

THE 1983 BUDGET

AN ANALYSIS

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Introduction

The budget is a comprehensive record of anticipated public expenditure and revenues. The expenditures are broadly classified into: recurrent and capital, and represent aggregates of expenditures recorded by objects of various uses are also classified by source such as taxes, duties, as well as revenues from other than taxes. This is followed by a comparison of Government expenditures with revenues and, in the event of a revenue shortfall (which incidentally is more regular than a surplus), the Finance Minister announces new proposals which usually include revisions to taxes and duties, borrowings in the domestic sector, and aid commitments from the international donor community. Thus, the budget is the principal mechanism of managing public expenditures and mobilizing resources to meet annual expenditure plans. It is also the main instrument of implementing the Government's fiscal policy.

This year's budget anticipates financing of Rs.49.6 billion; an increase of about Rs.11.0 billion from the last year's which now stands at Rs.38.8 billion. (This paper draws information from the 1983 Draft Estimates of Expenditure and Revenue of the Government and the Budget Speech of March 8, 1983). The 1983 total expenditure outlay consists of recurrent expenditures (Rs.26.5 billion) and capital expenditures (Rs.24.8 billion). The Minister of Finance and Planning proposes to finance the 1983 expenditure program by: (1) domestic revenue (Rs.26 billion), (2) foreign financing consisting of loans and grants (Rs.14 billion) and (3) borrowings from non-banking sources (Rs.8 billion). A Rs.1.4 billion unfinanced gap, however, still remains.

The purpose of this paper is to evaluate the 1983 budget, especially from an economic policy stand point, and relate it to the economic development process. The analysis is divided into three sections. In section I the expenditure outlay is briefly reviewed; section II covers resource mobilization in financing the budget; and section III evaluates the budget's impact on production and employment, inflation, the balance of payments and public debt.

PUBLIC EXPENDITURE PROGRAM

Table 1 provides a breakdown of public expenditures by major categories for 1983 as well as for 1982 and 1981 which help place the 1983 expenditure in a comparative perspective. The recurrent estimate of Rs.26.5 billion

accounts for almost 52 percent of the total expenditures. This represents a marginal decline in percentage terms relative to two previous years. Capital expenditures have increased to 48 percent in 1983 (accounting for Rs.24.8 billion) up from about 46 percent in 1981

(a) Recurrent Expenditure

The recurrent expenditures estimate for 1983 is approximately Rs.6 billion more than the 1982 provisional estimate of Rs.20.5 billion. This represents a 29 percent increase compared with the total budget increase of around 27 percent in 1983. The recurrent expenditure estimate of Rs.26.5 billion is represented by four major expenditure categories: (1) salaries (22 percent);

(Table 1) PUBLIC EXPENDITURE BY MAJOR CATEGORIES (RS. MILLIONS)

	1981	PERCNT	1982	PERCNT.	1983	PERCNT.
RECURRENT	16005.00	54.44	20484.00	49.60	26523.00	51.83
SALARIES	4080.00	13.88	4422.00	10.70	5645.00	10.99
INT.DEBT	3856.00	13.12	5612.00	13.59	7504.00	14.51
Domest.	3143.00	10.69	4281.00	10.37	5619.00	10.94
Foreign	713.00	2.43	1331.00	3.22	1835.00	3.57
SUB.& GRNT	3582.00	12.18	3760.00	9.10	4244.00	8.26
Fd. Stamp	1521.00	5.17	1510.00	3.66	1510.00	2.94
Kr. Stamp	164.00	0.56	177.00	0.43	288.00	0.56
Fertilzr.	637.00	2.17	1000.00	2.42	1000.00	1.95
Inf. Milk	82.00	0.28	125.00	0.30	100.00	1.19
Intst (1)	388.00	1.32	450.00	1.09	670.00	1.30
Other	790.00	2.69	498.00	1.21	676.00	1.32
MISCELLNS.	3589.00	12.21	7690.00	18.62	9019.00	17.56
CAPITAL	13393.00	45.56	20816.00	50.40	24847.00	48.37
LOANS	1619.00	5.51	2806.00	6.79	4767.00	9.28
Domestic	1002.00	3.41	2023.00	4.90	3410.00	6.64
Foreign	617.00	2.10	783.00	1.90	1357.00	2.64
TR.COP (2)	7345.00	24.98	11375.00	27.54	11132.00	21.87
Mahaweli	3816.00	12.98	7217.00	17.47	6773.00	13.18
Housing	1020.00	3.47	703.00	1.70	571.00	1.11
Electrc.	673.00	2.29	305.00	0.74	81.00	0.16
Watr. Sol.	343.00	1.17	957.00	2.32	1379.00	2.68
LN.COP (3)	69.00	1.94	1177.00	2.85	1252.00	2.44
Electrc.	195.00	0.66	470.00	1.14	695.00	1.35
Tr. Bd. (4)	171.00	0.58	526.00	1.27	450.00	0.88
AC.AST (5)	3860.00	13.13	5458.00	13.22	5730.00	11.15
UNDER EX.	—	—	2500.00	6.05	1966.00	3.83
TOTAL	29398.00	100.00	41300.00	100.00	51370.00	100.00

1. Interest Subsidy to National Savings Bank
2. Transfers to Public Corporations
3. Loans to Public Corporations
4. Loan to Sri Lanka Central Transport Board
5. Acquisition & Maintenance of Real Assets

* views expressed in this paper are solely those of the author.

(2) interest on public debt (29 percent); (3) subsidies, grants and contributions to public corporations to offset losses (16 percent); and (4) maintenance, repairs, transportation and allowances (all grouped under miscellaneous) (33 percent).

The increase in 1983 expenditures on salaries is about 28 percent over 1982 and this increase appears to include the Rs.100 salary increase announced for public employees receiving a monthly salary of Rs.1000 or less. The salary increases account for 20 percent of the increase in the recurrent expenditure. Interest on public debt is the most striking single item taking the biggest slice of recurrent expenditures. In absolute terms, interest on public debt has increased by approximately Rs.2 billion, representing a 33 percent increase over 1982. As a result, its share in the total recurrent expenditures, has gone up from 27 percent in 1982 to 29 percent in 1983. About 67 percent of this Rs.2 billion increase is accounted for by interest on domestic debt, a direct consequence of the increasing dependency on domestic sources (bank, as well as non-banking sources) to finance growing budget deficits. There has also been a corresponding increase in interest payments on foreign borrowings, as the pace on development projects has increased.

Subsidies, grants and contributions to public corporations is one category where the Minister of Finance and Planning has avoided increases. The Food Stamp Scheme, under which more than 50 percent of the population receive encashable coupons to purchase food commodities, remains unadjusted to take into account rising food prices. Despite a drop of more than 50 percent in real value of the food stamps since the implementation of the program in 1979, the Government has not increased the value of food stamps to protect recipients from rising food costs. Although the value of kerosene stamps has been increased by Rs.6.0 to Rs.15.50 per household per month, this increase will only partially offset

the price increases of kerosene since the kerosene stamp was introduced in 1979. Expenditures on the miscellaneous category have gone up by about Rs.2.7 billion to account for 33 percent of recurrent expenditures compared with 26 percent in 1982. This partly reflects increasing maintenance, repairs and transportation costs and partly increasing expenditures on services, eg., health and education.

(b) Capital Expenditure

Capital expenditures in 1983 are expected to reach a total of Rs.24.8 billion. However, when allowance is made for estimated under expenditure amounting to Rs.2 billion, the capital budget decreases to Rs.22.8 billion, representing a 25 percent increase over the 1982 provisional estimate. Of this total, loan repayments account for Rs.4.7 billion, leaving only Rs.18.1 billion for capital investments. In 1983, repayment of domestic loans increases to Rs.3.4 billion from Rs.2 billion in 1982, representing a 69 percent increase. Repayments on foreign loans increases by about 73 percent over 1982 to Rs.1357 million in 1983 (Loan repayments are included in the capital budget while interest payments are included in the recurrent budget).

Capital transfers to Public Corporations amount to Rs.11.1 billion and represent a marginal decline compared to Rs.11.3 billion in 1982. The Mahaweli Development Authority is the biggest recipient with Rs.6.8 billion, although this is 6 percent less than its share in 1982. The capital contributions to the National Housing Development Authority in 1983 will be Rs.571 million, a reduction of 19 percent compared to the capital contribution of Rs.703 million in 1982. The Water Supply and Drainage Board receives an increasing share of Rs.1379 million (compared to Rs.907 million in 1982), to carry out its on-going water supply and sewage-schemes in the country. The budget also accommodates loans to public corporations amounting to Rs.1252 million. The Ceylon Electricity Board is the largest recipient with Rs.695 million, followed by the Sri

Lanka Central Transport Board (SLCTB) with Rs.450 million.

(c) Capital Spending by Sectors

Table 2 summarizes the 1982 capital budget breakdown by sectors. The Government's policy of 'no new projects', which was first introduced in 1981 as a disciplinary measure in maintaining the consistency of actual expenditures to the budgetary allocations of respective Ministries, has not been relaxed in 1983. This means that the Ministries are not permitted to undertake projects which had not been approved earlier and included in the budget estimates; and implies that the 1983 allocation will be entirely utilized for on-going development projects.

(i) Agriculture

The Government emphasis, as reflected in budgetary allocation by sectors, is still on agriculture with particular attention on developing irrigation facilities and improving existing irrigation facilities for greater efficiency and better management. This continuing emphasis reflects the long conceived strategy of providing irrigation facilities in the dry zone as a means of increasing agricultural production. The Accelerated Mahaweli Program (AMP), which is now entering the fourth year of execution is still the country's lead irrigation development project receiving the priority in investment allocation. It accounts for 34 percent of the total capital spending and about half the allocation in agriculture. The AMP is still in the construction phase and, accordingly, the budgetary allocation will be utilized to finance the construction of dams, tunnels, irrigation canals, hydro power storage facilities and to provide other physical and social infra-structure such as roads, community centres, etc. At this stage, the successful completion of the AMP is vital to the nation as it offers vast opportunities for agricultural development, direct as well as indirect employment, and power supply for rural and industrial development. Accordingly, the Government's investment priority for the Mahaweli Program must be seen in the context of its substantial contribution to overall

economic growth and its likely responsiveness to economic problems confronting the country. Moreover, the project has already taken vast amounts of resources, and a retreat from the commitment made would represent the relative waste of scarce resources.

(ii) Economic Overheads.

For purposes of providing productive infrastructure, or economic overheads, the budget allocates Rs.4.1 billion accounting for about 20 percent of total capital spending. This allocation is divided among (1) transport development, including new additions to stock for railway and the Transport Board fleets (Rs.936 million), (2) development and improvement of power supply and distribution (Rs.788 million), (3) improve-

ments to water supply (Rs.1320 million) and construction and improvements of roads, bridges and public buildings (Rs.1007 million). Such investments are vital to economic development for many reasons including: (1) construction of, an improvements to, physical infrastructures contributes to the country's capital stock, and (2) expansion of economic activities requires the use of such facilities in the process of production, distribution and marketing of goods, commodities and services. In addition, these activities are usually not undertaken by the private sector because the heavy capital requirements do not provide it direct returns since the benefits of these developments are spread across most, if not all of the population.

(iii) Social Services

Providing basic social services such as sanitation, medical care, education, and community services is another major responsibility of the public sector. These services have been given an allocation of Rs.1260 million, divided between education (Rs.434 million) and health (Rs.826 million). Despite the scarcity of financial resources the government is still providing a share of around 6 percent on these services. The housing development, which can also be considered as falling partly within social overheads, is another lead project of the Government and its allocation is progressively being reduced as the National Housing Development Authority has now entered commercial production of houses, enabling the authority to recoupe the cost of (low cost) housing programs from the profits on the sale of houses.

The Government's lowered priority on direct participation in industrial development is clearly borne out from the relatively small share budgeted for industry. Under the open and liberalized economic policy pursued by the present Government, the private sector is expected to assume a greater role in producing agricultural and industrial outputs, and the Government is strengthening the private sector expansion by providing services.

Financing the Budget

The draft Estimates of Revenue and Expenditure of the Government which was prepared much in advance of the budget speech, reported Rs.20.1 billion from revenue sources, based on the assumptions of prevailing tax structure at the time of the preparation of these draft estimates. The reported revenue estimate left an unprecedented budget deficit of around Rs.29.0 billion. The Minister of Finance is responsible for bridging the deficit and the options available to him are limited to (1) increasing domestic revenue (2) mobilizing foreign assistance including commercial borrowings from abroad (3) borrowings from the non-banking domestic sector, (4) borrowings from

TABLE 2. SUMMARY OF CAPITAL EXPENDITURE BY SECTORS

	Total Capital Expenditures (Rs. Million)	Percent	Foreign Aid (Rs. Million)	Percent
1. Agriculture	9624.30	47.78	5476.00	58.9
Mahaweli	6763.00	33.58	4523.00	48.39
Other Irrigation	637.90	3.17	87.20	0.72
Land Dev. Forestry etc.	121.00	0.60	50.70	0.54
Field & Minor Export Crops	683.30	3.39	319.90	3.42
Plantations	746.70	3.71	442.50	4.73
Fisheries	132.10	0.66	54.20	0.58
Animal Husbandry	80.40	0.40	13.00	0.14
Other	459.90	2.28	10.90	0.12
2. Industry	62.20	0.31	59.00	0.53
3. Economic Overheads	4052.20	20.12	2369.70	25.35
Transport	935.80	4.65	530.70	5.68
Power	788.70	3.92	735.00	7.86
Water Supply	1320.60	6.56	640.90	6.86
Other	1007.10	5.00	463.10	4.95
4. Social Overheads	2055.20	10.20	1020.40	10.92
Education	432.20	2.16	41.30	0.44
Health	826.20	4.10	699.40	7.48
Housing	794.80	3.95	279.70	2.99
5. Other Programs	4348.30	21.6	129.40	1.38
6. Total	20142.20*	100.00	9346.50	100.00

* Total Capital Budget is Rs.24.8 billion. The figure shown here is without capital repayment of Rs.4.7 billion.

the domestic banking sector, and (5) issuing additional treasury bills. However, the government has opted to rely on the first three choices to increase the total receipts to an estimated Rs.48.0 billion; but this still leaves an unfinanced gap of around Rs.1.4 billion.

The government has first looked into the possibility of increasing revenue, and has looked to indirect taxes as the obvious choice. Although this is rather an unsatisfactory compromise, the reasoning for additional revenues from indirect taxes appears to stem from the proportionately higher share of indirect taxes in total revenue and, accordingly a revision will result in proportionately higher revenues, relative to other revenue sources. Moreover, an upward revision of direct taxes would undoubtedly be a deterrent to investment in the private sector, especially at a time when the Government is trying to induce more private investments to support the economic expansion that the country needs badly.

Taxes on consumption and imports were the two areas where the govern-

ment's attention has been particularly concentrated in bringing in additional revenues from indirect taxes. However, the revisions on these two categories were introduced in mid February '83 through a gazette notification which came to be popularly termed the 'Midnight Gazette'. In the past most former Finance Ministers penalized selective groups when gazetting for additional tax revenues. The most common groups were smokers; consumers of alcoholic beverages; buyers of luxury goods and appliances; and owners of assets and properties. This year, however, the Minister has deviated from this traditional norm by looking to previously untapped sources such as basic food items including rice, flour, sugar and bread. These items have been brought under the sales tax, and this means the consumer will have to fully bear the tax on each item. In addition, the consumer has been affected both directly and indirectly by the revised import duties on consumer items and raw materials. The government has, however, spared the producers. There are no new taxes on production in

1983, but producers will be effected by higher prices on raw materials such as petroleum, and this would in turn result in higher consumer prices.

These measures are expected to bring about Rs.3.7 billion in additional revenues. There is also another new source that the government has tapped to finance the budget expenditure, i.e. the Central Bank profits. The Minister has accommodated a request from the Central Bank to transfer Rs.1500 million of its profits to the Government's revenue and to reduce the Central Bank's treasury bill obligations to the Government by a like amount. These budgetary proposals increase the Government revenue to an estimated Rs.26.0 billion as compared to Rs.20.1 billion in the draft estimates (Table 3). The anticipated increase in Government revenues simultaneously reduces the budget deficit to about Rs.23 billion from the original estimate of Rs.29 billion.

According to figures reported in the draft estimates, the Government planned to utilize about Rs.10.0 billion from foreign assistance sources in the form of

TABLE 3 REVENUE ESTIMATES

	1981		1982 ¹		1983	
	Rs. Million	Percent	Rs. Million	Percent	Rs. Million	Percent
Indirect Taxes	12105.00	75.23	10748.00	59.05	18486.00	71.01
Sales (2)	2829.00	17.58	3139.00	17.52	8826.00	33.90
Excise	2027.00	12.60	1935.00	10.63	2600.00	9.99
Import Duties	3225.00	20.04	2800.00	15.38	4000.00	15.37
Export Duties	3685.00	22.90	2264.00	12.44	2600.00	9.99
Licence	95.00	0.59	336.00	1.85	180.00	0.69
Transfer of Assets	221.00	1.39	224.00	1.23	240.00	0.92
Direct Taxes	2029.00	12.61	3051.00	16.76	3600.00	13.83
Income Tax	570.00	3.54	619.00	3.40	570.00	2.19
Corporate Tax	1459.00	9.07	2432.00	13.36	3030.00	11.64
Non Tax Revenue (3)	1957.00	12.16	1969.00	10.82	3998.00	15.35
Total	16091.00	100.00	18200.00	100.00	26032.00	100.00

1. Revenue in 1982 is now estimated at Rs.18,200 million a drop of Rs.1602 million or 8% from the original estimate.

2. Additional revenue estimate of Rs.3729 Min. included in 1983. However, this consists of sales taxes as well as import duties. A breakdown is not possible at present.

3. The Central Bank profits transfer of Rs.1500 Min. included in 1983.

project and commodity loans, including Rs.2.2 billion in outright grants. The Minister now expects a higher utilization of foreign assistance and the anticipated expenditures have now been revised upward to Rs.14.0 billion (Table 4). This additional Rs.4.0 billion appears to come from unutilized foreign aid in 1982 and the pre-1982 years. The unutilized foreign aid that has been accumulated through the end of 1982, for example, works out to a total of more than Rs.20.0 billion in current prices, and in 1982 alone about Rs.4.0 billion appears to have been unutilized. Although the accumulated foreign aid is a possible source of budgetary support, the flexibility of mobilizing it is somewhat limited because of the conditions that must be fulfilled by the Government, especially in the case of project aid which is often tied to the rate of implementation of development projects.

is not planning any borrowings from the banking sector, which has been a regular source in the past. To what extent the Government can get by without the assistance from commercial banks is yet to be seen.

Sri Lanka's annual public expenditure program has been growing rapidly over the last few years. For example, the 1982 budget increased 32 percent over 1981 and the 1983 budget has increased 27 percent over that of 1982. To a great extent, this increase reflects the rapid growth in recurrent expenditures due to (1) inflationary tendencies in the economy resulting from higher costs of services, maintenance, etc., (2) new expenditure requirements for new development activities, and (3) progressively increasing budgetary allocations for interest payments on both foreign and domestic loans. Because of the necessity of such expenditures

investments on long run economic development especially under conditions of severe financial constraints. Ironically, without adequate spending on long run economic development, a nation cannot satisfactorily address itself to its pressing economic and social problems. Faced with this situation, most developing nations compromise for borrowings both from domestic and international sources for funds for investment on economic development. This action, on the other hand, often leads to adverse developments in the economy as reflected in high inflation and a weak balance of payments situation. Accordingly, public spending must be viewed from the joint perspective or evaluating both benefits and costs. This section takes a close look into this issue, with particular attention to the 1983 budget expenditure program.

TABLE 4. FINANCING THE BUDGET DEFICIT
(Rs. Million)

	1981	1982	1983
Total Expenditure	31101	38800	49409
Revenue	16228	18200	26032*
Budget Deficit	14873	20600	23377
Financing From:			
Project Loans & Grants	8183	9758	14016
Foreign Commercial Loans	—	836	—
Bank Borrowings (Domestic)	6296	6000	1361**
Non-bank Borrowings	432	4006	8000
Cash Balance	— 38	—	—
Total	14873	20600	23377

* Original Revenue Estimate was Rs.20803 million. The increase in revenues of Rs.5229 million is accounted for by revision in BTT on Feb. 18, 1983 (Rs.3729) and Central Bank profit transfer of Rs.1500 million.

** This reflects the unfinanced gap.

Borrowing from the domestic non-banking sector is a more regular source of financing the budget and, in 1983, about Rs.8.0 billion is expected from this source. This budgetary support to the Government mainly comes from (1) savings institutions, (2) insurance funds, and (3) provident and pension funds. Surprisingly, the Government

for providing administrative, economic, social and welfare services in the economy and maintaining the commitments on borrowings, the recurrent expenditures component of the budget is less susceptible to any cuts.

The sacrifice that the country has to make, when recurrent expenditures are growing rapidly, is often at the cost of

(a) Production and Employment

Capital spending shifts resources from present consumption to building up capital stocks in the country with a view to increasing production in the future and enabling the population to later enjoy higher consumption levels. This is the main consideration for a continuing emphasis on capital spending, as it serves the nation's economic progress. In the short run, capital spending generates more employment and creates increased demand for raw materials. When these developments are viewed from the income side, capital spending could lead to increased incomes, which in turn induces more consumption and production. In the long run, capital spending helps to increase capital formation as reflected in the development of and improvements to physical infra-structures, such as buildings, roads, dams, equipment and machinery. Increased capital formation enables a country to move into new production frontiers leading to progressive increases in production and thus increased availability of goods and services for consumption. Moreover, capital spending in the public sector motivates expansion in the private sector which in turn results in capital formation in the private sector.

Despite a considerable increase in the capital budget, there will be no new investments on new projects, a continuing measure introduced in 1981 following the rapid increase in the money supply and, thus, inflation in 1980 and 1981. However, such restrictions may adversely effect the economic progress in the country, especially when the expectations for more employment under an open economic system have been kept high. Without new development activities the growth of direct employment opportunities in the public sector, and indirect employment in the rest of the economy, will be gradually reduced, at least in the short run. The decline in the rate of income in economic growth and slackening of employment opportunities experienced from about 1981 partly emanate from lack of investments in new projects. A declining performance is likely to become more serious, especially in the area of employment, in the years to come as the government will have to face new issues such as the relocation of a labour force which will face displacement once on-going projects are completed.

The private sector's role in the economy, especially in the areas of production and employment, surpasses that of the public sector by significant margins. The private sector's dominant role in the economy is self-explanatory if the 70 percent share in the total capital stock and the 80 percent share in the total labour force are used as yardsticks. Therefore, cuts in public spending may not necessarily lead to slow economic performance provided that the private sector expansion in the economy can be ensured. It is for the purpose of increasing its role, that the private sector has been given various production incentives under the present liberalized economic setting, and the present tax structure.

Unfortunately, there appears to be a very slow response to such incentives, as producers are beginning to face high production costs which reduce the profitability of their business ventures. Moreover, the effectiveness of producer incentives is gradually eroded with higher production costs. In addition, producers

are facing stiffer competition from imports despite increased import duties. There are some bright spots in the budget for producers, however. The Government is making plans to boost exports by offering new incentives to exporters, but these incentives have yet to be announced. Hopefully, these incentives will bring at least marginal improvements in production and employment in the private sector. A price increase of Rs.5.0 per bushel has also been announced in the paddy floor price to induce higher price production. But this increase is likely to be absorbed by rising input prices and marketing costs. Similarly, a large part of the increase in the subsidy for replanting of tea and rubber may also be absorbed by rising replanting costs.

Analysing the budget in the context of production and employment it is not very promising for those who are already unemployed as well as those who are now entering the labour force. According to the Labor Force and Socio-Economic Survey of 1980/81 of the Department of Census and Statistics, the unemployed labor force has been reduced to about 845,000 as a result of more than a million jobs generated in the economy since 1977. The organised sector of the economy has also been able to absorb almost the entire number of new entrants into the labour force in 1978 and 1979. However, recent reports indicate a considerable job creation shortfall in the organised sector (The Central Bank Review, 1981). This is only a part of the problem, for example, based on the preliminary results of the 1981 population census, there were about 1.5 million in the age group between 10 and 29 who were neither attending school nor employed at the time of the Census. Although their status is not very clear, the majority would probably take up jobs if an opportunity presents itself. Even among the employed, only about 60 percent are occupied in a job which includes at least 37 weeks of work, implying that under-employment is as serious as unemployment.

(b) Inflation

The sources of financing the budget are, at least on the face of it, not as expansionary as they could be; being made up of foreign aid and non-bank borrowings. Therefore, the budget, unlike in the past few years, will not exert as much inflationary pressure on the economy. However, it is extremely doubtful that this budget will also not have to depend on bank borrowings to a considerable extent. This reasoning emerges, from the strong possibility of a financing shortfall because: (1) the revenue estimate of Rs.26 billion for 1983 appears to be highly unrealistic, (2) the actual utilization of foreign aid is likely to be much less than anticipated, and (3) the unfinanced gap will be much more than estimated due to omissions and under estimation of public expenditures.

Revenue shortfalls from anticipated targets have been very common in the past. In 1982, for example, a revenue shortfall of around Rs.1.6 billion has been recorded. The revised revenue receipts show only about Rs.18.0 billion accounting for an estimated 18 percent share of the GDP. Assuming a real growth rate of around 5 percent and an inflation rate of about 20 percent the expected revenue estimate of Rs.26.0 billion in 1983 roughly works out to about 23 percent of the 1983 GDP. Given a declining trend of revenues as a share of GDP from around 27 percent in 1978 to 18 percent in 1982, the possibility of increasing revenue by Rs.8.0 billion in 1983 is unlikely.

The revision of anticipated foreign aid utilization increases from Rs.10 billion to Rs.14 billion in 1983, and this addition appears to be made up of carryovers from the past which include an unutilized Rs.4 billion in 1982 alone. One conclusion that can be drawn from the comparison of the 1982 foreign aid under-utilization of Rs.4 billion and the overall under-expenditure of Rs.2.5 billion is that the domestic financing was not adequate to make use of the foreign aid available to Sri Lanka in 1982. Given the past experience of foreign aid under-utilization, the odds

appear to be more in favour of a substantial under-utilization in 1983 as well.

The unfinanced gap of Rs.1.3 billion needs adjustments to take into account omissions such as the subsidy revision on kerosene. This revision increased the subsidy transfer to the Petroleum Corporation to Rs.288 million from Rs.177 million accounted for in the draft estimates. However, this difference has not entered the revised computation of budget expenditure. Furthermore, both recurrent and capital expenditure estimates recorded in the draft estimates will have to be revised upward due to the recent rupee depreciation against the dollar. The author estimates the impact of rupee depreciation alone should boost public expenditures at least from 5 percent to 10 percent, thereby increasing the unfinanced gap.

The budget does not offer any indication as to how such uncertainties can be accommodated or what courses of action the Minister will consider if such developments occur. In all probability, the unfinanced gap could reach as high as Rs.8.0 billion. The issue here is the ability of the Government to finance a deficit of this size without resorting to domestic market borrowings, thus increasing the inflationary tendencies similar to those that occurred in the 1980-1981 period.

Apart from the likely contribution to inflation from the financing side of the budget, the price revisions introduced two weeks before the budget will further add a few percentage points to the Consumer Price Index (CPI) in 1983. However, the size of its contribution will depend on the price revision's impact on consumption. If there is no change in consumption level, the price increase will be fully reflected in the CPI, depending on weights of consumer items in the index. If consumers can accommodate only a part of the price increase, on the other hand, allowing the balance to be reflected in consumption cut backs, the effect of the price increase on the index could decline proportionately. However, the price increase of petroleum will make a more definitive contribution to inflation because of the widespread

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Table 5. Foreign Aid Commitment, Disbursements and Fixed Capital Formation 1977 - 1982

	US \$ Million					
	1977	1978	1979	1980	1981	1982
1. FOREIGN AID						
(i) Commitments	254	400	569	628	815	577
(ii) Disbursements	204	251	268	328	437	415
2. FIXED CAPITAL FORMATION						
(i) Public sector (b) (c)	185	329	413	742	688	853
(ii) Total (a)	386	646	851	1261	1210	1414

(a) Includes non Aid Group Assistance.

(b) Public Sector including extra Budgetary Investment.

(c) PEEC rate (Rs, US \$) for 1977 and respective nonfixed rates for other years.

(This table shows how the level of domestic capital formation, both government and total, has increased dramatically in recent years. The greater availability of foreign assistance had undoubtedly been an important factor in promoting this change).

Source: Public Investment, 1983-1987 Ministry of Finance and Planning.

nature of its effects on prices and costs.

(c) Balance of Payments

The demand for imported goods should experience slower growth in 1983 as a result of higher prices and the depreciation of the Sri Lankan rupee against the dollar. On the export side, tea is reported to have made good progress with an almost doubling of average prices for all grades in current prices relative to 1982. Based on current information, the tea export trade will remain favourable throughout the year and this should help not only the balance of payments situation, but also ameliorate the long period of stagnation in tea plantation production. The devaluation will also induce a higher volume of exports of rubber and coconuts, at least until higher production costs resulting from a devalued rupee begin to erode the higher income made possible to producers following the devaluation. These anticipated developments in 1983 should narrow the current account gap in dollar terms which will certainly help make the financing of the balance of payments much easier.

(d) Public Debt

Borrowings from both domestic and foreign sources have become a regular feature in supporting annual public expenditure programs Table 2. The rationale behind borrowings is that it is an alternative source of capital which can be utilized for productive purposes to generate new sources of income. These new income sources should help to reduce the debt burden and, at the same time, the economy is

benefitted with higher production, more services and new employment opportunities. However, the continued dependence on borrowings can become a serious issue and is open to the criticism that the country is heading towards a situation known as the 'debt trap'. The main criticism against the 'debt trap' is that the country requires more and more current borrowings to service the past, accumulated borrowings, as well as for economic survival.

Sri Lanka's debt situation is not very encouraging; it has been growing at an unprecedented rate since the middle of the last decade. The worsening situation is well-demonstrated when the public debt is expressed as a percentage of Gross Domestic Product (GDP). In 1975, for example, the public debt ratio remained at a moderate level of 40 percent of GDP, but due to increased dependency on borrowings afterwards, it has dramatically increased to over 70 percent at present. Interest and loan repayments in 1983 alone accounted for more than 25 percent of the total budget.

This clearly signals a potentially unhealthy financial situation and the need for the Government to generate increased revenues. To avoid more serious debt problems, the Government has two options: reduce public spending or increase Government revenue. The first option is clearly not viable given the country's commitments to more production, more employment, and higher incomes. This leaves basically the latter. However, this requires imaginative and non-traditional policy decisions to generate additional revenues without sacrificing production, employment and living standards.