

at a daily meeting of bankers. At the outset, the buying and selling rates for the U.S. Dollar were Rs. 15.97 and Rs. 16.03. By end of December, these rates have changed to Rs. 15.33 and Rs. 15.59 for the dollar.

#### THE GOVERNMENT FISCAL OPERATIONS

The Government fiscal operations for 1977 exerted a contractionary impact of Rs. 716 million on the economy. In the wake of two successive years of inflationary financing – Rs. 605 million in 1976 and Rs. 184 million in 1975 – this undoubtedly would have dampened the pressure on the price levels. While appreciating the salutary effect this accrual of unspent resources mobilised by the Government had on cushioning inflation, one cannot overlook the disappointing performance in capital expenditure which made this possible.

Provisional data on Government expenditure reveal a marginal increase of 4 per cent over the previous year, compared to an annual average increase of over 16 per cent in the period after 1970. The decline in 1977 was confined to capital expenditure. The recurrent expenditure rose by 11 per cent but its ratio to the Gross National Product showed a decline from 24 per cent in 1976 to 21 per cent in 1977. On the other hand, the capital expenditure in 1977 dropped by 19 per cent, and as a ratio of the Gross National Product, there was a decline from 12 per cent in 1976 to 8 per cent in 1977.

The lower capital expenditure in 1977 could be attributed to an absence of the usual vigilance over performance in an election year and the temporary administrative dislocation that occurs with changes of governments. Under-utilisation of capital funds which ranged between 19 to 25 per cent in the recent past was reduced to 9 per cent in 1976, but reached 27 per cent in 1977.

Government revenue improved in 1977. This was mainly due to a rise in export taxation arising from the continued improvement in the prices fetched by tea and rubber. The ratio of revenue to Gross National Product was 23 per cent, reflecting a marginal decline from the previous year.

The overall performance in the current account (the difference between the Government revenue and recurrent expenditure) in 1977 revealed a surplus of Rs. 188 million, after recording deficits in the two preceding years.

A summary of fiscal operations for 1977 and the approved estimates for 1978 is shown in Table 15. The net cash deficit of the Government, defined to exclude the effects of sinking funds and amortization payments with respect to borrowings, is presented in Table 9 in Appendix III.

#### Expenditure

According to provisional figures, total Government expenditure in 1977 amounted to Rs. 9,708 million. This was made up of Rs. 6148 million under recurrent programmes, a net capital expenditure of Rs. 2263 million, a contribution of Rs. 947 million towards sinking funds and amortization payments, and a net out-payment of Rs. 350 million under advance accounts.

**TABLE 14**  
**Government Fiscal Operations - 1974-1978**

Rs. Mn.

Items	1974	1975	1976	1977 Approved Estimates	1977 Provisional	1978 Approved Estimates
1. Revenue <sup>1</sup> ...	4,787	5,084	5,739	6,062	6,686	10,830
2. Recurrent Expenditure ...	4,500	5,159	5,554	5,888	6,148	9,972 <sup>4</sup>
3. Advance Accounts operations (deficit-/surplus+) ...	- 39	- 73	- 312	—	- 350	- 100
4. Current Account (+Surplus/deficit-) ...	+ 242	- 142	- 128	+ 174	+ 188	+ 758
5. Capital Expenditure ... Of which: Sinking Fund and Amortization payments and contributions to International Financial Organisations ...	1,841 (564)	2,556 (596)	3,448 (662)	2,904 (848)	3,210 (947)	5,181 <sup>4</sup> (1,092)
6. Budget Deficit ...	1,599	2,699	3,576	2,730	3,022	4,423
7. Financing the Deficit						
7.1 Domestic Sources ...	910	1,610	2,284	1,370	1,779	1,603
(a) Non-bank Market borrowing ...	976	1,075	1,160	1,300	1,504	1,750
(b) Non-Market borrowing ...	- 54	379	485	70	499	- 147
(c) Banking system <sup>2</sup> ...	- 12	156	639	—	224	—
7.2 Foreign Finance ...	650	1,059	1,326	1,350	1,736	2,820
(a) Project Loans ...	79	275	327	n.a.	368	n.a.
(b) Commodity Loans ...	319	380	633	n.a.	885	n.a.
(c) Grants ...	252	404	367	n.a.	483	n.a.
7.3 Use of cash balances ...	39	31	- 33	10 <sup>3</sup>	- 492	n.a.
8. Expansionary impact of Government Fiscal Operations	24	184	605	10	- 716	—

Sources: Central Bank of Ceylon &  
General Treasury.

1. Excludes Capital Grants in Revenue shown under Foreign Grants.
2. Includes Special Advances from Central Bank to meet the contributions to International Financial Organisations abroad.
3. On account of the Committee Stage amendments to increase Railway expenditure by Rs. 10 million.
4. Includes Rs. 1.7 million and Rs. 0.8 million respectively for recurrent and capital expenditure by Committee Stage amendments.

Recurrent expenditure of Rs. 6148 million reveals an increase of 11 per cent over the previous year. This is largely attributable to the higher cost of maintenance supplies, new staff recruited to public service, the built in recurrent costs of new capital works, higher personal emoluments to public servants, and the rising cost of servicing the public debt. These increases were most prominent in the ministries of Finance (Rs. 109 million), Education (Rs. 83 million), Health (Rs. 56 million), Industries and Scientific Affairs (Rs. 39 million) and Irrigation, Power and Highways (Rs. 14 million). However, when compared with the gross allocation of Rs. 6406

million, which includes supplementary allocations of Rs. 399 million, it reveals an under-utilisation of 4 per cent. A breakdown of Government expenditure under each ministry is shown in table 12 in Appendix III.

In 1977, Capital expenditure (net) recorded a decline of Rs. 523 million or by 19 per cent over the previous year. This compares with a sharp increase of Rs. 826 million or 42 per cent in 1976. Of course, 1976 was an unusual year in that the urgency to finalise the arrangements for the Non-Aligned Nations Conference led to an intensified program in infrastructure development. The actual development expenditure excluding sinking funds and amortization payments in 1977 was Rs. 2263 million. Compared with the gross allocation of Rs. 3103 million, which includes supplementary provisions of Rs. 354 million, it reflects an under-utilization of 27 per cent.

In relation to the actual Capital expenditure in the previous year, major short-falls in 1977 were seen under the Ministries of Irrigation Power and Highways (Rs. 139 million), Plantation Industries (Rs. 104 million), Local Government, Housing and Construction (Rs. 69 million) and Social Services (Rs. 57 million). As in the previous years, bulk of the expenditure was for infrastructure development. The investment by the Ministry of Irrigation Power and Highways was Rs. 413 million; Agriculture and Land development accounted for Rs. 341 million; Transport and Communications claimed Rs. 208 million; Postal and Telecommunication Services utilised Rs. 198 million. Local Government, Housing and Construction spent Rs. 127 million while expenditure on Shipping and Tourism was Rs. 32 million. On the other hand, the expenditure under the Ministry of Industries and Scientific Affairs which deals with most of the manufacturing industries amounted to Rs. 519 million.

In 1977, the net outpayments under advance accounts amounted to Rs. 350 million as compared with an outpayment of Rs. 312 million in the previous year. This year's outpayments consisted mainly of advances to government departments of Rs. 153 million, advances to government corporations of Rs. 95 million and advances under Sri Lanka-China trade account for purchase of rubber of Rs. 43 million. The heavy outpayments on this account in recent years has introduced an element of instability to fiscal management. Hence a re-appraisal of the procedure pertaining to advance accounts with a view to bringing their activities within the folds of the normal Budget, deserves urgent attention of the Government.

### Revenue

According to provisional data, Government revenue in the fiscal year 1977 amounted to Rs. 6686 million, revealing an increase of 17 per cent over the previous year. The better performance in 1977 is mainly attributable to the buoyant export prices and the relatively higher value of imports. Noteworthy increases were recorded under the Tea tax (Rs. 299 million), Export duties (Rs. 199 million), profits from State Corporations (Rs. 178 million), Tobacco tax (Rs. 139 million) and FEECs (Rs. 83 million). While no improvement was seen under corporate and personal income taxes, a decline of Rs. 39 million was recorded under turnover taxes. A summary statement of Government revenue can be seen in Table 11 in the Statistical Appendix III.

The tax rates applicable to the tea industry were revised thrice (in March, May and November) in the course of 1977, to recoup a higher share of the buoyant prices to Government revenue. In March and May, the ad-valorem tax on tea was raised. The revision in November, however, was to shift the weight of incidence to the tea export duty proper, and to recoup a substantial share of the enhanced export prices resulting from the unified exchange rate. Consequently, the specific export duty on tea was substantially raised from 86 cts. to Rs. 15.50 per kg. and the entire increase of Rs. 113 million in export duty over the previous year was realised in December, 1977.

Similarly, the sliding scale of duties on the export of rubber was raised in November to siphon off the price benefits that accrued from the unified exchange rate. However, the increase of Rs. 63 million from export duty on rubber was due more to the higher prices that prevailed in the earlier part of the year. Export duty on coconut products withdrawn in November, 1975 was reintroduced with the unification of the exchange rate. This levy had no significant impact on the revenue for 1977.

The higher receipts from profits and dividends from State Corporations was also due to the better prices fetched by exports. Surplus export proceeds with Janavasama and State Plantations Corporation (Rs. 240 million) were appropriated to Government revenue under provisions in the Finance Act No. 38 of 1971. Improvement in the Tobacco tax, inspite of several dislocations in the manufacture of tobacco products in 1977, is attributable to the higher excise (Rs. 77 per lb.) levied on tobacco leaf from the previous year. The proceeds from the sale of Foreign Exchange Entitlement Certificates continued to be the largest single item of Government revenue in recent years. The scheme was withdrawn in November, but the loss of revenue from this source is to be compensated by enhanced import and export duties.

### **Financing of the Budget Deficit**

The overall Budget deficit in 1977 according to provisional data is Rs. 3,022 million, exceeding the original estimate by Rs. 292 million. The Government raised Rs. 1,779 million from the domestic sector and Rs. 1,736 million from external sources to finance this deficit. The excess of Rs. 716 million over the financing requirement was used in part (Rs. 224 million) to liquidate the banking debt. The residue, Rs. 492 million enhanced the Government cash balances. According to Treasury records, this reflected an increase of Rs. 355 million in Government counter-part funds and an improvement of Rs. 137 million in Treasury cash balances.

Gross domestic financing of Rs. 1,779 million constituted a borrowing of Rs. 1,504 million from non-bank market sources and a receipt of Rs. 499 million from non-market administrative borrowings. Sale of rupee securities was the major source for market borrowings, and about 95 per cent of the contributions were received from savings mobilised by official institutions, National Savings Bank, Employees' Provident Fund, Insurance Corporation and Public Debt Sinking Funds.

Foreign assistance of Rs. 1,736 million received during the year consisted of Commodity Loans of Rs. 885 million, Project Loans of Rs. 368 million and Grants of Rs. 483 million.

### Public Debt

In December, 1977 the value of the Public debt stood at Rs. 24,986 million; reflecting an increase of 42 per cent or Rs. 7327 million over the previous year. The total domestic debt accounted for Rs. 14,159 million and the balance Rs. 10,827 million represented the foreign debt. The value of the sinking funds with respect to domestic rupee loans amounted to Rs. 2,552 million.

The domestic debt increased by Rs. 1,468 million. The major increases include the issue of Rs. 1,500 million in medium-term rupee securities and a book adjustment of Rs. 270 million for depreciation of the Rupee in the value of two foreign loans channelled through certain semi-government institutions. On the other hand, the Government retired Rs. 200 million in Treasury Bills and repaid maturing rupee loans amounting to Rs. 110 million. Also, the Central Bank advances to the Government increased by Rs. 17 million and holdings of Tax Reserve Certificates declined by Rs. 10 million.

All rupee securities issued in 1977 under the Appropriation Act No. 37 of 1976 were of 10-12 year maturities. Loans floated in the period January to July, 1977 amounting to Rs. 1,100 million carried an interest rate of 9 per cent per annum. The balance Rs. 400 million floated in the remaining period carried an enhanced rate of 10 per cent.

The liability on foreign debt increased by Rs. 5,859 million in 1977. Of this Rs. 4,849 million represent book adjustments in the value of the debt to accommodate changes in the Rupee exchange rate and fluctuations in rates of other relevant currencies. Thus the net transfer of resources was Rs. 1010 million.

The share of the foreign debt in relation to the total debt increased from 25 per cent in 1975 to 43 per cent in 1977. The variation in the course of 1977 is largely attributable to the unification of the exchange rate in November and the fluctuations in the value of other currencies. Net of these fluctuations, the share of the external debt increased from 23 per cent in 1975 to 30 per cent in 1977, indicating a greater reliance on foreign resources to finance the development effort in Sri Lanka.

Gross receipts of foreign loans in 1977 were Rs. 1,444 <sup>1</sup> million and significant contributions were received from United Kingdom (Rs. 294 million), USA (Rs. 272 million), International Development Association (Rs. 120 million), Asian Development Bank (Rs. 100 million), Japan (Rs. 99 million), India (Rs. 75 million) and Federal Republic of Germany (Rs. 70 million). Repayments of foreign loans in 1977 amounted to Rs. 434 million.

1. This figure differs from the corresponding value of Rs. 1253 mn. shown under financing of the Budget due to lags in recording and differences in classification.

Favourable export income received in the last several years has led to a gradual decline in the external debt service ratio (the external debt service payments as a percentage of exports of goods and non-factor services) from 23 in 1975 to 20 in 1976 and to 19 per cent in 1977. Meanwhile, the domestic debt service ratio (debt service payments as a ratio of Government revenue) has demonstrated a tendency to increase over the last decade or more. In 1977, it increased by 5 percentage points to 17 per cent. If the Government desires to keep the debt burden at manageable levels, it is essential to raise the quality of public investments.

## **MONETARY AND BANKING DEVELOPMENTS**

### **MONEY SUPPLY**

The year 1977 witnessed a very sharp monetary expansion for the second year in succession, when the money supply rose by Rs. 1200 million. This was an increase of 29 per cent, as against a rise of 35 per cent in 1976, 5 per cent in 1975 and 6 per cent in 1974. In fact, money supply has almost doubled itself over the four years 1973 to 1977; and over four-fifths of this increase occurred in 1976 and 1977.

The average of monthly money supply data during the year 1977 showed an increase of 32 per cent over the previous year. In other words, the money supply during 1977 was, by and large, a third higher than the level that prevailed during the previous year. By contrast, the average rise was 22 per cent in 1976, 2 per cent in 1975 and 18 per cent in 1974. A detailed comparison can be seen in Table 15 that follows.

As in 1976, seasonal factors failed to exert a significant influence on the course of money supply in 1977. Except in the month of July, there was a continuous expansion in money supply throughout the year. This is largely explained by the nature of the major underlying factor responsible for the monetary expansion; namely, the growth in external banking assets, which does not normally display any seasonal pattern. Moreover, commercial bank credit to co-operative institutions was also devoid of the usual seasonal fluctuations. In general, bank advances to co-operatives have tended to rise rather sharply during the first half of the year but taper off during the fourth quarter as the repayment of these advances gathers momentum. In 1977, advances to co-operative institutions rose rather sharply during the first 3 quarters of the year and continued to remain high during the rest of the year. Overall, the pattern of monetary expansion in 1977 was characterised by a very sharp increase in the first quarter, moderate increases in the second and third quarters and an acceleration in the fourth quarter.

The composition and the underlying factors responsible for this monetary expansion are shown in Table 16. The increase in money supply was made up of an increase in demand deposits by Rs. 489 million and an increase in currency held by the public of Rs. 711 million.