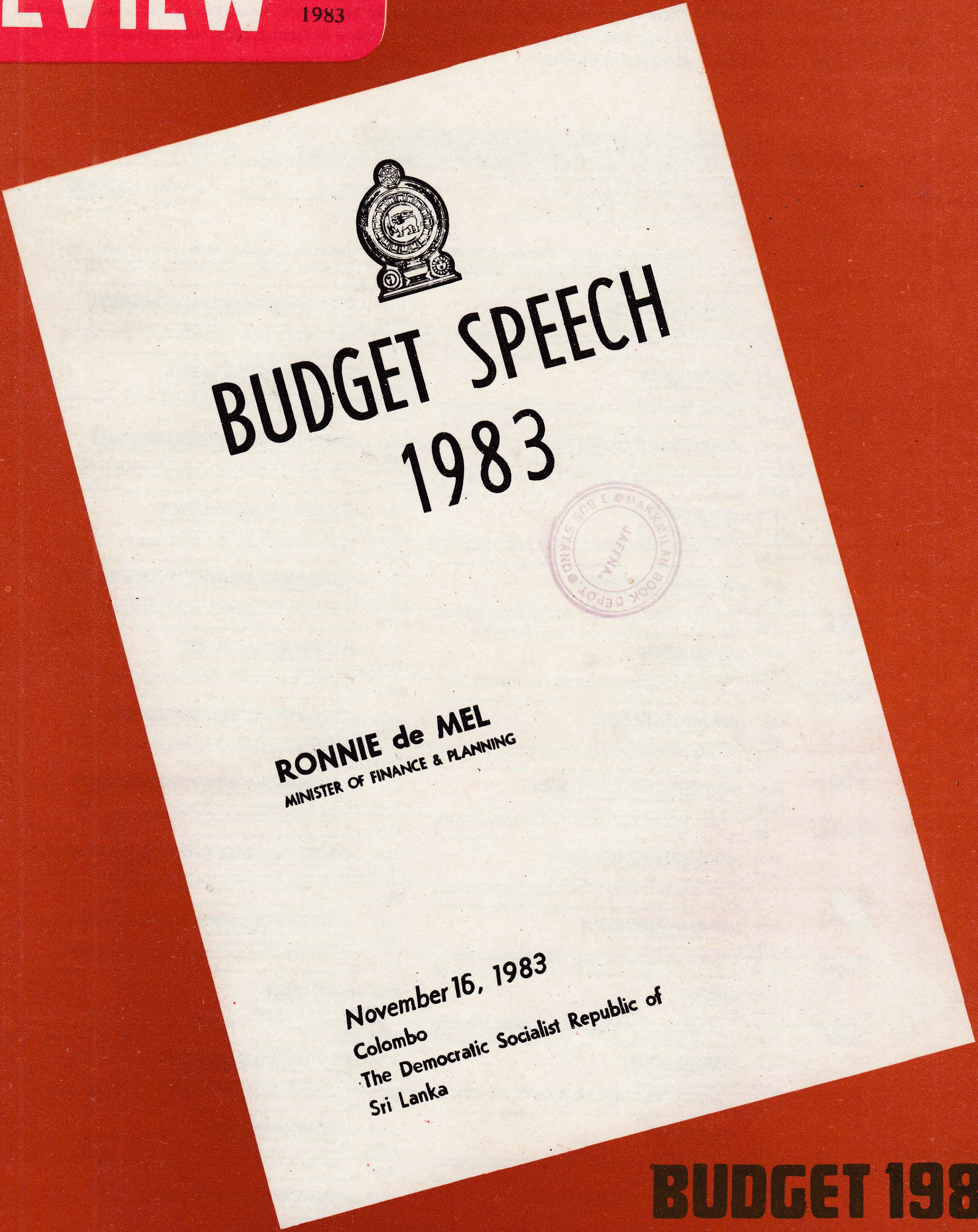
ECONOMIC REVIEW

November 1983



BUDGET SPEECH 1983

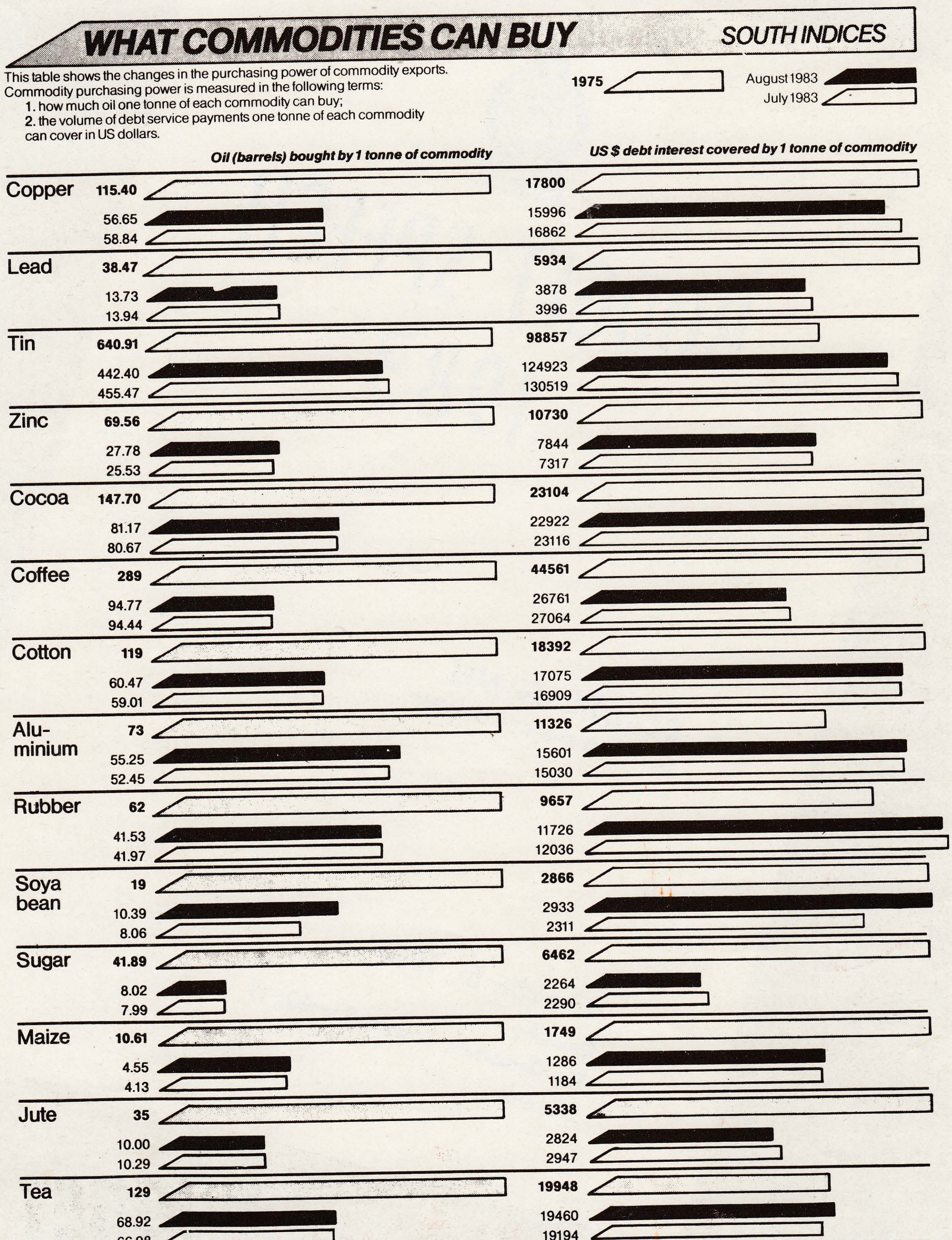
RONNIE de MEL
MINISTER OF FINANCE & PLANNING

November 16, 1983
Colombo
The Democratic Socialist Republic of
Sri Lanka

BUDGET 1984

COMMODITIES SITUATION CHANGES FOR SRI LANKA

For nearly nine years the *Economic Review* has reflected the constant fall in real value of earnings from Sri Lanka's major commodity exports. Tea was a prime example and we have occasionally illustrated the situation through this regular monthly diagram from the journal "*South*". The situation has changed dramatically for Sri Lanka which broke through the trend followed by the other 13 commodities that have been dealt with in this diagram. As seen below in January 1984, tea surges ahead of its 1975 position, contrary to the trend of all other commodities.



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COVER

Designed by Palitha Kannangara

THE ECONOMIC REVIEW is intended to promote knowledge of and interest in the economy and economic development process by a many sided presentation of views & reportage,facts and debate.

THE ECONOMIC REVIEW is a community service project of the People's Bank. Its contents, however, are the result of editorial considerations only and do not necessarily reflect Bank policies or the official viewpoint. Signed feature articles also are the personal views of the authors and do not represent the institutions to which they are attached. Similar contributions as well as comments and viewpoints are welcome.

THE ECONOMIC REVIEW is published monthly and is available both on subscription and on direct sale.

DIARY OF EVENTS

November

1 The Ceylon Electricity Board (CEB) imposed an island-wide power cut for two hours daily. This was an interim measure taken by the CEB with a view to conserving hydro power generation capacity in the months ahead. The interruption of electricity supply was to take place in different supply areas at staggered hours.

A Census of Industrial Establishments in Sri Lanka, sponsored by the United Nations Statistical Commission, commenced. The Census will cover the industrial sector in Sri Lanka, including the Investment Promotion Zone, comprising all establishments primarily engaged in mining and manufacturing and also those in production and distribution of electricity, gas and water. The Census is expected to cover seventeen districts in November and December 1983 and the rest in the first two months of 1984.

The General Agreement on Tariffs and Trade (GATT) established a new Trade Policies Division to examine non tariff restrictions on imports by member countries. These restrictions include technical barriers such as safety standards and licensing schemes.

10 The following price changes were announced: Coconut Arrack from Rs 40/- to Rs 43/- per 750 ml bottle: Extra Special Arrack Rs 35/- to Rs 38/- per 750 ml bottle: and cigarettes, an increase of two cents per cigarette on all brands locally manufactured.

16 The Budget for the fiscal year 1984 was presented in Parliament by Hon. Minister of Finance and Planning.

The Capital Development and Investment Company Ltd (CDIC) incorporated under the Company Act No. 17 of 1982, on October 12, 1983, commenced its business. The primary objective of the CDIC is to promote economic development through equity or equity type investment in the private sector enterprises in Sri Lanka. The CDIC endeavours to achieve its objectives by (a) partially filling the existing gap in equity or equity type investment needed by enterprises, (b) facilitating mixed sector enterprises (joint ventures between public sector and private sector), (c) assisting widespread share ownership and (d) supporting new capital market institutions. The financing from the CDIC will be available only for enterprises engaged in production or services in priority areas. The authorised share of the CDIC is Rs 1,000 million, out of which Rs 245 million worth of shares have been issued. The present shareholders of the Company are the Government of Sri Lanka, the National Development Bank of Sri Lanka, the Export Development Board, the Bank of Ceylon and the People's Bank.

20 The construction programme commenced on the Biyagama Investment Promotion Zone, Sri Lanka's second IPZ. The Biyagama Investment Promotion Zone (BIPZ) comprises an area of 450 acres of which the first stage would cover an area of 112 acres. About twenty industrial plots together with an administrative complex and other infrastructure facilities will be located within this area.

21 Letters were exchanged between the Governments of Japan and Sri Lanka providing for four grants amounting to Yen 4,660 million (approximately Rs 489 million). The proceeds of these grants will be made available for the purchase of agricultural machinery and fertilizer to increase food production; the purchase of Well Drilling Rigs to implement a Drinking Water Improvement Project; to meet the cost of equipment to improve the laboratory at the University of Peradeniya; and to be utilized to cover the cost of sprayers, equipment and vehicles to step up the Malaria Control Programme.

22 The General Agreement on Tariffs and Trade (GATT) established an independent group composed of international experts to study the international trading system and to consider how the problems affecting it can be overcome during the remainder of the decade.

23 An agreement was signed between Sri Lanka and the Asian Development Bank (ADB) providing for a loan to the extent of SDR 16.581 million (approximately Rs 430 million) to finance an Aqua-culture Development Project.

Heads of State and governments of member countries of the Commonwealth began a meeting in New Delhi to discuss their political and economic situation.

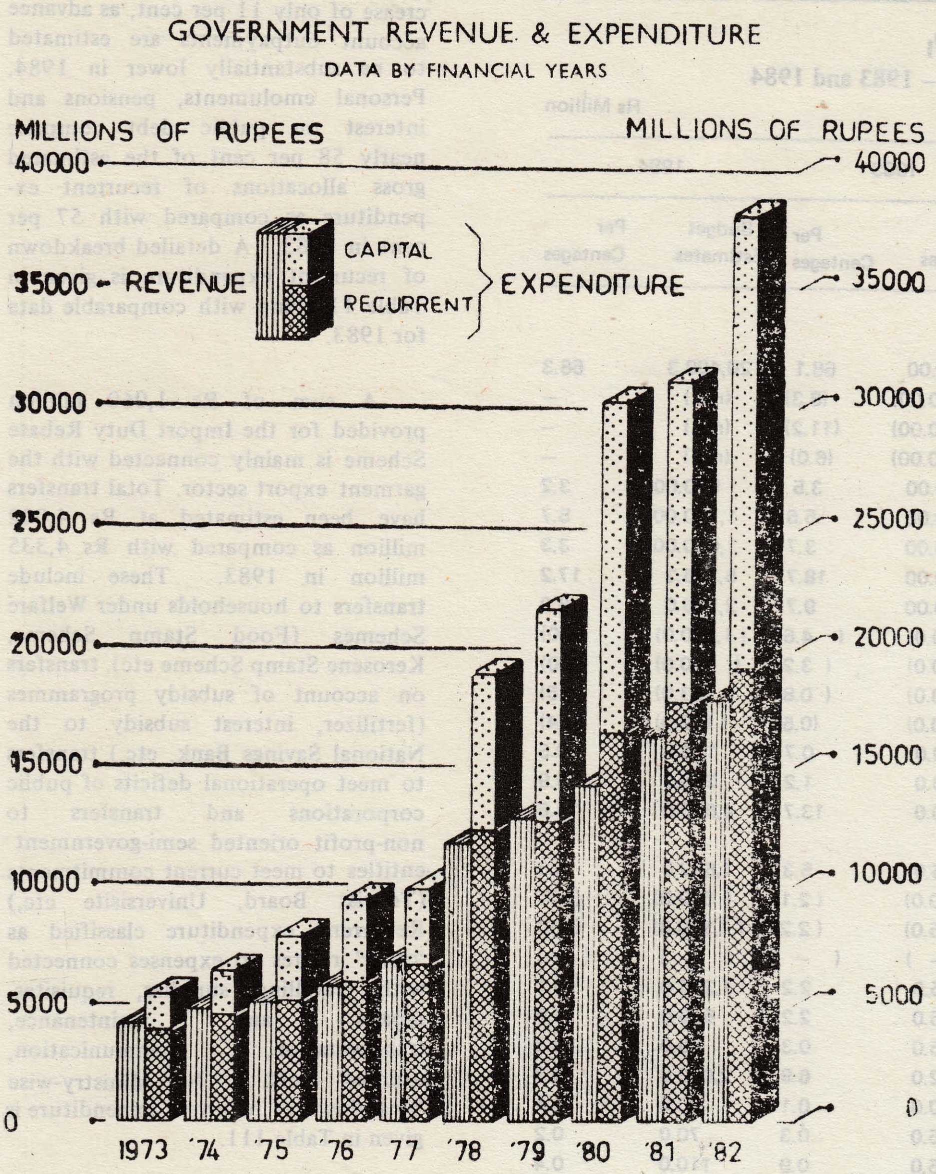
24 Jamaica unified its foreign exchange system and introduced a single exchange rate to be set by commercial banks on a daily basis within margins specified by its central bank. Initially, the margins are J$3 = US$1 (upper) and J$3.30 = US$1 (lower).

25 Winding up the budget debate in Parliament Finance Minister Mr Ronnie de Mel assured Parliament that this government will never mortgage the independence of this country to any bank – the World Bank or the IMF.

28 The Development Assistance Committee (DAC) of the OECD began itsa annual high-level meeting in Paris.

29 South Africa abolished its 5 percent import surcharge in response to a continuing improvement in the country's current account. The surcharge (initially set at 10 percent), was introduced in February 1982.

30 At the end of November 1983 the Wholesale Price Index maintained by the Central Bank of Ceylon, had reached 411.9 (for all items) as against 287.1 at the end of November 1982.



Central Bank of Ceylon

THE BUDGET 1984

On November 16, 1983 the Minister of Finance and Planning, Mr. Ronnie de Mel, presented his seventh consecutive Budget in Parliament. This is also the second budget of the second consecutive UNP government. In introducing his budgetary proposals the Minister emphasised that despite the economic difficulties of the country, which had been aggravated by the recent disturbances, he would attempt not to impose additional burdens on the less affluent sections of the people. He was offering, he said some relief which he hoped would be welcome and a few additional burdens on those who were most able to bear them.

The main strategy and thinking behind the budget is discussed in the note that follows. Other aspects of the budget are analysed in the contributions on "Problems and Prospects of Budget 1984", Targets and Implications of Recent Budgets", and "The Budget Proposals for 1984 – their impact on Revenue".

Main Features

Government revenue in 1984 is expected to yield Rs 30,770.3 million, while total current expenditure is estimated at Rs 28,650 and total capital expenditure is estimated at Rs 21,860 million.

The overall budget deficit is expected to be in the region of Rs Rs 16,543 million. The deficit is to be financed by way of Rs 3,550 million obtained from domestic non-bank sources, a sum of Rs 681 million from domestic bank sources, and a sum of Rs 12,312 million from foreign sources comprising foreign loans (both project and commodity) and grants.

Revenue

Total revenue receipts for the financial year 1984 are estimated at Rs 30,770 million indicating an increase of 28 per cent over the revised estimates for 1983. Indirect taxes on production and expenditure constitute nearly 66 per cent of estimated revenue as against 68 per cent for 1983. External trade oriented taxes inclusive of turnover taxes on imports are estimated to yield about 37 per cent of total revenue in 1983. Turnover taxes, including those on imports, continue to be the largest source of revenue accounting for 27 per cent of revenue receipts as compared with 25 per cent for 1983. Import duties form the second largest source of revenue with a share of 17 per cent as compared with 19 per cent for 1983. Receipts from direct taxes have been estimated at Rs 4,570 million showing an increase of Rs Rs 1,195 million or 35 per cent over the revised estimates for 1983. Income taxes, the major component of direct taxes, have been estimated at Rs 4,500 million showing an increase of 36 per cent. Among non-tax revenue, current transfers are estimated at Rs 2,080 million. These include a transfer of Rs 1,700 million from the Central Bank profits to be utilized in liquidation of Government obligations to the Central Bank. In 1983 Rs 1,500 million was transferred in this manner. A detailed breakdown of Govenment revenue is given in Table I along with comparable data for 1983.

Table 1

Government Revenue – 1983 and 1984

Rs Million

	1983		1984	
	Revised Estimates	Per Centages	Budget Estimates	Per Centages
1. Taxes on production and expenditure	6,410.00	68.1	20,408.3	66.3
(i) T.T. (non manufacturing)	(2,000.00)	(8.3)	(n.a.)	–
(ii) T.T. (manufacturing)	(2,700.00)	(11.2)	(n.a.)	–
(iii) T.T. (imports)	(1,450.00)	(6.0)	(n.a.)	–
(b) Excise on liquor	850.00	3.5	970.00	3.2
(c) Excise on tobacco	1,350.00	5.6	1,720.00	5.7
(d) Tea (ad-valorem) tax	900.00	3.7	1,030.00	3.3
(e) Import duties	4,500.00	18.7	5,285.3	17.2
(f) Export duties	2,200.00	9.7	2,735.0	8.9
(i) Tea	(1,110.0)	(4.6)	(1,550.0)	(5.0)
(ii) Rubber	(760.0)	(3.2)	(910.0)	(3.0)
(iii) Coconut	(200.0)	(0.8)	(153.0)	(0.5)
(iv) Other	(130.0)	(0.5)	(122.0)	(0.4)
(g) Licence fees	180.0	0.7	163.0	0.5
(h) Taxes on Transfer of assets	280.0	1,2	280.0	0.9
2. Corporate income taxes	3,300.0	13.7	4,500.0	14.6
3. Non-corporate income taxes				
4. Receipts from trading enterprises	1,285.0	5.3	1,632.0	5.3
(a) Railway	(500.0)	(2.1)	(532.0)	(1.7)
(b) Posts & Telecommunication	(785.0)	(2.2)	(1,100.0)	(3.6)
(c) Other	(–)	(–)	(–)	(–)
5. Rents and interest	525.0	2.2	1,270.0	4.1
6. Sales and charges	525.0	2.2	585.0	1.9
7. Social security contributions	75.0	0.3	95.0	0.3
8. Other current transfers	1,652.0	6.9	2,080.0	6.8
9. Sales of capital goods	20.0	0.1	20.0	0.1
10. Capital transfer	75.0	0.3	70.0	0.2
11. Repayment of loans and advances	225.0	0.9	110.0	0.4
12. Capital transfers from abroad	–	–	–	–
Total	24,095.0*	100.00	30,770.3	100.0

Source: *General Treasury*

**Inclusive of cash grant amounting to Rs. 3 Million*

The gross allocations under recurrent expenditure is estimated at Rs 28,650 million and net out-payments under advance accounts Rs 300 million. Total recurrent expenditure net of the anticipated under expenditure is estimated at Rs 28,077 million showing an increase of 14 per cent over the revised estimates for 1983. However, the recurrent expenditure inclusive of advance account out-payments for 1984 indicates an increase of only 11 per cent, as advance account outpayments are estimated to be substantially lower in 1984. Personal emoluments, pensions and interest on public debt comprise nearly 58 per cent of the estimated gross allocations of recurrent expenditure as compared with 57 per cent in 1983. A detailed breakdown of recurrent expenditure is given in Table 11 along with comparable data for 1983.

A sum of Rs 1,060 million provided for the Import Duty Rebate Scheme is mainly connected with the garment export sector. Total transfers have been estimated at Rs 4,002 million as compared with Rs 4,335 million in 1983. These include transfers to households under Welfare Schemes (Food Stamp Scheme, Kerosene Stamp Scheme etc), transfers on account of subsidy programmes (fertilizer, interest subsidy to the National Savings Bank, etc.) transfers to meet operational deficits of public corporations and transfers to non-profit oriented semi-government entitles to meet current commitments (Tourist Board, Universisite etc,) Recurrent expenditure classified as 'other' relates to expenses connected with travelling, supplies, requisites, repairs and maintenance, transportation, communication, utilities etc. A Ministry-wise breakdown of recurrent expenditure is given in Table 111.

Total provision under the capital budget for 1984 is estimated at Rs 21,860 million. Net of under-expenditure and amortization payments, total net capital expenditure is estimated to be Rs 16,568 million indicating an 8 per cent increase over the revised estimates for 1983. The share of capital expenditure in total government expenditure is expected to decline from 44 per cent in 1983 to 40 per cent. On the basis of gross allocations. The Ministry of Mahaweli Development would receive a sum of Rs 6,017 million, while Ministry of Local Government, Housing & Construction has been allocated Rs 2,056 million. A Ministry-wise breakdown of gross capital expenditure is given in Table 1 V.

BUDGET 1984 : THE GOVERNMENT'S STRATEGY BEHIND THE BUDGET — AN OFFICIAL VIEW

The Budget 1984 drew on previous experience and sought to consolidate past gains and to lay the foundation for sustained development in the future. It was set within the frame-work evolved in the Public Investment Programme (1983–87). The Budget Speech identified objectives, specified targets and outlined policies and measures for the period ahead.

The initial step in the whole process has been to try to evolve the optimal development strategy for Sri Lanka. In doing this it was recognised that each sovereign economic entity must base its strategy on the specific objective conditions that it has to contend with. The policy framework that has been adopted is based on the premise that the liberalisation of the economy has been a major source of growth impulses and dynamism in the economy, during the past six years. It recognises that autarkic strategies are not practicable in Sri Lanka, given the country's resource endownment and domestic market size. This has been amply demonstrated by the failure of these policies to promote growth and employment during the past twenty years. Inward looking policies have the potential for improving the material well-being of the people on a sustained basis only in a context where a strong capital goods sector can be developed out of domestic savings. Small ex-colonial countries like Sri Lanka do not have the capacity to generate sufficient savings, nor the resources or the market size to make a strong capital goods sector economically viable. In such a context sufficient foreign exchange must be earned to finance the capital and intermediate goods necessary for the structural tranformation of the economy. In Sri Lanka's case the foreign exchange bottleneck is exacerbated by the country's reliance on imported fossil fuels for its energy requirements. In 1983 imports of petroleum products are estimated to have absorbed about 40 percent of total export earnings.

Given the limited options and narrowly circumscribed room for manoeuvre confronting countries like Sri Lanka, export-led economic diversification and an open economy arguably provide the best possible framework for economic policy. This was the justification for the far reaching economic reform introduced in 1977. These policies constituted a significant break from the inward looking and regulatory policies of the past. Trade and payments were liberalised. The exchange rate was unified and realistically realigned. Steps were taken to render the Public Sector more efficient and to revitalise the private sector. Incentives were offered to enhance investment, production and employment. An environment was created which fostered innovation, and entrepreneurship. These policies have served to double both investment as a percentage of DGP and real growth. In addition the rate of unemployment has been almost halved.

Closing up of the economy could well stifle many of the growth impulses that have emerged during the last six years. This would have a negative impact on incomes and employment as well. These are the ideological considerations that underpin the measures introduced in the Budget. These measures sought to reduce instability introduced into the system

Table 11

Recurrent Expenditure – Estimates 1983 and 1984

Rs. Million

		1983 Revised Estimates	1984 Budget Estimates
1.	Personal emoluments	5,608	6,466
2.	Pensions	1,848	2,108
3.	Interest on Public Debt	6,912	7,995
.	Domestic	(5,442)	(6,261)
	Foreign	(1,470)	(1,734)
4.	Import Duty rebate	820	1,060
5.	Transfers		4,002
	Kerosene		387
	Food stamps		1,510
	Inters subsidy to NSB		500
	Free Text books	4,335	60
	Infant milk food		100
	Price Support Scheme for tea		24
	Milk Board		25
	Fertilizer subsidy		1,000
	Reimbursement of losses to Corporations		100
	Other public institutions		296
6.	Other	5,214	7,019
	Add: (Estimated under expenditure)	1,496	—
	Total	26,233	28,650

Source: *General Treasury*

Table 111
Recurrent Expenditure (Ministry-wise) – 1983 and 1984

	Ministry	1983 Revised Estimates (Rs. Mn)	Percentage	1984 Budget Estimates (Rs. Mn)	Percentage
1.	The President, Prime Minister, Supreme Court Judges, etc.	181.9	0.7	142.4	0.5
2.	Defence	1,184.6	4.6	1,416.5	4.9
3.	Foreign Affairs	228.4	0.9	250.3	0.9
4.	Plan Implementation	105.6	0.4	135.2	0.5
5.	Lands and Land Development	330.5	1.3	337.2	1.2
6.	Trade and Shipping	143.6	0.6	145.5	0.5
7.	Education	2,360.9	9.1	2,567.8	9.0
8.	Higher Education	280.8	1.1	335.3	1.2
9.	Power and Energy	41.3	0.2	56.2	0.2
10.	Labour	55.1	0.2	56.8	0.2
11.	Public Administration	1,722.1	6.6	2,013.1	7.0
12.	Rural Development	15.9		13.1	–
13.	Local Govt.Housing & Construction	621.9	2.4	589.4	2.1
14.	Industries and Scientific Affairs	46.8	0.2	54.6	0.2
15.	Finance and Planning	12,265.2	47.1	13,123.0	45.8
16.	Transport	857.6	3.3	1,090.3	3.8
17.	Transport Boards	1.0	–	1.0	–
18.	Private Omnibus Transport	0.9	–	0.9	–
19.	Plantation Industry	2.4	–	12.8	–
20.	Justice	212.8	0.8	239.9	0.8
21.	Agricultural Development & Research	348.3	1.3	331.7	1.2
22.	Fisheries	31.4	0.1	36.1	.1
23.	Mahaveli Development	302.6	1.2	268.7	0.9
24.	Youth Affairs & Employment	108.8	0.4	111.3	0.4
25.	Rural Industrial Development	50.9	0.2	51.7	0.2
26.	Posts & Telecommunications	589.6	2.3	747.1	2.6
27.	Health	1,005.8	3.9	1,250.9	4.4
28.	Colombo Hospitals & Family Health	280.0	1.1	316.6	1.1
29.	Indigenous Medicine	31.4	0.1	38.9	0.1
30.	State	217.4	0.8	251.6	0.9
31.	Social Services	186.4	0.7	187.0	0.1
32.	Cultural Affairs	29.6	0.1	30.8	0.1
33.	Parliamentary Affairs & Sports	17.1	–	17.3	0.1
34.	Food & Co-operatives	1,952.2	6.7	1,977.6	6.9
35.	Textile Industries	29.6	0.1	31.2	0.1
36.	Coconut Industry	1.6	–	1.5	–
37.	Regional Development	5.8	–	6.1	–
38.	Highways	173.6	0.7	180.0	0.6
39.	Janatha Estate Development	0.8	–	0.8	–
40,	State Plantations	0.4	–	0.4	–
41.	Home Affairs	210.7	0.8	228.2	0.8
42.	District Ministries	–	–	–	–
43.	Rehabilitation	–	–	1.2	–
	Total	26,233.2	100.0	28,650.0	100.0

Sources: *General Treasury, Central Bank of Ceylon.*

through the budget and to encourage exports and efficient import substitution. This would reduce price instability by increasing supplies and strengthen the balance of payments.

The budget has sought to set the course for the future on the basis of an honest appraisal of the country's resources. Notable progress has been made on the investment, output and employment fronts. These very successes, achieved in the context of an extremely hostile external environment have brought about certain imbalances in the economy. Global stagflation, weak commodity prices and increasing protectionism contributed in no small way to domestic price and external payments instability. The situation has been exacerbated by lack of discipline at the domestic level. The difficulties have been heightened by waste and non priority expenditures.

The mix of remedial fiscal, monetary and exchange rate policies have sought to balance the short-term need to bring about stabilisation and the long-term objective of increasing supplies and employment.

The fiscal measures incorporated in the Budget 1984 have sought to reduce the instability introduced into the system by the budgetary operations of the Government. At the outset of its period in office the Government was compelled to step up public sector infrastructural investment so as to enhance the productive and labour absorptive capacities of the economy. This was inevitable in an investment starved economy with extremely high unemployment. As a result public expenditure, particularly capital expenditure, has increased sharply. While this had beneficial effects in terms of higher employment and incomes, price instability was brought about because revenues were not buoyant enough to meet the increased expenditure. Increasing revenues was difficult at a time when

Table 1V
Capital Expenditure (MInistry-wise) – 1983 and 1984

Ministry	1983 Revised Estimates (Rs. Mn)	1983 Percentage	1984 Budget Estimates (Rs. Mn)	1984 Percentage
1. The President, Prime Minister Supreme Court, Judges etc.	134.5	0.5	64.7	0.3
2. Defence	836.9	3.3	912.9	4.2
3. Foreign Affairs	3.0	–	2.2	–
4. Plan Implementation	477.4	1.9	441.3	2.0
5. Land and Land Development	853.9	3.4	947.3	4.3
6. Trade and Shipping	269.6	1.1	219.2	1.0
7. Education	162.6	0.6	207.9	1.0
8. Higher Education	260.5	1.0	433.9	2.0
9. Power and Energy	808.8	3.2	747.4	3.4
10. Labour	10.9	–	23.4	0.1
11 Public Administration	0.5	–	2.0	–
12. Rural Development	5.0	–	5.0	–
13. Local Govt.Housing & Construction	2,490.9	9.8	2,056.9	9.4
14. Industries and Scientific Affairs	25.6	0.1	58.5	0.3
15. Finance & Planning	2,429.2	9.6	2,819.4	12.9
16. Transport	481.0	1.9	428.8	2.0
17. Transport Boards	156.2	1.8		–
18. Private Onmibus Transport	–		–	–
19. Plantation Industry	160.0	0.6	169.5	0.8
20. Justice	3.4	–	14.6	0.1
21. Agricultural Development & Research	724.3	2.9	860.0	3.9
22. Fisheries	182.1	0.7	199.3	0.9
23. Mahaweli Development	6,773.0	26.8	6,017.0	27.5
24. Youth Affairs & Employment	35.6	0.1	31.6	1.0
25. Rural Industrial Development	88.2	0.3	133.2	0.6
26. Posts & Telecommunications	574.5	2.3	512.1	2.3
27. Health	821.3	3.2	212.4	1.0
28. Colombo Hospitals & Family Health	6.2	–	18.4	0.1
29. Indigenous Medicine	3.0	–	14.3	0.1
30. State	12.3	–	60.8	0.3
31. Social Services	1.6	–	2.2	–
32. Cultural Affairs	36.0	0.1	19.5	0.1
33. Parliamentary Affairs & Sports	3.1	–	3.0	–
34. Food & Co-operatives	0.1		8.6	–
35. Textile Industries	24.8	0.1	55.6	0.3
36. Coconut Industry	166.7	0.7	229.7	1.1
37. Regional Development	13.5	0.1	13.8	0.1
38. Highways	225.7	0.9	221.0	1.0
39. Janatha Estates Development	344.8	1.4	389.0	1.8
40. State Plantations	86.0	0.3	95.5	0.4
41. Home Affairs	0.7	–	0.4	–
42. District Ministries	420.0	1.7	840.0	3.8
43. Rehabilitation	–	–	–	–
Total	20,413.5	80.7	19,492.4	89.2
Sinking Fund contributions and amortization payments	4,890.0	19.3	2,367.6	10.8
GRAND TOTAL	25,303.5	100.0	21,860.0	100.0

Sources: *General Treasury, Central Bank of Ceylon.*

(a) Includes a sum of Rs 10.6 million being unallocable to various ministries.

the export sector, which is still a major source of revenue, was afflicted by declining prices and when there was a perceived need to activate a private sector which had been stagnant for many years. Slowing down the momentum of the investment programme in mid-stream was also not feasible. Furthermore, the Government was anxious to implement its development programmes quickly so as to reduce the cost of energy in the economy and to combat the backlog of unemployment by increasing the opportunities for productive employment. The Budget 1984 introduced a mix of expenditure restraints and receipt increases which will serve to contain inflationary pressures emanating from the operations of the Government. Improved budgetary performance will also serve to reduce pressure on the balance of payments.

The Budget 1984 also reflects appreciation of the need to rely increasingly on domestic resources. The current levels of foreign financing (13.7 percent of GDP 1978–82) cannot be sustained without running into debt servicing problems. It is, therefore, noteworthy that the Government Current Account operations in 1984 are expected to yield savings that are contributing towards financing the development programme.

One may conclude that the formulation of the Budget 1984 was governed by the economic and social objectives of the Government for the next six years. These are to:–

(i) maintain the highest viable rate of investment, savings and growth in the economy;

(ii) increase employment opportunities;

(iii) reduce the pressure on the balance of payments;

(iv) maintain reasonable price stability;

(v) enhance equality of income distribution and the quality of life of the people.

It was within this framework that the Budget 1984 was drawn up. The proposals it contained fall into two categories –

(1) development oriented measures designed to increase supplies in the priority sectors, particularly exports and efficient import substitution.

(i) production subsidies for Tea and Coconut were increased

(ii) tax incentives for exports were rationalised and broadened –

(a) Tax holidays where applicable have been extended to cover partnerships and individuals, in addition to Companies. In the case of garment exports, tax holidays will be granted hereafter only on profits derived from exports outside the garment quotas.

(b) in the case of services the tax holiday is to be confined to ship repairing and ship breaking services, and production and export of computer software and computer related services.

(c) comapnies eligible for a tax holiday will also qualify for "approved undertaking" status,

(d) a new scheme is being formulated to encourage gem exporters to export through legitimate channels.

(iii) Five Year Tax Holidays will be granted to import substitution industries engaged in:–

(a) the production and processing of sugar,

(b) the production and processing of milk and milk products.

(c) livestock activities,

(d) fisheries activities,

(e) certain agro-based industries which will be specified,

(f) tax exemption of interest from non resident foreign currency accounts will be increased from 3 to 6 years.

(iv) In order to give more meaning to decentralisation and to strengthen the District Council system each DDC has been granted a block vote equivalent to the total sum a district was receiving under the decentralised budget. The total allocation for district budgets was, therefore, increased from Rs. 420 M. to Rs. 840 M.

(2) Revenue measures designed to enhance the surplus in the current account of the Budget:–

	Rs. (Million)
Income Tax	200
Rehabilitation levy	200
Rehabilitation surcharge	400
Turnover Tax	400
Tobacco Tax	100
Excise duties	90
Customs duties	30
Postal rates	130
Telecommunication charges	90
Passport fees	40
Government fees and rents	30
	1,710

Widespread tax evasion is to be reduced through the introduction of administrative reforms designed to improve the working of the Inland Revenue Department. In addition, relief has been provided to lower income groups by increasing the threshold and moderating the tax slabs. This helps to offset the "bracket creep" that has taken place due to inflation.

The final estimates of expenditure and revenue are as follows:–

			Rs. Million
(i)	Recurrent Expenditure	– 28,650	
	Less Provision for under-expenditure	+ 573	–28,077
(ii)	Revenue		+30,770
(iii)	Current Account Surplus		+2,693
(iv)	Capital Expenditure net of Public Debt Amortisation	– 19,492	
	Less Provision for under-expenditure	+ 2,924	–16,568
	Add Public Debt Amortization	– 2,368	–18,936
(v)	Net lending on Advance A/cs		–300
(vi)	Overall deficit		–16,543

The deficit is to be financed as follows

(a)	Foreign outright grants	Rs.4,150 mln.
(b)	Project/commodity and other	Rs.8,162 mln.
(c)	Domestic Rupee Loans	Rs.3,550 mln.
(d)	Banking System	Rs.681 mln.

It is noteworthy that Revenue is expected to increase from 19.9 percent of GDP in 1983 to 22.1 percent in 1984. Recurrent expenditure which amounted to 20.4 percent of GDP in 1983 is expected to be 20.2 percent in 1984. The decision not to undertake any new projects during the current year has meant that capital expenditure has decreased from 12.6 percent of GDP in 1983 to 11.9 percent in 1984. It is creditable that expenditure is expected to be lower than in 1983 when there was significant under-expenditure due to the vote on account and the July disturbances. This combination of increased revenue and restrained expenditure is expected to bring about significant improvement in budgetary performance. The current account is expected to move from a deficit of 0.5 percent of GDP to a surplus of 1.9 percent of GDP. In addition the overall deficit is expected to fall from 17.8 percent of GDP in 1983 to 11.9 percent in 1984. Another notable feature is the anticipated reduction in total domestic borrowing from 7.6 percent of GDP in 1983 to 3.0 percent in 1984. This means that the budget will pre-empt a smaller share of domestic resources, thus reducing the "crowding out" of the private sector. In addition bank borrowing is expected to be only 0.5 percent of GDP. This will mean that inflationary pressures stemming from the budget will be contained. The budgetary estimates for 1984 are conservative and do not take into account the windfall increase in tea earnings as a result of India's decision to limit her exports. The Budget 1984 has set out to curb price instability and improve balance of payments viability. It has gone some way towards placing the economy on a path of sustained growth and development in the medium and long-term.

Economic management in the modern world is a continuous process. It cannot be a once and for all effort at the time the Budget is presented each year. In our interdependent world constant fine tuning is necessary and continuous adjustment is far less painful than sudden spurts of policy change designed to make up a backlog of adjustment. Fiscal policies must be supplemented by monetary, tariff and exchange rate policies that maintain the competitiveness of the economy and create an environment that is conducive to non-inflationary growth and development. Given the exposure to uncertain external forces that the country experiences, it is also important to ensure that cyclical improvements in the external account do not detract attention from the need to effect structural transformation of the economy. Increased export earnings must be used to build up the productive capacity of the economy rather than on consumption.

THE BUDGET PROPOSALS FOR 1984 THEIR IMPACT ON REVENUE

Yasapala Karunasinghe (*Tax Consultant*)

The increase in the projected Gross Expenditure for 1984, is Rs 4.1 billion over that for 1983, on the basis of the Final Estimates (FE) of Revenue and Expenditure for the New Year. The approved gross expenditure for 1983 was Rs 51.1 billion while that envisaged for 1984 is Rs 47.0 billion. In the Draft Estimates (DE), the figure was Rs 51.2 billion.

The gross expenditure can conveniently be broken down into (a) Capital Expenditure, and (b) Recurrent Expenditure.

A decrease in the Capital Expenditure by Rs 5.9 billion is observed for 1984 since the estimated figure is Rs 18.9 billion compared with that for 1983 which stood at Rs 24.8 billion. This decrease is due to:

(a) New Projects not being planned for 1984, and
(b) the abolition of transfers from Capital Votes to Sinking Funds.

It is, therefore, to be assumed that the provision is for financing the on-going projects, (e.g. Mahaweli etc.) With regard to Recurrent Expenditure, an increase of Rs 1.5 billion over 1983 is observed (the figure goes up from Rs 26.5 billion in 1983 to Rs. 28.0 billion).

The Draft Estimates of Revenue and Expenditure of the Government being prepared much in advance of the presentation of the Annual Budget(usually around July – August while the presentation of the Budget is around mid – November) a more realistic picture of the country's prospective economy emerges at the latter period.

The provision in the Draft Estimates in respect of Recurrent Expenditure being found excessive and taking into account: –

(a) interest payable on Treasury Bills,
(b) rebate on duty to exporters, and
(c) interest subsidy to the National Savings Bank,

a reduction of Rs 700 million, on the basis of the above –
(a) Rs 300 M (b) Rs. 200 M, and (c) Rs. 200 M respectively is anticipated. This brings down the Recurrent Expenditure from Rs 29.3 billion to (DE) Rs 22.6 billion (revised Estimates).

Every successive Budget has shown that there is a fair percentage of under expenditure of voted funds, due no doubt to plausible reasons. This is in contradiction to the pre= sentation in Parliament of many supplementary estimates in the course of a Financial Year due to equally cogent reasons, such as floods, drough droughts,and other domestic calamities. Both the plus and minus factors seem to have right along yielded a net plus result and the Minister, taking into account all circumstances, estimates the net under-expenditure at a conservative 2 percent of the Recurrent Expenditure which would reduce the figure of Rs. 28.6 B to Rs 28.0 B (FE).

The Revenue for 1984 was reckoned at Rs 28.0 billion in the Draft Estimates, but in the Revised Estimates it went up to Rs 29.0 billion. The figure in the Final Estimates stands at Rs 30.7 billion, the increase being accounted for by:

a) Ad Valorem Duty on tea Rs 300 M (DE Rs.1,030 M)

b) interest on investment in Sinking Funds by Joint Investment Fund Rs 500 M (treated as income and not of the Funds)

c) Contribution by the Ceylon Petroleum Corporation towards Kerosene subsidy Rs 210 M (treated as item of revenue

d) revenue from Budget proposals Rs. 1710 M

Rs. 2,720 M

The overall Budget deficit for 1984 according to the Final Estimates stands at Rs 16.5B (the interim figures were: Draft Estimates Rs. 23.4 B and Revised Estimates Rs 18.2B).

Taxation

The Budget Proposals are designed to bring in Rs 1,710 M – A breakdown of the figure and comments thereon follow:

1. Income Tax

a) The exemption limit of Rs 12,000 of a resident individual's Assessable Income which was fixed in 1979, is being increased to Rs 18,000 from the Year of Assesment 1984/85. This is a welcome relief especially to those employed in the Private Sector. There was a persistent clamour by the employees of this sector for relief in view of the exemption of employment income of those in the public sector as well as the steady rise in the cost of living due to inflation. The demand, indeed was for the complete exemption of the employment income of the private sector too, on the principle of equal treatment of all employees or an increase in the exemption limit in keeping with the rise in the cost of living.

The increased exemption limit will not apply to non-resident individuals nor to expatriate employees, since they are not entitled to the tax free allowance now.

(b) Besides the raising of the exemption limit, the Income Tax Slabs applicable to Taxable Income are being widened, which in itself brings a further relief and serves as an added benefit to those earning lower incomes. The present Rate Schedule introduced in 1979, has been structured on a 10 tier slab basis, rising progressively from 7½% to 50% with a residual rate of 55% on the balance. The first 8 slabs consist of Rs 4,800 each with the 9th and 10th slabs containing Rs 7,200 each.

The proposed Rate Schedule applicable from the Year of Assessment 1984/85 has the first 8 slabs at Rs Rs 6,000 each with the 9th and 10th slabs containing Rs 9,000 each, the residual rate on the balance being at 55%.

Under the present Rate Schedule, with the exemption limit of Rs 12,000 a resident tax payer reached the highest slab of 55% on an income of over Rs 64,800. In the proposed Rate Schedule, with a tax free allowance of Rs 18,000 he will reach this highest rate, if his income goes above Rs Rs 84,000.

Since the present Rate Schedule is applicable to both resident and non-resident individuals, the proposed Schedule will apply to both categories. The non resident tax payer is, however not entitled to the tax free allowance. The following table shows the present and proposed Rates as well as the tax payable.

If the individual had any Qualifying Payments (Q/PP) (Donation to Government; Approved Expenditure; Investments in Quoted Public Companies; Approved Investments (e.g. housing loans, etc) Donation to approved charities: Premia on Life; Annuity or Medical Insurance Policies; Contributions to Provident/Pension Funds and Subscriptions to Professional Associations) he would get an exemption of his Assessable Income uoto 1/3 of his Assessable Income and in certain instances 100%.

In the above example, if the Qualifying payments are limited to 1/3 of Assessable Income, the position would be as follows:-

The revenue loss of these changes is estimated at Rs. 100 M. Income tax is levied on personal and corporate incomes in addition to Capital levies s such as Wealth Tax, Gifts Tax and Estate Duty. The Revenue Estimates for 1983 showed a yield from Direct Taxes:

	Present (Exemption limit Rs 12,000)		Proposed (from year of Assessnent 84/85) (Exemption limit Rs 18,000)	
Rate	Taxable Income	Tax	Taxable Income	Tax
7½%	4,800	360	6,000	450
10%	9,600	840	12,000	1,050
15%	14,400	1,560	18,000	1,950
20%	19,200	2,520	24,000	3,150
25%	24,000	3,720	30,000	4,650
30%	28,800	5,160	36,000	6,450
35%	33,600	6,840	42,000	8,550
40%	38,400	8,760	48,000	10,950
45%	45,600	12,000	57,000	15,000
50%	52,800	15,600	66,000	19,500
55%	Balance		Balance	

Example

Present			Proposed
Resident individual –			
Income from all sources		Rs 30,000	Rs 30,000
Less: Tax free allowance		12,000	Rs 18,000
		Rs 18,000	Rs 12,000
Tax on Rs 14,400		Rs 1,506	Tax on Rs 12,000 – Rs 1,050
Balance at 20%	Rs.3,600	720	First 6,000 @ 7½% – 450
			Next 6,000 @ 10% – 600
	Rs.18,000	Rs 2,226	Rs,1,050

Present Rs 2,226
Proposed 1,050

Relief 1,176

	Present		Proposed	
Income from all sources		Rs. 30,000		Rs.30,000
Less: Tax free allowance	Rs. 12,000		Rs. 18,000	
Q/PP	Rs. 10,000	Rs. 22,000	Rs. 10,000	Rs.28,000
Taxable Income		Rs. 8.000		Rs. 2,000
Tax on Rs. 4,800	–	Rs. 360	Tax on 2,000 @ 7½%	Rs150
Balance at Rs. 3,200	–	Rs. 320		
Tax payable	Rs. 6,000	Rs. 680	Therefore tax payable	Rs.150

Income Tax Rs. 570 M
Corporate Tax Rs 3,030 M

The additional Revenue from Income Tax for 1984, according to the proposals, is Rs 200 M (i.e. Rs 300 M from the changes under "8 Tax Evasion", below less Rs 100 M revenue loss under "1. Income tax", above).

2. Rehabilitation Levy

A levy of 1% on the gross remuneration of all employees in the Private and Public Sectors will be imposed during the Calendar Year 1984. This will apply to public servants including Ministers and Members of Parliament as well as Pensioners who are now exempt from Income Tax.

The purpose of this imposition is to recoup at least partly the heavy expenditure the Government had to incur due to the ethnic violences that erupted in July, 1983. The estimated Revenue from this levy is Rs. 200 M.

3. Rehabilitation Surcharge

This proposal prompted by the same reason as for the Rehabilitation levy is a once-and-for-all charge to be imposed on individual companies, bodies of persons and individuals for the Year of Assessment 1984/85 at the rate of 10% on Income Tax payable for that year. The anticipated Revenue is Rs 400 M.

4. Tax Holiday for Exports

Tax Holiday to Companies for exports and for provision of services for payment in foreign currency, was provided for under Section 20 (1) (b) of the Inland Revenue Act (IRA) for five years from the date of first exports or commencement of provision of services. The Holiday was limited to those Companies approved by the Minister, prior to March 31, 1983, by an Amendment passed in 1982.

The proposal is to extend this concession not only to Companies but also to Partnerships and Individuals with a view to giving a fillip to the development of exports. The rationale behind the proposal is the encouragement of exports because their contribution to the Gross Domestic Product is 1/3, and employment 1/4, while yielding about 1/5 of Government revenue.

The main features of the proposal are:–

(a) Companies' Partnership and Individual will be eligible to a Five Year Tax Holiday which was earlier limited to Companies formed after April 01, 1972. The restriction in regard to the date of incorporation of the company is being lifted.

(b) The Tax Holiday will apply to exports of non-traditional products (tea, rubber and coconut excluded) or the rendering of specified services by above three categories in respect of –

(i) Ship repairing and ship breaking services, and

(ii) production and export of. Computer Software and Computer related services irrespective of whether the businers had enjoyed a tax holiday earlier or not,

(c) the period will cover 1984/85 to 1988/89.

(d) Companies newly incorporated for above activities (see b) will be treated as approved undertakings under Section 3 (9) (b) of I.R.A. to enable investors to claim 1/3 of Assessable Income as a deduction under Q/PP. (Also see note)

5. Subsidies for Production

Certain subsidies or grants to producers are exempt from Income Tax under Section 13 of the Inland Revenue Act. Substantial increases in the subsidies paid for –

a) replanting of tea,
b) infilling of vacancies on tea land,
c) replanting and/or underplanting of coconut lands,
d) new planting of coconut lands, a and
e) rehabilitation of coconut lands

have been announced with a view to granting incentives for increased production in the Plantation Sector.

Note

1. Garment exports will qualify for the Tax Holiday only on Profits earned from exports outside the quotas. Those exports within the quotas will not qualify for the concession hereafter, but business already approved will continue to enjoy the benefit.

2. Consequent on the fall of gem exports through official channels the Gem Auctions held by the Ceylon Chamber of Commerce had been discontinued. A scheme is being drawn up by the State Gem Corporation, with the help of the Export Development Board to encourage Gem Exports through official channels. The value of gems exported through official channels fell from Rs 663 M in 1980 to Rs 393 M in 1982.

6. Import Substitution

A Five-year Tax Holiday has been proposed to grant investment relief under Q/PP to Companies engaged in activities such as:—

a) the production and processing of sugar,
b) the production and processing of milk and milk products,
c) livestock,
d) fisheries, and
e) specified agro-based industries.

This is with a view to encouraging investment in these priority areas.

7. Non-resident Foreign Currency Accounts

The interest accruing and the capital in these accounts are now exempt from Income and Wealth taxes during the period the holders are non-resident and for 3 years of their return to the Island. The proposal is to exempt them from the respective taxes for an additional period of 3 years for a total period of 6 years after their return. This is to make the scheme more beneficial to the holders.

8. Tax Evasion

The Minister stressed that evasion of Income Tax, Turnover Tax, Custom Duties and other taxes is rampant in the country. Although the money incomes have increased all-round during the last six years due to accelerated economic development, the tax exemptions, holidays and incentives that had been granted of late had resulted in the erosion of the tax base itself and therefore tax concessions which are no longer justified have been removed. It was said that effective action would be taken administratively to enforce collection more vigorously, with a view to increasing revenue. The following measures are contemplated in this regard:—

a) Streamlining of the Inland Revenue procedures and techniques,

b) taxing the non-monetary benefits such as housing, transport, etc. of the private sector executives more realistically in their hands and where they are not taxed, the disallowance of a deduction of such amounts to the employees, and

c) the reintroduction of the withholding tax at 20% on dividends declared by Quoted Public Companies.

The additional revenue expected from these measures is Rs. 300 M.

9. Turnover Tax

The Minister commented on a predominantly large scale evasion of over Tax and attributed it to the high rate of tax on trading activities and the undesirable cascading effect it has. The following changes were announced to be effective from 17.11.1983.

General Trading:

a) **Wholesale, retail and other distributors**

Reduction from 4% to 1%

b) **Excepted Articles**

This list is revised to limit the number of items in view of the reduction of the general rate to 1%.

The items are:
Books (excluding magazines, periodicals and newspapers), Bread, Crude oil and avaiation fuel, exports — articles manufactured in Sri Lanka and exported by the Manufacturer,. Infant milk food ONLY at the point of manufacture or import.

The following articles which were excepted at Wholesale and Retail are now liable at these points at 1% as well as at the import point at prescribed rates indicated within brackets where applicable.

Cement (15%); Cigarettes (40%); Fertilizer (3%), Infant milk food; Liquor (20%); Paddy; Petrol; Diesel Oil, Kerosene Fuel, Naptha and Bitumen (4%); Rice uncooked), rice flour, wheat and wheat flour (also at point of milling) (4%) and sugar (15%).

The following articles which were declared excepted articles effective from 2.6.83 are liable at both wholesale and retail points with effect from 17.11.83 at a general rate of 1%.

Cardamon, Cinnamon, Cloves, Green tea leaf, Nutmeg, Pepper and Rubber. (Also see note)

c) **Business of a Manufacturer or an Importer**

The following changes are effected at the point of manufacture or import:

	Old	New
(i) **Reduction of rate:**		
Fertilizer	4%	3%
Jams, Fruit Jellies, & Marmalades	10%	6%

(ii) (a) **Rates remain unchanged at 4%**
Mineral fuels, mineral oils and products of their distiliation.
Pharmaceuticals
Plywood Chests and Tea Chests, Rice and Rice Flour.

(b) **Rates on other items now taxed at 4% is increased to 6%**

(c) **Rate increased**	Old	New
Wines (other than Sacramental wine	10%	15%

(iii) **Rate remains unchanged in respect of;**

a) Sugar 15%; (b) Arrack 20%; c) Beedi 20%; (d) Cigarettes 40% e) Cigars 20%; (f) Pipe tobacco 20%; (g) Whisky, Brandy, Gin, Rum, Liquors and other fermented beverages (other than beer and wines) 20%.

Note

Paddy which was an excepted article has been removed from the list. The item has been added on to the list of Exempt businesses under 'Any business for the cultivation of tea, rubber, coconut or paddy. This is in order to give an incentive to the paddy cultivator who will now be exempt on the turnover of paddy sold by him.

(iv) **Other Items – Rates increased as follows:**

New	New
4%	6%(See (c)(ii)(b) above
7½%	10% (residual)
10%	15%
15%	20%

(d) Business (including professions & services trades)

	Old	New
(i) Reduction of Rates:		
The business of Leasing Plant, & Machinery, Agricultural and Industrial Equipment	4%	3%

(ii) **Rates remain unchanged:**

All other business – Rates varying at 5% and 10%

(e) **Tourist Hotels:** Reduced rate from 15% to 10% effective from October 21, 1983. Continues unchanged.

The additional revenue anticipated from these changes is Rs. 400 M.

10. **Excise Duties** (effective from 17.11.83)

Increase:	**Effect**
(a) Tobacco by Rs11.50 per kg.	All brands of cigarettes up by .02 per cigarette.

(b) Liquor

(i) Special arrack by Rs. 5/- per proof litre
Up by Rs. 3/- per bottle

(ii) Coconut Arrack by Rs 6/- per proof litre
Up by Rs 3/- per bottle

(iii) **Reductions**

Locally produced Foreign type liquor by Rs 33/– per proof litre down by Rs 16/50 per bottle.

The additional revenue anticipated is –

(a) Tobacco Tax Rs 100 M, and
(b) Excise Duties (liquor) Rs90M

11. **Import Duties**

(a) Abolition of Import Duty on books and periodicals with effect from 17.11.83. This measure results in a revenue loss of Rs 10M

(b) Measures have been proposed to strengthen the machinery for the effective collection of duties, which when implemented would bring in an additional revenue of Rs 40 M resulting in a net additional sum of Rs 30 M (taking into account the loss of Rs 10M under (a) above. (See Note Below)

12. **Passport Fees**

An increase from Rs 100 to Rs 200 per passport. The additional revenue anticipated, is Rs 40M.

13 **Government Rents**

a) **Land:**
An increase of 1% (from the present 4% to 5% on Rents on Government Lands (from allotees under the Crown Lands Ordinance, Forest Ordinance and Land Development Ordinances).-

b) **Buildings:**
An increase by 25% of the rent charged from non-government bodies and on houses rented to Public Servants.

The additional revenue expected under (a) and (b) is Rs 10 M.

14. **Other Government Fees:**

An increase by 25% on fees charged for – (a) Survey, (b) Valuations, (c) Testing Motor Vehicles, (d) Driving Licences, etc. Additional revenue is estimated at Rs 20 M.

15 **Fees and Charges**

(a) Postal Service

Charges have been revised to be effective from 1.12.83. Estimated additional revenue is Rs 30 M.

(b) Telecommunication Service Charges

Telephone calls – charges (effective from 1.12.83) – Telephone calls –charge increased from .70 to .90 per call, and Rental of private telephones increased from Rs. 250 to Rs 350/- – from 1984.

Expected additional revenue is Rs 90 M.

With the expected gross additional revenue of Rs 1,710 from the Budget proposals, the overall deficit stands at Rs 16,543 M according to the Final Estimates of Revenue and Expenditure. The Minister hopes to bridge this gap as follows:–

(a) Outright grants (Foreign)	Rs. 4,150 M
(b) Project, Commodity & other loans from Foreign Sources	Rs. 8,162 M
(c) Rupee Loans (domestic)	Rs. 3,550 M
(d) Banking System	Rs. 681 M
	Rs. 16,543 M

NOTE

1. The Minister announced that a stipulated percentage of 1% tax (wholesale, retail and other distributors in the general trade would be set apart as a part of the Government Grant to the Local Authorities in exchange for their assistance to the Inland Revenue Authorities in the identification of Turnover Tax Payers and the detection of cases of non-compliance (non-payment and underpayment). The assistance of the G.AA, and A.G.AA and G.S.NN has been solicited in assessment and collection of ALL Taxes.

NOTE

2. The Minister announced that his proposal made in the 1982 budget speech, to levey duties on all imports by Government Departments, will be implemented from January, 1984.

THE BUDGET FOR 1984: PROBLEMS AND PROSPECTS

– AN ACADEMIC OVERVIEW

(i) The Background Economic Picture

The budgetary proposals for 1984 (announced by the Finance Minister in November) have to be understood in the context of the developments that followed the post – 1977 economic reforms. On the positive side, there was a significant increase in the rate of economic growth and in the rate of investment, and a noticeable expansion in employment opportunities. However, the growth rate of the Gross Domestic Product has begun to decline over the years – from an average of 6.8 per cent during 1978–80 to 5.5 during 1981–82 and further to an estimated 4.2 per cent in 1983. The trend in employment generation has also been downward. The new employment in the organised sector of the economy has declined from 45,000 jobs in 1980 to 20,000 in 1981 and to a mere 16,000 in 1982. Inflation (as measured by the official cost of living index) which rose to a level of 26 per cent in 1980, declined to 11 per cent in 1982 but only to rise again in 1983. During 1983 January-November, the index had recorded an increase of 19 per cent. Severe imbalances characterised both the external accounts and the internal budgetary situation. The current account of the balance of payments continued to deteriorate, the deficit rising by almost seven-fold – from SDR 75 million in 1978 to SDR million 519 in 1982. Imports have tended to grow "at a pace beyond the country's capacity to pay", while exports have expanded at a little less than quarter of the pace of import growth. These developments could not but put downward pressure on the external value of the Rupee. The Rupee depreciation against the US Dollar was as much as 35 per cent since the end of 1977. The rising government expenditures coupled with lagging revenue growth led to a sharp rise in the budget deficit from about Rs 7 billion in 1978 to over Rs 21 billion in 1983. The budget deficit in 1982 was equivalent to some 20 per cent of the Gross Domestic Product. The rising budgetary gap led to substantial recourse to bank borrowing in many years, thereby aggravating the inflationary pressure in the economy. In 1980 as much as Rs 7 billion had to be borrowed from banking sources. During 1981 and 1982, bank borrowing had been brought down to levels around Rs 4 billion. Heavy recourse to foreign loans has become another important factor in the economic scene. The total outstanding foreign public debt stood at a level of Rs 43.5 billion in September 1983, having risen from Rs 10.5 billion at the end of 1977, an increase of over four-fold during the period. The per capita foreign debt stands at a level of Rs 2864 (equivalent to about 115 US Dollars). (It was only Rs 757 or US Dollars 48 at the end of 1977). The servicing of the foreign debt (amortisation and interest payments) had begun to absorb over 15 per cent of the export earnings from goods and services by 1982.

(ii) Highlights of the Budget

It was against the above economic background that the Budget for 1984 was introduced. Following are the highlights of the budgetary estimates:

Recurrent expenditure	Rs 28,000 M
Capital Expenditure	19,492 M
Revenue	30,770 M
Current Account Surplus	2,693 M
Overall Deficit	16,543 M

The deficit is to be financed as follows:

(a)	Foreign grants	Rs 4,150 M
(b)	Foreign loans	8,162 M
(c)	Domestic loans from non-bank sources	3,550 M
(d)	Banking system	681 M

These proposals suggest an improvement in the budgetary picture when compared with the previous years. For the first time since 1979, the current account in the budget is expected to record a moderate surplus. During 1980–83, the revenue has fallen short of the recurrent expenditure creating a deficit in the current account. Moreover, the overall deficit had been brought down from Rs 21.5 billion in 1983 to Rs 16.5 billion in 1984. The government revenue which had been around 18–19 per cent of the GDP in recent years is expected to rise to a level of about 22 per cent in 1984. Moreover, bank borrowing is expected to be a modest level of 0.5 per cent of the GDP, meaning that inflationary pressures emanating from the budget will be contained.

(iii) Prospects for 1984

Much depends, however, on how far the actual budgetary outturn would be in line with these estimates. In particular, the question arises: how far could the estimated increase in government revenue (from Rs 24 billion in 1983 to Rs 30 billion in 1984 – an increase of Rs 6 billion or 25 per cent) be expected to materialise in practice ? If this revenue target fails to materialise, the government would be compelled to choose between a cut in expenditure or an enhanced recourse to bank borrowing and both would be rather painful experiences. The same sort of question arises on the expenditure side: how far can the actual expenditure be limited to the estimated level ? Any failure to do so would enhance the budget gap necessitating either an increase in government revenue (through new measures) or a recourse to inflationary bank financing.

What happens on the balance of payments front is equally an important factor. The worsening of the balance of payments appears to have continued unabated in 1983. The import level has continued to rise faster than exports. The balance of trade deficit stood at a level of Rs 14.6 billion during January – October 1983 compared with Rs 12.6 billion in the same period of 1982. The external value of the Rupee came under severe pressure in 1983 leading to a significant depreciation – the rupee value of a US Dollar going up from Rs 21 in January to Rs 24.70 by November. This was an important cost-push factor which increased the inflationary pressure in the economy during the year. In this context, the question arises: what are the prospects for a better balance of payments picture in 1984 ? If not, how far can a further depreciation of the rupee be avoided ? One important sign of hope is the rising export prices of tea which should lead to a substantial increase in export earnings in 1984.

A further depreciation of the rupee and/or higher recourse to bank borrowing than estimated in the Budget (because of a revenue short-fall or an increase in expenditure) can only aggravate the inflationary situation in the country. Some of the key prices in the economy remain yet to be adjusted to reflect the new import costs following the Rupee depreciation of 1983. The cost of living index has already moved up by 19 per cent during January–November 1983 and the wholesale price index has gone up by 21.2 per cent during January-September November

TARGETS AND IMPLICATIONS OF RECENT BUDGETS

D.N.R. Samaranayaka *(Economist)*

The annual budget is essentially an accounting exercise trying to match the annual government expenditure with the financial resources available, or what can be mobilized during a given fiscal year. The financial resources available for financing public expenditure in a given year include: (a) government revenue, (b) domestic borrowings and (c) international borrowings and grants. International borrowings and grants are determined exogenously, depending on the country's ability to meet repayment commitments, and the Government's overall economic policy with particular emphasis on fiscal and monetary sectors. In general, borrowings from the domestic sector, which include market as well as bank borrowings, become the residual, that is, the difference between the total government expenditures and government receipts. Borrowing from the banking sectoı is kept as a residual in particular, because of its potential for generating inflation, and as such the government is trying to limit its dependency on bank borrowings to the minimum

A balance between government expenditures and receipts is carried out through adjustments to expenditure and revenue flows. Although the figures that come out of this adjustment process are estimates, they must depend on sound economic judgement, particularly with respect to government receipts. Any changes from the budgetary estimates mean revisions either to the revenue or expenditure side and such revisions not only diminish the strength of the budgetary proposals but also introduce difficulties on household spending and uncertanities on business. What is important in the adjustment on expenditures and revenue is, however, the substance of proposals behind such adjustments; it is the substance that contains the policy action of the authorities to bring about a discretionary change in the level of economic activity. Thus when the budget is considered as a policy instrument, the focus is on the substance to determine how the budget proposals influence economic targets such as output, employment, exports, imports, inflation and money supply. At the same time, the importance of the figures should not be undermined because the substance of the budget proposals is in fact reflected in the figures.

POLICY EMPHASIS OF RECENT BUDGETS

With the 1984 budget, the present government has presented eight budgets since 1977, the year that marked the change in public policy from controls and restrictions to economic liberalization. As opposed to most previous budgets, the policy package of the 1984 budget reflects the government's desire to reduce public spending while simultaneously making efforts to increase its revenue sources. The need for such measures were in fact recognized in 1981, partly as a result of external difficulties imposed on the economy with rising energy costs and world economic recession and partly due to the adverse developments accompanying the liberal economic policies and the persuit of rapid economic expansion.

In the budgets that followed, there were efforts to accommodate these constraints. These included measures such as a reduction in the rate of growth of public spending, increased revenue from higher taxes and postponement of new development projects. Nonetheless, they were not strictly enforced, particularly with regard to public spending. This difficulty arose because of the political rigidity of bringing about a drastic change in the liberalized economic policy. The government's emphasis is now shifting towards comprehensive measures on economic management to deal with the structural imbalances that emerged during the last few years.

In this brief presentation, the implication of this emerging shift will be examined. As a starting point, the budgetary proposals of 1984 will be compared with the revenue and expenditure proposal in the budgets of last few years to highlight the current policy emphasis. It is within this framework that the implications will be discussed in the subsequent sections.

(a) Revenue Proposals

As reflected in the budget proposals, the government expects Rs Rs 30.8 billion as revenue in 1984, an increase of Rs 6.6 billion or 28% compared with the 1983 revised revenue estimate of Rs 24.1 billion. As in the past, indirect taxes constitute the main source of government revenue and account for 67% of the 1984 total revenue target. Non tax revenue, grouped in the 'other' category accounts for 18% of the 1984 total revenue estimate, followed by direct taxes accounting for 15%.

As shown in the figures of Table 1 nearly the 1984 revenue target, is nearly double the revenue collection of 1981. Moreover, the absolute increase in revenue in current prices in 1983 and 1984 together works out to over 90% of the total revenue collection in 1980. In absolute terms more than 60% of the revenue increases between 1980 and 1984 is accounted for by indirect taxes, indicating its relative importance as a source of financing the growing budgetary expenditures.

(b) Expenditure Proposals

During the fiscal year 1984, the government's planned expenditure has been estimated at Rs 47.3 billion consisting of current spending (Rs 28.1 billion) and Capital spending

Table 1

SUMMARY OF REVENUE ESTIMATES (Rs. Million)

	1981	1982	1983*	1984*
Indirect a/	12,105.0	12,432.7	16,594.0	20,698.4
Direct b/	2,029.0	2,922.8	3,300.0	4,500.0
Other c/	1,957.0	2,453.2	4,200.4	5,572.0
Total	16,091.0	17,808.7	24,094.6	30,770.4
Actual Charge (%)	11.3	16.7	35.3	27.7

Source: *Budget Estimates*

a/ *Include (a) taxes on sales, (b) duties on excise, imports, exports and licences and (c) assets transfer.*

b/ *Include Income and corporate taxes.*

c/ *Include non tax revenue and capital receipts.*

* *Estimates*

(Rs 19.2 billion). The recurrent expenditure estimate shows an increase of Rs 3.4 billion or 15%, while the capital expenditure drops by 1.7 billion or 8%, over respective estimates of 1983.

Table 2 presents recurrent and capital expenditure estimates by major categories for the 1981 to 1984 period. As shown in the annual change, the rate of increase in overall expenditure is progressively coming down since 1982, after a modest increase between 1981 and 1982. As can be seen, reduced capital spending has been the main contributory factor for the overall expenditure levels to experience a declining trend. This has been largely due to the government's continuing policy on 'no new development projects', the decision that was adopted in 1981 due to serious resource limitations. In addition, because of the nature of expenditure involved, the capital budget has been the main focus of public spending cuts imposed by the government since 1981. A similar exercise has been difficult in the case of recurrent expenditure due to its continuous nature.

Table 2

SUMMARY OF BUDGETARY EXPENDITURES (Rs. Million)

	1981	1982	1983	1984
RECURRENT	16,005	20,113	24,737	28,077
Salaries	4,080	4,422	5,645	6,079
Interest on Debt	3,856	5,612	7,317	8,244
Subsidies & Grants	3,582	3,760	5,919	6,685
Other	3,589	6,319	5,854	7,067
CAPITAL	15,089	17,984	20,915	19,236
Loan	1,619	2,806	5,183	2,375
Capital Transfers	7,345	11,375	9,067	8,090
Other	6,125	3,803	6,664	8,769
TOTAL	31,094	38,097	45,652	47,313
ANNUAL CHANGE (%)	2.4	22.5	19.8	3.6

(c) **Financing of the Budget**

Revenue is the main source of financing the budget. If the total expenditure exceeds the total revenue the budget is in a state of deficit and, conversely, a budget surplus is where the total revenue exceeds the total expenditure. In terms of this definition, Sri Lanka is yet to experience a budget surplus, according to records available for the last two decades. In general, the revenue collection during the last two decades has been sufficient to support only the annual current spending. There were also some years where the annual revenue was below the annual current spending.

Table 3 presents the sources of budget financing during the 1981–84 period. According to figures presented in the budget, the total revenue in 1984 allows Rs 2.5 billion surplus over current spending and accounts for 55% of the total expenditure. This is followed by foreign assistance accounting for 26% of the total expenditure and 74% of the budget deficit in 1984. Foreign assistance has become an important source of budgetary expenditure and has accounted for a minimum of 50% of the annual budget deficits since 1977. In some years it's contribution to deficit financing has been over 70%.

The reduced reliance on bank borrowings, as a source of deficit financing in 1983 and 1984, is a clear indication of the government's decision to bring economic management to the forefront of government policy priorities. All other previous budgets of the present government very generously utilized this source to support expansionary budgets and

Table 3

FINANCING THE BUDGET (Rs. Million)

	1981	1982	1983	1984
REVENUE	16,228	18,200	24,095	30,770
EXPENDITURE	31,101	38,800	45,562	47,313
DEFICIT	14,873	20,600	21,557	16,543
Financing from:				
Foreign Loans & Grants	(8,183)	(10,594)	(12,342)	(12,312)
Domestic Non-Bank Borrowings	(432)	(4,006)	(8,625)	(3,550)
Bank borrowings	(6,296)	(6,000)	(608)	(681)

Source: *Budget Estimates and Statistics*

this has been a leading factor for sharp increases in money supply and inflation.

(d) A Comparative Assessment

The most convenient way to present the comparison of respective budgets is to express the main features of the budgets in terms of Gross Domestic Product (GDP) in current prices as shown in Table 4. These percentages clearly bring out the government's current policy priority of higher revenue and lower expenditure. The main objective of this policy emphasis is to reduce the size of the budget deficit and the need for borrowings from both international and domestic sources for financing the deficits.

Table 4

MACRO ECONOMIC INDICATORS EXPRESSED AS A PERCENTAGE OF GDP

	1980	1981	1982	1983*	1984*
Revenue	22.6	20.5	19.4	21.9	23.0
Expenditure	48.7	39.2	41.6	41.5	35.9
Deficit	26.1	18,7	22.1	19.6	12.5
Capital Spending	23.7	16.7	19.3	16.7	15.0
Non-Market Borrowing	–	.5	1.5	7.8	2.7
Market Borrowing	15.8	7,9	10.8	.6	.5
Foreign Aid	10.8	10.3	10.1	11.2	9.3

* *Estimate*

Source: *Own Computation based on Budget Estimates*

As can be seen from percentages, expressed in terms of GDP, all these macro targets are expected to improve significantly following the adjustments on revenue and expenditure brought about in the form of budgetary proposals in 1984. The expected improvement in the budget deficit and market borrowings are particularly important from an economic management perspective and a significant improvement in these two macro-targets has been the focus of policy recommendations to the international donor community during the last few years.

IMPLICATIONS OF BUDGET PROP– PROPOSALS ON THE ECONOMY

As an instrument of fiscal policy, the budget's role is to influence the economy through changes in the level, composition, and timing of government expenditures and revenues. The economy can be effectively influenced by the budgets through expenditure on goods and services. because Government spending constitutes a flow or injection into the economy. Private investments and export demands are also considered as having the same influence as public spending. All three sources generate incomes in the economy through spending on domestic product, goods and services. At the same time, there are also withdrawals from the national income; and such forms of withdrawals include taxes, savings and imports. Accordingly, the budget proposals can influence the economy through changes in the aggregate demand via changes in injection to and withdrawals from the economy. The changes in the aggregate demand in the economy indirectly influence the other two important public policies i.e. monetary and balance of payment policies.

The implications of the budget proposals on the economy can be examined by considering the national income aggregates, stated smybolically as follows:

1. Because of the difference in the raltionships between savings and investments and government revenue and taxation, the macro-economic aggregates stated in the above equation do not always add up to the Gross Domestic Product. For example, the national income that results when the 1982 values are substituted in the equation is different from the 1982 GDP in current market prices i.e.

$$Y = C + 1 + G + (X - M)$$
$$141.9 = 88.2 + 30.5 + 41.6 + (28.2 - 46.7)$$
(all in Rs. Million in current market prices)

This difference is accounted for by (a) higher investments (assumed to be equal to fixed capital formation) than domestic savings, and (b) higher government expenditure than revenue collection. The excess of investment over savings is accounted for by imports of capital and investment goods, while the difference between government expenditure and taxes is accounted for by borrowings and grants.

$$Y = C + I + G + (X - M)$$

This simply means that national income or output (Y) is made up of consumption (C) Investment (I) government expenditure (G) and Export (X) minus imports (M). There are two other important Macro-economic aggregates i.e. savings (S) and taxes (T) which are only implicit in this equation. Savings is generally defined as equal to investment plus the difference between exports and imports (i.e. $S = I + X - M$ or $Y - C - G$). Taxation is that part of income collected by the government from people, both directly and indirectly, to support the government expenditure programs. (1) It should be noted, however, that the revenue collection from taxation is not always equal to government expenditure and when government expenditure exceeds revenue collection, the difference should be supported from borrowings either from domestic or international sources

An increase in income from one period to another is also used up by the same macro-economic aggregates which constitute the national income. The manner in which the income in one period is utilized by these macro-aggregates again determine the level of income during the next period. However, the budget, though its revenue and expenditure proposals can shift the pattern of such utilization and, therefore, the budget effectively alters the growth path in the economy. The discussion that follows briefly examines the role of budget proposals in affecting changes on these macro-aggregates and the implications of such changes on economic growth.

(a) Consumption

Of all the Macro-economic aggregates, consumption is the most important determinant of national income. This importance stems from the fact that consumption generates demands for goods and services in the economy and such demands, through feedback effects, lead to further additions to the national economy. The demand for consumption of goods and services mainly comes from households, depending on their level of income and the availability of goods and services. The most important determinant of household income is the flow or injection of money into the economy through government expenditure, investment, and exports.

Since 1977, there has been a remarkable improvement in national income following the economic revitalization efforts brought about by the present government through its far sighted liberalized policies and development programs. The economic growth rate, for example, increased significantly from an average 3% between 1970–77 to about 6.2% between 1978 and 1982. As indicated by measures such as the Average Propensity to Consume (APC) and the Marginal Propensity to Consume (MPC) (2) this increase in income of households (resulting from higher economic growth) has, at the beginning gone mainly into consumption as evidenced from the values on APC and MPC shown in Table 5 for the period between 1977-1982.

The figures on APC show an increasing trend indicating that an increasing share of the additional income that has resulted during this period has been spent on consumption. In 1981, it recorded the highest share, but in 1982 both proportions have marginally declined. The decline in household consumption is more clearly shown in the values of MPC. Upto about 1980, an increasing share of the annual increase in income has been spent on consumption and this spending behaviour has been reversed in 1981.

Table 5

PRIVATE CONSUMPTION MEASURED IN TERMS OF APC AND MPC EXPRESSED AS PERCENTAGE

	APC (Current Price)	MPC (Current Price)
1977	69.2	48.4
1978	68.9	60.8
1979	70.9	79.1
1980	75.3	96.1
1981	76.4	80.1
1982	76.2	75.6

NOTE: Both APC and MPC have been computed after making adjustments for indirect taxation excluding export duties.

Source: Own conputation based on figures on private consumption GDP and indirect taxes reported in the Central Bank Reports.

The decline in consumption (as evidenced from both APC and MPC) is an important point for further consideration. The explanation for this in fact lies in (a) increasing indirect taxation and (b) reduced rate of economic growth. Due to the weak tax base, the government has been concentrating on indirect taxes as a means of increasing government revenue. For instance, the share of revenue from indirect taxes, out of the net annual increase in income, has risen sharply from 19.1% in 1980 to 24.7% in 1982 to an estimated 38.7% in 1983. It should be noted that these rates of increase in indirect taxes have been substantially greater than the annual GDP growth rates. In other words, the government is withdrawing an increasing share of the annual increase in income in the

2. While the APC is simply the proportion of income that goes into assumption the MPC is the Charge in Consumption with respect to charge in income.

form of indirect taxation and this increasing transfer to the government considerably affected the consumption pattern of the population. This point is very clear from the MPC figures from 1980 onwards. The figures indicate a sharp fall in marginal propensity to consume and this situation arises from higher indirect taxation leaving reduced incomes for consumption.

During the fiscal year 1984, the government has announced some relief in direct taxation. However, as a result of the rehabilitation tax and surcharge, the anticipated revenue from direct taxation is about 26% more than the 1983 revenue from the same source. In addition, the estimate on indirect taxation also shows a further increase of 24.7% over 1983 and this increase is accounted for by the increase in excise duties as well as taxes on general sales. Although some of these taxes are not directly applicable to the entire population, the overall situation is that the government is making efforts to collect more revenue from the households particularly through indirect taxation.

(b) Economic Growth and Development.

Recalling the relationship that exists between consumption and economic growth, the declining trend in consumption that emerges from the foregoing discussion is also in part due to reduced economic growth which in turn is accompanied by reduced consumer spending. It should be noted, however, a decline in current consumption does not necessarily lead to a drop in economic growth particularly if the society sacrifices current consumption and transfers real resources for the purpose of producing more goods and services. This allows the society to enjoy a high level of consumption in the future time periods which in fact is the sole end of economic activity, as economists such as Adam Smith and Keynes maintained.

This brings us to the need for consideration of the role of investments and public spending, the two important sources of income flow in determining the level of activity in the economy. The other income flow results from exports; the demand for which is determined by the factors exogeneous to the economy and only the supply is determined by domestic factors such as the level of production and technology. On the supply side, therefore, continued investment is necessary to increase or at least to maintain the level of production and production efficiency.

investment, is progressively declining in current as well as in real terms. The 1984 investment allocation, for example, is only about 76% of the 1980 allocation in current prices and only about 43% in real terms. The total capital expenditure allocation, however, shows an increasing trend from Rs 11,957 million in 1980 to Rs 19,236 million in 1984. This

Table 6

CURRENT PUBLIC SPENDING INVESTMENTS & CAPITAL FORMATION (Rs. Million)

	IN CURRENT PRICES			IN REAL PRICES		
Year	Current Public Spending	Public Investments	Capital Formation	Current Public Spending	Public Investments	Capital Formation
1979	11,588	7,729	13,246	10,077	6,721	11,518
1980	13,535	11,956	20,845	9,880	8,727	15,215
1981	16,005	11,261	23,279	9,700	6,825	14,108
1982	20,113	11,375	30,228	11,052	6,250	16,608
1983	24,737	9,102	–	11,836	5,663	–
1984	28,077	9,056	–	11,650	3,578	–

Source: *Central Bank Reports and Annual Budget Estimates*

Table 6 presents the trends in current public spending, public investments and capital formation in both current and real terms since 1979. It should be noted that the figures on capital formation include (a) public investment, (b) private investment and (c) capital expenditures related to replacement and purchase of real assets by both private and public sectors. However, due to the difficulty of proper disaggregation, public investment allocation is shown separately along with the capital formation figures.

Out of these three main indicators, the level of public investments is perhaps the most important from the economic growth point of view. This importance stems from the fact that over time the investment allocation allows growth in productive sectors as well as the expansion of economic and social services. Additionally, the public investment allocation is also important to enhance the private sector's role in production, distribution and marketing of goods and services.

The figures in the table show that the public expenditure allocation on

increase has been largely absorbed by non-investment expenditures such as capital repayment, acquisition of real assets and contributions to public corporations either in the form of share capital or loans for capital improvements. In contrast, the current spending allocation is progessively increasing in current terms. Even in real terms, the level of current spending has not been adversely affected. As noted earlier, the main reason why current spending is unaffected by public spending cuts is that it is continuous unlike the capital spending component. Therefore, the resource constraints of the government can only be effectively enforced on investment allocation.

Broadly speaking, therefore, the apparent emphasis of the budgetary proposals in this regard is not very encouraging for economic growth and development. On the revenue side, the government is making concentrated efforts to transfer resources to the government mainly through indirect taxation. This policy action on the part of the government reduces consumer spending of the general public. On the expenditure side, the government is enforcing restraints on real investments in the economy. This combination of increasing resource transfer to the government and reduced investment in-flow implies that the society is compelled to reduce its present spending on consumption without the hope of increasing the level of consumption in the medium term.

BUDGET AS A MECHANISM OF STRUCTURAL ADJUSTMENTS

It is important to briefly examine why the government is bringing in such controls when it is certainly aware of the considerable drawback on economic expansion and particularly the slow down in employment potential in the economy, following cut backs in public spending. Moreover, such controls will weaken business confidence and hinder private investments on new ventures. As mentioned earlier, the issue that mostly warrants the need for tighter fiscal measures is, however, the large and continuing external trade deficit and the resultant pressure on balance of payments. This increasing pressure, as evidenced, from nearly a ten fold growth in the external trade deficit between 1978 and 1982, has been due to a combination of slow growth in import volume, relative to export volume, and a drastic deterioration in the terms of trade.

The main stimulus for rapid growth in import volume resulted from economic reforms introduced in 1977 and the expansionary fiscal and monetary measures that followed. As a result, the volume of imports grew rapidly. At the end of 1982, for example, the average index on import volume indicated a 48% increase over 1977 and this compares with the 12% increase in export volume during the same period. In the case of export volume, the poor production performance, due to (a) inefficient management (b) lack of real investments on agricultural plantations, production technology and research, since the government's take over in early 1970's and (c) the government's over commitment to the food self sufficiency goal, had been the major contributory factors for slow growth in export volume. In addition, export prices also suffered heavily in the international markets due to depressed demand associated with the world economic recession of the early 1980's. Between 1978 and 1982, the average price of exports increased only by 19% compared with the increased of 209% of import prices, indicating an almost 1 to 11 ratio between the increases of export to import prices. This substantial price variation is well pronounced in the terms of trade which was only equivalent to 35% in 1982, when 1978 is taken as the base year.

Because of the large deficits in the external trade account, the current account of the balance of payments has also been in a state of deficit since 1978, despite increased remittances from Sri Lankans working abroad and positive balances in the service account. International borowings have been a principal source of financing these deficits, and this source alone has been responsible for accounting for between 50% to 70% of the current account deficits since 1978. In economic terminology, international borrowing is considered a 'stock' variable because it constitutes accumulation and repayment characteristics, as opposed to 'flow' variables such as receipts from exports of goods and services and private remittances. Accordingly, international borrowing can only extend support for short run disequilibriums, in the balance of payments, and no government can over-utilize this source without serious side effects on the economy, which arise from debt accumulation and increased repayment commitments.

In comparison with the countries currently facing serious external debt problems, Sri Lanka's external debt situation is certainly not very critical. Nevertheless, it has been growing rapidly during the last few years to warrnat being an issue of major economic significance. The likelihood of Sri Lanka reaching a critical external debt situation appears not too far, if the country continues to depend on external borrowings, both for budgetary, as well as balance of payments support, at the same pace as in the past few years. Sri Lanka's foreign debt has grown by Rs 25 billion since 1978 to reach the total outstanding external debt of Rs 49 billion by the end of 1983. This level of external debt is certainly high in terms of the country's ability to commit future resources for repayment requirements unless there is a substantial improvement in export earnings. In the Asian region, Sri Lanka occupies a prominent place among the countries having a relatively high ratio of outstanding external debt to Gross Domestic Product (GDP).

The magnitude of external debt is commonly measured in terms of the debt service ratio which expresses annual repayment commitments (Capital plus Interest) as a share of annual earnings from exports of goods and services. A higher ratio obviously indicates an increasing allocation of export receipts for such commitments. This is in fact the trend that Sri Lanka is beginning to experience, as shown by the increasing tendency of the ratio from 12.4% in 1980 to 15.2% in 1982 and to an estimated ratio of 19% in 1983. In computation of the debt service ratio, only the annual payments of long and medium term loans are taken into consideration, thus excluding the repayment commitments of short term and commercial credits. When the debt service ratio is computed on the basis of all forms of repayments, approximately 65% of Sri Lanka's total export earnings in 1982 has been accounted for by external repayments. In 1980 the ratio on the same basis stood at 30%. This wide range in the two ratios (i.e. with and without short term borrowings) is certainly not a healthy sign as it shows the increasing dependency on short term loans and credits from international financial markets at commercial interest rates. On the other hand, this situation compels the country to secure more borrowings due to shortfalls in foreign exchange requirements to meet the country's import needs.

It appears, therefore, that an improvement in the balance of payments is the principal target of the fiscal measures that have been contemplated in recent budgets. Despite a straight forward relationship between the fiscal policy and the developments in the balance of payments, an improvement in the balance of payments can be indirectly brought about by reduced public spending through lower demands for goods and services in the economy. This drop in demand follows a slow down in import demand as well. Additionally, a reduction in public spending also helps to stabilize the rate of inflation which is also an important determinant in the demand for imports.

The objective of public spending controls are best achieved when supplemented by restrictive policies on money supply growth. Recently, the Central Bank announced measures in this direction with higher reserve requirements by commercial banks with the Central Bank and instructions to commercial banks to give credit priority to productive sectors in the economy and to curtail bank lending to consumer orienten needs, particularly bank credit which goes into support the imports of consumer goods. The large and growing external trade deficit has also prompted the government to use the exchange rate policy more frequently in 1983 to dampen the volume growth in imports. While the rupee has depreciated by 63% against the US dollar since the 'adjustable peg system' was adopted in 1977, the rupee marked the highest rate of depreciation in 1983, in any given year, of 17% as against the US dollar. The government is currently using fiscal, monetary and exchange rate policies, both singly and jointly, to correct the balance of payments disequilibrium which, apparently, is the main target of the economic management efforts. An improvement in the balance of payments is needed to strengthen the domestic economy and to continue with open economic policies; without reintroducing the quantitative controls and restrictions of the period before 1977.

POLICY CONSIDERATION;

The rationale behind these policy adjustments is certainly understandable in the context of current economic difficulties faced by the country. Nonetheless, these policies must not be adopted at the expense of the country's growth prospects. Otherwise, the economy will be confronted with a situation known as the "low equi librium trap", which in specific terms implies economic stagnation, resulting from low investments, reduced economic growth and increasing unemployment, along with improvements in the balance of payments and the rate of inflation, the two specific targets of the current policy emphasis. Just as it is difficult to sustain the liberalized policies with continuing balance of payments disequilibriums the possibility of maintaining liberalized policies under continued economic stagnation is also highly doubtful.

While the society cannot readily conceive the implications of weak balance of payments on the domestic economy, it can, however, easily recognize the implications as well as the likely outcomes of economic stagnation, as evidenced from the role of economic factors in the 1977 election. The expectations of the society were set high at the beginning when the economy was freed from controls and restrictions and a free market system introduced in 1977. In addition, the society was compelled to undergo a number of sacrifices, including cuts in many forms of consumer subsidies which were hitherto enjoyed by the people at large. If the growth momentum is not maintained, there will be increased difficulties and disappointments on the domestic front with concommittant implications on economic liberalization and political stability.

Accordingly, the policy makers must attempt to strike for a compromise between the needs of economic management, on the one hand, and the necessity for continued economic growth and development, on the other. It is common knowledge that wastage and mismanagement are widespread in the public sector and these are the areas where policy focus is urgently needed, in order to improve economic management as well as economic efficiency. It is also important to frequently scrutinize the operational expenditure component of the government, which is growing at a rapid rate annually, to check on wastage and unnecessary expenditures. The aggregate current expenditure shown in the budget is infact prepared by respective ministers where the emphasis is on receiving a higher operational allocation every year rather than on financial management, planning and control. A large number of public corporations also fall into this category of poor financial management, especially those depending on continued government assistance for survival. Another area that can and should be economized is the government purchases of real assets, including equipment and vehicles. Strict controls need to be enforced to eliminate expenditures that do not contribute to the country's productive capacity.

At times of economic difficulties, government policy should be re-evaluated (1) to give priority to programs which contribute to the gross domestic product with relatively smaller annual investments and (2) to delay programs which add strains to the limited resources. Although the government has been giving investment priority to areas that will enhance medium and long term economic growth and development, such as the Accelerated Mahaweli Program, irrigation development and agriculture and infrastructural development such as energy, telecommunication and water supply, investment emphasis is also continuing on some programs which are economically not sound especially in the present context. A case in point is the government's costly housing development program. There are many reasons why the housing development program is a strain on the economy.

(a) Housing is considered as a durable consumer good. A greater proportion of raw materials required for production of housing units are of a non-renewable nature, such as bricks, cement, sand, iron and steel and roofing materials; while others such as timber require a longer gestation period to reproduce. Although most housing materials can be produced locally, the existing capacity is not suffi cient to meet rapidly increasing demands.

(b) The government intervention in housing development can be conceived as worthwhile, only if it brings economic benefits to the society, in general, and to the consumer, in particular. When public funds are used for development programs, the economic justification of investments is rather important. Apart from the aided self help program, all other housing programs are costly in per unit terms. The attraction that the owner's of government housing units are offered is the interest subsidy and a longer repayment period. Interest subsidy and longer repayment period, especially when the rate of inflation is higher than the rate of interest, are, on the other hand, direct economic costs to society.

Most countries in the world, both developed and developing, are not very actively engaged in housing development programs. Rather they have invested on production technology and production of housing materials. This approach not only helps the consumer with low costs on housing materials but also helps society with employment and increased productive capacity. Unfortunately, Sri Lanka is committed to produce an end product, that is housing. With rising costs of building materials, the demand for housing is slowing down and the dynamism of the housing and construction sector that prevailed in the economy in the early years after the liberalization is also gradually fading out.

Given the country's development needs arising from poverty, population pressure and high unemployment, a curtailment of investment on productive sectors is clearly not affordable. What should be done in the present context is to fucus on small scale projects with high capital/labor ratio, and projects that utilize local resources, talents and manpower. In this regard the government should invite the participation of banks, coooperatives, development councils, voluntary organizations and other local institutions. To make such development efforts successful, the government could set up a separate fund, managed by the Ministry of Finance and Planning, to provide the investment needs on projects designed by these institutions.

FISHERIES

CONCERN FOR CONDITIONS OF THE FISHWORKER

The fisheries sector has been among the most disorganised and neglected in the economies of most developing countries of the world. Invariably the actual producers (fishermen and women) reap only a small part of the return on their catch; it is the middleman-trader and retailers who appear to derive most from the labours of the fishworker.

Recent decades have witnessed the growing involvement of Governments and international agencies in fisheries development projects in the Third World, particularly countries like Sri Lanka. Simultaneously, there has been occasional agitation by small fishermen in those countries for betterment of their conditions. This could be expected in a situation where the activities and the industry built around the fisheries development schemes did not ensure that it was for the benefit and the development of the fishermen and related workers themselves. There is growing evidence that their living conditions have detiorated at different levels in various parts of the Third World, since the wealth from the sea seems to have accrued to those who have the enterPrieniurial power and/or the control over the trade.

An attempt was made recently at a meeting in Hong Kong where those representing the interests of the fishworkers met to plan an international conference where fish workers could work out a plan for betterment of their conditions. The International Conference of Fishworkers and their Supporters will take place in Rome from July 4–8, 1984, according to spokesmen Professor George Kent of the University of Hawaii at the conclusion of the three-day planning meeting in Hong Kong of fishworkers' representatives, concerned social scientists and technoligists from Africa, Asia, Europe and the United States.

(Fishworkers include children, women and men engaged as crew members, small fishers , processing workers and sellers).

"By any measure fishworkers are among the most disadvantaged in every society, despite the fact that they are major suppliers of protein", said Professor Kent.

Several factors prevent fishworkers from reaping the full benefit of their labour, including competition from large-scale fishing operations, destruction of fishing grounds through pollution, control of the market by middlemen and big corporations, the seasonal nature of their occupation and chronic indebtedness.

International agencies, national governments and local administrations have taken some action in support of fisheries development but often it has not served the interests of fishworkers.

Fishworkers in several countries have organised themselves to resist these pressures. Many however remain unorganised and vulnerable.

Professor Kent said the main concern of the conference in Rome will be to examine the socio-economic situation of fishworkers and to promote their solidarity and cooperation.

The International Conference in July, 1984 is timed to coincide with the FAO World Conference on Fisheries Management and Development.

L.A.

FEATURES

PRIVATE MOTOR CARS AND THE TRAFFIC IN COLOMBO CITY

P.C.H. Ranasinghe

This paper is the outcome of a traffic survey conducted by Dr. Mrs. P. C.H. Ranasinghe, Senior Lecturer of the Department of Geography, University of Colombo, during the months of March, April and May 1983. Though the survey was undertaken purely as an academic exercise, on analysis of the data it was found that some of the results would be of wider public interest. A major conclusion she arrives at is that if the number of private cars on city roads are limited, while a better public transport service is offered to the average traveller, the benefits would include: less expense for the authorities to maintain the city road net work; retaining the capacities of roads at present levels without the need for further expansion; a reduction on fuel oil consumption and on road investment. Another main suggestion is that stricter measures be introduced for enforcing road safety, speed limits and driver competence.

A traffic count was undertaken at 11 points which I consider as entry points to the city of Colombo. Both in-bound and out-bound traffic was counted. Counting was done manually and by the type of vehicles. It was conducted during normal working days from 6.00 to 1900 hours. (6 a.m. to 7 p.m.) The complexity of the vehicles made the observations particularly difficult. (Maps 1 and 2).

TABLE 1
VEHICLES ENTERING AND LEAVING THE CITY BETWEEN 0600 – 1900 HOURS

	SLCTB		Private buses		Motor Cars		
	Numbers	%	Numbers	%	Numbers	%	Total
In-bound	12,904	19.0	17,980	26.0	37,931	55.0	68,815
Out-bound	10,883	16.0	15,208	22.0	42,078	62.0	68,169

**includes all public as well as private cars and also taxis (4 wheeler)*

Table 1 and Fig 1 & 2 illustrate the in-bound and out-bound vehicles to and from the city from 11 entry points during a normal working day between 6 a.m. and 7 p.m. According to table 1, there are 68,815 passenger vehicles entering the city and 68,169 leaving the city. This figure clearly illustrates that out of the volume of traffic in the city the smallest proportion is composed of the public sector passenger vehicles, that is, 19.0% in-bound and 16.0% out-bound. Private passenger buses constitute 26.0% in-bound and 22.0% out-bound vehicles while Private motor cars contribute 55.0% in-bound and 62.0% out-bound traffic. But Table 2 below will show the correct picture regarding passenger transport.

Advantages of a Private Car

Everyone of us is aware of the inherent advantages of a private car. Especially when the public or mass transportation is so inadequate and unreliable, everyone of us would wish that we had a private car. A motor car gives its owner an unlimited independence, permitting him to travel as and when he decides, at speed equal or superior to most of the other land vehicles, following any route he wishes and stopping as and when he wants. Some people compare a motor car to a large handbag or an extension of one's home. For a busy person such as a businessman, a motor car becomes a necessity. But there is an underlying truth in the view that a motorist is not completely independent. He has to depend on several others, on a range of services and industrial products such as fuel, spare parts and even the road surface. In addition, he has to depend on somebody for the mechanical knowhow. Thus the independence of a private motor car owner is subject to limitations.

Preposterous Situation

The average commuter who travels by bus or train in the most uncomfortable manner leaves home very early because he has to be at his work place on time. This same person has hard working conditions during the rest of the day. By the time he reaches his home in the evening his children are sometimes asleep. But the 'car owner' on the other hand has the previlege of coming to work in a more relaxed fashion and also invariably has the 'authority' to pull-up his poor brethern who come late because they use mass transport. A car traveller also has the 'luck' of going home early and has the freedom to visit friends and relations or go for recreation in the evening. Thus, the question arises who rides on whose back ? The distorted relationship is further enhanced by the fact that decisions about the provision of buses or trains are made by decision makers who travel, by motor car. Of course the decision makers cannot afford to waste their 'valuable time' at bus halts or railway stations subjecting themselves to various natural hazards.

Pressure of Cost

The use of motor cars involve costs such as cost of buying them, and running them, and the cost of repairs and maintenance. Added to this we have the cost of environmental pollution and social injustice. Those who can own a private car today have to spend more on the car perhaps than what a worker receives for his whole family for a month.

If we look at the expenditure on petroleum by our country we can well understand the economics of using the private motor car indiscriminately. In 1978 Rs 2.4 m has been spent on petroleum and today 28% of the country's income is spent on oil imports. Half of this is said to be consumed by the private motor car.

It would not be unreasonable to believe that other costs in scarce resources are proportionate to this. Therefore, if travel is to be discouraged in order to conserve foreign exchange or any other resources, the primary discouragement should be placed upon car travel and not on mass transport. It is said that in Sri Lanka a private car rider requires approximately 10 times as much energy as a bus rider or a train rider, and travel by car is 6 or 8 times more expensive than travel by public transport.

In Sri Lanka it is difficult to obtain the correct figures of fuel usage for various types of vehicles because the sales records are not kept for that purpose. Hence, it is not easy to calculate the correct economics of fuel usage on various forms and types of vehicles. However, there is inherent energy thriftiness is mass transportation because of their high passenger mileage per gallon. It is true that there are other forms of energy which can be used for transport. Theoretically cars could be propelled by methanol gas or batteries or even hydrogen, but the practicality of these techniques are yet to be established.

Low Load Factor

If we look at Table 1 we understand that the biggest proportion of vehicular traffic during a day is composed of motor cars. If we estimate the proportion of passengers carried by these three types of vehicles, assuming that a SLCTB bus on the average carries 50 passengers, a private

TABLE 2
ESTIMATED PASSENGERS BETWEEN 6 a.m. TO 7 p.m. BY VEHICLE

	SLCTB buses		Private buses		Motor cars	
	Number	%	Number	%	Number	%
In-bound	645,200	51.76	449,500	36.06	151,724	12.17
Out-bound	544,100	49.79	380,200	34.79	168,312	15.40

passenger bus carries 25 passengers, and to give a motor car its full credit assuming that it carries 4 passengers, the following are the figures we derive.

Table 2 shows the estimated number and also percentage of passengers carried by these types of vehicles. Here if we compare the tables 1 and 2 with each other, we notice that out of the total in-bound traffic during a day although motor cars form 55.12% of the total number of vehicles, they carry only 12.17% of of the passengers, while out of the out-bound traffic 61.72% are cars but they transport only 15.40% of the passengers. It is worthwhile noting that although the SLCTB registers a lower percentage of vehicles they are responsible for carrying a bigger proportion of the passengers to and from the city. Table 3 shows the estimated number of passengers and their percentage during the morning and the afternoon peak hours.

gers. This figure illustrates that the SLCTB is responsible for carrying the largest number of passengers during the peak hour, compared to private buses and motor cars, while motor cars carry the least number of passengers..

Road Congestion

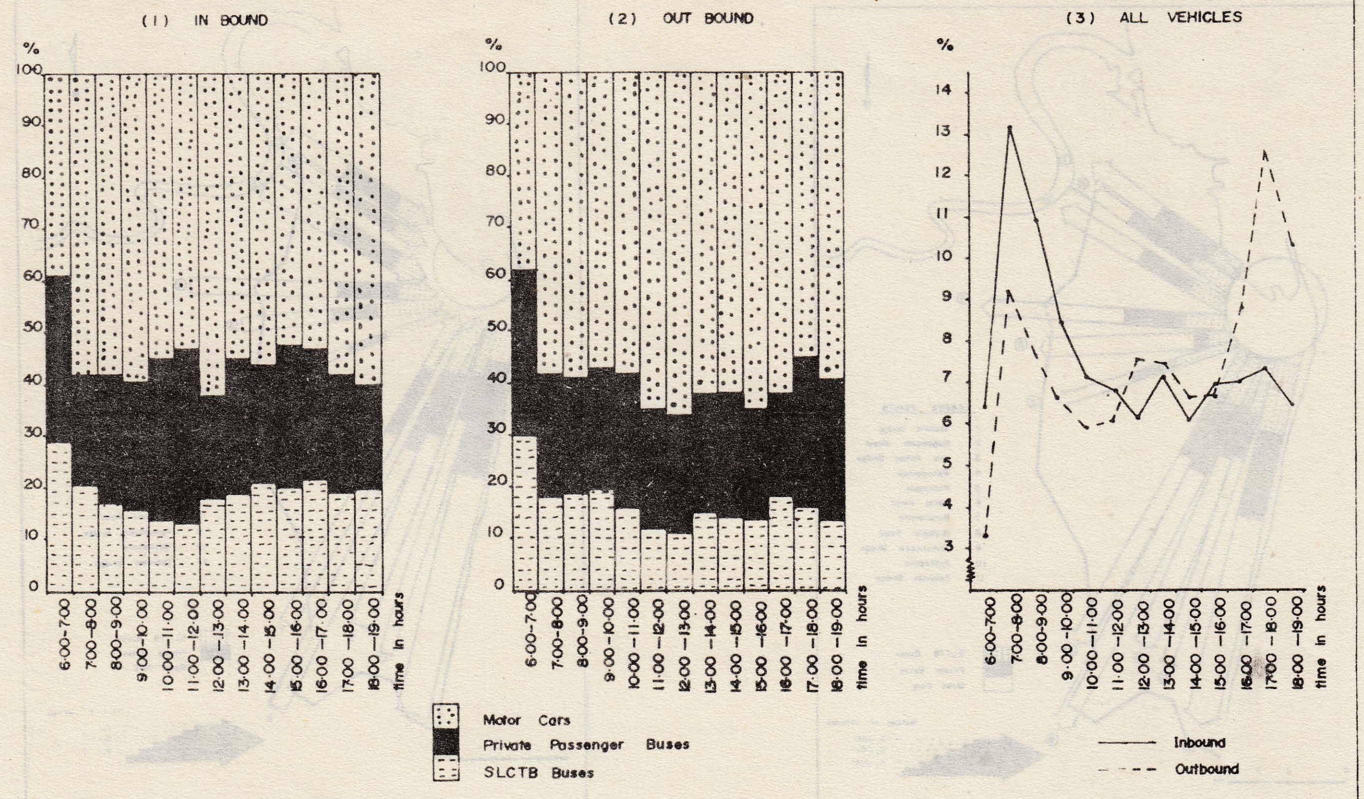
Anyone who would glance through the 'Transport Statisticies in Sri Lanka 1974–1981; published by the Ministry of Finance and Planning, would see that during the last four or five years, although the additions to the SLCTB bus fleet was insignificant, there had been a substantial increase in the number of private passenger buses and as well as in the number of motor cars. This implies that during the last five years a notable number of vehicles with a smaller capacity have been put on the roads

TABLE 3
ESTIMATED PEAK HOUR PASSENGERS 0600–0900 AND 1700–1900 HOURS

	SLCTB buses		Private buses		Motor cars	
	Number	%	Number	%	Number	%
In-bound	236,625	60.98	123,584	31.85	27,768	7.15
Out-bound	174,300	55.93	96,000	30.80	41,308	13.25

Here I have taken as the morning peak the two hours between 7.00 a.m. to 9.00 a.m. and the evening peak as between 5.00 p.m. to 7.00 p.m. I have assumed here that during the rush hour an average SLCTB bus carries 75 passengers, a private passenger vehicle carries 32 passengers and a motor car carries 4 passen-

in Sri Lanka, especially the roads of the city of Colombo. Although the city roads are usually wider than the rest of the road network of Sri Lanka, they are now subjected to heavy traffic volumes, taxing their capacities not only at peak hours but throughout many hours of the day. It is heartening to note that most



Percentage of vehicles Entering / Leaving the city during a normal week-day from 0 06 — 19 00 hours.

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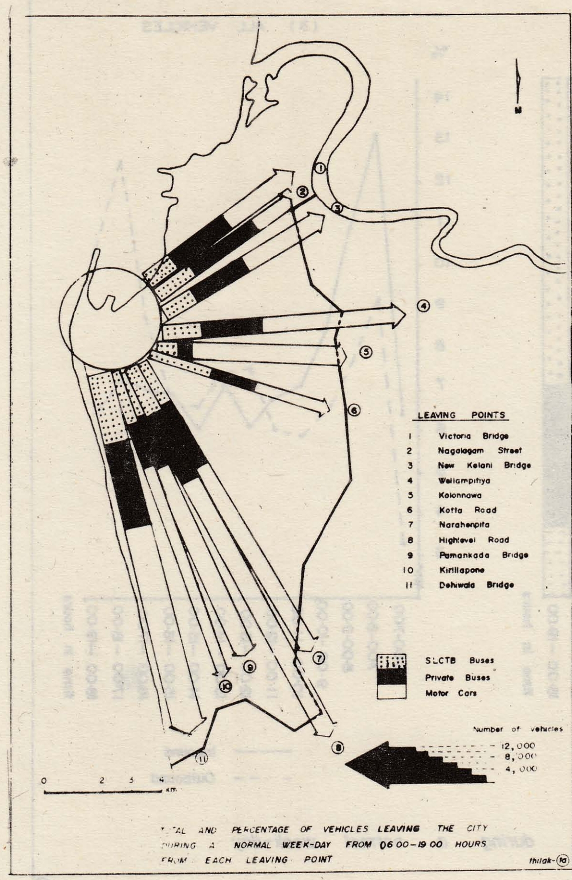
of the roads which were not originally designed for heavy volumes of traffic are now being widened. But one has to consider whether we are economically in a position to invest more and more money on widening of the city roads.

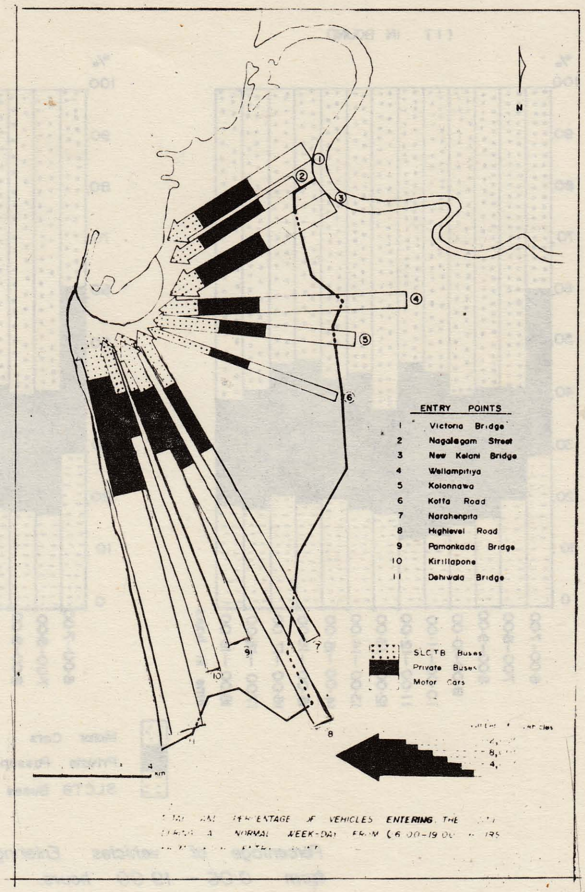
Environmental Pollution

From the traffic survey, as well as from the published data, it is clear that there are more motor cars on the city roads than before. These cars are not only the cause for traffic congestion but are also subjected to the same delays and hold-ups as other vehicles and are also part of them. This means lower speed and a larger amount of exhaust pollutants per vehicle kilometer. Numerous stops in traffic also result in less dilution of pollutants in the immediate neighbourhood. Although there is a popular belief that nature always takes care of the products discharged by our transport and industries, when too great a number of units emerge and all the emmissive products of transport and industry flow uncontrolled to the environment, harmful effects are unavoidable.

Exhaust gases from vehicles, with gasoline engines are said to contain 150–200 different compounds. Only a few of these have been identified as harmful. The products which have aroused most attention are carbon monoxide, hydrocarbons, oxides of nitrogen and compounds which contain lead. Lead is regularly added to automobile gasoline in order to extract more power from the internal combustion engine while maintaining its smooth, regular operation. However, this technique means that significant quantities of lead are emitted into the air due to the extensive and rapid increase of road traffic. It has not yet been possible to prove that lead has done harm to the Sri Lankan city population but there could be a risk of harmful effects after a long period of time or resulting from the combined effect of other substances. It can be believed that the problem of vehicle exhaust gases will become more severe if the trend is not arrested in time. The number of vehicles increase year by year. In addition to the vehicles entering and leaving the city limits, there are a fair number of vehicles within the city limits which are out on the road during most of the day. Thus, it could be expected that the load of air pollutants in the city of Colombo will increase even more steeply.

Noise is a social problem which has attracted more and more attention in recent years. Absence of noise constitutes an important part of the demand for good environment. How= ever, noise can also develop into a health hazard and a medical problem affecting the community. One of the major sources of noise in the city is the motor vehicle. Traffic noise is already severe and creates increasing annoyance and irritation. This





not only depends on the noise level of the individual vehicles but it is also due to the steady increase in the number of vehicles and also due to the technically unsuitable way in which they are being used especially in the city.

Parking Facilities

Parking facilities are invariably part and parcel of a transportation system. Parking demands are high, especially in the city centre, not only during the peak hour but throughout the working day. According to the Colombo Master Plan Project, in the year 2001 there will be an estimated 20,000 cars of employees and also 10,000 cars of visitors in the city centre. The Plan has also estimated that ground level parking would require 75 hectars of land. At present illogical, irresponsible and inconsiderate parking, especially on main roads aggravates problems like traffic congestion, waste of valuable time on the road, burning of fuel unnecessarily and causing irritation and strain to the road user. This could be minimized if not eliminated in two ways. One is having separate car parks and the other is by limiting the number of cars on the city roads.

Pedestrians

The right of use of the road by the pedestrians cannot be completely overlooked. Especially during the rush hour there is a heavy flow of pedestrians predominantly at the city centre. Along the carriageway pedestrian movement must be eliminated fully . Pedestrain crossings should be located logically at points on the street network, and sidewalks should be provided on every roadside and these sidewalks should not be used for purposes like pavement hawking and car parking.

Accidents

An important aspect that the transport planners should pay attention to is the number of accidents that are occuring at present. Today road accidents have increased tremendously. Statistics reveal that of the road accidents, the highest number recorded is in Colombo city area where the traffic concentration is highest. In 1980 of the total number of accidents recorded by Police Divisions, 25.27 were in the Colombo Police Division. Accidents not only incur economic costs but they also incur social costs. Accidents can be reduced to a minimum if we limit the motor vehicles on the roads.

Restraints on Motor Cars in the City

Any government that has the will to limit the supress travel by bus or train can do so, but car travel cannot be so easily curtailed. Once cars have been imported and ownership of them secured to individuals or institutions in the private and the government sectors, those owners have the right to use cars as and when they wish.

Only heavy restraint on the use of cars could significantly reduce car travel and petrol use. Some such restraints could include a significant increase in petrol prices, heavy parking taxes, road use pricing or a series of physical restrictions on the use of cars in urban centres.

For quite sometime, when the cities in most parts of the world were unable to manage traffic congestion, air pollution and noise caused by private cars, and added to these the energy crisis, many organizations such as Nelson Rockefeller's Commission on Critical Choice for Americans, the International Union for Public Transport and the Royal Institute of British Architects have recommended restraints on the use of cars especially in the cities. Many cities all over the world, infact, were taking firm decisions to restrict and control the use of private motor cars. Some of the direct as well as indirect restraints were, priority for buses at traffic signals, one-way for cars and both ways for buses, down-town car charges, limits to private parking places, pedestrians only-city centres, public-transport only city centres etc. Some countries even tend to welcome OPEC price increases as being a blessing in disguise because of their assistance to the restraints of motor car use.

If we limit the number of private cars on city roads, while extending a better service to the average traveller it could be less expensive for the authorities to maintain the city road network, and also the capacities of the roads could be retained at present level without further expansion. If we can induce part of the private car users to travel by bus or train by providing them better public transport systems, we could then hope that it would entail some reduction on oil consumption and in road investment. At the same time we have to take several strict measures concerning road safety, speed limits and driver competence.

INTERNATIONAL FINANCIAL COOPERATION: PROBLEMS AND PROSPECTS

Dragoslav Avramovic

In this paper on the disturbed state of the global financial scene Yugoslav economist Dr. Avramovic discusses some of the main crisis areas and makes proposals that need to be taken up by the Central Banks of the developing countries. Among his proposals are the need for a review and analysis of experiences in domestic monetary, financial and exchange rate policies. Dr. Avramovic, who is now an economic consultant in Geneva, has previously held eminent positions with the government of Yugoslavia, the World Bank and UNCTAD. This paper was the text of the 3rd Sir Purushotamdas Thakurdas memorial lecture, delivered by Dr. Avramovic in Bombay on December 12, 1983 under the auspices of the Indian Insititute of Bankers.

India as Chairman of the Non-Aligned Countries, has special responsibilities for guiding and co-ordinating their activities in reorganizing the international financial system, and I am therefore grateful for the opportunity to discuss these issues here. In a difficult, international financial scene today, especially as it affects the developing countries, India is one of the few which has succeeded, against all odds, in escaping the foreign exchange squeeze and is, therefore, in a good position to be in the forefront in the efforts of creating a better structure of international finance. It has already made major contributions to these efforts with its recent initiatives.

I propose to handle the following issues:

(1) the level of international interest rates;
(2) debt reorganization of the affected countries;
(3) the problem of instability;
(4) allocation of international liquidity;
(5) the future of development finance
(6) international financial institutions, and
(7) South-South financial cooperation.

International Interest Rates

Real interest rates are at a level which the international economy will find hard to sustain. About one-half of the total debt of developong countries is now owed to banks. Most of it is contracted at floating interest rates and is denominated in US dollars. These rates, consisting of the base rate (mostly LIBOR – London Inter-Bank Offer Rate – and sometimes US prime) and the margin to reflect "country risk", are now running at 12 per cent on the average. The US prices are currently increasing at 3–4 per cent per annum giving a real rate of interest of 8–9 per cent. The real rate facing the developing country borrowers is even higher, as their dollar export commodity prices have on the average stopped increasing, and their dollar prices of export manufactures are probably falling; hence for these countries the nominal rate of 12 per cent can be considered equal or even below the real rate. At this rate the debt burden will be rising with almost mathematical certainty for most debtor countries. They will be compelled to borrow at 12 per cent interest just to pay interest; and debt will increase faster than real output, resulting in a rising proportion of national income being absorbed by debt service abroad. The hopes that international interest rates would fall towards their long run real level of 2 per cent as international inflation is squeezed out have failed to materialize so far.

Scaling down the international rate of interest is important not only for countries in debt servicing difficulties, but for all developing countries which borrow abroad: not only will their future debt servicing burden be very large at present rates, but the range of investment projects which can be undertaken has narrowed down thus dampening the rate of investment growth and the associated debt servicing capacity over the long run. Protection in importing country markets, which adversely affects the choice of profitable projects, and the increasing difficulty of obtaining concessional finance give further impetus to these unfavourable tendencies.

Excessive interest rates are of major importance for the developed countries also: for as long as they last it is difficult to expect a significant revival of private investment, while government budgets operating under an enormous burden of interest payments are not in a position to accommodate a satisfactory level of public investment. (1) The Basel-based Bank for International Settlements, in its annual report of June, 1983, singled out the reduction of the rates in the leading developed countries as the most urgent economic objective. Individual country actions to reduce the rates are constrained under present conditions of international financial integration, however, as speculative capital movements would tend to defeat such individual efforts. An international solution to the problem must be sought.

The present high interest rates cannot be a result of high profit rates: it is a reasonably well established fact that the profit rates in the leading developed countries have been falling, certainly after 1973 and probably even earlier. Nor can the explanation be found in the uncertainty premium which the lenders charge the borrowers because of the volatility of interest rates; this volatility has now been reduced for the short-term rates and was never very pronounced for long-term rates. A hypothesis can be put forward that the explanation for persistently high rates may lie in the rates themselves: at the present enormous level of world indebtedness, national and international, at the present near-stagnation of economic activity and the correspondingly low flow of savings and investment, and at the present high interest rates, the demand for loans is to a large extent dictated by the need to pay interest on the existing stock of debt. In a way, it can be argued that the debt now has a life of its own, in a self-propelling mechanism of compound interest, which will tend to keep the interest rate up for as long as there are lenders willing to lend and there are debtors whose wages can be squeezed down. As new lenders become scarce and wages cannot be depressed further and if debt failure is to be avoided, the only way to bring down the demand for loans and the associated interest rate is to cut the rate itself.

Scaling down the international rate of interest is important not only for countries in debt servicing difficulties, but for all developing countries which borrow abroad: not only will their future debt servicing burden be very large at present rates, but the range of investment projects which can be undertaken has narrowed down, thus dampening the rate of investment, growth and the associated debt servicing capacity over the long run.

Such a solution would call for an international agreement to introduce ceilings on interest rates and thus restore the regulation of capital markets, nationally and internationally. The likelihood of this happening at the present time, with the economic philosophy prevailing in some major countries, is small; and even some not sharing this philosophy may question this solution. There may be another way around the problem, however. Governments, including those of developed countries, are borrowers in the capital market: should they be able to agree on a proportionate reduction of the interest rates they offer for their borrowing and that of their agencies, the average market rates should fall under the pressure of this collective monopsony of the buyers of funds, provided their share in aggregate demand for loanable funds is sufficiently large. The effect of successive cuts in government offer rates would be to alleviate the position of the debtors, including all developing countries, help revive investment and growth, and raise the prices of the existing stock of bonds and shares. The required cuts in the developing country offer rates should in principle be smaller than the average as their internal rates are frequently more repressed and their need to attract external capital is universally recognised to be large.

Further theoritical and empirical work is needed to verify these hypotheses. There may be serious snags in application, and there will be objections on the grounds of market acceptability as well as on a more philosophical or ideological basis. But it is difficult to see how without such or a similar international effort, the present unsatisfactory situation will be resolved.

Debt Rescheduling

At present some 40-50 developing countries are engaged in debt rescheduling discussions. The repayment periods are, on the average, too short. At the amortisation (repayment) rate of 1982, the aggregate medium and long-term debt of developing countries would be retired in seven-and-a-half years. (2) This is shorter than the life of most development projects. During the last few years, a remarkable shortening of debt maturities occurred in a number of countries, as maturing medium-term bank credits were replaced by shorter term loans. Furthermore, short-term credit was withdrawn in a number of cases as the debt crisis of 1981–82. struck. What was happening recently may be called debt reorganisation in reverse: long-term debts were partly converted into short-term, and some of the short-term debts were called in.

Many proposals have been made for a take-over of the existing debts by a new international agency on terms which would involve a reduction of the principal or interest or both. None of them seems to have been thoroughly considered by creditor country governments, for three reasons: they would involve budgetary resources as a rule; they would involve losses for the banks; and debtor countries' bargaining power has not been behind them. Throughout the debt crisis, debtor countries have been careful to preserve their good relations with the banks. A major, probably decisive, reason has been the need to preserve access to bank credit. It has been more expensive, but it had proven, until the debt crisis, more easily available and more freely usable than credit extended by governments or international lending agencies. A solution to the debt problem would have to be found which achieves the objective of alleviating substantially the debt servicing burden, and yet stays within two constraints: it preserves access to bank credit, and it involves little, if any, budgetary outlays of developed countries.

One of the bases for the solution will need to be an understanding between the debtor countries and the banks that it is in their mutual interest to postpone amortisation payments for several years, while preserving intact the debt principal. Such a postponement is not likely to affect greatly profits of the banks or the value of their assets. On the other hand, if the breathing space provided by the postponement of amortisation is properly used for expansion and modernisation of the production structure of the borrowers, their debt servicing capacity will improve, and this ultimately represents the best guarantee of debt repayment. For a rescheduling proposal to be seriously considered it would be necessary to identify the affected countries, creditors, amounts, classes of debt, the effects on the debtors and the creditors, the need for public support to banks suffering from illiquidity, the role of international financial institutions. Some organisation of developing countries would need to do this work: A New York banker has suggested that the central banks of developing countries may establish a suitable body which would, among other things, organise and manage debt rescheduling exercises.(3) Such a body could be a counterpart of the Institute of International Finance, recently established in Washington by major creditor banks. One of the aims of the latter is to provide "a convenient forum through which individual country borrowers can present to lenders information concerning their borrowing needs". There is no reason why the borrowers could not do this collectively and why borrowing needs could not include postponement of amortisation.

Instability

The US dollar appreciated 46 per cent from the fourth quarter of 1980 to September 1983 against a weighted average of the currencies of other major industrial countries. Against the German mark, the appreciation amounted to 40 per cent; against the yen, 13 per cent; against sterling, 59 per cent; and against the French franc, 83 per cent. This had followed a dollar depreciation of equally remarkable dimensions. There is no evidence that exchange rate instability is decreasing. As these currencies are also reserve currencies and none of them is linked to anything else but only float in a constantly moving relationship with each other, the world economy operates without a fixed point of reference. As Professor Mundell said recently:

"Today, in 1983, the US does not have a gold standard, or a Keynesian commodity standard, or a Friedman paper standard. It has a Volcker standard. But who can predict the future of the pound, the dollar or the yen on the basis of a Thatcher standard, a Volcker standard or a Nakasone standard ?"

(Robert Mundell, The Debt Crisis: Causes and Solutions, Wall Street Journal, 31 January 1983),

The representatives of the Group of 10 developed countries, in implementing the decision of the Williamsburg Summit, 1983, on the preparatory work for a possible international monetary conference, have recently decided to study the causes and consequences of exchange rate instability: many developed countries have felt hurt by it. The developing countries have also been affected adversely; instability of exchange rates has made their planning and management more difficult, and uncertainty as to the future value of their currency portfolio may have raised their reserve needs. More immediately, the appreciation of the US dollar has opened the currency scissors for most oil-importing developing countries: the majority of their exports is directed to the non dollar markets, while some vital payments – for oil, food, and debt service – are payable in dollars. The oil-exporting developing countries have been beneficiaries of this development, but only to a degree: fixed dollar prices for oil have in fact meant sharply rising prices in vital non-dollar markets, thus contributing to a reduction of oil sales and defeating the purpose of the stable oil price market strategy of the producers.

As new lenders become scarce and wages cannot be depressed further and if debt failure is to be avoided, the only way to bring down the demand for loans and the associated interest rate is to cut the rate itself.

A central point in currency instability has been speculative capital movements in magnitudes which strain credibility. A knowledgeable observer estimated two years ago that the value of spot trading in currencies alone was running at 15 to 20 times the value of world trade: "in other words, 95 per cent of trading in currency spot is not for investment, not for trade, but as a means of hedging or protecting positions. Heaven knows how many times – it could be 20, 30, 40, 50 times as much as world trade – is traded in currency futures in addition". (4) Professor Witteveen has called the present situation a "market based monetary system", where official liquidity has been gradually overwhelmed by huge sums of quickly movable private international liquidity.(5) Under these circumstances, it would seem that the solution to the problem of currency instability is either reintroduction of controls over capital movements, which are unlikely to be acceptable to the governments of some leading countries: or international coordination of monetary, fiscal and broad economic policies to a degree never tried before. In any case, an increase in official liquidity is needed.

For developing countries, commodity price instability remains a major unresolved issue. The sharpness of the price fall in 1981 82, only partly reversed in 1983, resulted in a major decline in export earnings, which in turn was a major factor in the foreign exchange crisis of recent years.

International LIquidity

Between the end–1980 and end–1982, the value of global official reserves – including gold valued at market prices, foreign exchange, IMF reserve positions, SDRs and ECUs – fell 19 per cent, from US $ 976 billion to US $ 796 billion.(6) The decline in the price of gold in 1983 has reduced the value of reserves further, so that they are now some 23 per cent below the end–1980 peak. Adequacy of official reserves has become an acute issue in so far as developing countries are concerned. Many of them have been drawing down their reserves rapidly and to the bone, including gold sales, in the present credit crunch. By the end of 1982, the ratio of non-oil developing country reserves to imports of goods and services had plummeted to 16.3 per cent, compared to 31.4 per cent in 1973 and 26 per cent in 1978. In addition, some 33 developing countries had payments arrears at the end of 1982, of which 20 were low-income.

The study organised by the Commonwealth Secretariat "Towards a New Bretton Woods", 1983, has put forward the policy problem aptly as follows:

"This large, sharp decline in global reserves, together with the drying up in commercial bank financing to developing countries, would suggest that it has become a matter of urgency to increase liquidity. One way to do this would be to resume allocations of SDRs (Special Drawing Rights). The urgency is reinforced by the maldistribution of reserves between countries, particularly the inadequacy of both owned-reserves and access to commercial bank credit by the poorer countries".

Throughout the debt crisis, debtor countries have been careful to preserve their good relations with the banks. A major, probably decisive, reason has been the need to preserve access to bank credit.

It is unlikely that there can be a solution to the problems of adequacy of official reserves and of fair distribution of international liquidity until the role of SDRs in the international reserve system and the principles of their country allocation are sorted out. The failure to find a way of distributing SDRs to countries drained of liquidity in the present crisis is a testimony to the inadequacy of present arrangements.

The representatives of the Group of 10 have decided to take up for study the issue of creation and distribution of international liquidity. This is an encouraging development.

Development Finance

The near-collapse of bank lending to developing countries in 1982 and the near-stagnation of official concessional (aid) finance in recent years have given rise to proposals for new forms of development finance, aimed at tapping new sources of long-term credit, using new financial instruments and developing new institional devices or expanding the existing ones. The proposed new sources of credit include insurance companies, pension and mutual funds, multinational companies, and new financial institutions. The proposed new instruments include guarantees, acceptance/commercial paper, index-linked bonds, commodity-linked bonds, and non-majority equity investments. The proposed instutional devices include sale of bank loan assets, finance of counter-trade and barter, export credit, co-financing, and insurance against political risk. Most of these porposals come from serious sources and need to be studied in detail.(7)

Whatever progress is made in new areas, it can be safely stated that the need to expand the public international development finance has gained an importance and urgency as commercial bank lending has fallen and the own export efforts of developing countries have encountered near-stagnant markets. In fact, some of the proposed new areas depend for their development on an expanded and more imaginative public development finance. The existing international financing agencies have increased their lending in such priority fields as energy finance and programme support; but the needs are enormous and the gaps, singled out, among others, by the Brandt Commission, continue to loom large. The need for a much larger long-term programme lending has been reconfirmed and further strengthened by recent experiences. Disbursements on project loans, which are normally tied to the provision by the borrower of the local currency component, have slowed-up *pari passu* with the domestic difficulties in the borrowing countries constraining local currency availability; project pipelines have lengthened; and public foreign lending has, it seems, operated in a cyclical rather than counter-cycical fashion. The special assistance programme of the World Bank of 1983–85, aimed at speeding up the disbursements, was adopted in recognition of these difficulties.(8) This activity is limited, however, and there is no information that other development finance agancies, such as regional development banks, have undertaken similar programmes.

A number of developing countries are now adopting measures to attract direct foreign investment, both from the traditional sources in the developed countries and the new suppliers of capital in the surplus oil-producing countries. Its relative financial attractiveness has increased in view of the high cost of loan capital and the excessive burden it imposes in the face of weak and fluctuating exports. In some cases, there is an excessive competition for direct investment, leading to offer of conditions causing resentment in developed country regions suffering from large unemployment, while conferring limited benefits to a developing country. There is also a potential problem of excessive investment in extractive industries and the associated adverse movement in the terms of trade of the borrowing country – the Singer effect;(9) but this is unlikely to be acute at present as most investments in major mining projects have been postponed due to the extended slump. (10)

Two major proposals for promoting direct investment within a multilateral framework have been made:

(a) Establishment of an international procedure for discussions and consultations on measures affecting direct investment, proposed by the Brandt Commission. This could ultimately lead to the adoption of an international legal regime for such investment, which would bring together all the various international codes of conduct currently under negotiations and those already agreed. The executive director of the UN Centre for Transnational Corporations has argued that there is a strong case for a multilateral regime under United Nations auspices, building on the Code of Conduct on Transnational Corporations now being negotiated.(11)

(b) Establishment of a multilateral investment insurance agency covering foreign investment, proposed by the President of the World Bank.(12)

Participation in these two arrangements would be voluntary, and management would presumably be shared between developed and developing countries. They could yield significant benefits, although not immediately; and their full effectiveness would depend on the general improvement in North-South economic relations.

International Financial Instutions

The representatives of the Group of 10 have undertaken to examine the strengthening of the role of the IMF in the surveillance of country economic and financial policies. The role and operations of the IMF have, of course, been of major concern to developing countries for decades, centered on conditionality – perhaps the single most thorny issue in North-South relations – and availability of IMF resources. Re-examination of the role of the IMF needs to go to the depths of its relations with both the developed and the developing countries and to its organization if it is to be fruitful.

The Group of 10 has not addressed itself to the issue of development finance, debts, the role of development finance institutions, their relations with the creditors and debtors and their organisation. The mandate given by the Williamsburg Summit has been limited to the international monetary system. Removal of this restriction is a major task before the developing country negotiations.

The issue of universality of membership in international financial institutions remains on the agenda. A New York banker has raised it recently in connection with the need to assure continuity in all lender-debtor relationships; (13) another banker has suggested a joint approach of the western developed countries and the Soviet Union on refinancing the Eastern European debts. (14) At the New York summit organised by the prime minister of India in late September 1983, the vice-president of Bulgaria was reported to have supported the French proposal for an international monetary and financial conference. Regretfully, the present international political climate sets narrow limits to possible advances in East-West financial relations.

Financial Cooperation among Developing Countries

Financial and monetary cooperation among developing countries takes place at three different levels; in bilateral relations, mostly between the surplus developing countries, a few, and the deficit developing countries, a large majority; in subregional and regional bodies, such as investment and trade financing banks majority-owned and operated by developing countries, payments agreements, and mutual reserve support schemes; and in interregional institutions of limited membership, but with beneficiaries world-wide (OPEC Fund for International Development) and coordinating groups with similar characteristics (Group of 24 in the IMF–World Bank complex). It is an over-lapping network, grown in response to needs through a series of ad hoc decisions. The weakest link in the chain is in the inter-regional sector: no world-wide institution with universal developing country membership exists either in investment finance or in balance of payments support, and only development finance companies of developing countries have organised a federation, still in the emerging state.

For developing countries, commodity price instability remains a major unresolved issue. The sharpness of the price fall in 1981-82, only partly reversed in 1983, resulted in a major decline in export earnings, which in turn was a major factor in the foreign exchange crisis of recent years.

Many intergovernmental meetings and discussions on South-South and North-South relations have been held by the developing countries; this stands in contrast to only slowly evolving operational approaches to crucial questions in organizing South-South finance on a stable organisational basis and in formulating specific proposals on open North-South issues in the difficult areas of debt, future monetary and financial system, and future organisation of international financial institutions.

Trade among developing countries has been affected adversely by the present crisis: the import capacity of those experiencing acute debt servicing, difficulties has fallen sharply, while the capacity of a number of developing country-exporters to provide export credit has been curtailed in light of their own shortage of foreign exchange. Brazil's exports to the rest of Latin America dropped from US $ 5.5 billion in 1981 to an estimated US $ 1.7 billion this year, and those to Nigeria from US $ 1.5 billion to one-quarter. The curtailment of demand in the Middle East due to the fall in petroleum revenue has affected exports of a number of developing countries exporting machinery, equipment and construction services. Singapore investment in Indonesia has slowed down. A Yugoslav oil exploration enterprise had to withdraw from projects in four countries recently, due to lack of convertible exchange. The reduction in the intra-trade and investment of developing countries comes at a time when it is most needed to offset, in part, the consequences of slow growth in the world economy and contribute to its recovery.

What needs to be done is to create an inter-regional facility to help finance intra-trade of developing countries on a bilateral and multilateral clearing basis so as to maximise trade per unit of convertible foreign exchange; extend support to existing payments and reserve arrangements; assist developing country intra-investments; provide commodity trade financing; and extend balance of payments support to the extent feasible. Further needed is the establishment of an association of central banks of developing countries to provide a forum for a systematic study and consideration of matters of common interest.

With respect to the financing facility, the Group of 77 has had a proposal for the establishment of a Bank of Developing Countries (South Bank) formally since 1979, and informally even earlier. The matter has moved forward after 1981; an Export Group meeting of G–77 was held in Kingston, Jamacia, in March 1982 to consider the economic justification of the Bank, (15) this was followed by the second meeting in Ljubljana, Yugoslavia, in August-September 1983 which reviewed the technical documentation on the feasibility of establishing it and its possible size, functions and capital structure. (16) The documentation had examined a broad-based institution, covering financing of investment, particularly joint ventures, export credit, balance of payments, commodity exports finance and support to regional and sub-regional finance schemes. Its capital would consist both of local currencies and foreign exchange, the latter, together with borrowed funds, providing a cushion to the envisaged use of local currencies. The next step is the third Expert Group meeting, including preferably the representatives of central banks, to be held before end-June 1984, to complete the work and submit recommendations to the governments of G–77.

There has also been an imaginative private initiative in this area. In July 1983, the president of the Bank of Credit and Commerce International SA proposed the establishment of a consortium of commercial banks of developing countries, private and government-owned, with paid-up capital of US $ 0.5 billion and borrowed funds for US $ 0.75 billion (i.e. with an initial resource base in excess of US $ 1 billion) to engage mainly in financing of trade among developing countries and short-term financing of their balances of payments and major commodity exports and imports. The proposed consortium bank would provide convertible foreign exchange for settlement of net balances resulting from clearing operations, issue its own unit of account to be used to promote trade among developing countries, and mobilise funds through the sale of its own bonds, certificates of deposit and other money market instruments. It was stated that the proposal was not competitive with the plan to establish the intergovernmental South Bank and that the consortium bank would be willing to become associated with it as a window should the G–77 decide to go ahead.(17)

With respect to the suggested association of central banks of developing countries. the topics it may handle could include the following:

(a) Review and analysis of the evolution of the international financial and monetary system and its effects on developing countries;

(b) Review and analysis of experiences in domestic monetary, financial and exchange rate policies;

(c) Exchange of information, experiences and views concerning external borrowing, lending and debt management; and

(d) Assistance to members on any of the above topics and associated activities.

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1. In the United States, for example, interest on the national debt in the fiscal year 1983 amounted to US $ 129 billion, or 66 per cent of the budget deficit of the federal government.

2. Amortization in 1982 amounted to US $ 70 billion, and the debt outstanding at the end of 1981 amounted to US $ 530 billion. At the end of 1982, the medium and long-term debt was about US $ 600 billion, and short-term debt US $ 150–160 billion, making for a total of more than US $ 750 billion.

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12. A.W. Clausen, Address to the Board of Governors. World Bank, 29 September 1981.

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14. Felix Rohatyn. New Bretton Woods conference needed. Financial Times 9, May 1983.

15. The documentation for the Jamica meeting; the Report by the Rapporteur General on its conclusions and the extract from the Manila Follow-up Action Adopted by the First Meeting of the Intergovernmental Follow-up and Coordination Committee on ECDC are contained in: Dragolav Avramovic ed. South-South Financial Cooperation. London 1983.

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