

The Making of the Budget

S. Tilakaratna

*Professor of Economics,
Sri Jayawardanapura University*

be covered by the JSP during the course of 1989.

The Budget for 1989 must be viewed against the background of at least three main factors namely:

- (i) the new vision of poverty alleviation, which will be the lead programme of the Government for about the next three years or so.
- (ii) The deterioration of the economic situation of the country in 1988, leading to severe internal and external imbalances; and
- (iii) the economic and social problems inherited from the particular development experience of the post-77 period in general.

With the entry of more families into the JSP in the next year, and given the continuation of the resource transfer for 24 months, the budgets for 1990 and 1991 will have to make substantial allocations for the programme; of a much higher magnitude than in 1989. The full financial picture will be known only with the reformulated public investment programme of 1989-93 which will be submitted to the Aid Group Meeting, now postponed for September 1989.

Deterioration of the Economic Situation in 1988

The objective of the new government as expressed through the budget is to make a transition to a new era of poverty alleviation. But this has to be achieved against the background of an economy which has virtually ceased to be dynamic, and is saddled with a series of structural problems inherited from the past economic policies. The task undertaken is indeed a very tall order. Let us briefly outline the vision and the challenges that have figured in the making of the budget.

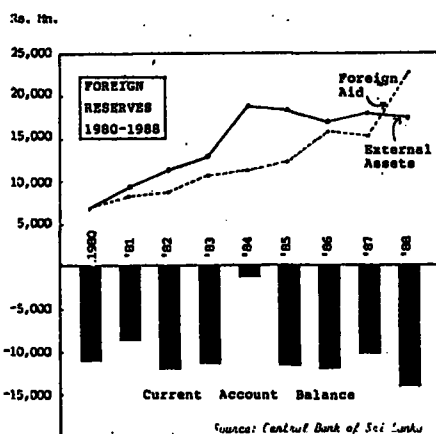
The annual rate of economic growth (as measured by the Gross Domestic Product in real terms) which had been maintained at an average of around 5 percent during 1978-86, declined sharply to an average of a mere 2 percent during 1987-88. This is the lowest level recorded since 1971. In 1987, the major reason for the poor growth performance was the decline in agricultural production, following the prolonged drought. In 1988, although agriculture had made a recovery, overall production in the economy was adversely affected by the civil disturbances and violence. Besides public sector industry and tea plantations, the output of the services sector (transport, trade and commerce) was particularly affected by the tensions that prevailed in the country.

Poverty Alleviation

The particulars of the Janasaviya Programme (JSP) are now well known. The crux of the programme is a resource transfer over a period of 24 months to enable the families concerned to raise their consumption levels and eventually to create a viable means of livelihood for them using the Savings fund of Rs.25,000/- deposited in their names during this period. It is expected that such a resource transfer would create opportunities for these families to acquire productive assets to make use of their abilities, skills and potentials in a process of self-development. The likely outcome would be the emergence of thousands of small scale projects, diffused throughout the country creating a broad-based equitable growth process.

The budget for 1989 has made the initial financial allocation to launch the JSP. With the total allocation of Rs.10 billion, (depending on the phased manner in which families will be brought under the programme) well over 500,000 families could be expected to

Coupled with the lower production growth, considerable demand pressures characterised the economy. Money supply rose by as much as 29 percent and inflation moved upto 14-18 percent (according to official indicators). Deterioration of the balance of payments followed and external assets fell to their lowest level since 1982. An important causal factor in this situation was the deterioration of the budgetary situation—the current account fell into deficit and the overall budget deficit rose significantly requiring heavy recourse to bank financing to meet the gap. The final outcome for 1988 proved to be a considerable deviation from the targets under the Medium-term policy framework (1988-90) announced in the 1988 budget. It has been reported that the country's failure to restrain the budget deficit, in-



flationary pressures and the deterioration of the balance of payments, led the IMF to suspend further credit under the Structural Adjustment Facility.

Structural Problems inherited from the Past

The budget for 1989 must also be viewed against the backlog of problems inherited from the particular development experiences of the post-77 era. These may be briefly summarised:

- Skewed growth pattern with a bias towards services as against commodity production (agriculture and manufacturing).
 - Worsening of the relative income distribution. The share of the richest decile (top 10 percent) of the income earners had risen to nearly 50 percent by 1985.
 - Rise in external indebtedness to a level of over 70 percent of the GDP (nearly Rs.10,000 in per capita terms) and the rise in the external debt service ratio to 29 percent (in relation to export earnings from goods and services).
 - Growth of a black economy the size of which has been roughly estimated to range from about Rs.20 billion to Rs.40 billion.
- Rise in unemployment to an estimated over one million persons or about 20 percent of the labour force.
- Sharp rise in defence expenditures since 1983, absorbing over Rs.10 billion per year in more recent years.

Moreover, the economic losses caused by the ethnic conflict has been estimat-

ed at Rs.50-55 billion upto August 1987.

Factors in the Budget Making

To make a transition to a new era against an economic and social background, as described above, must necessarily prove a tremendous challenge. It is a complex task of having to reconcile several conflicting objectives.

- How to allocate sufficient funds for poverty alleviation while the security situation in the country continues to demand a sizeable budgetary allocation.
- How to find new resources for the budget from those who have had the opportunities to accumulate incomes under the liberalised economy; that is, the top 10 percent or so of the income earners as well from those having hidden incomes (black economy) while not creating disincentives for private investment.
- How to minimise the recourse to inflationary sources of financing and in general restrain demand pressures which could upset the budgetary calculations (as happened in 1988) as well lead to external imbalances.

In short the challenge that the budget making faced in 1989 was how to maintain a substantial measure of external and internal economic balance (avoidance of domestic inflation as well as deterioration of balance of payments) while meeting the resource demands of poverty alleviation and the security situation as well as maintaining an adequate climate for private investment.

The budget has attempted to strike a balance among these competing/conflicting objectives. What has emerged is a compromise. The viability/sustainability of this budgetary exercise can be tested only when events begin to unfold as the year progresses.

Inflationary Impact

According to the budgetary estimates, although the overall budget deficit is of a massive magnitude of the order of Rs. 53 billion, recourse to bank-borrowing (inflationary sources) would be for a relatively small fraction of the order of Rs.3,395 million or 6 percent of the total deficit. As the Finance Minister has put it, "this is just a little over one percent of the projected GDP for 1989 and should not therefore cause any significant threat to financial stability."

In making this calculation, it has been assumed that (a) foreign loans would be available to the extent of Rs.18,000 million and (b) domestic loans from non-inflationary (non-bank) sources could be raised to a level of Rs.17,000 million. These figures, however, appear to be rather optimistic assumptions in the light of the actual budgetary performances on both these fronts in the past few years. (See Table below).

FINANCING THE BUDGET DEFICIT

In Rs. Millions

Year	Foreign loans	Domestic borrowing from non-bank sources	Domestic bank borrowing
1985 *	7,109	3,858	4,711
1986 *	9,061	6,096	3,047
1987 *	5,716	7,815	3,541
1988 *	7,319	10,163	10,996
1989 **	18,000	17,000	3,395

**Actual ** Estimated

As seen in the above table, the anticipated foreign loans in 1989 are nearly 150 percent more than that in 1988. A portion of these loans would be for rehabilitation and reconstruction purposes. Their actual utilization would however depend on the ground situation - that is, existence of peaceful conditions conducive to reconstruction.

The anticipated non-bank domestic borrowing in 1989 is more than two-thirds higher than that in 1988. The popularization of Treasury Bills as an attractive short-term investment appears to be the basis of this optimistic calculation.

However, any failure to realize the anticipated amounts from foreign and domestic non-bank sources (as happened in 1988) would invariably mean a corresponding increase in the recourse to bank financing with consequent inflationary implications.

Even without such a possibility, there is an expectation of a general price rise following the upward revisions of the BTT rates and other indirect taxes for a whole range of commodities. A number of trade unions have in particular commented on the possible inflationary consequences arising out of changes in indirect taxes; as the budget gave rise to a wave of expectations on a possible rise in the general price level.