

On the Delinking of Rupee from Sterling

On 24th May 1976, the Sri Lanka Rupee was delinked from the pound Sterling and linked to an appropriately weighted (undisclosed) basket of currencies. Our readers may recall that the *Economic Review* had been campaigning for this result in two of its issues (September 1975 and March 1976) and we are glad that the campaign has brought results. As early as in September 1975, we drew the attention of readers to the progressive decline in the external value of the Rupee that was occurring as a direct result of the fall in the value of the Pound in world money markets. In effect, the column questioned the desirability of continuing the Rupee link-up with the Pound.

In early March 1976, the value of the Pound fell to US\$ 1.90 and the *Review* in its March issue once again focussed on the urgent need to re-examine the viability of the Pound-Rupee link.

Subsequent events confirmed the forecasts we made. The Pound continued to deteriorate in the subsequent months, and by late May it has fallen to as low as US\$ 1.71. It was at this point that the Central Bank decided to sever the link of the Rupee with the Sterling. The following is the text of the communique issued by the Central Bank: "The Central Bank has been closely watching the exchange rate movement in the international markets especially during the last few months when the pound sterling has been declining sharply, thus causing instability in the exchange rate of the Sri Lanka rupee vis-a-vis other currencies.

"There was a strong possibility of sterling regaining confidence in response to corrective policies adopted by the U.K. government in containing inflationary pressures within the country. However, the events in the last few weeks indicated that these policies have not been able to arrest the downward trend of the pound sterling in the short-run. Fluctuations in the sterling exchange rate has been the results of random events unconnected with Sri Lanka but they exercised a disproportionate

influence on Sri Lanka's exchange parities.

"The Central Bank has therefore decided to sever the link of the Sri Lanka rupee with the pound sterling. The Sri Lanka rupee has now been linked to an appropriately weighted basket of currencies with effect from Monday, 24th May 1976."

On June 8th, exchange rates were fixed on the new basis and the result was a revaluation of the Rupee from Rs. 15.60 per Pound to Rs. 15.23 per Pound.

Taxation of International Trade

Taxation of foreign trade (taxes on exports, imports and foreign exchange transactions) continues to be the largest single source of government revenue in Sri Lanka. These taxes which accounted for over 50% of the government revenue in the 1950's, declined in importance in the 1960's and during 1970-73 their contribution had fallen to one-third of the government revenue. This decline was a result of lower export prices, progressive imposition of import

revenue realised from the taxation of foreign trade during 1974-75 is essentially reflection of the higher export and import prices and the higher import bill during these years.

Upto 1968, the taxation of foreign trade was confined to export and import duties. The introduction of the FEEC scheme in 1968 (which was originally conceived more as an exchange rate measure than as a revenue measure) added another form of taxation on foreign trade transactions. Over the years, the FEEC scheme has become a buoyant source of revenue and today it is the largest single revenue source accounting for over one-fifth of the total government revenue. The revenue from FECS rose from Rs. 285 million in 1968-69 to Rs. 1055 million in 1975, representing an increase of 270%. The share of FECS in the total government revenue rose from 11% to 21% during the same period. According to the budgetary estimates for 1976, the revenue from FECS are estimated at Rs. 1600 million or 28% of the total estimated government revenue.

The dependence of the government revenue on international trade goes beyond the direct revenue accruing from taxes on foreign trade. There is, for example, an indirect relationship between the revenue from the business

REVENUE FROM TAXES ON INTERNATIONAL TRADE

(Rs. Millions)

Year	Export Import		FECS	Total†	Total as % of Govt. Revenue
	duties	duties			
1970/71	266	282	396	964	33%
1971/72	233	258	536	1,071	33%
1973	386	222	674	1,321	33%
1974	660	277	964	2,062	43%
1975	430	336	1,055	1,987	39%
1976*	313	458	1,600	2,539	45%

*Estimate

†Includes the tea tax revenue

controls and the increasing tendency towards the importation of essential goods only (which carried low import duties). In recent years (1974-75) there has been a recovery in the importance of these taxes as a source of revenue. Export and import duties and FECS accounted for 43% and 39% of the government revenue in the years 1974 and 1975 respectively. According to the budgetary estimates for 1976, these taxes are estimated to bring in a revenue of over Rs. 2500 million or 45% of the estimated government revenue. The higher

turnover taxes and the level of the foreign trade. The bulk of the BTT revenue comes from import-substituting manufacturing industries and the output of these industries is crucially dependent on the availability of foreign exchange for raw material imports. BTT contributed 13% of the government revenue in 1975 and was the third largest source of government revenue in that year. Similarly, the revenue from the profit tax on plantations is dependent on the level of export price fetched by the plantation products.