SRI LANKA

HOUSING FINANCE STUDY

MARCH 1982

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

FOREWORD

This study was conducted in 1981 by the National Savings and Loan League under the auspices of the Office of Housing and Urban Development of the Agency for International Development and through funding provided by this office. The purpose of the study was to develop information and set forth the possibilities that exist for the Government of Sri Lanka to influence the expansion of housing finance.

The report was prepared by a team of consultants who spent three weeks in Sri Lanka in December 1981. The team was headed by Donald Gardner of the National Savings and Loan League. Additional members were Samuel Peck of the National League, Pradip Shah of the Housing Development Finance Corporation of India, and Bessy Kong of A.I.D.'s Office of Housing and Urban Development. Professor Charles Haar of the Harvard Law School assisted with the preparation of some of the legal background affecting housing finance.

While the report has been discussed with representatives of the Government of Sri Lanka, the report is not to be interpreted as an official position of either the Government or the Agency for International Development.

It is hoped, however, that the Government of Sri Lanka will find the report and its findings useful.

Peter Kimm

Peter M. Kimm
Director
OFFICE OF HOUSING
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VOLUME I

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I. INTRODUCTION

The approach to this study of housing finance in Sri Lanka was to be on a two phase basis: initial field work for the gathering of information and data with preliminary analysis followed by the dissemination of the report prepared from the field work to a small group of experts and AID Office of Housing personnel for consideration of the findings. Out of this would come any recommendations which could be developed.

The scope of work on which the study was based in Annex 1 to this volume. The report containing the results of the field work is published as Volume II of the study.

The study has been done by the National Savings and Loan League through its contract with the AID Office of Housing and was under the overall direction of Mr. Philip Gary, the Office of Housing's Advisor stationed in Sri Lanka. The field work was done in December 1981 and the report distributed in mid-January 1982.

The group of experts who participated in the discussion of the field report included Dr. James Christian, Chief Economist of the U.S. League of Savings Associations; Dr. Bruce Ricks, private consultant and Mr. Dennis Berlin, private consultant along with Donald Gardner of the National Savings and Loan League who was responsible for the field work and preparation of that report. Also participating and representing the Government of Sri Lanka were Dr. S. Rajalingam, Director of Economic Affairs, Ministry of Finance and Planning and Mr. Disa Weerapana, Additional Director, Projects and Planning, Ministry of Local Government, Housing and Construction. A comprehensive list of all participants is contained in Annex 2 which is a summary of the discussions.

Mr. Peter Kimm, Director of the AID Office of Housing, in his introductory remarks to the discussion meeting, set the tone for the meeting and this final report when he said that there was no specific goal to be achieved, but rather there should be a concentration on the exchange of ideas. This was reiterated at the close with the conclusion that such a two-day "seminar" constitutes a basic first step in dealing with the problem; at a later stage and as you proceed, details to an approach are worked out. The above reflects the competing economic, social, political, and bureaucratic forces at play in anything as complex as housing finance precluding any quick and easy answers.

This report, however, attempts to set forth the possibilities that exist for the Government of Sri Lanka to influence the expansion of housing finance, presenting realistic alternatives which recognize certain constraints. It was indeed evident from the discussions that there were distinct pros and cons to the different possible courses of action and that the chief value to the study at this stage lay in getting the issues out on the table and getting several days of uninterrupted concentration on these issues.

II. THE EXISTING FINANCIAL STRUCTURE AS IT RELATES TO HOUSING

In effect, no organized system for providing housing finance now exists in Sri Lanka at a level that can assist in dealing with the expanding housing problem. Pieces of a system do exist scattered throughout the institutional structure in Sri Lanka, but not in a way that can be brought meaningfully to bear on the problem. There is no institution or group of institutions in Sri Lanka similar to the savings and loan system in the U.S. or the building societies in the U.K. That is, no institution which takes in deposits and mobilizes resources with the primary aim of providing long-term housing finance to its clients.

With regard to resource mobilization, the commercial banks are the largest as a group with time and savings deposits of Rs. 13.7 billion as of September 1981. The government-owned National Savings Bank (NSB), utilizing its extensive branch network and that of the postal system, mobilizes substantial savings (assets over Rs. 5 billion). Two other government organizations, the Employees' Provident Fund (employer/employee contributions by law and slightly over Rs. 1 billion of new investments in 1980) and the Insurance Corporation (Rs. 2.7 billion of life insurance in force at the end of 1980) also mobilize substantial resources. However, all three of these institutions invest primarily in government securities or in the debentures of government corporations or agencies even though, for instance, the NSB could invest up to 40 percent of its resources in housing loans and the other agencies could also make other investments with government approval.

One newly created institution, the Employees Trust Fund (ETF) will require employers to contribute 3 percent of employee wages to a Fund that will make equity investments. ETF, when fully underway, will bring in some Rs. 12 million per month. Finally, there are some company and voluntary provident funds which attract some resources and finance companies, which also take in deposits, but they don't represent major sources.

With regard to capital markets and the possibility of mobilizing resources through some secondary market; there is no formal stock exchange in Sri Lanka but, rather, an informal, over-the-counter Colombo Share Market which has operated for many years. The market is a very narrow one but included in a share list for December 1981 are many government bonds as well as debentures for the SMIB and the NHF which sell for considerably below par to reflect current interest rates. In effect, there is no secondary market available for mortgages or housing bonds at present, even if backed by mortgages, because of the level of interest that government lenders (SMIB and NHF) are lending at.

With regard to the provision of housing loans, the State Mortgage and Investment Bank (SMIB) is the only institution in Sri Lanka primarily devoted to providing this type of finance. It is a wholly government-capitalized institution which began operations in its present form on January 1, 1979, resulting from a merger of the State Mortgage Bank and the Agricultural and Industrial Credit Corp. Both of its predecessors go back some years. For all intents and purposes, it is really a housing finance institution. Its current level of operations is at Rs. 60 million annually with a portfolio of about Rs. 128 million at the end of 1980. It raises its money through the issuance of debentures, the level and interest rate determined by the MOF. Because of the current interest rate it pays, 16 percent, all of its recent debentures have been purchased by the NSB, EPF and the Insurance Corporation, not by the public or by private corporations. Its loans for housing range from 12-18 percent with loans for the purchase of property going up to 22 percent.

It operates with a headquarters and two branches in the Colombo area but makes loans countrywide. Repayments can be made through the Bank of Ceylon branches.

As can be seen when comparing its operation with the government's direct programs which were close to Rs. 1 billion in 1981 and, historically, the commercial banks which had outstanding housing loans of about Rs. 875 million as of mid-1981 (see below), it is relatively small. Servicing has resulted in slow payments, but defaults are rare.

The NSB which, by law, could be a big housing finance operation (up to 40 percent of its assets, Rs. 5.2. billion in deposits at the end of 1980, could go for housing loans but, in fact, almost all goes for government securities or government agency obligations). Therefore, it doesn't have an experienced staff for housing finance operations and it is unlikely that government would free-up its resources in a major way--it's too much of a key to the government's overall financing needs.

The local commercial banks (Bank of Ceylon, People's and Hatton but excluding Commercial Bank) were significant lenders for housing up until about mid-1981 (see Conclusions Section). At that time BOC had outstanding housing loans of Rs. 324.6 million, People's Rs. 530.8 million and Hatton Rs. 17.9 million.

As far as could be ascertained, the commercial banks, even when engaged in housing finance, did it more as a service to clients, at least in later years, than as a profit-making venture and by the time they quit (mid-1981) loans were being made at less than the cost of money. This is still true of People's contract savings program where the loans are made at 15 percent.

However, by far the largest amount of housing finance at present comes from the government's own direct financing programs, i.e., loans made and administered by the National Housing Development Authority (NHDA) and the National Housing Department (NHD) which manages the National Housing Fund (NHF) loans. These programs are running between Rs. 700-800 million per year at present.

Government programs for housing fall into four broad categories with financing unique to each category: the Aided Self-Help (ASH) Program, primarily in rural areas, which provides financing for a package of building materials in the neighborhood of Rs. 25,000 at payments of Rs. 50 per month for 30 years (this represents a <u>zero</u> interest rate and does not even recover the full capital costs); the urban-oriented Direct Construction Program of apartments with prices going as high as Rs. 1 million per unit and interest rates varying from 6 to 12 percent depending on cost (although a recent project was being offered at 18 percent); the Urban Loans Program to finance houses for families owning their own land and with interest rates at a maximum of 9 percent; and the Slum and Shanty Upgrading Program, a new and as yet small program, which provides for upgrading infrastructure in these neighborhoods but as yet doesn't provide for improving the house.

In addition to these programs, the government maintains a rental stock of approximately 5,000 units. Furthermore, as best can be determined, cost recovery on government programs, both its loan programs and rentals, is extremely poor and is non-existent on the upgrading (see separate housing subsidy study).

Finally, to complete the picture there is some housing finance done by finance companies, the Insurance Corporation, private provident funds and company-assisted housing finance for employees. These are all relatively small in the overall scheme.

This is the structure that now exists on which to build an expanded housing finance system. Such an expanded system includes the possibility of a brand new institution(s) concentrating solely on housing finance, either a government housing bank and/or a private institution or some type of joint venture.

III. FINDINGS

It appears that (1) with the government's continuing level of deficit (1982 budget projection of a deficit of Rs. 21.1 billion and a final 1981 estimate of a deficit of Rs. 14.2 billion), (2) the resulting credit squeeze and the government's need to preempt almost completely its major "captive" sources of finance, i.e., the National Savings Bank, the Employees' Provident Fund and the Insurance Corporation of Sri Lanka, and (3) historically high interest rates, e.g., 22 percent for two-year fixed deposits, growing out of both the deficits and the need to attract savings into NSB, the availability of long-term housing finance for the private sector has almost dried-up.

The commercial banks have almost ceased to make housing loans (People's may still be making a few growing out of its contract savings plan) opting instead to use their available resources for more profitable short-term loans or utilizing the Central Bank's refinancing facilities for government-designated priorities of which housing is not one (at least in terms of Central Bank refinancing). There is also a perception among bankers that you can't make long-term housing loans above 15-16 percent; people won't borrow at higher rates or, if they do, repayment will be a problem.

The State Mortgage and Investment Bank, with its level of resources controlled by the government, will make housing loans in 1981 of only some Rs. 60 million. This is not a significant amount given the overall need. SMIB, incidentally, and contrary to some of the commerical bankers' opinions, reports a strong demand for its 18 percent housing mortgages (loan amounts between Rs. 100,000 and Rs. 200,000).

The National Savings Bank which, under its law, could invest up to 40 percent of its total assets in housing loans, in fact has less than 2 percent of its new investments going into housing (although it does purchase some SMIB debentures).

The Employees' Provident Fund does not allow withdrawals until age 55 (with minor exceptions). Thus, this source (its equivalent in India allows withdrawals by individuals to finance a home) is not available for housing finance until an individual is well along in his/her career.

The other major potential source for private individuals is the Insurance Corporation. Here, a policyholder can get a housing loan up to two times the face value of the policy. But the average policy is only about Rs. 15,000 so the loan available for housing is too small to be significant.

Other than direct government programs (see below), the remaining sources of housing finance available to private individuals are through company provident funds, personal short-term loans from commercial banks, family assistance, private borrowings (if available, again short term) and finance companies (also short term). These sources are usually for amounts that are small and/or high interest with a short term or reach only a small number of people.

When a family can affort it, it often pools the above sources to provide the difference between personal savings and the cost of a house, but the financing payments can be steep. Bear in mind that some 50 percent of Colombo's population resides in slum and shanty areas and, in the case of the latter, squatters build on illegally occupied land on a piecemeal basis).

When the new Public Investment Plan was put forth in 1977, it envisioned the government programs as providing 100,000 units over the ensuing six years and the private sector producing another 400,000; however, the private sector has not met its target. Although escalating costs have been a factor, the lack of long-term housing finance has contributed. Private developers, except for isolated cases, have almost ceased to operate because there is no effective demand. It does appear, however, that construction financing would be available from the banks for reputable builders if they were developing projects with long-term financing available.

Thus, with a limited resource pool in Sri Lanka and the government running sizeable deficits, the government has chosen to control the use of its "captive" resources very closely and to channel funds into housing only through the approval of limited debenture sales by SMIB and through direct allocation of budgetary resources to the NHDA or, in a small way, National Housing Fund resources.

The end result is that the direct government programs, which provide their own long-term finance, offer the best hope at the moment for most lower and lower-middle income families to get a house financed. However, the continuance of these programs at current levels is under severe pressure due to the budgetary constraints.

Rural families, when not able to get an ASH house, build their houses incrementally as they can afford. The urban poor, with the exception of the just beginning slum and shanty upgrading program and a small pilot program for building materials loans through Save The Children Foundation, squat illegally in "shanty" areas or overcrowd the existing slums. The "middle class," spanning a broad range of incomes, also wind up in multifamily households until they are able to obtain financing through one of the mechanisms outlined above.

Thus, the situation in Sri Lanka is that the need for housing, estimated to be on the order of 50,000 units annually in urban areas and perhaps double that in rural areas, is not being met. Some way of expanding the availability of long-term housing finance must be found if Sri Lanka is to begin to solve its housing problem.

It would appear, however, that any expansion of the housing finance system would have to come at the expense of competing demands by the government on the existing pool of resources and this doesn't appear likely. It does not appear that there are substantial untapped resources available in the economy. That is, a major effort by the SMIB, the commercial banks, or a new housing finance institution to attract new funds into housing would be simply a shift of resources from one pot into another. One answer might be the more effective use of resources.

However, despite the limited resource base in Sri Lanka, the Study Team found tremendous interest in Colombo, among government and private sector individuals, in setting up some sort of new housing finance bank with a private orientation. The feeling seemed to be that such an institution would be much more effective in its operations than a government institution and could raise deposits if people saw the opportunity of eventually obtaining a mortgage, i.e., an institution with which they could identify.

IV. ALTERNATIVE APPROACHES

A. FRAMEWORK

If one accepts the premise that there is a shortage of housing in Sri Lanka at most income levels (except perhaps the highest) and that this shortage is growing and, furthermore, the lack of long-term finance is one of the problems contributing to this shortage, the question then becomes what can be done to address the housing finance problem. The alternatives set forth in this section deal with that question.

The alternatives do not deal with the broader issue of whether the government should allocate a greater share of its existing resource base to housing, i.e., move housing up the scale of priorities. In fact, it is evident that there is not going to be a significant shift of government available or controlled resources into housing; the trend is the other way.

In dealing with this issue what must be looked at is whether there is an additional source of resources that can be tapped and/or whether the existing sources can be used more efficiently.

To summarize, the main considerations being faced when looking at a new or expanded housing finance system are:

1. Mobilization of Resources

2. The Institutional Structure

3. Lending Instruments

During the workshop there was some disagreement over the order in which these considerations should be addressed, the major difference being whether the institutional structure question should be addressed first and then the question of new and/or modified lending instruments dealt with or whether the two are so closely interlocked that they should be dealt with together. This final summary doesn't settle this issue but because more time was spent in the workshop on institutional matters, that is given more emphasis in the following discussion.

B. RESOURCE MOBILIATION

Several approaches to increasing government-controlled resources for housing finance present themselves. One, the government could approve a higher level of debenture issues by the SMIB, directing their purchase by NSB, EPF and/or ICSL. A variation of this would be to sell mortgages or mortgage-backed bonds to those institutions. Two, the government could shift some of its budgetary allocations now going to NHDA to SMIB in the form of increased capitalization. Three, the government could direct commercial banks (the two largest are government-owned) and/or the NSB to lend a percentage of their resources for housing or in the case of commercial banks, add housing to the refinancing availabilities of the Central Bank. Four, the government could permit or encourage the new Employees' Trust Fund to make equity investments in a new housing finance institution. Five, the government could provide tax benefits to savings in a housing finance institution (new or SMIB) similar to that currently available to NSB savers recognizing that this would be another way of shifting existing resources.

Since what we are talking about is not increasing total resources, just shifting them in some way, the rationale must be that this will result in a more effective utilization of these resources (staying away from the broader and more controversial issue of whether resources for housing should be increased at the expense of some other sector than the resources now going into housing). That is, if there is a shift of resources to housing finance from some other use, in whatever manner, and the government wants to limit the total resources going into housing, then direct government housing programs should or could be cut. The idea is that expanding the availability of housing finance to an institution lending to the private sector will result in a more efficient use of the resources than through direct government programs.

If this idea is adopted, a conscious policy decision must be made to limit the direct government housing programs by some amount without, however, reducing beyond a certain point because of the need to provide some level of assisted government housing. Another approach would be to shift the financing function in direct government programs, i.e., the making of housing loans and their servicing, to financial institutions and have the NHDA act only as developer/builder/administrator of government housing programs.

With regard to raising resources from the private sector, it should be pointed out that a number of individuals felt that the creation of a new deposit-taking housing finance institution would attract considerable clients if they could identify with such an institution as a possible source of a house loan. Further, that this could well attract additive overall resources not now going into the financial system. No information or data is available to support such a conclusion and it could well be that a new institution, while attracting deposits, would simply take them from existing institutions in which case it would just fall into one of the above categories. If SMIB were to take in deposits, it might also be able to achieve greater identification with its clients.

The major problem facing a new housing finance institution in the private sector would be the mobilization of its capitalization. Although there appears some enthusiasm for such an institution, there also appears to be an assumption that some considerable capital would come from government, either directly (NHF allocations) or through some government-controlled organization (e.g., ETF), and either as equity or loan. However, there was also real skepticism on the part of some that private funds would be invested in a new housing finance institution given the current level of interest rates to attract funds and what interest rate could be charged on mortgages. It is considered possible, though, that a broad range of private institutions could be tapped for relatively small amounts.

Finally, mortgage-backed bonds could be sold to the public or to private sector institutions by a housing finance bank (again, SMIB or a new one). With very little in the way of a capital market in Sri Lanka at present, this would probably be difficult to launch right now.

With regard to attracting individual deposits, some expansion of the contract savings concept should be considered. People's administers such a program now with limited success even though it's paying 22 percent and lending for 15 percent. Obviously, this approach isn't viable. The approach should be reversed with lower rates for savings with the reward being a mortgage. There are a number of variations of contract savings schemes and this should be studied in more detail.

Any housing finance institution should also have a fairly broad-based branch network it it is to attract individual savings.

C. INSTITUTIONAL STRUCTURE

Institutionally, expanding the availability of housing finance can take the form of increasing the capacity of the existing institutions now involved in housing finance and/or creating a new institution. The assumption is that these considerations will exclude the NHDA which currently acts as a housing finance institution for government produced or financed housing; that for the reasons cited in this report and others (subsidy study and Shelter Sector Assessment) NHDA and NHD should divest themselves of their housing loan administration roles (see below). The institutions involved in the considerations, therefore, are the SMIB, the NSB and the commercial banks.

The NSB, as one of the government's major sources of financing, with almost all of its resources going for that purpose (albeit with some of these resources used to purchase SMIB debentures) and with limited staff capability to make and service mortgage loans, should not be considered for an expanded role as a primary lender for housing. It can continue to be regarded as a potential purchaser of SMIB debentures, mortgage-backed bonds or mortgages as a secondary source of housing funds depending on government's other needs.

The commerical banks are not currently lending for housing (except People's small contract savings program) because of the high interest rates to attract deposits, the apparent feeling on the part of at least some management that housing loans can't be made above 15-16 percent, the greater profitability of industrial/commercial credits, both in terms of spread (its obviously negative now in mortgages) and the short-term nature of these credits. Fifteen or twenty-year terms for mortgages in a time of high and volatile interest rates is not appealing to the commercial banks. Finally, housing is not a priority lending sector as set by the Central Bank and its refinancing availabilities.

However, the commercial banks have the experience and capability, they've been major lenders for housing in the past and they do perceive a need on the part of their clients to provide mortgages. Therefore, they could be a factor in expanding the availability of housing finance and they could presumably do it efficiently. Whether or not they would be interested in participating beyond their immediate clients is not known. It was stated that people at the middle and lower end of the income scale do not identify with the commercial banks.

It would appear that for the commercial banks to again play a major role in the provision of mortgages, some facility would have to buy or refinance these mortgages as a secondary lender with the banks continuing to service the mortgages. This could be the Central Bank as it does for other sectors.

This, then, raises the issue of the proper role for SMIB, and, relative to government, whether it should create a new institution to deal with housing finance on a more comprehensive basis or whether it should improve the existing institution. Institutionally, there appear to be three factors that need to be addressed: the need for some secondary lending facility; the need for some type of regulatory function for housing finance; and the need for a banking-type institution to handle the long-term financing function of direct government programs rather than the NHDA and the NHD.

Certainly, there is much to argue for SMIB being utilized in some modified and/or expanded way. It is the government's existing housing finance institution. It has an organizational structure with trained staff and such staff are hard to come by in Sri Lanka. If the GSL were prepared to increase somewhat the level of debenture issue by SMIB (Rs. 100 million has been suggested for 1982) at a higher level of interest and to increase its capitalization as well as transfer some of the current government budgetary allocation for housing to the SMIB, SMIB could utilize a part of the increased resources for the purchase of mortgages form the commerical banks or other institutions, e.g., finance companies.

SMIB could continue to operate as a primary lender with a part of its resources, at least for the immediate future. All mortgages and home loans now being serviced by NHDA and NHD should eventually be turned over to SMIB and no more new loans (either from NHDA new construction or from National Housing Fund resources) should be made by these institutions, but instead by SMIB.

There was some strong feelings expressed that SMIB should get out of the primary lending business; that it should turn over both the origination of mortgages and the servicing of its portfolio to a private institution(s). This doesn't appear feasible at present from a governmental standpoint or from the standpoint of who would pick up the function. It would be unlikely that the commercial banks would want the SMIB portfolio and highly unlikely they would want to pick up the NHDA/NHD portfolios. Yet it is important that the latter be serviced by a financial institution.

Therefore, the solution that presents itself as most practical at present would be for SMIB to take on a broader role as both a secondary lender and to continue to carry out its functions as a primary lender including the financing of direct government programs. It would also begin to assume the powers of a regulatory agency with regard to housing finance in Sri Lanka. As time went on, it could increase its role as a regulatory institution and secondary lender and decrease its responsibilities in primary lending if there appeared to be justification for this.

As part of the process for this expanded SMIB role, there would have to be a detailed study of functions that SMIB should take on. The organizational and procedural study supposedly underway would have to be broadened to take new functions into account and, among other things, staffing needs assessed. Assuming that the primary lending role would continue for the present; in fact, be expanded to take on the direct government programs, SMIB would have to establish selected branches around the country.

To play such a role, SMIB would have to increase its resources other than increased debenture issuing authority and government allocation. Consideration should include, for instance, raising funds by deposits of various sorts and by issuance of mortgage-backed bonds.

With regard to the creation of a new housing finance institution, from the government standpoint the SMIB should be expanded rather than create a new govenrment institution. However, the possibility exists for the creation of a private housing finance institution. As was stated earlier, there appears to be support for such an institution although there is skepticism that private investment would be made available.

Such a decision, i.e., to create a new housing finance institution, should be left to private initiatives. If private investment does not see an adequate return, then the institution should probably not be created. However, there does appear to be a role for such an institution.

First, and as has been mentioned earlier, many families do not identify with the existing institutional structure, particularly the commercial banks, as serving their needs. Therefore, a housing finance institution devoted to that purpose could develop a broad base of clients, not only as potential borrowers, but savers as well. People do save for the opportunity of buying a house and there is a relationship of the rate of savings with the probability of getting a house financed. Finally, if there is some merit over the longer term (and this hasn't been established yet) in ultimately having the SMIB get out of primary lending other than government programs, then a private housing finance institution could play that role along with, possibly, the commercial banks.

Therefore, the government could encourage the creation of a privately-oriented housing finance institution. It could do this in several ways. One, it could contribute to the capitalization in a modest way but not so that it was in a position to exercise significant control. Since the Bank of Ceylon has played a lead role in the idea of a housing finance institution, it could further encourage, or at least not discourage, this effort, both on the part of the BOC but People's Bank as well. It could permit the new Employees' Trust Fund to make an equity investment. Foreign commercial banks could be encouraged to take small equity positions. Finally, SMIB could purchase mortgages to enable a new institution to expand its operations more rapidly.

Depending on what role government finally evolves for SMIB, government should enter into a dialogue with those private interests, but including government institutions run on a profit basis such as the commercial bnaks, who are interested in forming such a housing finance bank. If the idea moves forward and appears to be sound, government should then be prepared to approve.

D. LENDING INSTRUMENTS

The conclusion of this report is that Sri Lanka needs to make its basic institutional decisions with regard to housing finance first before beginning to deal with the complicated issue of different types of new lending instruments. This recognizes that there was some difference of opinion on this among the experts but also recognizes that, at present, the commercial banks are making no new mortgage loans (People's contract savings plan being the minor exception), that SMIB is a relatively small operation, and that financing under the government's highly subsidized operation isn't the place for innovation. Therefore, the institutional aspects appear paramount.

In fact, it was pointed out that standard mortgage practices have been in place in Sri Lanka for some time, are conservative, and it would be difficult to introduce new concepts. However, the institutions now making long-term housing finance loans in Sri Lanka at present, whether government-owned or not and those which are potential lenders (commercial banks and a new institution) face the same problems of mobilizing resources and making loans with interest rates at high levels that are being faced elsewhere. Therefore, there most be attention paid to adapting or trying out new instruments that may be applicable to Sri Lanka. At the moment, the SMIB presents itself as a place to start.

Finally, to make lending more attractive to the commercial banks and any new privately-oriented housing finance institution, some sort of mortgage insurance needs to be provided, probably by a government agency initially.

E. SUMMARY OF GOVERNMENT OF SRI LANKA REPRESENTATIVES' VIEWS

At the conclusion of the seminar, and based on the rather wide-ranging discussion and variety of approaches suggested, the GLS representatives outlined an approach, or series of steps, that they felt the government might be prepared to consider while recognizing that it did not represent official government position.

It appears clear that there will be steps taken to improve the housing finance situtation in Sri Lanka. However, it also appears clear that for the immediate future the emphasis would be on strengthening and expanding SMIB.

To start, SMIB would continue to carry out functions as a primary lender for housing and that it would (should) probably drop its other lending activities, i.e., agriculture and industry. However, there would be support for SMIB taking on the functin of a secondary lender for housing mortgages and eventually assume the role of a regulator of housing finance. The government would give consideration to increasing the level of debentures SMIB could issue (the figure of Rs. 100 million for 1982 was used) and make available the Rs. 45 million of loan funds from the government now going to the National Housing fund on an annual basis to SMIB.

In addition, the mortgages now being serviced by the NHD and NHDA could be turned over to SMIB. In the case of mortgages made from NHF funds, SMIB could keep the re-flows, even though NHF funds are Treasury loans, because with the loans considerably in arrears Treasury isn't being repaid anyhow. In the case of NHDA loans made from its budgetary allocations, some appropriate arrangement would have to be worked out.

Mr. Rajalingam said that he felt you needed to build an expanded institution one step at a time, not only with regard to resources, but with regard to operating efficiency. SMIB needs to be examined with a view to making administrative changes to strengthen its operations. In summary, SMIB could raise funds by deposits, increase the issuance of its own debentures (perhaps at a rate closer to market), set up a branch network, become more like a true bank and compete for savings.

As this process proceeded, different types of lending instruments could be considered, problems such as titles and title insurance addressed, mortgage insurance considered; in short, look to improving the entire system. With regard to the possible creation of a new privately-oriented housing bank, this would probably get government approval if the capital were raised in the private sector. Government participation couldn't be assured.

The importance of taking initial steps in the near future and looking toward improvement in the overall situation as soon as possible was stressed.

V. FINAL CONCLUSIONS

As was stated earlier, the evolution of this study with participation in it by both outside experts and GSL officials and recognition of the complexity of housing finance systems, pointed more toward opening a dialogue, the identifying of issues and alternative approaches, and agreeing on some first steps rather than producing a concrete set of firm recommendations. It is hoped that this study will, then, make a contribution toward the eventual improvement of the housing finance system in Sri Lanka by a concentrated focussing on the issues.

It seems clear that, with a limited resource base form which to draw on and a growing housing problem, a more efficient and effective utilization of the resources available for housing is a must. By improving the existing housing finance system as a starter, Sri Lanka would take an important step in this direction.

Specifically, by transferring decisions on types and levels of housing increasingly to private individuals and developers (from government programs), the resulting housing would be what people wanted and what could be afforded. The provision of adequate long-term finance is essential for this. In addition, the transfer of the servicing of existing NHD/NHDA mortgages to the SMIB, a rather simple procedure, should result in improved cost recoveries since at present cost recovery is extremely low.

Finally, it is recommended that the financing of direct government housing programs in the future be through an expanded SMIB by loan from Treasury rather than as a budgetary allocation to NHDA.

These steps could immediately improve the effectiveness of government housing programs and provide an expanded base of operations from which SMIB could increase its role. From this point additional steps could be taken to expand SMIB's role as a primary lender and depository institution and to take on the larger roles of secondary lender/housing finance regulator.

Government could simultaneously support efforts by private investment to create a new housing finance institution.

As a next step it is recommended that the government reconvene its committee to examine housing finance and, using this report as the basis, consider the alternative approaches set forth.

A N N E X E S

SCOPE OF WORK FOR SRI LANKA HOUSING FINANCE STUDY

I. PURPOSE

To provide a complete description of the existing system for providing financing for housing in Sri Lanka, government and private, banking and non-banking, construction financing for development and long-term financing for the homeowner; to assess the strengths and weaknesses of the system as a whole and the institutional and other sources of housing finance; and to make recommendations and/or present alternatives for consideration to improve the system.

II. BACKGROUND

The Sri Lanka Development Plan allocates approximately 80 percent of housing investment to the private sector. In fact, it appears that this goal is not being met. The current government in 1977 launched a major initiative to produce and finance housing by the public sector ranging from the upgrading of slum and shanty areas through aided self-help housing for poorer families up to expensive housing for more well to do families.

Even allowing for the construction of shanties by poor individuals to count as private sector housing, it does not appear that the private sector is producing housing at a rate comparable to the public sector.

In addition to the shortage and high cost of land and the rising cost of construction which have priced housing beyond the reach of most families, the lack of significant long-term housing finance has also acted as a constraint. With the exception of the government's financing of its own programs, there is little in the way of housing finance available. The government's Housing Loans Program, which was to provide for long-term housing loans for individuals owning their own land from National Housing Fund resources, ceased to operate in early 1980 because of a lack of funds.

The State Mortgage and Investment Bank (SMIB), which gets its funds from sale of debentures to government, has only a limited availability of funds. (New loans approved in 1980 amounted to Rs. 26.9 million).[1] The National Savings Bank allocates only some 5 percent of its resources to housing finance, the rest going to government in some form. Both the People's Bank and the Bank of Ceylon, government-owned commercial banks, do a small amount of mortgage lending but it is believed this goes mostly to employees. The activity of the other two local commercial banks, both private, in housing finance isn't known. Construction financing for housing projects is also reportedly in short supply.

1/ Exchange rate in September 1981 was approximately $1 = Rs. 20.

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Approximately one year ago a committee was formed by the govenment to look into the feasibility of creating a new housing bank. This committee's work is currently in abeyance. Nevertheless there is a clear interest on the part of the Ministry of Local Government, Housing and Construction (MLGHC) in creating such an institution.

III. SCOPE OF WORK

A. EXISTING SITUATION

1. The Banking and Financial Sector

This should be a relatively brief and concise description of the banking, financial and capital markets sector and should be couched so as to set the framework in which housing finance now takes place and in which an expanded housing finance activity could take place.

The contractor should obtain copies of the pertinent banking laws, rules and regulations, reserve requirements, etc., and should describe government's supervisory role and its organizational make-up to play this role, both the Ministry of Finance and the Central Bank. To the extent possible the study should also analyze government's overall philosophy toward banking in general, both toward government-owned banks and private banks, and the role of housing finance in the banking sector.

The study should also contain a brief description of how the government finances its debt and what it pays on this debt.

The contractor should briefly examine the extent to which there is a capital market, including methods for issuing bonds, in Sri Lanka and government's plans to create a Colombo Stock Exchange.

2. Government Housing Programs

Considerable information is available on government housing programs and the financing terms to beneficiaries in the USAID Shelter Assessment of late 1980 and the recent Housing Subsidy Study.

This study should contain only summary descriptions of these programs, incorporating the rest by reference, for comparison with the housing finance activities described in detail in the study. Special attention should be given to the raising of capital by government housing and urban development organizations, not including financial organizations, outside of government budget allocation, e.g., sale of debentures by the Urban Development Authority.

3. Institutional Analysis

This part of the study should contain a complete description of all institutions in the banking and financial sector; institutions which engage in housing finance activities, institutions which take in savings from the public or institutions which in some way have an effect or potential effect on housing finance activities, e.g., insurance companies, trust funds, provident funds, etc.

a. Commercial Banks: The study should provide a complete but overall description of each of the four major commercial banks operating in Sri Lanka:

Bank of Ceylon
People's Bank
Commercial Bank of Ceylon
Hatton National Bank

This should include the legislation governing (if any), capitalization, ownership, policies, resource mobilization, current activities, organization, coverage of country, staffing, and subsidiaries. Mention should also be made of any foreign bank branches which might have a significant role in domestic Sri Lankan banking.

Contractor should then provide a detailed description of any aspect of these bank's operations, including subsidiaries, which relate to the development or financing of housing.

b. National Savings Bank: As above, there should be a complete description of the operations of this bank with particular attention to the utilization of funds by Treasury. Here again, there should be detailed description of the Bank's housing finance activities.

c. State Mortgage and Investment Bank: This bank is a wholly-owned government bank which began operations in 1978. It was created by merging the State Mortgage Bank and the Agriculture & Industrial Credit Corporation. It now operates primarily as a home mortgage financing bank.

As such, the contractor should provide a complete and detailed description of the Bank's entire operations, policies and procedures. This should include an analysis of the Bank's relation and responsiveness to overall government housing policies and programs.

d. Other Financial Institutions: The contractor should examine other financial institutions such as insurance companies, trust funds and provident funds to determine the level of resources they attract, how these resources are applied, the extent, if any, to which housing is financed and the potential for financing housing. How are these institutions regulated?

e. Consumer Finance Companies: The contractor should obtain information on consumer finance companies such as The Central Finance Co. Ltd., and Mercantile Credit Ltd. to determine how and at what cost they raise funds, whether they lend for housing or housing-related improvements and any other pertinent facts relevant to this study. How are these companies regulated?

4. Market For Housing Finance

a. Housing Finance Gap: Based on existing statistics and the analysis outlined below, the contractor should develop an overall level of housing needs in the country and the amount of housing now being financed--government and private. From this, a rough order of magnitude of the gap that exists for housing finance should be determined.

b. Private Developers and Real Estate Brokers: The contractor should talk to a representative group of private developers or potential private developers to determine the degree to which they feel that the lack of finance, either for construction financing for their own operation or for the long-term financing for potential buyers, acts as a constraint. The contractor should attempt to elicit whether and at what level such developers might step up their operations if financing were available. In this connection other constraints such as availability of land or serviced land needs to be considered concomitantly.

Special attention needs to be paid to organization such as: (1) Property Development Limited, a subsidiary of the Bank of Ceylon, to determine if such a company or similar ones, are able to attract adequate financing from its parent; and (2) brokerage concerns such as the Real Estate Division of the Finance Co. Ltd. to determine whether or not they provide any financing services to their clients.

c. Private Individuals: Other than government programs such as the National Housing Development Authority (NHDA) and the limited financing presumably available from the SMIB and the commercial banks, how do individuals finance their housing now? Recognizing that this study cannot do any kind of detailed market analysis, the contractor should nevertheless attempt to determine whether and to what degree there appears to be a significant latent demand for long-term housing finance, particularly among middle-income families who could afford to pay market rates for long-term financing. Such analysis should be order of magnitude only.

The contractor should also ascertain the financing mechanisms, if any, and levels utilized by families in the informal sector, both urban and rural, in constructing their houses and shanties, either in squatter areas or on regularized land, e.g., money lenders, credit extended by petty contractors or building material suppliers, family sources.

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B. CURRENT GOVERNMENT VIEWS

Given the government's stated interest in considering the creation of a specific housing bank, contractor should give particular attention to the need for such a bank as a means of abbreviating the current shortage of long-term housing finance. The contractor should examine, to the extent possible, the deliberations of the housing bank committee, described in the Background Section, the types of issues that arose and the conclusions at the point at which the committee's work was interrupted. Views of other government officials should be sought and the current state of considerations assessed so that full weight can be given to this aspect in the final set of recommendations.

C. ANALYSIS, CONCLUSIONS AND RECOMMENDATIONS

This section of the study should contain the findings and conclusions of the contractor supported by appropriate analysis.

It should contain recommendations for improving and expanding the housing finance system in Sri Lanka when the contractor feels such recommendations can clearly be supported. Where the complexity of some aspects may not make it possible for the contractor to reach firm conclusions or make unqualified recommendations, the contractor, in such cases, should suggest areas where further and more detailed study should be undertaken.

Recognizing the above constraints, this section of the study should deal with the following issues although these are not necessarily all-inclusive:

State contractor's conclusions with regard to theneed for an expansion of housing finance resources in Sri Lanka and what form such an expansion might take e.g., creation of a new institution or expansion of existing mechanisms; more informal mechanisms outside of the formal institution structure; private vs. government.

The contractor should examine what income levels an expanded institutional structure should try to address, both initially and ultimately, i.e. who would the institution serve, who would its clients be? Should for instance, lower-income people be served exclusively by government programs run by NHDA or should some new bank, or modified existing institution try to serve poorer families, both urban and rural, as well. If not, can government programs adequately meet this need? Are there informal mechanisms which can be expanded, e.g., by providing formal financing to small contractors who in turn provide financing for poor families.

How can an expanded institutional structure obtain continuing resources; savings, or some form of modified savings such as contract savings, from households, institutional deposits, sale of debentures and to whom, and what impact would this have on existing savings institutions and on the utilization of these resources by others, particularly government? What is, say, the potential for secondary market funds from insurance companies, provident funds, etc.

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What kind of legislation would be needed to establish a new institutional structure, for instance, a bank or modification of an existing institution; how would government supervision be provided, the Ministry of Finance and, if so, what kind of policy guidance might be exercised by MLGHC?

Should an institution do construction financing for private developers or restrict itself to long-term financing for housing?

Recognizing that this is an area that might require further study the contractor hsould give its opinion on whether a new institution, if one is recommended or suggested, should be private, government or some mix and give pros and cons.

If an institution, if recommended, is to be private or mixed the contractor should look at likely sources of equity and, no matter whether government or private, the level of capitalization needed and the possible source of this capital, both equity and loan.

The contractor should look at the likely return required by equity investors, if any, and the likely cost of resources, both short and long-term.

If the institution is to be private, should there be mortgage insurance provided by government in order to permit lending with lower down payments or to poorer families?

Consideration should be given to a banking institution, new or existing, servicing for a fee existing NHF loans and loans growing out of NHDA programs i.e., direct construction and ASH, and have the NHDA play a strictly development role.

It may be that many of the issues listed above can only be identified by the contractor and proc and cons put forth for consideration by government with potential further study needed.

IV. TIMING AND METHODOLOGY

The study will be done on a two-phase basis. That part of the scope of work, i.e., Sections III, A&B, up to the conclusions and recommendations section would be done in three weeks of field work to include all of the data and information gathering contained in the scope. This will include discussions of preliminary findings with GSL officials and the USAID Housing Advisor. These findings and underlying analysis supplemented by all the information obtained would be written up in the form of a case study-type document after return to Washington. Washington time will be two weeks.

SRI LANKA HOUSING FINANCE STUDY

WORKSHOP

January 26-27, 1982

Participants: Philip Gary - USAID Sri Lanka Housing Advisor

Dr. S. Rajalingham - Director of Economic Affairs, Ministry of Finance, Government of Sri Lanka

D. Weerapana - Additional Director, Projects and Planning, Min. of Local Government, Housing and Construction.

Donald Gardner - National Savings and Loan League Consultant (member of field team)

Bessy Kong - Office of Housing (AID) (Member of field team)

James Grossman - Office of Housing (AID) Asia Backstop Officer

Bruce Ricks - National Savings and Loan League Consultant

Dennis Berlin - National Savings and Loan League Consultant

James Christian - United States League of Savings and Loan Associations Consultant.

Phil Jones - Consultant

Peter Kimm, Director, AID Office of Housing made brief introductory and closing remarks. In his introductory remarks he said that there was no specific goal for the meeting but rather a concentration on exchange of ideas.

The following is a summary of the remarks made during the discussions based primarily on notes taken by Phil Jones, Don Gardner and Phil Gary. The discussions lasted all day on January 26 and a half day on January 27. The participants had all received the background paper prepared from field work in December. That paper should be read in conjunction with these notes.

Phil Gary and Don Gardner made opening remarks to provide a further background to the discussions.

Dr. Rajalingam then made some initial comments relating to the paper and in general.

There are three main sources of funds for the Government, other than revenues, and these are "captive" resources for the government. Government agencies such as the State Mortgage and Investment Bank (SMIB) cannot go outside of government for a large amount of funds unless told to do so by government.

Rajalingam mentioned that the paper refers to "rumours" that IMF had required cuts in government expenditures. He said this was fact. Government expenditures have been cut in housing and in other sectors. These cuts are accepted within the ministries.

He said the problem in Sri Lanka is the limited size of the resource pool. He was concerned that the paper was an advocate for more housing finance (we said, no, the paper was intended to represent the situation, including views, as the team found them in Sri Lanka, not to prevent a case for increasing funds for housing in general or housing finance in particular and there might be other sectors more important at the present time).

He went on to say that he (hopes) these are temporary restraints, not to continue over a long term. Long term solutions (for housing finance) and new proposals should not be based on the present situation but should look at the longer term. He did say that he felt housing construction provided short-term employment and for this reason needed to be increased.

He corrected that point in the paper where it was stated that SMIB could not sell its debentures to the public and therefore the Central Bank purchased them. He said that Central Bank merely acted as agent for the government and that debentures were actually taken up by the National Savings Bank (NSB), the Employees Provident Fund (EPF), and the Insurance Corporation of Sri Lanka (CSL). He mentioned that the Urban Development Authority, in addition to SMIB, sold this type of debenture.

Dennis Berlin commented some on history of housing in U.S. and its special role in generating economic activity. He said it was not viewed as taking money out of one sector and putting it into another, i.e., agriculture vs. housing, etc.

Dr. Rajalingam responded that US is a developed economy. How could S&Ls divert funds? Not possible unless resources are increased. There could be no substantial diversion from the existing pool.

Gardner provided a brief background on the government's Public Investment Plan and the proposal by the new government in 1977 to finance 100,000 new housing units through government programs during the Plan period with the private sector building four times as many, i.e., 400,000. The question was posed that private sector was not fulfilling this role and that one of the problems was long-term housing finance.

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Dr. Rajalingam said that private institutions are not providing housing funds. Commercial banks have other higher priorities for their funds, i.e., private sector endeavors relative to industry, agriculture and exports.

Phil Gary asked what was the basis for the government assuming that private sector would build 400,000 units over the Plan period.

Rajalingam said that in 1977 government's two main projects from an expenditure point were the Mahaveli Multi-purpose Project and the Construction of 100,000 houses. But in 1980 there was re-thinking and changes because of budgetary and economic problems. Mahaveli is now contemplated to be a 15—year project rather than six years. There was a necessity to scale down expenditures on housing also. Other sectors were also being cut back (that is, in government programs). He said government wanted to encourage private sector to do more in housing. But he spoke of this in terms of SMIB financing private sector housing. (This is still really a government program as it is operated, however).

Christian said the new govenment budget appeared clear. That certain high priority items were being cut back. But you could use a housing finance system to mobilize new resources. In Sri Lanka it now appeared as if the NSB pre-empted the savings situation and it was a "captive" resource for government. New mechanisms would just compete with NSB. If you shift resources from one pot to another what have you done? According to some calculations that Christian had done, there is not much available in the way of savings in Sri Lanka that is not already tapped; maybe 10 percent. A new institution might be successful in a country if the untapped savings potential is 30-40 percent.

Gardner comment: But if you move savings from one institution to another, you might get much more effective use of those resources. For instance, there has been criticism of government's (NHDA's) direct construction program as being too expensive, uneconomic, non-responsive. ASH program is not recovering costs, etc.

Rajalingam said that MOF will encourage new mechanisms to improve housing finance. All long term lending in S&Ls has been on fixed rate basis. housing and other. This is not likely to change easily.

Ricks questioned subsidies, policies on collections, re-lending ability, lack of enforcement, etc.

Weerapana said there is a long history of subsidies in Sri Lanka. Sort of built in. No clear policy.

Ricks raised more questions on subsidies, etc. and asked how important are these things to a government seeking re-election.

Rajalingam said inflation and unemployment will be very important in election.

Christian spoke about housing finance considerations. Need to include secondary mortgage market.

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Developing countries usually consider only the primary system. In Sri Lanka it would be difficult to compete with NSB for savings.

Several choices face S&Ls on housing finance: Improve the present system (based on SMIB) or establish a new organization. For the primary system you could establish a branch network for SMIB aimed at households. Relative to a secondary institution, this ties into the existing commercial banks and lending for housing. But where would funds come from in a secondary approach by SMIB?

There is need to define realistic choices and eliminate those that are unsuitable.

Rajalingam said there would be no problem with creating a new institution in housing finance. (He did say as an aside he questioned whether private funds would be invested in a housing bank. In this sense he does not feel that Bank of Ceylon (BOC) is private; it's a government-owned bank It is also short of funds with its new headquarters building).

But, government agencies are not part of these private initiatives. SMIB is a government agency and will continue to be the only government agency doing public housing finance. (Gardner comment: Not quite sure what he was driving at here since NSB can make loans for housing, NHDA finances housing, BOC can engage in housing finance unless he is saying he (MOF?) would not support a new housing finance institution fostered by BOC). He went on to cite some statistics of increasing number of housing loans being made by SMIB and stated that even though it could make agricultural and industrial loans under its law that was not where it would be heading. He reiterated that it was MOF policy to support SMIB as the sole public housing finance agency.

As an aside it was mentioned that NSB pays 22 percent for fixed deposits and when it pays SMIB debentures it is only receiving 16 percent interest. Rajalingam said that government sets interest rates. There are no "market" rates (except for "black" money).

Gardner asked what is the purpose of SMIB relative to housing finance. What are its directions to be. Christian reiterated the question - what are government views for future of SMIB.

Rajalingam said to raise funds by deposits, issue its own debentures, set up a branch network (it does no advertising now to speak of), make it more like a commercial bank, maybe even compete with NSB for deposits.

Ricks suggested SMIB could be the "Central Bank" for housing.

Christian laid out the following scenario:

You could view SMIB as a secondary mortgage institution. You would not then need a new branch network. It would operate as an umbrella agency buying mortgages from the private sector and regulating housing finance. The primary system would complement the secondary.

You could set up a separate private institution from among banks or it could be mixed using existing and/or new personnel. Could compete with National Savings Bank on minimum basis but not really get on anybody else's turf.

The secondary market would be controlled by SMIB which then controls development of primary market.

Rajalingam countered by saying that SMIB should be responsive to Ministry of Housing. With regard to secondary market, he said that Central Bank provides relending facilities and that housing is not now eligible for CB refinancing. Rajalingam proposed that Central Bank be used as the secondary lender, SMIB as the primary lender.

Christian then suggested that mortgage-backed bonds provided a new instrument for the capital market. They would increase investor familiarity with long term financial instruments. The real estate is the underlying security.

Rajalingam mentioned that monetary control is extended to the entire financial system.

Ricks suggested that people will save for the opportunity of buying a house. There is a relationship of the rate of savings with the probability of getting a house.

Mid-day Break At This Point

Afternoon's opening discussion centered about Christian's proposal of whether private investors would get involved in such (housing finance) proposal. Christian presented example of Thailand. Rajalingam said he did not feel you can really get private money into housing finance institutions. You would if there was a source of money you could lend out at a profit.

Rajalingam presented rationale of the creation of National Development Bank in answer to Gardner's question as to why NDB was created when you have private Developemnt Finance Corporation of Ceylon. Essentially the answer was to fill a role not being played by DFCC, but this was not completely clear.

Ricks raised the possibility (in fact, he strongly proposed) of SMIB turning over mortgage servicing function to private institution. He suggested this would bring down the delinquency rate. He then went on to suggest that both the origination of loans and the servicing could be done better by a private institution. Ricks feels that SMIB should not be a primary lender.

Christian then discussed possible savings mobilizations by SMIB if it were to play this role:

1. Savings by small savers through branches established by SMIB or an agent

2. Debentures sold to investors

3. Institutional lenders such as pension funds or insurance companies

But he stressed that you must increase total savings, not just get piece of the same pie.

In response to a query on provident funds, Gardner described the Employees' Provident Fund, the private provident funds, and the newly established Employees' Trust Fund which is to make equity investments.

Ricks then suggested the GSL should encourage private pension funds which could make funds available for housing. Rajalingam countered by saying the government <u>discourages</u> private pension funds; that EPF is the preferred scheme.

Phil Gary asked whether there are other potential options for funding for housing.

Jim Christian mentioned the expanded role of IRAs in the US, of which the savings and loan system will get some part. He said that in the US IRAs and pension funds are about the same size: around $685 billion each.

January 27 - Christian opened with a discussion of savings mechanisms and discussed contract savings plan. He mentioned that they are tied to the housing delivery system and that future costs are unknown. You could tie in bonus at the end of the contract period. Contract savings can provide ways to obtain cheap money.

In designing a contract savings system, you could leave room for NSB to make direct housing loans as is possible under its charter (but not now done). But if you are to do such a program you need to make a commitment at the start to provide both mortgage financing and a bonus at the end.

There was some discussion at this point of the government's commitment to provide 100,000 new housing units during its tenure, with the private sector providing 400,000. Ricks asked how the private sector housing would be financed. Weerapana said non-institutional savings by families. But it was mentioned by Gardner that private sector is apparently not meeting its goal, and long-term finance is one of the problems.

Bessie Kong discussed the role of company pension funds and their loans for housing and the Transport Board (bus company) was used as an example.

Christian emphasized that he thought it was very important to establish and maintain a momentum in the direction of a new or expanded housing finance system and that the details would evolve. He mentioned Egypt as a place where a new system was established.

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Rajalingam mentioned that many houses in Sri Lanka are built by owner working with contractor. These are single family units.

As part of a general discussion of the National Housing Fund and its problems, Rajalingam said MOF would have no problem with having reflows staying with MLGHC for re-lending even though NHF funds are supposed to be a loan from Treasury. In fact these loans are considerably in arrears , so Treasury is not getting them anyhow. There was also a discussion of the possibility of the Department of National Housing portfolio (NHF loans) which is reputedly in bad shape,-- both accountingwise and delinquencies -- being turned over to SMIB or a new institution.

In response to discussion raised by Phil Gary, Rajalingam said the GSL would be willing to guaranty the foreign exchange risk of HG-type lending, i.e. market rate international funds, to a new institution. Weerapana said, however, that GSL would see this middle income recipients.

Ricks - what about Libor-tied long term loans?

Rajalingam said that MOF would tie variable rate on foreign loan to a variable rate to the end user. But he went on to say that it's difficult to commit long term variable rate funding.

Considerable discussion at this point by Ricks over systems now in use in informal sector in Sri Lanka, the need to come up with new mortgage instruments, etc. vs. Jim Christian's view that you should get institutional questions settled first.

Ricks and Gardner discussed what you might do with SMIB. It could be restructured somewhat to handle a higher volume of loans. Perhaps home improvement loans. Wrap-around old loans with new higher rate loans suggested by Ricks.

At this point Rajalingam offered what GSL could do:

Keep SMIB as the primary housing finance institution. It would continue to act as primary lender but would also serve as a secondary lender/regulator. GSL would make available the Rs. 45 million now going to NHF and, in addition, increase the amount of debentures SMIB could issue. Assign the old mortgages serviced by DNH to SMIB.

Look at the organization with a view to making administrative changes and improving. Address problems such as titles, title insurance. Improve the efficiency of the system. Offer new lending instruments.

Weerapana said that you need to do something that can be achieved in a short period of time. There is now no effective housing finance agency. Divert reasonable amount of resources to a new or expanded institution. Cut back subsidies. You need an acceptable initial step.

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There was then a general discussion of financial instruments in Sri Lanka; the nature of government debentures, interest rates, terms etc. The fact that government tried out bearer bonds but they did not work was mentioned. Rajalingam said that trying to attract "black money" with bearer bonds would not work because the holders of this money could make far more in other endeavors. As a variation Christian discussed discount bonds briefly; issued at lower than market rates but sold to the buyer at less than par to reflect current market rates.

At this point Ricks discussed various types of lending instruments: wrap-around loans for some percentage of the existing balance on a mortgage loan. Set up revolving loans for building materials purchases from suppliers. Or a revolving loan fund for the supplier. This concluded the general discussion, and Phil Gary asked each of the participants to give a short summary.

Ricks - Emphasized that whatever comes out with regard to a new or expanded housing finance system, it must avoid the U.S. problem of short-term borrowing and long term lending.

Focus on the level of mortgage payments, not interest rates in deter mining how an institution will lend. That is, to get over the conceptual hurdle of 15 percent interest rates being too high for housing loans, you need to focus on the monthly payments and what level can be afforded.

You must focus on the institutional structure and its lending instruments together. The institution will finance if given the instrument (I agree, the commercial banks would clearly start lending for housing again if they had a product).

Christian - Whatever is developed must be within the context of the overall national economic policy. There are a wide variety of competing claims for the existing resources base.

Therefore, what part of the market do you attack? what institution is best able to make the attack? What kind of instruments do you use to make the attack.

You can launch an effort with small steps but you <u>need</u> the institution to do this. Therefore, you need to determine the institution.

There are a number of options but some of these require significant changes in government policy.

<u>But</u>, important, you must make the beginning.

Berlin - Feels you must do some early experimenting with new instruments.

Gardner said that you must take a look at overall practices in housing as part of any consideration to expand the housing finance system. There are a number of non-economic government policies now related to housing which must be addressed.

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Rajalingam said you must build your housing finance institution one step at a time. Improve the efficiency of SMIB. Increase SMIB's resources. At the same time different lending instruments can be examined in light of the current situation in Sri Lanka. No elaborate mechanisms can be imposed overnight.

Weerapana agreed with Rajalingam and said before you do anything you must be satisfied that your institutioanl arrangement will be acceptable. He stressed a need to look for new potential resources.

Gary and Kimm made closing remarks. It was clear that no details were resolved. But such a two-day "seminar" constitutes a basic first step. At a later stage and as you go along you begin to work out the details.

There was a recommendation that both MLGHC and MOF should appoint a staff member to work on the problem and liaison with each other.

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32. Interview With Inland Revenue Commissioner.

I. INTRODUCTON AND PURPOSE

This report (Volume II of the Study of Housing Finance in Sri Lanka) sets forth a description of the existing mechanisms for financing housing in Sri Lanka; puts these mechanisms in the context of the banking and financial sector, government programs for housing, and the market for and private development of housing; and attempts to relate the whole in a general way to the existing economic/political situation in Sri Lanka and current government thinking on expanding the availability of housing finance.

The report was prepared by a team of consultants who spent three weeks in Sri Lanka in December 1981. The team was headed by Donald Gardner of the National Savings and Loan League. Additional members were Samuel Peck of the National League, Pradip Shah of the Housing Development Finance Corporation of India and Bessy Kong of AID's Office of Housing. Professor Charles Haar of the Harvard Law School assisted with the preparation of some of the legal background affecting housing finance.

Because of the short time available in the field work to cover a broad subject area, certain shortcomings emerged. First, because the study was done in December, published data for 1981 wasn't available for the most part. In fact, in Sri Lanka, as in many countries, published data in general was hard to come by and, in some cases, 1980 statistics were not yet published or even readily accessible for some institutions.

Second, and again because of the time frame, it was not possible in many cases to follow-up meetings when such a follow-up would have been desirable. In sme cases, the Team was able to see a key institution or individual only once. Consequently, there tended to be a concentration on those institutions considered most important and/or which were more accessible.

The end result is that some of the institutions are treated in more depth than others, and along with this, shortcomings are more easily identified. The reader should bear this in mind in reviewing the material, particularly as it relates to an institution such as the State Mortgage and Investment Bank.

The report was used to assess the housing finance situation in Sri Lanka at a two-day workshop ("brainstorming") session on January 26 and 27, 1982 in Washington. Participating in this session were three experts from the U.S. housing finance industry, several of the Team members who prepared the report, other officials of the AID Office of Housing and two Government of Sri Lanka officials involved in finance and housing. At the session the group discussed considering the strengths and weaknesses of the housing finance system as a whole and the institutional and other sources of housing finance specifically, with the intent to make suggestions and/or present alternatives to improve the system.

Volume I of the report contains the conclusions reached at the meeting, a more detailed treatment of the discussion, a list of participants and the scope of work for the overall study.

II. BACKGROUND

Sri Lanka's political system and economic policies underwent a dramatic change after the 1977 elections that swept in President J.R. Jayawardene's United National Party (UNP), placing Mrs. Sirimavo Bandaranaike's Sri Lanka Freedom Party (SLFP) in the opposition. The UNP changed the constitution, introducing a presidental system (with Mr. Jayawardene moving over from Prime Minister to President), and proportional representation. In terms of economic policies, Sri Lanka made an abrupt about-turn from a "controlled economy under a policy of state socialism to unbridled, free-enterprise capitalism." To push industrial development, Mr. Jayawardene slashed state welfare subsidies, scrapped import and price controls, lowered taxes, and devalued the rupee by 46 percent. Foreign borrowing was increased; Sri Lanka took a $110 million standby loan in 1978 and negotiated a $325 million extended facility for 1979-1981 from the International Monetary Fund (IMF). Under its Public Investment Plan, the government commenced work on four major capital projects that were intended to lay the foundation for longer-term development:

-- the Rs. 31 billion ($1.6 billion) Mahaweli irrigation and hydro-electricity project;

-- a 500 acre Free Trade Zone near Colombo airport;

-- a new parilamentary building and township at Kotte, east of the capital of Colombo; and

-- public housing.

(See Annex 1 for a Washington Post article on Sri Lanka's efforts.)

Along with unemployment, the shortage of housing was a key reason for popular disenchantment with the SLFP Government. In 1973, it had introduced a scheme for "self-help housing"--building materials and land provided by the state, labor by the future homeowner--but was not followed through. The UNP Government took up the idea partly because of self-help housing costs are much less than direct construction of completed units by the government and partly because the program was rural-based and related to the government's new "village re-awakening" efforts.

Public housing is the responsibility of the Prime Minister, Mr. Premadasa, who is also the Minister for Local Government, Housing and Construction (MLGHC). Mr. Premadasa is a strong advocate of public housing and pursued a vigorous program of housing development through two newly created agencies: the National Housing Development Authority (NHDA) and the Urban Development Authority. Programs launched by the new government ranged from the upgrading of slum and shanty areas through the aided self-help housing for poor rural families up to expensive housing for more well-to-do families.

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Despite the high priority accorded to government housing programs, the Public Investment Plan, a rolling five-year plan, allocated approximately 80 percent of housing investment to the private sector. In fact, it appears that this goal is not being met.

Even allowing for the construction of shanties by poor individuals to count as private sector housing, it does not appear that the private sector is producing housing at a rate comparable to the public sector.

In addition to the shortage and high cost of land and the rising cost of construction which have priced housing beyond the reach of most families, the lack of significant long-term housing finance has also acted as a constraint. With the exception of the government's financing of its own programs, there is little in the way of housing finance available. The government's Housing Loans Program, which was to provide for long-term housing loans for individuals owning their own land from National Housing Fund resources, ceased to operate in early 1980 because of a lack of funds.

The large expenditure on government housing programs was an important contributor to recent budget deficits. The substantial increase in investments, the greater use of foreign resources, and soaring construction costs resulted in a marked deterioration in the balance of payments, the rate of inflation, and the budgetary position for 1980. (See Annex 2 for the Central Bank's review of government's fiscal operations in 1980.)

The IMF suspended disbursements under the Extended Fund Facility (EFF) which had enabled the government to dismantle decades of exchange and import controls. In June 1981, Finance Minister, Ronnie de Mel, succeeded in negotiating a resumption of disbursements under the EFF. However, the IMF imposed a ceiling on the amount that Sri Lanka could borrow abroad, put a limit on bank credit, budget deficits and government expenditures, including housing. Excerpts from the 1982 budget message (see Annex 3), which also contain supplementary 1981 figures, focused further attention on the unsatisfactory budgetary situation and the need for trimming expenditures and raising finances. Annex 3 also contains an article analyzing the new budget.

III. GOVERNMENT ROLE RELATIVE TO HOUSING FINANCE

A. CURRENT GOVERNMENT THINKING

There appears to be a growing feeling in some government circles that a new housing finance bank or institution of some type would solve, or at least substantially contribute to solving, the housing problem.

The more recent history, recognizing that this account will tend to be over-simplified and may be missing some of the pieces, is as follows.

There was a visit to Sri Lanka by an IFC representative sometime in mid-1980 in which was discussed, with both GSL officials and individuals in the private sector, the idea of a housing finance bank. The approach was to float an idea for the Sri Lankans to think about.

IFC thinking was that it would be interested in some small equity position, say, up to 15 percent, and that the remainder of the equity would come from government and private participation. Initial capital might be on the order of Rs. 100 million. The Bank of Ceylon apparently evidenced the most interest in the idea.

Indicative of interest generated by the proposal were articles published in at least several of the newspapers at the time (see Annex 4) which implied that the creation of a new bank with IFC assistance was a distinct possibility.

One article said that the Prime Minister had appointed a committee to prepare a report on setting up of such a bank.

A committee was, in fact, formed to explore the idea. Its members were as follows:

Additional Secretary of MLGHC--Mr. Wijeyedasa
(still in this position)

Deputy Assistant Director for Planning and Project Development, MLGHC--Disa Weerapana
(still in this position)

Assistant Director for Planning-Ministry of Finance and Planning--H.M.A. Codipilly
(since gone to the World Bank)

General Manager of Bank of Ceylon

Deputy General Manager of Bank of Ceylon--Hugh Perumal
(since gone as head of Property Development Ltd., a BOC affiliate)

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Deputy General Manager of People's Bank--Mr. Amarasinghe

Director of Research of the Central Bank--A.S. Jayawardena (now Special Assistant to the Governor)

The Director of Economic Affairs, Ministry of Finance, Dr. S. Rajalingam, who oversees banking policy and regulation, was not a member of the Committee, but the Committee did meet with his Additional Director. The State Mortgage and Investment Bank (SMIB) representative(s) attended some meetings, but the SMIB was also not on the Committee.

The Committee had about five meetings and the work was then abandoned. As far as could be determined, there appeared to be several reasons for this. (The following are interpretations of the Team and do not imply government acceptance.)

First, there was a problem with with Treasury who appeared basically against the idea. This was primarily because it was not agreeable to letting some new institution such as this tap sources of funds which now are used by Treasury as its own source of funds. These are referred to as "captive" funds and include, for instance, the National Savings Bank and the provident funds. (The National Savings Bank, for instance, although permitted to invest up to 40 percent of its funds in mortgages, in fact invests over 95 percent of its resources in government bills and debentures.)

Second, there was the overall credit squeeze by government and a reluctance to start up a new program.

Third, many of the Committee members were occupied with other things and although some were keen on pursuing the idea, they didn't have the expertise or the time that was needed.

The first approach by the Committee was to consider setting aside the annual budgetary allocation for the National Housing Fund (NHF) to such a bank and let the bank lend it out for government programs rather than NHDA (NHDA would become strictly a developer).

The Committee was supposed to prepare a Cabinet paper on the idea but it never got beyond the draft stage. Apparently Treasury was not prepared to allocate any funds. There was Rs. 45 million for NHF in the 1981 budget, but Treasury wouldn't consider allocating this to a new housing bank. It suggested, instead, to get funds from NHF recoveries. As a consequence of the above, the Committee more or less died out.

The Bank of Ceylon, meanwhile, was proceeding on its own to pursue the idea. (The IFC has a $5 million loan to the BOC for on-lending to private, medium-scale industrial enterprises and a resident advisor to that bank.) In September 1981, Philip Gary, AID's resident housing advisor in Colombo and Don Gardner met with BOC officials in an introductory meeting. It was apparent that the bank had done a fair amount of thinking on the possibility of taking the lead in setting up a new housing bank. Details still appeared to be lacking; so did the level of interest at which such a bank might lend. It was

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clear, however, that BOC officials envisioned such a bank as serving middle- and upper-middle income clientele.

In a subsequent meeting with the Secretary of the MLGHC, he indicated that he thought the creation of a housing bank to be of the highest priority. He, however, saw such a bank as serving a wider income range and picking up the financing for some of the government programs and, thereby, somehow, adding to the funds available for housing finance for lower-income families.

In fact, what emerged at this point was a significant interest on the part of government in a new housing finance mechanism. It was decided that AID would proceed to assist in an examination of the housing finance question to be done later in the year.

Gardner then met with Mr. Rajalingam who, despite his title (Director of Economic Affairs, Ministry of Finance), oversees banking policy and regulation by the government. Rajalingam is on the Board of Directos of BOC and was both aware of its proposal to form a housing finance institution and of IFCs interest in the proposal.

Initial Treasury reaction at that time was negative to the BOC proposal and the BOC was asked to study the issue and come up with more detailed recommendations. There was a feeling at Treasury that there were too many government institutions being created and that the expansion of the State Mortgage and Investment Bank was an alternative to be considered.

In a meeting with Dr. Rajalingam, he stressed that there is a limited volume of savings and said the primary savings institution is the National Savings Bank which invests the bulk of its resources in government paper. If some other institution comes along (a new housing bank that would take in savings), it would probably reduce the funds flowing into NSB.

Therefore, he said government supports the SMIB by buying debentures from it rather than allowing it to take in savings. This gives control to government. Rajalingam said that the Ministry of Finance had just approved an additional Rs. 60 million in debentures for SMIB for the rest of 1981.

Other feelings at the time, however, particularly in the MLGHC, were that the idea of a new or expanded housing finance function was merited, but there is no money and people who need to focus on the issue are busy with other things; i.e., the need is established, someone must just carry through on the idea and the details. With regard to expanding the role of the SMIB rather than creating a new institution, it was stated that SMIB was not originally included as a member of the Committee because it had no way of attracting savings and it did not have a network of branches to operate countrywide.

Since these are obviously difficulties that could be overcome, it appears there are other reasons. It is clear that many people feel that SMIB management must be improved and its slow procedures speeded-up if it is to play an important role. There is also the question of SMIB being under the supervision of the Ministry of Finance and the desirability of a housing bank being responsible to a country's Ministry of Housing for policy guidance even if required to meet banking rules and regulations.

In late September 1981, the timing and approach to be used for this study were agreed to with the MLGHC.

During the course of the field work to gather the information presented in this report, the following emerged as relevant to considerations on where Sri Lanka should go with housing finance.

The MLGHC appreared to be very much interested in pursuing the idea of a new housing fiance institution.

The MOF appeared to favor an expanded role for SMIB rather than the creation of a new institution (at least a government institution). In addition to the source of funds issue, the shortage of experienced staff was cited as a problem.

The BOC has and is generating expanded support for its proposal to create a new privately-oriented housing finance institution in both the private and quasi-private sector. The BOC has produced a "feasibility" report in support of such an organization, but it is lacking in hard detail.

The SMIB is generally regarded by many people as not really up to an expanded role.

The receptivity in most financial and housing circles to a new housing bank is so high that a remark by a government official in a meeting with BOC officials that government <u>might</u> be <u>prepared</u> to support such an institution with inputs from NHF allocations was repeated to team members in subsequent days by a number of people as if it were already almost an accomplished fact.

It appears that with or without any recommendations emanating from a study such as this one, some type of new or expanded housing finance institution will probably proceed.

B. <u>GOVERNMENT AGENCIES AND HOUSING PROGRAMS</u>

The primary government ministries and organizations that are involved in the question of what to do about overall housing finance in Sri Lanka are the Ministry of Local Government, Housing and Construction (MLGHC), the Ministry of Finance and Planning, and the Central Bank. Other ministries with some involvement or interest would be the Ministry of Labor which supervises the provident funds and the Ministry of Trade and Shipping which supervises the insurance companies.

The MLGHC, whose minister (as pointed out earlier) is also the Prime Minister, is responsible for developing, implementing, and administering the government's housing program. Its operations are covered in detail in the Shelter Sector Assessment (SSA) of Sri Lanka and by AID's Office of Housing in September/October 1980. As pointed out in the SSA, there is no comprehensive national housing policy issued by the government. Housing is, however, one of the lead sectors of the Public Investment Plan, a rolling five-year plan adjusted each year, set forth by the current government after its election in 1977.

That Plan originally set out a goal of 100,000 new housing units to be constructed over the initial plan period and also envisioned a goal for the private sector of four times that number of units. (See Annex 5 for an excerpt from the 1981-85 Plan covering Housing and Urban Development and Table 19 from that Plan covering Allocation of Government Capital Expenditures.) The government's goal, while somewhat behind, is moving along but the private sector, although data is lacking, is apparently not providing housing at a level anywhere near to meeting the goal set forth for it. The SSA provides a complete description of government programs.

One of the problems in provision of housing by the private sector is the availability of long-term finance. What to do about this is, therefore, of great interest to the MLGHC. To this end and in response to the interest generated by the International Finance Corporation, the committee described in the previous section was formed.

The Ministry of Finance and Planning, as its name implies, is composed of the finance and planning functions of government, and these functions are still often referred to as the separate ministries they once were, i.e., Ministry of Finance (MOF) and Ministry of Planning (MOP).

The MOP plays an equivalent role to the U.S.'s OMB role in Sri Lanka and, as far as housing goes, has beee instrumental in efforts to cut-back on government allocations to housing as part of the overall effort to reduce the government budget. On the finance side, the MOF is responsible for policy decisions in money and banking, with more direct supervisory involvement withgovernment-owned banking or banking-type institutions such as the State Mortgage and Investment Bank, the National Development Bank, the National Savings Bank and the government-owned commerical banks, Bank of Ceylon and People's. The MOF's Director of Economic Affairs is on the Board of Directors of BOC, for instance. The establishment of a new commercial bank, the opening of a branch, or acquiring the business of another commerical bank must be approved by the MOF.

The Central Bank is involved in operations and supervision of the banking system.

C. CENTRAL BANK (CB)

The CB was established under the Monetary Law Act (MLA) to administer and regulate the monetary and banking system of Sri Lanka. There is no codified set of banking regulations per se. Regulatory measures applied to banking institutions are derived from the MLA and the Companies Act, a specific part of which deals exclusively with banks. Separate legislation governs the state-owned banking institutions such as Bank of Ceylon and People's Bank (commercial banks) and the National Savings Bank (NSB) as well as state-owned

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credit institutions such as the State Mortgage and Investment Bank (SMIB) and the National Development Bank (NDB). Finance companies are governed under the Finance Companies Act which was initiated by the CB.

The overall responsibility for management, operations and administration of the CB as well as the determination of policies and measures to be taken under the MLA rests with the Monetary Board of the CB. The Monetary Board is composed of the Governor of the CB, the Secreatry of the Ministry of Finance and Planning, and an appointee of the President, currently the Secretary of the Mahaveli Development Authority.

The Department of Bank Supervision is responsible for the continuous supervision and periodical examination of all commercial banks and other banking institutions in Sri Lanka. Commercial banks accept from the public or create demand deposits among other things. Other banking institutions refer to agencies or institutions acting on behalf of government to make loans, advances or investments, or to accept deposits from the public, e.g., SMIB, NSB, NDB. The establishment of such institutions must be approved by the MOF. However, a financial institution (finance company) that does not accept demand deposits and is not a government-owned institution does not require the approval of either the CB or the MOF. For such institutions there are, however, many other requirements plus inspection of books by the CB that do apply.

Among its many authorities (described in detail in the MLA) the CB insures deposits, issues the currency and regulates the supply, availability, and cost of money. It also sets reserve requirements for the commercial banks (currently 6 percent on total term and savings deposits and 14 percent on demand deposits), regulates credit, and provides the banking system with liquidity. It may discount, rediscount, buy and sell bills, acceptances, promissory notes and other credit instruments from commercial banks and the NSB for short-term commerical and production credits with maturity up to 270 days, and make short-term loans and advances against certain promissory notes for periods not exceeding 180 days. In certain special cases and with prescribed conditions, when the CB considers it necessary to promote or facilitate particular classes of operations, the CB may make loans against mortgages when supported by promissory notes supported by the mortgage.

The CB also fixes the interest and discount rates to be charged on its credit operations and general conditions under which the credit facilities are available. The bank rate is now 14 percent.

The CB also makes available various preferential lending schemes to the banking system, commercial banks and others such as the Development Finance Corporation of Ceylon (DFCC). These schemes are known as refinancing and are to facilitate government priorities. The bank makes the loan and, in effect, gets it "refinanced" by the Central Bank, i.e., the CB lends the bank an amount of money to cover the loan. The bank charges an interst rate to its borrower something above the rate charged by the CB to the bank, i.e., its spread. How this is determined isn't quite clear but in the case of long-term lending (see below), the DFCC refinances from the CB at 13 percent for industrial credits for which it charges 17 percent.

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Short-term CB Refinancing Rates

1. For cultivation of paddy and other government approved crops--1 1/2 percent.

2. For purchase of such commodities--3 percent.

3. For lending related to export financing--12 pecent.

4. For lending related to commercial and productive purposes--14 percent.

IMF restriction on credit in Sri Lanka has resulted in global limits on the amount of credit available under items 3 and 4 above. Thus, credit is distributed to banks on the basis of assets held on June 30. (Assets would be bills--discounted and purchased, overdrafts, and loans.) Foreign commercial banks are eligible for these facilities.

Above these global limits, penalty rates come into play as follows:

10% above limit the rate would be 21%

10-20% above limit the rate would be 22%

20-30% above limit the rate would be 24%

30-40% above limit the rate would be 26%

40-50% above limit the rate would be 30%

The CB also operates a Medium- and Long-Term Credit Fund on the following basis:

The repayment term is between 5 and 15 years.

1. For government approved agriculture and fishing projects -- 8 1/2%

   (Special horticulture project related to Ceylon Tobacco) -- 6 1/2%

2. Development Board approved projects for exports -- 10%

3. Agriculture, fishing, ect., projects not specifically aproved by government -- 11%

4. Projects such a tourism, warehousing, industry, etc. -- 13%

** NOTE: Housing is not on this list. The General Manager of the DFCC made a point of saying that if it were profitable, DFCC would be prepared to lend to a housing institution.
In addition, it should be noted that CB refinancing facilities cannot be used to finance working capital.

The Central Bank has the authority to limit the amounts of commercial bank loans and investments and to fix the maximum rates of interst which these banks pay on various classes of deposits. Currently, however, commercial bank interest rates have tended to follow the lead of the NSB. It appears that this was a decision involving the MOF, the CB, and Inland Revenue, but exactly how it ws arrived at isn't known. The high rates being paid have had some success in raising deposit levels of the NSB and the commercial banks.

Finally, the CB is empowered to guaranty loans of banking institutions. For instance, it can guaranty loans to small-scale enterprises by credit instituitons. Presumably, it could also guaranty mortgages for a housing bank.

With regard to the government, the CB acts as fiscal agency, banker, and financial advisor to the government. In this respect, the issue of securities of the government are made through the CB. The CB can subscribe, however, only to Treasury Bills.

The Central Bank has made some attempt to capture the "black" money supposedly in the economy. This is unreported money, much coming from the gem trade, which is reported to be significant but no one knows the level. The CB issued Bearer Bonds which were sold through the commercial banks at 10-12 percent. However, these were not competitive rates and, hence, the bonds were not successful.

IV. THE BANKING AND FINANCIAL SECTOR

A. OVERVIEW

Sri Lanka's financial sector is at an early stage of development. The private sector is mainly self-financed, while public corporations have drawn most of their resources from the central budget. The financial system is limited in breadth, dominated by the commercial banks of which the two state banks, Bank of Ceylon and People's Bank, are the largest in terms of assets, deposits, and size of branch network. The commercial banks account for some 85 percent of industrial credit. The government-owned savings institutions, National Savings Bank, Employees' Provident Fund (EPF), and the Insurance Corporation of Sri Lanka are used by the government as sources for funding the budget, with about 80 percent of their domestic assets invested in government paper.

The financial system also includes the Employees' Trust Fund (ETF); the Development Finance Corporation of Ceylon (DFCC), a private development finance company with a minority government participation; the recently established National Development Bank (NDB), a wholly government-owned apex development institution; the State Mortgage & Investment Bank (SMIB), 36 small, private finance companies; a leasing company and several corporate provident funds.

The government has approved the establishment of seventeen multinational banks (most of them with only one branch). It is also encouraging the establishment of an offshore banking market through the creation of foreign currency demand and time deposits from enterprises in the Free Trade Zone and by making advances to these enterprises.

Commercial banks provide over 80 percent of institution finance. About 74 percent of commercial bank advances are short term (below one year), 20 percent are medium term (1-5 years), and only 6 percent are long term (above 5 years). The maturity pattern of the advances made by the foreign banks is also characterized by concentration on short-term credit--only 2.4 percent of loans are medium term and 3.5 percent are long term. About 45 percent of all commercial bank loans are to the commercial sector; 28 percent to industry; 18 percent to agriculture.

Interest rates in Sri Lanka have been relatively high since 1977 and have kept pace with a fast-changing financial environment. To encourage greater financial savings, the maximum permissible deposit rate on time deposits of one year or more was raised in 1977 to 15 percent for commercial banks and 18 percent for the National Savings Bank and, subsequently, was further increased to their present levels; 20 percent for one-year deposits and 22 percent for two-year deposits. NSB and commercial banks pay the same. (See table on next page.) Real interest rates were still positive and attractive in 1978; however, the acceleration of inflation in 1979 and 1980, with an inflation rate reaching 40 percent, eliminated the differential. More recently the inflation

SELECTED INTEREST RATES IN SRI LANKA, September 1981

(percent per annum)

DEPOSIT RATES

	Minimum		Maximum
Commercial Banks			
Savings Deposits	10.0		14.0
Fixed Deposits			
3 months	12.0		16.0
6 months	15.0		18.0
1 year	20.0		20.0
2 years	22.0		22.0
National Savings Bank			
Savings Deposits		12.0 /a	
Fixed Deposits			
6 months		15.0	
12		20.0	
24 months		22.0	
Savings Certificates (10 years)		11.0	
Government Securities			
Treasury Bills		13.0 /b	
Secondary Market T-Bills		16.0	
LENDING RATES			
Bank Rate (Central Bank)		14.0	
Commercial Banks			
Inter-bank Call Loans	18.0		21.0
Bills Purchased and Discounted	15.0		25.0
Loans and Overdrafts Secured by:			
Government Securities	15.0		28.0
Shares of Joint Stock Companies	15.0		28.0
Stock in Trade	16.0		28.0
Immovable Property	13.0		28.0
Others	11.0		28.0
Unsecured	19.0		30.0
State Mortgage Bank and Investment Bank	5.0		24.0
National Housing Department	6.0		9.0
National Savings Bank	9.0		17.0
DFCC	10.5		17.0

/a Compounded interest on savings deposits.
/b Weighted average of bills issued on tender.

Source: Central Bank of Ceylon.

rate has dropped to 18-20 percent and long-term rates are once again positive. (Annex 31 is the cost of living index in Sri Lanka through September 1981.)

Interestingly, one foreign bank manager feels that NSB was a disturbance in the field because it offered very high interest rates and tax concessions. He felt that if NSB lowered interest rates on deposits there would be a general tendency for interest rates to come down.

Taking the oppositve view, another foreign official said that he does not believe that interest rates would generally go down if NSB lowered the rates it offers on deposits. He sees the extent of deficit financing by the government as the main reason for high interest rates and expects no substantial improvement in the budgetary position of the government.

The Study Team was also told that NSB is losing deposits. Although 1/3 of interest income received from NSB, up to Rs. 2,000 is tax free, commercial banks pay the same interest. They have the edge in that they provide overdraft and other banking facilities.

See Annex 6 for a series of statistics on banking through September 1981, covering assets and liabilities of commercial banks, reserve positions of commercial banks, commercial bank loan and deposit rates, lending rates of long-term credit institutions, and total amounts for savings and fixed deposits.

Capital Markets in Sri Lanka: There is no formal stock exchange in Sri Lanka. Thee is, however, something known as the Colombo Share Market which has existed since the 1800s. It is essentially a private institution run by the Colombo Brokers Association and has little direct support from government agencies.

The market, developed primarily to cater to the needs of the plantation and other ancillary industries, has been under the control of British investors and was directly supported by them. Sri Lankans in the past have not taken an active interest in share investment except for a very small group of middle-class urban investors. The market is principally an over-the-counter market and trading is conducted through "call-overs" at fixed hours, twice a day, and at set locations. However, most business is finalized later over the telephone.

On January 9, 1981, there were 89 public companies listed with the CBA, but trading was limited due to an extreme shortage of floating stock. Following passage of various tax incentives; ten new public companies came to the market during the period January to September 1981, as against five in 1980; three in 1979; and one in 1978.

One of the new issues this year was the Rs. 200 million by Property Development Ltd., a subsidiary of the Bank of Ceylon. This was an unprecedented issue in terms of size for Sri Lanka.

According to Forbes and Walker, a Colombo stock and commodity broker, only Rs. 127 million was actually subscribed by the public; the remaining Rs.

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93 million being taken by the BOC along with the 60 percent (Rs. 330 million) originally allocated to the Bank itself out of the total capitalization of Rs. 550 million. Nevertheless, brokers considered the issue a large success.

Forbes and Walker, which handles 90 percent of the new issues, says it has about 12 new issues coming up by early 1982. The General Manager for Forbes and Walker is working actively with the Bank of Ceylon on the idea of a new housing finance bank.

The International Finance Corporation has completed a study of the capital market in Sri Lanka and is actively pushing the idea of a formal stock exchange.

Included in the share list for the CBA for December 3, 1981, (copy available for review) are many government bonds as well as debentures for the State Mortgage Bank and the Urban Development Authority, which are selling considerably below par to reflect the current interest rates.

B. COMMERCIAL BANKS

1. Bank of Ceylon

a. Introduction: Because of its interest in developing a new housing finance institution (see section below for details), contacts with the BOC were more extensive than other commercial banks although most of the discussions centered around the possibility of a new housing bank.

BOC is one of the two largest commercial banks in Sri Lanka, the other being People's, and both are government owned. Several interviews were conducted with the Chairman and staff members followed by a series of meetings with the Assistant General Manager for Planning and Development, who is the individual most involved in the proposal to start a new housing finance bank.

The BOC was the recipient of a $5 million loan from the International Finance Corporation in 1981 for on-lending to medium-scale industrial enterprises. A comprehensive summary of the Bank and the scope of its operations taken from the IFC appraisal is contained as Annex 7. Highlights are covered in the narrative below. The 1979 Annual Report, the most recent the Study Team could obtain, is available for review. The Balance Sheet and Profit and Loss Statement through 1980 are contained in Annex 8.

b. Capitalization: The Bank is wholly owned by the Government of Sri Lanka. Paid-up share capital at the end of 1980 was Rs. 4.5 million. The government announced that its intention was to increase the paid-up capital to Rs. 50 million in 1981 and subsequently higher. It is not certain whether this has been done yet.

c. Organization and Staffing: As of the end of 1979, the bank had some 562 branches and sub-branches covering the entire island with 155 of these full service. Somewhat similar to People's, BOC had a number of sub-offices known as Agrarian Service Centers. Total employees at that time were close to 8,000. There has been some reorganization of BOC's management and this is described in the IFC Appendix.

d. Overall Figures: The 1980 figures indicate total assets were Rs. 10,077 million, of which Rs. 6,414 million were outstanding advances. Current deposits and other accounts at the end of 1980 totalled Rs. 9,500 million. Profits before taxes were Rs. 331 million.

e. Resource Mobilization: BOC mobilizes deposits similar to other commercial banks and at competitive interest rates. It does some borrowing abroad, primarily to finance trade (but also note the IFC loan) and also borrows from the Central Bank against the pledge of securities. It, along with the other commercial banks, participates in the on-lending of a World Bank loan for small-scale industries.

Its deposits for the years ending 1979 and 1980 were as follows:

	1979	1980
	(Rs.000)	
Current Accounts	2,215	3,147
Savings Accounts	579	806
Fixed Deposits	1,539	3,066

f. Investment: The Team was told that BOC's current policy, as set by the Central Bank, is to increase the financing of exports. The General Manager said that with funds in short supply it has stopped making long-term loans (this includes housing--see below).

General Categories of investments are as follows:

	1979	1980
	(Rs.000)	
Trade Bills	580	1,073
Government Securities	368	364
Advances and Other Acts	4,194	6,414
Investment in subsidiaries and other companies	33	328

The Bank is currently experiencing some cash flow problems because of the cost of its new headquarters building constructed.

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g. Housing Finance Activities: According to the Assistant General Manager for Planning and Development, the BOC stopped making housing loans as of 6/30/81. At that time the outstanding amount due on housing loans was Rs. 324.6 million; 81.7 percent on loans for new construction and 18.3 percent for loans for the purchase of existing houses.

As far as could be ascertained, the average interest rate on these loans is in the range of 8-10 percent with some loans apparently on the books at 7 1/2 percent but increasing up to 21 percent for the most recent. The average life of the loans is 15 years so it would appear that BOC is taking a substantial loss on the loans (even though this category is a relatively small percentage of BOC's assets), although initially they were probably profitable.

BOC made housing loans only to its customers, intending to encourage people to bank with BOC. Thus, housing loans were considered a tool for developing business.

BOC used to lend up to Rs. 220,000 for a given housing loan. The ceiling was calculated by applying the then estimated construction cost of Rs. 100 per sq. ft. to 2,000 sq. ft., which was then the ceiling on the size of a house. (The current ceiling stipulated by law is 3,000 sq. ft. and the estimate for current construction costs for upper-income housing is Rs. 250 per sq. ft.)

In making housing loans, BOC's loan processing procedures require details such as the applicant's income, assets, liabilities, other commitments, number of dependents, etc. BOC's credit officer would verify these details, guage the monthly expenditure of the applicant from informaiton such as the number of dependents, and determine the savings capacity of the applicant and the loan amount that BOC could offer. BOC also reviewed the applicant's business history with the bank. The maximum loan was limited to 75 percent of the value of the property. The installment on the loan was limited to 25-30 percent of income. Loan approval powers were delegated down to the credit officer's level. After the "approval in principle", a "title bond" and title search report were obtained form the title insurance company.

The bank's legal officers would scrutinize the title search report and if it was found acceptable, the mortgage bond was signed. After this step, title insurance was obtained and then disbursements could commence. The whole procedure could take from six months to one year, with the title insurance company responsible for a greater part of the delay.

h. BOC's Proposal for a New Housing Finance Institution: BOC's interest in setting up a new housing finance institution apparently goes back to discussions with IFC representatives in 1980. As a result of these discussions, a committee was formed by the government to look into a new housing bank (see earlier section on history of this). Both the General Manager and Deputy General Manager of BOC were members of this committee which, as described, ultimately disbanded.

Nevertheless, BOC kept up its interest in the idea; perhaps because of the working relationships established with IFC through IFC's loan to BOC for on-lending to medium-scale industrial enterprises and the secondment of a resident advisor by IFC for the loan. The IFC encouraged contact between the Housing Development Finance Corporation of India (in which IFC has an equity and also a loan and which has been a recipient of an AID-HG) and BOC for further development of the proposal.

In a meeting with the AID Housing Advisor in September, the Chairman of BOC outlined the BOC's interest in (at that time) setting up a subsidiary housing finance institution which would have other equity participation including the IFC.

The idea was that the institution would make loans to middle-income families for housing at something like 15 percent interest, terms at perhaps 15 years. The Chairman stressed that middle-income individuals in Sri Lanka could not now afford a house given current salaries (he suggested Rs. 4,000/ 5,000 per month as middle income and appeared to be talking about professional people, including the earnings of both husband and wife. As a result, many professional people were going to the Middle East to earn higher salaries and this was causing a big problem for Sri Lanka. If, among other things, such people could afford to finance a house it might be one inducement for them to stay. He specifically stated that he did not feel such a bank could deal with low-income people because they could not afford the interest rates.

He mentioned, as one of the inducements for forming such a bank, the modifications to the Inland Revenue Act (income tax act). Apparently, if a housing bank is formed as a public company, profits would be tax free for the first five-year period. Somehow or other, as explained, the tax-free status would permit the loans to be made at 15 percent.

The Chairman said the BOC is also interested in developing its own customers further (presumably builders, suppliers, etc.), as well as financing the houses of middle-income borrowers. As an aside he also mentioned the current interest in setting up a Colombo Stock Exchange and related this to the creation of the new bank (perhaps, by enabling such a bank to raise capital through selling its shares publicly).

As part of this study, the Team met with the Chairman again in early December to discuss the status of BOC's considerations.

The Chairman mentioned that one of the constraining factors in establishing a new bank was that there was no firm commitment by government, presumably as to both approval and commitment of some fiancing. He said he envisioned a capitalization of Rs. 500 million at the rate of Rs. 100 million per year for five years. One source of equity funding was the new Employees' Trust Fund (see separate section) and a meeting had been scheduled with ETF to discuss this possibility.

The Chairman again suggested 15 percent as the interest rate borrowers from the new bank should pay and, consequently, the bank needs to be able to raise its funds at no more than 12 percent which is what he intended to propose to ETF officials. Interestingly, in a later part of the discussion, the Chairman said that people in Sri Lanka are very conscious about things like interest rates and more and more are seeking out the best terms. He said that as a result BOC planned to raise its passbook savings rate to 14 percent in the near future.

The following are the Chairman's ideas on a new bank's operations. A twenty percent down payment (the person must have a stake); core housing with the individual to finish developing on his own; local authorities must provide the infrastructure and recover the capital cost over 30 years through rates and taxes. The borrower should pay only for the land and building. He did not think, however, that the bank should get involved in development. He also mentioned that the BOC has many rural depositors who he feels should be able to get housing loans.

It was at this meeting that the MLGHC representative raised the possibility of the government contributing some financing from the yearly allocation (some Rs. 45 million) that normally goes to the National Housing Fund.

At one point in the meeting the question of mortgage insurance came up. The BOC lawyer said it would not be legal but no one else thought so, or at least that it could be instituted. Everyone thought it was a good idea. (See comment on guarantees in Central Bank section.)

Several subsequent meetings were held with the Assistant General Manager for Planning and Development who appears to be the BOC officer most knowledgeable about the proposal. In fact, a brief feasibility report had been prepared which was deated August 17, 1981.

The report appeared to be based on BOC's willingness to contribute to the new company, Rs. 100 million per year for five years with the new company actually lending out about RS. 50 million each year. The report assumed that 20 percent of housing loans disbursed would be deposited with BOC as term deposits (thus effectively jacking up the lending rate). The report indicated that the new company would be viable and would generate an acceptable rate of return on investment, and that BOC would get total returns of Rs. 204.2 million in the first 10 years. (See Annex 9 for a brief synopsis of the report.)

The following summarizes the Team's understanding of BOC thinking based on the discussions held and the feasibility report.

The current thinking of top management at BOC seems to be that lending for housing fits in with the present government's policies and BOC perception of housing needs and its desire to play a role. BOC recognizes the fact that the Prime Minister gives high priority to housing and so BOC would like to do something in that direction without tying up too large an amount of assets for too long a time. Thus, it is actively promoting a new housing finance institution. If it could find suitable partners for such a company it would be willing to put in substantial seed capital to get it going.

BOC seems to believe that a new housing finance institution needs to and could raise Rs. 100 million as initial capital from banks, with perhaps Rs. 45 million each year from the National Housing Fund. BOC seems to believe that the company's continuing sources of funds (repayments and profits) would be adequate for its needs.

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The Study Team feels this does not appear to be feasible, however. BOC has not though about deposits as a source of funds for the new institution.

Further, BOC seems to believe that the company would be viable if it made housing loans at 15 percent per annum. In the current money market conditions, 15 percent appears to be an uneconomic rate of interest. BOC's justification for the 15 percent rate seems to be that at higher rates people will borrow and then have trouble and not repay, or not borrow at all. BOC does not appear to have given much thought to encouraging applicants to reduce their housing requirements and therefore their loan requirements. (If housing costs (and loans) could be reduced, perhaps rates higher than 15 percent could be affordable and feasible.) Indeed, BOC's thinking is that there should be no limit on the maximum amount of loan an individual can obtain--the maximum amount should be determined only with reference to repayment capacity.

BOC also feels the possibility of reducing housing outlays in the long run by educating applicants and by innovative construction management. In fact, in one meeting the Chairman spoke about core housing (see above).

BOC does not expect any interference or resistance from government officials to the idea of setting up a new housing finance company.

BOC acknowledges that the new housing finance company could find it profitable and convenient to lend to developers.

Just in the short period that the Study Team was in Sri Lanka, the BOC proposal seemed to be getting a lot of support. The Chairman of the ETF, subsequent to his meeting with BOC, seemed to be enthusiastic about supporting the proposal. There seemed to be a concensus among both private and government people that some sort of private housing finance institution was needed to permit the private sector to play its role.

2. People's Bank

a. Introduction: People's Bank is the second of the two government-owned commercial banks in Sri Lanka. Consistent with its name, it appears to be the bank most identified with lower-income people and the rural sector although it engages in the entire range of commercial banking activities. In connection with its rural activities, it operates a system of some 580 rural cooperative banks.

The Deputy General Manager for Finance and Development was interviewed. The latest annual report the Team was able to obtain, 1979, is available for review.

b. Capitalization: Established in 1961 by an Act of Parliament, 50 percent of the initial equity came from government and 50 percent from cooperative societies. Under pressure from People's in 1980 that it was under capitalized, government contributed an additional Rs. 40 million in equity in 1980; bringing the total paid in capitalization to Rs. 50 million. Rs. 46 million was held by the government.

c. Organization and Staffing: The Bank has a ten-person Board of Directors, eight of whom are appointed by the Ministry of Finance and two by the Ministry of Cooperatives. Thus, the MOF has a strong, direct control over all policies and operations.

The Bank is headquartered in Colombo and has 15 regional offices and 295 branches. It has recently been opening about 30 new branches annually. People's also supervises the cooperative rural banks. The total staff amounts to 9,500 with 1,500 at the manager, assistant manager, and loan-clerk level.

The branches carry out all standard commercial banking functions with the regional offices providing supervision and inspection as well as some technical assistance. Loans above certain levels must also go to the regional offices for approval. The headquarters' office carries out management of the regional offices as to operating policies and practices and approves loan application at the next higher level.

With regard to the cooperative rural banks, these banks take in deposits from their members and in turn deposit them with People's. In 1980, the cooperative banks deposited Rs. 50 million in People's. In return, People's makes below-market rate loans to cooperative banks (Rs. 25 million to date), which are not receiving adequate deposits to cover loan demand. People's disburses funds to the co-op banks for consumer loans to co-op members for anything from consumer, to housing, to agricultural, to industrial purposes. The credit reviews are performed by the co-op banks, with technical assistance provided by the regional offices of People's. People's also regularly provides technical assistance to the co-op banks free of charge in all accounting, bookkeeping and finance matters, as requested by the co-op banks.

As of June, 30, 1981, the rural banks had about Rs. 90 million in loans outstanding, 47 percent of which were for housing (see Annex 10).

For a detailed examination of the organization of People's, as an example of commercial bank organization, see the organization chart presented as Annex 11.

d. Overall Figures: As stated, the 1979 Annual Report is the latest comprehensive statement of figures although later figures in certain categories are stated in the narrative below.

Highlights through 1979 are as follows:

-- Total current assests: Rs. 7,959 million of which Rs. 6,124 million are outstanding advances

-- Current deposits and other accounts: Rs. 7,933 million

-- Profit before taxes: Rs. 168 million

e. Resource Mobilization: Like other commercial banks, People's mobilizes savings by offering current, fixed-deposit, and savings accounts at

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rates comparable to the other institutions. As of 12/31/79, People's had 56 percent of the total savings deposits in the commercial banking sector.

The magnitude and trends of fixed, savings, and current accounts are summarized below:

	As of 6/30/80	As of 6/30/81
	(Rs. millions)	
Current Accounts	1,443	1,502
Savings Accounts	1,411	1,653
Fixed deposits	1,845	2,890

People's has experienced a significant increase in deposit mobilization at all of its banks, particularly in fixed-deposit accounts. The target groups for the deposit mobilization campaign undertaken by People's has been the small-saver and Sri Lankans employed abroad. The reasons, in addition to higher interest rates which are clearly a major factor, presented by People's management for this increase are:

-- Increased investment by the government in rural development projects, most notably Mahaweli project. Rural income and demand for agricultural credit has therefore increased significantly.

-- More branches opened.

-- Close contact that People's maintains with the co-op banks and its customers, particularly in rural areas.

-- A more active savings mobilization advertising campaign (increase in advertising budget) and the introduction of several new types of accounts.

Examples of the new types of accounts are: The Investment Savings Account (explained below under housing)--a new instrument currently of insignificant magnitude, but with high public exposure; the Minor Extended Deposit Accounts--a lump-sum or a monthly deposit for 2-5 years which permits one's child, after reaching 21 years of age, to draw on it. This type of account currently pays 22 percent (see newspaper ad contained as Annex 12); and the Resident Foreign Currency Account.

This scheme is intended to attract foreign currency deposits that People's can use to re-lend to the Free Trade Zone and international business. Sri Lankans abroad can open a savings account in foreign currency, paying interest that is free of income tax. With a minimum of $1,000 in such an account, the depositor also qualifies for a 17 percent, 10- to 15-year loan up to Rs. 300,000 to purchase a house. This scheme was started in April 1981. No data was available on this scheme as yet.

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f. Investment: The investment portfolio has also increased significantly as indicated by the following:

	As of (Rs. millions) 6/30/80	As of 6/30/81
Overdrafts	771	1,148
Loans	3,751	4,060
Pawning	398	613

As specified by the Board of Directors, People's also holds reserves and government securities.

A study is currently underway to determine what percent of the portfolio should be invested in each sector of the economy.

g. Housing Loan Activity: Despite the current high interest rates, People's seems interested in continuing to try and provide the same level of housing finance as a service to its customers.

The procedures People's follows in processing housing loans are contained in Annex 13.

Of the total outstanding loans of Rs. 6,505 million as of 6/30/81 (there is some discrepancy here with the figures under Investment above), Rs. 531 million or 8.2 percent consisted of housing loans. Approximately 5,300 housing loans are outstanding and a major increase in housing loans applications is being experienced by People's. The two mechanisms used to mobilize savings specifically for housing loans are the Resident Foreign Currency Account scheme (described above) and the Investment Savings Account (ISA) scheme.

The ISA is essentially a contract savings plan and includes three other types of purchases besides housing. The plan is not large; there were approximately 10,000 loans in the portfolio with perhaps 2,500 active savings contracts towards the end of 1980. The program has been popular but, to conserve the limited funds available, the bank has set high credit and income standards for applicants.

For housing, the maximum loan amount under this plan is Rs. 150,000 or 60 percent of the value of the property, whichever is less. The interest rate is 15 percent on the mortgage and 22 percent of the savings account. The latter was increased substantially in the past year.

The ISA contract is for from one to five years with the length of time a saver actually participates determining the term of the mortgage. The amount of the mortgage is based on the maximum monthly payment allowable, which is ten times the monthly ISA contract payment. The minimum monthly payment is

Rs. 100. The longer the participation in the ISA contract, the longer the term of the resulting mortgage and the lower the montly payment per Rs. 1,000; thus the longer the mortgage that can be granted. The schedule for the ISA contract is:

Duration of ISA	Maximum Period of Repayment
12 - 18 months	8 years
19 - 24 months	10 years
25 - 36 months	12 years
37 - 48 months	14 years
over 48 months	15 years

Participants are encouraged to continue savings for the full five-year contract even if they exercise their claim on a mortgage earlier. The bank offers savers, who live up to the contract, the right to exercise the unused portion for another loan to extend or modify their home. Even so, most savers drop out when they receive their mortgage.

People's is prepared to offer these loans at 15 percent, although paying 22 percent for the savings, as a special service drawing on its profits from other operations. Thus, it represents a type of cross-subsidy. The bank does not, however, intend to increase its activities in this area while interest rates are high.

The repairs and extensions program (home improvement) is a short-term loan for a maximum of five years which carries an interest rate of 20 percent. Applicants are evaluated based on income and employment verification from their employers. Each loan is secured by a recorded lien against the property.

People's is also involved in an experimental low-income housing program which was developed in late 1980 with the American Save the Children Foundation. Experience is limited to date. Details can be found in Annex 14.

Essentially the program works as follows. The program involves approximately 300 low-income families in a shanty upgrading project being funded by the Foundation and which offers loans for building materials. The People's Bank branch in the vicinity of the project has established a program to evaluate loan applications, collect payments, and provide financial counseling to the residents. The financing is being provided through a grant from the Foundation and a type of revolving or participating fund will be set up. People's Bank's responsibility is administrative only, and for which it will collect a three percent fee. Costs to the bank for this program are estimated to be somewhat higher; the shortfall is regarded as a public relations cost.

Each applicant for a housing loan will be reviewed for basic criteria:

- He must be a project resident.
- He must not have been blacklisted for loans from People's in the past.

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- He must be a citizen.
- He must be over 21 years old.
- He must have a guarantor.

Each applicant will then be required to open a savings account and attend meetings in which the need for repaying the loan and maintaining the houses will be discussed. Bank officials expect to remain involved with this community after granting loans because they believe personal contact is necessary to achieve a reasonable rate of repayment. Similar loan programs in the past (with rural housing and street vendors) have had mixed success, but it is elt that the tight-knit community, the assistance of Save the Children, and close supervision by the bank personnel should yield a repayment ratio of about 85 percent.

In summary, relative to housing, People's said it can continue to provide some loans at 15 percent. This subsidized 15 percent rate of lending is possible as long as its lucrative import/export (25-26 percent) business continues. As a service to its customers and as a savings mobilization incentive, the bank is willing to continue to lose some money on housing loans at 15 percent. The sizable profits of its commercial banking activities are covering the losses incurred from making housing loans at 15 percent (when funds cost 20-22 percent). Profits for 1982 are being estimated at Rs. 206 million. This cross-subsidy approach to housing is certainly one alternative for improving housing finance conditions, but clearly has its limitations.

According to People's management, the main operating problems with the housing loan portfolio are: 1) borrowers do not make loan payments on schedule, frequently delaying 1-2 months; and 2) securing of land title is time consuming, taking up to 6 months and resulting in project delays and escalated buidling costs.

3. Commercial Bank of Ceylon Ltd. (CBC)

This is one of the two local, private commercial banks in Sri Lanka. It specializes in export trade finance. It does little consumer lending and has given no thought to housing finance.

One interview was conducted with the Deputy General Manager and an Assistant General Manager. In addition to the pertinent items from that interview which are presented below, there is a comprehensive annual report for 1980 available for review.

a. General Characteristics: CBC has 1,000 employees; 120 officers. It has 10 branches, none outside of Sri Lanka. It is 11-years old and is owned 40 percent by the State Chartered Group (England), 30 percent by the government, and 30 percent by the general public.

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b. Summary of Operations: CBC raises capital through fixed deposits (interest rate 12-20 percent), savings accounts (interest 12 percent), and current accounts. Total deposits amounted to Rs. 1,048 million at the end of 1980. Fixed deposit accounts are the dominant source of funds. All of its funding sources are short term, repayable in 1-2 years at the very most. CBC is not interested in either borrowing or lending long because of the risk attributable to volatile interest rates.

Known as the exporters' bank, most of CBC's lending activities (total advances to customer at the end of 1980 were Rs. 767.8 million) are in the export finance area. Working capital is provided to exporters through the following types of instruments:

-- Overdrafts: Interest rate charged on overdraft depends on the type of export and the customer, but averages 19 percent;

-- Packing credits: loans 19 percent, 1-3 months to pay for 75-80 percent of the cost of purchase--packing and export of goods;

-- Purchase of export bills at a discount.

CBC attempts to provide to its customers more export lending services more efficiently than its competitors through the following:

-- Credit provided on same day as requested;

-- Exchange-rate market instantly maintained;

-- Advice provided to clients on letters of credit, guarantees and export documents;

-- Seminars, meetings, and symposiums regularly provided by the Bank's technical experts to its customers.

CBC became specialized in export finance because it was originally part of Eastern Bank which had an aggressive, competent export fiance department. With this base, the Commercial Bank was a key contributor in building up many of the leading local export trading companies which have remained with the Bank for most of their export finance needs.

The longest term financing provided by CBC is for 5 years; 24 percent loans for commercial, industrial, and some agricultural purposes (all agricultural loans are granted out of one branch). CBC does not make loans, even with these terms, to any real estate developers. Long-term lending is a minor component of its overall lending operations. Demand for the 5-year loans far exceeds the amount of funds that CBC is prepared to allocate for long-term lending.

CBC's exposure to consumer lending is minimal because: 1) it believes that the return from export industrial lending is superior; and 2) the preference by state authorities, although not in writing, is to discourage consumer lending.

c. CBC's Exposure to Housing Finance: There is none except for mortgage loans to its own employees.

d. International Loans: None, except a portion of the World Bank loan for medium- and small-scale industry which is channeled to CBC through the National Development Bank. This loan scheme was started last year. The Commercial Bank made loans of Rs. 25-30 million at 16 percent.

e. Summary: CBC appears to be a highly profitable commercial bank. Cited as problem areas by its General Manager are: a lack of space to expand (a new building is being constructed); a heavy training burden associated with a rapidly expanding staff (70 employees 11 years ago to 1,000 currently); an inadequate mobilization of deposits to provide more long-term financing (5 years) for industry and tourism.

4. Hatton National Bank Ltd. (HNB)

Hatton is the other local, private commercial bank. It also does the bulk of its lending for commercial purposes. It does little consumer lending or housing finance but, contrary to the Commercial Bank, its Managing Director evidences some interest in lending for housing.

One interview was conducted with the Managing Director and an Assistant General Manager. The important facts from that interview are presented below. The 1980 Annual Report is also available for review. Because of the considerably greater interest shown by the HNB officials in the work of the Study Team, supplemental information was provided in the form of statistical data on advances and the Articles of Association.

a. History: HNB, in its present form, began operations on May 1, 1970, when it amalgamated with two branches of Grindlays Bank. Its history goes back to the late 1800s when it was formed as the Hatton Bank Ltd. In 1974, it absorbed the Mercantile Credit bank, also with a long history in Sri Lanka. The HNB and its merged interests have had a long involvement with the tea industry over many years.

b. General Characteristics: HNB has about 1,200 employees; some 300 of whom are professionals or non-clerk status. It has 27 branches.

c. Summary of Operations: HMB raises its funds (total deposits were Rs. 775.9 million at the end of 1980) through the standard means, i.e., fixed deposit (at rates up to 22 percent for two years) savings accounts and current accounts. Fixed deposits constituted some 72 percent of deposits at the end of 1980, reflecting a growing percentage over the last several years presumably due to the higher interest rates on this type of deposit. HMB plans to issue Certificates of Deposits early in 1982.

HNB's loans go primarily to exporters/traders, industry, and construction companies for up to 5 years (property collateral required on 5-year loans), at 25-27 percent; 3-year terms are the norm. HNB also loans for packing credit with terms of 6 weeks at 16.5 percent. In addition, it provides letters of credit and overdraft services and makes loans to other commercial banks from overnight to one month.

As with the other commercial banks, Hatton is involved in making loans to small- and medium-sized industries at special rates of 15 percent which includes a 4 percent spread. These are World Bank funds available through the National Devleopment Bank. Hatton made Rs. 112 million of these loans in 1980.

Hatton is also involved in loans to the Mahaweli Resettlement Project. It on-lends funds received from the Central Bank at 9 percent for small agricultural projects involving an average 2 1/2 acres per household.

It was stated that HNB does not invest in government debentures or T-bills because of their low return relative to the 25 percent Hatton can earn on most of its other lending activities.

To give a picture of Hatton's portfolio, outstanding loans as of September 30 in 1980 and 1981 are listed below:

	1981		1980	
	Rs(000)	%	Rs(000)	%
Commercial	771.9	79.8	627.2	78.7
Agriculture	19.1	2.0	14.0	1.7
Financial	13.4	1.4	14.9	1.9
Industrial	82.3	8.5	77.9	9.8
Housing	17.9	1.8	16.1	2.0
Consumption	23.4	2.4	12.1	1.5
Tourism	30.6	3.2	28.5	3.6
Others	9.1	.9	6.7	.8
Total	967.7		797.4	

The lending rates for the various types of loans is given in Annex 15.

With regard to housing, the Managing Director said that Hatton stopped making housing loans in 1977 when fixed-deposit interest rates at the National Savings Bank started increasing and eventually reached 20-22 percent. In response, the commercial banks followed suit. The consequent requirement that the cost of funds would result in loans with terms of at least 24-25 percent led Hatton to stop making housing loans. According to the Managing Director,

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"leave the housing loan market to the State Mortgage Bank who could provide subsidized interest rates under 18 percent." Hatton feels that the market could not support such high interest loans for housing. All Hatton employees, however, are eligible for 25 year, 4 percent housing loans.

Nevertheless, the Managing Director expressed some interest in Hatton's returning to the housing finance market. He felt it would provide Hatton's large customer base with a service in much demand. He sees Hatton as an excellent institution to undertake a housing finance program for the following reasons:

-- It can process loans applications, (and disburse funds) quicker and with greater precision than other institutions;

-- It has 27 branches.

-- Large customer base (250,000), a number of whom would be interested in a housing loan and about whom Hatton is familiar as to financial status and capabilities. It would, therefore, not have to start credit reviews from scratch.

-- Unlike the State Mortgage Bank, Hatton is not politically pressured into giving loans without proper evaluation of the loan applicant (this is his opinion, not a fact uncovered by the Team).

-- Hatton has an extremely low delinquency track record on its portfolio.

Presumably, these views relate to a comparison of Hatton with the State Mortgage Bank or some new institution. Certainly other commercial banks and, possibly, the National Savings Bank could also make these statements. The issue becomes, then, how could Hatton raise the funds for housing finance.

As opposed to the Commercial Bank, however, the interest is there.

5. Foreign Commercial Banks

With the recent opening of the Amsterdam Rotterdam (AMRO) Bank in December, the number of foreign banks operating in Sri Lanka rose to thirteen. These banks are not allowed to open branches with the exception of one branch in the Free Trade Zone.

To get some feel for their operations, the Study Team interviewed Citibank, Bank of America, and The Hong Kong and Shanghai Banking Corporation (HKSB). It is clear that these banks are not, and would not be a factor in houisng finance insofar as lending goes (although HKSB does lend to employees for housing). However, although the question wasn't specifically raised with the banks interviewed, the Team was subsequently told by others that they thought the foreign banks might be willing to put up some small equity in a new housing finance bank to demonstrate their interest in government priorities (although HKSB specifically said it would not invest in debentures by a housing bank).

There appears to be rather fierce competition among the foreign banks in the areas in which they operate. This does not include retail banking. They are lending mostly short term for export/import financing with some term and project financing. The latter is for things like hotel or industrial projects.

Deposits are raised in the usual ways, i.e., demand deposits, passbook savings and fixed deposits at rates competitive with the other commecial banks. Apparently four banks have now offered Negotiable Certificates of Deposit, American Express being one of them, paying at 17.5 percent for one-year maturities. HKSB does not plan to; it feels these are too closely associated with "black money." Bank of America doubts they will be successful.

C. NATIONAL SAVINGS BANK (NSB)

1. General

The NSB is a wholly government-owned savings bank which commenced operations on April 1, 1972. It is an amalgamation of the Ceylon Savings Bank; the Post Office Savings Bank, the Savings Certificate Section of the Postmaster-Generals's Department; and the National Savings Movement, all government organizations--some of whose operations go back over 100 years.

It operates as a savings bank and does not carry out commercial bank activities. It appears that its primary purpose is to mobilize savings from individuals through a variety of instruments and to utilize these savings for economic development programs of the government. These programs are not supported directly, but by purchasing government securities.

The National Bank Act requires that not less than 60 percent of the Bank's deposits must be invested in government securities, the remainder to be invested in various types of housing loans. In practice, at the end of calendar 1980 (the fiscal year), the latest year for which figures are available, 93.2 percent of the total deposits of Rs. 5.2 billion were invested in government securities. In 1980, 98.9 percent of the investments made by the Bank went into government securities.

According to the Bank's annual report for 1980 (see Annex 16), 30.2 percent of the total deposits of the NSB and all commercial bnaks in Sri Lanka of Rs. 17.2 billion were in the NSB. However, this had dropped to 28 percent by August 1981.

2. People Interviewed and Material Made Available

Three separate discussions were held with the General Manager and there was a brief meeting with the Chairman. Follow-up meetings were held with the Loans Manager, the Branch Manager, and the Chief Savings Program Officer.

There appeared to be aa initial reluctance to discuss the Bank's operations in very much detail or to provide specific information apparently due, at least in significant part, to some criticism of the Bank's operations and receipt of subsidies from the Treasury (see later discussion) in the newspapers in November. This necessitated a reply by the Bank to the Daily News dated 11/27/81 but a further articles appeared in The Island dated 12/13/81 while this study was going on (see Annex 17). Therefore, the statistical information contained in this study comes mostly from the 1980 Annual Report rather than from preliminary 1981 figures which might have been provided.

3. Organization

The general supervision, control, and administration of the affairs of the Bank are vested in a Board of Directors consisting of 7 members; namely, the Postmaster-General, the Deputy Secretary to the Treasury or his representative, a representative of the Ministry of Planning, and four others appointed by the Minister of Finance for a period of three years at a time. The Head of the Board of Directors is the Chairman, appointed by the Minister from among the seven Directors.

(Note that Finance and Planning are now under one Ministry.)

The Chairman and the Board of Directors constitute the governing body of the Bank and determine the basic policy framwork within which the Bank has to function. The translation of such policy into action is done by the General Manager under the direction of the Chairman who is the Chief Executive of the Bank. He is support in this task by a range of senior executives.

The Team was told that decisions with regard to the make-up of NSB's portfolio do not require specific MOF approval but, in effect MOF does exercise effective control if, in no other way, through the Board.

The key policy decisions, i.e., composition of the portfolio, interest rates paid to depositors and interest rates paid by the government on its securities purchased by NSB and interest rates charged by NSB on its housing loans are apparently all made by MOF although the Study Team was not able to find out how the process was carried out.

The Bank has a total staff of about 2,300--over 1,500 in Colombo--and has 45 branches, including the headquarters office, located throughout the country. The branches are located predominantly in provincial capitals but some have also been opened in more rural areas where the idea is to promote savings and thrift among the people. These branches accept deposits, pay withdrawals and maintain accounts, operating more or less independently and performing the functions of the savings bnak. Housing loan approvals, however, are reserved for the central office, although disbursements and collections are done at the branch level.

There are now some 340 post offices and 3,500 sub-post offices covering all areas of the country, no matter how remote. These post offices, in addition to their normal postal functions, also accept deposits and pay-out withdrawals for the NSB but do not maintain the customers' accounts. The returns of all such transactions are sent to the Head Office of the Bank where ledgers are maintained.

This widespread network of branches, post officers and sub-post offices, clearly gives the Bank by far the largest coverage of any financial institution in Sri Lanka. Annexes 18 and 19 provide a description of the Bank's network branches and postal agency operations.

4. Savings Mobilization

A variety of savings instruments are available to the Bank's depositors, many of them introduced since the new govenrment was elected in 1977, with specific efforts to serve the lower-income groups. Of significant importance is that all interest earned from the NSB receives a tax-free allowance of 33 1/3 percent or Rs. 2,000 per year, whichever is greater. A brief description of each type along with current interest rates follows with more detailed descriptions given in Annex 19.

a. Ordinary (Passbook) Account	12%
b. Fixed-Deposit Account	
6 months	15%
12 months	20%
24 months	22%

The minimum amount required to open an account is Rs. 100. Reduced rates of interest are paid if there is an early withdrawal. For deposits of Rs. 5,000 or above and with a minimum period of 12 months, interest can be paid monthly at a rate of 18.6 percent.

c. Premium Savings Bond: These bonds, priced at only Rs. 10 each, provide small savers with an opportunity to win a prize in monthly lottery draws in lieu of interest. Pruchasers of these bonds are guaranteed participation each month that they hold the bond. First prize is Rs. 10,000; second is Rs. 5,000; and there are 30 consolation prizes of Rs. 500 each.

d. Regular Monthly Income Savings Plan: This scheme provides for a monthly pension based on a monthly savings deposit. The interest rate paid is 13.2 percent. The minimum payment is Rs. 50 and after 5 years the participant will receive the amount of the payment monthly for life. There are variations of the scheme involving lump-sum payment.

5. Investments

As stated earlier, 98.9 percent of investments made by the NSB in 1980 were in government securities with total investments through that period up to 98 percent in government securities. With continued pressures on the government's capacity to raise money, this appears unlikely to change.

The government securities are for the most part short term (2-3 years) and are paying NSB an average of about 16 percent.

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The remainder of NSB's portfolio of Rs. 4,947.7 million at the end of 1980 was essentially in housing loans (RS. 70.4 million although the General Manager mentioned a current figure of Rs. 100 million) and call-money loans to commercial banks (Rs. 30 million). The latter are currently earning between 17-19 percent.

With regard to houisng, individual loans are made only on the security of first mortgages. Loans are made to any person, without restrictions, for construction, purchase, or payoff of existing loans as long as they can afford to service the loan.

The interest rate is now 15 percent with terms up to 20 years. Loans are made to a maximum of 75 percent of value and Rs. 200,000 for a one-unit house, or Rs. 300,000 for a two-unit house. Branch officers do the loan processing, with loan approval being given by the main office. Loan recods and files are maintained at the main office with machines used for most of the record-keeping.

Collections are made both at the branches and the main office. Delinquent accounts are pursued by branch perdonnel, as directed by the Collection Department. Accounts are "transferred for recovery" when they are six-months delinquent. The threat of foreclosure usually achieves collection of delinquent installments as mortgagors wish to retain their properties, particularly with rising property values. Foreclosures are few in number.

During 1980, NSB approved housing loans as follows:

Type of Loan	No. of Loans	Total Amount (Rs. millions)	Interest Rate
Building Site Purchase	39	.68	12-13%
Construction of House	531	6.90	12-15%
Purchase of House & Prop.	49	1.90	12-15%
	619	9.48	

Another Rs. 3.3 million was extended to employees for housing loans at 6 percent. Maximum loans for this purpose are Rs. 90,000.

As can be seen, the average loan for all purposes was Rs. 15,315. For a house and property, the loan average was Rs. 38,776. With a number of years operations behind it and a total portfolio of only Rs. 70.4 million (US$3.52 million at a 20-to-1 exchange rate), it is clear that NSB is not impacting heavily on housing in Sri Lanka.

6. Operations

The latest annual report, which covers calendar 1980, is attached as Annex 16. Unfortunately, as stated above, we were not able to obtain any later data from the NSB, but did get data with regard to savings and fixed deposits. The latter, which includes all commercial banks, were taken from the Central Bank Bulletin of October and are contained in Annex 6.

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There appears to have been some competitiion for savings between the NSB and commercial banks with the latter increasing their percentage. For instance, the MOF authoried the NSB to raise interest rates on 12- and 6-month deposits to 20 and 15 percent from 15 and 12 percent, respectively, in May 1980. This followed an earlier raise in September 1977.

The commercial banks quickly followed suit and added a 24-month deposit with a rate of 22 percent. NSB followed suit in April 1981.

As of the end of August 1981, the Bank's deposits by category stood as follows (excluding accumulated interest in fixed deposits and savings certificates).

Savings Deposits	Rs. 2060.1 million
Fixed Deposits	3064.9
Saving Certificates	31.7
Premium Savings Bonds	6.7
National Pension Scheme	5.6
	5169.0

It is difficult to compare this to the Rs. 5,201 million shown in the 1980 Annual Report for total depsoits since the latter figure does include accumulated interest. 1980 showed a net increase in deposits of Rs. 446.5 million, more than 100 percent of this coming in fixed deposits and offsetting a substantial drop in passbook savings. This apparently reflected a significant response to savers to the rapid rise in interest rates in fixed deposits despite an inflation rate at the time of over 30 percent. There were some 7.1 million accounts open at the end of 1981.

On operations in general, the 1980 profit and loss account showed a profit before income tax of Rs. 47.3 million and a new profit of Rs. 24.1 million. Out of this apparently grows some of the recent controversy. The profit and loss statement gives some breakdown on expenses, but none at all on income. One can derive that total income was Rs. 728 million and this is stated later in the report. Most of this obviously came from interest from government securities. However, since the interest being earned on these investments and from housing do not match the average cost of money plus administrative costs, some sort of supplemental payment is necessary. The average cost of money to NSB should be somewhere around 16 percent. In 1980, the NSB's investment in government securities show Rs. 621.5 million in 16 percent instruments. The Study Team's understanding is that NSB is currently getting between 13 and 16 percent on its government investments, but a more precise figure was not obtained.

This shortfall was covered in 1980, according to the 1980 Annual Report, through receipt of Rs. 300 million in a government grant. How this figure was arrived at is not clear since it enabled NSB to show a "profit" of Rs. 47.3 million. Why the government did not simply pay an interest rate closer to the

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market rate is also not clear. The NSB went to some lengths in its newspaper rebuttal to say that the Rs. 300 million was not a subsidy. This year, according to newspaper reports on the budget, NSB is asking for a supplemental grant of Rs. 405 million.

7. Appraisal and Views

The NSB, with its deposits of Rs. 5.2 billion (roughly $260 million at today's rates) as of the end of 1980 and legally permitted to loan up to 40 percent of its deposits for housing (theoretically, Rs. 2.8 billion at that time), could clearly be a major factor in housing finance in Sri Lanka. Its wide coverage of branches and large number of depositors would also be advantageous. Instead, outstanding housing loans amounted to only some Rs. 70 million by the end of 1980.

It also appears clear that, at least for the present, the government is unlikely to change the mix. The NSB definitely represents a "capitve" source of finance for the government at a relatively low rate of interest, even with the operating subsidy. The high rate of interest being paid for the fixed deposits, now some 60 percent of total deposits, would also make it difficult to reach a lower income level with housing loans.

Because of the competition for deposits expected in higher interest rates and the lessening of the tax advantage to depositors of NSB (civil servant salaries, for instance, are now entirely tax exempt), NSB's rate of increase in deposits has lessened as has its market share. Nevertheless, NSB has to be a factor inconsidering what to do about housing finance in Sri Lanka, both as a mobilizer or resources and as a potential lender for housing.

Interestingly, the General Manager supports the need for a new housing bank and the need for private orientation for such a bank. He did not indicate that there was an expanded role for NSB in housing finance, although admitting that housing loan applications had jumped considerably with the drying up of commercial bank lending for housing.

The Team was not able to get any real feel for the organizational efficiency of MSB other than general comments in the private sector about government inefficiency. Certainly, there was no widespread set of negative comments such as was encountered with the State Mortgage and Investment Bank. One reason, however, could be that since almost all resources go into government securities, very few people deal with the Bank other than as savers.

The Bank has continued to expand in 1981, opening several new branches. It appears to be trying to develop innovative, new means to generate savings. As to staff, its employees (below the executive level) now earn the equivalent to salaries of the government-owned commercial banks, although executives are still lower.

D. THE STATE MORTGAGE AND INVESTMENT BANK (SMIB)

1. General

SMIB became operational on January 1, 1979. It was a merger of the Ceylon State Mortgage Bank and the Agricultural and Industrial Credit Corporation of Ceylon and assumed the assets and liabilities of those organizations. It is governed by a specific law which spells out in detail SMIB's organization, line of business, and operational procedures. It is empowered to make loans for housing, agriculture, and industry.

The Bank is a wholly government-owned corporation. It is supervised by the Corporations Division of the Ministry of Finance which does audits, looks at operations, etc. Policy issues are set by the Director of Economic Affairs, MOF who, among other things, approves the issue of debentures by the Bank (its primary and at the moment only source of raising funds), the interest rate that SMIB can pay on these debentures, and the areas in which SMIB must concentrate. MOF could, for instance, shift SMIB away from housing and toward industrial lending.

Because the Bank is the only financial institution primarily involved in housing as its primary business, the Team's coverage was much more extensive than that of other institutions. Hence, some of the criticisms stated, relative to others, may simply be due to a greater understanding of SMIB's operations.

Original contacts with SMIB date back to September 1980 when interviews were conducted with the Chairman and General Manager in connection with the Shelter Sector Assessment and were followed by interviews with the same gentlemen in September 1981 in connection with a study on housing subsidies. For the current study, the Chairman and General Manager were interviewed again; followed by additional meetings which included the Senior General Manager for Administration, the Deputy General Manager for Finance, and the Chief Credit Officer. It should be pointed out the SMIB officials were very forthcoming with time and provision of information, not true with all institutions.

Several documents are included as annexes: Particulars Related to Mortgage Loans (Annex 20), Trends in the Bank's Activities (Annex 21), Total Loans Granted, Repaid and Oustanding 1958-1981 (Annex 22), and the P&L Statement and Balance Sheet for 1980 (Annex 23).

2. Capitalization and Overall Operations

The authorized capital of the Bank is Rs. 200 million with Rs. 75 million subscribed. What is shown as the Profit and Loss Account (presumably reserves) is Rs. 6 million.

Profits for 1980 before tax were Rs. 6.7 million and net profits after tax were Rs. 3.2 milion. On the asset side, investments (government securities and bank deposits) amounted to Rs. 5.7 million at the end of 1980 and

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outstanding loans to Rs. 127.9 million. (The current figure of loans outstanding is between Rs. 150-160 million.) Long-term liabilities (presumably mostly debentures) totalled Rs. 65.9 million at the end of 1980. See Annex 23 for further details.

The Bank is currently doing about Rs. 80 million in new loans per year with only limited advertising. The General Manager felt that with major advertising, sufficient resources and adequate staff, the Bank could do Rs. 1 billion per year.

Currently, the average interest on the Bank's portfolio is about 9 percent, the average cost of money about 8 percent. (Although, as pointed out later, some debentures coming due soon are at 5 percent which will raise the cost of money.)

The average loan was Rs. 50,000 up through 1979. It was expected to go to Rs. 75,000 in 1980 and then higher, but figures were not available.

3. Organization and Staffing

The Bank has a main office and two branches, all located in Colombo, with about 150 employees. There are three departments: one covering credit, valuations and legal, another for administration, and one for accounting and recoveries. An organization chart is included as Annex 24.

Loans are made throughout the country but applications must be submitted Colombo. The Bank of Ceylon is the SMIB transfer agent, accepting loan repayments on behalf of SMIB. Bank of Ceylon does not charge SMIB any fees for this service. However, SMIB keeps its major accounts in Bank of Ceylon in return for this transfer agent service.

Insepction on work in progress (related to loan drawdowns) is now done by the Bank's own staff even outside Colombo. Valuations in outlying areas are done by "panel valuers" (fee appraisers). The General Manager of Administration considers the logistical and organizational coordination between SMIB's two branches and the main office to require a major level of effort.

SMIB has had recent difficulty in retaining management and senior technical staff. This problem is not only attributable to positions available in other countries with higher salary structures (e.g., ten staff members have gone to the Middle East and Nigeria) but also due to the SMIB salary structure being lower than commercial banks. However, the SMIB salary structure is superior to the salary structure of the civil service. Because of this salary differential, it has served to some degree as a training ground for commercial banks. It also recently lost a department head to the National Development Bank.

The General Manager of Administration is, therefore, focusing most of his attention on staff matters. For instance, SMIB faces a shortage of experienced credit officers. The low salary structure in comparison with commercial banks prevents SMIB from attracting and retaining qualified credit officers.

Consequently, recent college graduates with minimal experience are hired and given some ad hoc training. Part of this training is done by SMIB credit personnel attending "short courses" at the National Institute of Buisness Management. This partial training situation has resulted in credit reviews/decisions taking longer than usual and sometimes not being performed properly or fully, as management sometimes finds out after the fact. SMIB currently has six credit officers, with four more to be added next year.

NOTE: The above point needs to be considered in appraising the possibility of a new institution.

4. Mobilizing Resources

a. 1981 Source of Funds: Rs. 60 million of debentures was sold through the Central Bank to government financial organizations, e.g., the NSB, at 16 percent, 3 years. This funding is expected to cover SMIB operations to March 1982. The debenture terms are set by the Ministry of Finance. SMIB is authorized to sell these debentures to the public. Unfortunately, recently they have not been purchased by the public (although they have been in the past) of better terms offered elsewhere, e.g., commercial banks and the National Savings Bank 2-year time deposits at 22 percent, 1-year time deposits at 20 percent and, in the case of NSB, 1/3 of interest is tax free up to Rs. 2,000. Finance companies are currently paying up to 30 percent on time deposits.

With no public response to debentures, Treasury was obligated to ensure the purchase of the full Rs. 60 million by the government institutions. SMIB sold the debentures in three Rs. 20 million installments; the last installment being sold in December. SMIB is authorized to take in time deposits, but given the current time deposit rates of 20-22 percent, it feels it is not feasible with mortgage rate ceilings set by SMIB at 18 percent. Passbook savings are not permitted.

b. 1982 Funding: SMIB is planning for a Rs. 100 million budget. The Central Bank is expected to provide the funding by purchasing debentures issued by SMIB on terms to be specified by the MOF. The estimated interest rate is 18 percent. SMIB's determination of what size budget to plan for is based on its estimates of staff capabilities, market demand, and what the MOF might feasibly provide.

In 1980, SMIB mobilized Rs. 10 million through 2-year debentures at a cost of 10 percent per annum. The average cost of debentures on the books is 18 percent. This includes some as low as 5 percent, but these are coming due. Currently, SMIB is paying 18 percent on overdrafts from commercial banks (presumably BOC since this is where SMIB banks).

5. Lending Operations

SMIB is authorized to lend for housing (new construction, additions to existing homes and land acquisition), agriculture and industry, atlhough housing predominates. The paper "Particulars Relating to Mortgage Loans," Annex 20, covers this in detail.

SMIB rates of interest range from 12 to 24 percent. The rates appear to be designed to link the average rate of interest with the average cost of funds and not marginal costs, which are much higher. The rates increase with the increase in loan amount and are much higher for purchase of property than for construction.

RATES OF INTEREST

Purpose Loan Amount		Percent Per Annum House Construction	Purchase of Property
Not exceeding	Rs. 50,000	12%	18%
Not exceeding	Rs. 100,000	16%	19%
Not exceeding	Rs. 200,000	18%	20%
Loans exceeding	Rs. 200,000	22%*	22%

* Applicable only to the amount in excess of Rs. 200,000; such excess is repayable in 5 years.

The maximum amount that may be granted to an applicant varies with the purpose for which the loans are borrowed.

	Maximum Limit
For purchase of a building site for construction	Rs. 50,000
Extension of an existing house	100,000
Purchase of a house property (per unit)	150,000
Construction of a swelling house (per unit)	200,000

Loans are limited to 75 percent of the value of the house property (including land), however, the Bank's exposure is usually less because the valuation is less than market value; further, the amount of the loan depends upon the repayment capacity of the applicant. The maximum loan per applications is limited to Rs. 500,000. The SMIB's lending policies therefore seem to encourage construction of a house rather than purchase, and smaller loans rather than larger loans.

SMIB grants loans only on security of immovable property, and, in most cases, requires a certificate of title assurance to be furnished from the Insurance Corporation of Sri Lanka. Repayment is in equal installments, monthly or half-yearly, over a period not exceeding 20 years with the last installment to be repaid before the applicant reaches the age of 70. SMIB collects an initial deposit together with the application to cover expenses in processing the application.

Credit Procedures: The period of the loan is determined on the basis of the individual's ability to pay. SMIB goes by the present income of borrowers; if the house will generate rental income, the repayment period is cut down.

The loan amount is determined with reference to the value of the property and repayment capacity. First, the bill of quantities is examined to ascertain cost of construction (value aspect). Next, income is reviewed and the amount an individual can repay is determined. SMIB gets a statement of expenditure from the individual--SMIB judges veracity of this statement from information as to number of dependents, location, etc. Sometimes inspectors are sent to visit the family and see their living conditions.

If husband and wife are working, incomes of both are included. All supplementary income (e.g., from agriculture) is also taken into account. Income of the past three years is taken into consideration. Only the person who owns property enters into the mortgage agreement.

The loan amount is determined on the basis of the amount of income which can be paid, up to about 30 percent of gross income. SMIB also asks for information about the sources of funds for the balance amount required for whatever purpose financing is being sought. Repayment obligations for and loans taken for this purpose are also taken into consideration in determining the loan amount. Generally, savings amount to about 30 percent of gross income.

SMIB lends mainly for single family homes although, in Colombo, SMIB finds home borrowers taking loans for an apartment (condominium system).

According to the Chief Credit Officer, the time from application to credit appraisal takes about one month. Then loan recommendations are put up to the Board for approval. This is sometimes as short as one week, when all the information is available. At each Board meeting (held twice a month), about 30 to 50 housing loans are approved. Other information, however, indicated it takes about three months for the process.

Rescheduling of loans and requests for supplemental loans are also handled by the Credit Department. There are three Credit Officers and one Chief at the main branch. In most cases the applicant is interviewed before approval of the loan. This interview takes place approximately 15 days after the application is made.

SMIB also makes loans to companies (up to Rs. 500,000) for housing for employees. There is no special application form for companies (there is one for individuals). SMIB has been receiving enquiries from companies for financial assistance in respect of housing for employees.

Disbursement can take 6 to 12 months from date of application. A lot of documentation is required, which seems to be the cause for such delay. Where

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construction is involved, the borrower must spend his share first, then disbursements are made for land, and finally construction. All advances are based on inspection. Five percent of the loan is held back pending a municipal certificate of completion.

Rejection of loan applications, when made, is usually on the grounds of inadequate repayment capacity. There are also some cases when the applicant does not have the legal capacity to own a house under the Ceiling on Homes Act.

The Chief Credit Officer feels that SMIB's credit appraisal procedures are similar to those of other bnaks (e.g., Bank of Ceylon) for housing loans; however, it is easier for banks to lend since they normally lend only to their customers and know the creditworthiness of those customers.

Currently, the main branch receives about 200 applications per month and the other branch receives about 60-80. The main branch deals only with the Colombo district (which is more affluent and therefore receives more applications).

Delegation of loan approval powers from the Board to lower levels would help speed-up approvals. Current approvals are running about 30-50 per month.

Loan application volume has increased significantly since mid-1981 when the National Housing Fund and commercial banks stopped making housing loans. The loan application volume increase has also been attributed to SMIB's newspaper advertising campaign.

6. Loan Servicing

Of the some 10,000 loans outstanding (some 90 percent are maintained in the Head Office and the remainder at one of the branches), approximately 3,000 are in arrears, some considerably. The Chairman and General Manager both said delinquencies might average as high as 40-50 percent, but they said this is constantly changing, i.e., the specific people who are delinquent at any time. The problem is that SMIB's manual system does not readily identify who is in arrears and by how much. Since so many loans are in arrears, SMIB does not have an accurate listing so that it can follow-up systematically. It is planning to install a computer system in early 1982 which should help solve this problem.

Normal procedures call for a first notice to be sent to a delinquent after three months. If there is then no action a letter is sent saying the delinquency will be published in the Gazette and with a copy of the Gazette notice (but before the notice is actually published). This usually gets action. The Bank has foreclosed only seven times in its history, only three times in the last three years.

One of the reasons causing arrearages is that borrowers are putting money into high-yielding deposits (up to 30 percent with finance companies) for as long as possible until the threat of foreclosure makes them pay.

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7. Summary of 1981 Operations, Appraisal and Comments

a. 1981 Lending (first 10 months): The average interest charged on loans made was 15.29 prcent, 15- to 20-year term. The maximum interest rate charged is 18 percent. SMIB has determined that, given the criteria of not allowing borrowers to pay over 1/3 of their monthly salary before taxes on mortgage debt, interest rates above 18 percent would not be affordable to a major portion of its clientele.

SMIB is currently in the process of considering a policy of establishing a 16 percent floor on loans. Mortgage demand at 18 percent is very strong; SMIB is unable to satisfy all of the demand. If SMIB were to raise capital for mortgage lending through time deposits, and it can do this paying the going rate of 22 percent, mortgages would have to carry a 24 percent interest rate (2 percentage points are required for administration costs). If SMIB pays under 22 percent on time depsoits, the rate would not be competitive with what other financial intermediaries currently pay and therefore would not attract depositors. SMIB is, however, considering the possibility of contractual savings.

SMIB is authorized to increase interest rates on outstanding mortgages but, for political and economic reasons, has not exercised this option.

b. Mortgage Payment Delinquency and Prepayments: As discussed above, up to 50 percent of the outstanding mortgages are delinquent at a given time and the emerging trend is for households to hold back on mortgage repayments until SMIB threatens them with foreclosure. The late charge penalty is too small to be a disincentive for late payment; in fact, the incentive is to put this money in high-yielding accounts. However, borrowers never default, they don't want to risk losing their houses at auction. Despite many low interest rate loans still outstanding and the tax deduction benefits of interest payments, the incidence of prepayments is high.

SMIB expects to have its computer (IBM) in operations by the first of the year. There is a Deputy General Manager in charge. The computer has the capacity to do much more than SMIB accounts and SMIB would be very much interested, for instance, in servicing National Houisng Development Authority accounts for a fee. The Team did not get into this in depth and it may have been that SMIB referred only to accounting, not collections and follow up. The General Manager did say, however, that he had talked to the National Housing Commissioner about this at one time.

c. Operations: The efficiency of SMIB procedures is open to some question. It can take as much as one year to get a loan from SMIB. (With an inflation rate running up to 40 percent and a typical construction cost of Rs. 250,000 per house, this delay alone means a significant increase in capital outlay). In 1980, SMIB processed 697 applications but its backlog of applications under process increased from 1,107 at the beginning of 1980 to 1,635 at the end.

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SMIB's principal objective seems to be social welfare and, in pursuing this aim to cover costs and show some profits, which is not difficult with the cheap funds SMIB gets from the Treasury. Their seems little emphasis on the commercial approach. SMIB has recently obtained permission to raise funds by way of deposits from the public, but has not yet thought of concrete ways of doing this.

While SMIB's marginal cost of funds is 16 percent, its average rate of interest on the loans it has made recently amounts to 15.29 percent. The policy appears to be to keep interest rates to borrowers as low as possible in order to provide adequate funds for housing to "marginal borrowers." Profitability is a second priority. SMIB has not been able to fully or even adequately satisfy the demand for housing construction finance on account of limited funds available for lending and the significant lead-time requirements, up to six months, with title insurance procedures taking up most of the time.

The array of routine operating procedures carried out, while limited in scope, are well organized and performed on a timely basis. SMIB is looking to the impending computer system to be installed at the instrument that will enable its staff to expand the scope of its day-to-day operations.

As far as marketing or corporate planning by management is concerned, there are no organized efforts being carried out on a regular basis even though substantial changes are occuring in housing trends. It appears that SMIB should develop and implement strategies to more effectively and profitably finance housing. There is an absence of any thinking (or aggressive lobbying) regarding alternative savings and mortgage schemes.

In addition, management must make a concerted effort to develop and implement work productivity standards and goals. For instance, the level of mortgage delinquency, recognizing that SMIB is still operating with a manual system, needs to be tabulated. While one accountant was assigned to monitor arrearage, up to date information was not available due to the overwhelming volume of loans he had to review.

d. Major Recent Developments: SMIB has applied to the government for an amendment to its charter to allow SMIB to take in passbook savings accounts. The other major change which SMIB applied for and received was the authority to develop a property development business. The idea would be to purchase land outside Colombo, install infrastructure, block off land into parcels, and sell to individual purchasers.

Also mentioned was an SMIB reorganization effort being considered. No details were available since this activity is just in a "preliminary conceptual phase" at this point in time.

Another approach being considered by SMIB to improve its earnings position is to borrow from the National Development Bank and on-lend the funds for industrial projects. The attraction of this opportunity is the wide 3.5 percent margin that these loans will generate. SMIB estimates that the loan from the National Development Bank will carry a 14 percent interest rate.

However, as far as the Study Team could ascertain, this approach would not be aproved by the MOF.

The general impression of SMIB gained by the Study Team was that it needs to improve its overall operations considerably. While reasonably administratively efficient in day-to-day loan disbursement, credit review, collections and accounting functions, SMIB needs to strengthen its analytical approach, to developing more aggressive strategies for raising capital and granting market rate loans and to devote more time to the resolution of upcoming problems and how to improve financial performance.

One problem may be that most of SMIB's direction and performance are too heavily controlled by government interest rates, funding policies, and regulations. Consequently, there is little evidence of a detailed familiarity with the housing market and the level of interest rates that clients could absorb, alternative mortgage mechanisms that might be applied in conjunction with higher mortgage interest rates (as far as the Team would ascertain, variable rate mortgages or graduated payment mortgages have not been considered), or experimental schemes to either raise capital from private and commercial sources. There does not appear to have been any hard thinking about branch expansion.

One's impression is that SMIB needs to take a dispassionate view of the effectiveness and efficiency of their operations and consider changing operations and objectives which are no longer suited to the current economic situation.

In summary, SMIB's earnings position is not impressive; although at least positive. It seems that as long as this position can be maintained, there is insufficient incentive or pressure for SMIB to deviate from its low-keyed style of operations. More structured, comprehensive and action-oriented corporate planning efforts are needed if SMIB is to play a more positive and significant role in financing housing in Sri Lanka.

The major problem areas that need to be addressed would certainly include:

-- Clarification of SMIB objectives;

-- Recruitment and remuneration of staff;

-- Training of staff;

-- More forward thinking as to the mobilization of resources and the structuring of its lending activities.

Perhaps some type of management technical assistance would be in order. Another approach is to create a new housing finance institution which could then pick and choose from SMIB's staff. Such an arrangement could take advantage of the expertise built up by SMIB without taking on its shortcomings.

E. OTHER BANKING INSTITUTIONS

1. National Development Bank (NDB)

NDB is a statutory body and is the newest of the financial institutions is the state sector, beginning operations in October 1979.

Up to now it has been solely dependent on its equity capital plus line of credit from the IBRD and the Asian Development Bank. Shareholders are:

Government	Rs. 400 million
Central Bank	100 million
People's Bank	50 million
Bank of Ceylon	50 million
	Rs. 600 million

Rs. 450 million has been paid in cash (all of the government's contribution plus commercial banks) and Rs. 150 million in non-interest-bearing promissory notes (Central Bank plus commercial banks).

As of 10/31/81, reserves were Rs. 208 million. Long-term liabilities were Rs. 109 million from IDA credit. NDB's investment portfolio on projects consisted of: term loans--Rs. 190 million; equity--Rs. 1[illegible] million; refinancing of small- and medium-industries (SMI) projects--Rs. 112 million.

NDB is still in the process of building up its staff. Lending got under way toward the middle of 1980 and was fully underway in 1981. NDB will lend up to 12 years for industrial and agricultural projects in both the public and private sector.

The Chairman does not feel it is possible to lend on a long-term basis for housing because of the high interest rates. He feels you cannot promote housing with these rates; it must be subsidized. With regard to possible equity in a housing finance institution, the Chairman is not sure the statute permits housing investments although he admits the Act is very broad (the Act does state, incidentally, that NDB should give special emphasis to the rural sector).

The Bank expects to get its resources in the future mostly from the private market, but hopefully will get some from the government budget. NDB wants to recycle as fast as possible.

Generally the Bank would like to take equity positions in companies to which it would also make loans, but would not intend to take more than 10 percent of a company's equity. It prefers to lend to an institution that will give a return on market terms.

At the moment, NDB is lending at 17 percent for 3-12 years with an appropriate grace period.

NDB has a $10 million loan from the Asian Development Bank at 11 or 12 percent. The first IBRD (IDA) credit was $16 million: $4 million for studies and TA; $12 million for on-lending. This is an IDA loan to government, NDB gets it a 9 percent. The ultimate borrower borrows 15 percent (somewhat at variance with the above 17 percent) allowing an appropriate spread for both NDB and commercial banks. Commercial banks get 80 percent refinancing on their loans from NDB which must go to small- and medium-size industries. Development Finance Corporation of Ceylon (DFCC) gets 100 percent refinancing from the Central Bank.

NDB is now ready for a second line of credit from the IBRD (28 million). The first $12 million is fully committed. It can now refinance anything up to Rs. 2 million. The State Mortgage and Investment Bank is eligible to participate in refinancing like other commercial banks because of its capacity to loan to agro-business around the country (see discussion under SMIB section where the General Manager of that organization mentions borrowing from NDB).

For small projects (under refinancing with commercial banks) NDB does not review; for larger projects it does (although it does not get involved with the borrower). Above a certain level the IBRD must approve.

NDB has approached the Employees' Trust Fund for co-financing. NDB has also proposed setting up an equity fund similar to the Employees' Trust Fund. NDB would appraise and manage equity investments in small, undercapitalized businesses. Ultimately it would sell off shares in the capital market. The Chairman again said, however, that housing does not seem to fit into this.

2. <u>Development Finance Corporation of Ceylon</u> (DFCC)

The DFCC was set up in 1956 by an Act of Parliament. It operates as a development bank in support of the private sector. DFCC has an equity of Rs. 55 million, both paid in capital and reserves, and a portfolio of loans and share investment of Rs. 430 million. Its pre-tax profit in the last financial year was Rs. 16 million.

Its major shareholders, all around 10 percent, include DEG (Federal Republic of Germany), the Netherlands Financing Co. for Developing Countries, the International Finance Corporation, and the Bank of Ceylon. The other three local commercial banks and several of the foreign commercial banks as well as the Insurance Corporation of Ceylon also hold shares, among others. NOTE: Its list of shareholders is important as an example if one were considering the creation of a new housing finance institution which would be privately oriented.

DFCC is a typical development bank. It has not been involved in housing finance to date. It lends for industry, some agriculture, and tourism. Loan terms are for up to 15 years with an average of eight years. It has recently commenced merchant banking activities whereby it will help entrepreneurs identify fields of investment and enter into loan syndications. It will also involve itself in equity investments, private placements, underwriting, and guarantees.

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In industrial and construction lending, the Central Bank provides refinancing facilities to DFCC (and other banks), but it does not do so for housing. Say, for an industrial credit, the Central Bank makes money available at 13 percent, the DFCC lends at 17 percent and gets a 4-percent spread. If such a facility existed for housing, DFCC would consider forming a housing finance company or be interested in participating; that is, as long as it would be profitable without a subsidy.

DFCC gets its rupee resources partly from a medium- and long-term lending fund for private sector lending provided by the Central Bank. Its foreign exchange resources come for ADB and IDA. It has also negoitated credits from the Dutch Development Bank which holds equity.

F. INSURANCE COMPANIES

The insurance business in Sri Lanka is nationalized. Two private companies, Ceylon Insurance Company and Trust Insurance Company, have been suspended from issuing new policies since the early 1960s. They are, however, still servicing old accounts.

The oldest existing company is the Insurance Corporation of Sri Lanka (ICSL), established in 1961. A new company, the National Insurance Corporation, was created in 1980, presumably to add some competition. Both companies issue life, motor and casualty insurance.

Two interviews were conducted with the ICSL. The first was with the Chairman; the second with the General Manager, the head of the housing loan department and an actuary. As with almost all organizations, up-to-date data was difficult to come by. The 1980 Annual Report is still in draft and did not include a balance sheet, and there was no ready access to information on housing loans.

The number of life insurance policyholders is about 230,000, up from 228,00 in 1980 and 218,000 in 1979. Gross premium income from life insurance was Rs. 134 million in 1980 and Rs. 125,000 million in 1979; and for general insurance Rs. 367 million and Rs. 286 million respectively. The Chairman estimated premium income for life insurance in 1981 to be Rs. 250 million and Rs. 400 million for general insurance, up considerably for the life category. He also estimated that the new National Insurance Corporation would take in Rs. 100 million of premiums on its general business in 1981. Life insurance reserves stood at about Rs. 990 million at the end of 1980, up from Rs. 856 million at the end of 1979. General insurance reserves were Rs. 208 million at the end of 1979.

The head office is located in Colombo. There are 32 branches, 14 of which are authorized to settle claims up to specified limits; the other 18 branches are sub-regional offices authorized only to issue policies and collect premiums. The ICSL has about 3,000 employees, 50 percent of whom are directly engaged in issuing policies and settling claims.

Investment of Premium Income: Most of the premium revenue is invested in Treasury bonds and debentures with 3-, 5- or 10-year terms. The return on

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these investments has been very low (8-10 percent) although in the past year the yield on Treasury paper has increased to the 16-18 percent range. As a state corporation, the Insurance Corporation is required to invest its premium income in government securities. However, with Ministry of Finance permission, it can invest in non-government securities and projects.

Currently, two major non-government investments are in two hotels being constructed:

-- Rs. 600 million or 55 percent equity in a city hotel, in collaboration with a hotel chain based in Singapore.

-- Rs. 125 million or 65 percent equity in a beach hotel, in collaboration with a German hotel chain.

Of the Rs. 111.4 million invested from life insurance premiums in 1980, Rs. 73 million (65 percent) was invested in government securities. In 1979, all of Rs. 118.7 million was invested in government securities.

Housing Loans: The ICSL makes loans for housing to its life insurance policyholders who have held policies for at least three years, up to double the size of the policy and with a limit of Rs. 100,000. It also makes housing loans to employees which seems to be a standard practice among financial institutions. Currently, about 200,000 of the 230,000 policyholders are eligible to take out loans.

The Chairman said that ICSL has not and is not interested in directly investing in mortgages because of the administrative requirements and the uncertainty as to the duration of each mortgage. It is only interested in getting a return on investment as a passive investor (without active involvement) so that it can concentrate on and service its insurance operations. However, he said it would be willing to consider a loan to a company which would actually make the individual mortgages and for which the ICSL would receive an agreed upon return on investment. However, such a loan has never been granted.

The Insurance Corporation is not allowed to make loans to other government-owned corporations engaged in housing finance such as SMIB or Bank of Ceylon. The requirement that the Insurance Corporation invest in government securities is the mechanism for supporting other state activities. The Insurance Company therefore chooses not to get directly involved in housing finance and to let those state institutions who make housing loans obtain funds from Treasury, which the Insurance Corporation heavily supports with its continued purchase of government bonds and debentures.

Since its inception in 1961, the Insurance Corporation has only disbursed Rs. 23 million of houing loans, or 932 loans as of June 1980. In the past few years, the average loan has been in the Rs. 30-40,000 range.

Housing Loans
(Rs. millions)

	1980		1979		1978		1977	
	No.	Tot. Amt.	No.	Tot. Amt.	No.	Tot. Amt.	No.	Tot. Amt.
Policyholders	94	3.36	85	2.73	112	3.01	78	1.76
Employees	189	7.61	89	2.87	25	.41	20	.26

The above represents a very low level of activity considering the premium income.

Loans to employees are at 3 percnet for 20 years (should an employee leave the Insurance Corporation, the interest rate goes to 12 percent for Rs. 0-50,000 loans and to 16 percent for Rs. 50-100,000 loans). Loans to policyholders are at 10 percent for 15 years.

The maximum housing loan that the Insurance Corporation is authorized to grant to a policyholder is two times the value of the life insurance policy. The average life insurance policy is Rs. 10-15,000, meaning that the maximum loan amount for such a policyholder is Rs. 20-30,000--not nearly enough to purchase or construct a house. The Insurance Corporation requires that the policyholder have the financing for the remainder of the cost of a house to be built or purchased confirmed as a precondition for the Insurance Corporation loan. In addition, the housing loan applicant must show clear title to the land, provide 80 percent collateral, and show that the loan repayment on the house as a whole will not exceed 25 percent of his income. Frequently, a loan is not disbursed because the policyholder cannot come up with the funds to pay for the cost of the house not covered by the Insurance Corporation loan. The average cost of houses for which the Insurance Corporation received loan applications in 1980 was as follows·

-- Construction — Rs. 100-150,000 with amenities
Rs. 80-100,000 without amenities (1 room, kitchen/toilet, with water services)

-- Purchase — Rs. 150-200,000

The Insurance Corporation provides a "decreasing-term collateral insurance policy" free of charge with each housing loan. No delinquency or foreclosure problems have been incurred. Since interest rates have increased in Sri Lanka, the rate of loan applications among life insurance policyholders and particularly employees has increased significantly.

The reasons for the minimal level of housing loans are as follows:

The Board of Directors has allocated Rs. 3-4 million a year of premium income to be invested in housing loans. The 1981 allocation was fully disbursed 3 months ago. The company's policy is that the housing loan scheme is only meant to serve as a method of attracting additional policyholders. At the time of selling a policy, the client is presented with the housing loan program as one of the benefits of a life insurance policy with the Insurance Corporation. After mentioning this benefit at the time of selling a policy, the housing loan program receives no further publicity or propaganda. The Insurance Corporation does not promote this program because publicity given to such a program is considered to be "bad insurance practice." This conclusion was reached because of the high incidence of policyholders who cancel their insurance policies once they have received a housing loan.

As with the other "captive" financial institutions of government, it does not appear that the insurance corporations could play a major role in housing finance. However, if a new housing finance institution were created on a private basis, according to what the Chairman of ICSL said, it might be possible to attract some insurance company funds on either an equity or loan basis.

G. PROVIDENT FUNDS

1. General

It is obligatory for employers and employees in Sri Lanka to contribute either to the Employees' Provident Fund (EPF), also referred to as the National Provident Fund, or to some provident fund approved by the Commissioner of Labor such as the provident fund for the employees of the Ceylon Tobacco Company Limited. It is not compulsory for self-employed persons to contribute to a provident fund. However, there are also other provident funds such as, for instance, the Public Servants Mutual Provident Fund Association and the Government Officers Benevolent Association, both organized for civil servants, and the Mercantile Service Provident Society sponsored by the Chamber of Commerce.

It was the Study Team's understanding that withdrawal from EPF and all withdrawn at the legal retirement age and cannot be used before that for any reason.

From what was ascertained, some of the voluntary funds appear to operate somewhat like a credit union in the U.S. In discusssing this with a civil servant who makes contributions to the two civil service funds cited above, he described the process as follows.

There is a registration fee to join the fund. The members give the fund authorization to deduct a percentage of their salary. This can be as low as one percent and can go up to 10 percent.

After a period of membership, a member can draw out the interest earned or the capital. You can also take a loan against your account, the amount determined according to the duration of your membership, for debt redemption, consumption, or purchase of a house or land.

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One of the civil servant funds pays about 6 percent in dividends and charges about 8 1/2 - 10 percent on loans. The loans for housing can be either short or long term.

The question was raised as to why people save here at such low rates. One reason is that the loans are also made at a low rate. Inputs to the fund can be very small. Most people put in two percent or less of their salary. Loan applications are processed very quickly, usually the same day. An applicant can get double his salary in loan on call. For long-term loans or larger amounts, it depends on the length of membership and what contributions have been.

Although the team was told that the superintendent of the Employees' Provident Fund could provide overall information on provident funds in Sri Lanka, this information was not available there and further overall information was not obtained. However, some additional information was obtained about company-sponsored provident funds which is contained in section V.B., Company-Assisted Housing.

To the extent that the voluntary funds are extensive and of a size to handle housing loans, they could be a factor in a housing finance system. The Mercantile Service Provident Society, for instance, does make housing loans. A more detailed discussion of this fund is also covered in the Company-Assisted Housing section.

2. Employees' Provident Fund

The interview with the EPF was conducted with the Superintendent. Since he had just assumed his duties a week earlier, he had invited the previous Superintendent to be present and this gentleman provided most of the information. A short paper, "A Review of the Operations of the Employees' Provident Fund Department for 1980" is included as Annex 24.

a. Organization: EPF is organized under the Employees' Provident Fund Act, 1958. Implementation of the Act is the responsibility of the Ministry of Labor. However, the investment of the funds is carried out by a department of the Central Bank, and its report for 1980 is included as Annex 25.

The staff of the EPF consists of some 80 officer-level personnel and a support staff of 470.

b. Size of Organization: The total assets of the EPF acount to about Rs. 5 billion. The EPF has a total membership of 2.8 million wage and salaried employees. However, a majority of these accounts are dormant, only 1.2 million are active accounts; i.e., only 1.2 million people currently contribute to their accounts. The EPF is growing in membership at the rate of about 10 percent per year.

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The reasons given for the dormant accounts are as follows:

1) the employee is out of a job;

2) the employee has changed jobs and is now with an employer that has a separate provident fund;

3) the employee may now be self-employed.

Employees are required to contribute 8 percent of their gross salaries/ wages and employers contribute another 12 percent. (Up until November 1980 these figures were 6 percent and 9 percent, respectively.)

The EPF's monthly collections amount to about Rs. 60 million. The EPF, therefore, invests about Rs. 1 to 1.2 billion every year comprised of contributions, interested earned on the assets, and proceeds from maturity of investments.

c. Withdrawals: Currently the EPF receives about 40,000 applications per year for withdrawals from members. Withdrawal is permissible for the following reasons: retirement, emigration, death, medically condemned and, for females only, marriage.

Withdrawal is not permitted for acquisition of a house (it is, for instance, in India). Thus, the principal purpose of the provident fund is to provide a lump-sum amount at the end of an employee's working life so that the employee can use it to generate some income and live a retired life. The retirement age is 50 for women and 55 for men.

In 1980, the total amount paid out by EPF in benefits to members was Rs. 205.36 million.

d. Interest on Member's Accounts: Members earn an interest of 8.5 percent on the amount in their account at the end of each year irrespective of the time for which the amount is deposited with the EPF. Thus, the annual rate can be and usually is slightly higher than 8.5 percent.

Members also get a tax concession on the amount they contribute to a provident fund and this enhances the return for some members.

f. Investment: The EPF Funds are invested in government securities as a policy decision, not as a requirement of law. This includes, for instance, UDA debentures, which are guaranteed by the government. The EPF says it has restricted itself to government securities because of the risk factor and because there is no capital market. A committee appointed by the Monetary Board periodically examines the feasibility of diversifying the investments of the Fund. In principle, the EPF is willing to consider diversification into the share market. EPF earned Rs. 351.61 million from investments in 1980.

g. Conclusions and Impressions: EPF resources could be an excellent way of financing housing. One way would be for the government to permit (by legislative amendment, if necessary) withdrawals by members for housing. For instance, government could permit withdrawal of up to 50 percent of a member's own contribution for housing. Withdrawals for such a purpose could help meet the objectives of setting up the EPF in that a member could be assisted in acquiring his own house at prices lower (in times of inflation) than they would be on retirement.

Here again, however, the government could see such a proposal as resulting in too many inroads on a source now used for financing the budget.

3. Employees' Trust Fund

The Employee's Trust Fund (ETF) was established under the Employees' Trust Fund Act in 1980 and became operational on March 1, 1981 under the control of the Ministry of Labor. Thus, it is a very recent organization and is not yet fully operational.

The primary purpose of this fund appears to be to give employees a stake in and identification with the country's enterprises through equity participations by the Fund. Although under the Ministry of Labor, the impetus for the Fund came from the Ministry of Trade and Industries.

Under the ETF Act, employers are required to contribute 3 percent of each employee's salary to the ETF. Thus, this contribution is an additional cost to employers except those who have been contributing more than the minimum to the National Provident Fund.

The Fund is starting operations in stages. Stage I which commenced from the start, covered all major private sector employees, i.e., those with more than 150 employees, and all state sector organizations. This category covered about 1,300 organizations with about one million employees.

Stage II started from September 1, 1981 when Fund coverage was extended to some 1,000 employers with 50 to 150 employees. This added a further 100,000 employees to the roles.

Stage III, effective January 1, 1982, will cover all remaining employers--13,000 "identified" employers (i.e., those who are contributing to the Provident Fund) and another 20,000 to 30,000 "unidentified" employers, totally involving another one million employees. ETF management admits this will involve tremendous administrative problems.

ETF is collecting about Rs. 11 million every month from Category I, Rs. 1 million from Category II, and expects to collect another Rs. 1 million per month from Category III.

Currently, (December 1981) ETF has Rs. 75 million invested in banks. ETF (unlike the Employees' Provident Fund) manages its own investment. Its bank deposits are for 1-year duration and were said to earn a return of 24 percent

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per annum although this rate seems much higher than what 1-year deposits earned with banks, according to other information).

ETF wants to maintain "political credibility" and, therefore, in the next few months, intends to invest in state-linked/state-supported companies, e.g., the state-sponsored cement company. ETF wants to give employees the feel of "ownership of capitalist enterprises" such as Lanka Orient Leasing Company Limited, Lanka Korea Footwear Limited, DFCC, etc. As such, it appears that ETF will emphasize investments in the private sector as it moves along.

The Chairman, who was and is the Managing Director of Agroskills Limited (an agricultural, industrial, management and planning consulting firm), took the job only on the condition that he do it on a part-time basis and receive no pay. As such, he works at ETF only in the early morning and late afternoon.

He is still recruiting for a General Manager. He says pay is a problem for the type of person he wants (say, Rs. 4,000 a month) both for the General Manager and other staff even though ETF can pay more than civil service. He proposes to get around this by setting up a management company as a subsidiary. He appears committed to running ETF more effectively and with less staff than the Employees' Provident Fund.

ETF at present has a staff of 12 executives and 30 assistants. It is curently operating out of a 7,500 sq. ft. office but expects to have an additional 3,000 sq. ft. of space available shortly. By way of contrast, the EPF has 80 executives, 470 support people, and 40,000 sq. ft. of office space.

Impressions and Implications for Housing Finance: The Chairman appears to be a dynamic individual, interested in new ideas and has what appears to be a wide range of contacts in government, the private sector and the labor movement. He gives the impression of being a decisive person who wants to improve a "private sector" outlook on the organization. The way ETF is currently managed, it is running parallel to the Employees' Provident Fund. Like the EPF, the ETF does not give any loans to individuals; the members are eligible to get money only on retirement. The Chairman acknowledged that the "Act is badly conceived" in this regard.

Therefore, with regard to housing, it is possible that ETF could eventually permit its members to borrow against a portion of their credited accounts for housing.

However, ETF seems to be an institution which will have a relatively free hand in investing its rather substantial resources, i.e., it will not have them channelled into government-directed investments. It, therefore, appears to be a potential source of housing finance. One approach is that ETF could be a source of funds for an expanded State Mortgage and Investment Bank.

But on the more innovative side, the Chairman is very much interested in participating in a new housing finance institution on an equity basis. As an organization dealing with a fund set up to benefit workers, he is very conscious of the need for more and better housing. He has already had preliminary discussions about participating with the Bank of Ceylon in its housing finance endeavor and other individuals in the private sector (the Chairman of the brokerage firm of Forbes and Walkeı, for one).

He also arranged for Study Team members and the USAID Housing Advisor to meet with some of ETF's Board members and a wide-ranging group of people, both government and private, late in the study for informal discussions. Although a number of people have their eye on the Fund, it still represents a potentially major contribution to a new housing finance institution, if one is created.

V. OTHER INSTITUTIONS

A. FINANCE COMPANIES/PRIVATE DEVELOPERS

1. General

All finance companies are controlled by the Central Bank under "The Control of Finance Companies Act". This Act, which the Study Team did not get a copy of, presumably determines the patterns of investment and the rules and procedures relative to the deposits for finance companies. Presumably the companies ar organized under the Companies Act.

It appears that there are a large number of finance companies in Sri Lnaka and that they raise money by taking in term depsits of up to two years. (However, the brochure of one company indicates a depositor can get his money on one working day's notice, although it doesn't say at what penalty.) Lending or investments can be for a variety of purposes. One way that was cited that permits them to afford their high deposit rates is that they make some high risk loans at 4 percent per month to small traders.

To get some feel for the operations of these companies, their role as financial institutions and, more specifically, whether they play any role in housing finance, four firms were interviewed. They were selected either because of prominent advertisements in the newspapers or by referral.

One specific characteristic emerged, at least with the firms that were interviewed, and it probably applies to a number of the larger firms, is that the firms, divisions of the firms or subsidiaries are involved in a variety of activities and businesses. For instance, the four firms interviewed (plus one other) appear to be the only private housing or housing-site developers of any significance in Colombo. About 50 percent of finance companies are involved in real estate in some way.

Consequently, this section of the study will deal with both finance companies and private housing development. To give more of a flavor of the thinking of the officials in these institutions, the information will be presented as outlined during the interviews.

2. Finance Companies

Four companies were interviewed:

-- Housing and Property Trades Ltd.--Part of a group now known as HPT Group Ltd. which includes, in addition to a variety of real estate services, some manufacturing subsidiaries and a management and secretarial services subsidiary.

-- The Finance Co. Ltd. (Real Estate Div.)--Besides real estate the company is involved in general insurance, diamond cutting, hotel business, printing, and construction.

-- Mercantile Credit Ltd.--Headed by the first Sri Lanka Governor of the Central Bank, it appears to be one of the largest of the finance companies. The group is involved in a number of businesses and has one subsidiary known as Mercentile Housing Ltd.

-- The Central Finance Co. Ltd.--It has its main office in Kandy. In addition to housing development, the company is heavily into transport financing.

Annex 26 includes some representative newspaper ads by finance companies as well as information taken from some typical brochures which give an idea of the interest rates being paid. It can be noted that these rates are considerably above bank rates.

According to what the Study Team could learn, there have been no major failures of finance companies; hence, risk is not yet a factor in depositors' minds.

a. The Finance Co. Ltd.: (See newspaper ad, Annex 26-3.) It raises its money by way of deposits. It has 15 branches all over the country. Deposits are term deposits for up to 5 years. Middle-income people and upper-income people (who have money for investment) are depositors. All finance companies are very reluctant to make installment facilities available to buyers. But some financing is provided for a maximum period of two years at 27 percent as a service to buyers. Interest is taken up front, not on diminishing balance. Thus, the effective rate is 36 to 38 percent. Finance companies generally don't lend for housing.

b. HPT Group Ltd.: See Annex 26-1 for the variety of deposit schemes available for HPT. There is considerable additional background data on this company available for review.

The company was one of the pioneer companies in the real estate business in Sri Lanka. It started out as a real estate broker in 1962 and was the first to organize real estate brokerage into a company. Prior to that there were just a number of individual brokers. It then moved into financing, taking other people's investments and putting them into mortgages, buying and selling property on behalf of others, and then giving mortgages on a sort of hire purchase.

With the election of the previous government in the early 1970s, real estate activity slowed down due to a variety of factors such as rent control, tenancy laws, ceilings on home ownership, etc., and HPT withdrew from financing and purchasing of housing.

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With the new government, HPT re-entered the real estate services business. Now HPT is in housing development, sales title work, locating financing, etc. It's also into some manufacturing and exporting. Total business is Rs. 2-3 million per month.

According to the Chairman, financing is the big problem for private housing. The private sector can't arrange financing because interest rates are too high. (Note the interest rates HPT is paying on deposits.)

HPT is not doing any financing now, just buying and selling real estate (for its own account), construction, and acting as broker.

c. Central Finance Co. Ltd. (CFC): The interview was with the Chairman who was a building-valuer for some 30 years. In fact, he still does valuations for the SMIB, the National Savings Bank, the National Housing Development Authority, and some of the commercial banks. Fees for this work are small, however, so he went into business for himself. Total deposits for CFC amounted to Rs. 33.7 million at the end of 1980.

CFC borrows are rates above commercial banks, up to 30 percent. Of the money raised, 95 percent goes to transport financing, turcks and buses, which tend to be individually owned or by small entrepreneurs. The loans are paid off in 3 years at a 26 percent compounded rate. Annexes 26-2 and 5 are newspaper ads which contain the latest statement of financial condition of CFC, along with deposit rates, as an example.

CFC, or a subidiary, is into development work and the Chairman had extensive views. See section below.

d. Mercantile Credit Ltd. (MCL): As mentioned above, the Chairman of the MCL was the former first Sri Lankan Governor of the Central Bank and is now an active businessman. The Mercantile Group includes a number of companies in a variety of businesses including travel and gems. He indicated that MCL now has Rs. 190 million of public deposits in two-year CDs, paying 19-24 percent per annum. It is the largest of the finance companies.

MCL has, according to its Chairman, 6,000 depositors, mostly middle- and lower-middle income people, as defined by him. Loans are primarily for transport, individual buses and trucks, at rates up to 27 percent per annum.

In discussing why people put money with a finance company rather than, say, the National Savings Bank, the Chairman cited the following reasons:

-- higher interest rates

-- prompt service

-- concern that government might freeze their account

-- concern that their business not be revealed to government (perhaps they don't disclose on their tax return the interest paid by a finance company)

Mercantile has done housing development in the past and is interested in getting involved again. The Chairman sees finance as the key. But he feels that the interest rate level is the major problem. If you could lend at 10-12 percent, you could develop a large market. He said that large government deficits are taking up the available finance and forcing up rates. "Savings are preempted by government to finance deficit."

e. Home Finance Ltd. (HFL): No interview was conducted with this firm although a newspaper advertisement for houses was followed up by phone. (See Annex 27.) For houses priced at Rs. 300,000 and Rs. 330,000, HFL indicated that it preferred full payment. However, it would consider a down payments of Rs. 220,000 (67-73 percent) with the balance later. No interest rate or length of time was provided, but the firm indicated it needed the money to continue its building operations.

3. Housing Developers

All of the housing developers that the Study Team talked to are affiliated with the finance companies described above. It was felt that the best way to describe the activities of these developers was to present highlights from the interviews. These are covered below.

There is a subsidiary of the Bank of Ceylon, Property Development Limited, which recently floated a public issue of stock. This firm is, among other things, developing BOC's new headquarters building. It was strongly recommended that the Team talk to this firm, but it was not possible to set something up. Whether or not this firm is, or would be, interested in getting involved in housing development is not known. It should be noted, however, that BOC is the biggest supporter of a new housing finance bank.

a. Finance Company Limited: Its business (in real estate) is to buy land, plot, develop, and sell it in Jaffna, Kurunegala, Kandy, Negombo, Matara, Colombo city, and within a radius of 20 miles from Colombo. They usually buy a large-sized tract of land up to 50 acres (sometimes as small as 20 perches) and plot it out. Selling prices range from Rs. 500 per perch to Rs. 18,000 per perch. (About 15 perches of land are required for construction of a house.)

Government can help increase housing by making available materials for construction at stable prices. The provision of finance would also help. Form the iviewpoint of a private developer, government housing is very attractive and difficult to compete with--government provides finance for 20-25 years (via State Mortgage & Investment Bank or National Housing Development Authority) at low interest rates.

According to FCL,"low-cost housing (up to Rs. 200,000)" has good prospects if long-term finance were available. The company is thinking of going into prefabricated housing (costing Rs. 150,000 per unit) in collaboration with a Singapore company.

Every seller of land collects a 2 percent Business Turnover Tax from the purchaser--this adds to housing costs.

The company feels that government should also lay down specifications for buildings--type of foundations and walls, timber, etc., otherwise unscrupulous contractors take buyers for a ride.

Dealing with SMIB is very time consuming--a lot of red tape.

Bank loans are given only if the title is good. Some banks want a title search going back 40 years but some want a 100 years. The minimum is a 30-year search. In Sri Lanka, only 30 percent of titles are perfect particularly because of "partition action" (this probably relates to the partition of joint families and consequent vesting of ownership of land in different families). The government could amend legislation to improve this process of transfer/ transmission of land.

One way a title is good is when the government acquires the land and passes it on.

b. <u>HPT Group Ltd.</u>: The Group currently has about ten houses under construction, which is about its average. Two of the houses will sell in the region of Rs. 1 million. The others are just outside of Colombo and will sell for a little under Rs. 300,000. They are not in a sub-development type of project, but a couple of them are close together. Another example cited was two houses which were built by the company about 1-1/2 years ago and sold to the Chairman of People's Bank for Rs. 1.5 million each. The financing came, not from the Bank, but from an English company that is working on the Mahaweli Project. The company will, in turn, rent from the People's Chairman.

HPT is now trying to cater to professional people and upper-level civil servants who can usually come up with Rs. 50-100,000 for a down payment (HPT says the propensity to save is very high in Sri Lanka and families help out). With this kind of down payment, if the house can be priced between Rs. 200,000 and Rs. 300,000 including land, the buyer is eligible to get financing from the State Mortgage and Investment Bank. Today, HPT feels it's impossible to get home financing from a comercial bank.

HPT is currently negotiating with the Colombo Municipal Council to buy a parcel of land in Colombo 10 (a good area) on which it proposes to build 70 houses. Land price would be Rs. 22,000 a perch. Current plans call for the houses to sell for just under Rs. 500,000, including land.

HPT approached SMIB regarding financing but SMIB will finance only a maximum of Rs. 200,000 per house. SMIB told HPT in a letter that it would have to try and get extra Rs. 14 million approved from MOF.

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Another problem is the very high land prices. The highest prices that land reached before 1977 were in 1969 when they reached Rs. 15,000 a perch in the very top areas of Colombo. Following the election of the new government in 1977, development speeded-up in Colombo, and land prices went up to Rs. 100,000 a perch in those areas. This was reached a year ago; they've been dropping now and recently were at Rs. 80,000 a perch.

But such land is not selling readily. Some land in less desirable areas of Colombo may go for Rs. 25,000 a perch and 15 miles outside of Colombo you can get land at Rs. 1,500-2,000 a perch. However, transport, rail or bus is not good in these areas and owning a car in Sri Lanka is expensive.

Building material costs are also high. A good house (one story) costs Rs. 250 per sq. ft., a two-story house is more. However, HPT says you could build a basic house with local fittings, basic facilities, asbestos roofing, etc., for Rs. 150 sq. ft. It was suggested that a middle-class family needs at least a 900 sq. ft. house. That would be Rs. 135,000. If you could locate in an area with land (at say, Rs. 4,000 a perch) and build on a 15 perch lot, that would be Rs. 60,000. Then add, say, 15 percent profit or Rs. 30,000 and you would be up to Rs. 225,000 (that is $11,250 at Rs. 20 to $1). Construction financing is 2 percent per month.

It was the HPT view that housing is such a political thing that there is reticence by the private sector to commit itself, particularly with new elections coming up.

Despite the Inland Revenue Act No. 28 of 1979 which provides for large tax incentives to developers who build and sell housing, the number of property developers is negligible because of the political situation, lack of financing, and other laws. For instance, an investor cannot build a house and rent it because of rent control and, even if rented, you can never evict a delinquent. Therefore, people are reluctant to invest in housing; consequently no development. As a result, the tax concessions to builders from the Act have not really been used.

c. Central Finance Company: CFC is not doing any housing development now but is buying land (4 or 5 acres) and putting in infrastructure, roads, fences, and a water distribution system, up to the lot boundary. Then it sells off the lots.

For example, it would sub-divide 5 acres into 20 lots (40 perches a lot). It would install water, electricity, and road frontage up to the lot boundary (other than Colombo there are no sewerage systems in Sri Lanka). It would then offer to sell these lots on a hire-purchase basis, say, 40 to 50 percent down, the balance over two years at 26 percent compounded.

Gross profit would be at the 50 percent level (net profit of 20-25 percent because of financing costs). However, many people make arrangements with a bank because it's cheaper. Most of the people buying land like this (95 percent) are earning their money abroad.

CFC is concentrating on Kandy because land is much cheaper. In the suburbs of Kandy one can buy land at Rs. 1,000-1,500 a perch. The maximum in Kandy is Rs. 8-10,000 a perch. Hilly land is cheaper.

The constraints to housing development by private builders are:

-- Lending institutions have no money. In some cases they just delay in processing applications. The inflation factor then presents a big problem.

-- The rate of interest.

-- The high cost of construction. In Colombo, for a comfortable house (well-fitted bathroom, but no built-in cupboards, etc.), it is a minimum of Rs. 200 per sq. ft., in outstations it may be up to 20 percent less.

-- The high cost of land. In Colombo it was as high as Rs. 100,000 a perch, now it is down to Rs. 70-80,000 a perch at maximum. In the surrounding areas of Colombo (3 and 5), it is Rs. 50,000 to 60,000 a perch. In Kotte it is Rs. 10,000 a perch.

There is no shortage of land or building materials. There is a shortage of skilled workers. Most have been absorbed by big builders or have gone to the Middle East; small contractors cannot get them. It is not difficult to get land to build on.

No one wants to live in a government "colony." People do not want to be part of a government scheme. Government projects are not well regarded by the people. That is why NHDA has difficulty in selling. People want individual houses; not all alike as in a sub-development or in an apartment.

The Chairman feels there is a collapse in real estate today. There are no buyers. Sellers are holding on, but prices won't get back to where they were. He ran through an example to show the problem:

Land at Rs. 80,000 perch - 10 perch lot	=	Rs.	800,000
2,000 sq. ft. house at Rs. 250 sq. ft.	=	Rs.	500,000
		Rs.	1,300,000

The type of person who would be interested in this kind of house is a professional earning maybe Rs. 50,000 - 60,000 a year. But he cannot handle a house like this now, it's too much.

In the past he might have rented such a house out to an expatriate with a 20 percent rate of return. Forgetting maintenance costs and depreciation, for the moment, that could be a rent of Rs. 260,000 per year. But with interest rates at better than 20 percent, that is more than the rent right away. In any event, the only alternative is to try and rent such a house to expatriate interests; the professional Sri Lankan cannot live in it himself unless incomes were to take a big jump.

One answer would be very low down payments, very long repayment, and subsidized interest rates; none very likely.

The Chairman said the market simply must drop. No one can operate now. He feels both rents and prices must come down.

The process for a builder of a house works something like this. He submits plans to the municipal authority for approval. After that, the Urban Development Authority must approve the plans to make sure it is not part of some larger urban project. Assuming the permit is granted, the builder then goes to a lending institution which involves more delays. The tremendous red tape adds to cost. Bridging finance is 25-30 percent per annum.

Generally in Sri Lanka, builders won't build unless the house is presold and progress payments are required.

If long-term housing finance were available at 15 percent, CFC would clearly do larger projects and include housing. In such a case, however, the Chairman said he would have to make the houses as different as possible. He cited a case where CFC had started a six-house project in Kandy in 1979, but it wasn't successful. Everybody wanted a different type of house. The project was cut down to two houses and the other four lots sold off.

An Australian firm has approached CFC about a prefab project. But, here again, the Chairman says it won't work. It is too difficult to convince people that such a house would be a good one.

It is possible for a builder to build one house and sell at a profit, but not schemes.

d. Mercantile Housing Limited: This company is one of the Mercantile group of companies. It does not appear to be active now, but its Chairman is very much interested if the financing question could be solved. Details on what MHL would be prepared to do are contained in Annex 28.

B. COMPANY-ASSISTED HOUSING

1. General

In many developing countries the provision of housing, or assistance in financing housing, is provided by companies to their employees. To ascertain whether this practice is a factor in Sri Lanka, the Study Team interviewed the Secretary to the Chamber of Commerce and three large companies: one in the public sector, the Ceylon Transport Board; and the other two private companies, Ceylon Tobacco Corporation and Lever Brothers Limited. To the extent that companies are involved in the process, the Secretary to the Chamber said it would undoubtedly be the larger ones (capitalization over Rs. 500,000). Thus, the companies interviewed were quite large and considered representative.

A brief treatment of each of the company's involvement in housing is presented below as well as a description of the Chamber of Commerce sponsored

Phase Two will involve the distribution of the case study to specialized experts in housing finance whose expertise isn't needed for the information-gathering field work. The group will include experts in housing finance systems, institutions, resource mobilization and capital markets.

This group would get together for a day of "brainstorming" on the housing finance situation in Sri Lanka to elicit approaches and recommendations from these individuals. The field team members should participate in this meeting answering any specific questions and providing comments on recommendations and suggestions. It is also intended that the USAID Housing Advisor and a Government of Sri Lanka representative will participate.

Based on this session, the contractor will finalize the Conclusions and Recommendations section of the report and complete the overall study.

V. TEAM COMPOSITION

The contractor's field team will be composed of a Senior Housing Generalist as team leader supplemented by two Housing Finance Specialists.

The expert advisory group will consist of a minimum of three individuals covering the areas of expertise outlined in Section IV above and will cover a two-day period of actual discussions. This assumes the experts will have sufficient time prior to the discussions for a thorough reading of the field material.

The team leader with appropriate assistance will be responsible for preparation of the final report. The amount of time for tbis purpose will be determined after the two-day discussion period.

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Mercantile Service Provident Society. As an interesting note, the Bank of America's manager said he though companies could be encouraged to finance housing for their employees since it is such a critical problem.

2. Mercantile Service Provident Society

The Mercantile service Provident Society (MSPS), the largest provident fund outside the EPF, offers six percent housing loans against 75 percent of accumulated savings. All companies that were members of the Chamber of Commerce before 1974 could also belong to this fund which is an approved fund by the Ministry of Labor.

Among the Chamber's 640 members, 105 firms also belong to MSPS, accounting for 7,661 individuals who have access to these housing loans.

Since 1974 an administrative restriction coming from the Commissioner of Labor has prevented additional members to MSPS, so although the Chamber's membership has grown tremendously, MSPSs has not. The Secretary feels that the government's position was taken to enourage the growth of the EPF. However, since MSPS's major investments are in government securities, housing and life insurance, he feels that argument is invalid. This is especially true when MSPS's performance is compared to that of EPF. He mentioned that EPF members would often have to wait months to a year to receive benefits after they were eligible. MSPS, in contrast, offered much more efficient and reliable service. The lifting of the restriction would bring hundreds of additional members to MSPS immediately and it is a position the Chamber has repeatedly argued.

3. Ceylon Tobacco Corporation (CTC)

The interview was conducted with a Personnel Officer at the CTC.

Ceylon Tobacco employs 2,500 people with average salaries about Rs. 1,500/month and no lower than Rs. 1,000/month. The company has two finance schemes for housing and are considering a third.

a. Thrift Fund: Each employee makes a voluntary contribution to the fund depending on the savings paln chosen. The minimum contribution is Rs. 10/month and the maximum is Rs. 125/month. As employees build up deposits, loans for housing (either land purchase or construction) up to Rs. 20,000 or triple their savings, whichever is lower, can be applied for. Interest is applied to only the employee's contribution or one-third the total loan at a 4 percent rate over 100 installments.

b. Provident Fund: Housing loans can be raised against 75 percent of an employee's savings in the company provident fund. These loans are only for direct construction or purchase of a house. At Ceylon Tobacco, the employee contributes 10 percent of salary while the employer contributes 12 percent in the first five years and 15 percent thereafter. Eight percent interest is charged over 150 maximum-monthly installments.

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c. Revolving Fund: This scheme is under investigation. CTC has been exploring a similar scheme set up by the Shipping Corporation which employs 600. The company would capitalize the project with Rs. 1 million at below-market rate interests. It would be up to a participating Bank to process and collect the loans.

The Personnel Officer stated that at one time the thrift fund's maximum loan of Rs. 20,000 was enough to finance the cost of a house. With increasing costs, however, he feels Rs. 50,000 would now be needed to construct a basic house for a worker. Although there will be a raising of the thrift fund maximum, it will not be up to Rs. 50,000. Withdrawing all savings from the provident fund at retirement and then getting a smaller loan by some other means appeared more feasible to the CTC official being interviewed.

It was felt that housing programs for employees are beneficial since they cut down on employee absenteeism, mainly caused by finance difficulties. In a company survey it was found that 40 percent of employees owned their own house while 60 percent lived with relatives or rented.

4. Sri Lanka Central Transport Board

An interview was conducted with the Director of Operations and Management, a Personnel Officer, and several accountants.

The Central Transport Board employs approximately 60,000 people throughout the country. Housing loans are provided through the Ceylon Transport Board Provident Fund. CTB employees make no contributions to EPF.

The CTB Provident Fund collects 10 percent of salary from the employees and 15 percent from the employer. To take out loans against this fund, employees must have five-years permanent service. Loans are given in two ways.

a. 75% Loans--Members borrow up to 75 percent of savings for house purchase, construction of house or land purchase. Title to land is used as security for the loan. Interest is six percent over five years or up to age of retirement (60).

b. 40% Loans--Members borrow up to 40 percent of savings for house maintenance or renovation. Interest is also six percent repayable up to age of retirement.

Employees can withdraw all savings form the fund when they leave the Transport Board. At present there are approximately 8,000 outstanding 75 percent loans and 34,000 outstanding 40 percent loans. Average loans for workers are Rs. 8-10,000 and Rs. 50,000 for management. Average repayment on loans is Rs.100/month. Average salaries are approximately Rs. 600/month. Almost 95 percent of all members eligible for loans will take one out.

Because of high land and construction costs and low salaries, additional funding is needed. This is provided from other banking or housing institutions, other savings or borrowings from family.

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5. Lever Brothers Limited

An interview was conducted with the Director of Personnel.

Lever Brothers emplloys 1,300 management personnel and workers. It has no direct housing construction program, but does have two housing loan schemes.

a. Mercentile Services Provident Society (MSPS): (See above) It provides housing loans only to management and staff who do not contribute to EPF. Workers must contribute to EPF so are, therefore, ineligible for loans under MSPS. MSPS is comprised of 12 percent employee and 12 percent employer contributions. Members can borrow up to 75 percent of their contribution at six percent, payable by the employee's age of retirement.

b. Supplementary Retire Fund: All employees are eligible for this fund. It is made up of one month's gross salary for every employee's year of service and is paid by Lever Brothers. An employee needs ten-years service to qualify and the fund is good only for 18-months salary. A member can borrow up to 90 prcent in his account at the fund at 15 1/2 percent interest.

Both loans are only for land purchase or construction, or purchase of a house. Outstanding loans as of the end of November 1981 were:

Manager	65
Staff	49
Workers	205
Total	319

At one time savings accrued in both funds were sufficient to purchase a house. This is no longer the case and employees need to supplement loans with assistance from family, dowry, or other sources. This is clearly less of a problem for management-level personnel than for work-force personnel.

Lever Brothers has looked into the revolving fund concept for housing but wasn't interested when the bank said Lever would have to put up the capital. The Personnel Director said the company "would rather do it itself." However, it does not seem to be moving in that direction.

6. Summary

It appears that perhaps substantial lending for housing does take place in at least the larger private and quasi-public organizations. Because of high rate of inflation which have not been matched by wage increases, people have had to find inventive means of "packaging" housing finance to go along with schemes provided by their companies. Whether this packaging is more of less efficient than single-institution financing can be questioned. In any

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case, it appears to work to some degree, i.e., workers with some assistance from their companies have some advantage.

C. HOUSING COOPERATIVES AND CREDIT UNIONS

1. Cooperatives

According to the Commissioner of the Government's Department of Cooperatives, there are no housing co-ops in Sri Lanka organized by the government. In fact, the only one of which he was even aware was one recently organized by his Senior Deputy Commissioner and registered with the Department.

According to other information received, housing coopeative societies do exist but the extent of their existnece is difficult to determine because they have not registered with the department of Cooperatives. Housing cooperative societies form to facilitate the process of land acquisition and to reduce planning and construction costs. Contributions for land and materials are made by members based on their requests. All financing is done individually although the co-op may act as guarantor for loans to members. Service fees charged to members based on size of land holdings go to the maintenance of common facilities and utilities.

The Commissioner did say that this was an area in which the Department would like to beomce involved, but did not see that possibility in the near future since the staff ws already so busy with on-going programs. If a decision to develop housing co-ops were to be made, it would have to come from the Department. Presently the co-op program in Sri Lanka concentrates on consumer co-ops covering every rural village.

Following, by way of example, is a brief description of the housing co-op of which the Deputy Commissioner is President. It is made up to 45 members, all executive level, working in state or parastatal organizations. They had originally formed because all were facing problems with their landlords.

The Society's objectives are to facilitate the acquisition of land and hire the necessry architects, site engineers, etc., to design a housing scheme which can be replicated at a cost effective level and manage the development's common facilities--infrastructure, accessways, and public space. Each member contributes a minimum of Rs. 100 to purchase one share in the co-op. Shares will be determined by the size of the plot each member chooses to buy, with the average lost size about 20 perches. The cost of land and the cost of the house construction will be borne by the member. The co-op will not get directly involved in loan financing except to act as guarantor for loans.

According to the Deputy Commissioner, the 45 membes had sufficient savings to purchase land and construct housing. If savings should fall short, personal loans were obtianable at commercial banks. Personal loans are taken out against collateral individuals' savings accounts. Rates are generally one percent above deposit rates. Banks will also accept land titles as collateral. If savings, loans, and borrowings from friends are exhausted before the completion of the house, then work will be temporarily halted until savings can be built up again. As an aside, the Deputy Commissioner stated there was a need for a housing finance system, especially for the middle-income levels.

It should be noted that People's Bank has ties to the cooperatives with some ownership from this source. Also see the discussion of People's Bank's system of rural cooperative banks and section below on Credit Unions and Societies).

2. Credit Unions and Societies

The Study Team did not run down the exact distinction between credit unions and credit societies if, indeed, there is one. Also, it appears that some of the voluntary provident funds seem to operate similarly to a credit union.

Credit unions are plentiful in both rural and urban areas. Most private corporations have some form of credit union with average rates of 8 percent savings and 12 percent for loans. In the rural areas, housing finance is taken care of in two ways:

a. Co-op Credit Societies: These are village societies of 45-50 members making loans of no more than Rs. 1,000 for short terms. Interest rates are quite low. Loans are normally for housing maintenance or improvement since the maximum size of loans precludes financing a new house or a major addition.

b. Multipurpose Credit Societies (MPCS): These are organized on a district basis and are large, centralized societies for savings and credit. Loans are made to members against collateral and are for medium term (3-5 years) at lower than commercial rates. Loans can be taken for housing though this is a very small share of total lending. MPCSs are governed by a Board of Directors made up of elected members and appointments from the Ministry of Cooperatives.

People's Bank covers all MPCS financing and, at least partly, was brought into existence to do just that. The MPCSs take loans from People's with Central Bank guarantees. MPCSs have been in existence since the 1920s while People's was founded in 1961. Although this information was provided by the Marga Institute, the MPCSs may actually be the same institutions as the rural cooperative banks covered under People's.

In one of the poor shanty areas of Colombo, the U.S. Save the Children Foundation has recently instituted a credit union project through local women's groups. By paying a Rs. 1-2 service charge per year, members can get small loans for 5-6 months to finance income-generating activities. Members of the credit union review each application and decide on project feasibility. Interest on the loan is voluntary depending on project profitability. USSC is investing Rs. 1,000 in 5 units to fund the program.

VI. MARKET FOR HOUSING FINANCE

A. HOUSING MARKET AND NEED

The lates information available to the Study Team on total housing needs in Sri Lanka is that contained in the Shelter Sector Assessment. Most of the detailed projections in that paper came for the Marga Institute's "Housing in Sri Lanka" published in 1976, or from studies which used that work as a base. The Department of Census and Statistics is just completing a 1981 enumeration of housing but information was not yet available. Therefore the SSA still provides the best available figures of overall needs. The summary section of that paper follows.

Need for Housing: There is a severe, current deficit in the supply of housing affordable by most income groups in Sri Lanka. Various projects indicate a need for 40-50,000 new units in urban areas and 100,000 new units in rural areas annually until the year 2000 to provide for new households and to replace or upgrade deteriorating existing stock. Although the rural needs in absolute terms are greater, the per capita need is substantially higher in urban areas.

Housing deficitis have existed for several decades but have been aggravated by recent low private sector participation in housing production. To put this need in perspective, it should be noted that during the period 1963-1971, only 16,000 units per year on the average were constructed in urban areas by both the public and private sector. The comparable figure for rural areas was about 80,000. From 1971-77, only a total of 4,800 units were constructed by the public sector. An additional 20,000 housing loans were made by the National Housing Fund during this period, but this included home improvement loans. Private sector figures are not available but fall short of needs, particularly among the poor.

Most housing for the poor is inadequate: high room and house occupancies, high per acre densities in urban areas, poor construction in terms of materials and foundations, and lack of such basic services as water and sanitary facilities.

Rural-urban migration has not been ocurring in Sri Lanka at the rapid rate it has in many developing countries. The urban population as a percent of the total population is projected to grow from slighly less than 20 percent in 1963 to only 30 percent by the year 2000. Currently it is approximately 24 percent of the total population. Colombo presents a special problem, however, with the metropolitan region now containing about 57 percent of the total urban population and it is expected to retain this percentage.

Rural housing, although in most cases built of temporary or semi-permanent materials and without piped water and sewage facilities, is not as serious a situation as the urban one because of the greater availability of land, easier access to building materials, the fact that it is possible to dig wells and pit latrines, and a more conducive situation for self-help.

Therefore, Sri Lanka's urban housing problem is increasingly serious as demonstrated most vividly by the large and growing slum and shanty areas of Colombo which contain nearly 50 percent of Colombo's people and which result in an economic and social segregation of the occupants.

As to effective demand for housing, details are lacking. The median urban family income at the end of 1980 was calculated in the SSA at Rs. 1,177 and Rs. 760 for rural areas.

B. PRIVATE DEVELOPERS

Most of the comments on private developers are covered under section V.A., above. As far as could be determined, private developers are generally able to get construction financing from banks when needed, ableit at rates of 25-30 percent, if they are a reputable firm and the project is sound and not too large. However, the Study Team heard from one source that property development companies do not have enough money to finish up projects in many cases because of inflation. Some are looking for additional private money from share capital. It is assumed that these are fairly sizable operations, for instance, the Property Development Company described in the section on Capital Markets.

The major problem for developers, as could be determined, was long-term finance. That is, even with the high cost of land and construction (both materials and land do seem to be available) builders could produce a house with a market if the long-term financing were available. No attempt was made, however, to put any kind of order of magnitude on this. (See again, developer comments in section V.A.) One private developer told the Team that he would be interested in forming a "housing society." His views on the target market were "A Rs. 500,000 house with a down payment of 40 percent."

An index relative to costs of construction is contained in Annex 29 and a table indicating the numbers of building plans approved by the Colombo municipality is Annex 30.

C. INDIVIDUALS

Here again, various comments on individual housing needs and preferences are contained in other sections.

It appears that the desire for home ownership on the part of families is very strong in Sri Lanka, so much so that they are willing to invest all their savings. As pointed out in the section on private developers, this desire is strongest for an individual house on a separate plot of land and this is in preference to a sub-development ("colony") type of house or an apartment. However with costs what they are now, this desire may have to be modified in Sri Lanka as in the U.S.

Middle-income persons often rely on accumulated savings, borrowing from families, or borrowing from institutions. Land is generally the single most important item to purchase on the way to becoming a homeowner. With a title to land, an individual has a better chance of obtaining a conventional mortgage or raising a "personal loan" from a bank. Thus, land acquisition is crucial to the entire process and, because of financing, is presently the most difficult hurdle to cross.

Because of the shortage of long-term financing, accumulated savings and help from families appears the best bet for many families today. Of the middle-income people who aspire to a particular level of house, many young marrieds will simply continue to stay with their parents (which creates major crowding problems) until the combination of savings, family help, and a personal loan enable them to buy a house outright or with a high down payment mortgage.

Poorer families often build on a step-by-step basis as they can afford it but the result, in many cases, are the slum and shantry areas of Colombo.

A number of times the idea was expressed to Team members that people do not identify with the commercial banks because they do not see them as providing services they need. The people would, however, be inclined to identify with a housing bank that they though might ultimately provide them with a loan and even be prepared to save at a lower rate in such a bank. It is this philosophy, obviously, which is leading People's into its ISA scheme.

Informal sector financing spans all income levels in both rural and urban areas. Although hard data is not available, this is the implication that can be drawn from conversations with public and private officials. Such informal sector methods certainly mobilize some capital for housing purposes.

The most obvious informal sector finance methods are borrowings from relatives, use of pawnbrokers and (less prevalent) the bridal dowry. For housing, it appears not uncommom to find construction of homes within a family compound. This gift of of land to family members represents a substantial contribution to housing costs and can be used to secure a loan from formal lending institutions.

In low-income areas, both rural and urban, local moneylenders are plentiful. These are usually merchants with access to cash, lending at from 2-20 percent per month. Loans are short term and require no security. Because interest rates are so high, borrowers often find they cannot repay capital and thus become tied to a system of continuing debt. Although moneylenders may have no legal recourse to collecting their loans, the very personal character of their lending and their proximity to the borrower makes loan defaulting an uncomfortable situation.

For middle- to upper-middle income level persons another method exists for informal financing. Lawyer-lenders aware of the existence of capital in a community--who has it and who wants it--will often act as middlemen in

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bringing borrower and lender together. These are generally medium- (3-5 years) to long-term (up to ten years) loans at 20-25 percent interest on security. The arrangement becomes formalized when the lawyer draws up documents attesting to the validity of the loan. Failure to make payments leads to legal processes against the borrower.

A final system which is prevalent in both rural and urban areas is the cheetu or chit system. This operates as a monthly lottery among a small group of friends or trusted individuals. A fixed amount is contributed by each member per month over an agreed period of time. At the end of each month a single member wins the accumulated contributions. In Sri Lanka, this system has not been used exclusively for housing although some housing purposes (repair, upgrading) may come from the use of the winnings.

There also exists in Sri Lanka an informal, or black market, money system. Wealth from the sale and export of gems often stays outside formal money markets. In order to draw some of this wealth back into the system, the Central Bank has approved the issuance of Bearer Bonds and Negotiable Certificates of Deposit, discussed separately.

The existence of informal credit units and the attempt to attract unreported capital implies a varigated system of savings and credit underlying the traditional banking and finance system.

It does appear that informal sector financing becomes an alternative for people with no access to formal markets or who find those markets insufficient.

The process of housing construction is well-suited to informal financing, particularly among the poor. Such housing construction, which takes place piecemeal or as people have money, may not necessitate long-term financing at commercial rates.

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VII. LEGAL ASPECTS AND TAX INCENTIVES

A. MORTGAGE AND TITLE PROCEDURES

Since there is little mobility to date, title is primarily by inheritance rather than through conveyancing. But good title is therefore hard to prove as record title.

Foreclosure proceedings are very sticky. While title will revert upon foreclosure, the occupant can't be thrown out. Special statutory provisions permit state institutions to evict upon default. (Apparently, a private housing bank would be unable to evict and would have to rely on informal sanctions.)

Although the Study Team did not obtain a copy, apparently there is a Mortgage Act which fixes ceiling (now 18 percent) on lending rates. However, the SMIB is governed by its own Act.

Since collecting mortgage payments can sometimes be difficult and since foreclosure is both difficult and time consuming, there would be merit in amending the Mortgage Act to improve foreclosure proceedings and remove rate ceilings.

B. TAX INCENTIVES FOR HOUSING

There are a series of tax incentives relative to housing. These are outlined in Annex 32, an interview with the Commissioner of Internal Revenue.

Relative to the savings side, as has been mentioned, is the tax-free interest on National Savings Bank's deposits up to 1/3, but not to exceed Rs. 2,000.

ANNEXES

ŝri Lanka Discovers Capitalism's Benefits and Pitfalls

By Stuart Auerbach
Washington Post Foreign Service

COLOMBO, Sri Lanka — The long e of sleek, new motorcycles parked der a shed illustrates the plus side this island nation's abrupt about-e 3½ years ago from a controlled onomy under a policy of state so-lism to unbridled, free-enterprise pitalism.

'We used to ride to work in owded buses, but now we have our n transport," said the hotel waiter oudly.

But the rush to capitalism after the 77 election victory of J. R. Jayawar-ne has produced unpleasant side ef-ts, including a galloping inflation e nearing 40 percent, which threat-s the goal of quick industrial devel-ment using prosperous Singapore as e economic model.

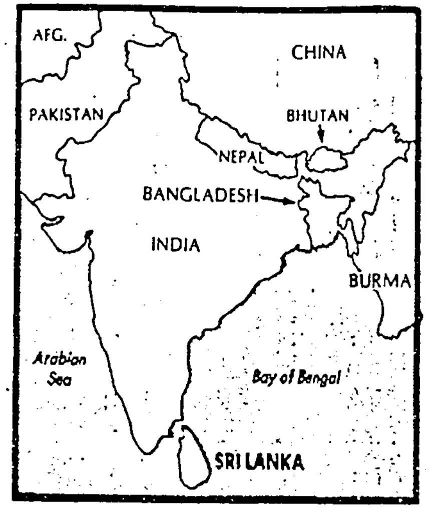
Besides inflation, massive power-ortages caused by the sudden influx consumer appliances such as tele-ion sets, air conditioners and elec-c stoves are hampering industrial-tion. These new appliances, brought during the past three years, use 30 gawatts a day, the equivalent of a all power station, according to the ylon Electricity Board.

Despite 5½ hours a day of sched-ed power cuts, the board estimates at Sri Lanka's hydroelectric power nerating capacity is rapidly dimin-ing, with the monsoon rains that l refill reservoirs to allow more wer generation still at least a week two weeks away.

The solution appears to be in-eased power cuts, which will further ld back industrialization.

Yet inflation remains the major oblem of Jayawardene's govern-ent, which is trying to lure industry e with the promise of cheap, $1-lay literate labor.

Jayawardene's government is trying to lure industry here with the promise of cheap, $1-a-day literate labor.



By Dave Cook-The Washington Post

It appeared that Sri Lanka was headed for quick economic prosperity... But the quick acceleration stalled.

The spiraling costs fueled by an increasing bill for imported oil and the inflationary pressure of rapid industrial development that some critics label "too much, too fast" hit hard on the marginal village economy. While the costs of such basic needs as public transportation, fish and wheat have gone up, the low wages have remained stable. "People are beginning to complain that things used to be better," said one diplomat here.

Nonetheless, Jayawardene's government appears to have maintained the popular support that gave it an unprecedented — for Sri Lanka, which specializes in close elections — 51 percent victory in 1977.

Part of the continued popular support for Jayawardene's United National Party rests with the inability of the splintered opposition to make political capital out of the worsening inflation.

The major opposition group, former prime minister Sirimavo Bandaranaike's Sri Lanka Freedom Party, has not recovered from its stunning 1977 defeat and Jayawardene's subsequent stripping of its leader's civil rights and the right to take part in politics because of what he called irregularities during her seven-year rule.

Bandaranaike appears to be a spent political force here, although her supporters point northward to India and recall how Indira Gandhi also appeared to be politically dead just months before she won a smashing re-election victory in January 1980.

But much of the Bandaranaike party cadre wants her to give up the party leadership. She has clung to the party presidency, however, causing disunity within her organization.

While opposition disharmony has given Jayawardene a respite, his government is under pressure to score quick economic gains, including slowing of inflation and increased employment before the next national election in 1983.

At the start of Jayawardene's rule it appeared that Sri Lanka was headed for quick economic prosperity. After decades of a slumbering economy, in which 90 percent of government spending went for welfare programs and hardly anything for development, economic growth soared to 8.2 percent in 1978. That was more than twice the growth rate of the previous two years.

But the quick acceleration stalled. The growth rate in 1979 dropped to 6.3 percent and is estimated to have gone even lower — to 5.6 percent — last year.

Furthermore, the agricultural sector slumped in its most important export crops — tea, rubber and coconut. Rubber and tea production last year was the lowest in the past five years, partly because of unusually dry weather but also because of a failure to maintain the publicly owned plantations.

Jayawardene is pinning hopes for economic growth on the 500-acre free trade zone near the Colombo airport, established to lure industries to make products for export on the basis of Sri Lanka's cheap labor.

So far, 24 companies employing almost 11,000 persons have started operations in the zone and another 40 have signed contracts to open factories. Most of the factories are labor-intensive, such as shoe or clothing manufacturers. In all, the zone is expected to add 35,000 jobs to the economy.

But that is a drop in the bucket compared to the official estimates of 875,000 unemployed Sri Lankans — down, the government claims, from 1.2 million before it took control. Overall, the government says it added 550,000 jobs to the economy in the past 3½ years but that 125,000 persons entered the labor market during that time.

To push industrial development Jayawardene cut heavily into state welfare subsidies that gave this economically backward country an extremely high quality of life that is the envy of most developing nations.

Education is compulsory to age 16 and about 80 percent of the children attend schools. As a result, the literacy rate is more than 80 percent. Widespread health care has reduced the infant mortality rate to 43 deaths pe 1,000 births and pushed life expec tancy to 68 years. Its population growth rate, 1.7 percent, is low for the Third World.

Recognizing those are assets Jayawardene left health and education programs alone while cutting stat subsidies for food, utilities and trans port.

But the country remains poor. I per-capita income is under $200 year and about half its population of 14 million qualifies for food stamps.

EXCERPTS FROM

CENTRAL BANK ANNUAL REPORT 1980

RE: Government Fiscal Operations

Debt amortization, which includes capital and interest payments in respect of all long-term foreign loans, suppliers' credit and repurchases (repayments) and service charges to the IMF also rose from Rs. 2,383 million (SDR 118 million) in 1979 to Rs. 2,763 million (SDR 137 million) in 1980. Despite this increase in debt amortization by 16 per cent, the debt service ratio declined from 13 per cent in 1979 to 12.4 per cent in 1980. This was due to higher earnings on merchandise exports and services which totalled Rs. 22,316 million (SDR 1,037 million) in 1980, as compared with Rs. 18,275 million (SDR 908 million) in 1979, reflecting an increase in gross foreign exchange earnings by 14 per cent. A further major contributory factor for the fall in the debt service ratio in 1980 was the re-emergence of short-term trade credit as a means of financing imports. A substantial part of oil imports in 1980 was financed on short-term trade credit. These were not reflected under amortization, as they were essentially of a very short-term nature. A further reason was the fact that official long-term debt contracted in the recent past was on more concessional terms, providing long periods of grace.

GOVERNMENT FISCAL OPERATIONS[1]

The fiscal operations of the Government in 1980 stimulated a very high level of aggregate demand in the economy with far reaching consequences on the growth of money supply and the price level on the one hand, and on the exchange rate and external payments position on the other. To an appreciable extent these developments in 1980 were the result of a failure to pursue a policy of fiscal stabilisation through conscious fiscal discipline. There were many pressures, both within and outside the control of Government, which made adherence to a strict budgetary programme and fiscal discipline a formidable task. Voted estimates of expenditure were frequently revised in the course of the fiscal year to accommodate additional commitments as well as cost escalations. Additional expenditures incurred by Ministries, not previously programmed and provided for, were covered through supplementary estimates. These increases in expenditure would not have caused strains on budgetary operations, such as were discernible during the year, had there been a commensurate growth in government revenue and financing resources. Relief from these latter sources was barely forthcoming. The growth of revenue seriously lagged behind the growth of expenditure.

The heightened level of trading and economic activities pursued in the private sector and the alignment of deposit rates of commercial banks with those offered by the National Savings Bank pre-empted savings that otherwise would have been available to finance the budgetary deficit in 1980. The flow of foreign resources channelled to the budget was inadequate to finance the resource gap with the result that the Government, trapped in a resource constraint of major proportions was compelled to resort to bank finance on an unprecedented scale.

The revised budget deficit in 1980 revealed a spectacular increase of 71 per cent over the approved original estimates. The increase in government revenue in 1980 approximated a meagre 12 per cent over the approved estimates as against an increase of 37 per cent in expenditures over the original budget estimate. The growth of capital and recurrent expenditure over the original budget estimate, both in absolute and relative terms, thus far exceeded the growth in revenue. The wide disparity between the relative rates of growth of revenue and expenditure, typifies the magnitude of the problem that emerged in fiscal management. Total government expenditure at Rs. 29,026 million in 1980 reflected an increase of 35

1. Based on provisional estimates. All data subject to revision when government accounts are finalised.

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TABLE 1.31

Government Fiscal Operations 1977 - 1981

Rs. Million

Item	1977	1978	1979	1980 Approved Estimates	1980 Estimated Outturn	1981 Approved Estimates
1. Revenue (a)	6,686	11,688	12,730	12,262	13,756	15,550
2. Recurrent Expenditure	6,148	10,408	11,502	11,119	13,558	15,332
3. Advance Accounts Operations (deficit – /Surplus +)	– 430	– 1,831	– 1,028	– 100	– 1,775	+ 675
4. Current Account (Surplus + /Deficit –)	+ 108	– 551	+ 200	+ 1,043	– 1,577	+ 893
5. Capital Expenditure	3,182	6,614	8,991	9,963	13,693	12,739
Of which: Sinking Fund and Amortization payments and contributions to International Financial Organisations	(947)	(1,165)(*b*)	(1,182)(*b*)	(1,346)	(1,502)(*b*)	(1,620)
6. Budget Deficit	3,074	7,165	8,791	8,920	15,270	11,846
7. Financing the Deficit						
7.1 Domestic Sources	1,786	2,653	4,582	3,100	8,885	3,750
(a) Non-bank market borrowing	1,504	2,033	2,806	3,100	2,692	3,750
(b) Non-market borrowing	505	453	1,096	—	– 884	—
(c) Banking system (*c*)	– 224	167(*d*)	680(*d*)	—	7,077(*d*)	—
7.2 Foreign Finance	1,779	4,454	4,237	5,820	6,253	8,100
(a) Commodity loans	885	1,371	1,434	2,420	1,432	
(b) Project loans	394	1,645	813	3,100	1,171	8,100
(c) Grants	500	661	1,390		2,137	
(d) Other loans (*e*)		778	599	300	1,513	
7.3 Use of cash balances	– 492	58	– 28	—	133	– 4
8. Expansionary Impact of Government Fiscal Operations	– 715	173	634	—	7,185	– 4

Sources: Central Bank of Ceylon
General Treasury.

(a) Excludes capital grants in revenue, shown under foreign grants.
(*b*) Includes repayment of foreign administrative borrowings of Rs. 174 million in 1978, Rs. 178 million in 1979 and Rs. 271 million in 1980 (Estimated outturn)
(*c*) Includes Special Advances from Central Bank to meet contributions to international financial organisations.
(*d*) Not adjusted for repayments of rupee loans of Rs. 52 million in 1978. Rs. 18 million in 1979 & Rs. 25 million in 1980 to the banking system.
(*e*) IMF Trust Fund loan. Other loans in 1980, Estimated outturn, include IMF Trust Fund Loan of Rs. 521 million, the Euro Currency commercial loan of Rs. 897 million and Iraq loan of Rs. 95 million.

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per cent over the previous year. Consequently, the share of government expenditure in Gross National Product, in nominal terms, increased to 47 per cent in 1980 as against 43 per cent in 1979.

Advance accounts operations resulted in a net out-payment of Rs. 1,775 million considerably in excess of what had been envisaged in the original estimate. The outcome was largely due to the trading operations of the Food Commissioner. Furthermore, outstanding liabilities and expenditure commitments under administrative borrowings amounting to Rs. 891 million at end of 1979 were settled from resources accruing in 1980. The problems of cash management were aggravated by a shortfall in the targetted finances from the domestic non-bank sector.

According to revised estimates, the current account registered a deficit of Rs. 1,577 million in 1980 as against a surplus of Rs. 200 million in the previous year. Had it not been for the heavy outpayments under advance accounts, the current receipts at Rs. 13,756 million would have accommodated the current payments amounting to Rs. 13,558 million as well as revealed a small surplus. Thus, the net advance accounts out-payments at Rs. 1,775 million denied a possible surplus in the current account. When compared with the previous year the share of government receipts in the GNP (nominal) declined from 26 to 22 per cent in 1980. Further, while GNP (nominal) recorded a growth of 25 per cent over the preceding year, government revenue registered a meagre growth of 8 per cent exhibiting a lack of buoyancy in relation to the growth in money incomes in the economy. Recurrent expenditure including net advance accounts payments at Rs. 15,333 million in 1980 showed an increase of Rs. 2,803 million or 22 per cent. However, recurrent expenditure as a share in the GNP was 25 per cent in 1980 as was in 1979. Capital expenditure including sinking fund contributions and debt repayments at Rs. 13,693 million, was 52 per cent higher than the preceding year's expenditure. The share of capital expenditure in GNP increased from 18 per cent in 1979 to 22 per cent in 1980. With the current account deficit at Rs. 1,577 million and the capital budget commitment at Rs. 13,693 million, the total budget deficit amounted to Rs. 15,270 million in 1980, recording an increase of 7[illegible] per cent over the approved budget deficit and a 74 per cent increase over the deficit of the previous year. The budget deficit registered in 1980 was 25 per cent of nominal GNP.

To finance the resource gap in the budget a sum of Rs. 16,162 million was obtained both from domestic and foreign sources. Of this amount, Rs. 891 million was utilized to settle deposit transfers and outstanding expenditure commitments of 1979. In gross terms, nearly 61 per cent of the total resources amounting to Rs. 9,909 million was obtained from domestic sector. Of this amount Rs. 7,077 million or 71 per cent was contributed by the banking sector. Domestic savings mobilized in 1980 amounted to Rs. 2,692 million or 27 per cent of total domestic resources, and financed 18 per cent of the budget deficit. Foreign assistance at Rs. 6,253 million accounted for 39 per cent of the total resources mobilized in 1980 and financed 41 per cent of the budget deficit. The major share of foreign assistance was received in the form of grants amounting to Rs. 2,137 million, while commodity and project loans amounted to Rs. 1,432 million and Rs. 1,171 million, respectively. Other foreign finances amounting to Rs. 1,513 million consisted of IMF Trust Fund loan (Rs. 521 million), Euro currency commercial loan (Rs. 897 million) and a loan from the Government of Iraq (Rs. 95 million). With the banking sector providing a sum of Rs. 7,077 million towards financing the overall budget deficit and a drawing down of cash balances totalling Rs. 133 million, the net expansionary impact of government fiscal operations in 1980 was in the region of Rs. 7,185 million as against Rs. 634 million in 1979.

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A summary of fiscal operations for the year 1980 and approved estimates for 1981 are given in Table 1.31. The net cash deficit on account of the government fiscal operations for 1980 is shown in the Statistical Appendix, along with comparable data for the past 10 years.

Revenue

Government revenue in 1980 has been estimated at Rs. 13,756 million, indicating an increase of 8 per cent over the preceding year. Indirect taxes on production and expenditure at Rs. 10,126 million showed an increase of Rs. 381 million or 4 per cent and comprised 74 per cent of total revenue receipt as against 77 per cent in 1979. As in the preceding years, external trade based taxes formed the principal component of the total indirect tax collections and its share when compared with the previous year, declined from 72 to 65 per cent. Direct taxes in 1980 amounted to Rs. 1,906 million revealing an increase of Rs. 495 million or 35 per cent over 1979. As a proportion of total revenue the share of direct taxes increased from 11 per cent in 1979 to 14 per cent in 1980.

When the total revenue is examined in relation to the performance in the overall economy, the revenue growth of 8 per cent is not impressive. Both the revenue/GNP ratio and the tax/GNP ratio declined during the year. While the revenue ratio declined from 26 to 22 per cent, the tax ratio decreased from 23 to 19 per cent, revealing a situation in which the rate of growth of incremental of overall revenue receipts including tax revenues failed to keep pace with the incremental rate of growth of national income. For instance, based on rough annual estimates a calculation of revenue elasticity with respect to national income revealed a coefficient of 0.289 for 1980 as against 0.322 for 1979 implying a reduced sensitivity of incremental revenue to increasing money income growth. It is important that the tax structure should not only raise adequate resources for the public sector but revenue also should expand at least in proportion to the increase in national income in order to finance a continuously expanding programme of investment.

The relative share of indirect taxes in a total revenue declined from 77 to 74 per cent, while the share of business turnover tax in the total indirect tax revenue increased from 12 to 17 per cent on account of a 44 per cent increase recorded in the business turnover tax collections. Increased receipts from business turnover taxes were due to an upward revision in the tax rates, the higher level of economic activity and the prevalent inflationary impulses in the economy. As far as tax incidence is concerned, indirect taxes exhibit a higher degree of regressivity. However, the exemption of wage of mass consumption goods like rice, flour and sugar from the business turnover tax somewhat minimised the extent of regressivity. Even with regard to import duties, a measure of tax progressivity has been introduced by levying duty rates in line with end use and the demand pattern relating to commodities.

The share of international trade oriented taxes declined from 55 to 48 per cent, largely due to a reduction in receipts from tea export taxes. Export duties formed the principal items of revenue in the production and expenditure oriented indirect taxes, accounting for 36 per cent of receipts as against the previous year's share of 43 per cent. Total collections from export duties decreased by Rs. 537 million or 13 per cent. In comparison to the previous year, duty collections from tea and coconut decreased by Rs. 530 million or 21 per cent and Rs. 127 million or 38 per cent, respectively. The reduction in duty receipts from tea was largely due to a downward revision in the specific export duty on bulk tea from Rs. 15.50 to Rs. 10.50 per kg., effective from July, 1979. The marginal decline in the volume of export by 3 million kgs. and the downward revision in duty of tea exported in packets and bags as from July, 1980 also contributed to the drop in revenue. With regard to coconut, which is also subject to a specific quantity based duty, the decrease was mainly due to a fall in the volume of exports, by 55 per cent and a drop in domestic production. On the other hand, despite a decrease in the volume of exports caused by a fall in domestic production, duty collections from rubber, where the duty rate is on a sliding scale, recorded an increase of Rs. 99 million or 8 per cent owing to higher export prices.

Though some of the minor export products such as cardamom, cocoa and citronella oil were exempted from export duty in November, 1979, the duty collected from minor exports increased by Rs. 21 million or by 21 per cent to Rs. 120 million. Coir fibre, one of the principal minor export products despite a marginal decline in the volume of exports contributed a sum of Rs. 58 million as export duties due to favourable export prices. Higher export prices also enabled a sum of Rs. 22 million to be collected as duties from cinnamon exports. In the case of graphite very favourable export prices enabled a contribution of Rs. 20 million as duties on an export turnover of Rs. 79 million despite a 41 per cent reduction in domestic production.

Import duties while being the second major item of revenue with a share of 27 per cent in the total indirect tax collections also accounted for 20 per cent of the total revenue receipt. Current import duty receipts of Rs. 2,754 million showed a 21 per cent increase over the previous year. However, the average rate of duty declined from 10 to 8 per cent. In other words, the incremental rate of growth of import revenue failed to keep pace with the incremental growth in the value of imports. In value terms imports increased by 49 per cent but import revenue expanded only by 21 per cent. This was mainly due to a substantial increase in the import value of non-dutiable goods like petroleum, fertilizer and government sector investment goods imports. Excluding identifiable imports such as rice, flour, sugar, petroleum and fertilizer, the average duty rate remained constant at 12 per cent when compared with the previous year.

Selective sales taxes, also a major item among indirect taxes recorded a reduction. Its share among indirect tax revenue declined from 20 to 18 per cent, while the share among total revenue decreased from 15 to 13 per cent. In absolute terms, collections from selective sales taxes recorded a fall of 7 per cent or Rs. 134 million. The outcome was due to lower receipt from tea ad-valorem tax and administrative levy on coconut kernel products. The decrease of Rs. 125 million from tea ad-valorem tax was due to the lowering of the tax rates and the upward revision of the price at which tax becomes operative. In the case of the administrative levy on coconut kernel products, the decrease was Rs. 275 million or 71 per cent resulting from a drop in the volume of exports of 55 per cent and an upward revision of the operative price. Excise on tobacco and liquor both recorded increased receipts. While receipts from excise on tobacco at Rs. 993 million showed an increase of Rs. 192 million or 24 per cent, receipts from liquor at Rs. 572 million registered an increase of Rs. 74 million or 15 per cent. The relevant increases were mainly on account of the upward revisions of excise duties relating to tobacco and liquor.

Total collections from direct taxes at Rs. 1,906 million showed an increase of Rs. 496 million or 35 per cent. Though disaggregated data are not available, it is evident that the increase was mainly caused by higher receipts accruing from the

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corporate sector. While the share of direct taxes in the total revenue receipts increased from 11 to 14 per cent, the proportion of direct taxes to GNP (nominal) also recorded a marginal increase from 2.8 to 3.1 per cent.

Recurrent Expenditure

According to latest estimates, the total recurrent expenditure including net out payments on advance accounts and supplementaries amounted to Rs. 15,333 million in 1980 showing an increase of 22 per cent over the previous year. In this total is included total supplementaries on recurrent votes amounting to Rs. 2,489 million and net outpayments on advance accounts of Rs. 1,775 million.

While personal emoluments and pensions amounting to Rs. 3,730 million and Rs. 735 million recorded an overall increase of 12 and 28 per cent respectively, its total share in the total recurrent expenditure decreased marginally from 31 to 29 per cent. Interest on public debt which amounted to Rs. 2,282 million showed an increase of 34 per cent, mainly due to higher interest payments on Treasury bills and rupee securities.

Though the interest subsidy to the National Savings Bank at Rs. 258 million in comparison to last year's payment of Rs. 92 million showed a three-fold increase, when adjusted for lags in last year's payment, the actual increase amounted to Rs. 36 million or 16 per cent.

The Income Support Scheme which came into operation in 1978 was withdrawn as from July, 1980 and unexpended monies in the original allocation of Rs. 230 million were transferred to the decentralised budget. Expenditure on the Food and Kerosene Stamps Scheme, which substituted a consumer price subsidy with direct income transfers amounted to Rs. 1,595 million and Rs. 182 million, respectively. However, in the case of infant milk food, there was a price subsidy, where the estimated expenditure was Rs. 105 million as against last year's expenditure of Rs. 75 million. The decision to distribute free text books among all school children in government schools necessitated a new vote on recurrent expenditure amounting to Rs. 73 million. The subsidy provision under the price support scheme for tea which guaranteed a minimum producer price amounted to Rs. 65 million. The total import duty rebate has been estimated at Rs. 350 million as against last year's payment of Rs. 140 million. The increase was mainly on account of a substantial increase in the value of garment exports which qualified for rebates on the duty paid on raw material imports.

The total amount transferred to semi-government entities or corporations during the year has been provisionally estimated at Rs. 1,722 million as against last year's transfer of Rs. 914 million. Transfers of current funds to semi-government entities were due to varied reasons. There was, firstly, the normal transfer to non-profit oriented semi-government entities to meet current commitments. Secondly, there were transfers of funds due to policy decisions such as the maintenance of certain subsidy schemes, and thirdly there were transfers relating to the reimbursement of losses. The increase in the transfer of current funds was mainly caused by higher payments made to the State Fertilizer Corporation and the Sri Lanka Transport Board (SLTB). The transfer of Rs. 800 million as against last year's payment of Rs. 395 million to the State Fertilizer Corporation was on account of the fertilizer subsidy. In the case of Sri Lanka Transport Board in comparison to last year's payment of Rs. 85 million, during the year a sum of Rs. 457 million was transferred for reimbursement of operational losses. The transfer of Rs. 53 million to the National Milk Board was due to the maintenance of a producer subsidy

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scheme. Under the subsidy scheme, a sum of Rs. 29 million was also transferred to the Paper Corporation. Under the category of non-profit oriented entities, the main recipients were, Universities and University Grants Commission (Rs. 109 million), Tourist Board (Rs. 49 million), National Apprenticeship Board (Rs. 41 million) and National Youth Service Council (Rs. 30 million).

Advance Accounts

Expenditure on advance account operations during the year amounted to Rs. 1,775 million as against Rs. 1,028 million in the preceding year. This accounted for nearly a 13 per cent of the total recurrent expenditure in 1980. In the previous year it was 9 per cent. With a net out payment amounting to Rs. 1,525 million, Food Commissioner's food purchase and distribution operations constituted a major part of the expenditure on advance account activities. The balance was accounted by the other advance accounts. Based on tentative data the operations relating to Sri Lanka-China Trade account would have resulted in a net out payment (expenditure) amounting to Rs. 208 million. Increased cost of goods and services and increased activities, losses on advance account activities which were not compensated with counterpart voted expenditure and increased loan facilities to state officers necessitated greater recourse to advances. Increased import prices, particularly sugar and wheat flour were primarily responsible for the heavy out payments on Food Commissioner's advance account. Expenditure on Food Commissioner's account also included trading losses and increases in trade debtors. The original budget, however, made allowance for only a sum of Rs. 100 million on all advance account activities. Therefore, for the third successive year, advance account operations continued to be a major element of budgetary disturbance. Previous reports and reviews focussed attention on this problem and emphasised the need to adjust budgetary format so that advance account activities could be explicitly by incorporated in the annual budget.

Capital Expenditure

Total capital expenditure including supplementaries amounted to Rs. 13,693 million, recording an increase of Rs. 4,702 million or 52 per cent over last year. Supplementary estimates amounted to Rs. 3,801 million, registering a 31 per cent increase over the original estimate. Net of Sinking Fund contributions and loan repayments, total capital expenditure was Rs. 12,191 million as against last year's expenditure of Rs. 7,809 million, recording an increase of 56 per cent. Sinking Fund contributions and loan repayments at Rs. 1,502 million showed an increase of Rs. 320 million over last year.

Due to non-finalisation of government accounts, acutual expenditure has not been ascertained as yet. With original estimates and the subsequent supplementaries matched against the total resource mobilization, it has been possible to obtain a tentative estimate on the extent of under-expenditure in the overall capital account. Accordingly, the derived rate of under-expenditure is 15 per cent. Net of sinking fund contributions and debt repayments, the net capital expenditure during the year recorded an increase of 56 per cent. It is pertinent to note in this regard, that capital expenditure data can only quantify the extent to which financial targets of expenditure have been acheived. Data would not correctly reflect the extent to which physical targets have been met. To realize the latter, Performance Budgeting is required. Particularly, in an inflationary context, capital expenditure data have to be deflated in order to ascertain the real increase. Using the implicit GNP deflator it is seen that the increase in total capital expenditure is around 32 per cent as against the increase of 56 per cent recorded at current prices. While increased capital expenditure is synonymous with investment activities aimed at increasing the capital stock in the country, it is also important to ensure that investment resources are apportioned in such a manner that there exists a meaningful balance between short-term quick yielding projects and long-term high return projects.

A ministry-wise classification of capital expenditure is given in the Statistical Appendix.

Based on provisional data, the actual expenditure on the Mahaveli Project was Rs. 3,137 million as against a total budgetary provision of Rs. 3,500 million, showing an under-expenditure of 10 per cent. In total, a sum of Rs. 439 million was spent on development work connected with Stage I, II, III and of which a sum of Rs. 428 million was spent on Stage II and III. Expenditure on the four major projects in the accelerated programmes amounted to Rs. 2,176 million, with the shares of each project being Victoria (Rs. 901 million), Kotmale (Rs. 862 million), Randenigala (Rs. 30 million) and Maduru Oya (Rs. 383 million). Expenditure on the associated Irrigation Systems amounted to Rs. 350 million, of which sums of Rs. 99 million and Rs. 240 million, were spent on the Irrigation Systems B & C, respectively. The balance sum of Rs. 172 million was spent on Ulhitiya Oya and Moragahakanda Reservoir Projects and the Rotalawela & Kandakadu Irrigation Complex.

The housing programme of the Ministry of Local Government, Housing and Construction, on which a sum of Rs. 1,038 million, was spent, absorbed as much as 48 per cent of the total ministry vote. The most important single item was urban housing programme with an expenditure of Rs. 634 million. Though the electoral housing programme had a provision of Rs.30 million, actual expenditure amounted to Rs. 167 million. The 'low cost housing programme' and emergency housing programme (Colombo Metropolitan Area) had very high rates of under expenditure. As against allocations of Rs 23 million and Rs. 22 million, these two programmes utilized Rs. 8 million and Rs. 7 million, respectively. Amounts spent on the aided -self-help housing programme and the model village programme were Rs. 130 million and Rs. 9 million, as against the allocations of Rs. 139 million and Rs. 8 million, respectively. In addition to the housing activities directly undertaken by the Ministry, a sum of Rs. 23 million was also spent by the National Housing Fund.

A sum of Rs. 562 million was spent by the main 'line' ministries on the Sri Jayawardenapura Parliamentary Complex in 1980. The allocation came from several ministries. The Department of Buildings spent Rs. 310 million on the main construction activities. The Reclamation and Development Board spent a sum of Rs. 105 million. The other items of expenditure on the project were Electricity (Rs. 56 million), Highways (Rs. 37 million), Telecommunication Services (Rs. 35 million) and Water Supply and Drainage (Rs. 19 million).

In addition to the 1980 allocation of Rs. 10 million, the GCEC also utilized a sum of Rs. 108 million being the amount transferred to Treasury deposits in 1979. However, actual direct expenditure during the year amounted to Rs. 54 million, which was spent on Investment Promotion Zones (Rs. 13 million), Negombo Town Development (Rs. 11 million), purchase of GCEC building (Rs. 23 million) and capital grants to Local Authorities (Rs. 7 million).

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The Decentralized Budget had an allocation of Rs. 420 million and utilized Rs. 413 million. This excludes the expenditure in the Anuradhapura district. The Income Support Scheme was withdrawn in July, 1980 and a part of the allocation under this vote was transferred to the decentralized budget. The main areas of activities under the decentralized budget were education (Rs. 118 million), communication (Rs. 102 million), agriculture and irrigation (Rs. 48 million), Local Government works (Rs. 43 million) and civil administration (Rs. 20 million).

Financing of the Budget Deficit

The budget deficit resulting from the government fiscal operations during the year amounted to Rs. 15,270 million as against the original estimate of Rs. 8,920 million. In comparison, the deficit in the previous year was Rs. 8,791 million. Resources available from the normal sources of finance did not, however, expand sufficiently to bridge the gap. Accordingly, steps were taken to obtain additional resources both from domestic and foreign sources. Total foreign finance (including commercial borrowings) aggregated Rs. 6,253 million as against the budget estimate of Rs. 5,820 million. Non-bank borrowing from the domestic sources was Rs. 2,692 million which was well below the original estimate of Rs. 3,100 million. This critical financial position was further intensified and aggravated in the field of non-market borrowings where the loan operations and the settlement of past commitments resulted in a net outflow of Rs. 88.4 million. Thus, the final outturn revealed a resource gap of Rs. 7,210 million. Consequently, the Treasury was faced with a problem of cash management. In order to meet its commitments, the government was compelled to resort to borrowing from the banking system. Total bank financing of the deficit amounted to Rs. 7,077 million, and was supplemented by drawing down the cash balance by Rs. 133 million.

Limited success in the mobilisation of funds in the domestic market necessitated the drawing down of the proceeds of the Euro currency commercial loan negotiated in 1979. Inclusive of the above commercial borrowing, total receipts from foreign sources amounted to Rs. 6,253 million, covering approximately 41 per cent of the overall budget deficit. However, when the Euro-dollar borrowing is excluded, the amount obtained by way of anticipated foreign assistance for budgetary purposes amounted to Rs. 5,356 million. In terms of the latter figure, foreign finances contributed 35 per cent towards bridging the budget deficit.

When compared with the preceding year, total foreign finance recorded an increase of Rs. 2,016 million or 48 per cent. While the loan finance increased by 45 per cent, grants increased by 54 per cent. When commercial borrowing is excluded, the increase in the loan finance registered only an 8 per cent increase. Cash loans including the commercial borrowing classified under "other loans" increased by Rs. 914 million and project loans by Rs. 338 million. Commodity loans recorded a marginal increase. Resources obtained under project loans amounted to Rs. 1,171 million, cash loans Rs. 1,513 million and commodity loans Rs. 1,432 million. Total grants amounted to Rs. 2,137 million.

Resources form captive sources, which normally form the major source of finance were crowded out by the private sector and extra budgetary activities. As a result, the domestic market borrowings from the non-banking domestic sources amounted only to Rs. 2,692 million as against Rs. 2,806 million in the previous year. On the other hand, non-market borrowings resulted in "negative financing" of Rs. 884 million. Thus, the resource gap was met by borrowings from the banking sector amounting to Rs. 7,077 million and by use of cash balance to an extent of Rs. 133 million.

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Domestic market borrowing from the non-bank sources consisted of Rs. 2,802 million obtained from rupee securities. When adjusted for the sale of Rs. 106 million in Treasury bill holdings and a surrender of Tax Reserve Certificates amounting to Rs. 4 million, a net sum of Rs. 2,692 million was available from this source. Attempts to augment resources by way of high interest rates on rupee loans which were revised in July, 1980 and introduction of medium term bonds, shortening the maturity period from 10-12 years to 3 years, apparently were not sufficient inducements for increased subscriptions. Contributions to rupee loans were exclusively made by the captive sources. On the other hand, there was a repayment of Rs. 25 million to the banking sector.

Under non-market borowings a sum of Rs. 884 million current resources was utilized for meeting previous year's expenditure. While there was a borrowing of Rs. 7 million under foreign administrative borrowings, there was a withdrawal of Rs. 592 million of Treasury deposits and repayment of Rs. 299 million under administrative borrowings. The withdrawal of deposits constitute a utilization of budgetary allocations transferred to deposits at the end of the preceding financial year in respect of committed expenditure.

Domestic market borrowings from the banking sources consisted of Rs. 7,077 million obtained by way of the issue of Treasury bills and Rs. 183 million under Central Bank advan es. In order to obtain finance through Treasury bills the statutory limit was raised on 4 occasions from Rs. 3,000 million to Rs. 10,000 million. Of the total bank financing, the Central Bank's gross contribution amounted to Rs. 7,131 million. Holdings of Treasury bills and Tax Reserve Certificates by Commercial banks decreased by Rs. 42 million and Rs. 12 million, respectively. Use of cash balances comprised drawing of counterpart funds amounting to Rs. 118 million and a draw down of cash by Rs. 15 million.

Public Debt

The outstanding gross public debt as at end of 1980 stood at Rs. 51,656 million, registering an increase of 46 per cent compared with the increase of 15 per cent in the previous year. In 1980, domestic debt increased by 50 per cent while foreign debt increased by 41 per cent. Accordingly, the proportion of foreign loans in total public debt declined from 45 per cent to 43 per cent. As at end of 1980, the gross domestic debt and foreign debt amounted to Rs. 29,379 million and Rs. 22,277 million, respectively. As a result, the proportion of public debt to GNP rose from 72 per cent in 1979 to 84 per cent in 1980. Interest payment on public debt increased from Rs. 1,633 million to Rs. 2,200 million in 1980. Thus, the proportion of public debt interest payments to GNP recorded a marginal increase from 3.3 per cent to 3.7 per cent. As total debt service payments, including amortization, amounted to Rs. 3,702 million, the share of debt service payments in government revenue increased to 27 per cent in 1980 as against 23 per cent in 1979. While the external debt service ratio declined from 13 per cent in 1979 to 12.4 per cent in 1980, the external public debt service ratio showed a marginal decrease from 4.7 per cent in 1979 to 4.5 per cent in 1980.

The gross domestic public debt at Rs. 29,379 million showed an increase of Rs. 9,745 million. While funded debt (long and medium term debt) increased by Rs. 2,470 million to Rs. 17,939 million in 1980, floating debt (Treasury bills, Central Bank Advances, Tax Reserve Certificates, etc.) increased by Rs. 7,276 million to Rs. 11,440 million in 1980. As a result of this three-fold increase in the floating debt, the share of the funded debt in total domestic debt decreased from 79 per cent in 1979 to 61 per cent in 1980. The share of floating debt increased from 21 per cent to 39 per cent.

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Total amount of resources raised from rupee securities amounted to Rs. 2,802 million as against Rs. 2,950 million in 1979. Of this, a sum of Rs. 1,600 million was raised during the first half of the year. These loans carried an interest rate of 10 per cent per annum and had a maturity period of 10-12 years. In July, 1980 the maturity period of bonds was shortened to three years and rate of interest was increased to 16 per cent per annum. During the second half of the year a sum of Rs. 1,202 million was raised under medium term loans. As in the past, the major subscribers were the Employees' Provident Fund (EPF), Sinking Funds and the Insurance Corporation of Sri Lanka and the National Savings Bank (NSB). While the subscription of Sinking Funds and the EPF recorded increases of 6 per cent and 8 per cent respectively, subscriptions from the NSB and the Insurance Corporation fell by 18 per cent and 25 per cent, respectively. In absolute terms, the decrease in the NSB's contribution to the loan programme was Rs. 211 million. The NSB continued to be the major contributor to rupee loans accounting for 33 per cent of total subscriptions.

The total amount of Treasury bills outstanding as at end of December, 1980 amounted to Rs. 9,800 million, recording an increase of Rs. 6,800 million over the preceding year. The banking sectors' holdings of Treasury bills increased from Rs. 2,706 million to Rs. 9,613 million. While the Central Bank's holdings recorded almost a four-fold increase, from Rs. 2,656 million to Rs. 9,605 million, commercial banks' holdings decreased from Rs. 50 million to Rs. 8 million. Holdings by the non-bank sector decreased from Rs. 294 million to Rs. 187 million. While the EPF reduced its holdings by Rs. 17 million the NSB realised its investments in Treasury bills, amounting to Rs. 99 million.

Provisional advances to the Government under section 89 of the Monetary Law Act showed an increase of Rs. 183 million as against Rs. 181 million in 1979. The total outstanding liabilities on provisional advances as at end of the year amounted to Rs. 1,319 million. Central Bank special loans to the Government for payment of subscriptions to international organizations was resumed in 1980 and borrowings amounted to Rs. 308 million. Outstanding Tax Reserve Certificates as at end of the year amounted to Rs. 13 million, recording a decrease of Rs. 15 million.

The total foreign debt outstanding as at end of 1980 amounted to Rs. 22,277 million, recording an increase of Rs. 6,436 million or 41 per cent, compared with the preceding year's increase of 9 per cent. The depreciation of the Sri Lanka Rupee in terms of other currencies increased the outstanding liability by Rs. 2,921 million. Remissions by creditors amounted to only Rs. 2 million as against Rs. 804 million in 1979. The net receipt of external assistance in the form of project, commodities and cash loans was Rs. 3,516 million. Repayment of foreign loans during the year amounted to Rs. 600 million. Of this, Rs. 352 million (59 per cent) was on commodity loans, Rs. 155 million (26 per cent) on project loan and the balance Rs. 93 million (15 per cent) on cash and equipment loans.

Interest payments on public debt amounted to Rs. 2,199 million[1], recording an increase of Rs. 566 million or 35 per cent. While interest on domestic debt rose by Rs. 510 million or 40 per cent, interest on foreign debt rose by Rs. 56 million or 16 per cent. Interest on domestic debt amounted to Rs. 1,787 million. The latter was made up of Rs. 1,330 million on rupee loans, Rs. 441 million on Treasury bills, Rs. 15 million on foreign administrative borrowings and Rs. 1 million on Tax Reserve Certificates.

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1. This excludes interest payments on temporary rupee borrowings and short-term foreign loans serviced by the Treasury.

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During the year under review government contracted 26 project loans, 7 commodity loans and a cash loan, the value of these loans amounted to Rs. 8,714 million, as against Rs. 6,457 million in 1979. The total utilization of loan finances however, recorded a decrease. As at end of 1980 the aggregate utilization of loans contracted since 1970 was 56 per cent. In 1979 this ratio stood at 60 per cent. A low level of utilization was noticeable in project loans where the utilization rate was as low as 36 per cent. Commodity loans registered a utilization rate of 81 per cent, while cash loans were fully utilized.

MONEY AND BANKING

A very sharp expansion in domestic credit and a substantial decline in external banking assets are the main features of monetary and banking developments in 1980. Domestic credit expansion during the year was Rs.11,174 million or 80 per cent. Both the private sector and the government sector shared in the increased bank credit. Gross credit to private sector increased by Rs. 5,123 million during the year, while net credit to Government rose by Rs. 6,051 million. Under the impact of this sharp and unparalleled credit expansion, there was increased pressure on the balance of payments, leading to loss of reserves. Altogether net external banking assets declined in 1980 by Rs. 4,096 million or 85 per cent. The fall in external banking assets helped to moderate the adverse monetary implications of very high credit expansion. It, however, considerably weakened the external financial position of the country by the end of the year.

Money Supply

In 1980, narrowly defined money supply (M_1), consisting of currency and demand deposits held by the public, increased by Rs. 1,759 million or 23 per cent, compared to an equally large increase of Rs. 1,733 million or 29 per cent during the preceding year. Meanwhile, the broadly defined money supply (M_2) comprising M_1 *plus* time and savings deposits of the private sector held with commercial banks, rose by Rs. 4,803 million or 32 per cent, as against the increase of Rs. 4,166 million or 38 per cent during the preceding year. Thus, the year 1980 witnessed a small deceleration in the rate of growth of monetary aggregates, even though the rates of growth were still appreciably high. During the year, the monetary aggregates moved somewhat erratically. The annual rate of growth of M_1 which recorded a 29 per cent level as at the end of December, 1979 declined to 24 per cent by the end of March 1980, remained unchanged at this level until the end of June, decreased further to a relatively low level of 15 per cent in September, increased sharply during the next two months to reach 24 per cent at the end of November and decreased marginally to 23 per cent in December, 1980. Following roughly the same pattern, M_2 declined from 38 per cent as at the end of December, 1979 to 24 per cent in March, remaining broadly at this level until July, but rising progressively to reach 32 per cent by the end of December, 1980.

The income velocity of both monetary aggregates (i.e. GNP at current factor cost, divided by the monetary aggregate) recorded a marginally declining trend in the past few years. In the case of M_1 which recorded an average income velocity of 7.1 during the period 1974 to 1977, it declined to 6.8 in 1978 to 6.5 in 1979 and 6.6 in 1980. Similarly, the income velocity of M_2 which stood at an average of 4.6 during the period from 1974 to 1977, declined to 3.7 in 1978, to 3.3 in 1979 and to 3.2 in 1980. The declining trend in the income velocity indicates that the rates of growth in both monetary aggregates had been faster than that in the output of goods and services, thereby exerting pressure on the price level.

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TABLE 1.32

Monetary Aggregates - 1978 - 1980

/Amount in Rs. Million

End of Period	Narrow Money Supply (M_1) 1978	1979	1980	% Change (1978 over '77)	% Change (1979 over '78)	% Change (1980 over '79)	Broad Money Supply (M_2) 1978	1979	1980	% Change (1978 over '77)	%Change (1979 over '78)	% Change (1980 over '79)
January	5,679	6,091	7,848	+ 35.1	+ 7.3	+ 28.8	9,222	11,297	15,118	+ 43.5	+ 22.5	+ 33.8
February ..	5,830	6,489	7,880	+ 31.6	+11.3	+ 21.4	9,507	12,305	15,488	+ 41.8	+ 29.4	+ 25.9
March ..	6,001	6,752	8,375	+ 27.4	+12.5	+ 24.0	9,975	12,913	16,052	+ 41.5	+ 29.4	+ 24.3
April ..	6,025	6,727	8,384	+ 26.4	+11.7	+ 24.6	10,097	13,018	16,379	+ 40.0	+ 28.9	+ 25.8
May ..	5,876	6,694	8,289	+ 22.2	+13.9	+ 23.8	10,006	13,229	16,316	+ 37.1	+ 32.2	+ 23.3
June ..	5,864	6,692	8,278	+ 18.5	+14.1	+ 23.7	10,180	13,179	16,414	+ 35.2	+ 29.4	+ 24.5
July ..	5,570	6,667	8,196	+ 13.8	+19.7	+ 22.9	10,078	13,346	16,658	+ 33.9	+ 32.4	+ 24.8
August ..	5,523	6,895	8,240	+ 12.4	+24.8	+ 19.5	10,063	13,548	17,100	+ 31.0	+ 34.6	+ 26.2
September ..	5,804	7,088	8,131	+ 15.5	+22.1	+ 14.7	10,389	13,879	17,700	+ 32.0	+ 33.6	+ 27.5
October ..	5,835	7,159	8,388	+ 15.3	+22.7	+ 17.2	10,589	14,200	18,369	+ 31.1	+ 34.1	+ 29.3
November ..	5,955	7,233	8,976	+ 13.3	+21.5	+ 24.1	10,796	14,433	19,040	+ 27.1	+ 33.7	+ 31.9
December ..	5,936	7,669	9,428	+ 10.6	+29.2	+ 22.9	10,892	15,058	19,860	+ 24.9	+ 38.2	+ 31.9
Monthly Average	5,825	6,846	8,368	+20.2	+17.5	+22.2	10,149	13,367	17,041	+ 34.4	+31.7	+ 27.5

Source: Central Bank of Ceylon.

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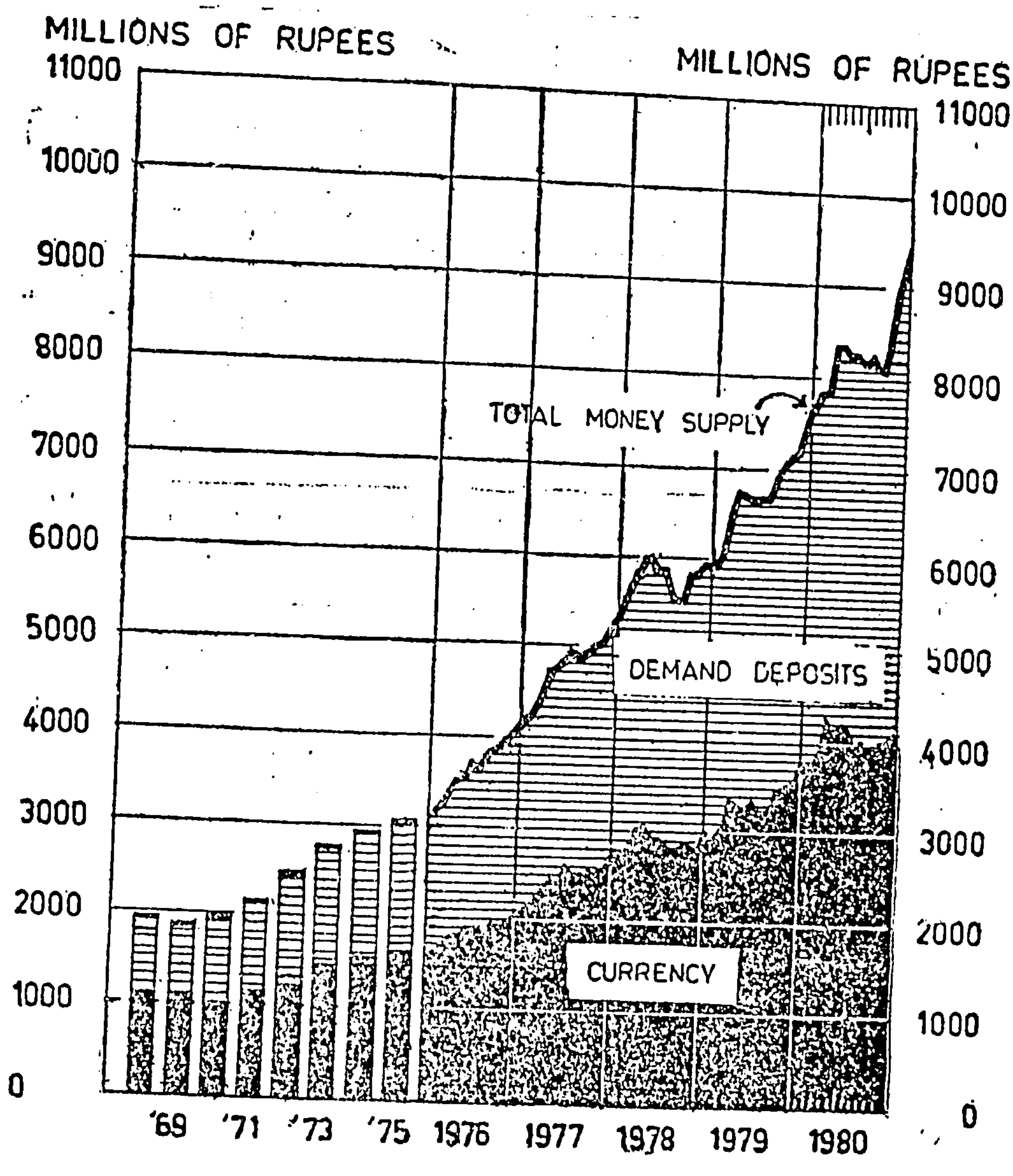
MONEY SUPPLY$_{(M_1)}$

1968—75 END YEAR FIGURES, 1976 ONWARDS END MONTH FIGURES



Central Bank of Ceylon.

During 1980, while currency held by the public increased by Rs. 407 million or 11 per cent, demand deposits of the public rose faster by Rs. 1,352 million or 35 per cent. Consequently, the share of demand deposits in M_1, which stood at 51 per cent as at the end of 1979, increased sharply to 56 per cent by the end of 1980. The experience in the past few years showed that there was no significant change in the public's preference to hold currency as against demand deposits; but the developments in 1980 indicated a marked shift in favour of demand deposits. If this trend were to continue, it could be considered as an indicator of a furthering of the banking habit among the public. It provides a bigger leeway for commercial banks to create credit, since the ratio of currency to demand deposits is an important determinant of the credit multiplier which ultimately determines the size of the money supply.

Expansion in narrow money as well as in quasi money was responsible for the growth in M_2 during the year under review. Time and savings deposits of the private sector rose by Rs. 3,044 million or 41 per cent in 1980, as compared with an increase of Rs. 2,432 million or 49 per cent during the preceding year. Of the increase in the time and savings deposits during 1980, the other private sector constituents accounted for a major share amounting to Rs. 2,442 million or 80 per cent, while the share of public corporations was Rs. 544 million or 18 per cent. In comparison, the time and savings deposits of the co-operative institutions recorded a marginal increase of Rs. 58 million. However, during the early part of the year, there was a slowing down in the rate of growth of private sector time and savings deposits. The increase during the first four months was only Rs. 607 million or 8 per cent, as against a much larger rise of Rs. 1,335 million or 27 per cent during the corresponding period of the previous year. The deceleration in the rate of growth of time and savings deposits during this period can be mainly attributed to a decline in the real rates of return on such deposits against continuing inflationary pressures in the economy. There were compelling circumstances for an upward revision of the deposit rates and this was effected in May, 1980. Since then, the growth of private sector deposits with commercial banks accelerated once again. During the last eight months of 1980, time and savings deposits of the private sector rose sharply by Rs. 2,437 million or 30 per cent, recording a monthly average increase of Rs. 305 million, as against a much lower monthly average increase of Rs. 152 million during the first 4 months of the year. Accordingly, the year 1980 as a whole recorded a monthly average rise of Rs. 254 million in private sector time and savings deposits with commercial banks, as compared with a monthly average increase of Rs. 203 million during the preceding year.

During 1980, the monetary scene was dominated by a substantial domestic credit expansion (DCE) amounting to Rs. 11,174 million or 80 per cent. The expansionary impact of this was, however, partially off-set by a sharp decline in external assets (net) of the banking system totalling Rs. 4,096 million or 85 per cent and an increase in the other items (net) of the banking system by Rs. 2,276 million. In comparison, in the preceding year, domestic credit expanded by a much lower magnitude of Rs. 3,624 million or 35 per cent, the expansionary impact of which was, however, reinforced by a considerable increase in external assets (net) of the banking system amounting to Rs. 1,236 million or 35 per cent. However, the expansionary impact of these factors were off-set, to some extent, by an increase in other items (net) of the banking system of Rs. 695 million, the principal item being the profits made by the banking system, including the Central Bank during the year.

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Table 1.33

Monetary Aggregates and Causal Factors

Amount in Rupees Million

Item	December 1978	December 1979	December 1980	Change 1978/79 Amount	Change 1978/79 Percentage	Change 1979/80 Amount	Change 1979/80 Percentage
Monetary Aggregates							
1. Currency held by the public	3,015.5	3,774.2	4,180.8	+ 758.7	+ 25.2	+ 406.6	+ 10.8
2. Demand deposits held by the public	2,920.8	3,895.1	5,247.3	+ 974.3	+ 33.4	+ 1,352.2	+ 34.7
Narrow Money Supply (M_1)	5,936.4	7,669.3	9,428.2	+ 1,732.9	+ 29.2	+ 1,758.8	+ 22.9
3. Time and Savings deposits of private sector held with commercial banks	4,955.7	7,388.3	10,432.0	+ 2,432.6	+ 49.1	+ 3,043.7	+ 41.2
3.1 Co-operative Institutions	181.6	257.7	315.4	+ 76.1	+ 41.9	+ 57.6	+ 22.3
3.2 Government Corporations	541.0	1,491.9	2,036.0	+ 950.9	+ 175.8	+ 544.1	+ 36.5
3.3 Other private sector constituents	4,233.1	5,638.7	8,080.6	+ 1,405.6	+ 33.2	+ 2,442.0	+ 43.3
Broad Money Supply (M_2)	10,891.8	15,057.6	19,860.2	+ 4,165.8	+ 38.2	+ 4,802.6	+ 31.9
Sources of Monetary Aggregates							
1. Domestic Credit	10,378.0	14,002.5	25,176.8	+ 3,624.5	+ 34.9	+ 11,174.3	+ 79.8
1.1 Net Credit to the Government	1,863.0	2,920.4	8,971.9	+ 1,057.4	+ 56.8	+ 6,051.4	+ 207.2
1.1.1 Gross Credit to the Government ..	3,875.8	4,706.2	11,904.6	+ 830.4	+ 21.4	+ 7,198.4	+ 152.9
by Central Bank	3,075.2	3,842.7	10,965.5	+ 767.5	+ 25.0	+ 7,122.8	+ 185.3
by Commercial Banks	800.6	863.5	939.1	+ 62.9	+ 7.9	+ 75.6	+ 8.7
1.1.2 Government deposits and cash balances ..	− 2,012.8	− 1,785.8	− 2,932.7	+ 227.0	+ 11.3	− 1,147.0	+ 64.2
1.2 Gross credit to the private sector	8,515.0	11,082.1	16,204.0	+ 2,567.1	+ 30.1	+ 5,122.8	+ 46.3
1.2.1 Co-operative Institutions(a)	1,377.7	938.6	741.5	− 439.1	− 31.9	− 197.1	− 21.0
1.2.2 Government Corporations	2,363.1	3,346.9	4,122.7	+ 983.8	+ 41.6	+ 775.8	+ 23.2
1.2.3 Other private sector constituents	4,774.2	6,796.6	11,340.7	+ 2,022.4	+ 42.4	+ 4,544.1	+ 66.8
2. External Banking Assets (net)(b)	3,573.9	4,809.6	713.7	+ 1,235.7	+ 34.6	− 4,095.9	− 85.2
3. Other items (net)	− 3,059.9	− 3,754.6	− 6,030.3	− 694.7		− 2,275.7	
3.1 Other liabilities (net) of the Central Bank ..	− 1,247.2	− 1,827.2	− 3,141.9	− 580.0		− 1,314.7	
3.2 Other liabilities (net) of commercial banks ..	− 1,713.0	− 2,069.4	− 2,720.6	− 356.4		− 651.2	
3.3 Adjustments for items in transit	− 99.7	142.0	− 167.8	+ 241.7		− 309.8	
Broad Money Supply (M_2)	10,891.8	15,057.6	19,860.2	+ 4,165.8	+ 38.2	+ 4,802.6	+ 31.9

Source: Central Bank of Ceylon

Note: Signs indicate the effect on M_2

(a) Credit to co-operative institutions has been adjusted to take account of monies held in Paddy Marketing Board Suspense Account pending liquidation of matured Goods Receipts. These amounted to Rs. 296.9 million, Rs. 969.3 million and Rs. 626.7 million by end 1978, 1979 and 1980, respectively.

(b) Changes in external banking assets attributable to exchange rate changes with contra entry in other liabilities and accounts (net) of Central Bank have been excluded from the analysis. At the end of 1978, 1979 and 1980 these amounted to Rs. 2,016 million, Rs. 1,998 million and Rs. 2,917 million, respectively.

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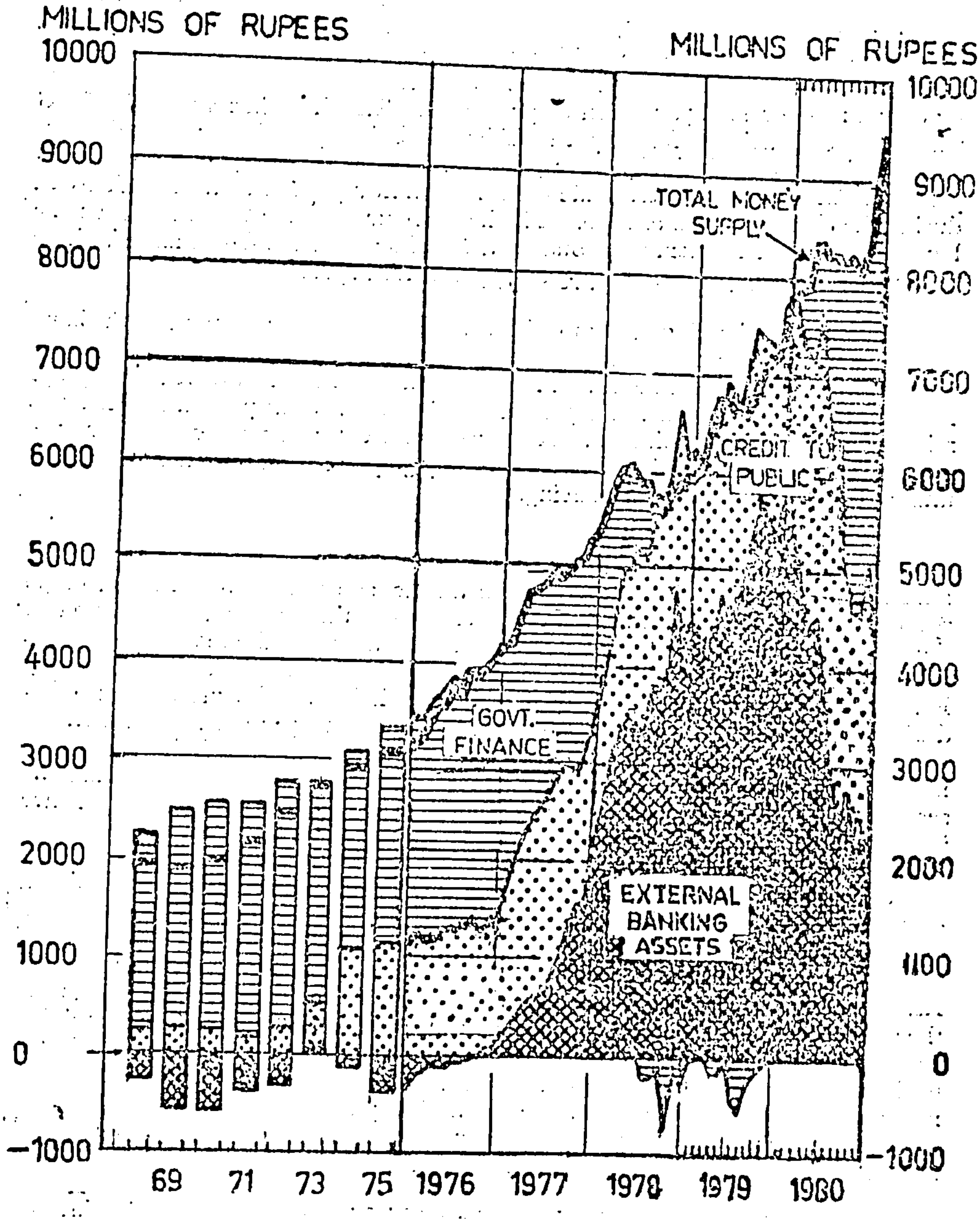
SOURCES OF MONEY SUPPLY (M_1)

1968—75 END YEAR FIGURES; 1976 ONWARDS END MONTH FIGURES



Central Bank of Ceylon.

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A feature of monetary developments during 1980 was the emergence of the government sector as the major user of domestic credit in the economy. In fact, net credit to Government (NCG) rose unprecedentedly by Rs. 6,051 million or 207 per cent during the year, as compared with a relatively moderate increase of Rs. 1,057 million or 57 per cent in the preceding year. Government's borrowings from the banking system during 1980 was mainly in the form of Treasury bills. In the absence of any significant subscriptions from non-bank sources, the Central Bank was called upon to subscribe to successive issues of Treasury bills and the Central Bank's contribution to the total issue of Treasury bills as at the end of the year was Rs. 9,604 million or 98 per cent. Consequently, gross credit to Government (GCG) by the Central Bank rose by a record Rs. 7,123 million or 185 per cent. However, Government's borrowings from commercial banks increased by only a moderate Rs. 76 million or 9 per cent. The sharp increase in the GCG was, however, partially off-set by a considerable build-up of Government deposits and cash balances with the banking system amounting to Rs. 1,147 million or 64 per cent. This was, however, made possible by a heavy use of Central Bank credit during the closing months of 1980. The heavy reliance of the Government on the banking system in financing the budget deficit increased the Government's share in the DCE from 29 per cent in 1979 to 54 per cent in 1980.

The major underlying factor for the Government's heavy recourse to the bank financing was a very sharp increase in government expenditure, particularly on account of capital commitments. The budget deficit in 1980 totalled Rs. 15,270 million, as compared with Rs. 8,791 million in the previous year, and Rs. 8,920 million in the original estimates. Resources from external sources and domestic non-bank sources were available to finance only 59 per cent of this deficit, necessitating considerable bank financing.

During 1980, gross credit to private sector (GCP) rose sharply by Rs. 5,123 million or 46 per cent, as compared with an increase of Rs. 2,567 million or 30 per cent during the preceding year. Even though there was an acceleration in the rate of growth of private sector credit during the year, the second half of the year witnessed a general slow-down in the rate of increase. In fact, GCP rose by Rs. 3,210 million or 29 per cent during the first half, but the increase recorded during the second half was only Rs. 1,916 million or 13 per cent. The monthly average increase dropped from Rs. 535 million during the first half to Rs. 319 million during the second half. This general slow-down in the GCP during the second half of the year was the outcome of a decline in gross credit to co-operative institutions and public corporations.

Gross credit to public corporations (GCPC) expanded by Rs. 776 million or 23 per cent in 1980, compared with a much larger increase of Rs. 984 million or 42 per cent during the preceding year. During the first half of 1980, GCPC rose by Rs. 1,033 million or 31 per cent, recording a monthly average increase of Rs. 172 million. However, there was a completely different development during the second half of the year when there was a reduction in credit of Rs. 257 million or 6 per cent. The decline in GCPC during this period could be mainly attributed to the use of foreign financing facilities, in the form of acceptance financing, by a major public sector corporation since the middle part of the year. However, the trading corporations and the plantation corporations continued to utilise commercial bank resources liberally throughout the year.

Gross credit to co-operative institutions (GCCI) declined sharply by Rs. 197 million or 21 per cent during 1980. In the preceding year, the decrease was Rs. 439 million or 32 per cent. The decline in credit was more marked during the second

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half than in the first half of the year. The decrease in credit to co-operative institutions was largely reflected in the advances for the purchase of paddy under the Guaranteed Price Scheme (GPS). These advances declined by Rs. 179 million or 85 per cent during the year. The outcome is wholly explained by the sharp decline in the quantity of paddy purchased by the Paddy Marketing Board (PMB) during the year. Paddy purchases by the PMB decreased from 541.2 thousand metric tons in 1979 to 211.3 thousand metric tons in 1980. Borrowings of co-operative institutions for marketing and cultivation purposes, too, declined marginally by Rs. 3 million and Rs. 9 million, respectively, during the year. The sharp decline in the GCCI indicate the relatively diminishing role played by co-operative institutions in the marketing of agricultural commodities due to growing competition from other private sector enterprises.

Gross credit to the 'other private sector constituents' (GCOP) rose sharply by Rs. 4,544 million or 67 per cent in 1980, compared with an increase of Rs. 2,023 million or 42 per cent during the preceding year. Even though the growth of bank credit to public corporations and co-operative institutions decelerated during the second half of 1980, credit to 'other private sector constituents' continued to increase throughout the year. While bank credit to 'other private sector constituents' increased by Rs. 1,986 million or 29 per cent during the first half of 1980, an equally large increase of Rs. 2,558 million or 29 per cent was recorded during the second half. On account of the larger absolute increase in credit during the second half, the monthly average increase in GCOP rose from Rs. 331 million during the first half to Rs. 426 million during the second half of the year. It is interesting to view this development in the light of the interest rate changes effected in May/June, 1980 which resulted in a considerable increase in the interest rates charged on different classes of loans and advances. The weighted average lending rate of commercial banks rose from 13.9 per cent as at the end of Decmeber, 1979 to 16.3 per cent as at the end of June, and to 17.0 per cent as at the end of September, 1980.

The external sector exerted a substantial contractionary impact on the monetary aggregates in 1980. Altogether, external banking assets (net) declined by Rs. 4,096 million or 85 per cent during the year. This development occasioned, in fact, a complete reversal of the trend observed since 1976, when the external assets (net) of the banking system registered continuing growth, reinforcing the expansionary impact of high DCE recorded during that period. The decline in external assets (net) during 1980 was the combined outcome of a sharp decline in the International Reserve (net) of the Central Bank by Rs. 4,677 million, off-set by an increase in the external assets (net) of commercial banks by Rs. 581 million.

The decline in external banking assets (net) in 1980 was the outcome of a significant deterioration in the country's balance of payments position. Under the impact of a very sharp increase in the import bill, the deficit on trade account widened considerably during the year. The trade deficit in 1980 was Rs. 16,140 million, as compared with a deficit of Rs. 7,288 million in the previous year. The higher trade deficit, in turn, led to a higher current account deficit which rose from Rs. 3,556 million in 1979 to Rs. 10,739 million in 1980. The substantially widened current account deficit was only partially financed by net receipts of long-term capital and resources made available from the I.M.F. and market borrowings, leaving a considerable overall deficit which had to be met by running-down accumulated reserves.

In sum, there was a slight deceleration in the rate of growth in monetary aggregates in 1980, even though the growth rates still remained at significantly high levels. Deviating somewhat from the pattern in the past few years, the monetary expansion in 1980 emanated from a very high DCE, partially offset by a sharp decline in net external banking assets.

Commercial Banking

Following the trend observed in the past few years, the resources of commercial banks rose sharply in 1980. During the year, commercial banks' resources increased by Rs. 7,918 million, which was the highest ever on record for any single year. In comparison, total resources in 1979 aggregated Rs. 4,817 million. Changes in all major categories of liabilities contributed to enlarge the resource base of commercial banks in 1980. Conforming to the pattern observed in the past few years, the increase in deposits provided the main impetus to the resource growth during the year. Both, demand and time and savings deposits registered sharp increases, but the growth in time and savings deposits accounted for the major share. In all, time and savings deposits rose to Rs. 3,091 million, largely in response to the upward revision of interest rates on these deposits during the first half of the year. Resource accrual through increases in deposits was further augmented by the increase in other liabilities of Rs. 1,591 million. This arose largely on account of profits of the banks and interest payable held in suspense. The increase in paid-up capital, reserve funds and undistributed profits also contributed to enhance commercial banks' resources during the year.

Reflecting the greater participation of the other private sector and the government corporations in economic activity, demand for bank credit by these sectors remained high during 1980. Commercial bank credit to the private sector rose by a record of Rs. 5,123 million. Despite the accrual of a large volume of resources, the liquidity position of commercial banks underwent sharp fluctuations during the year. In the first quarter of 1980, the commercial banks experienced short term liquidity problems arising mainly from heavy commitments on account of imports. Reflecting the acute need for funds, commercial bank borrowings from the

TABLE 1.34

Changes in Commercial Bank Resources and their Utilization

Rs. Million

	Sector	End 1977/ End 1978	End 1978/ End 1979	End 1979/ End 1980
1.	Government	220.8	15.6	450.5
2.	Central Bank	126.1	-872.2	409.2
3.	Government Corporations	-282.0	302.6	448.6
4.	Co-operative Institutions (a)	-213.8	589.8	251.9
5.	Other Private	-350.5	-60.2	-1477.2
6.	Inter Bank	484.3	276.2	451.8
7.	Foreign	15.0	-252.1	-534.7

Source: Central Bank of Ceylon.

(a) Credit to co-operative institutions has been adjusted to take account of monies held in Paddy Marketing Board Suspense Account pending liquidation of matured Goods Receipts. The changes for 1978, 1979 and 1980 amounted to + Rs. 238.0 million + Rs. 672.4 million and— Rs. 342.6 million, respectively.

Note: Minus Sign indicates net utilisation of resources.

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Central Bank which stood at Rs. 195 million as at the end of 1979 rose sharply to Rs. 1,331 million as at the end of March, 1980. The tight liquidity position continued during the second quarter and the commercial bank borrowings from the Central Bank stood at Rs. 1,305 million by end June, 1980. Thereafter, however, the liquidity position of commercial banks showed a marked improvement. Accordingly, borrowings from the Central Bank dropped to Rs. 719 million at the end of September and further to Rs. 686 million by the end of December, 1980. The improvements n liquidity was also reflected in the ratio of liquid assets to demand deposits which rose from 88 per cent at the end of 1979 to 91 per cent at the end of 1980.

Table 1.34 summarizes the changes in commercial banks' resources and thier utilization on a net basis. All sectors, except the other private sector and foreign sector contributed to the net accural of resources of commercial banks during the year. On account of increases in fixed and other assets (Rs. 1,648 million) and in till cash holdings (Rs. 278 million), utilization of resources within commercial banks absorbed Rs. 1,926 million. However, due to a large increase of Rs. 1,933 million in other liabilities together with an increase of Rs. 366 million in capital resources, there was a net inflow of Rs. 452 million from commercial banks on account of inter-bank transactions.

Government sector's utilization of commercial bank resources amounted to Rs. 140 million during the year, while the inflow of funds from this sector was Rs. 591 million. Accordingly, the net accural of resources from the government sector to commercial banks amounted to Rs. 450 million. Commercial bank advances to government corporations increased by Rs. 776 million, while their deposits with commercial banks rose by Rs. 1,224 million, thus contributing to a net resource inflow of Rs. 449 million to commercial banks. During the year, commercial bank's borrowings from the Central Bank rose by Rs. 571 million while their reserves with the Central Bank increased only by Rs. 161 million. Hence, there was a net inflow of resources from the Central Bank to commercial banks which contributed to augment their credit creating capacity. The co-operative sector, on the other hand, contributed to a net resource accrual to commercial banks through a reduction in their borrowings from the banking system of Rs. 197 million, as well as an increase in their deposits amounting to Rs. 55 million.

Meanwhile, there was a net outflow of resources from commercial banks to the 'other private sector' to the tune of Rs. 1,477 million. This was the combined outcome of an increase in advances amounting to Rs. 4,543 million and a deposit accrual of Rs. 3,066 million. Similarly, the foreign sector absorbed commercial bank resources to the extent of Rs. 670 million, while their resource contribution to the banking system was only Rs. 135 million, thus accounting for a net utilization of resources by this sector to the tune of Rs. 535 million.

Bank Branch Expansion

The total number of bank branches rose by 67 during 1980. This was made up of 27 new branches opened by the Bank of Ceylon, 30 by the People's Bank, 3 by the Hatton National Bank and 7 new foreign banks. As in the previous year, the Bank of Ceylon relocated 24 of its Agrarian Service Centre branches for security and economic reasons, thus making a total of 264 relocations by the end of 1980.

In persuance of the objectives of attracting foreign capital and promoting competition in banking business, foreign banks were encouraged to open branches in Sri Lanka since 1977. Accordingly, seven new foreign banks viz. American Express International Banking Corporation, Bank of Oman Limited, Overseas

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Trust Bank Limited, Bank of America, European Asian Bank, Algemene Bank Nederland N. V., and Habib Bank A. G. Zurich, commenced business during the year thus bringing the total number of foreign banks in Sri Lanka to 17. This, together with the four local banks made a total of 21 banks operating in the country at the end of 1980.

The Foreign Currency Banking Scheme (FCBS) continued to operate successfully in Sri Lanka during 1980. The number of Foreign Currency Banking Units (FCBUs) engaged in these operations increased from 11 as at the end of 1979 to 18 at the end of the year. Total assets and liabilities of these units which stood at US $ 39 million (Rs. 602 million) as at the end of 1979 rose to US $ 211 million as (Rs, 3,796 million) at the end of 1980.

The National Savings Bank (NSB) opened 6 branches during the year thus bringing the total number of its branches to 42.

Interest Rates

The rising inflationary pressures observed during the first quarter of the year and the declining trend in the rate of growth of savings due to negative real returns, necessitated an upward revision of short term interest rates during 1980. With effect from 21st April, 1980 Bank rate was raised from 10 to 12 per cent per annum and the structure of penal rates from the then existing range of 15 to 25 per cent to a range of 20 to 30 per cent per annum. The other short term interest rates which were centred around Bank rate moved in sympathy. The Treasury bill rate moved up from 9 to 13 per cent per annum and the rate on government securities from 10 to 16 per cent per annum with a shortened maturity period from 10 to 12 years to 3 to 5 years. Simultaneously, the interest rates of the deposits with NSB were raised to a higher level. In terms of this revision, the rate on savings deposits was raised from 8.4 per cent to 12 per cent per annum, while the rates on 6 month and 12 month fixed deposits were raised from 12 to 15 per cent per annum and from 15 to 20 per cent per annum, respectively. The NSB discontinued the practice of accepting 18 month fixed deposits.

The commercial banks responded to the upward revision of the Bank rate, penal rates and the NSB rates. Accordingly, effective 2nd May, 1980 the deposit and lending rates of commercial banks were revised upwards. In terms of the revision the interest rates on savings deposits were raised from a range of 5 to 9 per cent to a range of 10 to 14 per cent per annum; 3 month time deposits from 8.5 per cent to a range of 12-14 per cent per annum (the maximum rate was raised upto 16 per cent from October); 6 month time deposits from a range of 11 to 12 per cent per annum to 15 per cent per annum and from October to a range of 15 to 18 per cent per annum; 12 month time deposits from a range of 14 to 15 per cent to 20 per cent per annum. Commercial banks also recommenced accepting 24 month time deposits at 22 per cent per annum.

Lending rates of commercial banks were also revised consequent to the upward revision of deposit rates, but most banks provided preferential treatment to priority sectors. Accordingly, the rate on advances for export purposes was raised by only 2 percentage points to 16 per cent per annum, while advances for the construction of residential houses were provided at rates within a range of 13.5 to 17 per cent per annum. However, substantial increases were effected in the case of loans and advances for other purposes such as temporary overdrafts (from 18 to 30 per cent) consumption (16 to 24 per cent), hire purchase companies for relending (14.5 to 24 per cent) and tourism (14 to 22 per cent).

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The increased cost of credit arising out of high lending rates was felt in the inter-bank call money market where the interest rate moved up sharply from a range of 10 to 14 per cent prior to April 1980, to a range of 15.5 to 19.5 per cent by the end of June and thereafter, to a maximum of 25 per cent per annum by December, 1980.

Following the upward revision of short-term lending rates of commercial banks, medium and long-term credit institutions also raised their lending rates. The maximum lending rate of the Development Finance Corporation of Ceylon (DFCC) moved up from 16 to 17 per cent per annum effective from June, 1980. State Mortgage and Investment Bank (SMIB) revised upward its maximum lending rates on two occasions. Effective 9th May, 1980 the maximum rate was raised from 18 to 19 per cent per annum and from 1st August, 1980 to 20 per cent per annum. Effective 29th September, 1980 lending rates of the National Development Bank (NDB) moved up from 15 per cent to 17 per cent per annum. Similarly, the maximum lending rates of the National Savings Bank moved up from 13 per cent to 15 per cent in August and then to 17 per cent in December. The interest rates of the National Housing Department remained unchanged during the year. Meanwhile, the rates on refinance loans from the Medium and Long-Term Credit Fund (MLCF) of the Central Bank were raised with effect from May, 1980 by 2 percentage points.

Thus, consequent to the initial upward movement in the Bank rate, the penal rates and the deposit rates of the NSB, the entire interest rates structure moved to a new higher plateau by the end of June, 1980. Such a change was very vital for maintaining the savings momentum against the background of rising inflationary pressures in the economy.

Central Banking

The total assets /liabilities of the Central Bank increased sharply by Rs. 5,996 million or 36 per cent in 1980, compared with an increase of Rs. 2,597 million or 18 per cent during the preceding year. In contrast to the pattern observed in the past few years, when both domestic and foreign assets showed increases, the growth in assets in 1980 was wholly confined to the domestic assets of the Bank, which rose by an unprecedented Rs. 9,552 million or 108 per cent. On the other hand, the foreign assets of the Bank decreased sharply by Rs. 3,556 million or 45 per cent. In comparison, in 1979 both domestic and foreign assets recorded increases, the former by Rs. 768 million or 9 per cent and the latter by Rs. 1,828 million or 30 per cent. As a result of the sharp decline in the International Reserve (IR) during the year, the ratio of IR to sight liabilities of the Bank (i.e. currency issue plus demand deposits with the Central Bank) declined sharply from a peak level of 91 per cent as at the end of 1979 to 43 per cent by the end of 1980.

The International Reserve of the Central Bank which rose consecutively since 1975 declined by Rs. 3,556 million in 1980. In fact, the decrease in 1980 was almost of the same magnitude as the increase recorded during the previous two years. This sharp decline in the International Reserve reflected the strains under which the country's balance of payments position behaved during the year.

The domestic assets of the Central Bank rose by Rs. 9,552 million during the year. In view of Government's heavy dependence on bank borrowings, credit to Government recorded an all-time high increase of Rs. 7,123 million in 1980. Of this, government and government guaranteed securities accounted for Rs. 6,632 million, while provisional advances accounted for Rs. 491 million. In contrast to a decline of Rs. 428 million in 1979, loans and advances to others rose by Rs. 476 million. Of this sum, short-term loans accounted for Rs. 357 million, which was the

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extent to which the commercial banking system depended on the Central Bank to overcome short-term liquidity problems. The other assets and accounts of the Bank rose by Rs. 1,869 million, primarily due to an increase in the outstanding balance of the Asian Clearing Union (ACU) accounts by Rs. 1,316 million.

On the liabilities, side, the currency issue of the Bank rose by Rs. 688 million or 16 per cent, compared with an increase of Rs. 812 million or 23 per cent in the previous year. Deposit liabilities, excluding those of International Institutions, rose by Rs. 1,023 million, of which Government deposits accounted for Rs. 617 million. The increase in government deposits has to be viewed against the background of heavy bank borrowings during the year. With a view to restructuring the credit facilities made available by the Medium and Long-term Credit Fund (MLCF), the Central Bank transferred Rs. 250 million to meet the enhanced credit needs under this scheme. Meanwhile, 'other liabilities and accounts' rose by Rs. 3,745 million.

During the year, external liabilities rose by Rs. 205 million, as compared with a substantial increase of Rs. 874 million in 1979. The increase in external liabilities during the year was the combined outcome of increased borrowings abroad amounting to Rs. 360 million partly offset by a decline in the deposits of foreign government institutions totalling Rs. 155 million.

In sum, the monetary policy measures adopted since 1977 were carried over to 1980 and further intensified in April 1980, with a view to improving their effectiveness. The monetary situation in the first quarter of 1980 showed disturbing signs, indicating that the year would end up with undesirably high growth in monetary aggregates, particularly if the domestic credit expansion was to continue at the same pace as in the first quarter. Though the gradated scale of penal rates was meant to make the commercial banks more cost conscious, there was evidence to show that the commercial banks, particularly the two state sector banks, were once again resorting to heavy Central Bank borrowings. By the end of the first quarter, the commercial banks' borrowings from the Central Bank at the Bank rate and at penal rates rose sharply to Rs. 394 million and Rs. 937 million, respectively. It was evident that the heavy seasonal demand for credit specially for import purposes was met by resorting to increased credit from the Central Bank. Moreover, in the context of two digit inflation for the 4th successive year, there were signs of a set back to the momentum of deposit mobilisation effected since the August/September, 1977 interest rate reform. Hence, urgent action was required to restrict credit creation capacity of commercial banks, on the one hand, and to provide a positive rate of return to savers, on the other. At the same time, commercial banks continued to make numerous requests to Central Bank requesting an enhancement of the export credit refinance facility.

Accordingly, effective April, 1980 the export credit refinance facility was raised by 15 per cent or Rs. 30 million with a view to providing further relief to commercial banks with respect to export credit. Hence, the total export credit facility available at Bank rate moved up to Rs. 230 million. At the same time, in response to continuing excessive expansion in monetary aggregates, the Central Bank intensified the monetary policy measures. Effective 21st April, 1980, Bank rate was raised from 10 to 12 per cent, per annum. In order to further discourage commercial banks from resorting to Central Bank credit the penal rates structure was raised from a range of 15 to 25 per cent to a range of 20 to 30 per cent. Following the increase in Bank rate, the Treasury bill rate moved up from91 to 13 per cent per annum, while the rate on government securities was raised from 1.0 per cent to 16 per cent per annum within a considerably short maturity period. The above policy measure was further strengthened by the revisions in deposit rates

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of the NSB and the commercial banks. The lending rates of commercial banks and the other medium and long term credit institutions were also raised and the entire interest rates structure moved up. These policy measures were aimed at containing the excessive expansion in monetary aggregates and accordingly arresting the rising inflationary pressures in the economy.

In response to the intensification of monetary policy, the annual growth of M_1 dropped from 25 per cent in April to 15 per cent in September, 1980. At the same time, due to increased costs, commercial bank borrowings from the Central Bank dropped from Rs. 1,487 million in April to Rs. 738 million by the end of September. The reduced use of Central Bank accommodation caused increased pressure, in the inter-bank call money market, pushing the call market rates to an unprecedentedly high level of 25 per cent towards the end of the year. Meanwhile, in response to high deposit rates, M_2 registered a growth of 32 per cent at the end of the year, compared to the annual growth of 26 per cent recorded at the end of April, 1980.

But for the intensification of monetary policy in the second half of the year, the monetary situation for 1980 would have been far worse. Despite the progressive and rapid decline in international reserves, domestic credit expansion would have kept the growth of monetary aggregates at fairly high levels bringing renewed pressure on the price level. Largely in response to the tightening of monetary policy in April, 1980 the growth in monetary aggregates was maintained at relatively low levels for most part of the year. There were, however, disturbing developments in the monetary scene towards the closing months of 1980, when both M_1 and M_2 recorded sharp increases. This was very largely the outcome of excessive use of bank credit by the Government rather than lack of effectiveness of monetary policy, per se.

The above developments involved two major policy implications in the field of demand management during 1981. First the high rate of monetary expansion during closing months of 1980 would bring about further price pressure by mid 1981. Secondly, any further intensification of monetary policy without adequate fiscal discipline would not produce desired results, it is also likely to be counter-productive in achieving growth and employment objectives.

SUMMING-UP

In 1980, Sri Lanka's economy was subject to severe pressures in the task of aggregate demand management arising mainly out of her efforts to accelerate the pace of investment. Economic developments which were witnessed in 1980 and which had their antecedence in 1977, single out the difficulties of forcing the pace of development through a heavy investment programme in relation to the available resources. Demand pressures developed in 1980 causing strains on monetary management, on the general level of prices and on the level of external reserves. The inflationary tendencies stimulated by and arising from an interaction of these variables constituted the economic background for policy decisions. The management of the economy was made difficult by adverse movements in the international economic scene particularly through a marked decline in the terms of trade.

Under the impact of enhanced budgetary outlays, government's capital expenditure in 1980 increased to a high level of Rs. 13,693 million. The latter figure compares with Rs. 8,991 million in 1979 and Rs. 6,614 million in 1978 and reveals in broad terms the acceleration of capital outlays. The growth of total expenditure on the one hand and the slow growth of revenue on the other, resulted in a high budgetary deficit of Rs. 15,270 million.

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In bridging a budget deficit of this magnitude the government resorted to borrowings from domestic as well as foreign sources. It should be pointed out that a budget deficit financed from foreign borrowing is relatively non-inflationary to the extent that the accrual of foreign exchange enables domestic supplies to be augmented from abroad, while at the same time minimising a reduction in the country's external reserves. Borrowing from domestic non-bank source tends to be non-inflationary as real resources are mobilised from incomes already generated and are substractions from income flows. Borrowings from the banking systm, particularly from the Central Bank, provide more definitive inflationary causation and pressure on the balance of payments, as such resources not only constitute newly created money but also increase the liquidity base of the banking system.

The resources available to finance the 1980 budget defioit such as foreign aid and domestic market borrowing were limited. In the absence of non-inflationary financing sources the Government financed the residual gap by borrowing from the Central Bank. The increased borrowings from the Central Bank came in the form of fresh issues of Treasury bills. The volume of Treasury bills outstanding increased by Rs. 6,800 million and the Central Bank's holdings of Treasury bills rose by approximately Rs. 7 billion. The statutory limit on Treasury bills was raised to provide for these increases. The effect on the economy of government's inflationary deficit financing was to raise money supply and to swell the level of aggregate demand in the economy. The expansion of aggregate demand stemmed from both increased expenditure by the government as well as through increases in commercial bank credit to the private sector.

Bank credit to the private sector increased by Rs. 4,780 million or 49 per cent during the year. Although the level of private sector credit was running at a fairly high level, it was considered somewhat inappropriate to prune sharply the supply of credit to this sector on account of the contribution this sector makes towards facilitating supplies of goods and services. The Central Bank was mindful of the fact that a sharp cut back of credit to the private sector would have had adverse effects on the domestic economy. In the circumstances a more pragmatic policy using conventional instruments of credit control, bank rate changes and moral suasion was pursued.

In 1980 the availability of exchange reserves for financing imports permitted a moderation in the rate of increase in the price level. The annual average of the Colombo Consumers' Price Index registered an increase of 26 per cent in 1980. The Wholesale Price Index of the Central Bank too showed a higher increase in in 1980 over the previous year. The annual average of the index increased by 34 per cent in 1980 compared with a 9 per cent increase in 1979. Monetary aggregates too showed increases of similar magnitudes. Money supply (M_1 by 23 per cent and M_2 by 32 per cent) increased despite the running down of external reserves by 72 per cent. Resultant pressures on balance of payments led to a depreciation of the Sri Lanka Rupee vis-a-vis major currencies. This depreciation of the exchange rate was most marked during the second half of the year. The pattern of developments witnessed in 1980 of a high level of expenditure, increase in the money supply, running down of external reserves and a depreciation of the exchange rate, emphasise that an economy cannot continue to withstand a level of aggregate demand which is in excess of the availability of real resources. Increases in aggregate demand result in "overheating" and it is only a reduction in the level of demand which offers a longer term solution.

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Both the Governments' budget and the private sector credit requirements have to be worked out in the context of permissible targets on borrowings/lendings, feasible growth rates and a level of external reserves considered adequate for import requirements.

In so far as the budget is concerned, a closer balance of government revenue and government expenditure would be a helpful step in overall demand management. There is a strong case to re-examine the revenue base so as to make it more responsive to income increases .Mobilization of savings is another useful move in limiting bank borrowings. From the point of view of the private sector the institution of a credit budget so that the rate of absorption of resources by the two sectors could be specifically provided for and these be matched with the rate of growth of supplies would permit a better management of the economy. A reasonably designed credit budget appears to be a useful instrument for achieving economic growth targets while avoiding the ills of "overheating" and the pre-emption of funds by one sector.

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Revised Budgetary Estimates 1981

Mr. Speaker, the overall budget deficit anticipated for the year 1981 in the original estimates was Rs. 11,846 million. However, due to ...ge increases in expenditure in the course of ... year, the revised budget deficit for the current year now stands at Rs. 14,231 million. These changes are as follows:

	(Rupees Million) Original Estimates	Revised Estimates
Net recurrent expenditure	— 15,332	— 16,557
Revenue (inclusive of Advance A/c.)	+ 16,225	+ 16,176
Current A/c. deficit/surplus	+ 893	— 381
Capital expenditure	— 12,739	— 13,850
Overall budget deficit	— 11,846	— 14,231

Recurrent expenditure in 1981 is now expected to be 8 per cent higher than the original estimate. As in the previous two years, the escalation of petroleum prices has had its impact on the Budget. As a result I had to provide a subsidy of Rs. 200 million to the Sri Lanka Transport Board to cover its losses during the year. I have also provided a sum of Rs. 113 million to the Ceylon Electricity Board to cover arrears due to the Board from Local Authorities. Although I expected total net receipts of Rs. 675 million from Advance Account operations it now appears that only a sum of Rs. 194 million will be received.

Capital expenditure in 1981 is now expected to be 9 per cent higher than the original estimates. The major supplementaries under capital votes are in respect of the Mahaweli Project (Rs. 750 million), Water Supply Schemes (Rs. 280 million), Irrigation (Rs. 203 million) and Gas turbines for the Electricity Board (Rs. ... million). The additional expenditure of ... 1,825 million on supplementaries was partly off-set by a saving of Rs. 714 million on account of reductions in capital expenditure during the course of the year.

Increased revenue

On the revenue side, I expect an increase of Rs. 432 million during the year. The net increase in revenue is arrived at as follows:

	(Rs. Mn.)	
Increase		
Income Tax	267	
Taxes on assets and properties	95	
Licence Taxes	35	
Profits and Dividends	100	
Export duty (other)	17	
B.T.T.	80	
Excise on liquor	73	
Excise on tobacco	52	
Sales and charges	80	
Tea Advalorem tax	10	
Other	14	723
Decreases		
Sale of capital goods	— 61	
Export duty (rubber)	— 60	
Export duty (coconut)	— 20	
Administrative Levy (coconut)	— 55	
Export duty (tea)	— 60	
Trading enterprises	— 19	
Other	— 16	— 291
Net Increase		432

The higher level of economic activity and higher prices resulted in increased revenue from certain sources. However, this benefit was slightly offset by the drop in revenue colle...

... from export duties on rubber and tea, ...m the administrative levy on coconut products, and in the receipts from government ...rading enterprises.

A downward revision in the duty rate on ...ubber exports which became necessary after ...he sharp decline in rubber prices, was one of ...he main reasons for the fall in export duties. Duties and levies on tea and coconut were also ...educed during the year.

I expect to finance the revised overall budget deficit of Rs. 14,231 million as follows:

	(Rs. Mn.)
Appropriation Act Loans	2,550
Deposits	— 350
Projects loans and grants	4,209
Commodity loans and grants	2,552
Trust Fund loans	8
Foreign Commercial borrowings	1,500
Domestic bank borrowing	3,762
Total	14,231

Mr. Speaker, judging from data up to end of August, there appears to be some under-expenditure of voted funds. Given that situation I may not have to borrow as much as Rs. 3,762 million from domestic banks.

Picture has changed

The entire budgetary picture has changed remarkably in Sri Lanka during the last 10 years. Government expenditure has increased phenomenally. Government revenue has not risen correspondingly. In the 1970 Budget of the late Dr. N. M. Perera, government expenditure only amounted to Rs. 4,143 million.

In the 1976 Budget of the last government, government expenditure was only Rs. 9,314 million. The expenditure for 1981 is now projected to be Rs. 30,407 million representing an increase of Rs. 26,264 million in 11 years. In 1982, it will be Rs. 41,881 million.

As against this Government revenue in 1970 was Rs. 2,815 million. In 1976 revenue amounted to Rs. 5,739 million. In 1981, government revenue is projected to be Rs. 15,982 million. In 1982, it will be Rs. 19,319 million. Hon. Members will see the complexities of budgeting today with this phenomenal growth of expenditure while revenue has lagged far behind.

Mr. Speaker, I must warn the House that this budgetary situation is most unsatisfactory. We cannot possibly allow it to continue. If expenditure continues to increase far beyond our resources like this, there would soon be unmanageable inflation and unsustainable deficits in our balance of payments, which would jeopardise the chances of achieving the Government's development objectives within the framework of a free and liberal economy. While most of our economic disorders stem from outside our shores, it is still our inescapable duty to endeavour to put our own house in order as far as possible.

Courageous steps

Mr. Speaker, as you are aware, the Government has already taken a series of painful and courageous steps to reverse this trend. Prices of essential commodities like rice, flour, sugar and petroleum products have been frequently revised to reflect changes in international prices. Indirect tax rates have been adjusted on several occasions. These were politically unpopular decisions but had to be taken if development was to continue and employment was to grow.

Mr. Speaker, you will recall that last November I had to impose, with the co-operation of my Cabinet colleagues, a 25 per cent cut in our public investment programme for 1981. These were ad hoc cuts imposed in order to bring the Budget for 1981 into reasonable balance. The situation was reviewed in March and September this year and some adjustments were made while maintaining the overall objective of reasonable fiscal balance. As a consequence, we have been able to reduce the overall deficit in the Budget from 21 per cent of Gross Domestic Product in 1980 to an estimated 15 per cent in 1981. We have also been able to reduce recourse to the banking system to around half that of 1980. These fiscal policies were complemented by appropriate and sometimes harsh monetary policies designed to reduce overheating of the economy.

These financial policies were aimed at reducing inflation and arresting the deterioration in the balance of payments which had occurred in 1980. They clearly indicate the Government's determination to continue with the implementation of a stable and sustainable development program.

Mr. Speaker, these measures which we took during the latter half of 1980 and in the first half of 1981 appear to have already had good results. They have had a favourable impact on our balance of payments, on the money supply and on the price level.

While the value of imports in SDR terms during the first seven months of this year was marginally lower than the value of the imports in the corresponding period of last year, the value of our exports was 5 per cent higher.

Consequently, the trade balance showed a lower deficit of SDR 442 million in the first seven months of 1981 as compared with the deficit of SDR 479 million in the corresponding period of 1980.

Price increases

The current account deficit in the first half of 1981 was SDR 239 million, ... deficit of SDR 265 million in the first half of 1980. The deficit in the overall balance of payments also declined from SDR 118 million in the first half of 1980 to SDR 60 million in the first half of 1981. The gross external assets of the country rose marginally by SDR 1 million in this period as compared with a decline of SDR 97 million in the corresponding period of 1980.

For 1981 as a whole, according to current forecasts, the balance of trade is expected to register a lower deficit of SDR 717 million compared with the deficit of SDR 744 million in 1980.

The current account deficit is expected to show a larger improvement, declining from SDR 507 million in 1980 to SDR 409 million in 1981. The overall deficit, thanks to higher aid disbursements, is expected to show an even greater improvement, declining from SDR 166 million in 1980 to SDR 29 million in 1981. These are encouraging signs that our measures have begun to take effect.

Significant achievement

The money supply declined by 4 per cent during the first half of 1981 compared with an increase of 8 per cent in the first half of 1980. Prime increases have also been considerably lower in the first half of this year than in the corresponding period last year. The Colombo Consumers' Price Index rose by 9.7 per cent in the first half of 1981 as compared with an increase of 16.8 per cent in the first half of 1980. The Wholesale Price Index rose by 5.1 per cent in the first half of 1981 as compared with an increase of 12.6 per cent in the corresponding period of 1980.

While it would be foolhardy for anybody in a Third World country like Sri Lanka to venture and make a forecast on the rate of inflation, it would appear as if the inflation rate in this country, as measured by the Consumer Index, has fallen from a height of nearly 35 per cent in 1980 to about 18 per cent this year.

This is a significant achievement by any standards. We must, however, persevere with our efforts to curb inflation even further in the future.

Real output in 1981 expected to grow by 5.8 per cent as again at 5.5 per cent last

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year because of the strong performance of the agricultural sector and related processing industries.

Production of paddy and subsidiary food crops are expected to be higher while the plantation sector is expected to recover from the effects of the drought which affected output adversely in 1980. The output of the sector as a whole is expected to increase by 6.3 per cent compared with 3.1 per cent in 1980. The prospects for manufacturing output are brighter with an estimated increase in output of 5.3 per cent compared with 0.3 per cent in 1980. Construction activity proceeded apace though at a somewhat lower tempo. The service sectors continue to expand.

Mr. Speaker, these are remarkable achievements in the light of the extremely adverse external climate which continues to plague our country. They are indeed a complete vindication of the fiscal and monetary measures that we took in the latter half of 1980 and the first half of 1981.

Mr. Speaker, the policies and the programme of this Government have had the endorsement of the International community. The International Monetary Fund, which in 1980 suspended our drawings under the Extended Fund Facility, resumed the arrangement in June this year. The Sri Lanka Aid Group meeting was held on June 30th and July 1st this year in Tokyo. On July 23rd, I gave this House a complete account of its proceedings.

Highest level of aid

I will not repeat the details. Let me only say, Mr. Speaker, that Sri Lanka today receives almost the highest level of aid per head of population for any aid receiving country. The total aid committed by donor Governments and organisations in 1980 amounted to Rs. 10,674 million (SDR 496 million), as compared with only Rs. 1,602 million (SDR 165 million) of aid commitments in 1976, which was the final year of the previous government's term of office.

Aid commitments in the first ten months of this year amounted to Rs. 11,423 million (SDR 497 million). In spite of this vast increase in foreign aid, we have succeeded in keeping our Debt Service Ratio at 7.5 per cent in 1980 which is one of the lowest levels in the world today. This is because our aid has been obtained on very favourable terms.

Mr. Speaker, let me take this opportunity to thank all the many donor Governments and Agencies for their generous assistance in support of our development efforts. Our development programme could not have been undertaken without this assistance.

Mr. Speaker, while these are very favourable developments, there still remains the basic problem of a fundamental imbalance in the budgetary operations of the Government — our expenditure is still running far ahead of our resources. As I have indicated the Government has done all it could, consistent with its development strategy, to reduce expenditure in the public sector.

There is a point beyond which we cannot go. The scope for further cuts in recurrent expenditure is very limited. Government wages are modest and subsidies have already been reduced substantially. On the capital expenditure side, the Government has to support investment in the productive sectors of agriculture, fisheries, industry etc. and to maintain the expenditures in the social sectors of health and education. We have to generate employment for our people which, after all, is the reward for the sacrifices they have been called upon to make.

New taxation

Foreign aid as a source of financing government expenditure is drying up. I have on a number of previous occasions told this House that due to economic difficulties in the developed countries, their aid commitments are likely to decline in the future.

We should, therefore, expect a rather sharp decline in aid commitments from 1982 onwards. In this situation, if we are to continue with the massive development programme on which we have embarked, we must raise substantial resources of our own.

This can be done only by new taxation. New taxes would undoubtedly impose further hardships on our people. The burden must, therefore, fall more heavily on the affluent and those who have directly benefited from our policies.

Financial year 1982

Mr. Speaker, the Draft Estimates already presented to the House provide for a gross expenditure of Rs. 38,991 million. This compares with an estimated expenditure this year of Rs. 30,407 million.

Recurrent expenditure will rise from Rs. 16,557 million in 1981 to Rs. 19,499 million in 1982. In the context of the Government's firm commitment to the maintenance of the basic welfare measures such as medical services and education, recurrent expenditures cannot be pruned down.

Capital expenditure, which is estimated at Rs. 13,850 million this year, would rise to Rs. 19,492 million in 1982. I have decided to hold down capital expenditure, as the major means of containing total government expenditure within available resources. In fact, the bulk of the estimated capital expenditure in 1982 is for on-going projects. The Government's two lead projects of Mahaweli and Housing will absorb about 46 per cent of the estimated capital expenditure.

Mr. Speaker, the estimated revenue for 1982 at existing tax rates is Rs. 17,809 million, an increase of Rs. 1,827 million over this year's revenue. Import duties would increase by 23 per cent, BTT by 24 per cent and income taxes by 25 per cent. Export taxes, on the other hand, are expected to decline by 6 per cent because of the duty adjustments made this year consequent to the decline in export prices.

Mr. Speaker, public corporations have in the past been recipients of large sums of money from the Budget to finance their development and expansion programmes. As a rule, this Government has decided that these institutions should generate adequate internal resources to finance their investment programs.

The Government has further decided that trading and manufacturing corporations, embarking on new investment programs, should pay the Government a minimum dividend of 10 per cent on capital employed.

I expect a total contribution to government revenue of Rs. 200 million on this account. I also expect a net receipt of Rs. 100 million on Advance Account operations because of the reduced scale of operations by the Food Commissioner.

In summary, the pre-Budget picture for 1982 is as follows :

	(Rs. Mn.
I. Recurrent expenditure	—19,499
II. Advance Account Receipts	+ 100
	— 19,399
III. Revenue	17,809
Current Account Deficit	— 1,590
IV. Capital Expenditure	19,492
Overall Budget Deficit	— 21,082

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BUDGETS

Sri Lanka pays a price

Despite measures to increase domestic revenue, Colombo continues to depend heavily on foreign assistance

By Manik de Silva

Colombo: Sri Lanka's deficit budget for 1982, presented to parliament on November 12 by Finance Minister Ronnie de Mel, indicated that the South Asian island nation will continue to depend heavily on foreign assistance to keep its ambitious development programmes going. Sri Lanka has emerged as one of the highest per capita aid-receiving nations in the world.

De Mel claimed in his budget that "foreign aid as a source of financing government expenditure is drying up," and certainly the International Monetary Fund (IMF) for one has recently been taking a tougher line with Colombo — something reflected in the moves to boost domestic revenue next year. Nevertheless, the government expects to raise Rs 14.2 billion (US$909.1 million) from abroad (mainly in "soft" loans) to help finance the projected Rs 21.2 billion overall deficit on the 1982 budget.

The final budgetary picture for 1982 predicts recurrent expenditure of Rs 20.6 billion and revenue at Rs 19.3 billion, leaving a deficit of Rs 1.25 billion against Rs 400 million expected for 1981. Adding in projected capital expenditure of Rs 19.9 billion, takes the overall budget deficit to Rs 21.2 billion against Rs 14.2 billion in 1981. In addition to the Rs 14.2 billion coming from abroad, this will be financed through Rs 4 billion of domestic non-bank borrowing, leaving treasury bill issues to close the gap of Rs 3 billion.

"This is only 2% of the projected gross domestic product for 1982 and is a remarkable improvement over the past two years," said de Mel. "It is, however, necessary to keep strict control of expenditure during 1982 to keep within these limits."

The finance minister was acutely conscious of what rampant financial indiscipline in 1980 did to last year's budget. The IMF suspended disbursements under its Extended Fund Facility (EFF) which had enabled the government to dismantle decades of exchange and import controls and to liberalise what had long been a highly regimented economy.

In June, de Mel succeeded in negotiating a resumption of disbursements under the EFF. But the price he had to pay has been clearly visible in the continuing depreciation of the Sri Lankan rupee in recent months as well as in the need to raise more domestic revenue as demonstrated in the 1982 budget.

With prices continuing to rise way ahead of wages, and the government all too well aware of its increasing unpopularity in the country over prices, de Mel prepared his budget aware that his task was not merely to find the resources needed to bridge what was clearly going to be a huge budgetary gap. He also had to find the right mix of economic, social and financial policies. This meant giving a pay rise to the government's 450,000 employees, raising more revenue (with the minimum drawn from the broad masses) and massively pruning growing government expenditures.

Meanwhile, the government cannot escape the fact that the balance of payments and consumer price inflation (which de Mel said had come down to 18% this year against 1980's 35%) will continue to be major problems until the elections, due in 1983. The balance of payments is expected to be Rs 10 billion in deficit on current account in 1981 with an overall deficit of Rs 1.5 billion. High priority has to be accorded to containing these twin evils and restoring a reasonable degree of economic stability.

The World Bank and the IMF both pointed out that one of the best revenue opportunities for the Sri Lanka Government lay in a business turnover tax, which de Mel has now announced. The tax will be levied on most imports as well as on a wide variety of domestic produce, including rice, which had previously been tax exempt. The finance minister decided that the tax will be levied at differential rates of 2%, 5% and 10%.

The most price-sensitive items as well as those vital for the domestic production effort are charged at the lowest rate. These include agricultural inputs, building materials, food items, other than infant milk food which is free of the tax, fishing boats and nets, handloom and pure cotton textiles, pharmaceuticals including *ayurvedic* (traditional) preparations and other manufactured items that used to be subject to a 1% turnover tax.

"Some of these items are items of mass consumption, but I feel there is no alternative to taxing goods which are articles of mass consumption if additional resources of the magnitude required have to be mobilised. This is the price we have to pay for development and employment," de Mel said. He claimed, however, that price increases in many of these commodities would be only marginal. Taking rice as an example, he argued that seasonal price fluctuations on the market will greatly exceed the tax, which will amount only to about 10 Sri Lankan cents a "measure" (just under 1 kg.).

Most other items go into the 5% category, with only a few items already taxed at over 5% shunted into the 10% band. The old tax law contained a host of exemptions which the finance minister said were unjustified. De Mel removed most exceptions but undertakings processing the country's primary products of tea, rubber and coconuts have been styled "exempted businesses.". These manufacture or grow desiccated coconut, coconut fibre, coconut oil, copra, crepe, rubber, sheet rubber, block rubber or tea.

Other exempted items are infant milk foods, fertiliser, crude oil, articles manufactured in Sri Lanka and exported by the manufacturer (excluding jewellery and gems) and goods and materials imported as inputs for export manufacture. De Mel said that the additional revenue expected from his new scheme was Rs 1.3 billion. This was over half the total of Rs 2.2 billion raised by his various new revenue measures.

The other revenue-raising devices used in the 1982 budget include a surcharge on income tax and wealth tax, with the higher income groups carrying a bigger burden; an increase in the turnover tax on banks and pawnbrokers from 2% to 5%, and on finance companies from 5% to 10%; tax increases on hotels (up from 15% to 20%), luxury restaurants (up from 2% to 10%), building contractors (up from 2% to 3%) and architects and building consultants (up from 5% to 10%); an increase in the turnover tax on advertising receipts of newspapers and periodicals; an increase in excise duty and turnover tax on liquor; increased taxes on tobacco; stamp fees on liquor licences; increased stamp duty on cheques; a revision of fees levied by government departments, and increases in licence, registration and transfer fees of motor vehicles.

De Mel was compelled to give a wage rise to meet increasing discontent among wage-earners. He decided to compensate government employees with Rs 2 for every one-point rise in the cost of living index above a base figure of 360 for September 1981. This gave the government's employees an added Rs 62 in their pay packets. In addition, a salaries review committee report giving civil servants a minimum rise of Rs 45 a month has been accepted, giving a total of Rs 1 billion.

While state-owned companies have been required to follow the government's lead and pay the cost-of-living allowance from their own resources, the cabinet has said it will need to determine how those corporations lacking sufficient means will make payments without recourse to treasury funds. Many private concerns already compensate their employees for increases in the cost-of-living index and these are not likely to want to make further payments. But the government has announced that wages boards will consider wage levels in trades within their purview.

The general reaction to de Mel's fifth budget has been a sense of apprehension of what the business tax will do to prices. Opposition parties have concentrated their fire on this area. Former prime minister Sirimavo Bandaranaike's Sri Lanka Freedom Party has concentrated on the new tax, while the Tamil United Liberation Front said that what the government had given with one hand has been taken away by the other.

De Mel gave some incentives to the tea, rubber and coconut plantation tripod on which the Sri Lankan economy continues to rest. The minister, who has often expressed unhappiness about the performance of these primary crops, declared: "I have emphasised on several occasions the imperative need to revitalise our plantation sector. Only a satisfactory level of performance in this sector will assist us to secure a favourable balance in our external accounts and provide the base for industrial growth. The government has already taken, during the past few years, several policy measures to revitalise this sector . . . However, the results have not been quite up to expectations."

With the two big state-owned plantation corporations nearly broke, and the plantation industries in poor shape, the minister had little option but to offer higher replanting subsidies and reduce export duties and other taxes which would mean a revenue loss of Rs 380 million on tea, Rs 30 million on rubber and Rs 50 million on coconuts.

With government expenditure due to peak from next year until 1984, and with aid tightening up as work on the big development schemes gets into top gear, the government knows very well that its present economic problems are destined to grow.

The government of President Junius Jayewardene has had unprecedented success in mobilising foreign aid in 1980; total aid committed by donor governments and organisations added up to Rs 10.7 billion against the Rs 1.6 billion of aid commitments obtained in 1976, the final year of the previous administration. Aid commitments for the first 10 months of 1981 amounted to Rs 11.4 billion.

De Mel, who claimed a "vast increase in foreign aid," did not mention the fact that the Sri Lankan rupee has depreciated very sharply since the present United National Party administration took office in 1977, thereby boosting the local-currency value of foreign aid. It is true, however, that the government has succeeded in getting aid on terms which made it possible for Sri Lanka to maintain a 7.5% debt-service ratio last year. This, the minister claimed, "is one of the lowest in the world today." But the basic problem remains one of reducing dependence on foreign aid in the long term.

De Mel warned: "The budgetary situation is most unsatisfactory. We cannot possibly allow it to continue. If expenditure continues to increase far beyond our resources like this, there would soon be unmanageable inflation and unsustainable deficits in our balance of payments, which would jeopardise the chances of achieving the government's development objectives within the framework of a free and liberal economy." ◻

Annex 4

Vol. No. 15. NEW SERIES 5. COLOMBO, SUNDAY, OCTOBER 5th, 198?

IFC to help set up National Housing Bank

BIG BOOST FOR HOUSE BUILDERS

(By S. A. Gilbert Dias)

THE International Finance Corporation of Washington an affiliate of the World Bank is likely to assist the government to set up a National Housing Bank in Sri Lanka which will finance housing activities in the private sector.

The Prime Minister Mr. R. Premadasa, who is also the Minister of Local Government, Housing, Construction and Highways has decided to set up the new bank to assist prospective house builders to step-up the pace of construction activities to ease the present acute shortage of houses in the country.

According to authoritative sources, the need for an agency of this nature had been identified for a long time and it is envisaged that the present housing problem could be solved to a great extent with the establishment of a lending agency to help private individuals solve their own accommodation problems.

The Prime Minister has appointed an official committee to prepare a comprehensive report on the setting up of the Bank.

The proposal has already been discussed with representatives of the International Finance Corporation and they had agreed to help the Government by providing a part of the initial capital for the Bank.

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MIRRORSCOPE

DAILY MIRROR 10-7-80

Shelter takes priority

THE "Sunday Times" report that the International Finance Corporation of Washington will lend a helping hand to the government in setting up a National Housing Bank in Sri Lanka will no doubt warm the hearts of all citizens still waiting for their dream house.

The proposed Housing Bank is to be established to accelerate the house - building programme launched after this government came into power in 1977-and is a commendable step towards easing the acute shortage of houses in the country.

We have time and again come back to the topic of housing as this is a problem causing much concern — particularly among the middle class in the island.

It has become an almost impossible task for the average middle class worker in this country to build his own home. Land prices have shot up to unbelievable levels and the prevailing high cost of building materials has put a stiff hurdle before the middle class and their own accommodation.

We know for certain that this is also one of the biggest problems the Prime Minister too is faced with. As the Minister of Housing his main objective is to see that every family in this country has a house of its own. His concern in this direction has been immense, and he has explored every possible avenue open to him to make this objective a reality.

The move to set up a National Housing Bank is another step towards achieving this goal. And we hope this will result in relief being granted to the middle class to erect a roof over their heads.

The National Housing Bank, we once again reiterate, must lay emphasis on giving the middle class a fair deal. This particular group has borne the brunt of price increases and raging inflation. They deserve relief—and a remedy to their accommodation headaches will no doubt have the most soothing effect.

The International Finance Corporation which is an affiliate of the World Bank has already indicated its willingness to finance part of the capital needed to get things moving at the bank.

According to the "Sunday Times" report the Prime Minister has appointed an official committee to prepare a comprehensive report on the setting up of the bank. We hope this committee also steps up the pace and reports its observations without delay.

If this is done, we should see the foundations for a brighter future for several thousand citizens springing up before long.

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EXTRACTS FROM PUBLIC INVESTMENT PLAN 1981-85

Ministry of Finance and Planning
National Planning Division
May 1981

will be developed for a rotation of rice and upland crops and another 1,500 ha. under perennial irrigated crops. The project has been appraised by the World Bank and requests for co-financing have been made to the Governments of Japan and Kuwait. The estimated cost of development of Zones 3 to 6 inclusive of provision for price escalation is Rs. 3,600 million.

12.09 The feasibility report for System 'B', prepared by a Canadian consultancy firm was financed by the Government of Sri Lanka. The downstream development is being partly financed by USAID, and a loan agreement for a sum of US $ 10 millon has been signed. A contract has been signed with a US consultancy firm for the preparation of detailed plans and designs of the main irrigation distributory system and the agricultural development of a pilot area covering approximately 4,000 ha. Meanwhile, construction work on the roads and buildings is being proceeded with.

12.10 From 1983 onwards, the Mahaweli Programme will bring a steady and increasing stream of output annually. A major cause for concern however, is the heavy and unprecedented escalation in the costs and consequent problems of financing. Thus, the generous financial support pledged earlier by numerous governments and international agencies to cover the foreign costs of the programme is now inadequate. It is estimated that on the four reservoirs alone, the shortfall in foreign cost financing for the period 1981-1985 will be about US $ 280 million. Details of total cost, phasing of expenditures and financing are given in the tables in Part III. The firm and continued support of the international community would be necessary for the Government to bring this programme to fruition.

13. The Housing and Urban Development Programme[1]

(a) Housing

13.01 Public sector housing construction achieved good progress during the period 1978-1980. By the end of 1980, 20,841 housing units had been completed as follows: 5797 urban housing units under the direct construction scheme, 8699 units under the aided self-help (ASH) scheme including model villages and houses for the fisheries sector, 5880 electoral houses and 465 units under slum and shanty upgrading. In addition, another 39,556 housing units were in different stages of construction; 16,750 units under urban direct construction, 17,766 units under the aided self-help scheme and 5040 under the electoral housing programme.

13.02 Several steps have been taken by Government to check the rapid cost escalation in the housing and urban construction sector. The system of negotiated contracts has been replaced with the normal system of competitive tendering for all construction projects.

1. For convenience of presentation the water supply programme handled by the same Ministry is also discussed in this section although it is not part of the lead projects.

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A new scheme for determining architectural and consultancy fees, based on a sliding scale, has been evolved and agreed upon with the respective professional bodies so as to provide incentives for lowering construction costs. An IDA assisted Construction Industry Project designed to increase the supply of trained construction skills for the sector and to set up an equipment leasing company enabling contractors to acquire equipment at reasonable cost, has commenced. In addition, the initiatives taken by the Building Materials Corporation and the proposed Building Materials Advisory Centre at the Industrial Development Board under the Small and Medium Industry Project, are expected to stimulate the supply of building materials.

13.03 The entire housing programme has witnessed a marked shift in emphasis towards the aided self-help schemes. About half of the direct construction urban programmes, where unit costs are high, has been postponed. In addition to this change of emphasis, the Government has launched a programme to upgrade slum and shanty dwellings in the City of Colombo and other urban areas. During the year 1981, a total of 6255 slum and shanty units will be upgraded at a total cost of Rs. 32.5 million.

13.04 The total investment in the housing programme during the period 1981-1985 is estimated at Rs. 5116 million, from the government budget, and is directed towards easing the housing shortage in a manner which would place a diminishing burden upon the government budget over time. The most important step in this direction is the movement towards self-financing in the case of middle and lower-middle income housing schemes which are under construction or completed by the National Housing Development Authority (NHDA). The NHDA has initiated a programme to sell some housing units on an outright basis and the others on a down payment plus instalment basis so as to recover costs and provide a reasonable rate of return. In the case of low income housing, steps have been taken to charge more realistic rentals.

13.05 Initiatives have also been taken by the NHDA to shift from direct construction towards a system which could stimulate house building activity through private developers. The NHDA will acquire land, develop such land and sell to private developers on an undertaking that they would construct houses for sale. They are required to construct houses on approved plans, make no profits on land already developed, but derive profits only from the construction and sale of houses. Several tax incentives and concessions have been offered by the Government in this area of activity.

13.06 In the ASH programme, emphasis has fallen upon cost reduction through greater use of local building materials and development of designs more appropriate for rural living conditions. Rather than the State providing the entirety of building materials as in the past, with the allottee providing only the labour, the materials supplied by the State under the revised scheme will be confined to cement, bricks and tiles

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with the balance materials being obtained by the allottee from local sources through a cash allowance made available to him. The cost per unit incurred by the State could thus be reduced from the present level of Rs. 22,000 to Rs. 14,000 under the revised scheme.

(b) *Urban Development*

13.07 The urban development programme, based on the Greater Colombo Master Plan, envisages a number of programmes relating to land reclamation and drainage, development of transport infrastructure, land clearance, resettlement, physical planning in connection with the establishment of the investment promotion zones and the shifting of the parliamentary and administrative capital to Kotte.

13.08 A large part of the programme is to be handled by the private sector—mainly the Echelon Square development, Lotus Centre development and several new hotel development projects in the city.

13.09 Budgetary provision for urban development in the Investment Programme is limited to only the Kotte Parliamentary Complex which is scheduled for completion by the end of 1981. The other public sector projects under this programme, namely the two administrative blocks of 500,000 sq. ft. each at Kotte, St. John's Fish Market, the Pettah market complex and the Orugodawatte stores complex are to be financed by the sale of debentures.

(c) *Water Supply*

13.10 The task of providing safe drinking water and better sanitation has received increased emphasis since 1977. The total investment proposed for this sector in the period 1981-1985 is estimated at Rs. 3500 million and represents a three-fold increase over that envisaged in the 1979-1983 programme. There will also be room for admitting new projects in 1985.

13.11 The water supply and sanitation sector depends heavily on direct Government involvement in the preparation and implementation as well as in the operation and maintenance of projects. The Government has, therefore, taken a decision to charge water rates for domestic and commercial connections, while giving a subsidy to the lowest income groups who consume water through standpipes. This would enable the Water Supply & Drainage Board to cover the operational and maintenance costs of water supply schemes and to reduce the existing high rate of wastage. The metering programme included in the first Water Supply Project for Colombo has fallen behind schedule due to a number of reasons, mainly the delays in the supply of meters. These difficulties have now been overcome and metering in two Urban Council areas in the Colombo District, namely, Kotte and Kolonnawa, has already been completed. The metering programme for the Colombo Municipality which started in 1980 will be completed in two years. Two other Urban Councils, namely

Matara and Kegalle, have already started installing meters while a number of other local authorities have placed their orders for meters. Once the programme is completed, the water supply schemes will be able to cover their operational and maintenance costs.

13.12 The Government is also considering the possibility of involving rural communities in the planning and implementation of sanitation and water supply projects with a view to increasing the cost-effectiveness of such programmes.

13.13 The main programmes that are to be completed during the 1981-1985 period are given in Table 19 in Part III. The World Bank aided South-West Coast Water Supply Project Stage I is progressing on schedule. The work on the Greater Colombo Area Water Supply and Sewerage Project Stage II commenced in March 1981. Under the scheme for the provision of rural water supplies, 207 ground water wells were sunk successfully and pumps have been installed in 127 of these wells. Five piped water supply schemes for the supply of water to small towns have been completed with the assistance of UNICEF in 1980, in addition to 15 other piped schemes financed by the Government's own resources. The programme of water supply schemes under construction includes 31 major schemes, 11 minor schemes and 22 UNICEF assisted rural schemes. In addition, design works on 42 schemes have been completed and these are due to be implemented during the year 1981.

14. The Greater Colombo Economic Commission (GCEC)

14.01 The programmes of the GCEC were intended to be the major plank in the Government's strategy of export-led industrial growth. It envisaged the establishment of Investment Promotion Zones (IPZs) to attract foreign capital and technology for export oriented ventures, to create more employment and output and to enhance the country's foreign exchange earnings. The incentives offered to these firms have already been discussed in Part I Section 10. In addition to fiscal incentives, these zones are provided with a wide range of infrastructure facilities such as an air cargo terminal, containerized shipping, modern telecommunication facilities, additional housing, prepared factory sites, utility connections, access roads and other services. Security of investment is guaranteed by legislation.

14.02 The first IPZ has been successfully established in a complex covering about 300 acres adjacent to the Katunayake airport. A second IPZ at Biyagama located on 400 acres near the Kelani River is to cater to heavy and water consuming industries. Work on this project has commenced this year.

14.03 By end December 1980, 137 industries with a total investment of Rs. 4037 million had been approved under the Katunayake complex. Of these, 57 firms had signed agreements and twenty three had already commenced commercial production and

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exports. Gross exports from these firms increased from Rs. 152.1 million in 1979 to Rs. 505.3 million in 1980, while factory employment has risen from 5884 at the end of 1979 to 10581 in December 1980.

(B) OTHER SECTORAL PROGRAMMES

15. Agriculture

15.01 Outside the Mahaweli Programme investment in agriculture makes up 22 per cent of total budgeted investments for the period 1981-1985. When the agricultural components of the Mahaweli Project, the Decentralized Budget and the District Development Projects are included the share of agriculture increases to 54 per cent. The main investments in agriculture outside the Mahaweli are in plantations 4 per cent, field and minor export crops 4.4 per cent, irrigation 9 per cent and fisheries and animal husbandry 2 per cent.

(a) The Plantations

15.02 Budgeted investments in the plantations sector for the period 1981-1985 total Rs. 2,748 million and represent an 88 per cent increase over the investments envisaged earlier in the 1980-1984 programme. In addition, considerable extra-budgetary investment from cess funds and the resources of the state corporations is expected.

15.03 Investment options in tea, rubber and coconut have been examined in depth and investment priorities and strategies for the tree crops have now been identified. The medium-term investment programme for the tree crop sector reflects these investment priorities and strategies. Hence the investment programme would remain unchanged for the next five years except that the level of investment would be increased depending on the availability of foreign aid and favourable changes in the world prices for these commodities.

15.04 The main objective for the plantation sector for the next five years would be to reverse the declining trend in production and increase output in the short term as well as the long term and improve the quality of manufacture in order to maximise the foreign exchange earnings from these crops.

15.05 Complementary to the above objective would be the objectives of;

— maintaining the present employment levels in the sector by maintaining producer margins at remunerative levels;

— optimising land utilisation by diversifying uneconomic tea, rubber and coconut land into other subsidiary crops and bringing new land under tea, rubber and coconut in areas suited for these three crops; and

— improving the living standards of the estate labour by upgrading housing and other facilities.

TABLE 19

ALLOCATION OF GOVERNMENT CAPITAL EXPENDITURE 1981-1985

(A) Summary—All Sectors

(Rs. Million)

	1981		1982		1983		1984		1985		1981 - 1985			
	T	*FA*	*T*	*FA*	*T*	*FA*	*T*	*FA*	*T*	*FA*	*F.*	*L.*	*T.*	*FA*
1. Total Public Investment of which ..	14,612	—	18,457	—	19,124	—	18,676	—	18,710	—	—	—	89,579	—
(i) Extra Budgetary Resources	2,571 [2]	—	2,680 [2]	—	2,800	—	3,100	—	3,100	—	—	—	14,251	—
(ii) Non expansionary Resources available to Government Budget[1] ..	8,654	7,990	13,057	10,517	14,839	12,232	14,586	11,882	14,535	11,587	—	—	65,671	54,208
(iii) Supplementary financing required for investment programme ..	3,387	—	2,720	—	1,485	—	990	—	1,075	—	—	—	9,657	—
2. Total Budgetary Provision Allocated to:	12,041 [3]	5,102	15,777	8,756	16,324	8,767	15,576	6,281	15,610[5]	2,992	39,738[6]	30,623[6]	75,328[5]	31,898
(i) Agriculture ..	5,491	2,937	9,577	6,274	9,725	6,186	9,502	4,319	6,179	1,872	24,200	16,274	40,474	21,288
(1) Mahaweli ..	3,750	2,140	7,217	5,162	6,963	5,097	6,800	3,280	4,260	1,046	19,836	9,154	28,990	16,725
(2) Other Irrigation ..	461	310	773	418	941	307	910	270	481	179	1,482	2,084	3,566	1,484
(3) Forests & Lands ..	102	39	143	39	136	25	125	7	73	—	138	441	579	110
(4) Field & Minor Export Crops	665	252	635	284	686	290	709	323	498	262	1,319	1,874	3,193	1,411
(5) Plantations ..	220	118	511	262	661	324	718	351	638	299	781	1,967	2,748	1,354
(6) Animal Husbandry	115	32	129	49	118	42	88	18	97	25	266	281	547	166
(7) Fisheries ..	178	46	169	60	220	101	152	70	132	61	434	417	851	338
(ii) Housing, Water Supply & Urban Development ..	1,687[4]	811	1,973[4]	1,078	2,054	1,127	1,650	798	1,457	621	3,839	4,982	8,821	4,435
(1) Housing & Construction	909	479	1,004	543	1,087	527	1,075	511	1,041	475	1,681	3,435	5,116	2,535
(2) Water Supply ..	613	332	929	535	967	600	575	287	416	146	2,117	1,383	3,500	1,900
(3) Urban Development	165[4]	—	40[4]	—	—	—	—	—	—	—	41	154	205	—

Annex 5 (cont.)

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(iii) Industry	134	45	82	18	60	16	39	2	38	—	198	155	353	81
(iv) Economic Overheads ..	3,712	1,211	3,489	1,335	3,756	1,393	3,632	1,127	2,836	478	10,196	7,229	17,425	5,544
(1) Transport ..	1,033	337	957	416	889	314	767	207	366	—	2,832	1,180	4,012	1,274
(2) Power	749	515	431	310	504	311	446	115	431	—	2,225	336	2,561	1,251
(3) Posts and Telecom-munications ..	300	151	526	336	572	339	422	259	263	106	1,517	566	2,083	1,191
(4) Other Programmes of Economic & Administrative Overheads ..	1,630	208	1,575	273	1,791	429	1,997	546	1,776	372	3,622	5,147	8,769	1,828
(v) Social Overheads ..	455	98	656	51	729	45	753	35	703	21	1,305	1,991	3,296	250
(vi) Unallocated ..	—	—	—	—	—	—	—	—	4,397	—	—	—	4,397	—

(1) Figures provide for additional mobilisation in the years 1982-1985 and also Rs. 450 million in each of these years under US AID housing guarantee.

(2) Includes a sum of Rs. 520 million in 1981 and Rs. 280 million in 1982 in debentures for Urban Development.

(3) The figure of Rs. 12,041 m. is after the 10% cut on capital expenditure imposed by Cabinet and also provides for the following supplementaries not shown in the sectoral distribution. Rs.200 million for the Electricity Board; Rs. 500 million for irrigation, highways and construction; Rs. 60 million for fertilizer stores; Rs. 50 million for Randenigala. For this reason and because all ministries have not indicated the distribution of the 10% cut the sectoral figures will not total to Rs. 12,041 million.

(4) Together with Rs. 520 million provided for U.D.A. debentures in 1981 the sector total will be Rs. 2,207 million in 1981 and the amount for Urban development Rs. 685 million. In 1982 they will be Rs. 2,253 million and Rs. 280 million respectively.

(5) Includes Rs. 4,397 million for new projects to be identified.

(6) Will not add to 75,328 vide (3) and (5) above

T = Total Cost FA = Foreign Aid F = Foreign cost L = Local Cost

TABLE 19 (contd.)

III. HOUSING, WATER SUPPLY AND URBAN DEVELOPMENT

(Rs. Million)

	1981		1982		1983		1984		1985		1981 - 1985			
	Total	*FA*	*Total*	*FA*	*Total*	*FA*	*Total*	*FA*	*Total*	*FA*	*Foreign*	*Local*	*Total*	*FA*
1. Housing and Other Construction	909	479	1,004	543	1,087	527	1,075	511	1,041	475	1,681	3,435	5,116	2,535
—*Of which Housing* ..	(720)	(458)	(703)	(450)	(770)	(450)	(790)	(450)	(770)	(450)	(938)	(2815)	(3,753)	(2,258)
(i) Urban Housing ..	238	—	238	—	300	—	300	—	270	—	740	606	1,346	—
(ii) Aided Self-help and Electoral Housing ..	450	450	450	450	450	450	450	450	450	450	450	1,800	2,250	2.250
(iii) Slum & Shanty Improvement	32	8	15	—	20	—	40	—	50	—	39	118	157	8
(iv) IDA—Construction Industry Project ..	—	18	140	90	149	75	99	61	49	25	183	254	437	269
(v) Other Construction ..	160	3	132	3	140	2	152	—	185	—	231	538	769	8
(vi) Annual Programmes ..	2	—	2	—	3	—	3	—	4	—	3	11	14	—
(vii) Cultural Development, Archaeology & Museum	27	—	27	—	25	—	31	—	33	—	35	108	143	—
2. Water Supply	613	332	929	535	967	600	575	287	416	146	2,117	1,383	3.500	1,900
(i) South West Coast W.S.S.—Stage I ..	253	109	144	33	29	1	39	—	10	—	285	190	475	143
(ii) Greater Colombo W.S.S. II & Sewerage ..	8	7	307	214	580	427	485	284	378	143	1,055	703	1,758	1075
(iii) Matara-Dikwella W.S.S.	81	49	125	39	91	17	16	—	—	—	188	125	313	105
(iv) Trincomalee W.S.S. ..	210	167	253	184	121	65	—	—	—	—	380	204	584	416
(v) Jaffna W.S.S. ..	1	—	78	65	37	25	4	—	—	—	72	48	120	90
(vi) Other Schemes ..	60	—	22	—	109	65	31	3	28	3	137	113	250	71
3. Urban Development ..	165	—	40	—	—	—	—	—	—	—	41	164	205	—
(i) Parliamentary Complex, Kotte	165	—	40	—	—	—	—	—	—	—	41	164	205	—

MONEY AND BANKING

TABLE 6

Reserve Position of Commercial Banks

Rupees Million

End of Period	Demand Deposits (a) (1)	Reserves Required against Demand Deposits (2)	Time and Savings Deposits (3)	Reserves Required Against Time and Savings Deposits (4)	Total Required Reserves (2) + (4) (b) (5)	Actual reserves(e): Deposits with Central Bank (6)	Actual reserves(e): Till Cash Set Apart as Reserves (c) (7)	Actual reserves(e): Total (8)	Excess Reserves (8) – (5) (9)	Balance Till Cash (d) (10)
1968	951·4	167·0	801·2	43·9	210·9	142·3	70·8	213·1	2·2	35·8
1969	879·7	140·1	1,008·4	51·3	191·4	137·2	55·4	192·6	1·2	66·1
1970	1,173·3	259·2	1,191·7	59·6	318·8	224·6	109·6	334·2	15·4	36·1
1971	1,186·5	271·9	1,346·4	67·4	339·3	205·6	135·1	340·7	1·4	33·0
1972(f)	—	—	—	—	—	—	—	—	—	—
1973	1,493·5	393·3	1,498·8	74·9	468·2	496·6	83·7	580·3	112·1	131·7
1974	1,733·2	487·0	1,745·9	87·3	574·3	420·3	156·3	576·6	2·3	132·2
1975	1,763·3	211·6	1,748·1	87·4	299·0	242·9	79·0	321·9	22·9	201·3
1976	2,539·6	304·7	2,230·4	111·5	416·2	227·7	144·1	421·8	5·6	132·1
1977 1st Qtr.	2,673·2	320·8	2,417·6	120·9	441·7	306·6	138·7	445·3	3·6	235·0
2nd Qtr.	2,847·1	341·6	2,580·5	129·0	470·6	386·4	84·9	471·3	0·7	289·6
3rd Qtr.	2,854·1	342·5	3,031·4	151·6	494·1	429·6	70·3	499·9	5·8	320·0
4th Qtr.	3,179·0	381·5	3,559·1	173·0	595·5	606·5	—	606·5	47·0	426·2
1978 1st Qtr.	3,637·3	436·5	3,941·3	197·1	633·6	732·6	—	732·6	99·0	474·9
2nd Qtr.	3,396·5	407·6	4,289·3	214·5	622·1	694·6	—	694·6	72·5	451·8
3rd Qtr.	3,338·8	400·7	4,542·4	227·1	627·8	688·2	—	688·2	60·4	419·2
4th Qtr.	3,643·4	437·2	4,897·2	244·9	682·1	737·8	—	737·8	55·7	492·1
1979 1st Qtr.	3,895·1	467·4	5,893·5	294·7	762·1	813·2	—	813·2	51·1	550·2
2nd Qtr	4,074·1	488·9	6,109·9	305·5	794·4	912·3	—	912·3	117·9	472·8
3rd Qtr	4,517·3	542·1	6,652·2	332·6	874·7	925·9	—	925·9	51·2	477·6
4th Qtr.	4,636·3	556·3	7,394·5	369·7	926·0	966·0	—	966·0	40·0	546·2
1980 1st Qtr.	4,883·2	585·0	7,703·0	385·1	971·1	1,030·3	—	1,030·3	59·2	449·7
2nd Qtr.	4,809·7	577·2	8,444·5	422·2	999·4	1,061·9	—	1,061·9	62·5	534·7
1980 September	4,985·5	593·3	9,605·7	480·3	1,078·6	1,080·0	—	1,080·0	1·4	794·5
October	5,022·3	602·7	9,454·5	472·7	1,076·9	945·3	—	945·3	−131·6	775·7
November	5,601·8	672·2	10,281·2	514·0	1,186·2	1,220·2	—	1,220·2	34·0	653·6
December	5,740·3	688·8	10,651·1	532·5	1,221·3	1,263·7	—	1,263·7	42·4	824·4
1981 January	6,062·4	725·7	11,535·4	576·8	1,304·3	1,332·1	—	1,332·1	27·8	848·1
February	5,754·9	690·6	11,057·9	552·9	1,243·5	1,313·7	—	1,313·7	70·2	691·8
March	5,727·6	687·3	11,873·6	593·7	1,281·0	1,342·1	—	1,342·1	61·0	822·7
April	5,843·1	701·2	11,955·2	597·7	1,298·9	1,372·7	—	1,372·7	73·1	1,069·0
May	5,265·8	631·9	12,337·3	616·9	1,248·8	1,376·0	—	1,376·0	127·2	949·1
June	4,947·7	692·7	12,991·7	779·5	1,472·2	1,450·1	—	1,450·1	−22·1	749·3
July	4,933·6	690·8	12,487·7	770·9	1,461·7	1,587·4	—	1,587·4	125·7	732·5
August	5,433·9	761·0	13,272·0	796·0	1,557·0	1,579·0	—	1,579·0	22·0	759·2
September	5,433·3	761·3	13,686·1	821·1	1,582·4	1,634·9	—	1,634·9	52·5	751·8

Source: Central Bank of Ceylon.

Note: The required reserves are computed weekly every Friday on the basis of deposit liabilities as on the previou Wednesday. Figures so computed are applicable until the next Thursday.

(a) Includes inter – bank deposits.

(b) Pursuant to regulations under sections 10c, 93, 94, 95 and 97 of the Monetary Law Act chapter 422, commercial banks are required to maintain with the Central Bank cash reserves amounting at 1½ per cent of their demand deposits and 6 per cent of their time and savings deposits. Banks are also required to maintain 10 per cent of their special deposits accepted in terms of Section 69 (A) (2) (b) of the Inland Revenue Act No. 4 of 1963, as amended by Act. No. 13 of 1955. With effect from 10th February 1961, commercial banks (except People's Bank) were required to maintain special reserves of 38 per cent against any increase in their demand deposits over the level of such deposits as at the close of business on February 1, 1961. With effect from 18th June, 1955 People's Bank was required to maintain special reserves of 28 per cent against any increase in demand deposits above the level as at close of business on 9th June 1955. Between September 11, 1953 and August 26, 1959 the "statutory reserves" were 10 per cent of demand deposits and 5 per cent of time and savings deposits. With effect from April 7, 1975, Commercial banks are no longer required to maintain special reserves. Between 26th August, 1959 and 19th June 1981 the 'Statutory reserves" were 12 per cent of demand deposits and 5 per cent of time and Savings deposits.

(c) From July 1961, commercial banks are permitted to maintain required reserves partly in the form of till cash and partly in the form of rupee deposits in the Central Bank. From December to 2, 1977, the banks are required to maintain their reserves wholly in the form of deposits with the Central Bank.

(d) Total till cash less amount set apart as reserves.

(e) According to Central Banks Book's.

(f) The Banks were not able to make declarations under the reserve requirement regu'ations due to the strike by bank employees.

Rates
per annum)

TABLE 10

Savings Deposits (11)		Inter-Bank Call Loans (12)		Commercial Bank's Advances Rates: Bills Purchased and Discounted (13)		Loans and Overdrafts, Secured by: Government Securities (14)		Shares of Joint Stock Companies (15)		Stock in Trade (16)		Immovable Property (17)		Others (18)		Unsecured (19)	
Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min.	Max.	Min
2	2	2	2	8	4	7½	4½	8	5½	8	4½	8	5½	9	4	8	4½
2½	2	2	2	8	4	7½	4½	8	5½	8	5½	8	5½	9	4	8	5
2½	2	3	2¾	8	3¾	7½	3½	8	5½	8	6	9	6	8	5	8	5
2½	2	3	2¾	8	3¾	7½	3½	9	5	8	6	9	6	8	5	8	5
2½	2	3	2¾	8	4½	7	4½	9	6½	8	6	9	6	9	4½	9	5
3	2	3	3	8	4½	7	5½	9	7	9	6	9½	7	10	5	9	7
3	2	3	3	8	4½	7	5½	9	7	9	6	9½	7	10	5	9	7
3	2	3	3	8	4½	7	5½	9	7	9	6	9½	6½	10	5	9	7
3½	3	3½	3½	8	5½	8½	5½	9½	7	9½	7	9½	7	11	5½	10	7
3¾	3¾	4	4	9	5½	8½	5¾	10	7	11	7½	10	7	11	6	11	7½
4½	4½	4½	4½	10	6½	9½	6½	11	9	12	8½	11	8	12	6½	12	8½
4½	4½	5	5	10	6½	9½	6½	11	9	12	8½	11	8	12	6½	12	8½
4½	4½	5	5	10	6½	9½	6½	11	9	12	8½	11	8	12	6½	12	8½
4½	4½	5	5	10	6½	9½	6½	11	9	12	8½	11	8	12	6½	12	8½
4½	4½	5	5	10	6½	10	7	12	9	12½	8½	12	8	12½	6½	13½	8½
5½	5½	8	5	12	8½	11	7½	12	9	13	8½	12	8½	13	6½	14	9½
5½	5½	8	5	13	8½	14	7½	13	9	14	8½	14	8½	14	6½	14	9½
5½	5½	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	9½	7	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	10	9	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
7 1/5	7 1/5	13½	9½	21	11	18	12½	19	13½	19	13	19	13	20	10	20	18
9	5	11	9	21	13	18	12½	19	14	20	13	19	13	20	10	21	18
9	5	14	10	21	13	18	12½	19	14	20	13	19	13	20	10	21	18
14	10	19½	15½	25	15	28	15	28	15	28	15	28	13	24	11	30	22
14	10	19½	15½	25	15	28	15	28	15	28	15	28	13	24	11	30	22
14	10	22	16½	25	15	28	15	28	15	28	15	28	13	28	11	30	22
14	10	23	16½	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	25	21½	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	13	11½	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	14	12	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	14	11	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	16½	15	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	21	16	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	23	19½	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	21	18	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	20	17½	25	15	28	15	28	15	28	15	28	13	28	11	30	19
14	10	21	18	25	15	28	15	28	15	28	15	28	13	28	11	30	19

Source: Central Bank of Ceylon

MONEY AND BANKING

TABLE 10 (CONT)

Money (Per centum

End of Period	Government Treasury Bills: Primary Market (a) (1)	Secondary Market: Discount (2)	Secondary Market: Rediscount (3)	Central Bank Rate on Advances (Bank Rate) (b) (4)	Commercial Banks' Deposit Rates – Fixed Deposit: 3 Months (5) Max.	3 Months (5) Min.	6 Months (6) Max.	6 Months (6) Min.	12 Months (7) Max.	12 Months (7) Min.	24 Months (8) Max.	24 Months (8) Min.	36 Months (9) Max.	36 Months (9) Min.	48 Months (10) Max.	48 Months (10) Min.
1960 ..	2.60	—	—	4	2½	2½	2½	2½	2½	2½	—	—	—	—	—	—
1961 ..	2.68	—	—	4	2½	2½	2½	2½	2½	2½	—	—	—	—	—	—
1962 ..	2.80	—	—	4	2½	2½	2½	2½	2½	2½	—	—	—	—	—	—
1963 ..	2.80	—	—	4	2½	2½	2½	2½	2½	2½	—	—	—	—	—	—
1964 ..	2.80	—	—	4	2½	2½	2½	2½	2½	2½	—	—	—	—	—	—
1965 ..	3.00	—	—	5	3¼	2½	3¼	2½	3¼	2½	3½	3¼	3¾	3¾	3¾	3½
1966 ..	3.00	—	—	5	3½	2½	3½	2½	3½	2½	3½	3¼	3¾	3¾	3¾	3½
1967 ..	3.20	—	—	5	3½	3	3½	3	3½	3	3½	3¼	3¾	3¼	3¾	3½
1968 ..	3.64	—	—	5½	3½	3¼	3½	3¼	3½	3¼	3¾	3¼	3⅞	3⅝	4	3¾
1969 .	4.10	—	—	5½	4	3¾	4	3¾	4	3¾	4¼	4	4½	4¼	4¾	4¾
1970 ..	4.76	—	—	6½	4¾	4½	4¾	4½	4¾	4½	5	4¾	5¼	5	5½	5¼
1971 ..	5.00	—	—	6½	4¾	4½	4¾	4½	4¾	4½	5	4¾	5¼	5	5½	5¼
1972 ..	5.00	—	—	6½	4¾	4½	4¾	4½	4¾	4½	5	4¾	5¼	5	5½	5¼
1973 ..	5.00	—	—	6½	4¾	4½	4¾	4½	4¾	4½	5	4¾	5¼	5	5½	5¼
1974 ..	5.00	—	—	6½	4¾	4½	4¾	4½	4¾	4½	5	4¾	5¼	5	5½	5¼
1975 ..	5.00	—	—	6½	6¼	6	7	6½	7½	7	7½	7	7½	7	7½	7
1976 ..	5.00	—	—	6½	6¾	6	7	6½	7½	7	7½	7	7½	7	7½	7
1977 3rd Qtr. ..	5.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
4th Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
1978 1st Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
2nd Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
3rd Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
4th Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
1979 1st Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
2nd Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
3rd Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
4th Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
1980 1st Qtr. ..	9.00	—	—	10	8½	8½	12	11	15	14	—	—	—	—	—	—
2nd Qtr. ..	13.00	—	—	12	14	12	15	15	20	20	22	—	—	—	—	—
1980 September	13.00	—	—	12	14	12	15	15	20	20	22	22	—	—	—	—
October ..	13.00	—	—	12	16	12	18	15	20	20	22	22	—	—	—	—
November	13.00	—	—	12	16	12	18	15	20	20	22	22	—	—	—	—
December ..	13.00	—	—	12	16	12	18	15	20	20	22	22	—	—	—	—
1981 January ..	13.00	—	—	12	16	12	18	15	20	20	22	22	—	—	—	—
February ..	13.00	—	—	12	16	12	18	15	20	20	22	22	—	—	—	—
March ..	13.00	—	—	12	16	12	18	15	20	20	22	22	—	—	—	—
April ..	13.00	15.5	16.5	12	16	12	18	15	20	20	22	22	—	—	—	—
May ..	13.00	15.5	16.0	12	16	12	18	15	20	20	22	22	—	—	—	—
June ..	13.00	16.0	16.5	12	16	12	18	15	20	20	22	22	—	—	—	—
July ..	13.00	16.0	16.5	12	16	12	18	15	20	20	22	22	—	—	—	—
August ..	13.00	16.0	16.[illegible]	14	16	12	18	15	20	20	22	22	—	—	—	—
September	13.00	16.0	16.5	14	16	12	18	15	20	20	22	22	—	—	—	—

(a) Weighted average of bills issued on tender. From 15. 8. 1969 the rate paid on Treasury bills purchased by the Central Bank is 3.24 per cent. Begining November 1977, the Central Bank purchases Treasury bills at the current market rate.

(b) This is the rate at which the Central Bank grants advances to commercial banks for their temporary liquidity purposes. However since August 1977 each bank depending on selected assets items was allocated a certain quota of such borrowing at the Bank rate. Borrowings in excess of this quota was subjected to a penal interest rate of 15% per annum. In September 1979 a graduated scale of penal rates ranging between 15 and 25 per cent was introduced. It was further revised upward to a range between 20 to 30 per cent effective from April 1980. With effect from August, 1981 Bank rate was raised to 14 percent, while the penal rates were raised to a range between 21 to 30.

MONEY AND BANKING

Deposit Rates of Savings Institutions

TABLE 11

(per centum per annum)

End of Period	Post Office Savings Bank (b)	National Savings Bank (a)		Savings certificates (d)
		Savings Deposits (b)	Fixed Deposits (c)	
	(1)	(2)	(3)	(4)
1969	3·0	3·5	4·5	5·0
1970	3·6	4·0	4·5	5·0
[illegible]	[illegible]	[illegible]	7·5	5·0
		[illegible]		[illegible]
1973	—	7·2	7·5	11·0
1974	—	7·2	7·5	11·0
1975 ..	—	7·2	7·5	11·0
1976 ..	—	7·2	7·5	11·0
1977 1st Quarter ..	—	7·2	7·5	11·0
2nd Quarter ..	—	7·2	7·5	11·0
3rd Quarter ..	—	7·2	12 – 18	11·0
4th Quarter ..	—	8·4	12 – 18	11·0
1978 1st Quarter ..	—	8·4	12 – 18	11·0
2nd Quarter ..	—	8·4	12 – 18	11·0
3rd Quarter ..	—	8·4	12 – 18	11·0
4th Quarter ..	—	8·4	12 – 18	11·0
1979 1st Quarter ..	—	8·4	12 – 18	11·0
2nd Quarter ..	—	8·4	12 – 18	11·0
3rd Quarter ..	—	8·4	12 – 18	11·0
4th Quarter ..	—	8·4	12 – 18	11·0
1980 1st Quarter ..	—	8·4	12 – 18	11·0
2nd Quarter ..	—	12·0	15 – 20	11·0
1980 September ..	—	12·0	15 – 20	11·0
October ..	—	12·0	15 – 20	11·0
November ..	—	12·0	15 – 20	11·0
December ..	—	12·0	15 – 20	11·0
1981 January ..	—	12·0	15 – 20	11·0
February .	—	12·0	15 – 20	11·0
March ..	—	12·0	15 – 20	11·0
April .	—	12·0	15 – 20	11·0
May ..	—	12·0	15 – 22	11·0
June ..	—	12·0	15 – 22	11·0
July .	—	12 0	15 – 22	11·0
August ..	—	12·0	15 – 22	11·0
September ..	—	12·0	15 - 22	11·0

Source: Central Bank of Ceylon.

(a) The National Savings Bank took over the assets and liabilities of the Post Office Savings Bank, the Ceylon Savings Bank and the Savings Certificates Fund with effect from 1st April 1972. Interest rates shown before this date are those of the Ceylon Savings Bank and the Savings Certificates Fund.

(b) Compound interest on savings deposits.

(c) Rate on deposits for 12 months. The rate on Fixed Deposits of Rs. 100,000 and over is 8% with effect from 27th May 1975. From 7th September, 1977 deposits for periods of 6, 12 and 18 months are at interest rates of 12, 15 and 18 per cent per annum respectively. From 21st April 1980, the respective interest rates on deposits of 6 and 12 months are at 15 and 20 per cent per annum. From 22nd April, 19[illegible], the Bank accepts deposits for period of 24 months at interest rate of 22 per cent per annum.

(d) Rate on ten year certificates.

Lending Rates of Long-Term Credit Institutions

TABLE 12 (per centum per annum)

End of Period	State Mortgage Bank (1)	Agricultural & Industrial Credit Corporation (2)	Development Finance Corporation (b) (3)	National Housing Department (c) (4)	National Savings Bank (d) (e) (5)
1970	5 — 10½	9 — 12	9½ — 10½	11	10 & 12
1971	5 — 12	9 — 12	9½ — 10½	11	10 & 12
1972	5 — 12	9 — 12	9½ — 10½	11	10 & 12
1973	5 — 12	9 — 12	9½ — 10½	6 — 9	10 & 12
1974	5 — 12	9 — 12	9½ — 10½	6 — 9	10 & 12
1975	5 — 12	9 — 12	9½ — 12½	6 — 9	10 & 12
1976	5 — 12	9 — 12	9½ — 12½	6 — 9	9 — 12
1977 1st Quarter	5 — 12	9 — 12	9½ — 12½	6 — 9	9 — 12
2nd Quarter	5 — 12	9 — 12	9½ — 13	6 — 9	9 — 12
3rd Quarter	5 — 12	9 — 12	9½ — 13	6 — 9	9 — 12
4th Quarter	5 — 12	12 — 15	9½ — 13	6 — 9	9 — 12
1978 1st Quarter	5 — 12	12 — 15	9½ — 13	6 — 9	9 — 12
2nd Quarter	5 — 12	11 — 14	9½ — 13	6 — 9	9 — 13
3rd Quarter	5 — 12	11 — 14	9½ — 13	6 — 9	9 — 13
4th Quarter	5 — 12	11 — 14	9½ — 13	6 — 9	9 — 13
	State Mortgage and Investment Bank (a)				
1979 1st Quarter	5 — 14		9½ — 15	6 — 9	9 — 13
2nd Quarter	5 — 14		9½ — 15	6 — 9	9 — 13
3rd Quarter	5 — 18		10½ — 16	6 — 9	9 — 13
4th Quarter	5 — 18		10½ — 16	6 — 9	9 — 13
1980 1st Quarter	5 — 18		10½ — 16	6 — 9	9 — 13
2nd Quarter	5 — 19		10½ — 16	6 — 9	9 — 13
1980 September	5 — 20		10½ — 17	6 — 9	9 — 15
October	5 — 20		10½ — 17	6 — 9	9 — 15
November	5 — 20		10½ — 17	6 — 9	9 — 15
December	5 — 20		10½ — 17	6 — 9	9 — 17
1981 January	5 — 24		10½ — 17	6 — 9	9 — 17
February	5 — 24		10½ — 17	6 — 9	9 — 17
March	5 — 24		10½ — 17	6 — 9	9 — 17
April	5 — 24		10½ — 17	6 — 9	9 — 17
May	5 — 24		10½ — 17	6 — 9	9 — 17
June	5 — 24		10½ — 17	6 — 9	9 — 17
July	5 — 24		10½ — 17	6 — 9	9 — 17
August	5 — 24		10½ — 17	6 — 9	9 — 17
September	5 — 24		10½ — 17	6 — 9	9 — 17

Source: Central Bank of Ceylon

(a) The State Mortgage Bank and Agricultural & Industrial Credit Corporation were amalgamated from January 1st, 1979 to form State Mortgage and Investment Bank.

(b) The rates charged are as follows:—

1. Replanting of tea & rubber and establishment of alternate crops on tea and rubber lands (Loans granted by the Tea/Rubber Controller) — 5 % and 7%
2. Other loans — 10% — 24%

(c) Development loans—secured by
- immovable property — 11%
- movable property — 11% — 14%

Non-development loans—secured by
- immovable property — 12%
- movable property — 12% — 14%

(d) Rates on loans re financed by the Central Bank — 10½ %
- Other loans — 15% — 17%
- Foreign currency loans — 15%

(e) The rates of interest charged by the National Housing Department on loans granted from the National Housing Fund with effect from 23.3.1973 are as follows:
- on amounts not exceeding Rs. 10,000 — 6 %
- on amounts over Rs. 10,000 and upto Rs. 15,000 — 7 %
- on amounts over Rs. 15,000 — 9 %

(f) Rates on—
- Agriculture loans — 9 %
- Building & Other loans — 9 % — 17%

(g) The National Savings Bank took over the assets and liabilities of the Ceylon Savings Bank with effect from 1.4.72: the rates before April 1972 in this column represent those of the Ceylon Savings Bank

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MONEY AND BANKING

Savings Deposits, Fixed Deposits and Savings Certificates

TABLE 17

Rupees Million.

End of Period	Savings Deposits: Post Office Savings Bank (1)	Savings Deposits: Ceylon Savings Bank (2)	Savings Deposits: Commercial Banks (a) (3)	Savings Deposits: Total Savings Deposits (4)	Fixed Deposits: Ceylon Savings Bank (5)	Fixed Deposits: Commercial Banks (a) (6)	Fixed Deposits: Total Fixed Deposits (7)	Savings Certificates Fund (8)	Grand Total (4)+(7) + (8) (9)
1960 ..	343·4	75·5	129·0	517·9	—	243·2	243·2	32·2	823·3
1961 ..	351·9	75·3	130·6	557·8	—	233·1	233·1	32·7	823·7
1962 ..	362·3	75·4	140·9	578·6	—	285·5	285·5	32·9	897·0
1963 ..	375·5	77·2	165·2	617·9	—	334·0	334·0	34·4	986·3
1964 ..	402·3	81·6	193·5	677·4	—	357·6	357·6	37·4	1,072 4
1965 ..	427·1	86·6	223·9	737·6	—	382·8	382·8	41·8	1,162 2
1966 ..	438·4	91·2	243·7	773·3	—	358·9	358·9	56·5	1,188·7
1967 ..	450·6	93·2	272·0	815·8	—	428·8	428·8	78·7	1,329·3
1968 ..	473·3	100·2	319 9	893·4	0·1	506·3	506·4	91·3	1,491·1
1969 ..	490·5	102·0	375·6	968·1	0·4	610·1	610·5	86·3	1,664·9
1970 ..	594·4	112·8	534·8	1,242·0	0·5	633·7	634·2	73·1	1,949·3
1971 ..	659·0	172·7	615·0	1,446·7	25·0	702·3	727·3	65·3	2,239·8

End of Period	Savings Deposits: National Savings Bank (b) (1)	Savings Deposits: Commercial Banks (a) (2)	Savings Deposits: Total (3)	Fixed Deposits: National Savings Bank (b) (4)	Fixed Deposits: Commercial Banks (a) (5)	Fixed Deposits: Total (6)	Savings Certificates (b) (7)	Premium Savings Bond (c) (8)	National Pension Scheme (9)	Grand Total (10)
1972 ..	913·0	610·6	1,523·6	53·2	914·4	967·6	66·6	—	—	2,557·8
1973 ..	1,043·2	749·6	1,792·8	100·3	662·2	762·5	97·9	—	—	2,653·2
1974 ..	1,244·1	857 4	2,101·5	167·6	803·4	971·0	106·9	—	—	3,179·4
1975 ..	1,413·7	947·4	2,361·1	243·1	780·8	1,023·9	112·9	—	—	3,497·9
1976 ..	1,678·9	1,215·1	2,895·0	307·6	975·3	1,282·9	114·9	—	—	4,292·8
1977 1st Qtr. ..	1,737·2	1,269·4	3,006·6	334·0	1,114·5	1,448·5	114·9	—	—	4,570·0
2nd Qtr. ..	1,814·6	1,392·9	3,207·5	350·7	1,222·9	1,573·6	115·4	—	—	4,896·5
3rd Qtr. ..	1,760·8	1,495·5	3,256·3	546·4	1,490·2	2,036·6	113·2	—	—	5,406·1
4th Qtr. ..	1,727·3	1,645·1	3,372·4	771·5	1,796·4	2,567·9	96·7	—	—	6,027·0
1978 1st Qtr. ..	1,714·0	1,693·6	3,407·6	892 2	2,327·4	3,219·6	89·0	—	—	6,716·2
2nd Qtr. ..	1,700·3	1,813·7	3,514·0	964·9	2,545·1	3,510·0	86·3	—	—	7,115·3
3rd Qtr. ..	1,679·8	1,829·1	3,508 9	1,102·1	2,815·9	3,918·0	79·2	—	—	7,506·1
4th Qtr. ..	1,825·0	1,846·0	3,671 0	1,265·4	3,179·5	4,444·9	75·5	—	—	8,191·4
1979 1st Qtr. ..	1,881·2	2,104·6	3,985·8	1,476·9	4,150·6	5,627·5	70·9	1·3	—	9,685·5
2nd Qtr. ..	1,901·4	2,301·2	4,202·6	1 785 2	4,251·9	6,037·1	68·3	2·6	...	10,310·6
3rd Qtr. ..	1,866·7	2,196·4	4,063·1	1,970·1	4,699·6	6,669·7	64·5	3·7	0·2	10,801·2
4th Qtr. ..	2,029·5	2,308·6	4,338·1	2,193·8	5,200·4	7,394·2	57·8	4·8	0·7	11,795·6
1980 1st Qtr. ..	2,037·4	2,277·7	4,315·1	2,395·6	5,538·4	7,934·0	56·7	5·4	1·3	12,312·5
2nd Qtr. ..	2,022·8	2,298·0	4,320·8	2,563·1	5,976·0	8,539·1	49·0	6·0	1·9	12,916·8
1980 September ..	1,983·4	2,322·5	4,305·9	2,688·7	7,366·8	10,055 5	43·9	6·4	2·4	14,414·1
October ..	1,973·8	2,397·5	4,371·3	2,718·5	7,696·8	10,415·3	42·5	6·6	2·5	14,838·2
November ..	1,955·3	2,453·8	4,409·6	2,765·3	7,753·2	10,518·5	40·4	6·6	2·7	14,977·8
December ..	2,146·0	2,509·6	4,655·6	2,758·3	8,093·9	10,852·7	38·6	6·5	3·2	15,556·6
1981 January ..	2,136·8	2,530·4	4,667·2	2,797·1	8,951·1	11,748·2	37·6	6·5	3·4	16,462·9
February ..	2,126·6	2,558·3	4,684·9	2,837·4	8,545·2	11,382·6	37·1	6·6	3·7	16,114 9
March ..	2,114·4	2,595·8	4,710·2	2,858·5	9,440·1	12,298·6	35·6	6·6	4·0	17,055·0
April ..	2,107·8	2,663·6	4,771·4	2,887·5	9,472·1	12,359·6	34·2	6·6	4·3	17,176·1
May ..	2,099·5	2,693·8	4,793·3	2,912·5	9,730·0	12,642·5	33·5	6·6	4·6	17,480·5
June ..	2,088·7	2,752·6	4,841·3	2,958·9	10,063·1	13,022·0	32·9	6·6	4·9	17,907·7
July ..	2,075·6	2,751·3	4,826·9	3,013·4	10,500·5	13,513·9	32·2	6·7	5·3	18,385·0
August ..	2,060·1	2,846·9	4,907·0	3,064·9	10,431·7	13,496·6	31·7	6·7	5·6	18,447·6
September ..	2,052·3*	2,943·4	4,995·7	30,67·9*	11,428·9	14,496·8	30·7*	6·6*	6·0*	19,535·8*

Sources: Central Bank of Ceylon, Post Office Savings Bank, Ceylon Savings Bank. Savings Certificates Office and National Savings Bank.

(a) Figures of commercial banks include deposits of Government.
(b) The National Savings Bank took over the assets and liabilities of the Post Office Savings Bank, Ceylon Savings Bank and the Savings Certificates Fund with effect from 1st April, 1972.
(c) The premium Savings Bond Scheme was started by the National Savings Bank on 8th February 1979.
(d) The regular monthly Income Savings Plan was started in June 1979.
Note:—Figures of fixed deposits and Savings Certificates published in the Bulletin prior to December 1977 included accumulated interest. These figures have been now revised to exclude such interest.

History

Bank of Ceylon

3.01 BOC, established on December 1, 1938 as a private sector institution, was nationalized in 1961 under the Bank of Ceylon Act. It is one of the two largest commercial banks in Sri Lanka. With an extensive branch network of around 155 full-service branches and numerous sub-branches spread throughout the country, BOC offers a full spectrum of banking services. BOC's present authorized share capital is US$6.7 million equivalent (SLRs120 million) while its issued and paid-up capital is US$5.0 million equivalent (SLRs90 million), and US$250,000 equivalent (SLRs4.5 million) respectively1/. In the 1981 Budget speech, the Minister of Finance and Planning announced that GOSL is taking steps to increase BOC's paid-up capital to US$2.8 million equivalent (SLRs50 million) and that it is GOSL's intention to increase BOC's paid-up capital as quickly as possible to US$55.6 million (SLRs1 billion). BOC's 1979 year-end net worth was US$4.03 million equivalent (SLRs72.5 million). The importance of BOC in the commercial banking system is evidenced by the fact that its deposits as of December 31, 1979, represented about 35% of total commercial bank deposits and its loans as of the same date represented around 40% of total commercial bank loans in Sri Lanka.

Board of Directors and Senior Management

3.02 In 1977, BOC's Board of Directors was reconstituted by the new GOSL and strengthened by the induction of prominent businessmen and civil servants. Chairman Wijewardane, an ex-senior officer in the Ceylon Civil Service, has had a wide range of administrative experience, including a period as Managing Director of a large private sector industrial group in Sri Lanka. Day-to-day management is vested in a team of senior managers headed by Mr. C.J.E. Anthonisz, appointed General Manager in December 1977, who is a career banker and has held a variety of positions with BOC. BOC has a forward looking senior management group which has dealt effectively with the local business environment and traditional business practices. It has a reputation for taking decisions based on business considerations, and a tradition of managing its affairs with independence.

Organization Structure

3.03 The recent rapid increase in BOC's volume of operations gave rise to the need for BOC to change its style of management as well as its systems, controls and decision-making processes. IFC has helped BOC carry out an in-depth professional review of its existing organizational structure, systems and procedures, with a view to helping it meet the increased responsibilities that have been assigned to it by GOSL. The basic restructuring of the institution has already begun; the provision of expert assistance during this stage is being financed under the UNDP-IBRD "umbrella program".

3.04 Appropriate modifications have been made to the Central Office structure so that top management's responsibilities are more clearly focussed on policy formulation, with operational matters being delegated

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1/ The Government of Sri Lanka (GOSL) has a liability for uncalled capital of US$4.75 million equivalent (SLRs85.5 million). Under existing law, BOC may call this capital at any time if needed.

to middle management. The new organization structure, which is already in place, is predicated on a market segmentation approach aimed at meeting the requirements of broad sections of BOC clients. Customers are classified according to the following five market segments: agriculture; trade and small-scale industry; corporate; international; and personal. The proposed MSIE project will be implemented by the Corporate Branch which has been set up to cater to the needs of medium and large corporate customers.

3.05 To achieve better coordination with the district development plans of GOSL, BOC has also restructured its operations throughout the island into five zones, each managed by a Zonal Manager, with the rank of Assistant General Manager, who is based in Colombo to provide effective liaison with the Head Office and with operational staff in Colombo, as well as with concerned government agencies. Each zone will function as a profit centre. The activities of large branches are being segmented by appointing five sub-managers, each with total responsibility in serving the customer needs in his segment. As regards the small branches, there will be notional market segmentation through classification of the ledgers and accounts of customers according to the five market segments. BOC is also taking steps to introduce a new Planning, Budgeting and Management Information System which will be one of the key integrating mechanisms of the new organization structure. These measures are providing a new momentum to BOC's operations and will help transform the bank into a more aggressive institution.

Personnel

3.06 The rapid growth in BOC's branch network has brought in its wake a shortage of adequately trained staff to man its expanding operations. The number of employees more than tripled from 2,481 in 1970 to 7,867 at the end of 1979. BOC's senior management is taking steps to correct this situation through various training programs. The SMSIE project (see Section IV below) has enabled BOC to train personnel in the area of credit appraisal and supervision. Officers trained by the UNDP advisor in the SMSIE project will play an important role in the MSIE project. Twenty-five officers who have completed training in credit analysis will be assigned to the Corporate Branch and the five Zonal Offices. Moreover, under the Reorganization Program, IFC's recommendations that training programs be carried out on an ongoing basis at the district and zonal levels are being implemented.

Financial Position and Performance

3.07 BOC's comparative statements of financial condition for the years ended December 31, 1975 through December 31, 1979 are shown in Annexes 4 and 5 and reveal a rapid growth in BOC's operations. Deposits increased from US$72.2 million equivalent (SLRs 1.3 billion) in 1975 to US$238.9 million equivalent (SLRs4.3 billion) in 1979 , figures which represent a compounded annual growth rate of 27%. Loans during the same period increased from US$61.1 million equivalent (SLRs 1.1 billion) to US$266.7 million equivalent (SLRs4.8 billion) showing a compounded annual growth rate of 35%.

3.08 BOC's net worth increased from US$3.2 million equivalent (SLRs57.5 million) in 1975 to US$4.03 million equivalent (SLRs72.5 million) in 1979. After-tax return on average net worth in 1979 was 115.1%; if average net worth is adjusted to include the callable capital, after-tax return on average net worth would be 51.0%. Income before tax as a percentage of average net earning assets was 3.9% in the same year.

Role in Industrial Lending

3.09 BOC is playing an increasingly important and successful role in industrial financing. Industrial loans outstanding increased by nearly 77% from US$31.1 million equivalent (SLRs559 million) in December 1978 to US$54.8 million equivalent (SLRs987 million) in December 1979, the latter figure representing 32% of the total industrial loans made by all commercial banks in Sri Lanka. Despite the strong growth in import trading in 1979, the share of industrial loans as a percentage of total advances increased from 19% in December 1978 to 23% in December 1979. More significant is the very large increase in the medium- and long-term industrial loans outstanding, which increased nearly four-fold from US$3.2 million equivalent (SLRs58 million) in December 1978 to US$12.8 million equivalent (SLRs230 million) in December 1979; these term loans accounted for 23% of total industrial loans outstanding as of December 31, 1979. As it became increasingly aware of the benefits associated with a more diverse portfolio of loans, BOC has been taking a more active interest in long-term finance. To this must also be added a substantial increase in direct financing from foreign sources including suppliers credit, on the basis of guarantees given by BOC. BOC is now experiencing a constraint with respect to the availability of foreign resources.

Conclusion

3.10 BOC is evolving from a traditional bank that met the requirements of an economy based primarily on agriculture, trade and commodity exports to a modern financial institution geared to respond to the needs of a country embarked on a program of industrialization and modernization. It is now putting in place the basic organizational infrastructure and developing the human resources to expand this role. BOC management has realized the need for, and expressed its commitment to, the evaluation of term financing on the basis of project viability and cash flow for BOC-wide credit operations. Given its excellent reputation for business-like dealings, its organizational, personnel and financial resources, BOC is well suited to implement the MSIE project.

Annex 7 (cont.)
referenced as Annex 4 in
IFC Loan Paper

SRI LANKA

BANK OF CEYLON

MEDIUM-SCALE INDUSTRIAL ENTERPRISES PROJECT

Balance Sheets of Bank of Ceylon
(SLRs'000)

	As of December 31				
ASSETS	1975	1976	1977	1978	1979
Cash and Due from Banks	138,526	190,745	242,072	283,204	336,818
Deposits with Central Bank	106,200	101,600	247,010	275,355	377,593
Government Securities	280,494	377,489	371,564	368,473	367,771
Riskless Assets	525,220	669,834	860,646	927,032	1,082,182
Call Loans to Banks	14,390	14,865	10,746	4,092	33,159
Treasury Bills	38	21	-	-	-
Low Risk Assets	14,428	14,886	10,746	4,092	33,159
Short-term Loans	759,339	1,170,241	1,747,596	2,280,362	3,456,792
Medium- and Long-term Loans	309,368	377,145	433,146	1,023,335	1,317,368
Normal Risk Assets	1,068,707	1,547,386	2,180,742	3,303,697	4,774,160
Investments and Advances to Subsidiaries	2,037	1,479	1,258	1,516	1,736
Investments in Other Companies	3,622	3,931	3,948	3,378	31,150
Premises and Equipment	30,296	52.306	59,543	44,081	85,519
Illiquid Assets	35,955	57,716	64,749	48,975	118,405
TOTAL ASSETS	1,664,310	2,289,822	3,116,883	4,283,796	6,007,906
LIABILITIES AND NET WORTH					
Demand Deposits	827,166	1,251,057	1,524,709	1,785,764	2,215,100
Savings Deposits	323,892	383,105	436,304	493,076	578,595
Time Deposits	154,037	148,693	486,182	767,990	1,539,169
Proposed Dividends and Transfer to GOSL	3,775	4,775	5,764	6,775	568
Other Liabilities	277,940	442,692	602,424	1,116,691	1,601,974
Total Liabilities	1,586,810	2,230,322	3,055,383	4,220,296	5,935,406
Paid-up Capital	4,500	4,500	4,500	4,500	4,500
Capital Reserves	53,000	55,000	57,000	59,000	68,000
Total Net Worth	57,500	59,500	61,500	63,500	72,500
TOTAL LIABILITIES AND NET WORTH	1,644,310	2,289,822	3,116,883	4,283,796	6,007,906

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SRI LANKA

BANK OF CEYLON

MEDIUM-SCALE INDUSTRIAL ENTERPRISES PROJECT

Income and Expense Statements of Bank of Ceylon
(SLRs'000)

	12/31/75	12/31/76	12/31/77	12/31/78	12/31/79
Interest Earned	91,431	111,445	149,967	283,901	445,776
Less: Interest Paid	26,007	30,359	47,983	140,216	225,394
Interest Spread	65,404	81,086	101,984	143,685	220,382
Exchange Earnings	18,543	26,008	44,423	115,625	102,169
Commission Earnings	6,859	9,662	11,718	21,739	32,868
TOTAL OPERATING INCOME	90,806	116,756	158,125	281,049	355,419
Provision for Doubtful Accounts	143	527	689	32,218	25,983
Administrative Expenses	52,754	63,836	85,958	110,019	156,274
Depreciation	1,997	2,346	2,922	3,705	5,670
TOTAL OPERATING EXPENSES	54,894	66,709	89,569	145,942	187,927
NET OPERATING INCOME	35,912	50,047	68,556	135,107	167,492
Other Income	1,736	2,778	2,110	5,627	14,955
INCOME BEFORE TAXES	37,648	52,825	70,666	140,734	182,447
Taxes	23,650	32,975	44,675	105,000	104,175
NET INCOME AVAILABLE FOR APPROPRIATIONS	13,998	19,850	25,991	35,734	78,272
Appropriations					
Dividends and Transfer to GOSL	4,000	5,000	6,000	7,000	849
Transfer to General Reserves	9,998	9,850	16,991	18,734	17,423
Transfer to Reserve for Investments	-	5,000	3,000	10,000	-
Transfer to New Building Reserve Fund	-	-	-	-	60,000
Total Appropriations	13,998	19,850	25,991	35,734	78,272

FROM THE

ANNUAL REPORT

BANK OF CEYLON

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER 1980

	Note	1980 Sri Lanka Rupees '000	1979 Sri Lanka Rupees '000
Profit before transfer to Reserves and Taxation	1	330,961	208,431
Taxation		97	104,175
		330,864	104,256
Transfer to Reserve and Other Funds	2	329,949	103,407
		915	849
Dividends	3	915	849

The notes form part of these accounts.

CONSOLIDATED STATEMENT OF CONDITION—FINANCIAL YEAR END

	1980 Rs. '000	1979 Rs. '000
	Sri Lanka Rupees	
ASSETS:		
Cash & Short Term Funds	1,606,138	747,570
Trade Bills	1,073,475	580,047
Investment in Government Securities	364,406	367,771
Advances to Customers & Other Accounts	6,414,433	4,194,113
Investments in Subsidiaries & Other Companies	328,038	32,886
Premises & Equipment	290,546	85,519
Liabilities of Customers for Engagements	11,327,939	7,638,928
	21,404,975	13,646,834
LIABILITIES:		
Demand Deposits	3,147,552	2,215,100
Savings Deposits	806,378	578,595
Time Deposits	3,065,816	1,539,169
Other Accounts	2,479,525	1,601,974
Final Dividend	915	568
Engagements on behalf of Customers	11,327,939	7,638,928
	20,828,125	13,574,334
CAPITAL & RESERVES:		
Share Capital	4,500	4,500
Permanent Reserve Fund	6,000	6,000
Capital Reserve	204,350	—
General Reserve	162,000	62,000
Reserve for Bonus Issue of Share Capital ...	200,000	—
	21,404,975	13,646,834

(Subject to audit)

Notes on Bank of Ceylon's Feasibility Study dated August 17, 1981 regarding establishment of a housing finance bank.

Basic Assumptions:

- BOC would get tax relief on its investment in the bank.

- Since a minimum capitalization of Rs.500 million is required to obtain tax relief, the housing bank would be capitalized at Rs.500 million.

- The Housing Bank would enjoy tax holiday for 5 years and dividend income from the bank would be tax free in the hands of the shareholders for 5 years.

- BOC would put in each year Rs.100 million less any moneys the bank could raise from others.

- The Bank would finance 200 units per year @ Rs.250,000 per unit i.e. Rs.50 million of lending each year. The remaining 50 million it raised in the first five years would be invested in deposits with BOC to build up loanable funds.

- The average loan the bank would make would be Rs.100,000 @ 14.4% repayable after a two-year grace period over 18 years.

Returns to BOC

- Investment relief of upto Rs.250 million.

- Dividends, totalling Rs.204.2 million in the first ten years.

- Deposits (idle funds of the bank; 20% of the loan given to the customer would be deposited with BOC). By the end of the fifth year, fixed deposits with BOC would total Rs. 365.9 million (or 10% of the current base).

RURAL CREDIT AND BANKING – FIRST HALF OF 1981

CENTRAL BANK BULLETIN

October 1981

Rural Banks Loans by Purpose

	1980 (As at 30th June 1980)		1981* (As at 30th June 1981)	
	Amount in Rupees	Percentage of Total	Amout in Rupees	Percentage of Total
1. Production	18,218,450	26·9	25,831,541	28·7
1·1 Agriculture	(10,699,790)	(15·8)	(17,730,884)	(19·7)
1·2 Animal husbandry ..	(4,157,260)	(6·1)	(4,444,214)	(4 9)
1·3 Cottage Industry ..	(3,361,400)	(5·0)	(3,656,443)	(4·1)
2. Housing	30,791,633	45·4	42,227,546	46·9
3. Debt Redemption	9,302,518	13·7	8,951,146	9·9
4. Trade	4,195,630	6·2	4,766,799	5·3
5. Consumption	1,648,965	2·4	2,672,722	3·0
6. Electrification	694,585	1·0	1,278,073	1·4
7. Other	2,971,125	4·4	4,341,188	4·8
Total ..	67,822,906	100·0	90,069,015	100·0

*Provisional.

Source: People's Bank.

Rural Banks

In the first half of 1981, fifty five branches of rural banks were opened, bringing the total number of co-operative rural banks to 696. The data on deposits and advances of rural banks at the end of December, 1980 and June, 1981 are given in Table 2. During the period under review the number of deposits accounts (savings and fixed deposits) increased by 117,353 while the deposits increased by Rs. 19 million. The number of short term and pawning advances increased by 2,999 and 4,530 respectively. The outstanding short-term advances increased by Rs. 11 million, and the pawning advances increased by Rs. 25 million leading to an increase of about Rs. 36 million in the total advances outstanding. The net positive deposit position of the rural banks declined from Rs. 192 million at the end of December,1980 to Rs. 174 million at the end of June, 1981.

Table 2

Deposits and Advances of Rural Banks

	Position as at 31st December 1980		Position as at 30th June, 1981	
	No of Accounts	Amount (Rs.)	No. of Accounts	Amount (Rs.)
1. Deposits				
1·1 Savings ..	1,160,209	309,184,000	1,272,446	327,496,739
1·2 Fixed ..	9,180	59,170,000	14,269	59,472,320
Total ..	1,169,389	368,354,000	1,286,715	386,969,059
2. Advances				
2·1 Short term ..	59,331	79,676,739	62,330	90,194,387
2·2 Pawning ..	242,340	97,113,423	246,870	122,320,453
Total ..	301,671	176,790,162	309,200	212,514,840

Source: People's Bank.

The purpose-wise breakdown of the advances granted by rural banks during the first half of 1981 is presented in Table 3 along with the comparable figures for the first half of 1980. Total credit granted showed an increase of Rs. 22·3 million during the first half of 1981, when compared with the same period in 1980. Of this increase, little more than 50 per cent was accounted for by the increase reported in the credit granted for the purpose of housing, while another 31 per cent was accounted for by the increase reported in the credit extended for agriculture. Only in the case of credit granted to debt redemption purposes was a decrease reported.

Table 3

Rural Banks Loans by Purpose

	1980 (As at 30th June 1980)		1981* (As at 30th June 1981)	
	Amount in Rupees	Percentage of Total	Amout in Rupees	Percentage of Total
1. Production	18,218,450	26·9	25,631,541	28·7
1·1 Agriculture	(10,699,790)	(15·8)	(17,730,884)	(19·7)
1·2 Animal husbandry ..	(4,157,260)	(6·1)	(4,444,214)	(4 9)
1·3 Cottage Industry ..	(3,361,400)	(5·0)	(3,656,443)	(4·1)
2. Housing	30,791,633	45·4	42,227,546	46·9
3. Debt Redemption	9,302,518	13·7	8,951,146	9·9
4. Trade	4,195,630	6·2	4,766,799	5·3
5. Consumption	1,648,965	2·4	2,672,722	3·0
6. Electrification	694,585	1·0	1,278,073	1·4
7. Other	2,971,125	4·4	4,341,188	4·8
Total ..	67,822,906	100·0	90,069,015	100·0

*Provisional.

Source: People's Bank.

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However, even in this case, the decrease was marginal. Though the absolute amount of total credit granted by rural banks increased by 33 per cent, no significant changes took place in the distribution of credit by different purposes. As in the first half of 1980, housing continued to account for the bulk of the total credit (47 per cent), while the share of agriculture including animal husbandry was about 25 per cent. The corresponding shares for the first half of 1980 were 45 and 22 per cent, respectively.

Bank Of Ceylon Sub Offices

The Bank of Ceylon had 387 sub offices at Agrarian Service Centres at the end of June 1981 and no branches were opened during the first half of 1981. The number of current accounts at the sub-offices declined together with the amount deposited in the accounts during the period under review. The number of savings accounts and the outstanding deposits in these accounts decreased by 6,889 and about Rs. 1·9 million, respectively. Yet there was an increase in the number of special savings accounts and fixed accounts. The amounts outstanding in these two types of accounts rose by about Rs. 1·0 million and Rs. 7·9 million, respectively.

Table 4

Bank of Ceylon Sub.offices at Agrarian Service Centres

Deposits and Advances

Deposit Accounts	As at 31st December 1980		As at 30th June, 1981	
	No. of Accounts	Amount (Rs.)	No of Accounts	Amount (Rs.)
Current Accounts ..	7,813	31,424,176	7,380	24,144,492
Savings Accounts ..	143,905	52,706,414	137,016	50,833,012
Special Savings Accounts ..	314	205,066	2,739	1,186,457
Fixed Accounts ..	2,559	24,726,006	3,239	32,609,949
Total ..	154,591	109,051,662	150,374	108,773,910
Less: Current Accounts ..	146,778	77,637,486	142,994	84,629,418
Advance Accounts ..				
Loans ..	54,238	143,227,243	48,908	132,582,073
Overdrafts ..	272	3,690,994	283	2,924,185
Total ..	54,510	146,918,237	49,191	135,506,258

Source: Bank of Ceylon.

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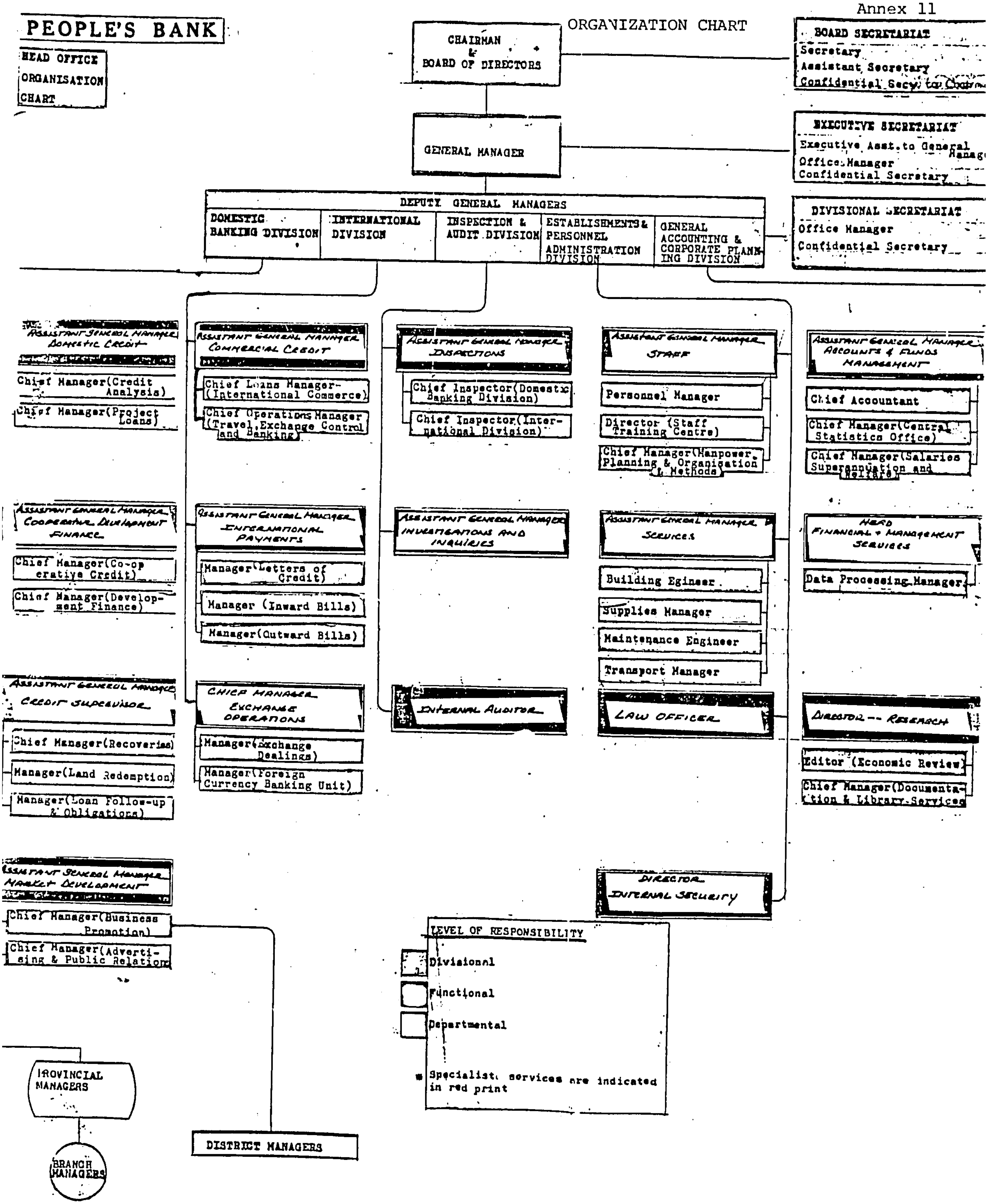
Annex 11



* PROVINCIAL MANAGERS SERVE UNDER THE ADMINISTRATIVE CONTROL OF THE DEPUTY GENERAL MANAGER (DOMESTIC BANKING DIVISION) FUNCTIONALLY THEY ARE DIRECTLY ACCOUNTABLE TO THE ASSISTANT GENERAL MANAGERS IN CHARGE OF THE RESPECTIVE SUBJECTS

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PEOPLE'S BANK

NOW PAYS A HIGHER INTEREST AND... GIVES ADDED BENEFITS TO EXTENDED DEPOSIT (MINORS) ACCOUNT HOLDERS

60 MONTHS DEPOSIT SCHEME

Monthly Instalment	Rs. 25	Rs. 100
Sum Accumulated		
At the end of 5 years	2114	 8456
" 7 "	3147	12588
" 9 "	4684	18736
" 11 "	6972	27888
" 13 "	10378	41512
" 15 "	15447	61788
" 17 "	22991	91964
" 19 "	34220	136880
" 21 "	50933	 203732
Monthly Payment after 21 years until capital is withdrawn	789	3157

Annex 12
Newspaper Ad
September 1981

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(rue)

LUMP SUM DEPOSIT SCHEME

Amount of Deposit Sum Accumulated	Rs. 500	Rs. 600	Rs. 1000	Rs. 1200	Rs. 13000
At the end of 2 yrs.	744	893	1488	1786	19348
" 4 "	1107	1329	2214	2658	28794
" 6 "	1648	1978	3296	3956	42856
" 8 "	2453	2944	4906	5888	63786
" 10 "	3652	4382	7304	8764	94944
" 12 "	5436	6523	10872	13046	141332
" 14 "	8091	9709	16182	19418	210362
" 16 "	12042	14451	24084	28902	313104
" 18 "	17924	21509	35848	43018	466028
" 20 "	26678	32014	53356	64028	693636
" 21 "	32548	39057	65096	78144	846536
" 22 "	39708	47650	79416	95300	1032416
Monthly Payment after 22 years until capital is withdrawn	615	738	1230	1477	16002

ADDED BENEFITS:-

Depositors may now convert their monthly deposit Accounts to 'Lump Sum Deposits' when the balance exceeds Rs 500/-. This Lump Sum Deposit could be built up in any manner convenient to the Depositor, not necessarily in regular instalments.

Note: The balances shown in the above chart are subject to increase/decrease depending on future changes in the rates of interest.

CONTACT THE NEAREST PEOPLE'S BANK BRANCH FOR APPLICATIONS

PEOPLE'S BANK – The People Who Serve People

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PEOPLE'S BANK

Summary of procedures followed in processing Housing Loans

These procedures are well-defined and rigourously implemented. The main steps of this procedure are summarized below in sequentical order.

- Application form submitted by the potential borrower. This application contains personal data about the applicant (age, employment, salary, dependents) as well as details concerning the house to be purchased.

- Title serarch conducted by the applicant covering 35 year period, and title deed is prepared

- Survey plan of property, building plan of Bill of quantities estimate submitted by applicant to the bank.

- If over Rs. 75,000, the loan application is submitted to the General Manager of Credit at the headquarters office. The application is reviewed and approved if the loan amount requested is less than Rs. 500,000 (average housing loan request 100,000 - 150,000 Rs.). Otherwise the loan application is submitted to the Board of Directors.

- Upon approval, loan applications sent back to the regional office where a lawyer prepares the mortgage bond and gets it signed by the borrower.

- Mortgage bond sent to the Land Registry Department for registering of the mortgage.

- Upon registry, loan document sent back to branch. Loan disbursed. In the case of construction, loan is disbursed in 24 installments based on progress of construction. The first installment disbursed is equal to 60 percent of the assessed value of the land.

- Borrower is required to purchase insurance for the house equal to the value of the assessed building (not including land). Benefit any rights assigned to the Bank.

HOME IMPROVEMENT LOAN PROGRAM WORKED OUT BETWEEN SAVE THE CHILDREN FOUNDATION AND PEOPLE'S BANK

The program was developed with People's Bank and related to the savings capacity of slum and shanty residents as applied to a self-help shelter improvement project of the U.S. Save the Children Foundation.

The self-help program in a shanty area of Colombo known as Kirillapone includes the provision of loans to applicants for building materials and labor. These loans are administered by the People's Bank from capital provided by AID contributions to the Save the Children Foundation. Applications for loans come initially to STC which then passes them on to People's Bank for approval and processing. To meet STC requirements, applicants must be residents of the project area. This has been determined through a baseline study which identified (1) number of people, (2) names, and (3) housing units. STC checks applications against this directory. The Bank then imposes its own set of requirements as follows:

1. The applicant must have a guarantor to co-sign the loan. A guarantor is defined as a fully-employed "outsider" (non-relative) contributing to a provident fund.

2. The applicant must be a project resident.

3. The applicant must open a current or savings account at People's from which the loan charges are automatically withdrawn each month. Current interest of savings is 12 percent.

STC currently maintains a directory of 370 families, inhabiting 335 units eligible for self-help loans. Renters are considered eligible for loans. Loans are for the construction of houses of 250-300 square feet on 2 perch lots. The maximum amount of a loan is Rs. 15,000 at 3 percent interest over 15 years. Average monthly charges are Rs. 90-100. Architects together with the applicant discuss the housing design to determine the amount of loan needed. Rs. 15,000 could finance a completed core housing with no partition walls.

The program was capitalized from a $10,000 contribution in 1979. For 1982, contributions to date are $29,000. (The majority of cont ibutions come from PACT, a U.S. voluntary aid organization: $7,000 in 1979 and 24,000 in 1981.) STC has set up a revolving fund at People's Bank from which loans are drawn. This fund is maintained by drawing from the current account and cannot exceed Rs. 150,000. Money is deposited into the current account as it is received (generally every six weeks) and transferred to the fund, or margin account, as it is needed. The limit on deposits into the fund means no more than 10 loans per month, on the average, are processed. STC also maintains an administrative expense account at People's. All accounts are non-interest bearing since STC is prohibited from investing contributions.

Other banks were approached when STC first conceived the idea of a housing loan program. People's was most receptive to the concept and also had similar accounts for other non-housing projects. There have been no problems thus far.

The 3 percent interest rate derives from People's own employees' housing program; the terms are the best the Bank could offer. STC is currently attempting to negotiate a longer term so monthly payments can be lowered but the Bank says it would then have to raise the rate, making payments about the same.

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		Minimum Rate Loan	Minimum Rate Overdraft
1.	Advances for Export Trading Packing Credit	20%	21%
2.	Advances for Import Trading (Including Trust Receipt & Pledge Loan)		
	Raw Materials	23%	24%
	Others	24%	25%
3.	Advances for Industry	24%	26%
4.	Advances for Tourism	25%	
5.	Advances for Internal Trading	26%	27%
6.	Advances for Consumption	30%	32%
7.	Others - (Not included in categories 1 - 6)	30%	32%
8.	**Special Advances:**		
	* (i) Housing (a) Construction	14%	
	(b) Purchase	15%	
	(ii) Development Loans	20%	
	* Housing Loans have been suspended since 1977. These rates are to be increased in respect of existing loans.		
	(iii) New Tractors & Commercial Vehicles	25%	(Special Rate applicable for Refinance Scheme)
9.	Advances against Savings Deposits	2%	above Savings Rate Minimum 12%.
10.	Advances against Fixed Deposits	2%	above Fixed Deposit Rate provided no monthly interest is paid.
11.	Advances against Convertible Rupee (Current) Accounts	12%	
12.	Temporary Overdraft (Clean)		27% - 32%
13.	Letter of Guarantee	2%	
	As far as possible, you should discourage the practice of granting Letters of Guarantee in favour of Corporations and large private firms as this is tantamount to a payment on demand like an overdraft, which should attract a rate of interest of at least 27% (Internal Trading)		
14.	Overdue Pledge Loans, Trust Receipt Loans, Packing Credit Loans.	Penal Rate 3%	
15.	Local Bills purchased Commission	½%	with a minimum of Rs 5/-

All existing preferential rates are withdrawn with immediate effect.

Annex 16

9th ANNUAL REPORT & ACCOUNTS 1980

NATIONAL SAVINGS BANK

SAVINGS HOUSE
KOLLUPITIYA

BOARD OF DIRECTORS

Chairman	—	**A. O. WIRASINGHE**
Directors	—	**D. K. SAMARASINGHE** *(Representing the Deputy Secretary to the Treasury from 1.5.1980)*
		W. S. NANAYAKKARA *(Representing the Ministry of Planning)*
		A. R. M. JAYAWARDENA, *ex officio* *(Postmaster General from 1.1.1980 to 30.4.1980)*
		A. P. HAPUDENIYA, *ex officio* *(Postmaster General from 1.5.1980)*
		A. M. M. SAHABDEEN
Worker Director	—	**V. C. WILATHGAMA** *(From 1.1.1980 to 15.5.1980)*
		J. A. S. WARNAKULASOORIYA *(From 9.7.1980)*
Secretary to the Board	—	**Mrs. P. D. NANAYAKKARA**

PRINCIPAL OFFICERS

General Manager	—	**T. V. A. CHANMUGAM** *(From 10.12.1979 to 30.6.1980)*
General Manager *Acting in addition to his duties as Deputy General Manager (Finance)*	—	**D. S. SAMUEL** *(From 1.7.1980 to 12.12.1980)*
Assistant General Manager (Staff)	—	**B. P. RATNAYAKE**

HIGHLIGHTS OF 1980

Total Depositors' Balances	: Rs.	5,201,104,433
Total number of accounts	:	7,113,551
Nett Savings mobilised	: Rs.	464,459,109
Share of Savings	:	30.2% of the total deposits of all Banks
Total investment in Sri Lanka Govt. Securities	: Rs.	4,847,054,600 representing 93.2% of the Bank's total Deposits
The highest contributor to Sri Lanka Govt. Loan	: Rs.	918,115,100
Gross Income for the year	: Rs.	728,057,617
Interest paid and payable to depositors (including P.S.B. prizes)	: Rs.	630,813,270
Interest paid and payable to depositors as a percentage of gross income		86.6%
Nett Profit before taxation	: Rs.	47,346,534
Total number of Branches	:	42

ANNUAL REPORT OF THE BOARD OF DIRECTORS

(FOR THE YEAR ENDED 31ST DECEMBER, 1980)

INTRODUCTION

The National Savings Bank completed its 9th year of operation in 1980. During this period the Bank followed the progressive interest reform policies initiated by the present Government in September 1977 in being the first Bank to increase the existing interest rates on Fixed Deposits by raising the interest rates on 12 months deposits and 6 months deposits to 20% and 15% from 15% and 12% respectively. Unfortunately, we were simultaneously given a policy decision by the Ministry that we should only accept deposits for a maximum period of 12 months in future. Commercial Banks began to accept 24 months deposits at 22% per annum shortly after to compete with us and increase their deposits in order to counter the credit restrictions introduced by the Central Bank. For this reason the National Savings Bank's share of the total savings deposits mobilised during the year by all financial institutions, which amounted to Rs. 3,559.0 million in 1980 (as against Rs. 3,474.8 million in 1979), decreased considerably. It is necessary to record however, that the step which was initially taken by the National Savings Bank in April 1980 to increase the interest rates resulted in an all round increase in the interest rates offered by Commercial Banks and other Financial Institutions which not only benefited depositors but increased the total savings deposits in all Banks during a period when the inflation rate ran to an all time high of 30%.

ACTIVITIES OF THE BANK

In order to meet the competition from Commercial Banks referred to above, the Bank had to review its savings facilities, stream-line and simplify its withdrawal and deposit procedures, and adopt its savings schemes to suit the various segments of the Savings Market. Personal letters were also addressed by the Chairman to all our depositors, a measure which appears to have been greatly appreciated judging from the replies received. Despite these new steps, the nett savings mobilised by the Bank during 1980 was only Rs. 464.5 million, compared to the record 1979 figure of Rs. 991.4 million.

IMPROVEMENTS TO EXISTING SAVINGS INSTRUMENTS

(a) Fixed Deposits

As already stated above, the interest rates of 15% per annum and 12% per annum on 12 months and 6 months deposits were raised to 20% per annum and 15% per annum respectively with effect from 21st April 1980 and the 18 months deposits scheme was simultaneously abandoned. This resulted in the nett savings mobilised through this instrument falling from Rs. 936.7 million in 1979 to Rs. 665.0 million in 1980.

(b) Ordinary Savings (Pass Books)

At the same time the interest rates on Pass Book Savings was increased from 8.4% per annum to 12% per annum. Despite this measure, due partly to the increasing cost of living and partly to the more attractive fixed deposit terms, the new deposits at Branches and Post Offices were Rs. 888.3 million and Rs. 269.5 million respectively against withdrawals of Rs. 916.5 million and Rs. 327.6 million.

1157.8

1244.1

(c) Premium Savings Bonds

The total sales of Premium Savings Bonds during the year was 231,033 compared to 476,299 sold during the eleven months of 1979 after the inauguration of this new Savings Instrument in February 1979, despite the fact that the number of consolation prizes was increased from 10 to 20 in April 1980, and from 20 to 30 in September 1980, and 'B' Grade Sub Post Offices were allowed to act as sales outlets for Premium Savings Bonds in March 1980. It is gratifying to note however, that although most of the Bonds sold in 1979 became eligible for encashment in 1980, only about 8% were encashed which indicates that the prospect of winning a prize at the monthly draw continued to be an attractive incentive to small depositors.

The decline in the average monthly sales of bonds is attributable to the fact that due to the increasing cost of living, small depositors to whom this instrument mostly appeals, found it difficult to buy additional bonds and large depositors preferred to invest their savings in instruments such as Fixed Deposits which bring them an annual income on their investments.

(*d*) Regular Monthly Income Savings Plan

In order to popularise this scheme among regular seasonal income earners, the rate of interest was increased from 9.6% per annum to 13.2% per annum, thereby curtailing the period at the end of which regular monthly income commences to 67 months instead of 87 months as before.

This step resulted in more depositors joining this scheme and a sum of Rs. 2.6 million was deposited from 2335 accounts.

(*e*) Special Savings Project for the Plantation Sector

During the year of 1980, 17 more estates were brought into the scheme increasing the total number of estates to 33, and the total number of accounts from 6111 to 12,241 which represents 52% of the total work force in the 33 estates where the Special Savings Scheme is being operated. The total contribution increased from Rs. 231,285 to Rs. 410,104 during this year and the annual average contribution per account increased from Rs. 38/- to Rs. 52/-.

ADDITIONAL MEASURES TAKEN TO MOBILISE SAVINGS

(*a*) Authorised Savings Canvassers

In order to mobilise the untapped potential in the rural Agricultural Sector, the Bank decided to introduce a new scheme in 1981 with the approval of the Hon. Minister of Finance and Planning, whereby Authorised Savings Canvassers are to be appointed in each Electorate to canvass and mobilise savings utilising the various savings instruments through the existing savings outlets of the Bank for the payment of commission.

(*b*) Mobile Banking Units

It was also decided to mobilise savings in this sector through Mobile Banking Units, particularly during harvest time in areas which are inadequately covered by our Branches. Under this proposal a Propaganda Van would be sent to a selected area in advance so that the residents are made aware that the Mobile Bank will operate at a particular centre on a date specified. On the announced date the Mobile Bank would go to the centre and commence operations by accepting deposits from the people who call over in response. These deposits would thereafter be lodged in the same day at the nearest Branch. In the first instance it was decided to launch this scheme as a Pilot project and although the preliminary work started in the latter part of 1980, the implementation of the pilot project commenced in the early part of 1981.

MEASURES TAKEN TO FACILITATE SAVINGS TRANSACTIONS

Postal Agency Network

With effect from 20th July 1979 the warrant withdrawal facility was increased from Rs. 10,000/- to Rs. 20,000/-. From 1st January 1980, on-demand withdrawal was increased from Rs. 50/- to Rs. 100/-, at all Grade A and Grade B Sub Post Offices in the agency network of the Bank. The warrant withdrawal facility at Grade A Sub Post Offices was increased from Rs. 400/- to Rs. 500/- and Grade B Sub Post Offices from Rs. 300/- to Rs. 400/-.

In addition sales of Premium Savings Bonds was extended to all Grade B Sub Post Offices with effect from October 1980.

SERVICE OUTLETS

Six new Branches were opened during the course of the year bringing the total number of Branches to 42. The new Branches are Gampaha, Avissawella, Embilipitiya, Nikaweratiya, Mahiyangana and Warakapola. The Board also approved the opening of 8 more Branches namely Moneragala, Panadura, Matugama, Beliatta, Welimada, Bandarawela, Hatton and Nawalapitiya in the coming year.

During the year, the Bank's agency network of Post Offices and Sub Post Offices was increased by 40 Post Offices and 131 Sub Post Offices bringing the total to 404 Post Offices and 2937 Sub Post Offices.

SAVINGS PROMOTION AND PUBLICITY

The Savings Promotion and Publicity Division of the Bank was enlarged under a permanent Chief Savings Promotion Officer with wider experience in publicity, and further steps were taken to intensify the regular press advertisements, radio programmes and spots, cinema slides and posters.

During the latter part of 1980 the radio programmes were reviewed and it was decided to continue the Tamil programme since it was popular with listeners.

The English programme 'Cash in with Music' was however, replaced by a programme with some dramatic interest and accordingly a new series of drama programme entitled 'Scotland Yard Confidential' will commence in January 1981.

In the case of Sinhala 'Savan Mihira' it was felt that as there were many similar musical programmes being broadcast in Channel 2 of the Sinhala services, greater interest would be covered by listeners through a quiz programme and an Islandwide Inter-school 'Do You Know' quiz programme was planned for commencement in 1981.

The new publicity medium of Television recently introduced into Sri Lanka was also used to televise a series of slides showing the new interest rates.

PERFORMANCE OF THE BANK

As stated earlier the total nett savings mobilised by the Bank declined and amounted to only Rs. 464.5 million as compared with Rs. 991.4 million mobilised during the year 1979.

The reasons for the decrease of the mobilisation of savings in 1980 as compared to 1979 can be attributed to the following causes beyond the control of the Bank:—

(*a*) Whilst the National Savings Bank was directed on 21st April 1980 by the Ministry of Finance and Planning to abandon the 18 months Fixed Deposits Scheme and to accept new deposits for only 12 months at 20% interest per annum, due to the tightness in the money market (caused by the Central Bank credit restrictions) Commercial Banks began to offer 22% interest per annum for deposits of 24 months and large numbers of our depositors naturally diverted their deposits to Commercial Banks. It was only after repeated representations had been made that this Bank was authorised to accept new deposits for 24 months at 22% interest per annum in April 1981.

(*b*) The National Savings Bank was also debarred by the Ministry of Finance and Planning from accepting new deposits from Institutions from 26th October 1978 till 1st December 1980 with the result that such institutions had to place their new deposits with Commercial Banks, and later transferred their existing deposits with us to these Banks when they offered the higher rate of interest mentioned at (*a*) above.

(*c*) This Bank could not offer facilities such as loans and overdrafts on Fixed Deposits which Commercial Banks (including the new Foreign Banks) offer. The tax concession which our depositors enjoy is no longer compensatory in the case of the middle income group due to the new tax system which exempts public servants' salaries and permits separate assessments with liberal allowances for husband and wife.

DEPOSITS DURING THE YEAR

The Deposits during the year totalled Rs. 3,650.58 million made up as follows:—

(A) Branch Network

(1) New Fixed Deposits

(*a*) Interest at 12%, 15% and 18% payable at maturity	... ...	Rs. 363.13 M
(*b*) Interest at 14.4% payable monthly	... ...	Rs. 2.72 M
(*c*) Interest at 16.8% payable monthly	... ...	Rs. 119.07 M
(*d*) Interest at 15% payable at maturity	... ...	Rs. 17.34 M
(*e*) Interest at 20% payable at maturity	... ...	Rs. 1,386.86 M
(*f*) Interest at 18.6% payable monthly	... ...	Rs. 373.87 M
(2) Old Fixed Deposits (Interest at 7.5% & 8%)	... ...	Nil
(3) Ordinary Savings (Interest at 12%)	... ...	Rs. 888.33 M
(4) Regular Monthly Income Savings Plan	... ...	Rs. 2.99 M

(B) Postal Network

(1) Ordinary Savings (Interest at 12%)	... ...	Rs. 269.52 M
(2) Fixed Deposit Certificates (Interest at 12%, 15%, 18%, & 20%)	...	Rs. 224.00 M
(C) Premium Savings Bonds	... ...	Rs. 2.46 M
(D) Savings Certificates (Compound Interest at 7.7%)	... ...	Nil
(E) Gift Tokens	... ...	Rs. 0.29 M
Total Deposits	... ...	Rs. 3,650.58 M

WITHDRAWALS DURING THE YEAR

The withdrawals during the year totalled Rs. 3,186.12 million, made up as follows:—

(A) Branch Network

(1) New Fixed Deposits

(*a*) Interest at 12%, 15% & 18% payable at maturity	... ...	Rs. 1,142.59 M
(*b*) Interest at 14.4% payable monthly	... ...	Rs. 14.81 M
(*c*) Interest at 16.8% payable monthly	... ...	Rs. 434.00 M
(*d*) Interest at 15% payable at maturity	... ...	Rs. 5.82 M
(*e*) Interest at 20% payable at maturity	... ...	Rs. 102.08 M
(*f*) Interest at 18.6% payable monthly	... ...	Rs. 28.28 M
(2) Old Fixed Deposits (Interest at 7.5% and 8%)	... ...	Rs. 3.34 M
(3) Ordinary Savings (Interest at 12%)	... ...	Rs. 916.49 M
(4) Regular Monthly Income Savings Plan	... ...	Rs. 0.39 M

(B) Postal Network

(1) Ordinary Savings (Interest at 12%)	... ...	Rs. 327.60 M
(2) Fixed Deposit Certificates (Interest at 12%, 15%, 18% & 20%)	...	Rs. 191.09 M
(C) Premium Savings Bonds	... ...	Rs. 0.39 M
(D) Savings Certificates (Compound Interest at 7.7%)	... ...	Rs. 19.11 M
(E) Gift Tokens	... ...	Rs. 0.13 M
Total Withdrawals	...	Rs. 3,186.12 M

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NETT SAVINGS

The Nett Savings during the Period amounted to Rs. 464.46 million arrived at as follows:—

	Total Deposits	Rs. 3,650.58 M
Less:	Total Withdrawals	Rs. 3,186.12 M
	Nett Deposits ...	Rs. 464.46 M

The decrease in nett savings in the year of 1980 compared to the previous year is attributed to the competition caused by the equalisation of interest rate with the Commercial Banks which provided short term credit facilities to the depositors. Restrictions on the institutional deposits and long term time deposits facilities to the depositors too contributed to this decline. Further, withdrawals exceeded deposits in Pass Book Accounts in Post Offices and Branches which is attributed to the rapid rise in the cost of living during 1980, and there had a drop in sales of Premium Savings Bonds.

The breakdown of the total figure of Rs. 464.46 million was as follows:—

Savings Instrument	*Nett Savings Mobilised*	*Percentage of Total*
1. Ordinary Savings	Rs. − 86.22 M	− 18.6%
2. Fixed Deposits & Fixed Deposit Certificates (Interest payable at maturity)	Rs. 546.41 M	117.6%
3. Fixed Deposits (Interest payable monthly)	Rs. 18.57 M	4.0%
4. Premium Savings Bonds	Rs. 2.06 M	0.4%
5. Regular Monthly Income Savings Plan	Rs. 2.60 M	0.6%
6. Savings Certificates & Gift Tokens	Rs. − 18.96 M	− 4.0%

The average monthly net collections for the first four months prior to the introduction of the new interest rates was Rs. 67.8 million as against the monthly collections of Rs. 24.1 million for the period May to December 1980.

It may be noted that Rs. 506.5 million was collected by the Bank's Branch Sector. Area wise analysis reveals that Rs. 342.6 million was mobilised by the 14 Branches in the Municipal Council areas averaging Rs. 24.5 million per Branch, Rs. 129.7 million by 13 Branches in the Urban Council Areas averaging Rs. 10.0 million per Branch and Rs. 34.2 million by 15 Branches in the Town Council and Village Council Areas averaging Rs. 2.3 million per Branch.

During the year 403,113 new accounts were opened and 141,931 accounts were closed. As at 31st December 1980, number of accounts remained open with the Bank were 7,113,551 with gross deposits amounting to Rs. 5201.1 million.

The total holdings of the National Savings Bank and in the Commercial Banks in the Island amounted to Rs. 17,236.0 million and the National Savings Bank holdings amounted for 30.2% of the total holdings.

INVESTMENTS

The Investments made by the Bank during the year included :-

Rs. 621,500,000	in 10% Sri Lanka Government Securities
Rs. 296,615,100	in 16% Sri Lanka Government Securities
Rs. 10,500,000	in 23.75% Call loans to Commercial Banks
Rs 928,615,100	

It will be seen that the investments in Sri Lanka Government Loans constituted 98.9% of the total investments made by the Bank during the year under review. Although it is a requirement of the constituent legislation of the Bank that investments in Government and Government guaranteed Securities shall constitute not less than 60% of the total deposits with the Bank, the nominal value of the investments in Sri Lanka Government Securities as at 31st December, 1980 was Rs. 4,847,054,600/- representing 93.2% of the Bank's total deposits.

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HOUSING LOANS

The only other investment made by the Bank is in the form of Housing Loans. The purpose of this scheme is to assist the low and middle income groups to divert a part of their earnings from consumption expenditure to capital investment. Housing Loans for the construction of houses are given by the Bank at low rates of interest, the loan plus interest being repayable in monthly instalments over a period of 20 years.

In view of the rising property and building costs in 1980, the loan limit for the purchase of construction of one unit house was increased from Rs. 120,000.00 to Rs. 150,000.00, of 2 unit house from Rs. 200,000.00 to Rs. 250,000.00.

During the year, the Bank granted sums amounting to Rs. 0.68 million at 12 - 13% interest to 39 persons for the purchase of building sites, Rs. 6.9 million at 12 - 15% interest to 531 persons for the construction of houses and Rs. 1.9 million at 12 - 15% interest to 49 persons for the purchase of house and property.

As at the end of the year Rs. 70.6 million was outstanding by way of housing loans.

PROFITS

The nett profit before taxation amounted to Rs. 47.3 million as compared with Rs. 36.4 million for the previous year, registering an increase of Rs. 10.9 million. The amount set apart for taxation was Rs. 27.3 million as against Rs. 20.0 million in 1979.

In computing the profits, account had been taken of the subsidy of Rs. 300.0 million granted by the Government to compensate the difference between the high rates of interest paid by the Bank on its Fixed Deposits and the low return the Bank received on these deposits when they are invested in Government loans. The Bank makes no profit on these transactions.

MANAGEMENT

BOARD OF DIRECTORS

During the year the Directorate of the Bank comprised Mr. A. O. Wirasinghe (*Chairman*), Mr. A. R. M. Jayawardena (*Post Master General*), Mr. D. K. Samarasinghe (*Deputy Director, Treasury*) is representing Deputy Secretary to the Treasury, Mr. W. S. Nanayakkara representing the Ministry of Planning, Mr. A. M. M. Sahabdeen and Mr. V. C. Wilathgama (*Worker Director*).

Mr. V. C. Wilathgama resigned with effect from 15th May, 1980 and Mr. J. A. S. Warnakulasooriya was appointed as Worker Director to the Board on 9th July, 1980. Mr. W. S. Nanayakkara resigned with effect from 30th July, 1980.

On Mr. A.R.M. Jayawardena's appointment as Secretary to the Ministry of Post and Telecommunication Mr. A. P. Hapudeniya assumed duties as Post Master General and was appointed to the Board by the Minister of Finance and Planning on 1st May, 1980.

The Board wishes to place on record its appreciation of services rendered by Mr. A. R. M. Jayawardena (*Secretary to the Ministry of Post and Telecommunication*), Mr. W. S. Nanayakkara (*Deputy Director, Ministry of Planning*), Mr. V. C. Wilathgama (*Former Worker Director*) during their period of office.

15 Meetings of the Directors were held including one sub-committee meeting and two special Board Meetings during the year.

STAFF

Mr. T. V. A. Chanmugam who was the General Manager since 10th December 1979, on secondment from the Bank of Ceylon resigned to accept an appointment in a Foreign Commercial Bank on 30th June, 1980 and Mr. D. S. Samuel who was the Deputy General Manager (*Finance*) and Chief Accountant acted as General Manager in addition to his other duties from 1st July, 1980 to 12th December, 1980 when he resigned to accept an appointment in the private sector.

Superannuation Scheme

The approval was granted for a new Superannuation Scheme by the Ministry of Finance and Planning on the request of Board of Directors of the Bank and came into operation with effect from 1st April, 1972. Trustees of the Employees Provident Fund and Pension Fund were appointed by the Board of Directors. Steps are now being taken to enroll the employees as members of the Superannuation Scheme and appoint and elect the Board of Managers in accordance with the Bank's Provident Fund rules.

Welfare Facilities

Welfare facilities which the Bank's staff enjoyed during the year included Distress Loans up to a maximum of 3 months gross salary, Vehicle Loans up to a maximum of Rs. 15,000/-, subsidised Canteen Facilities and an Annual Grant of Rs. 7,500/- to the Recreation Club. Confirmed employees of the Bank were also eligible to the facility of obtaining special Housing Loans up to a maximum of Rs. 90,000/- at the concessionary interest rate of 6% per annum and during the year under review, Housing Loans amounting to Rs. 3,253,929/- were granted to 86 employees of the Bank.

INTERNATIONAL CONFERENCES

The Chairman was invited by and at the expense of the United Nations Organisation to attend an International Symposium on the **"Mobilisation of Personal Savings in Developing Countries"**, held in Kingston, Jamaica in February 1980 and read a paper on **"The Behaviour of Savers and its Policy Implications"**. He was also elected to serve on the Committee which drafted the Report of the Symposium.

ADMINISTRATIVE IMPROVEMENTS

(*a*) **Improved Discipline and Customer Service**

The Bank wishes to place on record that due to stern disciplinary action against offenders, it was able to provide a better customer service at the end of the year under review, despite Trade Unions action in the months of April and May 1980 over the Salary revision dispute.

(*b*) **Training Division**

Training courses for Bank employees were improved as a result of the Training Division being moved into the Head Office Building.

(*c*) **Punch Card Operation**

Consequent to the computerisation of the depositors accounts in the Units which began in 1976, the punch card operations were carried out at the Central Bank. From 1980 the Bank hired eight Punch Card operative machines, to commence punch card operations in the Bank itself. The Bank has started a separate Data Entry Section with fully trained Punch Card Operators.

(*d*) **Security Service**

Consequent to a Cabinet decision that State Banks should not depend on reserve police personnel for security, a Security Division of the Bank was established in August 1980. The Security Division functions under a retired Senior Police Officer as Security Manager and has a staff of 174.

CONCLUSION

In conclusion the Bank wishes to express its thanks to the Post Master General and the officials of his Department, the officials of the Ministry of Finance and Planning, and the loyal and conscientious employees of the Bank for the satisfactory customer service extended to its depositors during the year.

On behalf of the Board,

Chairman.

21st August, 1981.

National Savings Bank

Profit & Loss Account for the year ended 31-12-1980

31.12.1979 Rs.		Rs.	Rs.
36,376,101	Nett Profit for the year before charging Income Tax		47,346,534
	AFTER CHARGING		
439,756,044	Interest paid and payable on depositors' accounts ...	630,813,270	
35,870,727	Administration, Establishment and Savings Promotion Expenses	48,279,483	
1,253,782	Depreciation	1,438,523	
3,900	Directors' fees and other emoluments	4,200	
124,534	Audit fees	175,607	
477,008,987		680,711,083	
	Deduct:		
19,962,748	Income Tax for the year		29,979,150
16,413,353			17,367,384
	Add		
2,002,690	Adjustments in respect of prior years		6,705,360
18,416,043	Nett Profit after charging Income Tax available for appropriation		24,072,744
	ALLOCATED AS FOLLOWS		
9,000,000	Contribution to Consolidated Fund		10,000,000
9,400,000	Transfer to Reserve		14,000,000
16,043	Balance transferable to General Reserve		72,744

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National

Balance Sheet

31.12.1979	LIABILITIES	31.12.1980
Rs.		Rs.
	CURRENT	
4,508,294,470	Depositors	5,201,104,433
19,886,804	Sundry Creditors	18,445,625
18,112,070	Provision for Income Tax	23,700,473
8,584,298	Staff Superannuation Fund	12,593,472
—	Post Master General's Current Account	1,653,141
4,554,877,642		5,257,502,144
	RESERVES	
20,800,000	General Reserve	34,872,744
7,665,000	Interest Equalisation Reserve	7,665,000
1,000,000	Low Income bearing Securities Reserve	1,000,000
2,500,000	Capital Expenditure Reserve	2,500,000
25,000,000	Capital Reserve	25,000,000
56,965,000		71,037,744
4,611,842,642		5,328,539,886

(Sgd) **A. O. WIRASINGHE**
Chairman

(Sgd) **A. NAVARATNAM**
General Manager

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TABLE SHOWING CHANGES AND TRENDS

Year ended 31st December	1972 (1st year)	1979	1980
Total balance inclusive of interest standing to the credit of all open accounts as at the end of the year ... ... Rs.	1,047,615,459	4,508,294,470	5,201,104,43
No. of accounts opened during the year	Apr.-Dec. 212,199	398,877	403,1
No. of accounts closed during the year	Apr.-Dec. 10,422	101,494	141,93
No. of accounts remaining open as at the end of the year	5,118,687	6,852,369	7,113,55
Average balance standing to the credit of an account as at the end of the year Rs.	205	658	73
Excess of deposits over withdrawals during the year ... ...Rs.	Apr.-Dec. 41,104,419	991,388,299	464,459,10
Total value of investments in Sri Lanka Govt. Securities as at the end of the year Rs.	987,882,800	3,942,259,600	4,847,054,60
Investments in Sri Lanka Govt. Securities as a percentage of depositors' balances as at the end of the year	94.8%	87.4%	93.2
Gross Income for the year ...Rs.	64,288,667	513,385,088	728,057,61
Total interest liability on depositors' balances for the year ... ...Rs.	47,482,872	439,756,044	630,813,27
Interest paid and payable to depositors as a percentage of gross income for the year	73.8%	85.7%	86.6
Cost Management during the year ...Rs.	7,715,050	37,252,943	46,849,45
Profit before taxation for the year ...Rs.	9,355,091	36,376,101	47,346,53
Income Tax for the year ... ...Rs.	5,502,464	19,962,748	29,979,15
Service Outlets in operation as at the end of the year			
(a) National Savings Bank Branches	3	36	4
(b) Post Offices	319	364	40
(c) Sub Post Offices	2,428	2,806	2,93

340 employees were recruited to the Bank's service during the year. The total strength in all grades of the Bank's service as at the end of the year was 2187.

STAFF TRAINING

Training for the National Savings Bank Staff

The Bank's Training School conducted a variety of training programmes for Bank personnel during the year. These included, Induction courses for Grade VI new recruits, Job Orientation Seminars for Savings Promotion Officers, Seminars on Courtesy and Public Relation for Grade VI employees, and Job Training for Grade IV promotees and new recruits.

Sri Lanka — Bangladesh Joint Workshop

The International Savings Bank Institute of Geneva has under their programme of Technical Co-operation between developing countries, sponsored a project in the field of savings mobilisation between our Bank and the National Savings Directorate of Bangladesh. This followed from the Chairman's participation in the International Symposium on mobilisation of savings in developing countries in Jamaica and his visit to the International Savings Bank Institute of Geneva in February 1980.

The objective of the project was to exchange for mutual benefit the experiences of the two countries with a view to identifying and adopting areas which would benefit each other from each other's system. The project consisted of two stages, one an information visit by an official of our Bank to Bangladesh and the other a joint workshop in this country between our Savings Bank officials and officials of Bangladesh.

Stage one of the project namely the information visit was completed in August 1980 when an official of our Bank made a ten days visit to Bangladesh and submitted his report on his return. This report formed the basis of the Workshop programme.

Stage two of the project was the Joint Workshop planned for December 1980 but due to problems of accommodation it was held at the Sri Lanka Foundation Institute from 12th to 16th January, 1981. The Workshop was inaugurated by the Hon. Minister of Finance and Planning and was attended by ten officials from our Bank and ten officials from Bangladesh. The Workshop programme included lectures on savings systems of the two countries, group discussions and preparation of workshop report. The report was finalised and printed and sent to International Savings Organisations including I.S.B.I. and also distributed among the participants at the Workshop and the senior officials of the National Savings Bank. The I.S.B.I. has expressed satisfaction that the printed report is up to international Standards.

The entire expenditure for the two stages of the project was met by the International Savings Bank Institute from their Development Aid Committee fund.

STAFF BENEFITS

Salary Revision

Following representations made by the Trade Unions of the Bank requesting an equation of the salary scale of this Bank consequent to the salary revision made by the Bank of Ceylon and People's Bank, in March 1980, on the instruction of the Hon. Minister of Finance and Planning a Committee comprising senior officials of the Bank and a representative of the Ministry of Finance and Planning was appointed to examine the existing salary structure in the Bank in relation to the salary structure of other state institutions. The recommendations of this Committee were thereafter considered by the Board of Directors and the final recommendations made by the Board were approved by the Hon. Minister and the new salary scales and allowances became effective retrospectively from 1st October, 1979. The salary scales and allowances of all employees other than Executives were raised to the same levels as in the State Commercial Banks. The revised salary scales of Executives are much higher than before but lower than those of comparable grades in the State Commercial Banks, since their responsibilities are less than those of their counterparts in these Banks. The effect of these increased emoluments is that the wages bill of the Bank has risen from Rs. 16.3 million to Rs. 26.3 million per annum.

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This article, obviously written by the NSB, was apparently written in response to some criticism in Parliament.

1981-12-01

Friday, November 27, 1981.

No Treasury subsidy for NSB

SPECIAL CORRESPONDENT

There appears to be a misconception in the minds of certain sections of the public on the role of the National Savings Bank in the economy, and the so-called "Treasury subsidy" which this Bank gets.

The NSB is not a Commercial Bank and was not established to function as a Commercial Bank. It was conceived by the then Finance Minister U. B. Wanninayake in 1968, and established in 1971, to centralise the various savings organisations which had existed for more than one hundred years, into one statutory body to maximise savings.

After the present government took office in 1977, this bank has been able to provide not only new savings instruments but various incentives which have resulted in a tremendous increase in the nett savings mobilised by the bank.

The NSB does not exist to make profits but to divert part of personal incomes from consumption to savings and to use these savings deposits for national development.

Although Section 59 (2) of the National Savings Bank Act No. 30 of 1971 lays down that investment in securities, stock debentures or treasury bills of, or guaranteed by the government should constitute not less than 60 per cent of the monies lying in the deposit and in savings accounts with the bank, the actual investments of the National Savings Bank in Government Securities in 1980 as stated on page 49 of our Annual Report for 1980 which has already been tabled in Parliament) was in fact 88.9 per cent of the total investments made by the Bank in 1980.

The balance was invested in long-term housing loans to the middle and low income groups at relatively low rates of interest to encourage them to divert part of their incomes from consumption into capital investment in homes.

Savings

At the United Nations Symposium on the Mobilisation of Savings in Developing Countries held in 1980, at the start of the Third UN Development Decade, it was emphasised that since personal savings was the principal source of capital development in developing countries, every effort should be made to increase the mobilisations of personal savings by offering attractive incentives.

One of these was an increased rate of interest to give a real return to depositors in the present world inflationary situation. To meet this objective, the NSB which had already increased our fixed deposit interest rates to 13 per cent per annum on 18 months deposits and 15 per cent per annum on 12 months' deposits in September 1977, increased it further to 20 per cent per annum on 12 months' deposits in April 1980 on a directive of the Minister of Finance and Planning.

The commercial banks which were paying annual interest on fixed deposits at 7 per cent per annum before September 1977 and 15 per cent per annum before April 1980 were compelled to follow suit. It is this single measure which has led to the tremendous increase in savings mobilised both by the NSB and by commercial banks since September 1977.

Commercial banks lend their savings to the private business sector either in the form of overdrafts or short-term loans at very much higher rates of interest and thereby make very large profits. The NSB lends all its money to the Government on long-term loans for national development projects at rates of interest varying from 12 per cent per annum for Treasury Bills to 16 per cent per annum for government loans.

Since the interest paid to depositors on most of their money is higher, the government naturally has to reimburse the Bank to the extent of the difference.

This is the so-called "Treasury Subsidy" to the NSB. The word "subsidy" is a misnomer. We can, like comercial banks, quite easily lend this money to the private sector on long-term investments at interest rates ranging at present, from 24 percent per annum and above.

If we did this, we would need a subsidy, and can make larger profits than at present. We would, however, be unable to contribute to the same extent — as now — to the government's plan for nation[al] development.

Despite the limitations on our investmen[ts] we are glad to sta[te] that the NSB has be[en] able to make a pro[fit] before taxation of [Rs.] 47 million in 1980. T[he] profit for 1981 befo[re] taxation is anticipat[ed] to be about Rs. [illegible] million.

The National Savi[ngs] Bank has not o[nly] proved its viability, b[ut] has been able to ass[ist] the government to [fight] inflation and to fi[nd] funds for the lo[cal] financing of its devel[op]ment plan to increa[se] production and [give] employment to the g[ro]wing population of [Sri] Lanka.

Annex 17

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NSB profits were govt subsidies

IS the National Savings Bank robbing Peter to pay Paul?

This question is being asked by bank insiders who say that the impressive figures declared by the bank in its annual report does not reveal its true financial position.

Informed sources point out that although the annual accounts of the NSB show that the bank had invested Rs. 928 million in Sri Lanka Government loans and steps that it had contributed to national development, an in-depth analysis of the accounts indicate that the bank received as much as Rs. 723 million from government sources—Treasury subsidies and interest from existing government investments. Thus in reality the figure contributed is not Rs. 928 million but Rs. 205 million.

Sources also point out that the nett profit declared by the NSB in its annual report for the year ending 1980 (the latest annual report of the bank) does not disclose that there has been an interest subsidy of almost 300 million rupees received from the Treasury.

In real terms, this would amount to a loss of Rs. 247 million. This year, the NSB has proposed that it needs a subsidy of Rs. 405 million.

Former Finance Minister and the Member for Kaduwela, Mr. M. D. H. Jayawardana said in the budget debate that he does not approve of the Rs. 405 million that was being asked as a subsidy for the NSB this year. Mr. Jayawardana's advice was that the Government should close down the NSB if it could not generate enough money to pay interest on its deposits. Sources within the NSB point out that although the bank's account show an increase of Rs. 693 million in depositors balances during 1980 it does not explain that the increase is mainly due to interest of Rs. 630 million credited to accounts at the end of the year.

Thus the nett increase exclusive of interest is a mere Rs. 63 million which is a figure difficult to reconcile with the statement in the report that the nett savings during the year amounted to Rs. 464 million rupees.

Another question that is being asked is whether the government

Continued on Page 3

NSB profits. . . . .

Continued from Page 1

by subsidising the NSB is in reality subsidising the rich. The argument is that although the affluent numbered by income groups in respect of the numbers of accounts held have a large slice of the amount of money deposited in the NSB.

There is also another invisible subsidy in that the constituents also enjoy income tax relief of one third the interest.

Although the chairman's report for 1980 makes out that competition from commercial banks which offer loans and overdrafts is responsible for decrease in savings mobilisaton, sources point out that the NSB enjoys the following advantages over commercial banks: A massive Treasury subsidy of Rs. 405 million (for 1981)

* Invisible subsidy from the government in that its constituents enjoy an income tax relief of one third the interest earned or Rs. 2000 which ever is higher. Thus the effective interest rate it pa tax payers is 3 to 4 percent than that of Commercial Ban has the widest network branches and sales outlets branches 404 Post offices 2,937 sub post offices sp throughout the country.

NATIONAL SAVINGS BANK BRANCH NETWORK AND ITS OPERATION

By Mr. D. U. WIJERATNE, (A.I.B., B.T.I.)
Chief Inspector of Branches,
National Savings Bank, Sri Lanka.

The National Savings Bank was established on 16th March 1972 by amalgamating four institutions namely:—

1. The Post Office Savings Bank
2. Ceylon Savings Bank
3. Savings Certificate Section of the Postal Department
4. National Savings Department (or Movement)

Of these the largest institution was the Post Office Savings Bank which at the time had its service outlets through 316 Post Offices and 2,363 Sub Post Offices and was controlled by the six units at Head Office.

The second largest institution, Ceylon Savings Bank accepted deposits at their main office at Colombo, Fort and at Kachcheries (or the present G.A.'s office). This office at Fort later became the Fort Branch of the National Savings Bank. On the same day the National Savings Bank was established, the Kollupitiya Branch also was opened. With the commencement of business at these two branches the Bank set itself up to the task of doing its banking activities through a network of its own branches and in the same year took the first steps in opening branches in the outstations. Galle Branch which was the first outstation branch and of which I had the good fortune of being the first Manager was opened in December, 1972.

During 1973, three more branches were opened. During the 5 year period 1972 to 1977 July, 23 branches were opened. From July, 1977 to the end of 1980 another 19 branches were opened bringing the total number of branches to 42. The branches though small in number, compared to Post Offices and Sub Post Offices, has played a dynamic role in attracting deposits to the Bank.

This could be shown by the following Table.

Nett increase in deposits (Rupees in million)

Year	*Deposits in Post Offices*	*Deposits in Branches*
1972	— 6 (nett decrease)	48
1973	6	104
1974	1	192
1975	—14 (nett decrease)	171
1976	41	190
1977	64	347
1978	112	316
1979	116	891

When the amount in deposits in branches is compared with the amount in deposits in Post Office network one could see that the branch sector has gradually but steadily increased the depositors balances and overtaken the depositors balances of the Postal sector by 1976 and had continued its upward trend in such a steady rate, that by 1979 the depositors balance of the branch sector was more than double that of the Postal sector.

The following Table will show the progress made by the two sectors where depositors balances are concerned.

Depositors balances (Rupees in million) (including Interest)

Year	*Postal Sector*	*Branch Sector*
1972	690	277
1973	744	402
1974	797	618
1975	836	827
1976	933	1061
1977	1060	1485
1978	1279	1996
1979	1452	2964

This figure would show that on the whole the deposits have continuously increased both in the Postal Sector and in the Branch Sector. The reason for such an increase could be:—

1. The increase of interest rate on Savings deposits from 3.6% to 7.2% and the increase of interest rate on fixed deposits from 4.5% to 7.5%. Whilst the interest rate of savings and fixed deposits in the Commercial Banks went up to about 5% to 6%, the increasing of deposits got a further booster with the raising of interest rates to 8.4% in Savings and 18% in Fixed Deposits almost as soon as the present Government came into power.

2. The liberal tax concession of Rs. 1,000/- per individual going up to Rs. 6,000/- per family of six persons which was later increased to Rs. 2,000/- per individual or 1/3rd of income whichever is higher, could be another reason for this general increase in deposits.

But why was the increase in deposits in the Branch Sector so phenomenal when compared to the increase in deposits in the Postal Sector? The reasons could be many and they could be stated as follows:—

(a) Though the Post Offices and the Sub Post Offices were large in number and scattered throughout the length and breadth of the country, the types of services which had no direct connections with banking activities rendered by these Post Offices were also wide and varied. The Post Offices were involved in the sale of stamps, registration of letters, Parcel posts, issuing of money orders and Postal orders, sending of telegrams, renewal of radio licences, issuing Postal identity cards etc. Most of the time of the officers working in the Post Offices was taken by these functions and they played a very passive role on what may be called an ancillary function of acceptance of deposits on Savings or Pass Book Accounts. On the other hand the branches were opened for the main purpose of servicing of depositors and the Branch Manager and his officers devote their full time to the interest of their depositors. Since there is a constant dealing with the depositors, the Bank Officers come to know their depositors on a much friendlier and personal level than the officers working in Post Offices. The attitude of the Branch staff to the customers coupled with the persistent drive of the Branch Manager and the Savings Promotion Officers even outside their offices by meeting the prospective depositors and canvassing their deposits and also the various steps taken by the Head Office such as advertisements in the Press and in the Radio would be very important reasons for the increased activities of the Branch sector.

(b) Another important reason is the time factor. The Postal network was controlled by Head Office through the six units under the overall supervision of the Unit Controller's Division. This means that though the Postmasters acted as receiving and paying agents, the actual accounting was done at Head Office. This arrangement of course had no problem where deposits were concerned, since the depositors could make their deposits over the counter at any Post Office and get these deposits recorded in the Pass Books. Though the recording of these deposits in the Ledger Accounts at the Head Office take time the depositor is not concerned about the delay. The only problem here was the difficulty

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the depositor had in making deposits of large amounts since the Post Offices are not geared for acceptance of large amounts. But the actual problem confronted by the depositor was at the time of withdrawals. The depositor cannot make withdrawals of large amounts over the counter since there are restrictions placed on this type of withdrawals called "on demand withdrawals". On demand withdrawals ranging from Rs. 50/- to Rs. 250/- are allowed in the Postal network and if a depositor wishes to make a withdrawal of a large amount, he has to necessarily come to Head Office, sometimes travelling hundreds of miles, or he has to make an application for a withdrawal by a warrant. This procedure would usually take more than a week. Thus a person who requires money for an urgent purpose like a funeral or some urgent medical expense could not obtain his immediate need of cash from the Post Office. On the other hand in a branch the depositor is not only able to make a quick deposit, he is also able to effect a quick withdrawal without any limit on the amount he desires to withdraw. This he is able to do because the branches are independent units and maintain the accounts within the confines of its own premises. An urgent withdrawal of any amount whatever could be obtained virtually over the counter. The depositors naturally respond to this type of quick service by not only making their new deposits with the branches but also by transferring their funds from the Postal Sector to the Branch Sector.

(c) Yet another reason could be the various facilities afforded to the saver through the Branch Sector as against the Postal Sector. You would have noted that at the inception the Postal network concentrated largely on deposits on Savings Pass Books and sale of Savings Certificates. It was only from 1977 October, that the Fixed Deposit Scheme which became a great success in the Branch network could be introduced in the Post Offices and this too in a restricted manner since the depositors could only obtain fixed deposit certificates in prescribed denomination with interest payable at maturity of the deposit. On the other hand the Branch Sector saver was given a wide choice of savings instruments like the Savings Pass Book Accounts, Savings Certificates, S.A.Y.E. Accounts for those employed on a permanent basis, F.D. accounts with no restrictions on the amount of deposit and which also gave the option to the depositor of obtaining his interest either at maturity of the deposit or monthly or at any other convenient interval. The Regular Monthly Income Savings plan which is a savings cum security plan is designed to suit self employed persons to provide for their non working age and Premium Savings Bond scheme introduced to mobilise the savings of small investors by offering them chances of winning substantial cash prizes at every monthly lottery draw. Thus we could see that various savings instruments could be introduced to the Branch network with convenience since the branch sector is directly under the Management of the Bank and it is very flexible. But on the other hand the Post Offices were merely acting as our agents and as they are not geared to undertake dynamic Banking activities, most of the work that is performed in the Branches cannot be performed at the Post Offices.

For purposes of record, I might mention that by 1979 there were 355 Post Offices and 2,735 Sub Post Offices.

Having given some of the reasons which could be attributed to the increase in deposits of the Branch Sector we shall now discuss the operation of the Branch network.

The present Management is for ever conscious of the important role played by the Branch Sector and is ever so willing to open branches. But they cannot be opened in a haphazard manner. A feasibility study has to be conducted to see:—

1. the income and savings potential of the people of that area and how far a branch could be a success in this area.

2. There should be a good building at a convenient spot to house the Branch.

3. Staff trained in branch work has to be detailed to run the Branches.

A branch could be opened only after requirements such as these are fulfilled.

At present there are 42 branches of the National Savings Bank functioning in the country.

A large number of these branches are presently located in the urban areas. The Management is exploring possibilities of opening more branches in the rural sector. These branches are established and are functioning more or less on a similar footing to that of the Branches of the Commercial Banks. The Branch Managers are given wide powers but controls are exercised by Head Office through various means and by circular instructions.

Let us see in greater detail the operation of the Branch network with regard to the various types of savings instruments.

1. Savings Accounts

The most common type of account is the Savings Pass Book Account. A prospective depositor could call over at any Branch of the Bank and open an account by filling up a very simple form called the Declaration Card which gives the full name and address of the depositor and his specimen signature. If he so desires he could open a Joint Account with one or more persons. He could even open an account on behalf of his minor child below 16 years of age. Our Bank is the only Bank where minors between the age limit of 7 and 16 years could open and operate on a savings account. When an account is thus opened by filling a Declaration Card and a cash deposit voucher and the cash handed over the counter, a savings account is opened and the pass book handed over to the depositor under acknowledgement. Thereafter he is free to make any deposits to or withdrawals from his account within business hours. If he so desires, he may make a deposit through any other Branch or through a Post Office, but for reasons of security withdrawals from any other Branch is limited to Rs. 250/-. The depositor is entitled to interest at the rate of 12% per annum. The interest is calculated on a monthly basis and credited to the account at the end of the year.

2. SAYE Accounts

The Save As You Earn Account is somewhat similar to the ordinary Savings Account. The only difference is that this type of account is introduced to those who are employed on a permanent basis. These employees could authorise their employers to deduct any amount of their choice from their paysheet and send it to the Bank. The employer undertakes to deduct the money, prepare a list giving the names and contributions of each employe and send these along with the cheque. A SAYE account of an employee is credited on realization of the cheque and he is free to withdraw the monies whenever he wishes. This type of savings instrument affords an opportunity to those who are employed at various work places and who are unable to call over at the Bank, to save something from their monthly salaries.

3. Special Savings for the Estate Sector

This is a parallel scheme to the SAYE scheme and was introduced in April 1979. This scheme is operated in estates on a voluntary basis and the savings of workers are deducted on the monthly paysheet by the Superintendent and remitted to the Branch to be credited to the estate workers' accounts. In case of an emergency, an estate worker could obtain Rs. 50/- from the Estate Superintendent by surrendering a withdrawal application form.

4. Fixed Deposit Scheme

Though the Savings Account is the most common type of account due mainly to its simplicity of operation, the most popular instrument of saving is the Fixed Deposit Scheme. This scheme has become exceedingly popular specially after the present Government introduced higher rates of interest going upto as much as 18 per cent on 18 month deposits in September 1977. The rates have again been increased in April 1980 and presently stand as follows:—

20% for one year deposits,

15% for six months deposits,

12% for deposits which remain in the Bank for at least three months.

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Depositors are allowed to withdraw their deposits whenever they want but subject to an interest rate as given above. A depositor could be given the option of obtaining his interest at maturity of the deposit, or monthly or at any other periodic interval. However, the rate of interest in such cases would be 18.6 per cent and the minimum deposit Rs. 5,000/-. The interest paid periodically on this type of Fixed Deposits could be sent to the depositor direct or to his Bank account. This has become an extremely popular scheme and more than 35 per cent of the amounts in Fixed Deposits in most of the Branches is on this type of periodic interest scheme. This serves a great advantage for those who have large sums of money at their disposal but without a regular source of income like a person who retires afer a long period of service and collects his provident fund. This money could be deposited under this scheme and interest earned periodically.

5. **Regular Monthly Income Savings Plan**

The Regular Monthly Income Savings Plan, as mentioned earlier, is a saving cum social security plan and this is designed to assist self-employed persons to provide for their non-working age or for the education of their children. Under this scheme a depositor has to deposit a fixed sum either monthly, quarterly or half yearly for a period of 65 months. At the end of that period he or his nominee will receive monthly for the rest of his life a sum equivalent to the monthly deposit. As no other savings instrument gurantees such a high rate of interest as much as 13.2% per annum over such a long period of time, this is a very attractive long-term investment plan, and the records reveal that though this plan was introduced in mid 1979, it is fast becoming a popular savings instrument.

6. **Premium Savings Bonds**

The Premium Savings Bonds Scheme inaugurated by the Hon'ble Minister of Finance and Planning on 8th April, 79 is a savings instrument meant to mobilise the savings of the small investors by offering them a chance of winning one of the 32 substantial cash prizes, the first of which is Rs. 10,000/- at every monthly lottery draw.

A bond holder is not entitled to interest but as long as he holds this bond, he gets a chance of winning a prize. If he so desires, he is at liberty to encash the bond priced Rs. 10/- at par value at the expiration of 12 months. This scheme has been introduced into the Branch Sector as well as to the Postal Sector.

7. **Collection and Crediting of Cheques**

Though our Bank is not regarded as a Collecting Banker and is not given a place in the Clearing House, it is encouraging to note that a very large percentage of the deposits made at the Branches, sometimes amounting to more than 60 per cent of the total deposits, is received in the form of cheques. Cheques issued in favour of the Bank to the credit of the depositors accounts are accepted for collection. Branch Managers are allowed the discretion of accepting the cheques written in favour of the depositors. All cheques so collected are sent to the nearest Commercial Bank Branch, to be collected and credited to the Branch Account. Depositors' accounts are credited as soon as our Branches are notified about the clearing of cheques.

8. **Checks and Controls**

Earlier in my paper I mentioned that the accounting aspect of the Branch sector is localised, in the sense that the Branches act quite independently of the Head Office where the opening and closing of accounts and recording of entries in the Ledger Accounts are concerned. The balancing of cash and of various entries are the responsibility of each Branch. Cash is balanced every day. All Ledger accounts operated on a particular day are balanced as at the end of that day by a process called "THE OLD BALANCE/ NEW BALANCE PROOF SHEET". All Control Accounts and General Ledger Accounts are posted and balanced daily. In addition, the balance of each ledger account whether operated or not is reviewed once a month by a process called "THE EXTRACTION AND BALANCING OF TRIAL BALANCES". The final balance of a group of accounts is listed and balanced with the Control figure pertaining to this group. Thus, at each stage there is a self-imposed system of checking and balancing of accounts. These are internal checks and controls exercised by each Branch and is adopted to maintain strict accuracy regarding the entries made in branch accounts and to prevent any frauds taking place. The Branches are also required to send to the Branch Inspection Division

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various statements of accounts and statistics and are required to follow instructions given by the Head Office. In addition to this, the Inspection Division deploys inspection teams consisting of experienced personnel to make surprise visits to Branches and check on their working. Any minor shortcomings are corrected by the team but serious lapses are reported to the higher Management for remedial action. These are actually remote controls exercised by the Head Office to ascertain whether the Branches perform their functions smoothly and efficiently. Within these controls the Branch Manager is given fairly wide powers to run his Branch in a smooth and efficient manner and to attract more and more deposits.

In this seemingly wide subject, I feel I have made a concentrated effort to explain as best as I could the dynamic role played by our Branch network which though small in number has thrown a great challenge not only to its brother Post Offices but also to the very widespread network of Branches of the well established Commercial Banks of our country.

In conclusion I must say that the present Management of the Bank under the very able guidance of our Chairman, Mr. A. O. Wirasinghe, a dynamic personality, with a vast experience in the Public and Private Sector is making a very successful contribution towards achieving the goal of the development programme of the National Government.

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NATIONAL SAVINGS BANK'S POSTAL AGENCY NETWORK AND ITS OPERATION

By Mr. M. P. HANDUNPATHIRAJA
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I. HISTORY IN BRIEF

1.1. Prior to the establishment of the National Savings Bank in April 1972, the mobilization of the domestic savings was handled by the Post Office Savings Bank and the Ceylon Savings Certificate Branch, both of which were under the Postmaster-General and the Ceylon Savings Bank. The Post Office Savings Bank with the wide geographical coverage of postal network was able to reach the rural population without much difficulty. The Ceylon Savings Bank had no provincial branch offices but made use of the Kachcheries and Treasury Offices in provincial towns as its Agencies. The Ceylon Savings Bank did not have the facility to tap the rural population for their savings.

1.2 Those three institutions were governed by three different ordinances; The Ceylon Savings Bank Ordinance, the Post Office Savings Bank Ordinance and the Savings Certificate Ordinance all of which were repealed with the establishment of the National Savings Bank. The Post Office Savings Bank and the Savings Certificates Fund were managed by Boards of Trustees consisting of the Deputy Secretary to the Treasury, Secretary to the Ministry of Post & Telecommunication and the Postmaster-General. These two institutions functioned as two Divisions of the Post and Telecommunication Department where the Postmaster-General was the Head of that Department.

1.3 The financial structure inherited by Sri Lanka at the time of independence in 1948 was fairly sound. As years passed by with the increase in foreign debt and adverse balance of payment position, the urgent need for domestic savings mobilisation by raising the marginal propensity to save was strongly felt. Thus with a view to make the techinques of collection of savings more dynamic with better customer satisfaction and also to unify the activities of State sponsored savings organisation, the Government established the National Savings Bank by Act No. 30 of 1971 to carry on among other activities, the business carried on by the Post Office Savings Bank, Ceylon Savings Bank and the Savings Certificate Branch of the Postal Department. Thus when the National Savings Bank started its operation we had a ready made agency service — the postal service network. At that time, there were 319 post offices and 2,428 sub-post offices in the island that were performing savings bank work. The post offices and sub-post offices did not maintain the accounts of depositors. They accepted deposits and paid out withdrawals. All accounts of depositors were centralised in the Head Office in Colombo. There were nearly 4.5 million savings bank accounts with a total deposit of nearly Rs. 1,000 million at that time. Without causing any inconvenience to the holders of Post Office Savings Bank Accounts, the National Savings Bank took over the functions of the Head Office, and allowed the post offices and sub-post offices to accept deposits and pay out withdrawals in the same manner as before. Thus, even today, most of the pass book holders in rural areas have not felt any change.

1.4 To mobilise more savings, we have opened branches of the National Savings Bank annually and today we have a network of 42 branches and have a programme to open more and more branches. These branches, unlike post offices and sub-post offices, perform only functions of the Savings Bank, maintain the accounts opened at the respective branches and operate more or less independently. Thus in towns where there are branches, the public have two alternate service points *viz*: the Branch of the NSB and the post offices and sub-post offices in the area, which work independent of each other but under the control of the Head Office.

1.5 I have given a brief outline how the postal network became the Agent for National Savings Bank. Today with the growth of post offices and sub-post offices, we have a network which stretches to even the remotest part of the country-side. There are nearly 2,400 servicing points at present and consequently the service is easily utilized by the public at large. The growth of post office network from 1972 is as follows:

	1972	*1973*	*1974*	*1975*	*1976*	*1977*	*1978*	*1979*	*1980*
Post Offices	319	321	323	323	324	332	345	364	400
Sub-Post Offices	2428	2468	2473	2474	2528	2580	2654	2806	2960

2. OPERATION OF THE SAVINGS SCHEMES THROUGH POST OFFICES

2.1 The Bank has a number of Savings Schemes such as the Ordinary Savings Scheme, Savings Certificate Scheme, Gift Tokens Scheme, Fixed Deposit Scheme, Regular Monthly Income Savings Plan and Premium Savings Bonds Scheme, for the mobilisation of savings. There will be other speakers who will talk on the details of these schemes. I shall confine myself to the description of the manner in which the different savings schemes are operated through the post offices. Except for the Regular Monthly Income Savings Plan which was started in mid 1979, all other schemes of savings are operated through the post offices and sub-post offices in the island at present.

2.2 ORDINARY SAVINGS

2.2.1 Deposits:

In the case of ordinary savings bank deposits, the post offices and sub-post offices, when accepting deposits affix numbered savings bank labels in the pass book indicating the value of deposits accepted. This was the same system adopted under the Post Office Savings Bank. The members of the public could open accounts at a post office or sub-post office with an initial minimum deposit of Rs. 5/- by filling up a declaration card at a post office. The pass book stating the initial deposit is issued to the depositor over the counter, but at a sub-post office a temporary receipt is issued in the first instance and the pass book is issued by the controlling post office and delivered to the depositor after recovering the temporary receipt. When making subsequent deposits, the pass book along with the cash is handed over at the counter at a post office or sub-post office. The Counter Officer will affix labels to the value rendered in the pass book, make the relative credit entries and return the pass book immediately to the depositor. Particulars of the account and the amount deposited are entered in a specified form and forwarded on the day itself to the Controller of Units, at the Head Office of the Bank. From these particulars, relative entries are made in the ledgers of the depositors. The cash collected in respect of these deposits are remitted to the Chief Accountant, Postal Department. I shall explain later how this money is remitted by the Chief Accountant, Postal Department to the Bank.

2.2.2 Before proceeding further, it may be appropriate to explain why Savings Bank labels are affixed for deposits in pass books operated through the post offices and sub-post offices. In the case of branches, no labels are affixed in pass books. The ledgers are maintained in the branch itself and withdrawals are permitted only at the same branch. Thus the credit balances can be verified from the ledgers before effecting payment. In the case of savings accounts operated through the postal network, the depositor is able to make on-demand withdrawals of not exceeding Rs. 250/- at any post office in the island. Thus it is not possible for the Postmaster to verify the balance to the credit of any account at the time of allowing the withdrawal, because the ledgers are maintained at the Bank. He is only guided by the entries in the pass book. Unless labels to the value of each deposit are affixed on the pass book, the entries could be easily altered and fraudulent withdrawals manipulated easily.

2.2.3 The labels are controlled on an imprest system. The Bank maintains stock records. The labels also constitute a device to exercise control over the cash collected by the Postmasters on account of deposits. In another way, it also gives some mental satisfaction to the not so literate depositors, that they have got some stamps of value affixed in their pass books when a deposit is made. The total value of labels utilized daily at each post office is verified with the deposits accepted on that day and balanced. This prevents any misuse of labels. The label accounts remitted by the Postmasters monthly are checked at the Bank by the Controller of Units with the total monthly deposits at each post office. Although the label system may be considered cumbersome, it has to be continued until such time a better control system is introduced for these transactions.

2.3 Withdrawals:

Depositors holding savings bank accounts opened at post offices and sub-post offices have the advantage of being able to make withdrawals from any post office or sub-post office in the island. They could make an on-demand withdrawal only upto a maximum of Rs. 250/-. If they wish to withdraw a larger amount, they have to make an application to the Controller of Units at the Head Office of the bank who will issue a payment order (warrant) which could be cashed at the post office or sub-post office desired by the depositor. A relative debit entry is made on the pass book by the Postmaster when effecting payment. All withdrawals made at post offices or sub-post offices are entered in a specified form and forwarded to the Head Office of the Bank to make relative entries in the ledgers. When withdrawals are made on-demand from the post office or sub-post office, the pass book is retained at the post office for seven days before returning same to the depositor through the postman. This is done, so that if there be any discrepancy between the pass book balance reported by the Postmaster and the ledger, the pass book could be called for and examined by the Bank.

2.4 Savings Certificates:

This scheme was already in operation under the Post Office Savings Bank in 1972 when it was taken over by the National Savings Bank. The Bank printed the certificates and issued stocks of certificates of Rs. 5/- Rs. 10/- Rs. 50/- Rs. 100/- Rs. 1,000/- Rs. 10,000/- denominations to the Postmasters

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for issue to the public. NSB continued with this scheme until 1977 when its importance declined with the introduction of the Fixed Deposits Scheme at a higher rate of interest. In 1979, the Bank withdrew the issue of savings certificates from the post offices and now the post offices only pay for the certificates issued by them when they are tendered for payment.

2.5 Gift Tokens:

This scheme was started in 1972 with the commencement of business by the NSB. This was a scheme where printed certificates of Rs. 5/- Rs. 10/- Rs. 15/- and Rs. 25/- were issued by the Bank and sold to the public through post offices and bank branches. The purchaser could gift such certificates to anybody he wished and the recipient had to deposit such certificate into his savings account with the NSB. When deposited into the pass books, the Postmasters have to accept such certificates as cash, affix the necessary stamps and account for them accordingly. The gift token scheme did not become popular among the public. As its cost of administration did not justify its continuance through post offices, the Bank withdrew their sales from the post offices and confined the sales only to the Bank branches. The post offices now only accept for deposit in the pass books those gift tokens which are sold at bank branches.

2.6 Fixed Deposits:

On 1.10.77, the Bank started the fixed deposit scheme through post offices. The Postmasters now issue fixed deposit certificates to the public. The fixed deposit certificates are printed by the Bank and the Postmasters are supplied with stocks of fixed deposit certificates of Rs. 100/- Rs. 500/- Rs. 1,000/- and Rs. 5,000/- denominations. Applications for fixed deposits made to the Postmasters are filed in the respective offices and the certificates for the amount tendered are issued over the counter. Particulars of certificates issued are intimated to the Chief Accountant of the Bank daily and the cash is remitted to the Chief Accountant, Postal Department.

3. ACCOUNTING FOR TRANSACTIONS

3.1 The method of accounting for transactions done by the Postal Agency on behalf of the Bank in respect of various savings schemes is generally the same. The forms and registers to be used in respect of each savings scheme are designed by the Bank in consultation with the postal authorities and are printed and supplied to the Postmasters by the Bank. The Postmasters receive deposits and make payments under the respective savings schemes daily and send daily returns of such transactions to the Bank. They also send duplicates of such returns together with the day's cash summary and the cash remittances to the Chief Accountant, Postal Department. The Chief Accountant maintains separate accounts for each scheme of the NSB and updates such accounts with the information received daily from the Postmasters. The National Savings Bank in turn verifies the accuracy of the returns it receives daily from the Postmaster by comparing them with the figures recorded by the Chief Accountant, Postal Department. When the balance to the credit of the National Savings Bank, in the books of the Postal Department exceeds agreed limits, (now Rs. 10 million at any time) the Chief Accountant, Postal Dept. remits the excess to the NSB by cheque.

3.2 The records in the NSB in respect of various savings schemes are up-dated from the information contained in the daily returns sent by the Postmasters. Of all the schemes operated through post offices at present, the most voluminous is the ordinary savings scheme.

3.3 In the NSB Head Office, the ledgers in respect of the ordinary savings accounts opened at post offices are maintained in the alphabetical order of the post office of issue. The post offices of the island are divided into six units, each unit having an unequal number of post offices depending on the volume of transactions involved in those post offices. Each unit is headed by a Manager and an Assistant who have about eighty clerical hands under them. All the six units come under the immediate administrative control of a senior executive designated as "The Controller of Units".

3.4 The accounting at Head Office for these savings accounts are partly mechanised. The posting of daily deposit and withdrawal information into the ledgers is done by ledger posting machines. Since the volume of transactions is so large, it was decided in 1975 to do a feasibility study for the computerisation of the Head Office accounting of these transactions. As a result of such a study done by the Computer Bureau of the Central Bank, a system of part computerisation parallel to the mechanised manual system was undertaken in 1976 by the Computer Bureau of the Central Bank itself. The calculation of interest on these savings accounts is now done by the computer and the interest is entered into the ledger accounts manually with the help of computer print-outs.

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3.5 I give below some recent statistics relating to these savings accounts.

		1976	1977	1978
No. of operative accounts		2,906,662	2,416,665	2,664,904
No. of accounts opened during the year ...		171,484	187,794	209,337
No. of accounts closed during the year ...		28,778	14,876	29,832
No. of transactions during the year — deposits		3,047,772	3,204,734	2,539,582
— withdrawals				913,787
Total deposits during the year ...	Rs.	200,051,834	236,021,082	245,748,612
Total withdrawals during the year ...	Rs.	117,345,351	133,721,185	147,639,970

Accounts categorised according to balances:

				1976	1977	1978
Cts.	1 to	Cts.	99	28,518	1,928	1,998
Rs.	1 to	Rs.	9.99	1,084,138	758,933	817,321
	10 to		99.99	998.691	857,300	932,192
	100 to		999.99	580,314	590,170	669,110
	1,000 to		9 999.99	170,416	178,626	197,856
	10,000 to		99,999.99	12,199	11,550	11,941
	100,000 and over			9	15	21

3.6 The accounting for fixed deposits, savings certificates and gift tokens is handled by one Division of the NSB Head Office and another Division handles the accounting for Premium Savings Bonds. In the case of all these schemes, printed and pre-numbered certificates are issued by the Bank to the Postmasters and the accounting in the Bank involves the summarising of the daily and monthly returns sent by the Postmasters and up-dating of the issue and encashment records maintained by the Bank with the information contained in the daily returns of the Postmasters.

3.7 Some of the recent statistics relating to these schemes are as follows :

		Value of Sales Rs.	*No. of Certificates Sold*	*Value of Encashments Rs.*	*No. of Certificates Encashed*
Savings Certificates —	1979	—	—	23,130,551	14,189
	1980	—	—	28,298,599	12,444
Fixed Deposits	1979	177,966,600	96,252	108,581,594	53,978
	1980 (1st 3 quarters)	100,171,700	49,604	73,418,946	31,140
Gift Tokens	1979	—	—	35,550	2,155
	1980 (1st quarter)	—	—	28,545	3,111

4. CONTROLS EXERCISED

4.1 The accounting control of the various schemes of savings are exercised by several means. In the case of ordinary savings accounts, the Bank issues pre-numbered savings labels to the Postmasters to be affixed in the pass books against the value of each deposit received by them. The label stocks are controlled on a[illegible]st basis and the Postmasters have to submit monthly returns of label stocks to the Bank. The Bank in turn verifies the accuracy of those returns by comparing them with the daily deposit return sent by the Postmasters to the Bank as well as the Chief Accountant, Postal Department.

4.2 The pass books are also printed, pre-numbered and stocks are supplied to the Postmasters by the Bank. A comprehensive record of pass books supplied to each post office is maintained by the Bank and therefore the Bank can ascertain at any time from which post office a particular numbered pass book has been issued. The savings accounts in respect of all the issued pass books are maintained at the Bank and this information helps the Bank, if necessary, to ascertain the stocks of pass books that should be available at any post office as at any particular date.

4.3 In the case of other savings schemes, namely the savings certificates, gift tokens, and fixed deposits, the Bank prints and issues to the Postmasters, stocks of pre-numbered certificates. Upto date, issue, encashment and stock records of certificates delivered to each post office is maintained by the Bank with the help of the daily issue and encashment returns received from the post offices. The daily returns received from the post offices are also compared with the daily returns sent by the Postmasters to the Chief Accountant, Postal Department.

4.4 In addition to the documentary controls which the Bank exercise over the Postmasters and Sub-Postmasters against any possible irregularities or frauds they could commit in the exercise of their agency functions, the Postal Department itself has instituted a number of controls, administrative or otherwise, which act as safeguards against malpractices by Postmasters.

4.5 One of such controls is the limitation of the magnitude of transactions at different grades of post and sub-post offices. For example, the maximum amount that a Sub-Postmaster can pay on an on-demand withdrawal at a Sub-Post office of A or B grade is limited to Rs. 100/-, whereas in a post office, the limit is Rs. 250/-. Similarly, the amount of a deposit that could be accepted at a sub-post office is also limited to Rs. 600/- in an A grade office and Rs. 400/- in a B grade office provided such offices have motor/train mail services. Where runner services exist, the limits are reduced to Rs. 400/- and Rs. 300/- respectively. Limits exist in respect of a A grade and B grade post offices as well.

4.6 The Postal Department has also a group of examiners of accounts who pay sudden and unexpected visits to post and sub-post offices and examine the accuracy of records maintained and the transactions accounted by the Post and Sub-Postmasters. They make physical counts of cash, stocks of labels, pass books, savings certificates, gift tokens and fixed deposits certificates, compare them with stock records and report any discrepancies observed to the Bank as well as to the Chief Accountant, Postal Department.

4.7 I have so far discussed the controls available against possible irregularities by the Post and Sub-Postmasters. There are also certain controls available against possible irregularities or frauds by the depositors. One such control is the requirement that the Post and Sub-Postmasters must identify the customers to their satisfaction before any payment is made. The identification can be either documentary or personal provided the Postmaster is satisfied. The burden is therefore on the depositor to identify himself to the satisfaction of the Postmaster concerned.

4.8 Another control is the retention of the pass book in the post office for seven days, when an on-demand withdrawal is made from a pass book. When such a withdrawal is made, the Postmaster is expected to state in the withdrawal application, the final balance appearing in the pass book after such withdrawal and send the application to the Bank. At the Bank, the balance stated in the application is compared with the ledger balance and if any difference is observed, the pass book is called for examination and investigation.

4.9 The limitation of the on-demand withdrawals to a maximum of Rs. 250/- is yet another control against frauds and malpractices. A depositor who wants to withdraw a sum in excess of Rs. 250/- at any one time, has to apply to the Bank for the issue of a payment warrant. The Bank issues such a warrant payable at any post office desired by the depositor only if funds are available in the depositor's account.

5. INVESTIGATION INTO FRAUDS AND IRREGULARITIES

5.1 Although the Bank and the Postal Department has instituted a number of control measures against the commission of frauds and irregularities by the depositors as well as Post and Sub-Postmasters, it has not been possible to stop their commission completely. The irregularities usually consists of wrong accounting and non-compliance of instructions or misinterpretation of instructions.

5.2 The frauds are mainly concentrated in the Ordinary Savings Account Scheme and the modes of operations are varied and interesting to study. Most of these frauds are perpetrated by making use of the facility provided for on-demand withdrawals. Some of the types of frauds detected and investigated are given below. In all these cases, either withdrawals have been made or deposits have been misappropriated by resorting to irregular practices. They are —

i. Withdrawal of money from pass books belonging to other depositors. This takes several forms:

(a) persons completely unknown to depositors withdrawing money from their pass books. In these cases, the pass books come into the hands of fraudulent parties in several ways such as incorrect delivery by the postman, stealing of the pass books, accidentally coming into possession of those pass books forgetfully or carelessly left by depositors at their work places, buses etc.;

(b) Withdrawal of money by members of the same family from pass books belonging to other members.

(c) Withdrawal of money by Sub-Postmasters and Postmasters from pass books entrusted to them by depositors for getting the interest inserted or for making deposits. .. ..

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ii. Affixing of used labels, extension of wrong balances and making fraudulent withdrawals from pass books, sometimes by the depositors themselves and very commonly by Sub-Postmasters;

iii. Withdrawal of money from deceased depositors' pass books;

iv. Misappropriations by the Sub-Postmasters of the money given to them by the depositors for depositing in their pass books;

v. Withdrawal of money from pass books by altering the figures therein by the depositors themselves or others;

vi. Making of warrant withdrawals from depositors' pass books by the Sub-Postmasters by getting the illiterate depositors to sign the necessary forms;

vii. Introduction of inside pages from closed pass books into other pass books and making fraudulent withdrawals;

viii. Introduction of the cover pages from one pass book to another and making fraudulent withdrawal by producing identity;

ix. Alteration of the printed figures in the labels and extension of the balance accordingly for making fraudulent withdrawals;

x. Alteration of the interest figures, extension of the balance accordingly for making fraudulent withdrawals;

xi. Alteration of the carried forward balance into other pages of the pass book for making fraudulent withdrawals.

xii. Alteration of the amount withdrawn and extension of a wrong balance for making fraudulent withdrawals.

5.3 It has been observed in investigations that most of these fraudulent withdrawals have been made by or with the connivance of the staff in the sub-post offices who are only Commission Agents of the Postmaster-General, and are not his permanent employees.

5.4 All the fraudulent withdrawals made from pass books issued from the post offices are reported to the Postal Department and the Investigating Inspectors of the Department collect the relevant documents from the Bank and make the necessary inquiries. On completion of inquiries, the Postal Department refer the cases involving criminal offences to the Police to take suitable legal action. Wherever possible, the fraudulently withdrawn amounts are recovered by the Postal Department and remitted to the Bank. In cases where the Department employees are involved in the frauds, various disciplinary punishments are inflicted on them including dismissal from service.

5.5 The total number of cases that were subject to investigation at the end of each of the recent years were as follows:—

	1978	*1979*	*1980*
No. of cases	2779	2876	1346

6. PAYMENT FOR SERVICES RENDERED BY THE POSTAL DEPARTMENT

6.1 The National Savings Bank pays postage for all articles despatched by post. A special postage rate below the normal postage is paid for the delivery of pass books to depositors. The telegraph and telephone bills are paid to the Posts & Telecommunications Department by the Bank like any other institution. The Postal Department renders a bill annually as service charge for the Bank work done at post offices and sub-post offices. For this purpose, the Postal Department measures the work performed at each post office and sub-post office on a unit basis depending on the time involved for each item of work. The Department separates the units in respect of Bank work and works out a ratio of this work to the entire work done at post offices and sub-post offices. On this ratio basis, the total expenditure incurred by the Postal Department is divided and the Bank is called upon to meet its share.

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6.2 It has been observed recently that the payment made as service charge on this unit basis to the Postal Department has been on the high side and uneconomical. A study of the computation of the service charge was made recently by the Bank and it was revealed that there were discrepancies such as use of wrong statistics in the system which affected the Bank adversely. The Postal Department has now agreed to fix the service charge on the basis of the number of transactions performed at the post offices and sub-post offices. The rate of payment for each transaction is now being worked out.

7. LIAISON BETWEEN THE BANK AND THE POSTAL DEPARTMENT

7.1 A staff grade officer from the Postal Department is attached to the Bank designated as Liaison Officer to co-ordinate the work between the Bank and the Postal Department. He is provided with the necessary clerical staff and an office by the Bank.

7.2 All the instructions to the Postmasters and Sub-Postmasters with regard to the implementation of various savings schemes of the Bank as well as rectification of irregularities committed by the Postmasters are conveyed by means of Post Office Circulars and Instruction guides issued by the Postmaster-General. The Liaison Officer does all the necessary preliminary work to get such instructions published in time.

7.3 The Bank corresponds direct with the Postmasters and Sub-Postmasters with regard to Bank work. Where a Postmaster or a Sub-Postmaster does not respond to a request or instructions given by the Bank with regard to Bank matters, such cases are referred to the Liaison Officer who has disciplinary authority over the Postal employees.

7.4 It is not uncommon to meet with several operational problems when one deals with a large number of agents who transact business for him. The Bank is not an exception and the most common type of problems we face day-to-day with Postmasters and Sub-Postmaters are —

- i. Delay in rendering daily accounting statements;
- ii. Misdirection of accounting statements;
- iii. Wrong interpretation of instructions;
- iv. Wrong accounting;
- v. Public complaints of discourtesy;
- vi. Frauds and misappropriations.

7.5 Monthly meetings of the representatives of the Bank and the Postal Department are held with the Postmaster-General as the Chairman, where changes in the system of working and other operational problems are discussed and solutions are arrived at, and conveyed to the Postmasters or the Bank as the case may be.

7.6 In addition the Bank also conducts seminars for the Postal Department Staff with the assistance of the Postal Department in different districts to create a better understanding between the two institutions and to mobilise savings. Since 1979 the Bank has so far conducted ten seminars for Postmasters in the following Postal Districts:—

Colombo,
Matara & Hambantota,
Galle & Kalutara,
Badulla, Nuwara-Eliya & Moneragala,
Kandy & Matale,
Kurunegala & Chilaw,
Ratnapura & Kegalle,
Anuradhapura & Polonnaruwa,
Trincomalee, Batticaloa & Amparai,
Vavuniya & Jaffna.

Seminars for Sub-Postmasters are being arranged for 1981.

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GENERAL REVIEW OF SAVINGS ORGANISATION, SAVINGS INSTRUMENTS AND MOBILISATION TECHNIQUES IN SRI LANKA

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Domestic savings play a key role in the economy of a developing country like Sri Lanka. In the past, the view was often expressed that the development process could not rely on domestic household savings accumulation, but had to be based on the inflow of external resources. This view has, however, revealed itself to be erroneous, since no self-sustaining growth can be achieved without the co-operation of the whole population, and a support given by a broad mass of small savers goes far beyond the modest flow of transferred savings thus obtained, because it means the appearance among the population of a mentality oriented towards progress, and hence, conducive to a level of self sustaining economic development. In recent years, it has been realised that the greater part of a country's development efforts have to be financed by domestic resources. The prospect that developing countries will be able to provide profitable domestic industries to attract foreign capital is largely dependant on the success of development plans and of mobilising adequate domestic resources for investment.

In most developing countries, Commercial Banks and Savings Organisations are the predominant financial institutions, by and large constituting the capital market. Such a capital market has to be termed as a primary one, but as it matures into an advanced capital market, there will appear skill-intensive financial institutions such as Investment banks, brokerage firms and other specialised securities Investment Institutions.

Personal or household savings which embody the purchasing power retained after consumption become Institutional savings when they are put, for return for financial benefits, at the disposal of savings Institutions.

The process through which savings originating in households are put at the disposal of specialised Institutions is called "Mobilisation".

Mobilisation of personal or household savings is considered to be of great importance to economic development, since the redistribution of purchasing power is performed in such a way as to use the transferred purchasing power for production and not consumption, needs.

The activity of financial institutions engaged in the mobilisation of personal or household savings consists in offering a variety of financial benefits which the household units are willing to accept in exchange for the amounts of money saved. From country to country, the households show specific preferences for different type of financial benefits and the effectiveness of existing financial institutions depends very much on their ability to adjust to such preferences. The task of such institutions is relatively easy in developed, but difficult in developing countries.

In developed countries, savings that are not directly invested by the households generally take the form of monetary savings and it is ready to enter savings institutions in exchange for suitable financial benefits. On the other hand, in developing countries like Sri Lanka, the household savings over which savings institutions can exercise their mobilisation function is only partially composed of monetary savings, the great bulk being in kind. Consequently, the task of savings institutions in developing countries is two fold, one to educate the people to save in monetary form rather than in kind and the other to make people to accept attractive financial benefits in exchange for the money they have saved.

It is thus understandable that, with regard to household savings, in a developing country the existing problem is first of all a problem of mobilisation. Bearing in mind that the task of increasing voluntary savings, in fact, involves the question of mobilising savings rather than generating savings the performance realised in this field by various institutions which form part of the financial systems in developing countries may first be noted.

Commercial Banks now exist in all developing countries but there are serious drawbacks to their emergence as ideal savings institutions. It is doubtful whether a set of incentives and subsidies adopted by the Government would change the philosophy of Bank operations and transform Commer-

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cial Banks into institutions truly devoted to the cause of small savers. It is more probable that Government support would further strengthen the orientation of Commercial Banks toward the field of interest with which they are presently concerned. Furthermore, it is unlikely that small savers will gradually come to regard Commercial Banks as their own financial institutions, and not the institutions of business enterprises and rich people.

Another popular institution in developing countries is the Post Office Savings Bank. The figures of postal deposits collected with these institutions in different countries show a continuous increase in the total amount of savings collected, but this fact in itself, does not prove that Post Office Savings Banks are institutions best fitted to mobilise personal or household savings in developing countries. The joint operation of postal services and savings services creates confusion that leaves the latter service in a secondary position.

In this perspective, one can easily understand that savings institutions such as the Post Office Savings Banks are not conducive to a full realisation by savers themselves of the importance of their savings. What is needed is an institution which while providing a safe place for depositing the accumulated savings, gives an adequate reward in the form of interest and contributes to improving local economic and social conditions. This institution must be an independent institution based on genuine co-operation from the people and entirely devoted to the savers, who will thus be convinced of having their own financial institution.

The Savings Banks, which are still the only organisation whose principal objective is to encourage and collect personal savings, appear as the most suitable institution, possessing all the necessary requisites. The problem of savings mobilisation in developing countries consists essentially in seeking the most appropriate institution which must be entirely dedicated to the cause of the savers. Savings Banks certainly meet the requirements and deserve adequate support from every government that is aware of the importance of household savings for economic development.

The stability of a savings organisation depends on its ability to win the confidence of the people it is designed to serve by establishing a reputation for a reliability through meticulous custody of the funds entrusted to it. Government backing in one form or another might also add to its dependability and trustworthiness.

The task of mobilising savings involves firstly the devising of attractive savings schemes to suit the preferences of different classes of depositors, secondly the carrying out of aggressive savings promotion programme aimed at spreading the virtue of thrift, developing the habit of savings and publicising the different savings schemes and the benefits that accrue therefrom among the people and thirdly the providing of a wide network of service outlets and of a streamlined service with a view to facilitating transactions by the people. All these three form the tripod of savings mobilisation techniques.

The Savings Banks should seek to offer instruments which are easy to understand and readily available for small amounts and which provide variety, maximum safety, permit easy and prompt withdrawal of the funds deposited and yield a satisfactory return. As a reward for renouncing immediate pleasure derived from consumption by postponing spending the funds saved, savers should receive interest commensurate with the duration of that renunciation.

The efficacy of a Savings Bank is also dependant on it providing convenient service outlets and a personalised and streamlined service with good customer relations and simple and expeditious procedures. If these tend to make the Institution inaccessible and difficult for business transactions, they could seriously impede the savings mobilisation endeavours.

Furthermore the Bank's activities and services must be adequately published so that savers could promptly avail of them for mutual advantage.

With these preliminary remarks, I will now proceed to review the savings organisation, savings instruments and mobilisation techniques in Sri Lanka.

To begin with it may not be out of place to recount here, in brief, the history of the National Savings Bank in Sri Lanka.

SAVINGS ORGANISATION

The earliest reference to a Savings Bank in Sri Lanka is to be found in an editorial in the Gazette of December 17, 1831 where the editor supported the establishment of a Savings Bank for the benefit of the public.

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However, the earliest of the savings institution in Sri Lanka, the Ceylon Savings Bank, was opened by private people on the 6th August 1832 and entrusted to a Committee of Management, consisting of prominent residents of Colombo, Government and Mercantile officials. In 1860, the Government took control of the Bank and 12 years later completely overhauled the administration. The Ceylon Savings Bank with almost 140 years of existence did not make any appreciable headway in the task of mobilising savings.

The Post Office Savings Bank was established in May 1885, under Ordinance No. 5 of 1882. In 1941, a separate Post Office Savings Bank Ordinance No. 18 of 1941 came into force. In terms of this Ordinance, the Management of the Bank was entrusted to a Board of Trustees comprising of Deputy Secretary to the Treasury, Permanent Secretary of the Ministry of Posts and Postmaster-General. The Bank, over the years met with some amount of success though not to the extent a developing country like Sri Lanka would require.

Savings Certificate Section of the Postmaster-General's Department was established in September 1938. The Savings Certificates were first issued in this year. The Savings Certificates gave a higher rate of return than the Post Office Savings Bank, but were limited in liquidity. As the Certificates were not transferable, cash could be obtained only by surrendering the Certificates involving a loss of interest. The Certificates therefore had little appeal to the public.

The National Savings Movement known originally as the Ceylon War Savings Movement, was started in January 1942. It was set up as a Government Department, under a Commissioner. In the main, it functioned as the publicity arm and induced persons to save regularly with the Ceylon Savings Bank, the Post Office Savings Bank or in Savings Certificates.

The above institutions constituted the Governmental Savings Banking edifice in Sri Lanka until their amalgamation. The principal reason for the amalgamation was that the existing savings institutions were not geared to cope with the tremendous task of savings mobilisation in the context of the importance of savings to the development effort of the country. The need to reorganise the savings institutions and to bring them under one co-ordinated structure was felt and therefore, the National Savings Bank Bill which was introduced by the late Mr. U. B. Wanninayaka in 1969, was subsequently enacted with very minor amendments as the National Savings Bank Act, No. 30 of 1971. It became law when the Governor-General gave his assent to the Bill on 31st August 1971. The Bank itself was established on the 29th September 1971, but the National Savings Bank Act was brought into operation on 1st April 1972.

The Bank is authorised to carry on and transact all kinds of business generally carried on and transacted by Savings Banks. It could also undertake any activities whatsoever in connection with the promotion or mobilisation of savings, or in the raising of the marginal propensity to save. The National Savings Bank is expected to nurture new ideas for the maximum mobilisation of savings of the community for financing economic development and to provide a variety of savings instruments to the public so that the preferences of different classes of depositors, particularly those in the rural sector, could be effectively exploited.

The general supervision, control and administration of the affairs of the Bank are vested in a Board of Directors, consisting of 7 members namely, the Postmaster-General, the Deputy Secretary to the Treasury or his representative, a representative of the Ministry of Planning and 4 others appointed by the Minister of Finance for a period of 3 years at a time. The Head of the Board of Directors is the Chairman appointed by the Minister, from among the seven Directors.

The Chairman and the Board of Directors of the Bank constitute the Governing Body of the Bank and determine the basic policy framework within which the Bank has to function. The translation of such policy into action is done by the General Manager under the directions of the Chairman who is Chief Executive of the Bank. He is supported in this task by a range of senior executives.

Basically and as was envisaged, the Bank was formed by the amalgamation of the Ceylon Savings Bank, the Post Office Savings Bank, the Savings Certificate Section of the Postmaster-General's Department and the National Savings Movement. The activities of these institutions were taken over by the National Savings Bank on 1st April 1972. With the take over the Colombo Office of the Ceylon Savings Bank became the Fort Branch of the National Savings Bank.

As newly set up, the Bank started to carry on its operations in earnest at its own Branches at Fort and Kollupitiya and through the network of agencies consisting of all the Post Offices and the Sub-Post Offices situated throughout the country. The accounts opened and operated through the agency network continued to be centralised in and handled by the Units housed in the Bank's Head Office in Kollupitiya as in the days of the Post Office Savings Bank.

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SAVINGS INSTRUMENTS AND MOBILISATION TECHNIQUES

Savings Instruments

From the commencement of its operation, the Bank addressed itself to the need to provide variety in the savings schemes offered to the public. The Savings Schemes in vogue at the time the Bank came into being were the Pass Book Savings Account, the Fixed Deposit Account and the Savings Certificate. The Bank while continuing with these either extended their ambit or brought in modifications in them or introduced new forms.

The Pass Book Savings Account or Ordinary Savings Account as it is now called was extended to encompass the salaried employees by formulating a Save As You Earn Scheme, students by designing a School Bank system and recipient of gifts by introducing a savings instrument known as the Gift Token. The Ordinary Savings Account carried an interest rate of 7.2% per annum.

Fixed Deposits

The Fixed Deposit Accounts underwent some meaningful modifications in that the minimum deposit in respect thereof was reduced from Rs. 10,000/- to Rs. 5,000/- and subsequently to Rs. 1 000/- and the upper limit of Rs. 15,000/- was removed. The minimum period for fixed deposit was also reduced from 3 years to one year. Moreover the interest on fixed deposit which was earlier paid only annually was allowed to be drawn monthly or quarterly or half yearly, as may be desired by the depositors at a slightly reduced interest rate to meet administrative costs.

Fixed Deposits yielded interest at the rate of 7.5% per annum for every single deposit below Rs. 1 lakh and interest at the rate of 8% per annum for a deposit of Rs. 1 lakh or more.

Savings Certificates

The Bank also introduced a new ten year (second series) Savings Certificates, carrying 11% interest per annum.

Despite these new measures and the simultaneous demonetization of large currency not the response from the public was disappointing. The average annual deposits from 1972-1977 was only Rs. 180.7 million as compared with the average annual deposit of Rs. 121.6 million in the previous 2 years.

Interest Rate Changes

In September 1977, major monetary operation was introduced through the National Savings Bank when the present Minister of Finance and Planning directed the Bank —

(i) to increase the rate of interest payable on savings accounts to 8.4% per annum.
(ii) to offer the following greatly enhanced interest rates on new Fixed Deposit Accounts:

(*a*) On deposits of 18 months 18% per annum.
(*b*) On deposits of 12 months 15% per annum.
(*c*) On deposits of 6 months 12% per annum.

Since the prevailing interest rates on savings accounts and Fixed Deposits were only 7.2% per annum and 7.5% per annum respectively, the new rates created banking history.

The effect of the new rates on the mobilisation of savings by this Bank was not as pronounced as was expected and to remedy this situation the Bank introduced in July 1978 with the approval of the Hon. Minister of Finance and Planning, the following new measures:—

(*a*) Payment of monthly interest at the rate of 14.4% per annum on 12 month deposits of over Rs. 5,000/- and 16.8% per annum on 18 month deposits of over Rs. 5,000/-, and

(*b*) Payment of interest on premature withdrawals of Fixed Deposits at the following rates:

After 3 months — 8.4% per annum
After 6 months — 12% per annum
After 12 months — 15% per annum

These measures proved attractive, particularly the monthly interest payment schemes which contributed to a large measure together with the other incentives and new savings instruments to the very substantial increase in savings mobilised since their introduction. In 1979 the net savings mobilised was Rs. 991 million as compared with Rs. 233 million in 1976.

In the light of developments in the monetary situation in the country, the Bank, on the directions of the Hon. Minister of Finance and Planning effected a further upward revision in the interest rates from May 1980, as follows:—

(*a*) Ordinary Savings — from 8.4% to 12%.
(*b*) For 6 months Fixed Deposits (Interest payable at maturity) — from 12% to 15%.
(*c*) For 12 months Fixed Deposits (Interest payable at maturity) — from 15% to 20%.
(*d*) For 12 months Fixed Deposits (Interest payable periodically) — from 14.4% to 18.6%.

With regard to Fixed Deposit withdrawals before maturity the following rates of interest were introduced.

(*a*) 3 months to 6 months — 12%.
(*b*) 6 months to 12 months — 15%.

NEW SAVINGS INSTRUMENTS

Conscious of its role of being a partner in the social and economic progress of the country, the Bank also fashioned its activities to cater specifically to the low and middle income groups by introducing a low priced Premium Savings Bond, a Social Security Savings Plan, a Special Savings Project for the plantation sector, and Fixed Deposit Certificates of a low denomination carrying the same rates of interest as Fixed Deposits.

Premium Savings Bonds

This new savings instrument was inaugurated on 8th February 1978 by the Hon. Minister of Finance and Planning. Priced at Rs. 10/- each, the Premium Savings Bonds cater to small savers and present them with chances of winning prizes in monthly lottery draws, in lieu of interest which they would otherwise earn through Ordinary Savings Accounts. With an appeal to an individual's speculative instinct, the Bonds offer the holder the unique prospect of receiving a substantial fortune without losing his original investment, unlike in the case of other speculative ventures.

The Bonds could be purchased by individuals over 16 years of age by themselves, and individuals under 16 years of age through their guardians. The Bonds are non-transferable and are registered in the names of purchasers who could encash them at par after the expiry of 12 months from the date of purchase. The Bonds ensure for the purchasers automatic participation in each monthly draw, after one calendar month from the date of purchase, such participation continuing for so long as the Bonds remain unencashed.

The prizes offered are —

(*a*) First Prize — Rs. 10,000/-.
(*b*) Second Prize — Rs. 5,000/-.
(*c*) 30 consolation prizes of Rs 500/- each.

Regular Monthly Income Savings Plan

This new savings scheme was inaugurated on 19th May 1979, by the Hon. Minister of Finance & Planning. It aims at social security through the provision of a monthly pension based on a monthly savings deposit. A guaranteed monthly income for life to the self employed in their declining years, an additional monthly income for life to the employed to better the life for himself and his family and an endowment to the dependents of the depositor after his life is ensured for those who participate in it.

Under this scheme, an individual could open an account for himself or for the benefit of others and contribute a fixed sum of money monthly, quarterly or half yearly for an un-interrupted period of 5 years and 5 months. Thereafter, by allowing the capital, that is the sum total of his contributions over the 65 months together with accrued interest, to lie with the Bank, he or his beneficiary will from the 67th month onwards commence receiving for life a monthly income of a sum equivalent to the quantum of the monthly contribution. The depositor has also the option of leaving the capital with the Bank, without drawing the monthly income, for a further period of 65 months, so as to receive from the 133rd month onwards, a sum two times that of the monthly contribution, as monthly income. Unlike insurance annuities, the depositor can at any time withdraw the capital and move out of the scheme.

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Special Savings Project for the Plantation Sector

The incomes of plantation workers improved considerably from the second half of 1977, consequent to a rise in their wages and an increase in the number of working days in the plantations. Due to the absence of convenient savings banking facilities a fair amount of the savings potential remained untapped in the Plantation Sector. The Bank therefore, with the approval of the Ministries of Finance and Planning and of Plantation Industries launched a Save-As-You-Earn Scheme for this Sector in April 1979.

The Scheme provides for monthly deductions of amounts which the workers can conveniently save to be made from their wages and sent to the nearest Branch of the Bank to the credit of the workers. Pass Books are issued to the workers for the accounts opened in their names. These Pass Books are kept in the respective estates themselves where withdrawals not exceeding Rs. 50/- for a month are permitted to be made from each Pass Book. The scheme has been so designed as to enable the workers to transact savings banking business without having to visit Branches of the Bank or Post Offices.

Low Denomination Fixed Deposit Certificates

In recognition of the need to extend the benefit of the high rate of interest on Fixed Deposits to small savers the Bank introduced in January 1979, a Fixed Deposit Certificate of the denomination of Rs. 100/- carrying the interest rate of 18% per annum, as on a Fixed Deposit. Previously, Fixed Deposit Certificates were available only in denominations of Rs. 500/- and above.

Incentives and Concessions

In order to enthuse the people to save with the Bank, the Bank offers its Depositors the following incentives and concessions.

Tax Concessions

The offer of concessions like tax exemption on interest earned assist in some measure the mobilisation of savings. With effect from April 1972, interest of Rs. 1,000/- per individual up to a limit of Rs. 6,000/- for a family of 6 individual account holders was exempted from income tax. This tax concession was further enhanced with effect from 1st April 1978. The interest earned from deposits in the Bank up to Rs. 2,000/- or 33 $\frac{1}{3}$% of the total interest whichever is higher is exempt from income tax.

Other Unique Facilities

Minors between the ages of 7 to 16 enjoy the facility of opening and operating accounts with the Bank, unlike in Commercial Banks. The age of majority is 21 years in the common law provision which is followed by the Commercial Banks.

Nomination facilities are also available to the Bank's depositors so that by a simple process they could obviate the necessity for lengthy testamentary proceedings in the event of the sudden demise of a depositor. These facilities are not available in other Banks which are quite popular with our depositors.

The repayment of all deposits in the Bank and the payment of interest thereon is guaranteed by the Government of Sri Lanka.

Business Outlets and Streamlined Service

From the time of the commencement of business by the Bank in 1972, it realised the need to provide the savers with necessary business outlets. Though the widespread network of Post and Sub Post Offices in the Island, serve as agencies of the Bank to collect savings, the Bank felt the necessity to open and operate its own branches where direct control could be exercised and a streamlined service provided in keeping with the standards of modern savings banking. The Bank therefore has so far opened 42 Branches. The Branches are located predominantly in Provincial Capitals. Branches have also been opened in rural areas where the criterian in selection is not profitability but, serviceability and the desire to propagate the ideals of savings and thrift amongst people.

Coupled with the above, were the steps taken by the Bank to streamline procedures to further facilitate transactions by the people. In its own Branches, withdrawals of any amount could be made over the counter. In the Post Offices, the amount that could be withdrawn on demand had been increased from Rs. 100/- to Rs. 250/-, and in the Sub Post Offices from Rs. 50/- to Rs. 100/-, thereby making it easy for the small saver to transact business with the Bank. One of the complaints against the format of Post Office Savings Bank had been the inordinate delay experienced by the members of

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the public whenever they wished to withdraw money from their savings account in that Bank. This delay, which was the product of cumbersome withdrawal procedures proved to be a disincentive to the small saver to save with the Post Office Savings Bank. It was to facilitate the transaction by people, the National Savings Bank increased the on-demand withdrawal limits. The Bank also has made arrangements at its Head Office for depositors to call over and withdraw any amount on Pass Books issued at Post Offices. Furthermore in an effort to rationalise deposit and withdrawal procedures, the minimum initial as well as subsequent deposit into an Ordinary Savings Account has been increased from Re. 1/- to Rs. 5/-, and the encashment of Fixed Deposit Certificates at the Post Office which had previously been restricted to a maximum of Rs. 10,000/- has been increased to Rs. 20,000/-.

Moreover for the convenience of customers, the banking hours which had previously been between 0900 hours to 1330 hours for the Head Office and the Fort Branches and the Postal Units and between 0830 hours and 1500 hours for outstation Branches were with effect from 1st March 1979, extended to 0830 hours to 1330 hours for the former and amended to 0830 hours to 1430 hours for the latter.

Savings Promotion and Publicity

One of the drawbacks which the predecessors of the National Savings Bank suffered from was their failure to embark on any aggressive policies of savings mobilisation in consequence of which they failed to offer any competition to Commercial Banks.

The National Savings Bank therefore, addressed itself to this task and undertook savings promotional and publicity campaigns. These included house to house canvassing, advertising by posters, in the press and through the radio, sponsoring or conducting Essay, Art, or similar competitions, and participation by the Bank in religious, cultural, sports and other allied activities of the public. In these campaigns emphasis was laid on the higher interest rates paid by the Bank on its deposits, the tax concessions enjoyed by the depositors and the absolute security of the deposits in the Bank, ensured by the guarantee of the Government.

For a time, there was a slackening in the campaigns and therefore, in the latter half of 1978, efforts were made to completely revitalise and intensify such campaigns. In this regard, weekly radio programmes, radio spots, cinema slides, posters and regular wide press advertisements were organised. In addition special publicity campaigns with the assistance of professional advertising companies were launched for special savings schemes. Leaflets for information of customers publicising the various facilities available at the Bank were also printed and distributed.

In order to intensify the savings promotion campaigns in rural areas, savings promotion officers were recruited and sent to the Branches to augment the existing cadre of officers.

The present Government which assumed office in July 1977, has taken steps to revive the staggering economy of Sri Lanka and to increase its Gross Domestic Product and its annual growth rate through the expansion of the Agricultural, Commercial, Construction and Industrial Sectors and by the immediate implementation of National Development Projects such as the Accelerated Mahaveli Development Scheme, the Free Trade Zone and the Greater Colombo Area Development Scheme.

During the last decade, the average annual growth rate of the Gross National Product at Constant prices (1970) was 4.09 per cent while the Gross Domestic Product remained at 3.8 per cent. According to the official estimates, a highest growth rate of 8.2 per cent was achieved in 1978. During the year of 1979, the growth rate was 6.2 per cent. These represent considerable improvement in the growth rates of the previous years of 1970's which averaged only 3.2 per cent per annum. Activities in construction, mining, electricity, finance and general services dominated the industrial growth in 1979.

Prior to the establishment of the Bank, the annual average mobilisation of savings by its predecessors amounted to Rs. 30.7 million for the years 1966 to 1969, and to Rs. 121.6 million for 1970 and 1971. As at 31st March 1972, the total number of accounts stood at 4.7 million and the total savings at Rs. 956 million. Since then, the Bank has made a steady progress and has mobilised nett savings totalling Rs. 4461.6 million from April 1972 to December 1980 and the number of accounts increased to 6.8 million. (Note : Rs. 18 = 1 U. S. $)

It is significant to note that during the two and half years, in which the present Government has been in office, due to its realistic policies creating confidence in the minds of investors the total domestic

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savings mobilised in this period, amounted approximately to Rs. 1566.9 million as against a total of Rs. 997.6 million in the five year period between the establishment of the Bank in April 1972 and July 1977. The Nett Savings mobilised during the year 1979 alone totalled Rs. 991.3 million.

CONCLUSION

To sum up, Sri Lanka has a unified savings institution in the National Savings Bank, entirely devoted to the savers who can look to it as an institution of their own. Mobilisation of savings being its principal task, it continuously strives to adopt effective techniques by formulating and implementing new instruments, adjusting interest rates in response to monetary developments and enhancing tax incentives with a view to accelerating the mobilisation process. Customer convenience and satisfaction is another area which requires constant attention from a savings institution. And this involves the setting up of a very wide network of business outlets and the adoption of easy and quick transactional procedures. The Bank has consciously taken steps towards these and by vigorous promotion and publicity activities created an awareness amongst the public of its facilities and services.

STATE MORTGAGE AND INVESTMENT BANK

Particulars Relating to Mortgage Loans

(in efect late 1981)

1. PURPOSES:

Loans are granted by the Bank for the following purposes:

(a) **House Construction and Agricultural Development:**

Construction of dwelling houses;

Extensions to dwelling houses;

Purchase of building sites for construction provided construction of a dwelling house is commenced within one year from the date of granting the loan for purchase of the building site.

Agricultural Development.

Note: Agricultural development includes the raising of crops, Medicinal plants and herbs, Horticulture, Sericulture, Bee-keeping, Forestry, Animal husbandry, Poultry farming, Dairy farming, (including livestock rearing and breeding, growing pasture and fodder and marketing of produce), and the establishment or development of agro-based industries (including Paddy Mills, Tea and Rubber factories, Coconut Oil, Dessicated Coconut and Fibre Mills). However, the Bank does not grant loans for agricultural purposes in respect of which other institutions provide subsidies.

(b) **Purchase of Property:**

House property;

Agricultural Land.

(c) **Redemption of Debts:**

Loans to repay debts, incurred in connection with any of the above purposes.

Note: **Restriction on Ownership:**

Applicants are advised that there is a ceiling on ownership of houses and agricultural land. They are requested to ensure that such ceilings are not exceeded. An affidavit to this effect must be submitted on the form provided.

2. RATES OF INTEREST:

The following rates of interest per annum will apply:—

(a) House Construction and Agricultural Development:

Amount			*Interest*
Loans not exceeding	Rs. 50,000/-(Construction)	...	12%
	(Agriculture)	...	14%
Loans not exceeding	Rs. 100,000/-	...	16%
Loans not exceeding	Rs. 200,000/-	...	18%

For house construction, the first Rs. 200,000/- will be granted at the interest rate of 18% on normal repayment terms. The loan in excess of Rs. 200,000/- will be granted at 22% repayable in 5 years.

(b) **Purchase of Property:**

Loans not exceeding	Rs. 50,000/-	...	18%
Loans not exceeding	Rs. 100,000/-	...	19%
Loans not exceeding	Rs. 200,000/-	...	20%
Loans exceeding	Rs. 200,000/-	...	22%

(c) **Redemption of Debts**

On all loans ... 24%

INTEREST RATES ARE LIABLE TO CHANGE WITHOUT NOTICE.

LOAN LIMITS :

The maximum amount that may be granted to an applicant for each purpose is as follows :—

Purpose	Maximum Limit Rs.
Construction of a dwelling house (per unit)	200,000/-
Extensions and additions to an existing dwelling house	100,000/-
Purchase of a building site for construction	50,000/-
Purchase of house property (per unit)	150,000/-
Purchase of agricultural land	300,000/-
Agricultural development	500,000/-

(Where re-financed under Tea and Rubber Controller's factory development Scheme the Limit may be extended to Rs. 1,000,000/-

Redemption of debts—limits will be as for the purpose for which the debt was incurred.

Loans are further limited to a percentage of the value of property being mortgaged as follows :—

Nature of Security	Limit on value of Security %
House property (includes building sites)	75
Agricultural Land	60

Value of the security will be the purchase price (where the property being purchased is offered as security), the value assessed by the Bank or the value placed by the applicant, whichever is lowest.

On applications for loans exceeding Rs. 100,000/-, the security tendered will be inspected independently by two valuers.

The quantum of loan will depend on the merits of the application and the capacity of the applicant to finance the transaction and repay the loan.

The maximum loan per application would be limited to Rs. 500,000/-.

SECURITY FOR LOANS :

Loans must be secured by a primary mortgage of land in respect of which the Insurance Corporation of Sri Lanka is prepared to issue a Mortgagee's Title Insurance Policy acceptable to the Bank and without any exclusion from coverage. The Policy must be for an amount to be decided on at the time the loan is sanctioned. If the applicant fails to obtain a Title Assurance Certificate within 3 months of being referred to the Insurance Corporation, his application may be rejected; a fresh application may, however be submitted *after* a Certificate is obtained.

Undivided shares in land, and land which is subject to floods, has tenements, is occupied by, unauthorised persons, or to which there is no proper access, are not accepted as security. Leasehold property will be accepted as security provided the lessor's title to it is sound and the unexpired period of the lease is not less than 30 years.

TITLE INSURANCE:

The Bank grants loans only on security of immovable property. Other than in cases where the applicant derives title directly from the State or from a Partition Decree, a Certificate of Title Assurance has to be furnished from the Insurance Corporation of Sri Lanka. The procedure adopted by the Insurance Corporation to grant a Policy of Title Insurance is as follows:—

(a) An applicant may obtain a Title Report from any lawyer on the panel of the Insurance Corporation of Sri Lanka. This Title Report must be submitted to the Insurance Corporation with a letter from the Bank and the following documents from the Local Authorities:—

(1) Certificate of Ownership;

(2) Certificate of Non-Vesting;

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(3) Assessment Tax Receipt for the last quarter;

(4) Annual Assessment Notice for the current year;

(5) Street Line Certificates, and a fee of Rs. 105/- to the Insurance Corporation of Sri Lanka.

The Valuation Report for the purpose of issuing a Title Insurance Policy will be sent direct by the Bank to the Insurance Corporation of Sri Lanka. The Bank will inform the applicant the amount for which the security should be insured, in due course.

REPAYMENT:

Loans are granted at the entire discretion of the Board, Repayment will be on the equated instalment basis, monthly or half-yearly over a period not exceeding 20 years with the last instalment to be repaid before the applicant reaches the age of 70. However, where the security tendered is agricultural land, the re-payment period is limited to 15 years.

Penal Interest at the prescribed rate will accrue on the principal outstanding if an instalment is not credited to our Bank Account by the due date.

BANK CHARGES:

An Initial Deposit in accordance with scales given below must be paid to meet the expenses that will be incurred by the Bank in processing the loan applications and valuing the security offered. The Initial Deposit payable is as follows:—

Amount			Bank Charges
Rs.		*Rs.*	*Rs.*
Not exceeding —		25,000/-	405/-
25,001/-	to	35,000/-	435/-
35,001/-	to	50,000/-	465/-
50,001/-	to	75,000/-	495/-
75,001/-	to	100,000/-	525/-
100,001/-	to	150,000/-	830/-
150,001/-	to	200,000/-	885/-
200,001/-	to	250,000/-	990/-
250,001/-	to	350,000/-	1,095/-
350,001/-	to	450,000/-	1,200/-
450,001/-	to	500,000/-	1,305/-
500,001/-	to	1,000,000/-	2,105/-

If at any stage the deposit made is found to be insufficient, a further sum will be called for.

Important: The applicant shall write "New Loan Applications" against the item Loan Reference Number in the pay-in-slip which is handed in to the Bank of Ceylon with the initial Deposit. *On no account should the serial number of the cash receipt issued for the purchase of application forms be written in this space.*

The receipt issued by the Bank of Ceylon in acknowledgement of the deposit should be attached to the loan application.

The Stamp Duty on the Mortgage Bond in favour of the Bank and the Stamp Duty and the Bank's charges on Deed of Transfer (in case the loan is for purchase and the applicant wishes the Bank to prepare and attest the Deed of Transfer), must be paid by the applicant when the loan is sanctioned.

The Bank's charges equal to 1% of the loan sanctioned or the expenses actually incurred whichever is greater, will be recovered from the loan. Cost of any inspection carried out by our Officers must in addition be borne by the applicant.

Where an application for a loan is withdrawn by the applicant or is refused or rejected by the Bank, the deposit made by the applicant will be refunded, after deducting the expenses incurred by the Bank in connection with the application.

PROCEDURE FOR ACCEPTING AND PROCESSING OF LOAN APPLICATIONS :

Application forms for loans will be accepted and processed only at the two Branches of the Ban situated at premises No. 292, Galle Road, Colombo-3 and at No. 2, Gnanartha Pradeepa Mawatha Colombo-8. Where the security tendered for loans is situated within the Colombo District, the application will be accepted and processed at the Kollupitiya Branch. The Initial Deposit in respect of such applica tions should be paid to the credit of the State Mortgage and Investment Bark at the Bank of Ceylon Galle Road, Colombo-3. Where the security tendered for loans is situated outside the Colombo District the application will be accepted and processed at the Borella Branch. The initial Deposit in respect of such applications should be paid to the credit of the State Mortgage and Investment Bank at the Bank of Ceylon, York Street, Colombo-1.

An application will be processed in the following order :—

(a) Entertainment of Application;

(b) Consideration of application by the Board. If acceptable the loan will be approved subject to Title investigation and Valuation;

(c) Board decision will be conveyed to the applicant in writing. If accepted by the Board, applicant will be referred to the Insurance Corporation for Title Insurance;

(d) Applicant should obtain a Title Report from a Lawyer on the Panel of the Insurance Corporation of Sri Lanka and take it with a letter from this Bank to the Insurance Corporation Office. A fee (at present Rs. 105/-) has to be paid by the applicant to the Insurance Corporation for this purpose;

(e) On receipt of the Title Assurance Certificate from the Insurance Corporation, the security will be valued by the Bank;

Note : In order to expedite the grant of a loan (c) and (e) could be undertaken simultaneously at the request of an applicant;

(f) The final offer sanctioning the loan and the exact amount (based on value of security) will be conveyed.

(g) Issue of Mortgagee's Title Insurance Policy by the Insurance Corporation of Sri Lanka;

(h) On receipt of applicant's acceptance of the loan, the Mortgage Bond will be prepared;

(i) Mortgage Bond will be signed by the applicant and sent for registration at the Land Registry;

(j) Furnishing a fire insurance policy by the applicant, if so required by the Bank;

(k) Registration of the Mortgage Bond by the Registrar of Lands and issue of extended extracts of encumbrances showing the registration;

(l) Disbursement of loan proceeds.

Note : Loans given for construction and Agricultural Development will be released in stages solely at the discretion of the Bank as such construction or development proceeds. For debt redemption and for purchase of property, payment will be made direct to the creditor or vendor, as the case may be.

Applications in respect of loans for purposes of construction (new dwelling houses or extensions to houses) must be submitted with the following :—

(1) An approved building plan;

(2) A certified Bill of Quantities.

2. If the loan requested is in excess of Rs. 50,000/- the bill of quantities must be certified by a Chartered or Registered Architect. Otherwise it will be referred to the Bank's Consultant Architects for certification. The cost of such certification must be borne by the applicant. The amount certified by the Architect will be taken as the cost of construction in processing the application.

3. If the cost of construction as certified in the Bill of Quantities exceeds the amount of the loan, applicant must produce proof as to how the balance finance will be obtained. In any event the loan will be disbursed in instalments only after construction to the value of such difference has been completed.

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GENERAL:

At any time after the approval of a loan and before actual payment of the money, the Bank may without assigning any reason thereto cancel or modify such approval and withhold payment of the whole or portion of the money.

After a loan is paid out the Bank may order that the loan be repaid in full with interest if the Bank is satisfied that :—

(a) The loan has not been applied for the purpose for which it was granted.

(b) The security has depreciated in value to such an extent as to endanger the safety of the loan.

(c) The title of the borrower is such that it ought not to have been accepted.

(d) That due to material mis-statements by the borrower or mis-apprehension of the actual facts by the Bank, the loan was granted in circumstances in which it would not have been granted if the true facts had been known.

(e) When the borrower has failed to comply with or has contravened the terms of the mortgage bond and loan agreements.

If after a loan is obtained the mortgagor executes any instrument of sale or any other disposition affecting the mortgaged property, the Bank has the power to recall the Loan granted or charge such new owner, the current rate of interest and for this purpose requires the new owner to enter into any agreement as may be deemed necessary.

POWER TO FORECLOSE:

In the event of a borrower defaulting in the repayment of a loan, the Bank is empowered either to sell by the Public Auction the property mortgaged to it and to recover from the proceeds of the sale, the principal outstanding, interest, penal interest and all charges and expenses incurred by it or take possession of the mortgaged property and manage it until all monies are recovered.

APPLICATION FORMS:

Sold at the Bank Offices at Rs. 5/- payable in cash or by postal order drawn in favour of the bank. Requests by mail should accompany a self-addressed stamped envelope size 9" x 4". Purpose of loan should be clearly stated.

INSTALMENT TABLE ON THE EQUATED SYSTEM

Monthly Instalment Per Rs. 1,000/-

Period	12%	14%	16%	18%	19%	20%	22%	24%
5 Years	22.24	23.27	24.32	25.39	25.94	26.49	27.62	28.77
10 Years	14.35	15.53	16.75	18.02	18.67	19.33	20.67	22.05
15 Years	12.00	13.32	14.69	16.11	16.83	17.57	19.06	20.58
20 Years	11.01	12.44	13.91	15.43	16.21	16 99	18.57	20.17

N. B. APPLICANTS ARE ADVISED TO DEAL DIRECTLY WITH THE BANK AND NOT THROUGH THIRD PARTIES.

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DOCUMENTS TO BE SUBMITTED ALONG WITH THE LOAN APPLICATION

1. Plan of the building - approved by the local authority. If the building to be constructed is within a Village Committee area where such approval is not required, a letter from such local authority to that effect.

2. A bill of quantities showing the estimated cost of construction. If the value of loan exceeds Rs. 50,000/- this should be certified by a Chartered or a Registered Architect regarding the price, quantities and the total value.

3. Two copies of the Survey Plan of the property offered as security.

4. Income certificates of the Applicant or Applicants. (letters from employer). A certificate of the assessable income and wealth for the past 3 years issued by the Department of Inland Revenue in the absence of notice of assessment is accepted. Such a certificate is not necessary if (a) the annual income does not exceed Rs. 12,000/- or (b) in respect of income from employment in the public sector.

5. A sales agreement or a letter from the vendor consenting to the sale and indicating the sale price, if the loan is for the purpose of purchasing property.

6. In the case of applications for Agricultural Development, a project plan for development together with a cash flow statement should be attached.

HEAD OFFICE : No. 91, Horton Place,
Colombo—7.

BRANCH OFFICES : (1) No. 292, Galle Road,
Colombo—3.

(2) No. 2, Gnanartha Pradeepa Mawatha,
Colombo—8.

THE STATE MORTGAGE AND INVESTMENT BANK Annex 21

TRENDS IN THE BANK'S ACTIVITIES

	Terminal Dates	31.12.75	31.12.76	31.12.77	31.12.78	31.12.79	31.12.80
1.	Investments on Govt. Security	1,553,000	1,553,000	1,553,000	1,553,000	1,510,000	1,510,000
2.	Investments on Loans	100,009,544	102,194,595	101,492,910	102,972,613	112,810,111	127,881,976
3.	Interest Outstanding	12,235,956	13,543,548	13,895,424	14,401,777	15,303,770	15,556,052
4.	Penal Interest Outstanding	2,114,262	2,272,896	2,296,683	2,338,338	1,883,906	1,549,850
5.	New Loans given	9,288,705	11,887,047	11,668,950	12,390,828	22,970,629	26,874,603
6.	Interest Receivable	7,302,768	8,452,156	8,950,999	9,462,102	9,954,860	11,989,441
7.	Nett Profit	1,563,141	1,591,754	1,539,927	2,184,440	5,912,[illegible]	6,690,470
8	Debenture Outstanding	32,250,000	32,250,000	32,250,000	32,250,000	47,250,000	57,250,000
9	Bank Overdraft	38,744,876	37,[illegible],283	39,669,577	40,951,542	-	-
10	Central Bank Loan	2,317,734	2,387,914	2,110,028	1,832,503	1,564,707	1,301,856
11	Debenture Interest Paid	2,451,952	2,455,000	2,455,000	2,455,000	3,454,657	4,698,836
12	Overdraft Interest paid	1,988,977	2,571,120	3,121,982	3,076,357	662,210	15,776
	Capital Repayment	7,209,736	8,931,623	12,470,845	10,911,126	13,133,131	13,628,317
14	Government grant Balance	34,150,000	34,150,000	34,150,000	34,150,000	61,150,000	61,150,000
15	Reserve Fund/Capital	10,[illegible],559	11,[illegible],611	11,344,375	11,861,122	74,812,900	74,812,900

Notes: (1) The State Mortgage and Investment Bank became fully operative on 1st January 1979.

(2) The figures upto 31st December 1978 are the combined figures for Ceylon State Mortgage Bank and Agricultural and Industrial Credit Corporation.

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MONEY AND BANKING

Agricultural and Industrial Credit Corporation and State Mortgage Bank

Loans granted, Repaid and Outstanding

TABLE 18

Rupees Thousand

Period	Agricultural and Industrial Credit Corporation(a)			State Mortgage Bank(a)		
	Loans granted during the period (1)	Capital Repayments received during the period (2)	Total Loans Outstanding at the end of the period (3)	Loans granted during the period (4)	Capital Repayments received during the period (5)	Total Loans Outstanding at the end of the period (6)
1958 – 59	4,538	3,831	30,906	8,628	3,016	48,380
1959 – 60	5,111	4,250	31,766	11,797	4,040	56,135
1960 – 61	3,202	4,010	30,958	4,284	4,157	56,272
1961 – 62	2,347	3,377	29,929	2,670	3,851	55,359
1962 – 63	3,449	3,789	29.589	2.900	3,782	54,477
1963 – 64	4,777	4,168	30,198	3,653	4,095	55,558
1964 – 65	5,311	3,427	32,082	3,956	3,986	53,645
1965 – 66	3,941	4,002	32,021	4,501	4,138	54,066
1966 – 67	3,527	3,903	31,645	5,022	4,644	54,425
1967 – 68	2,739	3,806	30,577	6,005	4,467	55,616
1968 – 69	4,109	3,822	30,364	8,315	4,280	58,924
1969 – 70	4,855	3,586	32,125	10,903	4,923	64,714
1970 – 71	3,476	4,012	31,580	5,947	5,058	66,086
1971 – 72 (b)	2,399	4,146	29,842	6,137	6.116	66.347
1973	1,049	2,613	28,272	6,393	6,298	66,442
1974	1,927	2,467	27,732	7,966	5,325	69,083
1975	1,481	2,182	27,088	8,913	5,056	72,940
1976	1,727	2,344	26,452	9,366	5,774	76,532
1977	2,279	5,007	23 730	9,373	8,141	77,763
1978	3,968	3,050	24,648	8,420	7,854	78,328

STATE MORTGAGE & INVESTMENT BANK(c)

Rupees Thousand

Period		Loans Granted during the period (1)	Capital repayments received during the period (2)	Total Loans outstanding at the end of the period (3)
1979		23,011	13,107	112,810
1980		26,695	12,705	126,618
1980	June	2,449	934	118.573
	July	2,502	1,278	119,795
	August	1,666	1,187	120,274
	September	2,221	1,089	121,406
	October	2,970	933	123,444
	November	2,303	1,075	124,672
	December	3,509	1,830	126,618
1981	January	2,482	971	127,862
	February	2,745	10,60	129,546
	March	3,200	1,403	131,343
	April	4,233	891	134,685
	May	2,586	1,013	136,258
	June	3,359	947	139,601*
	July	4,350	1,240	141,451*
	August	4,879	1,478	144,653*
	September	5,768	1,628	148,992*

Source: Agricultural and Industrial Credit Corporation, State Mortgage Bank and State Mortgage & Investment Bank.

(a) Until 1971 the financial year was from 1st October to 30th September.

(b) Figures for 1971-1972 cover a period of 15 months (1st October 1971–31st December, 1972).

(c) The State Mortgage Bank & Agricultural & Industrial Credit Corporation were amalgamated from January 1st, 1979 to form State Mortgage and Investment Bank.

* Provisional

The State Mortgage and Investment Bank

Profit & Loss Account for the year ended 31-12-1980

31.12.1979 Rs.		Rs. Cts.	Rs. Cts.
5,912,734	NetProfit for the year before taxation		6,690,469.77
	AFTER CHARGING		
4,321,659	Interest Payable	5,154,318.61	
2,203,590	Working Expenses	3.376,261.51	
57,788	Repairs & Renewals	89,765.34	
25,359	Depreciation	31,845.64	
6,608,396		8,652,191.10	
	Deduct:		
2,975,153	Income Tax for the year		3,384,745.00
	Less Extraordinary Items:		3,305,724.77
191,145	Adjustment in respect of previous year	45,882.08	
	Loss on Sale of Motor Vehicle	15,834.00	61,716.08
2,746,436	Nett Profit after tax		3,244,008.69
	Add Balance Brought Forward		2,746;436.34
	Balance Carried Forward		5,990,445.03

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The State Mortagage and

Balance Sheet as at 31st.

1979 Rs.	LIABILITIES	1980 Rs.
74,812,900	Capital	74,812,899.43
2,746,436	Profit & Loss Account	5,990,445.03
56,039,707	Long Term Liabilities	65,929,856.07
133,599,043		146,733,200.53

(Sgd.) L. PIYASENA
Chairman,

(Sgd.) D. L. FERNANDO.
General Manager

214

Investment Bank

December 1980.

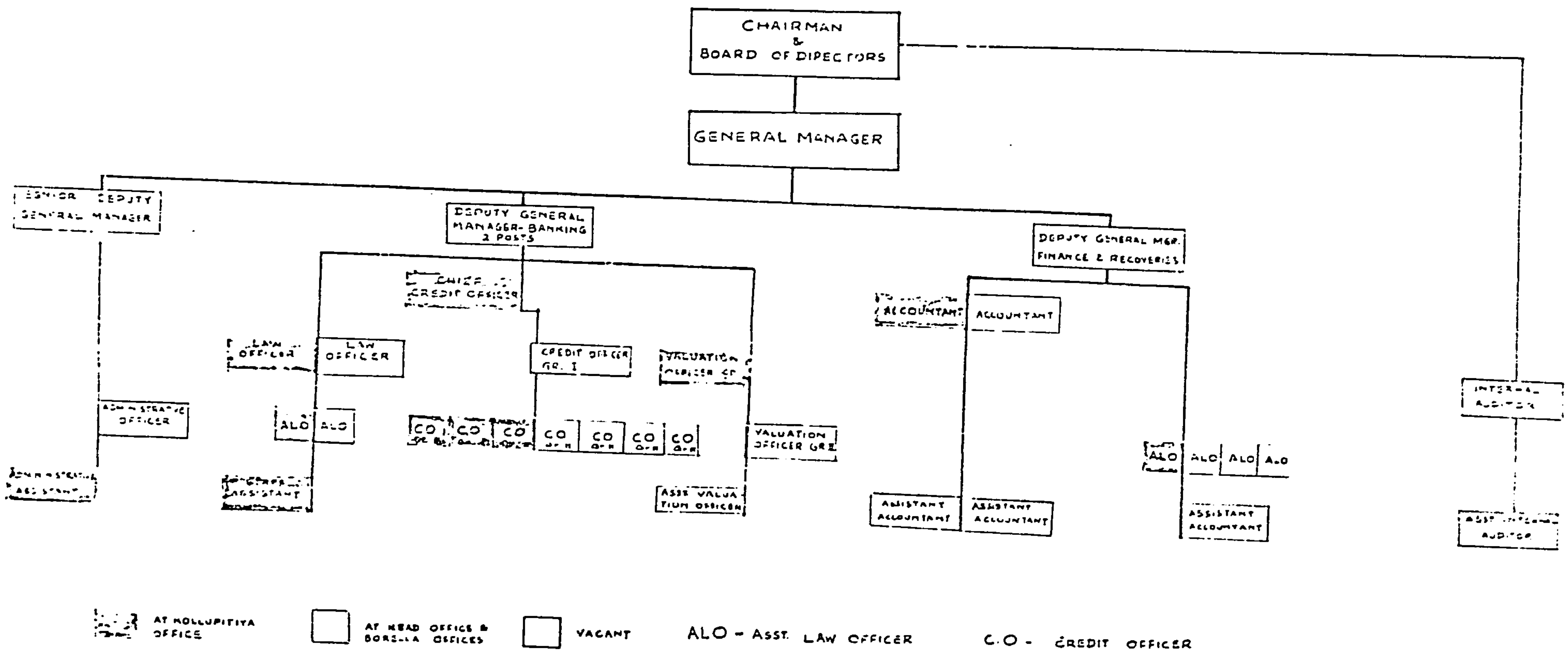
1979 Rs.	FIXED ASSETS	Cost	Depreciation	Additions	1980 Rs. Cts. Balance
120,276	Land & Buildings	240,867.42	122,605.40	—	118,262.02
224,011	Furniture & Equipment	224,011.20	22,505.85	183,580.00	385,085.35
40,000	Motor Vehicles	40,000.00	40,000.00	100,673.33	100,673.33
384,287					604,020.70
	INVESTMENTS				
9,327,631	Govt. Securities			1,510,000.00	
	Bank Deposits			4,190,008.92	5,700,008.92
114,000,938	**LOANS**				127,881,976.89
	CURRENT ASSETS			21,058,508.97	
9,886,187	Less Current Liabilities			8,511,314.95	12,547,194.02
133,599,043					146,733,200.53

In terms of the directive in Circular No. MF 6/13/1/1 dated 13th July, 1981 of the Secretary to the Ministry of Finance and Planning, I certify that the accounts of the State Mortgage and Investment Bank for the year ended 31. 12. 80 were prepared on the basis of generally accepted principles of accounting applied on a basis consistent with that adopted in the preceding year.

(Sgd.) **M. P. B. EKANAYAKE**
Deputy General Manager
(Finance)

225

ORGANISATION – STATE MORTGAGE AND INVESTMENT BANK – 1980



Annex 23 (cont.

A Review of the Operations of the Employees' Provident Fund Department for 1980.

The Monetary Board of the Central Bank of Ceylon, through its Employees' Provident Fund Department continued to receive all sums paid under the Employees' Provident Fund Act No.15 of 1958, as contributions, surcharges, and other income from the investment of moneys of the Fund and to perform its other functions in respect of these moneys in terms of Section 5 of the Act. A brief note on its operations during the year 1980 is given below.

Contributions :

The contributions received by the Fund during the year 1980, amounted to Rs.741.03 million, as against Rs.597.54 million in 1979. This represents an increase of Rs.143.49 million or 24.01 per cent over the level of contributions made during the previous year.

During the year under review the Employees' Provident Fund Department co-ordinated its work with the Ministry of Labour, with a view to assisting them in the enforcement of the provisions of the Act. This scheme is primarily intended to identifying the employers who default on EPF contributions and provide the Commissioner of Labour with a classified monthly statement of all contributions.

In November 1980, the Government decided to increase the rate of contributions to EPF from 6% - 8% by the employee and 9% - 12% by the employer effective from January 1981.

Members' Balances :

Members' balances as at end of 1980 stood at Rs.4620.34 million before allocation of interest for 1980, which is an increase of Rs.851.06 million or 22.58 per cent over the level of 1979. The 1979 balances amounted to Rs.3768.28 million.

Investments :

During the year under review, the Fund invested a sum of Rs.1022.50 million in Government Securities which includes maturity proceeds of earlier securities amounting to Rs.137.21 million as against Rs.781.06 million in 1979. The net increase therefore is Rs.104.23 million or 13.34 per cent over the level of 1979. A Committee appointed by the Monetary Board examines periodically the feasibility of diversifying the investment of the Fund.

Income from Investments :

In 1980 the income from investments of the Fund amounted to Rs.351.61 million as against Rs.268.83 million in 1979. This records an increase of Rs.82.78 million or 30.79 per cent as against an increase of 62.70 million or 30.42 per cent in the previous year. This increase was mainly due to the investment of increased volume of contributions received by the Fund and the re-investment of income derived from investments during the year under review.

Refunds :

The total paid out by way of refund of EPF benefits to members in 1980 amounted to Rs.205.36 million as against a sum of Rs.140.51 million in 1979. This reflects an increase of Rs.64.85 million or 46.15 per cent as compared with 1979. The number of refunds made in 1980 amounted to 50968 as against 43966 in 1979.

The Department introduced in 1978 a new scheme for refunding EPF benefits to repatriates of Indian Origin. Under this scheme, repatriates are paid their EPF benefits by cheque which can be encashed exclusively for the transfer of funds to India by mail transfer. This scheme ensures that repatriates are paid their EPF benefits in shortest possible time.

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Interest on Members' Balances :

The Employees' Provident Fund is required to pay interest on members' balances as at end of each year out of the income from investment of moneys of the Fund. The rate of interest payable on members' balances as at end of 1980 was increased from 8 per cent to 8.5 per cent.

Interest is paid on the balances standing to the credit of members at the end of the year and thereafter interest accumulates on that aggregate sum, interest being, therefore, a compound form of interest. Besides, interest is paid for the entire year on the balances standing to the members' credit at the end of the year irrespective of the date when any portion of that balance (which represents current year's contributions), was received by the Fund to the members' credit, e.g. contributions received in December gets interest for the full year in the same way as contributions received in January of that year. Therefore, the effective rate of interest is somewhat higher than 8.5per cent.

Administration of the Dept. :

(a) In the year under review the efforts of the Department have been directed towards the advancement of 3 objectives of primary importance. Firstly, the preparation of the annual statements for 1979 by the end of January,1981 (the earliest). This would enable the preparation of 1980 statements to be commenced in March,1981.

(b) To this end the Department has already brought up-to-date, on to a current basis, the checking of names and membership numbers on forms C received daily from employers; and the processing of C forms on a current basis.

(c) In April 1980, the Department set up a Systems Review Committee to review the EPF system, and to draw up a comprehensive, revised EPF system.

(d) The Committee also discussed and decided to adopt as a pilot project, the issue of forms C with names and membership numbers pre-printed.

A comprehensive statement of the operations of the Fund, on data presently available, is given in the annex.

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E.P.F. STATISTICS - 1979/1980

	1979	1980
(1) Total Number of Employments	54,823	N.A.
(2) Contributions Received (Rs)	597,542,565*	741,032,542**
(3) Investments (Rs)	781,057,583	1022,500,194***
(4) Income Received from Investment (Rs)	268,830,708	351,608,138
(5) Refund Payments (Rs)	140,514,129	205,355,353
(6) Number of Refunds	43,066	50,968
(7) Rate of Interest (%)	8.0	8.5
(8) Interest on Members' Balances (Rs)	301,542,604	392,728,706

* Excludes contributions credited to suspense accounts.

** Includes contributions credited to suspense account pending transfer to contributions No.1 A/c.

*** Includes maturity proceeds re-invested in Government Securities.

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EMPLOYEES' PROVIDENT FUND

Annex 25
From Central
Bank Annual
Report 1980

The Monetary Board of the Central Bank of Ceylon, through its Employees' Provident Fund Department continued to receive all sums paid under the Employees' Provident Fund Act No. 15 of 1958, as contributions, surcharges, and other income from the investment of moneys of the Fund and to perform its other functions in respect of these moneys in terms of Section 5 of the Act. A brief note on its operations during the year 1980 is given below.

Contributions

The contributions received by the Fund during the year 1980, amounted to Rs. 741.03 million, as against Rs. 597.54 million in 1979. This represents an increase of Rs. 143.49 million or 24.01 per cent over the level of contributions made during the previous year.

During the year under review the Employees' Provident Fund Department co-ordinated its work with the Ministry of Labour, with a view to assisting them in the enforcement of the provisions of the Act. This scheme is primarily intended to identifying the employers who default on EPF contributions and provide the Commissioner of Labour with a classified monthly statement of all contributions

In November 1980, the Government decided to increase the rate of contributions to EPF from 6 per cent to 8 per cent by the employee and 9 per cent to 12 per cent by the employer effective from January, 1981.

Members' Balances

Members' balances as at end of 1980 stood at Rs. 4620.34 million before allocation of interest for 1980, which is an increase of Rs. 851.06 million or 22.58 per cent over the level of 1979. The 1979 balances amounted to Rs. 3768.28 million.

Investments

During the year under review, the Fund invested a sum of Rs. 1022.50 million in Government Securities which includes maturity proceeds of earlier securities amounting to Rs. 137.21 million as against Rs. 781.06 million in 1979. The net increase therefore is Rs. 104.23 million or 13.34 per cent over the level of 1979. A committee appointed by the Monetary Board examined periodically the feasibility of diversifying the investments of the Fund.

Income from Investments

In 1980 the income from investments of the Fund amounted to Rs. 351.61 million as against Rs. 268.83 million in 1979. This records an increase of Rs. 82.78 million or 30.79 per cent as against an increase of Rs. 62.70 million or 30.42 per cent in the previous year. This increase was mainly due to the investment of increased volume of contributions received by the Fund and the re-investment of income derived from investments during the year under review.

Refunds

The total paid out by way of refund of EPF benefits to members in 1980 amounted to Rs. 205.36 million as against a sum of Rs. 140.51 million in 1979. This reflects an increase of Rs. 64.85 million or 46.15 per cent as compared with 1979. The number of refunds made in 1980 amounted to 50,968 as against 43,066 in 1979.

The Department introduced in 1976 a new scheme for refunding EPF benefits to repatriates of Indian origin. Under this scheme, repatriates are paid their EPF benefits by cheque which can be encashed exclusively for the transfer of funds to India by mail transfer. This scheme ensures that repatriates are paid their EPF benefits in shortest possible time.

Interest on Members' Balances

The Employees' Provident Fund is required to pay interest on members' balances as at end of each year out of the income from investment of funds. The rate of interest payable on members' balances as at end of 1980 was increased from 8 per cent to 8.5 per cent.

Interest is paid on the balances standing to the credit of members at the end of the year and thereafter interest accumulates on that aggregate sum, interest being, therefore, a compound form of interest. Besides, interest is paid for the entire year on the balances standing to the members' credit at the end of the year irrespective of the date when any portion of that balance (which represents current year's contributions), was received by the Fund to the members' credit, e.g. contributions received in December gets interest for the full year in the same way as contributions received in January of that year. Therefore, the effective rate of interest is somewhat higher than 8.5 per cent.

Administration of the Department

(a) In the year under review the efforts of the Department have been directed towards the advancement of 3 objectives of primary importance. Firstly, the preparation of the annual statements for 1979 by the end of January, 1981 (the earliest). This would enable the preparation of 1980 statements to be commenced in March, 1981.

(b) To this end the Department has already brought up-to-date, on to a current basis, the checking of names and membership numbers on forms C received daily from employers; and the processing of C forms on a current basis.

(c) In April 1980, the Department set up a System Review Committee to review the EPF system, and to draw up a comprehensive revised EPF system.

(d) The Comittee also discussed and decided to adopt as a pilot project the issue of forms C with names an d membership numbers pre-printed.

A comprehensive statement of the operations of the Fund, on data presently available, is given in the following table.

TABLE 2.12

E. P. F. Statistics 1979 - 1980

Item	1979	1980
1. Total number of employments	54,823	n.a.
2 Contributions received (Rs.)	597,542,565(*a*)	741,032,542(*b*)
3 Investments (Rs.)	781,057,583	1022,500,194(*c*)
4 Income received from investment (Rs.)	268,830,708	351,608,138
5 Refund payments (Rs.)	140,514,129	205,355,353
6 Number of refunds	43,066	50,968
7 Rate of interest (%)	8.0	8.5
8 Interest on Members' Balances (Rs.)	301,542,604	392,728,706

(*a*) Excludes contributions credited to suspense accounts.

(*b*) Includes contributions credited to suspense account pending transfer to contributions No. 1 A/C.

(*c*) Includes maturity proceeds re-invested in government securities.

HPT GROUP

PROPERTY HOUSE, COLOMBO 8. SRI LANKA
PHONE: 91471 94356, 96036, 95744, 91631
P. O. BOX 1077. CABLES: 'HOUSANPROP'
TELEX: 21203 A/B HPT CE.

Dear Investor,

This letter serves to set out before you our revised Schemes of Investments and rates of interest which have been arrived at after careful deliberation on all financial aspects. There are three catagories of investments which are available to the Investors:-

a) Term Deposits :- Deposits are accepted for fixed terms at varying rates of interest as follows :

3 months - 16% per annum - Interest will be paid at the end of the three months period.

6 months - 18% per annum - Interest will be paid at the end of the period.

b) Fixed Deposits - Fixed Deposits are accepted for fixed periods at varying rates of interest as follows :

	1 YEAR		2 YEARS	
	MONTHLY INTEREST	INTEREST ON MATURITY	MONTHLY INTEREST	INTEREST ON MATURITY
Rs. 1000/- to Under Rs. 50,000/-	21%	22%	23%	24%
Rs. 50,000/- to Under Rs. 100,000/-	22%	23%	24%	25%
Rs. 100,000/- and over	23%	24%	25%	27%

Interest is payable monthly as requested by the Investor on all fixed deposits.

A special feature in this scheme too is that withdrawal of your investments before maturity is allowed with benefits at the discretion of the Company.

Interest on such withdrawals will be calculated on the following rates if withdrawer

Before 3 months — Interest will not be paid
Before 6 months — 15% per annum
Before 12 months — 18% per annum
Before 18 months — 19% per annum
Before 24 months — 20% per annum

As mentioned earlier, we are proud to state that since inception all calls on Fixed Deposits by our investors for a pressing requirement have never been refused, though it was not obligatory on our part to refund such deposits before its maturity.

232

Annex 26/2

SEPT 1981

A SAFE AND SECURE INVESTMENT PLUS AN ATTRACTIVE RETURN FROM A LONG ESTABLISHED AND DEPENDABLE FINANCE HOUSE

30%

THE CENTRAL FINANCE CO., LTD.

(A Public Limited Liability Company Incorporated on 5th July, 1957)

PERIOD	AMOUNT	INTEREST PER ANNUM Paid Monthly	Paid Annually	At Maturity
2 Years	Rs. 500/- and Less than Rs. 100,000/-	22%	25%	27%
2 Years	Rs. 100,000/- and over	24%	27%	30%

Directors:- C. Wijenaike (Chairman & Managing Director. A. S. Karunaratne J.P. Attorney-at-Law. T. A. Dunuwille O.B.E. Attorney-at-Law, M. C. Sansoni B. A. (retd. Chief Justice), T. M. Dunuwille B.A., Col. E. J. Divitotawela and Col. A. T. Nugawela.

Principal line of business:- Financiers. Real Estate Developers, Importers, Agents and Distributors.

Financial Information:-

	1977/78 Rs.	1978/79 Rs.	1979/80 Rs.
Capital	1,522,500	1,522,500	1,522,500
Reserves	3,107,970	7,030,225	8,742,785
Capital & Reserves	4,630,470	8,522,725	10,265,285
Deposits	27,684,075	29,952,100	33,671,700
Borrowings	207,205	2,333,606	5,075,248
Profit before payment of interest to Deposit Holders	6,642,954	8,075,252	9,411,865
Interest paid to Deposit Holders	3,746,107	4,814,736	5,882,417
Nett profit before taxation	2,896,847	3,260,516	3,529,448
Nett profit after taxation	1,786,805	1,775,842	2,135,945
Dividends	319,725 (21%)	365,400 (24%)	411,075 (27%)

THE CENTRAL FINANCE CO., LTD.

Head Office
No: 24, Dalada Vidiya
Kandy.
Tel: 4098, 3818, 3076

Branch Office
No: 250, K.K.S. Road,
Jaffna.
Tel: 7049.

City Office
No: 221/5, Dharmapala
Mawatha Colombo 7.
Tel: 93792

Nearly twenty five years in the business of making money grow for others

233

THE FINANCE CO. LTD.

SAVINGS DEPOSITS

Invest monthly Rs. 50/- or multiples thereof for a period of 24 months, and earn interest at 15% p. a. payable at MATURITY.

TIME DEPOSITS

Here's a Scheme where you do not 'tie-up' your money. Investments are accepted in cash with a minimum of Rs. 5,000/ with interest at 15% p. a. and is withdrawable on one working days notice. This you will agree is virtually having your money over the counter.

TERM DEPOSITS

The rates of interest paid on term deposits varies with the period for which the deposit is made:

12 months	20% p. a.
24 months	22% p. a.

For Deposits of 100,000/- & over for a period of 24 months 24% p. a.

Your interest is payable either monthly, Quarterly. Half yearly or Annually.

NEW QUICK YIELD DEPOSIT SCHEME

These deposits are accepted for either 18 months, 24 months, or 36 months with the interest becoming payable at MATURITY, along with the capital. The rates of interest offered on these deposits are:

18 months	22% p. a.
24 months	25% p. a.

For Deposits of 100,000/- & over for a period of 24 months 27% p. a.

MATURITY DEPOSITS

We pay 20% p. a. on MATURITY when you invest Rs. 1,000/- or Rs. 5,000/- for a period of 12 months only.

BRANCHES

* Jaffna	* Ratnapura	* Nugegoda
Kurunegala	Kandy	Amparai
Matara	Badulla	Anuradhapura
Polonnaruwa	Pettah	Negombo
Batticaloa	Kalutara	Union Place

COLOMBO DAILY NEWS

Saturday, December 5, 1981

25 plus 10

Your money does more for you at HIDEKI

Add Hideki's industry, perseverance and dynamism to yours and make your investments yield more, faster!

HIDEKI DEPOSIT SCHEMES

INTEREST PAID	INTEREST	BONUS	PROFIT	TOTAL
A. ONE-YEAR				
Monthly	22%	2%	2%	26%
Quarterly	23%	3%	3%	29%
Half yearly	24%	4%	4%	32%
B. TWO-YEAR				
Monthly	23%	3%	3%	29%
Quarterly	24%	4%	4%	32%
Half yearly	25%	5%	5%	35%

HIDEKI FINANCE & INVESTMENTS LTD.

Incorporated on July 4th, 1980

Board of Directors:

Mr. Kalpage Wickremasinghe B.Sc., C. Engineer (Mech)	Chairman & Managing Director
Mr. Nagalingam Anantakrishnan F.C.A.	Director
Mr. Lakshman de Silva	Director
Mr. Samson Silva	Director

PRINCIPAL LINES OF BUSINESS:
Finance & Investments, Industries, Construction & Marines.

POST THIS COUPON TODAY

Please send me details of the unique Hideki Fixed Deposit Schemes.

Name ....

Address ....

....

HIDEKI FINANCE & INVESTMENTS LTD.
12, Galle Face Court,
Sir Mohamed Macan Markar Mawatha,
Colombo 3.
Tel: 35000, 547781, 89059.

a member of the HIDEKI Group of Companies

HIDEKI - where your money does more for you

COLOMBO DAILY NEWS

Tuesday, December 8, 1981.

Annex 26/5

A SAFE AND SECURE investment plus an attractive return from a long established and dependable finance house 30%

THE CENTRAL FINANCE CO., LTD.

(A Public Limited Liability Company Incorporated on 5th July, 1957)

PERIOD	AMOUNT	INTEREST PER ANNUM Paid Monthly	Paid Annually	At Maturity
2 Years	Rs. 500/- and less than Rs. 100,000/-	[illegible]	25%	27%
2 Years	Rs. 100,000/- and over	24%	27%	30%

DIRECTORS:- C. Wijenaike (Chairman & Managing Director), A.S. Karunaratne J.P. Attorney-at-Law, T.A. Dunuwille O.B.E. Attorney-at-Law, M.C. Sansoni B.A. (retd. Chief Justice), T.M. Dunuwille B.A. Col. E.J. Divitotawela and Col. A.T. Nugawela.

PRINCIPAL LINES OF BUSINESS:- Financiers, Real Estate Developers, Importers, Agents and Distributors

FINANCIAL INFORMATION:-

	1977/78 Rs.	1978/79 Rs.	1979/80 Rs.
Capital	1,522,500	1,522,500	1,522,500
Reserves	3,107,970	7,030,225	8,742,785
CAPITAL & RESERVES	4,630,470	8,522,725	10,265,285
Deposits	27,684,075	29,952,100	33,671,700
Borrowings	207,205	2,333,606	5,075,248
GROSS ASSETS	36,378,176	46,252,738	55,703,505
PROFIT BEFORE PAYMENT OF INTEREST TO DEPOSIT HOLDERS	6,642,954	8,075,252	9,411,865
INTEREST PAID TO DEPOSIT HOLDERS	3,746,107	4,814,736	5,882,417
Nett profit before taxation	2,896,847	3,260,516	3,529,448
Nett profit after taxation	1,786,805	1,775,842	2,135,945
Dividends	319,725 (21%)	365,400 (24%)	411,075 (27%)

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THE CENTRAL FINANCE CO., LTD.

HEAD OFFICE: No. 24 [illegible] Vidiya, Kandy. Tel. [illegible]

CITY OFFICE (Managed by Forbes & Walker Limited): No. 221/5 Dharmapala Mawatha, Colombo 7. Tel. 93792

BRANCH OFFICE: No. 250, K.K.S. Road, Jaffna. Tel. 7049

NEARLY TWENTY FIVE YEARS IN THE BUSINESS OF MAKING MONEY GROW FOR OTHERS

236

NEWSPAPER AD - The Island
9/12/81

Annex 27

HOME FINANCE LIMITED

House & Property Sale

IDEAL HOMES

The home you were waiting for, just 4 miles from Pamankada Bridge, on the Piliyandala Road, at Nilani Gardens, Bokundara, with all amenities including Electricity, Pipe borne water and Drainage on 15 perches of land, tarred roadway around four feet wall.

Convenient bus service, Security and Privacy guaranteed.

FOR FURTHER INFORMATION:—

HOME FINANCE LTD

463, Galle Road,
Colombo 3.

Tel: 589190
587680

NOTES FROM TELEPHONE CALL

6 identical houses, completed and ready for occupation.
Total floor area 980Sq.ft.
comprising : 2 bedrooms
1 attach bathroom
servants toilet
living room
dining room
store room
kitchen
garden space available for garage.

Houses are on lots of
12 perches, 14 perches
and 18.9 perches
Price:
House on 12 perches costs
Rs. 300,000/=
House on 18.9 perches costs
Rs.330,000/=

Full payment is preferred.
But will consider down payment of Rs.220,000/= and balance later.

Intend putting up more houses hence full payment preferred.

Location: 5 miles from Colombo on the 120 bus route to Piliyandale.

MERCANTILE HOUSING LTD.

Mercantile Housing Ltd was incorporated in June 1968 and is an Approved Building Company under the National Housing Act Chapter 401 of the Legislative Enactments of Ceylon (Revised 1956).

It is the first Building Company to pioneer Housing Estates in Sri Lanka. Housing Estates in 6 locations close to Colombo, covering an extent of altogether 53 acres and consisting of 407 Housing Lots were developed. Each Housing Estate was provided with macadamized roads with side drains, street lighting and piped water for each housing lot from a central water supply and a pumping station, where appropriate. After development, the housing lots were sold on the basis that either the buyer constructed his own house or the Company on its own constructed the houses and sold them to prospective buyers.

However, as these Housing Estates were developed at a time when the business climate was unfavourable, as it was during the regime of the previous Government, and because of the operation of the so-called House Ceiling Act, which was designed to depress values on land and houses, the Company had to incur a loss. Subsequently, after the present Government assumed office, Government acquired in May 1979, a property of 29 acres in extent owned by the Company which adjoined one of the former Housing Estates the Company had developed, in order to establish a State Housing Scheme. This action was unfortunate from the point of view of the Company, because the property had a high potential value as middle class Housing Estate since it was located in close proximity to the new Capital City which the Government is developing.

Despite a sharp rise in construction cost, there is scope for an entrepreneur-developer to promote Housing Estates for the Low-Middle Income Group whose housing requirements are for accommodation in extent of 800 - 1250 sq ft floor area.

However, a major factor inhibiting housing development by entrepreneurs is lack of adequate facilities providing :

(a) bridging finance, and

(b) mortgage finance on a long term basis for 15 years to, preferably, 20 years, at a reasonable rate of interest.

In view of the credit stringency which is currently prevailing and will continue to be a feature in the foreseeable future, in the context of an inflationary situation, access to long term housing finance could materially assist house developers to embark on a program of house construction from the Low-Middle Income Group.

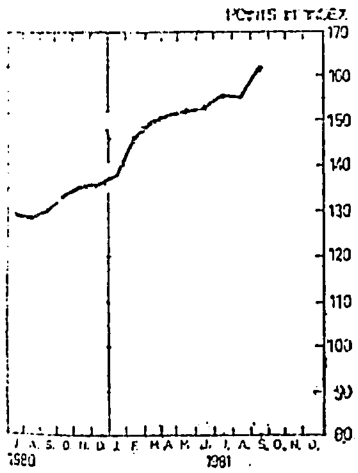
MHL would be willing to embark on a Housing Project of the kind canvassed, if loan finance is made available. Houses could be constructed by resorting to modern construction methods by a Construction Company established under the name of Mercs-Ballast-Nedam (Ceylon) Ltd as a Joint Venture between , Mercantile Credit Ltd, the largest Finance Company in Sri Lanka, and Ballast-Nedam International b.v., Holland, which is one of the largest construction companies in the Netherlands. Ballast-Nedam International b.v. has already 2 construction contracts in Sri Lanka for a value of Rs 750 million. A speciality of Ballast Nedam International is house development

Increased production levels in real terms were recorded by Textile (Rs. 119 million), Cement (Rs. 41 million) and Paper (Rs. 8 million) Corporations. Significant decreases in the production were recorded by Petroleum (Rs. 127 million), Oils and Facts (Rs. 27 million), Tyre (Rs. 24 million) and Steel (Rs. 13 million) Corporations. The substantial decrease in the production of the petroleum refinery was mainly due to the shut down of the refinery for repairs and maintenance in February, this year. However, petroleum products represented more than 50 per cent in the overall output of the public sector major industrial enterprises during this period. Detailed statistics are presented in Table 51 of the Statistical Appendix.

Investment Promotion Zone

Sep.ember, 1981.

The Greater Colombo Economic Commission (GCEC) has approved 152 projects by the end of September, 1981. Of these, 68 firms have signed agreements with GCEG to set up various industries. The factories in the Katunayake Investment Promotion Zone (KIPZ) provided employment for 17,816 persons.



INDEX OF COST
OF CONSTRUCTION - HOUSES
1979 OCTOBER = 100

CONSTRUCTION

September, 1981

In September 1981 the index of cost of construction of house increased by 4·3 per cent.

The increase was the result of higher labour charges (masonary 19 per cent and carpentry 5 per cent) and a marginal increase in prices of basic building materials, such as bricks.

The index rose by 19·2 per cent in the first nine months of 1981 and by 24·4 per cent during the twelve months ended September, 1981. (See Statistical Appendix Table 58.

Table XIX

Index of Cost of Construction — Houses

ITEM	August 1981	Sept. 1981	% Change	Average of 12 months ended Sept. 1981
All Items ..	155·2	161·8	+4·3	147·4
Basic building materials ..	153·7	154·4	+0·5	153·4
Timber ..	147·2	147·2	—	133·0
Roofing Materials ..	144 2	144·2	—	149·5
Iron & Steel ..	142·5	142·5	—	132·2
Metal & Brass Fittings ..	152·4	152 4	—	137·0
Electrical Wires & Fittings ..	151·8	151·8	—	131·1
Water piping & Gutters ..	100·5	100·5	—	100·5
Ceramic Fittings ..	146·7	146·7	—	146·7
Steel & Glass ..	136·7	136·7	—	133·8
Paints ..	115·5	115·5	—	114 8
Labour (Masonary) ..	191·9	228 1	+ 18·9	171·5
Labour (Carpentry) ..	167·1	175·6	+ 5·1	150·6
Labour (Electrical) ..	148·0	148·0	—	128·0

Source: Central Bank of Ceylon.

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TABLE 58

Index of Cost of Construction – Houses

(1979 October = 100)

Period	All Items (1)	Basic Construction Materials (2)	Timber (3)	Roofing Materials (4)	Iron & Steel (5)	Metal & Brass Fittings (6)	Electrical Wires & Fittings (7)	Water Piping & Gutters (8)	Ceramic Fittings (9)	Sheet Glass (10)	Paints (11)	Labour (Masonary) (12)	Labour (Carpentry) (13)	Labour (Electrical) (14)
Weights ..	100·00	28·56	19·76	09·47	02·16	01·84	02·61	03·81	0·59	02·04	02·[illegible]2	15·29	10·81	0·84
1979 October ..	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00	100·00
November ..	105·85	117·43	100·00	106·37	100·00	110·94	102·57	100·00	100·00	100·00	100·00	100·00	100·00	100·00
December ..	109·10	126·31	100·00	106·37	105·89	115·02	102·57	100·00	100·00	100·00	100·00	103·33	100·00	100·00
1980 January ..	114·84	134·38	100·00	117·94	105·89	115·02	103·94	100·00	100·00	101·42	103·94	116·26	101·97	100·00
February ..	122·45	154·45	100·00	127·07	105·89	115·02	105·18	100·00	100·00	101·42	103·94	121·65	102·20	116·00
March ..	123·06	154·45	100·00	132·02	105·89	115·02	105·18	100·00	123·02	101·42	103·94	121·65	102·20	116·00
April ..	124·33	156·95	100·00	134·50	106·82	122·93	110·64	100·00	123·02	101·42	104·66	121·65	102·20	116·00
May ..	123·81	151·19	100·00	134·50	106·82	124·90	111·72	100·00	123·02	101·42	104·66	124·45	108·04	116·00
June ..	127·39	151·24	104·94	136·98	106·82	124·90	112·23	100·00	123·02	101·42	104·66	134·64	115·31	116·00
July ..	129·02	151·22	104·94	150·74	106·82	124·90	112·23	100·00	137·69	101·42	104·66	134·82	117·29	116·00
August ..	128·43	147·34	105·28	150·74	118·76	124·90	112·89	100·53	146·72	101·42	109·31	134·82	117·29	116·00
September ..	130·09	147·34	105·28	150·74	118·76	125·08	112·89	100·53	146·72	101·42	110·16	142·76	121·23	116·00
October ..	133·85	147·34	105·28	150·74	118·76	125·43	117·16	100·53	146·72	101·42	110·19	158·55	132·58	116·00
November ..	135·49	149·93	105·28	150·74	122·49	125·43	117·16	100·53	146·72	136·65	114·52	158·55	132·58	116·00
December ..	135·71	150·70	105·23	150·74	122·49	125·43	117·27	100·53	146·72	136·65	114·52	158·55	132·58	116·00
1981 January ..	137·82	151·93	105·28	150·74	122·49	125·43	117·27	100·53	146·72	136·65	114·52	166·17	137·50	124·00
February ..	146·08	152·23	146·53	150·74	122·49	125·43	117·27	100·53	146·72	136·65	115·53	166·17	137·50	124·00
March ..	149·94	156·00	146·53	152·08	122·49	128·41	117·44	100·53	146·72	136·65	115·53	172·61	152·34	124·00
April ..	151·25	156·00	146·53	152·08	142·47	143·54	140·47	100·53	146·72	136·65	115·53	172·61	152·34	124·00
May ..	152·69	156·00	146·53	152·08	142·47	145·23	140·55	100·53	146·72	136·65	115·53	175·83	160·17	132·01
June ..	153·00	156·46	147·21	152·08	142·47	147·56	140·76	100·53	146·72	136·65	115·53	175·83	160·17	132·01
July ..	155·55	156·46	147·21	144·24	142·47	147·56	144·16	100·53	146·72	136·65	115·53	191·88	167·06	132·01
August ..	155·19	153·74	147·21	144·24	142·47	152·38	151·79	100·53	146·72	136·65	115·53	191·88	167·06	148·01
September ..	161,84	154·37	147·21	144·24	142·47	152·38	151·79	100·53	146·72	136·65	115·53	228·12	175·62	148·01

Source: Central Bank of Ceylon.

PRODUCTION

Approval of Building Plans by Colombo Municipality●

TABLE 57

Period	New Houses: Houses	New Houses: Flats	New Houses: Total	Commercial Buildings	New Industrial Buildings	New School Buildings	Additions & Alterations	Other Buildings	Total
1971	120	31	151	28	45	–	533	–	757
1972	240	22	262	16	–	–	500	–	778
1973	148	26	174	48	10	–	532	–	764
1974	230	12	242	41	6	–	398	–	687
1975	263	20	283	47	11	4	409	–	754
1976	351	23	374	57	4	2	385	–	822
1977	338	37	375	75	–	5	423	–	878
1978	343	75	418	125	46	12	321	7	929
1979	580	212	792	118	101	24	736	5	1,776
1980	271	292	563	67	36	5	456	7	1,134
1950 January ..	37	24	61	12	8	1	44	1	127
February ..	30	18	48	10	8	2	55	–	123
March ..	20	44	64	18	2	1	53	–	138
April ..	29	33	62	3	3	—	39	–	107
May ..	32	22	54	3	1	—	28	1	87
June ..	21	41	62	3	2	—	47	—	114
July ..	17	27	44	3	2	—	73	—	122
August ..	15	12	27	—	—	—	25	1	53
September ..	17	19	36	2	—	—	29	1	68
October ..	16	24	40	3	—	—	21	—	64
November ..	18	22	40	5	5	1	22	1	74
December ..	19	6	25	5	5	—	20	2	57
1981 January ..	25	23	48	5	—	—	57	—	110
February ..	11	31	42	5	—	—	55	—	102
March ..	29	19	48	5	—	—	38	—	91
April ..	34	43	77	5	2	1	40	1	126
May ..	26	11	37	2	—	—	37	3	79
June ..	23	18	41	5	1	2	47	3	99
July ..	32	24	56	5	1	—	66	1	129
August ..	28	7	35	1	—	—	43	—	
September ..	23	6	29	6	—	1	33	1	70

Source: Colombo Municipality

● Excludes Government and Corporations building plans.

PRICES AND WAGES

Cost of Living Index Numbers—Colombo

TABLE 41

Period	Nov. 1938 - April 1939 = 100(b)	1952 = 100(a)								
			Commodity-wise					Sector-wise		
	All Items (1)	All Items (2)	Food (3)	Cloth-ing (4)	Fuel and Light (5)	Rent (6)	Miscel-laneous (7)	Domes-tic Group (c) (8)	Import Group (d) (9)	Export Group (e) (10)
1963 .. .	305·7	108·8	103·0	118·2	103·0	101·5	126·6	113·4	102·5	117·7
1964	315·3	112·2	106·4	127·2	103·2	101·5	129·3	116·7	106·6	115·3
1965 .. .	316·1	112·5	107·3	126·8	100·7	101·5	128·3	116·4	106·4	127·2
1966 .. .	315·6	112·3	109·1	117·0	95·9	101·5	127·3	116·8	105·4	127·6
1967	322·6	114·8	112·7	116·7	96·5	101·5	128·9	117·1	111·2	123·9
1968	341·3	121·5	121·2	120·1	103·2	101·5	133·6	123·2	117·3	[illegible]
1969	366·8	130·5	127·9	130·9	124·9	108·4	147·1	134·3	123·5	148·2
1970	388·3	138·2	136·6	137·3	136·1	109·8	153·2	142·9	129·3	157·3
1971	398·7	141·9	139·1	145·0	140·8	109·8	159·5	148·9	129·7	157·9
1972	423·7	150·8	147·5	163·4	145·9	109·8	169·4	161·6	136·1	140·6
1973	464·8	165·4	164·8	186·1	161·4	109·8	170·0	167·8	162·5	171·9
1974	522·0	185·8	189·7	204·6	221·0	109·8	178·3	176·1	195·7	251·4
1975	557·3	198·3	204·3	208·2	237·1	109·8	191·9	189·5	213·5	214·5
1976 . .	563·9	200·7	202·1	211·7	265·2	109·8	203·8	195·5	209·2	219·8
1977	570·9	203·2	203·3	223·8	257·5	109·8	208·4	200·6	195·6	317·5
1978	640·2	227·8	237·5	226·2	262·2	109·8	224·8	223·8	243·8	358·2
1979	708·9	252·3	263·3	231·2	328·5	109·8	252·4	249·3	283·7	385·2
1980	894·2	318·2	339·7	239·9	563·9	109·8	293·8	283·9	417·7	438·1
1979 2nd Quarter ..	682·7	243·0	254·0	230·6	269·8	109·8	247·3	242·2	263·6	377·1
3rd Quarter ..	710·8	253·0	263·2	232·2	328·5	109·8	255·8	251·4	282·9	383·7
4th Quarter ..	766·1	272·6	284·9	232·6	445·9	109·8	262·1	263·9	325·2	413·3
1980 1st Quarter ..	824·6	293·5	310·7	233·5	499·6	109·8	275·6	273·5	373·8	421·4
2nd Quarter ..	887·2	315·7	340·3	236·2	525·0	109·8	289·4	284·3	420·2	431·2
3rd Quarter ..	916·5	326·2	350·7	241·4	593·8	109·8	292·3	291·6	435·8	442·0
4th Quarter .	948·6	337·6	357·3	248·5	637·0	109·8	317·9	306·0	441·1	457·9
1981 1st Quarter ..	994·8	354·0	370·3	252·3	723·8	109·8	341·0	320·2	463·4	490·3
2nd Quarter ..	1,041·3	370·6	392·8	256·4	766·5	109·8	343·1	336·5	488·0	507·6
3rd Quarter ..	1,066·1	379·4	404·5	259·3	789·3	109·8	345·0	346·8	497·1	522·7
1980 September ..	923·7	328·7	352·7	244·4	611·8	109·8	293·3	293·5	439·7	442·0
October ..	932·1	331·7	355·0	248·0	631·0	109·8	295·5	296·8	440·4	443·3
November ..	952·3	338·9	357·6	248·0	631·0	109·8	325·4	308·8	440·5	460·2
December ..	961·3	342·1	359·2	249·4	649·0	109·8	332·9	312·5	442·3	470·3
1981 January ..	971·4	345·7	359·9	250·5	692·3	109·8	339·2	315·9	445·5	479·7
February ..	996·2	354·5	370·5	252·0	730·6	109·8	341·6	320·5	465·1	489·9
March ..	1,016·7	361·8	380·5	254·5	748·6	109·8	342·3	324·3	479·5	501·3
April ..	1,028·7	366·1	387·1	255·4	748·6	109·8	343·1	330·0	483·9	501·3
May ..	1,041·4	370·6	392·9	256·2	766·4	109·8	343·1	336·2	488·3	510·7
June ..	1,053·8	375·0	398·5	257·7	784·4	109·8	343·1	[illegible]	491·9	510·7
July ..	1,059·0	376·5	401·0	258·0	784·4	109·8	343·1	345·0	492·0	510·7
August ..	1,061·6	377·8	401·5	259·5	791·8	109·8	345·9	346·9	494·2	510·7
September .	1,078·8	383·9	411·1	260·4	791·8	109·8	345·9	347·6	505·2	546·7

Sources: Department of Census and Statistics and Central Bank of Ceylon

Note:– Annual figures shown are average of monthly figures.

(a) Colombo Consumers' Price Index – from January, 1956, onwards: index numbers on base 1952 = 100 with the following percentage weights for the groups based on an average total expenditure of Rs. 202·24 – in 1949 1950. Food 61·9: clothing 9·4: fuel and light 4·3: rent 5·7: miscellaneous 18·7.

(b) The All Items Index with base November, 1938 – April 1939 = 100 was as follows: August – December 1939 = 108 1948 = 260; 1950 = 272; 1951 = 283; 1952 = 281.

(c) Comprises items of domestic origin. Weight 60 per cent from January 1968. Previous weight 51 per cent.

(d) Comprises imported goods. Weight 35 per cent from January 1968. Previous weight 44 per cent.

(e) Comprises domestic goods mainly exported. Weight 5 per cent.

Gross National Product 1975 - 1980

TABLE 45

Rupees Million

Sectors	At Current Factor Cost Prices						At Constant (1970) Factor Cost Prices					
	1975	1976	1977	1978*	1979*	1980*	1975	1976	1977	1978*	1979*	1980*
1. Agriculture, Forestry and Fishing ..	7,798	8,133	10,644	12,332	13,412	17,151	3,847	3,894	4,299	4,532	4,622	4,766
(a) Agriculture and Livestock ..	7,173	7,459	9,588	10,951	11,073	14,210	3,536	3,571	3,977	4,176	4,239	4,348
(b) Forestry and Fishing ..	625	674	1,056	1,381	2,339	2,941	311	323	322	356	383	418
2. Mining and Quarrying ..	450	639	595	732	947	1,249	395	571	515	619	652	684
3. Manufacturing ..	5,158	5,620	8,023	8,094	9,484	11,048	2,263	2,371	2,357	2,541	2,659	2,681
(a) Processing of Tea, Rubber and Coconut	1,848	2,509	4,219	3,675	3,692	3,810	832	860	823	840	877	791
(b) Factory Industries ..	2,647	2,416	3,017	3,551	4,546	5,910	1,158	1,214	1,227	1,362	1,417	1,468
(c) Cottage Industries ..	300	335	396	444	507	507	171	185	189	214	365	402
(d) Other ..	363	360	391	424	739	821	101	113	118	125		
4. Construction ..	1,018	1,164	1,133	1,965	3,218	5,552	649	685	619	794	960	1,066
5. Electricity, Gas, Water and Sanitary Services	164	171	194	259	398	601	117	122	131	158	190	209
6. Transport, Storage and Communications ..	2,079	2,286	2,723	2,994	4,744	5,293	1,497	1,425	1,498	1,607	1,716	1,638
7. Wholesale and Retail Trade ..	4,975	5,456	6,239	7,536	9,435	10,893	2,886	2,928	2,999	3,267	3,551	3,849
8. Banking, Insurance and Real Estate ..	336	419	542	845	1,243	1,755	276	246	295	318	350	402
9. Ownership of Dwellings ..	639	726	832	969	1,293	1,457	463	467	475	499	518	549
10. Public Administration and Defence ..	798	948	1,177	1,516	1,664	1,965	729	760	791	854	905	959
11. Services n.e.s. ..	2,276	2,470	2,582	3,257	3,944	5,247	1,865	1,962	2,099	2,212	2,378	2,572
12. Gross Domestic Product ..	25,691	28,032	34,684	40,479	49,782	62,246	14,987	15,431	16,078	17,401	18,501	19,575
13. Net Factor Income from Abroad ..	-213	-282	-252	-237	-240	-432	-91	-86	-79	-90	-112	-170
14. Gross National Product ..	25,478	27,750	34,432	40,242	49,542	61,814	14,896	15,345	15,999	17,311	18,389	19,405

Source: Central Bank of Ceylon.

Notes: i. The Central Bank has introduced a new National Income Series. A Technical note explaining the changes is found in the Central Bank's Annual Review for 1978 pp. 22 & 23.

ii. Estimates are provisional.

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INTERVIEW WITH

J.A.R. Felix, Commissioner of Inland Review

December 14, 1981

Inland Revenue collects Rs.2.5 billion in direct taxes, and the same amount in indirect taxes.

It is progressive tax rate, ascending from 7½% to 55% . Those earning Rs.12,000 ($600)a year begin to pay taxes. His estimate is that tax incentives become important with the Rs.24,000 group.

Tax Incentives

The key exemption for housing is Section 12 of the Code. It provides:

"12. (1) There shall be exempt from income tax -

(a) the net annual value of not more than one place of residence owned by, and occupied by or on behalf of , an individual;

(b) The income accruing to the owner of a house for the year of assessment in which the construction of that house was completed and for the six years of assessment immediately succeeding that year of assessment if such house is used solely for residential purposes and -

(i) is a house to which the Rent Act, No. 7 of 1972, applies, or

(ii) is occupied by the owner thereof; or

(iii) has a floor area (inclusive of the thickness of the walls) not exceeding two thousand square feet:

Provided that where the floor area of the house is one thousand square feet or less, the income accruing to the owner shall be exempt from income tax for the year of assessment in which the construction of that house was completed and for the nine years of assessment immediately succeeding that year of assessment;

(c) the income accruing to the owner of a house, the income from which was or is not exempt from income tax under paragraph (b) of this subsection and which house is converted into two or more places of residence, each such place of residence being separately assessed fo the purpose of rates, such income accruing being the income from each such place of residence for -

(i) the year of assessment in which such conversion was effected and for the five years of assessment immediately succeeding that year of assessment, if the floor area of such place of residence does not exceed one thousand square feet; or

(ii) the year of assessment in which such conversion was effected and the three years of assessment immediately succeeding that year of assessment, if the floor area of such place of residence exceed s one thousand square feet but does not exceed two thousand square feet;

(d) the net annual value of any land and improvements thereon owned by a body of persons the primary object of which is the promotion of any sport which is recog nized as a sport for the purposes of the Sports Law, No. 25 of 1973, and used for that object by that body.

(2) For the purposes of this section -

(a) a certificate issued by the Commissioner for National Housing upon an application made by the owner of any house and specifying, as the case may be -

(i) the date of completion of the construction of that house or the date of conversion of that house into more than one place of residence, and

(ii) the floor area (inclusive of the thickness of the walls) of that house, or the floor area of each of the places of residence obtained by the conversion of such house,

shall be conclusive evidence of the matters specified in the certificate;

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(b) "owner" includes a co-owner; and

(c) "income", in relation to any house which is let means the authorized rent within the meaning of the Rent Act, No. 7 of 1972. "

Section 14 is also important. It provides:

"14. There shall be exempt from income tax -

(a) any capital gain arising on -

(i) the sale by any individual of any house constructed by him and used solely for residential purposes, such sale being the first sale of that house;

(ii) the sale of any house owned by any individual and used solely for residential purposes, if such individual has not sold on or after April 1, 1978, any house other than a house referred to in sub-paragraph (i);

(iii) the sale to a customer, of any property held by the vendor primarily for sale to customers in the ordinary course of his trade or business; "

Aslo important is Section 21.

" 21. Where any person who carries on an undertaking for for the construction and sale of houses, being an undertaking approved by the Commissioner for National Housing have regard to the housing policy of the Government, sells any house or flat, the construction of which was commenced by such person on or after January 1, 1977, such sale being the first sale of that house or flat -

(a) the entirety of the profits and income arising from such sale, if the floor area of such house or flat does not exceed five hundred square feet;

(b) seventy-five per centum of the profits and income arising from such sale, if the floor area of such house or flat exceeds five hundred square feet but does not exceed one thousand two hundred and fifty square feet; and

(c) fifty per centum of the profits and income arising from such sale, if the floor area of such house or flat exceeds one thousand two hundred and fifty square feet but does not exceed two thousand square feet,

shall be exempt from income tax."

Approval under 21 (c) is prompt -- " a couple of weeks, if given all the information."

Recent examples are Bank of Oman and Bank of Dubai.

He believes that 100%investment relief is necessary in order to attract local capital. But the approval is conditioned on one interesting requirement: If there is an agreement to become a quoted public company. This caused quite a policy controversy in government circles. The economists argued that development has always been inspired by private companies. But his answer is that 19th century expansion was at a time with no universal suffrage. We start at a different level -- democracy, and the people have to be convinced they'll get a share in the prosperity. The rule of thumb is that 30% has to be offered to public - he's suggesting 40%, but 20% is not unknown, he admits.

Further examples of this tax inducement. Nestle's (Agriculture), Booke's (sugar); all hotels (banks; dyers). Again, in return for the tax concessions, have to go public.

Close to our interests, is their use for luxury flats (which cuts into scarce capital and materials for housing, it seems to me, and also makes less appealing the use of taxes for inducing low and moderate income housing). So the flats on which the Urban Development Authority ran out of funds, are now being joint ventured with Singapore Group NG ENG GHEE, CHEE TAT HOLDINGS GROUP, with the use of tax concessions.

Location Policy

There is an effort to encourage decentralization of activity (and housing) through the use of tax incentives. Section 18 (c) provides:

> 18.(1) The profits and income within the meaning of paragraph (a) of section 3 (other than any profits and income from the sale of capital assets) of any undertaking referred to in subsection (2) shall, subject to the provisions of subsections (3) and (4), be exempt from income tax for the period commencing from the date of commencement of that undertaking and ending on March 31, 1983.
>
> (c) which carries on its production or manufacture outside the administrative limits of a Municipality within the meaning of the Municipal Councils Ordinance."

Like our efforts to induce job creating industries to move to Central City locations, this has proven to be a mixed bag. Entrepreneurs prefer to stay in Colombo, and the tax inducement doesn't change their mind. He also believes that local businessmen don't even know about this section to take advantage of it. Their accountants and tax advisors aren't helping them on this.

TABLE 4

Assets and Liabilities of Commercial Banks (a)

Rupees Million

End of Period	Assets: Cash on Hand (1)	Due from Central Bank (2)	Due from Domestic Banks (3)	Cash Items in Process of Collection (4)	Foreign Currency on Hand and Balances due from Banks Abroad (5)	Investments: Govt. of Sri Lanka Obligations: Treasury Bills (6)	Investments: Govt. of Sri Lanka Obligations: Government Securities (b) (7)	Investments: Other Investments (8)	Loans and Advances: Bills Purchased and Discounted: Local (9)	Loans and Advances: Bills Purchased and Discounted: Imports (10)	Loans and Advances: Bills Purchased and Discounted: Exports (11)	Loans and Advances: Overdrafts (12)	Loans and Advances: Loans (13)	Loans and Advances: Total (14)	Fixed and Other Assets (c) (15)	Total Assets or Liabilities (16)	Percentage of Liquid Assets to Demand Deposits (d) (17)	Precentage of Loans and Advances to Total Deposits (18)
1966 ..	104.5	88.0	49.5	107.1	60.1	115.9	324.6	0.9	—	75.9	52.4	391.9	338.1	88.3	137.3	1,846.4	55.3	57.1
1967 .	84.5	143.9	43.7	56.9	66.5	108.6	267.6	2.7	—	235.7	53.4	418.9	444.8	1,152.8	195.2	2,122.7	74.0	70.4
1968 ..	106.6	141.6	39.6	52.5	77.1	110.8	275.5	2.7	0.1	144.5	80 2	497.8	600.7	1,323.2	212.8	2,342.5	67.5	73.2
1969 ..	121.5	136.6	30.8	42.0	52.5	34.9	258.3	5.1	—	210.8	85.9	626.0	737.0	1,659.7	212.7	2,564 3	70.3	86.6
1970 ..	145.7	224.9	34.9	180.3	44.1	281.4	356.8	5.4	—	38.0	106.5	589.1	814.2	1,547.7	300.8	3,122.0	68.6	64.6
1971 ..	168.1	209.6	25.8	113.6	69.7	320.8	368.1	5.2	—	36.8	115.5	721.7	891.4	1,765.5	429.0	3,475.1	76.8	70.2
1972 (b) ..	239.5	248.4	118.3	306.5	127.6	370.4	365.3	5.0	1.0	171.0	192.7	832.1	962.6	2,159.4	844.8	4,785.3	77.2	65.9
1973 ..	215.4	488.1	98.1	149.9	94.7	153.6	344.3	3.3	—	51.6	202.0	870.8	1,127.6	2,252.1	486.0	4,285.5	69.1	71.1
1974 ..	288.5	486 1	14.1	280.8	90.1	59.6	325.1	4.0	—	125.6	303.8	1,023.3	1,844.0	3,296.7	515.1	5,360.1	71.5	92.7
1975 ..	280.3	220 2	61.2	222.4	78.3	50.4	325.1	3.5	—	282.3	316.7	1,060.2	1,873.8	3,533.0	519.8	5 296.1	65.2	97.8
1976 ..	326.2	251.1	74.7	343.2	92.8	65.3	569.5	18.3	—	227.4	479.8	1,130.5	2,413.1	4,250.8	595.0	6,586.8	52.4	86.0
1977 2nd Qtr.	373.5	380.3	220.6	694.5	97.7	...	569.6	17.1	—	347.7	590.5	1,317.3	2,960.3	5,215.8	601.3	8,170.2	63.5	96.0
3rd Qtr.	390.3	397.1	250.4	816.5	138.8	1.0	570.5	17.1	—	314.7	674 7	1,237.7	2,980.7	5,207.9	618.2	8,407.8	64.5	88.9
4th Qtr.	426.2	579.3	138.9	713.9	298.5	12.4	556.4	15.6	0.1	703.1	944.4	1,359.6	3,338.5	6,345.7	1,164.6	10,251.5	88.4	93.4
1978 1st Qtr.	474.9	718.5	154.0	914.2	363.8	148.8	558 7	8.4	0.2	545.6	963.5	1,578 5	4,081.3	7,169.1	746.9	11,257.2	89.5	94.2
2nd Qtr.	451.8	646.7	198.2	1,312.9	378.0	180.2	575.5	8.1	—	768.3	823.2	1,608.9	4,275.6	7,476.0	691.2	11,918.5	89.4	93.5
3rd Qtr.	419.2	857.7	144.7	1,325.4	388.4	76.2	550.8	8.0	...	820.1	942 7	1,800.1	4,619.6	8,182.5	968.5	12,921.5	97.5	115.4
4th Qtr.	492.1	615.1	234.8	1,179.6	267.1	100.4	547.7	6.3	...	717.7	1,049.1	1,985.5	5,075.6	8,827.9	1,565.7	13,836.6	84.8	99.8
1979 1st Qtr.	550.2	995.5	160.4	1,193.7	343.9	73.4	577.0	7.5	...	1,008.2	1,047.6	2,297.6	6,144.2	10,497.6	832.0	15,230.9	99.0	101.6
2nd Qtr.	472.8	935.7	252.1	1,583.1	476.5	68.4	574.6	8.2	0.4	1,126.2	1,125.1	2,414.3	5,948.8	10,614.8	1,092.5	16,078.7	102.6	99.7
3rd Qtr.	477.6	1,133.4	122.1	1,626.6	725.4	165.1	580.7	23.1	0.3	1,170.6	1,179.1	2,601.8	6,312.0	11,263.8	1,342.9	17,460.8	107.8	98.9
4th Qtr.	546.2	1,062.8	132.7	1,522.1	475.5	34.4	595.3	21.6	0.1	929.0	1,205.7	2,912.6	6,900.4	11,947.8	2,314.6	18,653.2	88.0	96.8
1980 1st Qtr.	449.7	1,286.8	246.3	1,517.0	709.8	48.9	595.4	33.8	3.7	1,491.0	1,144.4	3,247.4	7,685.9	13.572.4	1,755.8	20,215.9	103.8	106.4
2nd Qtr.	534.7	1,263.3	447.6	1,524.9	675.1	48.9	567.7	31.8	—	1,953.8	1,017.9	3,642.2	8,066.8	14,680.8	2,735.4	22,530.4	110.0	110.6
1980 Sept. .	794.5	1,111.1	389.7	1,373.0	972.8	—	594.8	22.0	—	1,499.4	1,132.7	3,932.3	8,594.5	15,208.9	3,428.0	23,894.8	107.3	102.2
Oct. ..	775.7	1,150.3	402.4	1,480.2	1,004.6	—	595.4	271.4	1.2	1,893.4	1,379.2	4.096.5	8,785.6	16,155.9	3,580.7	25,416.8	116.9	105.0
Nov. ..	653.6	1,199.4	327.7	1,465.0	1,045.6	—	562.7	303.6	0.9	1,994.0	1,448 4	3,610.9	9,692.3	16,746.5	4,420 0	26,724.2	103.0	102.5
Dec. ..	824.4	1,224.3	468.8	1,348.0	645.1	7.9	557.2	362.2	0.6	1,713.2	1,501.9	3,888.8	9,895.7	17,000.2	3,963.0	26,601.1	91.2	98.3
1981 Jan. ..	848.1	1,467.7	306.7	1,231.8	1,198.9	87.0	557.2	362.2	0.6	1,922.9	1,318.4	4,210.1	10,128.1	17,580.1	2,922.4	26,562.1	107.0	98.6
Feb. ..	691.8	1,433.8	439.5	1,272.2	1.099.0	4.5	552.6	362.2	0.6	1,487.6	1,392.6	4,281.7	10,253.3	17,415.8	3,251.7	26,523.3	98.5	100.7
March ..	822.7	1,498.4	444.4	1,470.5	758.7	163.2	552.6	423.6	0.4	1,842.3	1,423.1	4,533.9	10,709.6	18,509.[illegible]	3,492.7	28,165.4	99.5	99.5
April ..	1,069.0	1,490 3	593.8	1,410.3	783.6	152.5	650.3	401.1	0.6	1,682.0	1,372 0	4,900.6	10,913.0	18,868.2	3,236.0	28,654,8	108.4	104.1
May ..	949.1	1,547.3	620.9	1,257.7	846.5	50 8	640.6	424.1	—	1,986.3	1,355.0	4,858.7	10,937.4	19,137.9	3,310.1	28 845.1	120.4	106.3
June ..	749.3	1,380.5	1,011.2	1,473.2	969.1	6.3	640.0	518.2	—	2.534.4	1,320.1	4,935.4	11,007.3	19,797.2	4,032.2	[illegible]0,537.0	125.6	107.9
July ..	732.9	1,490.6	443.9	1,280.6	643.9	249.2	640.0	518.3	—	1,996.9	1,496 2	5,262.7	11,148.6	19,904.1	[illegible]	29,993 3	120 5	106.3
Aug. ..	759.2	1,668.7	557.0	1,254.0	937.8	5.0	640.0	518.3	—	1,701.8	1,632.5	5,362 0	11 195.5	19,891.8	[illegible]	30,853.6	120.0	105.5
Sept. ..	751.8	1,403.0	711.7	1,174.1	1,002.3	300.6	640 0	518.3	—	731.2	1,873.9	5,223.3	11,403 5	20,231.9	[illegible]8.7	[illegible]2 062.9	129.0	100.7

(a) The number of banks was 14 in 1960, 13 in 1961, 12 from 1962 to March 1974, 11 up to March 1979, 12 in April 1979, 13 in May 1979, 14 in December 1979, 15 in March 1980, 16 in April 1980, 17 in May 1980, 18 in July 1980, 19 in September 1980, 21 in November 1980, 22 in March 1981 and 23 in June 1981.
(b) Includes Government guaranteed securities and Central Bank issues.
(c) Fixed and other assets consist of Banks' property, furniture, fittings and sundries (commission, interest-etc. adjustments.)
(d) Liquid assets consist of: Cash on hand, balances due from the Central Bank, foreign currency on hand and balances due from banks abroad, Government of Sri Lanka Treasury bills and bills discounted. Balances due from domestic banks and cash items in process of collection have been excluded from liquid assets and domestic [illegible]

Annex 6
From Central Bank Bulletin
October 1981

Assets and Liabilities of Commercial Banks

TABLE 4 *(Continued)*

Rupees Million

End of Period	Liabilities: Paid-up Capital Reserve Fund and Undistributed Profits (e)	Demand Deposits: Inter-bank Domestic	Demand Deposits: Inter-bank Foreign	Demand Deposits: Govt. of Sri Lanka	Demand Deposits: Resident Constituents	Demand Deposits: Non-resident Constituents	Time and Savings Deposits: Govt. of Sri Lanka	Time and Savings Deposits: Resident Constituents	Time and Savings Deposits: Non-resident Constituents	Total—All Deposits: Demand	Total—All Deposits: Time and Savings	Total—All Deposits: Total	Borrowings: Domestic Inter-bank (f)	Borrowings: Foreign	Other Liabilities
	(19)	(20)	(21)	(22)	(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)	(31)	(32)	(33)
1966	83·9	1·2	1·0	126·0	756·7	14·2	18·0	557·2	27·3	899·1	602·6	1,501·7	90·5	2·3	168·0
1967	91·2	0·5	2·0	111·6	804·7	17·5	14·2	655·5	31·1	936·3	700·8	1,637·1	143·6	1·4	249·3
1968	97·3	2·8	2·2	136·7	823·0	17·5	15·0	766·8	44·4	982·2	826·2	1,808·5	126·4	8·5	301·7
1969	111·8	3·3	1·2	131·1	780·5	15·4	16·3	933·7	35·6	931·5	985·6	1,917·1	201·0	11·5	322·9
1970	129·6	0·2	1·9	200·7	1,005·3	17·3	20·4	1,111·5	36·7	1,225·5	1,168·6	2,394·0	213·9	3·6	380·8
1971	154·2	0·2	1·5	167·3	1,008 9	21·0	31·4	1,250·7	35·2	1,199·0	1,317·3	2,516·2	228·2	10·6	565·8
1972 *(g)*	161·9	2·7	5·4	482·4	1,241·4	19·9	31·9	1,455·7	37·4	1,751·8	1,525·0	3,276·8	192·8	82·7	1,071·0
1973	170·6	12·1	1·8	410·0	1,311·9	20·9	35·6	1,336·6	39·6	1,756·7	1,411·8	3,168·6	324·6	12·7	609·0
1974	214·0	...	2·3	492·1	1,377 2	22·8	38·3	1,582·4	40·2	1,894·5	1,660·6	3,555·3	694·3	9·7	886·9
1975	238·9	...	2·5	412·6	1,442·5	24·7	39·2	1,647·8	41·1	1,882·4	1,723·2	3,610·5	592·2	18·1	836·3
1976	281·4	...	3·4	677·5	2,037·8	32·4	36·1	2,116·7	38·6	2,751·1	2,191·4	4,942·6	419·5	28·5	914·7
1977 2nd Qtr.	401·9	...	3 0	501·0	2,284·1	31·1	35·1	2,534·4	46·3	2,819·3	2,615·8	5,435·1	1,336·2	53·2	943·9
3rd Qtr.	367·0	...	2·9	520·4	2,412·9	34·6	138·2	2,804·8	42·7	2,970·8	2,985·7	5,956·5	951·6	40·1	1,092·6
4th Qtr.	374·0	...	11·9	780·5	2,525·5	33·7	90·5	3,303·3	47·6	3,351·7	3,441·5	6,793 2	975·0	42·0	2,067·3
1978 1st Qtr.	556·9	...	13·3	629·2	2,912·7	36·6	46·8	3,917·7	56·5	3,592·0	4,021·0	7,613·0	1,320·4	77·7	1,689·2
2nd Qtr.	561 8	...	9·4	705·1	2,887·9	31·2	47·6	4,265·3	51·0	3,633·6	4,363·8	7,997·5	1,659·5	96·8	1,602·9
3rd Qtr.	532·1	...	9·7	651·5	2,895·9	38·0	60·2	4,524·9	59·9	3,595·2	4,645·0	8,240·1	1,645·5	84·9	2,419·1
4th Qtr.	520·3	...	7·5	908·5	2,863·2	41·5	69·8	4,907·9	47·7	3,820·7	5,025·5	8,846·3	1,287·7	127·0	3,055·3
1979 1st Qtr.	904·5	...	9·9	689·1	3,338·6	23·0	93·5	6,115·4	46·3	4,060·7	6,255·2	10,315·9	1,511·0	120·2	2,379·4
2nd Qtr.	921·4	...	6·9	778·6	3,284·4	26·5	66·4	6,439·2	47·5	4,096·4	6,553·1	10,649·5	1,729·7	109·2	2,668·9
3rd Qtr.	938·5	..	19·6	843·4	3,611·9	23·6	105·2	6,743·7	47·0	4,498·5	6,896·0	11,394·5	1,222·3	179·1	3,726·4
4th Qtr.	905·8	...	15·3	936·0	3,856·5	26·3	120·7	7,313·7	74·6	4,834·1	7,509·0	12,343·1	736·0	220·8	4,447·5
1980 1st Qtr.	1,320·3	...	21·7	827·8	4,056·3	35·1	139·5	7,625·8	50·8	4,941·1	7,816·1	12 757·2	1,972·5	239·3	3,926·6
2nd Qtr.	1,249·9	...	22·1	849·3	4,099·8	23·7	137·6	8,089·7	46·8	4,994·9	8,274·0	13,268·9	2,498·5	295·5	5,217·6
1980 Sept.	1,256·8	1·8	15·2	1,055·0	4,077·9	34·5	121·0	9,520,3	47·9	5,184·3	9,689·3	14,873·6	1,749·5	259·8	5,755·2
Oct	1,300·6	0·2	19·8	943·6	4,291·7	42·6	113·5	9,927·8	52·8	5,298·1	10,094·3	15,392·3	2,245·0	344·6	6,134·2
Nov.	1,251·7	1·3	42·7	1,175·4	4,874·5	40·3	143·0	10,010·7	53 1	6,132·3	10,207·0	16,339·2	1,797·5	463·8	6,871 9
Dec.	1,272·3	2·0	40·8	1,411·2	5,138·5	95·5	171·4	10,376·4	55·6	6,687·8	10,603·5	17,291·3	1,719·1	280·3	6,038·0
1981 Jan.	1,341·1	0·2	31·4	1,264·9	4,964·8	76·9	157·7	11,269·8	54·0	6,338·3	11,481·5	17,819·8	1,430·2	296·4	5,674·6
Feb.	1,865·6	1·1	25·1	1,195·2	4,925·8	46·3	192·3	10,852·1	59·1	6,193·6	11,103·6	17,297·1	1,720·0	392·1	5,248·3
March.	2,102·7	6·2	26·7	1,071·4	5,410·9	43·8	176·5	11,796·6	62·7	6,559·1	12,035·9	18,595·0	1,521·4	545·2	5,401·1
April	2,221·2	2·0	71·0	953·9	4,913·1	39·9	154·1	11,905·7	75·9	5,979·9	12,135·7	18,115·6	2,441·7	460·2	5,415·1
May	2,177·6	1·4	40·6	843·4	4,653·1	40·9	154·5	12,177·6	91·6	5,579·5	12,423·8	18,003·3	2,764·1	486·5	5,413·6
June	2,226·6	2·8	33·9	902·7	4,543·4	47 1	155·0	12,555·1	93·3	5,530·0	12,803·5	18,333·5	3,129·8	536·3	6,310·8
July	2,239·6	...	39 0	834 5	4,524 9	72·7	150 9	12,893·6	73·9	5,471·1	13,118 8	18,589 9	2,625 6	392·9	6,145·3
August	2,199 8	...	87·7	786·1	4,640·8	53·0	147·7	12·891·5	76·5	5,567·0	13,116·2	18,683·5	2,641·7	299·0	7,029 4
Sept.	2,216·6	...	51·0	810·8	4,781·2	58 8	164·6	13,923·7	91·8	5,701·9	14,180 1	19,882·0	2,393·2	309·3	7,361·8

(e) Paid-up capital applies only to local banks.

(f) Includes Central bank

Source: Central Bank of Ceylon.

(g) These figures are distorted as a result of the strike by the employees of Commercial banks which began on 01-09-1972 and ended on 17-12-1972.