

The inflow of long-term official loans, drawings from the IMF, private direct investments and the allocation of SDRs generated a surplus in the capital account. This surplus was more than sufficient to finance the current account deficit and the external resource gap and, therefore, additional resources spilled over to external assets.

The considerable improvement in Sri Lanka's external assets during the last 4 years has strengthened the country's credit worthiness in international capital markets. In June, the government negotiated an eight year US \$ 50 million (Rs. 781 million) Eurodollar loan on attractive terms of 7/8 of one per cent per annum over LIBOR (London Inter-bank Offered Rate) during the first 4 years, and at 1 per cent over LIBOR, thereafter. However, as the country's asset position was strong, this loan was not drawn during 1979.

The changing pattern of the modes of financing of the external resource gap in recent years is partly responsible for the decline in the debt service ratio (i.e. capital repayments and interest on foreign loans including IMF transactions and bank borrowings, as a percentage of earnings from merchandise exports and services) from 15 per cent in 1978 to 13 per cent in 1979. Excluding IMF transactions, the debt service ratio fell from 12 per cent in 1978 to 8 per cent in 1979. The actual debt service payments declined by 16 per cent from Rs. 1,862 million (SDR 95 million) in 1978 to Rs. 1,620 million (SDR 80 million) in 1979, owing to the changes in the maturity structure of the debt contracted in the recent past. The easing in debt service burden is explained partly by the increase in earnings from exports and services in 1979 and partly by the more favourable terms on which recent borrowings have been made. For instance, about 70 per cent of the total number of long-term loans amounting to 74 per cent of the total value contracted in 1979, carried a grace period of 10 years or more. The outstanding level of external debt rose from Rs. 17,506 million (SDR 865 million) at the end of 1978 to Rs. 18,447 million (SDR 906 million) at the end of 1979, as a result of a higher utilization of project and commodity loans, and drawings from the IMF under the EFF and the Trust Fund.

The cumulative changes of exchange rates since 16th November, 1977 when the Sri Lanka Rupee was allowed to float, showed that by the end of 1979, the Rupee appreciated by 4 per cent against the U.S. Dollar and 1 per cent against the Japanese Yen. On the other hand, the Rupee depreciated by 16 per cent against the Pound Sterling, 21 per cent against the Deutsche Mark and 7 per cent against the SDR.

GOVERNMENT FISCAL OPERATIONS

The provisional data of government revenue and expenditure in 1979 revealed a current account surplus of Rs. 200 million, in sharp contrast to the original budgeted surplus of Rs. 895 million. The deterioration of the current account has been largely on account of increase in the recurrent expenditure and a heavy underestimation of payments under advance accounts. Provisional capital expenditure, including sinking fund contributions and repayments, amounted to Rs. 8,991 million, and with a current account surplus of Rs. 200 million, the overall budget deficit was Rs. 8,791 million. This was financed to a great extent from domestic resources amounting to Rs. 4,589 million, and a sum of Rs. 4,229 million obtained from foreign sources. The final expansionary impact of the government fiscal operations was Rs. 634 million.

The total government expenditure in 1979 was Rs. 21,521 million, when compared with the preceding year's total expenditure of Rs. 18,853 million, showing a 14 per cent increase. Recurrent expenditure, including expenditure under

advance accounts, amounted to Rs. 12,530 million, and capital expenditure comprised the balance Rs. 8,991 million. When compared with the year before, while recurrent expenditure rose by 2 per cent, capital expenditure rose more, by 36 per cent. However, as a ratio of GNP, the total government expenditure decreased from 49 to 42 per cent. The share of recurrent expenditure in the GNP decreased from 32 to 25 per cent, while the ratio of capital expenditure rose from 17 to 18 per cent. Government revenue rose by 9 per cent from Rs. 11,688 million in 1978 to Rs. 12,730 million in 1979. However, the ratio of revenue to GNP decreased from 30 to 25 per cent.

Summary of fiscal operations for the year 1979 and approved estimates for 1980 are shown in Table 1.23. The resultant net cash deficit on account of the government fiscal operations for 1979 is shown in Table 22 of the Statistical Appendix, along with the comparable data for last ten years.

Revenue

According to provisional data, government revenue in 1979 amounted to Rs. 12,730 million, registering a 9 per cent increase over the preceding year's revenue of Rs. 11,688 million. Nearly 77 per cent of the total revenue of 1979 was derived from indirect taxes on production and expenditure, a slight reduction over last year's 79 per cent.

Export duties alone of Rs. 4,168 million contributed as much as 42 per cent of the total indirect tax revenue. On the whole, export duty collections showed a marginal decline of about 2 per cent over the preceding year, mainly on account of lower collections from tea and coconut. The decrease in respect of tea of Rs. 286 million was largely due to the lowering of export duty and the marginal decline in export volume. With regard to coconut kernel products, the decrease in duty collection was mainly on account of a change in the composition of exports - a shift from desiccated coconut to coconut oil. Duty receipts from rubber showed a significant increase of about 24 per cent, despite a decline in export volume, largely on account of higher prices. Export duties on minor exports dropped by 9 per cent, mainly on account of a reduction in rates.

Import duties comprised the next major item of revenue, accounting for 23 per cent of the total tax revenue realized from production and expenditure. Compared with last year, import duty receipts increased by 55 per cent, netting a total collection of Rs. 2,271 million, largely owing to the substantial increase in imports.

In a context of higher economic activity amidst price inflation, the revenue receipts from general sales and turnover tax (BTT) showed an increase of 26 per cent, after deducting arrears of Rs. 128 million from the preceding year's receipts and Rs. 14 million from current year's. Selective sales tax receipts recorded a marginal increase of 1 per cent, with a total collection of Rs. 1,907 million. Despite the increase in excise taxes on liquor, receipts showed a 10 per cent decline, realizing a revenue of Rs. 498 million, when compared with Rs. 555 million last year. This decrease was artificial, as previous year's collections included certain arrears. Tea tax (ad-valorem) also showed a marked decline of about 56 per cent. While excise collection on tobacco showed an increase of 6 per cent, with a total receipt of Rs. 801 million, collections relating to administrative levy on coconut kernel products reflected a more than five-fold increase, with a total revenue of Rs. 385 million, when compared with last year's meagre revenue of Rs. 60 million. This sharp increase was on account of the widening of coverage of the administrative levy to include all coconut kernel products since August, and also due to increased export prices.

TABLE 1.23
Government Fiscal Operations 1976-1980

Rs. Million

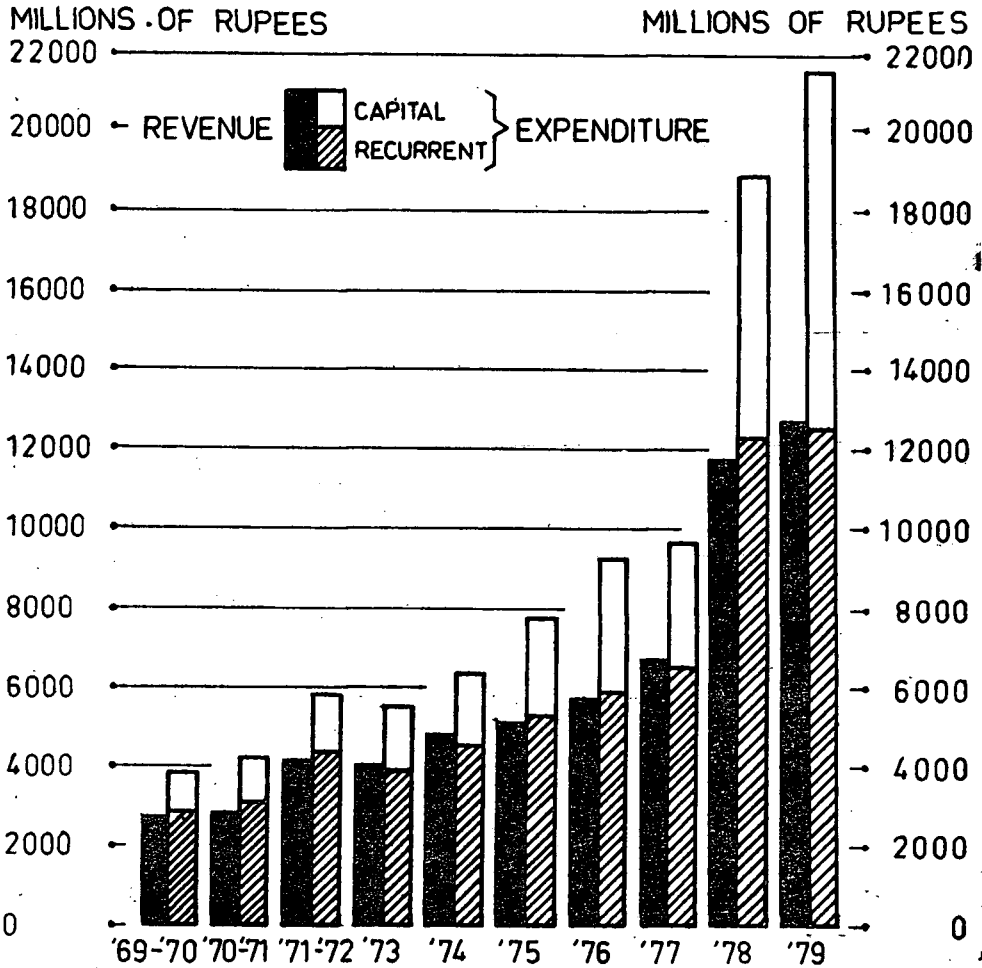
Item	1976	1977	1978	1979 Approved Estimates	1979 Provi- sional	1980 Approved Estimates
1. Revenue(a)	5,739	6,686	11,688	11,429	12,730	12,262
2. Recurrent Expenditure	5,554	6,148	10,408	10,734	11,502	11,119
3. Advance Accounts operations (deficit-/surplus+)	- 312	- 430	-1,831	+ 200	-1,028	- 100
4. Current Account (Surplus+/-/deficit-)	- 128	+ 108	- 551	+ 895	+ 200	+ 1,043
5. Capital Expenditure Of which: Sinking Fund and Amortization payments and contributions to International Financial Organisations	3,448 (662)	3,182 (947)	6,614 (1,165)(b)	7,195 (1,328)	8,991 (1,182)(b)	9,963 (1,346)
6. Budget Deficit	3,576	3,074	7,165	6,300	8,791	8,920
7. Financing the Deficit						
7.1 Domestic Sources	2,284	1,786	2,653	1,950	4,589	3,100
(a) Non-bank market borrowing	1,160	1,504	2,033	1,950	2,806	3,100
(b) Non-Market borrowing	485	505	453	—	1,103	—
(c) Banking system(e)	639	- 224	167(d)	—	680(d)	—
7.2 Foreign Finance	1,326	1,779	4,454	4,350	4,229	5,820
(a) Commodity Loans	633	885	1,371	2,200	1,434	2,420
(b) Project Loans	327	394	1,645	2,150	813	3,100
(c) Grants	367	500	661		1,383	
(d) Other loans(e)	—	—	778		599	
7.3 Use of cash balances	- 33	-492	58	—	- 28	—
8. Expansionary impact of Government fiscal operations	605	- 715	173	—	634	—

Sources: Central Bank of Ceylon,
 General Treasury.

- (a) Exclude Capital grants in Revenue, shown under Foreign grants.
 (b) Includes repayment of foreign administrative borrowings of Rs. 174 million in 1978 and Rs. 178 million in 1979.
 (c) Includes Special Advances from Central Bank to meet contributions to international financial organizations.
 (d) Not adjusted for repayments of rupee loans of Rs. 52 million in 1978 and Rs. 18 million in 1979 to the banking system.
 (e) IMF Trust Fund Loan.

GOVERNMENT REVENUE & EXPENDITURE

DATA BY FINANCIAL YEARS*



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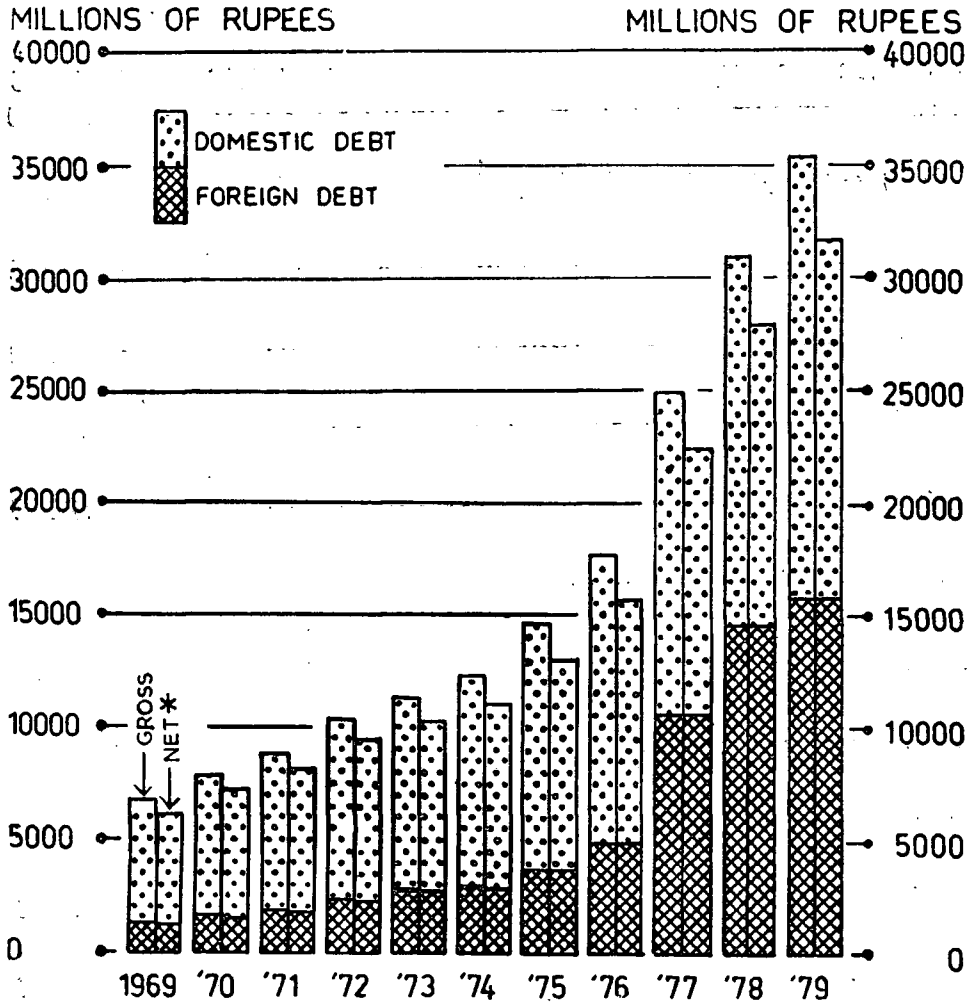
[Sources: General Treasury, Central Bank of Ceylon

* Financial years upto and including 1970/71 are for 12 months ending on the 30th September. Financial year 1971/72 relates to 15 months from 1st October 1971 to 31st December 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 organizations) together with expenditure financed from the National Development Reserve and net payments on advance account operations. See also Appendix Table 22.

‡ 1979 figure are provisional

COMPOSITION OF PUBLIC DEBT



Dept. of Economic Research

Source: Central Bank of Ceylon

* Gross Public Debt less Sinking Funds
1979 Figures are provisional

Tax receipts from corporate and non-corporate incomes showed a 17 per cent increase, with a receipt of Rs. 1,289 million. Other receipts, comprising licence and property transfer taxes, interest, dividends and profits, gross receipts from trading enterprises, sales and charges, capital receipts etc., showed an increase of 18 per cent, with a receipt of Rs. 1,794 million. This included a sum of Rs. 138 million, being proceeds of gold received from the IMF.

Indirect taxes on production and expenditure accounted for nearly three-fourths of total revenue. Of these, 72 per cent was derived from Sri Lanka's external trade. This trade related tax revenue also accounted for 55 per cent of total revenue, revealing a substantial dependence of the budget on foreign trade. Thus, domestic fiscal operations can be greatly affected by adverse price fluctuations in the international markets, which can impose serious constraints on the budgetary programme, as was evident in the latter half of 1979, when export duties on tea had to be reduced to relieve the industry. Further, growing importance of indirect taxes as a proportion of total revenue also has its bearing on the subject of tax incidence. Though benefits of public expenditure have also to be taken into account when issues of tax incidence are discussed, there is no ambiguity that all indirect taxes, in one form or the other, have a built-in-element of regressivity, especially in a context where there is skewed distribution of income. Therefore, if the indirect tax rates are determined with reference to the tax incidence on different income groups, the element of regressivity can be mitigated to a very great extent.

Taxes on corporate and non-corporate incomes accounted for only 10 per cent of the total receipts, while there was a 17 per cent growth in revenue over 1978, which was of the same magnitude as in the previous year. Given the 22 per cent growth in GNP at current prices in 1979, and the evidence of worsening of income distribution referred to elsewhere, the slow growth of direct tax revenue could be deemed as unsatisfactory. It is quite apparent that over-generous tax holidays and capital allowances have contributed to this situation, and this in turn would have affected income distribution adversely.

Recurrent Expenditure

Total recurrent expenditure, including net outpayments on advance accounts, amounted to Rs. 12,530 million, reflecting an increase of 2 per cent. excluding the advance accounts payments, the recurrent expenditure showed an increase of 11 per cent.

Recurrent expenditure, less those incurred under advance accounts, amounted to Rs. 11,502 million, of which, personal emoluments accounted for nearly 30 per cent with a total of Rs. 3,275 million. The interest payment on public debt amounted to Rs. 1,634 million, reflecting an increase of 22 per cent. The original food subsidy of Rs. 2,333 million has been scaled down to Rs. 1,705 million, with the commencement of the Food Stamp Scheme from September. However, the cost of the Scheme for the remaining period has been estimated at Rs. 510 million. Thus, saving on food subsidies in 1979 would be in the region of Rs. 118 million. According to provisional data, production oriented subsidies in respect of fertilizer, fisheries, the National Milk Board and green leaf tea amounted to Rs. 728 million. The subsidy to the National Savings Bank has been estimated at Rs. 113 million.

Though the position relating to advance accounts operations seemed to be better than that of the preceding year, it yet reflected a situation wherein about 8 per cent of recurrent expenditure has come to be financed outside the normal

budgetary provisions. Increased cost of goods and services, maintenance of higher stocks with greater volume of activities, would necessitate additional outlays on such operations. Major increase was with regard to government departments, amounting to Rs. 803 million, with the Food Commissioner's purchases and distribution account and the Railway department drawing sums of Rs. 371 million and Rs. 147 million, respectively. Loans from advance accounts and surplus balances amounted to Rs. 306 million.

Advance accounts appear to have emerged as a major form of financing government expenditure since 1978, when net outpayments rose to Rs. 1,831 million from the previous year's Rs. 430 million. Advance accounts, which are reportedly not encountered anywhere else in the world, were started in Sri Lanka in the thirties to create a revolving fund, to finance minor government activity in production and trading. Ever since, they have come under severe criticism, as pre-empting parliamentary control of public finance. Theoretically, any government activity which can be reasonably forecast, could be incorporated in the Budget. The Public Corporation form could be adopted, if some financial flexibility has to be provided for state activity. Hence, now that these accounts have come to assume such significance, it may be appropriate to assess whether these accounts should be continued at all in the future.

Under expenditure of recurrent votes in 1979 was in the region of 4 per cent. This compared with 7 per cent last year. This improvement could be largely attributed to the rise in prices.

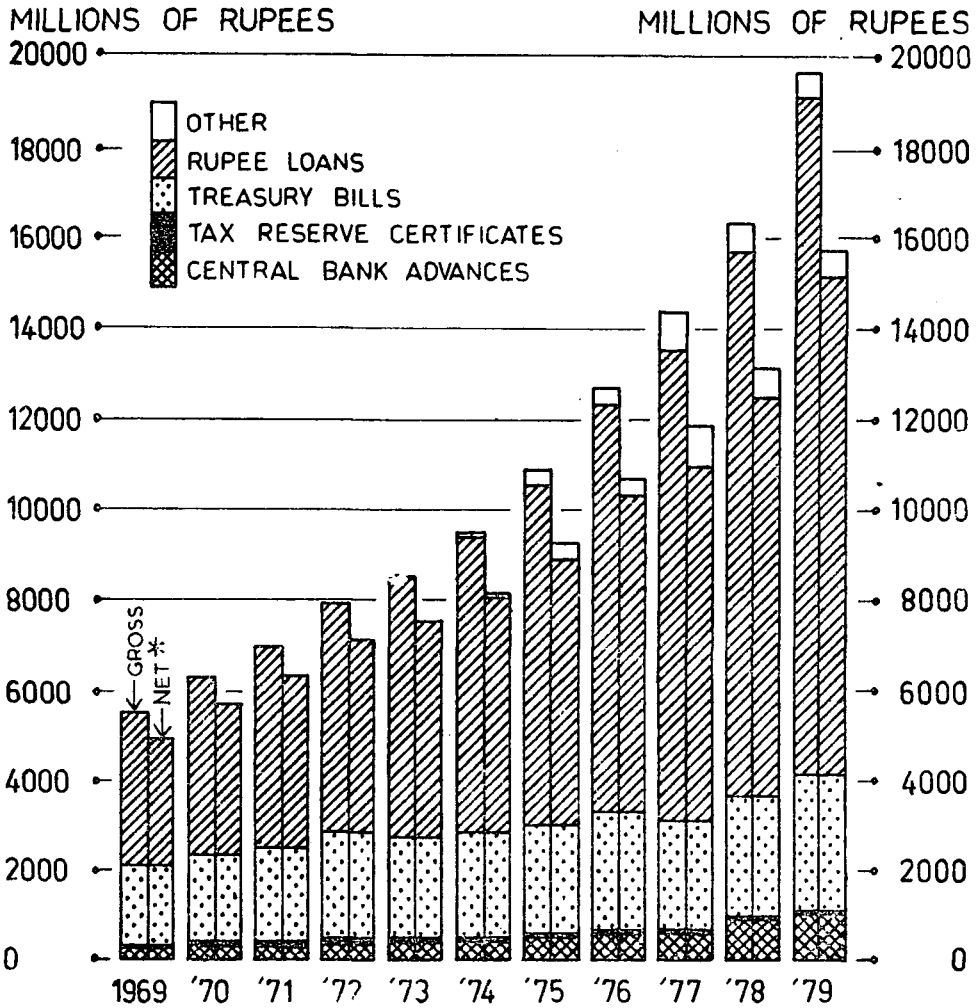
Capital Expenditure

Gross capital expenditure of Rs. 8,991 million in 1979 showed 36 per cent increase over the last year. When provision for debt repayment of Rs. 1,182 million is excluded, capital expenditure of Rs. 7,809 million reflected a 43 per cent increase. During the course of the year, cost escalation and additional activities warranted supplementaries to the extent of Rs. 2,334 million, which enhanced the original budget provision by 32 per cent. Provisional data revealed that there had been an under-utilization of 19 per cent, compared with the adjusted level of under-utilization of 22 per cent in 1978.

Ministries of Mahaveli Development (Rs. 1,497 million) and Housing, Local Government & Construction (Rs. 1,224 million) accounted for nearly 35 per cent of the capital expenditure. The Ministry of Industries & Scientific Affairs accounted for Rs. 690 million, largely in respect of the Urea factory. The Transport Ministry accounted for Rs. 815 million, of which 69 per cent was for the Railways for acquisition of rolling stock etc. and the rest went to Sri Lanka Central Transport Board for purchase of bus chassis and construction materials. Capital expenditure of other major ministries were Power & Highways, Rs. 471 million; Finance & Planning, Rs. 590 million; Plan Implementation, Rs. 493 million; Posts and Telecommunication, Rs. 236 million and Fisheries, Rs. 116 million. Sector-wise, agriculture received nearly 26 per cent of the total investment resources.

It is pertinent to note that a greater quantum of funds has been allocated to large scale infra-structure-oriented investments, which would yield results after a long period of gestation. In the short-run, these expenditures would add to money incomes of people, without a commensurate growth in the production of goods consumed by them. This will naturally tend to raise domestic prices, unless the necessary wage goods can be imported, which could then cause severe strain on available foreign exchange resources. Therefore, this type of capital expenditure should be undertaken with a determination to prevent sectoral imbalances. There has to be a judicious apportionment of investment funds between long-gestation and

COMPOSITION OF DOMESTIC DEBT

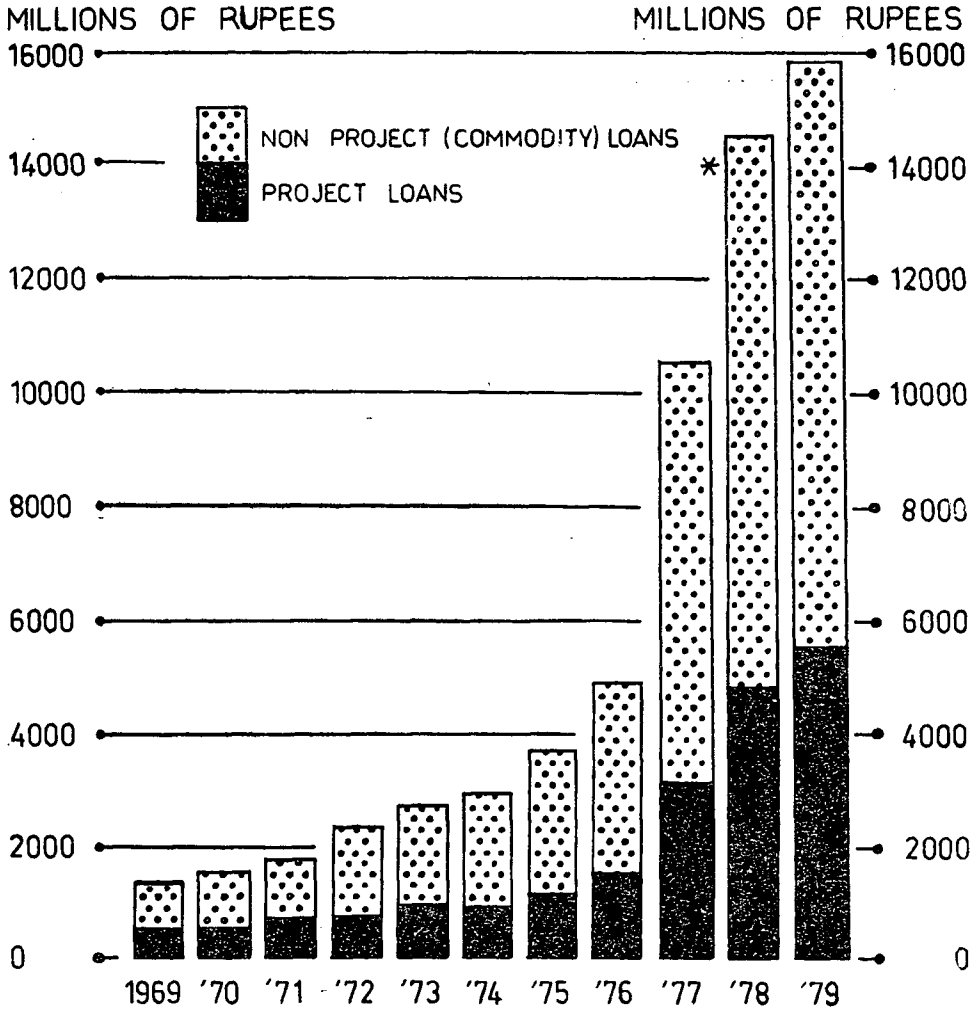


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Source: Central Bank of Ceylon.

* Gross public debt less sinking funds.
1979 figures are provisional.

COMPOSITION OF FOREIGN DEBT



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Source: Central Bank of Ceylon

* 1978 onwards, Non-Project (Commodity) Loans Inclusive of IMF Trust Fund Loan.
1979 figures are provisional.

short-maturing projects, so that one group would not pre-empt resources from the other. Infra-structure related capital expenditure, in the first instance, should be concentrated on those areas which will avert a possible breakdown of on-going current activities, and which will improve their operational efficiency. The emerging pattern of public expenditure seem to indicate the need for closer co-ordination between micro-project planning and macro-economic targets.

Financing of the Budget Deficit

The budget deficit in 1979 amounted to Rs. 8,791 million, in comparison to Rs. 7,165 million in the previous year. To finance this deficit, Government raised Rs. 4,589 million from the domestic sector, while Rs. 4,229 million was obtained from foreign sources as loans and grants.

Domestic loans included Rs. 3,486 million obtained from market sources and Rs. 1,103 million from non-market sources. Market borrowings constituting Rs. 2,950 million was obtained from rupee loans, Rs. 357 million from Treasury bills and Rs. 181 million as Central Bank advances. Contribution to rupee loans were confined to the non-bank sector, while the Government repaid Rs. 18 million of rupee loans held by the banking sector. In the case of Treasury bills, holdings of the banking sector increased by Rs. 495 million, while those of the non-bank sector decreased by Rs. 138 million, reflecting a net increase of Rs 357 million. Net Central Bank advances for the year amounted to Rs. 181 million. The borrowings from the banking sector as a whole thus amounted to Rs. 680 million.

Foreign resources used in financing the budget deficit amounted to Rs. 4,229 million. These included Rs. 813 million of project loans, and Rs. 1,434 million of non-project loans, grants of Rs. 1,383 million, and an IMF Trust Fund loan of Rs. 599 million.

Public Debt

The outstanding gross public debt as at end of 1979 stood at Rs. 35,475 million, reflecting an increase of 15 per cent, in comparison with last year's increase of 24 per cent. While domestic debt amounted to Rs. 19,634 million, foreign debt comprised Rs. 15,841 million.

The gross domestic debt, which included both funded and floating debt, recorded an increase of Rs. 3,267 million. Medium and long-term loans increased by Rs. 2,722 million during the year, compared with an increase of Rs. 1,513 million in the preceding year.

The authorized limit of Government Treasury bills remained unchanged during the year. The total amount of Treasury bills outstanding as at end of December, 1979 amounted to Rs. 3,000 million, recording an increase of Rs. 365 million over the preceding year. The banking sector's holdings of Treasury bills increased from Rs. 2,200 million in 1978 to Rs. 2,706 million in 1979. While Central Bank's share recorded an appreciable increase from Rs. 2,088 million to Rs. 2,656 million, commercial bank holdings decreased from Rs. 112 million to Rs. 50 million. Provisional advances to the Government by the Central Bank increased by Rs. 181 million, and the total outstanding liability as at end of the year amounted to Rs. 1,137 million. The overall short-term rupee debt increased by Rs. 545 million, with an outstanding liability of Rs. 4,165 million.

Fourteen rupee loans totalling to Rs. 2,950 million were floated. These loans were of a maturity period of 10 to 12 years, and carried a rate of interest of 10 per cent per annum. The National Savings Bank, Sinking Fund and Employees'

Provident Fund continued to be the major subscribers to rupee loans. The NSB increased its relative share of contribution from 22 per cent in 1978 to 38 per cent in 1979, owing to increased fixed deposits with the bank. Though the Employees' Provident Fund increased its contribution during the year by 45 per cent, its relative share fell from 33 to 28 per cent. With regard to administrative borrowings, there was a repayment of Rs. 164 million, thereby reducing the outstanding liability to Rs. 540 million. The total outstanding liability of long and medium domestic debt thus rose to Rs. 15,470 million in 1979.

The total foreign debt outstanding as at end of 1979 recorded an increase of Rs. 1,258 million or 9 per cent, compared with the preceding year's increase of Rs. 3,988 million. The total foreign debt outstanding consisted of project loans (Rs. 5,570 million), commodity loans (Rs. 8,901 million) and IMF Trust Fund loans (Rs. 1,370 million). The outstanding liability was greatly reduced on account of remission by creditors to the extent of Rs. 804 million. The U.K. government wrote off debts to the tune of Rs. 792 million. Exchange rate variations in favour of Sri Lanka also reduced the liability by about Rs. 316 million. In 1979, gross receipts of foreign loans amounted to Rs. 2,878 million, comprising project loans of Rs. 857 million, commodity loans of Rs. 1,422 million and IMF Trust Fund loan of Rs. 599 million. With a repayment of Rs. 499 million, the net transfer of resources amounted to Rs. 2,379 million.

The major sources of project loans during the year were, Netherlands (Rs. 188 million), International Development Association (Rs. 181 million), Asian Development Bank (Rs. 160 million), United States of America (Rs. 144 million), Federal Republic of Germany (Rs. 52 million), India (Rs. 35 million), International Bank for Reconstruction and Development (Rs. 33 million) and Kuwait (Rs. 26 million). Major donors of commodity loans were United States of America (Rs. 473 million), Japan (Rs. 398 million), Federal Republic of Germany (Rs. 250 million), India (Rs. 113 million), Canada (Rs. 96 million) and France (Rs. 90 million).

When compared with last year, the proportion of foreign loans in the total public debt declined from 47 to 45 per cent, due to remissions by creditors and favourable exchange rate changes. Unlike last year, there was a decreasing dependence on foreign resources to finance the budget deficit. As a percentage of the deficit, foreign resources amounted to 48 per cent in 1979, when compared with last year's share of 62 per cent.

The domestic debt service ratio (public debt service payments as a ratio of government revenue) increased from 14 per cent in 1978 to 15 per cent in 1979, as the rate of increase of revenue was only 9 per cent, when compared with the rate of growth of domestic debt by 20 per cent.

MONEY AND BANKING

The healthy containment of monetary expansion within a manageable limit of 11 per cent in 1978 was negated in 1979, when money supply grew by 29 per cent. This was largely the result of growth in external banking assets (net) and in credit to government. In continuation of the trends observed since the 1977 interest rate reforms, there was continued acceleration of deposit mobilization by commercial banks; time and savings deposits alone rising by Rs. 2,483 million, as compared with a rise of Rs. 1,572 million in 1978. Despite relatively high interest rates, demand for credit remained high. Commercial bank branch expansion accelerated in 1979, although the reorganization of the Agricultural Service Centre branches of the Bank of Ceylon would have led to a decline in the spread of banking activity; and three new foreign banks opened in Colombo.