

imports. Second, considerable savings in import expenditure were effected on account of lower commodity prices for the major food imports of rice, flour and sugar, as well as fertilizer from among the intermediate goods category.

The import item with the highest increased outlay was crude oil and petroleum by-products. This was partly due to a higher volume being imported in 1976 as compared with the previous year and partly due to a 10 per cent increase in prices imposed by the OPEC in October, 1975.

The main invisibles contributing to the foreign exchange earnings in 1976 were port earnings of Rs. 156.7 million and tourist earnings of a record Rs 198.4 million. Earnings from tourism have shown a marked up-trend in recent years. It increased from Rs 95 million in 1974 to Rs 124 million in 1975 and Rs 198.4 million in 1976 as already stated.

The small current account deficit of Rs 49.8 million made the financing of it easier than in previous years. After allowing for repayments of Rs 232.5 million, long term loans provided Rs 710.4 million. Gross inflows of long term aid of Rs. 942.9 million consisted of Rs 338.4 million of commodity aid, Rs 169.2 million of food aid, Rs 315.8 million of project aid and Rs 119.5 million of other aid. This last residual category refers to cash loans of Rs 93 million received from the United Arab Emirates and Rs 27 million from the People's Republic of China. This level of external assistance enabled the country to avoid increasing indebtedness on account of suppliers and short term credits. In fact, the country's short term indebtedness which also includes suppliers' credits (from year end to year end) decreased by Rs. 91.4 million.

In addition, resources available from the IMF for balance of payments support amounted to Rs 272.8 million. Of this Rs 158.0 million became available under the scheme of Compensatory Financing of Export Fluctuations while another Rs 114.8 million was available as the final instalment due to Sri Lanka under the 1975 Oil Facility Decision. Once repurchases from the IMF on account of past drawings of Rs 189.9 million are set off, the net contribution of IMF resources to balance of payments support was Rs 86.7 million.

The IMF resources, together with the loan transactions discussed earlier were substantially in excess of the deficit and contributed to building up the country's external assets by Rs 568.3 million. It also helped Sri Lanka reduce indebtedness in the bilateral accounts maintained with her trading partners. The reduction of liabilities of this account amounted to Rs 73.1 million.

#### **THE GOVERNMENT FISCAL OPERATIONS**

The fiscal operations for 1976 clearly indicate an accelerated participation of the Government in economic activity. The net Government spending constituted 35.9 per cent of the GNP compared to 32.8 per cent for 1975 and an average of 31.6 per cent for the previous ten years. The increase is mainly due to the higher level

of capital spending by the Government. The GNP share of recurrent expenditure has remained relatively stable around 24 per cent.

On the revenue side, except in a few isolated years, the revenue/GNP ratio has tended to lag behind the ratio of recurrent expenditure/GNP. In fact the revenue/GNP ratio, which reached a peak of 26.6 in the fiscal year 1973, declined to 23.8 in 1976.

The fiscal performance in 1976 reveals a current account deficit of Rs 128 million, compared to a deficit of Rs 142 million in 1975. The current account deficit reflects the extent to which borrowed resources are used to finance recurrent expenditure of the Government.

A summary of fiscal operations for 1976 and the approved estimates for 1977 are shown in Table 14. The net cash deficit of the Government defined to exclude the effect of sinking funds and amortization payments with respect to borrowings is presented in Table 9 in the Appendix.

### **Expenditure**

The total Government expenditure in 1976 of Rs 9,314 million constituted an increase of nearly 20 per cent over the previous year. The expenditure in 1976 was made up of Rs 5,554 million under recurrent votes, a net outpayment of Rs 312 million under advance accounts, Rs 2,786 million under capital votes and Rs 662 million for contributions to sinking funds and amortization payments.

The average annual increase in total expenditure from 1969/70 is about 20 per cent. The increase in expenditure could be attributed to two major reasons; the global inflation that prevailed in the period 1973/75 and the increase in the Government's investment programme which reached a peak in 1976.

Actual recurrent expenditure in 1976 was Rs 5,554 million. This was an increase of 7.8 per cent over the previous year. Compared with the gross allocation of Rs 5,764 million, which includes a supplementary provision of Rs 305 million, the actual expenditure reveals an under-expenditure of 3.6 per cent.

The composition of recurrent expenditure now conforms to a regular pattern. In 1976, Social Services including education and health accounted for 22 per cent; the Food Subsidy claimed 17 per cent; Civil and Defence administration required another 16 per cent. Interest on public debt was 15 per cent and Pensions to retired Government employees required 7 per cent. The only item subject to fluctuations in this group is the Food Subsidy. In spite of certain reliefs granted to consumers, the relatively lower commodity prices in 1976 led to a decline in the share of the food subsidy from 23 per cent in 1975, to 17 per cent in 1976.

The cost of servicing the Public Debt has shown a slow but steady increase over the years; and this is quite understandable in view of the stepped up borrowing

**TABLE 14**  
**Government Fiscal Operations**

Rs. Million

Items	1974	1975	1976 Approved Estimates	1976 Provisional	1977 Approved Estimates
Revenue <sup>1</sup>	4,787	5,084	5,645	5,739	6,062
Recurrent Expenditure	4,506	5,153	5,355	5,554	5,888
Advance Accounts operations (deficit-/Surplus +)	- 39	- 73	- 100	- 312	—
Current Account (+ Surplus/deficit-)	+ 242	- 142	+ 190	- 128	+ 174
Capital Expenditure	1,841	2,556	2,486	3,448	2,904
Of which Sinking Fund and Amortization payments and contribu- tions to International Financial Organisations	(564)	(596)	(649)	(662)	(848)
Budget deficit <sup>2</sup>	1,599	2,699	2,296	3,576	2,730
Financing of the deficit					
1. Domestic Source	910	1,610	1,300	2,270	1,370
A. Non-bank market borrowing	976	1,075	1,300	1,160	1,300
B. Non-market borrowing	- 54	379	—	471	70
C. Banking System <sup>3</sup>	- 12	156	—	639	—
2. Foreign Finance	650	1,059	1,000	1,340	1,350
Project loans	79	275	n.a.	327	n.a.
Commodity loans	319	380	n.a.	633	n.a.
Grants	252	404	n.a.	380	n.a.
3. Use of cash balances	39	31	- 4	- 33	10*
Expansionary impact of Government Fiscal Operations	24	184	- 4	605	10

Sources: Central Bank of Ceylon &amp; General Treasury.

1. Excludes Capital Grants in Revenue shown under Foreign Grants.
2. Please see Table 9 in Appendix for details of Net Cash Deficit.
3. Includes Special Advances from Central Bank to meet the contributions to International Financial Organisations abroad. For 1974 - Rs. 2.7 million, 1975 - Rs. 2.6 million.

\* On account of the Committee Stage amendments to increase Railway expenditure by Rs. 10 million.

programme followed by the Government. Government could receive adequate compensation for an increasing debt service burden if its investments contribute a satisfactory return.

In 1976, capital expenditure (net) recorded a sharp increase of 42 per cent over the previous fiscal year. In absolute terms it increased by Rs 826 million. The actual development expenditure, excluding the sinking fund contributions and amortization payments, was Rs 2,786 million. Compared with the corresponding gross allocation of Rs 3,056 million, it reveals an under-expenditure of 9 per cent, the lowest level in the last several years. The usual level of under-expenditure in the recent past had ranged between 20 and 25 per cent.

As in previous years, the bulk of the capital spending was for the infra structural development of the economy. Expenditure under Irrigation, Power and Highways was Rs 553 million. Agriculture and Lands claimed Rs 188 million. Public Administration, Local Government and Home Affairs spent Rs 90 million. Development of Postal and Telecommunication Services required Rs 51 million. The expenditure on Industries, Fisheries, Shipping and Tourism was Rs 608 million.

In the fiscal year 1976 net outpayments under advance accounts amounted to Rs 312 million. The significant items were an advance of Rs 163 million to Government departments, payments of approximately Rs 50 million each to State Corporations and the Ceylon-China Trade Account, and an advance of Rs 17 million to finance the purchases of stores and materials. These extra budgetary outpayments constitute a part of Government current expenditure and exert an adverse effect on the overall current account balance on Government fiscal operations.

### Revenue

Compared with the actual revenue for 1975 the collections in 1976 reveal an increase of 13 per cent. Total revenue for 1976 was Rs 5739 million. Substantial increases were recorded under income taxes (Rs 165 million), import duties (Rs 140 million), tea tax (Rs 111 million) and turnover taxes (Rs. 69 million). Net receipts from FEECs increased by Rs 19 million<sup>1</sup>. On the other hand, marginal shortfalls were observed under export duties (Rs 9 million), tobacco tax (Rs 8 million) and liquor products (Rs 16 million.)

The better performance of income taxes and turnover taxes are mostly attributed to the relatively higher prices that prevailed during the period 1975/76. Import duties reflect the higher value of imports of that year. The fall in export duty is explained by the withdrawal of export duty on coconut products in November, 1975, and the decline in the exports of tea in 1976. The revenue collected from tobacco (tax on domestically produced leaf and duty on imported leaf) increased in 1976.

Export taxes, import duties and FEECs constituted 39 per cent of the Government revenue in 1976. Turnover taxes, largely dependent on imported raw materials, constitute another 13 per cent. This amply illustrates the dependence of Government revenue on the foreign trade sector of the economy and indicates the need for diversification of the tax base.

### Financing of the Budget Deficit

The Budget deficit for 1976 at Rs 3,576 million exceeded the original estimate by Rs 1,280 million owing to Rs 928 million<sup>2</sup> of supplementary estimates and net outpayments of Rs 312 million under advance account. The additional deficit was financed

1. The lower income in FEEC revenue is largely attributed to the better performance of non-traditional exports in 1976.

2. The more significant items include provisions of Rs. 176 million largely to finance River Valley and Electricity development, Rs. 165 million for drought relief work, Rs. 76 million to finance the personal emoluments for new teachers, Rs 79 million to supplement the allocations for pensions, a capital contribution of Rs 60 million for the Petroleum Corporation and Rs 64 million for the purchase of Railway Rolling Stocks.

partly with borrowings from the banking system. Total domestic borrowings, including accommodation from the banking system, amounted to Rs 2,270 million, and foreign loans and grants to Rs 1,340 million.

The external resources received to finance the Budget were made up of project loans Rs 327 million, commodity loans Rs 633 million and grants Rs 380 million.

In the domestic sector, non-bank market borrowings contributed Rs 1,160 million. As in recent years, the captive sources (the National Savings Bank, the Employees' Provident Fund and the Insurance Corporation) were primarily responsible for the mobilisation of domestic savings. The contribution of domestic non-market sources amounted to Rs 471 million. Food purchases on deferred payment terms amounted to Rs 214 million of this and deposits with the Treasury provided another Rs 103 million. The balance came from administrative borrowings and miscellaneous funds at the disposal of the Treasury.

The residue of Rs 639 million was financed by the banking system. The Central Bank through the purchase of the Treasury bills financed Rs 366 million and the balance was subscribed by the commercial banks primarily through the purchase of rupee securities.

When adjusted for an increase of Rs 33 million on Government cash balance, the net expansionary impact of Government fiscal operations stood at Rs 605 million.

### **Public Debt**

In the fiscal year 1976 the public debt increased by 21 per cent, or Rs 3,095 million, to Rs 17,659 million. The share of the domestic debt was Rs. 12,691 million and the balance Rs 4,968 million constituted the foreign debt. When adjusted for the sinking fund contributions (Rs 2,039 million), the net domestic debt stood at Rs 10,653 million. There are no sinking fund contributions on foreign loans.

The major share of the domestic debt is in rupee securities whose sales in 1976 amounted to Rs 1,457 million. Other items include the sales of Treasury bills (Rs 350 million), Tax Reserve Certificates, other Miscellaneous receipts and Central Bank advances under Section 89 of the Monetary Law Act. Subscriptions to rupee securities in 1976 reflect a contribution of Rs 240 million from commercial banks as against negligible or no contributions in the several preceding financial years. Similarly by the end of the year the total increase of Rs 350 million in Treasury bills in 1976 was held by the Central Bank. In contrast to a gradual decline observed in the last several years, this led to an increase in the share of the domestic debt held by the banking system from 29.9 per cent in 1975 to 30.6 per cent in 1976. In 1970, the share of the domestic debt held by the banking system was 45.1 per cent.

In 1976, the foreign debt increased by Rs 1,263 million. This constituted an increase of 34 per cent compared with an increase of only 26 per cent in the previous year. However, the net transfer of resources (net of debt repayments amounting to Rs 230 million) to finance economic activity in Sri Lanka was only Rs 730 million.

the balance of Rs 533 million reflected the increase in liability due to exchange rate changes in the major international currencies. Parity changes in international currencies also introduced an element of instability into our external indebtedness.

The better export earnings in 1976 led to a decline in the external debt service ratio (the external debt service payments as a percentage of exports of goods and non-factor services) from 22.9 per cent in 1975 to 20.1 per cent in 1976. However, the high external debt ratio and the interest burden of the domestic debt are causes for concern. The repayments and interest on public debt amounted to Rs 1,432 million or 52 per cent of the gross loan proceeds in 1976, as compared to 61 per cent in 1975.

## **MONETARY AND BANKING DEVELOPMENTS**

### **Money Supply**

At the end of 1976 the money supply as shown in Table 15 had increased by Rs 1,077 million compared to the end 1975 position. This represented an increase of 34.9 per cent compared to increases of 4.8 per cent in 1975 and 6.0 per cent in 1974. The average of the monthly money supply figures (which as an index embodies the characteristics of the money supply movement over the entire year) rose by 22.4 per cent in 1976 compared to increases of 1.9 and 18.1 per cent in 1975 and 1974 respectively.

The usual pattern of seasonal fluctuation in money supply was not displayed in 1976; except for the month of July, the money supply showed a continuous upward movement. During the year, effects of government's deficit financing and increased external assets were large enough to obscure the seasonal changes that occurred. Some of the factors generating seasonal changes did not show up at all. For instance, the level of advances under the Guaranteed Price Scheme, which are generally seasonal, rose to Rs 371 million in July 1976 and continued to remain high during the rest of the year.

Comparison of monthly money supply figures for 1976 with the figures for the corresponding months of the previous year shows a rate of increase ranging from 6.4 per cent in January to 34.9 per cent in December with an almost continuous increase through the year; the largest such increase in 1975 was 6.1 per cent.

The principal factors responsible for the increase in money supply during the year were the financial operations of the government and the increase in net external banking assets. During the year, government financial operations with the banking system resulted in an expansionary impact of Rs 540 million on the money supply. The Government had heavy recourse to financing from the banking system in an attempt to maintain a high level of capital and recurrent expenditure including welfare subsidies in the face of a sluggish increase in revenue. There was a sharp expansion in bank credit in favour of the government, which was offset to some extent by an increase in its deposits with the banking system. Altogether, commercial bank credit to government increased by Rs 366 million during the year. While commercial