.8	2.7	2.5	2.7	2.6	2.6
Health	1.6	1.6	1.5	1.4	1.4	1.4	1.3
Economic services	6.1	6.6	5.2	4.5	5.6	5.4	5.8
Interest	6.6	5.8	6.4	6.2	5.4	5.4	5.2
	(In percent of total expenditure)						
General Public Services	19.6	25.9	25.8	26.5	25.0	27.0	23.3
Of which: Defense 1/	11.6	17.0	17.2	15.7	14.1	15.9	12.6
Social services	33.0	32.6	31.5	30.2	30.8	29.5	29.5
Of which: Education	10.6	9.1	9.2	9.5	10.8	10.0	10.4
Health	5.5	5.3	5.3	5.1	5.6	5.4	5.4
Economic services	21.2	21.3	18.2	16.9	22.2	20.6	23.7
Interest	22.7	18.7	22.1	23.4	21.5	20.5	21.1

Source: Data provided by the Ministry of Finance.

1/ Figures are derived from national presentation and do not precisely correspond to total expenditure and net lending reported in other tables.

Table 18. Sri Lanka: Current and Capital Transfers to Public Corporations and Public Institutions, 1994–99

	1994	1995	1996	1997	1998 Budget	1998 Outturn	1999 Budget
	(In billions of Sri Lanka rupees)						
Total	17.3	28.1	26.1	22.3	28.1	27.4	36.4
Public corporations	6.9	15.5	14.2	8.6	8.8	9.8	11.9
Public institutions	10.4	12.6	11.9	13.7	19.4	17.6	24.5
Current transfers	4.6	10.0	10.5	5.4	7.8	7.3	8.5
Public corporations	2.6	7.8	8.2	2.7	2.4	3.0	2.5
Public institutions	2.0	2.2	2.3	2.7	5.4	4.3	6.0
Capital transfers	12.7	18.1	15.6	16.9	20.4	20.1	27.9
Public corporations 1/	4.2	7.6	6.0	5.9	6.4	6.8	9.4
Public institutions	8.4	10.4	9.6	11.0	14.0	13.3	18.5
Total transfers to selected corporations and institutions							
Cooperative Wholesale Establishment	--	5.0	5.5	1.0	--	--	--
Shippping Corporation	--	2.4	--	0.2	--	--	--
Mahaweli Authority	2.6	3.1	1.9	1.6	2.4	2.0	3.0
Plantation Corporations	0.2	0.1	0.1	--	--	--	--
Ceylon Electricity Board	1.2	1.2	0.5	1.1	1.7	1.0	2.2
Transport Board	0.5	0.5	0.5	0.2	0.7	1.2	1.9
Housing Development Authority	0.2	0.5	0.2	0.5	0.9	0.9	0.9
Water Supply and Drainage Board	2.4	3.2	3.4	2.6	3.0	2.5	4.2
Road Development Authority	3.7	5.1	4.6	6.1	7.8	7.7	8.0
	(In percent of GDP)						
Total transfers	3.0	4.2	3.4	2.5	2.7	2.7	3.2
Current	0.8	1.5	1.4	0.6	0.8	0.7	0.7
Capital	2.2	2.7	2.0	1.9	2.0	2.0	2.4
Public corporations	0.7	1.1	0.8	0.7	0.6	0.7	0.8
Public institutions	1.5	1.6	1.2	1.2	1.4	1.3	1.6
Total, excluding Mahaweli	2.5	3.7	3.1	2.3	2.5	2.5	2.9

Source: Data provided by the Ministry of Finance.

1/ The 1995 estimate includes Rs 2.3 billion transferred to the Shipping Corporation to clear the loan balance appearing in treasury books. An offsetting amount is included as repayment under net lending.

Table 19. Sri Lanka: Transfer and Subsidy Payments to Households, 1994–99

	1994	1995	1996	1997	1998 Budget	1998 Outturn	1999 Budget
	(In billions of Sri Lanka rupees)						
Total	28.3	29.1	32.1	37.1	35.4	37.1	36.1
Of which: Excluding pensions	15.4	15.1	16.7	18.3	17.1	17.8	18.3
Food subsidy and food stamps	2.5	1.4	0.4	0.1	0.1	0.1	0.1
Infant milk	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Food stamps	2.3	1.4	0.4	---	---	---	---
Pensions	12.9	14.1	15.5	18.8	18.3	19.3	17.9
Kerosene stamps	0.6	0.4	0.1	--	--	--	--
NSB interest subsidy 1/	0.1	--	--	--	--		
Fertilizer subsidy	0.6	1.3	1.5	1.9	1.5	2.2	1.5
Samurdhi/Janasaviya/School uniform	5.0	6.2	8.6	8.7	8.7	8.7	8.4
Department of Welfare payments	0.6	0.2	1.3	2.4	2.0	2.1	1.4
Free textbooks	0.4	0.4	0.5	0.7	0.9	0.7	0.7
Midday meal	1.2	1.8	--	--	--	--	--
Other	4.5	3.3	4.2	4.5	3.9	4.1	6.2
	(In percent of GDP)						
Total	4.9	4.4	4.2	4.2	3.5	3.7	3.1
Pensions	2.2	2.1	2	2.1	1.8	1.9	1.5
Other transfers and subsidies	2.7	2.3	2.2	2.1	1.7	1.8	1.6

Source: Data provided by the Ministry of Finance.

1/ National Savings Bank.

Table 20. Sri Lanka: Deficit Financing (Economic Classification), 1994–99

(In billions of Sri Lanka rupees)

	1994	1995	1996	1997	1998 Budget	1998 Outturn	1999 Budget
Total financing	60.7	67.2	72.4	70.0	66.6	93.2	68.9
Foreign grants	8.3	9.0	7.7	7.5	9.0	7.2	8.0
Net foreign borrowing	11.8	21.2	10.2	9.7	16.4	10.2	12.3
Gross foreign borrowing	19.4	29.7	20.7	23.0	31.5	28.5	29.7
Repayments	-7.6	-8.5	-10.5	-13.3	-15.1	-18.4	-17.4
Net foreign borrowing by type	11.8	21.2	10.2	9.7	16.4	10.2	12.3
Net project loans	13.2	14.2	14.3	15.3	...	21.9	...
Gross project loans	18.2	19.8	20.3	22.4	...	30.4	...
Repayments	-5.0	-5.6	-6.0	-7.1	...	-8.4	...
Net commodity loans	-1.7	-1.3	-2.4	-2.2	...	-2.5	...
Gross commodity loans	0.6	1.5	0.4	0.6	...	0.6	...
Repayments	-2.4	-2.8	-2.7	-2.8	...	-3.1	...
Net other loans	0.3	8.3	-1.8	-3.3	...	-6.8	...
Gross loans	0.5	8.4	0.0	0.0	...	0.0	...
Repayments	-0.2	-0.1	-1.8	-3.3	...	-6.8	...
Net domestic financing	40.7	37.0	54.5	52.8	41.2	75.8	48.7
Nonbank borrowing	39.5	29.9	41.4	54.9	41.2	56.8	48.7
Nonmarket	-0.7	0.5	10.4	-9.4	0.0	-0.9	0.0
Market	37.2	26.4	26.3	41.8	33.2	53.3	40.7
Asset sales	3.0	3.0	4.7	22.5	8.0	4.4	8.0
Bank financing	1.2	7.1	13.1	-2.2	0.0	19.0	0.0
Central Bank	1.8	7.7	9.9	-14.0	0.0	5.6	0.0
Commercial Bank	-0.6	-0.6	3.2	11.8	0.0	13.3	0.0

Sources: Data provided by the Ministry of Finance; and Fund staff estimates.

Table 21. Sri Lanka: Outstanding Central Government Debt, 1994–98 1/

(In billions of Sri Lanka rupees, end of period)

	1994	1995	1996	1997	1998
Total domestic debt	249.1	285.8	349.0	383.0	446.5
Rupee securites	137.6	157.9	206.0	239.5	250.6
Treasury bills	98.9	113.8	125.0	115.0	120.0
Treasury bonds	--	--	--	10.0	48.9
National defense bonds	--	--	--	--	--
Treasury CDs	0.1	0.2	0.2	0.1	0.0
Other	12.5	13.9	17.8	18.4	27.1
Banking system	100.0	113.4	103.6	102.0	100.9
Central Bank	21.3	28.7	34.8	25.0	29.2
Rupee loans	--	--	--	--	--
Treasury bills	9.0	15.0	17.1	6.7	9.0
Advances	12.4	13.7	17.7	18.3	20.2
Commercial banks	0.0	0.0	0.0	0.0	0.0
By debt instrument	78.7	84.7	68.7	77.0	71.8
Rupee loans	24.8	24.9	44.3	44.3	44.3
Treasury bills	53.9	59.7	24.4	30.9	14.9
Treasury bonds	--	--	--	1.8	5.8
Other	0.0	0.0	0.0	0.0	6.8 2/
By institution	78.7	84.7	68.7	77.0	71.8
Bank of Ceylon	39.5	42.3	37.2	43.7	} 63.4
People's Bank	18.4	17.8	16.0	18.7	
Other	20.9	24.6	15.6	14.6	8.3
Sinking Fund	0.1	0.1	0.1	0.1	0.1
Rupee loans	0.1	0.1	0.1	0.1	0.1
Nonbank sector					
By debt instrument	148.9	172.3	245.4	280.9	345.5
Rupee loans	112.6	132.9	161.6	195.1	206.1
Treasury bills	36.1	39.0	83.5	77.4	96.2
Treasury bonds	--	--	--	8.2	43.1
National defense bonds	--	--	--	--	--
Treasury certificates	0.1	0.2	0.2	0.1	0.0
Other	0.2	0.2	0.1	0.1	0.1
By institution	148.9	172.3	245.4	280.9	345.5
National Savings Bank	46.4	48.4	47.8	62.5	67.3
Other savings institutions	15.8	19.3	44.4	40.2	84.1
Employees' Provident Fund	79.7	95.5	113.2	134.9	157.7
Insurance companies	0.3	0.3	9.0	9.3	13.1
Other	6.7	8.7	30.9	34.0	23.4
Total foreign debt	301.8	346.3	359.4	383.1	460.9
Project loans	246.1	286.8	302.7	321.1	399.9
Nonproject loans	55.7	59.4	56.7	62.0	61.0
Concessional loans	293.6	336.8	350.0	362.4	445.9
Multilateral	124.2	145.9	161.7	175.3	213.4
Bilateral	169.3	190.9	188.4	187.1	232.6
Commercial loans 3/	7.4	8.6	8.5	12.2	12.8
External suppliers' credits	1.0	1.0	0.9	0.5	0.6
Total outstanding debt	550.9	632.0	708.4	766.1	907.4

Source: Data provided by the Ministry of Finance.

1/ Includes external debt-financed military expenditure.
2/ Includes $100 million (Rs 6.8 billion) loan from foreign currency banking units.
3/ Includes bilateral and multilateral non-concessional loans.

Table 22. Sri Lanka: Monetary Survey, 1995–99 1/

	1995	1996	1997	1998				1999	
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	(In billions of Sri Lanka rupees; end of period)								
Net foreign assets	64.7	63.1	90.5	94.2	87.5	104.5	105.6	108.9	100.9
Monetary authorities 2/	73.7	73.5	89.9	89.5	89.7	92.9	101.7	98.8	95.4
Commercial banks	-8.9	-10.5	0.6	4.8	-2.2	11.6	3.9	10.1	5.5
Net domestic assets	194.7	225.6	243.2	249.4	261.1	251.2	272.1	282.1	296.7
Domestic credit	262.7	292.4	323.0	329.8	342.0	346.3	369.5	378.2	393.6
Public sector	51.7	62.6	59.9	61.4	64.7	65.4	75.5	75.9	85.9
Claims on government (net)	38.4	47.1	45.3	48.5	51.6	55.1	64.6	68.2	77.0
Monetary authorities	24.4	34.3	20.3	25.2	23.7	30.3	25.9	32.0	33.2
Commercial banks	14.0	12.8	25.0	23.4	27.8	24.9	38.7	36.2	43.7
Claims on public corp.	13.3	15.5	14.7	12.8	13.2	10.3	10.8	7.6	8.9
Claims on private sector	210.9	229.8	263.1	268.4	277.3	281.0	294.1	302.3	307.7
Other items (net)	-68.0	-66.8	-79.9	-80.4	-80.9	-95.2	-97.4	-96.1	-96.9
Broad money	259.4	288.7	333.7	343.6	348.6	355.7	377.7	391.0	397.6
Narrow money	75.2	78.2	85.9	92.2	90.1	93.5	96.3	102.6	99.9
Currency	42.2	42.6	45.7	48.9	47.7	49.0	51.8	55.5	52.1
Demand deposits	33.0	35.6	40.2	43.3	42.5	44.5	44.5	47.1	47.8
Quasi-money	184.2	210.5	247.8	251.4	258.4	262.2	281.5	288.4	297.7
	(Annual percentage change)								
Net foreign assets	10.2	-2.6	43.5	54.0	42.0	17.2	16.7	15.5	15.3
Monetary authorities 2/	14.1	-0.2	22.3	27.5	28.6	-1.1	13.1	10.4	6.4
Commercial banks	53.2	17.4	-105.4	-153.2	-73.2	-341.8	591.1	111.6	-352.0
Net domestic assets	25.2	15.9	7.8	5.8	8.6	9.9	11.9	13.1	13.6
Domestic credit	27.5	11.3	10.5	9.3	8.6	13.7	14.4	14.7	15.1
Public sector	22.3	21.0	-4.3	-4.9	-6.1	17.5	25.9	23.6	32.7
Claims on government (net)	24.4	22.6	-4.0	-1.2	-8.8	29.5	42.8	40.5	49.3
Monetary authorities	45.7	40.4	-40.8	14.2	-24.0	179.6	27.6	27.3	40.2
Commercial banks	-0.8	-8.4	94.3	-13.7	10.1	-21.7	55.1	54.8	57.1
Claims on public corp.	16.6	16.4	-5.4	-16.7	6.0	-21.4	-26.1	-40.6	-32.5
Claims on private sector	28.8	8.9	14.5	13.1	12.8	12.8	11.8	12.7	11.0
Other items (net)	34.6	-1.7	19.6	21.6	8.8	24.9	22.0	19.5	19.7
Broad money	21.1	11.3	15.6	15.7	15.4	12.0	13.2	13.8	14.1
Narrow money	6.7	4.0	9.8	14.1	13.1	13.6	12.1	11.3	10.8
Currency	8.5	0.9	7.3	10.6	12.1	12.0	13.3	13.6	9.3
Demand deposits	4.6	7.9	12.7	18.2	14.3	15.4	10.8	8.7	12.6
Quasi-money	28.1	14.2	17.8	16.4	16.2	11.4	13.6	14.7	15.2
	(Percent contribution to broad money growth 12 months ago)								
Net foreign assets	2.8	-0.6	9.5	11.1	8.6	4.8	4.5	4.3	3.8
Net domestic assets	18.3	11.9	6.1	4.6	6.8	7.1	8.7	9.5	10.2
Domestic credit	26.4	11.5	10.6	9.4	9.0	13.1	13.9	14.1	14.8
Public sector	4.4	4.2	-0.9	-1.1	-1.4	3.1	4.7	4.2	6.1
Private sector	22.0	7.3	11.6	10.5	10.4	10.0	9.3	9.9	8.7
Other assets (net)	-8.2	0.4	-4.5	-4.8	-2.2	-6.0	-5.3	-4.6	-4.6
Memorandum items:									
Money multiplier (BM/RM)	3.3	3.4	4.0	3.9	4.1	4.0	4.1	4.0	4.3
Velocity (GDP/geom. avg. BM)	2.9	2.8	2.9	2.9	2.9	2.9	2.9	2.9	2.9

Source: Central Bank of Sri Lanka.

1/ Adjusted to reflect the reclassification of foreign liabilities of domestic banking units and the inclusion of foreign currency banking units.

2/ Cash balances held abroad by the monetary authorities have been adjusted for transactions with FCBUs.

Table 23. Sri Lanka: Balance Sheet of the Monetary Authorities, 1995–99

	1995	1996	1997	1998 Mar.	1998 Jun.	1998 Sep.	1998 Dec.	1999 Mar.	1999 Jun.
	(In billions of Sri Lanka rupees; end of period)								
Net foreign assets	73.7	73.5	89.9	89.5	89.7	92.9	101.7	98.8	95.4
Central Bank (net)	66.7	66.5	82.4	81.9	80.6	83.8	92.6	87.3	80.2
Assets	108.3	106.7	121.5	116.3	118.0	119.7	131.2	121.4	118.3
Cash and balances abroad 1/	39.0	34.8	51.9	42.6	38.9	65.7	59.4	27.0	20.1
Foreign securities	65.9	67.9	67.1	71.0	76.0	50.1	67.7	90.1	94.3
Other	3.3	3.9	2.5	2.7	3.2	3.9	4.1	4.2	4.0
Liabilities	41.6	40.2	39.1	34.4	37.5	36.0	38.5	34.1	38.2
Government (net)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Treasury IMF account (net)	7.0	7.1	7.5	7.5	9.1	9.1	9.1	11.5	15.2
Net domestic assets	4.9	12.0	-6.2	-0.9	-4.4	-3.1	-8.9	-0.7	-1.9
Net claims on government	24.4	34.3	20.3	25.2	23.7	30.3	25.9	32.0	33.2
Claims on government	27.5	37.8	26.8	30.0	28.2	32.6	29.0	35.4	36.4
Advances	14.3	18.3	18.9	21.0	21.2	20.9	20.8	23.8	23.6
Treasury bills	12.5	17.1	7.2	9.0	6.3	11.2	8.2	11.6	12.8
Cash items in collection	0.6	2.4	0.7	0.1	0.8	0.4	0.0	0.0	0.0
Government deposits	-3.0	-3.5	-6.5	-4.9	-4.5	-2.3	-3.1	-3.4	-3.2
Claims on commercial banks	2.8	2.3	1.7	1.6	1.5	1.5	1.1	1.1	1.0
Medium- and long-term	2.8	2.2	1.7	1.6	1.5	1.5	1.1	1.1	1.0
Short-term	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other assets (net)	-22.3	-24.6	-28.2	-27.7	-29.6	-34.9	-35.9	-33.8	-36.2
Reserve money	78.6	85.5	83.7	88.6	85.3	89.8	92.9	98.1	93.4
Currency in circulation	46.7	49.5	53.1	57.3	55.7	57.3	60.1	65.5	61.6
Commercial banks deposits	31.9	35.9	30.5	31.3	29.6	32.4	32.7	32.6	31.9
Deposits of government agencies	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
	(In annual percent change)								
Net foreign assets	14.1	-0.2	22.3	27.5	28.6	-1.1	13.1	10.4	6.4
Net domestic assets	41.4	143.0	-151.8	-152.5	-151.2	-77.2	43.3	-17.9	-55.7
Net claims on government	45.7	40.4	-40.8	14.2	-24.0	179.6	27.6	27.3	40.2
Claims on commercial banks	-16.7	-19.6	-25.1	-26.1	-29.3	-29.7	-33.7	-32.6	-33.5
Medium- and long-term	-16.8	-19.7	-25.0	-25.8	-28.9	-29.1	-33.7	-32.7	-33.3
Short-term	-15.3	-14.8	-32.7	-38.5	-44.2	-50.0	-34.3	-28.1	-41.4
Reserve money	15.5	8.8	-2.1	23.4	8.9	11.9	10.9	10.7	9.6
	(Percent contribution to reserve money 12 months ago)								
Net foreign assets	13.4	-0.2	19.2	26.8	25.4	-1.3	14.1	10.5	6.7
Net domestic assets	2.1	9.0	-21.2	-3.5	-16.6	13.2	-3.2	0.2	2.9
Net claims on government	11.3	12.6	-16.4	4.4	-9.6	24.2	6.7	7.8	11.2
Claims on commercial banks	-0.8	-0.7	-0.7	-0.8	-0.8	-0.8	-0.7	-0.6	-0.6
Other assets (net)	-8.3	-2.9	-4.2	-7.0	-6.2	-10.2	-9.2	-7.0	-7.7

Source: Central Bank of Sri Lanka.

1/ Cash balances held abroad have been adjusted to take into account transactions with FCBUs.

Table 24. Sri Lanka: Balance Sheet of Commercial Banks, 1995–99 1/

	1995	1996	1997	1998				1999	
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	(In billions of Sri Lanka rupees; end of period)								
Foreign assets	14.3	15.6	25.8	28.9	22.7	30.8	30.1	32.7	31.9
Banks abroad	8.2	8.7	18.3	20.6	14.5	22.6	22.8	25.5	25.1
Other	6.1	6.9	7.5	8.3	8.2	8.2	7.4	7.2	6.7
Cash and deposits	54.6	61.2	65.8	71.0	73.5	73.7	80.4	81.7	81.9
Cash in till	4.5	6.9	7.5	8.4	8.0	8.3	8.3	9.9	9.5
Deposits with CBSL	31.0	34.3	29.0	28.6	28.1	30.4	31.3	30.6	28.8
FCBUs 2/	13.1	12.9	22.8	26.4	27.3	23.4	28.9	32.4	32.8
Due from other banks	6.0	7.1	6.5	7.6	10.1	11.6	11.8	8.8	10.9
Claims on government	20.3	27.1	39.8	35.5	39.8	38.8	44.3	38.2	46.0
Treasury bills	11.6	15.5	20.5	17.1	17.5	11.7	13.6	8.8	7.7
Two-year Treasury notes	0.0	0.0	1.8	2.5	2.5	4.8	5.0	4.5	8.9
Other government securities	0.8	0.8	0.8	0.3	0.3	0.3	0.3	0.3	0.3
Other	8.0	10.8	16.7	15.6	19.6	21.9	25.4	24.6	29.1
Claims on public corporations	8.5	9.9	10.3	9.8	11.1	8.8	9.5	7.6	8.9
Claims on private sector	180.1	193.8	216.0	220.3	226.0	231.7	243.5	252.6	256.8
Other assets	57.7	82.1	85.0	96.9	89.9	96.4	93.8	98.1	102.5
Assets = Liabilities	335.5	389.8	442.8	462.4	463.0	480.1	501.7	510.9	528.0
Foreign liabilities	17.4	19.8	23.7	26.6	26.5	26.7	29.0	32.3	36.0
Banks abroad	3.0	2.9	4.0	6.3	4.4	4.5	4.3	7.0	10.6
FCBUs 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NRFC 3/	12.3	14.0	16.3	17.0	18.7	19.5	20.4	20.9	21.8
RNNFC 4/	0.9	1.2	2.0	2.2	2.3	1.7	3.3	3.4	2.5
Other	1.2	1.6	1.4	1.1	1.1	1.0	1.1	1.0	1.1
Demand deposits	33.0	35.5	40.1	43.3	42.4	44.4	44.5	47.1	47.8
Domestic NRFC deposits	17.8	20.7	25.6	28.7	32.8	33.0	38.1	41.9	44.5
Time and savings deposits	153.3	175.0	202.4	205.0	206.8	208.2	219.9	222.0	227.8
Government deposits	9.5	12.9	13.7	11.0	10.9	12.7	11.6	10.1	10.5
Demand	8.2	10.9	9.8	8.5	9.2	11.4	10.4	8.8	9.2
Time and savings	1.3	2.0	3.9	2.5	1.8	1.4	1.2	1.2	1.3
Due to CBSL	3.6	4.1	4.8	4.4	4.6	4.7	4.8	4.9	4.8
Due to banks	9.9	21.0	8.7	10.6	8.1	11.9	11.8	8.9	8.9
Due to OFIs	0.8	1.1	10.7	11.5	11.1	10.9	11.8	11.1	12.0
Capital	33.5	39.2	44.4	47.1	44.1	45.6	50.2	47.5	48.4
Other liabilities	56.8	60.5	68.8	74.2	75.5	81.9	80.0	85.1	87.3

Source: Central Bank of Sri Lanka.

1/ Adjusted to reflect the reclassification of foreign liabilities of domestic banking units and the inclusion of foreign currency banking units.
2/ A foreign currency banking unit is a unit in a commercial bank which accepts deposits and grants advances in foreign currency from and to non-residents, commercial banks, Board of Investment (BOI) enterprises, and other approved residents.
3/ Non-Resident Foreign Currency accounts.
4/ Resident Non-National Foreign Currency accounts.

Table 24. Sri Lanka: Balance Sheet of Commercial Banks, 1995–99 (concluded) 1/

	1995	1996	1997	1998				1999	
				Mar.	Jun.	Sep.	Dec.	Mar.	Jun.
	(In percent of total assets and liabilities)								
Foreign assets	4.3	4.0	5.8	6.3	4.9	6.4	6.0	6.4	6.0
Banks abroad	2.4	2.2	4.1	4.4	3.1	4.7	4.5	5.0	4.8
Other	1.8	1.8	1.7	1.8	1.8	1.7	1.5	1.4	1.3
Cash and deposits	16.3	15.7	14.9	15.3	15.9	15.3	16.0	16.0	15.5
Cash in till	1.3	1.8	1.7	1.8	1.7	1.7	1.7	1.9	1.8
Deposits with CBSL	9.2	8.8	6.6	6.2	6.1	6.3	6.2	6.0	5.5
FCBUs	3.9	3.3	5.2	5.7	5.9	4.9	5.8	6.3	6.2
Due from other banks	1.8	1.8	1.5	1.6	2.2	2.4	2.4	1.7	2.1
Claims on government	6.0	7.0	9.0	7.7	8.6	8.1	8.8	7.5	8.7
Treasury bills	3.4	4.0	4.6	3.7	3.8	2.4	2.7	1.7	1.5
Two-year treasury notes	0.0	0.0	0.4	0.5	0.5	1.0	1.0	0.9	1.7
Other government securities	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Other	2.4	2.8	3.8	3.4	4.2	4.6	5.1	4.8	5.5
Claims on public corporations	2.5	2.5	2.3	2.1	2.4	1.8	1.9	1.5	1.7
Claims on private sector	53.7	49.7	48.8	47.6	48.8	48.3	48.5	49.4	48.6
Other assets	17.2	21.1	19.2	21.0	19.4	20.1	18.7	19.2	19.4
Foreign liabilities	5.2	5.1	5.3	5.8	5.7	5.6	5.8	6.3	6.8
Banks abroad	0.9	0.8	0.9	1.4	0.9	0.9	0.8	1.4	2.0
FCBUs 2/	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NRFC 3/	3.7	3.6	3.7	3.7	4.0	4.1	4.1	4.1	4.1
RNNFC 4/	0.3	0.3	0.5	0.5	0.5	0.4	0.6	0.7	0.5
Other	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Demand Deposits	9.8	9.1	9.1	9.4	9.2	9.3	8.9	9.2	9.0
Domestic NRFC deposits	5.3	5.3	5.8	6.2	7.1	6.9	7.6	8.2	8.4
Time and savings deposits	45.7	44.9	45.7	44.3	44.7	43.4	43.8	43.4	43.1
Government deposits	2.8	3.3	3.1	2.4	2.4	2.7	2.3	2.0	2.0
Demand	2.5	2.8	2.2	1.8	2.0	2.4	2.1	1.7	1.7
Time and savings	0.4	0.5	0.9	0.5	0.4	0.3	0.2	0.2	0.2
Due to CBSL	1.1	1.0	1.1	1.0	1.0	1.0	1.0	1.0	0.9
Due to banks	2.9	5.4	2.0	2.3	1.8	2.5	2.4	1.8	1.7
Due to OFIs	0.2	0.3	2.4	2.5	2.4	2.3	2.3	2.2	2.3
Capital	10.0	10.1	10.0	10.2	9.5	9.5	10.0	9.3	9.2
Other liabilities	16.9	15.5	15.5	16.0	16.3	17.1	15.9	16.7	16.5

Source: Central Bank of Sri Lanka.

1/ Adjusted to reflect the reclassification of foreign liabilities of domestic banking units and the inclusion of foreign currency banking units.

2/ A foreign currency banking unit is a unit in a commercial bank which accepts deposits and grants advances in foreign currency from and to non-residents, commercial banks, Board of Investment (BOI) enterprises, and other approved residents.

3/ Non-Resident Foreign Currency accounts.

4/ Resident Non-National Foreign Currency accounts.

Table 25. Sri Lanka: Advances by Purpose and According to Maturity, 1997-98 1/

	97Q4	98Q1	98Q2	98Q3	98Q4
	(In billions of Sri Lanka rupees; end of period)				
By Category					
Commercial	99.2	96.7	99.5	99.8	102.9
Financial	7.6	7.7	8.4	8.7	11.3
Agriculture	11.8	11.7	12.5	12.2	13.1
Industrial 2/	25.3	25.9	26.2	26.7	27.6
Tourism	3.3	3.7	6.2	3.9	4.1
Housing 3/	25.1	28.9	28.3	30.9	31.2
Consumption	19.5	20.6	21.4	23.3	23.3
Other loans	25.0	25.9	25.1	25.8	27.8
Total	216.7	221.1	227.6	231.3	241.3
	(In percent annual growth)				
Commercial	11.3	4.3	8.0	7.3	3.8
Financial	-8.3	5.4	18.9	15.6	48.4
Agriculture	10.9	6.3	4.1	13.3	11.5
Industrial 2/	-2.6	1.8	2.3	5.0	9.0
Tourism	-2.4	13.3	86.4	18.1	23.6
Housing 3/	4.6	19.6	16.7	20.2	24.3
Consumption	18.8	18.0	21.9	27.9	19.6
Other loans	29.3	18.8	18.7	15.0	11.4
Total	10.0	8.9	12.1	12.1	11.3
	(In percent of total)				
Commercial	45.8	43.7	43.7	43.1	42.6
Financial	3.5	3.5	3.7	3.8	4.7
Agriculture	5.4	5.3	5.5	5.3	5.4
Industrial 2/	11.7	11.7	11.5	11.6	11.4
Tourism	1.5	1.7	2.7	1.7	1.7
Housing 3/	11.6	13.1	12.4	13.3	12.9
Consumption	9.0	9.3	9.4	10.1	9.7
Other loans	11.5	11.7	11.0	11.1	11.5
Total	100.0	100.0	100.0	100.0	100.0
By Maturity					
Short term	63.9	63.6	64.0	64.0	63.7
Medium term	23.9	24.1	23.4	23.3	23.7
Long term	12.2	12.3	12.6	12.7	12.6
Total	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Sri Lanka.

1/ Domestic banking units only. Advances include loans, overdrafts, and bills discounted; and exclude cash items in process of collection.
2/ Includes advances granted to the Engineering and Building Trade, Mining and Fishing.
3/ Housing covers personal housing (including purchase, construction, and repairs); construction of business premises; and property development.

Table 26. Sri Lanka: Selected Interest Rates, 1994–99

(In percent; end-of-period)

	CBSL Rates		Money Market Rates			Bank Rates		Memorandum:
	Repos	Reverse Repo	Interbank Call Rate 1/	Treasury Bills 3 Months	Treasury Bills 12 Months	Prime Lending 1/	Time and Savings 1/	CPI Inflation Annual Rate
1994	20.0	n.a.	...	18.7	19.4	17.8	12.6	4.2
1995	16.5	...	...	19.3	19.0	19.9	12.4	11.5
1996	12.8	n.a.	15.0	17.5	17.4	18.4	12.3	16.8
1997	11.0	n.a.	11.2	10.0	10.2	14.2	10.0	10.7
1998	12.0	15.0	13.0	10.4	10.6	15.0	9.9	3.7
97Q1	7.0	n.a.	13.4	11.9	13.5	15.8	12.0	14.3
97Q2	9.0	n.a.	11.5	11.0	12.7	14.9	11.4	3.9
97Q3	9.0	n.a.	9.8	9.9	10.5	13.0	11.0	6.8
97Q4	11.0	n.a.	10.0	10.0	10.2	14.2	10.0	10.7
		n.a.						
Jan-98	12.0	n.a.	12.1	10.4	10.6	15.0	9.9	13.2
Feb	12.0	n.a.	12.9	11.4	11.5	15.0	9.9	12.1
Mar	12.0	n.a.	13.3	11.3	11.4	15.0	9.8	11.4
Apr	11.7	n.a.	13.0	11.7	12.0	15.5	9.6	10.3
May	12.2	n.a.	12.0	11.6	12.0	14.5	9.6	12.1
Jun	12.1	n.a.	12.3	11.8	12.1	14.4	9.6	14.1
Jul	12.1	n.a.	14.8	12.2	12.8	15.8	9.6	10.5
Aug	12.1	n.a.	12.8	12.5	13.0	14.9	9.6	6.8
Sep	12.0	n.a.	13.3	12.4	13.0	15.1	9.6	5.8
Oct	11.8	n.a.	13.8	12.6	13.1	15.3	9.2	7.5
Nov	11.8	15.5	12.9	12.6	13.0	14.8	9.2	5.8
Dec	11.3	15.0	12.7	12.0	12.6	15.1	9.2	3.7
Jan-99	11.0	14.6	11.7	11.7	12.5	14.3	9.2	3.8
Feb	11.0	14.6	12.3	11.7	12.5	14.3	9.2	5.0
Mar	11.0	14.6	13.4	11.8	12.6	15.4	9.2	5.0
Apr	10.5	14.2	15.6	11.8	12.6	14.9	9.1	7.7
May	10.5	14.1	12.6	11.7	12.6	15.1	9.1	6.6
Jun	10.0	14.1	11.0	11.8	12.7	13.7	9.1	3.4
Jul	9.5	14.2	11.6	11.8	12.7	14.7	9.1	1.6
Aug	9.5	13.7	10.3	11.4	12.3	13.1	...	4.7

Source: Central Bank of Sri Lanka.

1/ Weighted average.

Table 27. Sri Lanka: Reserve Position of Commercial Banks, 1994–98

(In billions of of Sri Lanka rupees)

	Deposits			Required reserves				Actual reserves						Excess
	Demand	Time and Savings	Foreign currency	Demand	Time and Savings	Foreign currency	Total (4)+(5)+(6)	Deposits with CBSL	DFCC bonds	Government securities	Till cash	Total (8)+(9)+(10)+(11)	Balance till cash	reserves (12)-(7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
1994	38.1	119.5	27.0	5.7	17.9	2.8	26.4	24.8	0.4	0.0	1.8	27.0	2.4	0.6
1995	39.0	151.5	32.1	5.8	22.7	3.4	32.0	31.9	0.3	0.0	1.3	33.5	3.2	1.5
1996	42.0	179.5	35.1	6.3	26.9	3.7	36.9	35.9	0.3	0.0	1.6	37.8	5.4	0.9
1997 January	42.5	183.2	22.7	5.9	25.6	3.4	35.0	33.5	0.3	0.0	2.2	36.0	3.7	1.0
February	41.4	186.0	22.0	5.8	26.0	3.3	35.1	33.7	0.3	0.0	1.9	36.0	3.4	0.8
March	42.8	188.8	23.0	5.1	22.7	2.8	30.6	21.3	0.3	0.0	2.2	23.7	4.2	-6.8
April	42.3	190.9	24.1	5.1	22.9	2.9	30.9	26.7	0.3	0.0	3.8	30.8	4.2	-0.1
May	44.9	191.7	22.7	5.4	23.0	2.7	31.1	30.9	0.3	0.0	2.6	33.8	3.7	2.7
June	44.4	194.8	23.0	5.3	23.4	2.8	31.5	28.9	0.3	0.0	2.0	31.2	4.7	-0.3
July	43.6	197.9	22.8	5.2	23.7	2.7	31.7	27.0	0.3	0.0	2.7	30.0	3.7	-1.7
August	44.2	202.1	21.9	5.3	24.3	2.6	32.2	29.8	0.3	0.0	3.0	33.1	2.7	0.9
September	45.2	203.8	27.0	5.4	24.5	3.2	33.1	29.7	0.3	0.0	2.8	32.8	3.9	-0.3
October	42.4	205.8	20.9	5.1	24.7	2.5	32.3	31.0	0.3	0.0	2.2	33.5	4.2	1.3
November	46.5	208.8	21.1	5.6	25.1	2.5	33.2	29.2	0.3	0.0	2.4	31.9	3.7	-1.2
December	46.6	210.7	20.4	5.6	25.3	2.5	33.3	30.5	0.3	0.0	2.7	33.6	4.7	0.2
1998 January	46.3	213.8	21.1	5.6	25.7	2.5	33.7	29.6	0.3	0.0	2.2	32.1	4.0	-1.7
February	46.7	215.2	20.9	5.6	25.8	2.5	33.9	30.8	0.3	0.0	2.5	33.6	3.9	-0.4
March	48.7	215.5	21.9	5.8	25.9	2.6	34.3	31.3	0.3	0.0	2.6	34.2	5.8	-0.1
April	51.3	218.4	25.2	6.2	26.2	3.0	35.4	30.0	0.3	0.0	4.3	34.6	0.4	-0.8
May	52.5	215.4	25.8	6.3	25.8	3.1	35.2	32.6	0.3	0.0	3.5	36.4	4.0	1.1
June	50.3	214.7	26.0	6.0	25.8	3.1	34.9	29.6	0.3	0.0	3.2	33.1	4.8	-1.8
July	47.4	213.6	27.9	5.7	25.6	3.3	34.7	31.6	0.3	0.0	3.5	35.4	4.4	0.8
August	51.3	214.8	27.3	6.2	25.8	3.3	35.2	31.3	0.3	0.0	3.1	34.6	5.2	-0.6
September	54.0	215.0	27.0	6.5	25.8	3.2	35.5	32.4	0.3	0.0	3.3	36.0	5.0	0.5
October	51.6	218.7	24.7	6.2	26.2	3.0	35.4	31.4	0.3	0.0	3.6	35.3	3.8	-0.1
November	52.6	221.0	25.6	6.3	26.5	3.1	35.9	32.3	0.3	0.0	2.6	35.2	5.2	-0.7
December	54.1	222.5	32.3	6.5	26.7	3.9	37.1	32.7	0.3	0.0	2.9	35.9	5.4	-1.1

Source: Central Bank of Sri Lanka.

Table 28. Sri Lanka: Balance of Payments 1994–98

	1994	1995	1996	1997	1998
			(In millions of U.S. dollars)		
Trade balance	-1,559	-1,505	-1,344	-1,225	-1,157
Exports	3,209	3,807	4,095	4,639	4,735
Imports	4,767	5,311	5,439	5,864	5,891
Services, net	180	152	105	159	143
Receipts	745	821	765	875	913
Payments	566	669	660	716	770
Income, net	-162	-170	-197	-160	-179
Receipts	171	226	186	234	214
Payments	333	396	383	393	392
Of which: Interest	250	312	307	303	288
Private transfers, net	622	675	710	788	848
Current account (excluding grants)	-919	-848	-726	-438	-345
Official transfers	58	61	49	44	55
Current account (including grants)	-860	-786	-677	-393	-289
Capital and financial account	943	699	459	602	395
Capital account (net)	113	117	96	87	61
Financial account	830	581	363	515	333
Long-term:	705	502	381	716	397
Direct investment	158	53	120	430	193
Foreign direct investment, net	158	16	86	129	137
Privatization proceeds	0	37	33	301	56
Private, long-term (net)	295	91	2	47	7
Disbursements	384	194	156	150	149
Amortization	90	103	155	102	142
Government, long-term (net)	253	358	259	239	197
Disbursements	440	674	497	500	488
Amortization	187	315	238	262	291
Short-term, net	124	79	-18	-201	-64
Portfolio investment, net (CSE)	28	-2	7	13	-24
Private short-term, net	172	33	-44	-20	8
Commercial banks (net) 1/	-76	49	19	-194	-48
Errors and omissions	157	139	150	-46	-68
Overall balance	240	52	-68	163	37
Net international reserves	-240	-51	68	-162	-37
Increase in gross official reserves (-)	-347	-41	126	-92	45
Central bank borrowing, net 2/	40	24	-13	-4	1
Use of Fund credit, net	67	-34	-45	-66	-83
Memorandum items:			(In percent of GDP)		
Current account (excl. official transfers)	-7.8	-6.5	-5.2	-2.9	-2.2
Overall balance	2.0	0.4	-0.5	1.1	0.2
Total debt	70.8	66.7	61.1	54.3	55.6
Exports of goods and services	33.7	35.6	35.0	36.5	30.1
Imports of goods and services	45.5	45.9	43.9	43.6	37.5
Total debt service (percent of exports of goods and services)	13.7	16.5	15.3	13.3	13.4
Of which: Interest	6.3	6.7	6.3	5.5	5.1
Amortization	7.3	9.8	9.0	7.8	8.3
Gross official reserves (in millions of U.S. dollars)	2,022	2,063	1,937	2,029	1,984
(In months of imports of goods and services)	4.5	4.1	3.8	3.7	3.6
Net official reserves	1,342	1,393	1,325	1,488	1,524
GDP (in millions of U.S. dollars)	11,719	13,029	13,897	15,091	15,706

Sources: Data provided by the Central Bank of Sri Lanka; and staff estimates.

1/ The Foreign Currency Banking Units (FCBUs) have been treated as part of the domestic banking system from 1994 onwards. Data reflect this reclassification of activities associated with the FCBUs.

2/ Includes valuation effects.

Table 29. Sri Lanka: Exports by Commodity, 1994–98

	1994	1995	1996	1997	1998 1/
	(Value in millions of U.S. dollars)				
Total	3,209	3,807	4,095	4,639	4,735
Agricultural products	702	829	961	1,060	1,088
Tea					
Value	424	481	615	719	780
Volume (million kg)	229.6	240.8	244.1	268.5	271.9
Unit value (US$)	1.85	2.00	2.52	2.68	2.87
Rubber					
Value	72	111	104	79	44
Volume (million kg)	69.1	68.3	72.2	61.5	41.5
Unit value (US$/kg)	1.05	1.64	1.45	1.29	1.06
Coconuts					
Value	50	69	81	82	56
Volume (million nuts)	437.0	579	475	505	435
Unit value (US$/nut)	0.11	0.12	0.17	0.16	0.13
Coconut products (value)	26	34	29	35	38
Other agricultural products					
Value	129	133	132	145	170
Volume (million kg)	101.6	92.4	54.6	58	58
Unit price (US$/kg)	1.27	1.44	2.41	2.49	2.93
Industrial products	2,399	2,870	2,990	3,422	3,527
Gems (value)	225	240	243	208	113
Of which: Processed diamonds (value)	145.7	163.4	156.3	125.0	58
Garments and textiles					
Value	1,552	1,853	1,902	2,274	2,460
Volume (million pieces)	529.5	593.1	324.7	360.4	371.3
Unit value (US$/piece)	2.9	3.1	5.9	6.3	6.6
Other industrial products (value)	620	767	845	940	953
Petroleum products					
Value	80	85	104	97	73
Volume ('000 metric tons)	611.8	616.1	660.9	538.1	473.5
Unit value (US$/ton)	131.1	138.1	157.2	180.3	154.2
Miscellaneous exports	36	37	40	60	47
	(In percent of total exports)				
Traditional exports 2/	17.9	18.3	20.3	19.7	19.8
Of which: Tea	13.2	12.6	15.0	15.5	16.5
Nontraditional exports	82.1	81.7	79.7	80.3	79.1
Other agricultural products	4.0	3.5	3.2	3.1	3.6
Garments and textiles	48.4	48.7	46.4	49.0	52
Gems	7.0	6.3	5.9	4.5	2.4
Other industrial products	19.4	20.2	20.6	20.3	20.1
Petroleum products	2.5	2.2	2.5	2.1	1
Other	0.8	0.8	1.0	1.3	1.5
Total	100.0	100.0	100.0	100.0	100.0

Source: Data provided by the Central Bank of Sri Lanka.

1/ Preliminary estimates.

2/ Consists of tea, rubber, coconuts, and coconut products.

Table 30. Sri Lanka: Imports by Commmodity, 1994–98

	1994	1995	1996	1997	1998 1/
	(Value in millions of U.S. dollars)				
Total	4,767	5,311	5,439	5,864	5,891
Consumer goods	1,048	1,180	1,234	1,222	1,255
Rice					
Value	13	2	91	73	42
Volume ('000 metric tons)	58.4	9.5	341.2	306.1	167.6
Unit value (US$/ton)	220.9	252.6	267.0	238.8	251.0
Wheat					
Value	118	198	204	139	127
Volume ('000 metric tons)	826.4	1,057.9	913.0	789.0	879.6
Unit value (US$/ton)	143.8	187.2	223.8	175.7	144.4
Sugar					
Value	180	170	145	184	129
Volume ('000 metric tons)	491.7	417.9	381.2	545.2	444.3
Unit value (US$/ton)	362.0	406.8	380.4	336.8	290.9
Other food	291	349	361	385	425
Other consumer goods	447	461	433	442	532
Intermediate goods	2,307	2,702	2,767	3,096	2,977
Crude petroleum					
Value	231	240	304	263	215
Volume (million barrels)	14.2	13.7	15.1	13.5	15.8
Unit value (US$/barrel)	16.3	17.5	20.1	19.5	13.6
Refined petroleum	65	146	175	276	129
Fertilizer					
Value	63	86	76	66	62
Volume ('000 metric tons)	426.1	452.4	360.6	332.5	440.4
Unit value (US$/ton)	146.9	190.1	209.9	161.2	139.9
Textiles	1,038	1,159	1,168	1,386	1,397
Other intermediate goods	910	1,071	1,044	1,105	1,173
Investment goods	1,366	1,189	1,204	1,325	1,477
Of which: Machinery and equipment	559	503	649	742	786
Transport equipment	454	304	179	208	264
Building materials	241	272	263	272	303
Unclassified 2/	45	240	234	220	182
	(In percent of total imports)				
Food	12.6	13.5	14.7	13.3	12.3
Petroleum	6.2	7.3	8.8	9.2	5.9
Textiles	21.8	21.8	21.5	23.7	23.7
Other intermediate goods 3/	20.4	21.8	20.6	19.8	21.0
Investment goods	28.7	22.4	22.1	22.6	25.1
Other 4/	10.3	13.2	12.3	11.3	12.1
Total	100.0	100.0	100.0	100.0	100.0

Sources: Data provided by the Central Bank of Sri Lanka; and staff estimates.

1/ Preliminary estimates.
2/ Includes non-monetary gold and military equipment.
3/ Includes fertilizer.
4/ Includes non-food consumer goods and unclassified imports.

Table 31. Sri Lanka: Minor Nontraditional Industrial Exports, 1994–98

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998 1/
Food, beverages, and tobacco	86.2	98.3	95.4	90.8	117.4
Fruits and vegetable juices	1.3	0.8	0.4	0.5	0.6
Fish, fresh and frozen	13.8	8.8	8.6	11.6	13.3
Fish, salted	2.7	3.9	3.0	3.9	2.8
Crustaceans and mollusks	44.8	53.8	56.9	50.9	78.8
Manufactured tobacco	6.2	12.6	5.3	5.9	3.0
Other	17.4	18.3	21.2	17.9	19.1
Chemical products	23.4	28.1	25.2	25.2	27.9
Glycerol, glycerine	3.4	3.8	0.0	0.6	1.9
Soap	0.4	0.6	0.7	0.2	0.2
Activated carbon	14.3	17.3	16.7	19.4	19.1
Other	22.8	35.4	7.7	5.0	6.7
Leather, rubber, paper, wood, and ceramics	342.1	384.6	404.0	469.7	502.9
Footwear	39.0	44.4	50.6	70.2	65.0
Rubber tires	37.5	62.4	68.1	73.3	85.0
Other rubber products	64.2	90.8	101.2	104.9	93.4
Wood products	34.7	26.3	13.6	11.0	8.8
Wall tiles	9.0	9.3	9.8	11.2	11.0
Domestic items	38.9	17.3	48.0	52.3	49.8
Other	129.3	115.8	122.0	155.1	189.9
Mining and quarrying	7.6	9.3	9.4	6.3	4.4
Natural graphite	1.9	1.9	2.7	2.8	2.9
Ilmenite	3.5	2.5	1.2	1.8	0.0
Ores and iron, pyrites	0.4	1.7	3.8	0.1	0.0
Other	1.8	3.1	1.7	1.6	1.5
Machinery, mechanical and electrical appliances	92.5	123.9	155.1	204.7	182.9
Total	551.9	644.1	689.0	796.6	835.5
(As percent of total exports)	17.2	16.9	16.8	17.1	17.6
Memorandum items:					
Garments and textiles	1,551.9	1,852.5	1,905.9	2,279.1	2,466.3
Gems and jewelry	249.6	273.1	278.9	225.2	123.8

Source: Data provided by the Central Bank of Sri Lanka.

1/ Preliminary estimates.

Table 32. Sri Lanka: Minor Agricultural Exports, 1994–98

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998 1/
Fruits and vegetables	15.0	9.7	9.9	8.3	7.3
Coffee	7.6	2.5	1.0	1.5	2.2
Cinnamon	32.9	33.6	34.8	46.7	50.6
Cloves	0.8	1.3	1.5	2.2	2.2
Peppers	6.4	7.0	7.1	13.7	26.6
Other spices	1.0	1.2	1.4	1.6	2.1
Cashew nuts	2.3	2.2	1.9	3.1	2.4
Sesame and other oilseeds	0.2	0.2	0.1	0.5	0.5
Essential oils	3.5	5.2	3.3	3.8	5.3
Unmanufactured tobacco	32.6	35.7	42.4	34.4	41.0
Betel leaves	1.3	1.2	1.3	0.9	0.8
Other	25.6	34.1	27.2	28.2	30.0
Total	129.2	133.8	132.0	145.0	170.7
(As percent of total exports)	4.0	3.5	3.2	3.1	3.6

Source: Data provided by the Central Bank of Sri Lanka.

1/ Preliminary estimates.

Table 33. Sri Lanka: Direction of Trade, 1994–98

(In percent)

	Exports					Imports				
	1994	1995	1996	1997	1998 1/	1994	1995	1996	1997	1998 1/
European Union	30.9	31.8	29.7	30.1	27.3	18.1	17.9	17.7	16.9	17.6
Of which:										
France	2.7	2.3	2.7	2.2	2.2	1.2	1.2	1.0	0.9	1.3
Germany	7.1	6.8	6.0	5.0	4.9	3.8	3.5	3.1	3.3	3.6
Netherlands	3.6	3.7	3.1	3.0	2.2	1.6	1.8	1.6	1.4	1.7
United Kingdom	9.1	9.2	9.7	11.5	11.3	5.5	5.1	5.0	5.0	5.3
United States	35.4	36.1	34.7	36.4	40.3	6.4	3.6	3.9	3.3	4.0
Japan	5.2	5.3	6.4	5.1	4.2	11.8	10.5	9.9	8.5	9.7
Middle East	8.9	7.2	7.6	7.4	9.0	5.4	7.3	8.3	9.4	6.5
Of which:										
Egypt	1.0	0.9	0.6	0.9	3.1	0.4	0.6	0.3	0.3	0.1
Iran, Islamic Republic of	0.5	0.7	0.9	0.5	0.4	2.0	1.8	3.0	1.8	2.0
Iraq	0.0	0.0	0.0	0.1	0.3	0.0	--	--	--	0.0
Saudi Arabia	1.3	0.5	0.8	0.8	1.0	0.5	1.7	2.3	3.2	1.7
Asia 2/	9.7	9.4	8.7	8.4	7.3	48.5	50.0	49.8	50.3	52.1
Of which:										
China	0.1	0.1	0.3	0.2	0.3	3.5	3.4	2.9	3.0	4.0
India	0.8	0.9	1.1	1.0	0.8	9.0	9.8	11.2	9.9	9.5
Pakistan	1.4	1.2	0.9	0.8	0.6	1.4	1.1	1.4	1.5	1.6
Singapore	2.4	2.0	1.5	1.3	0.9	5.2	5.2	5.1	5.1	5.4
Former Soviet Union	1.2	2.4	3.1	3.7	3.1	0.2	0.2	0.4	0.3	0.3
Other countries	9.9	9.8	11.2	8.9	8.8	10.4	10.5	9.8	11.7	9.8
All countries	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Data provided by the Central Bank of Sri Lanka.

1/ Preliminary estimates, based on data excluding military imports.
2/ Excluding Japan.

Table 34. Sri Lanka: Indicators of Trade Performance, 1994–98

	1994	1995	1996	1997	1998
			(In percent of GDP)		
Exports	27.4	29.2	29.5	30.7	30.1
Imports	40.7	40.7	39.1	38.9	37.5
Consumption	8.9	9.1	8.9	8.1	8.0
Food	5.1	5.5	5.8	5.2	4.6
Other	3.8	3.5	3.1	2.9	3.4
Intermediate 1/	19.7	20.7	19.9	20.5	18.9
Petroleum	2.5	3.0	3.4	3.6	2.2
Other	17.2	17.8	16.5	16.9	16.7
Investment	11.7	9.1	8.7	8.8	9.4
Other	0.4	1.8	1.7	1.5	1.2
Trade balance	-13.3	-11.5	-9.7	-8.1	-7.4
			(Annual percentage change)		
Export volume	16.9	7.2	4.1	10.6	0.1
Of which:					
Traditional 2/	18.7	4.3	2.0	9.5	-3.9
Nontraditional 3/	18.1	11.7	11.5	12.3	0.5
Export unit value 4/					
(U.S. dollar terms)	-4.2	10.8	4.2	1.3	1.7
Of which:					
Traditional	-4.7	13.1	2.9	4.1	2.1
Nontraditional	-9.2	8.8	7.0	-1.7	1.6
Import volume	19.8	2.7	0.3	12.4	12.4
Import unit value 4/					
(U.S. dollar terms)	-0.8	8.5	0.2	-2.7	-10.6
Terms of trade	-3.4	-0.9	-0.5	6.8	14.2
Real effective exchange rate 5/	-4.7	-1.9	12.4	14.8	-10.5

Sources: Data provided by the Central Bank of Sri Lanka; and staff estimates.

1/ Consists of fertilizer, petroleum, textile and other intermediate goods.

2/ Consists of tea, rubber, coconuts, and coconut products.

3/ Consists of gems, garments and textiles, other industrial exports, minor agricultural products, and miscellaneous exports; includes petroleum products.

4/ From 1990 = 100 index.

5/ Changes are December to December as calculated by the IMF, Information Notice System.

Table 35. Sri Lanka: Services and Income, 1994–98

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998 1/
Total services	180	152	105	159	143
Receipts	745	821	765	875	913
Payments	566	669	660	716	770
Transportation	139	135	138	156	137
Receipts	293	336	339	389	400
Payments	155	201	201	233	263
Travel	61	40	-10	29	28
Receipts	231	226	166	209	230
Payments	169	186	176	180	202
Insurance services	8	17	10	10	16
Receipts	21	27	28	30	34
Payments	13	10	18	20	18
Other business services	-21	-28	-27	-29	-29
Receipts	176	213	208	223	224
Payments	197	240	235	252	253
Government Expenditure n.i.e.	-7	-11	-7	-6	-9
Receipts	25	19	24	25	25
Payments	32	31	31	31	34
Total income	-162	-170	-197	-160	-179
Receipts	171	226	186	234	214
Compensation of Employees	9	11	11	12	12
Direct Investment (Profits and dividends)	1	1	1	2	2
Other (interest)	162	214	173	220	200
Payments	333	396	383	393	392
Compensation of employees	10	13	12	13	13
Direct investment (profits and dividends)	74	71	64	77	91
Other (interest)	250	312	307	303	288
Memorandum items :					
Exports of goods and nonfactor services	3,954	4,628	4,860	5,514	5,648
(In percent of GDP)	33.7	35.5	35.0	36.5	36.0
Imports of goods and nonfactor services	5,333	5,980	6,099	6,580	6,661
(In percent of GDP)	45.5	45.9	43.9	43.6	42.4

Source: Data provided by the Central Bank of Sri Lanka.

1/ Provisional.

Table 36. Sri Lanka: Financial Account, 1994–98

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998 1/
Total, net	829.8	581.4	363.2	515.1	333.0
Central government, net	252.8	348.2	241.4	221.3	183.9
Concessional medium- and long-term	284.1	306.1	284.0	183.6	308.2
Disbursements	415.2	446.8	424.3	332.5	465.7
Amortization	131.1	140.8	140.3	148.9	157.4
Nonconcessional medium- and long-term	-31.2	42.1	-42.6	37.7	-124.4
Disbursements	25.0	235.4	72.9	167.8	21.8
Amortization	56.2	193.3	115.5	130.1	146.1
Private sector medium- and long-term 2/	294.5	100.8	19.4	64.7	21.1
Disbursements	384.3	185.5	156.1	149.7	149.3
Amortization 3/	89.8	84.6	136.7	85.0	128.2
Direct investment, net 4/	186.3	50.8	126.5	442.9	169.3
Short-term, net 5/	96.2	81.5	-24.2	213.8	-40.3
Memorandum items:					
Total aid disbursements	607.3	855.9	637.6	627.4	597.4
Loans	440.2	682.3	497.2	500.3	487.4
Project loans 6/	415.2	446.8	424.3	332.5	465.7
Commodity and program loans	25.0	235.4	72.9	167.8	21.8
Grants	167.1	173.6	140.4	127.1	110.0
Project grants	108.6	112.8	91.3	82.5	55.2
Commodity and technical assistance grants	58.5	60.8	49.1	44.5	54.8

Sources: Data provided by the Central Bank of Sri Lanka; and staff estimates.

1/ Preliminary estimates, including external debt-financed military imports.

2/ Consists of public corporations and private companies.

3/ Including progress payments for acquisition of commercial aircraft by Air Lanka.

4/ Includes foreign direct investment, and privatization proceeds.

5/ Includes portfolio investment, net short-term private, net foreign assets of commercial banks, and net short-term government.

6/ Includes nonconcessional project loans.

Table 37. Sri Lanka: External Debt-Service Payments, 1994–98 1/

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998 2/
Interest	235.5	223.5	243.5	229.4	222.4
Government	119.2	130.4	123.5	117.1	116.3
Concessional	105.6	116.6	109.7	103.9	100.4
Multilateral	21.6	24.5	24.7	25	25
Bilateral	84.0	92.0	85.0	78.8	75.5
Nonconcessional	13.6	13.8	13.8	13.3	15.9
Private	59.4	55.3	74.2	71.9	68.4
Public corporations 3/	27.6	30.9	47.9	46.7	50.5
Private sector 3/	16.9	8.4	6.0	4.3	
Other public corporations 4/	1.7	0.1	0.2	0.1	17.9
Other private sector	13.2	8.6	10.7	14.9	
Fund	7.3	7.7	6.6	6.1	5.8
Short-term debt 5/	49.5	30.2	39.3	34.3	31.9
Amortization	278.2	433.3	422.1	413.8	501.5
Government	187.8	315.4	238.4	262.4	290.6
Concessional	127.3	140.7	140.7	149.6	158.4
Multilateral	18.5	20.2	23.8	34.5	31.7
Bilateral	108.8	120.5	116.8	115.1	126.7
Nonconcessional	60.5	174.7	97.7	112.8	132.2
Private	77.5	84.7	137.0	85.4	128.2
Public corporations 3/	50.3	29.6	38.0	53.1	105.1
Private sector 3/	4.3	6.1	24.8	6.6	
Other public corporations	0.1	0.1	0.1	0.1	23.1
Other private sector	22.8	59.7	80.8	38.6	
Fund repurchases	13.0	33.2	46.8	66.1	82.7
Memorandum items:					
Total debt-service ratio 6/	13.0	14.2	13.7	11.7	12.8
Of which: Interest payments	6.0	4.8	5.0	4.2	3.9
Medium- and long-term official debt-service ratio 7/	10.6	12.0	11.2	10.1	11.4
Interest payments/total outstanding debt	2.8	2.6	2.9	2.8	2.5
Average interest rate on concessional debt	1.8	1.9	1.8	1.8	1.5
Average interest rate on non-concessional debt	4.0	3.4	3.7	3.1	5.0

Source: Data provided by the Central Bank of Sri Lanka.

1/ Excludes debt service payments arising from loans on buses, wheat, defense, and CGR, which are not captured by the External Debt Monitoring Unit.
2/ Provisional.
3/ With government guarantee.
4/ Without government guarantee.
5/ Includes interest payments on trade credits, borrowings from FCBUs, Central Bank and commercial bank liabilities and foreign currency deposits of nonresidents.
6/ Including Fund credit, private sector debt, and short-term debt; excludes net inflows of short-term debt.
7/ Including Fund credit.

Table 38. Sri Lanka: External Debt Outstanding, 1994–98

(In millions of U.S. dollars)

	1994	1995	1996	1997	1998 1/
Total medium and long term	7,173	7,556	7,458	7,286	7,898
Government	6,216	6,637	6,554	6,346	6,897
Concessional	5,875	6,237	6,180	5,916	6,580
Multilateral	2,444	2,662	2,819	2,820	3,063
IDA	1,344	1,464	1,517	1,509	1,648
AsDB	1,026	1,124	1,231	1,243	1,397
Other	74	74	71	68	18
Bilateral	3,431	3,575	3,361	3,095	3,518
Japan	1,787	1,879	1,761	1,611	1,953
United States	695	699	692	684	676
Germany	500	539	482	420	445
Other	450	458	426	380	445
Commercial	341	400	374	431	316
Multilateral	16	13	12	10	8
Bilateral	2	3	3	17	24
Financial markets	148	159	151	200	188
Supplier credits	176	225	209	204	96
Public corporations and private sector 2/ 3/	696	640	637	670	724
Other public corporations and private sector 3/ 4/	261	279	267	270	278
Short-term debt 3/ 5/	510	542	498	479	487
IMF	615	596	530	433	367
Total debt	8,298	8,694	8,486	8,197	8,753
Memorandum items:					
Total medium- and long-term debt 6/	7,788	8,152	7,988	7,719	8,266
(In percent of GDP)	66	63	57	51	53
(In percent of exports of goods and nonfactor services)	197	176	164	140	146

Source: Data provided by the Sri Lanka authorities.
1/ Provisional.
2/ With government guarantee.
3/ From 1994 debt stocks have been revised.
4/ Without government guarantee.
5/ Excluding nonresident foreign currency deposits.
6/ Including use of Fund credit.

Table 39. Sri Lanka: Net International Reserves, 1994–98

(In millions of U.S. dollars; end of period)

	1994	1995	1996	1997	1998
I. Central Bank, net	1,905	1,941	1,803	1,874	1,843
a. Assets	1,970	2,015	1,886	1,982	1,935
Gold	6	5	5	5	4
SDR holdings	0	1	2	0	1
Liquid balances abroad	247	729	614	842	872
Bilateral credit balances	0	0	0	0	0
Foreign securities	1,654	1,220	1,197	1,094	999
ACU credit balance 1/	8	5	3	1	0
Statutory reserves on foreign deposits of com. Banks	56	56	65	40	59
b. Liabilities	65	75	83	108	93
Nonresident deposits	1	1	1	1	0
Borrowings from abroad	0	0	0	0	0
ACU debit balance 1/	65	74	82	107	92
II. Government, net	-563	-548	-478	-387	-319
a. Assets	52	48	52	47	49
Reserve position in IMF	30	30	29	27	29
Investment	0	0	0	0	0
Other 2/	23	17	23	20	20
b. Liabilities	616	596	530	433	367
Use of Fund credit	616	596	530	433	367
III. Commercial banks, net	-117	-165	-185	9	57
a. Assets	853	839	780	1,103	923
Liquid balances	210	162	166	307	344
Export bills	102	104	109	114	101
FCBU assets with nonresidents	540	574	504	682	479
b. Liabilities	969	1,004	964	1,094	866
Foreign bank borrowings	42	52	35	53	54
Foreign bank deposits	8	5	17	12	9
Nonbank demand deposits 3/	21	11	15	15	13
Nonbank time deposits 3/	234	255	282	307	352
FCBU liabilities with nonresidents	665	682	615	707	438
IV. Net international reserves (I+II+III)	1,225	1,228	1,140	1,497	1,582
Memorandum items:					
Gross official reserves (Ia+IIa)	2,022	2,063	1,938	2,029	1,984
(in months of imports of goods and services)	5	4	4	4	4
Net official reserves (I+II)	1,342	1,393	1,325	1,488	1,524
Exchange rate (SL Rs/U.S. dollar, end-of-period)	50.0	54.1	56.7	61.3	67.8

Source: Data provided by the Central Bank of Sri Lanka.

1/ Asian Clearing Union.
2/ Includes special disbursement accounts and revolving credit balances.
3/ Commercial banks' NFA currently do not reflect the reclassification of activity associated with the foreign currency banking units, which have now been incorporated in the monetary accounts.
4/ Includes NRFC and RNNFC deposits.

Table 40. Sri Lanka: Vulnerability Indicators, 1994–98

(In percent of GDP, unless otherwise indicated)

	1994	1995	1996	1997	1998
Official risk indicators 1/					
Share of nonperforming loans (as percent of total loans)					
State-owned commercial banks	...	16.2	18.9	20.2	19.5
Domestic private banks	...	9.2	12.0	12.4	13.4
Risk-based capital asset ratio (capital over risk-weighted assets) 2/					
State-owned commercial banks	...	...	10.7	9.2	8.2
Domestic private banks	...	...	11.8	10.9	12.3
Foreign banks	...	...	13.8	13.9	13.9
Financial sector risk indicators					
Public sector debt	101.5	101.1	97.0	90.6	94.3
Broad money (percent change, 12-month basis) 3/	18.7	21.1	11.3	15.6	13.2
Private sector credit (percent change, 12 month basis) 3/	21.7	29.0	8.9	14.5	11.8
Share of deposits in broad money 3/	81.8	83.7	85.3	86.3	86.3
Share of foreign currency deposits in total deposits 3/	15.4	14.3	14.6	15.2	18.9
Share of foreign exchange loans in total loans 3/	...	1.6	1.7	1.5	1.0
Share of private credit collateralized by immovable property, plant, and machinery 4/	26.1	24.7	26.9	25.7	26.6
Share of housing and property development in private credit 4/	13.2	12.1	12.3	11.6	12.9
Market assessment indicators					
Stock market index (1985=100)	987	664	603	702	597
Share price index of financial institutions (1985=100)	2,998	2,003	1,728	1,772	1,356
External indicators					
Exports (percent change, 12-month basis in US dollars)	12.0	18.6	7.6	13.3	2.1
Imports (percent change, 12-month basis in US dollars)	18.8	11.4	2.4	7.8	0.5
Current account balance (excluding official transfers)	-7.9	-6.3	-5.3	-2.9	-2.2
Capital and financial account balance	8.9	6.4	3.3	4.0	2.5
Of which: Inward portfolio investment	0.2	0.0	0.0	0.1	-0.2
Medium- and long-term inflows	7.2	6.8	4.7	4.3	4.0
Inward foreign direct investment	1.3	0.1	0.6	0.9	0.9
Gross official reserves (in millions of US dollars)	2,022	2,063	1,937	2,029	1,984
Central Bank short-term foreign liabilities (in millions of US dollars)	64.6	74.1	81.7	106.8	92.2
Central Bank foreign currency exposure (in millions of US dollars)	–	–	–	–	–
Short-term foreign assets of commercial banks (in millions of US dollars) 5/	744.0	730.0	709.0	974.0	832.0
Short-term foreign liabilities of commercial banks (in millions of US dollars) 5/	936.0	957.0	903.0	1,023.0	818.0
Foreign currency exposure of commercial banks 3/ 6/	97.0	103.3	107.5	96.5	102.9
Gross official international reserves (as percent of imports of goods and services)	37.9	34.5	31.8	30.8	29.8
Gross official international reserves (as percent of broad money)	45.3	41.7	37.0	36.4	34.7
Short-term debt 7/	12.9	13.3	11.3	11.2	12.5
Gross official international reserves (as percent of short-term debt)	134.1	119.2	123.5	119.7	101.0
Total external debt	70.8	66.7	61.1	54.3	55.6
External interest payments (as percent of exports goods and services)	6.3	6.7	6.3	5.5	5.2
External amortization payments (as percent of exports goods and services)	7.3	9.8	9.0	7.8	8.3
Exchange rate (Rupee per US dollar, period average)	49.4	51.3	55.3	59.0	64.6

Sources: Data provided by the Sri Lanka authorities; and staff estimates.

1/ Excluding foreign currency banking units (FCBUs).
2/ Weighted averages of individual bank data.
3/ Including foreign currency banking units (FCBUs).
4/ Based on quarterly survey of loans and advances of commercial banks.
5/ Domestic and foreign currency banking units.
6/ Foreign currency liabilities as a percent of foreign currency assets.
7/ Includes CPC acceptance credits, other trade credits, borrowings from FCBUs, Central Bank ACU balances, and commercial bank liabilities.