Debt amortization, which includes capital and interest payments in respect of all long-term foreign loans, suppliers' credit and repurchases (repayments) and service charges to the IMF also rose from Rs. 2,383 million (SDR 118 million) in 1979 to Rs. 2,763 million (SDR 137 million) in 1980. Despite this increase in debt amortization by 16 per cent, the debt service ratio declined from 13 per cent in 1979 to 12.4 per cent in 1980. This was due to higher earnings on merchandise exports and services which totalled Rs. 22,316 million (SDR 1,037 million) in 1980, as compared with Rs. 18,275 million (SDR 908 million) in 1979, reflecting an increase in gross foreign exchange earnings by 14 per cent. A further major contributory factor for the fall in the debt service ratio in 1980 was the re-emergence of short-term trade credit as a means of financing imports. A substantial part of oil imports in 1980 was financed on short-term trade credit. These were not reflected under amortization, as they were essentially of a very short-term nature. A further reason was the fact that official long-term debt contracted in the recent past was on more concessional terms, providing long periods of grace.

GOVERNMENT FISCAL OPERATIONS[1]

The fiscal operations of the Government in 1980 stimulated a very high level of aggregate demand in the economy with far reaching consequences on the growth of money supply and the price level on the one hand, and on the exchange rate and external payments position on the other. To an appreciable extent these developments in 1980 were the result of a failure to pursue a policy of fiscal stabilisation through conscious fiscal discipline. There were many pressures, both within and outside the control of Government, which made adherence to a strict budgetary programme and fiscal discipline a formidable task. Voted estimates of expenditure were frequently revised in the course of the fiscal year to accommodate additional commitments as well as cost escalations. Additional expenditures incurred by Ministries, not previously programmed and provided for, were covered through supplementary estimates. These increases in expenditure would not have caused strains on budgetary operations, such as were discernible during the year, had there been a commensurate growth in government revenue and financing resources. Relief from these latter sources was barely forthcoming. The growth of revenue seriously lagged behind the growth of expenditure.

The heightened level of trading and economic activities pursued in the private sector and the alignment of deposit rates of commercial banks with those offered by the National Savings Bank pre-empted savings that otherwise would have been available to finance the budgetary deficit in 1980. The flow of foreign resources channelled to the budget was inadequate to finance the resource gap with the result that the Government, trapped in a resource constraint of major proportions was compelled to resort to bank finance on an unprecedented scale.

The revised budget deficit in 1980 revealed a spectacular increase of 71 per cent over the approved original estimates. The increase in government revenue in 1980 approximated a meagre 12 per cent over the approved estimates as against an increase of 37 per cent in expenditures over the original budget estimate. The growth of capital and recurrent expenditure over the original budget estimate, both in absolute and relative terms, thus far exceeded the growth in revenue. The wide disparity between the relative rates of growth of revenue and expenditure, typifies the magnitude of the problem that emerged in fiscal management. Total government expenditure at Rs. 29,026 million in 1980 reflected an increase of 35

1. Based on provisional estimates. All data subject to revision when government accounts are finalised.

TABLE 1.31

Government Fiscal Operations 1977 - 1981

Rs. Million

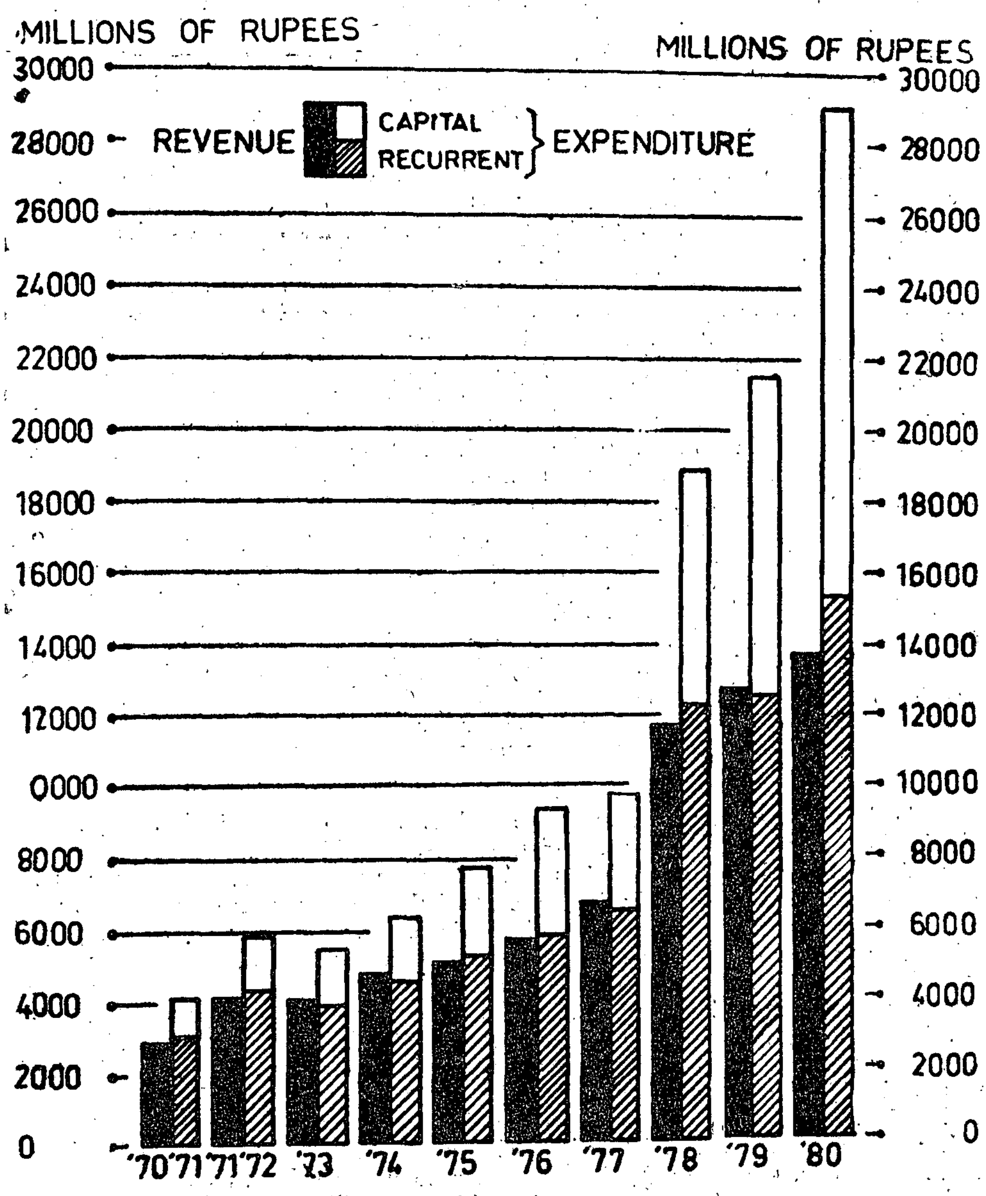
Item	1977	1978	1979	1980 Approved Estimates	1980 Estimated Outturn	1981 Approved Estimates
1. Revenue (*a*)	6,686	11,688	12,730	12,262	13,756	15,550
2. Recurrent Expenditure	6,148	10,408	11,502	11,119	13,558	15,332
3. Advance Accounts Operations (deficit – /Surplus +) ..	– 430	– 1,831	– 1,028	– 100	– 1,775	+ 675
4. Current Account (Surplus + /Deficit –)	+ 108	– 551	+ 200	+ 1,043	– 1,577	+ 893
5. Capital Expenditure	3,182	6,614	8,991	9,963	13,693	12,739
Of which: Sinking Fund and Amortization payments and contributions to International Financial Organisations ..	(947)	(1,165)(*b*)	(1,182)(*b*)	(1,346)	(1,502)(*b*)	(1,620)
6. Budget Deficit	3,074	7,165	8,791	8,920	15,270	11,846
7. Financing the Deficit						
7.1 Domestic Sources	1,786	2,653	4,582	3,100	8,885	3,750
(a) Non-bank market borrowing	1,504	2,033	2,806	3,100	2,692	3,750
(b) Non-market borrowing	505	453	1,096	—	– 884	—
(c) Banking system (*c*)	– 224	167(*d*)	680(*d*)	—	7,077(*d*)	—
7.2 Foreign Finance	1,779	4,454	4,237	5,820	6,253	8,100
(a) Commodity loans	885	1,371	1,434	2,420	1,432	
(b) Project loans	394	1,645	813		1,171	
(c) Grants				3,100		8,100
(d) Other loans (*e*)	500	661	1,390		2,137	
		778	599	300	1,513	
7.3 Use of cash balances	– 492	58	– 28	—	133	– 4
8. Expansionary Impact of Government Fiscal Operations ..	– 715	173	634	—	7,185	– 4

Sources: Central Bank of Ceylon
General Treasury.

(a) Excludes capital grants in revenue, shown under foreign grants.
(*b*) Includes repayment of foreign administrative borrowings of Rs. 174 million in 1978, Rs. 178 million in 1979 and Rs. 271 million in 1980 (Estimated outturn)
(*c*) Includes Special Advances from Central Bank to meet contributions to international financial organisations.
(*d*) Not adjusted for repayments of rupee loans of Rs. 52 million in 1978. Rs. 18 million in 1979 & Rs. 25 million in 1980 to the banking system.
(*e*) IMF Trust Fund loan. Other loans in 1980, Estimated outturn, include IMF Trust Fund Loan of Rs. 521 million, the Euro Currency commercial loan of Rs. 897 million and Iraq loan of Rs. 95 million.

GOVERNMENT REVENUE & EXPENDITURE

DATA BY FINANCIAL YEARS*



Central Bank of Ceylon.

* Financial year 1970/71 is 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 frcm 1973 relate to the year ending 31st December.

† 1980 figures are provisional.

per cent over the previous year. Consequently, the share of government expenditure in Gross National Product, in nominal terms, increased to 47 per cent in 1980 as against 43 per cent in 1979.

Advance accounts operations resulted in a net out-payment of Rs. 1,775 million considerably in excess of what had been envisaged in the original estimate. The outcome was largely due to the trading operations of the Food Commissioner. Furthermore, outstanding liabilities and expenditure commitments under administrative borrowings amounting to Rs. 891 million at end of 1979 were settled from resources accruing in 1980. The problems of cash management were aggravated by a shortfall in the targetted finances from the domestic non-bank sector.

According to revised estimates, the current account registered a deficit of Rs. 1,577 million in 1980 as against a surplus of Rs. 200 million in the previous year. Had it not been for the heavy outpayments under advance accounts, the current receipts at Rs. 13,756 million would have accommodated the current payments amounting to Rs. 13,558 million as well as revealed a small surplus. Thus, the net advance accounts out-payments at Rs. 1,775 million denied a possible surplus in the current account. When compared with the previous year the share of government receipts in the GNP (nominal) declined from 26 to 22 per cent in 1980. Further, while GNP (nominal) recorded a growth of 25 per cent over the preceding year, government revenue registered a meagre growth of 8 per cent exhibiting a lack of buoyancy in relation to the growth in money incomes in the economy. Recurrent expenditure including net advance accounts payments at Rs. 15,333 million in 1980 showed an increase of Rs. 2,803 million or 22 per cent. However, recurrent expenditure as a share in the GNP was 25 per cent in 1980 as was in 1979. Capital expenditure including sinking fund contributions and debt repayments at Rs. 13,693 million, was 52 per cent higher than the preceding year's expenditure. The share of capital expenditure in GNP increased from 18 per cent in 1979 to 22 per cent in 1980. With the current account deficit at Rs. 1,577 million and the capital budget commitment at Rs. 13,693 million, the total budget deficit amounted to Rs. 15,270 million in 1980, recording an increase of 71 per cent over the approved budget deficit and a 74 per cent increase over the deficit of the previous year. The budget deficit registered in 1980 was 25 per cent of nominal GNP.

To finance the resource gap in the budget a sum of Rs. 16,162 million was obtained both from domestic and foreign sources. Of this amount, Rs. 891 million was utilized to settle deposit transfers and outstanding expenditure commitments of 1979. In gross terms, nearly 61 per cent of the total resources amounting to Rs. 9,909 million was obtained from domestic sector. Of this amount Rs. 7,077 million or 71 per cent was contributed by the banking sector. Domestic savings mobilized in 1980 amounted to Rs. 2,692 million or 27 per cent of total domestic resources, and financed 18 per cent of the budget deficit. Foreign assistance at Rs. 6,253 million accounted for 39 per cent of the total resources mobilized in 1980 and financed 41 per cent of the budget deficit. The major share of foreign assistance was received in the form of grants amounting to Rs. 2,137 million, while commodity and project loans amounted to Rs. 1,432 million and Rs. 1,171 million, respectively. Other foreign finances amounting to Rs. 1,513 million consisted of IMF Trust Fund loan (Rs. 521 million), Euro currency commercial loan (Rs. 897 million) and a loan from the Government of Iraq (Rs. 95 million). With the banking sector providing a sum of Rs. 7,077 million towards financing the overall budget deficit and a drawing down of cash balances totalling Rs. 133 million, the net expansionary impact of government fiscal operations in 1980 was in the region of Rs. 7,185 million as against Rs. 634 million in 1979.

A summary of fiscal operations for the year 1980 and approved estimates for 1981 are given in Table 1.31. The net cash deficit on account of the government fiscal operations for 1980 is shown in the Statistical Appendix, along with comparable data for the past 10 years.

Revenue

Government revenue in 1980 has been estimated at Rs. 13,756 million, indicating an increase of 8 per cent over the preceding year. Indirect taxes on production and expenditure at Rs. 10,126 million showed an increase of Rs. 381 million or 4 per cent and comprised 74 per cent of total revenue receipt as against 77 per cent in 1979. As in the preceding years, external trade based taxes formed the principal component of the total indirect tax collections and its share when compared with the previous year, declined from 72 to 65 per cent. Direct taxes in 1980 amounted to Rs. 1,906 million revealing an increase of Rs. 495 million or 35 per cent over 1979. As a proportion of total revenue the share of direct taxes increased from 11 per cent in 1979 to 14 per cent in 1980.

When the total revenue is examined in relation to the performance in the overall economy, the revenue growth of 8 per cent is not impressive. Both the revenue/GNP ratio and the tax/GNP ratio declined during the year. While the revenue ratio declined from 26 to 22 per cent, the tax ratio decreased from 23 to 19 per cent, revealing a situation in which the rate of growth of incremental of overall revenue receipts including tax revenues failed to keep pace with the incremental rate of growth of national income. For instance, based on rough annual estimates a calculation of revenue elasticity with respect to national income revealed a coefficient of 0.289 for 1980 as against 0.322 for 1979 implying a reduced sensitivity of incremental revenue to increasing money income growth. It is important that the tax structure should not only raise adequate resources for the public sector but revenue also should expand at least in proportion to the increase in national income in order to finance a continuously expanding programme of investment.

The relative share of indirect taxes in a total revenue declined from 77 to 74 per cent, while the share of business turnover tax in the total indirect tax revenue increased from 12 to 17 per cent on account of a 44 per cent increase recorded in the business turnover tax collections. Increased receipts from business turnover taxes were due to an upward revision in the tax rates, the higher level of economic activity and the prevalent inflationary impulses in the economy. As far as tax incidence is concerned, indirect taxes exhibit a higher degree of regressivity. However, the exemption of wage of mass consumption goods like rice, flour and sugar from the business turnover tax somewhat minimised the extent of regressivity. Even with regard to import duties, a measure of tax progressivity has been introduced by levying duty rates in line with end use and the demand pattern relating to commodities.

The share of international trade oriented taxes declined from 55 to 48 per cent, largely due to a reduction in receipts from tea export taxes. Export duties formed the principal items of revenue in the production and expenditure oriented indirect taxes, accounting for 36 per cent of receipts as against the previous year's share of 43 per cent. Total collections from export duties decreased by Rs. 537 million or 13 per cent. In comparison to the previous year, duty collections from tea and coconut decreased by Rs. 530 million or 21 per cent and Rs. 127 million or 38 per cent, respectively. The reduction in duty receipts from tea was largely due to a downward revision in the specific export duty on bulk tea from Rs. 15.50 to Rs. 10.50 per kg., effective from July, 1979. The marginal decline in the volume of export by 3 million kgs. and the downward revision in duty of tea exported in packets and bags as from July, 1980 also contributed to the drop in revenue. With regard to coconut, which is also subject to a specific quantity based duty, the decrease was mainly due to a fall in the volume of exports, by 55 per cent and a drop in domestic production. On the other hand, despite a decrease in the volume of exports caused by a fall in domestic production, duty collections from rubber, where the duty rate is on a sliding scale, recorded an increase of Rs. 99 million or 8 per cent owing to higher export prices.

Though some of the minor export products such as cardamom, cocoa and citronella oil were exempted from export duty in November, 1979, the duty collected from minor exports increased by Rs. 21 million or by 21 per cent to Rs. 120 million. Coir fibre, one of the principal minor export products despite a marginal decline in the volume of exports contributed a sum of Rs. 58 million as export duties due to favourable export prices. Higher export prices also enabled a sum of Rs. 22 million to be collected as duties from cinnamon exports. In the case of graphite very favourable export prices enabled a contribution of Rs. 20 million as duties on an export turnover of Rs. 79 million despite a 41 per cent reduction in domestic production.

Import duties while being the second major item of revenue with a share of 27 per cent in the total indirect tax collections also accounted for 20 per cent of the total revenue receipt. Current import duty receipts of Rs. 2,754 million showed a 21 per cent increase over the previous year. However, the average rate of duty declined from 10 to 8 per cent. In other words, the incremental rate of growth of import revenue failed to keep pace with the incremental growth in the value of imports. In value terms imports increased by 49 per cent but import revenue expanded only by 21 per cent. This was mainly due to a substantial increase in the import value of non-dutiable goods like petroleum, fertilizer and government sector investment goods imports. Excluding identifiable imports such as rice, flour, sugar, petroleum and fertilizer, the average duty rate remained constant at 12 per cent when compared with the previous year.

Selective sales taxes, also a major item among indirect taxes recorded a reduction. Its share among indirect tax revenue declined from 20 to 18 per cent, while the share among total revenue decreased from 15 to 13 per cent. In absolute terms, collections from selective sales taxes recorded a fall of 7 per cent or Rs. 134 million. The outcome was due to lower receipt from tea ad-valorem tax and administrative levy on coconut kernel products. The decrease of Rs. 125 million from tea ad-valorem tax was due to the lowering of the tax rates and the upward revision of the price at which tax becomes operative. In the case of the administrative levy on coconut kernel products, the decrease was Rs. 275 million or 71 per cent resulting from a drop in the volume of exports of 55 per cent and an upward revision of the operative price. Excise on tobacco and liquor both recorded increased receipts. While receipts from excise on tobacco at Rs. 993 million showed an increase of Rs. 192 million or 24 per cent, receipts from liquor at Rs. 572 million registered an increase of Rs. 74 million or 15 per cent. The relevant increases were mainly on account of the upward revisions of excise duties relating to tobacco and liquor.

Total collections from direct taxes at Rs. 1,906 million showed an increase of Rs. 496 million or 35 per cent. Though disaggregated data are not available, it is evident that the increase was mainly caused by higher receipts accruing from the corporate sector. While the share of direct taxes in the total revenue receipts increased from 11 to 14 per cent, the proportion of direct taxes to GNP (nominal) also recorded a marginal increase from 2.8 to 3.1 per cent.

Recurrent Expenditure

According to latest estimates, the total recurrent expenditure including net out payments on advance accounts and supplementaries amounted to Rs. 15,333 million in 1980 showing an increase of 22 per cent over the previous year. In this total is included total supplementaries on recurrent votes amounting to Rs. 2,489 million and net outpayments on advance accounts of Rs. 1,775 million.

While personal emoluments and pensions amounting to Rs. 3,730 million and Rs. 735 million recorded an overall increase of 12 and 28 per cent respectively, its total share in the total recurrent expenditure decreased marginally from 31 to 29 per cent. Interest on public debt which amounted to Rs. 2,282 million showed an increase of 34 per cent, mainly due to higher interest payments on Treasury bills and rupee securities.

Though the interest subsidy to the National Savings Bank at Rs. 258 million in comparison to last year's payment of Rs. 92 million showed a three-fold increase, when adjusted for lags in last year's payment, the actual increase amounted to Rs. 36 million or 16 per cent.

The Income Support Scheme which came into operation in 1978 was withdrawn as from July, 1980 and unexpended monies in the original allocation of Rs. 230 million were transferred to the decentralised budget. Expenditure on the Food and Kerosene Stamps Scheme, which substituted a consumer price subsidy with direct income transfers amounted to Rs. 1,595 million and Rs. 182 million, respectively. However, in the case of infant milk food, there was a price subsidy, where the estimated expenditure was Rs. 105 million as against last year's expenditure of Rs. 75 million. The decision to distribute free text books among all school children in government schools necessitated a new vote on recurrent expenditure amounting to Rs. 73 million. The subsidy provision under the price support scheme for tea which guaranteed a minimum producer price amounted to Rs. 65 million. The total import duty rebate has been estimated at Rs. 350 million as against last year's payment of Rs. 140 million. The increase was mainly on account of a substantial increase in the value of garment exports which qualified for rebates on the duty paid on raw material imports.

The total amount transferred to semi-government entities or corporations during the year has been provisionally estimated at Rs. 1,722 million as against last year's transfer of Rs. 914 million. Transfers of current funds to semi-government entities were due to varied reasons. There was, firstly, the normal transfer to non-profit oriented semi-government entities to meet current commitments. Secondly, there were transfers of funds due to policy decisions such as the maintenance of certain subsidy schemes, and thirdly there were transfers relating to the reimbursement of losses. The increase in the transfer of current funds was mainly caused by higher payments made to the State Fertilizer Corporation and the Sri Lanka Transport Board (SLTB). The transfer of Rs. 800 million as against last year's payment of Rs. 395 million to the State Fertilizer Corporation was on account of the fertilizer subsidy. In the case of Sri Lanka Transport Board in comparison to last year's payment of Rs. 85 million, during the year a sum of Rs. 457 million was transferred for reimbursement of operational losses. The transfer of Rs. 53 million to the National Milk Board was due to the maintenance of a producer subsidy scheme. Under the subsidy scheme, a sum of Rs. 29 million was also transferred to the Paper Corporation. Under the category of non-profit oriented entities, the main recipients were, Universities and University Grants Commission (Rs. 109 million), Tourist Board (Rs. 49 million), National Apprenticeship Board (Rs. 41 million) and National Youth Service Council (Rs. 30 million).

Advance Accounts

Expenditure on advance account operations during the year amounted to Rs. 1,775 million as against Rs. 1,028 million in the preceding year. This accounted for nearly a 13 per cent of the total recurrent expenditure in 1980. In the previous year it was 9 per cent. With a net out payment amounting to Rs. 1,525 million, Food Commissioner's food purchase and distribution operations constituted a major part of the expenditure on advance account activities. The balance was accounted by the other advance accounts. Based on tentative data the operations relating to Sri Lanka-China Trade account would have resulted in a net out payment (expenditure) amounting to Rs. 208 million. Increased cost of goods and services and increased activities, losses on advance account activities which were not compensated with counterpart voted expenditure and increased loan facilities to state officers necessitated greater recourse to advances. Increased import prices, particularly sugar and wheat flour were primarily responsible for the heavy out payments on Food Commissioner's advance account. Expenditure on Food Commissioner's account also included trading losses and increases in trade debtors. The original budget, however, made allowance for only a sum of Rs. 100 million on all advance account activities. Therefore, for the third successive year, advance account operations continued to be a major element of budgetary disturbance. Previous reports and reviews focussed attention on this problem and emphasised the need to adjust budgetary format so that advance account activities could be explicitly by incorporated in the annual budget.

Capital Expenditure

Total capital expenditure including supplementaries amounted to Rs. 13,693 million, recording an increase of Rs. 4,702 million or 52 per cent over last year. Supplementary estimates amounted to Rs. 3,801 million, registering a 31 per cent increase over the original estimate. Net of Sinking Fund contributions and loan repayments , total capital expenditure was Rs. 12,191 million as against last year's expenditure of Rs. 7,809 million, recording an increase of 56 per cent. Sinking Fund contributions and loan repayments at Rs. 1,502 million showed an increase of Rs. 320 million over last year.

Due to non-finalisation of government accounts, acutual expenditure has not been ascertained as yet. With original estimates and the subsequent supplementaries matched against the total resource mobilization, it has been possible to obtain a tentative estimate on the extent of under-expenditure in the overall capital account. Accordingly, the derived rate of under-expenditure is 15 per cent. Net of sinking fund contributions and debt repayments, the net capital expenditure during the year recorded an increase of 56 per cent. It is pertinent to note in this regard, that capital expenditure data can only quantify the extent to which financial targets of expenditure have been acheived. Data would not correctly reflect the extent to which physical targets have been met. To realize the latter, Performance Budgeting is required. Particularly, in an inflationary context, capital expenditure data have to be deflated in order to ascertain the real increase. Using the implicit GNP deflator it is seen that the increase in total capital expenditure is around 32 per cent as against the increase of 56 per cent recorded at current prices. While increased capital expenditure is synonymous with investment activities aimed at increasing the capital stock in the country, it is also important to ensure that investment resources are apportioned in such a manner that there exists a meaningful balance between short-term quick yielding projects and long-term high return projects.

A ministry-wise classification of capital expenditure is given in the Statistical Appendix.

Based on provisional data, the actual expenditure on the Mahaveli Project was Rs. 3,137 million as against a total budgetary provision of Rs. 3,500 million, showing an under-expenditure of 10 per cent. In total, a sum of Rs. 439 million was spent on development work connected with Stage I, II, III and of which a sum of Rs. 428 million was spent on Stage II and III. Expenditure on the four major projects in the accelerated programmes amounted to Rs. 2,176 million, with the shares of each project being Victoria (Rs. 901 million), Kotmale (Rs. 862 million), Randenigala (Rs. 30 million) and Maduru Oya (Rs. 383 million). Expenditure on the associated Irrigation Systems amounted to Rs. 350 million, of which sums of Rs. 99 million and Rs. 240 million, were spent on the Irrigation Systems B & C, respectively. The balance sum of Rs. 172 million was spent on Ulhitiya Oya and Moragahakanda Reservoir Projects and the Rotalawela & Kandakadu Irrigation Complex.

The housing programme of the Ministry of Local Government, Housing and Construction, on which a sum of Rs. 1,038 million, was spent, absorbed as much as 48 per cent of the total ministry vote. The most important single item was urban housing programme with an expenditure of Rs. 634 million. Though the electoral housing programme had a provision of Rs. 30 million, actual expenditure amounted to Rs. 167 million. The 'low cost housing programme' and emergency housing programme (Colombo Metropolitan Area) had very high rates of under expenditure. As against allocations of Rs. 23 million and Rs. 22 million, these two programmes utilized Rs. 8 million and Rs. 7 million, respectively. Amounts spent on the aided -self-help housing programme and the model village programme were Rs. 130 million and Rs. 9 million, as against the allocations of Rs. 139 million and Rs. 8 million, respectively. In addition to the housing activities directly undertaken by the Ministry, a sum of Rs. 23 million was also spent by the National Housing Fund.

A sum of Rs. 562 million was spent by the main 'line' ministries on the Sri Jayawardenapura Parliamentary Complex in 1980. The allocation came from several ministries. The Department of Buildings spent Rs. 310 million on the main construction activities. The Reclamation and Development Board spent a sum of Rs. 105 million. The other items of expenditure on the project were Electricity (Rs. 56 million), Highways (Rs. 37 million), Telecommunication Services (Rs. 35 million) and Water Supply and Drainage (Rs. 19 million).

In addition to the 1980 allocation of Rs. 10 million, the GCEC also utilized a sum of Rs. 108 million being the amount transferred to Treasury deposits in 1979. However, actual direct expenditure during the year amounted to Rs. 54 million, which was spent on Investment Promotion Zones (Rs. 13 million), Negombo Town Development (Rs. 11 million), purchase of GCEC building (Rs. 23 million) and capital grants to Local Authorities (Rs. 7 million).

The Decentralized Budget had an allocation of Rs. 420 million and utilized Rs. 413 million. This excludes the expenditure in the Anuradhapura district. The Income Support Scheme was withdrawn in July, 1980 and a part of the allocation under this vote was transferred to the decentralized budget. The main areas of activities under the decentralized budget were education (Rs. 118 million), communication (Rs. 102 million), agriculture and irrigation (Rs. 48 million), Local Government works (Rs. 43 million) and civil administration (Rs. 20 million).

Financing of the Budget Deficit

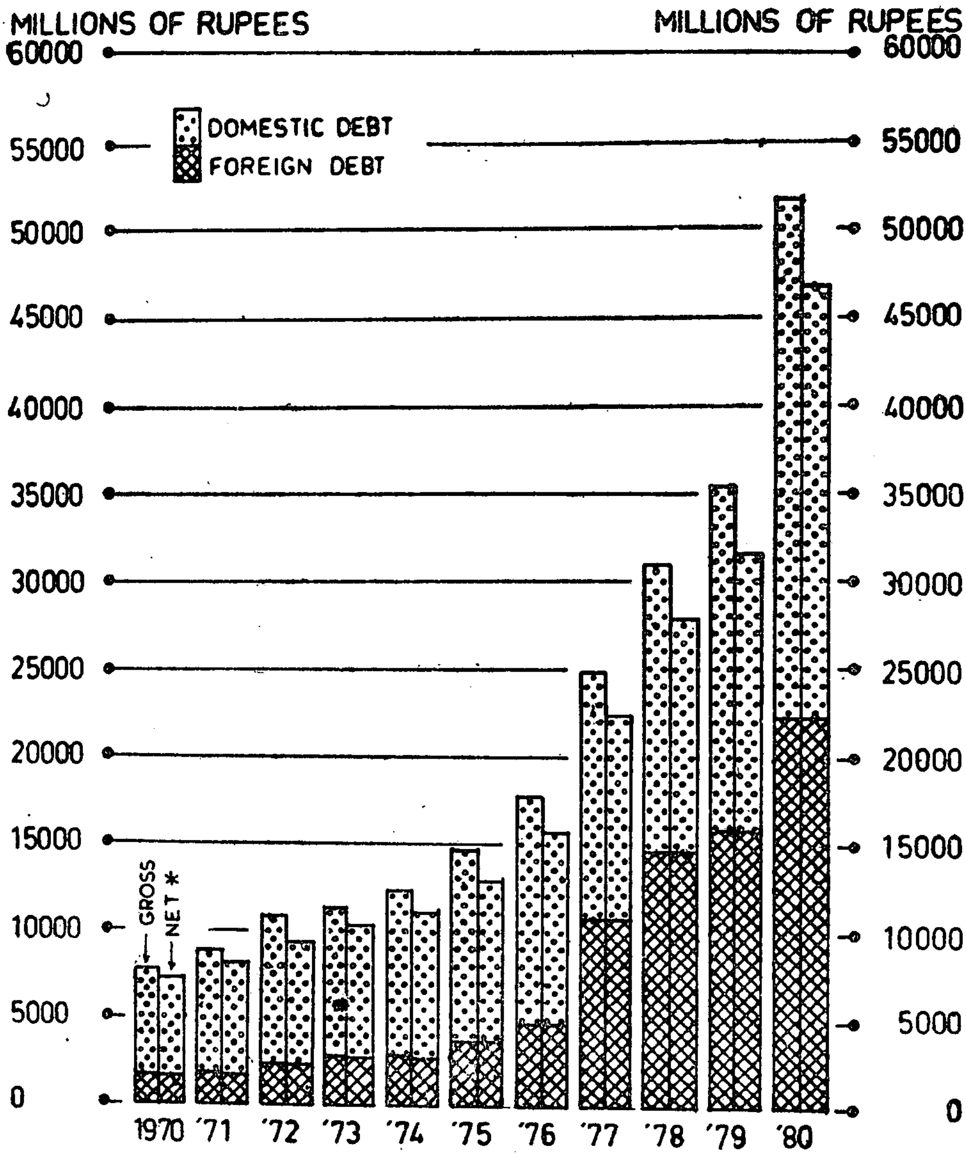
The budget deficit resulting from the government fiscal operations during the year amounted to Rs. 15,270 million as against the original estimate of Rs. 8,920 million. In comparison, the deficit in the previous year was Rs. 8,791 million. Resources available from the normal sources of finance did not, however, expand sufficiently to bridge the gap. Accordingly, steps were taken to obtain additional resources both from domestic and foreign sources. Total foreign finance (including commercial borrowings) aggregated Rs. 6,253 million as against the budget estimate of Rs. 5,820 million. Non-bank borrowing from the domestic sources was Rs. 2,692 million which was well below the original estimate of Rs. 3,100 million. This critical financial position was further intensified and aggravated in the field of non-market borrowings where the loan operations and the settlement of past commitments resulted in a net outflow of Rs. 884 million. Thus, the final outturn revealed a resource gap of Rs. 7,210 million. Consequently, the Treasury was faced with a problem of cash management. In order to meet its commitments, the government was compelled to resort to borrowing from the banking system. Total bank financing of the deficit amounted to Rs. 7,077 million, and was supplemented by drawing down the cash balance by Rs. 133 million.

Limited success in the mobilisation of funds in the domestic market necessitated the drawing down of the proceeds of the Euro currency commercial loan negotiated in 1979. Inclusive of the above commercial borrowing, total receipts from foreign sources amounted to Rs. 6,253 million, covering approximately 41 per cent of the overall budget deficit. However, when the Euro-dollar borrowing is excluded, the amount obtained by way of anticipated foreign assistance for budgetary purposes amounted to Rs. 5,356 million. In terms of the latter figure, foreign finances contributed 35 per cent towards bridging the budget deficit.

When compared with the preceding year, total foreign finance recorded an increase of Rs. 2,016 million or 48 per cent. While the loan finance increased by 45 per cent, grants increased by 54 per cent. When commercial borrowing is excluded, the increase in the loan finance registered only an 8 per cent increase. Cash loans including the commercial borrowing classified under "other loans" increased by Rs. 914 million and project loans by Rs. 338 million. Commodity loans recorded a marginal increase. Resources obtained under project loans amounted to Rs. 1,171 million, cash loans Rs. 1,513 million and commodity loans Rs. 1,432 million. Total grants amounted to Rs. 2,137 million.

Resources form captive sources, which normally form the major source of finance were crowded out by the private sector and extra budgetary activities. As a result, the domestic market borrowings from the non-banking domestic sources amounted only to Rs. 2,692 million as against Rs. 2,806 million in the previous year. On the other hand, non-market borrowings resulted in "negative financing" of Rs. 884 million. Thus, the resource gap was met by borrowings from the banking sector amounting to Rs. 7,077 million and by use of cash balance to an extent of Rs. 133 million.

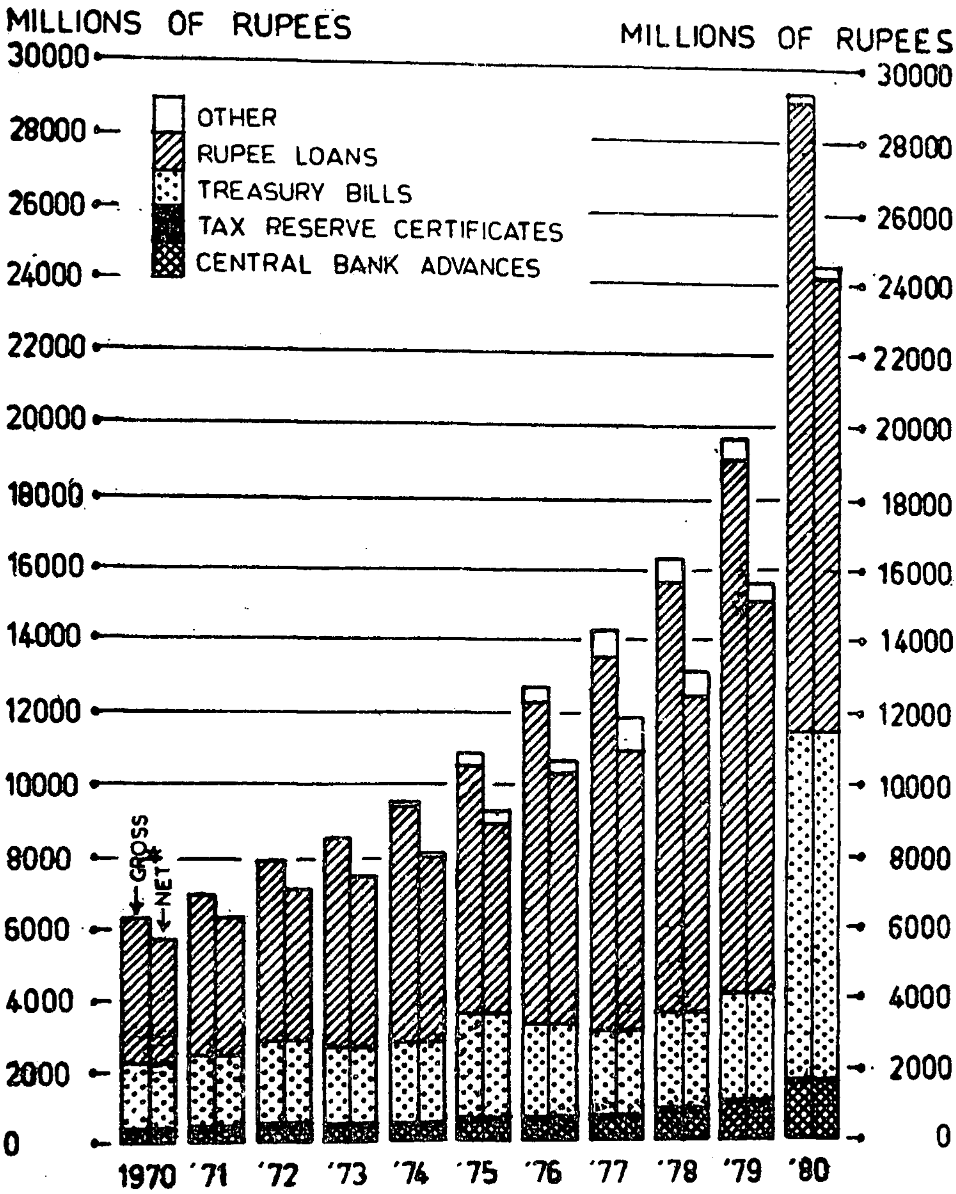
COMPOSITION OF PUBLIC DEBT



*Gross public debt less sinking funds. 1980 figures are provisional.

Central Bank of Ceylon

COMPOSITION OF DOMESTIC DEBT



* Gross public debt less sinking funds 1980 figures are provisional.

Central Bank of Ceylon.

Domestic market borrowing from the non-bank sources consisted of Rs. 2,802 million obtained from rupee securities. When adjusted for the sale of Rs. 106 million in Treasury bill holdings and a surrender of Tax Reserve Certificates amounting to Rs. 4 million, a net sum of Rs. 2,692 million was available from this source. Attempts to augment resources by way of high interest rates on rupee loans which were revised in July, 1980 and introduction of medium term bonds, shortening the maturity period from 10-12 years to 3 years, apparently were not sufficient inducements for increased subscriptions. Contributions to rupee loans were exclusively made by the captive sources. On the other hand, there was a repayment of Rs. 25 million to the banking sector.

Under non-market borowings a sum of Rs. 884 million current resources was utilized for meeting previous year's expenditure. While there was a borrowing of Rs. 7 million under foreign administrative borrowings, there was a withdrawal of Rs. 592 million of Treasury deposits and repayment of Rs. 299 million under administrative borrowings. The withdrawal of deposits constitute a utilization of budgetary allocations transferred to deposits at the end of the preceding financial year in respect of committed expenditure.

Domestic market borrowings from the banking sources consisted of Rs. 7,077 million obtained by way of the issue of Treasury bills and Rs. 183 million under Central Bank advan es. In order to obtain finance through Treasury bills the statutory limit was raised on 4 occasions from Rs. 3,000 million to Rs. 10,000 million. Of the total bank financing, the Central Bank's gross contribution amounted to Rs. 7,131 million. Holdings of Treasury bills and Tax Reserve Certificates by Commercial banks decreased by Rs. 42 million and Rs. 12 million, respectively. Use of cash balances comprised drawing of counterpart funds amounting to Rs. 118 million and a draw down of cash by Rs. 15 million.

Public Debt

The outstanding gross public debt as at end of 1980 stood at Rs. 51,656 million, registering an increase of 46 per cent compared with the increase of 15 per cent in the previous year. In 1980, domestic debt increased by 50 per cent while foreign debt increased by 41 per cent . Accordingly, the proportion of foreign loans in total public debt declined from 45 per cent to 43 per cent. As at end of 1980, the gross domestic debt and foreign debt amounted to Rs. 29,379 million and Rs. 22,277 million, respectively. As a result, the proportion of public debt to GNP rose from 72 per cent in 1979 to 84 per cent in 1980. Interest payment on public debt increased from Rs. 1,633 million to Rs. 2,200 million in 1980. Thus, the proportion of public debt interest payments to GNP recorded a marginal increase from 3.3 per cent to 3.7 per cent. As total debt service payments, including amortization, amounted to Rs. 3,702 million, the share of debt service payments in government revenue increased to 27 per cent in 1980 as against 23 per cent in 1979. While the external debt service ratio declined from 13 per cent in 1979 to 12.4 per cent in 1980, the external public debt service ratio showed a marginal decrease from 4.7 per cent in 1979 to 4.5 per cent in 1980.

The gross domestic public debt at Rs. 29,379 million showed an increase of Rs. 9,745 million. While funded debt (long and medium term debt) increased by Rs. 2,470 million to Rs. 17,939 million in 1980, floating debt (Treasury bills, Central Bank Advances, Tax Reserve Certificates, etc.) increased by Rs. 7,276 million to Rs. 11,440 million in 1980. As a result of this three-fold increase in the floating debt, the share of the funded debt in total domestic debt decreased from 79 per cent in 1979 to 61 per cent in 1980. The share of floating debt increased from 21 per cent to 39 per cent.

Total amount of resources raised from rupee securities amounted to Rs. 2,802 million as against Rs. 2,950 million in 1979. Of this, a sum of Rs. 1,600 million was raised during the first half of the year. These loans carried an interest rate of 10 per cent per annum and had a maturity period of 10-12 years. In July, 1980 the maturity period of bonds was shortened to three years and rate of interest was increased to 16 per cent per annum. During the second half of the year a sum of Rs. 1,202 million was raised under medium term loans. As in the past, the major subscribers were the Employees' Provident Fund (EPF), Sinking Funds and the Insurance Corporation of Sri Lanka and the National Savings Bank (NSB). While the subscription of Sinking Funds and the EPF recorded increases of 6 per cent and 8 per cent respectively, subscriptions from the NSB and the Insurance Corporation fell by 18 per cent and 25 per cent, respectively. In absolute terms, the decrease in the NSB's contribution to the loan programme was Rs. 211 million. The NSB continued to be the major contributor to rupee loans accounting for 33 per cent of total subscriptions.

The total amount of Treasury bills outstanding as at end of December, 1980 amounted to Rs. 9,800 million, recording an increase of Rs. 6,800 million over the preceding year. The banking sectors' holdings of Treasury bills increased from Rs. 2,706 million to Rs. 9,613 million. While the Central Bank's holdings recorded almost a four-fold increase, from Rs. 2,656 million to Rs. 9,605 million,commercial banks' holdings decreased from Rs. 50 million to Rs. 8 million. Holdings by the non-bank sector decreased from Rs. 294 million to Rs. 187 million. While the EPF reduced its holdings by Rs. 17 million, the NSB realised its investments in Treasury bills, amounting to Rs. 99 million.

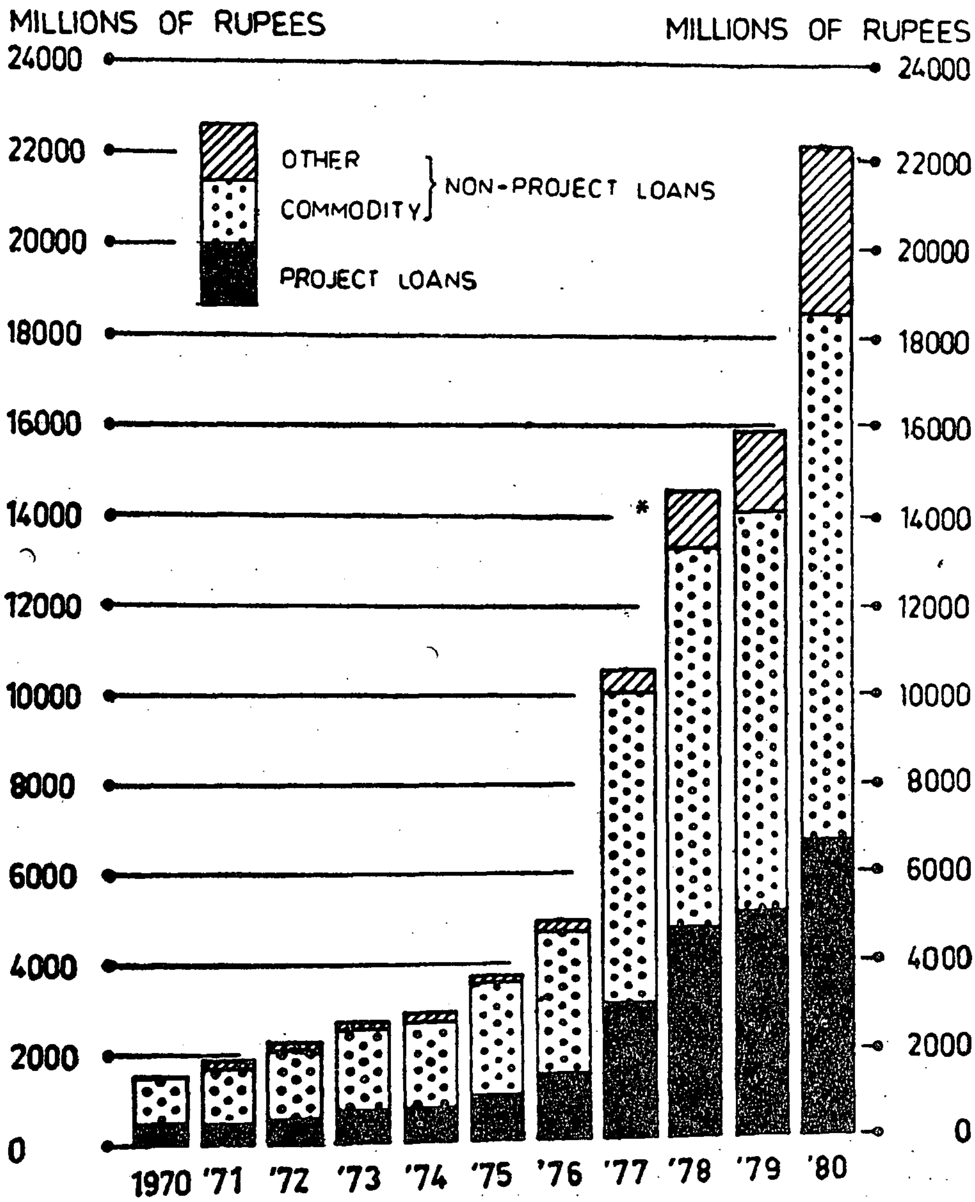
Provisional advances to the Government under section 89 of the Monetary Law Act showed an increase of Rs. 183 million as against Rs. 181 million in 1979. The total outstanding liabilities on provisional advances as at end of the year amounted to Rs. 1,319 million. Central Bank special loans to the Government for payment of subscriptions to international organizations was resumed in 1980 and borrowings amounted to Rs. 308 million. Outstanding Tax Reserve Certificates as at end of the year amounted to Rs. 13 million, recording a decrease of Rs. 15 million.

The total foreign debt outstanding as at end of 1980 amounted to Rs. 22,277 million, recording an increase of Rs. 6,436 million or 41 per cent, compared with the preceding year's increase of 9 per cent. The depreciation of the Sri Lanka Rupee in terms of other currencies increased the outstanding liability by Rs. 2,921 million. Remissions by creditors amounted to only Rs. 2 million as against Rs. 804 million in 1979. The net receipt of external assistance in the form of project, commodities and cash loans was Rs. 3,516 million. Repayment of foreign loans during the year amounted to Rs. 600 million. Of this, Rs. 352 million (59 per cent) was on commodity loans, Rs. 155 million (26 per cent) on project loan and the balance Rs. 93 million (15 per cent) on cash and equipment loans.

Interest payments on public debt amounted to Rs. 2,199 million[1], recording an increase of Rs. 566 million or 35 per cent. While interest on domestic debt rose by Rs. 510 million or 40 per cent, interest on foreign debt rose by Rs. 56 million or 16 per cent. Interest on domestic debt amounted to Rs. 1,787 million. The latter was made up of Rs. 1,330 million on rupee loans, Rs. 441 million on Treasury bills, Rs. 15 million on foreign administrative borrowings and Rs. 1 million on Tax Reserve Certificates.

1. This excludes interest payments on temporary rupee borrowings and short-term foreign loans serviced by the Treasury.

COMPOSITION OF FOREIGN DEBT



Central Bank of Ceylon.

During the year under review government contracted 26 project loans, 7 commodity loans and a cash loan, the value of these loans amounted to Rs. 8,714 million, as against Rs. 6,457 million in 1979. The total utilization of loan finances however, recorded a decrease. As at end of 1980 the aggregate utilization of loans contracted since 1970 was 56 per cent. In 1979 this ratio stood at 60 per cent. A low level of utilization was noticeable in project loans where the utilization rate was as low as 36 per cent. Commodity loans registered a utilization rate of 81 per cent, while cash loans were fully utilized.

MONEY AND BANKING

A very sharp expansion in domestic credit and a substantial decline in external banking assets are the main features of monetary and banking developments in 1980. Domestic credit expansion during the year was Rs. 11,174 million or 80 per cent. Both the private sector and the government sector shared in the increased bank credit. Gross credit to private sector increased by Rs. 5,123 million during the year, while net credit to Government rose by Rs. 6,051 million. Under the impact of this sharp and unparalleled credit expansion, there was increased pressure on the balance of payments, leading to loss of reserves. Altogether net external banking assets declined in 1980 by Rs. 4,096 million or 85 per cent. The fall in external banking assets helped to moderate the adverse monetary implications of very high credit expansion. It, however, considerably weakened the external financial position of the country by the end of the year.

Money Supply

In 1980, narrowly defined money supply (M_1), consisting of currency and demand deposits held by the public, increased by Rs. 1,759 million or 23 per cent, compared to an equally large increase of Rs. 1,733 million or 29 per cent during the preceding year. Meanwhile, the broadly defined money supply (M_2) comprising M_1 *plus* time and savings deposits of the private sector held with commercial banks, rose by Rs. 4,803 million or 32 per cent, as against the increase of Rs. 4,166 million or 38 per cent during the preceding year. Thus, the year 1980 witnessed a small deceleration in the rate of growth of monetary aggregates, even though the rates of growth were still appreciably high. During the year, the monetary aggregates moved somewhat erratically. The annual rate of growth of M_1 which recorded a 29 per cent level as at the end of December, 1979 declined to 24 per cent by the end of March 1980, remained unchanged at this level until the end of June, decreased further to a relatively low level of 15 per cent in September, increased sharply during the next two months to reach 24 per cent at the end of November and decreased marginally to 23 per cent in December, 1980. Following roughly the same pattern, M_2 declined from 38 per cent as at the end of December, 1979 to 24 per cent in March, remaining broadly at this level until July, but rising progressively to reach 32 per cent by the end of December, 1980.

The income velocity of both monetary aggregates (i.e. GNP at current factor cost, divided by the monetary aggregate) recorded a marginally declining trend in the past few years. In the case of M_1 which recorded an average income velocity of 7.1 during the period 1974 to 1977, it declined to 6.8 in 1978 to 6.5 in 1979 and 6.6 in 1980. Similarly, the income velocity of M_2 which stood at an average of 4.6 during the period from 1974 to 1977, declined to 3.7 in 1978, to 3.3 in 1979 and to 3.2 in 1980. The declining trend in the income velocity indicates that the rates of growth in both monetary aggregates had been faster than that in the output of goods and services, thereby exerting pressure on the price level.