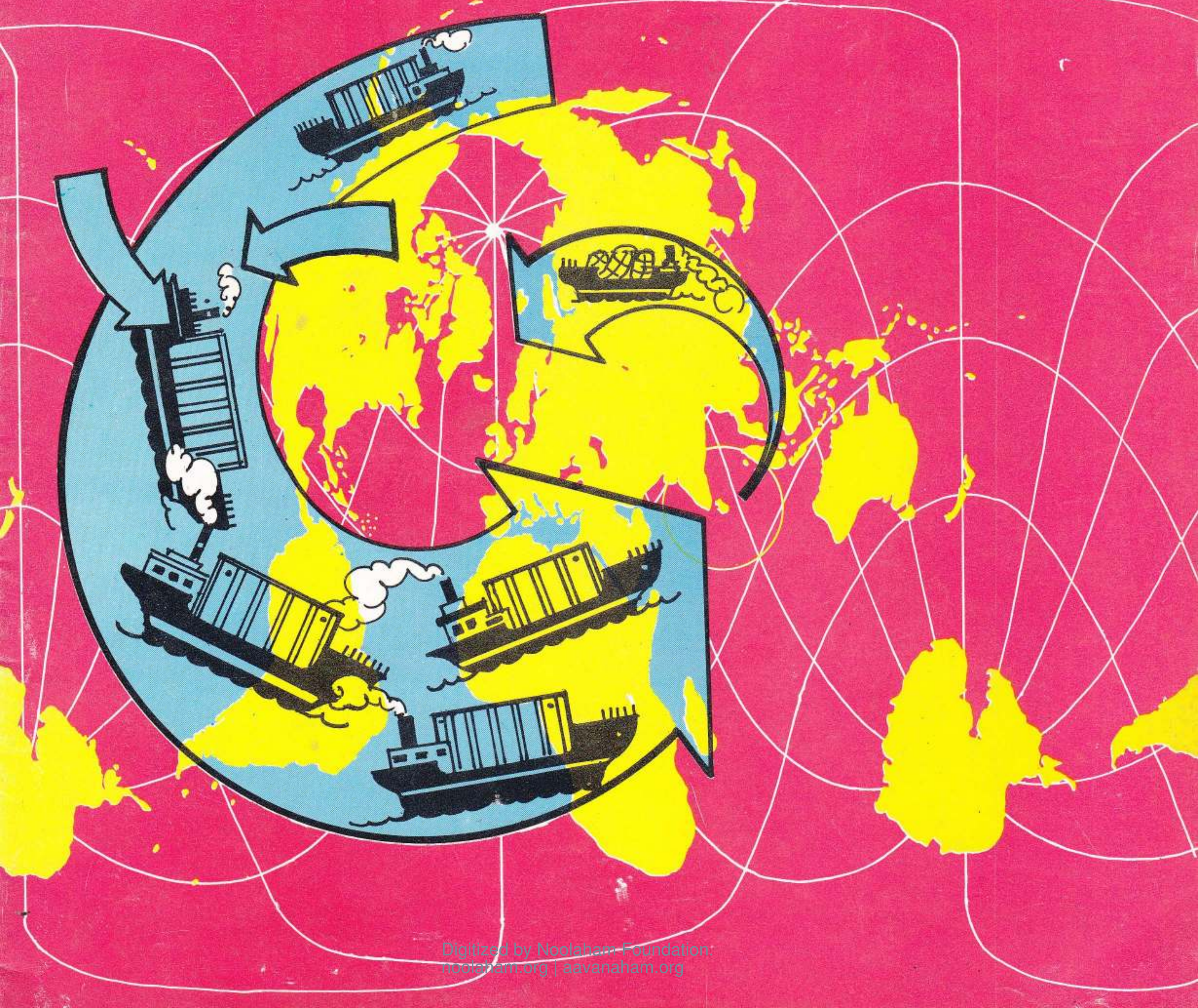
ECONOMIC REVIEW

July/August

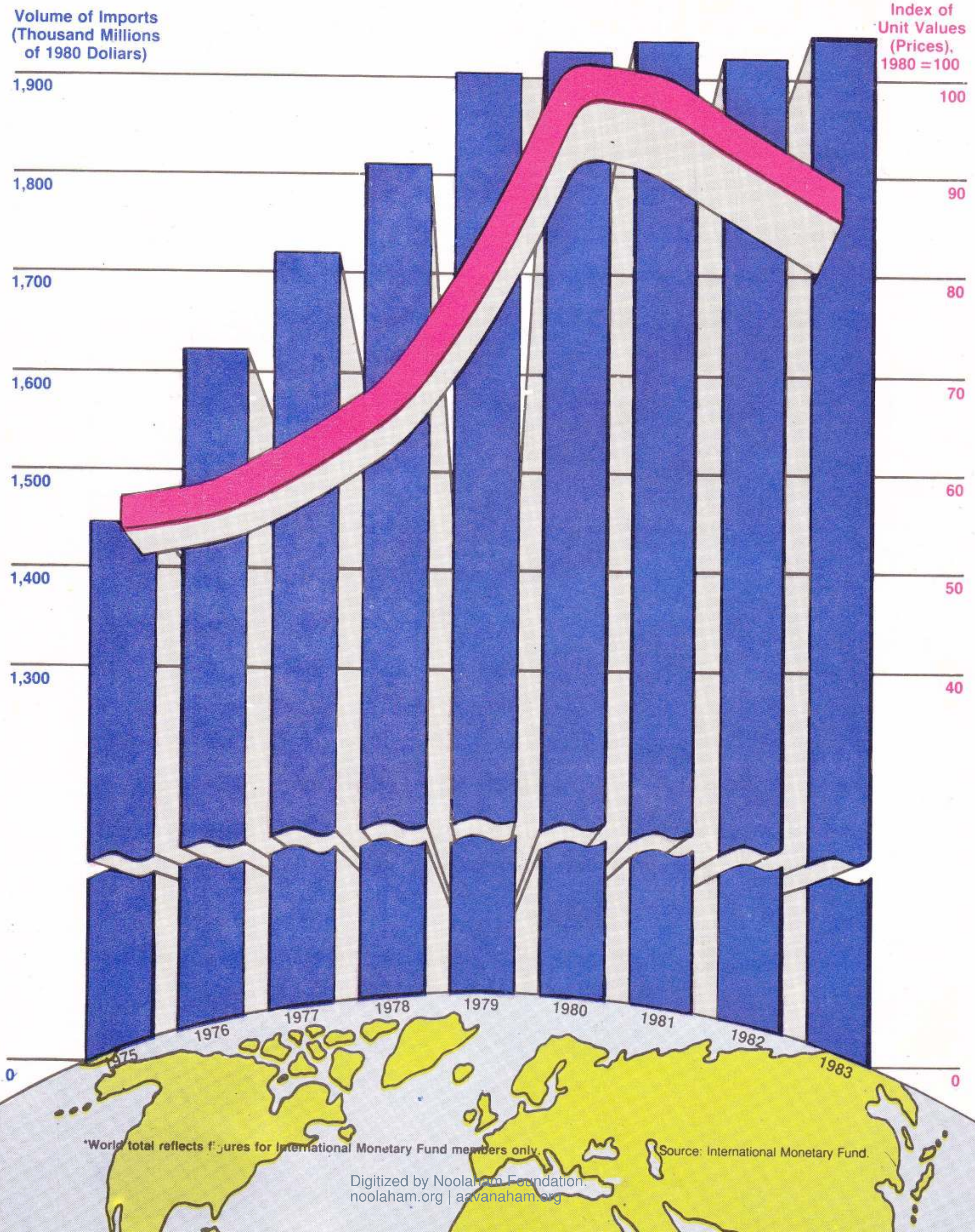
1984

# EXPORT DEVELOPMENT

26



## WORLD TRADE TRENDS*



*World total reflects figures for International Monetary Fund members only.

Source: International Monetary Fund.

# ECONOMIC REVIEW

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### SPECIAL REPORT

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.

### NEXT ISSUE

- The Mahaweli Project: six years of development on the headworks
- Chemical engineering and the chemical industry in the economy of Sri Lanka.
- The need for a more orderly and equitable financial system

**COVER DESIGN**
Gibson P. Athulathmudali

June

21 The annual Aid Group meeting held in Paris under the chairmanship of the World Bank pledged US $ [illegible] million for Sri Lanka in 1984-85 which is a [illegible] per cent increase over the total pledged last year of $ [illegible] million. Of the total pledge of $ [illegible] million, food and commodity aid [illegible] $ [illegible] million, aid for the Mahaweli Project [illegible] $ [illegible] million and aid for [illegible] Government development work amounts to $ [illegible] million.

[illegible] Letters were exchanged between the Governments of Sweden and Sri Lanka for [illegible] grants totalling [illegible] [illegible] million [illegible] of which [illegible] million is for the [illegible] Project and the balance for [illegible] and Integrated Rural Development. [illegible] [illegible] the introduction of energy [illegible] techniques [illegible] the [illegible] of energy utilization in Sri Lanka.

29 Letters were exchanged between the Governments of Canada and Sri Lanka providing for a grant [illegible] Canadian dollars [illegible] million [illegible] [illegible] [illegible] three years [illegible] the purchase and transport [illegible] from Canada. The [illegible] funds [illegible] will be [illegible] to meet the local cost of the Accelerated Mahaweli Development Programme [illegible] in Sri Lanka.

30 At the end of June 1984 the Cost of Living Index figure (Colombo Consumers' Price Index) [illegible] compiled by the Department of Census and Statistics [illegible] [illegible] as against [illegible] at the end of [illegible] 1984 and [illegible] at the end of April 1983.

July

1 The Ceylon Petroleum Corporation signed an agreement with Sinochem of the People's Republic of China for the purchase of [illegible] metric tons of [illegible] [illegible] according to the Chairman of the CPC.

[illegible] The National Savings Bank (NSB) reduced its deposit rates from 20 to 18 per cent per annum. The interest rate on [illegible] fixed deposits was reduced by one percentage point to 14 per cent per annum. This reflected a deviation from the [illegible] of fixing deposit rates with the approval of the Ministry of Finance and Planning. The NSB was given a greater degree of flexibility in fixing its deposit and lending rates in view of the [illegible] collection in the Government's reliance on NSB funds.

[illegible] The [illegible] [illegible] [illegible] for the first six months of this year [illegible] an all time high of Rs. [illegible] million as against Rs. [illegible] million for the same period last year, which is a [illegible] [illegible] [illegible].

[illegible] [illegible] [illegible] [illegible] [illegible] is [illegible] [illegible] of [illegible] [illegible] workshops for [illegible] [illegible] the CTB has urgently [illegible] Government for [illegible] million [illegible] [illegible] on the road, according to an official statement.

The Food Commissioner increased the [illegible] [illegible] price of sugar by 40 cents to Rs. [illegible] per kilogram.

The price of [illegible] [illegible] was increased from Rs. [illegible] to Rs. [illegible] per [illegible].

26 The Government announced a [illegible] [illegible] of [illegible] [illegible] Rs. [illegible] per kilogram. This [illegible] is intended to provide relief to producers in the context of a decline in [illegible] market prices and [illegible] costs of production. The [illegible] [illegible] from this [illegible] for 1984 is estimated at Rs. [illegible] million.

31 At the end of July 1984 the Cost of Living Index figure (Colombo Consumers' Price Index) [illegible] compiled by the Department of Census and Statistics [illegible] [illegible] as against [illegible] at the end of [illegible] 1984.

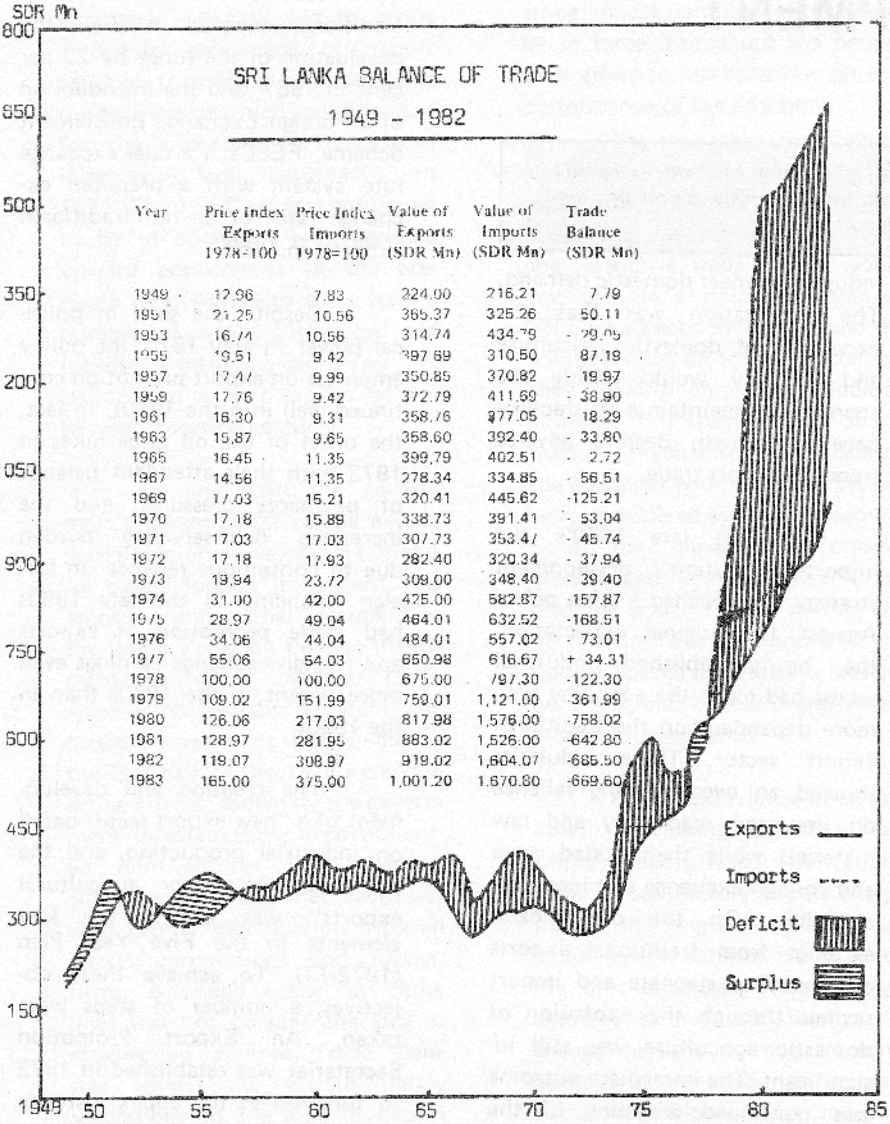
August

1 The interest rate on Government [illegible] [illegible] [illegible] 13 per cent per annum with a maturity period of [illegible] years. This [illegible] was made with a view to [illegible] funds on the Government's [illegible] [illegible] programme. The rate on Government [illegible] before this change was 14 per cent per annum with a maturity period of [illegible] years.

2 Letters were exchanged with the European Economic Community (EEC) providing for a grant of 20 million European Currency Units (approximately Rs. [illegible] million) to meet the cost of the [illegible] Rural Development [illegible] in [illegible] 2 & 3 of [illegible] [illegible] of the Accelerated Mahaweli Development Programme.

3 Letters were exchanged between the Governments of Canada and Sri Lanka for a [illegible] of Canadian dollars [illegible] (approximately Rs. [illegible]) [illegible] [illegible] techniques for the production and marketing of [illegible] and vegetables [illegible] for small scale farmers in the [illegible] and a [illegible] of Canadian dollars [illegible] million (approximately Rs. [illegible] million) [illegible] by the Canadian International Development Agency (CIDA) for [illegible] [illegible] [illegible] [illegible].

8 Letters were exchanged between the Norwegian Agency for International Development (NORAD) and the Government of Sri Lanka providing for a grant of Norwegian Kroner [illegible] million (approximately Rs. [illegible] million) for the strengthening of environmental pollution control measures and the [illegible] of [illegible] Environmental Agencies.



SRI LANKA BALANCE OF TRADE

1949 - 1982

| Year | Price Index Exports 1978-100 | Price Index Imports 1978=100 | Value of Exports (SDR Mn) | Value of Imports (SDR Mn) | Trade Balance (SDR Mn) |
|---|---|---|---|---|---|
| 1949 | 12.96 | 7.83 | 224.00 | 216.21 | 7.79 |
| 1951 | 21.25 | 10.56 | 365.37 | 325.26 | 50.11 |
| 1953 | 16.74 | 10.56 | 314.74 | 434.79 | - 29.05 |
| 1955 | 19.51 | 9.42 | 397.69 | 310.50 | 87.19 |
| 1957 | 17.47 | 9.99 | 350.85 | 370.82 | - 19.97 |
| 1959 | 17.76 | 9.42 | 372.79 | 411.69 | - 38.90 |
| 1961 | 16.30 | 9.31 | 358.76 | 377.05 | - 18.29 |
| 1963 | 15.87 | 9.65 | 358.60 | 392.40 | - 33.80 |
| 1965 | 16.45 | 11.35 | 399.79 | 402.51 | - 2.72 |
| 1967 | 14.56 | 11.35 | 278.34 | 334.85 | - 56.51 |
| 1969 | 17.03 | 15.21 | 320.41 | 445.62 | -125.21 |
| 1970 | 17.18 | 15.89 | 338.73 | 391.41 | - 53.04 |
| 1971 | 17.03 | 17.03 | 307.73 | 353.47 | - 45.74 |
| 1972 | 17.18 | 17.93 | 282.40 | 320.34 | - 37.94 |
| 1973 | 19.94 | 23.72 | 309.00 | 348.40 | - 39.40 |
| 1974 | 31.00 | 42.00 | 425.00 | 582.87 | -157.87 |
| 1975 | 28.97 | 49.04 | 464.01 | 632.52 | -168.51 |
| 1976 | 34.06 | 44.04 | 484.01 | 557.02 | - 73.01 |
| 1977 | 55.06 | 54.03 | 650.98 | 616.67 | + 34.31 |
| 1978 | 100.00 | 100.00 | 675.00 | 797.30 | -122.30 |
| 1979 | 109.02 | 151.99 | 759.01 | 1,121.00 | -361.99 |
| 1980 | 126.06 | 217.03 | 817.98 | 1,576.00 | -758.02 |
| 1981 | 128.97 | 281.95 | 883.02 | 1,526.00 | -642.80 |
| 1982 | 119.07 | 308.97 | 919.02 | 1,604.07 | -685.50 |
| 1983 | 165.00 | 375.00 | 1,001.20 | 1.670.80 | -669.60 |

# EXPORT DEVELOPMENT

Export earnings have been a vital factor in determining the pace and stability of growth of Sri Lanka's economy and also the incomes and living standards of her people. The geographical location of the country, its resource endowment and size and the urgency to contain the widening resources gap have made it absolutely essential to accelerate export growth. The Government firmly upheld this view after 1977 and the policy changes introduced since then resulted in a liberalisation of trade with greater emphasis on exports and a free inflow of imports. But the measures adopted in pursuing these policies and the economic environment have not been sufficiently conducive to development of exports and achieving the intended goals.

A significant initial measure in the new policy objectives was the enactment of the Sri Lanka Export Development Act No. 40 of 1979 which made it a statutory requirement to prepare a National Export Development Plan. In terms of this requirement the Export Development Board initiated this work and with the assistance of specialised committees formulated a Plan to cover the period 1983 - 1987. The importance of exports and the major problems encountered by the export sector are summed up as follows in the Plan.

On the importance of exports it states "Export contribute one-third of the gross Domestic Product, one-quarter of the employment generated and about one-fifth of Government revenue. A change in exports affects almost all the other sectors of the economy; and a decline in exports has inevitable repercussions on domestic investment, the production of consumer goods and on the revenue and expenditure of the Government. The country is critically dependent on her export earnings for almost all her requirements of investment goods and a substantial proportion of essential consumer goods

Exports also determine to a large extent the level of activity in the modern industrial sector. Although over the years the economy has become more and more diversified and widened, exports still remain an important determinant of economic growth and have a marked impact on the general well being and living standards of the people. Sound export performance is therefore vital for the stability and the long-tern development of the Sri Lanka economy. Exports are also vital for a favourable balance of payments situation. While some scope exists for import substitution, particularly in agriculture, the location, resource endowment and size of Sri Lanka limits the scope for efficient import substitution".

A general overview of the export sector and its significance for Sri Lanka's economy and a detailed discussion of export policies and their impact appear in the paper on the following pages.

Drawing attention to specific problem areas in this sector the Plan makes several such forthright comments; "Two main factors affect the capability of exporting goods from a country; they are quality and costs or profitability. It is a fact that Sri Lanka has lost ground in the world markets whereas its competitors have made substantial gains even in products where Sri Lanka possesses greater natural advantages. During the last few years the cost of production in Sri Lanka has increased steadily not only increasing the price of the commodity but also reducing substantially the profit margins of producers and manufacturers. The problem has been aggravated by the rapid lowering the quality of most of its products. In addition, Sri Lanka has not been able to make any significant advance with new products or new markets.

# EXPORT DEVELOPMENT

## Policies and Achievements

Premachandra Athukorale

*Dr. Premachandra Athukorala [illegible] PhD from La Trobe University [illegible] Trade [illegible] Department of Commerce [illegible] Management [illegible] University.*

### HISTORICAL BACKGROUND

The economic structure Sri Lanka inherited from the colonial past at her political independence in 1948 was typical of a colonial "export economy". The growth momentum of the economy was heavily dependent on the fortunes of the three primary export products : tea, rubber and coconut. These three items together accounted for about 97 per cent of total export earnings. They directly contributed about 40 per cent of the Gross National Product (GNP) while their indirect contribution via associated supportive services was substantial. Nearly 50 per cent of Government revenue came from export taxes.

Ever since the end of the second World War, there were indications that unfavourable structural changes were taking place in world demand for traditional exports, notably tea and rubber, with possibilities of adverse repercussions on Sri Lanka's long-term growth prospects. For instance, the World Bank economic mission which visited the country in 1951 reported that, "the old momentum in the export sector is unlikely to be maintained". However, during the post-independence period upto about late 1960, no steps were taken towards diversifying the export structure and be ready with new products in order to face the future challenges. Throughout this period the emphasis of the development policy was on "import substitution" - the development of domestic agriculture and industry to meet domestic demand. The expectation was that the expansion of domestic agriculture and industry would enable the economy to maintain a satisfactory pace of growth despite adverse trends in export trade.

By the late 1960's, the import-substitution development strategy had reached a crisis point. Against the original expectation, the newly-established industrial sector had made the economy even more dependent on the traditional export sector. These industries showed an overwhelming reliance on imported machinery and raw materials while their added value and foreign exchange earnings were negligible. On the other hand earnings from traditional exports continued to stagnate and import savings through the expansion of domestic agriculture was still insignificant. The immediate outcome was continued widening of the balance of payments deficit which led to unanticipated import curtailments, with adverse repercussions on the growth momentum of the economy.

These circumstances generate a new emphasis on export diversification from the mid 1960's leading to a number of policy revisions within the existing import-substitution policy framework. The policy measures included the establishment of an import duty rebate scheme (a scheme to refund import duties paid on imported inputs used in export production) from December 1964, introduction of a Bonus Voucher Scheme (an import-entitlement scheme for selected non-traditional exports) in 1966, the devaluation of the rupee by 20 per cent in 1967, and the introduction of a Foreign Exchange Entitlement Scheme, FEECs, ( a dual exchange rate system with a premium exchange rate for all non-traditional exports) in 1968.

Despite the shift in political power in May 1970, the policy emphasis on export promotion continued well into the 1970s. In fact, the onset of the oil price hikes in 1973 with their attendant balance of payments pressures, and the increasing debt-servicing burden due to continuous reliance on foreign financing in the late 1960s had made promotion of exports and foreign exchange earnings even more urgent in the 1970s than in the 1960s.

The creation and development of a "new export sector based on industrial production, and the promotion of minor agricultural exports" was among the key elements in the Five Year Plan (1972-77). To achieve these objectives, a number of steps were taken. An Export Promotion Secretariat was established in 1972 to function as the apex institute of directing and co-ordinating the export development effort of the country. The State Gem Corporation was set up in 1971 with the objectives of promoting gem exports and channelling illegal gem exports into institutional sources. A replanting and new planting subsidy scheme, compiled with provision of extension services, was introduced for selected minor agricultural export crops under the newly established Department of Minor Export Crops. These institutional arrangements apart, a new export incentive scheme - the Convertible Rupee Account (CRA) Scheme - (an import entitlement scheme under which non-traditional exporters were allowed to credit a certain percentage of export earnings to specific bank accounts the balances of which could be used for the importation of restricted imports) - was inaugurated in 1971. The FEEC scheme continued to be in operation with periodic upward adjustments in the premium rate. Added to these were a number of newly introduced tax incentives including an 8-year tax holiday on export profits of approved exporting ventures.

In line with the government's commitment to the export diversification drive, export-oriented direct foreign investment was accorded preferential treatment in the White Paper on Foreign Investment issued in August 1972. Another noteworthy feature of the foreign investment policy during the first half of the 1970's was the active interest shown by the government in establishing export-oriented joint-ventures (for example, Noritake and Wall-tiles factories) with capital participation between public corporations and foreign firms. Although action on those lines was not pursued the idea of establishing a Free Trade Zone was among the various policy suggestions in the area of export promotion embodied in the Five-Year Plan.

## POLICY REFORMS SINCE 1977

Export promotion attempts pursued since the late 1960's in fact, brought about noteworthy results in the field of non-traditional exports (See Section on Overall Export Trends). However, the rate of export expansion achieved was highly inadequate when compared with the magnitude of the balance of payments disequilibrium brought about by escalating import prices and the poor performance of the traditional export sector. Therefore, strice import controls continued to be in force throughout the period with adveerse repercussions on the performance of the economy.

The new government which came into power in May 1970 was strongly convinced that piecemeal adjustments within the existing restrictive trade regime would not provide a lasting solution to Sri Lanka's economic crisis, and the solution must be found in a radical shift towards an outward looking strategy. The strengthening of the market mechanism and linking the economy with the world system were considered essential pre-conditions for enhancing economic growth and development. A far-reaching policy reform in this line of thinking was announced in the Budget Speech presented in November 1977, and further changes were affected subsequently.

As the experience of certain other developing countries has amply demonstrated, the attainment of satisfactory export expansion is the single most important factor which determines the viability of the outward-oriented development strategy. If foreign exchange receipts do not, at some point, start growing at a rate sufficiently higher than the rate of growth of demand for imports, the country might be forced to fall back on quantitative restrictions in order to contain foreign exchange expenditure at levels permitted by foreign exchange receipts. While private foreign capital inflows and aid receipts can offset a deficit in the trade balance, their rate of growth is closely related to how well export earnings are performing. Under the new policy reforms, export development has therefore been accorded the highest priority in the overall development programme.

The major elements of the policy mix such as the removal of quantitative controls on most imports (trade liberalisation), considerable relaxation of control on many types of exchange payments, replacement of the dual exchange rate system by a unified floating exchange rate, and elimenation of various controls on the domestic economy are aimed, among other things, at generating an economic climate which is conducive for export expansion through private sector initiative. For instance, the abolition of import controls is expected to ensure the timely availability of imported inputs and machinery for export production at competive prices.

Also fair competition under liberalised trade may enhance quality consciousness of local producers enabling them to compete successfully in foreign markets. The relaxation of exchange control on business travel may promote market research and marketing efforts in foreign markets. The maintenance of a realistic external value for the Sri Lankan rupee through an exchange rate reform is expected to preserve and enhance price competitiveness of exports. However, in a country with hardly any tradition of exporting other than a handful of primary products and which still has a strong import substitution bias inherited from the past, the mere improvement of the general economic climate cannot by itself generate the desired export push. On these considerations a number of policy steps directly aimed at export development have been introduced as an integral part of the policy reform. These measures are briefly discussed below:

### Institutional Resources

In order to establish a sound institutional background under which the commitments of the government to the export development drive at the highest political level could be ensured, the Export

Development Act No. 40 was enacted by the National State Assembly in 1979. The Act provided for the establishment of two pivotal institutions : the Export Development Council of Ministers, and the Sri Lanka Export Development Board (EDB).

The Export Development Council of Ministers, which functions under the Chairmanship of the President, has the assigned task of providing guidance and direction to the national export development effort. The EDB, which replaced the Export Promotion Secretariat, is the "Executive arm" of the Export Development Council of Ministers. Its functions include advising the Council on export development policies, formulating export development programmes and monitoring their implementation and the co-ordination of the activities of various government bodies responsible for various aspects of export development.

### Export Oriented Direct Foreign Investment

The success of an export-led development strategy depends crucially on the ability of domestic industries to penetrate advanced-country markets. It is believed that product expertise and marketing skill gained through foreign collaboration has an important role to play in this connection. Guided by this belief, a number of policy steps, have been taken to provide an environment conducive to foreign investment. The setting up of the Greater Colombo Economic Commission (GCEC) in 1978 with the assigned task of establishing and operating Investment Promotion Zones, relaxation of traditional norms with respect to foreign participation in export-oriented projects, entering into Investment Protection Agreements and Double Taxation Relief Agreements with major investing countries and guaranteeing such agreements under Article 157 of the Constitution of Sri Lanka, and launching investor promotion campaigns abroad. Further details on policies of export-oriented direct foreign investment may be seen in Economic Review (Special Issue on the Katunayake IPZ - Vol. 8 No.3, July 1982).

### Tax Concessions for Exporters

As already noted, an eight-year tax holiday for companies in the field of non-traditional exports was introduced in 1972. However, from 1976 this concession remained virtually inactive because of the decision to limit it only to "broad based" companies. As an element of the new tax reforms introduced in November 1978, all companies set up (on or after 16.11.1978) for the exportation of non-traditional exports were made eligible for a new five year tax holiday. As a further step, by the 1983 Budget the export sector was singled out for special treatment by announcing that the five-year tax holiday would be continued beyond 31.3.83 only for this sector. (Upto this date other companies involved in other activities such as the tourist industry, import substitution production and construction were also eligible for similar, or even more attractive tax concessions).By the 1984 Budget this concession was extended to cover individual entrepreneurs and partnerships too (in addition to companies).

With effect form the 1978/1979 tax year, the full cost of advertising and the sales promotion activities, and travelling expenses in connection with promotion of non-traditional exports have been made deductable in calculating taxable income. Under the Turnover Tax Rebate Scheme which came into force in April 1982, goods or material imported for export production are exempted from import turnover tax. In addition to these, over the past six years steps have been taken either to completely abolish or to reduce considerably export duties on non-traditional agricultural products.

### Special Export incentives and other Assistance to Selected Product Sectors

Various financial incentives and, assistance in product development and export marketing provided by the EDB, export financing facilities provided by the Central Bank, and various export insurance schemes of the Sri Lanka Export Credit Insurence Corporation come under this category.(See Box on Financial Incentives).

## OVERALL EXPORT TRENDS

Table I presents data pertaining to the overall export performance of Sri Lanka over the period 1960-83. Throughout the period upto 1973 export earnings (in current SDR terms*) in all the years but 1964 and 1965 were below the level in 1960. (Column 2) Since then an upward trend was recorded with the onset of the recent world commodity boom. However, with the cessation of the boom, the growth momentum has slowed down. For instance, the average annual compound growth in 1978-1983 was 8.2 per cent compared with 18.5 per cent in 1972 - 1977. The analysis of growth in current terms is, in any case, misleading since the bulk of value increases in recent years reflects of constant, export volume column (4), the export behaviour indicates

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* A rupee value export data series is inappropriate for an analysis because of drastic variations in the external value of the rupee in recent years. It is necessary therefore to covert this series into a stable foreign currency. The most stable currency unit one can use for this purpose is the SDR (Special Drawing Rights).

a rather erratic pattern. Since the middle of the 1960s, the real export index has been on the decline with only minor upward deviations in a few years. The overall conclusion is that there has been no steady acceleration as far as overall export performance is concerned.

From the point of view of the external payments position of a country, what is more important than the level (current or real) of export earnings is the import purchasing power of export earnings. The index constructed to indicate the behaviour of import purchasing power**of Sri Lankan export earnings is given in column 8 of the Table. The index has declined over most of the years under study, while the annual rate of decline has accelerated in recent years. Import purchasing power in 1983 was only 30 per cent of what prevailed in 1960.

$$\text{** Import Purchasing Power} = \frac{\text{Export Value}}{\text{Import Price}}$$

$$= \frac{\text{Export Volume} \times \text{Export Price}}{\text{Import Price}}$$

$$\left(\text{Where, } \frac{\text{Export Price}}{\text{Import Price}} \text{ is the Terms of Trade}\right)$$

$$= \text{Export Volume} \times \text{Terms of Trade}$$

Import purchasing power is the product of export volume and the terms of trade (the ratio of

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Table 1

## BASIC DATA ON SRI LANKA'S OVERALL EXPORT PERFORMANCE 1960-83

| Year | Export Values in Current SDR | | Export Volume Index | Export Unit Value Index | Import Unit Value Index | Terms of Trade Index (a) | Purchasing Power of Exports (b) |
|---|---|---|---|---|---|---|---|
| (1) | '000 SDR (2) | Index (3) | (4) | (5) | (6) | (7) | (8) |
| 1960 | 384,712 | 100 | 100 | 100 | 100 | 100 | 100 |
| 1961 | 368,923 | 95 | 103 | 94 | 100 | 94 | 95 |
| 1962 | 379,672 | 99 | 141 | 94 | 100 | 94 | 99 |
| 1963 | 363,503 | 94 | 107 | 94 | 111 | 85 | 85 |
| 1964 | 393,952 | 102 | 116 | 94 | 133 | 71 | 77 |
| 1965 | 409,454 | 106 | 121 | 94 | 122 | 77 | 87 |
| 1966 | 357,143 | 93 | 110 | 88 | 122 | 72 | 76 |
| 1967 | 355,042 | 92 | 114 | 81 | 131 | 62 | 70 |
| 1968 | 342,017 | 89 | 117 | 80 | 124 | 65 | 72 |
| 1969 | 322,017 | 84 | 112 | 80 | 133 | 60 | 63 |
| 1970 | 341,681 | 89 | 116 | 80 | 142 | 56 | 62 |
| 1971 | 327,227 | 85 | 113 | 80 | 154 | 53 | 56 |
| 1972 | 296.313 | 77 | 111 | 70 | 140 | 50 | 55 |
| 1973 | 342,988 | 89 | 112 | 73 | 166 | 44 | 54 |
| 1974 | 432,370 | 112 | 97 | 109 | 278 | 39 | 40 |
| 1975 | 466,047 | 122 | 116 | 97 | 308 | 31 | 39 |
| 1976 | 494,856 | 129 | 111 | 98 | 240 | 41 | 54 |
| 1977 | 637,021 | 166 | 102 | 148 | 274 | 54 | 61 |
| 1978 | 674,478 | 175 | 109 | 143 | 270 | 53 | 65 |
| 1979 | 758,697 | 197 | 110 | 153 | 402 | 38 | 49 |
| 1980 | 802,649 | 209 | 108 | 162 | 528 | 31 | 40 |
| 1981 | 891,001 | 232 | 111 | 159 | 657 | 24 | 35 |
| 1982 | 919,234 | 239 | 122 | 144 | 704 | 20 | 34 |
| 1983 | 997,456 | 259 | 118 | 199 | 854 | 23 | 30 |

Note : Unit value indexes are in terms of SDRs. The rupee indexes have been converted into SDR using annual average SDR- rupee exchange rates obtained from the Annual Report of the Central Bank of Ceylon. All indexes, which are on a 1978 base in the original source, have been transferred to a 1960 base.

(a) The ratio of export unit value index to import unit value index ( (5)/(6) x 100)

(b) The ratio of the value of exports to the unit value of imports ( (3)/(6) x 100)

Source ; *Sri Lanka Customs Returns (for export value) and Central Bank of Ceylon, Review ofthe Economy (for all trade indexes).*

average export price to average import price). Escalation of import prices (notably since the onset of the oil crisis in 1972) in the face of declining or slow moving export prices, resulted in a sharp deterioration in the terms of trade throughout the period under study. On the other hand, export volume stagnated. The cumulative outcome of these movements was the sharp erosion of the import purchasing power of the economy. It is well known that Sri Lanka has almost no control over import prices, and almost none over export prices. But in the long run, she does have a considerable degree of control over export volume. Therefore it is not logical to place the blame for the decline in import purchasing power only on extraneous world market forces. A significant portion of the explanation for these adverse movements must be found in the nature of export policy pursued.

The essential corollary to the erosion of import purchasing power has been the decline in the percentage contribution of export earnings to total expenditure on the import bill. In the years 1970 - 77, on the average, earnings from merchandise exports contributed around 90 per cent of the country's total import outlay. This high percentage is, in fact, misleading in view of strict import controls prevalent during this period. With the liberalization of import trade in November 1977, the inadequacy of the degree of export expansion, compared with the country's import demand, has become obvious. For instance, in 1978 about 85 per cent of imports was financed through export earnings. Since then this percentage declined continuously reaching only 56 in 1983. The major portion of the remaining gap was filled through recourse to foreign financing which invariably has a negative impact on future import capacity of the economy by way of "debt servicing payments" (repayments of loans plus payment of interest thereon). The debt service ratio ( the ratio of debt repayments and interest payments to total export earnings) increased from 12.4 in 1980 to 21.8 in 1982. The major portion of foreign finance (about 85 per cent on average) obtained during 1978- 83 was long-term debts the amortisation of most of which is due to commence in 3 to 5 years (Central Bank of Ceylon, Annual Report 1983, p. 92). Therefore the debt service

Table 2

### SRI LANKA'S EXPORT PERFORMANCE IN A WORLD CONTEXT

| Year | Merchandise Exports (US '000) | | | Sri Lanka's share in | | Share in World Exports |
|---|---|---|---|---|---|---|
| | World | NO-DC | Sri Lanka | World Exports | Exports of NO-DC* | No-DC* share in world exports |
| 1950 | 57,420 | 17,581 | 328 | 0.566 | 1.864 | 30.371 |
| 1955 | 85,520 | 21,380 | 407 | 0.476 | 1.903 | 25.000 |
| 1960 | 115,520 | 24,676 | 111 | 0.366 | 1.665 | 21.356 |
| 1965 | 168,000 | 32,027 | 409 | 0.243 | 1.277 | 19.063 |
| 1966 | 184,600 | 34,720 | 357 | 0.193 | 1.028 | 18,806 |
| 1967 | 197,700 | 35,239 | 348 | 0.176 | 0.987 | 11,874 |
| 1968 | 216,200 | 37,686 | 342 | 0.158 | 0.907 | 17,432 |
| 1969 | 247,900 | 42,275 | 322 | 0.128 | 0.761 | 17.080 |
| 1970 | 284,900 | 46,519 | 342 | 0.120 | 0.735 | 16.334 |
| 1971 | 319,700 | 48,777 | 344 | 0.107 | 0.705 | 15.257 |
| 1972 | 378,800 | 58,244 | 337 | 0.089 | 0,578 | 15,376 |
| 1973 | 527,400 | 84,672 | 410 | 0.077 | 0.484 | 16.066 |
| 1974 | 779,700 | 121,479 | 527 | 0.067 | 0,433 | 15,580 |
| 1975 | 804,600 | 118,668 | 566 | 0.070 | 0.477 | 14.736 |
| 1976 | 916,700 | 139,476 | 570 | 0.062 | 0.408 | 15.215 |
| 1977 | 1041,500 | 164,7272 | 763 | 0.072 | 0,457 | 15,816 |
| 1978 | 1199,800 | 198,084 | 846 | 0.070 | 0.440 | 16.676 |
| 1979 | 1624,100 | 246,085 | 981 | 0.064 | 0.400 | 15.061 |
| 1980 | 1868,300 | 312,021 | 1,074 | 0.067 | 0,344 | 16,701 |
| 1981 | 1837,200 | 323,932 | 1,066 | 0,067 | 0.328 | 17.826 |

* NO DC: Non-oil Developing Countries

Source: *IMF, International Financial Statistics, Supplement on Internal Trade Data, 1982.*

## Table 3

### ANNUAL AVERAGE EXPORT GROWTH RATES AT CURRENT SDR PRICES, 1965-69, 1970-77 AND 1978-82

| | | *Average annual growth rates* | | |
|---|---|---|---|---|
| | | *1965-69* | *1970-77* | *1978-82* |
| 1. | Primary Products | -5.95 | 12.43 | 0.68 |
| 1.1 | Traditional Agricultural Products | -6.35 | 6.74 | -1.46 |
| | a. Tea | -4.62 | 10.08 | -3.62 |
| | b. Rubber | 4.62 | 11.91 | 3.94 |
| | c. Coconut Kernel Products | 4.40 | 9.42 | 14.74 |
| 1.2 | Non-Traditional Primary Products | 0.32 | 13.81 | 16.02 |
| | a. Coconut by-products | -4.35 | 10.43 | 9.84 |
| | b. Spices | 3.60 | 11.37 | 15.32 |
| | c. Other Agricultural Products | 9.37 | 7.32 | 65.23 |
| | d. Minerals | -6.21 | 65.72 | 2.78 |
| | Gems | -53.93 | 213.65 | 11.66 |
| | Graphits | 5.27 | 8.55 | 12.12 |
| | Other | - | 112.52 | 87.54 |
| 2. | Manufactured Goods (including petroleum products) | 9.77 | 78.22 | 32.22 |
| | Manufactured Goods (excluding petroleum products) | 9.17 | 51.71 | 53.42 |
| 2.1 | Food, Beverages and Tobacco | 70.90 | 56.54 | 15.38 |
| 2.2 | Textile, Wearing Apparel & Leather Industries | 50.20 | 65.21 | 65.64 |
| | a. Garments | 58.18 | 62.75 | 65.98 |
| | b. Leather products/footwear | 0.23 | 0.09 | 0.02 |
| 2.3 | Chemical, Rubber & Plastic Products | -3.17 | 26.81 | 12.78 |
| | a. Chemicals | -3.17 | 25.23 | 9.14 |
| | b. Rubber Goods | - | 28.35 | 25.32 |
| 2.4 | Petroleum Products | - | 144.06 | 23.92 |
| 2.5 | Non-Metalic Mineral Products (Ceramic-ware and wall-tiles) | -4.92 | 272.28 | 20.74 |
| 2.6 | Machinery and Equipment | 19.94 | 120.30 | 20.52 |
| 2.7 | Other Manufacturing | 5.15 | 39.07 | 110.53 |
| 3. | Unclassified exports | 0.15 | 39.17 | 31.16 |
| 4. | Total domestic merchandise exports ('000 SDR) | -5.83 | 9.84 | 7.31 |

Notes : (a) Exclusing processed tea (tea bags and instant tea
(b) Including processed tea (tea bags and instant tea.
(c) Data series starts in 1968
(d) Data series starts in 1970.
(e) Data series starts in 1972

Source: *Compiled from Sri Lanka Customs Returns (Annual Issues, 1965-82).*

ratio is bound to increase at a rapid rate unless a major break through occurs in the export front. Given invariable institutional limitations on the availability of foreign finance and increasing debt sercive burden, it has now become obvious that "Sri Lanka cannot expect to achieve its development goals while maintaining a relatively liberalized system of trade, unless our exports increase rapidly. "(Budget Speech, 1983, p.35).

### SRI LANKA'S SHARE IN WORLD TRADE

When Sri Lanka's exports are examined in the global context, the most striking feature one would note is the continuous decline in her export share both in world exports as well as in exports from "non-oil" developing countries (Table 2), while world exports (in dollar terms) grew by 146 per cent between 1960 and 1970, and by 475 per cent between 1970 and 1981, Sri Lanka's exports recorded a negative growth rate of 17 per cent in the former period and a less impressive growth rate of 210 per cent in the latter. As a result, Sri Lanka's share in world exports declined from 0.355 per cent in 1960 to 0.120 per cent in 1970 and to 0.057 per cent in 1981.

While world exports grew by 475 per cent between 1970 and 1981, exports of non-oil developing countries grew by 553 per cent. As a result the export share of the latter had increased from 15 per cent in 1971 to 18 per cent in 1981. The most striking feature to be noted is that, Sri Lanka has continued to lag behind the non-oil developing countries as a group. For instance, her share in total exports of this group declined from 1.864 per cent in 1950 to 0.735 per cent in 1970, and to 0.328 per cent in 1981. It is worth noting that Sri Lanka could not show any notable sign of improvement in her relative position even in the period 1974-77 when her two major export items - tea and rubber - experienced highly favourable market prices.

## THE PATTERN OF EXPORT GROWTH

The unequivocal conclusion of the previous section is that Sri Lanka's aggregate export performance lagged behind both her own import requirements and the global export experience during the period under study. We now turn to a more detailed analysis of the export structure in an attempt to identify stagnant export items and growing items, and their relative contribution to the observed overall pattern.

The data required for the analysis are summarised in Tables 3 and 4. In compiling these tables the overall time period, 1965-81, has been divided into three sub-periods, with a view to highlighting the impact (if any) of recent policy shifts on the export pattern. Table 3 is based on current SDR values. In a comparative analysis of this nature, current value figures might lead to distorted interpretations because the impact of world inflation has been considerably uneven across various commodities. Therefore the current price growth rates will be supplemented with constant price (real) growth rates as given in Table 4.

Table 4
ANNUAL AVERAGE EXPORT GROWTH RATES AT CONSTANT (1980) PRICES

| Comodity Category | Annual Average Growth Rate % | | |
|---|---|---|---|
| | 1965-69 | 1970-77 | 1978-82 |
| Traditional Primary Products | -1.14 | 1.90 | 1.89 |
| Tea | 2.24 | -0.26 | -0.23 |
| Rubber | 9.69 | 4.94 | -3.0 |
| Coconut Kernel Products | 5.86 | 3.50 | 28.43 |
| Non-Traditional Primary Products | 2.00 | 7.15 | -8.22 |
| Coconut By-products | 0.53 | 3.29 | 1.36 |
| Spices | 3.56 | 18.23 | 3.44 |
| Other Agricultural Products | 15.42 | 10.71 | 32.28 |
| Minerals | 2.29 | 53.10 | -20.55 |
| Gems | 4.14 | 82.14 | -22.54 |
| Others | 5.72 | -0.69 | 8.37 |
| Manufactured Goods (Excluding Petroleum Products) | 45.50 | 32.34 | 14.78 |
| Food Beverages & Tobacco | 57.53 | 50.15 | 1.43 |
| Sea Foods | 60.97 | 171.73 | 0.11 |
| Others | 170.00 | 158.35 | 13.04 |
| Garments | | 32.58 | 60.07 |
| Other Manufactured Goods | 0.32 | 134.10 | 8.67 |
| Total Export (Excluding Petroleum Products) | -0.75 | 2.75 | 3.61 |

Source : *Compiled from Sri Lanka Customs Returns (Annual Issues, 1965-82).*

Method :
*To obtain constant price estimates, current value series of each commodity category was deflated by a unit value index (with weights of the current year) constructed for that category. Compared with the base-weighted (Laspeyres) index, the current-weighted (Paasche) index has the added advantage of taking into account variations over time in the given commodity mix.*

## GROWTH OF INDIVIDUAL COMMODITIES

The most important aspect by both real and current price data is the highly unsatisfactory relative growth performance of the "traditional triplet" - tea, rubber and coconut kernel products. Out of these three commodities, only rubber indicated a positive average growth rate (4.9%) during the period 1970-77 in real terms but this too was much lower than the average growth (9.7%) pertaining to the period 1965-69. This supports the view that the fairly high annual average growth recorded by the three products in current terms in the first half of the 1970s was mainly due to favourable world market conditions. In 1978-82, both constant and current price growth rates of tea and rubber were negative reflecting the adverse movements in both market price and export volume. The high positive average growth rate (28%) of constant price value of coconut exports in 1978-82 is highly misleading. It merely reflects sporadic export spurts in 1978, 1981 and 1982 over rather low levels in preceding years. Average annual real exports value of coconut products in 1978-82 was only 1.5 per cent higher than that in 1970 - 77.

Export earnings (current SDR) from non-traditional (minor) agricultural exports have recorded a noteworthy increase over the period under review. More disaggregated export figures (not reported here) show that for most of the commodities in this group, this up-turn commenced somewhere in the late 1960s or early 1970s. The other agricultural products category which comprises live trees and other plants (including cut-flowers), vegetables, betel leaves, oil seeds and edible fruits and unmanufactured tobacco has recorded above-average growth rates in 1970-77 and 1978-82. All these items are new-comers' to Sri Lanka's export list, with a continuous export history of only 6 to 10 years. Growth rates of coconut by-products, spices and essential oils, commodities which have a longer history of export performance, were slightly below the average growth rates for the whole group. Constant price growth rates of all these categories remained positive in all the three sub-periods. However, only the growth rate of "other agricultural products" indicated continuous increases. For coconut by-products and spices growth rates in 1978-82 were much lower than that in the 1970-77 period.

Export performance of mineral products has been rather disappointing in recent years. Current SDR export earnings of this commodity category indicated an impressive average growth rate of 65.7 per cent during 1970-77. This declined to about 2.8 per cent during 1978-82. The real growth rates for the two periods were 53.1% and -20.5%, respectively. The major contributory factor for this unfavourable trend was the sharp fall in export earnings from gems which contributes about 80 per cent of Sri Lanka's total value of mineral exports. Real export earnings from this commodity recorded an annual average decline of 22.5 per cent in 1978-82 compared with the impressive growth rate of 62.1 per cent in 1970-77

Total manufactured exports have indicated a higher degree of growth dynamism compared with non-traditional primary exports, since about the early 1970s.Current value of these exports increased from the average annual level of SDR 40.5 million in 1970-77, to SDR 233.5 million in 1978-82. The average annual growth rates in the two periods were 78.2 per cent and 32.2 per cent respectively. This overall picture is, in fact, misleading since part of the variation is due to the re-classification of export earnings from the sales of bunker oil as merchandise exports from 1972 onwards, in contrast to the previous practice of including such earnings in the category of service earnings. Since that year, this single item annually accounted for between 50 to 70 per cent of total manufactured exports until 1981 when wearing apparel became the dominant item. Therefore, a meaningful analysis of manufactured export expansion calls for the exclusion of this item from the aggregate figure. When this revision is done, average annual growth rates for the two periods, 1970-77 and 1978-82, turn out to be 51.7 per cent and 53.4 per cent respectively. In terms of absolute figures, the increase in the average annual level was from SDR 4.9 mn in 1970-77 to SDR 126.0 mn in 1978-80. In real terms, annual average growth of non-petroleum manufactured export earnings was 14.8 percent in 1978-82, compared with 32.3 per cent in 1970-77.

Among the non-petroleum manufactured exports, garments has indicated the most impressive steady growth record. Beginning from a low starting base of SDR 0.4 mn in 1968, apparel exports expansion at the average annual rate for the two periods were 32,.6 per cent and 58.1 per cent respectively. SDR export value of this item increased from 1.3 mn in 1970 to 13.4 in 1977, and 149.9 mn in 1982. The next major item in the non-petroleum export category is sea foods. Export earnings of this item has increased from SDR 1.2 mn in 1970 to 11.3 mn in 1977 and to 26.8 mn in 1982. However, the real growth rate in recent years has been near zero (the average growth in 1978-82 was 0.11%) indicating that the observed nominal increase is mainly due to increase in export unit prices. From an overall point of view, average annual growth rates of the remaining manufactured export items given in Table 4 seems impressive. However, a close look at annual figures of individual commodities reveals that their growth has been rather sporadic. Only a few items, in particular manufactured rubber goods, articles made from coir fibre (mainly brooms and brushes) and ceramic-ware and wall-tiles have indicated continuous annual increases.

## CHANGES IN COMMODITY COMPOSITION OF EXPORTS

Throughout the period under study, the aggregate share of the three traditional exports declined continously, and since the latter part of the 1970s the decline was more sharp. In 1982 this share was 46 per cent compared 72 per cent in 1978, and 89 per cent in the late 1960s. If the share is calculated for total exports, excluding petroleum products, the decline is much less marked; but still appears to be considerable. For instance,the revised figure for 1982 was 57 per cent compared with the average level of 85 per cent during the period 1970-77. In the late 1960s and the early 1970s, unfavourable price trends was the major reason (notably for tea and rubber) for the observed declined in the share of traditional exports. Since then, both continous stagnation of export volume of these products and higher growth rates of non-traditional.

The simplest way to shed light on these issues is to examine the behavioural pattern of Sri Lanka's export market shares of selected commodities. If external factors were the sole contributor to unsatisfactory export performance and if exporters exploited the existing market opportunities, the country would then, at least, have maintained its share in world exports of the given commodity. If this has not happened, then the explanation should lie in the country's own internal policies and various other supply bottlenecks.

Estimates of Sri Lanka's market shares in selected export products for the period 1976-1982 are given in Table 5. Let us examine this data starting with the traditional exports. For all the five commodities - tea, rubber, dessicated coconut, copra and coconut oil - the market share has slipped drastically throughout the period. For instance, the market share of tea in 1982 was 26 per cent compared with 34 per cent in 1976. This decline is even more striking if we use the share for 1965, the peak year of Sri Lankan tea production, as the base for comparison. Sri Lanka's share of the world tea market in that year was 52.5%. It is pertinent to compare Sri Lankan Experience with the other two traditional tea producers - India and Indonesia. During this period, India was able to maintain her export market share at the average level of 37 per cent, with only insignificant annual deviations, even in the face of increasing internal demand pressure. Indonesia's share increased from the average level of 7 per cent in 1970 - 72 to 10 per cent in 1979 - 81. (Data from FAO, Trade Year Book).

In the case of rubber, the decline in market share is less dramatic. However, the overall trend was on the decline. For instance, none of the years after 1976 could exceed the 1976 share of 4,4 per cent.

The three coconut kernel products indicate the most unfavourable relative growth record. The share of Desiccated Coconut declined from 35,3 per cent in 1976 to 22.5 per cent in 1982. Sri Lanka's position in the world copra market had reached an almost negligible level by 1982. Market share of Coconut oil has indicated a high degree of instability, but again the overall trends for the period showed a

Table 4 A

## TOTAL EXPORTS, IMPORTS AND BALANCE OF TRADE IN MERCHANDISE (1953 - 1983)

(Million U.S. $.)

| Year | Domestic Exports | Total Exports | Imports | Balance of Trade | U.S.$. Equivalent in Rs. |
|---|---|---|---|---|---|
| 1953 | 317.8 | 329.3 | 337.6 | - 8.3 | (4.7619) |
| 1954 | 361.0 | 379.9 | 293.4 | – 86.5 | " |
| 1955 | 383.1 | 407.4 | 306.6 | + 100.8 | " |
| 1956 | 347.0 | 364.3 | 342.2 | + 22.1 | " |
| 1957 | 333.5 | 353.1 | 378.9 | 25.8 | " |
| 1958 | 346.8 | 355.2 | 360.5 | - 1.3 | " |
| 1959 | 355.3 | 368.3 | 421.0 | - 52.7 | " |
| 1960 | 372.7 | 384.6 | 411.5 | - 26.9 | " |
| 1961 | 352.9 | 363.9 | 357.7 | + 6.2 | " |
| 1962 | 370.8 | 379.3 | 348.5 | + 30.8 | " |
| 1963 | 357.9 | 363.4 | 315.0 | + 48.4 | " |
| 1964 | 383.7 | 393.9 | 414.6 | - 20.7 | " |
| 1965 | 402.3 | 408.2 | 309.6 | + 98.6 | " |
| 1966 | 352.0 | 357.0 | 425.9 | - 68.9 | " |
| 1967 | 333.3 | 346.4 | 356.3 | - 9.9 | (4.8824) |
| 1968 | 331.8 | 341.9 | 365.1 | - 23.2 | (5.9524) |
| 1969 | 315.0 | 321.9 | 427.3 | - 105.4 | " |
| 1970 | 335.2 | 341.6 | 409.7 | - 68.1 | " |
| 1971 | 337.3 | 340.2 | 356.0 | - 15.6 | " |
| 1972 | 324.2 | 326.7 | 364.5 | - 37.8 | (6.1488) |
| 1973 | 407.1 | 410.5 | 425.8 | - 15.3 | (6.3752) |
| 1974 | 517.0 | 520.7 | 683.0 | - 162.3 | (6.6877) |
| 1975 | 552.1 | 553.6 | 739.1 | - 185.5 | (7.1049) |
| 1976 | 568.8 | 571.4 | 651.3 | 80.1 | (8.4263) |
| 1977 | 745.4 | 746.0 | 675.1 | + 70.9 | (8.8362) |
| 1978 | 844.6 | 846.6 | 941.4 | - 94.8 | (15.60) |
| 1979 | 978.3 | 981.1 | 1448.0 | - 466.9 | (15.58) |
| 1980 | 1046.2 | 1051.9 | 2034.9 | - 983.0 | (16.53) |
| 1981 | 899.4 | 1026.8 | 1806.3 | - 779.4 | (19.67) |
| 1982 | 998.6 | 1015.6 | 1772.9 | - 757.3 | (20.80) |
| 1983 | 1058.3 | 1073.7 | 1788.6 | - 715.9 | (23.52) |

sharp decline. This data shows that the world demand situation can hardly be blamed for the stagnation in export earnings from traditional exports. The explanation must be found in supply constraints which prevented Sri Lanka from maintaining her market position.

Among six minor agricultural commodities only in the case of cinnamon and to a lesser extent, in the case of cloves, did Sri Lanka occupy a significant position in the world market. Among all spices, cinnamon is considered to be the commodity which has least benefitted from the overall increase in the world consumption of spices. The high concentration of the major share (nearly 70 per cent) of world consumption of the commodity in a single country, Mexico, which has been confronted with severe balance of payment problems in recent years, and the rapid market penetration of Cassia, a cheaper but almost perfect substitute for Cinnamon, has led to a continous deterioration in market prospects of this commodity. Given the predominant postion of Sri Lanka in the world Cinnamon trade, the slow growth of her export earnings from this commodity in recent years can be described mainly to this adverse market situation. In the case of cloves, the high degree of volatility of market share reflects the relative importance of domestic supply factors in determining export earnings. The same comment applies for the other items too. Moreover, for these latter items Sri Lanka's market share remains rather small indicating possibilities for further expansion even under the existing level of world demand.

For mineral products, world market data is not available for a meaningful international comparison. However, there is some evidence which suggests that the world demand situation can hardly be blamed for unfavourable export growth of these commodities. In an interesting article that appeared in the Economic Review (Volume 8, Number 5, August 1982; pp. 17.18) N.U. Jayawardena has analysed reasons for unprecedented increase in "record" gem exports during 1972-77 and their drastic decline there after. The major reason for export increase in the former period was the incentives provided under the CRA scheme introduced in 1972. In a highly restricted import trade regime, CRA credits (first 25 per cent and later 20 per cent of exports) allowed to gem exporters for financing scarce imports fetched a premium of 150 per cent to 200 per cent in the market. The upshot was to bring more gems into the open market and to discourage smuggling. With the November 1977 liberalisation, the CRA scheme was abolished as this type of a scheme was no longer relevant under a liberalised trade regime. However, no new incentives were introduced to preserve the degree of profitability of "recorded" gem exports at the high level that existed in the CRA era. The result was the resumption of illicit exports. The introduction of a new 5 per cent BTT on gem exports in 1980 (this was abolished in 1983) and the lack of effective action to prevent the ingress of Thai nationals into the illicit gem trade further aggravated this situation.

Table 5

### IMPORT DEPENDENCE OF MANUFACTURED EXPORTS 1982

| | Contribution to total manufactured exports (%) | Import content of exports (%) |
|---|---|---|
| Food, beverages and tobacco | 8.25 | 17.91 |
| Garments | 46.57 | 71.23 |
| Leather goods and footwear | 0.70 | 48.71 |
| Petroleum | 39.10 | 85.88 |
| Rubber goods | 1.40 | 22.18 |
| Ceramic and Wall-tiles | 1.75 | 19.76 |
| Machinery and equipment | 1.52 | 43.20 |
| Other manufactured goods | 0.72 | 31.25 |
| Total manufactured goods | 100 | 68.78 |
| Manufactured goods excluding petroleum | 60.90 | 60.00 |

Source : *Column 1, Sri Lanka Customs Returns*
*Column 2, EDB records.*
*Supplemented with data from the Department of Census and Statistics Survey of Manufacturing Industry, 1980.*

A reecent ADB study (ADB 1981) Graphite Mining Project, Finland Report has reported useful evidence on Sri Lanka's performance in the world graphite market. According to this study, Sri Lanka's share in the USA graphite market declined from 7.5 per cent in 1978 to 3.4 per cent in 1980. The decline in the share of the Japanese market (the second largest market for Sri Lankan graphite, next to the USA) was from 6.5 per cent to 3.8 per cent between the same two years. Sharp price increases introduced without considering the level of prices from other competitive sources, and the wrong marketing strategy of attempting to promote higher grade graphite against buyers preferences are the two major reasons given in this study as explanations for this unfavourable market trend.

The degree of world market penetration by Sri Lanka in the field of manufactured exports still remains very low Out of the eight commodities given in the table, leather goods, foot wear and soap have indicated declines in their shares in total developing country exports during 1978-82. Shares of wall tiles, jewellery and fish products have shown erratic time patterns. Both these features support the view that these export items are not yet established on a sound footing to exploit successfully the existing market opportunities.

Ceramic ware and garments are the only two commodities in the list which have recorded continous and note-worthy increases in market shares. The share of ceramic ware increased from 0.38 per cent in 1971 to 5.3 per cent in 1982, while the increase in the garments was from 0.14 per cent to 2.6 per cent between this same eleven year period. The country-wise data indicates that Sri Lanka's export experience in these commodities compares favourably with other Asian countries. For instance in the case of ceramic ware, Sri Lanka occupied the seventh position among these countries after South Korea, Hong Kong, Malaysia, India, Thailand and the Philippines. By 1981 she had been elevated to position 4 out-stripping Malaysia, India and Hong Kong. In the field of garment exports, Sri Lanka's overall performance seems to be relatively better than that of the "Asian new-comers", notably Malaysia, Thailand, Thailand and Indonesia. By 1982 she had out stripped Malaysia and Indonesia in the ranking of Asian exports. Philippines and Thailand still occupy higher positions in the ranking, but their annual rate of expansion seems to be relatively lower than that of Sri Lanka.

Quota restrictions enforced by the major importing countries within the Multi-Fibre Textile Arrangement (MFA) have begun the impinge on Sri Lanka's garment exports since the second half of the 1970s. The first quota agreement under MFA was signed with Norway in 1976, and by 1980 exports to all other major markets in the Western Europe and North America had come under similar agreements. At the initial stage, the coverage of quota restrictions was limited only to shirts and blouses, but gradually most of the "popular" garment items were included in the restricted list. It is difficult to tell how serious the impact of quota restrictions on exports is, without having recourse to data at individual exporter level. However, the growing concern of garment exporters on the issue of quota allocation, notably the agitation of exporters outside the IPZ for reducing quotas allocated to IPZ firms, indicates that the restrictive impact of the quota system is, in fact, real.

Apart from the immediate impact on export volume expansion, quotas might have adverse repercussions on the long-term viability of the garment industry in yet another way. The presence of quotas generate "export pessimism" among producers (and perhaps even among policy makers) preventing them from establishing sizeable export production capacity and/or undertaking necessary improvements in the production process. A minimum sales volume in one country is needed to bear the high cost of export marketing.

The mere existence of quota restrictions does not however imply that prospects for the future expansion of garment exports is bleak. One can even argue that those restrictions play a useful protective function in favour of "new-comers" against already established third world countries. Exporters in other countries have in fact benefitted from restrictions against East Asian countries in this sense. It is hard to imagine that Sri Lanka would have penetrated the Western European and North American markets at the rate she had recorded during the past four years had an open-competitive market environment prevailed. This view is supported by Sri Lanka's declining share in the Middle East market, the only significant dynamic market where quota restrictions do not exist, in the face of increasing competition from the East Asia exporters.

Throughout the period since the early 1970s, quota limits on garment exports from Hongkong, Taiwan and Korea have been highly restrictive. Despite these restrictions, these three countries have managed to maintain their shares in total developing country exports at a steady level. The two major underlying reasons for this success are the successful exploitation of the scope for export increases left to them under the quota system, notably by increasing the unit value of exports and the diversification of exports to new markets, particularly to the capital surplus petroleum exporting countries.

Sri Lanka's garment exports still indicate a heavy dependence on items such as shirts, blouses, trousers and jackets which have already attracted quota restrictions. (See Economic Review, Vol. 9 No.10/11, 1983, pp. 28-33). Therefore, opportunities exist in the short-run to expand exports by shifting to other items. But with the expansion of export volume these items are also bound to come under quotas. Therefore, the long-term prospects are invariably dependent on the ability to increase unit values (by shifting to quality garments) within existing quota limits and to diversify exports to non-quota markets.

## IMPORT DEPENDENCE OF MANUFACTURED EXPORTS

An important aspect to be taken into account in assessing the net benefit to the economy of manufactured exports is their import dependence or percentage of imported inputs embodied in FOB exports. The higher the import dependence the lower the contribution of the given export item towards the balance of payments position. On the other hand the essential corollary of high import dependence is low utilization of local raw materials which in turn limit the "spread effect" (trickle-down effect) of manufactured export expansion on the domestic economy.

Table 6 gives details of import content in FOB export earnings and contribution to local manufactured exports of selected products. According to the table the import co-efficient of total manufactured exports is about 89 per cent. Even when petroleum exports are excluded as an exceptional case, the co-efficient still remains as high as 80 per cent. This high degree of import dependence is the outcome of heavy concentration of exports in garment exports. Garments which account for nearly 78 per cent of non-petroleum exports has an import co-efficient of 71 per cent. The import co-efficients of most of the other products, notably that of resource based products such as food, beverages and tobacco, rubber goods, and ceramics and wall tiles, appear to be significantly lower. However, despite increased emphasis on export diversification, the relative positions of these products in the export mix still remains very low.

It is pertinent to mention here that estimates of import content do not portray the full story as to the balance of payments impact of manufactured exports. Over the period since 1977 foreign direct investment (DFI) has become increasingly important in this field (See Box). The share of non-petroleum manufactured exports handled by firms with DFI participation increased from 24 per cent in 1977 to 46 per cent in 1982; and nearly 57 per cent of the incremental exports between these two years originated in these firms. Therefore, other foreign exchange outflows such as profit and dividend repatriation, royalty payments and perhaps other "indirect drains" by way of price manipulations in intra-firm trade, related with the exports, might be substantial. The net balance of payments impact can be meaningfully assessed only through an indepth empirical investigation which takes into account all these aspects.

## CONCLUSIONS

The above analysis of Sri Lanka's export performance over the period since the early sixties results in the following conclusions: while current export prices in terms of SDRs recorded an upward trend from about the first half of the 1970s, this expansion has not been adequate compared with the acceleration in import prices and expanding import demand of the economy. This has led to an increasing dependence of the economy on foreign sources for balance of payments financing, a trend which cannot possibly continue without adverse repercussions on the economy's long-term growth momentum. When examined in the global context, Sri Lanka's share in both world exports and exports from non-oil developing countries has continuously declined throughout the period.

The analysis of export performance of individual commodities and commodity categories compared with similar exports from other competitive sources suggests that, with the exception of few isolated cases (in particular, cinnamon and perhaps garments) for most of the commodities the causes of unsatisfactory export performance are of internal origin. The three traditional exports - tea, rubber and coconut have continued to lose their world market positions solely because of unsatisfactory expansion in export volume. From about the early 1970s non-traditional exports as a group have continued to record some expansion. However, at the disaggregated level a high degree of diversity as to growth rates may be observed. It is noteworthy that gem exports which constituted the most dynamic element in the export mix in the seventies upto 1977 have on the average recorded a negative trend thereafter.

The growth record of manufactured exports seems more impressive compared with other non-traditoional products. However, even in this field, Sri Lanka's export expansion does not, to a large extent, match that of her competitors. Among the main manufactured exports from Sri Lanka only garments and ceramic ware have shown satisfactory market penetration as indicated by their continuous increase in the world market share. Other items do not seem to have yet been established on a sound footing to exploit successfully the existing market opportunities.

When the manufactured export mix is taken as a whole, the most prominent feature is the high degree of commodity concentration. Garments account for about 80 per cent of non-petroleum manufactured exports. As an outcome of this heavy dependence on a single import-intensive item, total import content of manufactured exports remains at the level of 80 per cent (89 per cent when petroleum products are included). This heavy import dependence plus the fact that direct foreign investment has assumed an important role in this field suggests that the net balance of payments impact and the spread effect on the economy of export expansion is much less than that revealed by the growth rate in FOB exports

## Export Incentives and Other Assistance provided by the Export Development Board.

[illegible] export [illegible] policy [illegible] specific export incentives as well as [illegible]

(1) Export Incentives

(a) Import Duty Rebate

[illegible] with a limited domestic market size, one of the [illegible] for the expansion of manufactured exports [illegible] the EDB [illegible] the policy [illegible]

[illegible] duty rebate [illegible] was introduced [illegible] Customs Department [illegible]

[illegible] assistance to the Customs Department in the payment of duties on imported inputs. [illegible]

At the inception [illegible] list of [illegible]

Actual disbursements under the [illegible]

(b) [illegible]

This scheme was introduced [illegible] by the Customs Department [illegible]

[illegible]

(c) Export [illegible]

The [illegible] scheme [illegible] introduced in June 1981 [illegible] In October 1983, this was replaced by a modified scheme [illegible]

[illegible]

At present the total grant [illegible]

Total payments under the grant scheme in 1982 [illegible]

## (d) Presidential Export Awards

The President's Export Awards scheme was introduced in 1981 as a means of according national recognition to the contribution made by exporters in the development of the export sector. The awards are made to exporters who make significant export performance in selected product areas in each year, based on the basis of criteria established by a committee appointed by the EDB and the Ceylon Chamber of Commerce and headed by a retired Judge of the Supreme Court. Each award carries a cash prize of Rs 100,000, and the number of awards vary from year to year. 22 were awarded in 1981 and 7 in 1982.

## (3) Other Measures

### (a) The Exporters Forum

The Exporters' Forum is a monthly meeting organised by the EDB under the chairmanship of the Minister of Trade and Shipping, which is attended by exporters, and officials of Government departments concerned and the commercial banks. It provides a regular platform for discussion of specific problems related to export activities. Over the past four years the Forum has been instrumental in successfully resolving a number of issues relating to credit, banking, tax, export procedures, customs, [illegible] freight and export duty rebates.

### (b) Trade Facilitation

A major problem faced by exporters has been the cumbersome [illegible] and various procedures involved in the export procedures and export documentation. In order to make recommendations for reforms and improvements in this connection, a special advisory committee with the participation of both private sector and public sector government bodies has been set up under the auspices of the EDB.

### (c) National Packaging Centre

Poor quality of packaging is a major barrier faced by Sri Lankan exporters in their attempts to penetrate competitive markets. In recognition of this problem, in 1983 the EDB set up a National Packaging Centre as a joint venture, with the participation of the Ceylon Institute of Scientific and Industrial Research (CISIR), National Engineering Research Development Centre (NERDC), the Bureau of Ceylon Standards (BCS) and the Sri Lanka Institute of Printing (SLIP). The task of the centre is to undertake research and adequate packaging development, and to provide information and laboratory facilities in the field of packaging.

### (d) Production Subsidies

Subsidies to certain export-oriented [illegible] production activities [illegible] disadvantages facing the export development activity have been implemented by the EDB. For instance in 1982 the Board introduced an interest subsidy scheme for the exporters of rubber goods in order to cushion them against high cost of locally purchased raw materials. There is also a scheme to subsidise production costs of [illegible] exporters.

### (e) Export Production Village Programme

The Export Production Village Programme is an experiment in extending the export development effort to the villages with a view to enlisting the energies of export development and development of the rural economy. The first export production village (EPV) was set up on 11.12.81 at Kannangara in Dambadeniya. By the end of July 1984 as many as 26 EPVs had been established.

[illegible]

Each EPV is managed by a people's company incorporated under the Companies Act (1982) with shares held by the village producers. The EDB supports the activities of EPVs by providing free export [illegible], packaging, marketing, technical and other assistance. The EPVs have been provided with the following incentives:

i. Exemption of [illegible] tax to exporting firms.

ii. [illegible]

iii. A [illegible] grant by the EDB of 2% on export sales.

iv. Market [illegible] Development

The EDB over the [illegible] years has been undertaking a wide range of programmes of product and market development, with technical and financial assistance from international organisations such as the ITC, the [illegible] and the Commonwealth Secretariat. These include [illegible] technical assistance for [illegible] designing, quality control, provision of market information, [illegible] and promotional support [illegible] programmes [illegible] manufacturers [illegible].

### (f) Export Financing

The EDB operates two credit schemes to provide [illegible] to selected exporters [illegible]. These schemes [illegible] under the Central Bank's refinancing facilities at the financial institutions and directly by the EDB.

## Export Financing and Export Credit Insurance

### (1) Export Financing

The existing schemes in regard to financing exports can be divided into two groups:

i. The Central Bank's refinance facilities.
ii. Financial facilities directly provided by the EDB.

### (a) Central Bank's Re-financing Facilities

Export credit refinancing facilities provided by the Central Bank are of three types: pre-shipment credit refinancing scheme, supplementary financing facility, and the medium and long term refinancing scheme.

The pre-shipment refinancing scheme for non-traditional exports was introduced in December 1977, and became operational from about the second half of 1978. Under this scheme, the Central Bank provides refinance on a concessionary rate in respect of loans granted by the [illegible] to exporters [illegible]. At the inception, the refinancing rate and the maximum rate charged for borrowers were 10% and 14% respectively. These were increased to 12% and 18% in January 1980, and then reduced to 10% and 14% in January 1983. Each refinance then is granted in the first instance for a period of 90 days, with a possible extension of upto a maximum of 180 days.

The level of refinancing under the scheme has increased [illegible] from Rs.71.2 million in 1978 to Rs.185.4 million in 1980, and to Rs.405.9 million in 1982. As at September 1983 the [illegible] had [illegible] to Rs. 1,294.5 million.

[illegible] from March 1982, the Central Bank provides [illegible] to the banks a facility [illegible] supplementary financing facility in the form of [illegible] rediscounting [illegible] at concessional rates for exporters at a rate not exceeding 12 per cent. The [illegible] pre-shipment refinancing scheme is made available for [illegible] compared with the [illegible] of [illegible] other than tea, rubber, coconut and products derived from these three products, garments, [illegible] and petroleum products. By the end of the [illegible] September [illegible] the total outstanding credit under the scheme was Rs. 99 million (Data from Central Bank).

The medium and long term refinancing scheme for export oriented projects was introduced in 1981. Under this scheme the Central Bank provides finance to commercial banks, the National Development Bank and the Development Finance Corporation to provide [illegible] loans to export projects approved by the EDB for periods ranging from 3 to 15 years. The interest rate charged by the Central Bank is 10 per cent while the lending institutions are allowed to charge a maximum interest of 14 per cent. At the initial stage, finance provided by the Central Bank covered only 80 per cent of total lending to a project. Exporting projects which undertake to export at least 25 per cent of total output in the first year of commercial production are eligible for obtaining finance under this scheme, with [illegible] limit of Rs.20 million.

By the end of 1982, the EDB had approved refinance for 37 projects involving a total lending of Rs. 157 million. However, [illegible] the Central Bank had provided refinance only for 10 projects amounting to Rs.35 million reflecting the [illegible] of the commercial banks largely due to the [illegible] on their own funds [illegible] to finance these projects. In January 1983, the Central Bank [illegible] increased the extent of refinance to 100 per cent. By the end of 1983, the EDB had approved [illegible] projects [illegible] Rs.390 Mn. and [illegible] of them 30 projects had received Central Bank [illegible] refinancing.

### (b) EDB's Financing Schemes

Financial Assistance is offered by the EDB to selected export oriented projects [illegible] equity participation, and the [illegible] to projects [illegible] for exporters [illegible].

The EDB participates in equity capital of selected export projects for [illegible] to carry up to [illegible] of 15 per cent. The basic objective of this scheme is to [illegible] private sector activities in the field of export production by providing [illegible] capital during the [illegible] of the project in the [illegible]. By the end of 1982 the Board had [illegible] Rs.17.0 million [illegible] projects [illegible] in products such as rubber gloves, [illegible] and [illegible].

The short term credit scheme for industrial exports was introduced in 1983 to help existing export industries in export production and to improve product quality. Under the scheme the EDB finances [illegible] cost of [illegible]

**PERFORMANCE OF SLECIC, 1979 - 1983**

| Year | GUARANTEES ISSUED |  |  |  |  |  | VALUE OF BANK ADVANCES GIVEN UNDER GUARANTEES | EXPORT INSURANCE POLICIES ISSUED |  |  |
|---|---|---|---|---|---|---|---|---|---|---|
|  | Pre-Shipment Guarantees |  | Post-shipment Guarantees |  | Export Performance Guarantees |  |  | (Rs. Million) |  | Value of Shipment Covered |
|  | No. | Value | No. | Value | No. | Value |  | No. | Value |  |
| 1979* | 126 | 220.8 | 12 | 16.2 | 2 | 8.0 | 235.0 | 82 | 129.6 | 121.6 |
| 1980 | 219 | 423.9 | 37 | 33.2 | 14 | 39.7 | 1,434.0 | 150 | 194.8 | [illegible] |
| 1981 | 287 | 258.0 | 5 | 68.8 | 18 | 93.5 | 1,270.8 | 168 | 204.8 | [illegible] |
| 1982 | 324 | 192.0 | 61 | 79.2 | 20 | 49.0 | N.A. | 208 | 338.2 | N.A. |
| 1983** | 304 | 185.0 | 55 | 92.4 | 20 | 90.5 | N.A. | 218 | 290.2 | N.A. |

NOTE: * For the four months, September to December.
** For the first quarter. N.A. Not Available.
SOURCE: CBC, Review, April 1984, [illegible]

ducts involved. Export market potential, expected net foreign exchange gain, and the period of payback are the major criteria used in selecting projects for financing. Under this scheme during the period upto the end of 1983 11 ventures have been assisted with a financial commitment of Rs90 Mn.

## (2) Export Credit Insurance

The first attempt in the field of export credit insurance in Sri Lanka was the Packing Credit Guarantee Scheme which came into operation in January 1977 under the auspices of the Development Finance Department of the Central Bank. Under the Scheme certain categories of risks were guaranteed in respect of preshipment credit granted to the exporters by commercial banks. In 1977 and 1978 the total permitted credit limit under such guarantees were Rupees 73 and 90 million respectively (CBC, Annual Report, 1978: 87).

On 8 February 1979, the Sri Lanka Export Credit Insurance Corporation (SLECIC) was established under Act no. 15 of 1978. With its opening, the Central Bank ceased to operate the packing credit guarantee scheme and transferred its assets and liabilities to SLECIC. At present SLECIC operates a full-scale export credit insurance package which provides for (a) issuing bank guarantees on behalf of exporters and (b) issuing insurance policies to exporters to cover the risk of non-payment (default) or delayed payment by the buyer abroad. Bank guarantees are of three types: preshipment credit guarantees, post-shipment credit guarantees, and Export Performance credit guarantees. These guarantees help exporters obtain credit from commercial banks on liberal terms. The protection given by insurance policies encourages exporters to export to new markets and new buyers, as well as to increase exports to existing clients on easy credit terms without being disturbed by the attendant risks. The exporters can also use these guarantees as collateral in obtaining post-shipment credit from banks.

During the past four years the SLECIC has shown a noteworthy performance record in terms of both the number of guarantees and insurance policies issued and total volume of transaction. Related data is summarised in the Table at left.

The first signs of foreign capital inflow into export-oriented labour intensive manufacturing industries in Sri Lanka could be seen by the middle of 1970s. According to records of the Ministry of Industries during the period 1974-77, there were 13 instances of establishing manufacturing joint ventures (garments - 9, diamond cutting - 1, gemcutting - 1, ceramic ware - 1, wall-tiles - 1) to produce for the export market.

There has been a rapid upsurge in foreign investment following the policy reforms initiated in November 1977. The number of manufacturing units in production in the KIPZ had increased upto 60 by the end of 1983. Of these, 51 firms had foreign capital participation. As at 30 June, 1983 the number of manufacturing firms set up outside KIPZ under the approval of the Foreign Investment Advisory Committee (FIAC) was 114. A comparison of the list of these firms with exporter-wise Customs Returns shows that at least 60 per cent of these latter firms export at least a portion of their total output. For both KIPZ and FIAC investors, garments has been the major industry of attraction; about 70 per cent of export-oriented joint-ventures belong to this industry. Rubber goods (11%), lapidary and jewellery (8%), toys and sports goods (4%) and other low-skilled labour intensive goods such as footwear and brooms and brushes are the other areas of investment. To date, the attraction of foreign capital to high-skilled labour intensive export industries such as electrical and electronic goods has not indicated noteworthy trend.

Estimates of the relative contribution of firms with foreign capital participation (henceforth, "foreign firms" for short) for the three years 1977, 1979 and 1982 are summarised in the table below. The percentage share of foreign firms in total manufactured exports was 24 in 1977. This increased to 31 in 1979 and to 46 in 1982. Their share in total merchandize exports in these three years were 2%, 4% and 14% respectively.

Out of the six two-digit SITC commodity categories in the Table, in all the cases except food beverages and tobacco (SITC 31), the foreign share of exports has indicated a noticeable increase over the period under study. At a more disaggregated level, rubber goods, ceramics and wall-tiles, footware, and toys and sport goods indicate the highest level of foreign investment. In the case of garments, the major manufactured export from Sri Lanka, the foreign share indicated about 60 per cent increase between 1979 and 1982 (from 30% to 48%).

This pattern of an increasing importance of foreign involvement in manufactured exports is closely related to the expansion of production in the KIPZ. It is noteworthy that the relative share of non-KIPZ foreign firms in total manufactured exports declined from 27 per cent in 1979 to 14 per cent in 1982. On the other hand, the share of KIPZ firms increased from 4 percent to 31 per cent between these two years. This increase was dominated by the rapid expansion of garment exports from the zone.

It is pertinent here to examine why non-KIPZ foreign firms have indicated a relatively unsatisfactory growth trend. One obvious reason seems to be the closing down (due to internal managerial problems) in 1981 of two leading foreign garment producing firms which upto then accounted for about 15 per cent of garment exports from Sri Lanka. The indifferent attitude of "import-substitution type" foreign firms towards exporting under the liberalized import regime appears to be another reason. The highly restricted import control regime that prevailed prior to November 1977, had an inbuilt compulsion for these firms to export a portion of their output as an effective way of ensuring for themselves the availability of foreign exchange to meet their import requirements. A close examination of firm-level export data reveals that during this period a significant portion of manufactured exports, notably in the categories of processed food, chemicals and footware was propelled by this motive. Under the liberalized import regime there is no such compulsion since foreign exchange required for imports is easily available. A high ranking official of a local subsidiary of a big multinational, when interviewed by the present writer, fully confirmed this view. Prior to the liberalization this company's export surpassed its import requirements. In 1982, according to Customs Returns, its exports covered only 20 per cent of the import bill).

## PERCENTAGE CONTRIBUTION OF FOREIGN FIRMS TO DOMESTIC MERCHANDISE EXPORTS BY SECTOR OF ORIGIN 1979 AND 1982 (EXPORT VALUES ARE IN THOUSAND SDRs)

| | | 1977 | | | | | 1979 | | | | 1982 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Export share of Foreign Total Firms | | | Export share of Foreign Firms | | | | Export share of Foreign Total Firms | | |
| SITC Division | Exports (1) | KIPZ (2) | Non- % (3) | Total KIPZ% (4)=(2+3) | Exports % (1) | KIPZ (2) | Non- % (3) | Total KIPZ% (4)=(2+3) | Exports % (1) | KIPZ (2) | Non- % (3) |
| 31. Food, beverages, and Tobacco | | 12536 | - | 10.29 | 10.29 | 19822 | - | 18.79 | 18.78 | 20159 | 2.04 |
| Fish products | | 9079 | - | 8.42 | 8.41 | 15279 | - | 11.81 | 11.81 | 16872 | - |
| Processed tea | | 1228 | - | - | - | 1118 | - | - | - | 3332 | 9.35 |
| Other | | 2232 | - | 30.62 | 30.52 | 3425 | | 56.56 | 56.56 | 7055 | 3.81 |
| 32. Textiles, wearing apparel and Leather industries | | 14496 | - | 31.70 | 31.70 | 56306 | 5.70 | 26.29 | 30.98 | 153967 | 36.72 |
| Wearing apparel | | 13737 | - | 29.49 | 29.49 | 56589 | 5.76 | 24.58 | 30.34 | 151698 | 36.38 |
| Leather products/footwear | | 758 | - | 71.89 | 71.89 | 708 | 3.88 | 80.34 | 80.34 | 2268 | 56.68 |
| 35. Chemicals, rubber & plastic products | | 1925 | - | 1.51 | 1.51 | 2876 | 2.24 | 7.74 | 9.89 | 6669 | 66.70 |
| Chemicals | | 1642 | - | 0.60 | 0.60 | 2251 | | 4.35 | 4.35 | 2098 | - |
| Rubber goods | | 281 | - | 7.48 | 7.48 | 425 | 14.11 | 25.58 | 39.79 | 4571 | 95.88 |
| 36. Non-metallic mineral products (ceramic-ware and wall tiles) | | 2981 | | 61.50 | 61.50 | 4801 | - | 55.51 | 55.51 | 5695 | 0.26 |
| 38. Machinery and equipment | | 2383 | - | 8.12 | 8.12 | 3889 | - | 2.28 | 2.28 | 4062 | 21.63 |
| 39. Other manufacturing | | 1369 | - | 35.89 | 35.89 | 2402 | 0.01 | 29.33 | 29.34 | 7628 | 37.51 |
| Articles made from coir | | 132 | - | - | - | 609 | - | - | - | 2285 | 26.01 |
| Jewellery | | 36 | - | - | - | 180 | 1.13 | - | 1.13 | 998 | 11.63 |
| Toys & sport goods | | 43 | - | - | - | 150 | - | - | | 1182 | 83.61 |
| Other | | 1178 | - | 42.30 | 42.30 | 1464 | - | - | 48.31 | 2186 | 36.63 |
| Total manufactured goods | | 35718 | - | 23.64 | 23.64 | 89698 | 3.64 | 27.16 | 30.80 | 209080 | 31.34 |
| Total merchandise exports | | 24646 | - | 1.90 | 1.90 | 766,488 | 0.43 | 3.76 | 4.19 | 802023 | 6.49 |

Notes:- - Indicates zero values
a. Tea bags and instant tea
b. Excluding petroleum products

Source:- *Compiled from unpublished firm-wise export records, Customs Department*

# THE ROLE OF CO-OPERATIVE RURAL BANKS IN SRI LANKA'S RURAL SECTOR

M.W.Panditha

*This paper was read by M.W. Panditha, Deputy General Manager, Co-operative Development, Accounts and Planning of the People's Bank at the Senior Executive Group Study/Observations Programme 1984 of the Asian Pacific Region Agriculture Credit Association held in Colombo. Mr. Panditha was closely associated with the Rural Credit Department and during the period of the pioneering of the Rural Credit Scheme.*

Rural Banks or Co-operative Rural Banks (CRBs) as they were subsequently renamed (1) celebrated the 20th anniversary of their establishment in March this year. This banking system was launched by the People's Bank during its formative stages as an institutional device through which the Bank could supplement its programme for provision of banking facilities to the rural sector through the Co-operative Movement. A CRB is not a Bank in the conventional sense but, it is the financial arm of a Multi-Purpose Co-operative Society. It is not a separate legal entity and does all its business in the name of the Multi-Purpose Co-operative Society of which it is a part. At present, there are 298 CRBs and 576 CRB branches covering the entire island.

In this paper, an attempt would be made to describe the objectives and functions of these institutions, the rationale for their setting up and their role in rural credit.

## BACKGROUND

The concept of combining credit, marketing, resource mobilization and other general purpose activities at village level in one single organisation is not new to the Co-operative Movement. Raiffeisen, the father of the Credit Society himself appears to have harboured similar views. (2)

In Sri Lanka too, in 1957 when the proposal for re-organisation of the Co-operative Movement was adopted and the single purpose Co-operative Societies were amalgamated into Multi-purpose Co-operative Societies, the inclusion of banking as one of the functions of these Societies was accepted as essential for the dynamic role they were expected to play in the development of the rural economy.

The Committee which recommended the formation of Multi-purpose Co-operative Societies in 1957 inter alia made the following observations:

> “ It should be noted that all Multi-purpose Co-operative Societies will be primary Rural Banks and their relation with District Bank or Co-operative Development Bank (3) are matters for settlement after discussion with the latter Bank.”

I shall now outline briefly some facts of the rural setting as it existed before establishment of the People's Bank, as a backdrop to the understanding of the role of CRBs.

Of the 4.5 million acres of agricultural land, about 2.3 million acres were cultivated with tree crops, mainly tea, rubber and coconut which form the principal agricultural exports. These crops are run mostly on commercial lines. On the other hand, the agriculture of the small farmer is primarily paddy cultivation. The size of holdings in this sector is small, and are uneconomic at the lower end. The number of holdings stood at 1,189,801 of which paddy holdings accounted for 49 percent. An average holding being 1.9 acres the farm sizes differed widely. (4) Natural hazards pose a constant threat.

Approximately 72% of the population live in village areas and are engaged mostly in agriculture. Since agricultural incomes are seasonal and subject to wide variations, specially among small farmers, there is a constant need for credit in the rural sector both for purposes of production and consumption. Due to lack of adequate

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(1) *In 1972, with the amalgamation of Multi-Purpose Co-operative Societies into a large Primary Societies, Rural Banks were re-named Co-operative Rural Banks.*

(2) *“The object of the society is to improve the situation of its members, both materially and morally, to take necessary steps for some to obtain through the common guarantee the necessary capital for granting loans to members for the development of their business and other household needs, to bring idle capital into productive use for which purpose a Savings Bank will be attached to the Society”*

(3) *The Co-operative Development Bank referred to above however did not see the light of day, but in its place was established in 1981, the People's Bank with almost identical objectives.*

(4) *Cencus of Agriculture 1983.*

(5) *To Government (2.5%); Co-operatives (4.1%); Commercial Banks (1.1%); Relations and Friends (44.2%); Landlords (8%); Private Money Lenders (15.5%); Traders (11.5%); Others (13%).*

(6) *In early fifties institutions which provided rural credit consisted of unlimited credit societies, Co-operative Agricultural Production and Sales Societies, Kacheries and the Dept. of Food Production.*

institutional credit facilities in rural areas, (5) villagers have been compelled to obtain their credit requirements from private sources at high rates of interest. This heavy burden of debt had also contributed inter alia, to the poor productive capacity of the village cultivator. A survey of rural indebtedness conducted in 1957 (6) revealed that 46% of rural debts was from "undesirable sources of credit."

This survey also exposed the inadequacy of the then existing Co-operative Credit structure to make a significant contribution in the sphere of rural credit.

It also revealed the inherent weaknesses of the single purpose Co-operative Society and its inability to be an effective instrument in developing the rural economy.

Besides, the tenurial reforms which were introduced in the mid 50's warranted the establishment of institutions to finance tenants who were hitherto assisted by the land owners.

The re-organisation of the large number of single purpose Co-operatives into Multi-purpose Co-operative Societies was considered to be the answer. It was expected to be "the Village Bank, the Village Stores Society, the Marketing Society and the Labour Society, all rolled into one." The establishment of an islandwide network of Multi-purpose Co-operative Societies was therefore undertaken in 1957. Studies which made an identification of credit requirements of farmers in 1957 pointed out that the newly formed Multi-purpose Co-operative Societies should make arrangements for provision of not only productive credit but also non-productive credit such as expenditure on ceremonies, festivals, etc., and for redemption of existing debts.

## The Establishment of the People's Bank

Provision of funds for this vast network required the establishment of a powerful Co-operative apex Bank. This Bank was established in 1961 as a Commercial Bank under the name of People's Bank. The purposes of the Bank were to develop the Co-operative Movement, rural banking and agricultural credit.

After the establishment of the People's Bank, provision of financial assistance to the Co-operative Movement increased in quantity to a marked degree. But this increase represented merely an expansion of the already existing services which were provided by the Co-operative Banks rather than a new departure to develop rural credit on the lines envisaged in the Bank Act. During the initial stages the Bank established a large number of branches, specially in areas which had not been hitherto served by commercial Banks. It also opened the doors to the people in lower income groups who could not obtain facilities from other commercial Banks. But these facilities were provided mostly to fixed income earners in lower income levels.

In contrast to the Bank's success in assisting such small fixed earners, was its inability to make a worthwhile impact in the sphere of agricultural credit in the rural sector. Access to credit, absence of bankable securities, irregular pattern of income and other inherent defects in rural agriculture inhibited to a large extent the Bank's ability to expand its role in the rural sector. Besides, the inadequacy of the normal canons of commercial lending in assessing credit-worthiness of rural cultivators and the magnitude of the problem itself precluded the Bank from finding an effective solution to this problem on its own.

## The First Step Towards the Rural Sector

The Bank's lending to the rural sector through Co-operatives which was confined initially to financing of paddy purchases, consumer and other trading requirements of MPCSs, was expanded for the first time in 1965 with the launching of the Extended Rural Credit Scheme. Under this scheme, short and medium-term credit facilities were made available to certain selected MPCSs for re-lending to their members. (7)

Short-term crop loans were however not provided as there was a scheme already in operation by the Government.

A review of the performance of this scheme by the Bank in early 1984 surfaced several weak aspects which are described below and formed the basis for an improved system. (8).

(a) The managerial capabilities of the staff had to be strengthened by providing external support and training.

(b) In providing credit, pre-sanction and post-sanction evaluations of applications should be done in a methodical way.

(c) Methods will have to be evolved (i) to accept securities available in village level such as lands without clear title (ii) to recognize the credit standing of borrowers who could not provide documentary evidence of their worth.

(d) There is a need for delegation of authority of the Boards of Societies to sub-committees and Credit Managers to enable quick decision making in disbursing credit.

(e) The procedures relating to (i) proper custody of documents, (ii) maintenance of up-to-date Book-keeping records; (iii) security arrangements and (iv) loan documentation, should be strengthened.

(f) This scheme as it was constituted, was inadequate both in terms of its scope and its operations to meet the rural credit requirements and to act as a catalyst in promoting the rural sector.

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(7) *Facilities were granted for the following purposes initially Production (Rs.2,500/-); Consumption (Rs.500/-); House Repairs (Rs.2,500/-); Redemption of Debts (Rs.2,500/-); with a maximum of Rs.2,000/ per member and was extended later.*

(8) *This scheme continued till 1979 side by side with the Rural Bank Scheme.*

(g) The provision of a credit line and supporting services in themselves were inadequate to restore the confidence of the rural community who had witnessed for nearly half a century the disbursement of credit by Co-operatives. The Credit Department of Co-operatives had to be given the image of a Bank.

(h) The Societies' lending should be linked to Bank lending.

### Setting up of Rural Banks

The lessons drawn from this experiment and the agonizing re-appraisals of its own limited role in the rural sector, led the People's Bank in 1964 to develop the concept of banking through Co-operatives into a practical and working proposition. The result was the formulation of the Rural Banking Scheme.

The objectives of setting up Rural Banks were then enunciated as follows

i) To provide credit facilities in a fruitful manner to members of societies.

ii) To provide credit supervision for facilities granted.

iii) To up-grade the book-keeping and documentation system.

iv) To develop methods for savings mobilization.

And the scope and functions of Rural Banks were framed thus :

i) To provide loan facilities for any purpose within a limit of Rs.3,000/-. Facilities above this limit to be considered by the nearest branch of the People's Bank.

ii) Linking credit with marketing.

iii) Development of Rural Banking and Depsit Mobilization.

iv) Pawn Broking as People's Bank's agents.

To ensure their viability, the new scheme was thrown open to those MPCSs which conformed to the eligibility criteria prescribed. (10) Priority was given to societies operating the Extended Scheme successfully.

Eligible Societies could make their applications to the Bank to join the scheme. Thereafter the Bank did the selection on a case by case basis after an inspection and scrutiny of the Society. Once selected, the Society and the Bank entered into an Agreement setting out the terms and conditions under which the Rural Bank was to operate.

As an initial step for the establishment of Rural Banks, the selected Societies were expected to amend their By-laws to enable them to establish Rural Banks. The People's Bank in turn provided the following : (a) financial assistance for on-lending; (b) managerial assistance by seconding one of its own employees; (c) safes, counters, stationary and equipment for pawning; (d) supervision.

Under this scheme, credit facilities were made available to members for production, housing, debt redemption, trade, consumption, emergencies and for rural electrification. These facilities were provided both as short-term and medium-term loans with repayments ranging from 1 year to 5 years.

These Rural Banks were authorized to engage in pawning as agents of the People's Bank

Crop loan facilities of a seasonal nature however were not introduced as a scheme of granting cultivation loans, implemented by the Government, was in operation. However, provision of temporary Bridging finance facilities was envisaged against such loans.

Facilities were made available both for members and non-members to maintain different types of savings accounts such as, ordinary savings accounts, minor's savings accounts and Investment Savings Accounts. Members were expected to enter into a Marketing Agreement with the Society. All sales proceeds were expected to be credited to their accounts. Fixed Deposits were also accepted from members and non-members. Current Account facilities too were provided to members of the first three Rural Banks at the initial stage after which this facility had to be hastily withdrawn when certain legal impediments were encounted. Had these current accounts been maintained, more innovative credit facilities would have been evolved.

By 1971 this scheme had been extended to 111 Societies and the number of accounts attracted had grown to 60871. By this time this institution had not only gained the confidence of the rural population, but had also attracted the attention of academicians, researchers and officialdom as a new banking concept worth taking seriously. The establishment of banking sections in all amalgamated MPCSs was accepted as Government policy.

### Changes in Rural Banks after Amalgamation of MPCSs

The amalgamation of a multitude of small MPCSs to a relatively small number of, large MPCSs covering a wider area of operation, necessitated in 1973 certain organisational changes in the structure of Rural Banks. These Banks which were hitherto run on unitary lines, became a branch banking system with Head Office operations and Branch operations. Most of the former Rural Banks became branches of the new Banks. The name

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(9) *vide Rural Credit and Banking Circular No.1/84 of 22-03-64.*

(10) *(i) Minimum membership of 500; (ii) Shares of at least 75% members should be upto date; (iii) There should be no default by any creditor; (iv) Society is run at a profit; (v) Should be atleast 3 years after establishment; (vi) Should be an agent for paddy purchases; (vii) Should have a strong building.*

Rural Bank too was changed to Co-operative Rural Bank. A new cadre of Co-operative employees designated "Marketing and Credit Manager"(11) was placed in-charge of these Banks. Accounting and maintenance of records were centralized. The role of the People's Bank became more supervisory. This change, brought in its wake a weakening of the People's Bank's control over these institutions.

In 1973, to cope with the newly introduced expanded crop loan scheme, functions of CRBs were re-defined and widened as follows - (a) Mobilisation of deposits from members, (b) Provision of loan facilities to members for production and consumption purposes aligned to MPCS Development programme. (c) Pawn broking facilities for members and non members. (d) Provision of money, payments and transfer services. The provision of crop loans was also brought within the ambit of CRBs. The Co-operatives however lost their monopoly over cultivation credit as the Bank of Ceylon too joined the scheme in 1973. The concept of considering the farmer as a unit of production and assessing all his credit needs within a comprehensive plan under which a credit limit was to be approved for each farmer was introduced and was called the Comprehensive Credit Scheme.

Although different types of credit requirements came under a single credit limit, refinance from the Central Bank was available only for crop loans. Therefore, different lending schemes came to be maintained separately.

### Lending Schemes

Thus, three main lending schemes came to be operated - (1) Short and Medium term facilities provided under the Comprehensive Credit Scheme and the original Rural Banking Scheme, (2) Seasonal crop loan facilities for paddy and other subsidiary food crops provided under the Comprehensive Credit Scheme, (3) Pawning as People's Bank's agents.

TABLE I

**CRB CREDIT FACILITIES**

| | Purpose | Maximum Amount | | | | Maximum Repayment Period |
|---|---|---|---|---|---|---|
| | | 1964 | 1966 | 1970 | 1980 | |
| 1. | Production | 2,500 | 5,000 | 7,500 | 15,000 | 1-5 years |
| 2. | Housing | 2,500 | 5,000 | 7,500 | 15,000 | 3-5 years |
| 3. | Debt Redemption | 2,500 | 5,000 | 5,000 | 5,000 | 5 years |
| 4. | Trade | - | - | 1,000 | 2,000 | |
| 5. | Consumption (Purchase of consumer durables like radios, sewing machines) | 500 | 500 | 1,000 | 5,000 | 1 year |
| 6. | Emergencies | 200 | 200 | 200 | 500 | 1 year |
| 7. | Electrification | - | 600 | 1,000 | 3,000 | 3 years |
| | Maximum loan limit per individual member | 3,000 | 5,000 | 7,500 | 15,000 | |

TABLE II

**TOTAL ADVANCES**

| | | No. of Advances | Balance (Rs.) |
|---|---|---|---|
| 1. | Agricultural Production Sub total | 13082 | 23,901,671 |
| 2. | Consumption | 3,796 | 4,671,167 |
| 3. | Industries | 2,814 | 6,278,481 |
| 4. | Housing | 29,220 | 79,416,216 |
| 5. | Redemption of Debts | 7,677 | 12,425,440 |
| 6. | Trade | 8,441 | 5,723,127 |
| 7. | Animal Husbandry | 4,863 | 6,989,074 |
| 8. | Electrification | 976 | 1,800,469 |
| 9. | Others | 3610 | 6,929,096 |
| | TOTAL | 67,384 | 147,703,669 |

### Short and Medium Term Lending

Purposes for which these credit facilities are provided and their terms are given in Table I. This also shows the gradual increase in limits under each purpose. The current rates of lending to Societies for CRB funding is 18% p.a. CRBs re-lend to members retaining a margin of about 4 - 5 %. The People's Bank does not specify the on-lending rate. Loans upto Rs.5,000/- could be obtained against the guarantee of two acceptable members, and for those above this limited collateral security is taken. There is provision even to accept lands with undivided ownership as security. Village notaries attend to title investigations and mortgages. Loans against 90% of fixed and savings balances are also provided.

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(11) *They are now called Banking Service Managers.*

Within the prescribed ceilings, funds are provided for the full cost of a project, without calling for an enquity contribution, (12).

As at 31.12.1983, Medium and Short-term loans outstanding was Rs.147.7 million in respect of 67,364 loans. A purpose- wise breakdown of these facilities are given in Table II

A regional-wise analysis indicates that 92% of the loan volume has been disbursed outside Colombo District thereby demonstrating the strong rural biased dispersion in lending.

Lending operations and credit disbursements have not been upto expectations. Apart from the mimum share requirements for borrowings, relatively high interest rates, internal administrative problems, the lack of emphasis on identification and appraisal of small scale rural projects too appear to contribute to this position.

## Crop Loans

Since 1973, the provision of seasonal crop loans too were brought within the CRB Scheme. Credit facilities are provided for paddy and sixteen Subsidiary Food Crops for purposes such as land preparation, seed, fertilizer, agrochemicals and for harvesting. The scales of finance per acre are periodically decided by the Ministry of Agriculture in consultation with the Banks. (13) Under this scheme the Central Bank provides 100% refinance facilities and the People's Bank lends these funds to MPCSs which, in turn relend to member farmers through the CRBs. The performance of this scheme is summerised in Annex II.

Since a fuller discussion of this scheme is being made in another paper, suffice it to add here that Proposals for major changes to expand the coverage of this lending scheme have been made by Bank to the Central Bank, under which due recognition has been given for the setting up of an inbuilt mechanism for re-scheduling of loans by way of a STabilization Fund to cover loan defaults due to natural hazards, a problem which had bedevilled many a lending scheme in the past.

## Pawning

Loan Facilities granted against pledge of jewellery can be considered as the most successful lending operation of the CRBs. Societies could engage in pawning either with their own funds or after obtaining overdraft facilities from the People's Bank. Pawning loans are given both for essential purposes and consumer purposes to non-members and members. These advances are repayable within a year. Renewal of advances are however allowed after payment of the annual interest. The Bank lends funds for these purposes currently at 23% p.a. and the CRBs in turn re-lend at 28 - 30% p.a. As at 31.12.83, pawning advances stood at Rs.243.9 million in respect of 350,265 advances.

## Savings Mobilization

CRBs have proved to be a very effective medium of mobilising rural savings. Both the volume of savings and the number of savers bear witness to this phenomenon. As at 31.12.83, Savings and Fixed Deposit balances outstanding were Rs.718 Mn. Of this Rs.590 Mn were held in 1,612,000 savings accounts. Another noteworthy feature of savings mobilization is that 63% of savings deposits and 59% of savings accounts were held by non-members, which demonstrates the extent of confidence reposed by the rural community in CRBs.

The deposits and advances position under the CRB scheme as at 31.12.1983 could be summarised as follows:-

| | | Volume (Mn) | No. of Accounts |
|---|---|---|---|
| **Advances** | | | |
| 1) | Short and Medium-term Loans | 147.7 | 67,364 |
| 2) | Pawning | 244.0 | 339,816 |
| 3) | Crop Loans scheme since 73/74 (Maha) | 507.1 | |
| | | 898.8 | |
| **Deposits** | | | |
| Savings | | 589.7 | 1,612,485 |
| Fixed Deposits | | 129.2 | |
| | | 718.9 | 24,765 |

Although the gross loans/ deposits ratio indicates a lending surplus, when cultivation loans for which Central Bank refinance is available, to the People's Bank are set aside, the advances/deposits ratio is only 54%.

Much has been said about the short-fall of lending vis-a-vis, the deposits mobilized. One cannot overlook the fact that the bulk of savers being non-members are ineligible for loans except pawning advances. Viewed in this light the position does not look so unfavourable.

## Investment of Supplies Funds

The People's Bank provides facilities for Rural Banks to invest their surpluses in the form of Fixed and Savings Accounts. Surpluses built in current accounts are periodically transferred to Savings Accounts maintaining only minimum balances required in current accounts. In addition CRBs too invest their surpluses in the National Savings Bank when their rates are more favourable. Besides, the healthy savings surpluses position has enabled a large number of societies to satisfy the demand for credit from their members

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(12) *This is however counter-balanced by the share contribution requirement up to 10% of a loan.*

(13) *At present these scales vary from Rs.1,400/- to Rs.2,400/- per acre of paddy.*

with their own resources. Latest figures indicate that, of the 843 Rural Banks 685 are managing with their own funds.

### Profile of a Co-operative Rural Bank

The Board of Directors of a MPCS holds the overall responsibility of the CRB through the General Manager who is assisted by an Executive Grade Officer designated as "The Banking Services Manager", whose sole function is the management of banking activities. Generally, a CRB will have 2-3 branches. These branches are under the control of Branch Managers. A typical CRB branch will be a small unit consisting of a Branch Manager and assisted by one or two clerks. There will be about 75 - 100 transactions a day covering savings accounts, pawning and other lending operations. Monthly about 10 loan applications would be handled during off seasons and a heavier work load during the cultivation season. The processing time of loan applications would vary from 1 - 6 weeks, depending on the nature of securities and the purpose.

Applications for credit by members are entertained at a Branch of the CRB or Society. These are examined by the Branch Manager and the Branch Committee of elected members and are referred to the Banking Services Manager at the Head Office of the society. Processing of applications are generally handled at the Head Office and are referred to the Sub-committee of the Board of Directors where the General Manager, People's Bank representative and a few members of the Board participate, in making recommendations to the Board of Directors. These applications are thereafter submitted to the Board of Directors for approval. The Banking Services Manager is delegated with authority to grant loans for emergencies, and he thereafter seeks the covering sanction of the Board of Directors.

Banks are open for business generally from about 9.00 - 1.30 p.m. but in certain areas hours are extended upto about 3.30 p.m. Most CRBs are open for business on Saturdays as well.

### Overall Profitability

It may also be of interest to examine the overall profitability of Rural Banks. The main source of income of Rural Banks is the interest received from pawning advances. Their administrative costs are fairly low as these units are managed by a small staff. As at 31.12.83 of the 843 Rural Banks, are reported to be running at a profit. Their total profits were Rs.16.9 Mn and the total loss of the balance 42 were Rs.414,000/-. Thus, the CRBs have become one of the main profit centres of MPCSs.

### Financial Safeguards

Certain safeguards have also been introduced to strengthen the financial viability of lending operations and safety of deposits. Under these arrangements (1) MPCSs are expected to make an annual assessment of the delinquent loans and set apart a portion of their annual profits to a "Reserve for Bad and Doubtful Debts." (2) All CRBs are also required to deposit monthly to a special Savings account at the People's Bank styled "Rural Bank Deposit Guarantee Fund". An amount equivalent to one-tenth of 1% of the total monthly deposits made by depositors to Fixed and Savings Accounts maintained with them and (3) a Contingency Fund for pawning has been set up to which the CRBs contribute monthly a portion of the interest received, and is meant to recoup losses which are not covered by insurance.

### Supervisory and Review Mechanisms

Operations of these institutions are reviewed periodically by several institutions. In addition to the internal audit conducted by the Society itself the Development Assistants of the People's Bank are also expected to audit all vouchers and transactions handled daily by CRBs. These audits are conducted normally during weekly visits. They are also subject to the annual Co-operative Department's Audit. The Regional Offices of the People's Bank carry out annual inspections and quarterly surprise checks to review lending operations and other activities. As at 31.12.83, 630 of 843 CRBs had been inspected by the REgional Offices during the year. In addition, the Rural Credit Department of the Central Bank of Ceylon also inspects the Rural Bank which are selected at random.

### Conclusion

Now that the CRBs have come of age and have demonstrated their capabilities to undertake wider responsibilities, some of the lines on which further expansion could be examined are -

a) Introduction of Current Accounts, enabling provision of facilities through these Accounts as Overdraft facilities revolving credit facilities etc., for which amendments to existing law would be necessary.

b) delegation of authority to CRBs to act as the People's Bank's agents and accept and transmit to the People's Bank, applications for larger facilities from members and non members,

c) to bring these institutions closer to the development process by permitting them to lend under special schemes such as, Integrated Rural Development Projects, Dry Zone Development Project, etc.

Our Bank is presently examining the feasibility of expanding their services on these lines.

# A MORE EFFICIENT ADMINISTRATIVE SERVICE

A.S. Amaraskera

*A.S. Amaraskera who has been with the Sri Lanka Administrative Service since 1975 served a four year term as Sri Lanka's First Secretary (Commercial in Singapore during this period. He makes these observations strictly in his personal capacity, from his experience and study of both. the Sri Lanka Service and the Singapore Service*

At a time when much controversy has arisen regarding the role of the Administrator,, his importance vis-a-vis the professional and a host of other questions about the administrative structure of out country and its effectiveness in development, it seems appropriate to examine the Sri Lanka Administrative Service (SLAS) in relation to an equivalent service in a developing country in the region. The Singapore Administrative Service (SAS) has been chosen for this comparison mainly because of the nature of its achievements over the past two decades which has resulted in its acceptance worldwide as an exemplary Administrative Service. This paper is the result of over four and a half years of close contact and association with Singapore's premier service within its public service (still called the Civil Service) and the experience thus gained in working in an environment and with a system the objectives of which always appear to be improvement and achievement.

The Singapore Administrative Service (SAS) is the country's premier service in all respects-prestige, functions, wages and importance. It is generally referred to as the No. 1 service and is ranked higher than the Engineering, Medical, Scientific and other professional services. There are several similarities as well as differences between the structure, concept and functions of the SLAS and the SAS. While some of the differences are obviously results of the disparity in the stages of economic development of the two countries, some differences originate from other sources too. Similarities have been occasioned by the fact that the two services both stem from and have been initially modelled on the British Civil Service. However, the nature, functions and objectives of the two Administrative Services as they stand today are far different to the original British model.

Recruits to the SAS are from among persons with high academic qualifications and this is true of the greater number of SLAS recruits too. The number of SAS officers as a percentage of the total Civil Service is .3 percent while the comparative figure for the SLAS is about .34 percent. Both services initaited primarily to maintain law and order and collect revenue have over the years been gradually transformed and now engage in direct participation in development activities in their respective countries. All officers of the SAS as well as the SLAS are transferable and as a result perform a varied set of functions and duties as they progress in the service. Finally the goal of most recruits to each service is to reach the rank of Permanent Secretary (Secretary in this country) which is considered the most high ranking and prestigious post in the public service. The differences between the SAS and SLAS are likely to become clearer on a closer examination of the SAS.

## RECRUITMENT

Only persons who have obtained a first class Honours degree or a second class (upper division) are eligible for selection to the SAS. Although recruitment takes place immediately following their obtaining the degree, actual selection takes place, generally, years earlier soon after the local General Certificate of Education (GCE) 'A' Level results have been released. At this stage applications are invited from those who have performed exceptionally well. Candidates who have passed the preliminary examination for admission to the Universities of Oxford or Cambridge are also eligible to apply. Selection is by interview by the PSC or panel or board nominated by it. On selection the prospective recruits are offered a scholarship through the University on condition that they join the Service and serve the government for at least eight years after graduation. The assessment of their academic prowess at GCE 'A' Level is so accurate that almost all those selected after 'A' Level reach the required standard of a 1st Class Honours or a 2nd Class Upper Division. The probationary period is two years during which the 'cadets' are trained at home and abroad. They are also assigned brief planned postings under the superivision of experienced senior officers.

A factor worthy of note is that the subjects offered for the GCE 'A' Level or the degree are not material in the selection process. Candidates from such varied disciplines as the Arts, Sciences, Engineering, Medicine, Business Studies and even Languages are given an equal opportunity provided their achievements conform to the basic academic excellence required. Once recruited and trained, the government sees to it that maximum use is made of the particular subject or discipline the officer has specialised in. As a result, the knowledge, expertise and experience of these officers in their varied fields are never lost to government. Recruitment is also carried out to a very limited extent by means of open advertisement in the newspapers. The minimum qualifications required are the same as those outlined above. This affords an opportunity for late developers who may not have performed exceptionally well at the 'A'- Levels but have succeeded in obtaining the required honours degree.

In the recruitment procedure, academic excellence and intellectual ability are not the only criteria for selection to the SAS. Aptitude, character and leadership qualities received equal weightage. The Public Service Commission (the appointing authority) has laid down the following requirements for entry to the SAS:

> *"A good Honours Degree. Apart from good academic qualifications, Administrative Officers must possess integrity, self-discipline and commitment to the service. They should have a clear and analytical mind, able to size up problems or situations and come up quickly with practical solutions. They should also be self-assured, innovative and adaptable, coping well with the demands and pressures of change and able to get work done quickly"* (1).

Although these requirements are not specifically stated, it is presumed that Selection Boards look for these qualities when selecting officers for the SLAS and therefore in this respect the criteria are similar. The differences however are more marked and greater in number. There are three methods of selection to the SLAS, namely Open Competitive Examination, Limited Competitive Examination and the Merit Promotion Scheme. The number taken in under the Open Competitive Scheme is the largest, comprising 60 percent of the intake while the other two schemes cater to 20 percent and 20 percent respectively. While the Open Competitive Scheme is purely for graduates it laid down (until recently) no specific academic excellence except the possession of a degree.

A significant difference between the schemes of recruitment to the SAS and the SLAS (Open Competition) was the emphasis placed on academic distinction by the SAS and the total absence of such a requirement for entry to the SLAS. An SAS recruit must necessarily possess a 1st or 2nd class Upper (Honours) Degree but the SLAS entrant could get by with a mere pass degree. An emphasis on high academic qualifications did however, exist under the Ceylon Civil Service (CCS) recruitment scheme and for some years (since its formation in 1963) under the SLAS scheme. Sarath Amunugama, writing to the Economic Review in 1977 refers to this as the "Haileybury Tradition" which dominated the Colonial Civil Service. The scheme which was initiated in 1977 which he called a "radical departure from this system" had no such such stress on academic learning.

The examination for entry was in two parts - (1) an Elimination Test and (2) Selection Test. The Elimination Test was made up of two papers - (a) Comprehension and (b) Intelligence Test. Successful candidates then faced the Selection Test which consists of an Essay paper, a General paper and a viva voce. It will be seen that although the very basis of the SAS scheme of recruitment is academic excellence, the SLAS entry scheme did not at that time require a test of academic knowledge. However, a decision has been taken recently to go back to the "Haileybury Tradition" and candidates have now to sit for 4 subject papers and 2 general papers-General Intelligence, Comprehension and General Knowledge. In fact the intake of SLAS cadets in 1983 was on this basis.

The Limited Competitive Exam is for those in service who have served over ten years (graduates five) and the Merit Promotion generally for those who have probably served longer and reached the 'top' with no further avenues of promotion open to them in their service. In all three schemes final selection is by interview. In contrast the SAS has no room for persons other than those with 1st class or Second Class Upper Honours Degrees, and does not entertain officers from the ranks either through competition or merit.

The SLAS scheme of recruitment appears more democratic in that it gives a chance through its Limited Competitive and Merit Promotion schemes, to intelligent officers who may not have been able to graduate due to lack of opportunity, to prove their capabilities and qualify to enter the service. In a country where educational opportunities and facilities vary considerably from district to district such arrangements are both humane and democratic. However, from the point of view of the usefulness and the effectiveness of these two schemes in the furtherance of government policy and development, arguments could be raised against as well as for them. For instance those competing for entry through the Limited Competitive Examinations are usually in the clerical and allied services and have thus been working at levels below the Administrative over long periods. As a result, these mature officers have formed ways of thinking that do not measure up to management level and are not therefore suited to take on a new and more demanding role which necessitates an almost complete change in outlook. Again, those promoted on merit are advanced in years and may serve only 3-5 years before they retire. The benefit here is mainly to the officer as he would draw a higher pension on retirement but the benefit to government is possibly minimal as he serves only a brief period in his new role. As against these disadvantages, these officers have experience in working within the system, have gained a knowledge of governmental activities, programmes and procedures and are therefore equipped in a sense to fit into their new positions.

The Singapore Administrative Service recruitment procedure is, on the other hand, autocratic. There are no second chances. Either one makes the grade at a particular stage or one loses the opportunity altogether. However, the formulation of this rigid system appears to have been governed by two important factors which are peculiar to Singapore. One is that the small population of 2.4 million places limitations on the availability of human resources with the high level of attainment required to enter the SAS. The best intelect and talent therefore has to be put to the best use.

A Senior Singapore Civil Servant has put this rather simply but forcefully as follows:

> *"Singapore is a small country. We do not have resources such as minerals; nor have we got the expanse of land to develop argilculture. But one thing we do have and that is human resources; and the philosophy for development is to maximise the use of our citizens' abilities in the development of the economy".*

The second reason lies more in the Singapore Concept of the 'Administrator' as compared with our own and this merits closer scrutiny.

## CONCEPT

In terms of the Singapore Concept, the Administrator's responsibilities could be conveniently crystallised into three basic functions thinking, planning and decision making. As a thinker it falls within the purview of the Administrator to project his mind forward not a month or a year, but decades and to assess the state of development in the world as well as in the region and its possible repercussions on his country at that point of time e.g. in the year 2010. He is expected to do so by making use of statistical data, reports and other information in the relevant areas, which are made available to him. As a planner, the Administrator must then, necessarily assist in the formulation of plans and programmes to meet the demands that would be made on his country in terms of the assessment he has made stage by stage, year by year, decade by decade. As a result of this type of activity the Singapore Educational Programme has been drawn up to meet the needs of the year 2010, while the Family Planning Programme envisages a population of 3.4 million in the year 2030. From this point onwards Singapore expects to achieve a zero rate of population growth.

As a decision maker the Administrator is called upon to deal with a host of problems that crop up in the inplementation of programmes. He is constantly compelled to make quick decisions under great pressure; his decisions have to be directed towards the ultimate goal of achieving the objectives and targets set by his thinking and planning activities. To borrow an expression from Professor G.G. Thomson, SAS officers are doers or thinkers preparing for doing.

The explanation of the Singapore Concept of the Administrator given above may appear over simplified but could be considered basic to the thinking of the Singapore authorities on the subject. The following extract from the "Scope and Nature of Duties" as outlined in a memorandum on the SAS would serve to illustrate this:

> *"The Administrative Service is the premier service in the Civil Service Holding key positions in ministries and departments, Administrative Officers assist minimeters in the formulating and implementation of Government policy as well as in the co-ordination and improvement of Government machinery. Work in this elite service is especially challenging, varied and rewarding and will be increasingly so with the growing complexity and modernisation of Government activities."*

What becomes increasingly clear from the foregoing is that the SAS officer does not engage in routine work or establishments work as the SLAS officer knows it. He will not approve the granting of an increment to a subordinate nor approve applications for leave. He is not concerned with an underpayment of a few hundred dollars to government or the refund of an overpayment. His own time and energies are too valuable and cannot be spent on these day to day matters. These are left to the 'Executive Officers' - a kind of middle grade in the Civil Service which functions at a level between the Administrative and the Clerical. The functions of the executive officer are similar to those of the Office Assistant (OA) or Chief Clerk (CC) in the local set up. He attends to office administration routine or establishments work and leaves the SAS officer's 'routine' consists in attending seminars, conferences, discussions at ministry and interministerial level, engaging in studies, compilation of reports and handling special assignments both at home and abroad. It will therefore be seen that he clearly functions at a level and in an area in keeping with the intellectual abilities and commitment that are required of him as an SAS Officer.

When one considers how often SLAS officers at all levels (this does not exclude "permanent" Secretaries) are hampered by having to see to routine matters which leaves them little time to engage in thinking, planning and formulation of policy and programmes, one wonders whether it is not time that the scope and nature of duties of SLAS officers is re-examined in the light of the Singapore Concept. One weakness may lie in the lack of a proper definition of the scope and nature of duties a deficiency which could be set right without much difficulty. While total absorption or imitation of the Singapore Concept is not intended, the possibility of modifying it to suit the role of the SLAS officer in the local environment seems to be desirable.

## TRAINING

The training of SAS officers is carried out by the Civil Service Institute (CSI) which is in many ways the counterpart of the Sri Lanka Institute of Development Administration (SLIDA). The induction training for SAS cadets lasts two months culminating in a two week tour of the ASEAN countries. The CSI conducts courses for all levels in the Civil Service but those relevant to the SAS are the Middle Management Course and the Senior Management Course. Middle managers are instructed in the principles of management, quantitative analysis and economic policies. The subjects are reminiscent of those covered by SLIDA for SLAS middle managers.

The more interesting and significant course is the Senior Management Course which is a residential course for Heads of Departments and Permanent Secretaries. This course deals mainly with concepts of management. The CSI also conducts English Language Courses at all levels but concentrates on the Senior and Middle level management. It is well known that the Singapore Prime Minister once made all Permanent Secretaries follow a two weeks English Language Course at the Civil Service Institute.

## PROMOTIONAL PROSPECTS

Opportunities for promotion to higher grades in the SAS are attractive depending on the ability and performance of each officer. The higher grades of appointment with salaries applicable to each are given in Table I at right.

An Administrative Service officer begins his career as an Administrative Assistant drawing S$ 1600 p.m. Within a period of 4-6 years it is possible for him, depending on his abilities, to reach the grade of Assistant Secretary which carries an initial salary of S$ 3300 p.m. The next grade called Principal Assistant Secretary could be reached within another 3-4 years and would bring as monthly remuneration S$4300.

Usually a Principal Assistant Secretary would reach the maximum in two years time and be eligible for promotion to the Deputy Secretary Superscale G at which he would earn S$5500 p.m. In this category there are two other levels Grade E and Grade D which carry salaries of S$6500 and S$7500 p.m. respectively. By the time an officer reaches Superscale Grade D, he would have put in about 15 years service and served in several ministries and departments. He would now be eligible to become a Permanent Secretary in Superscale Grade C drawing S$ 9,500 p.m. From this point onwards promotion is slower but a Permanent Secretary can aspire to receive a salary of S$21,700 p.m. in the top grade of the service called Permanent Secretary Staff Grade III. As far as the writer is aware no officer is at present drawing this salary the closest being that drawn by the Permanent Secretary Ministry of Finance who draws almost S$18,000 p.m.

Two features worthy of note in the composition of the scales is the rapidity of promotion and the increases in salary even after reaching the rank of Permanent Secretary. There is no 'stagnation' at any point thus creating an atmosphere of recognition of ability and performance.

Sir Derek Rayner Adviser to the present British Prime Minister writing in "The Administrator" has made two significant observations on the lack of recognition of ability and performance in the UK and the need to correct this situation. Sir Derek says that "Too often it is the capacity to avoid error which collects the honours" and in the same vein states elsewhere in his paper

> *"Succession planning should be developed to ensure that those who are known to have capacity are promoted to top positions when the time comes and not those who claim to them in seniority."*

Further, in the context of living costs in Singapore an SAS officer has few financial problems as his salary is more than adequate for his needs and the maintenance of his social position. This is because wages are based on actual cost and allowances made regularly for inflation.

Salaries in the private sector are, as in most developing countries, more attractive and jobs are accompanied by the usual fringe benefits. On the other hand, while a post in the SAS is both secure and satisfying, employment in the private sector though more remunerative, lacks stability. This is partly borne out by the fact that 'job hopping' is a common phenomenon among private sector establishments in Singapore. Again an SAS officer could look for a job

Table I

Permanent Secretary

(a) Staff Grade III*S$21,700 p.m.
(b) Staff Grade II S$18,600
(c) Staff Grade I S$15,900
(d) Superscale Grade A S$13,600
(e) SuperscaleGrade B S$11,500
(f) Superscale Grade C S$9,500

Deputy Secretary

(g)Superscale Grade D S$7500
(h)Superscale Grade E S$6500
(i)Superscale Grade G S$5500
Principal Assistant Secretary
(j)S$4300 - 300 x 2 - 4900
Assistant Secretary
(k)S$3,300 - 250 x 5 - 4550

*S$ 1 = Rs 10 (approx.)

outside only after his 8 year compulsory 'bond' term which acts as a deterrent. Thirdly officers in the higher echelons of the service have a sense of commitment which may very well be the deciding factor in their desire to continue in the SAS. Whatever the reason, 'defections' to the private sector are few and far between and have never posed a serious problem to the authorities.

## POLITICAL INTERFERENCE

It would not be correct to say that members of Parliament do not attempt to interfere at all in dealings the public as with the bureaucracy. However, such interventions often involve only an exchange of letters. To take an example : a Member of Parliment may at the request of one of his constituents write to the Permanent Secretary of the Ministry of Housing inquiring as to why one of his constituents has not been granted a Housing Board Flat although he has applied for one and been on the waiting list for over 2 years.

The Permanent Secretary would send the MP a polite reply (probably) stating that (1) 2000 flats have been allocated (2) the constituents number on the waiting list is 3,221 and therefore would he (the MP) kindly inform his constituent that he would have to wait for his turn. It is obvious from this exchange of letters that both parties are aware that the situation cannot be changed. The system must not be violated. This is the basis of the relationship between the MP and the public servant and it is always recognised and respected.

## THE ADMINISTRATOR AND THE PROFESSIONAL

As mentioned earlier, in the Singapore Administrative set up the professional always takes second place. Whatever the profession the scale of salary and the maximum enjoyed by the Administrator is way above it. This will be apparent in a comparison with the salaries of professionals listed in Table II below.

It will be noticed that except for the Engineering Service the initial salary of which is on par with the SAS at S$ 1600 p.m., the initial salaries of the Medical, Dental and Psychologists Services are higher. However, the maximum in any service does not exceed S$ 9500 p.m. In comparison, in the SAS S$ 9500 is the starting salary of a Permanent Secretary (Superscale Gr. C in Table 1). The Permanent Secretary scale rises from this point to S$ 21,700 which is the maximum in the scale while no other professional or scientist could aspire to receive more than S 9500 in the service. However, as mentioned earlier, officers who have achieved academic excellence in other fields could always apply to join the SAS when vacancies are advertised.

Table II

| Initial Post | Salary | Highest Grade | Salary |
|---|---|---|---|
| Engineer ESO (Gr XI) | | ESO Grade I Superscale | |
| Mechanical | S$1600 | " | S$9500 |
| Electrical | S$1600 | " | S$9500 |
| Civil | S$1600 | " | S$9500 |
| Chemical | S$1600 | " | S$9500 |
| Architectural | S$1600 | " | S$9500 |
| Defence Engineering and Scientific Officer | S$1600 | Defence Engineering and Scientific Officer Gr.I Superscale E | S$6500 |
| Medical Officer MBBS | S$2050 | Medical Officer Superscale | S$8500 |
| | | Gr.D + Allowance | S$1750 |
| Dental Officer BDS | S$1800 | Dental Officer Superscale | S$8500 |
| | | Gr.D + Allowance | S$1750 |
| Psychologist Gr.(V) Division I | S$1700 | Psychologist Gr.I Superscale G | S$5500 |

## CAREER DEVELOPMENT

Upto the middle of 1983 the Confidential Report System, which is followed in Sri Lanka too, served as the basis for promotion as well as for career development. However, it had been felt over the last year or two that there had been so much emphasis over the past two decades on economic development that little attention had been given to the development of human resources. The Singapore Government had also seen the need to develop the Administrative Structure to meet the demands of the next few years. In this context it was recognised that a special unit should be set up to appraise the performance of officers in the Service with special attention to the SAS. The new Division set up to handle career development is to implement what is known as the Open Appraisal System as opposed to the earlier Confidential Report System. Under this scheme an officer would be rated at the end of each year on his performance and not on a Confidential Report submitted by his superior or Head of Department. The new appraisal is to take the form of an interview or discussion with the officer on the role he has played over the past year with special reference to his successes as well as his failures, his abilities and inadequacies etc. Steps would then be taken to see that the officer is supervised and trained so that he would be able to perform better. Consideration would also be given to special abilities and skills in appointing the officer to subsequent positions. Thus there would be a 'real' appraisal with a view to career development as opposed to the former purely subjective Confidential Report. This new system has been adopted by the Singapore Government after a team of officers headed by the Permanent Secretary of the Ministry of Finance had made a detailed study of the Open Appraisal System (now being implemented by Shell in the United Kingdom) and made its recommendations to the government.

The SLAS too depends on the Confidential Report System and the form of its operation at present leaves much to be desired. Reports are called for months or even years after an officer has left the department. The head of department who prepared the report is very often unable to recall sufficient information about the officer in order to write an accurate report. On the other hand some heads feel that the officer would not stand a chance of promotion unless he gives him 'A' gradings for all the qualities and abilities he is asked to report on. All these have contributed to making the Confidential Report System a meaningless exercise and the scheme needs looking into. Perhaps a degree of appraisal may be considered initially until an entirely new scheme is formulated.

## CONCLUSION

The appointment recently of a 'high powered' Cabinet Sub-Committee to look into the salary scales of public servants seems most opportune in the light of the basic questions raised in this paper which are summarised below.

(1) Should the present schemes of recruitment to the SLAS continue or should they be modified to recruit persons who would make the best contribution to the country.

(2) Should the SLAS be thrown open to technical and professional officers.

(3) Should the present salary structure of the SLAS be revised to make it the premier service or should it remain a second rate service.

(4) Should the concept of the Administrator be redefined so that he could perform the functions of thinking, planning and policy formulation or should he continue to devote his time to routine work,

(5) Should the system of appraisal through Confidential Reports continue or should it be discontinued and a study made with a view to introducing a new scheme, possibly Open Appraisal.

As mentioned at the very outset, the Singapore Administrative Service is committed to improve and achieve and this it has done admirably over 2½ decades. The secret of its success appears to be that officers are content in their jobs. They have no financial burdens. Promotional prospects are good and promotion is quick. Ability and performance are recognised and rewarded. Above all there is a sense of commitment to the task the Administrator is ultimately involved in the task of nation building. If nothing else, this should commend the SAS as an example to be followed by the Administrators.

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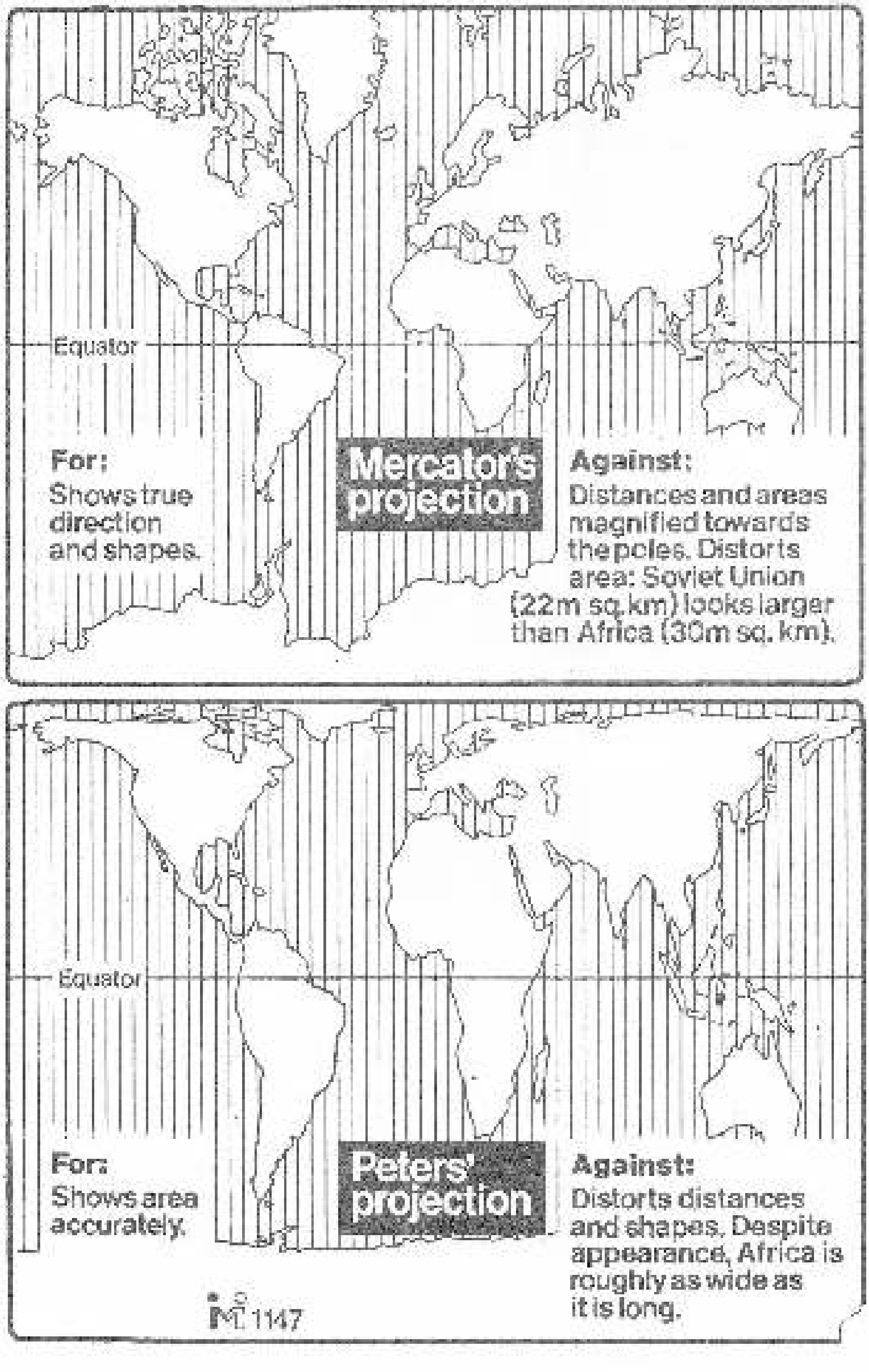
FACTS AND TREADS

# New Map – New World?

## How we look at the world



**Mercator's projection**

**For:** Shows true direction and shapes.

**Against:** Distances and areas magnified towards the poles. Distorts area: Soviet Union (22m sq.km) looks larger than Africa (30m sq. km).

**Peters' projection**

**For:** Shows area accurately.

**Against:** Distorts distances and shapes. Despite appearance, Africa is roughly as wide as it is long.

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