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## Chapter 9

# TRADE, BALANCE OF PAYMENTS AND TOURISM

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### 9.1 Overall Developments

In 2002, the external sector was subject to both global and domestic developments that entailed favourable as well as unfavourable repercussions on the economy. Recovery in the global economy, after significant weakening in the previous year, remained slow. World output grew by 3.0 per cent in 2002. The economies of the US and the Euro area, Sri Lanka's major export markets, grew at 2.4 per cent and 0.8 per cent, respectively. As a result, external demand for goods produced in developing countries grew only moderately, at 6.3 per cent in 2002, recording an acceleration against a growth rate of 3 per cent in 2001, but still below the rate of 15 per cent achieved in 2000. Uncertainty prevailing in the Middle East, and disruptions to oil production in Venezuela, the third largest oil exporter in the world, raised oil prices and reduced the demand for developing country exports in general. However, the unfavourable effects on Sri Lanka's external sector arising from these developments were mitigated to a large extent by the peace initiative commenced by the government by signing a memorandum of understanding with the Liberation Tigers of Tamil Ealam (LTTE) in early 2002, and the macroeconomic policy adjustments undertaken by the government including reforms agreed under the Stand-By Arrangement (SBA) with the International Monetary Fund (IMF).

A relatively large surplus in the overall balance in the balance of payments and a corresponding increase in official external reserves, partial recovery in international trade, a significant recovery in the tourism sector, recovery in port activities, a turnaround in portfolio inflows and increased capital flows and an increase in private transfers were the highlights in external sector developments in 2002. International trade remained broadly flat with a drop in exports by 2.4 per cent and a rise in imports by 2.2 per cent. The trade deficit increased from 7.4 per cent of GDP in 2001 to 8.5 per cent in 2002. The drop in exports was mainly in textiles and garments (4.7 per cent) and tea exports (4.3 per cent). It was partially off set by increases in exports of other agricultural products, processed diamonds and other industrial products. The drop in garments exports reflected Sri Lanka's heavy dependence on the US and European Union markets for these exports. They account for about 63 per cent and 31 per cent, respectively, of Sri Lanka's garments exports.

With the phasing out of the Multifibre Arrangement (MFA) in 2005, the small firms which depend heavily on quotas for survival and those which are not ready to take up the challenges of a competitive market environment, would be in

severe difficulty, with adverse consequences on the balance of payments and employment. Some small firms may merge with large ones and some may adopt new technology to enable firms to move up market. Improved infrastructure facilities and improved functioning of institutions can permit them to deliver output efficiently. The time is also ripe for Sri Lanka to focus more on the services sector, particularly at a time when the government is targeting a sustainable high economic growth of over 7 per cent in the medium term. Sri Lanka's investment policy should be re-directed to attracting more investments, both domestic and foreign, to rapidly growing sectors, where Sri Lanka has a comparative advantage and could maximize the use of its quality human resources.

Imports of investment goods increased by 8.2 per cent and crude oil and other petroleum products by 7.9 per cent. Other intermediate goods imports grew by 4.4 per cent. Increasing imports of investment goods and other intermediate goods were welcome developments for sustained recovery in the economy. The increase in the outlay on oil imports was the result of high international oil prices, due both to interruptions to oil production in Venezuela and to uncertainties prevailing in the Middle East.

The services account showed marked improvement owing to increases in receipts from foreign tourists and receipts from non-resident Sri Lankans which was notable during the year with progress in the peace process. Meanwhile, the continued decrease in global interest rates reduced interest payments on external debt and reduced the deficit on income account. Net current transfers, which reflected only a moderate growth during the first half of the year, increased by 12 per cent in 2002 with a significant increase in private transfers during the latter part of the year, perhaps induced by tension in the Middle East. The increased trade deficit, although offset to some extent by the improvement in the services account, resulted in the deficit on current account widening from 1.5 per cent of GDP in 2001 to 1.6 per cent in 2002.

However, the deficit on current account was more than off-set by increased net inflows in the capital and financial accounts. This was facilitated by foreign direct investments, net long-term borrowing by the private sector and portfolio investments. The potential for high growth in the years to come under new political conditions and signs of economic recovery are likely to have increased foreign investor confidence, inducing them to make both short and long-term commitments. These developments resulted in a surplus of US dollars 338

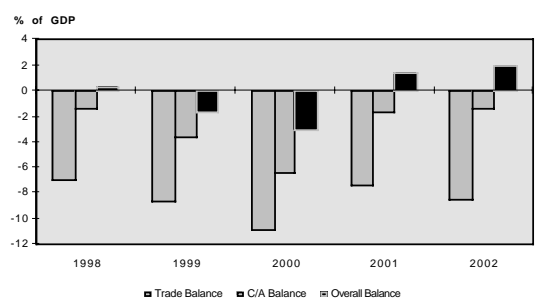
**TABLE 9.1**  
**Balance of Payments Analytic Presentation**  
**(Incorporating FCBUs of Commercial Banks as Part of the Domestic Banking System) (a)**

Item	US dollars Million					Rupees Million				
	1998	1999	2000	2001	2002(b)	1998	1999	2000	2001	2002(b)
Trade Balance	-1,092	-1,369	-1,798	-1,157	-1,406	-69,742	-96,702	-134,176	-102,592	-134,706
Exports	4,798	4,610	5,522	4,817	4,699	310,401	325,170	420,114	430,372	449,855
Imports	5,889	5,979	7,320	5,974	6,106	380,142	421,873	554,290	532,964	584,561
Services, net (c)	145	147	38	175	271	9,300	10,342	2,907	14,692	26,035
Receipts	914	968	953	1,355	1,268	59,084	68,132	72,187	120,937	121,340
Payments	770	820	915	1,180	997	49,783	57,791	69,280	106,246	95,304
Income, net (d)	-180	-254	-305	-267	-252	-11,556	-17,831	-23,009	-23,843	-24,093
Receipts	214	167	152	108	75	13,882	11,810	11,568	9,584	7,201
Payments	394	421	456	375	327	25,437	29,640	34,577	33,427	31,294
Goods, Services and Income (net)	-1,127	-1,476	-2,064	-1,249	-1,387	-71,997	-104,191	-154,278	-111,743	-132,763
Private Transfers, net	848	887	974	984	1,097	54,843	62,472	73,620	87,837	104,980
Receipts (e)	999	1,056	1,160	1,155	1,287	64,585	74,356	87,697	103,180	123,183
Payments	151	169	186	172	190	9,742	11,884	14,078	15,343	18,202
Official Transfers (net)	52	26	24	22	26	3,359	1,816	1,801	1,925	2,485
Current Account	-226	-563	-1,066	-244	-264	-13,795	-39,903	-78,857	-21,981	-25,267
Capital and Financial Account	413	373	443	562	506	26,570	30,473	31,827	49,088	46,589
Capital Account	80	80	50	198	55	5,109	5,650	3,795	17,766	5,296
Capital Transfers (net) (f)	80	80	50	198	55	5,109	5,650	3,795	17,766	5,296
Receipts	84	86	56	203	61	5,410	6,018	4,230	18,241	5,859
Payments	5	5	6	5	6	301	368	435	475	563
Financial Account	334	293	393	364	451	21,461	24,823	28,032	31,322	41,292
Long-term:	398	435	304	164	398	25,906	30,985	22,594	14,348	35,783
Direct Investment	193	177	176	172	235	12,379	12,449	13,319	15,271	22,452
Foreign Direct Investment	137	177	173	82	230	8,846	12,449	13,119	7,310	22,017
Privatisation Proceeds	56	-	3	90	5	3,533	-	200	7,961	435
Private Long-term (net),(d)	2	196	82	-257	1	352	14,086	5,622	-22,907	98
Inflows (g)	146	361	298	45	139	9,686	25,727	22,134	4,054	13,341
Outflows (f)	145	165	216	302	138	9,334	11,641	16,512	26,961	13,242
Government, Long-term (net) (h)	203	62	47	249	162	13,175	4,451	3,653	21,984	13,233
Inflows	493	381	355	575	542	31,896	26,896	26,965	51,193	51,843
Outflows	290	319	308	326	380	18,721	22,445	23,312	29,209	38,610
Short-term:	-64	-142	88	201	53	-4,445	-6,162	5,438	16,974	5,509
Portfolio Investment	-24	-13	-45	-11	25	-1,521	-886	-3,355	-1,025	2,443
Private Short-term (net),(d)	8	-10	100	-42	68	414	-667	7,569	-3,798	6,548
Commercial Bank Assets (net),(d)	180	-19	-141	183	104	5,035	1,766	-18,736	2,867	6,893
Commercial Bank Liabilities (net),(d)	-228	-101	174	71	-145	-8,374	-6,375	19,960	18,929	-10,375
Government Short-term (net),(d)	-	-	-	-	-	-	-	-	-	-
SDR Allocations	-	-	-	-	-	-	-	-	-	-
Valuation Adjustments	-	-	-	-	93	8,559	2,103	5,189	22,245	8,900
Errors and Omissions	-151	-73	101	-98	3	-7,534	-6,857	10,902	-19,587	5,859
Overall Balance (i)	37	-263	-522	220	338	13,800	-14,184	-30,939	29,765	36,051
Monetary Movements (i)	-37	263	522	-220	-338	-13,800	14,184	30,939	-29,765	-36,051
Exchange Rate Rs/US\$	64.6	70.4	75.8	89.4	95.7	64.6	70.4	75.8	89.4	95.7
Ratio to GDP in percentages										
Trade Account	-6.9	-8.7	-10.8	-7.4	-8.5	-6.9	-8.7	-10.7	-7.3	-8.5
Current Account	-1.4	-3.6	-6.4	-1.5	-1.6	-1.4	-3.6	-6.3	-1.6	-1.6
Current Account without Grants	-1.8	-3.6	-6.6	-1.7	-1.8	-1.7	-3.8	-6.4	-1.7	-1.8

Source: Central Bank of Sri Lanka

- (a) This presentation conforms as far as possible to the Balance of Payments Manual, 5th Edition (1993) of the International Monetary Fund. In addition, beginning 1994, Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system.
- (b) Provisional
- (c) Services receipts in 2001 include US dollars 382.4 mn. received by Sri Lankan Airlines as insurance claims for the aircraft destroyed by the attack on the airport in July 2001, while Services payments in 2001 include US dollars 292.8 mn. paid to the lessors of the aircraft. The net receipt of these insurance claims was US dollars 89.6 mn..
- (d) From 1994 onwards Foreign Currency Banking Units (FCBUs) have been treated as a part of the domestic banking system in the compilation of balance of payments statistics. Accordingly, transactions involving FCBUs and non-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded.
- (e) Includes US dollars 78 mn., US dollars 85 mn. and US dollars 45 mn. received in 1998, 1999 and 2000 as compensation of US dollars 2,500 per person to 31,279, 37,343 and 29,323 Sri Lankans, respectively, who lost employment in Kuwait due to the Gulf War in 1990. In addition, US dollars 27 mn was also received as second round payments of US dollars 1,500 each to 18,244 Sri Lankans in 1999.
- (f) Includes US dollars 147.6 mn. in respect of a technical amortization under private capital outflows and a corresponding adjustment under capital transfer receipts in 2001 for the remaining capital of the aircraft destroyed by the attack on the airport in July 2001.
- (g) Includes adjustment to capital inflows in 1999 and 2000 on account of the import of aircraft for which advance payments had been made in previous years.
- (h) Data since 1994 have been revised to incorporate additional information.
- (i) All transactions in the Monetary Sector are converted at the end of year exchange rates.

**Chart 9.1  
Balance of Payments (a)**



(a) With the change in classification from BPM4 to BPM5 format changes in commercial banks assets and liabilities are excluded from the overall balance.

**TABLE 9.2  
External Trade Performance**

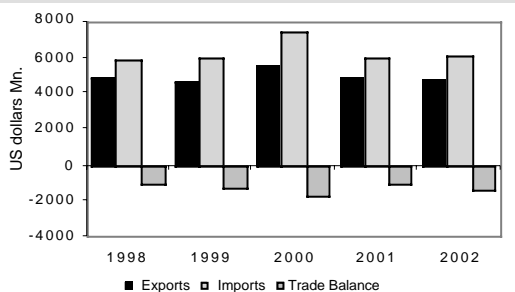
Year	Growth in Value (a)		Unit Value Index (1997=100)		As a percentage of GDP		
	Exports	Imports	Exports	Imports	Terms of Trade (b)	Exports	Imports
2000 (c)	19.8	22.4	125.2	123.8	101.1	33.3	44.1
2001 (d)	-12.8	-18.4	139.6	139.9	99.8	30.6	37.8
2002 (e)	-2.4	2.2	143.1	138.2	103.5	28.4	36.8

Sources: Sri Lanka Customs  
Central Bank of Sri Lanka

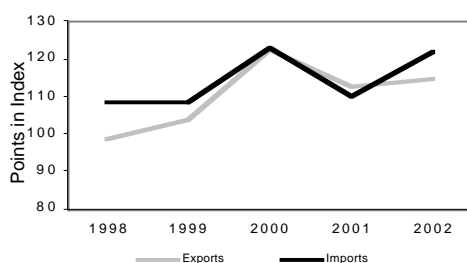
- (a) Growth rates are given in US dollar terms
- (b) (Export unit value index / Import unit value index) X 100
- (c) Import index in 2000 is calculated excluding aircraft imports
- (d) Revised
- (e) Provisional

**Chart 9.2  
External Trade**

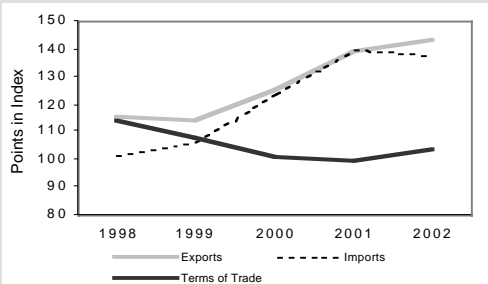
**Chart 9.2.1  
Trade Balance**



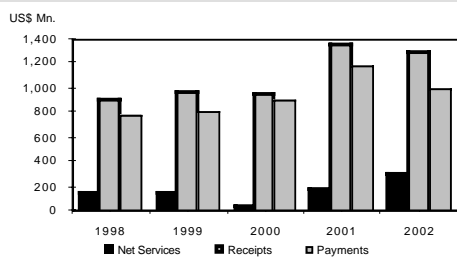
**Chart 9.2.2  
Export and Import Volume Indices (1997 = 100)**



**Chart 9.2.3  
Unit Value Indices (1997=100)**



**Chart 9.2.4  
Trade in Services (a)**



(a) With the change in classification from BPM4 to BPM5 format, services exclude Income which now appears as a separate item in the current account.

million in the overall balance of payments for the second consecutive year. Correspondingly, official external reserves improved to a level sufficient to cover 3.3 months of merchandise goods imports at end 2002.

The external debt of the country, consisting of medium and long-term debt of the government, private sector short-term trade credit and liabilities to the IMF, increased by 8.7 per cent to US dollars 9,291 million due to increased government borrowing and higher liabilities to the IMF, and exchange rate effects arising from the depreciation of the US dollar in international markets. However, as a percentage of GDP, the external debt stock remained at 55 per cent in 2002. Government debt increased by 9 per cent during the year due to new borrowings from multilateral lending agencies, which rose by 13.5 per cent to US dollars 420 million. Net liabilities to the IMF increased by US dollars 78 million or 37 per cent, reflecting purchases under the Stand-by Arrangement signed in April 2001.

Total gross external assets of the country increased by 11 per cent to US dollars 2,495 million at end 2002 and were sufficient to cover 4.9 months of imports in 2002. Total gross official reserves increased by 27 per cent to US dollars 1,700 million and were sufficient to cover 3.3 months of imports in 2002.

Since the flotation of the rupee in 2001, the exchange rate, now determined by market supply and demand, appeared to be more stable. The rupee depreciated by 3.7 per cent against the US dollar in 2002 in comparison to a depreciation of 11.3 per cent in 2001. The real effective exchange rate of the Sri Lankan rupee against a five currency basket (i.e. the US dollar, the sterling pound, the Japanese yen, the Deutsche mark and the Indian rupee) depreciated by 0.5 per cent and against a twenty four currencies basket, it depreciated by 2 per cent during the year, making Sri Lanka's exports more competitive in international markets.

On the policy front, the government further liberalised the capital account in the balance of payments by completely relaxing restrictions on foreign direct investments in Sri Lanka. Areas in which further liberalisation took place were, banking, insurance, stock broking, financial services, mass transportation, telecommunications and professional services.

## 9.2 Exports

Export volume increased by 2 per cent in 2002. However, a larger decrease in export prices by 4.3 per cent reduced export value. The drop in export value was less than in 2001. Total export earnings in 2002 amounted to US dollars 4,699 million, compared with US dollars 4,817 million in 2001, a decline of 2.4 per cent. The decline in 2001 was 12.8 per cent. The cumulative rate of decline slowed down after recording a peak of 17 per cent at the end of the second quarter, slowing down to 8 per cent at the end of the third quarter and reaching 2.4 per cent at end 2002. Of the three major export categories, in value terms, agricultural exports grew by 0.6 per cent, industrial

exports declined by 2.1 per cent, and mineral exports grew by 4.4 per cent. The volume of industrial exports grew by 2.2 per cent but balancing the price drop of 4.3 per cent, the value of industrial exports decreased by 2.1 per cent. As industrial exports account for 77 per cent of total exports, the value of total exports fell. With a decline in import prices by 7.9 per cent, the terms of trade improved by 3.9 per cent in 2002.

Industrial exports are dominated by textile and garments with a share of 67 per cent. The volume of textile and garment exports grew moderately by 1.4 per cent, but prices declined by 6 per cent. Increased competition from low cost producers, and the sluggish global economic recovery, contributed to depress international prices. The increased prominence of China in global markets, partly as a result of China's entry into the World Trade Organisation (WTO) and continuing high productivity of labour in China may further strengthen the downward trend in international prices. Sri Lanka may face reduced demand for textile and garments with the proposed phasing out of the MFA in 2005 unless strong corrective measures are taken well in advance. The weak performance in exports underscores the vulnerability of Sri Lanka's economy, still dominated by a few items and concentrated in a few markets. Both export products and export markets must be diversified.

### Export Structure

The diversification of exports from agriculture to industrial exports has contributed significantly, to increase export earnings. Industrial exports are still prominently concentrated in textile and garments. The share of industrial exports increased gradually from 14 per cent in 1977 to 77 per cent in 2002. Correspondingly, the share of agricultural exports decreased from 79 per cent in 1977 to 20 per cent in 2002. The share of other exports, including mineral exports, declined from 7 per cent in 1977 to 3 per cent in 2002. During the decade from 1992 to 2002, the share of industrial exports continued to grow, while the share of agricultural exports declined. However, the composition of industrial exports during the last decade had not undergone an appreciable change.

Compared with 2001, the export structure in 2002 shows marginal change. Although the share of industrial exports in total exports remained unchanged at 77 per cent, the respective shares of major sub-categories within industrial exports underwent a slight change. Minor agriculture exports, dominated by cinnamon, un-manufactured tobacco, pepper, and cloves, showed significant improvements in 2002. The share of tea among agricultural products decreased from 74 per cent in 2001 to 70 per cent in 2002. All non-plantation agricultural exports accounted for 18 per cent of total agricultural exports.

### Industrial Exports

Earnings from industrial exports declined by 2.1 per cent in 2002, compared to a decline of 13.4 per cent in 2001. Textile

**TABLE 9.3**  
**Composition of Exports**

Category	US dollars Million					Rs. Million				
	1998	1999	2000	2001(a)	2002 (b)	1998	1999	2000	2001(a)	2002(b)
1. Agricultural exports	1,088	947	1,005	932	938	70,225	66,751	76,271	83,252	89,682
Tea	780	621	700	690	660	50,280	43,728	53,133	61,602	63,105
Rubber	44	33	29	24	27	2,808	2,305	2,179	2,129	2,552
Coconut	94	129	121	82	84	6,110	9,119	9,174	7,348	8,009
Kernel products	56	84	77	41	41	3,632	5,973	5,786	3,639	3,958
Other	38	45	45	42	42	2,478	3,146	3,388	3,709	4,051
Minor agricultural products	170	165	155	136	168	11,027	11,598	11,784	12,174	16,016
2. Industrial exports (c)	3,607	3,551	4,283	3,710	3,631	233,508	250,516	325,931	331,687	347,657
Food, beverages and tobacco	118	86	152	128	123	7,586	6,093	11,573	11,389	11,799
Textiles and garments	2,460	2,425	2,982	2,543	2,424	159,303	171,068	226,930	227,360	232,027
Petroleum products	73	74	98	68	73	4,662	5,210	7,414	6,053	7,003
Rubber products	178	161	196	172	182	11,528	11,350	14,924	15,417	15,441
Ceramic products	54	49	47	42	42	3,478	3,442	3,558	3,791	4,046
Leather, travel goods and footwear	214	201	176	150	84	13,855	14,140	13,391	13,400	8,045
Machinery and equipment	182	201	244	245	266	11,811	14,155	18,594	21,895	25,509
Diamond and jewellery (d)	131	171	192	185	205	8,491	12,064	14,546	16,495	19,634
Other industrial exports	197	184	197	177	231	12,794	12,995	15,002	15,887	24,153
3. Mineral exports	60	64	97	86	90	3,863	4,540	7,352	7,666	8,628
Gems	56	61	93	82	86	3,577	4,326	7,091	7,276	8,173
Other mineral exports	4	3	3	4	5	286	214	262	390	455
4. Unclassified (c) (e)	43	48	137	88	41	2,802	3,363	10,560	7,767	3,883
Total exports (c)	4,798	4,610	5,522	4,817	4,699	310,398	325,171	420,114	430,372	449,850

(a) Revised

(b) Provisional

(c) Adjusted

(d) Diamond exports reported by the Sri Lanka Customs from 1999 onwards were adjusted for data obtained from the National Gem and Jewellery Authority.

(e) Includes re-exports

Sources: Sri Lanka Customs

Ceylon Petroleum Corporation and Other exporters of petroleum

Central Bank of Sri Lanka

National Gem and Jewellery Authority

and garments, which has been Sri Lanka's largest single export item since 1986, contributed 67 per cent to the total export earnings in 2002. The other major categories were machinery, mechanical and electrical equipment (7 per cent), diamonds and jewellery (6 per cent), rubber products (5 per cent), food, beverages and tobacco (3 per cent), leather products and footwear (2 per cent), petroleum products (2 per cent) and miscellaneous items totalling to 8 per cent.

The value of textile and garment exports declined by 4.7 per cent in 2002 compared to 14.7 per cent decline in 2001. The volume of textile and garment exports increased by 1.4 per cent, while unit prices dropped by 6 per cent. Sri Lanka's major export destinations for textile and garments were USA and EU, which purchased more than 94 per cent of all textile and garment exports in 2002. Sri Lanka has enjoyed quota free access to EU markets since January 1, 2001, however the benefits from it were not fully realised in 2002.

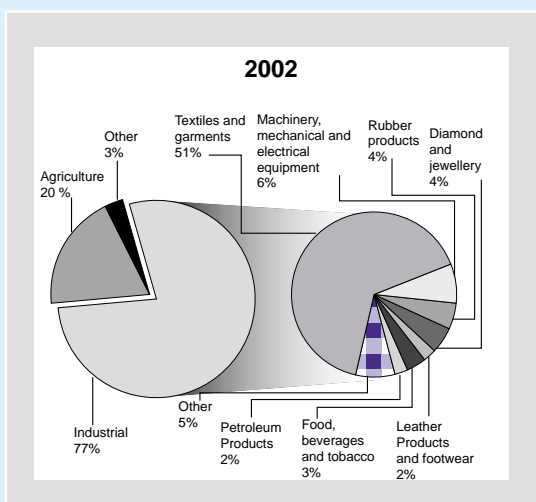
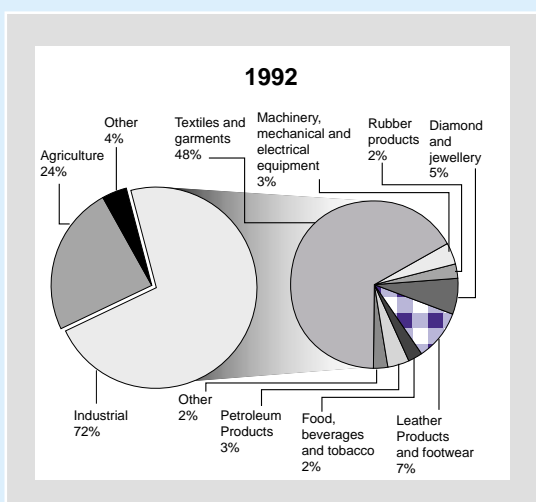
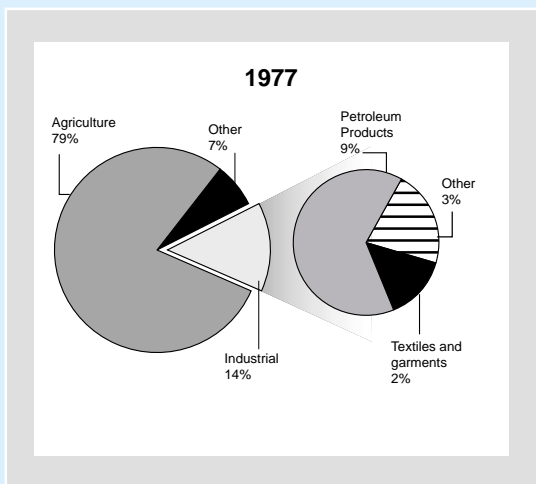
In 2002, more than 92 per cent of textile and garment exports came from BOI enterprises. Export earnings of BOI enterprises decreased by 3 per cent compared to 15 per cent in 2001. Exports by non-BOI enterprises declined by 18 per cent in 2002 compared to 13 per cent in 2001. Garment exports fell by 4 per cent and textile exports, although having a share of only 3 per cent in this sub category, grew by 13 per cent.

Exports of yarn and other made up articles declined by 6 per cent and 41 per cent, respectively. The value of garment exports to USA declined by 5 per cent.

Industrial exports, excluding textile and garments, grew by 3 per cent in 2002, compared to the decline of 10 per cent in 2001. Among those categories, export of machinery, mechanical and electrical equipment increased by 9 per cent. Earnings from rubber based product exports increased by 6 per cent in contrast to the decline of 12 per cent in 2001. The growth of rubber based product exports came mainly from retreaded tyres and surgical gloves. Exports of retreaded tyres and surgical gloves together accounted for 24 per cent of total rubber based product exports in 2002, and increased by 10 per cent and 52 per cent, respectively. Non-surgical gloves, which accounted for 26 per cent of total rubber based product exports declined marginally in 2002. Exports of solid or cushion tyres and tyre treads, which accounted for 29 per cent of the total, declined by 5 per cent in 2002.

Export of diamonds and jewellery increased by 11 per cent in 2002, compared to a decline of 4 per cent in 2001. According to the Gem and Jewellery Authority, the sector benefited by the exemption from the VAT granted to raw material imports. Jewellery exports declined by 27 per cent in 2002 due to increased competition from India and Thailand. USA continued

**Chart 9.3**  
**Share of Exports by Major Categories**



to be the largest buyer of jewellery from Sri Lanka followed by Germany, Japan, Switzerland, UK and Singapore.

Export earnings from the food, beverages and tobacco declined by 4 per cent in 2002 compared with a 16 per cent in 2001. Earnings from crustaceans and molluscs, and fresh and frozen fish declined by 19 per cent and 17 per cent, respectively, due to lower demand from USA, Japan and France. Demand for these products from Asian countries including Singapore, Hong Kong, South Korea and Thailand remained unchanged. Among other food exports, canned or bottled fruit and animal fodder increased, while cocoa preparations, fruit and vegetable juices, manufactured tobacco, coconut milk powder, coconut cream, malted milk, sweet biscuits and mineral water exports declined in 2002.

Earnings from the export of petroleum products increased by 8 per cent compared to a decline of 31 per cent in 2001. The growth was a combined effect of a 9 per cent increase in export volume and a 1 per cent decrease in the unit price. Growth in this sub sector was largely attributed to the sale of bunkering and aviation fuel in response to improvements in ports and aviation services. Export earnings from all other major categories including, plastics, ceramic products, chemical products, articles of wood, toys, articles of copper, quartz, brooms, brushes, and stringed musical instruments improved while earnings from travel goods and footwear declined significantly.

### Agriculture Exports

Agricultural exports include the three plantation crops and minor agricultural export. The share of plantation crops in agricultural exports in 2002 was 82 per cent, dominated by tea. The share of tea in agriculture exports was 70 per cent, followed by coconut and rubber with shares of 9 per cent and 3 per cent, respectively. The remaining 18 per cent belonged to other agriculture exports, which is dominated by cinnamon, cloves and un-manufactured tobacco. In 2002, export of plantation crops declined by 3 per cent, while other agricultural products increased by 23 per cent.

### Plantation Crops

Earnings from plantation crops, declined by 3 per cent in 2002 compared to a decline of 6 per cent in 2001. Despite increased tea production in 2002, the volume of tea exports declined to 292 million kg. reflecting a 1 per cent decline in volume and a price decline of 3 per cent.

The decline was attributable to the increased global supply of tea during the first half of 2002, as a result of the release of stocks built up in 2001 by major producing countries, and disturbance in the Middle East market due to the potential outbreak of war in Iraq during the fourth quarter of 2002. International tea prices declined during the first three quarters of the year, but increased slightly towards the end of last quarter of 2002. The average export price of tea declined from US dollars 2.34 per kg. in 2001 to US dollars 2.26 per kg. in 2002.

Of total tea exports, 64 per cent was in bulk form, and 29 per cent was in packed form. The remaining 7 per cent was in tea bags and higher value added forms such as domestic tea blended with foreign teas and instant and green teas. Orthodox tea accounted for 94 per cent of Sri Lanka's tea production, while Cut, Tear and Curl (CTC) tea production continued to be at 6 per cent in 2002. At present, the global demand for CTC tea is declining. Most often, the average price of CTC is lower than the price of orthodox tea. Sri Lanka imported 3 million kg. of tea for blending, out of 4 million kg. permitted during the year. This import was 1 per cent of domestic production in 2002.

Russia continued to be the largest buyer with a share of 19 per cent in 2002. United Arab Emirates (UAE) became the second largest buyer with a share of 11 per cent, followed by Syria with a share of 10 per cent. Other major buyers were Iraq and Turkey (6 per cent each), Iran (5 per cent), Ukraine and Saudi Arabia (3 per cent each). As a group, Middle East countries bought 44 per cent of total tea exports, while CIS countries bought 24 per cent and EU bought 10 per cent in 2002.

Earnings from the three major coconut products, namely, desiccated coconut, copra and coconut oil, increased by 1 per cent in 2002, in contrast to a decline of 47 per cent in 2001. The modest increase is a result of significant price increases, which were almost neutralised by significant declines in volumes. Exported volumes of those products declined by 43 per cent, 10 per cent and 25 per cent, respectively, whereas prices increased by 59 per cent, 61 per cent and 43 per cent, respectively. There has been a continuous decline in world coconut production since the last quarter of 2001. Sri Lanka's harvest of 2,392 million nuts in 2002 was the lowest since 1993. Despite a lower harvest of fresh nuts, coconut product exports, other than the three major products, increased by 2 per cent in 2002. Export earnings from coir fibre mattresses increased by 6 per cent, the increase coming from the sale of stocks carried forward from previous years.

Export earnings from rubber increased by 11 per cent to US dollars 27 million in 2002. The volume of exports increased by 14 per cent and prices declined by 3 per cent in 2002. In 2001, both prices and volumes dropped by 16 per cent and 1 per cent, respectively. Local consumption of rubber increased from 54 million kg. to 56 million kg. in 2002 as the rubber based manufacturing sub-sector expanded during 2002. In order to meet input requirements of the local industrial sector, a significant amount of natural rubber, 4,898,969 kgs. was imported in 2002 compared with the import of 726,865 kgs. in 2001. Surpluses in major producing countries, and lower demand for natural rubber in the world market, particularly in USA, contributed to lower rubber prices. Earnings from rubber exports accounted for less than 1 per cent of total exports earnings.

### Other Agricultural Exports

Earnings from other agricultural exports, usually known as minor agricultural exports, recorded a significant growth in 2002 after declining during the last three years. Other agricultural exports grew by 23 per cent to US dollars 168 million in 2002 from US dollars 136 million in 2001. Earnings in 2002 from this sub-category was the highest since 1998. In 1998, earnings amounted to US dollars 170 million. This growth was entirely from an increase in the volume by 23 per cent.

The major components of other agricultural exports are cinnamon, cloves, un-manufactured tobacco and pepper. Those four products together accounted for 75 per cent of total other agricultural product exports. Earnings from cinnamon exports increased by 6 per cent. Despite lower prices, earnings from un-manufactured tobacco increased by 6 per cent as the quantity exported increased. Cloves became a significant commodity among other agricultural product and grew by 121 per cent in 2002. The price of cloves increased by 7 per cent and quantity by 106 per cent due to high demand from India. The quantity of pepper exported increased significantly in 2002. However, pepper prices declined by 30 per cent, continuing a decline since early 2000 due to increased global production. Prices of nutmeg and mace remained stable during the year due to demand from India. Cardamom prices increased during the last two quarters of 2002. An increased volume of exports of vegetable resulted in a higher export value, despite lower prices. Export earnings from coffee, cocoa products and betel leaves, increased, while dry and fresh fruits and cashew nuts declined in 2002.

### Mineral Products

Earnings from mineral exports increased by 4 per cent in 2002. Gem exports, which accounted for 95 per cent of mineral exports, increased by 4 per cent against a 12 per cent decline in 2001. Gem sales were higher in the local market with the revival of the tourist industry during the latter part of 2002, but exports were affected by unresolved issues in the gemstone trade, especially the controversy over artificial quality improvements to sapphires in Thailand.

Sri Lanka continued to be the largest supplier of top quality large blue sapphires of natural colour to the world market and the prices of these products were stable during the year. The demand for calibrated blue, pink and yellow sapphires in the European and US markets remained stable throughout the year. USA continued to be the largest buyer of Sri Lankan gems in 2002. Hong Kong has maintained its position as the centre for fine gems and jewellery in the Asia-Pacific region. Japan and Thailand continued to be major markets for Sri Lankan gems while Switzerland, France, UK and Germany were among the major buyers in the European market. Earnings from other mineral exports including metallic ores and iron pyrites grew by 9 per cent.

### 9.3 Imports

Expenditure on imports in 2002 was US dollars 6,105 million, a 2.2 per cent increase over 2001. The increase in imports was largely attributable to improved demand from higher economic activity and the reduction of the surcharge on imports duties from 40 per cent to 20 per cent with effect from 15 April 2002. Imports of consumer goods increased by 7 per cent, intermediate goods by 5 per cent and investment goods by 8 per cent in 2002.

The increase in the value of imports is a composite result of an 8 per cent drop in average import prices and an 11 per cent increase in the volume i.e. food and consumer durables (sugar, wheat, milk products, motor vehicles, radios and television sets), intermediate goods (crude oil, textiles, chemicals and plastics) and investment goods (building materials). Lower international prices of major inputs such as textiles and some investment goods contributed to the decline in average import prices.

#### Import Structure

There has been a gradual shift from consumer goods to intermediate and investment goods imports during the last 25 years following economic liberalisation in 1977. A shortage in the domestic supply of rice and other food items led to the

increase in food imports. Expansion in the industrial sector required higher imports of intermediate goods, while improvements in infrastructure facilities and the construction and transport sectors, combined with increased use of advanced technology, increased imports of investment goods. The import structure in 2002 showed a further marginal shift towards intermediate and investment goods, reflecting the improvement in economic activity. When compared with 2001, the relative importance of intermediate and investment goods increased from 73 per cent to 76 per cent, while that of consumer goods increased from 21 per cent to 22 per cent. The share of other imports (including defence related imports) decreased from 6 per cent to 2 per cent in 2002, following the peace process.

#### Consumer goods

Expenditure on both food and consumer durable imports increased in 2002. Imports of food recorded an increase of 6 per cent in 2002. Wheat grain imports increased to 993 thousand metric tons in 2002 due to increased demand from the local bakery and confectionery industry and the reduction in domestic stocks. Flour imports increased from 6,338 metric tons in 2001 to 11,325 metric tons in 2002. Sugar imports increased responding to lower international prices. Rice imports increased from 51,943 metric tons in 2001 to 95,100 metric tons in 2002 following the removal of licensing

**TABLE 9.4**  
**End-Use Classification of Imports**

Category	US dollars million					Rs. million				
	1998	1999	2000	2001 (a)	2002(b)	1998	1999	2000	2001(a)	2002 (b)
1. Consumer goods	1,255	1,242	1,388	1,235	1,319	80,956	87,505	105,403	110,059	126,181
Food and drink	723	661	693	654	696	46,543	46,562	52,584	58,466	66,540
Rice	42	46	4	11	18	2,621	3,290	288	969	1,732
Sugar	129	106	141	115	132	8,384	7,448	10,777	10,289	12,634
Wheat	127	111	127	110	130	8,133	7,792	9,625	9,783	12,427
Other	425	398	421	419	415	27,405	28,032	31,894	37,425	39,746
Other consumer goods	532	581	696	581	623	34,413	40,943	52,819	51,593	59,641
2. Intermediate goods	2,982	3,057	3,789	3,321	3,492	192,494	215,658	287,196	296,522	334,357
Petroleum	345	500	901	731	789	22,275	35,344	68,381	65,190	75,627
Fertiliser	62	66	80	67	76	3,989	4,690	6,059	6,047	7,259
Chemicals	143	136	147	142	155	9,241	9,590	11,152	12,647	14,792
Textiles and clothing	1,397	1,320	1,471	1,320	1,321	90,099	93,105	111,386	117,993	126,438
Other intermediate goods (c)	1,035	1,035	1,190	1,061	1,151	66,890	72,929	90,218	94,644	110,241
3. Investment goods	1,477	1,565	1,737	1,081	1,170	95,322	110,599	130,889	96,185	112,046
Machinery and equipment	786	678	787	610	640	50,592	47,736	59,538	54,287	61,296
Transport equipment (d)	264	523	529	129	151	17,098	37,191	39,489	11,469	14,449
Building materials	303	260	305	249	272	19,590	18,296	23,087	22,145	26,013
Other investment goods	124	105	116	93	108	8,042	7,376	8,776	8,285	10,288
4. Unclassified imports	176	115	406	337	125	11,367	8,126	30,802	30,198	11,907
Total imports (e)	5,890	5,980	7,320	5,974	6,105	380,138	421,888	554,290	532,964	584,491

- (a) Revised  
 (b) Provisional  
 (c) Diamond imports reported by the Sri Lanka Customs in 1999 and 2000 were adjusted for data obtained from major importers.  
 (d) Includes the value of 3 aircraft each imported by SriLankan Airlines in 1999 and 2000.  
 (e) Adjusted

Sources : Sri Lanka Customs  
 Co-operative Wholesale Establishment  
 Ceylon Petroleum Corporation  
 Major importers of diamonds  
 Central Bank of Sri Lanka  
 Prima Ceylon Ltd.

requirements in Budget 2002. A specific duty of Rs 7.00 per kg. on rice was introduced on 21 January 2002, replacing the 35 per cent import duty. Out of 95,100 metric tons of rice imported, 36,085 metric tons were imported in March 2002 as the CWE was allowed to import 30,000 metric tons of rice at a reduced duty of Rs. 4.00 per kg. for the festive season. Higher domestic prices reduced the demand for milk and fish products. Potato imports were low because of high import duties and increased local production. The imports of lentils and fruits increased after the reduction of the import duty surcharge.

In the durable consumer goods category, imports of motor cars and motor cycles increased by 60 per cent in 2002. Imports of radio receivers and television sets increased by 11 per cent in 2002, while the import of rubber tyres and tubes increased by 24 per cent. Imports of medical and pharmaceutical products increased by 12 per cent. Other consumer durables imports which increased in 2002 were plastics tableware and kitchenware, books, footwear, skin care products, other articles of vulcanised rubber and padlocks and locks. All these items were subject to the surcharge of 40 per cent on import duties from 21 February 2001 till 14 April, 2002 and a reduced surcharge of 20 per cent from 15 April 2002.

**TABLE 9.5**  
**Volume of Major Imports (a)**

Item	1998	1999	2000	2001	2002(b)
Rice	168	214	15	52	95
1st Quarter	136	24	7	3	51
2nd Quarter	12	12	7	7	9
3rd Quarter	2	31	...	2	10
4th Quarter	18	146	1	40	25
Wheat	880	859	922	760	993
1st Quarter	340	207	266	231	309
2nd Quarter	155	263	210	229	215
3rd Quarter	126	189	247	177	221
4th Quarter	259	200	199	123	248
Sugar	444	479	562	420	554
1st Quarter	79	152	128	100	146
2nd Quarter	129	64	185	127	141
3rd Quarter	99	138	85	109	110
4th Quarter	137	125	164	84	157
Petroleum (Crude oil)	2,156	1,832	2,347	1,954	2,300
1st Quarter	567	244	608	237	539
2nd Quarter	431	503	583	539	513
3rd Quarter	662	548	613	624	593
4th Quarter	496	537	543	554	655
Fertiliser	440	539	559	460	537
1st Quarter	109	97	149	66	103
2nd Quarter	98	158	102	183	163
3rd Quarter	82	129	174	83	138
4th Quarter	151	155	134	128	133

(a) Adjusted  
(b) Provisional

Sources: Sri Lanka Customs  
Co-operative Wholesale  
Establishment  
Ceylon Petroleum Corporation  
Prima Ceylon Ltd.

### Intermediate Goods

The value of imports of intermediate goods increased by 5 per cent in 2002 due to higher prices for crude oil and higher volumes of crude oil and fertiliser. The price of crude oil increased gradually and was relatively high during the last quarter of 2002 compared with the previous year. The volume of crude oil imports increased from 14 million barrels in 2001 to 17 million barrels in 2002. The average price of crude oil increased from US dollars 24.47 per barrel to US dollars 25.13 per barrel (3 per cent) between these two years. The value of refined products decreased by 3 per cent as the quantity imported was less than in 2001, when refined products were used for power generation. The total value of petroleum product imports increased by 8 per cent. Intermediate good imports, excluding petroleum products, increased by 4 per cent responding to positive growth in the industrial sector in the second half of 2002.

Textiles imports accounted for 38 per cent of intermediate good imports in 2002. Expenditure on textile imports increased marginally in 2002. Value of diamond imports increased, by 22 per cent, reflecting the improved world market for diamonds. Fertiliser imports increased by 13 per cent while other intermediate goods imports increased by 7 per cent, marked by higher imports of inputs for soap, chemicals and rubber based manufacturing industries. Imports of edible oils increased considerably to substitute for lower domestic production of coconut oil. Imports were also encouraged by a reduction in the specific surcharge from Rs. 20 per kilogram to Rs 5 per kilogram with effect from 01 April 2002, and the withdrawal of the surcharge with effect from 26 September 2002.

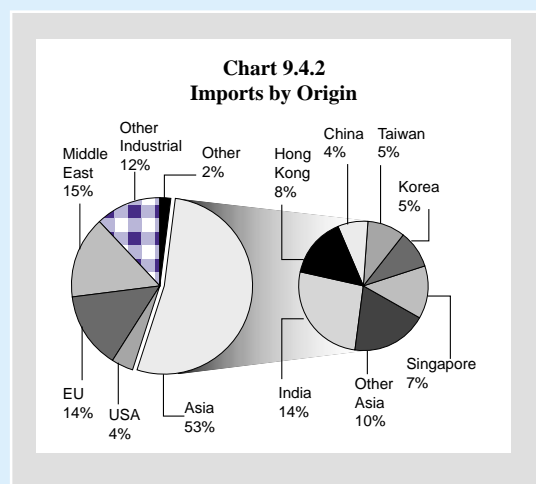
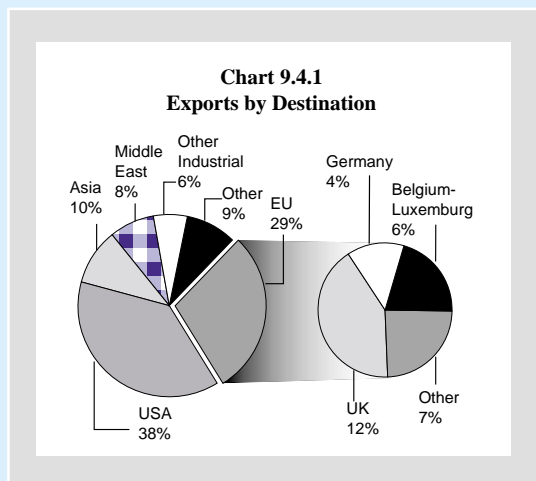
### Investment Goods

Import of investment goods increased by 8 per cent in 2002. Import of transport equipment, mainly buses and trucks increased by 17 per cent. Machinery and equipment imports increased by 5 per cent due to higher imports of electric generators and reception apparatus for television. Import of building materials increased by 9 per cent. The major items which increased were cement, iron and steel bars. Imports of other major investment goods including medical instruments and appliances, aluminium wire, electric conductors and electric meters increased by 15 per cent.

### Direction of Trade

Industrialised countries continued to be the main destination for Sri Lankan exports in 2002. However, the market share of these countries declined marginally from 75 per cent in 2001 to 74 per cent in 2002. The share of developing countries increased from 21 per cent to 22 per cent while the share of Eastern European countries remained unchanged at 4 per cent. Developing countries, the major origin of Sri Lanka's imports, secured 70 per cent of the Sri Lankan market while industrial countries shared 30 per cent against 67 per cent and 33 per cent, respectively, in 2001.

**Chart 9.4**  
**Direction of Trade**



Countries in the South Asian Association for Regional Cooperation (SAARC) accounted for 5 per cent of the total exports and 15 per cent of total imports. In the SAARC region, India was Sri Lanka's largest export destination (4 per cent of total exports) and the largest country of import origin (14 per cent of total imports). EU accounted for 30 per cent of total exports and 15 per cent of total imports in 2002. In the EU, UK was the most important export destination (13 per cent) and country of import origin (4 per cent). Exports to CIS countries, accounted for 4 per cent of Sri Lanka's export market, with higher tea exports to Russia.

USA continued to be the largest single buyer of Sri Lanka's exports since 1979. The market share of USA decreased to 38 per cent in 2002 from 41 per cent in 2001, and the value of exports to USA declined by 8 per cent in 2002.

Textiles and garment exports accounted for 80 per cent of total exports to USA. However, garment exports to USA declined by 5 per cent in 2002. UK, the second largest buyer, recorded a share of 13 per cent, followed by Belgium and Luxembourg (6 per cent) and Germany and India (4 per cent each). Garments and tea accounted for 76 per cent and 3 per cent, respectively, of goods exported to UK. Diamonds and garments accounted for 69 per cent and 17 per cent, respectively of goods exported to Belgium and Luxembourg. Japan was one of Sri Lanka's major markets for frozen shrimps, machinery parts and accessories, tea, fish products and precious stones. Out of the total exports to Germany, garments and tea accounted for 39 per cent and 6 per cent, respectively. Accordingly, Western industrial countries as a group continued to be Sri Lanka's largest trading partner in 2002.

Once again, India was the largest single exporter (14 per cent), while Hong Kong (8 per cent) and Singapore (7 per cent) became the second and the third largest exporters to Sri Lanka in 2002. Imports from Japan (fourth largest exporter) increased by 5 per cent because of an increase in motor vehicle imports in 2002. Imports from Hong Kong declined by 2 per cent, while those from Singapore increased by 6 per cent. Imports from India increased by 39 per cent. Food was the major item imported from India. Fabric and accessories for the garment industry were the major items imported from Hong Kong. Petroleum gasses, sewing machines, telephone equipment and data processing machines and parts were among the major items imported from Singapore. Other major exporters to Sri Lanka were the Republic of Korea and Taiwan (5 per cent each), USA, UK, China and UAE (4 per cent each). Accordingly, Asian countries, as a group, continued to be the major origin of Sri Lanka's imports. However their market share decreased from 56 per cent in 2001 to 53 per cent in 2002. In absolute value terms, imports from Asian countries increased by 7 per cent, mainly as a result of higher imports from India.

## 9.4 Services and Income

The services account registered a surplus of US dollars 271 million, an increase of 55 per cent over the previous year, due to higher receipts from travel and transportation services. Earnings from tourism increased by 17 per cent to US dollars 248 million. Receipts from non-resident Sri Lankans who travelled to Sri Lanka during the year are estimated at US dollars 115 million in 2002.

As a result, travel related net receipts increased from a negative US dollars 38 million to a positive US dollars 100 million during the year. The increase in receipts from passenger fares, reflecting the recovery in tourism and port-related services receipts, raised net receipts from transportation services by 139 per cent to US dollars 184 million in 2002. Net receipts from telecommunications services increased by 79 per cent to US dollars 61 million. However, net receipts to Sri Lanka from the telecommunications sector was far below its potential due to

heavy traffic in the External Gateway System, as there was only a single operator in the market in 2002. The lack of adequate gateway capacity in the international telecommunications services have compelled foreign investors to request their local counterparts to initiate communications from Sri Lanka. Speedier liberalisation of the international telecommunications market is vital to exploit the potential benefits arising from peace in Sri Lanka and the government's objective in the Regaining Sri Lanka initiative. Under the National Communications Policy, the government took steps in early 2003 to liberalise the international gateway. However, it is important that the market operates in a competitive environment under an efficient regulatory mechanism, to maximise benefits from a liberalised telecommunications market.

Receipts from computer and information services (information technology exports) decreased by 24 per cent to US dollars 50 million. Market for these services was slack because of slow global economic recovery, particularly in the United States. Foreign exchange receipts from construction

services, at US dollars 34 million, dropped 17 per cent during the year. Net receipts from insurance services declined by 83 per cent to US dollars 18 million during the year. However, net receipts from insurance services, excluding the extraordinary receipt of US dollars 90 million to Sri Lankan Airlines as insurance payments for the aircraft destroyed in the LTTE attack on the Katunayake International Airport in 2001, grew by 12 per cent during the year.

Reflecting the impact of declining global interest rates on interest payments, the deficit in the income account contracted during the year. The deficit in the income account declined by 6 per cent as both net interest payments and payments on account of profits and dividends declined during the year. Despite an increase of 9 per cent in the external debt stock, interest payments on external debt declined by 16 per cent due to the sharp decline in interest rates in international markets.

## 9.5 Current Transfers

Total net current transfers, comprising net private current transfers and net official current transfers, increased by 12 per cent to US dollars 1,123 million. Net private transfers increased by 12 per cent. This is partly due to an increase in the number of Sri Lankans migrating for foreign employment by 10 per cent to 230,629 during the year. Gross private transfers increased by 11 per cent to US dollars 1,287 million, which included US dollars 1 million received on account of compensation payments in 2002 to Sri Lankan workers who had been displaced in the Gulf War in 1991. The increase in private transfers, particularly during the fourth quarter of 2002, was attributed to increased income in oil exporting countries due to rising crude oil prices and uncertainties in the West Asia, which encouraged Sri Lankans living there to remit more funds.

Worker remittances from the West Asian region accounted for over 60 per cent of total private transfer receipts. However, with the increasing employment in Europe, the share of the West Asian region has declined since 2000. Seventeen per cent of total transfer receipts came from countries in the European Union and this share has gradually increased over the past three years. North America, other European countries and the Far East continued to account for about 7 per cent and 5 per cent each of the total remittances, respectively. Private transfer receipts, which continue to be the second largest foreign exchange earner after net garment exports, were sufficient to cover over 90 per cent of the trade deficit and the deficit in the goods, services and income accounts. These remittances are important for the Sri Lankan economy. However, hardships faced by Sri Lankan workers, particularly in West Asia continue unabated. For example, 228 Sri Lankans were reported dead during employment abroad in 2002, while a large number of Sri Lankans are said to be in prisons abroad. Meanwhile, a section of Sri Lankan workers have been subject to communicable diseases while employed abroad. Ignorance on the part of Sri Lankan workers may be a prime factor for the increasing rate of HIV infection. These issues warrant urgent

**TABLE 9.6**  
**Net Services, Income and Transfers (a)**

Item	US dollars Million		Rs. Million	
	2001	2002(b)	2001	2002(b)
1. Transportation	77	184	6,767	17,618
2. Travel	-38	100	-3,513	9,616
3. Telecommunication Services	34	61	3,095	5,795
4. Computer and Information Services	66	50	5,896	4,783
5. Construction Services	3	3	215	275
6. Insurance Services (c)	106	18	9,480	1,710
7. Other Business Services	-79	-134	-7,877	-12,773
8. Government Expenditure n.i.e.	7	-10	628	-989
<b>Total Services</b>	<b>175</b>	<b>271</b>	<b>14,692</b>	<b>26,035</b>
1. Compensation of Employees	-2	-4	-187	-425
2. Direct Investment	-101	-97	-8,982	-9,315
3. Interest and Other Charges(d)	-164	-150	-14,674	-14,352
<b>Total Income</b>	<b>-267</b>	<b>-252</b>	<b>-23,843</b>	<b>-24,093</b>
1. Private (e)	984	1,097	87,837	104,980
2. General Government	22	26	1,925	2,485
<b>Total Current Transfers</b>	<b>1,005</b>	<b>1,123</b>	<b>89,762</b>	<b>107,465</b>

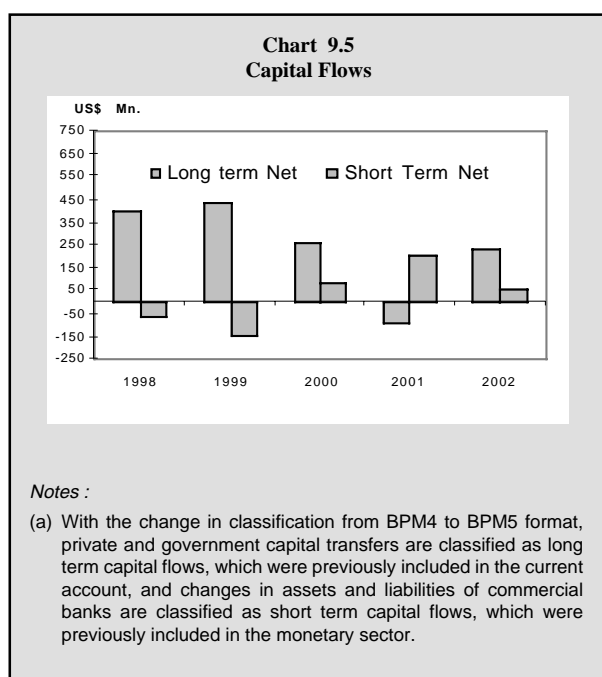
Source: Central Bank of Sri Lanka.

- (a) This presentation conforms as far as possible to the Balance of Payments Manual, 5th Edition (1993) of the International Monetary Fund.
- (b) Provisional
- (c) Services receipts in 2001 include US dollars 382.4 mn. received by Sri Lankan Airlines as insurance claims for the aircraft destroyed by the attack on the airport in July 2001, while Services payments in 2001 include US dollars 292.8 mn. paid to the lessors of the aircraft. The net receipt of these insurance claims was US dollars 89.6 mn..
- (d) From 1994 onwards Foreign Currency Banking Units (FCBUs) of commercial banks have been treated as a part of the domestic banking system in the compilation of balance of payments statistics. Accordingly, transactions involving FCBUs and non-residents are taken into account in the compilation of balance of payments statistics, while those involving FCBUs and residents are excluded.
- (e) Includes US dollars 45 mn. received in 2000 as compensation of US dollars 2,500 per person to 29,323 Sri Lankans, who lost employment in Kuwait due to the Gulf War in 1990.

government intervention through diplomatic channels as they have become serious economic and social issues.

## 9.6 Capital Movements

The cessation of hostilities between government forces and the LTTE under the Memorandum of Understanding signed in February 2002 and the continuation of the negotiations under the peace process created a favourable environment for foreign investments in the country. This was supported by the policy agenda adopted by the new government, which undertook the continuation of structural reforms under the SBA with the IMF. The Sri Lankan government further liberalised restrictions in foreign direct investments to facilitate its efforts to regain Sri Lanka's growth momentum.



However, Sri Lanka faced some set-back in its international operations due to delays in the proposed privatisation programme. The plan to replace the sovereign bond issue with long-term borrowing in the international market also did not materialise, due to high risk premiums. The government finally opted to borrow from FCBUs of domestic banks at relatively low interest rates with a longer maturity.

Despite noticeable improvements in foreign direct investments, private long-term borrowings and portfolio investments, net capital and financial flows dropped by 10 per cent in 2002, mainly due to an increase in net foreign assets of commercial banks and a drop in privatisation proceeds.

### Long-Term Capital

Private long-term capital flows to Sri Lanka increased from US dollars 45 million in 2001 to US dollars 139 million in 2002, mainly due to long-term trade credit. Despite the favourable domestic environment for investment and relatively high real

lending rates in the domestic financial market, no significant foreign borrowing was made by the private sector, as they continued to adopt a wait and see policy. Further, utilisation of credit under the US dollars 100 million Indian line of credit was far short of expectations. Sri Lanka had utilised only US dollars 7.3 million during 2002 and only US dollars 10 million so far since the loan agreement was signed, well below the original target of US dollars 75 million, due to a host of factors including administrative complexities. However, it would be inadvisable for this facility to be used by the government, as that would add to the government's non-concessional debt stock, with little productive resource utilisation or return. It is highly desirable that the facility remains open for use by the private sector for the importation of capital goods. More efficient use of scarce financial resources by the government, at every level, is vital at a time when the country is facing severe financial difficulties.

With the restoration of relative stability on both political and economic fronts, foreign direct investments (FDI) increased significantly to US dollars 242 million in 2002 from the low US dollars 82 million in the previous year. During the year, FDI flowed mainly to power ( 25 per cent), communication ( 10 per cent), port services ( 15 per cent) and manufacturing ( 20 per cent). Attracting foreign direct investment to Sri Lanka in the years ahead would be challenging task, due to a host of factors. Chief among these are the high cost of power generation, which is considered to be the highest in the region, high labour costs, rising labour unrest in the industrial sector, lack of infrastructure, heavy traffic in the international gateway for telecommunications which has already damaged international investor perceptions of Sri Lanka's capacity to provide access to international markets through communications, delays due to regulations/controls and significantly reduced fiscal incentives. Improvements in productivity and product quality would be key to Sri Lanka's success in increasingly competitive international markets. Educational and labour reforms can play a pivotal role in this respect.

Privatisation receipts amounted to US dollars 5 million during 2002, arising from the sale of a small fraction of the public offering of Sri Lanka Telecom to foreign investors. Investor interest in the telecommunications sector has been poor for several years. The lack of foreign interest in the proposed privatisation of the Sri Lanka Insurance Corporation (SLIC) resulted in the postponement of the privatisation of SLIC to 2003.

Long-term loan capital received by the government during 2002 declined by 14 per cent to US dollars 492 million, of which 89 per cent was on concessional terms. The balance 11 per cent was on commercial terms and conditions. The value of loan capital sharply dropped as the government did not use long-term trade credit for defence related imports. Net disbursements during the year declined from US dollars 249 million to US dollars 112 million. The decline mainly reflects

the payment of US dollars 144 million on account of deferred payments on defence related imports. An increasing number of loans at commercial rates were negotiated and signed by the Sri Lankan government during the year. Although increasing reliance on non-concessional loans is unavoidable given Sri Lanka's rising per capita income and the resultant disqualification for access to facilities from the International Development Association (IDA) and loan facilities at concessional rates from the Asian Development Bank (ADB), it is wise to exercise caution in the utilisation of non-concessional loans, as external debt service burden can rise rapidly in the medium to long term.

Care should also be taken to maximise the use of available resources at concessional rates. Recourse to non-concessional loans should be made only after loans at concessional rates are exhausted. The use of non-concessional loans for projects in sectors such as health and education, for which concessional loans may be readily available, should be minimised to avoid Sri Lanka falling blindly into a debt trap. The relative stability of the US dollar against other major international currencies in the medium term and the high concentration of Sri Lanka's external earnings in dollars and reserves in dollar denominated assets would make dollar denominated loans more attractive. The near zero interest rates on yen denominated loans may encourage emerging market economies to borrow in yen.

However, borrowing in yen involves higher risks due to potentially heavy fluctuations in the value of the currency.

The majority of foreign resources received by the government were for power generation and projects in the private sector, while Small and Medium Enterprises (SME) development, water supply, education and irrigation sectors also received significant donor assistance. Major projects financed by multilateral and bilateral lending agencies are given in the following table.

Multilateral lending agencies provided the bulk of foreign loans in 2002. ADB and IDA continued to be the major multilateral donor agencies providing US dollars 147 million and US dollars 92 million, respectively. Bilateral assistance amounted to US dollars 213 million, of which US dollars 147 million or 69 per cent was from Japan. Assistance from Japan accounted for 35 per cent of total concessional loans, while ADB and IDA accounted for 32 per cent and 20 per cent, respectively, during the year.

One of the problems facing Sri Lanka with respect to concessional donor funding has been the low utilisation of funds which has been exacerbated by the slow progress in achieving project targets. A recent ADB study revealed that the country, on average, maintained a low utilisation rate of around 20 – 25 per cent of the concessional funding provided by that bank. Hence in order to address this issue, a concerted effort

**TABLE 9.7**  
**Major projects financed by foreign lending during 2002**

Donor	Project	Amount Disbursed US dollars Mn
Asian Development Bank	Power Sector Development Programme	30.0
	Private Sector Development Programme	24.7
	SME Credit Assistance Sector Development programme	16.9
	Water Supply and Sanitation	9.1
	Southern Provincial Road Improvement Project	7.8
International Development Association	Renewable Energy for Rural Economic Development	13.0
	Second General Education Project	13.0
	North-East Irrigated Agriculture Project	8.5
	Mahaweli Restructuring and Rehabilitation Project	7.8
Japan	Kukule Ganga Hydroelectric Power Project	27.0
	Kelanitissa Combined Cycle Power Plant	18.0
	Kalu Ganga Water Supply Project	13.7
	Medium Voltage Distribution Network	11.2
	Port of Colombo North Pier Development Project	11.2
	Telecommunications Network Expansion Project in Colombo	10.9
	Small and Micro Industrial Leader and Entrepreneur Project.	10.0

needs to be made to accelerate donor assistance utilisation rates. For this purpose, during the year, the government appointed a Committee to assist in the monitoring of the progress of foreign funded projects. The Committee is also expected to streamline systems with a view to increasing donor funded project utilisation rates and reducing the implementation times delays, so that the country would reap the maximum benefits from scarce concessionary donor assistance.

### Short-Term Capital

Net short term capital receipts fell in 2002 against a significant increase in the previous year. This was mainly because the NFA of commercial banks increased by US dollars 40 million in 2002, in contrast to a decline in NFA of US dollars 254 million in 2001. The improvement in NFA was the combined outcome of a decrease in foreign liabilities of commercial banks by US dollars 145 million due to a drop in liabilities of Foreign Currency Banking Units (FCBUs) and a decrease in foreign assets by US dollars 104 million due to a drop in assets of FCBUs.

Private short-term credit, comprising short-term trade credit rose, reflecting the recovery in imports during the year. With the peace process going forward, the Colombo Stock Exchange registered a net inflow of US dollars 25 million against a continuous outflow experienced since 1998. The attractive prices of blue chip companies, together with potential for a rapid growth under a peace scenario induced foreign investors to invest in Sri Lankan equities. The Colombo bourse performed exceptionally well during the year, the Milanka Price Index (MPI) and the All Share Price Index (ASPI) increased by 33 per cent and 31 per cent, respectively.

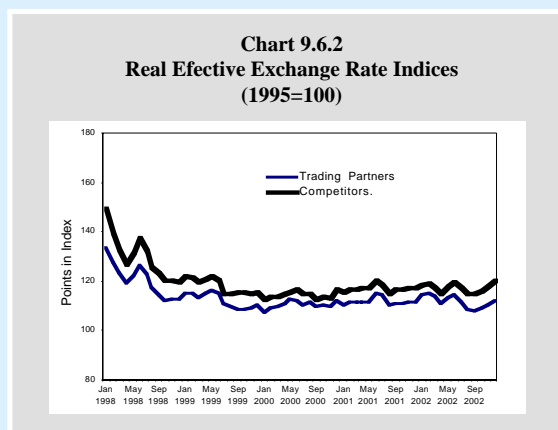
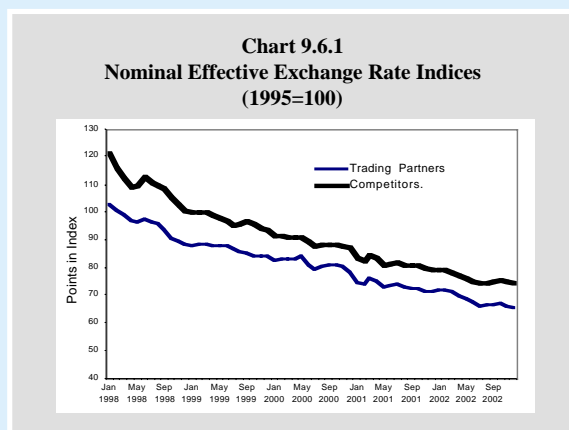
## 9.7 Foreign Exchange Market Developments

International foreign exchange markets were volatile during the year reacting to corporate scandals and dubious accounting practices and governance issues in the United States, slower than expected recovery in major industrial economies and geopolitical uncertainties. The US dollar lost ground against all major international currencies during the year. It depreciated by 18.7 per cent against the euro in comparison to an appreciation of 4.9 per cent in the previous year. Despite continued fragility in the domestic economy and the concerns regarding delays in banking reforms, the Japanese yen appreciated by 10.9 per cent against the US dollar in 2002. In contrast, the yen had depreciated by 12.8 per cent in 2001. Following the trend in other international currencies, the pound sterling appreciated by 10.8 per cent against the US dollar during the year.

Exchange markets in more advanced economies in the Asian region followed the global trend, with the Korean won and the Singapore dollar appreciating by 10.8 per cent and by 6.7 per cent, respectively against the dollar, during the year. The Indonesian rupiah, which depreciated by 7.6 per cent in 2001, appreciated by 16.2 per cent against the US dollar in 2002. The Philippine peso, the Thai baht and the Indian rupee were relatively stable during the year. While the Thai baht and the Indian rupee appreciated by 2.2 per cent and 0.6 per cent, respectively, the Philippine peso depreciated by 3.0 per cent. Malaysia continued its fixed exchange rate policy during the year with the ringgit being fixed at 3.8 per US dollar.

Sri Lanka's domestic foreign exchange market was relatively stable due to a weakening dollar, increasing capital

**Chart 9.6**  
Effective Exchange Rate Indices



inflows and attractive real interest rates in the domestic market. The independently floating, market determined exchange rate policy reduced speculative elements to a large extent and helped to stabilise the exchange rate, while maintaining competitiveness. The rupee depreciated by 3.7 per cent against the US dollar during 2002. The better than expected economic recovery in the third and fourth quarters and high capital flows, specially private remittances, during the second half of the year appear to have contributed to this development. However, the cross exchange rate effects between the US dollar and other major currencies resulted in a larger depreciation of the rupee against other currencies during the year. The rupee depreciated by 18.8 per cent against the euro, 13.1 per cent against the Japanese yen, and 12.9 per cent against the pound sterling. The rupee also depreciated against SDR, the composite unit of account, by 10.7 per cent during 2002.

The nominal effective exchange rate (NEER) of the Sri Lankan rupee against a five currency basket comprising the US dollar, Japanese yen, pound sterling, Deutsche mark and the Indian rupee depreciated by 9.4 per cent. Meanwhile against a twenty four currency basket, which includes both trading partners and competitor countries, it depreciated by 10 per cent. Against this backdrop, the real effective exchange rate (REER) against the five currency basket depreciated by 0.5 per cent, while against the twenty four currency basket, it depreciated by 2 per cent during 2002, improving Sri Lanka's external trade competitiveness.

### The Forward Exchange Market

Forward market transactions grew significantly during the year owing to a stable market environment and market participants gaining confidence under the independently floating exchange rate regime. Forward market transactions accounted for 37 per cent of total transactions. The total volume of forward market transactions increased by 52 per cent to US dollars 944 million during the year. The average monthly volume of forward transactions increased from US dollars 52 million in 2001 to US dollars 79 million in 2002.

With the restoration of market stability in response to improved political stability and capital flows, forward premia decreased significantly during the year. The stable environment in the foreign exchange market was also evident in an increase in the length of the maturity period of forward contracts. During the period of uncertainty, immediately after the floatation of the rupee in 2001, in particular, contracts longer than three months were negligible and transactions with maturities over six months non-existent. A notable development in the forward market in 2002 was the increase in the length of the maturity period to one year. Forward transactions with maturities over three months accounted for 28 per cent of total forward market transactions during the year.

The premium on one month forward transactions declined from 11.65 per cent at end 2001 to 6.33 per cent at end 2002, while the premium on three month contracts declined from 11.25 per cent to 6.8 per cent. This indicated a drop in the average premium on one month contracts from 14.87 per cent to 8.68 per cent, and on three month contracts from 14.1 per cent to 8.82 per cent. Towards the latter part of the year the premium on forward transactions was less than the interest rate differential, indicating market perceptions of a further weakening of the US dollar and a decline in domestic interest rates.

### 9.8 External Assets

Total external assets of the country and gross official reserves increased significantly for the second consecutive year, after a severe drain in 2000. Despite higher import demand, reserves increased on account of large capital flows to the country in the form of private remittances, foreign direct investments, public and private sector long term borrowing and short term capital flows to the share market with the improved political stability and the commencement of peace negotiations. External reserves were further boosted by the use of IMF resources under the Stand-By Arrangement (SBA), purchase of foreign exchange in the domestic forex market by the Central Bank and the issue of dollar denominated SLDBs.

**TABLE 9.8**  
**Exchange Rate Movements**

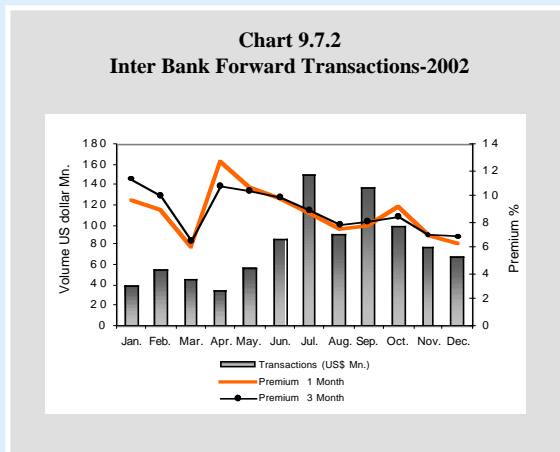
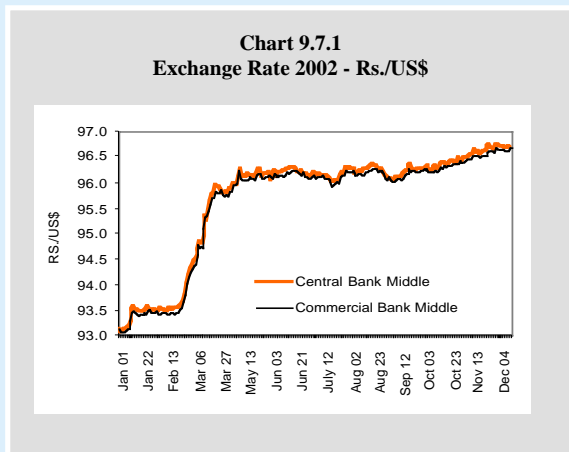
Currency	In Rupees per unit of Foreign Currency						Percentage Change Over Previous Year (a)			
	End of Year Rates			Annual Average			Point to Point		Annual Average	
	2000	2001(b)	2002	2000	2001(b)	2002	2001	2002	2001	2002
Deutsche Mark	38.00	42.07	51.84	35.76	40.90	46.37	-9.7	-18.8	-12.6	-11.8
French Franc	11.33	12.54	15.46	10.66	12.19	13.79	-9.7	-18.8	-12.5	-11.6
Euro	74.32	82.27	101.38	69.94	79.99	90.43	-9.7	-18.8	-12.6	-11.5
Indian Rupee	1.77	1.93	2.01	1.68	1.89	1.97	-8.2	-4.3	-11.2	-4.0
Japanese Yen	0.72	0.71	0.82	0.70	0.74	0.77	1.5	-13.1	-4.4	-3.8
Pound Sterling	123.23	135.06	155.12	114.78	128.66	143.74	-8.8	-12.9	-10.8	-10.5
US Dollar	82.65	93.16	96.73	75.78	89.36	95.66	-11.3	-3.7	-15.2	-6.6
SDR	107.69	116.97	130.99	99.90	113.75	123.93	-7.9	-10.7	-12.2	-8.2

Source: Central Bank of Sri Lanka.

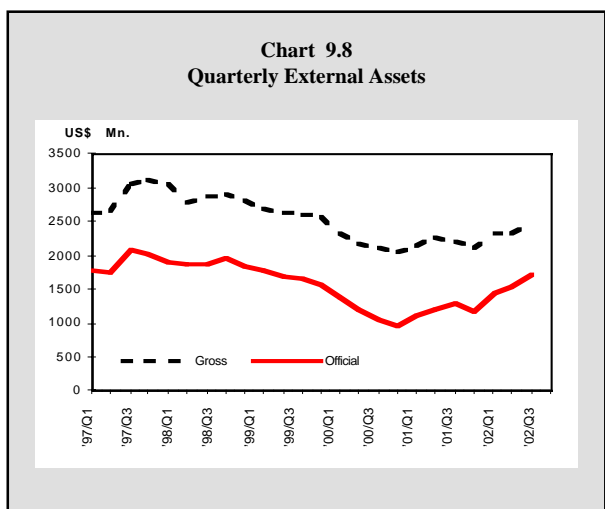
(a) Changes computed on the basis of foreign currency equivalent of Sri Lanka rupees. A minus sign indicates depreciation.

(b) With effect from 23 January 2001, the Central Bank refrained from announcing these rates and allowed the market forces of supply and demand to determine the market rate.

**Chart 9.7**  
**Exchange Rate Movement - 2002**



**Chart 9.8**  
**Quarterly External Assets**



Sri Lanka successfully completed the SBA signed in April 2001, and drew a further US dollars 126 million in 2002, augmenting gross official reserves by that amount. Meanwhile, the Central Bank was able to purchase US dollars 177 million net from the domestic forex market, despite larger outlay on imports arising from both economic recovery and rising crude oil prices. The Government of Sri Lanka issued the remaining US dollars 91.5 million worth of SLDBs of the originally proposed US dollars 250 million issue. These were purchased primarily by foreign currency banking units (FCBUs) of commercial banks. However, neither the forex purchases in the domestic market by the Central Bank nor the issue of SLDBs to FCBU did have any impact on total reserves of the country

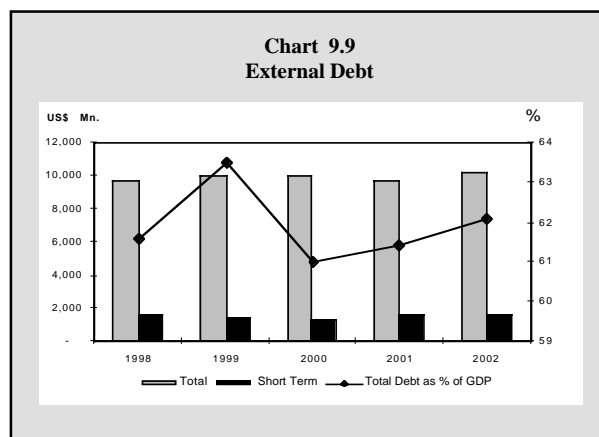
1 Reserves are calculated at market values with the adoption of International Accounting Standards (IAS) by the Central Bank of Sri Lanka in December 2001.

as they reflected only a shift in foreign exchange reserves from commercial banks to the Central Bank, raising official external reserves.

As a result of these developments, total gross external reserves of the country increased by 11.0 per cent to US dollars 2,495 million, sufficient to finance 4.9 months of imports in 2002<sup>1</sup>. The increase in total reserves was the outcome of an increase in gross official reserves by US dollars 362 million (27 per cent) to US dollars 1,700 million, a level sufficient to cover 3.3 months of imports, and a drop in gross external assets of commercial banks by US dollars 105 million to US dollars 795 million. The drop in foreign assets of commercial banks was a result of a drop in assets of FCBUs.

Meanwhile, foreign liabilities of commercial banks dropped by US dollars 144 million to US dollars 865 million due to a drop in external liabilities of FCBUs. Gross official liabilities increased by US dollars 105 million, reflecting a net increase of US dollars 78 million in liabilities to the IMF. As a result, net official reserves increased by US dollars 338

**Chart 9.9**  
**External Debt**



**TABLE 9.9**  
**External Assets of Sri Lanka**

Ownership	US dollars million (a)					Rupees million (a)				
	1998	1999	2000	2001	2002 (b)	1998	1999	2000	2001	2002 (b)
1. Government	20	20	22	78	46	1,372	1,441	1,767	7,302	4,424
2. Government Agencies	-	-	-	-	-	-	-	-	-	-
3. Central Bank	1,964	1,619	1,026	1,260	1,654	132,900	116,571	81,819	117,365	160,018
4. Total Official Assets	1,984	1,639	1,049	1,338	1,700	134,272	118,013	83,585	124,668	164,442
5. Commercial Banks	923	942	1,083	900	795	62,561	67,946	86,682	83,815	76,921
6. Total External Assets	2,907	2,582	2,131	2,238	2,495	196,833	185,958	170,268	208,482	241,364
7 Gross Official Assets in Months of										
7.1 Merchandise Imports	4.0	3.3	1.7	2.7	3.3					
7.2 Import of Goods and Services	3.6	2.9	1.5	2.2	2.9					
8 Total Assets in Months of										
8.1 Merchandise Imports	5.9	5.2	3.5	4.5	4.9					
8.2 Import of Goods and Services	5.2	4.6	3.1	3.8	4.2					

Source: Central Bank of Sri Lanka.

(a) Converted at the following end year rates except for certain items in the International Reserve of the Central Bank which were converted at the representative rate agreed with the IMF

Year	1998	1999	2000	2001	2002
Rs. per US dollar	67.78	72.12	80.06	93.16	96.73

(b) Reserves for 2002 are calculated at market value.

million, equivalent to the surplus in the overall balance in the balance of payments.

## 9.9 External Debt

Total external debt of the country increased by 9.0 per cent to US dollars 9,291 million at the end of 2002. The increase was reflected in an increase in liabilities to the IMF, an increase in concessional government debt and a rise in long-term private sector debt. Cross rate changes of the international currencies accounted for US dollars 66 million or 31 per cent of the total increase in the debt stock registered in US dollar terms in 2002.

Medium and long-term debt, accounting for about 93 per cent of the total debt stock, mainly consisted of concessional debt (86 per cent), with non-concessional debt representing the remaining 14 per cent. Central government debt, which accounted for 85 per cent of medium and long-term debt and for 70 per cent of the total debt, increased only by 7 per cent due to an increase in concessional loans by 13 per cent and a drop in the government's commercial debt stock by 45 per cent. This, however, excludes foreign exchange liabilities of the government to FCBUs (US dollars 300 million) as they are considered domestic debt according to definitions under the fifth edition of the IMF's Balance of Payments Manual.

The government guaranteed external debt stock declined by 7 per cent as the government was cautious in providing guarantees to public corporations and private sector borrowers in accordance with the policy of reducing contingent liabilities. This decline was due entirely to the amortisation of debt owed by SriLankan Airlines and Sri Lanka Telecom during the year. Meanwhile, the debt stock of public corporations and private sector without government guarantee increased by 9 per cent to US dollars 272 million during the year, mainly due an increase in long-term trade credits.

Meanwhile, liabilities to the IMF increased by US dollars 78 million owing to net effect of the purchase of the remaining

SDR 97 million (US dollars 126 million) under the SBA and repayments on account of borrowings under the Enhanced Structural Adjustment Facility (ESAF). Sri Lanka successfully completed the SBA signed with the IMF in April 2001 and had drawn the entire SDR 200 million (US dollars 257 million) by June 2002. Initial discussions were held between the Government of Sri Lanka and the IMF in October 2002 for a long-term Poverty Reduction and Growth Facility (PRGF) aimed at structural reforms geared to achieving sustainable high growth and to reducing poverty.

The short-term debt stock of the country (based on original maturity), which consists of trade credit, increased by 13 per cent to US dollars 601 million reflecting the partial recovery in imports during the year. However, the share of short-term debt in the total debt stock remained low at 6 per cent of GDP. Short term debt as a percentage of official reserves declined from 40 per cent in 2001 to 35 per cent in 2002, as official reserves rose during the year. This reflects an improvement in the external sector vulnerability of the country. The total external debt to GDP ratio increased from 54.3 per cent in 2001 to 56.1 per cent in 2002 as the GDP in dollar terms increased by 5.4 per cent against the 9 per cent increase in the total debt stock during the year. Meanwhile, banking sector external liabilities dropped by 10.5 per cent owing to a decline in external liabilities of commercial banks by 14.3 per cent in 2002. As a result, total external debt and banking sector liabilities rose by 6.5 per cent, while short-term debt including banking sector liabilities as a percentage of official reserves declined from 123 per cent to 94 per cent.

## 9.10 Debt Service Payments

The sharp drop in global interest rates had a favourable impact on Sri Lanka's external debt service payments during 2002. Total debt service payments, which include both amortisation

**TABLE 9.10**  
**Outstanding External Debt and Banking Sector External Liabilities**

Item	US dollars Million					Rupees Million				
	1998	1999	2000	2001	2002(a)	1998	1999	2000	2001	2002(a)
<b>1. Medium and Long-term Debt</b>	<b>8,264</b>	<b>8,613</b>	<b>8,456</b>	<b>8,011</b>	<b>8,690</b>	<b>557,530</b>	<b>620,274</b>	<b>676,045</b>	<b>746,270</b>	<b>840,619</b>
1.1 Government	6,902	7,125	6,989	6,808	7,442	467,798	513,785	559,544	634,255	719,902
1.2 Public Corporations and Private Sector with Government Guarantee	718	944	1,028	744	689	48,673	68,105	82,302	69,349	66,618
1.3 Public Corporations and Private Sector without Government Guarantee	277	286	278	249	272	18,789	20,618	22,257	23,203	26,311
1.4 IMF Drawings	367	258	161	209	287	22,271	17,766	11,943	19,463	27,787
<b>2. Short-term Debt</b>	<b>484</b>	<b>475</b>	<b>575</b>	<b>533</b>	<b>601</b>	<b>32,833</b>	<b>34,240</b>	<b>46,034</b>	<b>49,648</b>	<b>58,100</b>
2.1 Government	-	-	-	-	-	-	-	-	-	-
2.2 Other(CPC and other trade credit) (b)	484	475	575	533	601	32,833	34,240	46,034	49,648	58,100
<b>3. Banking Sector External Liabilities (c)</b>	<b>958</b>	<b>885</b>	<b>1,076</b>	<b>1,119</b>	<b>1,001</b>	<b>64,926</b>	<b>63,838</b>	<b>86,132</b>	<b>104,201</b>	<b>96,807</b>
3.1 Central Bank	...	...	...	2	1	24	7	33	172	123
3.2 Commercial Bank	865	765	938	1,009	865	58,656	55,142	75,101	94,030	83,655
3.3 ACU Liabilities	92	121	137	107	135	6,247	8,689	10,998	9,999	13,029
<b>4. Total External Debt (1+2)</b>	<b>8,749</b>	<b>9,088</b>	<b>9,031</b>	<b>8,544</b>	<b>9,291</b>	<b>590,363</b>	<b>654,514</b>	<b>722,079</b>	<b>795,918</b>	<b>898,718</b>
<b>5. Total External Debt and Liabilities (1+2+3)</b>	<b>9,707</b>	<b>9,973</b>	<b>10,106</b>	<b>9,662</b>	<b>10,292</b>	<b>655,289</b>	<b>718,352</b>	<b>808,211</b>	<b>900,119</b>	<b>995,526</b>
<b>MEMORANDUM ITEMS</b>										
<b>Medium and Long-term Debt</b>										
(1) Project Loans	5,150	5,517	5,346	5,385	4,415	349,043	397,882	427,965	481,186	422,328
(2) Non-Project Loans	1,656	1,612	1,426	1,144	3,075	112,237	116,247	114,174	102,214	294,189
(3) Suppliers' Credits	251	182	338	316	100	17,020	13,146	27,074	29,411	9,718
(4) IMF Drawings	367	258	161	209	287	22,271	17,766	11,943	19,463	27,787
(5) Other Loans (d)	840	1,043	1,185	958	812	56,960	75,233	94,890	113,996	86,596
<b>Short-term Debt and Banking Sector Liabilities</b>	<b>1,442</b>	<b>1,360</b>	<b>1,650</b>	<b>1,651</b>	<b>1,602</b>	<b>97,759</b>	<b>98,078</b>	<b>132,166</b>	<b>153,850</b>	<b>154,907</b>
Total External Debt as a percentage of GDP	55.5	57.8	54.5	54.3	56.1	58.0	59.2	57.5	56.6	56.7
Total Banking Sector External Liabilities as a percentage of GDP	6.1	5.6	6.5	7.1	6.0	6.4	5.8	6.9	7.4	6.1
Total external debt and liabilities as a percentage of GDP	61.6	63.5	61.0	61.4	62.1	64.4	65.0	64.4	64.0	62.8
Short-term Debt as a percentage of GDP	3.1	3.0	3.5	3.4	3.6	3.2	3.1	3.7	3.5	3.7
Short-term debt and banking sector external liabilities as a percentage of GDP	9.2	8.7	10.0	10.5	9.7	9.6	8.9	10.5	10.9	9.8
Short-term Debt as a percentage of Total Debt and Liabilities	5.0	4.8	5.7	5.5	5.8	5.0	4.8	5.7	5.5	5.8
Short-term liabilities as a percentage of Total Debt and Liabilities	9.9	8.9	10.6	11.6	9.7	9.9	8.9	10.7	11.6	9.7
Short-term Debt as a percentage of Official Reserves	24.4	29.0	54.8	39.8	35.3	24.5	29.0	55.1	39.8	35.3

(a) Provisional

(b) Includes acceptance credits of Ceylon Petroleum Corporation and other trade credit.

(c) ACU debits and foreign liabilities of commercial banks including those of FCUBs.

(d) Includes long term loans of public corporations and private sector institutions.

Sources: Central Bank of Sri Lanka

External Resources Department

of long-term and medium-term debt and interest payments on all foreign debt, decreased by 3 per cent due to the combined effects of an increase in amortisation payments by 3 per cent and a drop in interest payments by 16 per cent during the year.

Repayments on account of government debt accounted for 66 per cent of total amortization payments. The debt service payments of the government, at US dollars 533 million, accounted for 68 per cent of the country's total debt service payments during the year. The low interest payments, which accounted for 27 per cent of debt service payments, indicated high concessionality of a major part of the existing debt stock. However, as Sri Lanka progresses forward in terms of its per capita income, it would automatically be disqualified from

concessional loans from multilateral donor agencies such as IDA and ADB. Sri Lanka has already graduated upward in IDA and ADB lending, limiting Sri Lanka's access to purely concessional loans. In such a scenario, it is vital that Sri Lanka focuses on maximising available concessional loans, increases efficiency in loan utilization, exhibits professionalism and exercises caution in loan negotiations, in particular non-concessional loans, in the best interests of the country.

Debt service payments, as a percentage of receipts from merchandise exports and services, remained at 13.2 per cent in 2002. As a percentage of receipts from goods, services, income and private transfers, debt service payments decreased marginally from 10.9 per cent to 10.7 per cent reflecting both

**TABLE 9.11**  
**External Debt Service Payments (a)**

Item	US dollars Million					Rs. Million				
	1998	1999	2000	2001	2002(b)	1998	1999	2000	2001	2002(b)
<b>1. Debt Service Payments</b>	<b>759</b>	<b>846</b>	<b>953</b>	<b>813</b>	<b>788</b>	<b>48,773</b>	<b>59,321</b>	<b>74,554</b>	<b>72,612</b>	<b>74,663</b>
1.1 Amortization	469	550	621	559	574	30,076	48,472	49,410	49,910	54,200
(i) To IMF	83	100	97	78	56	5,100	6,813	9,700	6,966	4,647
(ii) To Others	387	451	524	481	518	24,975	31,658	39,711	42,944	49,553
1.2 Interest Payments	289	296	332	254	214	18,697	20,850	25,144	22,702	20,463
(i) To IMF	7	5	5	4	4	443	376	410	348	398
(ii) To Others	282	291	326	251	210	18,254	20,474	24,734	22,354	20,064
<b>2. Earnings From Merchandise Exports and Services</b>	<b>5,712</b>	<b>5,578</b>	<b>6,476</b>	<b>6,172</b>	<b>5,967</b>	<b>369,484</b>	<b>393,303</b>	<b>492,301</b>	<b>551,309</b>	<b>571,195</b>
<b>3. Receipts From Merchandise Exports, Services, Income and Private Transfers</b>	<b>6,925</b>	<b>6,801</b>	<b>7,787</b>	<b>7,436</b>	<b>7,330</b>	<b>447,951</b>	<b>479,469</b>	<b>591,567</b>	<b>664,073</b>	<b>701,579</b>
<b>4. Debt Service Ratio (b)</b>										
4.1 As a percentage of 2 above										
(i) Overall Ratio	13.3	15.2	14.7	13.2	13.2	13.2	15.1	15.1	13.2	13.1
(ii) Excluding IMF Transactions	11.7	13.3	13.1	11.8	12.2	11.7	13.3	13.1	11.8	12.2
4.2 As a percentage of 3 above										
(i) Overall Ratio	11.0	12.4	12.2	10.9	10.7	10.9	12.4	12.6	10.9	10.6
(ii) Excluding IMF Transactions	9.7	10.9	10.9	9.8	9.9	9.7	10.9	10.9	9.8	9.9
<b>5. Government Debt Service Payments (c)</b>										
5.1 Government Debt Service Payments (c)	419.5	449.0	437.0	450.9	498.0	27,125.8	31,612.9	33,099.6	40,190.0	49,927.6
5.2 As a percentage of 1 above	55.3	53.1	45.9	55.5	63.2	55.6	53.3	44.4	55.3	66.9

Source: Central Bank of Sri Lanka

(a) Provisional.

(b) Debt service ratios calculated in rupee values and US dollar values differ due to variations in exchange rates during the year.

(c) Excludes IMF transactions.

the drop in debt service payments and a recovery in current external receipts. These debt service ratios still indicate a very low levels of total country risk with respect to its vulnerability and exposure to external debts.

## 9.11 External Trade Environment and Policy

In 2002, the external trade and tariff policy aimed at stimulating the economy through increased openness. At the beginning of 2002, the tariff regime consisted of two major tariff bands of 10 per cent and 25 per cent, in addition to the zero tariff band. A few special items were placed at 5 per cent and 35 per cent. The 5 per cent rate was applicable to machinery and equipment, whereas the 35 per cent was applicable to mostly agricultural products. A 40 per cent surcharge on almost all imports, excluding a few essential items were in place. A few items such as liquor and tobacco were subject to higher rates of 75 and 100 per cent.

During 2002, several measures were taken to disturb the existing policy path of achieving a more liberal and less protective tariff regime with a lower and simplified tariff structure. The existing tariff policy regime was interrupted with the introduction of specific duties on selected agricultural products in early 2002, while the simplicity of the tariff structure was disturbed by distributing the zero tariff items between a new 2 per cent band and the existing 10 per cent tariff band. Some items in the 5 per cent and 10 per cent bands

were distributed among the 10 per cent and 20 per cent bands. A positive measure was that of reducing the import surcharge of 40 per cent to 20 per cent in April 2002.

### Tariff and Taxes on External Trade

In 2002, the government presented two Budgets, one in March and the other in November, 2002. The March 2002 Budget was the postponed Budget of November, 2001. In that Budget, the surcharge of 40 per cent on import duty under Section 10(A) of the Customs Ordinance was reduced to 20 per cent with effect from 15 April, 2002. However, the tariff regime became less simple with the introduction of new tariff bands of 2 and 20 per cent in November, 2002. Items in the zero per cent band were allocated to the 2 per cent band and 10 per cent band, mainly out of revenue considerations. However, distortions to the tariff regime by way of duty waivers, exemptions and surcharges were maintained at a minimum level. A Tariff Advisory Council was set-up in 2002 to examine and correct anomalies and distortions in the tariff structure and to address representations made by importers and industrialists.

A few specific duties were introduced during 2002. Specific duties were introduced on rice in January, 2002 and on red onions, big onions and chillies on 22 March 2002, replacing the ad valorem tariff of 35 per cent. However, the specific duty on rice was brought down from Rs.7.00 per kg. to Rs. 5.00 per kg in line with the objective of lowering the cost of living against rising domestic rice prices. Furthermore,

existing ad valorem taxes on uncooked or cooked potatoes, preserved and dried onions, cowpea, dhal, green gram, rice flour and jaggery, were replaced with specific duties, while some motor vehicle spare parts and footwear were brought under specific or ad valorem taxes in Budget 2003. With these revisions, items under specific duties increased to forty six, while items under the category of 'specific or ad valorem rates' increased to thirty one.

In November 2002, nearly 1,500 products, which enjoyed duty free entry, were placed in either the 2 or 10 per cent category with the majority of items placed under the 2 per cent tariff band, except for crude oil, textiles and wheat. Textiles and wheat remained duty free, while some petroleum products which were either 10 per cent or 25 per cent, were made duty free. Accordingly, the number of duty free items declined to

650 at end November 2002. Duty rates on a few items were increased from 10 per cent to 20 per cent or from 5 per cent to 10 per cent.

The specific surcharge of Rs. 20 per kg. on soya bean oil, palm oil, sunflower oil, coconut (copra) oil, palm kernel or babassu oil and other vegetable oils was reduced to Rs. 5 per kg. from 1 April 2002 and fully withdrawn with effect from 26 September, 2002. Masoor red dhal and yellow dhal were exempted from the 20 per cent import duty surcharge on 26 September 2002 out of cost of living considerations.

Duty waivers on import was limited to a very few essential items. Duty payable on the import of crude oil and refined products including LP gas was waived during 2002 in view of the high cost of petroleum products. Duty forgone due to these waivers was Rs. 8,900 million in 2002 as against Rs.6,127 million in 2001. Import of rice and palm oils were granted partial duty waivers of Rs. 3 per kg. and 5 percentage points of the tariff rate, respectively. A partial duty waiver was granted to import of shoe soles and footwear. Other waivers were limited to donations to charitable institutions, religious institutions, diplomatic missions, and goods imported for development projects in terms of the agreement signed by the government with donor agencies. Accordingly, the number of duty waivers granted was limited to 453 as against 2,536 in 2001.

With the revisions made to the tariff structure in March and November, 2002, the average import duty, i.e., the ratio of import duty collection to total adjusted imports, declined marginally from 4.9 per cent in 2001 to 4.8 per cent in 2002. The average import duty rate, without the impact of the 40 per cent surcharge till April, 2002 and 20 per cent surcharge thereafter was 4.1 per cent. The share of dutiable imports in total imports increased from 25 per cent in 2001 to 28 per cent in 2002 as more dutiable items were imported where rates of duty payable were lowered. The drop in imports of defence related material, which enters duty free, also contributed to this change.

Dutiable imports within the consumer goods category increased from 56 per cent in 2001 to 61 per cent in 2002 due to the imposition of duty on duty free items. The average import duty rate on food and drink declined as the surcharge on selected food items was reduced. The average import duty rate on non-food consumer goods categories increased. When adjustments are made for the 20 per cent surcharge, the average duty rate on consumer goods was about 12 per cent.

In the intermediate goods category, dutiable imports declined from 12 per cent to 10 per cent, while in the investment goods category, dutiable imports increased from 40 per cent to 45 per cent in 2002. Despite the prevailing import surcharge of 20 per cent, the average duty rate on intermediate goods declined marginally to 1.6 per cent due to the impact of the duty waivers on petroleum products. The average duty rate on investment goods increased marginally due to the surcharge on imports. However, excluding the surcharge, the average duty rate would be 4 per cent in 2002.

TABLE 9.12

## Average Import Duty Collection Rate (a)

Item	1998	1999	2000	2001(b)	2002(b)(c)
Consumer goods	12.7	12.8	11.5	13.3	13.3
Food and drink	12.6	13.6	11.7	15.3	14.4
Rice	2.4	16.4	30.0	21.2	32.9
Flour	...	-	6.2	13.3	12.3
Sugar	20.8	21.3	15.9	16.2	16.0
Wheat and meslin	...	0.3	...	-	-
Milk and milk products	11.5	11.6	10.6	15.3	11.9
Dried fish	1.1	1.2	1.3	2.0	7.9
Other fish products	4.8	4.8	5.1	6.3	6.8
Other food items	20.5	19.9	18.7	25.4	22.9
Non-food consumer goods	12.8	12.0	11.3	10.9	12.1
Motor cars & cycles	23.6	20.1	16.6	21.1	23.3
Radio receivers- television sets	12.4	11.9	6.8	8.3	8.6
Rubber tyres & tubes	32.0	28.4	23.5	29.6	27.9
Medicinal & pharmaceutical products	0.9	0.6	0.5	0.6	0.6
Other non-food items	10.1	9.1	11.1	9.7	9.4
Intermediate goods	4.7	4.1	2.9	1.7	1.6
Fertiliser	-	-	-	-	0.4
Crude oil	25.8	15.8	7.4	...	-
Other petroleum products	16.7	16.1	5.3	0.9	0.8
Chemical elements and compounds	5.8	3.6	3.2	3.3	1.1
Dyeing, tanning and colouring	7.5	5.3	5.2	6.3	4.0
Paper and paper boards	6.0	5.7	5.0	6.7	5.2
Textiles & clothing	0.1	0.1	0.1	0.1	0.1
Other intermediate goods	4.8	4.1	3.5	4.2	4.3
Investment goods	6.0	4.4	4.0	5.3	5.5
Building materials	9.3	7.8	7.5	9.3	7.4
Transport equipment	11.8	7.4	7.4	10.3	11.0
Machinery and equipment	3.0	2.2	1.8	2.7	3.7
Other investment goods	4.4	3.4	3.2	4.2	3.8
Total	7.4	7.0	4.5	4.9	4.8

(a) Actual import duty collection as a percentage of total adjusted import value (c.i.f.).

(b) This includes the impact of 40 per cent surcharge imposed on selected imports on 21 February 2001 and the 20 per cent surcharge from 1 April 2002.

(c) Provisional

Sources: Sri Lanka Customs  
Co-operative Wholesale  
Establishment  
Ceylon Petroleum  
Corporation  
Prima Ceylon Ltd.

### Import and Export Controls

As positive initiatives, licensing requirements on the import of rice other than paddy was removed with effect from 21 January 2002. The procedure for importing low value items was simplified by removing duties, surcharges and other levies applicable to any import with a value less than Rs. 10,000 sent through parcel post in Budget 2002. Amendments were made to the Imports and Export (Control) Act No. 01 of 1969, by Gazette Notification No 1228/15 dated 22 March 2002. Meanwhile a fee of 0.1 per cent was imposed on import licences, subject to a minimum charge of Rs.100 from 22 March 2002 deviating from the objective of minimising constraints on external trade. As the items under the import control licences are limited the revenue from this levy has no significant impact on the government revenue. Gold has been imported to Sri Lanka by licensed commercial banks only on consignment basis. Imports of books, periodicals or ornamental fish for re-exports were also brought under this restriction on 29 August 2002. A total of 353 items at 6 digit level of Harmonised System of Codes (HS Code) remained under import controls by end of 2002.

Export licensing requirements on coral chanks and shells were withdrawn while several mineral products such as waste and scrap of copper, nickel, aluminium, lead, zinc, tin, tungsten, molybdenum, tantalum and magnesium were brought under licensing on 18 November 2002. Three categories of exports, i.e., wood and articles of wood (ebony), ivory and ivory products and passenger motor vehicles (first registered in Sri Lanka prior to 1945) continued to remain under licence with the objectives of environmental protection and preservation of antiques. A levy of Rs. 100 was imposed on export control licences from 22 March 2002.

Except quartz, iron and non-alloy steel products, the entire export sector has continued to be free from all export and ad valorem sales taxes since end 1992. However, export cesses are applied on tea, coconut and coconut products and rubber. A Export Development Board cess is applied on cashew nuts in shells, raw hides and non-ferrous scrap metal exports. A nominal fee of royalty is levied on conch shells, coral chanks, elephants and tuskers.

The number of items on the list of exemptions remained unchanged at 41 until 6 November 2002. This list was revised by removing 20 items and adding imports of personal items and samples worth not more than Rs.10,000 in relation to business. The thirteen items deleted from the list of exemptions were incorporated in the list of concessions and came under a concessionary duty rate of 2 per cent. Accordingly, 22 categories of goods remained exempt from import duty. The Director General of Customs has to be satisfied that those goods are imported for the purpose approved under the respective categories and that approval been obtained from the Secretary to the Treasury. With these revisions, the list of concessions, which had only 2 items, increased to 15 by 6 November 2002.

In place of the stamp duty, which was abolished on 30 April 2002, a Ports and Airports Development Levy (PAL) of 1 per cent of the c.i.f. value of imports was introduced with effect from 1 May 2002. Imports for processing and re-export were been subject to PAL at 0.75 per cent of the c.i.f. value of imports, became subject to 0.5 per from 1 January 2003.

### Textile and Garment Quota Allocation

Allocation of textile and garments quota under the quota system began in 1978 at the Ministry of Textile Industries. Since 1 July 1992, the administration of the quota system has been the responsibility of the Textile Quota Board (TQB), currently under the Ministry of Enterprise Development, Industrial Policy and Investment Promotion. However, quota restrictions are to be phased out completely by 2005 under the Uruguay Round Agreement on Textiles and Clothing (MFA) of 1994. The process was to be implemented in four phases, starting on 1 January 1995. The first two phases of integration of quota categories were implemented in 1996 and 1998, respectively. The third phase of integration became effective on 1 January 2002.

Under the third stage of integration, USA has fully integrated 20 categories of garments, 5 categories of fabric, 7 categories of made up articles and 4 categories of yarn and partially integrated 4 categories of garments and a category of made up articles. EU removed all quota restrictions on textile and garment exports to EU countries on 1 January 2001. However, exporters to EU have to obtain export visas from the BOI or the Textile Division of the Ministry of Industrial Development for the purpose of monitoring exports, while ensuring that export items were produced in Sri Lanka.

Approximately 33 quota categories were open to export to USA and 15 categories to Canada in 2002. Basic quota availability to USA and Canada declined by 8 per cent and 10 per cent, respectively. Accordingly, overall quota availability to those countries decreased by 8 per cent in 2002 due to the phased elimination of quota under the MFA. This will avoid the risk of removing a large number of quotas at the last stage of the phasing out process in 2005.

The overall quota utilisation rate in 2002 declined to 71 per cent, compared to 72 per cent in 2001, in response to weak export demand. The utilisation of quota varied widely across different product categories and countries. The utilisation of the US quota dropped marginally from 73 per cent in 2001 to 72 per cent in 2002 because of lower demand. The under-utilisation was partly due to insufficient demand for particular items, preference of local producers to use their capacity to produce high value added garments under other quota categories or to produce non-quota garments. This was evident in the increased exports of non-quota garment categories and full utilisation of some popular categories. Quotas allocated for certain popular categories like trousers, underwear, knit shirts and blouses were fully

utilised. As in previous years, the utilisation rate of quota submitted by Canada was lower than that by USA. The overall utilisation rate of Canadian quota declined significantly from 42 per cent in 2001 to 33 per cent in 2002. The only category that was fully utilised was trousers, overalls and shorts. Total exports earnings from USA on account of textile and garments declined by 5 per cent in 2002, while earnings from textile and garment exports to Canada decreased by 11 per cent. Export earnings from non-quota countries declined marginally in 2002.

### **Incentives to Exporters**

The government implemented several incentives proposed in Budget 2002 and Budget 2003, targeting exporters as well as other industrialists, with the objective of reviving the export sector which experienced contracted growth in 2001. A special incentive package was granted for companies under the BOI law. The concessions were determined on the basis of the location of enterprises. Region I was identified as the Western Province, while other provinces were identified as Region II. Industries engaged in the manufacturing and exports, including non traditional exports, were granted tax holidays of 3 years in Region I and 5 years in Region II. For the expansion of such industries, 2 year tax holidays were granted, regardless of the region. Investments in agriculture fisheries and agro-processing other than tea and prawns, amounting to Rs. 1 million, will be granted a 5 year tax holiday while from the sixth year onwards a concessionary rate of 15 per cent will be charged.

### **Institutional Support to Exporters**

In 2002, exporters continued to receive institutional support from the Ministry of Enterprise Development, Industrial Policy and Investment Promotion, export development organisations, such as the Export Development Board (EDB) and the Sri Lanka Export Credit Insurance Corporation (SLECIC) and other related ministries and government institutions. The Ministry of Plantation Industries provided support for the development of traditional exports, while EDB played the major role in the development and promotion of non-traditional exports. SLECIC provided credit insurance and guarantee services. Other relevant institutions, especially the Ministry of Foreign Affairs and the Ministry of Commerce and Consumer Affairs, continued to educate exporters on facilities available through bilateral, regional and multilateral organisations and were instrumental in establishing contact between Sri Lankan entrepreneurs and foreign counterparts. Private sector institutions such as Chambers of Commerce, played an active role in promoting exports sector.

The objectives of SLECIC are to issue insurance policies to exporters and guarantees to banks and financial institutions for the development of exports. In 2002, the number of policies and guarantees in force was 204 compared to 205 policies at end December 2001. These included whole turnover export

payments, insurance policies, specific policies, small scale insurance policies, policies covering entrepot trade, computer software and special schemes for tea exports to Iraq. During 2002, SLECIC issued 57 new insurance policies amounting to Rs.548 million as against 49 policies in 2001. New guarantees in force at end 2002 amounted to 1,927 to the value Rs.2,975 million. A few insurance policies were in place for new and small scale exporters, enabling them to compete in international markets with confidence.

EDB channelled its resources towards promoting non-traditional exports through its programmes on entrepreneur development, product development and market development. It also provided trade related information through electronic means and granted financial assistance and policy recommendations on export related issues. The activities and programmes carried out during the year focused on assisting private sector export oriented enterprises to be competitive in international markets. During the year assistance was given to improve quality and skills for specific products and product development for industrial products such as electronic products, footwear, printing and stationery, handicrafts, engineering, gems and jewellery, wood products, handloom and textile products, ceramic and porcelain products and agricultural products such as fruits and vegetables, floriculture, spices, essential oils, organic products, coir products, oil seeds and pulses, seaweed and cashew. EDB carried out several market development activities to maintain the market share in the existing markets and to identify and develop new markets. EDB assisted exporters to participate in 11 international trade fairs while trade promotion missions were sent to China, Saudi Arabia and South Africa. EDB is expecting to establish a Sri Lanka Centre in Chennai, India to promote a selected range of products targeting the middle and upper segments of the Indian market in order to reap the benefits of concessions under the Indo-Lanka Free Trade Agreement (ILFTA).

EDB continued to provide advice and assistance to exporters to resolve various operational problems relating to sea and airfreight and entrepot trade. Awareness programmes and seminars were conducted on e-commerce, import/export procedures, export packaging and on quality circles. EDB provided multi-faceted services to the export sector ranging from computerised database facilities, bulletin board service, advisory services and library facilities. EDB initiated setting up of export processing companies in the provinces in collaboration with the Ministry of Rural Economy aiming to mobilise rural producers of exportable products with suitable institutional means, (viz. Export Promotion Village Companies), as viable commercial entities and linking them directly with export houses of such products. The link exporters of such project will establish export processing companies for value addition where the link exporters will be the main investor. The Ministry of Rural Economy and the EDB will jointly provide seed capital.

**Box 18****Harnessing the Potential of International Cooperation Agreements**

International cooperation agreements allow countries to realise political harmony and economic benefits. The first international cooperation agreements (Treaties of Rome), which set forth a wave of regionalism, were signed among a few European nations in the aftermath of the World War II. The Treaties establishing the European Economic Community and the European Atomic Energy Community were signed by Belgium, France, Germany, Italy, Luxembourg, and the Netherlands in Rome on January 1, 1958. The Treaties were mainly intended for preserving political harmony. The economic agreement gradually evolved into a preferential trading agreement, followed by a free trade agreement, a customs union and finally, a monetary union. The membership of the union continues to increase. In addition to political harmony, the benefits of the continuing integration were access to a large common market, specialisation and economies of scale arising out of the large market, and trade creation, which leads to higher incomes in member countries. The costs of integration are mostly political in nature for member countries, such as the loss of sovereignty, and reduced self-sufficiency. Costs are more severe for non-members as they face trade diversion and marginalisation.

Since the first cooperation agreement, countries have entered into an overlapping web of such agreements mostly as a strategic response to rival cooperation agreements. The World Trade Organisation (WTO) had ratified over 200 trade related agreements by 2002. As trade is not the only basis for international cooperation, there is a multitude of cooperation agreements in the world on various other themes such as investment, technology, research, culture, and the arts.

International cooperation, if effectively handled, could derive vast benefits. It enables specialisation and economies of scale arising from large markets, developing networks of production and distribution, sharing of and building up infrastructure, bringing down barriers to trade and investment, encouraging social development, and promoting environmental protection and management. It can accelerate the pace of development through sharing space, resources, knowledge, and expertise provided by geographic proximity. Partner countries can forge powerful and positive bonds among themselves, and increase their relevance in the international economy. They can face challenges of international forces such as globalisation, more effectively. They can also cooperate to combat

international crime such as money laundering that destabilises economic systems. This, in turn, provides a crucial basis for peace, stability, and economic growth.

After regaining Independence, Sri Lanka became a member of several bilateral, regional and multilateral groupings. Following the establishment of the Central Bank, Sri Lanka became a member of the International Monetary Fund (IMF) and the World Bank on 29 August 1950. Since 1955, Sri Lanka has been a member of United Nations (UN), and a large number of UN related organisations.<sup>1</sup> An important organisation is the Generalised Agreement on Trade and Tariff (GATT) established in 1944, which later graduated to a fully fledged WTO. Sri Lanka has been a member since the inception of WTO in 1994.

Sri Lanka became a member of G-77, a group established at the United Nations Conference on Trade and Development (UNCTAD) in 1964. The purpose was to look after special interests of developing countries. A sub-group from G-77 was established as G-24 in 1972, to look after the interests of the developing countries in monetary and financial issues in the international arena. Sri Lanka is one of the founder members of G-24. A similar grouping, G-15, operates to promote South-South consultation and co-ordination, where South represents developing countries. Sri Lanka became a member of G-15 in 1998.

Sri Lanka receives preferential tariff under the Generalised System of Preferences (GSP) as well as from the Global System of Tariff Preferences (GSTP). Under GSP Sri Lanka and other developing countries receive concessional tariff rates from participating developed countries. Under GSTP, Sri Lanka exchanges tariff concessions with other participating developing countries.

Sri Lanka's first regional preferential trading agreement is the Bangkok Agreement established in 1975. Participating member countries are India, Bangladesh, South Korea, Laos, and China. Sri Lanka became a founder member of the Asian Clearing Union (ACU), in 1975. The members of ACU are Bangladesh, India, Iran, Nepal, Pakistan, Sri Lanka and Myanmar. ACU is basically a settlement system that promotes trade among its members.

With the establishment of the South Asian Association for Regional Cooperation (SAARC) in 1985, Sri Lanka embarked on regional cooperation encompassing economic, social and cultural aspects. The South Asian Preferential Trading Arrangement (SAPTA) was established in 1995 with the objective of extending tariff concessions among members. Plans are underway to establish a South Asian

<sup>1</sup> The UN was established in 1944 in the aftermath of the World War II. The IMF and World Bank were established in 1945.

Free Trade Agreement (SAFTA) in the future. Related to SAARC is the SAARCFINANCE, an organisation of Governors of South Asian Central Banks and Secretaries of Ministries of Finance established in 1998, whose major objective is cooperation on financial issues. Sri Lanka is also a member of IOR-ARC (Indian Ocean Rim Association for Regional Cooperation) and BIMST-EC (Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation), which were established in 1997 and 1998, respectively.

Sri Lanka's most far reaching agreement was the Free Trade Agreement with India established in 1998. The trade is free of tariff barriers with respect to some products, and will be freer as two countries gradually make more products free of tariff. Sri Lanka has signed a similar agreement with Pakistan in 2002. Sri Lanka continues to have bilateral economic cooperation agreements with a large number of countries in various parts of the World, e. g., Western and Eastern Europe, North America, Latin America, Africa and Asia.

### **Challenges in Managing International Cooperation**

The basic aim of international organisations such as IMF, World Bank and WTO is to enhance global economic growth through liberalisation and de-regulation. Thus, since joining IMF and the World Bank, Sri Lanka has been under pressure to liberalise its markets, and the exchange rate regime. Liberal markets foster economic growth through increased competition and creative destruction, to the extent that a country is willing to accept rapid change, and its physical, social and legal infrastructure is conducive to reap the benefits of liberalisation.

Bilateral, Multilateral and Regional Agreements also generate similar effects of liberalisation and competition, as participating countries demand greater access to the domestic market. Those agreements pave the way for Sri Lanka's entrepreneurs to have access to their markets too. To derive tangible benefits from those agreements and resulting market access opportunities, domestic industries should be sufficiently competitive, and Sri Lanka's macroeconomic environment and infrastructure should facilitate to improve country's competitiveness. If factors supporting competitiveness are lacking, the agreements generate asymmetric benefits at the expense of less competitive partners.

Countries can avoid asymmetric benefits through negotiations, as terms of agreements on international cooperation are usually negotiated. Based on a country's preparedness, it can open itself only in strategically important sectors. A country should develop strong policy research to identify areas of potential benefits. Negotiations

should be conducted with effective commercial diplomacy. The country should follow up continuously the developments in each agreement, and ensure that tangible benefits are reaped from each agreement.

### **Problems in Managing International Cooperation**

International cooperation is not a short-term solution to a country's development problems. As Sri Lanka has already recognised, it is a complex and long-term process that poses many challenges for governments, development agencies, private entrepreneurs, and local communities. The process requires significant amounts of time, human capital and financial resources to develop institutions, attitudes, and national capacities that are able to recognise and explore the opportunities that exist.

The existence of large number of international cooperation agreements imposes a significant demand on managing responsibilities of the cooperation agreements. A common trend in many cooperation agreements is to propose a preferential or a free trade agreement at early stages. Thus, each new commitment and responsibility agreed to at international fora should be consistent with Sri Lanka's existing policy framework, as well as existing commitments. Each new commitment should be pursued to ensure that Sri Lanka gains, and that its long run vision is achieved. The overlapping membership also poses challenges in maintaining consistency.

In Sri Lanka several government institutions act as focal points of international cooperation. The Central Bank and the Ministry of Finance spearhead cooperation on financial matters. The Ministry of Foreign Affairs coordinates all economic, cultural and political matters with the assistance of line ministries. The Ministry of Trade and Consumer Affairs and the Department of Commerce are the focal points on trade related matters. Those institutions operate with a network of representatives spread across countries. Other public sector and private sector institutions are also drawn into the process as and when it is deemed necessary by the focal institutions.

At present, while focal institutions attempt to ensure that all commitments made under different agreements are components of major strategies of Sri Lanka's long run development policy, it is yet to be explained and presented as a comprehensive set of agreements and how those agreements formulate an effective strategy or strategies for economic development. Central to this effort is the availability of human resources in all focal institutions. As Sri Lanka has not yet reformed the civil service effectively, all focal points suffer from typical state sector human capital problems commonly found in developing countries.

Sri Lanka suffers from inadequate policy research to underpin its initiatives on regional cooperation. It also does not conduct sufficient follow up work to harness the benefits of cooperation agreements. Those problems become evident when Sri Lanka attempts to forge common strategies with its partners, as most of Sri Lanka's partners are her competitors. Thus, only a well-researched strategy could sharpen Sri Lanka's competitive edge against her competitors.

The modes of negotiations have also created inherent difficulties in negotiation. When heads of countries and senior ministers meet, they usually discuss already agreed issues. Thus, the mode and tone of discussion is formal, non-confrontational and cordial. However, the discussions by officials should not be too formal. Officers should feel free to discuss intricate matters at length and be very critical of unhealthy developments.

### **Strategies of Managing International Cooperation**

Sri Lanka needs to develop a comprehensive map of all international agreements, and how each individual agreement plays a strategic role in her development policies. To facilitate this, improving close coordination among

institutions involved is essential. The institution should build public awareness on responsibilities associated with international cooperation agreements, and parties involved in the agreements, and their accountabilities.

Sri Lanka should develop a set of negotiators well conversant in commercial diplomacy. Commercial diplomacy requires special skills in negotiations, use of information and communication technology applications, trade management, languages and understanding of people from other cultures. It also requires a thorough understanding of national trade policies, knowledge of country-specific international trade agreements, as well as an understanding of institutions that facilitate exports, govern trade and fund investments.

Sri Lanka should continue to develop a conducive environment with enabling infrastructure to support creative destruction, and industrial restructuring to benefit from rapid liberalisation and deregulation. Continuing international cooperation will intensify competition in Sri Lanka. Thus, cooperation can benefit Sri Lanka, to the extent that it can develop entrepreneurs, strategies based on policy research, continuing follow up, consistency and developing skills in commercial diplomacy.

During the year, the Chambers of Commerce held seminars and discussions on important issues in order to understand their issues better and to identify alternative solutions while building up consensus among different interested parties. Chambers also participated in meetings organised by government officials, enhancing their contribution to policy dialogue and facilitating settlement of issues faced by industrialist. An Exporters' Forum was set up in February 2002 with the participation of relevant ministries, government institutions and industrialist to address problems faced by industrialists. In the Forum government officials met with the industrialist to solve problems with minimum delays.

### **Freight Rates**

During 2002, average freight rates for several destinations showed mixed changes, despite the removal of the war risk surcharge. The general freight rate to UK, North Continent (Germany, France, Austria, Denmark and the Netherlands), Scandinavian, Mediterranean, USA, Canadian and Mexican ports increased during the year. The freight rates to UK, North Continent, Scandinavian, Baltic and Mediterranean ports for garments, tea, and soft toys increased, while rates for rubber, rubber tyres, rubber gloves, brooms and brushes, coconut milk powder and activated carbon decreased. The freight rate to USA for garments and travel bags decreased, but increased for rubber tyres and rubber gloves. The freight rates to the Middle East, Singapore and Australia decreased. The freight rate to

Japan generally decreased, except for tea. There was no change in the terminal handling charge during the year. They were US dollars 115 per 20 foot container, US dollars 184 per 40 foot container, US dollars 216 per 45 foot container, US dollars 331 per 20 foot reefer container and US dollars 496 per 40 foot reefer container, to all regions.

The war risk surcharge applied within a range of US dollars 70 to 100 per 20 foot container and US dollars 104 to 200 per 40 foot container during the first four months of 2002 to UK, North Continent and the Europe region, was removed in May 2002. The war risk surcharge applied within a range of US dollars 70 to 100 per 20 foot container and US dollars 140 to 200 per 40 foot container to USA during the first five months was removed by several lines in the first week of June 2002. However, certain leading carriers applied the surcharge of US dollars 100 per 20 foot container and US dollars 200 per 40 foot container to this region till November 2002. The war risk surcharge applied within a range of US dollars 50 to 100 per 20 foot container in the first seven months of the year was removed towards the end of the year.

The bunker adjustment surcharge fluctuated during 2002. This surcharge to UK, North Continent, Mediterranean and French ports varied within the range of US dollars 35 to 80 per 20 foot container. This surcharge to USA fluctuated from US dollars 40 to 140 per 20 foot container, US dollars 50 to 185 per 40 foot container and US dollars 65 to 235 per 45 foot container. A new charge called the 'Export Bill of Lading Fee' of US dollars 20 per bill of lading was imposed with effect from 01 January 2002 by almost all shipping lines.

## 9.12 Trade Relations, Trading and Clearing Arrangements

In 2002, Sri Lanka took several steps to strengthen regional, bilateral and multilateral relations and continued to foster a freer trade regime by entering into bilateral agreements with some additional countries. One of the main strategies during 2002 was to identify countries of significance to Sri Lanka's bilateral trade relations. Ministerial level trade promotion missions were undertaken by the Ministry of Trade and Consumer Affairs to consolidate existing trade relations and to explore trade potential and new opportunities for mutual co-operation with countries such as India, Pakistan, USA, Thailand, China, Vietnam, Japan, Egypt, Saudi Arabia, Iraq, UAE, Belgium, and UK. The Joint Commission Mechanism played an important role in promoting Sri Lanka's exports and increasing economic and technical co-operation on a bilateral basis.

The Ministry of Trade and Consumer Affairs initiated action to conduct feasibility studies for free trade agreements in 2002, with special emphasis on South Asian countries and USA. Countries with greater potential for increased co-operation in trade, services, investment and tourism were identified to follow a fast track approach.

The Framework Agreement on the Pakistan - Sri Lanka Free Trade Agreement (PSLFTA) was signed on 1 August 2002 in Colombo. This agreement is similar to ILFTA, with some variations in phasing out procedures for tariff concessions, rules of origin and eliminating non-tariff barriers. This Agreement will allow Sri Lanka to gain free market access to Pakistan with a population of 137.5 million, and will generate opportunities for trade and investment. Discussions are being held in Colombo and Islamabad to finalise the respective negative lists, zero duty lists and list of items that would be phased out under the PSLFTA.

In addition to the PSLFTA, Sri Lanka signed a Trade and Investment Framework Agreement (TIFA) with the Government of the United States of America on 25 July 2002. USA had signed similar TIFAs with a few other countries, but Sri Lanka was the first country in the South Asian region to sign such an agreement. The broad objective of TIFA is to create an environment conducive to international trade, investment and economic co-operation, and to make arrangements necessary for greater access to markets in both countries. TIFA also aims at persuading Sri Lanka to complete successfully the Doha Development Agenda and to establish a Joint Council on Trade and Investment. The first meeting of the Joint Council of TIFA was held on 20 November 2002 in Colombo. At this meeting, both countries explored and examined ways to promote increased co-operation in trade, investment and services, especially, private sector led initiatives.

Sri Lanka and India took several steps to further strengthen ILFTA, which reached the third year of implementation in 2002. The Indian Government reduced tariff

rates on 2,799 tariff lines in the residual list of Sri Lanka's imports by 90 per cent in its Budget 2002/2003 effective from 1 March 2002. These items received 50 per cent tariff reductions under the first phase of ILFTA. Under Article XII of ILFTA, a Joint Committee established at the Ministerial level has to meet at least once a year to review progress in the implementation of ILFTA.

The First meeting of the Joint Ministerial Committee (JMC) was held 6-7 June 2002 in New Delhi, to find solutions to a number of operational problems faced by Sri Lankan exporters. This was followed by a series of meetings to review the progress of ILFTA. As a result, India agreed to provide Calcutta and Mumbai as additional ports for garment exports to India, while raising the quota of 1.5 million pieces of permitted categories of garment exports per annum to 2 million pieces. India also agreed to relax restrictions on using Indian fabrics to qualify for concessions. In addition, India agreed to provide Mumbai and Vizag as additional ports for tea exports, while Sri Lanka agreed to consider the import of Indian tea under the prevailing duty and quality parameters. Other major issues discussed at JMC were the revision of the Rules of Origin criteria, a joint marketing strategy for tea, a feasibility study on a futures market for tea in Colombo and a draft Memorandum of Understanding between the Export Inspection Council of India and the Sri Lanka Standards Institute.

During the first half of 2002, exports increased to US dollars 31 million compared to US dollars 6 million in the first half of 2001 under ILFTA. Imports from India increased by 39 per cent to US dollars 835 million in 2002, from US dollars 601 million in 2001.

The Sri Lankan delegation, led by the Ministry of Trade and Consumer Affairs, participated in the Sixth Session of the Sri Lanka- Iraq Joint Commission on Economic and Technical Co-operation held in Baghdad from 30 October – 1 November 2002. Proposals to increase bilateral co-operation in trade, economics, finance, science and culture were discussed. The Second Session of Sri Lanka- Egypt Joint Commission on Economic and Technical Co-operation was held in Cairo, 3-5 November 2002. Sri Lanka planned to regain the Egyptian market for Ceylon tea, which was gradually lost to Kenya with the launching of the agreement on the Common Market for Eastern and Southern Africa (COMESA).

Regional economic co-operation was fostered further in 2002 with continuing discussions with SAARC, Bangkok Agreement, Bangladesh, India, Myanmar, Sri Lanka, Thailand-Economic Co-operation (BIMST-EC) and Indian Ocean Rim Association for Regional Co-operation (IOR-ARC).

The First Meeting of the Inter Government Group on Trade Liberalisation to initiate the Fourth Round of Trade Negotiations under SAPTA was held at the SAARC Secretariat, Kathmandu, 27-28 March 2002. The meeting reviewed progress in implementing the Third Round of Trade Negotiations under SAPTA, concluded initial bilateral negotiations and exchanged request lists and information on

trade controls. Requests for deeper tariff concessions from the four Least Developed Countries (Bangladesh, Bhutan, the Maldives and Nepal) were also considered. Subsequently, the Fourth Round of Trade Negotiations under SAPTA was held in December 2002, subject to ratification of Consolidated National Lists by the member countries. Sri Lanka granted concessions on an aggregate of 100 tariff lines to other member states, with margins of preference ranging from 10-100 per cent, while Sri Lanka received tariff concessions on 53 tariff lines from other countries with similar margins of preference.

Sri Lanka hosted the fifth Ministerial Meeting of BIMST-EC on 20 December 2002 in Colombo. The Second Business Forum and the Economic Forum of BIMST-EC were held in Colombo in December 2002. Government and private sector representatives from Bangladesh, India, Myanmar, Sri Lanka and Thailand participated in the Economic Forum and the Business Forum. The recommendations of the Economic and Business Forums were discussed at the Senior Officials Meeting held, 18-19 December 2002 in Colombo. The recommendations included encouraging investors in education and health sectors, holding a business convention and a trade fair in Sri Lanka in August 2003, encouraging free flow of travel among BIMST-EC countries and providing entry visas on arrival.

The Meeting of the Working Group on Trade and Investment of IOR-ARC was held in May 2002, followed by the Meeting of the Committee of Senior Officials of IOR-ARC in Muscat, Oman in May 2002. Recognising that a Preferential Trading Arrangement for the IOR-ARC region would be beneficial, a core group comprising India, Kenya, Oman and Sri Lanka was appointed to study the feasibility of preferential trading arrangements.

Sri Lanka continued to receive tariff concessions from the developed countries participating in the Generalised System of Trade Preferences (GSTP). The European Commission implemented a new GSTP regime for beneficiary countries with effect from 1 January 2002, which will remain effective till 31 December 2004. Under the new GSTP regulations, products are broadly classified into two categories, namely, sensitive and non-sensitive.

To prepare for the forthcoming negotiation on Trade in Services in the multilateral trading system, a seminar was conducted on the General Agreement on Trade in Services (GATS) in collaboration with the WTO Secretariat, Geneva, 18-20 June 2002. The consultation and meeting of the GATS Inter-ministerial Sub-Committee on Services resulted in the submission of Sri Lanka's requests for liberalisation of the service sectors to around 18 select trading partners. These initial requests were further refined and modified during the year. Sri Lanka also received requests from USA, EU, India, Singapore, Korea and Japan to liberalise the services sector across a wide range of categories, which would subsequently form the basis of offers to be prepared by 31 March 2003.

The Eighteenth Sessions of the Standing Committee of the Bangkok Agreement (BA) was held in Beijing in April 2002 and members exchanged their request lists. The Committee also agreed to change the name of the agreement to Asia Pacific Trade Agreement. The Committee discussed the proposed draft of the BA.

Legislation aimed at protecting domestic industry from unfair trade practices, namely dumping and subsidised imports and import surge, was finalised and submitted for Cabinet approval. The proposed enactment of Anti-Dumping, Countervailing and Safeguard legislation in Sri Lanka constitutes legitimate WTO sanctioned multilateral trade remedies designed to promote and safeguarding the domestic industry of the WTO member countries from unfair trading, causing or threatening to cause 'serious injury' to domestic industry.

On 15 November 2002 China acceded to WTO. This will be a significant challenge to the textiles and apparel industry as China has advantages of production capacity, a strong fabric base, continuous improvement of technology and relatively high labour productivity. With the phasing out of the quota system in the apparel industry by 2005, China could be a major competitor in international markets. The increasing share of China in the world's garment exports might also affect Sri Lanka's garment industry.

### 9.13 Internal Trade and Institutional Arrangements

With the revival of the economy in 2002, and the opening up and increasing normalisation of the North and the East for trading activities, internal trade grew by 3.4 per cent compared to a decline of 2 per cent in 2001. As in previous years, internal trade was conducted in a relatively free market environment with minor intervention by the state in price determination and trade regulation. Such intervention usually, prevents harmful effects on consumers as well as producers from anti-competitive practices. State intervention on price determination was limited to a few essential consumer goods and services. The intervention in pharmaceutical prices was lifted at end October 2002, and the import of petroleum products was liberalised from 17 December 2002.

To ensure the availability of essential items, the government intervened in marketing essential items through a few state sector institutions, such as the Food Commissioner's Department (FCD), the Co-operative Development Department, the Co-operative Wholesale Establishment (CWE), Lanka Salu Sala Limited, STC General Trading Co. Ltd. and the State Pharmaceuticals Corporation of Sri Lanka (SPCSL). The two regulatory bodies attached to the Ministry of Commerce and Consumer Affairs, namely, the Department of Internal Trade (DIT) and Fair Trading Commission (FTC) continued to maintain price controls on pharmaceutical products till October 2002 and probe unfair trading practices.

Until December 2002, the CPC was the sole authority to import, refine and distribute petroleum fuel, except lubricants and LP gas. The government withdrew from the monopoly over the import of petroleum products from December 2002. Since January 2002, products of CPC have been free from administered pricing, and were determined by a formula based on international prices, cost of transportation, exchange rate movements, taxes and other fees. FCD acted as the sole authority for the purchase and distribution of wheat flour milled by Prima Ceylon Ltd. till August 2001. The import of wheat and the distribution of wheat flour were handed over to Prima Ceylon Ltd. in September 2001. However, FCD continued to monitor the island-wide distribution of wheat flour and intervene to stabilise prices of essential food commodities during 2002. Even though wheat and wheat flour imports have been liberalised since February 2000, the import of wheat grain and distribution of wheat flour were handled entirely by Prima Ceylon Limited in 2002 as it was the company that had milling capacity and facilities, while only a small quantity of wheat flour was imported in 2002.

A number of institutions operating under the Ministry of Commerce and Consumer Affairs underwent restructuring. Lanka Salu Sala Limited underwent a structural change and redefined its operating procedures. There was a staff reduction through a voluntary retirement scheme. The Lanka General Trading Company Ltd. (STC General Trading Co. Ltd. since February 2002) has established strategic business units. CWE also underwent a significant change in 2002 to meet the challenges of operating as a profit making institution, while functioning as a welfare generating institution for both consumers and producers. With Cabinet approval, CWE has been planned to be restructured to form six strategic business units, viz, Sathosa Retail Ltd., Sathosa Wholesale Ltd., Sathosa Developers Ltd., Sathosa General Ltd., Sathosa Transport Ltd. and Sathosa Security Ltd., to handle key operations of CWE. Of those, Sathosa Retail Ltd. was formed in 2002 and expressions of interest have been called for management and divestiture of 40 per cent of shares of the company.

CWE imported several food items to compensate for shortages in the local market, when domestic production was low, and imports by the private sector were not sufficient to meet domestic demand. It also purchased products locally when supplies were in excess. CWE intervened in the rice market by importing 25,700 metric tons of white rice in 2002, amounting to 27 per cent of total rice imports. CWE was granted a special duty waiver to import 30,000 metric tons of rice at a lower duty rate of Rs. 4.00 per kg. CWE increased its domestic purchases of big onions to 380 metric tons from 19.5 metric tons in 2001, while importing 3,370 metric tons in 2002 compared to 4,184 metric tons in 2001. CWE's import share in total imports was not significant in other major imported food items such as chillies, lentils, sugar, dried fish, and milk foods. In 2002, CWE operated through 158 retail shops and 40 wholesale shops. Total turnover declined marginally to Rs.7,383 million,

compared with Rs.7,750 million in 2001. The Franchise Dealer scheme was not in operation in 2002, as franchise shop dealers were not actively engaged in trading activities with CWE from 2001.

Co-operative societies also engaged in trading activities, with a total turnover of Rs.36,138 million in 2002. The services were provided through 622 wholesale and 8,011 retail outlets which operated under 311 co-operative societies. Compared to 2001, the number of wholesale shops increased by 5, and retail shops by 172. The societies were responsible for distributing dry rations to Samurdhi beneficiaries and to displaced people, in addition to other business activities.

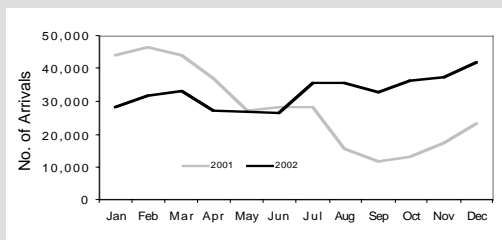
Price controls on pharmaceutical products were removed from 1 November 2002, encouraging increased private sector participation in the sale of pharmaceuticals. SPCSL continued to be the sole supplier of pharmaceutical products to government health care institutions and a major supplier to the local market, with 40 per cent of market share. SPCSL operates with an island wide sales network of 46 distributors, 39 franchise Osu Sala outlets, 14 Rajya Osu Sala outlets and 17 authorised retailers.

The two regulatory bodies, viz, DIT and FTC, made efforts to enhance consumer awareness on consumer rights, take measures to protect consumer rights, establish fair trading practices, and regulate internal trade. FTC investigated seven anti-competitive practices and several complaints under the provisions of the Fair Trading Commission Act, No. 01 of 1987. In 2002, DIT carried out 2,991 raids under the Consumer Protection Act, Price Control Act, and Fertiliser Regulation Act, of which 1,706 cases were filed in courts and 1,688 offenders were prosecuted. In order to remove duplication of objectives and functions between DIT and FTC, and to create a stronger institution to probe trading practices and to regulate internal trade, a proposal was made in 1997 to amalgamate the two institutions. In January 2002, the Consumer Affairs Authority Bill was formulated and placed before Parliament and under this Act, FTC and DIT was merged to form the Consumer Affairs Authority. This Authority will have wider powers than FTC and DIT.

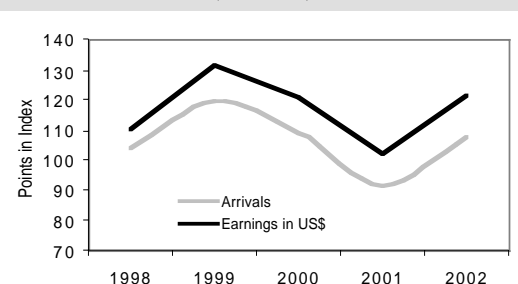
## 9.14 Tourism

The peace dividend was strongly felt in the tourism sector. Plagued by unhealthy security conditions, both domestically and internationally, tourist arrivals declined by 15.9 per cent in 2001, followed by a decline of 24 per cent in the first half of 2002. In the second half of 2002 tourist arrivals increased by 100.8 per cent. For 2002, as a whole tourist arrivals increased by 16.7 per cent. Most countries relaxed both travel advisories and travel warnings placed against Sri Lanka following the commencement of the peace process in the country. Total tourist arrivals in 2002 were 393,171 compared to 336,794 in 2001. Gross earnings from tourism increased by 16.4 per cent from US dollars 213 million in 2001 to US dollars 248 million in 2002.

**Chart 9.10**  
**Monthly Tourist Arrivals**  
**2001 & 2002**



**Chart 9.11**  
**Tourism Statistics**  
**(1997=100)**



Western Europe continued to be the major source of tourists to the country, accounting for 51 per cent of the arrivals in 2002. However, the share declined from 61 per cent in 2001, as arrivals from Western Europe dropped by 2 per cent in 2002. This drop was compensated by the increased arrivals from other parts of the world, particularly India. Arrivals from UK, the largest single source of arrivals from Western Europe, declined by 0.4 per cent, while arrivals from other major Western European sources also declined. Major declines were from Germany (-9 per cent), France (-5 per cent) and the Netherlands (-7 per cent). Increases were recorded in arrivals from Switzerland (51 per cent), Austria (3 per cent), Norway (28 per cent) and Italy (1 per cent). Arrivals from Asia increased by 59 per cent, accounting 36 per cent of the total arrivals, against 27 per cent recorded in 2001. Arrivals from East Asia increased by 49 per cent, led by increases in arrivals from Japan (47 per cent), Malaysia (147 per cent), Singapore (64 per cent), China (17 per cent), Hong Kong (62 per cent) and Thailand (34 per cent). Arrivals from South Asia increased by 66 per cent with a 106 per cent increase in arrivals from India. Tourist arrivals from North America, Eastern Europe, Middle East and Australasia increased by 24 per cent, 14 per cent, 17 per cent and 1 per cent, respectively.

A country-wise analysis shows that the highest number of arrivals in 2002 were from India (69,960) followed by UK

(67,533), Germany (55,170) and France (19,989). In 2001, the highest number of arrivals were from UK (67,830), Germany (60,405), India (33,924) and France (20,949). The substantial increase in arrivals from India in 2002 was mainly due to a promotional campaign launched by SriLankan Airlines from August 2001 to June 2002. This enabled the Indian tourists to get a free ticket for each ticket purchased from SriLankan Airlines. This offer was extended to tourists from Thailand, Singapore and Malaysia from 15 February to 15 June 2002. Tourist arrivals from SAARC countries were issued visas on arrival under a new tourism promotion scheme launched by the government from 23 January 2003. SriLankan Airlines, in collaboration with an online reservation service, offered a comprehensive package for making reservations on tickets and accommodation in Sri Lanka.

The majority of tourists visited the country on vacation, while about 15 per cent came on other purposes such as business, visiting friends and relatives, and for religious and cultural purposes. Of all tourist, 80 per cent travelled on regular inter-regional flights, 18 per cent arrived on regular intra-regional flights and 2 per cent on charter flights. SriLankan Airlines brought in 52 per cent of the tourists in 2002, compared with 55 per cent in 2001.

Confirming Sri Lanka's potential for developing new tourist products such as eco-tourism and cultural tourism, revenue from tourists visiting wild life parks, botanical gardens, zoological gardens and the Cultural Triangle increased in 2002. The Sri Lanka Convention Bureau continued to promote meetings, incentive travel, conventions and exhibitions (MICE) tourism in 2002. MICE is considered to be one of the more lucrative niches of tourism in the world. The Bureau sponsored 38 conferences in 2002. Tourists visiting the country under the MICE category were estimated at 2,914 in 2002 against 1,796 in 2001, an increase of 62 per cent. The Bureau participated in several international campaigns, promoting Sri Lanka as a destination for MICE tourism in Asia.

Following the improvement in the tourist industry, foreign guest nights at tourist hotels declined marginally in 2002 against a decrease of 23 per cent in 2001. The room occupancy rate increased to 43 per cent, compared with 42 per cent in 2001. Room occupancy rate, which declined in the first half of 2002, increased in the second half. The highest room occupancy rate was in Colombo City (56.4 per cent) followed by the East Coast (44.8 per cent), Greater Colombo (42.8 per cent), Ancient Cities (42.4 per cent) and the South Coast (38 per cent). The number of hotel units in the graded accommodation sector increased from 209 to 222. The increase were in Greater Colombo (39 to 44), South Coast (85 to 91) and the Hill Country (16 to 17). However, the number of active hotels in the East Coast (4) remained unchanged in 2002, while in the City of Colombo (22 to 21) declined. With increased hotel units, room capacity grew from 13,408 in 2001 to 13,818 in 2002. According to the star- classification of hotels, graded hotels increased by 3 from 72 in 2001. There is a growing demand for rooms in the

**TABLE 9.13**  
**Tourism Statistics 2000 – 2002**

Item	2000	2001 (a)	2002(b)	Percentage Change	
				2001	2002
1. Tourist arrivals	400,414	336,794	393,171	-15.9	16.7
2. Tourist guest nights ('000)	4,056	3,342	3,989	-17.6	19.4
3. Room occupancy rate (%)	52.3	42.1	43.1	-19.5	2.4
4. Gross tourist receipts (Rs.mn)	19,095	19,034	23,724	-0.3	24.6
5. Per capita tourist receipts (Rs.)	47,688	56,515	60,340	18.5	6.8
6. Total employment (No.)	91,063	80,904	87,600	-11.2	8.3
Direct	37,943	33,710	36,500	-11.2	8.3
Indirect	53,120	47,194	51,100	-11.2	8.3

(a) Revised  
(b) Provisional

Sources: Sri Lanka Tourist Board  
Central Bank of Sri Lanka

East Coast. The Sri Lanka Tourist Board and the Ministry of Tourism and Civil Aviation need to jointly, work out a plan to increase accommodation in that sector.

The average duration of stay (ADS) of tourists in the country increased from 9.9 days in 2001 to 10.1 days in 2002. The increase in ADS was mainly due to the increase in ADS of Western Europe despite a 2 per cent decrease in the arrivals from Western Europe, who usually stay longer. The average stay of tourists from Western Europe increased from 11.0 days to 11.9 days in 2002. The average stay of tourists from Germany was high (13.6 days), followed by tourists from Austria (13.2 days), the Netherlands (12.9 days), Switzerland (12.7 days) and Denmark (12.6 days), compared to those from India (7.6 days), Pakistan (8.6 days) and Japan (8.9 days).

Both direct employment and indirect employment in the sector increased in 2002. Direct employment is identified as employment in hotels and restaurants, travel agencies, tour operators, airlines, agencies providing recreational facilities and tourist shops. Domestic producers and suppliers of inputs, manufacturers and suppliers of handicrafts generate indirect employment.

Tourism has been identified as one of the key areas for bilateral and regional co-operation in many fora recently. Sri Lanka has served as the lead country in tourism in BIMST-EC since 1998. Sri Lanka relinquished its lead role in tourism to accept the lead role in the technology sector. Sri Lanka hosted the 5th ministerial meeting of BIMST-EC on December 20, 2002 in Colombo. This was the first meeting of BIMST-EC held at the level of Foreign Ministers. Sri Lanka took over the Chairmanship of the Group at this meeting and would continue

for one year until Thailand takes over the Chairmanship in 2004. Under the activities of the Indian Ocean Rim Academic Group Sri Lanka has undertaken a joint study with India for promoting tourism in IOR-ARC. Sri Lanka will assume the chairmanship of the IOR-ARC and Indian Ocean Rim Business Forum at its meeting, held for the first time in Sri Lanka in the last week of March 2003. Tourism promotion and development is one of the main topics to be discussed at this meeting. Following initiatives by the government, the Chinese government accepted Sri Lanka as an official tourist destinations in 2002. This would enable Sri Lanka to have greater access to the Chinese tourist market by officially promoting tourism in China. Sri Lanka will urge the Russian government to include Sri Lanka in its official destinations list.

The Ministry of Tourism and Civil Aviation signed seven bilateral agreements with Iran, Cyprus, the Czech Republic, Greece, Israel, Malaysia and India to increase flying frequency in 2002. The number of charters operated in 2002 was 4 against 9 in 2001. Three new scheduled airlines and four charter airlines were in operation in 2002. The scheduled airlines were Oman Air, Mahan Air and Malaysian Airlines. The charter airlines were Aeroflot, Edelweiss Air, CSA Czech Airlines and T'vansavia Airlines.

The tourist industry faces a severe shortage of seats in the immediate winter season 2002/2003 from major markets such as Germany, France, UK and Italy. There is a need to increase flights operating to and from these destinations. It is also important to have an efficient highway and road network and other infrastructure facilities to reduce the discomfort and inconvenience caused to tourists.