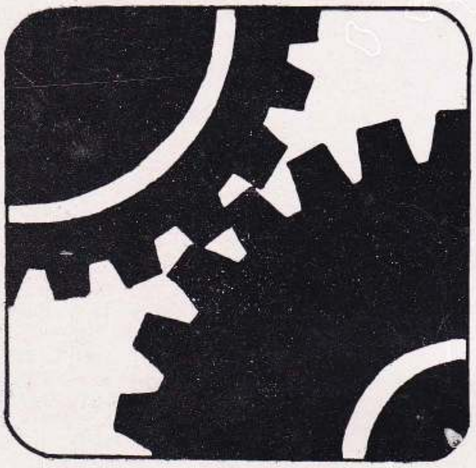
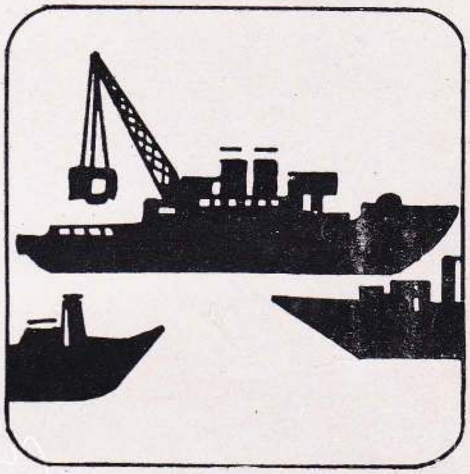
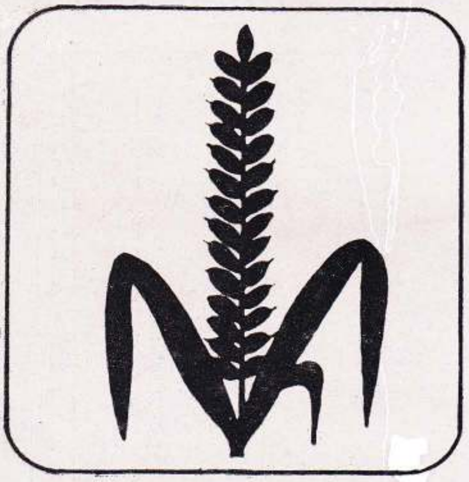
ECONOMIC REVIEW

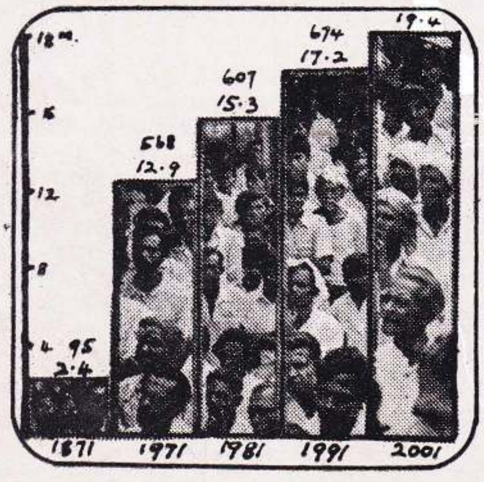
1981

May







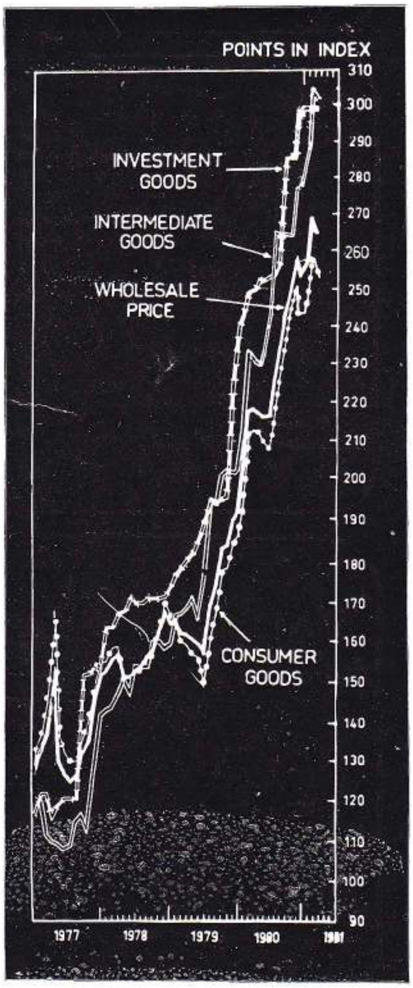


Sri Lanka's Economy

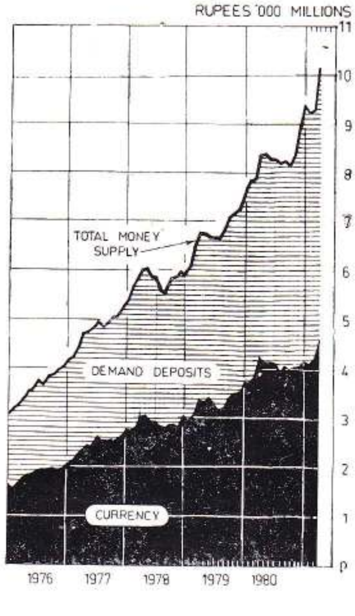
SRI LANKA'S ECONOMY

The new directions in the country's development programme have resulted in increasingly heavy pressures on the economy, particularly over the last two years. Some of the results are evident in the economic indicators shown on this page, while an analysis of the constraints and policies, and possibilities, appears in the main section of our Special Report. An official view of what the economy may be like by the mid 1980's appears on pages 8 to 13. Carried without comment are these views on investment expectations, policy directions and growth potential in the immediate years ahead, with emphasis on domestic production and resources and the balance of payments issues.

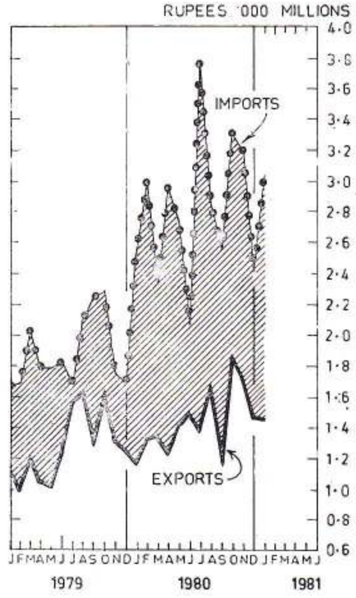
ECONOMIC INDICATORS



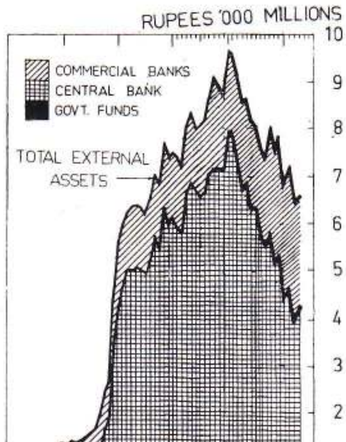
Wholesale Price Index
Central Bank
1974 = 100



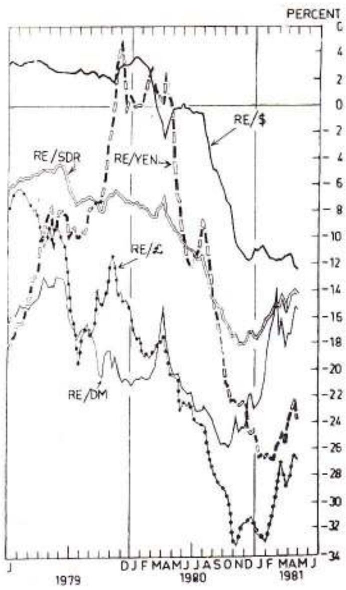
(Narrow) Money Supply



Merchandise Imports and Exports



External Assets



Exchange Rates
(Cumulative Percentage Change)

A progressive liberalisation of the economy has gone on over the past four years, though the adjustment process has not been an easy one. In making a determined effort to move towards international prices for major commodities the government has faced what is described as "a case of shooting at a moving target". Domestic prices have climbed steeply from 1978, as this Central Bank Wholesale Price Index shows. These diagrams also show how money supply has kept increasing despite the running down of external reserves. Meanwhile, resultant pressures on the balance of payments have led to a depreciation of the Sri Lanka rupee vis-a-vis the major currencies; while to keep liberalised trade moving freely more and more had to be imported and, with exports not keeping pace, the merchandise trade gap reached unprecedented levels.

Fears were expressed that with the increasing money supply, falling external reserves and depreciating rates of exchange the economy cannot continue to withstand a level of aggregate demand which was well in excess of the availability of real resources.

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COVER ARTIST

Palitha Kannangara

THE ECONOMIC REVIEW is intended to promote knowledge of and interest in the economy and economic development process by a many sided presentation of views & reportage, facts and debate.

THE ECONOMIC REVIEW is a community service project of the People's Bank. Its contents, however, are the result of editorial considerations only and do not necessarily reflect Bank policies or the official viewpoint. Signed feature articles also are the personal views of the authors and do not represent the institutions to which they are attached. Similar contributions as well as comments and viewpoints are welcome.

THE ECONOMIC REVIEW is published monthly and is available both on subscription and on direct sale.

Diary of Events

MARCH

3 The Minisers at their weekly meeting agreed to review the financing of existing projects so that the Government will not strain the capacity of the country's economy to carry out the considerable development projects already underway, it was officially announced.

At the Colombo tea auctions a line of Special Silver Tea, manufactured by Walahanduwa Factory sold at Rs. 3,000 a kilo, an all time record for any tea sold in the world.

4 Gold slumped by $9 an ounce on world bullion markets to its lowest levels for nearly 15 months, according to reports from London.

7 The price of Lakspray dried milk powder (400 grams) was increased from Rs. 10/50 to Rs. 11/50.

8 International Women's Day was officially celebrated in Sri Lanka for the first time, with a special ceremony organised by the Women's Bureau of Sri Lanka.

9 The UN Secretary General reopening the UN Law of the Sea Conference voiced "deep regret" over the Reagan administration's decision to delay completion of an international sea law treaty, according to a report from the U.N. Headquarters in New York.

10 The controlled price of bread was raised to Rs. 2/30 a pound loaf as against the earlier price of Rs. 2/05, and the price of flour was increased to Rs. 5/50 a kilogram from an earlier price of Rs. 5/22.

Proposed private foreign investment in Sri Lankan business ventures totalled approximately Rs. 3,980 million in 1980, as against an estimated Rs. 2,100 million total investment in 1979, according to a press announcement. This investment is expected to come from a total of 182 ventures which were approved by the Foreign Investment Advisory Committee (FIAC) and the Greater Colombo Economic Commission (GCEC) last year.

The second of three 20 mg. wts. gas turbines being installed by the Ceylon Electricity Board at Kelanitissa, to augment power supply in the country, was commissioned.

11 The government approved a new scheme of assistance for fruit growers who will be provided with one-third the cost of cultivating an acre.

The government approved a proposal to set up Agency Post Offices (APOs) with the assistance of the private sector.

The Ministers reviewing the economy at their weekly meeting decided to impose a ceiling on the expenditure of the government for the current financial year by cutting down on funds voted in the last budget.

12 The Ceylon Petroleum Corporation's Rs. 750 million nylon plant, which will produce synthetic textile filament, was commissioned.

15 Sri Lanka's projected import bill for 1981 is Rs. 41 billion, while projected export earnings are estimated at Rs. 21 billion, leaving a merchandise trade deficit of Rs. 20 billion, according to Finance Ministry projections, stated a Sunday Observer report.

17 The Bank of Dubai opened a Branch in Colombo; the tenth foreign bank to open a Branch here since 1978.

Over 70,000 enumerators visited houses and buildings throughout Sri Lanka taking a final count in the country's population and housing census.

20 Rubber shippers in the private sector will be permitted to export sheet rubber (grades 1, 2 and 3) stated a Trade Ministry announcement.

21 Sri Lanka's population stood at 14,859 on March 17, when the national census was taken, according to the results of the census released officially. The population in the 1971 census was 12,689,897 showing a 17.1 percent increase in population or a 1.7 percent growth rate over the 10 year period from 1971.

23 The 71st joint collaboration agreement between a Hong Kong manufacturer and a leading local manufacturer of chemical products was signed with the GCEC in Colombo, for the manufacture of rubber latex thread at the Biyagama IPZ.

24 RSS No. 1 spot rubber prices on the London Physical Market fell to 53 pence a kilo, which was the lowest since December 1978.

25 Air Lanka has chosen a group of banks to arrange a two part syndicate loan totalling $24 million to pay for a second-hand Lokheed L 11 Tristar plane and partly for two new Tristar planes to be purchased in 1982, according to the Ceylon Daily News.

26 The Ministry of Industries has been requested to report to the Cabinet on the existing computer capacity of the country and feasibility of creating a Computer Servicing Centre which will serve the Government Departments and Corporations, according to an official announcement.

27 The Washington based South East Asian Oil Company (SEAOC) is due to sign an oil exploration contract with the Ceylon Petroleum Corporation in April, according to a press report. The exploration will cover an off-shore area of 3,100 square miles between Hambantota and Hanwella.

28 The International Monetary Fund is reported to have reached an agreement on a borrowing of approximately $5 billion from Saudi Arabia; while in exchange the Kingdom was to be given enhanced voting power stated a London Financial Times report.

APRIL

1 The Government decision to allow tea imports for the purpose of blending, packeting and making of tea bags exclusively for export became operative.

The floor price relating to the ad valorem tax on tea was increased, from Rs. 16/00 to Rs. 18/00 per kg. with a view to improving producer margins in the context of increased costs of production.

4 The Business Turnover Tax was increased for Ship Chandlers or aircraft caterers, and Financiers from 5 percent to 10 percent; and Pawn Brokers from 2 percent to 10 percent.

10 A Memorandum of Understanding between the Government of Sri Lanka and Australia was exchanged for a grant of Australian Dollars 3 million for the Muthukandiya Reservoir Development Project in the Dry Zone, which is estimated to cost Rs. 98 million at 1980 prices.

Sri Lanka's Economy in 1980 — Constraints and Policies

S. T. G. Fernando

Sri Lanka's economy was subject to oppressively burdensome pressures in 1980. If this experience is to be avoided, Dr. S. T. G. Fernando maintains that there is a compelling responsibility for Government at the highest level to accept the premise that rapid economic development with relative price stability can be achieved only through the closest and strictest adherence to ceilings determined within the frame work of a comprehensive monetary survey and a supporting credit budget. Dr. Fernando was Director of Economic Research, Central Bank, before he assumed duties recently as Chairman, People's Bank. The views expressed in this paper are those of the author and in no way represent the viewpoints of either the Central Bank or the People's Bank.

In 1980 Sri Lanka's economy was subject to almost oppressively burdensome pressures arising mainly out of her determined efforts to accelerate the pace of investment and capital formation. The pace of investment was quickened to make possible a structural transformation of the economy within the briefest time period possible. A noteworthy feature, among several others, discerned in economic developments which took place during 1980, was the very sharp acceleration in the Government's capital investment programme. A conscious policy decision to pursue a high level of investment is reflective of a genuine and concerted effort to break away as speedily as possible from the demonstrable vicious circle of poverty, unemployment and low utilization of productive factors. The latter had been the country's experience for many years. Investment and capital formation on the one hand and better utilization of existing resources on the other, are the principal means for propelling a growth mechanism.

INVESTMENT

The behavioural role of investment demand as conventionally incorporated in macro-economic planning is at times overplayed. But the latter is indisputably a critical and decisive factor in influencing an economic situation. While the importance of non-economic factors is not under estimated, the role of investment in sharpening the point of take-off in the growth process should be stressed. A take-off into self sustained growth is closely correlated with high savings and investment ratios in real Gross Domestic Product. A high level of real investment is a pre-requisite for a "take-off" process.

Investment is an activity in respect of which wide differences of opinion prevail. The pace of investment growth, the distribution of investment as between competing ends, the means of influencing investment and the precise time horizon of investment planning are all areas in which debate and disputes are most acute. Despite uncertainties and even imprecision in theoretical casual linkages, it should be conceded that investment plays a dual role in the course of economic growth. Investment makes possible an expansion of a country's stock of productive capital and contributes to the volume of output so that the country would be able to produce more both currently as well as in the future. Thus real investment is synonymous with capital accumulation and the latter influences national income or total product via the supply side. Investment is thus crucially associated with current and potential aggregate supply and concomitantly has to be reckoned explicitly in policies aimed at influencing aggregate supply management.

In addition, investment demand constitutes a very important component of total expenditure i.e. aggregate demand, and exercises a pervasive influence on the level and growth of both real and money national income and employment multipliers. The emphasis placed on investment is therefore justified and the high tempo of investment in 1980 was, from these premises, a nationally desired activity. The level of investment, whether it be high or low, the inter-temporal choice of an investment strategy as either favouring heavy capital construction with long gestation in output flows, or profiles providing for quick yielding projects with lower capital outlays or the pursuit of a balanced investment mix, the desired tolerance limits of inflationary price increases and consequently the extent and spread of real income reductions are highly inter-related issues. Choice between these policy and parametric possibilities involves complex policy decisions which once selected constitute a background against which events have to be appraised. The events that have taken place since 1977 have thus to be viewed against the investment strategy chosen and not necessarily as an occasion to question the fundamentals of growth aspirations. One point needs to be stressed emphatically to eliminate any likelihood of facile conclusions in this regard. The theory of investment demand even in reputed theoretical works or in the naively abstract formulations of 'reduced form' econometric models, has still not been concretised with realism to present sets of relevant behavioural equations which measure the full impact and consequences of all the factors that have been enumerated or referred to above. Thus an evaluation of investment activities pursued as a factor responsible for the economic strains in 1980 should be done with care and judgement. Likewise increasing or reducing its pace or possible directional changes should be undertaken only after very careful study.

PRESSURES

Developments which were apparent in 1980 and which had their antecedence in 1977, single out the policy of forcing the pace of development through a heavy investment programme in the context of limited real resources and the means available for their supplementation, as the most important source for economic problems. Resultantly, acute pressures developed on several fronts causing severe strains on the economic management of money income flows, total supply, the general level of prices and the level of external reserves. Likewise inflationary expectations were stimulated by the interaction of these variables. The management of these rather excruciating problems was made further difficult by the equally tortuous and adverse developments in the international economic scene.

Given the framework of a mixed economy, the active participation of both the government and the private sector in the growth process, the resuscitation of market forces and in particular the pricing system as an allocative instrument for capital formation and investment activity, there was bound to be a competitive bidding for real resources from both private and government sectors. In the private sector, capital investment was to be promoted through the pursuit of rational economic policies and through the provision of incentives, all of which were expected to inject an element of confidence, nurture expectations of stability and dynamism while being guided by norms of profit maximization. In the government sector, capital investment was to be augmented on a broad front through increased governmental commitments on projects too large to be undertaken by private enterprise and or shunned by private enterprise on account of low economic returns; nonetheless, projects which are socially highly desirable. The government's role in capital formation was to assume at one and the same time the role of catalytic supplementation of private sector activity as well as be a source of pioneering activity.

Under the impact of enhanced budgetary allocations and cost escalations, government's capital expenditure increased to an unprecedentedly high level of Rs. 13,693 million in 1980. The latter compares with Rs. 8,991 million in 1979 and Rs. 6,614 million in 1978 and reveals in broad terms the pace of acceleration in capital outlays. The growth of current expenditures alongside capital expenditures on the one hand, and slow growth of receipts on the other resulted in an all time high budgetary deficit of Rs. 15,270 million.

BORROWINGS

As is generally the case, an enormous budget deficit of this magnitude has to be bridged by borrowing and the government resorted to borrowings from domestic as well as foreign sources. The manner of financing a budgetary deficit is of pointed relevance to assessing the inflationary impact and the resultant pressures, if any, on the balance of payments. When, for instance, a deficit is financed from foreign borrowing it is relatively non-inflationary in impact, to the extent that the corresponding accrual of foreign exchange enables domestic supplies to be augmented from abroad, while at the same time protecting and minimising a reduction of the country's reserves. Higher the inflow of food and consumer items and intermediate goods, lower the pressures on the domestic price level. Conversely, higher the content of capital goods in the composition of imports the smaller the inflow of basic consumption items adding to aggregate supply and therefore higher the inflationary impact. Again, borrowing from domestic non-bank sources tends to be non-inflationary as real resources are mobilised from incomes already generated and are in fact reductions from income flows which would otherwise have induced consumption. Here too, a qualification is called for, as the extent of inflationary impulses set in motion depends on the relative marginal propensities of consumption of sectors releasing resources through the dimunition of disposable incomes and the relative marginal propensities of consumption of sectors benefitting by the transfer process. Borrowing from the banking system, particularly from the Central Bank on the one hand, provides more definitive inflationary causation and balance of payments pressures as such resources not only constitute newly created money but also form the base for further credit expansion by the banking system by providing higher leverage through additions of 'high powered' money.

Resources available to finance the 1980 budget deficit from non-inflationary sources such as foreign aid and domestic market borrowing were necessarily limited. In the absence of any other source of financing from non-inflationary sources, the government was forced to finance the residual gap, which was comparatively very large by borrowing from the Central Bank. Since the credit available under provisional advances from the Central Bank is limited to 10 per cent of the estimated revenue for the year, the increased borrowings from the Central Bank came in the form of fresh issues of Treasury bills. Over the year 1980, the volume of Treasury bills outstanding grew by Rs. 6,800 million and the Central Bank's holdings of Treasury bills by approximately Rs. 7 billion. The statutory limit on Treasury bills was raised by Parliament to accommodate these increases. At the end of the year, the outstanding volume of Treasury bills was Rs. 9,000 million registering a 227 per cent increase during the year. There was thus an unparalleled expansion in financing by recourse to Treasury bills in the year 1980.

MONEY SUPPLY

The effects on the economy of Government's inflationary deficit financing of an order of this magnitude was to raise money supply and so to swell the level of aggregate demand in the economy. The expansion of aggregate demand rose from both increased expenditure by the government on goods and services and indirectly through resultant increases in commercial bank credit creation and in the disposable incomes of households. There are also grounds to believe that consumption expenditures of households were influenced by "money illusion" of increasing nominal incomes fostered by the inflationary process that was operative.

The behavioural equations which attempt to trace relationships between variables such as the size of the overall budget deficit, an increase in money supply, increases in aggregate, demand, a fall in reserves and the impact on the general level of prices are brought together in theoretical exercises on relationships which can be statistically quantified. Such quantification is subject to severe limitations depending on the adjustment process introduced and the reaction lags incorporated. In Sri Lanka, it is only *'expost'* outcome, i.e. a post mortem, which facilitates the introduction of policy changes for the next year as *'exante'* targets. Despite the high degree of imprecision that prevails where data are scanty, the impact of a rise in aggregate demand on the general price level would depend, in the short run on the response of the increase in aggregate supply that would be forthcoming. Where the increase in aggregate supply is less than the proportionate rise in aggregate demand, the index of the general level of prices would tend to move upwards and its pace of increase would be determined by the values of the response (elasticity) coefficients. For Sri Lanka, short run response coefficients are assumed to be less than unity.

Given the general paucity of statistical data and a reasonably acceptable behavioural model tracing the inter-relations of factors mentioned above, it is difficult to isolate precisely the extent to which the domestic supply situation in 1980 responded to increased money demand. Altogether, the country's overall growth performance during the year was satisfactory and approximated almost to the macro economic growth target of 6 per cent and, for that matter the country's average growth performance for the three years 1978 to 1980 was equally satisfactory. But, the immediate output response of the projects financed by Government, that is the public component of capital expenditure, was generally low as the majority of these projects exhibited considerably long gestation periods for output increases and supply augmentation. The time profile of investment outlays and the resulting flows of supplies together provide a further dimension for evaluating Government expenditure policies and the economic forces influencing economic growth under conditions of relative price stability. It is the long gestated time profiles of investments pursued which make it imperative for the country to possess a comfortable external reserves position to facilitate the delicate task of attaining economic growth with reasonable price stability.

PRICES

For as long as imports are relatively free from restrictive controls and other curbs — a minimum of trade and exchange regulations — and the means for paying for imports are available, the supply of imports would tend to increase in response to a quick rise in aggregate demand, whatever be the source of the latter increase. This implies that the level of prices insofar as it relates to imported goods will be relatively unaffected by the expansion in aggregate demand. It would reflect largely the price movements in international markets and any exchange depreciation of local currency vis-a-vis foreign currencies and prices quoted in foreign currency. The impact of a rise in aggregate demand would, however, be different on domestically produced goods for which there are generally no substitutes. Here, the effect of prices would depend on the response in domestic output. Where production cannot increase rapidly, prices will rise and the inflationary consequences of the monetary expansion of the long gestated investment profile would become more readily apparent.

In 1980, while the economy recorded a growth rate of 5.5 per cent, the volume of imports was the highest ever recorded indicating that the economy was, at least statistically speaking, well supplied during the year. A small qualification is called for, as the extent of the price dampening effect of imports depends on the commodity composition of imports. Higher imports of machinery and capital goods and investment goods do not dampen inflationary pressures. Cement and bulldozers are not substitutes for wheat flour and sugar; neither guns for butter. Therefore, notwithstanding the availability of increased supplies of goods and services, both out of domestic production as well as through imports, there was considerable pressure on the general price level in the economy during the year. The Colombo Consumers Price Index — 1952 = 100 — recorded an annual price increase of 25 per cent on a year-to-year basis. The Wholesale Price Index revealed an annual price rise of 32 per cent on the same basis.

An increase in the price level of the order of 30 to 40 percent has grave consequences on income distribution within the country and if allowed to continue unchecked would be disastrous. The increase in the price level would have been significantly higher without the offsetting influence brought by a substantial running down of external assets. Had Sri Lanka been unable to have recourse to these funds, there would clearly have been a very marked and rapid expansion in the total money supply. By limiting the increase in money supply, the drain on Sri Lanka's external reserves served to restrain an otherwise torturous increase in domestic prices. Nevertheless, the fact that money supply (M1 by 23 per cent and M2 by 32 per cent) increased despite the running down of external reserves by 72 per cent signifies that the expansionist influence of the budget deficit had not been totally absorbed in this way. The above fact has pointed relevance for economic management in 1981 as well. The high money supply in circulation constitutes a potential source of additional demand for goods and services and hence of continuing inflationary pressures in the economy.

CREDIT EXPANSION

In all, a major share of the blame for the unsteady economic scenario should be attributed or imputed to fiscal sources. Another factor which induced pressure on the balance of payments through a high level of aggregate demand and on the general price level was the credit expansion permitted in favour of the private sector. In all, bank credit to the private sector rose by Rs. 4,780 million or 40 per cent during the year. Although the level of private sector credit was running at a fairly high level, it would appear that the Central Bank considered it somewhat inappropriate to cut sharply on the supply of credit to this sector. The Bank generally speaking was mindful of the fact, that a sharp cutback of credit to the private sector would have had adverse effects on the domestic economy on several fronts, ranging from output, employment, export earnings, incentives and even negating the underlying role of this sector as a partner in progress. In the circumstances, the Central Bank in 1980 pursued a more guarded policy with only moderate monetary restraint using the conventional instruments of credit control, bank rate changes and moral suasion, yet standing ready to intervene should the external assets position become very grave.

TERMS OF TRADE

Of course, the movement of terms of trade as usual exacerbated the situation. There was a sharp deterioration in the terms of trade in 1980. The movement of the terms of trade revealed that the deterioration was wholly due to the rise in the index of import prices which more than offset the improvement registered by movements in the Export Price Index.

There are at least two ways in which the decline in the terms of trade in 1980 exerted adverse effects and limited the area of effective policy measures. Firstly, by reducing the purchasing power of Sri Lanka's export earnings, the adverse movement of the terms of trade reduced the total volume of imports that could have been obtained for any volume of export earnings or external assets. Had Sri Lanka's terms of trade not deteriorated during the year, or had it improved, Sri Lanka would have been able to secure a higher volume of imported supplies than in fact she had obtained for the external outlays incurred in 1980. In the alternative, with better income terms of trade, pressures on Sri Lanka's external assets position would have been less severe. Either course of movements would have been beneficial to the Sri Lanka economy. The larger flow of imported supplies would have helped to lessen the pressures on the price level while simultaneously augmenting the productive capacity of the economy. Similarly, a stronger external assets position would have strengthened the country's capacity to meet future requirements. Viewed from either point of view, the decline in the terms of trade worsened Sri Lanka's economic position.

Secondly, the decline in the terms of trade reacted adversely on the overall budgetary position of the Government. The increase in import prices necessitated larger outlays on the part of the Government and a corresponding enlargement in the budget deficit. The magnitude of expansionary financing as a component in budgetary financing was therefore increased and this further aggravated the inflationary pressures on the economy while continued private sector credit expansion in 1980 proceeded to add further pressures on prices. The decline in the terms of trade contributed to heighten these pressures by increasing the severity of the balance of payments constraint as well jeopardising budgetary cash management.

Under-scoring the deterioration in the balance of payments and the consequent loss of reserves, the Rupee exchange rate for major currencies was subject to constant pressure during the year. The exchange rate for the Sri Lanka Rupee vis-a-vis most major foreign currencies depreciated significantly, thereby further compounding the inflationary problems in the economy.

EXCESS DEMAND

Appropriate policy prescriptions for the economic situation resulting from the above interplay of economic forces, without exaggeration, are painful. But a quick recovery is conceivable and practicable. A structurally imbalanced economy, such as evident in Sri Lanka, highly dependent on the movements in international trade cannot continue to withstand an excess demand for reasons whether through budgetary imbalances and or over extended credit to the private sector without generating pressures on the balance of payments. Neither the Government, the overall public sector, nor the private sector can compete without restraint for the limited real resources available. Increases in aggregate demand from both sources result in 'over-heating', and in the context of a liberalised economy that is now maintained, there would indubitably result a heavy inflow of imports, a drawing down of foreign exchange reserves and ultimately, an inescapable sharp depreciation of the exchange rate with all its attendant consequences. The 1980 developments questioned very seriously the underlying basis for a liberalised economy and the ability of the economy to continue with the policy package enunciated in 1977, if the economic game were not played according to monetary and fiscal rules guiding it.

If the process of over-heating the economy through competitive claims on resources, by both the private and public sectors, continues unabated, the only way to prevent the exchange rate from a further depreciation would be to re-introduce a regime of import and exchange controls, price controls, trade quotas etc. all of which were readily discarded without any compunction whatsoever. The re-introduction of such controls would no doubt be tantamount to acceptance of a failure of policies pursued and be a major reversal. To avoid this possibility there is an urgent need to bring about a closer balance between Government revenue and Government expenditure, to fine tune the latter to more realistic time profiles of investment and output responses and to fix the limits of credit growth to private sector activities. These measures are required so as to avoid, on the one hand, expansionary budgetary deficits by Government and heavy net credit to the private sector for low priority investment on the other. As a first step to achieving this objective there is a strong case to re-examine, from a fiscal standpoint the revenue base of Government; secondly, to review in full the measures instituted for development and mobilisation of savings, as well as the global relationship of aggregate savings to other macro parameters; and thirdly from the point of view of the role of the private sector, the institution of a credit budget so that the rate of absorption of resources by the two sectors could be matched with the rate of growth of supplies to permit a better and effective management of the rate of growth of money and the general price level. The latter exercise is well within the technical competence of the Central Bank and its implementation depends on the will of the government to comply with the rules of the game. It is to examination of these three courses that the succeeding paragraphs are devoted.

REVENUE STRUCTURE

The pattern of revenue in recent years indicates certain severe limitations in Sri Lanka's revenue structure. Expansionist budgets and domestic credit expansion generally result in an increase in money national income. Given a responsive revenue system there should be related increases in revenue without frequent revisions in the bases of taxation. The structure of Government revenue as presently existing is such that while revenues respond satisfactorily to increases in money national income caused by a rise in export earnings, they are less responsive to increases which occur through other causes. For instance, where the increase in national income, whether through Government spending or through other causes, is more widely distributed, there does not arise spontaneously a relative increase in revenue through direct taxes. This is one of the limitations of the present revenue structure, and one which requires to be remedied. While levels of Government expenditure may rise independently of increases in export earnings, some of the major sources of revenue tend to be unresponsive in marginal terms to siphon off purchasing power. Revenues from import duties constitute an exception as tax receipts flow in at a pace dictated by consumer spending. This would also be true of revenues from sales taxes, business turnover tax and excise duties. However, the present tax structure should gear itself to higher mobilisation of incremental income and expenditure. These changes should be supported by an intensification of tax efforts together with revenue through better enforcement and as well provide for a sharpening of existing tax instruments so as to overcome the revenue constraint. Higher revenue permits higher expenditure and thus a large fiscal contribution to economic growth at the expense of other competing sources.

SAVINGS MOBILIZATION

The Sri Lanka economy has — viewed in its broadest terms — completely neglected the potential of savings mobilisation as a measure for budgetary financing. The savings effort of the War years is now a memory of a few who speak eloquently of it. The majority recall only the savings certificates issued but rarely ever refer to the institutional structure developed for making savings a continuing reality.

A strategy for rapid economic growth via increased investments has to be supported by both domestic savings and foreign assistance. The popularly known "two-gap approach" suggests that the difference between investments and savings will have to be covered by foreign assistance, particularly when import requirements dominate an investment programme. To the extent that export proceeds can narrow down the trade gap and help to finance import requirements and also where available domestic savings can bridge the overall resource gap, excessive recourse to foreign assistance can be restricted. If foreign capital is invested in productive uses, thereby raising the national product, the multiplier effects could enhance domestic savings. The economic reforms of 1977 fall within this framework and were directed to open up the economy by promoting exports and generation of domestic savings to mobilize resources for investment.

Although there has been a noticeable increase in institutional savings during the late 1970s, total saving as a percentage of GDP has not grown at the same rate. The domestic savings ratio appears to have stabilised at a modest level by 1980 in relation to its behaviour since 1977. From the relatively high level of 17.4 per cent in 1977, the savings rate dropped to 14.8 per cent in 1978, but apparently settled down around 13.5 per cent in the past two years. The proportion of savings as a percentage of GDP is a reflection of the country's ability to sustain an adequate growth rate. In this sense, if Sri Lanka's savings rate could be maintained at least at the current level, that itself would be an achievement, particularly in an inflationary situation, when economic forces in general tend to work against the harnessing of savings.

Statistically, in marco accounting, domestic savings is estimated as Gross Domestic Investments, less the external balance on goods and net factor services (defined as foreign savings). In other words, the domestic savings figure is derived as a residual after the item foreign savings is taken into account. The method of estimation excludes both official and private transfers in defining the external balance of goods and services. In the recent past, however, private transfers have become increasingly important mainly because of remittances made by Sri Lankans employed abroad. The inward remittances of private transfers increased from Rs. 610 million in 1978 to Rs. 935 million in 1979 and registered a phenomenal increase in 1980 reaching Rs. 2,523 million. Since migrant workers, particularly in the Middle East, are not recognised as residents of the countries in which they work, their remittances should be considered as requitted transfers which add to the income of the recipient country. As such, if the current account balance is defined to include private transfers the country's savings ratio would rise to a higher level than the currently estimated figure.

Another accounting refinement in the estimation of savings would be to conduct a proper valuation of private sector inventories. Since 1977 the value of the inventory accumulation of the private sector including public corporations should have been higher primarily due to the import liberalisation programme. Therefore, if the inventory accumulation of the private sector is properly valued, it is likely that there would be a further improvement in the savings ratio in the years following 1977.

There has been no reduction in the savings ratio in 1980 compared with 1979 although this ratio was lower than its level in 1977 and 1978. The outcome was probably due to the adjustments in consumption to changes in real income in view of inflationary trends. The expansion in the employment opportunities in the recent past would have stimulated the propensity to consume while at the same time contributing to the aggregate savings volume. The prospects of raising the savings rate commensurately with the increase in the real income might have been hindered by such socio-economic factors such as the presence of a "demonstration effect" which would have induced particularly the newly-employed to spend their incomes on wage goods which became widely available consequent to import liberalisation. The pent up demand for such consumption commodities would have depressed the willingness to save in 1978 and 1979. After a time-lag, however, the savings rate appeared to have stabilised at a reasonably satisfactory level in 1980.

In the context of rising prices and particularly with the expectation that inflation would continue, consumers tend to hedge against inflation by accumulating assets while reducing their cash balances. These adjustments are undertaken to protect the real value of wealth. When the real rate of interest is very low or negative there is no incentive to save. In Sri Lanka, owing to the undeveloped nature of the financial market, the scope for shifting asset portfolios in accordance with inflationary pressure is rather limited. Hence, ordinary savers have a very restricted choice in portfolio management and tend to convert cash to consumer durables or real estate.

The changes in the pattern of income distribution also would have influenced the savings rate in the late 1970s. The Consumer Finance Survey of 1978/79 reveals that the rate of growth of income of those in the top bracket has been higher than that of the lower income earners. As inflation affects different income groups differently the capacity to save will be determined by the pattern of income distribution. Therefore, low income groups would not have been able to increase their rate of savings while the upper income groups have been able to do so subject to the condition that the latter would not have resorted to luxury consumption. Hence, in view of a decrease in the savings capacity of lower income groups, an effective fiscal policy framework is necessary in order to channel the potential surpluses of the high income groups towards productive investment.

Meanwhile, other monetary and institutional mechanisms need to be employed to encourage and mobilise savings. The banking sector should become more vigilant and efficient in absorbing the seasonally high incomes of the rural sector and the profits arising, if any, from improved internal terms of trade of the agricultural sector. While it is true that exorbitant nominal interest rates are likely to fuel a cost-push type inflation, it is also important to offer a positive real rate of return to elicit a favourable response from the savers. Contractual savings schemes (such as the Employees' Provident Fund, Insurance Funds and Pension Schemes) have the potential to provide security to individuals in a variety of risk-ridden situations while functioning as modes of mobilising savings, provided that the real rate of interest as against the nominal is sufficiently attractive. Furthermore, development of a financial market is a vital pre-requisite for increasing domestic savings. In all these areas, the monetary policy instruments have to be supplemented with proper fiscal approaches and adequate institutional measures.

A CREDIT PLAN

The control of investment activity by the private sector should be through the medium of a credit plan prepared for the entire banking system. Such a plan should in the first instance set out reasonable monetary limits of growth and the priorities in investment promotion. These should be supported by action taken by the Central Bank to control the availability of commercial bank credit to the private sector. Conventionally, monetary controls are carried out by the Central Bank to bring about an equilibrium in the balance of payments by means of a general deflation in the economy and a reduction in total investment. Such a process is not wholly appropriate for Sri Lanka. There are many reasons for this simplified conclusion. A general reduction of economic activity on a hit-or-miss basis would react adversely not only on the pace of economic development but also on Sri Lanka's exports and the capacity to finance basic imports. A more selective approach to credit control is therefore needed where emphasis is placed on the direct reduction of credit for imports, particularly for the import of less essential items, of advances for speculative purposes, consumption etc. by consciously furthering credit for priority sectors thus aiding the development process. All these considerations imply that it is necessary not only to operate a credit plan but to introduce new monetary weapons fashioned in accordance with this objective.

A reasonably designed credit plan is a very useful tool for achieving economic growth targets, avoiding the ills of over heating, sudden exchange rate depreciation and monetary 'turmoil'. It is the Central Bank's responsibility to take the overall, longer term view in contrast to sectoral and sectional myopia.

Two significant conditions which inhibit central banking in Sri Lanka and which may affect success in credit planning should be noted. The first is the rudimentary nature of the money market and the second is that important factors determining the level of economic activity are quite often outside Central Bank's control. In 1980 Government's fiscal operations were one such factor, and as mentioned, assumed a magnitude much greater than in previous years. The ability of the Central Bank to take effective monetary action in 1980 was severely limited by fiscal and other policies to which the Government was committed. During the year, the Central Bank, as financial adviser to the Government, it is now known, repeatedly suggested the consideration of a number of measures to reduce the budgetary gap and/or stressed the consequences of failing to take effective action. But for various reasons the Government either postponed or could not carry out the suggestions.

Though the Central Bank was aware of the adverse effects of Government's fiscal policy, the Central Bank in carrying out the statutory functions of the Government, could not abandon its role of co-operation with the Treasury to meet expenditures as had been budgeted. With the acceptance of a credit budget, the Government too would have to steer policy on a financial trajectory agreed to in advance and based on macro economic tolerance levels of price increases.

The competing claims of Governments over the private sector, the proper balance between long and short gestated projects, the extent to which reserves could be reduced and the level at which the exchange rate should be maintained can, in general, be conveniently provided for, through a credit budget and a supporting monetary survey which provides for these movements explicitly in quantitative terms. If, the sad experience of 1980 in fiscal management is to be avoided, there is a compelling responsibility for Government at the highest level to accept the premise that rapid economic development with relative price stability can be achieved only through the closest and strictest adherence to ceilings determined within the framework of a comprehensive monetary survey and a supporting credit budget. Harmonised monetary and fiscal policies are possible in such a disciplined environment and the task of aggregate demand management would be greatly simplified.

Some Aspects of the Proposed Investment Programme Over the next Five Years

Public Investment 1981 — 1985

The first step towards a re-examination of the public programme was taken in 1980. The scope of the two major lead projects namely, the Accelerated Mahaveli Development and Housing, Water Supply and Urban Development, was scaled down. The Mahaveli Programme was to be confined to the headworks of Victoria, Kotmale and Maduru Oya dams together with reduced down-stream development. In the Housing, Water Supply and Urban Development Projects, there was a shift towards aided self-help and a postponement of nearly half the urban housing programme. Likewise, the investment in the new Capital of Sri Jayawardenapura was limited only to the Parliamentary Complex and two administrative buildings. In the case of other investments emphasis was shifted towards projects with quick and high returns and high net savings in foreign exchange.

These policy measures and the attempts at scaling down public investment proved to be inadequate as the performance of the economy in 1980 has shown. Consequently, a further attempt at containing public investment within available financial resources was made in November 1980 at the time of presentation of the Budget for 1981. Government imposed an across the board reduction of 25 per cent in the capital budgets of most Ministries, which were asked to re-order their priorities in order to confine capital expenditure within these limits. These reductions, however were of an ad hoc nature and had to be reviewed subsequently.

This review was done in March 1981 and the new capital expenditure by Government envisaged for 1981 is an investment of Rs. 12,041 million. Public investment 1981-85 is a greatly reduced programme, with its share in GDP declining from 16.6 per cent in 1981 to 11.7 per cent in 1985. The lead projects still retain a prominent position and have assumed greater urgency. The completion of the Victoria, Kotmale and Randenigala dams on schedule is of crucial importance in view of the critical shortages of power which are already beginning to appear. Likewise the pessistent shortage of housing has underlined the urgent necessity of completing the on-going housing programme which again is a greatly curtailed one.

In the rest of the investment programme, emphasis has fallen upon projects in the directly productive sectors such as the rehabilitation of the Tree Crops, Tea, Rubber and Coconut, the village Tank Rehabilitation Project, and projects on fisheries and forestry. Some investments in economic infrastructure, notably highways and telecommunications, have also become essential in view of the growing demand for such facilities, specially by the private sector. In industry, the main focus is on the promotional role that Government could play in increasing the volume of industrial exports in order to counter a deteriorating balance of payments position. Export-led growth has been and still is one of the key elements in the country's development strategy.

Further adjustments in administered prices were also made in early 1981. The prices of domestic and imported rice were raised by 23 per cent and 24 per cent respectively and the prices of wheat flour and sugar by 5 per cent and 20 per cent respectivly. In addition, the prices of fertilizer, petroleum products and fares charged for public transport were increased. The increases in administered prices raised the index of prices of essential commodities in the first quarter of 1981, by 42 per-cent (annual rate) while the balance of the index increasd by 28 per cent. The approach to administered prices is that they must at least cover costs.

The Government also took several decisions in March 1981 in order to restore balance in the economy. No new supplementary estimates which would increase the investment programme of Rs. 12,041m. for 1981 are to be allowed except where they become necessary to allow for effects of exchange rate changes on the local currency equivalent of foreign aid. Ministries have also been directed to stop purchases, for their own use, of equipment and machinery, vehicles and electrical appliances and to halt new construction or extension of buildings, except with the approval of a high-level committee.

As a result of all these measures and changes, the overall deficit in the Government's 1981 budget is expected to be 14.5 per cent of GDP as against 21 per cent in 1980. The deficit to be financed from the banking system is expected to be 4 per cent of GDP, in contrast to 10 per cent in 1980. The Government also expects that, while the terms of trade are likly to deteriorate further in 1981, through appropriate trade and exchange rate policies, it would be possible to contain the current account deficit in the balance of payments at 12 per cent of GDP, compared with 16 per cent in 1980.

Over the medium term 1981-85, the economy is projected to grow at an average annual rate of 5.7 per cent in real terms; major contributions are expected from domestic agriculture, industry, construction and services.

Domestic Production and Resource Availability

The projection of GDP by industrial origin is shown in Table 1. The momentum achieved in the construction sector in the past two years would make it the fastest growing sector, even though its growth is now likely to stabilise at 12.0 per cent per annum during the next five years. The activities of quarrying for building materials would closely follow the fast growth in construction. Thus, the mining and quarrying sector could achieve a growth rate of about 9.2 per cent per annum.

Table I. GROSS DOMESTIC PRODUCT BY INDUSTRIAL ORIGIN

1980, 1981 and 1985

	Rs. Million at Constant (1979) Prices			*Average Annual Compound Growth 1980–1985 at Constant Prices*
	1980 *Estimated*	1981 *Projected*	1985	
1. Tea Growing	1070	1160	1176	1.9
2. Rubber Growing	747	758	770	0.6
3. Coconut Growing	1689	1911	2050	4.0
4. Paddy (incl. of processing)	2938	3058	3750	5.0
5. Other Agriculture	7182	7505	9166	5.0
6. Total Agriculture	13626	14392	16912	4.4
7. Mining and Quarrying	1136	1272	1761	9.2
8. Tea, rubber, coconut processing	3323	3655	3775	2.6
9. Other Industries	6145	6575	9140	8.3
10. Construction	3572	4001	6295	12.0
11. Services	24768	25966	31562	5.0
12. Gross Domestic Product at constant factor cost prices	52570	55861	69445	5.7

The value added in the agricultural sector accounts for nearly 26 per cent of the domestic product even though its planned growth rate is a relatively modest 4.4 per cent, the resultant contribution to the total increase in the domestic product during 1981-1985 period would be about 18 per cent. During the next 5 year period, the growth in this sector is expected to arise mainly from domestic agriculture including, paddy, subsidiary food crops, minor export crops, animal husbandry and fisheries.

Paddy output is expected to increase from 102 million bushels in 1980 to 135 million bushels in 1985. With the extension of the asweddumised acreage under Mahaveli and other major irrigation schemes and the extension of the cropping acreage due to improvement of irrigation facilities under the minor tank rehabilitation programme, this target is well within realisation. The upward adjustment of the floor price for paddy, adjustment of the administered price of wheat flour, improvement in extension services and agricultural credit, and the gradual removal of the supply bottlenecks affecting fertilizer distribution, will more than compensate for the reduction of fertilizer subsidies and given normal weather conditions self-sufficiency in rice could be reached in 1985.

In the case of tea and rubber no significant increase in output is expected. This is partly due to poor maintenance and slow replanting in the past and partly due to the short term effect of an accelerated replanting programme now being undertaken. Even to maintain the very modest growth rates shown in Table 1, a concerted effort, involving higher fertilizer application, intensive rehabilitation and adoption of more effective cultural practices would be necessary. The present level of production of coconuts is somewhat below the maximum potential, partly on account of several short term factors such as adverse weather conditions and lack of regular fertilizer application. Starting from the low base of 1980, the 4.0 per cent average growth of output anticipated in this crop is considered feasible in view of the policies now being implemented with respect to fertilizer promotion, credit and tube well irrigation of coconut lands in selected areas.

On account of the inability of the tree-crop sectors to contribute significantly to the growth in agriculture in the medium term, the achievement of the overall growth target in agriculture necessarily depends on the performance of "other agriculture". The production prospects in this area are conditioned by policies relating to remunerative prices, availability of inputs and credit. For all these products there exists a great deal of unsatisfied demand and there are no technological constraints in the expansion of their production. Therefore, government policies would place increased emphasis on securing maximum output in this sector.

Industrial output other than processing of tea, rubber and coconuts during the medium term is projected to grow at an annual rate of 8.3 per cent at constant prices. Of these, the factory industries are likely to grow at a higher rate in comparison with cottage and small scale industries, in the present environment of liberalised economic policy. The main contributions to this growth will come from the industries in the public sector and those in the FTZ. However, the small industries will continue to receive official support where appropriate so that the incomes and employment in such industries will increase at an adequate rate.

Activities in the service sector are closely related to the growth in commodity producing sectors. The demand for power, transportation, communications and storage are to some extent influenced by the anticipated increases in agricultural and industrial output. A rapid expansion in the capacity of road transport service was witnessed during the last three years which represented a process of rehabilitation of a depleted capital stock. Taking into account the slightly lower rates of overall growth of the economy in 1981-1985 compared with the past two years, the services output is now projected to grow at 5.0 per cent per annum.

The increases in value added in the various sectors of the economy add up to an annual growth rate of 5.7 per cent for GDP at constant factor cost prices. In terms of the potentialities in the economy, and given favourable weather conditions it may even be possible to exceed this target.

On translating these targets to current prices, it is estimated that GDP at current factor cost prices would increase from Rs. 81.6 billion in 1981 to Rs. 147.4 billion in 1985, amounting to a compound rate of growth of 15.9 per cent per annum. Table 2 below shows the domestic resource availability in the economy, in terms of GDP at current market prices.

Table 2. DOMESTIC RESOURCES

(Rs. Billion at Current Prices)

		1980 *Estimate*	1981 *Projected*	1985 *Projected*	*Average Annual Compound Growth, 1980-85*
1. GDP at current factor cost	...	62.3	81.6	147.4	16.8
2. Add indirect taxes less subsidies	...	6.0	6.2	13.1	16.9
3. Equals GDP at current market prices	...	68.3	87.8	160.5	[illegible]

Domestic Savings and the Resource Gap

Concentrated efforts have been and are being made by Government to raise the level of domestic savings to meet the requirements of investment over the medium term. In the public sector, emphasis falls on generating a high level of public savings by raising total revenue despite short-falls in the revenue from the tree crop sector and low direct taxes due to tax holidays offered to new ventures, curtailing current expenditure to minimum feasible levels and generating surpluses in public corporations. Likewise, steps have been taken to increase the level of private savings through a number of measures such as increasing interest rates on savings deposits and the provision of attractive tax incentives for investment. Although the level of total domestic savings is expected to rise from about Rs. 9.7 billion in 1981 to Rs. 14.8 billion in 1985, the rapid escalation in project costs as well as the deteriorating balance of payments position, caused principally by rising costs of imports, will make such levels of savings inadequate to finance investment. Thus, in the short term substantial external assistance would be necessary not only to meet the investment-savings gap but also to cushion the effects of a deteriorating balance of payments positions. Table 3 below, shows the extent of the resource gap which will have to be met in the short term.

Total Resources and Utilisation

Total investment in the economy during the period 1981-85 is expected

Table 3. THE RESOURCE GAP

(Rs. Billion at Current Prices)

1. Export of Goods	...	17.6	22.5	36.2
2. Import of Goods	...	33.6	40.3	70.3
3. Non Factor Services (Net)	...	1.3	2.0	5.1
4. Net Import of Goods and Non Factor Services (The Resource Gap)	...	14.9	15.8	28.5

to reach a level of Rs. 169 billion as compared with Rs. 126 billion for the period 1980-84, the increase being almost entirely due to cost escalations. As a proportion of GDP at market prices, the total investment is expected to decline from a level of 36 per cent in 1981 to 27.0 per cent by 1985. The share of public investment in 1981 which is forecast at 57.3 per cent of total investment or 16.6 per cent of GDP at market prices is expected to decline gradually to a level of 43.2 per cent of total investment or 11.7 per cent of GDP at market prices by 1985. This reflects a conscious attempt to shift a greater volume of economic activity to the private sector, over time.

Table 4. TOTAL RESOURCES AND THEIR UTILIZATION

(Rs. Billion in Current Market Prices)

	1980 *Estimate*	1981 *Projection*	1985 *Projection*	1981-85 *Total*
1. Total Resources	83.2	103.6	189.0	717.3
(*a*) GDP at Market Prices ...	68.3	87.8	160.5	606.7
(*b*) Net Imports (Goods & Non Factor Services) ...	14.9	15.8	28.5	110.6
2. Total Utilization	83.2	103.6	189.0	717.3
(*a*) Consumption	58.7	78.1	145.7	548.0
of which (i) private consumption	53.0	71.5	132.7	499.2
(ii) public consumption	5.7	6.6	13.0	48.8
(*b*) Investment	24.5	25.5	43.3	169.3
of which (i) private investment	10.2	10.9	24.6	79.7
(ii) public investment	14.3	14.6	18.7	89.6
3. Financing of Investment ...				
(*a*) National savings ...	11.4	11.3	20.9	76.3
(*b*) Foreign resources ...	13.1	14.2	22.4	93.0

The implicit incremental capital output ratio for the period 1981-85 worked out in terms of 1979 prices is estimated at 4.7 per cent. This somewhat high figure partly reflects the long gestation character of major public sector projects, benefits from which are expected to flow substantially beyond the 1981-85 period. In terms of current prices, total investment is expected to grow at 12.1 per cent per annum while the growth of GDP at market prices is forecast at 18.6 per cent. The calculations assume a sharp price increase of about 21 per cent for GDP at market prices during 1981 and a 10 per cent increase thereafter from year to year. The price increase in investment expenditure is estimated at around 23 per cent during 1981 and at 10 per cent per annum thereafter. The underlying assumption in both cases is that during 1981 the economy would adjust to the rate of world inflation estimated at 10 per cent per annum. The projected levels of total resources, their utilization as well as the proposed financing of investment are set out in Table 4.

As seen from the above table, approximately 45 per cent of the total investment is to be financed from national savings while the balance is to be financed from external resources. More than half of the latter consists of concessional aid in the form of grants, project loans and commodity loans. Net aid disbursements are expected to rise from a level of US $378 million in 1981 to US$ 628 million by 1985. The balance inflow of external resources is expected from direct foreign investment, and commercial loans. The commercial loan component would no doubt have unfavourable consequences upon the country's debt service ratio which has been successfully brought down to a level of about 12.4 per cent of export earnings in 1980 from levels over 20 per cent in the 1970s, through a deliberate shift towards concessional assistance and higher export earnings. However, it is the Government's policy to keep commercial borrowing to the minimum level feasible.

The projected levels of private consumption in the above table reflects a growth rate of 20 per cent per annum in current terms. Although the larger share of investment during the terminal year 1985 is expected from the private sector, for the period 1981-85 as a whole, the share of the public sector is estimated at 53 per cent. This is largely attributable to heavy public expenditure on essential infrastructure during the early phase, in order to support private sector activity during the mid-1980s. The total public sector investment including extra budgetary investments is estimated at Rs. 89.6 billion in current market prices for the period 1981-85 as against a total of Rs. 67.3 billion for the period 1980-84.

The increase is entirely due to cost escalations; there is, in fact, a decline of public investment in real terms when estimated at constant 1979 prices, and reflects a conscious attempt by the Government to hold down public investment. Table 5 sets out the magnitudes of public investment, the proposed method of financing and the allocations as between the lead projects and other projects.

As seen from Table 5, the extent of total public investment to be financed from foreign sources is estimated at 60 per cent. This is lower than the projected level of 63 per cent for the period 1980-84 and reflects the Government's desire to achieve self reliance in financing development efforts.

As mentioned earlier, a conscious attempt is also being made by the Government to alter the composition of public investment in favour of production oriented investment outside Mahaveli, despite the heavy on-going content of the programme. Investments in agriculture and other production oriented programmes are expected to rise gradually from a level of 21.3 per cent of total public investment financed from the government budget in 1981, to a level of nearly 30 per cent in 1985.

Imports, Exports and the Balance of Payments.

According to the best indicators presently available, it is likely that Sri Lanka will continue to face a difficult balance of payments situation in the next five year period, despite the anticipated increases in net foreign exchange earnings from several sectors of the economy. Thus, if Sri Lanka were to fall back on its own resources she will not be able to maintain a free flow of imports essential to the well-being of the community in general, and to implement the important development projects in particular, on which the long-term solution to many pressing economic and social problems crucially depends.

The balance of payments prospects during the medium term depend on the movement of international prices of Sri Lanka's exports and imports on the one hand and the production prospects for the key export commodities and import de-

Table 5. FINANCING OF PUBLIC INVESTMENT

(Rs. Million at Current Market prices)

	1980 *Estimate*	1981 *Projection*	1985 *Projection*	1981-85 *Total*
1. Public Investment (government budget)	12,772	12,041	15,610	75,328
2. Public Investment (extra budgetary)	1,500	2,571	3,100	14,251
3. Total Public Investment ...	14,272	14,612	18,710	89,579
4. Financed by				
(*a*) Public Savings (including surpluses of public corporations) ...	351	157	1,006	4,764
(*b*) Domestic Borrowings ...	8,204	6,465	6,117	30,607
(*c*) Net Foreign Resources ...	5,717	7,990	11,587	54,208

Table 6. BALANCE OF PAYMENTS 1980, 1981 AND 1985
(In US $ Million at Current Prices)

	1980	1981 (Projection)	1985
1. Merchandise			
(a) Exports	1064	1321	1991
(b) Imports	2049	2188	4809
2. Trade Balance	985	867	2818
3. Non-factor services (net)	79	108	224
4. Factor Services (net)	22	86	168
5. Private transfers (net)	157	176	500
6. Current account balance	796	769	1212
7. Net aid disbursements	358	478	628
8. Direct foreign investment	43	56	82
9. Public Sector other medium and long-term loans (net)*	66	100	20
10. Private Sector other medium and long-term loans (net)	49	58	88
11. SDR Allocation	16	16	
12. Other Financing Items **	308	- 143	243

* This group includes corporations and businesses under public sector management.
** Includes short-term monetary movements and errors and omissions.
Exchange rate assumptions 1981-85: US $ 1.00 = Rs. 18.45 (Average).

mand on the other. Sri Lanka's average export and import prices are expected to rise annually by 8 per cent and 11 per cent respectively. These rates are generally in line with the price forecasts for primary commodities made by the World Bank. Thus, the terms of trade for Sri Lanka are expected to deteriorate from 100 in 1980 to 91 in 1985. The volume of exports originating in the tree crops sector which continues to be the mainstay of Sri Lanka's external trade does not show the potential for an appreciable increase during the medium term.

The balance of payments projections for the medium term are shown in Table 6.

A large part of the deficit is attributable to an increase in the value of intermediate goods particularly those of crude oil and raw materials for export processing industries. However, the current account deficit* as a proportion of GDP is expected to decline from 18 per cent in 1980 to 11 per cent in 1985.

It is important to note that Sri Lanka would reach self sufficiency in rice during the period considered and that wheat flour imports have already ceased after the commissioning of the Prima Flour Milling Complex early this year. Further savings on imports of consumer goods have been anticipated chiefly due to the increase in the production of paddy and other field crops, fisheries and livestock. The impact of these significant changes will be somewhat marred by the sharp price increases in the important items of imports. The imports of capital goods are projected to increase substantially over the period. The project content of investment is such that considerable imports of machinery and equipment (including transport equipment) will be required during the next five years. The scope for import substitution in intermediate goods though marginally higher than in the case of investment goods, will not be sufficient to make an impact on the balance of payments position. However, the present projections for the medium term show that the share of consumer goods could fall from 28 per cent of total imports in 1980 to 22 per cent, while that of intermediate goods could rise from 43 per cent to 57 per cent during the same period.

Out of the identified imports in the trade projections presented in Table 7 below, petroleum, wheat grain, sugar and fertilizer imports account for an average share of about 42 per cent of total imports over the period 1981-85. The demand for crude oil is projected to increase from 1.86 million tons in 1980 to 2.27 million tons in 1985. Wheat grain imports are likely to increase from the 1980 level of 216 thousand tons to about 627 thousand tons by 1985. Imports of fertilizer from now on, will be mainly the non-nitrogenous varieties, since the new urea factory has already reached the stage of commercial production. The increase in the volume of fertilizer imports after the year 1983 indicates the increase in demand for varieties other than urea. Overall, the imports are expected to grow at an average rate of 18 per cent in current prices or at 1.8 per cent in constant prices during the period 1980-1985. Table 7 below shows the trade projections for the years 1981 and 1985 alongside the estimated values for 1980.

During the period 1980 to 1985 the total exports of goods are expected to grow at an average rate of 13.4 per cent per annum or 4 per cent per annum in constant prices. During the same period the share of tree crop exports could decline from 54 per cent of the total to about 46 per cent. Relatively high growth rates are expected in the case of industrial products, minor agricultural products and gems.

Table 7 below shows that, exports of industrial goods will increase from US$ 151 million in 1981 to US$ 410 million in 1985. The export prices for these goods have been assumed to increase pari passu with interna-

Table 7. EXPORT AND IMPORT PROJECTIONS 1980, 1981 AND 1985
(Value in US $ Million at Current Prices)

	1980	1981 (Projection)	1985
1. Exports f.o.b.	1064	1321	1991
Tea volume ml. kg.	188	190	198
Value	373	395	544
Rubber volume ml. kg.	131	135	134
Value	256	172	255
Coconuts volume ml. nuts	339	511	477
Value	46	79	132
Gems value	41	52	68
Petroleum products—value	289	208	557
Industrial goods—value	151	177	410
Minor agricultural products—value	79	94	166
Urea fertilizer—value	—	5	5
Rice value	—		2
Other exports—value	30	38	92
2. Imports c. & f.	2049	2188	4809
Rice volume th. mt.	190	150	—
Value	52	43	—
Wheat flour volume th. mt.	351	—	—
Value	107	—	—
Sugar volume th. mt.	288	150	200
Value	117	137	196
Wheat grain volume th. mt.	216	483	627
Value	33	120	242
Fertilizer volume th. mt.	376	250	323
Value	81	52	98
Petroleum i. Crude oil volume mn. tons.	1.86	1.95	2.27
Value	442	541	992
ii. Products value	52	73	127
Other consumer goods—value	255	248	418
Other intermediate goods—value	407	463	939
Investment goods—value	391	495	797
Unclassified	7	10	—

* Corresponds to the definition adopted by the Central Bank i.e. current account deficit shown in Table 6 above plus official transfers.

tional inflation. The bulk of the increase in industrial exports is expected to come from made-up garments and processed foods. The industries set up, both in and outside the GCEC are expected to contribute to this increase.

The projections of payments and earnings in the service account of the balance of payments represent an encouraging picture since a considerable surplus is likely to be realised during the period. Earnings from tourism are expected to rise from US$ 199 million in 1980 to about US$ 317 million in 1985. Likewise, the private transfers from abroad are expected to increase from US$ 137 million in 1980 to US$ 500 million in 1985 largely representing remittances by Sri Lankans working in the Middle East.

Foreign Aid

Foreign assistance from bilateral and multilateral sources has enabled the Government of Sri Lanka to plan and initiate large development projects without recourse to excessive expansionary financing in a period when the domestic resources have become scarce and severe constraints in the balance of payments have emerged. Such adverse conditions are, by and large, due to factors beyond the control of the Government and the view held by the Government has always been that, foreign assistance used judiciously, would enable Sri Lanka to make the necessary structural changes and build up a strong economy capable of self sustained growth and of withstanding adverse external factors.

The call of the present Government for large commitments of aid for massive development projects such as the Accelerated Mahaveli Development Programme has met with a positive response from the international community. The total aid commitments increased rapidly in the years after 1977. Table 8 below shows that the level of domestic fixed capital formation (both government and total) also increased at an even higher rate during the same period.

It may be noted that the greater availability of foreign assistance was undoubtedly an important factor promoting this dramatic growth in investment which followed the economic reforms of 1977.

However, during the period 1976-1980 the average increase in aid disbursement had been 8.1 per cent per annum as against an average increase of 11.0 per cent in commitments. Since 1979, disbursement rates have shown a further downward trend. This trend is explained mainly by the fact that there has been a definite shift during the same period from commodity aid to slow disbursing project aid and a substantial increase in commitments. The Government is fully aware of this problem and steps are being taken to remove procedural bottlenecks affecting disbursements.

The total foreign aid disbursements in the period 1981 to 1985 will depend to a large extent on the rate of implementation of the public investment programme. A large proportion of the budgetary public investment programme (65 per cent in 1981) is to be financed through foreign aid. Of the already committed aid, disbursements on the Accelerated Mahaveli Development Programme are now expected to reach a peak of about US$ 245 million per annum during the two year period 1982-83. For purposes of making a projection of aid disbursements for the period 1982 to 1985, it has been assumed that foreign aid commitments other than those for Mahaveli headworks will increase approximately at the rate of 10.8 per cent per annum and that the disbursement rates on such aid will improve over time. The aid disbursements on Mahaveli headworks have been related to the actual implementation schedules that are currently available. The table 9 above shows the gross foreign aid projection which is used in the medium-term framework.

The aid commitment assumption made in the projection shown in the above table may be considered as representing the minimum expectation. In particular it does not take into account any additional commitments in respect of Mahaveli headworks.

Since 1977, large price increases occurred in the international markets. According to price indices prepared by the World Bank, the total increase in the prices of manufactured products exported from the industrialised countries to developing countries was about 45 per cent, in the period 1977 to 1980. This resulted in a considerable decline in the quantum of real resources represented in the undisbursed aid commitments. As a consequence of this development, and several other factors, large differences between foreign aid requirements and availability have now emerged in the major development projects. The smooth implementation of the public investment programmes depends crucially on whether additional commitments would be made by the donors to fill these gaps. Where unavoidable, the Government may use commercial financing to supplement concessionary assistance. However, it is the policy of the Government that, such financing will be used only as a last resort.

Table 9. GROSS FOREIGN AID DISBURSEMENTS 1981-1985
(US $ million)

	1981	1982	1983	1984	1985
1. Disbursements on Accelerated Mahaveli	113	248	241	150	110
2. Other aid	317	372	473	579	613
3. Total disbursements ...	430	620	714	729	723

Table 8. FOREIGN AID COMMITMENTS, DISBURSEMENTS AND FIXED CAPITAL FORMATION 1976-1980
(US $ Million)

	1976	1977	1978	1979	1980
1. Foreign Aid *					
i. Commitments ...	180	227	384	567	744
ii. Disbursements ...	265	189	242	205	300
2. Fixed capital formation (Government) **	159	185	320	432	607
3. Fixed capital formation (total) **	329	419	545	821	1088

* Includes Non-Aid Grant assistance.
** Rates of exchange used: FEEC rate for years 1976 & 1977 and respective unified floating rates for the other years.

and the amount so mobilised would be kept to a minimum.

The recently observed shift to project based aid had the effect of slowing down the rate of aid disbursements. In view of the relatively large deficits on the balance of payments projected for the next five years, it has become necessary to have in the aid pipeline a larger component of quick disbursing aid, not necessarily tied to implementation of development projects. Therefore, the most important need now is for more flexible commodity aid, including aid which could be used to import capital equipment for development projects, where gaps in foreign financing have appeared.

Capital Budgets 1980 and 1981

Budget performance in 1980 was unsatisfactory with the overall fiscal deficit expanding from 14 per cent of GDP in 1979 to 21 per cent. This was largely due to the implementation of the public investment programme the cost of which had greatly exceeded original expectations. The capital votes in respect of the Mahaveli Development Board, the National Housing Authority, the Urea Project, the National Television Project, the Amortization of Public Debt, Irrigation, and Urban Development Authority were supplemented substantially during the budget year 1980. These increases in capital expenditure together with increases in recurrent expenditure amounting to Rs. 2430 million led to a situation in which the Government was compelled to borrow from the banking system to the extent of Rs. 7077 million. Total investment in the economy also rose dramatically (36 per cent of GDP in 1980) without a corresponding increase in domestic savings. In fact the latter declined to 13.5 per cent in 1979 and 1980.

With a view to preventing the recurrence of this situation in 1981, Government undertook a complete review of its investment programme in November 1980 as well as in March 1981. It is a key element of Government's policy that capital expenditure in the government budget must be contained within limits consistent with the volume of financial and real resources estimated to be available for public investment. The Government has therefore, set itself expenditure ceilings, which it is determined to adhere to.

Source: *Public Investment 1981–1985, Ministry of Finance and Planning; May 1981, P.P. 5-6, 13-23.*

EMPLOYMENT

Uncertain Unemployment Picture

One of the favourable outcomes of the policies introduced since late 1977 has been the creation of a large number of new and remunerative jobs in several sectors of Sri Lanka's economy. This is generally accepted and evident in the employment figures. The total number of new employment opportunities created within the organised sector, during the three year period 1978-80, is officially reported to have totalled 278,035. There was also a large reservoir of employment in the informal sector and if at least 25 per cent of the 278,035 were found jobs in this sector a considerable dent could have been created in the problem of unemployment which faced the Government in late 1977. It is officially maintained that the increase in employment in the public sector and the organised private sector was about 145,000 in 1978 and 135,000 in 1979 and that these employment growth levels are 82 percent to 70 per cent more than the employment growth trend of 85,000 job opportunities per year recorded for the period 1972 to 1976.

Provisional data from the Central Bank's Consumer Finance and Socio-Economic Survey of 1978 revealed that the rate of unemployment had dropped to 15 per cent in 1978 from a rate of 24 per cent in 1973. This Survey is also reported to have found that the average number of dependents per income receiver had dropped by about 20 per cent in 1978, which also confirms that there was a definite improvement in the employment situation that year. Although gathered more than 3 years ago this data is still tentative as the Report has yet to be officially released.

Using the data from the Socio-Economic Survey, the Ministry of Plan Implementation concluded in its *"Performance Report 1980"* that the number of unemployed which was estimated at over 1 million in 1979 has come down to 875,000 according to estimates available from this Survey. It reports that the increase in employment in the public sector and the organised private sector was about 145,000 in 1978 and 136,000 in 1979. The Ministry of Plan Implementation also conducts its own 'Survey of Jobs Advertised in the Press' and from this Survey it has found a positive improvement in employment generation over the years, with the 1980 performance apparently improving on that of the previous two years. To quote its publication *Performance* "The following pattern of employment generation was revealed by a recent survey by the Ministry of Plan Implementation:

Period	No. of posts Advertised
1978	16,462
1979	24,915
1980 (Jan.-Jul.)	23,031

This gives a rough indication that employment generation has increased over the years".

The Central Bank which has conducted its own annual survey for many years now has reported a contrary situation for 1980. Its Annual Report for 1980 has shown that the rate of growth in employment in 1980 was relatively low.

It is argued that the relatively lower rate of growth in employment in 1980 could be mainly attributed to the general reduction in the labour absorptive capacity of the key sectors of the economy. The Central Bank report maintains "Despite the high cumulative total for the period 1978—80, there has been a steady decrease in the rate of employment creation in the organized sector, particularly in 1980. Compared with 145,000 and 115,000 opportunities in 1978 and 1979 respectively, the number of employment offered by government departments, semi-government institutions and other organized private sector enterprises (i.e. those contributing to the Employees' Provident Fund) amounted to only 18,035. This does not, however, include the additional jobs created in the unorganised private sector, the traditional agricultural sector as well as any increase in self-employment in various sectors in the economy.

According to the Central Bank's annual survey of employment in the public sector, employment in government departments rose by 6,193 in 1980, as against an increase of 33,173 in 1979. In semi-government institutions, the number of new jobs created in 1980 was 8,812, compared with 63,000 in 1979. Provisional data obtained from the Employees' Provident Fund records, and also from a sample of establishments in the private sector, indicated a total of 3,030 new employment opportunities generated by the organised private sector institutions".

It is clear that employment opportunities would have to be created at a much faster rate if the number of unemployed are to be kept down. Even if 500,000 jobs were created over the last 3½ years less than half the estimated 1.2 million unemployed in 1977 could have been found placements. In addition, there are around 125,000 more persons entering the labour forces and seeking employment every year. On this basis upto date the new entrants to the labour force since mid 1977 could be estimated at around 500,000, which means that unless the job creation rate is stepped up we could still be in the same position as four years ago.

RUBBER

Depressed conditions keep down prices

Depressed conditions in the rubber market both internationally and locally continued to effect producers and the trade in Sri Lanka throughout May. Most effected have been the country's rubber small-holders who produce sheet rubber and were having problems of disposing off their stocks. Upto the end of April there was a heavy stock build-up of sheet rubber and in an attempt to relieve the situation the Ministry of Trade initiated sheet rubber auctions in Colombo.

The first private sector sheet rubber auction was conducted in Colombo on April 3 by the Colombo Rubber Traders' and Colombo Brokers' Association. At the first auction, where 178 tonnes of sheet rubber were on offer, attractive prices were realised for all grades with the average price ranging from Rs. 10/95 per kg. for RSS 1 to Rs. 6/55 per kg. for RSS 5. But the next week's auction and those that followed showed that the initial April 30 auction prices could not hold and seemed to be artificial. Prices dropped over the next few auctions till only at the end of May there was some improvement.

At the second sheet rubber auctions in the first week of May prices declined from the previous week for all grades. Two auctions were held during the week. At the first sale RSS No. 1 declined by Rs. 1/52 to Rs. 1/78 per kg. whilst RSS No. 2 dropped by 70 cts. to Rs. 2/36 per kg. At the second sale RSS No. 1 was dearer by 38 to 70 cts per kg. whilst RSS No 2 was 16 to 30 cts. per kg. better. Prices of all other grades eased.

The sheet rubber offered at the next auction in mid May also did not meet with strong demand and a general decline in prices over the previous week was observed. At the next auction at the end of May there were two sales, and both met with good demand and higher prices for all grades

The conditions in the rubber market were a reflection of the international situation where depressed trading conditions were a regular feature. Weekly market reports commented on the 'inactive' conditions in the London rubber market with values easing at the beginning of May; and again in the following week 'quiet' conditions and 'lack of buying support' in the Singapore market; while in the London rubber market 'thin and featureless' conditions prevailed. Towards the end of May there was a very slight improvement with prices of most major terminals moving up quietly, as anxiety grew over the Middle East situation and in turn prompted some speculative buying.

The trade was concerned about the uncertainities and generally depressed conditions (in the London market, on March 24, RSS 1 reached its lowest level since December 1978), and drew attention to adverse effects of price instability on both producers and consumers. As the *"Natural Rubber News"* maintained in a 1980 issue, on this subject of price instability in world markets, such a situation could destabilise the incomes of small-holder's who are the mainstay of production in most of the rubber producing countries; the trading position of producer nations, particularly those who rely heavily on this commodity, can be changed dramatically by a sustained fall in prices; a high degree of uncertainty as for the course of prices could tend to restrain the level of investment in expanding acreage, replanting and in processing facilities below the required levels; and instability could also pose problems for issues of development planning such as policies regarding employment, investment and plantations.

TEA

Production and Price Rises

A favourable trend in Sri Lanka's tea production was the increased crop upto the end of April. Production was up by 11.1 mn. kg. from 57.4mn. kg. in 1979 to 68.5 mn. kg. in the first four months of 1980. Total production of major producing countries have also increased by about 9 mn. kgs. during this period with larger increases being recorded in South India, Malawi and Bangladesh. The North Indian crop suffered a 5.6m kg. reduction as a result of the drought conditions prevailing in the region around March this year. Sri Lanka, however, recorded the highest crop increase upto the end of April. (See table below).

CROP FIGURES OF MAJOR PRODUCING COUNTRIES (In Million Kg.) (Jan-April)

Country	1980	1981
Sri Lanka	57.4	68.5
Bangladesh	3.7	4.1*
North India	33.0	27.4*
South India	35.2	38.5
Kenya	26.5	24.5
Malawi	17.4	19.2
Tanzania (a)	3.9	3.6
	177.1	185.8

* Estimated.
(a) Upto February.

Total gross sales averages upto the end of May showed a Rs. 2/50 increase per kg. over the same period in 1980. The total sales average per kg. for Jan. — June 1980 amounted to Rs. 17/88 per kg. as against Rs. 20/30 for the same period this year; the highest increase being Rs. 2/83 per kg. for medium grown teas. Production costs, however, were also reported to have recorded a marked increase as a result of the cuts in the power supply and other factors. Costs of production were reported to have increased by nearly 50 percent between 1978 and 1980 and had increased further in 1981.

According to a Central Bank computation the cost of production per kg. over the last 3 years was as follows:

Year	Rs. per kg.
1978	10.50
1979	12.70
1980	15.50

SPICES

Clove and Cinnamon exports rise

Export earnings from spices in 1980 showed a marked improvement of 27 percent over 1979 levels. This was primarily due to the exceptional performance of cloves, earnings from which increased by Rs. 96.4 million or 101 percent over 1979 levels. Cinnamon too made a small contribution towards this favourable trend with an increase in earnings of 12 percent. Although cardamoms, pepper, nutmeg and mace recorded an increase in earnings during the last quarter of 1980 as compared with the same period in 1979, over the whole year the earnings from these spices recorded a decline over 1979 levels.

One reason that could be identified for the drop in earings from cardamoms was the tension in the middle-east during the latter half of 1981 due to the Ian-Iraq war. As a consequence buyers were not interested in making purchases for fear of delayed shipments. This situation led to a drop in prices at the local auctions during this period (Table I). With the easing of tension during the early part of 1981, a dearer market trend was observed and prices for cardamoms gradually improved as evident in Table I. Although export figures for this period were not available, one could expect a more favourable trend during the early part of the year. Prices of cloves too have shown an increasing trend since September last year, and if this trend coninues, one could expect an even better year of performance from this spice than in 1980. Cinnamon, pepper and nutmeg, on the other hand have been maintaining a steady level of prices to date.

Volume of all spices exported during the last quarter of 1980 showed increases over 1979 levels. However, when comprising this performance over the whole year, only cinnamon and cloves recorded an appreciable increase of 14 percent and 52 percent, respectively, while cardamoms, pepper and nutmeg and mace all recorded declines. (Table II). As for quantities of spices offered at the local auctions, with the exception of cardamoms, only small amounts of the other spices were offered for sale when compared with volumes exported. (Table III).

No accurate data on the volume of production of spices is readily available. But on the basis of the volume of exports (considering volume of exports as approxy) production of cloves and cinnamon have recorded a significant increase, while the export volume of pepper, nutmeg, cardamoms and essential oils had fallen. However, the drop in export volume may be partly attributed to factors such as increased domestic consumption. The total extent planted under the Minor Export Crop Assistance Scheme in 1980 recorded only a marginal increase over the previous year. The only significant increase in the area planted was recorded in the case of cloves, where 387 hectares were brought under cultivation as compared to 202 hectares in 1979.

TABLE I. AVERAGE PRICES AT COLOMBO BROKERS AUCTIONS SEPT-FEB. 1980-81
(Prices in Rs. per kilogram)

Month		Cardamoms L.G.L.L.G.		Cinnamon H.2/?	Cloves G.L.	Pepper G.L.	Nutmeg (Shelled)
Sept.	...	231–285	216–245	21–24	178–183	23–24	33.50
Oct.	...	230–260	158–204	43–24	190–195	24	33.50
Nov.	...	179–188	138–170	22–23	211–212	22–25	31.50
Dec.	...	208–244	156–189	21–23	198–216	24	31.50
Jan.	...	252–292	168–218	22–23	171–179	22–24	31.50
Feb.	...	n.a.	185–227	21–23	190	22	31.50

Source: *Colombo Brokers' Reports*

TABLE II. VOLUME OF SPICE EXPORTS 1979-1980
(Thousand kilograms)

Year			Cardamoms	Cinnamon	Cloves	Pepper	Nutmeg & Mace
Fourth	1979	...	26.9	2396.6	64.2	129.2	57
Quar.	1980	...	41.3	3264.3	262.0	199.6	89.3
Whole	1979	...	179.4	6786.9	785.5	876.0	398.7
Year	1980	...	153.9	7825.0	1193.7	646.3	277.5

Source: *Central Bank Bulletin*

TABLE III. QUANTITIES OFFERED FOR SALE AT COLOMBO BROKERS AUCTIONS OCT.-FEB. 1980-8
(Quantities in kilograms)

Month		Cardamoms	Cinnamon	Cloves	Pepper	Nutmeg
October	...	13,596	10,315	Nil	5,378	Nil
		(11,500)	(510,400)	(93,300)	(61,800)	(38,000)
November	...	12,498	6,970	61	524	Nil
		(11,400)	(776,600)	(38,800)	(46,000)	(17,600)
December	...	18,400	6,399	234	1,598	Nil
		(18,400)	(2077,380)	(129,800)	(91,600)	(33,700)
January	...	10,975	5,749	571	7,179	Nil
		(n.a.)	(n.a.)	(n.a.)	(n.a.)	(n.a.)
February		6,162	8,899	221	3,325	Nil

Source: *Colombo Brokers' Reports and Central Bank Bulletin.*

1/ Only for three weeks in February. Figures in brackets are export Volumes.

This table from *SOUTH*, the Third World magazine, shows the changes in the purchasing power of commodity exports. The changing value of how much oil one tonne of each commodity can buy is illustrated here; the top column indicating the position in 1975, the second column that of April 1981 and the third in May 1981. Two of Sri Lanka's major exports, tea and rubber, are included; their falling value is evident.

Unprecedented Imports and Deteriorating Terms of Trade

A feature of the pattern of trade in 1980 was the unprecedented increase in Sri Lanka's import bill and the sharp deterioration in the terms of trade. This was a direct impact on the liberalisation of trade, introduced in November 1977, whose objective was to ultimately boost exports to an extent that would finance any merchandise trade deficit. Unfortunately, the anticipated exports boost has found difficult to materialise in a situation of growing global recession and uncontrolled domestic inflation. Also, the lure of quick and big profits through imports and trade in the domestic market has attracted more manufacturers and traders to the domestic market rather than to exports.

The argument was that when a country embarked on a development programme, as it did in 1977, it was not uncommon to incur current account deficits in its balance of payments. It is generally through such deficits that foreign resources are absorbed into the economy. In this sense, the deficits recorded in 1978 and 1979 were not considered as adverse. One factor during these two years, that may be considered fortunate, was that the country was able to mobilise sufficient external resources to finance the current account deficits. In 1980, on the other-hand, the balance of payment developments were such that the external resources mobilised were not sufficient to finance much of the current account deficit. This resulted in a substantial adverse trade balance which had to be financed by other means. In these circumstances the only recourse was to running down accumulated foreign reserves and subjecting the country to a weakened foreign exchange situation. The overall balance of payments situation which stood at a surplus of Rs. 3,313 million at the end of 1977 had now turned to a deficit of Rs. 2,967 million by the end of 1980.

The major factor responsible for the adverse trade position last year was the sharp increase in the value of imports which amounted to Rs. 33,637 million (SDR 1,563); this was an increase of Rs. 11,077 million or 49 percent over that of the previous year. In contrast, the export earnings increased only by 13 percent to Rs. 17,273 million (SDR 803 million).

TABLE 2. FOREIGN TRADE INDICES 1970–1980
Index Number (1978=100)

Year	VOLUME All Exports	VOLUME All Imports	PRICES All Exports	PRICES All Imports	Terms of Trade
1970	107	77	17	16	106
1971	104	68	17	17	98
1972	102	67	17	18	94
1973	103	60	20	24	82
1974	89	42	31	42	72
1975	107	52	29	49	58
1976	102	57	34	44	78
1977	94	73	55	54	102
1978	100	100	100	100	100
1979	101	123	109	152	72
1980	99	140	126	217	58

Source: *Central Bank of Ceylon*

The net result (see Table 1) was an adverse merchandise trade balance of Rs. 16,364 million, the worst the country has ever faced. This situation was also reflected dramatically in the terms of trade.

As seen in table 2, the increase in the total value of imports was largely the result of an increase of 65 percent in the import price index and a 17 percent expansion in the volume of imports. Export earnings also increased but this was entirely due to a 17 percent upward movement in the export price index. The volume of exports as indicated in the export volume index decreased by about 2 percent. The result was that the terms of trade deteriorated 14 percentage points last year, from 72 in 1979 to 58 in 1980. This decline in terms of trade was a major feature in the adverse trade balance recorded last year. Sri Lanka is reported to have been among the most severely affected, in its terms of trade, of the countries of the region. For instance, though countries such as Philippines and Singapore suffered a decline in terms of trade the impact was not as strongly felt as in the case of Sri Lanka. A significant feature in the terms of trade, as seen in table 2, is that these terms have been deteriorating after 1977, gradually upto 1978 and more rapidly thereafter. It is important to realise the significance of the impact of the movements in the terms of trade, particularly its bearing on the performance of the economy. The main reason is that foreign trade still plays a major role in the economy of the country.

EXPORTS

Export performance, particularly volume of exports, was disappointing in 1980. The export volume of all export sectors, with the exception of industrial exports, recorded a decline last year. The increase in international prices, through global inflation helped export earnings to show some improvement. Export earnings, in rupee terms recorded an increase of 13 percent over that of the previous year while in SDR terms, the increase amounted to only 6 percent.

Tea exports continued to provide the major share of the country's export earnings despite the bleak tea production picture last year. Tea production in 1980 is reported to have decreased by

TABLE 1. EXTERNAL TRADE ACCOUNT 1975–1980
(SDR Million in brackets)

	1975	1976	1977	1978	1979	1980
Exports						
Rs. Millions	3,933	4,815	6,638	13,206	15,273	17,273
	(466)	(495)	(659)	(674)	(759)	(803)
Imports						
Rs. Millions	5,251	4,646	6,007	14,687	22,560	33,637
	(617)	(477)	(630)	(774)	(1,121)	(1,563)
Trade Balance	–1,318	+170	+631	–1,480	–7,287	–16,364
Rs. Millions	(–151)	(+18)	(+29)	(–100)	(–362)	(–761)
Terms of Trade						
(1978=100)	58	78	102	100	72	58

Source: *Sri Lanka Customs Returns and Central Bank of Ceylon*

TABLE 3. MAJOR ITEMS OF EXPORT 1978-1980

Item			Value Rs. Million 1978	1979	1980	Percentage of Exports 1978	1979	1980
Tea	...	...	6,401	5,722	6,170	48	38	36
Rubber	...	...	2,021	2,491	2,390	15	16	13
Coconut	...	...	1,271	1,699	1,234	10	11	7
(a) Kernel Products		...	972	1,298	754	7	8	4
(b) Other Products		...	299	401	480	2	3	3
Minor Agricultural Crops *			723	825	840	6	6	5
Industrial Exports *		...	1,944	3,737	5,496	15	24	32
(a) Textiles and Garments		...	481	1,108	1,814	4	7	11
(b) Petroleum Products		...	945	1,926	2,999	7	13	17
(c) Other	...	...	518	703	682	4	4	4
Gems	...	...	531	490	458	4	3	3
Other Exports	...	...	315	309	483	2	2	3
Total Exports	...	...	13,206	15,273	17,273	100	100	100

* Selected items

Source: *Sri Lanka Customs Returns*

7 percent over the previous year to the lowest level of output recorded since 1968. The volume of tea exports too, fell from 193 m.m. kgs in 1978, to 186 mn. kgs in 1979 and 185 mn. kgs in 1980. Favourable prices, however, helped these reduced supplies to net higher earnings than in the previous year.

Rubber also brought in slightly higher earnings, when compared with the previous year, despite the 13 percent drop in production in 1980. The quantities exported continued to fall from 136 mn. kgs in 1978 to 128 mn. kgs in 1979 and 121 mn. kgs in 1980. Export prices, however, improved last year and this helped in keeping earnings from rubber above those of the previous year.

Earnings from minor agricultural crops also showed an increase, though the proportion of earnings from this sector to total export earning dropped. As shown in our Commodities column on page .... the contribution from cloves, cinnamon and arecanut was significant while pepper, nutmeg, cardamoms, tobacco, papain and essential oils showed a drop in exports. The supply situation in these minor export crops once again proved to be a constraint and the country was unable to reap the benefits of favourable prices in world commodity markets for these products.

The most disappointing export performance in 1980 was produced by the coconut sector, mainly due to limitations in supply. (This is dealt with at length in our Special Report). The deteriorating trend in exports and production of coconut products continued into 1981.

A significant trend in the overall export pattern was the emergence of industrial exports as a major contributor to the country's export earnings. Largely responsible for this situation were the earnings from processed petroleum products which amounted to nearly Rs. 3,000 million or 17 percent of total export earnings in 1980.

Textiles and garments also took a major leap in earnings in 1980 and contributed almost Rs. 2000 million or 11 percent of total export earnings. The progressive increase in the contribution of textiles and garments to total export earnings over the last three years is noteworthy. If this trend continues, earnings from industrial exports are likely to overtake the contribution to total exports from tea (the major export earner) very shortly.

The drop in the value of earnings from gems is also significant and lends support to the view of customs and other informed sources that illegal and unrecorded exports of gems are being carried on at an increasing pace. Gross export earnings from the GCEC Investment Promotion Zone, one of the lead projects of the present Government amounted to Rs. 50.3 million in 1980 as against Rs. 15.2 million in 1979; with garments exports providing nearly 85 percent of the earnings. The overall export picture, however, was far from encouraging and what appeared to boost values of exports most in 1980 was the increase in international prices as a consequence of world inflation. A warning note was struck by the Central Bank which commented that "in the context of the phenomenon of deteriorating terms of trade which Sri Lanka is experiencing since 1977 a more concerted effort has to be made in order to increase the level of growth of exports while improving the fortunes of the traditional sector. In view of the near stagnant demand for tea and supply constraints impeding the growth of rubber and coconut exports, considerably greater attention has to be given towards the development of the non traditional exports". In the present circumstances, with import values continuously rising, it is clear that the only means of containing the widening trade deficit and the alternative to heavy external indebtedness would have to be an intensive export development programme.

IMPORTS

Import expenditure once again showed a considerable increase and during 1980 rose by nearly 50 percent: from Rs. 22,698 million in 1979 to Rs. 33,675 million in 1980. The sharp increase in the value of imports was mainly the result of a 43 percent increase last year in the import price index, as seen in Table 2. The increase in the volume of imports in 1980 amounted to 14 percent.

The downward trend in consumer goods imports continued into 1980, according to a categorisation of imports by the Central Bank. (See table 4). The share of consumer goods in total imports has kept falling from 43 percent in 1977 to 29 percent by 1980. Mean-

TABLE 4. COMPOSITION OF IMPORTS BY CATEGORIES 1976-1980
(Percentage shares are given within brackets)

(Rs. Million)

CATEGORY			1976	1977	1978	1979	1980
Consumer Goods	...	...	1,689	2,634	5,618	7,824	9,884
			(36)	(43)	(38)	(35)	(29)
a. Food and drink	...	...	1,491	2,181	4,127	4,807	6,134
b. Textiles	...	...	49	150	531	1,536	1,721
c. Consumer durables & other goods			149	203	958	1,481	2,029
Intermediate Goods	...	...	2,359	2,648	5,591	9,143	15,405
			(49)	(44)	(38)	(41)	(46)
a. Petroleum	...	...	1,164	1,441	2,703	3,912	8,090
b. Fertilizer	...	...	99	51	252	673	1,533
c. Others	...	...	996	120	446	502	544
Investments Goods	...	...	641	746	3,367	5,459	8,141
			(14)	(12)	(23)	(24)	(24)
a. Machinery & equipment		...	364	286	1,846	2,900	4,212
b. Transport equipment		...	173	292	983	1,613	2,421
c. Building materials	...	...	104	129	150	368	610
Unclassified	...	...	54	79	110	134	118
			(1)	(1)	(1)	(1)	(1)
Total	...	...	4,643	6,007	14,687	22,560	33,673

Source: *Central Bank of Ceylon*

TABLE 5. MAJOR ITEMS OF IMPORT IN 1978, 1979 AND 1980

	Value Rs. Million			Percentage of Imports		
	1978	1979	1980	1978	1979	1980
Petroleum products ...	2,403	3,961	8,170	16.4	17.5	24.3
Boilers, machinery and appliances ...	1,846	2,089	3,394	12.6	9.2	10.1
Motor vehicles and parts	988	2,076	3,000	6.7	9.2	8.9
Iron and steel articles ...	928	1,160	1,618	6.3	5.1	4.8
Electrical machinery, equipment and parts	554	904	1,546	3.8	4.0	4.6
Building materials ...	150	368	610	1.0	1.6	1.8
Sugar and sugar confectionery ...	620	945	1,931	4.2	4.2	5.7
Cereal flours ...	2,192	1,708	1,801	14.9	7.6	5.4
Rice and cereals ...	689	1,484	1,338	4.7	6.5	4.0
Fertilizers ...	252	674	1,333	1.7	3.0	4.0
Textiles and textile articles	1,218	2,323	2,308	8.3	10.3	6.9
Paper and paperboard based articles ...	239	396	407	1.6	1.8	1.2
Others ...	2,608	4,537	6,219	17.8	20.1	18.5
Total ...	14,687	22,628	33,675	100.0	100.0	100.0

Source: *Department of Commerce, Statistics Division and Sri Lanka Customs Return*

TABLE 6. IMPORTS 1977, 1978, 1979, AND 1980
SRI LANKA'S 25 MAIN SUPPLIERS OF FOREIGN PRODUCTS IN 1980

		1977		1978		1979		1980	
		Rs.m.	%	Rs. m.	%	Rs. m.	%	Rs. m.	%
1.	Japan ...	398	6.6	1,590.4	11.0	3,005.3	13.3	4,301.8	12.8
2.	Saudi Arabia	747	12.4	1,385.3	9.6	1,569.7	7.1	3,527.5	10.5
3.	U.K. ...	327	5.0	1,396.1	9.6	2,014.9	8.9	3,206.0	7.6
4.	Iraq ...	—	—	20.5	1.5	704.0	3.1	2,082.2	6.2
5.	Iran ...	586	9.7	858.3	5.7	739.7	3.3	1,814.3	5.4
6.	India ...	377	6.2	1,242.0	8.6	2,334.4	10.4	1,594.2	4.7
7.	Singapore	126	2.1	405.0	2.8	1,358.8	6.0	1,520.1	4.5
8.	U.S.A. ...	538	8.9	1,104.6	7.6	1,211.0	5.4	1,492.6	4.4
9.	France ...	231	3.8	690.7	2.6	481.7	2.1	1,309.7	3.9
10.	Germany F.R.	223	3.7	831.9	5.7	1,222.1	5.4	1,176.9	3.5
11.	China ...	284	4.7	452.5	3.1	1,039.2	4.6	840.2	2.5
12.	Netherlands	107	1.7	380.3	0.7	354.2	1.6	772.5	2.3
13.	Hong Kong	44	0.7	213.5	1.2	517.3	2.3	689.0	2.0
14.	Australia ...	291	4.8	738.4	5.1	1,077.9	4.8	653.0	1.9
15.	Belgium ...	73	1.2	230.7	1.6	141.9	.6	552.2	1.6
16.	South Africa	10	.2	100.4	0.5	354.2	1.6	523.4	1.6
17.	Pakistan	273	4.5	172.2	4.8	491.9	2.2	496.2	1.5
18.	Sweden ...	33	0.5	106	0.7	352.3	1.6	448.6	1.3
19.	Canada ...	71	1.1	263.4	1.8	291.3	1.3	402.6	1.2
20.	Burma ...	167	2.7	498.7	3.4	196.1	.9	389.6	1.2
21.	Switzerland	22	.4	100.7	0.7	295.6	1.3	280.4	0.8
22.	Italy ...	139	2.3	275.2	1.9	263.9	1.2	233.4	.07
23.	Malaysia ...	29	.5	100.4	0.5	140.3	.6	197.6	0.6
24.	U.S.S.R. ...	131	2.1	237.5	1.6	167.8	.7	177.4	0.5
25.	Thailand ...	287	4.8	47.7	0.3	167.0	.7	165.9	0.5
	Sub-Total	5,514	91.8	13,443.4	92.0	20,615.3	91.4	28,847.2	85.8
	Others ...	493	8.2	1,170.0	8.0	1,945.1	8.6	4,790.2	14.2
	Total ...	6,007	100.0	14,613.4	100.0	22,560.4	100.0	33,637.4	100.0

Source: *Sri Lanka Customs Returns and Statistics Division, Department of Commerce*

while, the category of intermediate goods increased its relative share upto 46 percent in 1980; and the share of investment goods amounted to 24 percent of the total goods last year. Tables 4 and 5 present an over-all picture of the major items and categories of imports.

A notable feature in the pattern of imports was that petroleum products took up almost 25 percent of the total import bill in 1980. In terms of value the other items which showed major increases were sugar and sugar confectionary; fertilizers; building materials, boilers, machinery and appliances; motor vehicles and parts; and electrical machinery, equipment and parts. Despite the sharp increases in CIF prices the objective of diverting more resources to investment goods and investment oriented activities was actively persued over the last three years.

The value of investment goods imported during 1980 amounted to Rs. 8,141 million, an increase of about 50 percent over that of 1979. Machinery and equipment took up a large part of this category of imports, together with transport equipment and building materials.

The expenditure on import of consumer goods amounted to nearly Rs. 10,000 million, an increase of almost 25 percent over that of the previous year. A considerable part of these imports were categorised as consumer durables and also non-essential or luxury goods; the steady inflow of the latter into the country began to cause concern to the authorities in the early part of 1981. The annual report of the Central Bank for 1980, estimated that consumer durables were only 6 percent of total imports and only some items from these were non-essentials though later official estimates ranked at 10 percent and above.

Another significant item in the import bill was that of textiles, which went up from Rs. 1,536 million in 1979 to Rs. 1,729 million in 1980. Though textiles and garments contributed 11 percent to the total export bill in 1980 nearly 70 percent of this has been estimated to be the import content. In the case of petroleum products too there was a similar pattern.

SOURCES OF SUPPLY

For the third successive year Japan continued to be the major supplier of Sri Lanka's imports. This was in a way a reflection of the import trade pattern that set in following the liberalisation of the country's trade in 1977. Japanese agencies made the most of the situation with the country demanding more investment and intermediate goods such as machinery, equipment, fertilizers and also electronic and electrical goods and appliances. Saudi Arabia which had been the foremost supplier of the country's imports for the three years upto 1977, because of its petroleum supplies, occupied second position on the list of Sri Lank's import sources. This was to be expected with nearly 25 percent of the import bill being spent on petroleum products. Iraq, and Iran also provided fair quantities of oil and therefore occupied fourth and fifth position, respectively. U.K. retained third position once again with its large supplies of machinery and equipment for the country's development projects, particularly the Mahaveli project and power supplies. India which was the second most important supplier of Sri Lanka's imports in 1979, dropped to sixth position, while Singapore and USA each dropped one position in 1980. The other major suppliers were France and West Germany, occupying ninth and tenth positions, also largely through imports of investment and capital goods. Imports from China which picked up in 1979 fell once again in 1980, and the proportion of China's value of imports in the country's total import bill fell to 2.5 percent, the lowest on record since 1978.

FOREIGN MARKETS

USA which emerged as Sri Lanka's leading export market in 1979 maintained this position in 1980 as well, when it took Rs. 1,925 million worth of goods and accounted for as much as 11.4 percent of the value of the country's total exports last year. Mainly responsible for this situation was the increasing imports of industrial products, particularly ready made garments, and larger quantities of tea into the U.S. market. A significant feature of trade with U.S. is that though imports amounted to a substantial value the balance of trade still remained in favour of Sri Lanka; in strong contrast to the situation with regard to Japan where there was a Rs. 3,350 million adverse trade balance, U.K. a Rs 1,858 million adverse balance, France an adverse balance of Rs. 1,008 million, and India a Rs. 1,626 million adverse balance. There were also countries such as Saudi Arabia, Iraq, Iran and Singapore where the adverse balance exceeded Rs. 1,000 million, but in the case of these countries the possibilities of absorbing Sri Lanka's exports were not as strong as in the case of the former five countries.

U.K. continued to occupy the second position as the country's main market, accounting for 7.4 percent of the total value of Sri Lanka's exports; while West Germany moved up as an important trade partner to occupy the third position. This is the first time the FRG has come within Sri Lanka's three principal markets. China occupied fourth position taking nearly 5 percent worth of the country's exports while major petroleum suppliers Iran and Saudi Arabia with their increasing purchases of tea accounted for around 3.5 percent each of Sri Lanka's export earnings. They were followed by India, Pakistan and UAR, each contributing about 3.3 percent of the country's export earnings; while Japan's position weakened considerably in 1980 moving down from third position last year and fourth position in 1978 to tenth position in 1980. The other major markets for Sri Lanka in 1980 were Iraq, USSR, Netherlands, Italy, South Africa, Canada and France with exports to these countries ranging from around Rs. 250 million to Rs. 500 million last year. The main 10 buyers in the list of countries buying Sri Lanka's products took nearly 50 percent of the value of Sri Lanka's exports; while the other 50 percent exports went to nearly 90 other countries. Of the East European socialist block countries USSR, Poland and Yugoslavia were among the first 25 of Sri Lanka's markets; while among the South East Asian nations was only Singapore; and the main Middle East markets were Iraq, Saudi Arabia, UAR, Iran and Syria.

Table 7. EXPORTS 1977, 1978, 1979 AND 1980
THE 25 MAIN BUYERS OF SRI LANKA'S PRODUCTS IN 1980

		1977		1978		1979		1980	
		Rs. m.	%	Rs. m.	%	Rs. m.	%	Rs. m.	%
1.	U.S.A. ...	500	7.5	924.9	6.8	1,525.5	10.4	1,925.3	11.2
2.	U.K. ...	528	8.0	1,028.5	7.6	1,230.9	8.1	1,258.4	7.4
3.	Germany F. R.	261	3.9	561.9	4.1	902.2	4.2	918.0	5.3
4.	China ...	431	6.6	955.6	7.1	856.8	5.6	848.4	4.9
5.	Iran ...	356	5.4	457.7	3.3	461.6	3.1	613.2	3.6
6.	Saudi Arabia	175	2.7	629.9	4.6	448.6	2.9	607.0	3.5
7.	India ...	90	9.0	118.2	0.8	194.2	1.3	568.0	3.3
8.	Pakistan ...	534	8.0	669.4	5.0	686.2	4.5	568.0	3.3
9.	U.A.R. ...	304	4.6	559.6	4.1	452.6	2.8	567.2	3.3
10.	Japan ...	321	4.9	766.3	5.6	1,047.1	6.8	552.0	3.2
11.	Iraq ...	123	1.8	568.4	4.2	326.7	2.7	549.5	3.2
12.	U.S.S.R. ...	125	1.9	192.0	1.4	477.0	3.1	518.9	3.0
13.	Netherlands	186	2.8	367.3	2.7	484.6	3.2	473.8	2.8
14.	Italy ...	110	1.7	402.7	3.2	452.9	2.8	362.9	2.1
15.	S. Africa ...	201	3.0	201.4	1.5	259.0	1.7	312.6	1.8
16.	Canada ...	127	1.9	291.1	2.1	226.5	1.5	258.2	1.5
17.	France ...	94	1.4	172.2	1.3	252.7	1.7	248.0	1.4
18.	Singapore ...	98	1.5	278.0	2.0	157.2	1.0	196.5	1.1
19.	Australia ...	198	3.0	254.8	1.9	228.1	1.5	189.3	1.1
20.	Syria ...	169	2.6	362.4	2.6	298.2	1.9	186.9	1.1
21.	Hong Kong	134	2.3	198.3	1.4	179.5	1.1	172.5	1.0
22.	Poland ...	69	1.1	165.1	1.2	241.1	1.5	148.1	0.9
23.	Switzerland ...	155	.8	151.5	1.1	79.5	.5	130.5	0.8
24.	Yugoslavia ...	42	.6	60.5	.4	76.7	.5	114.0	0.7
25.	New Zealand	68	1.0	127.8	0.9	125.6	.8	107.7	0.6
	Sub Total ...	5,240	79.2	10,400.5	75.9	11,678.5	76.5	12,414.2	71.8
	Others ...	1,375	20.8	3,290.0	24.1	3,594.5	23.5	4,879.6	28.2
	Total ...	6,615	100.0	13,690.5	100.0	15,273.0	100.0	17,293.8	100.0

DEMYSTIFYING THE ENERGY ISSUE

Mahbub ul Haq

The efforts to organize global negotiations on a New International Economic Order have continued into 1981 with no significant result. There are still substantive and fundamental differences between the approaches of the North and the South to these negotiations. One area of major misunderstanding is that of energy, more specifically the petroleum issue. In a recent paper titled "Negotiating the Future" in the US Journal *Foreign Affairs* Mahbub ul Haq, Director of Policy Planning at the International Bank for Reconstruction and Development and author of the Poverty Curtain and several other works on development issues maintains that the deadlock is not a cause for pessimism but an invitation to sober reflection. In the course of this paper Haq examines closely some of the major issues in the debate including energy; the global monetary situation; international resources mobilization; and the world food system. Reproduced here is his analysis of the energy issue.

One can hope that both the rich countries of the North and those of the South have learned some quiet lessons from the experience and mistakes of the last few years. These should be drawn upon in making a new attempt to revive the stalemated global negotiations.

A fresh approach can be made by examining the premises of the old global order in several specific fields — such as energy, food, the monetary system, resource transfers, trade, economic development, technology, multinational corporations, and international institutions. The basic strategy should be to let the analysis itself lead to the final solution rather than to start with any preconceived proposals. Four concrete questions must be posed in each case:

- What are the premises on which the old order was based?
- Are these premises still valid?
- If not, what are the new premises which should replace them?
- Will the new global order meet the legitimate interests of all sides?

We will make an attempt in the following discussion to analyze the present framework of the global order in several economic fields in this spirit.

The energy issue must be demystified. No reasoned dialogue on that issue has taken place so far, as it gets bogged down in side issues and peripheral controversies. Either OPEC (the Organization of Petroleum Exporting Countries) is made to feel guildy — which is hardly a brilliant strategy for soliciting its co-operation — or the industrialized nations and developing countries are asked to adjust to a new energy environment without having a clear idea of what historical and long-term forces are shaping this environment.

The energy problem can be seen in its proper perspective only if it is viewed as one of the many structural transformations that the world is going through, and if it is placed within the framework of restructuring of national and international orders which has become increasingly urgent. The energy issue arose when the world was already confronting a profound transition: concern for protecting the world environment; for eradicating absolute poverty; for developing new self-reliant styles of development in the South and a new value system in the North; for controlling the impending international monetary crisis; for the establishment of a New International Economic Order. The energy issue greatly sharpened the global perception of these other transitions by demonstrating the essential interdependence and vulnerability of all nations. It is within that broad perspective that the energy issue can be helpful as an engine of transition, so long as it is linked with other related issues.

There is a popular belief that the energy crisis (i.e. the rising real cost of energy) has "caused" the world economic crisis. This, in a way, reverses the sequence of events. The rising real cost of energy is the result of the overload of the world system, not its cause. The fast rate of increase in oil consumption in the past few decades has led to a rapid depletion of non-renewable resources. This happened because the price of oil was kept artificially low by international oil companies for a long period. Paradoxically, it was this artificially low price of oil which caused the eventual crisis by leading to an unregulated appetite for energy. If the oil price had been set not in relation to the cost of production — which was irrelevant — but the cost of alternatives, the adjustment process would not have become so abrupt and traumatic.

A Fallacy

It is widely believed that oil prices are being kept artificially high at present through cartel-like action by OPEC: with the dismantling of OPEC, prices will crash. This is a fallacy. The current price of oil is largely determined by the forces of supply and demand as well as by the cost of alternatives. Before there are any screams of protest, let it be noted that production decisions are generally made by the national policies of OPEC members — not collectively — much the same way as the United States decides to curtail its wheat production to limit excessive supply.

In fact, many OPEC members are producing more oil (because of international considerations) than is required by their own national needs for revenue. If OPEC did not exist today, oil prices would probably stay at the same level or even rise, since it is a reasonable premise that oil-producing and exporting nations may well decide to eliminate financial surpluses they do not immediately need and instead try to protect the real value of their depleting assets by keeping more of the oil in the ground.

Moreover, there is no substitute for oil on the horizon which is cheaper than oil right now. In fact, those oil-importing nations which are making costly and long-term investments in finding alternative sources of energy have a major interest by now in a relatively high price of oil which alone would justify these investments in alternatives. Finally, and most important, the real determining factor for the future price of energy may well turn out to be on the demand side: the extent to which conservation policies are pursued.

There is a widespread belief that OPEC nations are extremely rich; that they 'create" enormous financial surpluses which they cannot use themselves and which put considerable pressure on the world economy; and that they are responsible for compensating oil-importing developing countries for the rise in their oil-import bills but are as yet providing inadequate financial assistance to them. Such reasoning only tries to put OPEC nations on the defensive, without either having the benefit of objective analysis or leading to any constructive results.

Most OPEC Nations Are Not Rich

To begin with, most OPEC nations are not rich. They are liquid but not wealthy, though liquidity and wealth are being freely confused these days. Even including the capital-surplus nations of Saudi Arabia, Kuwait, the United Arab Emirates, Qatar, Libya and Iraq, the thirteen OPEC members had an average per capita income of less than $1,000 in 1978, only one-eighth of that in industrialized nations. Besides, most of the OPEC nations are underdeveloped, with low level of technology and research, little diversified development outside the oil sector, and with all the problems of a single-resource economy. OPEC nations have suddenly become financially liquid but they have yet to translate their good fortune into lasting sources of real wealth.

Second, OPEC does not "create" financial surpluses; it is the appetite of the industrialized nations for energy which does. These surpluses are "desired" by industrialized nations. If OPEC were to cut production further to eliminate present surpluses, the world economy would experience a severe slump. For OPEC nations, the economics of these surpluses is not very clear; there is a fair question whether oil in the ground will appreciate more over time than the real value of these financial surpluses. Moreover, let us also remind ourselves that these surpluses become a problem only because the world monetary system has not yet discovered either adequate market mechanisms or international intermediation through which these surpluses could be recycled to deficit countries on appropriate terms. This requires a reform of the monetary system, not of oil-pricing policies.

Finally, the capital-surplus OPEC nations have already provided over 4 percent of their gross national product (GNP) on the average during 1974—79 for concessional assistance, compared to 0.35 percent by industrialized nations — in other words, about 18 times as much as developed countries even when their per capita income is less than half that of developed countries.[7] This is truly remarkable when it is realized that OPEC assistance is being given not out of current income but out of the proceeds of oil — a depleting capital asset. Hardly any other nation in the world provides assistance by running down its capital. This is not to suggest that OPEC assistance policies are optimal, or to foreclose any further avenues of mutual collaboration between OPEC and the rest of the Third World, but only to restore some perspective on this issue.

In short, the old premises of the global energy order have all collapsed by now; new premises cannot be constructed under the dark shadow of unfounded myths and unnecessary controversies. It is possible to identify key areas for global negotiations only within such a perspective. Let me turn now to three critical questions in this field.

Identifying Interests

First, how will future oil prices be determined? Obviously they will no longer be determined by a handful of powerful oil corporations dominating the international oil market — nor by the unilateral actions of OPEC. They will be determined by a whole range of decisions and factors: OPEC national production policies; global conser- industrialized nations; investment in vation policies, particularly in the industrialized nations; investments in the expansion of oil production and other energy alternatives in the non-OPEC nations; the probable cost of future oil substitutes; the pace of growth in the world economy, etc. Until some of these unfold and have their full impact, the international community will live through a transition period when oil prices may remain volatile unless a tacit international understanding is reached.

Most present forecasts indicate a real increase in oil prices (by three to five percent a year) over the 1980s. All nations have to gain if such an increase is gradual and predictable, rather than in sudden and delayed bursts. But before any international understanding or agreement can be reached in this area, the interests of various sides will have to be identified. While oil importing nations would like to have some agreement on the future course of oil prices, OPEC nations would probably be reluctant to enter into any such agreement without clear understandings on conservation policies in industrialized nations, protection of the real value of their financial surpluses, and assistance with the conversion of their oil revenues into real, long-term development in order to prepare their economies for a post-oil stage. It must also be recognized that OPEC alone cannot "enforce" or "guarantee" any particular oil price, since a whole range of policy decisions will influence the market, as argued above. OPEC can only reach understandings on matters within its direct control.

Second, policies for energy conservation will be an extremely crucial part of adjustment during the 1980s. Cheap oil has encouraged wasteful patterns of energy consumption and choice of inappropriate technologies. One of the problems in adjustment is that some of the decisions are frozen by now in some societies, e.g., stress on private automobiles and public highways, suburban modes of living, energy-intensive industries. Unfreezing these decisions for the future will require tremendous political and economic courage, particularly in the industrialized nations. The developing countries have as yet more options available if they review their future patterns of development and consumption styles in the light of the new energy situation. There is generally considerable room for economizing if energy prices are allowed to rise to their proper level in oil-importing nations. To a limited extent, conservation policies are already working in some of the industrialized countries, but the eventual adjustment in their patterns of consumption and development is so fundamental that it has barely begun.[8]

Third, oil-importing developing countries require substantial resources for financing larger investments in domestic energy production. These investment needs are estimated by the World Bank at around $30 billion a year (in current dollars) during 1980—90. Various proposals are currently being made to provide investment resources to oil-importing developing countries for energy development, such as an energy affiliate in the World Bank to provide $5 billion a year over the next five years; expansion of the present OPEC Fund into a development agency with a capital of $20 billion; schemes for mobilization of larger private foreign investment. The total investment needs in energy are so large that there is room for all these initiatives and great merit in having diversification of channels for this purpose. What is important, however, is to ensure that these initiatives lead to additional transfers; that they reflect the changing balance of financial power in the world; and that they are based on a participatory system of management and control.

These are some of the key issues around which global negotiations can be organized in the field or energy.4 The energy issue was analysed at length merely to illustrate that even in a sensitive area like this, there are ways to avoid irrelevant issues and to focus on the new premises which should replace the old while meeting the legitimate interests of various nations.

(The author illustrates this point further in areas such as the international monetary field and the world food system, in the context of continuing global negotiations and the North-South Summit due to be held in Mexico later this year. His final conclusion in this regard is: **"A productive way of making a fresh start on the North-South dialogue would be to take up concrete areas of the global economic order, to examine critically the premises on which they were built in the past, and to negotiate new premises where ever the old assumptions have been eroded with the passage of time or new assumptions are required to serve the mutual interests of all nations. Such an approach would take the present dialogue away from empty rhetoric, costly filibuster, and skillfully engineered stalemate to more practical and constructive channels.")**

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Unemployment of Labour—Voices from a Bangladesh Village

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The chronic underemployment of Bangladesh's landless and poor peasants represents a terrible waste of the country's greatest resource: the labor of its people. The demand for agricultural labour is highly seasonal - in the peak periods of harvesting, weeding the spring rice and transplanting the rainy season rice, most of the poor can find work. But between these periods they are often unemployed, with no income at all. Taking these seasonal fluctuations into account, a United Nations study in 1977 set the unemployment rate in rural Bangladesh at a staggering 42 per cent. For many, this figure translates into chronic hunger and even starvation.

Massive underemployment means that millions of people cannot afford to buy basic consumer goods. This lack of what economists call "effective demand" is in itself a cause of economic stagnation. Industry cannot grow without a market, but families who can hardly afford to eat are not about to become consumers of even basic items such as footwear and soap. Indeed, their lack of buying power may act as a brake on food production too. Discussing the prospect of rising unemployment, a cable from AID's Dacca mission states, "These findings in turn cast doubt upon the feasibility of current foodgrain production strategies, implying as they do a general reduction in the level of demand".

The rural poor of Bangladesh represent a huge, untapped work force for labor-intensive agricultural and industrial projects. Mobilized for development, they could be transformed from a drain on the nation's economy into a powerful asset. Yet despite the fact that labor-intensive rural works projects are frequently endorsed as a key to development in Bangladesh, efforts to implement such projects run aground on hard political realities; the government has other priorities. As the AID cable notes; "The government's Rural Works Programme is widely reported to have been in a state of deterioration in recent years owing to a variety of management difficulties".

For their part, the rural poor have no incentive to undertake such projects as long as they are deprived of the land which would be improved by their labour. Even if more rural works projects were instituted, the extent to which the landless would benefit is open to question. As an AID study points out

> "Such projects (eg. the buildings of a farm to market road) provide income to rural workers for a specified period, but do nothing generally to change the fundamental economic conditions that produced unemployment in the first place. At the same time, such projects tend to provide long-term benefits to landholders who, in this example, use the road to gain access to local markets."

Among the most pressing issues that emerged with the world-wide recession of recent times were the problems of the growing rates of inflation and unemployment. In our last issue (April 1981) we carried country perspectives on the unemployment problem from Mexico, India and Pakistan. Held over from our last issue were three more such overviews covering Bangladesh, Japan and Britain. A recent issue of the UN's *"ONE WORLD"* Supplement carried various country perspectives of these problems. The overviews on unemployment in Japan and France published here, are from this supplement; while Hartman and Joyce of the US Institute of Food and Development Policy discuss Bangladesh; and Samuel Brittan of *FINANCIAL TIMES* deals with the situation in Britain.

In the same vein, the World Bank warns that the scope for reducing unemployment and poverty through rural works projects "would be offset by the inequitable distribution of secondary benefits of the programme". As one experienced Bank official told us. "It's hard to see much we can really do for the landless". Hard, that is, under the present inequitable social order.

Water, Water Everywhere, But...

The present structure of landownership in Bangladesh results in the underutilization of another precious agricultural resource: water. Although Bangladesh has vast surface and ground water resources, only 12 per cent of the country's cropland is currently irrigated. Irrigation would bring tremendous production increases in the dry winter season, would insure the regular spring and monsoon season crops against drought and would allow earlier plantings which reduce the risk of flood damage. But today the uneven distribution and fragmentation of landholdings blocks the co-operative effort needed to harness Bangladesh's great water resources.

Although it would be a formidable engineering challenge, there is certainly great potential for taming Bangladesh's rivers through construction of dams, embankments and canals. These could provide not only irrigation but also much-needed flood control and drainage for millions of acres. Bangladesh has no shortage of manpower to undertake these tasks. But, as we have seen, the mobilization of this labour is almost impossible under the present social order. Moreover, the fact that land is fragmented into many individual holdings poses great difficulties for any such scheme. For instance, who would decide whose precious plots would be sacrificed to the construction of canals and channels?

Indeed, fragmentation and unequal distribution of land-holdings today undermine even modest efforts to provide irrigation with low-lift pumps and tubewells.

Priorities of the Elite

There is another important dimension to the inefficiency of inequality in Bangladesh. The priorities of the government reflect the interests of a narrow elite rather than the needs of the poor majority.

Agriculture suffers not only from a lack of funds, but from a lack of commitment on the part of the government officials. The World Bank notes pointedly: "Examples of the few countries which have been successful in rural development (e.g. China, Taiwan and Korea) show that government officials have diligently and persistently worked with local people. "In Bangladesh, even the most optimistic foreign aid officials admit this diligence and persistence in rural development is hard to come by. The concept of public service is alien to most members of Bangladesh's elite, who look upon the poor majority with disdain. For them, villagers are to be escaped, not to be served.

In fact, the main development which has taken place in Bangladesh in recent years is the development of the elite. Bangladesh's most pressing employment problem is providing work for the millions of landless rural people, but as the the World Bank reports. "The only sector which has been booming in terms of employment is public administration". While real wages of landless labourers are plummeting, the government recently increased the salaries of civil servants by 20 to 25 per cent.

Although Bangladesh suffers from a shortage of skilled workers, ranging from doctors to mechanics, the government is now encouraging such workers to go abroad so they will send home foreign exchange. (One reason the government needs foreign exchange is to repay foreign aid loans). At present more than 3,000 Bangladeshis migrate to the Middle East each month. More of Bangladesh's senior nurses now work there than in their own country! The New York Times reports from Dacca that the mass exodus of skilled labour is "so serious that the Agency for International Development has all but stopped sending Bangladeshis to the United States for training, even though specialised skills are badly needed here to promote development." Exporting labour which is needed at home is like exporting food when people are hungry: resources go where the profits are highest, not where the needs are greatest.

Prevention Rather Than Cure

Toshio Hukuo *Asahi Shimbun* (Tokyo)

Our century-old newspaper, Asahi Shimbun, just moved into its new ultra-modern headquarters in Tsukiji, Tokyo, from its antiquated building in the old Yurakucho area. And we editorial writers, in keeping with our tradition of fair deal for everyone, drew lots to decide where in the new room our desks were to be placed. Though relatively a junior among my colleagues, I was lucky enough to draw a place near the window commanding an open view.

"Madogiwa-zoku" or "window seater" is a clever Japanese expression coined a few years ago. It refers to an employee, from middle-age up, relieved from the mainstream of company activities and assigned a desk near the window where he cannot be in the way of his bustling juniors. The expression, still used popularly, has a touch of pathos, and is a product of the unique Japanese employment practice of keeping a salaried worker, once employed, on the company payroll until the retirement age of 55 or 60. This is without regard to such factors as business recession or structural changes in industry which might make him redundant. The expression must be difficult to understand for anyone from a country where lay-offs are commonplace.

No figures exist indicating just how much this practice of keeping a redundant labour force on the pay-rolls contributes toward lowering the unemployment ratio. But the sum total of this redundant force was estimated at around two to two-and-a-half million people a couple of years ago. If this number were to be struck off the payrolls, unemployment would be more than doubled.

The existence of business enterprises which allow such an excess labour force, and the existence of a society which welcomes such paternalistic practices, explain in part Japan's low rate of unemployment.

That is not to say that the existence of these "window-seaters" is a total loss for the companies. They, too, pull their weight in a way The work assigned to them, however, is far different in most cases from that which they were used to performing during the 10, 20 or even 30 years they were with the companies. But hardly any complaint is heard from them at least, not audibly. They continue to do their assigned tasks.

We are reminded, here again, of another Japanese expression: "hakoiri-masume" or "sheltered flower". It refers to a naive and unspoiled maiden brought up cloistered in her home, protected from the harshness of life's realities.

Japanese firms employ university graduates periodically every year. But they are not looking for ready made lawyers from among the graduates of law schools, nor economists from those with a degree in economics. The same can be said about those finishing courses in the department of science. In other words, Japanese firms are not after "finished products" in the various fields of academic life. What they look for in the new recruits is not professional knowledge which can be put into immediate and practical use, but fresh and pliable material which the management can put into any sort of mould they wish.

Bright young souls just out of the country's top universities suddenly turn into meek lambs. If a new recruit with a degree in law is assigned say, to the accounting department, he starts by learning to keep books. The young man is not in the least outraged by this.

The category of work in which a company is engaged might be changed overnight to keep pace with market trends. There might be no alternative-if the company wants to survive. The faithful employees then face the new task with renewed spirit and vigour. The workers go through stiff retraining, both individually and in company-sponsored retraining institutes, and prepare themselves for the new challenge.

The high fluidity of labour within a given organization in Japan contributes to its dynamic constitution and high growth. Though the world at large has entered into an era of low economic growth, this country still enjoys a relatively high rate of economic growth-measured at least with the Western yardstick.

The rate of economic growth is in inverse ratio to the rate of unemployment. The low rate of unemployment here, presently around two per cent, is really a reward for high economic growth brought about by the diligence of the "hakoiri-masume", or the faithful "sheltered flower".

Britain's cost of employing the unemployed

Samuel Brittan *Financial Times* (London)

It is well known that high unemployment is very costly to the Government. The unemployed pay no taxes and receive State benefits, and are thus doubly expensive to the Exchequer.

A typical calculation of the cost of an unemployed man on the average wage with two children is given in the table. The Government loses over £3,000 per annum on taxes and National Insurance contributions and pays out nearly the same amount in benefits, giving a total cost of £6,000-indeed more if the figures are updated to 1981 levels.

The figures are overdramatic because a man with two children on the average wage is not typical of the unemployed. Nearly a third of the unemployed are women and of the men over half are unmarried. Even among heads of household those with below average income are much more prone to unemployment.

But even if we put the true average cost at say £3,500 per unemployed person, it is still true that a jobless level of 2½m, which is a fairly moderate estimate for this year, costs the Exchequer more than £5bn a year compared with what a jobless level of 1m would cost. One can then play games with this sum and say, for instance, that it is more than the whole of the likely overshoot in the Public Sector Borrowing Requirement this year, hgher than present North Sea oil revenues or equivalent to the cost of reducing the basic tax by 7p or 8p in the pound.

THE RIGHT TO WORK

Michel Castaing *Le Monde* (Paris)

The right to work may be enshrined in all the constitutions of the world, but earning one's living today appears to have assumed the status of a luxury

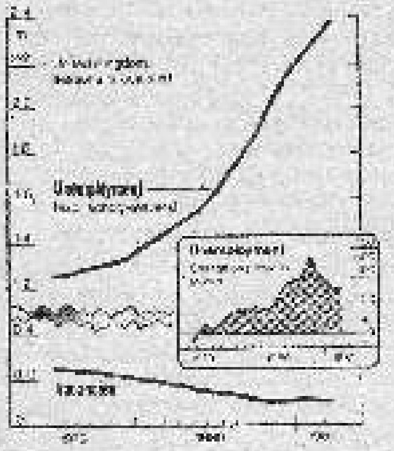
The OECD experts estimate that despite low productivity the number of unemployed will rise in their area from 20 million at present to 23 million at the end of the first half of 1981, or by almost seven per cent of the working population. Of the 24 member counries, the USA, with over eight million unemployed, will be worst hit by rising unemployment, according to OECD experts.

But almost all countries are faced with a major difficulty which threatens to assume even greater proportions and create a serious social problem: the unemployment of young people. In OECD member countries as a whole (excluding Turkey), youth unemployment, i.e. among the working population under 25 years of age, increased from 10.4 per cent in 1976 to 11.3 per cent in 1979, its share in total unemployment climbing from 44 to 47 per cent.

Only Japan, where the influx of young people into the labour force has begun to decline, seems to have escaped the general scourge.

And yet the majority of governments have taken steps to stimulate employment, with special measures on behalf of the under-25 age group .... Generally speaking, these measures have unboubtedly curbed the rise in unemployment; but they have not been able to check its inexorable advance.

The fact remains that aside from all statistical data, evaluations and forecasts and whatever the fabulous sums spent throughout the world on compensation, unemployment is a social cancer which cannot be regarded as predestined — and individuals are being crushed by it.



Registered unemployment in Britain has risen by a bleak leap in the year up to the middle of March, 1981, according to *The Economist*. The seasonally adjusted figure for adult unemployment is now 2.38mn, or 9.9% of the working population. The total adjusted figure, including school leavers is 2.48mn or 10.3%. Northern Ireland is worst hit with 16.4% unemployed; and in the north of England and Wales adult unemployment is 12.9%. About 700,000 are being kept off the register by the government's special employment measures. Over and above the official figures the manpower services commission reckons that about 350,000 are looking for work but have not registered.

On top of that the evidence suggests that a proportion of "discouraged" workers, i.e. married women or those near retirement age, have probably opted out of the labour market. The labour force has been decreasing since March, 1979, even though the population of working age has been growing by about 150,000 a year. Though the rate of increase in unemployment was slowing down, the 3mn mark is now on the horizon in Britain.

But all such arithmetic does not prove any of the profound points that some people suppose that it proves. If the level of unemployment were caused by the Government deliberately switching on one button, or refusing to switch off another button, then it would indeed show the high cost of such stupidity. As it is the "cost" of high unemployment to the Exchequer-as distinct from its human cost-is in principle no different to the cost of low productivity, or other economic misfortunes or inefficiencies, all of which would boost Government revenues if removed.

The rise in unemployment, admittedly more severe in Britain than elsewhere, has been a worldwide phenomenon and has been taking place in a series of spasms for more than a decade. One does not have to be a great believer in political enlightenment to doubt whether governments of all parties and in all parts of the world would needlessly impose a financial burden on themselves which at the same time dramatically reduced their reelection prospects, if they knew a way of escape.

If the implicit argument is that Government spending could be raised, or taxes cut by £6bn, without any net cost to the Exchequer, then that is a very different and highly dubious proposition. The effects of such a boost on output and employment would depend on the impact on wages, prices, the exchange rate, imports, interest rates, inflationary expectations, and above all the supply response of industry, on all of which there is enormous room for argument. The effective stimulus would have to be improbably large for it to be self-financing.

At the back of the political criticism of the "cost of unemployment" is a dim memory that some economists used to believe that there was a trade-off between unemployment and price stability; and a suspicion that the Government has deliberately chosen a combination of low inflation and high unemployment. This theory is as dead as the dodo. A more up-to-date version states that there is a transitional unemployment cost in reducing inflation; but it also states that if we refuse to pay this cost we will not get any more jobs in the long run and may get fewer. In any case the bulk of present unemployment probably has nothing to do with the Government's anti-inflationary programme.

There is, however, a much more limited and tangible proposition which does not involve such abstruse speculations. This is known as the "Len Murray point." It simply stresses the absurdity and waste of paying the unemployed the dole and other benefits when the Government could instead be paying them the same money to do useful work on the public payroll.

WHAT UNEMPLOYMENT COSTS THE GOVERNMENT
£ p.a. December, 1979 to November 1980 inclusive

	Married man with two children on Average wage	Single man on Average wage
LOSS OF REVENUE		
Income Tax	1,328	1,547
Indirect Tax	400	531
Employee N. I. Contributions ...	434	404
Employers N. I. Contributions ...	887	887
Total revenue loss	3,049	3,399
COST OF BENEFITS ...		
Flat rate unemployment benefit ...	1,734	900
Other Benefits*	1,223	1,336
Total cost of benefits	2,957	1,837
TOTAL FINANCIAL COST ...	6,006	5,236

* Earnings related supplement, supplementary benefits, income tax rebate, rent rebate, rate rebate, free school meals, free welfare milk.

Source: *House of Lords Hansard, November 12, 1980. Written Answer to Lord Kilmarnock*, Col. 1464.

Pesticides and People in a Hungry World — A Victim Every Minute

David Weir and Mark Schapiro

David Weir who as an English teacher for the US Peace Corps first noticed the Kool-Aid pack, (with cyclamates in its ingredients) selling in Afghanistan, has together with Mark Schapiro, from their Centre for Investigative Reporting in US, launched a decade long series of inquiries into the banned exports of pesticides and other agro-chemicals. Their efforts have provoked an explosive reaction both in the U.S. and other parts of the world. The United Nations passed a resolution on these hazardous chemical exports while new tough legislation was introduced in the U.S. Congress. The Weir and Schapiro package published in "*Mother Jones*" a U.S. magazine, won the 1980 National Magazine Award for reporting and was named the "Best Censored" story of the year by a panel of judges selecting the most important stories ignored or under-played by the Press. Their efforts have culminated in a book published by the Insititute for Food and Development Policy in the United States. It documents 'a scandal of global proportions' — the export of banned pesticides from the industrial countries to the third world and tells of how massive advertising campaigns by multinational pesticide corporations have turned the third world into not only a booming growth market for pesticides but also a dumping ground. Dozens of pesticides too dangerous for unrestricted use in the United States are shipped to under-developed countries. There, lack of regulation, illiteracy, and repressive working conditions can turn even a "safe pesticide into a deadly weapon. We reproduce here the second chapter of their book titled "Circle of Poison".

For Chemical Company executives, exporting hazardous pesticides is not 'dumping". If one country bans your product, move to where sales are still legal. It's just good business. But "'good business" practice seldom takes account of the human toll inflicted by the massive use of pesticides.

Every minute of the day, on the average, someone is poisoned by pesticides in the third world. This World Health Organization statistic amounts to 500,000 poisoned people every year. A pesticide-caused death occurs about every hour and 45 minutes totalling at least 5,000 each year. Yet those estimates tell us nothing about the number of cancers, miscarriaages, deformed babies and still-births resulting from the use of pesticides.

The rate of pesticide poisoning in underdeveloped countries is more than 13 times that in the United States, despite vastly greater use here, according to Virgil Freed, a consultant to the U.S. Agency for International Development (AID). But why are there so many more victims in the Third World? The following accounts from around the world tell why.

Culiacan, Mexico

In Culiacan in Northern Mexico, where large plantations grow tomatoes for American supermarkets, government doctors report seeing two or three pesticide poisonings every week. Sometimes workers are brought in with convulsions. Since they get no paid sick leave, often they return immediately to the fields, where their condition deteriorates. Every two or three weeks a federal hospital in Culiacan treats a farm worker for a plastic anemia, a blood disease linked to organochlorine pesticides used in the area. About half of these victims die.

But Los Angeles Times reporters Laurie Becklund and Ron Taylor were told by one group of workers that "someone in their camp dies every two or three days." The farm workers are routinely poisoned by drifting pesticide sprays and leaking pesticide applicators, according to the reporters.

The workers live along the small patches of earth between the crops and the irrigation canals that receive all of the pesticide run-off. "They wash their babies, their dishes and their clothes in the canals and then turn back to the canals to fill discarded insecticides tubs with canal water to drink," reports the *Times*. While the workers become ill from contaminated water, modern greenhouses with purified water systems have been erected to nurture the tomato seedlings. "The seedlings are more important than the people," one US-born grower explained.

Central America

More than 14,000 poisonings and 40 deaths from pesticides were tabulated between 1972 and 1975 in the cotton-growing Pacific coastal plains of Central America, according to a 300-page report by the Central American Institute on Investigation and Industrial Technology (ICAITI). The actual total is undoubtedly much higher, but impossible to determine. According to the report, "some of the large cotton producers maintain their own clinics partly to hinder public health officials from detecting the seriousness of human insecticide poisonings."

Although the pesticides are applied mainly to cotton grown for export, food crops-mainly corn and beans-are often contaminated simply because they are near the cotton fields. The report says that 75 percent of the sprayed pesticide frequently misses the cotton fields complttely. And toxic residues contaminate the soil.

"According to the World Health Organization, someone in the under-developed countries is poisoned by pesticides EVERY MINUTE".

(Proceedings of the U.S. Strategy Conference on Pesticide Management, U.S. State Rept., June 7—8, 1979, p. 33).

"Many people have died from swallowing and also coming into contact with poisons designed to kill insects, weeds and rodents. But these deaths represent only a small percentage of the actual pesticide poisonings that occur daily in our country. Some people may become mildly ill and fail to realize that they, or their children, have actually been poisoned.

There are many cases of fatal pesticide poisoning each year. The figures we have only cover poisons taken by mouth. Poisoning from inhalation and absorption through the skin cannot even be guessed at. Not surprisingly, 75 per cent of the victims are children".

(Dr. G. P. Jayawardena — "Pesticides: handle with care" in the 'Ceylon Daily News' March 23, 1981, p. 8).

Some farm workers try to wash the pesticide from their skin, the ICAITI study revealed, But they use the irrigation drainage ditches, laced with the toxic runoff of insecticides, thereby compounding their contamination. Washing would not remove much of the parathion anyway due to its pernicious tendency to concentrate in the oil on the skin, which transmits it directly into the bloodstream.

Parathion, which causes 80 percent of Central America's poisonings, was originally developed for chemical warfare by Nazi scientists during World War II. Slight chemical alterations converted it into a profitable insecticide after the war. The lethal dose of parathion to human beings is about one-sixtieth that of DDT: that is, it is 60 times more toxic. Parathion, explains Dr. H. L. Falk, of the National Institute of Environmental Sciences, "breaks down the substance which your body produces to stop the movement of your finger or your eye, for example. So those movements won't stop. You exhaust the muscles until they stop functioning altogether. You go into convulsions and die."

The legacy of heavy pesticide use in Central America is ominous. Average DDT levels in cow's milk in Guatemala are 90 times as high as allowed in the United States. People in Nicaragua and Guatemala carry 31 times more DDT in their blood than people in the United States, where the substance has been banned since 1970.

In Guatemala, reports *New York Times* correspondent Alan Riding, "the worst conditions, though the best pay are on the cotton plantations. Here, pesticide spraying levels are so high that shipments of meat from cattle ranches in the area are frequently rejected by the United States Department of Agriculture because of their high DDT content. Studies also show that DDT levels in human blood in the cotton districts are eight times higher than in Guatemala city. Yields, though, are among the highest in the world. It's very simple," explained Eduardo Ruiz, a young cotton planter. "More insecticide means more cotton. Fewer insects mean higher profits."

"But little concern is shown for those living and working in the region," reports Riding. "At the height of spraying (in the Tiquisate area), 30 or 40 people are treated daily in the nearby government clinic for the toxic effects on the liver and other organs".

"The farmers often tell the peasants to give another reason for their sickness, but you can smell the pesticide in their clothing," a nurse said. "And we know the symptoms — dizziness, vomiting and weakness. Only people who die in the clinic are reported. Otherwise bodies are buried on the farms".

Pakistan

A World away from Central America, pesticides also kill. In Pakistan, at least five persons died and 2,900 others became ill in 1976 from malathion supplied in part by New York — based American Cyanamid for a US government programme to eradicate malaria. Monte Edison, an Italian chemical company, also supplied the malathion.

Government silence

Few Third World countries have either adequate pesticide regulations or the capacity to enforce them. As a result, the multinational pesticide producers have a free hand. Central America, for instance, has been turned into 'a sort of experimental grounds for pesticide manufacturing companies," concludes the detailed study cited earlier.

Most third world governments are reluctant to disclose their poisoning statistics, incomplete as they might be. Robert Chambris, who supervised the GAO's investigation of pesticides, cites three reasons the pesticide poisonings are often hushed up.

"One is tourism," he explains. "It doesn't look good to have press reports about contaminated food. Two, no government wants to admit it was poisoning its own people. Would you admit you were allowing dangerous conditions in your country with President Carter's emphasis on human rights? Three, the countries are worried that if they report poisonings, the FDA will start to check their food exports to the United States and find illegal residues. This could have a severe adverse impact on their export earnings."

Poisons in a Coke bottle

Pesticide poisonings are much more common in the Third World than in the industrial countries not only because of the more brutal working conditions there, but also because of hazards of distributing any poison in societies where most people cannot read and have never had to learn the dangers of man-made chemicals.

"Small shops in Indonesia sell pesticides right alongside the potatoes and rice and other foods," says Lucas Brader of the U.N. Food and Agriculture Organization (FAO). "The people just collect it in sugar sacks, milk cartons, Coke bottles — whatever is at hand."

"The laws in less developed countries typically say no repackaging of pesticides," Fred Whittemore of AID explains. "But in the villages it is done routinely. Parathion in Coke bottles stuffed with newspapers with no label is typical. Gramoxone which contains the deadly weed-killer paraquat, is not only sometimes sold in Coke bottles-it's the same colour as Coke."

In Pakistan and Middle-Eastern countries, peasants sometimes wrap pesticides in their turbans, then place the turbans back on their heads to carry the pesticide to the fields.

"In the rainy season in many tropical countries, the plastic liners used in pesticide bags are used as raincoats," says Whittemore. "That is an acute problem causing poisonings."

Gramoxone killed at least 18 people during a four-year period in the Western Highlands of Papua New Guinea, where it is used on coffee plantations and home gardens. "On June 16 a pastor conducted a religious service at Tega village near Mt. Hagen. He accidentally gave gramoxone instead of wine for communion to four people. They all died over the next week," Dr. D. J. Wohlfahrt, assistant secretary for Health in the Mt Hagen district, wrote in the Papua New Guinea *Post Courier* of July 25, 1980 "In mid-1979 a young father bought gramoxone and stored it in a bottle. He asked his young son to go and get him a drink. He accidentally brought back the gramoxone and gave it to his father. After a gulp, the father realised it was not water he had drunk. But it was too late — he died," Wohlfahrt says.

"Gramoxone is legally marketed by the manufacturer in plastic bottles with built-in carrying handles that are just perfect for villagers to store their drinking water in after they have used up the weed-killer.

"How many people are we prepared to kill for the conveni ence of also easily killing weeds? asks the doctor.

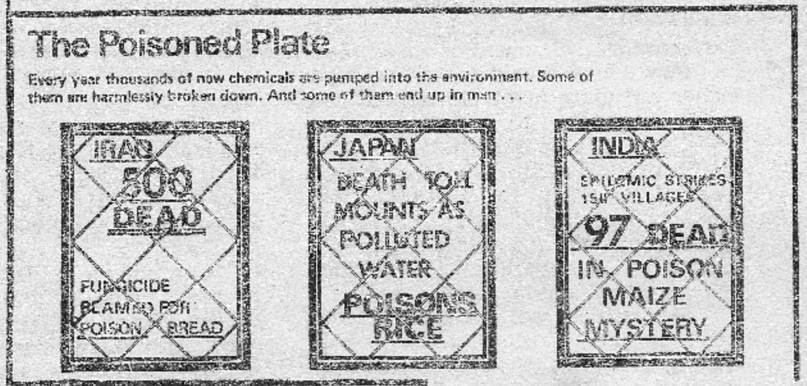
Inadequate labeling or deliberate mislabeling of pesticides also causes poisoning in Third World countries. During 1979 the government of Colombia fined Hoechst and Shell for mislabeling pesticides, and fined Dow Velsicol Ciba-Geigy American Cyanamid, and Hoechst for selling substandard products. A recent check in Mexico disclosed that more than 50 percent of the pesticides sold there were labelled incorrectly.

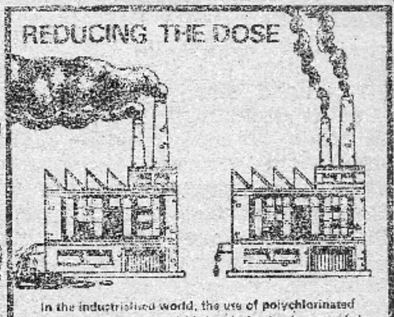
"One aid post orderly came to collect his medicines at Mt. Hagen Hospital and brought an empty gramoxone bottle to put the cough mixture in. The label read 'Poison' and had all the instructions written in English, but how many plantation labourers or village people can read English?" asks Dr. Wohlfahrt.

"Disposal of pesticides is a major problem, too," says Virgil Freed. "One horrible example is dieldrin in the Cameroon. A couple of years ago too much dieldrin was ordered, and the extra drums were simply placed outside in a jungle area. Now the containers have deteriorated and the dieldrin is spilling all over. I was there and saw the chemical sitting in puddles on the ground. There were people living in huts nearby. There could very well be subtle effects on them."

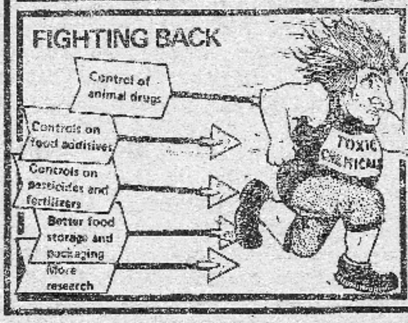
Indiscriminate, widespread promotion of pesticides is especially disastrous in the Third World. In countres where most people cannot read, what use are warning labels on pesticide packages? In countries which outlaw unions that could protect farmworkers, what chance do peasants have against the crop duster's rain of poison? In countries with neither enough scientists to investigate pesticide dangers, nor enough trained government officials to enforce regulations, should foreign pesticide makers be given a free hand to push products so dangerous they are banned at home?

Toxic chemicals





In the industrialised world, the use of polychlorinated biphenyls — a known 'risk' chemical — has been cut by 90% in five years.



GEMS – the Global Environmental Monitoring System – is at the centre of a growing network of national programmes for monitoring food contamination. Set up by the United Nations Environment Programme in 1974, GEMS is based at UNEP's headquarters in Nairobi, Kenya.

Graphics : David Eaton

ECONOMIC REVIEW, AUTHOR INDEX, VOLUMES 1-6 (1975 April-1981 March)

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ECONOMIC REVIEW

The Economic Review in its five years of publication has produced several issues that are still in high demand. For the benefit of the several members of the reading public who have made repeated inquiries, we give below a list of some of the issues of which few copies are still available.

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