

Cut in Government Spending: the New Remedial Measures

The economic policies of the past three years have clearly overheated the economy. The outcome is an unprecedented inflation and the emergence of bottlenecks in key sectors such as power supply. Cost escalations of the order of 200-300 per cent have become a feature in practically all major government projects and cost estimates had to be continually revised to accommodate the unanticipated cost escalations. Government expenditure has progressively risen from less than Rs. 10 billion in 1977 to Rs. 28 billion in 1980 and to over Rs. 30 billion (estimated) in 1981, reflecting partly the cost of massive development projects such as Mahavell and partly the escalating costs. The available funding sources — taxation, foreign finance, and domestic borrowing from non-inflationary sources — had to be stretched to their limits to meet the mounting expenditure. Having exhausted these possibilities, resort to heavy bank borrowing became inevitable. An increase in the ceiling on the issue of Treasury Bills from Rs. 3000 million to Rs. 10,000 million within the course of one year (1980) to raise the short-term borrowings was required to meet the yawning budgetary gap. The money supply which rose by 29 per cent in 1979, continued to rise by another 20 per cent in 1980 and was rising more rapidly in early 1981.

Such is the background against which the government decided to implement an important remedial measure, namely to impose cuts on public spending. The budgetary proposals for 1981 (announced in November 1980) imposed the first cut around that time as a means to reduce the budgetary deficit. The capital expenditure of large spending Ministries was pruned by a total of Rs. 2,722 million or an average of about 22 per cent. But this cut proved inadequate as a remedial measure. Hence, on March 11 this year the government having made a review of the economy, de-

cidied to impose a further cut on funds voted at the last budget. The principal decisions were as follows:

- to keep down the expenditure on the Mahavell Project at Rs. 3,750 million as against the voted sum of Rs. 4,500 million, that is a cut of 17 per cent. (It was later announced, however, that it was proposed to restore this cut).
- to keep down the expenditure in the Ministry of Local Government, Housing and Construction to Rs. 2,180 million as against Rs. 2,680 million voted in the last budget. This is a cut of 19 per cent.
- all other Ministries to limit their expenditure to 90 per cent of the voted funds, that is a cut of 10 per cent.
- In view of the electricity shortage, spending on capital items which consume electrical energy such as air-conditioning, electrical appliances and elevators, will be pruned. (Moreover, the Urban Development Authority will not authorise any more new high rise buildings in view of the power shortage).
- Ministers will continue with the completion of the schemes already started but will not put up any new capital schemes for 1982 and 1983. Even in the case of public corporations, prior approval of a high-level Committee of the government is required for any capital schemes even when financed with own funds.
- The two guide-lines in the determination of priorities for public spending would be (a) quick returns on capital spent and (b) employment generation. This would mean that capital-intensive projects with long gestation periods would have low priority in the public spending programme of the next few years.

These decisions were followed by pronouncements by key government spokesmen on the need to maintain 'financial discipline' in government spending, the need to avoid waste and to adopt proper financial management. There can be no doubt that there is much waste and redundancies in government expenditures and that there is considerable scope for economies. Though lead projects will continue to be adequately funded (the cut of Rs. 750 million imposed on the Mahavell budget has been restored), it is likely that restraints will be imposed on some of the supporting and ancillary projects that accompany the lead projects, particularly construction of buildings of various sorts. Moreover, for the next two to three years, no new major projects are likely to be planned by the government.

While there are many factors that contributed to the current inflationary situation in the country, there can be no doubt that the sharp rise in government expenditures on long-gestation projects (such as Mahavell) on the one hand, and projects which are not directly productive (such as Parliamentary complex and the housing program) on the other, has been a distinct inflationary source over the past two years or so. The bulk of the government investments has been devoted to infra-structure development as against directly productive activities (which directly raise output and are hence counter-inflationary) thereby creating a serious imbalance in the development efforts. The principal sources of economic growth in the past few years have been construction, trade, transport and commerce, rather than agriculture and industry. Inflation is a necessary corollary of such a growth pattern; it is a principal manifestation of imbalances in the development efforts. The shift in emphasis to smaller and quick yielding projects and the cuts imposed on government spending are policy measures directed to curb the inflationary pressures.

Internal imbalances have as their corollaries the external imbalances, that is, the mounting import bill, widening trade gap and declining external assets. Sri Lanka's experience has clearly shown that

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