GOVERNMENT FISCAL OPERATIONS

The economic reforms of November, 1977 had a distinct impact on the level and direction of the fiscal operations in 1978. Changes in prices, widening of the tax base, adjustments of tax rates and higher expenditure, almost doubled the size of the Budget. In relation to direction, there was a distinct effort to restructure Government expenditure from consumption to investment. In view of the magnitude of change arising from the 1977 reforms, it was not easy to forecast in advance the ultimate out turn of the 1978 Budget. Finally, the current account turned out to be a deficit, of Rs. 701 million.

The data in Government accounts revealed a nominal expansionary impact of budgetary operations of Rs. 173 million in 1978. But, when adjustments were made to offset certain financial transfers effected at the end of the year and to take account of a higher volume of uncleared cheques at the end of the year, the budgetary operations show a contractionary impact in the region of Rs. 893 million.[1]

Total Government expenditure increased from Rs. 9,760 million in 1977 to Rs. 18,939 million in 1978, an increase of 94 per cent. The recurrent expenditure amounted to Rs. 10,408 million and as a ratio of the Gross National Product, it showed an increase from 23 per cent in 1977 to 34 per cent in 1978. Capital expenditure was Rs. 5,441 million. The ratio of Capital expenditure to the Gross National Product, which declined from 12 per cent to 8 per cent in 1977, rose sharply to 15 per cent in 1978. When, certain end of the year financial transfers to Treasury deposits and the Central Bank were discounted, the Capital expenditure ratio drops to 13 per cent, which is yet appreciably higher than in the previous year.

Revenue for 1978 amounted to Rs. 11,633 million, indicating an increase of 74 per cent over the previous year. Consequently, the ratio of revenue to Gross National Product rose from 23 per cent in 1977 to 32 per cent in 1978.

The Budget deficit in 1978 amounted to Rs. 7,307 million, which was 39 per cent of total expenditure. This was considerably higher than the deficit for the previous year of Rs. 3,074 million, which was 31 per cent of that year's expenditure. The rate of increase of recurrent expenditure and revenue were broadly of similar magnitude in 1978. On the other hand, capital expenditure showed a higher rate of growth. This accounted for the expansion of the budget deficit in 1978.

Summary of fiscal operations for the year 1978 and approved estimates for 1979 are shown in table 1·14. The net cash deficit resulting from the government fiscal operations for 1978 is shown in table 9 of appendix along with comparative data for the last twelve years.

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1. Data adjusted for the nominal transfer of Rs. 390 million meant for the National Development Bank to the Central Bank and also for an end of the year cheque float of Rs. 666 million.

Table 1·14

Government Fiscal Operations 1975–1979

Rs. Million

Items	1975	1976	1977	1978 Approved Estimates	1978 Provisional	1979 Approved Estimates
1· Revenue[1] ..	5,084	5,739	6,686	10,830	11,633	11,429
2· Recurrent Expenditure ..	5,159	5,554	6,148	9,972[3]	10,408	10,734
3· Advance Accounts operations (deficit–/surplus+) ..	– 73	– 312	– 430	– 100	– 1,926	+ 200
4· Current Account (+Surplus/deficit–) ..	– 142	– 128	+ 108	+ 758	– 701	+ 895
5· Capital Expenditure ..	2,555	3,448	3,182	5,181[3]	6,606	7,195
Of which: Sinking Fund and Amortization payments and contributions to International Financial Organizations ..	*(596)*	*(662)*	*(947)*	*(1,092)*	*(1,165)*[4]	*(1,328)*
6· Budget Deficit ..	2,699	3,576	3,074	4,423	7,307	6,300
7· Financing the Deficit						
7·1 Domestic Sources ..	1,610	2,284	1,786	1,603	2,778	1,950
(a) Non–bank Market borrowing ..	1,075	1,160	1,504	1,750	2,033	1,950
(b) Non–Market borrowing ..	379	485	505	– 147	578[5]	—
(c) Banking system[2] ..	156	639	– 224	—	167	—
7·2 Foreign Finance ..	1,059	1,326	1,779	2,820	4,471	4,350
(a) Commodity Loans ..	380	633	885	1,620	2,128	2,200
(b) Project Loans ..	275	327	394	} 1,200	1,665	} 2,150
(c) Grants ..	404	367	500		678	
7·3 Use of cash balances ..	31	– 33	– 492	—	58	—
8· Expansionary impact of Government Fiscal Operations ..	184	605	– 715	—	173	—

Sources: Central Bank of Ceylon
General Treasury.

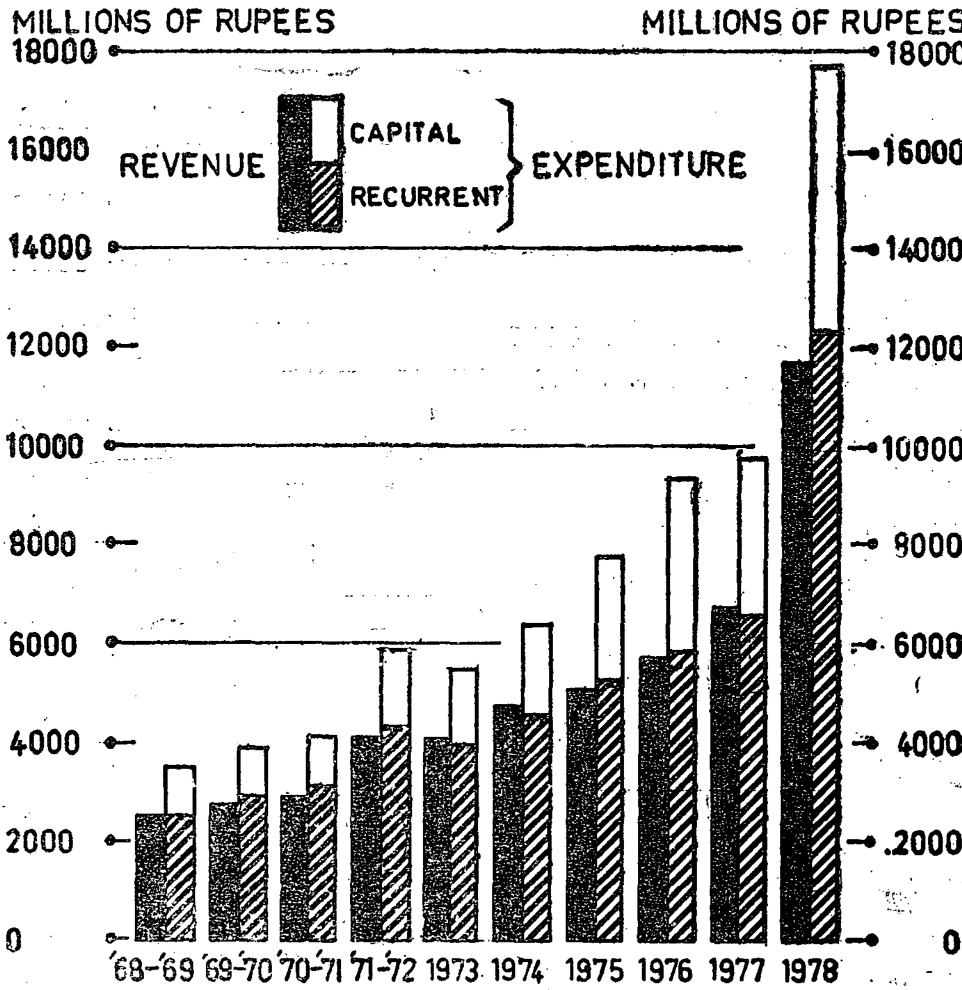
1· Excludes Capital Grants in Revenue shown under Foreign Grants.
2· Includes Special Advances from Central Bank to meet the contributions to international financial organisations abroad.
3· Includes Rs. 1·7 million and Rs. 0·8 million respectively for recurrent and capital expenditure by Committee Stage amendments.
4· Includes repayment of foreign administrative borrowings amounting to Rs. 174 million.
5· Not adjusted for a repayment of rupee loans amounting to Rs. 52 million to the banking system.

Revenue

According to provisional data, government revenue in 1978 amounted to Rs. 11,633 million, which indicate an increase of 74 per cent over 1977. This increase is partly attributable to the economic resurgence in 1978, and partly to the adjustments that became necessary after the economic reforms of November, 1977. The reforms of 1977, inter alia, included restructuring of export duties, import duties, business turnover taxes and also certain revisions in income

GOVERNMENT REVENUE & EXPENDITURE

DATA BY FINANCIAL YEARS



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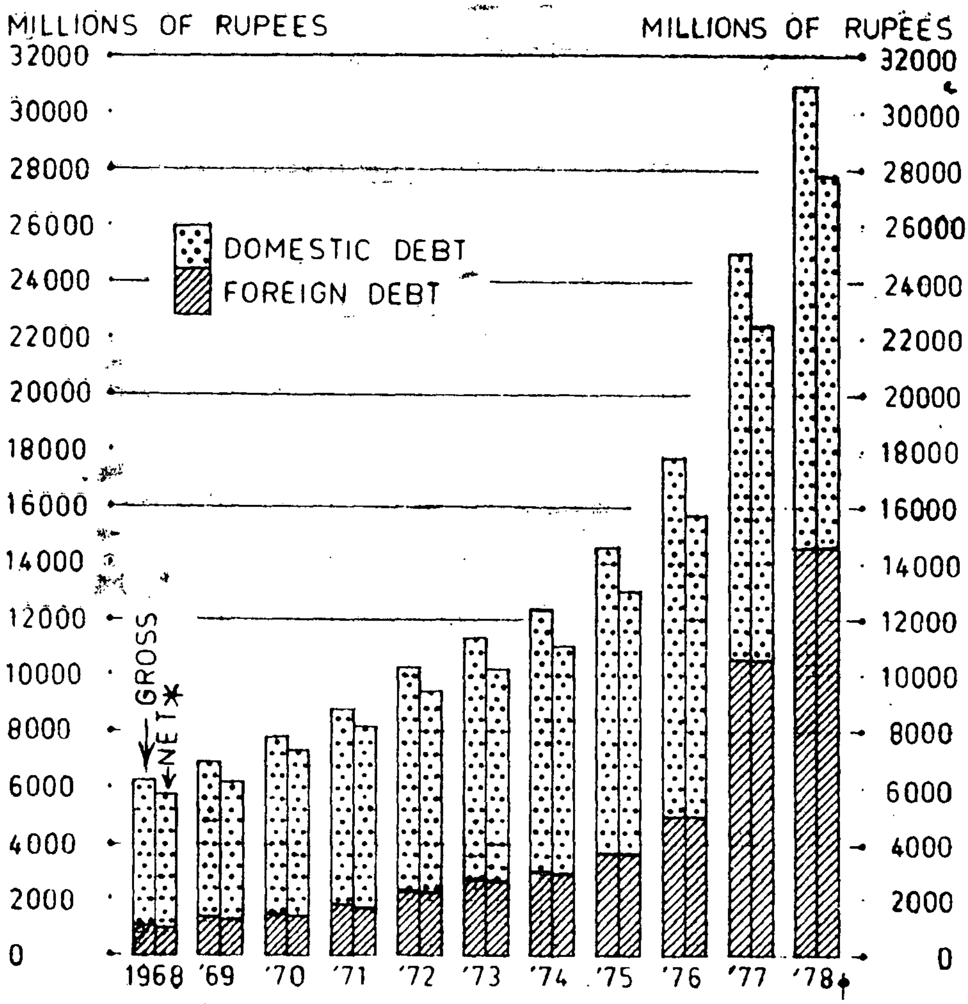
Sources: General Treasury
Central Bank of Ceylon

* Financial years upto and including 1970/71 are for 12 months ending on the 30th September Financial year 1971/72 relates to 15 month from October 1, 1971 to December 31, 1972. Financial years from 1973 relate to the year ending 31st December.

Data on expenditure refer to total voted expenditure (excluding sinking fund contributions, direct repayments of public debt from revenue and special payments to international financial organisations) together with expenditure financed from the National Development Reserve and net payments on advance account operations. See also Appendix Table 9.

1978 figures are provisional

COMPOSITION OF PUBLIC DEBT



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Source: Central Bank of Ceylon

* Gross Debt less Sinking Funds.

† 1978 Figs are provisional

taxes. Export duties were increased substantially to siphon off devaluation gains in the case of tea, rubber and coconut. Although the rates of import duty were reduced, the unification of the exchange rates enhanced the duty base, while liberalisation of imports increased the volume of imports. Business turnover taxes were also restructured by reducing the number of rate bands from ten to three with a few exceptions.

The export duties increased nearly eight-fold and accounted for nearly 30 per cent of the total revenue for the year. As exports rose only by about 4 per cent in 1978, this phenomenal increase in revenue could be attributed largely to tax rate increases and enhanced tax base, following the exchange reforms. Proceeds from import duties almost trebled. This was accounted for by the exchange rate changes and a 30 per cent increase in imports. Turnover taxes which declined marginally during the previous year increased substantially by 62 per cent this year owing to increased activity in the business and manufacturing sectors, and also on account of a collection of arrears of taxes amounting to Rs. 128 million from the Petroleum Corporation which offset a reduction in the rates of tax. Revenue from tobacco tax increased by 28 per cent due to increases in sales of tobacco and also due to increases in the rate of duty. Same reasons accounted for the 130 per cent increase in collections from the excise on liquor. However, collections from tea tax dropped by Rs. 65 million on account of lower prices. Arrears collected from FEECs scheme withdrawn in November, 1977 amounted to Rs. 329 million. These collections were largerly due to forward purchases of exchange for imports on deferred payment terms.

During the year under review, there was no revision in the export duty on tea or rubber, except for a reduction of Rs. 2 per kilo granted to exports of packeted tea, and an enhancement of the duty on block rubber from 50 to 75 per cent. Specific duties amounting to Rs. 6,450 per metric ton of desiccated coconut, Rs. 1,650 per metric ton of coconut oil and Rs. 5,420 per metric ton of copra were imposed with effect from August 1, 1978. The duty on fresh nuts was fixed at Rs. 450 per 1000 nuts. Further, an administrative levy was collected from coconut kernel products. Export duties on minor export crops, namely cardamom, cocoa, cinnamon, cocoa beans and citronella oil were reduced during the year. Rates of import duties were kept under constant review and modifications to existing rates on the recommendations of the Tariff Review Committee were made from time to time.

Tax holidays were granted for investments in deep-sea and off-shore fishing, animal husbandry, rice-milling and small industries. Exemptions were granted for capital gains from housing, while adjustments with respect to depreciation allowances were granted for investments in industry. In regard to personal income taxes, the basic family allowance was raised from Rs. 3,600 to Rs. 5,000 per annum. Substantial exemptions were also granted for investments in industries to be established in the "Investment Promotion Zones" of the Greater Colombo Economic Commission.

The significant feature in the structure of revenue in 1978 was the sharp increase in the relative share of indirect taxes as well as the share of taxes on external trade in total revenue. Indirect taxes as a percentage of the total revenue increased substantially from 67 per cent in 1977 to 79 per cent in 1978. This rise was mainly due to an increase in the share of taxes on external trade from 43 per cent in 1977 to 53 per cent in 1978. The shift of emphasis to indirect taxes, could ease problems associated with tax collections; but from a theoretical point of view, would reduce the progressive nature of the tax system. It should be possible, however, to design a relatively progressive tax system by a judicious mix of indirect taxes.

Expenditure

Government expenditure in 1978 amounted to Rs. 18,939 million. Recurrent expenditure amounted to Rs. 10,408 million, indicating an increase of 69 per cent while net capital expenditure increased by 143 per cent to Rs. 5,441 million. Contributions to sinking funds and direct repayments of debt amounted to Rs. 1,165 million. net payments under advance accounts indicated an all time high of Rs. 1,926 million.

The higher recurrent expenditure was partly the outcome of the higher level of prices and costs arising from the depreciation of the exchange rate. Increased cost of maintenance of consumer subsidies, other social services and public utilities and the increase in the quantum of public service emoluments were the other reasons for this increase. Food subsidy continued to be the major item of recurrent expenditure, in spite of the withdrawal of the subsidy from nearly one half of the population. The main reasons for this increase were the increase in the guaranteed price for paddy from Rs. 33 to Rs. 40 per bushel, and the increase in the rupee value of imported rice and flour due to the depreciation of the exchange rate. Interest on public debt rose to Rs. 1,368 million, while other current expenditure of the Ministry of Finance such as provisions for salary increases to government servants, subsidy on fertilizer, reimbursement of losses to public corporations and the interest subsidy to the National Savings Bank amounted to Rs. 1,683 million. Recurrent cost of education amounted to Rs. 1,040 million while expenses of the Ministry of Public Administration, which included pensions to retired Government servants amounted to Rs. 676 million. Expenses of the Ministry of Agriculture amounted to Rs. 510 million, while that of Health to Rs. 523 million, Transport to Rs. 508 million and Defence to Rs. 430 million.

Net payments under advance accounts amounted to Rs. 1,926 million. The major increase here was an advance of Rs. 1,050 million to the Food Department to finance purchasing operations. Other items include an advance of Rs. 200 million to the Paddy Marketing Board, Rs. 200 million to the Commissioner of Commodity Purchase to finance his trading operations under the Sri Lanka-China Trading Account and an increase of Rs. 117 million for the purchase of stores and materials.

Capital Expenditure

Net Capital Expenditure in1978 at Rs. 5,441 million reflected an increase of 143 per cent over the previous year. This excludes a contribution of Rs. 1,165 million for sinking funds and direct repayments of public debt. It appears that, while some part of the increase in capital expenditure accommodated the cost escalations due to the exchange rate changes, a substantial share of the increase was to finance new development activity. Also, provisional data revealed that the level of under-utilisation of allocated funds declined from 27 per cent in 1977 to 16 per cent in 1978. However, the lower level of under-expenditure was partly due to the transfer of certain budgetary allocations to Treasury deposits and to the custody of the Central Bank, pending their final utilisation eventually. Such transfers to Treasury deposits approximated to Rs. 280 million. This included a sum of Rs. 50 million meant for the housing programme of the Government to be spent in 1979. Also, the Government transferred an allocation of Rs. 390 million meant for the initial capital of the National Development Bank to the custody of the Central Bank. When adjusted for these transfers, the level of under-utilization stands at 27 per cent.

The Ministry of Finance and Planning spent nearly 31 per cent of the total capital budget while the Ministry of Industries & Scientific Affairs accounted for 18 per cent. Ministries that were engaged in agricultural development namely Land and Land Development, Mahaveli Development and, Agricultural Development and Research accounted for Rs. 831 million or 15 per cent of the total capital budget. An amount of Rs. 752 million or 14 per cent was spent by ministries engaged in development of infrastruture, namely Power and Highways, Transport, and Posts and Telecommunications. The level of utilisation of funds was high in the ministries of Industries & Scientific Affairs and Agricultural Development & Research, while ministries that recorded high levels of under-expenditure in relation to the overall average were Land and Land Development (52 per cent), Fisheries (45 per cent), Power & Highways (29 per cent) and Plan Implementation (28 per cent).

Financing of the Budget Deficit

The budget deficit in 1978 amounted to Rs. 7,307 million in comparison to a deficit of Rs. 3,074 million in the previous year. The Government raised Rs. 2,836 million from the domestic sector while Rs. 4,471 million was obtained from foreign sources as loans and grants.

Domestic loans included Rs. 2,200 million obtained from the market sources and Rs. 578 million from the non-market sources. Market borrowings constituted Rs. 1,750 million obtained from rupee loans, Rs. 124 million from treasury bills and Rs. 338 million of Central Bank advances, while there was a reduction of the holdings of tax reserve certificates by Rs. 12 million. Contributions to rupee loans were confined to the non-bank sector. However, the Government repaid Rs. 52 million of rupee loans held by the banking sector. In the case of treasury bills, holdings of the non-bank sector increased by Rs. 295 million while those of the banking sector decreased by Rs 171 million, reflecting a total increase of Rs. 124 million. Net Central Bank advances for the year amounted to Rs. 338 million. The net borrowing from the banking sector as a whole amounted to Rs. 116 million once adjustments are made in regard to repayments of Rs. 171 million and Rs. 52 million on treasury bills and rupee loans, respectively.

Treasury deposits amounting to Rs. 628 million constituted the major source of non-market borrowing, while there was a net repayment of adminis trative borrowing amounting to Rs. 224 million. In addition, Rs. 58 million was obtained by running down of cash balances of the Treasury.

Foreign resources used for financing of the budget deficit amounted to Rs. 4,471 million. These included Rs. 1,665 million of project loans and Rs. 2,128 million of non-project loans, while Rs. 678 million was obtained as grants.

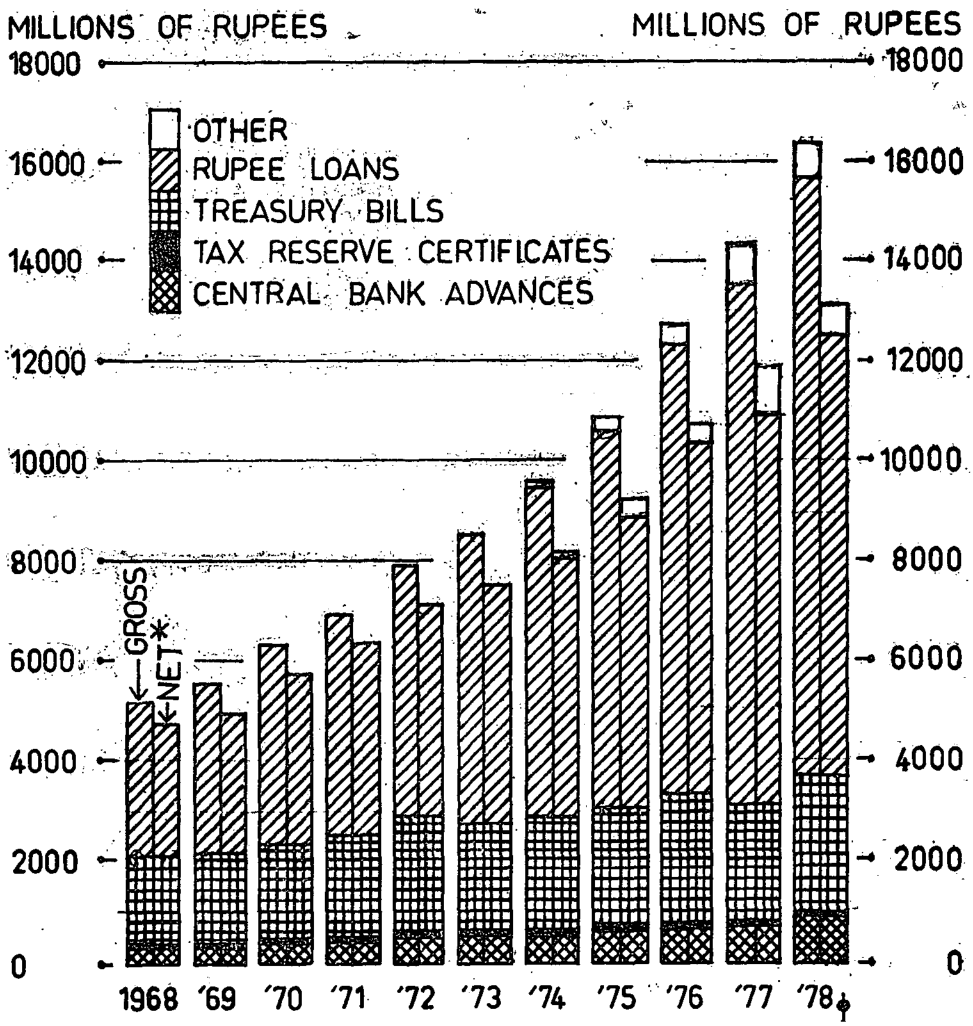
Public Debt

The public debt outstanding increased by 24 per cent in 1978. This compares with an increase of 42 per cent during the previous year. The high increase in the previous year was due to a susbtantial change in the debt liability due to unification of the exchange rate of Sri Lanka rupee. The gross public debt amounted Rs. 30,950 million. Domestic debt accounted for Rs. 16,368 million while the foreign debt amounted to Rs. 14,582 million.

The gross domestic debt increased by Rs. 1,975 million to Rs. 16,368 million during 1978. Medium and long-term rupee loans, the major item among domestic debt increased by Rs. 1,657 million during the year after making adjustments for repayments during the year. This compares with an increase of Rs. 1,390 million in the previous year. In contrast to a net repayment of Treasury bills of Rs. 200 million during the previous year, the Government raised Rs. 135 million in Treasury bills to finance the Budget and the total amount of bills outstanding increased to Rs. 2,635 million at the end of the year. Central Bank advances increased by Rs. 338 million while holdings of Tax Reserve Certificates declined by Rs. 11 million.

Rupee loans with a maturity period of 10 to 12 years amounting to Rs. 1,750 million were issued in terms of the Appropriation Law No. 25 of 1977 and these securities carried a rate of interest of 10 per cent per annum. Since the loan programme was fully subscribed by November, no new loans were floated in the last two months of the year. The traditional investors in government loans were provided with an opportunity to invest in Treasary bills. The major contributors to the loan programme during the year were the Sinking Funds, Employees' Provident Fund, National Savings Bank and the Insurance Corporation. The Employees' Provident Fund increased its relative share of contributions from 27 per cent in 1977 to 33 per cent in 1978, mainly on account of increased contributions received by the fund. On the other hand, the relative share held by the National Savings Bank dropped from 27 per cent in 1977 to 22 per cent in 1978. This was partly due to the Bank's need to invest in shorter maturities in order to meet its maturing short term fixed deposits.

COMPOSITION OF DOMESTIC DEBT



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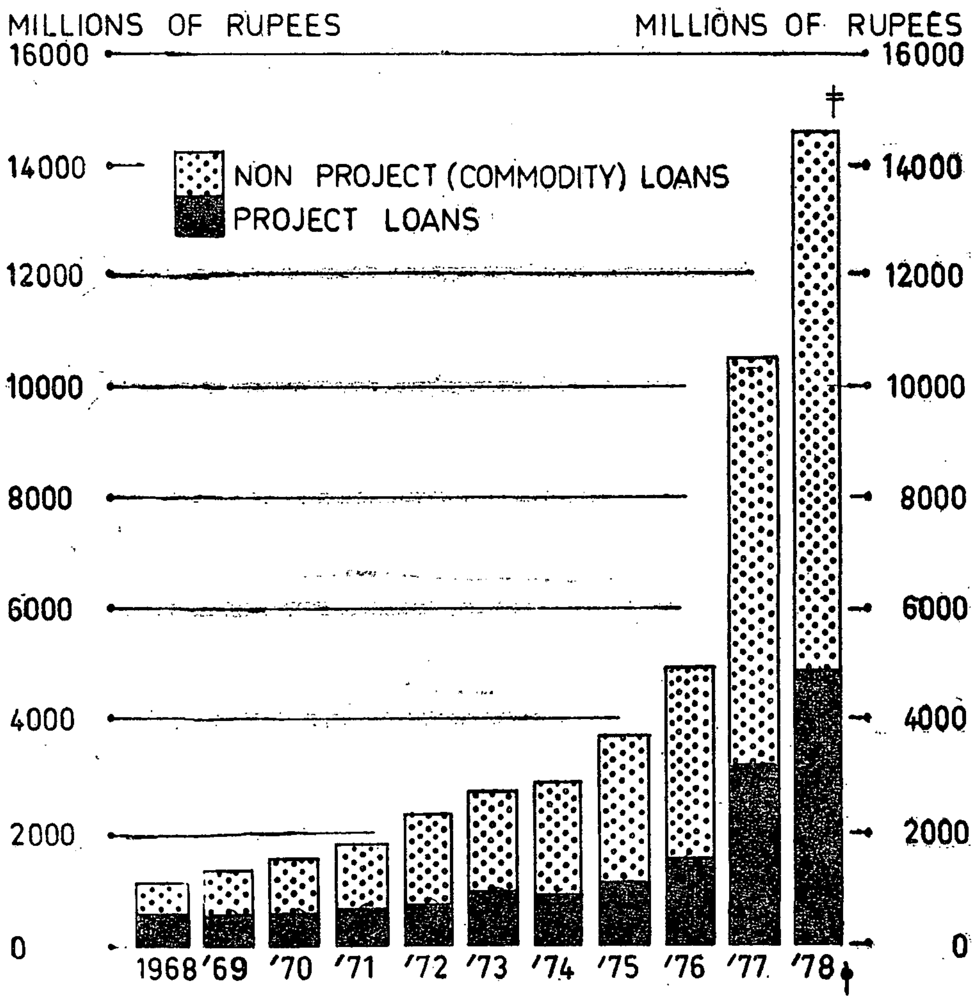
Source: Central Bank of Ceylon

* Gross Public Debt less Sinking Funds.

† 1978 Figs. are provisional

COMPOSITION OF FOREIGN DEBT



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Source: Central Bank of Ceylon

ǂ Non Project (Commodity) Loans Inclusive of IMF Trust Fund Loan.

† 1978 Figs are provisional

Gross receipts of foreign loans in 1978 was Rs. 3,716 million. Repayments amounted to Rs. 501 million. Thus the net transfer of resources amounted to Rs. 3,215 million together with a liability of Rs. 773 million to accomodate exchange rate variations, the gross foreign debt outstanding increased by Rs. 3,988 million, indicating a higher rate of increase than that of domestic debt for the fourth successive year. Foreign debt which amounted to 25 per cent of total debt at the end of the year 1975 progressively increased its share to 28 per cent in 1976, 42 per cent in 1977 and to 47 per cent in the year 1978. It reveals a higher reliance on long term foreign resources to finance the economic development programmes of the country. In 1978 nearly 60 per cent of the capital budget was financed by foreign loans obtained in this manner. Heavy reliance on external resources to finance the development budget would increase the debt service burden of the economy as well as in future budgets, unless it is possible to increase export earnings in a significant manner in the future. The external debt service ratio decreased from 23 per cent in 1975 to 13 per cent in 1978 inspite of the substantial increases in the debt liability and a slow growth of exports. This improvement in the debt profile arose largely because most of the loans negotiated in recent years have long repayment periods with generous grace periods (when no repayment is due) ranging from 5 to 10 years. It was also due to a lesser reliance on short term credits in recent years. However, the debt service burden would register an increasing trend in the naer future with the completion of the grace periods of past loans.

The gross receipts of foreign loans included receipts of Rs. 1,584 million of project loans, Rs. 1,343 million of non-project (commodity) loans and a loan of Rs. 789 million from the Trust fund of the International Monetary Fund.

Contributions to project loans in 1978 included Rs. 348 million from the Netherlands, Rs. 329 million from the Federal Republic of Germany, Rs. 96 million from India, Rs. 61 million from Kuwait, Rs. 47 million from China, Rs. 31 million from the Union of Soviet Socialist Republics, Rs. 12 million from Denmark, Rs. 5 million each from Canada and the United States of America and Rs. 1 million from the United Kingdom. During the same period Rs. 439 million was received from the Asian Development Bank, Rs. 167 million from the International Development Association, Rs. 26 million from the International Bank for Reconstruction and Development and Rs. 16 million from the Organization for Petroleum Exporting Countries. Non-project loans received during the year were from the United States of America (Rs. 582 million) Japan (Rs. 462 million), Canada (Rs. 141 million) India (Rs. 79 million), the Federal Republic of Germany (Rs. 46 million), France (Rs. 30 million) and Rs. 1 million each from U. S. S. R. and Hungary.

The domestic debt service ratio (debt service payments as a ratio of total government revenue) decreased during the year. The drop in the ratio from 18 per cent in 1977 to 14 per cent in 1978 was partly a result of the 1977 fiscal reforms, when collections of revenue increased at a much higher rate than in the previous year while domestic debt increased only at 14 per cent.