The Problems of Domestic Resource Mobilisation in Sri Lanka * – Part I

W. A. Wijewardena
Deputy Director of Economic Research
Central Bank of Sri Lanka.

The basic function of any economic society is, by and large, to produce goods and services for use by its members. Since the needs of the members are diverse, the innumerable number of commodities (and services) to be produced requires the use of a wide range of inputs, the mobilisation of which in correct quantities at correct times becomes a matter of crucial importance to production. In the case of a developing country like Sri Lanka, mobilisation of resources is needed not only to maintain the current production levels, but also to expand the production boundary so as to improve the standard of living of her people. Money economies are supposed to perform this task successfully through the proper functioning of the market mechanism; yet, on account of many factors such as externality, monoploy and irrationality that lead to a failure of the market mechanism, conscious efforts have to be made for the purpose of mobilising resources for development.

This paper consists of 4 parts. Part I discusses methodological problems associated with estimation of savings, mobilisation of resources etc. in developing countries. Part II concerns itself with an analysis of the development of the financial system and its relationship with the mobilisation of resources. Part III is confined to a discussion of the role of the capital market in domestic resource mobilisation. Finally, Part IV presents a summary of the paper.

PART 1

Methodological Problems

The term 'resources' generally means real resources, natural or human, that are needed for the production of a real commodity or a service that provides utility to its ultimate user. Mobilisation of resources involves the process by which they are made available to production entities for use in production. However, resources do not move from one place to another on their own accord; they have to be shifted by conscious efforts of individuals who gain a private benefit by doing so. Since human efforts are costly in real terms, effective mobilisation of resources takes place only when they are adequately compensated in real terms for their efforts. The profit seeking individual working under the market conditons will reach the optimal level, when the marginal benefit he gets by mobilising resources is equal to the marginal cost of his efforts. The market mechanism, if allowed to function properly, will ensure an efficient allocation of resources among competing ends in the economy.

The purchasing power needed to acquire real resources for the production of goods and services is generated by a flow of financial savings transferred from surplus units in an economy to deficit units. By definition, savings constitutes that part of income not spent on consumption. Consumption consists of two parts; use of Exhaustible items during a particular period and the value attributable to that period in the use of durable items. Hence, the change in the net value of durable goods owned by an individual between two points in time represents a part of an individual's savings.

Savings of a society can be measured by **three** methods. First, at the aggregate level, it could be measured as a residual, if the income and the consumption can be appropriately measured. Though convenient and easy to calculate, this method of measuring aggregate savings hides many qualitative features of savings that are useful to appraise the structure of savings of a country. Furthermore, relative shifts in different modes of savings in response to various policy measures adopted by authorities and to autonomous market developments cannot be gauged from the aggregate measure of savings as a residual.

Second, also at macro level, savings of a society can be measured by aggregating the change in financial and real assets owned by different individuals in an economy. For this mea-

surement, savings is defined as the net change in the value of both financial and real assets owned by individuals at the aggregate level between two points in time. Under this method, measurement of savings requires the preparation of an aggregate balance sheet of the whole economy at different time points and the aggregation of the changes in various assets between any two points of time. The savings so measured could be classified into two main forms: financial savings and savings in tangible form.

Financial savings can further be broken into 3 major types:

(a) Discretionary or voluntary savings such as, currency holdings, bank deposit holdings, purchase of shares, bonds, securities etc.
(b) Contractual savings such as contractual deposit schemes, save as you earn schemes, insurance policies etc.
(c) Compulsory savings such as compulsory contributions to pension and provident funds.

In developing countries, tangible savings basically take the form of acquisition of jewellery, gold and bullion, gems and other precious stones, antiques, paintings, consumer durables etc. By social custom, gold and jewellery and sometimes precious stones are the most preferred forms of tangible savings by people in eastern societies such as Sri Lanka.

Measurement of financial savings as listed above does not pose a serious problem for an exercise involving the estimation of savings, since they could easily be ascertained from the aggregate balance sheets of institutions that issue these liabilities to the public. However, problems arise when valuing these savings at the prevailing market prices. Financial assets that are traded in a secodary market usually fetch a price other than their respective face value involving or a capital loss if it is below. Since a capital gain has to be reckoned as income for the current period, any increase in the value of an asset due to a rise in the market price of a financial asset should be regarded as savings for the period. The same treatment holds for a capital loss which should represent a dissaving for that period.

Estimation of the change in the tangible assets, especially jewellery owned by individuals, becomes problematic in view of the existence of a large number of retail outlets selling these items. Value of items such as radios, television sets, motor cars etc. can be estimated at the manufacuring and import levels. However, owining of jewellery cannot be ascertained accurately at the marco level, since a bulk of the industry's requirement of gold in these countries is usually obtained through smuggling on which reliable data are not available. Micro aggregation of the sales by each jeweller during a given period is also a very cumbersome and costly exercise. Hence, the estimation of savings in the form of tangible assets in developing countries is subject to a high margin of error.

The third method of estimating savings is through sample surveys conducted at different time intervals. In Sri Lanka, data on savings by individuals are gathered through surveys on Consumer Finance conducted by the Central Bank of Sri Lanka once in every 10 years upto 1973 and in every 5 years since then. Savings for the purpose of the survey have been defined as the difference between income and consumption where consumption does not include the expenditure on consumer durables. Hence, as in the simple macro aggregation, savings include the changes in the holdings of both financial and tangible assets.

The savings pattern in Sri Lanka in different sectors in the economy as revealed by the Consumer Finances Survey of 1981/82 is given in Table 1.

The all-island savings ratio of 11.7 per cent as revealed by the Consumer Finances Survey of 1981/82 turns out to be very close to the domestic savings ratio of 11.9 per cent in 1982 estimated as a residual in the national income accounts at macro-level. However, there is a wide variation in the savings ratios of different sectors with the urban sector recording the highest rate of 17.2 per cent and the estate sector recording a dissaving of 21.2 per cent.

In the case of financial assets, the savings in the form of currency and in the case of tangible assets, savings in such unproductive forms as jewellery, do not directly contribute to the mobili-

Continued on page 33

24

Continued from page 25

sation of real resources for productive investment. Currency in the hand of public serves to meet liquidity requirements, but any currency held in excess remains idle and should be treated as hoarded. With the development of an economy and the expansion of its banking system, the currency base is usualy expected to decline over time, raising the proportion of interest bearing deposits with deposit accepting institutions. However, in Sri Lanka, currency held by public as a percentage of GNP declined from 7.7% in 1977 to 6.3% in 1984 but recorded a gradual increase thereafter reaching a level of 9.3% in 1988. At the same time, interest bearing deposits as a percentage of GNP rose from 21% in 1978 to 38% in 1987. Reflecting the need for higher liquidity during the period of disturbances, this ratio fell 32% in 1988.(Table 2)

The main role of a financial system of a country is to induce a transfer of unproductive savings into the organised financial sector so that the resources so transferred could be made available to deficit units in the economy for productive investment. Holding of savings in the form of currency is costly in two ways. First inflation erodes its face value over time. Second, the saver has to incur a cost inthe form of the foregone interest revenue. Hence, the financial institutions should induce individuals to maintain only the bare minimum requirement of currency balances by offering attractive savings schemes, offering a real positive rate of interest, ensuring the safety of the deposits by maintaining solvency of the institutions and lowering the transaction costs to be incurred by depositors by improving the quality of banking services. The savings so mobilised are then transferred to investors to fulfill their requirements of capital funds: short-term loans to fulfill the working capital requirements and medium and long-term loans to fulfill the investment capital requirements. The provision of working capital in required amounts will enable the economy to maintain the current production level by creating an uninterrupted demand for real resources. The investment capital, on the other hand, will enhance the existing production level helping the business sector to raise the installed capacity of their production units. It will generate a new demand for real resources which will eventually lead to a higher level of resource utilisation in the economy. In this sense, the financial system of a country acts as the 'engine' of the domestic resource mobilisation efforts.

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The long-term capital necessary to enhance the production capapcity of an economy is basically demanded in two different forms: equity capital and loan capital. Equity capital gives a share of the ownership of the enterprise to a prospective investor. In the case of the corporate business sector, the institutional mechanism for the supply of equity capital is the country's stock exchange which provides, at the first instance, and subsequently, the secondary share market facilities for those who desire liquidity and/or wish to make a re-adjustment of their investment portfolio. In the case the primary share investment facilities to would be investors of the non-corporate sector, merchant banks, venture capital companies and seed capital companies take up equity by providing a part of the equity capital requirements of the entrepreneurs. In order to build-up their resource base, these companies should mobilise savings from the public.

Loan capital requirements of the business sector are met in two differnet forms: first, bonds or debentures are issued by companies through the stock exchange to investors with a fixed coupon rate and a given maturity period. Second, instalment loans repayable within a fairly long-period of time are issued by commercial banks and other long-term lending institutions. In the first case, the general public directly makes the investment in the bond, while in the second case, their savings are routed to the companies concerned through the lending banks. The instalment loans normally form the bulk of the loan capital requirments of the business sector. Hence, *an efficient financial intermediaiton is a* **sine – qua – non** for the mobilisation of resources for economic growth through the financial system.

See page 39 for Tables

Continued from page 37

ity can be maintained only by natural regulation) to exclusively economic or artificial ecosystems (being used only for socio-economic purposes and of which the stability has to be regulated by almost totally artificial means). An example of the former is Sinharaja and of the latter Colombo and other urban, industrialized areas. In between there are natural ecosystems which are being used mainly as a source of supply of renewable resources but without much artificial means to sustain their stability and productivity (e.g., fishing in lagoons) and cultivated ecosystems in which natural processes have to be artificially modified and controlled to sustain and enhance their productivity (e.g., paddy fields, plantations, pastures, aquaculture).

On this basis, we can formulate three guiding principles for environmental management:

1. To enhance and maintain the stability of all ecosystems by balancing ecosystem conditions and development objectives and opportunities in accordance with the significance of a particular ecosystem as a natural or economic resource and with due recognition of the inter-dependence of ecosystems. Therefore, the overall objectives of environmental management is: **To enhance and maintain ecosystem stability by adequate appraisal, control and management of ecsosystem conditions.**

2. The more an ecosystem is being valued as a reservior of genetic resources more emphasis should be placed on reservation of adequate space and non-interference to preserve its carrying capacity. **Non-deterioration of natural values by maximum protection of the ecosystem as a whole.**

3. The more an ecosystem is being valued as an economic resource more emphasis should be placed on the protection and management of ecosystem functions that are crucial to sustain the productivity and stability of the system. **Sustained productivity of renewable resources by adequate control and management of ecosystem functions.**

(To be continued in the next issue)