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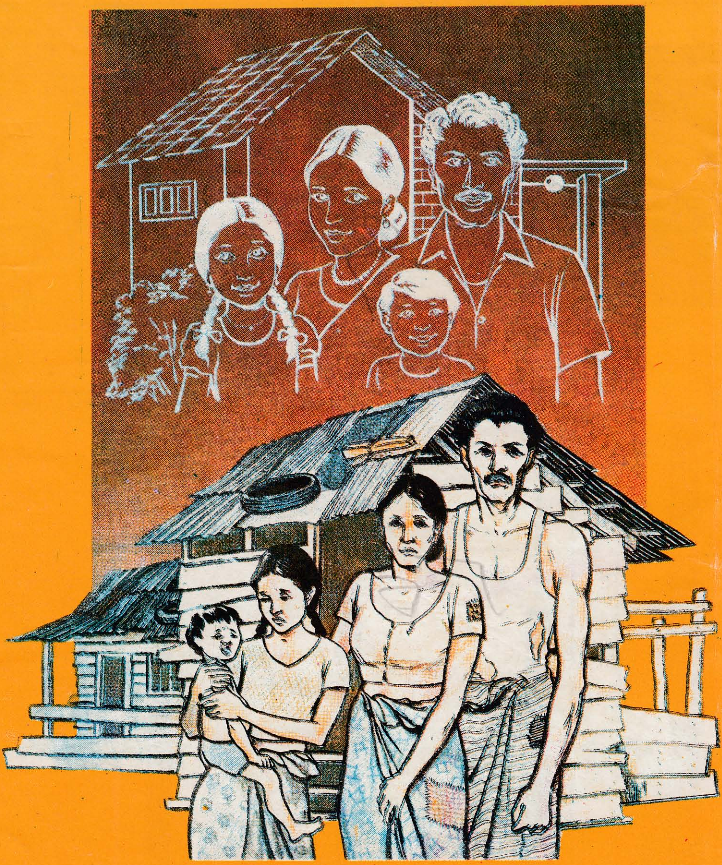
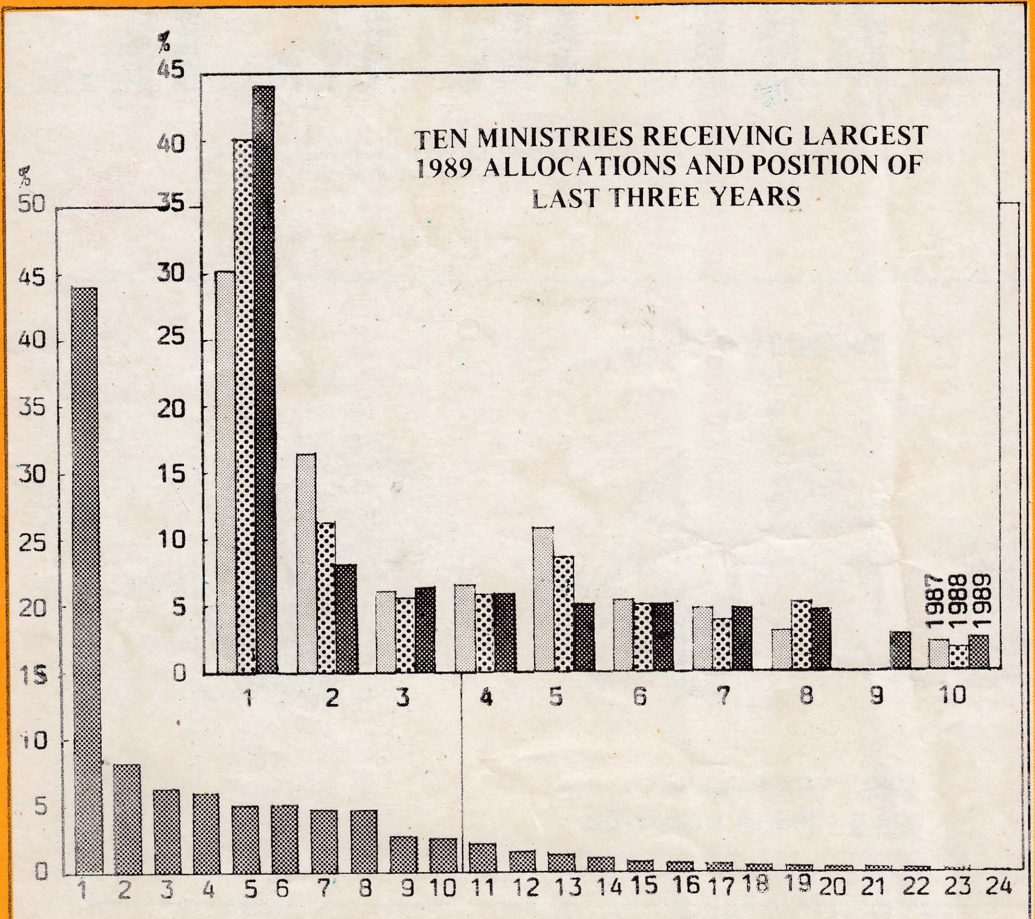
ECONOMIC REVIEW

MARCH 1989



BUDGET 1989



EXPENDITURE ALLOCATIONS BY MINISTRIES - 1989

MINISTRY

1. Finance
2. Defence
3. Public Administration Prov.Councils & Home Affairs
4. Education,Cultural Affairs & Information
5. Land,Irrigation & Mahaweli
6. Health & Women's Affairs
7. Transport & Highways
8. Power & Energy
9. Labour & Social Welfare
10. Agriculture,Food & Co-operatives
11. Posts and Telecommunications
12. Housing & Construction
13. Higher Education,Science & Technology
14. Policy Planning and Implementation
15. Plantation Industries
16. President,Prime Minister,Judges etc.
17. Justice & Parliamentary Affairs
18. Foreign Affairs
19. Fisheries and Aquatic Resources
20. Youth Affairs and Sports
21. Trade and Shipping
22. Textile & Rural Industries Development
23. Industries
24. Tourism

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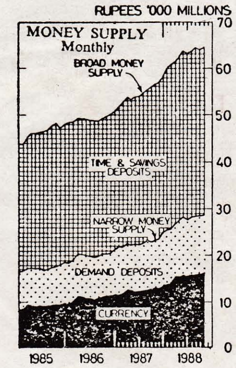
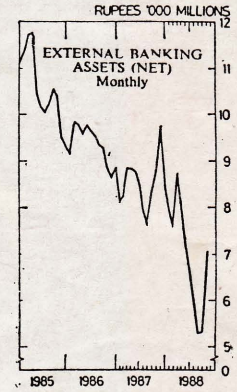
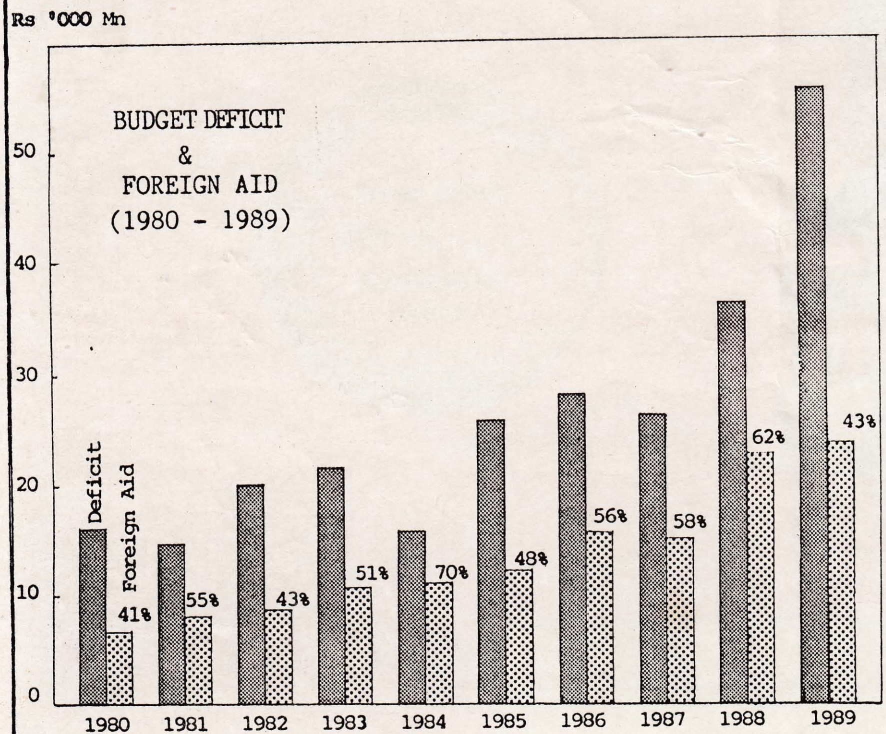
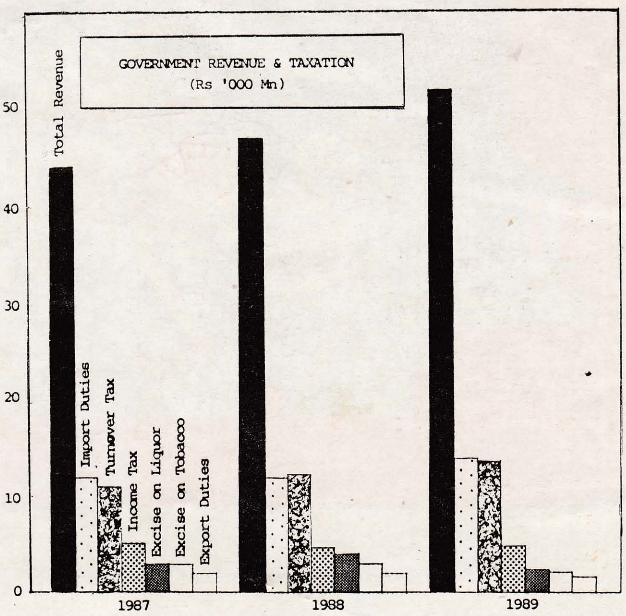
ECONOMIC INDICATORS



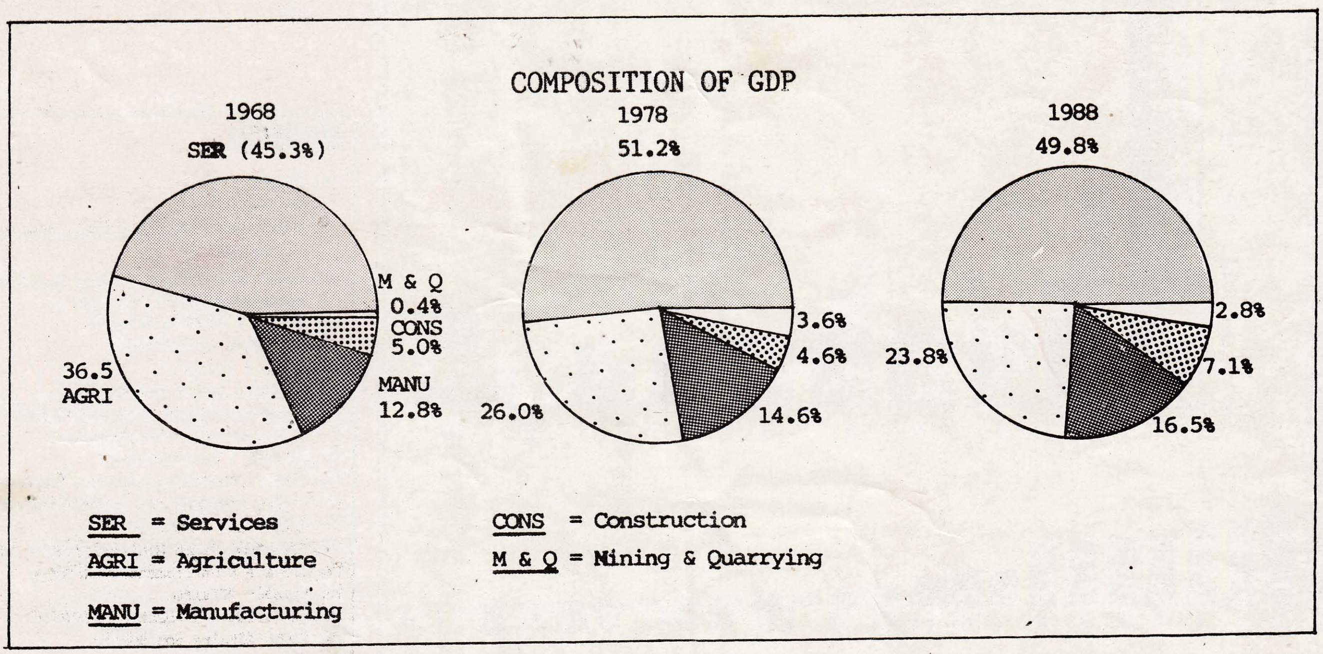




Source: Central Bank of Sri Lanka
& Budget Speech - 1989



Source: Estimates of the Revenue and Expenditure
of the Government of Sri Lanka - 1989



Source: Central Bank of Sri Lanka
Review of the Economy & Economic Survey 1988

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* Research and Development links with the productive sector in Sri Lanka
* The rising costs of agricultural inputs in the 1980's

(The source for data in our cover diagram is the "Estimates of Revenue and Expenditure of the Government of Sri Lanka 1989".)

COVER DIAGRAM

Sepalika Fernando

Published by the People's Bank,
Research Department,
Head Office,
Sir Chittampalam A. Gardinar Mawatha,
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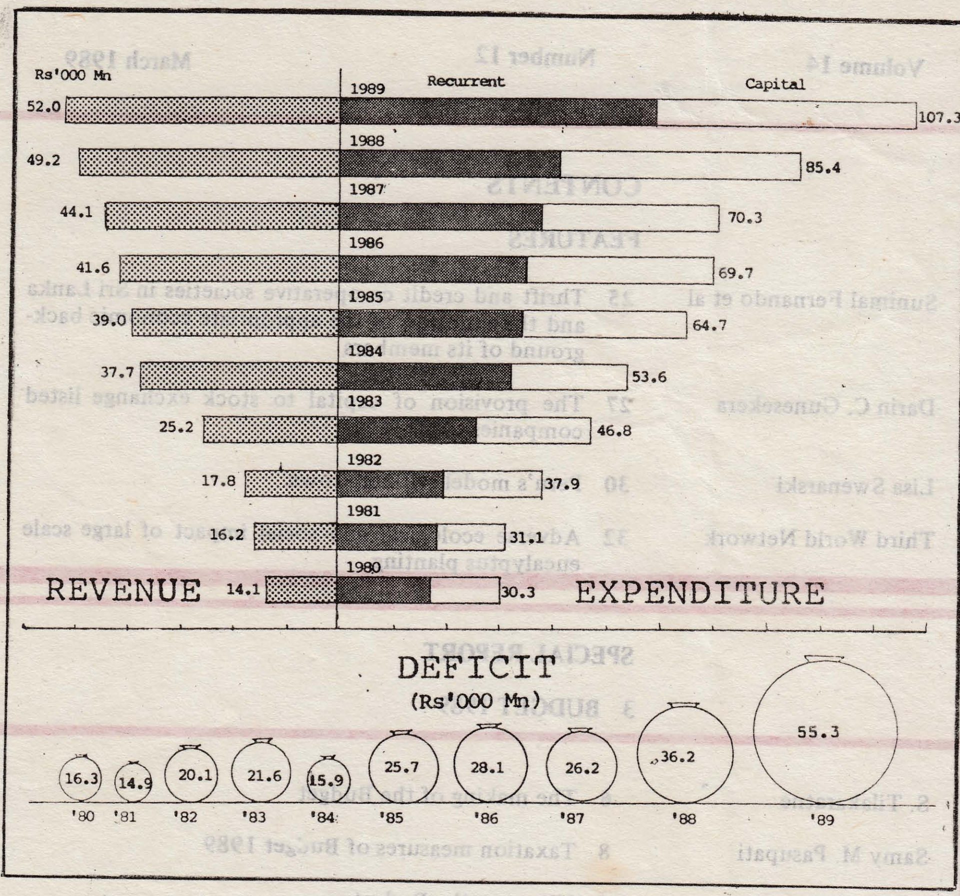
Sri Lanka



BUDGET 1989

The main thrust of the Finance Minister's Budget Speech on March 16 on behalf of the new government, was focussed on the implementation of President Premadasa's "Poverty Alleviation Programme". In a departure from tradition the entire Budget Speech was completed under 60 minutes. The usual review of the economy, which comes as a preamble to the proposals was tabled as a seperate document, prepared by the Central Bank of Sri Lanka titled "Economic Survey 1988". The Minister referred to a "new vision" that has "awakened the whole country to tread a new path". He emphasised that it was his "sincere endeavour to reflect this new vision and to address the aspirations of the common people through this first Budget of this Government".

A theme of the Budget Speech was "the factors that contributed to an increasing impoverishment and malnutrition among our people. As a result, the productivity of the poor has steadily declined with a colossal waste of our precious human resources. This waste cannot be measured merely in economic terms. The frustration and discontentment in the society that we see today have arisen from this deprivation of our people and militates against social stability and peace".

The Minister emphasised that "it is to redress this imbalance in our economy that His Excellency the President has emphasised that the main thrust of the country's development programme in the next two years would be on the alleviation of poverty and the creation of village based self-reliant organisations and small production units which would help to increase the productivity of the poor through creation of new employment opportunities ..... This marriage between the big investors and the small producers will increase production, cut down on overheads, reduce inflation and generate sustainable employment, and will also be the surest way to accelerate the development of our remote and backward areas. This is the essential philosophy behind the Janasaviya Programme".

The Finance Minister maintained that the essential elements of the "new vision" of the President were the restoration of peace, enforcement of discipline and alleviation of poverty and it was his endeavour to reflect this new vision through this Budget. But two important factors that have to be considered, (as pointed out in the following note on the Budget by Dr.S Tilekeratne) are the deterioration in the economic situation in 1988 and the economic and social problems that have spilled over from previous years. The success of the new lead programme will no doubt be closely related to how successfully the impact of these problems are overcome. The minus factors in Sri Lanka's economic performance of 1988 clearly outway the gains, according to the Central Bank's review. The adverse circumstances confronting the economic, social and political situation in the country had led to a serious deterioration in the budgetary position, an excessive growth in money supply, an escalation of consumer price levels, and unfavourable trends in the balance of payments, with external reserves continuing to fall heavily. Also, the significant bias in the economy towards services as against production, worsening of relative income distribution in favour of the highest income earners, a rise in external indebtedness, the growth of a considerable 'black' economy and a sharp rise in defence expenditure are all factors to be contended with.

In preparation of the Draft Estimates of Expenditure and Revenue priority has been given to provision for the Poverty Alleviation Programme. Total budgeted expenditure for 1989 reaches Rs. 108,103 mn, the highest on record and nearly 30 percent more than the previous highest expenditure of Rs.82,923 mn for 1988. Of the Budgetary Expenses of Rs.108 bn, about 55 percent is earmarked for Recurrent Expenditure and the balance for Capital Expenditure.

Of the total Budgeted Expenditure as much as 44 percent, amounting to Rs.47 bn, is allocated for the Ministry of Finance. Approximately 50 percent of this (Rs.23.6 bn) is allocated for the Public Debt, covering payments and repayments on loans. The other major allocation close to 10 percent of total ex-

TABLE 1 - ESTIMATES OF GOVERNMENT EXPENDITURE 1987 - 1989

MINISTRY	1987 EXPENDITURE (Rs.Mn.)	%	1988 EXPENDITURE (Rs.Mn.)	%	1989 EXPENDITURE (Rs.Mn.)	%
1 MINISTRY OF FINANCE	21,270.3	30.3	33,416.9	40.3	47,239.1	44.0
2 MINISTRY OF DEFENCE	11,519.9	16.4	9,372.7	11.3	8,917.8	8.3
3 MIN.OF PUBLIC ADMINSTRATION PROV.COUNCILS& HOME AFFAIRS	4,239.6	6.0	4,591.9	5.5	6,797.5	6.3
4 MINISTRY OF EDUCATION,CULTURAL AFFAIRS AND INFORMATION	4,558.0	6.5	4,929.3	5.9	6,359.5	5.9
5 MINISTRY OF LANDS,IRRIGATION AND MAHAWELI DEVELOPMENT	7,579.5	10.8	7,074.9	8.5	5,370.2	5.0
6 MINISTRY OF HEALTH AND WOMEN'S AFFAIRS	3,697.1	5.3	4,109.6	5.0	5,319.3	5.0
7 MINISTRY OF TRANSPORT & HIGHWAYS	3,413.1	4.9	3,261.2	3.9	5,285.4	4.9
8 MINISTRY OF POWER AND ENERGY	2,127.7	3.0	4,232.2	5.1	5,015.2	4.7
9 MINISTRY OF LABOUR AND SOCIAL WELFARE	83.4	0.1	106.6	0.1	2,928.2	2.7
10 MINISTRY OF AGRICULTURE,FOOD AND COOPERATIVES	1,465.2	2.1	1,559.8	1.9	2,716.5	2.5
11 MINISTRY OF POSTS AND TELECOMMUNICATIONS	1,755.4	2.5	1,678.5	2.0	2,338.5	2.2
12 MINISTRY OF HOUSING AND CONSTRUCTION	1,939.1	2.8	1,744.5	2.1	1,653.7	1.5
13 MINISTRY OF HIGHER EDUCATION,SCIENCE & TECHNOLOGY	1,005.5	1.4	1,076.1	1.3	1,539.7	1.4
14 MINISTRY OF POLICY PLANNING AND IMPLEMENTATION	1,251.8	1.8	1,374.6	1.7	1,301.6	1.2
15 MINISTRY OF PLANTATION INDUSTRIES	1,339.8	1.9	1,176.1	1.4	886.0	0.8
16 PRESIDENT,PRIME MINISTER,JUDGES ETC.	294.7	0.4	347.5	0.4	682.6	0.6
17 MINISTRY OF JUSTICE & PARLIAMENTARY AFFAIRS	699.3	1.0	1,018.5	1.2	662.2	0.6
18 MINISTRY OF FOREIGN AFFAIRS	455.3	0.6	481.3	0.6	537.4	0.5
19 MINISTRY OF FISHERIES AND AQUATIC RESOURCES	240.7	0.3	212.6	0.3	443.8	0.4
20 MINISTRY OF YOUTH AFFAIRS AND SPORTS	561.8	0.8	224.3	0.3	315.2	0.3
21 MINISTRY OF TRADE AND SHIPPING	149.2	0.2	374.2	0.5	287.3	0.3
22 MINISTRY OF TEXTILE AND RURAL INDUSTRIES DEVELOPMENT	105.3	0.2	130.1	0.2	250.9	0.2
23 MINISTRY OF INDUSTRIES	98.8	0.1	142.9	0.2	223.0	0.2
24 MINISTRY OF TOURISM	223.0	0.3	247.7	0.3	153.7	0.1
25 MINISTRY OF BUDDHA SASANA	10.2	0.0	11.9	0.0	26.2	0.0
TOTAL EXPENDITURE	70,083.5	100.0	82,895.8	100.0	107,250.5	100.0

penditure, is Rs.10,000 mn for the Poverty Alleviation and Nutrition Programme; and Rs.8,500 mn for Financial Assistance and Special Treasury Services and Expenses. In addition there is an allocation of Rs.4,600 mn for Rehabilitation and Reconstruction.

The next highest vote, of Rs.8.9 bn, is for the Ministry of Defence. The percentage of total expenditure for Defence has come down to 8.3 percent in 1989 as compared with 11.5 percent in 1988 and 16.8 percent in 1987. These two lead Ministries are followed by the Ministry of Public Administration, Provincial Councils and Home Affairs 6.3 percent; and Ministry of Education, Cultural Affairs and Information 5.9 percent. In fifth position is Lands, Irrigation and Mahaweli Development with 5.0 percent; though this Ministry was earlier in third position, taking up 8.7 percent of total expenditure in 1988 and 11 percent in 1987.

The other 5 main Ministries, where allocations exceeded Rs. 2 bn and were over 2 percent of total expenditure, were Health and Women's Affairs 5.0 percent; Transport and Highways 4.9 percent.; Power and Energy 4.7 percent; Labour and Social Welfare 2.7 percent; Agriculture, Food and Co-operatives 2.5 percent; and Posts and Telecommunications 2.2 percent. Together these 10 Ministries account for nearly 90 percent of total expenditure for 1989. Among these 10 Ministries Capital Expenditure was high among the 3 Ministries of Lands, Irrigation and Mahaweli Development; Power and Energy; and Transport and Highways. Recurrent Expenditure was high for the 5 Ministries of Defence, Public Administration, Provincial Councils and Home Affairs; Education, Cultural Affairs and Information; Health and Women's Affairs; and Labour and Social Services. The 2 Ministries of Finance; and Posts and Telecommunications have an almost equal share for both Capital and Recurrent Expenditure. (See Table 1 for details).

Of total Current Expenditure of nearly Rs.58 bn, almost half will be for salaries, wages, goods and services; while interest payments will take up about 30 percent. The balance will be mainly for transfer to public corporations and to households and for pensions.

Revenue from existing taxes and levies amounts to Rs. 52 bn and is expected to cover almost half the total expenditure. The main item in the Rs. 52 bn Government Estimates of Revenue is Rs. 38.6 bn from Taxes on Production and Expenditure as against Rs.32.8 bn expected in 1988. (See Table 2).

The balance Revenue or resource requirements of the Budget was around Rs. 44 bn and was expected to be filled through Foreign Aid 54 percent and Domestic Borrowings 46 percent.

The final budgetary out turn shows an Overall Deficit of Rs. 53 bn in 1989, as against Rs. 36 bn in 1988.

Recurrent Expenditure had increased 42 percent, from Rs.40.7 bn in 1988 to Rs.57.9 bn in 1989; while Capital Ex-

TABLE 2 - ESTIMATES OF GOVERNMENT REVENUE 1988 AND 1989

Heads 1-12	Financial Year 1988 (Revised Estimates) Rs.	Financial Year 1989 (Original Estimates) Rs.
Taxes on Production and Expenditure	32,838,810,000	38,579,740,000
Taxes on Corporate Income	3,120,000,000	3,175,000,000
Taxes from Non-Corporate Income	1,510,000,000	1,552,000,000
Receipts of Trading Enterprises	2,846,600,000	2,810,000,000
Rents, Interests, Profits and Dividends received	2,244,397,000	1,760,000,000
Sales and Security Charges	924,854,000	1,100,000,000
Social Security Contributions	177,500,000	350,000,000
Other Current Transfers	1,803,259,000	2,035,060,000
Sales of Capital Goods	50,000,000	20,000,000
Capital Transfers from Domestic Sector	1,296,580,000	67,000,000
Capital Transfers from Abroad	---	---
Repayment of Loans and Advances	463,000,000	551,200,000
Total Revenue	47,275,000,000	52,000,000,000

TABLE 3–THE FINAL BUDGETARY OUT-TURN

	1988 (Rs. Mn)	1989 (Rs. Mn)	Percentage Change
Recurrent Expenditure	-40,716	-57,891	+ 42.18
Revenue	+49,260	+52,000	+ 5.56
Current Account Surplus/Deficit	+ 8,544	- 5,891	- 68.94
Capital Expenditure	-44,620	-46,724	+ 4.72
Overall Budget Deficit	-36,176	-53,015	+ 46.55
Financing the Deficit			
Budget Revenue Proposals (Net)	1,910	7,020	+ 267.53
Foreign Aid-Loans	17,600	18,000	+ 2.27
Foreign Aid-Outright Grants	5,000	5,600	+ 12.00
Domestic Borrowings - (Non-Inflationary)	11,000	17,000	+ 54.55
Domestic Borrowings -Banking	2,576	3,339	+ 29.62

Source: *Budget Speeches November 1987 and March 1989*

penditure has increased by 5 percent, from Rs.44.6 bn in 1988 to Rs.46.7 bn in 1989.

Revenue from existing sources (as given in the Govt. Estimates) shows a 5.6 percent increase in 1989. The Current Account Revenue less Current Expenditure Advance Accounts shows a drop of 69 percent, from plus Rs.8.5 bn in 1988 to minus Rs.5.9 bn in 1989. Meanwhile, the overall Budget Deficit in 1989 is 46.6 percent more than in 1988.

In financing of the Budget Deficit, the comparative position for these two years shows that the largest increase of 54.6 percent is in Domestic Borrowings from non-inflationary sources; while Domestic Borrowings from banking sources shows a 29.6 percent increase.

In the final budgetary position of these two years Foreign Aid-Loans shows a 2.3 percent increase; and Foreign Aid-Grants a 12 percent increase (See Table 3).

A summary of Government Fiscal Operations for 1979-1988, as given in the Central Bank Review of the Economy, 1987 (Table 88) shows the following position upto 1988. (See Table 4).

The Government's budgetary performance and fiscal operations in 1988 are very relevant to how expenditure and revenue expectations can be realised in 1989. The following brief review by the Central Bank shows where the major shortfalls occured and also clearly indicates the trends in fiscal operations.

TABLE 4. SUMMARY OF BUDGETARY POSITION 1979-1989

(Rs. million)

Year	Revenue	Expenditure	Budget Deficit	Financing the Deficit: Bank Borrowing	Non Bank Borrowing	Foreign Loans	Foreign Grants
1979	12,730	21,521	8,791	680	3,902	2,847	1,390
1980	14,068	30,343	16,274	7,126	2,485	4,116	2,620
1981	16,228	31,094	14,866	3,917	2,779	5,487	2,721
1982	17,809	37,900	20,091	4,006	7,606	5,418	3,376
1983	25,210	46,815	21,606	1,204	10,146	7,478	3,473
1984	37,731	53,592	15,861	2,644	6,589	7,958	3,293
1985	39,010	64,685	25,676	7,451	8,520	8,898	3,307
1986	41,644	69,715	28,071	2,299	9,178	12,081	3,753
1987 Approved Estimates	44,115	70,300	26,185	3,470	7,500	11,120	4,095
1988 Approved Estimates	49,260	85,436	36,176	2,576	11,000	17,600	5,000
1989 Budget Estimates	52,000	105,015	53,015	3,339	17,000	18,000	5,600

GOVERNMENT FINANCE IN 1988

Fiscal Trends

The revised 1988 estimates of government revenue and expenditure reveal a current account deficit of Rs.4,819 million and an overall deficit (before grants) of Rs.34,553 million in 1988. In the previous year, the current account of the budget was in surplus to the extent of Rs.2,585 million, although the overall budget was in deficit of Rs.21,749 million.

The deterioration in the fiscal position during 1988 was the outcome of several factors. First, government revenue showed only a marginal increase due to the unsettled conditions which resulted in a lower collection from a number of revenue sources. Second, there were increased commitments on account of several items of current expenditure such as salaries and wages, the Food Stamps Scheme and drought relief programs. Third, advance account operations. Fourth, large numbers of supplementary capital expenditure programs were permitted for on-going development activities. As a result of these developments, government revenue/GDP ratio declined from 21.4 percent in 1987 to 19 percent in 1988, while total expenditure and lending rose from 32.5 percent to 34.1 percent, leading to an increase of the budget deficit from 11 percent of GDP to 15 percent.

Revenue

According to revised estimates, government revenue in 1988 totalled Rs. 43,338 million. This was an increase of 3 percent over the previous year's revenue of Rs.42,145 million. Total revenue of the government consisted of Rs. 37,266 million of tax revenue (86 percent) and Rs.6,072 million of non tax revenue (14 percent). While tax revenue reflected an increase of 6 percent, non tax revenue registered a decline of 14 percent over the amounts received in the previous year.

Despite the unsettled conditions in the country, revenue collection from turnover taxes rose by 16 percent mainly due to higher prices and revisions in excise duties on tobacco, the revenue collection from this source showed a decline of 19 percent due to the shortfall in the volume of sales resulting from both labour disputes and unsettled conditions in the country. However, revenue collection from excise duties on liquor at Rs. 1,800 million reflected an increase of 9 percent mainly due to the upward revision in duty rates.

Despite a substantial increase in the value of imports, revenue from import duties at Rs.12,000 million registered only an increase of 9 percent. This was mainly due to the downward revisions in duties on selected items such as motor vehicles, liquor, tobacco and wheat flour and the exemption of essential consumer items such as rice from import duties.

Revenue collection from export duty on rubber continued to improve due to favourable price developments. However, revenue from export duty on tea declined by 29 percent owing to a reduction in export duty on tea. Owing to a decline in the value of coconut exports, revenue collection from export duty on coconut declined to Rs.65 million in 1988 from Rs. 148 million in 1987.

Meanwhile, estimated revenue from income taxes at Rs.4,825 million recorded a marginal decline of 2 percent, largely due to a reduction in personal income taxes. Taxes on property transactions at Rs.1,693 million showed a growth of 8 percent mainly due to increased stamp duties on Letters of Credit. Central Bank profits, interest income and surplus of the Department of Telecommunications continued to be the largest sources of non-tax revenue of the government.

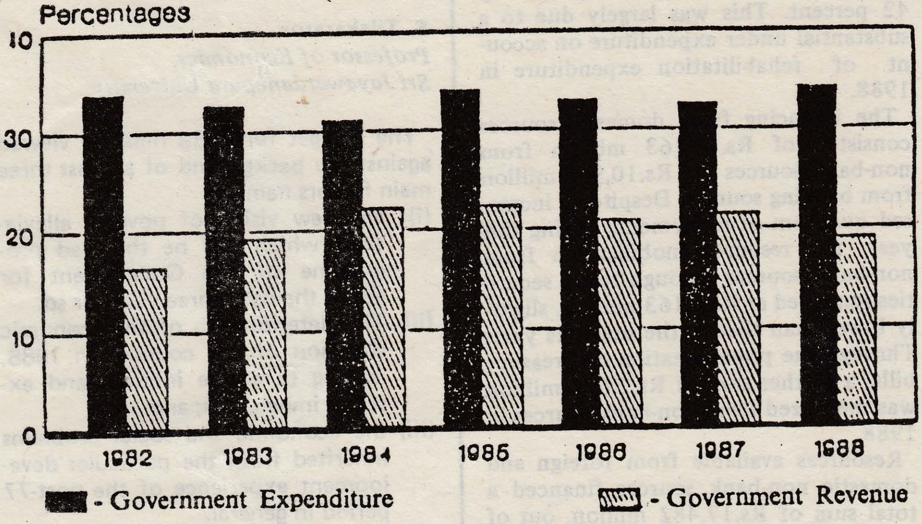
Expenditure

According to the latest available data, total expenditure in 1988 amounted to Rs.77,891 million. This represented a 22 percent increase over the expenditure in the previous year. The expenditure in 1988 consisted of Rs.48,157 of current expenditure and Rs.29,734 million of capital expenditure and net lending.

Current expenditure at Rs.48,157 million accounted for three-fifths of total expenditure in 1988. Total salaries and wages at Rs.10,671 million was an increase of 33 percent over the salaries and wages bill of the previous year. The substantial increase in salaries and wages was entirely due to the salary revisions effected in 1988. The expenditure on other goods and services at Rs.11,779 million was an increase of 13 percent,

GOVERNMENT REVENUE AND EXPENDITURE

(as a Percentage of GDP)



and this was largely due to enhanced expenditure on defence and security related activities.

Interest payments on government debt in 1988 amounted to Rs.12,412 million. This was an increase of 22 percent over the previous year's payments of Rs. 10,157 million. Interest payments on domestic debt rose by 24 percent owing to both a rise in outstanding liabilities, as well as an upward movement in interest rates, particularly on Treasury bills. Meanwhile, interest payments on foreign debt rose by 16 percent owing to servicing of an enhanced quantum of outstanding debt, reinforced by exchange rate variations.

Total transfer payments in 1988 at Rs. 14,515 million was an increase of 33 percent. The substantial increase in transfer payments was due to the additional outlays on pensions, the food stamp scheme and drought relief and enhanced current transfers to public enterprises.

Capital expenditure and lending at Rs. 29,734 million was 22 percent higher than the amount utilised in the previous year. Despite a substantial under-utilization of rehabilitation expenditure, capital expenditure and lending during 1988 showed considerable growth owing to additional supplementary expenditure provided under various development programs such as Air Port development, Telecommunications and Electricity. The Mahaweli Development Scheme, Development of Air Port and Aviation services, Water Supply and Drainage Scheme, Road Development, Power and Energy and Land Development and Telecommunications continued to be the major capital expenditure programs of the government.

Summary of Government Fiscal Operations (Economic Classification)

Rs. Million

Item	1987	1988 Estimates
1. Total Revenue & Grants	46,822	49,413
2. Total Revenue	42,145	43,338
2.1 Tax Revenue	35,119	37,266
2.2 Non Tax Revenue	7,026	6,072
3. Grants	4,677	6,075
4. Expenditure & Lending Minus Repayment	63,894	77,891
4.1 Current	39,560	48,157
4.2 Capital	22,816	23,123
4.3 Lending - Repayment	1,518	6,611
5. Current Account Surplus/Deficit (–)	2,518	– 4,819
6. Budget Deficit (Before Grants)	–21,749	–34,553
7. Budget Deficit (After Grants)	–17,072	–28,478
8. Financing	17,072	28,478
8.1 Foreign Borrowing	5,716	7,319
8.2 Domestic Borrowing	11,356	21,159
8.2.1 Non-market	1,415	0
8.2.2 Market	9,941	21,159
8.2.2.1 Non-Bank	6,400	10,163
8.2.2.2 Bank	3,541	10,996

Sources: *General Treasury, Central Bank of Sri Lanka*

Financing of the Budget Deficit

The revised estimates for 1988 reveal a budget deficit (after grants) of Rs. 28,478 million, as against a deficit of Rs.17,072 million in the previous year. In financing the deficit, a sum of Rs. 7,319 million was obtained from foreign sources, while Rs.21,159 million was utilized from domestic sources.

The net foreign borrowings of Rs. 7,319 million, which reflected an increase of 28 percent over the preceeding year, financed 26 percent of the budget deficit. The original budget estimates for 1988 anticipated the utilization of Rs.12,520 million of foreign financing.

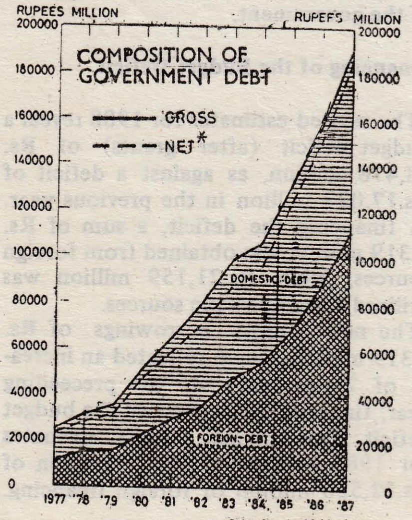
Accordingly, the actual utilization of foreign financing in 1988 was lower by 42 percent. This was largely due to a substantial under expenditure on account of rehabilitation expenditure in 1988.

The financing from domestic sources consisted of Rs.10,163 million from non-bank sources and Rs.10,996 million from banking sources. Despite an increased quantum of repayments during this year, net resource mobilization from non-bank sources through rupee securities remained at Rs.6,163 million, slightly lower than that in the previous year. Through the popularization of Treasury bills, a further sum of Rs.2,601 million was mobilized from non-bank sources in 1988.

Resources available from foreign and domestic non-bank sources financed a total sum of Rs.17,482 million, out of an overall deficit of Rs.28,478 million. In financing this resource gap, a sum of Rs.11,249 million was obtained from banking sources through the issue of Treasury bills, while a further sum of Rs.926 million was obtained from the Central Bank under provisional advances. However, due to a cash build up of Rs.1,179 million, the net bank financing of the budget deficit was restricted to Rs.10,996 million. The latter none-theless represented a three-fold increase over the amount borrowed from the banking system in the previous year.

Government Debt

The outstanding government debt as at the end of 1988 was Rs.223,503 million. This was an increase of 15 percent over the debt outstanding amounting to Rs.191,634 million at the end of the previous year. Domestic debt rose by 25 percent to Rs.98,594 million, while foreign debt increased by 11 percent to Rs.124,909 million.



Central Bank of Sri Lanka.

The Making of the Budget

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The Budget for 1989 must be viewed against the background of at least three main factors namely:

(i) the new vision of poverty alleviation, which will be the lead programme of the Government for about the next three years or so.

(ii) The deterioration of the economic situation of the country in 1988, leading to severe internal and external imbalances; and

(iii) the economic and social problems inherited from the particular development experience of the post-77 period in general.

The objective of the new government as expressed through the budget is to make a transition to a new era of poverty alleviation. But this has to be achieved against the background of an economy which has virtually ceased to be dynamic, and is saddled with a series of structural problems inherited from the past economic policies. The task undertaken is indeed a very tall order. Let us briefly outline the vision and the challenges that have figured in the making of the budget.

Poverty Alleviation

The particulars of the Janasaviya Programe (JSP) are now well known. The crux of the programme is a resource transfer over a period of 24 months to enable the families concerned to raise their consumption levels and eventually to create a viable means of livelihood for them using the Savings fund of Rs.25,000/- deposited in their names during this period. It is expected that such a resource transfer would create opportunities for these families to acquire productive assets to make use of their abilities, skills and potentials in a process of self-development. The likely outcome would be the emergence of thousands of small scale projects, diffused throughout the country creating a broad-based equitable growth process.

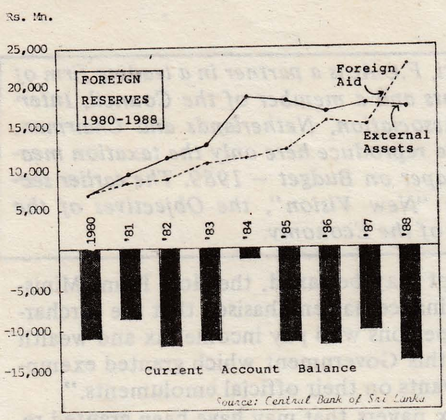
The budget for 1989 has made the initial financial allocation to launch the JSP. With the total allocation of Rs.10 billion, (depending on the phased manner in which families will be brought under the programme) well over 500,000 families could be expected to be covered by the JSP during the course of 1989.

With the entry of more families into the JSP in the next year, and given the continuation of the resource transfer for 24 months, the budgets for 1990 and 1991 will have to make substantial allocations for the programme; of a much higher magnitude than in 1989. The full financial picture will be known only with the reformulated public investment programme of 1989-93 which will be submitted to the Aid Group Meeting, now postponed for September 1989.

Deterioration of the Economic Situation in 1988

The annual rate of economic growth (as measured by the Gross Domestic Product in real terms) which had been maintained at an average of around 5 percent during 1978-86, declined sharply to an average of a mere 2 percent during 1987-88. This is the lowest level recorded since 1971. In 1987, the major reason for the poor growth performance was the decline in agricultural production, following the prolonged drought. In 1988, although agriculture had made a recovery, overall production in the economy was adversely affected by the civil disturbances and violence. Besides public sector industry and tea plantations, the output of the services sector (transport, trade and commerce) was particularly affected by the tensions that prevailed in the country.

Coupled with the lower production growth, considerable demand pressures characterised the economy. Money supply rose by as much as 29 percent and inflation moved upto 14-18 percent (according to official indicators). Deterioration of the balance of payments followed and external assets fell to their lowest level since 1982. An important causal factor in this situation was the deterioration of the budgetary situation- the current account fell into deficit and the overall budget deficit rose significantly requiring heavy recourse to bank financing to meet the gap. The final outturn for 1988 proved to be a considerable deviation from the targets under the Medium-term policy framework (1988-90) announced in the 1988 budget. It has been reported that the country's failure to restrain the budget deficit, in-



flationary pressures and the deterioration of the balance of payments, led the IMF to suspend further credit under the Structural Adjustment Facility.

Structural Problems inherited from the Past

The budget for 1989 must also be viewed against the backlog of problems inherited from the particular development experiences of the post -77 era. These may be briefly summarised:

- Skewed growth pattern with a bias towards services as against commodity production (agriculture and manufacturing).
- Worsening of the relative income distribution. The share of the richest decile (top 10 percent) of the income earners had risen to nearly 50 percent by 1985.
- Rise in external indebtedness to a level of over 70 percent of the GDP (nearly Rs.10,000 in per capita terms) and the rise in the external debt service ratio to 29 percent (in relation to export earnings from goods and services).
- Growth of a black economy the size of which has been roughly estimated to range from about Rs.20 billion to Rs.40 billion.

  Rise in unemployment to an estimated over one million persons or about 20 percent of the labour force.
- Sharp rise in defence expenditures since 1983, absorbing over Rs.10 billion per year in more recent years.

Moreover, the economic losses caused by the ethnic conflict has been estimated at Rs.50 -55 billion upto August 1987.

Factors in the Budget Making

To make a transition to a new era against an economic and social background, as described above, must necessarily prove a tremendous challenge. It is a complex task of having to reconcile several conflicting objectives.

- How to allocate sufficient funds for poverty alleviation while the security situation in the country continues to demand a sizeable budgetary allocation.
- How to find new resources for the budget from those who have had the opportunities to accumulate incomes under the liberalised economy; that is, the top 10 percent or so of the income earners as well from those having hidden incomes (black economy) while not creating disincentives for private investment.
- How to minimise the recourse to inflationary sources of financing and in general restrain demand pressures which could upset the budgetary calculations (as happened in 1988) as well lead to external imbalances.

In short the challenge that the budget making faced in 1989 was how to maintain a substantial measure of external and internal economic balance (avoidance of domestic inflation as well as deterioration of balance of payments) while meeting the resource demands of poverty alleviation and the security situation as well as maintaining an ade quate climate for private investment.

The budget has attempted to strike a balance among these competing/conflicting objectives. What has emerged is a compromise. The viability/sustainability of this budgetary exercise can be tested only when events begin to unfold as the year progresses.

Inflationary Impact

According to the budgetary estimates, although the overall budget deficit is of a massive magnitude of the order of Rs. 53 billion, recourse to bank-borrowing (inflationary sources) would be for a relatively small fraction of the order of Rs.3,395 million or 6 percent of the total deficit. As the Finance Minister has put it, "this is just a little over one percent of the projected GDP for 1989 and should not therefore cause any significant threat to financial stability."

In making this calculation, it has been assumed that (a) foreign loans would be available to the extent of Rs.18,000 million and (b) domestic loans from non-inflationary (non-bank) sources could be raised to a level of Rs.17,000 million. These figures, however, appear to be rather optimistic assumptions in the light of the actual budgetary performances on both these fronts in the past few years. (SeeTable below).

FINANCING THE BUDGET DEFICIT

In Rs. Millions

Year	Foreign loans	Domestic borrowing from non -bank sources	Domestic bank borrowing
1985 *	7,109	3,858	4,711
1986 *	9,061	6,096	3,047
1987 *	5,716	7,815	3,541
1988 *	7,319	10,163	10,996
1989 **	18,000	17,000	3,395

*Actual ** Estimated

As seen in the above table, the anticipated foreign loans in 1989 are nearly 150 percent more than that in 1988. A portion of these loans would be for rehabilitation and reconstruction purposes. Their actual utilization would however depend on the ground situation — that is, existence of peaceful conditions conducive to reconstruction.

The anticipated non-bank domestic borrowing in 1989 is more than two-thirds higher than that in 1988. The popularization of Treasury Bills as an attractive short-term investment appears to be the basis of this optimistic calculation.

However, any failure to realize the anticipated amounts from foreign and domestic non-bank sources (as happened in 1988) would invariably mean a corresponding increase in the recourse to bank financing with consequent inflationary implications.

Even without such a possibility, there is an expectation of a general price rise following the upward revisions of the BTT rates and other indirect taxes for a whole range of commodities. A number of trade unions have in particular commented on the possible inflationary consequences arising out of changes in indirect taxes; as the budget gave rise to a wave of expectations on a possible rise in the general price level.

TAXATION MEASURES OF BUDGET 1989

Samy M. Pasupati

Mr. Samv M. Pasupati, F.C.A. is a partner in a leading firm of Chartered Accountants and a member of the Council, International Financial Association, Netherlands and Chairman, Sri Lanka Branch. We reproduce here only the taxation measures from a larger paper on Budget – 1989. The earlier sections dealt with the "New Vision", the Objectives of the Budget and a Review of the Economy.

INCOME TAX

SURCHARGE ON INCOME TAX AND WEALTH TAX

A 15 percent surcharge on the amount of income tax and wealth tax will become payable for the years of assessment 1989/90 and 1990/91 in two equal installments in August and November in the year of assessment.

Since the liablility will be on a current year basis and therefore cannot be correctly ascertained, it is anticipated that the law will provide that no penalty will be payable if the installment of surcharge payable is computed by reference to the income tax and wealth tax payable for the preceding year, any short fall being paid on or before the end of November in the following year of assessment. Surcharge on employment income will be collected monthly under the PAYE scheme.

Sri Lankan tax payers are now familiar with the Surcharge method of collecting additional tax which has been adopted as a convenient measure also in previous years. We have had surcharges as follows:–

Year	Rate of Surcharge	Exemptions:
1978/79	20%	Companies–Dividend tax & Remittance tax Employees–Employment income for April to December 1978.
1980/81	10%	Companies–Dividend Tax & Remittance Tax Employees–Terminal Benefits (Administrative Concession) Income of non-national employees paying tax @ 25%
1981/82	On Income Tax Rates of 5 to 15% with marginal relief On Wealth Tax 10%	Companies–Dividend Tax & Remittance Tax Employees–Terminal benefits Income of non-national employees paying tax 25%
1984/85	10%	As above

The legislation relating to the surcharges for 1981/82 and 1984/85 provided that the aggregate of income tax, wealth tax and surcharge should not exceed 80 percent of (assessable income plus exempt income other than net annual value of residence and subsidies).

This limitation was applied as an administrative concession for 1980/81 but no such relief was granted for 1978/79.

In view of reports that emoluments of public servants that emoluments of public servants which are now exempt may be taxed, the Hon. Prime Minister and Minister of Finance has emphasised that the surcharge will apply only to persons who pay income tax and wealth tax and that "it was this Government which granted exemption to the public servants on their official emoluments."

A Section of the tax payers that may have been granted relief is the middle class private sector employees. They are now being subjected to a surcharge whereas public servants who perhaps with some justification are exempt from income tax will be exempt also from the surcharge. A relief by way of at least an earned income allowance may have been justified in these circumstances.

In the recent past the effective marginal rates of tax for individuals which have come down progressively from 60.5 percent in 1984/85 to 55 percent in 1985/86, to 40 percent in 1988/89 now with the levy of a surcharge, will record an increase to 46 percent for 1989/90 and 1990/91. Similarly tax rates of companies which also recorded a progressive reduction up to 1988/89 will now record a small increase for 1989/90 and 1990/91. In this connection, see Annex 1 (a)

Annex 1 (b) is a table of comparative taxes payable for the years of assessment 1987/88, 1988/89 and 1989/90. Tax payers below the range of approx. Rs.208,000 will pay for 1989/90 slightly more taxes than in 1988/89 or 1987/88 and those above this figure will pay more than in 1988/89, but less than in 1987/88 notwithstanding the surcharge since the marginal rate for 1987/88 was 50 percent and that for 1989/90 is only effectively 46 percent including the surcharge.

TREASURY BILLS HELD BY CENTRAL BANK – A NON REFUNDABLE TAX OF 9 PERCENT

A non refundable withholding tax of 9 percent on the face value of the treasury bills held by the Central Bank is being imposed. The payment of interest by Government to the Central Bank was reflected as expenditure in this Budget, while this same interest received by the Central Bank forming part of its income flowed back to Government. This tax will now be reflected as revenue, thus neutralising the position.

Treasury bills held by persons other than the Central Bank will not be liable to the non-refundable withholding tax. An announcement made by the media (not the press) immediately after the Budget Proposals did not state the position clearly and there was concern amongst investors for a short time on this account.

A problem area could be in regard to Treasury Bills traded in the Secondary Market. If the 9 percent is collected at point of issue, it will result in excess transfer of revenue and if at point of maturity it will cause immense hardship. This matter is being looked into.

ANNEX 1 (a)

MARGINAL RATES OF TAX, SURCHARGE AND EFFECTIVE TOTAL TAX

INDIVIDUAL

Y/A	Marginal Rate	Surcharge	Effective Total Marginal Rate
1984/85	55%	10% (Maximum)	60.5%
1985/86	55%	–	55%
1986/87	50%	–	50%
1987/88	50%	–	50%
1988/89	40%	–	40%
1989/90	40%	15%	46%

COMPANIES

Y/A	Marginal Rate			Surcharge	Effective Total Marginal Rate		
	Qtd.	Unqtd.	Non.Res.		Qtd.	Unqtd.	Non.Res.
1984/85	40	50	55 + 11.11	10%	44	55	60.5 + 11.11
1985/86	40	50	50 + 11.11	–	40	50	50 + 11.11
1986/87-88/89	40	50	50 + 11.11	–	40	50	50 + 11.11
1989/90	40	50	50 + 11.11	15%	46	57.5	57.5 + 11.11

ANNEX 1 (b)

TAX PAYABLE

INDIVIDUAL

Income	Slab	Rate	Tax on Slab	1987/88	Total Tax 1988/89	1989/90 Incl. 15% Surcharge
27,000	27,000	Tax Free	–	Nil	Nil	Nil
48,000	21,000	10	2,100	2,100	2,100	2,415
72,000	24,000	20	4,800	6,900	6,900	7,935
96,000	24,000	30	7,200	14,100	14,100	16,215
120,000	24,000	40	9,600	23,700 Balance at 50%	Balance at 40%	Balance at 46%

For Instance

INCOME	1987/88	1988/89	1989/90
50,000	2,500	2,500	2,875
100,000	15,700	15,700	18,055
150,000	38,700	35,700	41,055
200,000	63,700	55,700	64,055
208,875	68,137	59,250	68,137
300,000	113,700	95,700	110,055
400,000	163,700	135,700	156,055
500,000	213,700	175,700	202,055

WITHHOLDING TAX ON GOVERNMENT SECURITIES AND TREASURY BILLS

With a view to greater tax compliance Banks and Financial Institutions were required to deduct from interest payable by them on or after 1.4.86, a sum of 20 percent (or such lower percentage as may be directed by the Commissioner-General of Inland Revenue) in respect of deposits made by any person in his own name or in the name of some other person.

This deduction was not required in the case of Government Securities, and since it applied only to monies deposited by a person in his own name or in the name of some other person, the deduction requirement did not apply also to Certificates of Deposits as these were bearer bonds.

Changes have now been made as follows:–

a) **Treasury Bills**

Tax will be withheld. However, as Treasury Bills are issuat veryinge rates of discount, as a matter of convenience, it has been decided to withhold tax by reference to the face value at a rate of 2.5 percent per annum. It may be noted from the following tables based on the tenders accepted for the week-ending 17.03.89, that the proposed withholding approximates to 20 percent of the Discount.

Maturity Period	Face Value	Weighted Av Bid Price	Discount	If at 20% on Discount	Proposed Withholding (2.5%) on face value
Months	Rs.	Rs.	Rs.	Rs.	Rs.
3	1000	968.52	31.48	6.29	6.25
6	1000	934.58	65.42	13.08	12.50
12	1000	862.09	137.91	27.58	25.00

b) **On other Government Securities:**

20 percent will be withheld on the interest payable.

c) **Certificate of Deposit:**

These will now be liable to a stamp duty in lieu of the withholding tax. Please see comments under 'Stamp Duty'

Changes referred to under (a) and (b) will require an amendment to the law.

TAX ON PROVIDENT FUND

The taxation of Provident Funds has seen many changes in the recent past. Provident funds approved by the Commissioner General having previously been exempt from the payment of income tax, the Hon. Minister of Finance in his Budget Speech for 1987 observed that "no tax has been charged on the investment income of these approved funds in the past, mainly because their monies had been earlier invested almost exclusively in low income bearing Govt. Securities. This is no longer the case today. The major part of the monies of these approved funds are now invested in Bank fixed deposits and company shares. It is difficult to justify the exemption from tax of the investment income of these funds when even approved charities are taxed on their investment income."

He therefore proposed to levy a tax of 20 percent on the investment income of these funds other than on income derived from Govt. Securities. Liability arose on investment income earned on or after 1.4.87.

Trustees of many Provident Funds argued that these were monies held in trust for their employees and if they had invested the monies wisely bringing a better return, the levy of a tax for that reason would amount to a penalty for efficient management. It was also pointed out that the Provident Fund would be liable to tax and once again when distributed the employee would, subject to the exemption, be liable to tax thus reducing further their retirement benefits.

In the subsequent year, apparently in view of these representations, the Minister announced that any distributions out of that portion of the Provident Fund money which represents the investment income which has already been taxed in the hands of the fund would be exempt in the hands of the employee. This exemption applied retrospectively as from 1.4.87.

It is now proposed to tax from 1.4.89 all investment income, whether from Government Securities or not, but at only 10 percent, as against the original rate of 20 percent. In that event all distributions out of all such income will also be exempt. The principal beneficiance will be those receiving large terminal benefits, since they would effectively be taxed at only 10 percent (being the tax paid by the Provident Fund) instead of the maximum 15 percent to which they would have been liable. On the other hand, the employee who receives a relatively small terminal benefit and therefore would have been exempt will effectively suffer a 10 percent tax, and on the income of the last two years, 20 percent tax. He will therefore be wrose off. It might have been best if none of the above changes have been made.

EXEMPTION ON DIVIDEND INCOME UP TO RS.12,000 - WITHDRAWN

The provisions relating to distribution of exempt profits as exempt dividends and the further distribution of such exempt dividend income by companies remain unchanged.

Apart from the exempt dividend income as above which is exempt all dividend income which would otherwise have become liable to tax were exempt upto an amount of Rs.12,000/-.

The then Minister of Finance in his Budget Proposals for 1985 had referred to the economic double taxation of company profits, viz. first on the company and then again when the profits are distributed, in the hands of the shareholder, and observed that "the present system of taxation has also inhibited the development of an active share market which is a pre requisite for a healthy corporate sector. The Government intends to do everything possible to encourage company information and the growth of the share market."

The then Hon. Minister of Finance therefore proposed "to exempt from income tax dividend income up to Rs.12,000 per year received by an individual and observed that "the small investor will as a result be totally exempt from income tax on dividends received by him." and hoped "this measure will reduce the incidence of tax, promote broad based share ownership and encourage active participation in the share market."

The Government has since partialy relieved economic double taxation by the introduction of a half imputation system. It is hoped that in the near future when conditions permit that this will be extended to full imputation.

Provisions have also been made to encourage conversion of proprietary and partnership business into limited companies by treating these as a continuining business and defering of any gains or losses arising from conversion for assessment when such assets are ultimately disposed by the company.

There has however been some criticism in regard to the exemption of dividend income of Rs.12,000 on the basis that this exemption is inequitable in that the tax payers in the higher income bracket benefit at their marginal rates of 40 percent whereas to the smaller tax payer benefit is small or insignificant. Just a few countries have similar small exemptions but these are more for reasons of administrative convenience.

In the above circumstances, and with the move towards imputation the withdrawal of the dividend exemption from 1st April 1989 may be justified.

It may be noted that if dividends are declared before 31st March, 1989, the following benefits may accure:

a) to the share holder
   i) the above dividend exemption of Rs.12,000 would be available
   ii) the surcharge on income tax would not apply

b) to the company
   if the declaration is out of profits for the year ended 31st March, 1989 the imputation tax will be available to the extent of half against the tax payable for the year of assessment 1988/89.

ADMINISTRATIVE PROVISIONS - APPEALS

In the representations made to the then Hon. Minister of Finance & Planning, it was pointed out that

" a far greater degree of compliance can be expected where the tax system, the administration and the laws are fair. The tax payer should be assured that he has a fair deal. Most countries have therefore taken steps in this regard. For instance, in Indonesia, it is provided that unless an appeal is settled within one year the appeal will deem to have been allowed and in Canada the tax disputed is not payable till determination and a penalty will be payable only if it is considered that the appeal was made malafide. Certain provisions or perhaps the absence of provisions in our revenue laws have no parallel in other countries."

The Hon. Minister of Finance & Planning having considered these representations announced in his Budget Speech for 1987 that

> "every petition of appeal preferred .... on or after April 1, 1987 shall be agreed to or determined within 2 years from the date on which such petition of appeal is received by the Commissioner–General, unless the adjustment or determination of such appeal depends on the furnishing of any documents or the taking of any action by any person other than the appellant or the Commissioner–General or an assessee. Where such appeal is not agreed to or determined within such period the appeal shall be deemed to have been allowed and tax charged accordingly. The receipt of every appeal received ..... shall be acknowledged and the date of the letter of acknowledgement shall be .... deemed to be the date of receipt of such appeal."

This was a most welcome provision and has resulted in the Dept. taking up appeals lodged for early settlement. The proposal to extend the period of 2 years to 3 may also perhaps be justified but the entire provision can be nullified by the proposal that the time limit will not apply when a tax payer fails to furnish information and other particulars called for to settle the appeal.

There have been instances where information has been called for some times even after almost 25 years quite apart from the appeal not having been taken up for settlement for many years. The correct procedure if a tax payer fails to furnish information and other particulars called for is to determine the appeal in favour of the Revenue. An amendment as proposed will enable the Dept. to keep the appeal open indefinitely as before.

Tax payers are not unconscious of the demand for "arrears of taxes" being called for, for periods of 15 to 20 years earlier. This means that every tax payer will have to keep his records indefinitely notwithstanding the liability having been agreed and taxes paid. In the U.S. for instance, the taxes cannot be collected after a period of 6 years. On the other hand Sri Lanka still has some unique legislation, for instance that which enables the Revenue Authorities to issue assessment at any time even say 50 years later merely on the grounds that the tax payer had made a late return even though such return may have been correct in all its aspects.

While on the one hand tax payers must comply by making correct and complete returns in due time, the Revenue Authorities should also create a climate of confidence in which the tax payers should feel that its pays to be honest. While every effort is being made by the Commissioner–General and his Commissioners to instill confidence in the minds of tax payers, legislation of the above nature are counter-productive.

E.P.F. & E.T.F. CONTRIBUTIONS BY EMPLOYERS DOUBLE DEDUCTION IN CERTAIN INSTANCES

New undertakings which create employment under the Jana Saviya Programme will be permitted a double deduction of the employers contribution to the Employees Provident Fund and Employees Trust Fund for tax purposes if it is in respect of a new industrial or agricultural undertaking with employment opportunities for at least 10 persons in specified areas of high unemployment or those covered by food stamps/Jana Saviya Programme. The incentive of allowing double deduction has been adopted also by other countries. For instance, Singapore had allowed a double deduction of Research & Development expenses in approved undertakings and of expenses incurred in promoting Singapore manufactured goods at approved overseas trade fairs and exhibitions.

STAMP DUTY

CERTIFICATES OF DEPOSIT

Please see para 3 under Income Tax. There has been considerable criticism that whereas interest paid by Banks and Financial Institutions were liable to a withholding tax, Certificates of Deposits were exempt. A corresponding amount was therefore intended to be collected by way of a Stamp Duty. This need not be collected as a withholding tax since it would not be a tax withheld which would be claimed by a tax payer since, as the Hon. Prime Minister and Minister of Finance has stated, these are under "the scheme of Certificates of Deposits in Commercial Banks (which) was introduced some time back to encourage hoarder of black money to bring such money into circulation."

It is also best that it is collected as a stamp duty and not as a withholding tax as it may have created a certain degree of panic amongst such depositors resulting in their withdrawing such deposits as did happen to some extent in the case of other deposits with Banks and Financial Institutions when the scheme of withholding tax was originally introduced.

The stamp duty applies also to the Treasury Certificates of Deposits.

The amount payable is 3 percent. If it had been on a per annum basis, as may be seen from Annex111, the stamp duty would have been approximately equal to the tax that would have been withheld on the discount at 20 percent on current rates of discount. However, as the gazette notification prescribes just one rate of 3 percent on the face value irrespective of the period of the collection the d ty collected will not be as apparently intended. As gazetted now it is inequitous and is due to be amended.

ANNEX 111

CERTIFICATE OF DEPOSIT

PROPOSED STAMP DUTY COMPARED WITH WITHHOLDING TAX

Period	Nominal Value	Purchase Price	Discount	If Withheld at 20% p.a. on Discount	Stamp Duty at 3% on NV if on p.a. basis
6M	100,000	94,340	5,660	1,132	1,500
12M	100,000	86,207	13,393	2,759	3,000
24M	100,000	73,529	26,471	5,294	6,000
36M	100,000	62,500	37,500	7,500	9,000

Pl. Note:

The notifications require payment of stamp duty on the face value at 3% (irrespective of the period). This will mean that a Certificate of Deposit for Rs.100,000 will be liable to a stamp duty of Rs.3,000 irrespective of the period, whereas if the period was taken into account it would have been as in the last column and comparable with a withholding tax of 20%.

Under the Inland Revenue Act these discounts are not exempt from tax. Persons declaring this income should not therefore invest their funds in Certificates of Deposit for the reason that the Stamp Duty, being not a withholding tax, will not be available for credit and they will end up paying both stamp duty and income tax.

TURNOVER TAX

WITHHOLDING TAX ON SALES BY MANUFACTURERS/ IMPORTERS

Most countries are now placing greater emphasis on Consumption Tax. This has the major advantage that persons outside the tax net who invariably have the capacity to and in fact incur considerable amount of wasteful expenditure are thereby brought into the tax net. This is possibly very relevant in the Sri Lankan context.

Of course it may be argued that Consumption Tax may cause some hardship to the poorer sections of the community but this can be overcome to a large extent by the grant of exemptions for essential commodities. In practice this should work as the pattern of expenditure of the wealthier classes will be that a major part of their consumption will be on luxuries and therefore they would contribute proportionately more to Consumption Tax whereas in the case of the poorer sections a major part of their consumption will be in respect of items which would be exempt.

Value Added Tax (VAT) is being favoured by most countries mainly for the reason that the cascading effect of taxation at different points is done away with and also it would be self policing in that the tax collected by the seller at the point of sale is allowed as credit to the buyer against his tax, resulting in a chain of transactions . There is already a VAT System in operation in Sri Lanka where a manufacturer or importer sells to a manufacturer. However this chain of transactions of input tax credit is broken when a sale is made to a non-manufacturer.

The Minister has therefore taken a further step in this direction by requiring the withholding of 1 percent by all manufacturers and importers on all sales other than of excepted articles made by them. This 1 percent collected will be paid quarterly with his own taxes.

There can be certain practical problems for instance where an importer also deals in articles purchased by him in the local market.

Under the proposed system which requires an amendment to the law, to be made effective from 1.4.89 a trader who is not a manufacturer will be able to claim the credit of 1 percent withheld against the turnover tax payable by him whereas a manufacturer who purchase from a manufacturer or importer will be able to claim as credit this 1 percent withheld in addition to the input credits he would have been entitled to under the old scheme. In this connection, please see Annex 11. All input credits, as now, can be deducted from the tax payable for the quarter in which they have been paid, and to the extent that they cannot be duducted, carried forward for deduction in the following quarter and so on. Such excess will not be available for refund. However, representations have already been made in regard to the excess carried forward by importers and manufacturers that these be refundable. The same considerations will apply in this instance too and it is expected that provision enabling a refund will be made shortly.

OTHER CHANGES (EFFECTIVE FROM THE MID-NIGHT OF 16/17TH MARCH 1989)

1. **Rates**
Importers at point of import, and manufacturing business at point of sale

Coconut oil (previously exempt)	– 5%
Luxury items Cosmetics & Toilet preparations (example: perfumes, eau-du-cologne, toilet powder, hair dyes & hair tonic) but excluding soaps, tooth paste and tooth powder	– 40%
Carpets, mats and tapestries (coir carpets & rugs – no change – 12%)	– 40%
Solar electric panels (now 12½%)	– 3%
Non-manufacturing business	
Sales made by Duty Free Shops (now 10%)	– 20%

Considerable concern has been expressed as to whether the Duty Free Shops will be able to pass on this additional 10 percent. Of course in the light of an increase in the rate applicable to importers of luxury articles an increase on the rate applicable to the sales by Duty Free Shops, a large proportion of which are to Sri Lankan nationals, the increase may be justified.

Excepted Articles

It has been the policy of Government to promote exports and several incentives had been granted, including the exemption from Turnover Tax for exports.

This exemption is now being extended to gems and jewellery sold (whether by a trader or a manufacturer) for payment in Foreign Exchange by persons authorised by the Central Bank of Sri Lanka, on the basis that these sales are as beneficial as exports, to Sri Lanka.

ANNEX 11

TURNOVER TAX
DEFINITION OF "TURNOVER"

1. IN THE CASE OF AN IMPORTER

1.1 At point of import:
The aggregate of
- i. CIF (Value as ascertained for Customs Duty)
- ii. Custom Duty
- iii. 10 percent of (i + ii)

1.2 If Sold:
The total amount received or receivable

2. IN THE CASE OF A MANUFACTURER

2.1 If sold to another manufacturer
The amount received or receivable before adding amount due as turnover tax .

2.2 If sold to any others
The total amount received or receivable.

Contd.

3. **IN THE CASE OF A TRADER (Not being a 'Manufacturer')**
The total amount received or receivable.

I ARTICLES IF IMPORTED AND SOLD IMPORTER

CIF	100	
Duty (Say)	50	
	150	
Turnover Tax (say) 20%	33	(a) (20% of (150 + 50 = 165 Pl. see Definition 1.1)
	183	
If other expenses & Profit (Say)	120	
is sold for	303	

A. UNDER SCHEME PRIOR TO 1.4.1989

1. If sold to a Manufacturer

The bill will be as follows:
Selling Price 300
Turnover Tax (1%) 3 (b)
Total Received or Receivable 303

Note:
The manufacturer can claim as a credit against the turnover tax payable by him, the aggregate of (a) + (b) i.e., : 36
The importer will pay on his sale turnover tax of 1% of 300 viz: 3

2. If sold to any others

The bill will merely show the total selling price of 303

A trader selling this for (say) 400 will pay turnover tax of 4 (i.e. 1% on his selling price)
The importer will pay on his sale, turnover tax of 1% of 303, viz: 3.03

B. UNDER THE SCHEME FROM 1.4.1989

1. If sold to a Manufacturer

The bill will be as follows:
Selling Price 300
Importer's turnover tax (1%) 3 (b)
303
Buyers turnover Tax (1%) 3 (c)
Total Received or Receivable 306

Note:
The manufacturer will claim as a credit against turnover tax payable by him, the aggregate of (a + b + c) viz: 39

The importer will pay, on his sale, as before, 3, plus the further 3 on behalf of the buyer.

2. If sold to any others

The bill will be as follows
Selling Price 303.00
Buyers turnover tax (1%) 3.03
Total Received or Receivable 306.03

A trader who sells this for (Say) 400.00
will be liable to turnover tax at 1% as before 4.00
Less: Turnover tax paid on his behalf 3.03
and pay only the balance 0.07

The importer will pay, as before 3.03 plus a further 3.03 on behalf of the buyer.

Annex II (contd.)

II. ARTICLES IF MANUFACTURED AND SOLD MANUFACTURER

C. UNDER OLD SCHEME

1. If sold by Manufacturer (M1) to another Manufacturer(M2)

The bill will be as follows:
Selling price (say) 250
Turnover tax at Manufacturer's rate (say 10%) 25 (d)
Received or Receivable 275

NOTE:
The second Manufacturer (M2) will claim (d) from the turnover tax payable by him.

Manufacturer (M1) will pay Turnover Tax (d) 25 (less turnover tax if any charged on his inputs by another manufacturer, or turnover manufacturer, or turnover tax (a + b) paid by an Importer as in Example:. A1)

2. If sold by Manufacturer (M1) to any others

The bill will be merely show Selling Price of 275

A trader selling this (say) for 400 will pay turnover tax of 4 (i.e. 1% of his selling price).

Manufacturer (M1) will pay 10% of 275, ie. 27.5 (less turnover tax if any charged on his inputs by another manufacturer, or turnover tax (a + b) paid by an Importer as in Exaple A1)

D. UNDER THE SCHEME FROM 1.4.1989

1. If sold by Manufacturer (M1) to another Manufacturer (M2)

The bill will be as follows:
Selling Price (say) 250.00
Turnover Tax at Manufacturers rate (say) 10% 25.00 (d)
275.00
Buyers Turnover tax (1%) 2.50 (e)
Total Received or Receivable 277.50

NOTE:
The second manufacturer M2 will claim (d + e) from the turnover tax payable by him.

Manufacturer M1 will pay as in C1 plus a further 2.50 (e) on behalf of M2

2. If sold by Manufacturer (M1) to any others

The Bill will be as follows
Selling price 275.00
Buyers Turnover Tax (1%) 2.75
277.75

A Trader who sells this for (say) 400.00
will be liable to turnover tax at 1% as before 4.00
Less: Turnover tax paid on his behalf 2.75
1.25

The Manufacturer M1 will pay as in C1 plus a further 2.75 on behalf of Buyer.

TAX AMNESTY

There are strong views against the grant of amnesties. However, in practice, countries have been compelled to grant amnesties to give an opportunity to those outside the tax net to come into the tax stream. However, we find that progressively countries have reduced the concession available to such tax payers. The recent amnesty in Australia required that such persons must pay all their taxes. They were exempt only from the penalties.

In Sri Lanka we have had a number of amnesties. There was one in 1964 by the S.L.F.P. Government and another in 1966 by the U.N.P. Government. There was a Demonetisation Amnesty in 1970, a Foreign Exchange Amnesty in 1971 and a Gem Amnesty in 1973.

Another Amnesty was granted by the U.N.P. in 1978. This required the payment of a tax of 30 percent and the balance had to be held in a Special Deposit Account with the National Savings Bank till 31st March, 1983.

However, a person was permitted to withdraw such deposits for investment in projects approved (for Investment Relief) by the Minister under the Inland Revenue Act, a GCEC project, or utilize such deposits for purposes of any Approved Expenditure in terms of the Inland Revenue Act or the purchase or construction of a house if such purchase or construction was approved by the Commissioner for National Housing.

The Amnesty now proposed is in a way similar to the 1978 amnesty but in this instance the Hon. Prime Minister and Minister of Finance has stated

1. that the deposits will have to be made within 3 months commencing 1st April, 1989
2. the tax payable will be 20 percent of the deposit
3. the balance amount held in deposit should be invested within 2 years in an agricultural or industrial project under the Jana Saviya Programme with employment opportunities for at least 10 persons.

Note What is intended is that the balance in deposit cannot be withdrawn for a period of 2 years, except for investment in an agricultural or industrial project under the Jana Saviya Programme with employment opportunities for at least 10 persons.

Specific legislation will be enacted shortly.

EXCISE DUTIES

Excise duties and import duties on tobacco and liquor have always been an easy (and possibly justified ?) avenue for collecting additional revenue. This year too the Minister has raised the duties and also gone a step further by abolishing with immediate effect the duty free sale of liquor and cigarettes at the Duty Free Shops located outside the Airport.

CUSTOMS DUTY

Duties on cars have been increased and effect has also been given to the recommendations of the Presidential Tariff Commission.

SPECIAL EXPORT TAX

The U.S. Commerce Dept had taken the view that some textile imports from certain countries, including Sri Lanka, are being traded unfairly because they are subsidised. A team of officials were in Sri Lanka in 1984 to examine the position further and a Countervailing Duty of 3.06 percent on garments and 5 percent on textiles exported from Sri Lanka was imposed from the year 1985 to counter the "unfair advantage" that these exports had in the U.S. Among the countries that were examined by the U.S. authorities were Argentina, Peru, Malaysia, Singapore, Thailand, Columbia, Indonesia, Mexico, Phillipines and Turkey. It appears that some of the countries or sectors had agreed to renounce the use of subsidies and thereby avoid the imposition of the countervailing duty by the U.S.

The Minister has proposed that we should impose a special export tax of an amount equal to the Countervailing Duty which is the measure of the "unfair advantage" that our exports have in the U.S. It is fair that the U.S. authorities should agree to abolish their duty. Pending negotiations the imposition of the Special Export Tax has been deferred to 1st July, 1989. If the U.S. agrees this would bring in additional Revenue to Sri Lanka without causing any hardship to the exporters.

CHARITABLE INSTITUTIONS

Although the Hon. Prime Minister made no reference to Charitable Organisations, the reduced rate of 10 percent applicable to the investment income of provident funds will apply also to the investment income of charitable institutions as against the present rate of 20 percent. Since income of charitable institutions is invariably from investments, the Bill when drafted may provide that all income (not merely investment income) of a charitable institution will be liable at 10 percent.

EXPORT PROFITS - EXTENSION OF EXEMPTION

Representations were made for the extension of the five year period of tax exemption now available for profits from the export of articles other than black tea in bulk, crepe rubber, sheet rubber, scrap rubber, coconut oil, desiccated coconut, copra, fresh coconuts, coconut fibre or gems. This exemtion is due to expire on 31.3.1989. Although the Prime Minister and Minister of Finance did not refer to this matter in the Budget Speech, there will be an extension of one year under the Inland Revenue Amendment Bill to be tabled shortly.

The exemption for export of gems or sale locally for foreign currency is currently available without limitation under certain other provisions of the Inland Revenue Act.

TAXATION COMMISSION

It is over 20 years since a Taxation Enquiry Commission had made a comprehensive enquiry about tax system. The Hon. Prime Minister and Minister of Finance therefore proposes the appointment of a Taxation Enquiry Commission to "undertake a complete review of the Tax System and to recommend changes necessary to make it both effective and efficient."

VIEWS ON THE BUDGET

TRADE CHAMBERS

The Federation of Chambers of Commerce and Industry of Sri Lanka, President, Mr. C. Karunanayake: "The Private Sector welcomes the anticipated continuance of the open economic policy of the Government. It was also expected that the main trust of the Government's development programme would be on the alleviation of poverty and the creation of new employment opportunities particularly through small production units.

All in all, no harships have been placed on the ordinary people. The Trade welcomes the measures for the relief of the tea industry as well as the exemption from turnover tax on sales of gems and jewellery for payment in foreign exchange.

The 15 percent surcharge on Income tax and Wealth Tax for the years 1989/90 and 1990/91 appears to have been inevitable due to the need for additional revenue by Government. While the increase in turnover tax on luxury items and the duties on motorcars appears reasonable, it is noted that the minimum duty on plant, machinery and materials goes up from 5 percent to 10 percent by way of a surcharge for 2 years.

An efficient and effective system of taxation has been a long-felt need. Business will therefore welcome the proposal to re-examine the entire tax system by a Taxation Inquiry Commission. It is hoped that the Private Sector which is the major contributor to tax revenue will be consulted in the reform of the tax system which, at present, exempts Public Servants from Taxation on their official emoluments.

Despite an overall budget deficit of Rs. 53 billion the Government has attempted to meet both the demands for distribution and equity as well as growth and development. However the economic strategy of the Government would require a large measure of foreign assistance and a concerted effort to eliminate all waste, eradicate corruption and increase efficiency in public offices.

It is also hoped that the necessary policy measures which have been promised will be taken early to support the producer and the exporter by the maintenance of a realistic Exchange rate and to check domestic inflationary pressures."

The National Chamer of Commerce of Sri Lanka, President, Mr. Karu Jayasuriya: "The Budget in this instance has been presented, departing from tradition. In the context of the enormous tasks before the Minister in financing the Janasaviya Programme what he has been able to achieve is very commendable.

We are concious of the fact that H.E. The President is determined to eradicate poverty, one of the main causes of the present unrest.

In our opinion therefore, it is prudent for the Government to tackle this problem in the first instance in a meaningful manner and thereafter proceed with rapid economic development on a phased programme which will yield better results.

Since peace and stability to vital for a sound economic base, the National Chamber of Commerce of Sri Lanka is hopeful that proposals contained in the Budget, directed towards poverty alleviation, will bring about stability in the not too distant future.

The reference to the already repealed Business Acquisition Act is certainly encouraging and will restore confidence to the private sector. But emergency provisions to nullify the repeal of the Act should not be invoked.

The creation of a single umbrella body to promote and co-ordinate foreign investments in the operation of the G.C.E.C. and F.I.A.C. is a step in the right direction provided the organisation is geared to achieve speedy disposal of investment proposals.

We also note that the Government intends to proceed with its plans for privatisation in a realistic manner. We welcome the Minister's bold reference to a plan for closing down of public enterprises performing inefficiently, but we hope that the plan will not be shelved for political reasons.

We consider it most essential to protect and develop the 'Tree Crop Sector', for this segment will remain the main source of livelihood so to say, for many years to come.

The surcharge on income tax, though an additional burden to the tax payer will no doubt be a sacrifice to achieve the objects of the Janasaviya Programme. We expect the retail trade to show their sincerity by absorbing the additional turnover tax of 1 percent meant to be collected from them.

Reduction in the rate of taxation of 10 percent on certain Provident Funds will be a great relief. However, we strongly urge the Government to totally eliminate tax on terminal benefits.

We note that duty on Plant and Machinery has been raised from 5 percent to 10 percent. This can negate some of the good intentions for employment creation. What is of greater concern is the increase in duty on raw materials from 5 percent to 10 percent as it will be a continuing burden.

The National Chamber of Commerce is very conscious of the tremendous problems the Government has to contend with and would wish that the budget proposals will achieve for the country the objects it seeks to realise."

The Chairman, Sri Lanka Apparel Exporters Association, Mr. Lyn Fernando in a letter to the Hon. Prime Minister and Minister of Finance on the Proposed Tax of 3.06 percent on apparel exports to the U.S.A. states:

We feel that there is some serious misunderstanding on this proposal and consequently we are appealing to you through the Honourable Minister of Textiles and Rural Industrial Development and the Honourable Minister of State for Textiles in order that you may study this matter in greater detail with a view to withdrawing this proposal.

Among some of the issues raised in the Association's letter are the following:

If this tax is to be levied on factories operating in the Free Trade Zone it would require special legislation which would be contrary to the Agreements already entered into by the GCEC and these factories which specially prohibit such taxes. Any attempt to introduce such legislation which is retrospective would also have adverse effects on future much needed foreign investments. Consequently if the GCEC factories are excluded from this tax in the same manner as they are now exempted from the Rs.1/- per piece quota levy the net result will be that the factories operating in the Free Trade Zone would not only be more competitive than those outside, but in effect make factories outside the Zone pay for the incentives given to manufacturers in the Zone.

What will be the position of firms who have filed successful petitions to the US Dept. of Commerce and have succeeded in obtaining an exemption on the payment of the countervailing duty ? Will they also be liable to this tax? For your information, there were many other firms desirous of filing action in the United States but were persuaded by the Sri Lankan Authorities not to do so.

If Government decides to proceed with this tax, it is imperative that Officials from the US Dept. of Commerce visits Sri Lanka and make a re-examination of the incentives or subsidies. What would be the position if they determine a higher rate?

The rationale for this proposal is that the withdrawal of the Countervailing Duty would result in a higher price simply because a tax imposed in their own country is removed.

The Apparel Export Industry has had a spectacular growth from an export value of about Rs.60 million in 1976 to over Rs.12.5 billion last year. We are all agreed that the net foreign exchange earning is only about 30 percent of this figure but in the current context of His Excellency the President's poverty alleviation programme it is important to understand its socio-economic benefit by the enormous amount of employment generated both in the industry and in its feeder industries such as the manufacture and supply of ancillaries to the industry. Additionally Government has also identified proposals for backward linkage and if implemented would result in an additional amount of foreign exchange earned by the country and more particularly in the provision of employment to a larger number and thus effectively contribute to the policies pursued by His Excellency the President.

The proposed tax is therefore contrary to these policies and would only act as a severe dis-incentive to the growth of this industry and the generation of employment.

BUDGET 1989 – An OVERVIEW

Bernard Soysa

Mr. Bernard Soysa, a former Chairman of the Public Accounts Committee and the Secretary of the LSSP was for long years regarded one parlimentarian who made an authoritative contribution to the Budget debate and has also addressed many professional forums on fiscal policy and public sector finance.

In most budgest that I have seen in the past few years I find -whether there is a deliberate attempt to hoodwink the public or not, I do not know - or whether they are hoodwinking themselves - a good many of the figures that have been put forward have been erroneous. In other words they were bogus figures. I have a strong suspicion - it only amounts to a suspicion - that in this year's budget too revenue expectations have been slightly understated. In any event, with all that there emerges a position that should make a person putting forward a budget nervous and unhappy. This is that whatever be the treatment of the Capital budget there is an anticipated deficit on the Recurrent Expenditure side, which without any further comment means that you are living beyond your means.

Regarding Capital Expenditure - I have not seen the detailed estimates. I therefore do not know to what extent there has been any pruning as compared with what was provided last year. I cannot say. Sometimes, any reduction of the estimate could mean that the project for which money was voted before has been completed or nears completion. I know a number of estimates for projects that have begun and are nearing completion and any attempt to slash those votes would mean that either you are paying people for doing nothing for some time, or on the other hand halting works for a period of time which would mean that the benefit expected from that project will also be delayed for that period, while the money spent remains tied up with that incomplete project.

Now this Budget is expected to have a different structure from previous budgets. In all the earlier Budgets Mr. Ronnie de Mel added up results in this way: considerable reliefs, Tax reliefs granted to the affluent in various ways. I am not here trying to justify them or to say that they were unjustified. That is not the aspect with which I am concerned now. Those tax reliefs were sought to be justified entirely on the footing that they were necessary in order to get the private sector harnessed to development to get the private sector to work in an expanded manner. That is, apart from whatever they were doing at the time to harness them for development in a big way. Has this happened? I do not see such results, or any worthwhile results to show for it. There has been a considerable growth in regard to Infrastructure development but that was almost all carried out on government expenditure. Private sector expansion has been principally in regard to Services, in Commerce; commercial activities have undoubtedly expanded on a large scale. What has that brought us? Added inflation. A consumerist bonanza for some.

The theory that tax reliefs would encourage capitalist development is one that has been found to be inadequate over many many years. It was revived and strongly adhered to by the previous Government which was in office for eleven years. It was revised on an acceptance of the economic theories of Hayek and Milton Friedman. An the ideas that they put across have been practised by governments as different from ours as Mrs. Thatcher's Government in Great Britain or that of Ronald Reagan in the United States. Any failure on the part of those governments have been attributed by the economists who propounded the theories to the fact that their theories were not fully implemented. If they had been fully carried out, they say, things would not have been so bad.

In any event, the activities of the last Government in this country for eleven years were said to be contrasted with "the socialist policies of the previous government". That is totally incorrect. There were no socialist There were no socialist policies of previous governments, not even in the days of the Coalitions. Dr. N.M. Perera and others, on two occasions, tried to turn the country in that direction. But there was no great socialist transformation, save the nationalisation projects that were effected. What was done in a big way was in respect of land: the land distribution policy, the limitation on the extent of ownership and the nationalisation of the foreign owned estates. Those were big items: but they did not add up to socialism. These are not the things most mentioned when the new policy was contrasted with the "socialism" of the past. The principal reference was to the "controls". Price control, exchange control, rationing and the like.

However, there was certainly a new departure with Mr. Ronnie de Mel's budgets.

To be continued.

The Budget and Janasaviya

The Minister of Finance emphasised in his Budget Speech that in preparing the Draft Estimates for 1989 he had given "the highest priority to adquately provide for the Poverty Alleviation Programme" (PAP). Among the features he emphasised in his programme were:

* It will be a lead programme for the Government to raise the productivity and quality of the people in a short time;

* The Multi-faceted nature of the programme is kept in view, requiring simultaneous action of many fronts, to alleviate the condition of the poorest of the poor.

* Creating sustainable and productive employment opportunities will be an important part of this programme.

* A number of steps are being taken to ensure that the entire public sector, including Corporations, adopt Poverty Alleviation as an important component of their operations and activities.

* In providing new employment in the state sector, other things being equal, preference will be given to applicants covered by the Food Stamps Scheme and the Poverty Alleviation Programme.

* The public sector will reserve at least 50 percent of its new semi-skilled and un-skilled jobs for this programme.

* A sustaintial part of the new jobs in the State and Corporation sectors, numbering over 100,000 that become available in 1989, would be given to the poorest of the poor.

* Preference for this segment of the poor will also be shown in the matter of selection of families for settlement under the Mahaweli Scheme and also in other major irrigation projects, as well as during alienation of lands elsewhere.

* The numerous projects under the Reconstruction and Rehabilitation Programme, for which nearly Rs. 5,000 million has been provided in the 1989 Estimates, should also provide over 150,000 new employment opportunities to the unemployed.

* The State banks have been directed to actively participate in the Poverty Alleviation Programme by making available the much needed credit facilities to the poor on affordable terms and with minimum paper work.

* The private sector is invited to actively participate in this programme. Liberal incentives have been provided for additional employment generation, particularly in poverty stricken areas.

* An initial allocation of Rs.10,000 million has been made for the nine months of 1989, for disbursement under the Poverty Alleviation Programme. These disbursements will be made in a phased manner as the beneficiaries are identified.

* All donations to the Janasaviya Fund are to be made 100 percent tax deductable; and the Fund will accept donations to be used in a particular hamlet or village.

JANASAVIYA, PRODUCTION AND INFLATION

"Conditions have been created to bring about a new growth of small scale and large scale industries. In the next two years we should fully commit overselves and direct our efforts, to transform half of our population who now live on Food-Stamps, into people with some means and capability. This population, if taken as consisting of families having five members each, would amount to 15 lakhs of families. Those15 lakhs of families may comprise seventy lakhs or, may be, eighty lakhs of induviduals who are now living in utter want. It is to meet this challenge that we should direct our efforts on all fronts - our science, technology and even administration. That is to strengthen our people. I believe that a family of five living on Food Stamps is not receiving more than Rs. 350/- inclusive of even the recent increase. How can that family live on that income? If they have one meal, they will have to skip the next. They do not have enough clothes to permit a change of clothes. Their children suffer from malnutrition. They do not have a piece of land or a house to call their own. What we are now trying to do, through Janasaviya, is to strengthen these people. Today, we are investing money on various projects. Hereafter, we are going to invest money on our people. I believe, the most fruitful investment is the investment on people. It it is the people who are going to benefit from our development activities, we should strengthen the people, so that they will be able to help themselves. We should get the people to participate in our development work. It is only through production that a country's wealth can be increased. What we need is people-based production.
This Janasaviya Programme is for that purpose."

President R. Premadasa
From a speech, to the High Level Official Conference, on "Policy Guidelines on Poverty Alleviation".

"Orthodox economists and others who think on traditional lines obviously would have fears about the prudence of this new strategy. Their fear is that if poor people are given opportunities of consuming more goods, there would be a shortage of goods and there would be severe inflation.

Already, such people and organisations are ringing the alarm bells of inflation. This is because they have not fully understood the final objectives of the new strategy contained in the poverty alleviation programme nor have they any hunch as to how the programme is going to be managed.

There is also a fear that much of the money for this programme would come through the creation of new money. There is also the view held that additional funds could only be found from expansionary sources.

Our task here is to see whether the fears that have been expressed have any meaning in regard to the argument that financing of direct consumption by the government is bad.

The answer is while it is true that all people must earn money, it is equally true that the poor who cannot earn due to no fault of their own should have access to purchasing power and this money should come from the savings of other people in the community.

On the other hand, even if some part of the expenditure has to come through newly created money, but if parallel arrangements are made to increase production both the producer and the consumer would benefit, prices will not increase and inflation cannot take place."

Dr. H.N.S. Karunatilake
Governor, Central Bank of Sri Lanka from an article in the Daily News of March 16,1989.

JANASAVIYA AND EMPLOYMENT

H.N.S. Karunatilake, *Governor, Central Bank of Sri Lanka*

The main thrust of the current economic policies are heavily focussed on the welfare of the poor people through the Janasaviya Programme. The poorest of the poor number about 300,000 families out of a total of nearly 3 million families and this is about 10 percent of the toal population.

As more employment is created, poor families will go out of the scheme. The administration is giving equally high priority to the rapid creation of a large number of productive job opportunities.

The most important component in job creation is proper economic and investment management with the active participation of the people. The Janasaviya programme has grass roots level co-operation, collective action and production as its main objective.

Today, out of an estimated one million unemployed those who are desperately in need of employment would number about one third of this figure. This would imply that those who badly need employment would largely come from the poorest of the poor families.

Accordingly, it would be meaningful for employment to be given on a priority basis to those in poorest of the poor families in the country. If 300,000 jobs for the youth can be found in the next twelve months and these are given exclusively to those from the poorest 300,000 families, then the expenditure on the Janasaviya programme would be reduced considerably because the incomes of such families would immediately rise above the cut off point.

The Janasaviya programme would thus have achieved its objective even without making payments for consumption to poor families on a monthly basis.

The dynamics of the programme is firstly, lifting families beyond the subsistence threshold by increasing the intake of nutritive food, by family productive activities and by finding employment for family members.

The main object is to make the poor efficient producers and to organise them on viable productive endeavours in the environments in which they live. In this respect, the core of the programme is the investment component which will be placed in bank accounts in favour of the family.

From the second year onwards, and where possible even in the first year, this money will be the capital needed for production. Under a village change agent leadership families will jointly organise themselves in productive activities using local resources and the assets available in the environment.

The emphasis will be on small scale industries in the villages. Such small scale industries could manufacture a wide range of products for domestic use and export.

Under Janasaviya, the people will have opportunities of thinking, planning and designing. The Government will act as the catalyst giving them immediate help where such assistance is needed, whatever it may be.

The success of these small industries will depend on the capacity for self reliant and joint endeavours, the motivation and training the government can provide and the assistance they would get from Government for their financial, credit, marketing, export, technical and raw material procurements.

It will also depend on the machinery that would be set up to monitor, coordinate and implement small projects at the village level.

Financial Resources Available

People had doubts whether we could find the money. This is because they never understood the final objective and the rationale behind the poverty alleviation programme (PAP). The programme is aimed at the poorest of the poor, and therefore in terms of numbers and implementation capacities is manageable. We have found the money without cutting down development or even restructuring the ongoing programmes. We have started this at a time soon after we have completed the large projects like Mahaweli. Investments in agriculture, small irrigation works, water supply, housing and development of the plantations would continue..

As expenditure is incurred under the budget and as strict monitoring, controls and supervision are exercised there will be grater economics, and a considerable sum of money would be saved. More important than the figures and allocations in the budget will be the care and emphasis given to the implementation of proposals. Our strategies are different, every stage of implementation would be carefully watched and supervised.

The PAP sets the ground for an islandwide micro planning and development programme with the people providing the leadership for co-operative and self-reliant effort at the grass roots level. This will activate rural production and provide new vigour to the co-operative movement.

The actual expenditure in the budget is only a fraction of what pessimists were originally thinking of —Rs.42 billion and Rs. 70 billion. With the allocation of Rs.10 billion (only 7 percent of total expenditure) three components of the PAP have been covered, the PAP itself, the doubling of food stamps and the free mid-day meals. This is because the money is being meaningfully and profitably spent, with end use supervision. There is no waste. The PAP has built in conservation and economising-elements. As new employment is created, people will rise above the threshold of poverty.

People who are not entitled to food stamps would not be given the benefit. Surveys have confirmed that very large numbers of well to do people are receiving food stamps. The people will themselves decide who are the really poor and the real beneficiaries of PAP.

Investment

The more important component of the PAP is the investment part. At the end of two years every family will have capital assets — an earning asset in the bank. They are free to employ it for production. The people will be motivated to co-operate, be self-reliant and use resources in their own environment for production. They can be geared to big manufacturing units. The family becomes a miniature factory serving a much larger unit. The PAP is a basic prerequisite for rapid development of the backward rural sectors.

Extracted from a recent article and also a speech reported in the 'Daily News.'

THE ROLE OF CO-OPERATIVE SOCIETIES UNDER THE JANASAVIYA PROGRAMME

Asoka P. Munasinghe

Assistant Secretary, State Ministry for Co-operatives.

Before examining the role of co-operatives in the Jana Saviya Programme it is necessary to understand what a co-operative society is and the values on which it is based. The principle of co-operatives is helping each other, "Each for all and all for each" is the theme of this Movement. Mutual help is one of the aims of the Co-operators.

The Jana Saviya Programme is expected to help eliminate poverty with people helping each other. It is therefore clear that there is a very close relationship between the objectives of Jana Saviya and those of the Co-operative Movement.

The Co-operative Societies in this country could be classified broadly into two categories, namely those societies that handle the distribution of essential food items and those societies engaged in production activities. Although there are other types of societies these two are the types closest to the people.

Let us first examine the societies handling the distribution of essential food items. These societies not only handle distribution, but are also engaged in the purchase of these items. In addition, they provide loan facilities to their members for starting agricultural and industrial projects, and also provide equipment and other supplies for agricultural production.

The policy of the Jana Saviya Programme is to give the poor people the confidence to come up in life through self reliance. The Food Basket distributed under this programme will be supplied to them through the Multi-Purpose Co-operative Societies. The 285 Multi-Purpose Co-operative Societies distributed through out the island have about 9,000 branches. The Co-operatives already serving the Food Stamp holders will continue to provide this service by supplying the necessary food items under the Jana Saviya Programme. This is a more responsible role.

The reason is that a family will be getting a benefit of about three times that of Food Stamps. It could be questioned whether the MPCS could handle this volume of work. Most of these societies have the storage facilities as well as transport facilities and the labour force.

It is true that most societies have financial problems. The reason is that the Co-operatives are not profit earning institutions. They supply essential items to people while keeping a small margin of profit or no profit at all. Therefore some of these societies find it difficult to even pay their employees. Although such societies could face financial difficulties in implementing the Jana Saviya Programme, there will not be any problems as the Government will give them the necessary assistance; so that there is no reason why the Multi-Purpose Co-operative Societies should not be able to serve the gradually increasing beneficiaries under the Jana Saviya Programme.

The Food Basket will contain locally produced cereals, and the societies will have to purchase these items either from the local producers or from the CWE or similar institutions. When the Co-operatives start purchasing it will be an incentive for local agricultural production; and those farmers who had no interest earlier will also now start growing these items.

Let us consider rice production. When more and more rice is needed for sale, societies will be forced to purchase rice in larger quantities. This will benefit the rice millers. This will also eliminate the middlemen and bring about better trade relations. Needless to say, with Jana Saviya per capita consumption of rice will increase. In addition to food items they will also get agricultural implements and other necessary agricultural inputs. This will induce them to get into cultivation or start some other income generating projects. Thus it will be seen that MPCS will indirectly contribute to the growth of national wealth. It will also help to uplift the living standards of the farmer.

It is essential that the beneficiaries are encouraged to save the additional allowance of Rs. 458 without using it for consumption.* Here the Co-operative Rural Banks will be called upon to play a special role in saving is for future benefit. The money saved for two years could be used by them for starting a viable project. The Society could assist them. The deposits of Rural Banks have exceeded Rs.1,800 million, but only about 40 percent of these funds have been used for the development of the rural sector. The rest has been used in investments away from the rural people. It will be possible to grant bigger loans to members under the Jana Saviya Programme as they will now have "Secutity". The Co-operative Societies could assist the Jana Saviya beneficiaries by granting them loans to start projects without waiting for the two year period. The loan given in installments may not exceed the Rs. 20,000 limit. The educatioanl division of the Society could help them firstly to identify locally available resources, and then help in use of these materials and their marketing. Thus they should be able to use these funds profitably.

Just as Jana Saviay beneficiaries will be assisted by the Society, they will also in turn help the Society. Since the income of these societies is expected to increase the employees will be able to get better salaries, and their living standards should also improve. It has been estimated that the turnover of a Co-operative Branch will go up by Rs.37,850 with the implementation of the Jana Saviya Programme, while the monthly sales of an MPCS will go up by about Rs.105,000/-.

Production Co-operatives will also have a role to play in the Jana Saviya Programme. Another objective of Jana Saviya will be to assist the local producers. The service that could be rendered by the Agricultural Co-operatives is im-

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*Each family will receive Rs.2,500/- per month, over a period of 24 months. Of the monthly allowance Rs.1,042/- will be invested on behalf of the recipient; and the balance Rs.1,458/- will be the consumption component, of which Rs. 1,000/- may be spent on the food parcel and the other Rs.458/- could be spent according to the preferences of the recipient. This balance Rs.458/- could be spent on more goods or invested in savings.

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mense. For instance, the Co-operatives in the Mahaweli 'H' Zone could encourage their farmers to grow more chillies and other subsidiary food crops. Therefore, the Co-operative Societies while helping the farmers to increase their incomes could also contribute to the economic development of the country. The Co-operatives should provide the institutional facilities, loans and other incentives, the marketing and necessary guidance. A major ILO decleration, as far back as June 1966, has accepted the Co-operative System as the best way to improve the living standards of poor villagers in developing countries.

The other Co-operative Societies also could play a role in the Jana Saviya Programme. The Handloom Co-operatives that found it very difficult to sell the products of their members, since the Jana Saviya basket will have textiles as well. The unemployed village girls can now produce handlooms and sell their products to the Co-operatives.

The policy statement of the new Government declares that "Poor families will be encouraged to be independent and manage their economic upliftment by being provided credit facilities and avenues for savings. Organising them will be the responsibility of the Co-operative Credit Society. This is one of the development activities they should undertake"

In this sphere the Women's Committees of the primary societies could also help. They could educate the rural women in the use of resources, markets etc.

Mother is the unofficial leader of the family. Her leadership is the base for the success of this institution called the Family. Therefore, the Women's Committees of the Credit Society can guide the beneficiaries. The building up of the mental condition needed to get these poor people to have confidence in themselves, could be brought about through the training programmes of the Co-operative Credit Societies.

In this programme of Poverty Alleviation the co-operative organisations should be an important force, encouraging people to engage in development work and also be a force in development activities. In this context the Co-operative Societies should be clear about the role they are expected to play.

PEOPLE'S BANK INVESTMENT SUPPORT FOR JANASAVIYA PROGRAMME

A major focus of the Janasaviya Programme will be on people-based production by setting up of Small Production Units at village level. The object is to make the poorer people efficient producers and to organise them on viable productive endeavours in the environments in which they live. This programme is therefore expected to transform half the country's population, now living on Food Stamps, into people with some means and capability.

Under the Janasaviya Programme each poor family will receive Rs.2,500 a month, over a period of two years, of which each month Rs.1,458 will be allocated for consumption, while the balance Rs.1,042 will be invested on behalf of the recipient. Together with the interest earned from this investment over two years, each family should be in a position to find a source of sustainable and durable employment with a saving of Rs.25,000 accumulated by the end of this period. But the guidance and inducements for investment are also necessary. In implementing this investment aspect the state banks have launched a scheme of cheap and readily accessible credit for small scale entrepreneurs with viable projects, which are production oriented and income generating.

The People's Bank is playing a leading role in this endeavour. It has introduced several special loan schemes geared towards assisting each poor family in utilizing their investment component of the Janasaviya Programme to start a worthwhile enterprise. The Bank's intention is to direct these families to some suitable form of trades, or small industry, or cultivation or other type of self-employment in order that they are ultimately ensured of an independent existence. Among the new schemes already launched in this regard by the Bank are the Praja Naya Niyamaka or 'Agency Banks' scheme, a 'start-up' loans scheme, of which the most recent was the loan scheme for purchase of Three Wheel scooters; and the Sub-Contracting loan scheme.

Praja Naya Niyamaka Scheme

The Praja Naya Niyamaka (PNN) scheme is one of the Bank's major contributions to President Premadasa's Janasaviya Programme, which aims at the alleviation of poverty. Under this scheme the two state banks will ultimately appoint 7,000 PNN's each, to cover all the Grama Seveka Divisions in the country. The People's Bank has targetted the setting up of 7,000 such Agency Bank's by the end of 1989. By the end of March this year over 2,000 units had been identified and about 1,000 PNNs appointed; the largest number being in the Western and Southern provinces where population concentration is highest. The main objectives of the PNN scheme are:

(1) to devise a mechanism with a view to providing credit to borrowers on easy terms
(2) to extend banking facilities to areas which are inaccessible to formalised institutions and
(3) to provide credit at a comparatively low cost, much lower than the existing rates in the informal money market.

In the informal money market, money lenders often charged as much as 20 to 30 percent monthly interest, thus placing a heavy debt burden on the borrower, and often discouraging potential investors from undertaking a viable income-generating project.

The programme is intended to be implemented through:

(a) Co-operative Rural Banks
(b) Acceptable Organizations, and
(c) Individuals

The eligibility criteria for selection of a PNN are that he should have no past due commitments as a borrower or guarantor to the Bank or any other financial organisation, and that his financial standing should be sound; that he should be capable of contributing 15%—20% of the amount advanced by the Bank as his equity contribution to the on-lending programme.

The lending of this scheme will be disbursed through a Fund. A Fund would be created for on-lending for each PNN unit with the Bank's advance and the PNNs equity contribution. It would be necessary for each PNN operating this loan scheme to open a Current Account. The Bank will advance Rs.100,000/- initially and increase this sum upto Rs.

The first Agency Bank, opened by the People's Bank, at Wattala, was inaugurated by President Premadasa late last year. The picture shows Hon. R. Premadasa lighting the oil lamp at the inauguration ceremony. Also in the picture are Mr. John Amaratunge then MP for Wattala and Deputy Minister of Finance and Mr. Lakshman Watawala Chairman of People's Bank.

200,000/- after reviewing the progress achieved. The maximum advance given will be limited to Rs.5,000/- for each applicant; and loans will be granted for a short period not exceeding 12 months. The PNN has also to be capable of undertaking certain activities which can contribute to the success of this loan scheme. The PNN should arrange to lend monies to sub-borrowers from the Fund maintained for that purpose. It would be necessary for the PNN to maintain records of this account according to instructions given by the Bank, and the Bank will inspect records maintained by the PNNs. The PNNs are expected to display their conditions of lending (in particular the interest rate charged by them), approval of the People's Bank, etc. prominently at the respective premises.

The Bank will obtain immovable property as security for this loan scheme from the PNNs where land mortgages are not possible; or balances on fixed deposits or any other acceptable security. The PNNs in turn will have a right to obtain security considered by them to be adequate. The application and demand pro-note is the type of security normally available to PNNs. The PNN is to be a link between formal and informal money markets, and therefore his operation should narrow down to a bare minimum inconvenience and social disablities caused to the poorest of the poor. The Bank has given much priority and prominence to this scheme as it is an integral part of the Poverty Alleviation Programme of the Government. The People's Bank is already operating 65 PNN units in the Anuradhapura district and 40 units in the Kegalle district; while by end March 2,088 PNNs had been identified and 1,313 PNNs had been appointed. The Bank's stategy is to open all 7,000 PNNs before the end of 1989.

Praja Naya Niyamaka Scheme – Number of Units by Province as at end March 1989

Province	No. Identified	No. Appointed
North Central	300	145
Eastern	97	61
Uva	50	149
Western	377	227
Southern	285	242
Northern	42	08
North Western	351	99
Central	356	194
Sabaragamuwa	230	188
	2,088	1.313

Start up Enterprise Loans Scheme

Another significant scheme supporting the Janasaviya Programme is the People's Bank's new project oriented credit scheme named the "Start up Enterprise Loan Scheme." It is intended to assist youth who due to lack of financial resources have not been able to commence any enterprise, to establish themselves in various lines of economic activity. Financial facilities are available under this scheme upto a maximum of Rs.30,000. The assistance provided in the form of loans is mainly for the purchase of machinery, equipment and a small working capital component; and also for electrification where required.

This scheme is directed at school leavers and young people between the ages of 18 and 35, who had an opportunity to follow on-the-job training programmes or vocational training at recognised and acceptable training institutions. only those persons not already engaged in any other enterprise are eligible for this assistance; including those who have not already borrowed for business or other economic activity from any bank or financial institution. Joint applications, within the maximum of Rs. 30,000/- from two eligible applicants are also being entertained. The types of projects for which finance is being provided to commence such small business/service units include: Tailoring and Dress Making; Tyre Repair Shop; Masonry; Barber Saloon; Carpentry; House Electrical Wiring; Motor Car Repairs; Shoe Making and Leather Work; Light Engineering and Welding Shop; Spray Painting (Vehicles and other equipments); Motor/Push Cycle Repair Shop; Brick Making; Coir Products; Plumbing; Trading (Working Capital and Basic Implements); Pottery; Cane Work and Reed Ware. The trade could include Pingo Carriers, Push Carters and Cycle-pedlars and others.

A further facility being offered in this scheme will be the identifying of particular projects suitable for specific areas. A list of seventy such projects have been identified so far and project profiles are being prepared for those who may have an interest in any of these areas. The subjects of the profiles include: Semi-precious Stone Cutting; Radio/TV repairing; Brass utensils; Paper bags; Washing soap; Artificial flowers; Mushroom cultivation; Mosquito coils; Writing chalk; Candles; Fast foods; Compost fertilizer packeting; Herbal poridge; Firewood stoves; Hand bags and purses; Iron grills and racks, Hollow blocks; Envelopes; Instant Fruit Drinks, (Cordials); Papadam and Yoghurt.

Loans upto Rs.10,000/- will be allowed a maximum repayment period of five years; while loans over Rs.10,000/- will have a maximum repayment period of seven years.

Loans upto Rs.10,000/- would not require equity contributions, and a borrowers skills or labour could be considered his contribution; while for loans over Rs.10,000/- a 20 percent minimum equity is necessary. Equity contribution could consist of cash or any other asset of the project, including property where the project is located.

For loans upto Rs.10,000/- the guarantee of parents or members of the family or other acceptable guarantors would be required as security; while for loans of over Rs.10,000/- the mortgage of moveable assets of the Unit, the guarantee of parents or earning members of the family or any other acceptable guarantors, or the mortgage of properties owned by parent or the applicant will be accepted. In order to motivate borrowers on the project and encourage regular repayments a 3 percent rebate is being allowed on interest.

By the end of January this year the Bank had approved around 170 projects valued at nearly Rs. 2 million; while loans had been released for 52 of these projects. The largest number were in the Kurunegala Region where 73 projects were approved and loans released to 24. In the Colombo Outer Region there were 39 such projects approved. The other Regions where there was interest in this scheme were Ratnapura, Nuwara Eliya, Matale, Galle, Kalutara, Kandy and Anuradhapura.

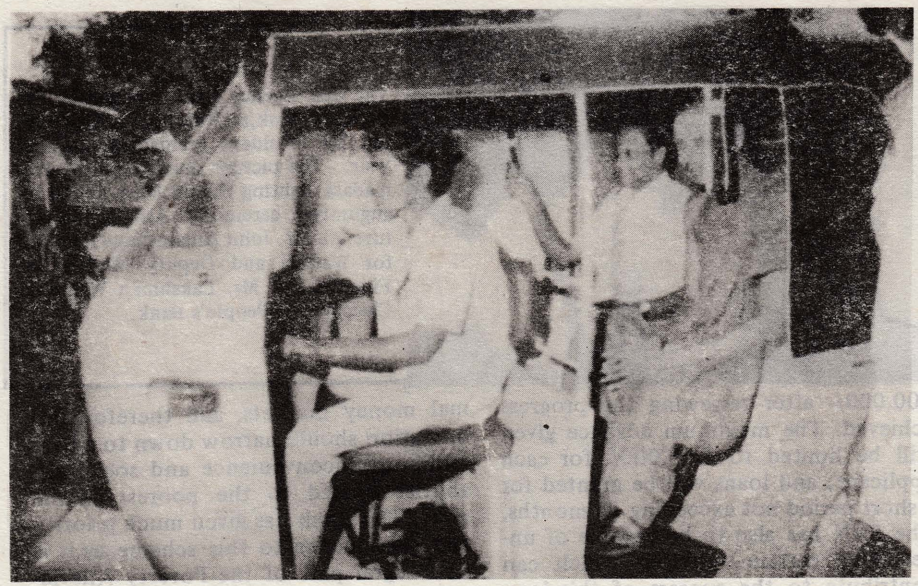
Start-up Enterprise Loan Scheme Position as at 28.2.89

1.	No. of Approvals Requested	1,879
2.	Value of Approvals Requested	26,000,000
3.	No. of Approvals	349
4.	Value of No. Approved	4,500,000

Three Wheel Scooter Loan Scheme

Another self-employment loan scheme designed by the People's Bank and linked to the Janasaviya Programme is the Bajaj Three Wheeler Scooter Loan Scheme launched this year. This is an employment generating project for the urban youth who would have some equity and driving licences. The Bank has planned to promote this programme as a joint enterprise with a leading Company who are agents for Bajaj three wheeler scooters in Sri Lanka. Under this programme the Bank will contribute 60 percent of the project cost or cost of the vehicle, while the borrower will contribute 40 percent. The maximum repayment period for such loans is 48 months while the rate of interest will be 20 percent. The Company would collect the borrowers daily income and remit the repayment for the loan to the Bank.

The basis of security on these loans will be : where the loan amount is less than 50 percent of the purchase price, the mortgage of the vehicle with the assignment of the Comprehensive Insurance Policy; where the loan amount is more than 50 percent of the Purchase Price (but less than 60 percent) in addition to the mortgage of the vehicle, Assigment of the Comprehensive Insurance Policy, Two guarantors acceptable to the Bank, and any other securities the applicants/prospective borrowers could provide.



The first scooters, under the Three Wheel Scooter Loan Scheme, were handed over by President R. Premadasa at the Gangaramaya Hunupitiya on Sunday March 19th. This picture shows President Premadasa and Ven. Galboda Gnanissara, Viharadipathi of the Gangaramaya Hunupitiya taking a ride in a three-wheeler. This is one of the three-wheel scooter-taxis presented to twenty youths trained and sponsored by the Sri Jinaratana Ayatana Palaka Sabhawa (SJAPS) and the National Youth Services Council. This new enterprise scheme for self-employment has been launched by the People's Bank and Bank of Ceylon under the "Janasaviva Programme".

Sub-Contracting Loan Scheme

The Minister of Finance emphasised in his Budget Speech that "small production units will provide the valuable link between large industries and our agriculture, adding value to the produce of the farmer. This will not only bring additional income to the people in the villages, but will also provide a sound indigenous base to our industry. This marriage between the big investors and the small producers will increase production, cut down on overheads, reduce inflation and will generate sustainable employment for the vast majority of our rural poor. It will also be the surest way to accelerate the development of our remote and backward areas."

The most feasible methods by which small production units could be linked to larger units has been found to be through the system of sub-contracting. The Bank's Sub-Contracting Loan Scheme is intended to fulfill this vital requirement. More details and a full discussion of this Sub-Contracting Loan Scheme are contrained in the accompanying article by the Bank's Chairman Mr. Lakshman R. Watawala.

Solar Power Panels Loan Scheme

The Minister of Finance in his Budget Speech drew attention to the fact that the generation of electricity from sunlight is an alternative source of energy for the future and to encourage use of Solar Power Panels System in Sri Lanka he proposed to reduce turnover tax on the manufacture of these items from 12½ percent to 3 percent.

Meanwhile, the People's Bank has formulated a special scheme to encourage this venture. This loan scheme is intended to help in reduction in household expenditure onkerosene;be an alternative source of power for domestic heating as well for operation of T.V. sets and even water pumps; have the capacity to increase the voltage of electricity produced at a given installation by merely increasing the number of panels; to be having lower capital costs when compared to the costs involved in obtaining a connection from the National Grid and is of Convenience and lower operation costs. The maximum loan amount will be Rs.20,000 for purchase of a solar power panel system consisting of all essential components; and owners and co-owners of the house for which solar power panels are required will be eligible for such loans;being given at a rate of interest of 17 percent per annum.

JANA SAVIYA PRODUCTION UNITS — A SCHEME FOR SUB-CONTRACTING

Lakshman R. Watawala

Chairman, People's Bank

One of the main highlights in the Budget Speech presented by Hon. D.B.Wijetunge, Prime Minister and Minister of Finance wa the setting up of Small Production Units at village level using indigenous raw-material and the linking of these Units with large Industrialists, Agriculturists and Exporters. The relevant extract from the Budget Speech is given below:—

"The main thrust of the country's development programme in the next two years would be on the alleviation of poverty and the creation of village based self-reliant organisations and small production units which would help to increase the productivity of the poor through creation of new employment opportunities. These small production units will also provide the valuable link between large industries and our agriculture, adding value to the produce of the farmer. This will not only bring additional income to the people in the villages, but will also provide a sound indigenous base to our industry. This marriage between the big investors and the small producers will increase production, cut down on overheads, reduce inflation and will generate sustainable employment for the vast majority of our rural poor. It will also be the surest way to accelerate the development of our remote and backward areas.

This is the essential philosophy behind the Jana Saviya Programme, which is conceived, developed and now being translated into reality by His Excellency the President to uplift the poor and to bring them back into the economic mainstream of the country. Jana Saviya is not a hand out - it is not a dole programme - to perpetuate our people in poverty. It is a sound investment in our human base.

Our welfare programme will also provide for a free mid-day meal for all school-going children in the country. His Excellency the President has already directed the Provincial Councils, which will implement this programme, to use, as far as possible, only local produce in the mid-day meals. This will provide an incentive to the local producer to grow more and improve his income. His Excellency has also given a slogan to this island-wide mid-day meal scheme: "Income to parents and nutrition to their own children"

The method by which the small production units could be linked to larger units would be, by the system of sub-contracting. The system of sub-contracting has been in existence for a long period of time and this is a method by which large Industrialists and Exporters have helped the small scale businessman.

The Jana Saviya Programme, launched by His Excellency the President to alleviate poverty, has now highlighted the importance of the system of sub-contracting to set up small production units at village level, linked to large units.

Methods by which sub-contractors could be linked to larger organisations are as follows:—

1. **Manufacturing Industries —**

   These are existing organisations which are involved in the production and manufacturing of finished products. These industries could purchase components, packing materials and other items required for manufacture or assembly.

2. **Export Houses —**

   These are organisations which are exporting various items and have a ready export market for various products, and services. These fall into industrial and agricultural products, services and other exportable products.

3. **Trade or Marketing Houses —**

   These are organisations which are mainly involved in trading and marketing actvities in the local market.

In the case of Sub-contractors it is envisaged that they would be directly linked to any of the above mentioned organizations. There is a definite advantage for small sub-contractors to be linked to larger organisations and some of them are as follows:—

- i) The large organisation could identify the product or item to be supplied by the sub-contractors.
- ii) The training and assistance for setting up of the sub-contract unit could be carried out by the larger organisations.
- iii) The supply of raw-material will be ensured and the quality of the raw-materials controlled.
- iv) Quality control standards will be laid down.
- v) The larger organisations would buy back the items manufactured by the sub-contractors and thereby guarantee a market.
- vii) The large organisation could arrange to deduct the loan instalments and repay the Banks from the money realised on the purchase of the products from the sub-contractors.
- viii) The sub-contractor would be able to concentrate on production activities as the large organisation would be responsible for all other matters.

In order to assist the sub-contractors to set up these Projects, the Banks would have to play a major role in providing the necessary funds. Two methods could be adopted for funding the sub-contractors.

1. (a) The Banks could lend the money to the larger organisation which in turn will disburse the monies to the sub-contractors.

   (b) The Banks could lend money direct to the sub-contractors, provided the project is viable and has a direct link with the larger organisations which are committed to provide the necessary technical expertise and guarantee the buy back.

2. The Banks could provide additional funds to the large organisations to provide for working capital financing such as purchase of raw-materials and finished goods from sub-contractors.

The large and well established Industrial, Agricultural, Export and Marketing organisations have a definite role to play in promoting sub-contracting and thereby setting up small scale production units at village level. Therefore, the Private, Corporation and Government Sector organisations should play an active role to promote the setting up of small scale units in order to achieve the main objective of the Jana Saviya Programme of alleviating poverty and the creation of village based self-reliant organisations and small production units. The methodology for the setting up of Jana Saviya Production units or sub-contracting units linked to large organisations under the Jana Saviya Programme are as follows:—

1. All Private, Corporation and Government manufacturing, trading and export organisations should be brought under the scheme of sub-contracting.

2. Each of these organisations should identify the type of product or service that could be given out for sub-contracting. They should set up a minimum of 10 sub-contracting units, employing a minimum of 2 - 5 persons.

3. A Government policy directive regarding use of locally manufactured products would enhance the setting up of the sub-contractors or Jana Saviya Production Units.

4. (a) Tax benefits should be given to the large industrial organisations that set up sub-contracting units, such as the deduction of the total capital investment of sub-contractor from profits of the Company for purpose of income tax.

   (b) Sub-contractors should not be liable for any type of taxation for a period of 3 years. Sub-contractors should be treated as a part of the informal production centres.

5. All items of Industrial, Agricultural, Fisheries, Livestock, Services and other areas should be brought under this scheme of sub-contracting.

6. In the case of agricultural and food items, the Co-operatives, C.W.E., Paddy Marketing Board and other private and public sector marketing organisations should be made use of.

7. Sub-contracting could be started on a large scale for the Diamond and Gem cutting and polishing and Jewellery trade.

8. Setting up of specialised Export Houses and Local Marketing Organisations should be encouraged.

The People's Bank has already commenced a Scheme for granting loans to sub-contractors. For example, a loan granted to an Export Company for the purpose of giving loans to sub-contractors was worked out on the following basis :—

1. The Export Company provided training to the sub-contractors in their own factory.

2. The Export Company submitted a Project Report.

3. The cost of machinery and raw-materials required by the sub-contractors was worked out together with earning capacity of each sub-contractor.

4. The Bank agreed to give the Company a loan to be disbursed to each of the sub-contractors on the following basis:
   (a) The Company would train the sub-contractors.
   (b) The raw-material would be supplied.
   (c) The Company would buy back the finished product.
   (d) The loan instalments would be deducted and remitted by the Export Company to the Bank.
   (e) The Company would guarantee the loan.

Another example was where the Bank gave the loans direct to the sub-contractor on the following basis :—

(a) The large organisation undertook to train the sub-contractors.
(b) Raw-materials were to be supplied by the large Company.
(c) The finished products would be purchased by the large Company.
(d) The loan instalments would be deducted and remitted direct to the Bank.
(e) The supervision of the sub-contracting Units would be done by the large organisations.
(f) The Bank would give the loan direct to the sub-contractor.

There a number of advantages in the scheme of sub-contractors being linked to larger organisations, rather than their setting up small scale units on their own. Among the reasons for such advantages are the following:

1. The larger companies with their experience and knowledge would be able to start up Projects which are viable after taking into consideration the marketing, technical, production, raw-material and finance aspects.

2. The sub-contractors or Jana Saviya Production Units will be able to obtain assistance and support of the large organisations and they will feel more confident in starting up these small Units.

3. The sub-contractor could concentrate on production as other matters will be looked after by the large Company.

4. The Banks would be able to consider the grant of loans to sub-contractors on a project basis, taking into consideration the viability and the other inputs of the larger organisations such as marketing and technical areas.

5. Large Organisations could make use of sub-contractors to produce goods at lower cost.

6. The Capital Investment of large Companies will be reduced while production would be increased without increase in Fixed Costs by the use of sub-contractors.

7. The large company should pay a reasonable price to the sub-contractors in order to make the scheme of sub-contracting a success.

8. Sub-contractors could find an opportunity to improve management methods and skills. Poor management has in many instances resulted in failure of many projects and companies.

Therefore, considering all these matters sub-contracting could be a very convenient and low cost method for achieving the objectives of the Jana Saviya Programme and for the setting up of 'Jana Saviya Production Units.'

THRIFT AND CREDIT CO-OPERATIVE SOCIETIES IN SRI LANKA AND THE QUESTION OF THE APPROPRIATE ECONOMIC BACKGROUND OF ITS MEMBERS

Sunimal Fernando et al

Sunimal Fernando, Willie Gamage, Charmawansa Peiris, M. Sri Shanmugarajah and R.M. Ranaweera Banda facilitated a study on "Aspects of Support-Based Rural Housing in the Galle, Matara, Jaffna and Puttalam districts of Sri Lanka" and a report was prepared in late 1987 by IRED-Development Innovations and Networks. This extract from the Study of the working of 5 out 4,500 Thrift and Credit Co-operative Society (TCCS) functioning in the island provide a useful insight into the credit requirements and operations in four diferent districts of the country. The focus is mainly on the rural though some comparisons of the urban situation are also given. This account from the larger study is particularly useful in the context of the investment component that is to be provided to a large number of families in Sri Lanka under the Janasaviya Programme and the Agency Bank Scheme (PNNs) to be launched by the state banks.

The Thrift and Co-operative Credit Society (TCCS) is a village level organisation which serves to mobilise rural savings and make credit available to its members when required at rates of interest well below those prevailing in the non-institutional credit market (i.e. with money-lenders)*. The rates of interest vary in different TCCSs. The Hirigama and Pahalagama TCCSs in the Matara district offer 14 percent interest on ordinary deposits while the Minirankuliya TCCS offers 15 percent interest on ordinary savings and 18 percent interest on fixed deposits. The rates of interest on savings offered by TCCSs are generally higher than those offered by commercial banks. Similarly, the interest charged by a TCCS on loans is lower than the interest on loans charged by commercial banks.

The upper limit of loans as well as the conditions under which loans are given vary among different TCCSs. At Sarumellagaha (Galle district) the upper limit of a loan is Rs.15,000/-; at both Pahalagama and Hirigama (Matara district) it is Rs.5,000/-; while at Minirankuliya (Puttalam district) it is Rs. 10,000/- . At the Pahalagama TCCS in the Matara District, within the Rs. 5,000/- limit, the maximum loan a member could obtain is 3 times his savings in the TCCS; at Minirankuliya, within the Rs.10,000/- limit, it is 10 times his savings in the society; while at the Hirigama TCCS in the Matara district the norm varies from 5 times the savings for loans upto Rs.1,000/- to twice the savings for loans between Rs.2,500/- and Rs.5,000/-. In respect of all NHDA housing loans, however, a member is entitled to a loan upto 10 times his total savings in the society. The period of repayment for ordinary loans and self employment loans varies from 1-3 years; for NHDA housing loans, from 5-15 years and for small emergency loans it is usually one month. A member seeking a loan from a TCCS has to produce two guarantors who should be members of the society. Most TCCSs stipulate that a guarantor too should have savings in the society to the value of 10 percent of the loan requested. Certain TCCSs make additional requirements of guarantors: For instance, the Sarumellagaha TCCS (Galle district) lays down that a guarantor should also have a good attendance record at TCCS meetings, while the Minirankuliya TCCS maintains that a guarantor should have the confidence of the office bearers. The TCCSs studied from the Galle, Matara and Puttalam districts further stipulate that, apart from other conditions, a member should have a share capital of Rs.100/- in the society before he is entitled to loan facilities. The TCCSs studied from the Jaffna district, on the other hand, do not have such a rule.

The rules, procedures and financial norms of the TCCSs studied apply to the various economic and sociological categories in a village in different ways. In the cases studied, the low income families would generally not be able to participate in the TCCS process because they would find it difficult to conform with TCCS procedures and financial norms. To start with a poor family will find it difficult to get two guarantors acceptable to the TCCS, even if it is able to subscribe the minimum share capital and meet the 'minimum savings' qualification. The rich, on the other hand, would not require the TCCS for a different set of reasons. The rural rich have good connections outside the village, not merely with businessmen and other influencial persons from whom they could borrow money when they need to do so, but even with formal financial institutions such as banks and other lending agencies.

Though the village rich can earn a higher interest on their savings if deposited with a TCCS and borrow money (within the stipulated limits) paying a lower rate of interest than they would need to pay to a commercial bank, rural social norms will constrain them from doing so: The rural rich will consider it to be beneath their dignity to borrow money from a village level institution in which less affluent social groups also participate. They would borrow money at a higher rate of interest from outside the village, rather than compromise their status and dignity in the village by taking loans from the village TCCS. Had this social norm not been operative in rural society, it is possible that, especially in villages having a sizable 'rich class', TCCSs could have taken a course through which the rich families begin to progressively dominate and control the TCCS to their financial advantage. Fur-

* TCCSs are voluntary associations of poor people operating on a local basis. Membership of a TCCS usually ranges from 40-60 while there were some societies which could boast of a membership of 150 or more. TCCSs, as institutions, represent the collective strength of groups of poor people who normally do not have mortgageable assets or who do not have access to commercial banks. They are formed for the purpose of meeting the savings/credit/investment needs of the members.

There has been a steady expansion of TCCSs in the country since the movement started over 75 years ago with 37 societies. By 1963, after 50 years, there were 3,784 societies and by March 1987 nearly 5,300.

The strategy of the TCCSER is to set up al least one new TCCS in each of the Grama Sevaka (GS) administrative divisions in the country.

thermore, in so-called urban low-income communities such as at Navagampura where there exists a sizeable number of high-income families, if an urban TCCS (or an 'Urban Thrift') is established, it can very easily fall under the control of the relatively 'rich' class because the rural social norm that constrains such families from participating in a TCCS does not apply in an urban context. Navagampura, however, does not have an 'Urban Thrift'.

In the rural context, therefore it is to the middle-income families that the TCCS makes its appeal. Middle-income families constitute the largest category of families in any village. Among them, some persons work outside the village on a regular basis either for businessmen or else on plantations. Such families find it possible to obtain loans on easy repayment terms from their employers: The TCCS is therefore not a very relevant institution for them. Thus the TCCS is most relevant to that category of persons who are self-employed in economic activities which:

- Are small in scale and level of investment;
- Are confined to the village or its immediate outskirts; and
- Do not entail continuing economic /business relationships with affluent persons.

As the loans given out by TCCSs are small, they are useful only to such persons whose level of investment is also small. For instance in an up-country vegetable-farming economy where small farmers need to invest heavily on seed material, fertilizer and agro-chemicals, the TCCS system as it functions today cannot intervene to meet their credit needs. In a small-scale marine fishing economy too, where the credit needs of mechanised artisanal fishermen are high (e.g. for repairs to boats and engines, replacement of damaged fishing gear etc.), the TCCS does not appear to be a useful credit institution. In the rural context therefore, the TCCS can usefully service middle-income level self-employed families engaged in economic activities with a relatively low level of investment in or around the village itself. Sarumellagaha (Galle district) Hirigama and Pahalagama (Matara district) and Minirankuliya (Puttalam district) provide a substantial number of families having the appropriate economic background for meaningful participation in a TCCS. It is also seen that it is such families whose economic ties are largely within the village rather than outside the village that have a vested interest in making a success of a village level institution that bases itself on the mobilisation of village level resources; those whose economic horizons are largely outside the village would not commit themselves in the same way to making a success of a TCCS.

When a TCCS evolves and develops on its own, the above defined categories of families would comprise its membership. But when the process is expedited so that TCCSs may be formed at village level to handle NHDA housing loans under the RHSP, families which on account of their socio-structural position cannot contribute to the long term success and stability of a TCCS may join it merely in order to get access to NHDA housing loans. These would include families whose economic horizons largely lie outside the village; families whose economic activities are not based primarily in or around the village but outside. It is such families, which, not having a vested interest in making a success of an institution such as a TCCS, tend to default in loan repayment; not because they cannot afford to pay but because they are not willing to do so.

A resident of Jaffna district, aged 50 is a postman having 2 sons and a daughter. His monthly income is around Rs.2,000/-. He lives in a mud based house thatched with Palmyrah leaves. He had collected sufficient money to build a house but applied for a NHDA housing loan to the TCCS. The TCCS President who was also a retired public servant recommended a loan of Rs.7,500/- and persuaded the housing sub-committee to approve his recommendation. This man took the first instalment of Rs. 4,000/- but did ot even commence building his house. He does not even repay the loan. He explains his failure to build the house or repay the loan by saying that both his sons had been arrested by the security forces and that all the money he had, including the loan instalment, has been spent on trying to get the sons released. Because of the arrest of his sons, the politically-oriented SSO has not taken any steps to get him to build his house and repay the loan. In real fact, he is an affluent man who has no vasted interest in making a success of a village level credit institution like the TCCS. His economic horizons are largely outside the village.

Another man of Matara district is a member of the TCCS. His monthly income is around Rs.3,500/-. He is a rich land owner with inherited wealth. He is a member of the TCCS committee. Living in a well constructed house of 1500 sq.feet, he obtained a NHDA loan of Rs.3,500/- from the TCCS for contructing a kitchen of 500 sq.ft. He was found to be the worst loan defaulter of that TCCS and had defaulted 8 loan instalments. Even though he is a member of TCCS Committee, he does not really have an interest in making a success of such a village level credit institution because his economic horizons are well outside the village.

On the other hand:

A woman (aged 58), a widow of Pahalagama (Matara district) who lives with her 3 daughters and earns by making coir and sewing clothes got a NHDA loan of Rs.2,500/- from the TCCS to tile her roof. Her brother-in law, a trader in Colombo, contributed Rs.3,000/-. The owner of a local timber depot give her the necessary roofing timber on loan, while her daughter borrowed another Rs.2,500/- from the TCCS. This is how she mobilised resources to instal a permenant roof to her house.

A man (washerman) aged 55 from Jaffna district who built his house with the aid of a NHDA loan of Rs. 5,000/- and by borrowing another Rs.15,000/- from a local money-lender at 36 percent annual interest is finding it very hard to meet his loan obligations as his monthly family income is only about Rs. 650/-. He and his sons are now canvassing more work for their laundry in order to increase the family income and thereby meet their loan obligations. The family has also cut down on food in order to reduce family expenditure. Though poor, the family regularly repays its NHDA loan.

The economic context of the urban poor is qualitatively different from that of the rural poor. To start with, the economic ties of urban garden families such as those of Navagampura are almost entirely outside the settlement : (See Fernando. Sunimal et al : December 1986). The urban garden is the place to which people return in the evenings after working in various parts of the city. These economic ties external to the local settlement enable the majority of urban garden families to obtain loans, when required, from various patrons and employers. The ties that could link rural families to a TCCS do not exist in an urban context.

Furthermore, the type of income-generating investment that is made by entrepreneurial families of the urban poor is generally a high-risk high-capital investment which differs qualitatively from the low-risk low-capital investment made by the middle-income self-employed persons in rural society. Whereas the latter type of investment can be supported financially by a TCCS, the former type of investment cannot fit into a TCĆS loan portfolio. In May 1987, the 'Urban Thrift' at Nagagahapura, off Polhengoda road in Colombo, gave out 10 project loans of Rs.1,000/- each to members to start a small-scale business such as selling eggs, rice, vegetables, kerosene, firewood etc. These loans are payable in 1½ years at 14 percent annual interest. It is still too early to monitor the progress of such loans given through an 'Urban Thrift'.

A study of the Urban Thrift at Gotamipura off Gotami Road (TCCS established in February 1986) and Nagagahapura (TCCS established in November 1986) in the city of Colombo showed that in an urban context TCCSs perform an important function in providing emergency loans to its members. Whereas in the rural context an emergency loan of Rs.100/- or more can be very easily obtained on trust without any interest from a relative, friend or neighbour to be returned in a day or two, in an urban context such a loan carries an interest rate of 10 percent per day. Often such a loan of Rs.100/- or more also requires security in the form of a chair, a saree, a piece of clothing or a piece of furniture. In both 'Urban Thrifts' studied, a substantial number of emergency loans of Rs.100/-, repayable in one month, have been given out to members at an annual interest rate of 14 percent. The repayment rate of emergency loans in 1986 at Gotamipura was 94 percent. NHDA housing loans under the UHSP however have not been given through TCCSs in Colombo.

THE PROVISION OF CAPITAL TO STOCK EXCHANGE LISTED COMPANIES

Darin C. Gunesekera

Many senior personnel in the private and public sectors have advised the author though sole responsibility, for the opinions expressed in this article, is that of the author. The author was the founding Secretary General of the Colombo Stock Exchange. He directs the Wiros Lokh Institute, for autochthonous Economics and Policy Research.

This papaer utilises material made available elsewhere recently[1] so as to highlight certain problems that exist in the Sri Lanka Stock Exchange Market and our methods of financing enterprises.

Background

The Sri Lanka Stock Exchange was brought under the aegis of public direction only after the passage of the Securities Council Act in 1987. From 1982 upto that point there was a Stock Exchange bringing a wider and public range of interests to bear on the market. In the period from 1981 onwards, there was public promotion, at least in intention, of the Stock Market. Prior to that the market was run as a private club. The traditions and personnel of the market date largely from that early peiriod.

The Share Market began after the creation of companies by law in Sri Lanka about five years after such legislation was introduced in England. By 1977 the local commodity brokers and agents who handled the export commodities were also handling sufficient volume of shares to organise into an informal association called the Colombo Brokers Association. The share ownership comprised largely British colonials and London Stock Exchange investors. From the mid 1950s to 1981, the volume of transactions declined and the ownership of companies concentrated. These matters have been dealt with by the author elsewhere in greater detail.

Stock Market Companies

In the publications noted above[2] detailed material on the 167 companies listed in the Stock Exchange on March 31 1984 were given. The companies whose businesses had been nationalized, such as the Estates, were excluded from these studies. This paper utilizes this data in the discussion that follows.

This means that our discussion is biased towards recent events; for only 38 (ie. 22.8%) companies of the 167 were incorporated prior to 1948. Indeed, 83 of the companies had been brought into the Stock Market following the new promotional measures in the eighties.

The paid up capital of the listed companies amounted to Rs.6,256.8 million distributed into mainly Manufacturing 37.8 percent; Hotels 32.1 percent; and Property Development 18.2 percent. The concentration in the largely capital intensive hotels and property sectors is clear. It should be realised that under Sri Lankan practice, in contrast to practices elsewhere, especially our commercial neighbour India, capital issue is not the same as the cash payment to the enterprise. Our practices allow initial share issues for items such as promotion or lease that suffer loose quantification. It is also possible to revalue assets, make a book entry into reserves and to issue shares against such reserves to existing shareholders. These amounts also appear as issued capital. Therefore it may be prudent, at this preliminary stage, to improve estimates by reducing the amounts of bonus issues from issued capital. Rs.386.6 million bonus shares had been issued of which Manufacturing accounted for Rs. 262.5 million.

Capital

From the point of view of the provision of capital, 30.9 percent came from foreigners and should be regarded as Trade Investments rather than Portfolio or Share Market Investments as the capital really serves further interests than

1. *Dr. Darin C.Gunesekera and D.L.L.P. Jayawardena, Preliminary data analysis of stock exchange listed company ownership and provision of capital SLAAS Annual Sessions, December 1988.*
A more complete treatment of the survey data will be available in D.L.L.P.Jayawardena's forthcoming book from Sathosa Printers.

2. *vide note 1.*

market shareholding. Statutory bodies held 19 percent, and 8.4 percent was held by government and associated bodies. Domestic private investors held 37.2 percent of the issued share capital as stated at the outset. But this is not the actual market amount. The primary market for shares may be defined to be the amounts raised by public offer. Only Rs.1,466.1 million had been raised by primary offer to the public (a much larger amount had been offered) and Rs. 541.6 million by way of rights offers to shareholders.

These sums of money are small and need to be tempered with the fact that the 167 companies accounted for only 47,341 jobs. This incidently amounts to an issued capital, of various vintage Rupee of Rs.128,000 per job. This is a high per job cost both in terms of the national economy and by general domestic company standards. It suggests that the quoted companies are the high capital intensity end of the Sri Lankan commercial sector. This actually confirms Economic Logic. The Stock Market was being promoted by tax measures that made cost of capital low and provided Government enhancements to increase returns to capital. So we diverted national resources into this market where capital intensity – generally speaking imported machines and modern buildings - was much higher.

The loans granted these companies amounted to Rs.4.53 billion, of which 43.4 percent was foreign agencies and foreign banks; while 40.4 percent was from governmental sources. The rest were from in-group companies, directors, local private banks, and finance companies. The debt equity ratio of manufacturing, the largest debtor, was .83. These amounts relate to loan capital as disclosed by the companies. It is not equal to the total bank liability to equity position.

In Sri Lanka, bank short term loans and advances to these enterprises are of a fairly permanent nature and are given against security of liquid assets or other mortgaged assets. There is therefore a case to include these with loan capital, which would make the Debt Equity ratio very much higher.

Ownership

Nine of the listed companies were closely affiliated in ownership to other listed companies. The gross number of shareholders was 88,859 with 40.1 percent in manufacturing and 30.4 percent and 8.9 percent in Hotels and Property, respectively. However, on glancing through the lists of shareholders of the companies it appeared that certain companies had fewer than twenty shareholders in total. Therefore the percentage of shares held by the largest twenty shareholders was ascertained.

No distinction was made as to whether the shareholders were distinct entities or close relatives or one owning the other, as may be the case with corporate shareholders. This will be considered at a following stage in so far as shareowners of the same address may be lumped together. In the case of 51 companies the top twenty held 90 - 100 percent of the issued shares and in a further 50 companies the holding was 80 - 89 percent. In 75 percent of the listed companies, the twenty largest individually listed shareholders owned more than 70 percent of the shares. In only 4.7 percent of the cases did the top twenty hold below 50 percent. As the name and address lists in the data suggest the twenty top holders are largely related in business, family or by power of attorney or constitute the existing directorate; and this depiction is consistent with the increasing concentration of shareholding suggested above. The data is also consistent with the model constructed by the author and referred to elsewhere.

It was noted that a modification of this data should be made to take into account certain features of these companies when interpreting the data. These features are those peculiar to new companies as the greater weight of promoters' shares and shares issued in lieu of initial services. However, even taking these factors into account the concentration depicted above is hardly lessened.

It was interesting to note that several companies did not possess even 20 shareholders. This was without any test of whether the persons were indeed seperate persons without relationships or ownership amongst them. It was thus clear that the Stock Market's own Rule on ownership must be in gross violation. The Rule is that 20 percent of shares must be with the general public.[3]

By all standards abroad - developed and underdeveloped - the above is not a situation that can be called a Stock Market. By way of comparison in an underdeveloped country of our general level of development, India, shareholding of companies is in the millions (even of Bombay only situations) and 40 percent is the minimum general public holding. The term general public is stringently defined and applied.

Change

This situation demands change. The agents of change may inquire why this situation arose. The reason lies in the role of Banks. The Banks have been lending short term but permanent in practice to the quoted companies without demanding Share Capital increase. This is particularly clear when one notes the poor position of paid in share capital at the commercial private banks themselves. As they had been not asking for fresh subscriptions as the balance of ownership on their own Board, for instance Hatton National Bank Ltd., at the date of this survey, would be disturbed as all could not meet such cash demands, they could hardly force borrowers to raise owners' paid-in-capital.

The solution proposed by the Stock Exchange project was to give the Banks an interest in expanding companies' capital base. This meant a financial reward in this business. They brought banks in as broker-dealers in the Stock Exchange. The Finance Ministry and Central Bank's Governor at the time disallowed it[4] and the Commercial Banks withdrew from the project. However, it should be recorded that all the four Sr

3. A senior Chartered Accountant who has advised many of these companies informed me as follows. "The printed Rule states that 20 percent shares must be offered to the public. It does not state that this must be taken up nor that it must be continued after listing is given. The matter of what constitutes "offer" was much debated following Central Bank Governor Tennekoon's ruling on the transfer of Hatton National Bank shares. Events overlook any final conclusion. Presently (1989) these Rules are required to be considered as Guidelines. The rationale is that the present situation is in a stage of growth and flux. One is remined of the motorist in Rome 'traffic lights are advisory' he told the policeman.

4. For reasons not concerning the Stock Market listed companies.

Lankan commercial banks at the time did join the project and thus signalled their own acknowledgement of the situation and their desire to make things progressively better.

Foreign

Looking over the above data, it is clear that the major function of the Stock Exchange has been the facilitation of Foreign Investors. It enables foreign investment in share and loan Capital - the dominant amount - to be combined with similar Government contributions in government approved fields and ventures. Domestic private sector collaborators purchase or receive a share as well. The usefulness of the market is to enable a continuous evaluation of the stake in Sri Lanka for the investing organisation and in setting a fair price at point of sale[5] Proceeds of Stock Market share sales and dividends are remittable and are of financial "seniority" at a time of applying foreign remittance restrictions.

Individual consideration of the largest companies makes this clear. Shaw Wallace, largely foreign owned, relies on a good dividend (100% in recent years) to reward owners. Such rates would not be a reasonable strategy for a purely domestic broad based company. Ceylon Tobacco and Reckit and Coleman have a well over 80 percent foreign partner ownership. Where Ceylon Tobacco is concerned, there is a ready demand for its shares. The 93 percent British America Tobacco foreign holding must be attributed to a desire for return by way of dividend rather than gain through managerial practice.

In highlighting these features, it is my intention to make the evolution, practices, personnel, attitudes[6] and so on at the Stock Exchange more understandable. An economic situation may or may not be good depending on the viewpoint and development strategy. To understand an economic situation is not to make such a judgement but to see why aspects that may not be logically obvious are being compelled to be that way.

GLOSSARY OF TERMS

STOCKS, SHARES – Terms now used interchangeably. The ownership of a registered company is effected through ownership of its shares. The list of share owners is maintained by the Company's Secretary, who is required to annually file this list with the Registrar of Companies. The Companies Act deals primarily with matters relating to shares and share ownership. Persons acquire shares by way of initial issue of shares, subsequent issues of shares by sale, distribution of shares as a Bonus to shareholders, by way of Rights offered to shareholders or purchase or transfer of shares from an existing owner.

CAPITAL – The term is used in the sense of Finance Capital. It is usually divided into Loan Capital and Equity Capital. Loan Capital is long term Liability or Loans. Equity capital is the sum of issued shares at their value received by the Company and Reserves. The reserves of a company should be shown in two accounts. Earned reserves are actually earned and retained profits where the company received money. Other reserves are gains of an accounting nature as when assets are revalued but not sold.

STOCK EXCHANGE – Is the market place for already issued stocks. Only brokers or dealers registered with the exchange may do sale/purchase at the Exchange. Since, 1987, no transfers of ownership in companies listed at the Colombo Exchange can take place outside it. This is a law unique to Sri Lanka. In other countries restrictions on sales/purchase are limited to those imposed by companies at their secretaries' offices and listing requires them to remove these so as to make shares more readily negotiable.

LISTED COMPANIES – Also called quoted companies. These are companies whose shares are available for trading on the exchange. The normal principle is that listed shares must be available for sale to anyone equally. However, we protect our foreign investor groups from hostile tactics customary elsewhere. No issued share may be sold to a foreigner without a 100 percent penalty tax on the value of the transaction. This effectively prevents replacement or substitution of foreign partners. It also prevents the addition of new foreign partners without acceptance by existing foreign investors. It is this rule, also unique to Sri Lanka, that makes our exchange essentially a vehicle for foreign investors. The article shows that the attractions have worked in getting in foreign investment. Our exchange also permits restrictions on share sales to groups wishing to gain control of companies unlike in the US type exchanges where this is encouraged. There exists these two views as to whether changes in control are good or bad. Practically, listed companies in Colombo are very much more difficult to take over than in other reported markets. Share ownership reflects this.

According to current legislation a 100 percent transfer tax applies on the transper of land and shares to non-nationals. Now the abolition of the transfer tax on shares is being contemplated though the tax on transfers of land to non-nationals will continue.

5. *Upon passage of money and shares the deal is valid by law and acceptable for all purposes. Certain companies contain Articles requiring share ownership transfer to be further approved by its Board. But stock exchange market price is accepted. This is the reason for careful scrutiny of this process.*

6. *Relative degree of new investor search, for instance. Unlike many developing countries we do not have door to door salesmen of shares. Another is dress, speech and business style in which this sector is guided by the senior foreign companies in this country.*

IDEAS

COMMUNITY DEVELOPMENT

Peru's Model Self-Help Town

Villa El Salvador has won international praise for its effective grass-roots management

By Lisa Swenarski
Special to The Christian Science Monitor
VILLA EL SALVADOR, PERU

Villa El Salvador is always the good news in the Peruvian press. Among the articles reporting higher inflation, peasants massacred, and a deteriorating presidency, journalists and readers alike look forward to the stories about this "new town" of more than 300,000 people on the outskirts of Lima. In only 18 years, residents have created a community that is a remarkable example of self-help development.

Ever-expanding shantytowns –*pueblos jovenes* (young towns) surround Lima. Many are literally sand dunes made into cities by poor people fleeing rural poverty and warfare where guerrillas and government soldierscompetefor the peasants' loyalty.

Villa is just one *pueblo joven,* but its triumphant style of self-management has thrust it onto the national political scene and the international as well. It has won two awards: The prize of the Prince of Austurias, which is voted on by the Latin American ambassadors to Spain, and the designation of Peace Messenger by the United Nations.

"Since its birth, the people of Villa El Salvador had in mind that this couldn't be a traditional *pueblo joven,"* said second-term mayor Miguel Azcueta. "The people have achieved a unity and their own identity on a national level in Peru."

Politicians from every party want to take credit for supporting Villa El Salvador. The most recent law passed on Villa's behalf took nine days, a record in Peru.

"The poor people have always been used by politicians to get elected," said attorney Patricia Iturregui. "Now it's the contrary." In this case, a popular poor community has gained influence over elected leaders. Villa has been the salvation of thousands of families, and 300 more people arrive monthly hoping to start a new and better life.

Your shoes fill with sand as you walk along the unpaved roads. The streets are busy with vendors selling food, people hauling their garbage toward the truck that stops momentarily at each corner, and many residents are destined for meetings with a women's club, youth group, or trade union.

Seventy percent of Villa's inhabitants are under 25 years old. Wage-earners make an average of $70 per month. (The national average in 1984 was $ 940.) But Villa has electricity, water every two days (though for some it is delivered by a truck in plastic bags), schools, and health centres. And it is the only city managed from the grass-roots level in Peru. For these reasons it has been visited by world leaders such as Pope John Paul II, former Tanzanian President Julius Nyerere, and Nicaraguan Minister of the Interior Tomas Borge.

In addition, Villa is a sister city to cities in Spain, France, West Germany, and the Soviet Union. This year the World Assembly of Mayors of Sister Cities brought 200 mayors from around the globe to Villa.


PHOTOS BY LOIS JENSEN

SHELTER HELPERS: *Residents construct a building out of straw. Almost all the housing in Villa El Salvador is built by community volunteers.*

The community's success story began in the early morning hours on May 1, 1971, when 500 poor families living in unsanitary, crowded Lima slums, packed their belongings and invaded an unused pieced of private property. By May 3, there were 4,000 settlers. And by May 5, the confrontation between them and the government resulted in Villa's first martyr.

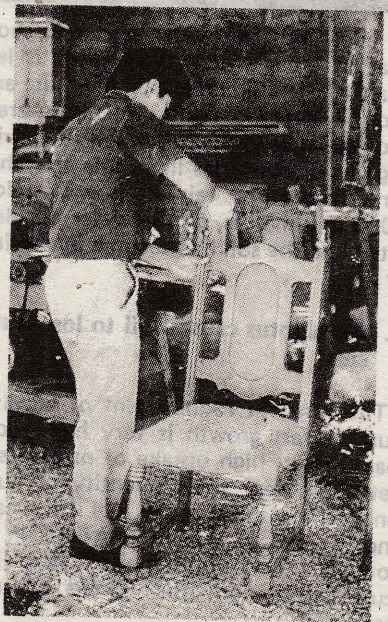
Gen. Juan Velasco, who had come to power in a coup in 1968, was determined to accomodate the poor peasants arriving in Lima from the countryside (some as a result of his failed agrarian policy). He designated a parcel of state land southwest of the capital for them, giving free lots so that they could construct their own homes, albeit from straw. For this his likeness is depicted by Villa's only public statue.

Now, only the newest arrivals live in straw houses.

In 1973, the people designed their own type of government, officially called CUAVES, the self-Managed Urban Community of Villa El Salvador. They follow their own model of urban development, which allows for private enterprise in a communally focused system. The plan, the Popular Integral Development Plan, is nationally famous.

Everyone has a voice in this highly organised and decentralized system. There are 110 residential groups of 2,500 people each. Within a redidential group are 16 blocks, each of which consists of 24 families. The block elects a leader, and because of the small number of families, many people get a chance at the two-year position. Each residential group has a secretary-general, who is responsible for developing his or her area according to the development plan.

For example, each residential group has a central park which normally consists of a basketball court, surrounded by the meeting hall, health post, communal kitchen, and kindergarten. These are planned by the people themselves, and built on Sunday, the communal labour day.



SMALL BUSINESS: *The community's industrial park provides space for a furniture maker.*

The leaders of the blocks bring their concerns to the secretary-general of the residential group, who brings the concerns to CUAVES. This bottom-up democratic structure is an unprecedented Peruvian experience.

"We struggle for our own method of development with the participation of everyone," says Mayor Azcueta. "That's extremely rare in Peru."

The system is not flawless. Some new arrivals do not want to live in such a structured environment. They refuse to integrate themselves into a residential group and do not participate in the Sunday work projects.

Although many residents have learned to help themselves, that is often not enough to overcome the obstacles of poverty. Maria Theresa Mendieta-Theodor, a United Nations volunteer, must confront the worst side of Villa as a nurse in one of the clinics.

"They come traumatized," she said of the children who arrive from areas of guerrilla warfare. Many have speech problems or cannot speak at all. Her sympathy and coaxing are not enough to compensate for the lack of professional attention.

Despite the problems, you can always find progress somewhere in Villa.

Currently the industrial park is making headlines. Twenty-five local enterprises are moving their cramped home workshops into the park. The United Nations Development Programme (UNDP) is financing the 17-year-old dream. Not only in Villa, but in all of Lima, thousands of entrepreneurs are operating in informal sectors of unregistered vendors and industrialists. They make up 60 percent of the active economic population and produce 38 percent of the country's gross domestic product.

Some 800 of these businesses are operating in people's homes in Villa El Salvador. Sewing machines and scraps of material crowd Elva Suarez's kitchen. The shoe-making machinery of Fidel and Rosalia Castro fills their house with dust. And the noise from Maximo Huarcaya's metalworks provokes his neighbors to throw rocks on his roof. The industrial park is only one of many activities percolating in Villa.

A farm in the middle of the sand dunes produces cotton, papaya, corn, oranges, and is the site of cattle -and pig-raising.

The Youth Federation has just finished the production of a video about the history of the young town, and other youths have created their own cement-block factory.

The Women's Federation distributes 70,000 glasses of milk a day for Villa's children. And in each residential group there is a communal kitchen, a project initiated by the poorer families to reduce their food bill: They buy their food together in bulk and the women take turns cooking the meals.

Church members, of which 90 percent are Roman Catholic, participate in active parishes. And high school graduates are attending Villa's first institution of higher education – Universidad Libre – which opened a year ago with funding of £ 200 collected from community members.

Although Villa cannot yet be considered a major political force, it is part of a growing popular movement in Peruvian politics, and has earned respect and attention from the government.

"Our strategy consists of mobilization and conciliation," said Azcueta. "We work first and then approach the government to get such things as water, schools, health services, and support for the industrial park. We do a lot of work and then the government has to do something also."

Villa supported President Alan Garcia in his more popular days, but with inflation at 2,000 percent and unemployment on the rise, Garcia has lost support from virtually every sector. And in Villa political parties from left and right have joined the race to fill the current political void.

Azcueta, a member of the United Left coalition, an alliance of seven leftist parties, including socialists and communists, is a possible candidate for Lima's mayoral election. And his party is seen as a potential victor of the 1990 presidential election.

Azcueta and other Villa residents are determined not to make Villa and island, but rather a model for others to follow. Talks are given in other towns and encouragement given to those seeking to develop along similar lines. Villa is also the headquarters of the National Popular Assembly, a national organization of groups which promote communal, democratic organization.

But most significant is what Villa has taught those who have grown up in a residential group and helped work for free on Sundays. Children born in Villa have learned the fruits of organization and participation.

"Even when they play soccer, they elect a president, vice-president, and secretary," says Ms. Mendieta. "Their parents are an incredible people. They have a courage that keeps them struggling."

Courtesy: *THE CHRISTIAN SCIENCE MONITOR*

ADVERSE ECOLOGICAL AND SOCIAL IMPACT OF LARGE- SCALE EUCALYPTUS PLANTING IN THE THIRD WORLD

A Report Compiled by the "Third World Network"

PART 1 : MOUNTING PROTESTS AGAINST EUCALYPTUS PLANTING

In recent months and years, there have been serious scientific critiques on the large-scale planting of eucalyptus trees in Third World countries. This eucalyptus planting is a major component of so-called "Social Forestry" projects that are supposed to improve social welfare and the environment. In reality, they have caused disastrous impact on the environment and adversely affected the water, soil and agricultural activities of surrounding poor communities. This has led to protests by farmers in Thailand and India.

The launching of Thailand's eucalyptus tree planting project has met with strong resistance. In June 1988, there were firery protests from angry villagers who stormed a forestry station and burned down eucalyptus nurseries, living quarters and equipment in Northern Thailand. The villagers were protesting against the spread of the commercial planting of eucalyptus, which they claimed would hurt the environment, and the government's attempt to remove them from their land to make room for the plants.

In March 1983, farmers in Karnataka, India demonstrated against new plantations of eucalyptus and destroyed hectares of seedlings. Their action was provoked by the drying up of streams due to the planting of eucalyptus in water-catchment areas. There have been similar protests from villagers in other parts of India which have been planted with eucalyptus. The villagers claim that eucalyptus causes wells to dry up makes the soil infertile and kills nearby plants.

The problem began when planting of eucalyptus in Third World countries was encouraged by the World Bank under its Social Forestry Plan. The plan was supposed to meet the needs of rural people for fuel, fodder and small timber.

In India, forest department officials have further claimed that the eucalyptus is the most suitable species for afforestation, being able to adapt well to dry and infertile ground. It also grows rapidly and is used for the production of pulp for paper and rayon mills. It also provides fuelwood and various types of eucalyptus oils. In Brazil, it has been used to produce charcoal for steel industries as well as timber and firewood. The government of Thailand has embarked on the planting of eucalyptus to ensure adequate firewood supplies.

PART 11: ADVERSE ECOLOGICAL AND SOCIAL IMPACTS

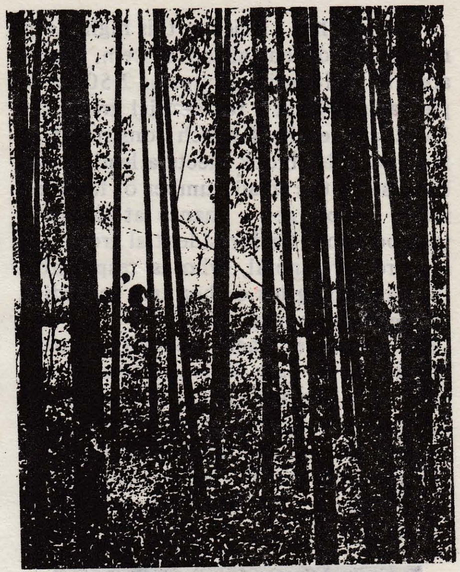
However, scientific evidence that has emerged together with complaints from grass-roots communities has thrown grave doubts on the usefulness of eucalyptus plantations. Large-scale planting of the eucalyptus has generated serious concerns about its ecological impact on essential resources and its implications for the long-term productivity of the land. The major problems caused by eucalyptus planting include:

1. Destruction of Natural Forests to make way for Eucalyptus

Vast amounts of rich natural forest in Karnataka, India, which have provided the basic material needs of villagers for centuries have been cut down to plant the eucalyptus tree under the huge World Bank sponsored social forestry plan.

2. Eucalyptus absorbs a lot of water from the ground, depriving surrounding communities of water for Domestic & Agricultural use

The eucalyptus tree has long roots which suck up too much water, depriving the land of vital moisture. Eucalyptus trees which grow in low rainfall zones have shallow and laterally spread root systems. This vast network of roots just below the soil surface extracts every bit of moisture in the soil, inhibiting other plant growth by creating competition for scarce moisture. It also inhibits recharging of groundwater, thus drying up the surface soil.



Long-term experiments on the impact of eucalyptus on water resources show that in areas where the rainfall is less than 1000 millimetres, soil moisture and groundwater are badly affected in areas around eucalyptus trees. In the drier regions of countries like India and Thailand where the rainfall is well below 1000 millimetres, groundwater has depleted and the soil has become increasingly dry.

3. Eucalyptus causes soil to lose Nutrients

The nutrient requirement of eucalyptus for fast growth is very high. Compared to its high uptake of nutrients, it returns a very small quantity of nutrients to the soil through leaf litter, causing the soil to lose its nutrients in the long run. This would make it very difficult indeed for other plants to grow around it.

4. Eucalyptus makes soil toxic, affecting nearby crops

The eucalyptus also makes the soil toxic, inhabiting seed germination and plant growth, thereby reducing the yield potential of nearby crops in the vicinity. In some areas, the impact has been so severe that farmers surrounded by eucalyptus plantations had to dig trenches to protect their food crops. Studies carried out at the University of Agricultural Sciences in Bangalore showed that toxic substances added to the soil remain for a long time in low rainfall areas, making it impossible for crops to grow successfully near eucalyptus trees in such areas. The eucalyptus is also toxic to soil orga-

-isms such as earthworms which are responsible for building soil fertility and improving soil structure.

5. Eucalyptus increases threat of desertification

The effects of eucalyptus on soil moisture, groundwater, soil fertility and other plant life also reduces the potential of land for biological production, thus creating the threat of desertification. The destruction of the biological productivity of agricultural ecosystem would result in the destruction of livelihoods leading to forced migration to urban-centres. With the displacement of foodcrops, the only employment and livelihood of millions of farmers would be threatened.

6. Eucalyptus reduces Biological diversity

Biologists in Brazil, where eucalyptus plantations abound, say that the densely planted eucalyptus shelter few indigenous animals or plants, therefore reducing the biological diversity of the region. The small holdings of villagers in Brazil have shrunk as huge areas of land are given over to agroforestry and cash crops for export. Eucalyptus also increase soil erosion, and are unsuitable for steeply sloped areas in the mountain ranges of Eastern Brazil.

PART 111: SOURCE OF PROBLEM: WORLD BANK AND OTHER FINANCING OF EUCALYPTUS PROJECTS

Wherein lies the problem? The Social Forestry Project of Karnataka, one of several social forestry plans, is funded by the World Bank and the Overseas Development Administration of the United Kingdom. Under the plan, large-scale plantation of eucalyptus on private rainfed farmlands is encouraged. Although the plan is stated as serving the needs of the rural people, it has not benefited the rural community at all. Eucalyptus produces insufficient fuel and fodder. (Local cattle cannot browse on eucalyptus leaves). Worse still, farmlands which previously produced foodcrops have been rendered infertile and therefore useless, much to the dismay of local farmers.

The principal interest in the massive planting of eucalyptus is in ensuring large supplies of wood and pulp for industrial use. The social forestry plan serves no social purpose, it is merely the conversion of foodcrop lands into massive tree farming for industrial interests — at the expense of the rural poor.

Dr. Vandana Shiva, coordinator of the Research Foundation for Science, Technology and Natural Resources Policy at Dehra Dun, India, said that eucalyptus has failed to provide for the basic material needs of Indian farmers. She further criticized the project for failing to address the problems of the community's poorest people. She also lamented the rocketing of fuelwood prices in India as a result of the widespread planting of eucalyptus as a cash crop.

In addition to the social forestry plan, the World Bank and several of its related organizations have started a Tropical Forests Action Plan. It is actually an expansion of on-going World Bank forestry projects supposed to have been set to "save tropical forests". In fact, it prescribes reforestation of natural forests with commercial planting of industrial wood. Again, it focuses exclusively on the economics of production of commercial wood and ignores the indigenous people of the forests.

PART IV: CONCLUSION: EUCALYPTUS PROJECTS SHOULD BE REVIEWED AND HALTED

In view of its negative social and ecological effects, further eucalyptus planting projects should be cancelled, and the World Bank should halt all projects. Third World Governments should learn a lesson from India's eucalyptus -planting project, and not embark on eucalyptus planting.

We hope that Third World countries will heed repeated warnings from environmentalists as well as indigenous villagers who have cultivated agricultural land for centuries. The indiscriminate planting of eucalyptus would render their agricultural land useless. Village farmers would lose precious land and livelihood through this unwise plan.

Swift action is necessary in order to urge respective governments not to carry on this project which would ruin the lives of thousands of indigenous farmers.

(Report on Adverse Ecological and Social Impacts of large-scale Eucalyptus planting in the Third World).

Courtesy: *Third World Network.*

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