THE ECONOMIC DEVELOPMENT OF CEYLON

(WITH SPECIAL REFERENCE TO INDUSTRIALISATION)

A. THIAGARAJAH

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KARAINAGAR, CEYLON.

FOREWORD BY

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To

Dr. Gamani Corea

FOREWORD

Monsieur Robert Buron, President of the Development Centre of the O. E. C. D. observed at the Seminar on "Development Strategy and Adminis-tration" which is currently being held in Colombo, that one of the factors of underdevelopment in countries like Ceylon is the lack of "a Dynamic Documentation Service". Policy makers and their Economic Advisors cannot fail to agree with him. Policies formulated and decisions taken in the development sphere should always take account of past events and current trends in the economy. A full appreciation of contemporary economic problems is essential in the basic tasks connected with economic planning and policy formulation; and for this the mass of unsorted-out information must be sifted, processed and brought out in the form of readable material. In this respect there is a great deficiency in Ceylon.

While International Organizations like U. N., I. L. O. and O. E. C. D. are contributing much to fill, at least partially, this deficiency, the main responsibility in this matter is clearly ours. In this context, Mr. Thiagarajah's work in this field is a pioneering effort. In this book he presents a lucid account of the role and significance of Foreign Trade, Balance of Payments, Savings, Investment, Capital Formation, etc. as well as of the main trends which seem to have influenced the behaviour of the national economy during the period since Independence. He concludes by offering suggestions for gearing the economy to the goal of development.

Mr. Thiagarajah's book is of interest not only to those who are concerned with economic policy formulation and administration but also to students who need a reference book on the Ceylon Economy. Mr. Thiagarajah does not claim his discussion to be a comprehensive and faultless documentation. Inspite of the admitted deficiencies this book has, I hope, adequate material in it to stimulate thought and provoke discussion on such an important subject as Ceylon's economic development and progress.

V. Kanesalingam

Department of National Planning,
Colombo.

December 7th, 1966.

PREFACE

This book has been published with the sole purpose of presenting a simple and connected account of the entire system of our economy and its problems as it emerged in the post-Independence era. It claims no distinction to originality. It merely reproduces the thinking of our economists and foreien experts on various aspects and problems of our economy and foreign trade into a chain of causation and effect which is not apparent to the layman. The core of the argument is taken from the Ten-Year Plan Report of 1959 and the papers read at the continuing seminar on the Report held by the economic section of the CAAS in 1961. The Central Bank Reports also proved very valuable. Needless to say past Reports and Sessional Papers on the general economy and industrial development helped to enrich the background. The book is based on the direct link between the Foreign Trade and the Economic Development of the country. The challenge of the Foreign Trade is the opportunity for Economic Development. This acts through Industrialisation and hence the bias given to it in this book at the expense of agricultural development which I regard as principally a technical problem. The problem of our economy is one of finding the money for a well-planned pattern of development. No doubt such things like regional co-operation, and social and cultural changes and outlook, would go a long way in raising the tempo of development and lifting the economy out of stagnation and putting it on an even keel.

The sequence of the book is based on the detection of the symptoms of underdevelopment, then a diagnosis of the causes for non-development, and finally the suggestion of a series of remedial measures to promote development. Part II deals with some aspects of the economy which indicate why development has not taken place, and Part III investigates the problems of the economy which were responsible for retarding any progress. Part IV therefore discusses the remedial measures in a broad way. Taking per capita income as the criterion for development I have shifted the emphasis from internal resources to massive inflow of foreign capital, from import substitution and small-scale industries to export promotion and large-scale industries, and from the limited local market to the bigger regional market. This has become a sheer necessity, especially with the explosive population expansion taking place. A combination of economic and commercial policies are very essential and the results can be seen only over a long period. I see no miracle to happen in a short time. Sacrifice, hard work and patience alone can reward the nation and its leaders with enduring progress. The reader will therefore find one theme running through the entire book. As this is the first attempt at presenting a composite picture of the interrelated problems of the economy I have omitted many details and digressions which would cloud the main argument. Any deviation if any is meant only to strengthen and emphasise the main tenor of the book. One would of course realise the great role the Finance Minister and his Budgetory Policy would have in creating the necessary climate for investment in the public and private sectors so that development could be unhampered and rapid.

The account of the economy is mainly up to the early part of the sixties, but the inferences and interpretations of available statistics has not changed even to date, nor have the policies been materially altered as yet. But steps are being taken to create a favourable climate for investment by local and foreign investors, albeit as yet with great hesitancy. Many other bold steps await positive action. Truly we are still far from having adopted a series of economic and commercial policies whose joint action could have some telling effect on the economy, and change it from stagnation to development. The reader must await a more and fuller account of the measures being taken currently and their material results for a later occasion. He should now be satisfied with the causes of the economic malaise and the lines of approch at our disposal to correct the imbalance in it. The canvas has been prepared for him to understand the shape of the inset. I therefore take the shelter under the feeling that the general reader and the young student would find the account instructive and would in turn help promote development.

I do not intend to hurt the susceptibilities of our many able economists when I say that the general arguments connecting all the problems of our economy is the result of the simple and lucid writings and speeches of Dr. Gamani Corea who has given a meaning and a purpose to all the interacting forces in our economic system. This book therefore presents his thinking on the subject and therefore is dedicated to him. I would regard it as a tribute to his understanding and exposition of our problems though in a small way. Apart from what flowed from his pen, I have had the benefit of frequent discussions and assistance from Dr. V. Kanesalingam of the Planning Department. But what contributed a sense of realism to the book was the presentation of papers at the continuing seminar of the economic section of the CAAS in 1961 and the papers by visiting economists. They gave the necessary correctives to the Ten-Year Plan Report and made it more purposive. To all of them I am indebted.

I suppose books of these nature see the light of day rarely, because of handicaps in the way of time, energy and money. Even so the pausity is unpardonable, especially with so many talented and qualified persons in the subject. I am least qualified for it. Yet I hope this book not only fills a void but is also timely. I therefore hope the reader will overlook many shortcomings which I am aware of. Yet I invite my readers to suggest improvements to this book so that the next time it appears a more complete and correct account of our economy is given. Meanwhile I thank the publishers for their unstinted response and good printing.

KARAINAGAR   *THE AUTHOR*

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CHAPTER I

ECONOMIC GROWTH SINCE INDEPENDENCE

1. The Economy of Ceylon

The economy of Ceylon is under-developed and undiversified. This is reflected in the low per capita income of the country and the undue dependence on the export trade of three commodities. Between the two, under-development is certainly a much greater cause of weakness than undiversification. Tea, rubber and coconut exports sustain the economy of the country. Tea and rubber are almost entirely exported while only coconut has a substantial home market. There is also great dependence on imports even for essentials. The local production of rice is adequate to meet only about half the normal requirement. The two major risks inherent in this dependence on imports are that wars or other causes may suddenly cut off or reduce foreign supplies, and the terms of trade may suddenly worsen. The demand for and supply of these exports are subject to the vicissitudes of international trade and those may affect the economy of the country. All three exports may be affected simultaneously. Further all three are labour-intensive agricultural industries and their fortunes in the export market would, therefore affect labour widely. Hence development and diversification are the fundamental remedies necessary to give added security and stability to the economy.

There are other features of the economy as well which should be mentioned. They are the high proportion of expenditure on consumption, low saving and investment, lack of coherent planning and industrialisation, inflationary pressure, rising burden of taxation, rise in public debt, fall in external assets, deficit budgeting and adverse balance of payments, high proportion of expenditure on social services like health and education at the neglect of economic development, soaring wages bill and administrative costs in the public sector, and a phenomenal growth of population. All these are the results of defective State policies and planning with regard to development and trade.

2. Population and Income

It will be useful to examine briefly the structure and trends of the national economy in the period 1948 — 60 before we proceed to examine the problems of economic development and foreign trade — their nature and remedial measures. Ceylon's economic position is such that while her per capita income is far behind western standards, it is not much below some of the countries of Europe and South America. Her National Income rose by 50% in the post-Independence era, and was Rs. 6,313 million or Rs. 604 per capita in 1962. National Income has been increasing at the rate of 3·5 per cent and population at the rate of 2·6 per cent per annum, so that the reckonable rise in per capita income has been only 0·9 per cent on the average over this period. It is generally accepted that the desirable rate of growth in per capita income should be 3·5 per cent per year. But Ceylon is faced with the tremendous impact of her population growth which is one of the highest in Asia, and only second to Formosa. If population growth is less rapid, it would take Ceylon considerably less time to double the national income per head. But at the present rate, the progress made is very small and a great effort is required in the future. A policy of restraining population growth would now have its effects in about twenty years' time only. Meanwhile the population explosion which began in 1947 has made itself felt by the increase in the unemployed work-force which stood at 152,000 in December 1962, as registered at the Employment Exchanges. No accurate data on unemployment for the whole country are available. But data regarding urban unemployed indicate that after a drop in the Korean boom, it has been regularly increasing. In fact the problem of unemployment and under-employment are much greater than are usually realised or revealed by Employment Exchange figures. An I L O survey revealed that there were about 375,000 unemployed persons in 1959. About a third of those employed were under-employed. Moreover about 1·2 million persons would be added to the work-force over the Ten Year Plan period between 1959 and 1968. These figures constitute a challenge to the opportunities for employment.

Ceylon has no emigration outlets, while her density of population, rate of population growth, and the dependency ratio are very high due to a sharp fall in the mortality rate since 1947 and to the high fertility rate. The fall in mortality rate was both among infants and young children, so that the problem of finding employment to the rapidly increasing work-force would have to be faced by the nation. Between 1946 and 1953 the population increased from 6·7 to 8·1 millions at the rate of 2·6 per cent per annum compared to 1·5 per cent for the whole of Asia during 1950 — 56. It was 10·6 million in 1963 and is expected to increase to 12·3 million by 1968. The work-force is reckoned to be 94 per cent of men and 42 per cent of women aged 15 — 59. While under-population may be a problem in some of the developed countries of the West, over-population is a hindrance in under-developed countries, so much so that according to forecasts in the Ten Year Plan, national income is expected to rise by 88 per cent during these ten years while per capita is expected to rise only by 36 per cent. But for population pressure the target for national income could be achieved in a shorter time because more money would be available for direct investment. Shortage in land, abundance of unskilled labour but lack of opportunities, scarcity of capital and low incomes are factors that impede development. The remedy lies in adopting a population control policy and in augmenting investments for the development of the country.

3. Production and Trade

Though the foreign trade of the country earns the highest proportion to national income among countries in Asia and Oceania, ie. about 36 per cent, that share had declined over this period, especially in the export sector. Between 1948 and 1960, 45 per cent of the increase in gross national product had been due to an increase in the production of goods for domestic use, 35 per cent due to services and only 20 per cent due to the production of goods for exports. The increase in national income earned by tea exports was 25 per cent. Exports rose by 30 per cent, principally due to tea, for it had shown an increase of Rs. 506 million, while other export products had shown a decline of Rs. 87 million. Tea rose at an average rate of 4 per cent per annum. In per capita real terms the growth in exports had been disappointing. While the volume of total exports rose at an annual rate of 1·7 per cent during the last decade, in per capita terms it had declined at an annual rate of 0·9 per cent. The rate of development would therefore be extremely low if the country continued to depend heavily on exports.

This is not all. On the other hand, the demand for imports has been income elastic. A rise in export income brings about an increase in the demand for imports of which an average of 74 per cent constitutes consumption goods. But a fall in exports income does not reduce imports or national income by a corresponding scale. One reason may be the growth in the domestic sector which grew at 1·5 per cent per capita, perhaps due to the monetisation of the economy and growing money incomes. However it may be, we should not overlook the increase in deficit financing and the fall in external balances.

During this period, primary production increased at 2·6 per cent and its share in total production was 3·6 per cent lower in 1960 than in 1948. Secondary industries increased their production at 3·4 per cent during the last five years but their share of the total income was only 5·2 per cent in 1956 and 5·6 per cent in 1960. Services increased at 1·7 per cent in per capita real terms and their share was 32·8 per cent in 1948 and 33·4 per cent in 1960. It has been estimated that the average annual rate of growth of production per agricultural worker was 2·8 per cent, while in non-agricultural activities it was 1·5 per cent. Thus the production per worker in agriculture has risen faster than in the non-agricultural sector of the economy. Yet in absolute terms the output per worker in agricultural activity was Rs. 1,200 in 1957 while it was Rs. 1,500 in non-agricultural activity. Although these are not precise estimates and are subject to wide margins of errors, yet they help in the inter-temporal and inter-sectoral comparisons. A high rate of investment and capital / output ratio would alone raise the per capita income to desirable levels.

4. Consumption, Savings and Investment

Though gross production increased by only 1 per cent per capita terms the rise in the private consumption per capita was 1·9 per cent. This is reflected in the fact that the domestic demand in 1948 had been only 82 per cent of gross national product which had increased to 104·5 per cent in 1960. The excess of 22·5 per cent was met by current account deficits in the balance of payments. Of the increase in income 89 per cent went towards consumption, and only 11 per cent towards investment. Further, there has been a significant rise in the consumption of durable consumer goods which on the average rose by 13 per cent annually over the last decade. In absolute terms it rose from Rs. 21 million in 1948 to Rs. 110 million in 1960. Imports rose from 23 per cent to 29 per cent of the gross National Product between 1948 and 1960 while exports fell from 36 per cent to 26 per cent, of the demand and supply of goods respectively, the former caused by a rise in internal demand for goods and services and the latter by a relative increase in the gross retained output. On the average capital formation accounts for nearly 13 per cent of gross national product. Allowing for capital consumption or depreciation, the net capital formation would be 8 per cent of national income. But the ideal rates would be 21 per cent and 17 per cent of gross and net national product respectively, as otherwise the rate of growth in per capital income would be low.

It may be useful to consider the constituents of capital formation and their growth. The public sector had grown at a faster rate over this period. Thus, while the private investment increased from Rs. 133 million in 1948 to 289 million in 1958 public investment increased from Rs. 157 million to Rs. 382 million over the same period. In the Government sector the bulk of the capital formation is in the nature of social overhead capital which will give a return only after a long period of years. Only about 10 per cent of it went to the industrial sector during the last four years. In the private sector the bulk of the investment is dissipated in unproductive investments such as luxury housing and the building up of stocks. The former rose from 50 per cent in 1950 to 55 per cent in 1960 of private capital, ie. about 70 per cent over the decade. In the case of machinery and equipment, its ratio to national product had averaged 20 per cent of capital formation during the last five years. In Ceylon about 30 per cent of investments represents imported capital goods. This checks a spontaneous rise in the investment co-efficient in the absence of an external incentive for development or of a planned policy. The trade and financial situation is now such that foreign capital inflow must be encouraged through suitable incentives and policies to sustain development.

5. Terms of Trade and Income

Perhaps the only relieving feature in the economic landscape is the gains from trade which Ceylon is fortunate to enjoy, especially as her external trade constitutes a very high proportion of national income. Taking 1948 as the base year the contribution of the terms of trade to national income was 12 per cent in 1954, and 19 per cent in 1955. This is quite impressive. Between 1948 and 1960, gross income without the terms of trade contribution rose by 44 per cent while with the terms of trade contribution by 60 per cent. Apart from the direct effect of a rise in available goods and services more than the gross product, a favourable terms of trade is a potential source of capital formation. It also has the indirect effect of a better utilisation of existing capital. More over, rise in the terms of trade increases the capacity to import. But these effects that would normally lead to greater development have not been operative in Ceylon because the gains from trade have been wasted on consumption. This can be seen in the absolute as well as relative increase in consumption. The remedy lies in mobilising internal and external resources, and in diversifying the economy.

6. Standard of Living

The growth in national income during the last decade may be more apparent than real. The rise though small it may be is the consequence of urbanisation and industrialisation, and the monetization of the economy. Therefore, these are actually social costs of development. Further the standards of living between backward countries and advanced countries are not only wide but are getting wider with the greater heights reached in the latter. At constant prices it would take seventy five years to raise the per capita income from Rs. 50/- per month to Rs. 100/- per month. With rising costs and unemployment the raising of the standard of living would be more difficult of achievement. Planning therefore is the only means of raising the standard of living.

7. Money and Finance

The post-war period is characterised by a series of deficit budgets which have been covered more by inflationary finance than by non-inflationary borrowing. The establishment of the Central Bank and its role of subservience to the Minister of Finance has been chiefly responsible for this. Over the years 1955 - 56 to 1959 - 60 Government expenditure rose at an annual rate of 9·8 per cent, and revenue only at 2·8 per cent. The public debt and debt servicing charges may not be heavy but are substantial enough to impede development. The balance of payments position has always been deteriorating because of net deficits even though the external balances rose to great heights in the boom years of 1951 and 1955. Normally, Ceylon's balance of payments and terms of trade have risen and fallen together except since 1957 to date, when the terms of trade were favourable while the balance of payments was adverse. This was due to inflation and high imports despite fall in prices of imports and rise in volume of exports. There cannot be any more inflation nor unrestricted imports. At the end of 1962 foreign liabilities (Rs. 474 million) were equal to the foreign reserves (Rs. 504 million), thus necessitating import restrictions of a severe order. The immediate measures are the restriction of imports to improve the balance of payment position, the balancing of the budget and the restriction of credit; and a long-run measure is to develop the productive capacity of the country if further unemployment and fall in standards are to be avoided. Further, the policies of nationalisation and Ceylonisation have tended to drive capital out of the country. The boom in 1951 was followed by a collapse in 1952 and 1953, a tea boom in 1954 and 1955, a decline in exports in 1956, 1957 and a rise from 1958 onwards. The pecularity in the situation since 1958 was the fall in external balances to what is considered the safety level while terms of trade were favourable. While the impact on the balance of payment of inflationary finance was the most felt, the impact on money and prices was much less, because the adverse external balance served to restrain them. But this could not continue any further. The rise in the total money supply had eventually caused inflationary pressure on prices and costs. But mere monetary policy was inadequate. Fiscal and commercial policies had to be modified.

8. Economic Planning and Legislation

The idea of planned economic development was mooted as early as 1931, but the great depression and the world war intervened. The proposals of the Board of Ministers published in 1946 was a step further, the first six-year investment programme of 1947 — 53 was next, the second six-year investment programme of 1954 — 60 followed it, and finally we have now before us the Ten-Year Plan for 1959 — 68. The Colombo Plan for 1951 — 57 was yet another international measure to augment the six-year plans. The second six-year plan was scrapped by a new Government that came to power in 1956. The Ten-Year Plan is a comprehensive plan in great detail and well conceived with a practical bias. It envisages an investment of Rs. 13,600 million, a rise in national income by 88 per cent and per capita income by 36 per cent. Investment would rise to 21 per cent because an accelerated investment rate is one of the key instruments of a development plan. And the degree of self-sufficiency is expected to rise from 70·7% to 89·0% in Agriculture, from 29·8% to 86·7% in Fisheries, and from 21·2% to 40·1% in Industries. This would also alter the composition and direction of trade. The Ten-Year Plan's strategy is devised for a planned and an unplanned sector, as well as for a public and a private sector. It states all the means and the ends. It must be pointed out here that the plan was preceeded by financial and technical studies, and by economic development models by local experts and visiting economists. Mention may be made of the various International Agencies under the U. N., and other countries which have extended, in increasing measure, help with capital and technical know-how. But they are inadequate for the rapid economic development of the country. Internal sources for development have been attempted by providing greater incentives for savings, providing numerous institutions for better short-term and long-term credit facilities, and by levying taxes on higher incomes and wealth. The National Provident Fund, the People's Bank and the Kaldor Taxes fall within this perview. The Paddy Lands Act and the proposed establishment of a Tariff Board are measures directly aimed at improving agriculture and industry. But the Quota Regulations for agriculture and industry and the Rice Subsidy Scheme are anomolous and defective. Emphasis is now being given to technical education. Thus planned development requires the adoption of a well-defined policy for the development of the public and the private sectors and for the creation of a climate for investment.

9. Conclusion

The structure and trends in the economy of Ceylon indicates that undue stress and emphasis on social development had been laid during the fifties so that deficit financing had led to adverse balance of payments and resulted in import restrictions and rise in the internal level of prices. This was aggravated by the slow growth in exports and a rapid rise in imports. The rise in consumption and the fall in capital formation were the cause of stagnation in production and standards of living. In terms of per capita income the last few years witnessed a stationary level because the rate of increase in population remained high. With the fall in foreign reserves and a rise in consumption above the increments in the GNP it became evident that capital formation was maintained precariously. These are dangerous trends in the foreign trade and economy of the country calling for considerable re-orientation of economic and commercial policies in order to diversify and develop it to assure stability and progress to the entire system. Thus the problems of economic development depend for a solution on the attainment of a diversified economy through structural changes in the pattern of production for the employment of a growing work-force, for the raising of the standards of living, and for the achievement of a reoriented foreign trade through changed economic and commercial policies. A long-term solution for achieving true results therefore consists in mobilising internal and external resources for investment, in promoting balanced development including rapid industrialisation, in planning and implementing a development programme, in reorienting tariff and other commercial policies, and in co-operating with other countries of Asia for economic development. These form the corner stone of the measures and policies recommended here.

CHAPTER II

TRENDS IN FOREIGN TRADE

1. Ceylon's Trade from 1948 to 1960

Many remarkable changes had taken place in Ceylon's Foreign Trade both in structure and the composition of imports as well as exports. There were even striking diversified movements in the direction of both imports and exports. We shall however discuss only the general trends in the trade.

The share of Ceylon's domestic exports to national income is a fair indicator of the dependence of the economy on its export earnings. In the case of Ceylon the share of exports (net of the import content in exports) to national income remained at about 32 per cent during 1948. By about 1960 the share of exports of national income reflected a remarkable decline to nearly 29 per cent. The drop in this proportion of domestic exports to national income gives a clue to the fact that there has been a gradual decline in the dependence of Ceylon's economy on its exports. A greater and greater share of the additional generation of national income is from the non-export sector. However, more definite conclusions could not be made on these lines unless the terms of trade figures are analysed in detail. Ceylon economy being "open" to a very large degree, is susceptible to the impact of price fluctuations generally created from foreign sources. A rise in the terms of trade would induce the purchasing power of Ceylon's exports in terms of her imports to improve favourably to Ceylon and thereby induce the share of exports to national income to rise considerably. The reverse is also true. To get a realistic picture of the dependence of Ceylon's economy on its exports we should actually analyse the real national income instead of the gross national product. There are some indications that the non-export sector of the Ceylon economy is enlarging perhaps due to the implementation of some of the development proposals. It should also be kept in mind that market prices of goods and services in the export sector of the economy has also been increasing to phenomenal heights due to favourable labour legislations and social service amenities. These factors would have definitely inflated the share of the non-export sector out of the national income. Therefore, yet to get a realistic picture we should also know the relative changes in the inflationary levels both in the export sector and the non-export sector.

Between 1948 and 1960 the gross national income and market prices have more than doubled. In fact it has increased by about 110 per cent. The domestic exports (net of the import content in exports) has increased by only 90 per cent. The lower rate of expansion in the domestic exports when compared with the rate of growth in the national income implies that the importance of the domestic exports in national income is deteriorating to some degree. This fact has been already indicated earlier when the relative importance of domestic exports in national income was analysed.

The total value of imports between 1948 and 1960 also reflected a phenomenal increase — about 97 per cent. It should be noticed that the rate of expansion in the value of imports is higher than the rate of expansion in the value of domestic exports. This itself is not a very serious weakness in the economy, yet if the composition of imports is tilted more due to imports of capital goods than consumer necessities. Unfortunately, a detail analysis of imports later would indicate that very high proportion of Ceylon's imports is still dominated by basic consumer goods. This gives a clue to the fact that the increase in exports is more financed to purchase an increase volume of consumer necessities. The situation becomes worse when the declining rate of expansion in domestic exports is financed more and more to purchase an increasing rate of expansion in the value of imports of consumer necessities. This would definitely have serious repurcussions in the economy because if capital goods are imported it would definitely help the generation of national income at least in the future. The situation as seen now would not only create a balance of payment problem, but also may impoverish the economy which appears to have a policy to eat to the belly-full even at the expense of borrowing.

As shown in table below there appears to be certain cyclical features in both Ceylon's imports and exports. The impact of these is reflected in the visible balance of trade. From 1948 to 1951 there was a fairly prosperous trend which reached a climax in 1951 coinciding with the Korean boom. There was a gradual movement in the value of imports between 1948 and 1949 which picked up in 1950 and increased further in 1951. In the case of exports too the same movements prevailed except perhaps there was a greater increase in the value of exports in 1950 than in 1951. During 1952 the depression gradually set it. The imports were continuing to expand whereas the exports dropped by about 21 per cent over the previous year. The first downward trend in the balance of trade figures appears to coincide with an increase in imports and a decline in exports. There appears to be a time lag and the imports seem to fall much later than the fall in the exports. This is quite natural because if there has been an increase in exports the incomes increase, the purchases goes on increasing which induces the imports to continue to rise. In the following year in 1953 the imports began to decline whereas the exports reflected a slight increase. The imports declined much further in 1954 and during this year the exports picked up by about 15 per cent. The deficit balance of trade in 1952 is due to (as stated earlier) an increase in the imports as well as a drop in exports. The deficit balance of trade in 1953 however is more due to the lower rate of the fall in imports despite the increase in exports. The phenomenal surplus balance thereafter in 1954 is equally shared by a drop in imports as well as an increase in exports. In 1955 however the imports increased but the exports expanded to phenomenal heights perhaps to a record so far in the history of Ceylon's exports. Ceylon was able to accumulate a record surplus balance of trade of Rs. 479 million. The decline in the surplus balance of trade in 1956 is both due to the increase in imports and a decline in exports. As in the previous cycle it could be noticed that the imports go on increasing even though the exports decline. This phenomena created a deficit balance in 1957—a year when the imports still continued to increase when the exports declined. The exports picked up in 1958 but the total value of imports declined heavily thereby reducing the deficit trade balance to about Rs. 6 million. In 1959 however, Ceylon recorded the highest value of imports so far of Rs. 2,007 million. Even though the exports increased slightly, this was more than defeated by a large increase in imports. This induced the balance of trade to turn adversely to a record height of Rs. 253 million. In 1960 the value of imports reflected a slight decline whereas the exports increased and the balance of trade though remained a deficit improved by a remarkable degree. Table below gives the details of these movements clearly.

Table on Balance of Trade.

(in Rs. Million)

Year	Total Imports	Total Exports	Total visible Balance of Trade
1948	994	1,011	+ 17
1949	1,039	1,063	+ 33
1950	1,169	1,563	+394
1951	1,562	1,904	+342
1952	1,707	1,502	−205
1953	1,610	1,568	− 42
1954	1,397	1,809	+412
1955	1,461	1,940	+479
1956	1,633	1,734	+101
1957	1,806	1,682	−124
1958	1,717	1,711	− 6
1959	2,007	1,754	−253
1960	1,962	1,832	−130

2. Terms of Trade

The export prices increased by 48 per cent in 1960 when compared with 1948. The import prices also advanced by about 4 per cent. The lower rate of expansion in the import prices as against the heavy rise in the export prices induced the terms of trade figures to move in Ceylon's favour. Compared with 1948 there was 42 per cent improvement in the terms of trade. The large share of the improvement in the terms of trade is due to the heavy rise in prices in practically all the export commodities. Tea prices advanced by about 34 per cent, rubber had a phenomenal increase of 132 per cent and coconut products about 27 per cent. If we analyse the price indices in detail there appears to be a relationship, as expected, between favourable balance and favourable terms of trade. The peak in the export prices was reached in 1951. During that year all the export prices shot up to an aggregate average of 75 per cent. The most remarkable improvement was experienced in the case of rubber. Rubber prices improved by 267 per cent, whereas tea prices during that year shot up by only 32 per cent and coconut prices also improved by 69 per cent. In the following year however, there was a sagging effect in most of the export prices which coincided with the 1952 recession. During 1952 there was a drop in the prices of tea, rubber and coconut products. The fall was very heavy in the case of rubber and coconut products. The drop in the export prices and a rise in the import prices was primarily responsible for the heavy deficit trade balance accumulated in 1952. The terms of trade figures fell from 151 in 1951 to 109 in 1952. In the following year the export prices picked up a bit mainly due to the rise in the tea and coconut prices whereas the import prices fell. Both these favourable influences lashed down the deficit trade balance to a figure of Rs. 42 million. In 1954 however, tea prices began to shoot up even though the other export products reflected declining trends. The import prices returned to the 1948 level. The heavy improvements in the export prices perhaps due to the rise in the tea prices alone induced the balance of trade to improve to a remarkable degree and thereby accumulate a surplus of Rs. 412 million. In the following year in 1955 tea and rubber prices began to maintain the rising trend whereas coconut products fell into hot waters. In the net however, all export prices reflected a rising trend. Even though the import prices increased by about one per cent, the rise in the export prices was so high that it was able to counteract the increase in the import prices and thereby the terms of trade improved further by about five per cent. This again was reflected in a high surplus balance of trade of Rs. 479 million recorded in 1955. During 1956 tea and rubber prices fell and coconut prices maintained the 1955 level and all export products reflected a drop in prices. The import prices during this year increased by about 12 per cent. The drop in the export prices and an increase in the import prices cut into the balance of trade position. Though there was a surplus balance of trade in 1956, the accumulated balance was less than a quarter of what was recorded in 1955. 1957 reflected a further deterioration in the tea and rubber prices. But coconut prices however, picked up to some degree. The import prices also fell but the fall in the export prices was so high it induced to some degree the balance of trade to move against Ceylon's favour. During this year, however, the quantum of imports also improved very high. During 1958 there was a further drop in tea and rubber prices and a remarkable rise in the coconut prices. Yet the total export price indices reflected a decline. There was a phenomenal drop in the import price indices and this had a very favourable effect on the balance of trade. Even though the balance of trade remained deficit in 1958 yet there was a remarkable decline from the lower ebb of 1957. In the following year the tea prices still fell whereas rubber prices picked up and the coconut prices maintained the rising trend. There was a slight advance in the import prices too. The terms of trade however, deteriorated in 1959 perhaps due to the higher rate of increase in the import prices over and above the advance in the export prices. This again was reflected in a deficit trade balance. A part of this high trade balance of 1959 should be attributed to the heavy increase in the volume of imports. Rubber prices improved heavily in 1960 whereas the tea and coconut prices reflected reverse trends. However, the indices of all exports and all imports remained at the previous year's level. The balance of trade though deficit in 1960 declined to nearly half of what was recorded in 1959. This may be mainly due to the increase in the volume of exports and to the decrease in the volume of imports to some degree.

From the above figures one point that emerges clearly is that the terms of trade has a definite impact on the balance of trade position. A favourable trade balance more or less coincides with a favourable terms of trade and an unfavourable trade balance falls in line with an unfavourable terms of trade. There appears to be a high correlation between the terms of trade and the balance of trade. Even though adverse movements in the quantum of imports and exports would have counteracted the favourable movements in terms of trade yet during the period 1948 to 1960 there appears that the price indices have had generally the weaker hand over the quantum indices.

3. Problems of Foreign Trade

The effects of the War continued into the post-war period for some years and was followed by devaluation in 1949. The conditions had stabilised by 1950 and we may therefore examine for our purposes the foreign trade problems of Ceylon as felt during the decade 1950-60 and the consequences that followed from them. (i) The first is that imports outpaced exports. This highlights the unfavourable trend in Ceylon's foreign trade. While exports have risen slowly, imports rose markedly high. The prices of exports and imports did not vary very much between the two years[1], but the volume of imports increased much more than the volume of exports so that the value difference increased with years and eventually the favourable balance of trade which counterbalanced the recurrent unfavourable invisible account was itself turned

1 The discrepency in the account of Price Indices under this section and in the previous section is due to the devaluation of the Rupee in 1949 which shot up the export prices prior to 1950 which remained stable thereafter except for the Korean boom in 1951 and the Tea boom in 1955. Refer Table I of Appendix.

unfavourable in the last few years. This aggravated the Balance of Payments Problem for Ceylon. The following indices reveal the trends in the foreign trade of the country:—

Trade Indices (1948 : 100)

Year	Tea	Rubber	Coconut	All Exp.	Cons. Goods	Capi. Goods	All Imp.	Terms of Trade
Volume								
1950	101	128	112	110	119	120	119	—
1956	118	94	155	118	141	144	142	—
1960	138	113	109	127	156	188	162	—
Prices								
1950	127	229	133	143	98	101	99	144
1956	151	217	85	148	99	131	106	140
1960	134	233	106	145	96	122	102	142
Value								
1950	128	281	149	158	117	121	118	—
1956	177	203	132	175	139	190	150	—
1960	186	264	116	185	149	229	166	—

The above table shows that the prices of exports and imports did not show perceptible changes and that export prices increased slightly and import prices decreased slightly. This showed slight improvement in the terms of trade over the period as a whole which somewhat mitigated the severity of the Balance of Payments Problem. Of the exports tea alone increased in volume by a third, while rubber and coconut products were subject to fluctuations and hardships. Generally the supply of these products is inelastic and prices are determined by demand in the international market. A moderate increase in the supply of tea is absorbed in the world market with only a slight reduction in price, and tea has been making a steady increase in volume at stable prices. Rubber and coconut products did not show any secular improvement in volume or price or value, but fluctuated in price and volume according to changes in demand in the international market. Rubber fluctuated more than coconut products, but the latter had to face adverse circumstances since international supplies of coconut products and other competitive fats and oils generally increased in the world market just when there was decline in industrial activity abroad. But the supply of coconut products to the world market can be somewhat adjusted because about half the production is retained for domestic consumption. Synthetic rubber and newer inventions have minimised the demand factor for natural rubber. Thus the tea exports and the terms of trade are the only two redeeming features of the export trade of Ceylon. On the side of imports the volume and value increased much more than exports, especially in recent years. Consumer goods increased considerably, and though the percentage of capital goods to the total import trade was small, it increased in volume, price and value at a much higher rate than consumer goods. Food and drink continued to constituted a very considerable proportion of imports though it had declined relatively in recent years. This was due to the explosive growth in population and to increased standards of living, through transfer of wealth by increased wages and larger food subsidies.

(ii) Some attempts were made to diversify rhe trade by seeking new markets for both exports and imports. Apart from the Sterling Area, Dollar Area and the E. E. C., bilateral trade and payments agreements were entered into with China, U. S. S. R. and other East European Countries, but rubber alone benefited from these, and barring China, the trade with others has been negligible. Yet it must be said that the search for new trade contacts relieved the necessity to depend exclusively on the traditional markets, however important the latter were to the major foreign trade of Ceylon. There was some set-back in the trade with the Middle East due to bilateralism and shortage of sterling, while the trade with the E. E. C. showed improvement, particularly on the import side. While formerly Empire countries imported the major share, now non-Empire countries make the major imports, but the Empire countries even now constitute the major market for Ceylon's exports. At present the Dollar Area continues as the only customary trade surplus area for Ceylon. On the whole it must be said that these attempts to change the direction of trade in order to diversify it have not to any appreciable extent altered the basic problems of the stagnation in exports and the rise in imports leading to adverse balance of payments.

(iii) Nor is the position made any better with regard to items other than Merchandise in the balance of payments account. Investment income, private remittances and migrant transfers, and private capital movements have all created a net debit and imposed a strain on the balance of payments. The outflow of certain types of private capital transfers was curtailed by restrictions introduced in 1957 though income and profits have not been restricted from remittance. The stringent measures to restrict imports introduced in August, 1960, and January, 1961, have also somewhat mitigated the deteriorating position of the Balance of Payments which is reflected in the fall of imports in the first half of 1961 which was Rs. 808·6 million as compared with Rs. 962·4 million in the first half of 1960, showing a decline of Rs. 153·8 million. Unfortunately exports too declined due to rubber which fetched Rs. 92 million less in the first half of 1961 as compared with the first half of 1960. The climate for foreign private capital investment has been wanting, and other policies have not only discouraged investment but even tended to drive foreign capital out. It is not likely that in future private capital will flow in. This has been compensated in recent years by official donations and loans for the economic development of the country. Capital aid from the I. B. R. D., Colombo Plan, America, the U. S. S. R., China and other countries have varied from year to year, but the sums have been very inadequate either for Economic Development or for bridging the Balance of Payments gap.

(iv) The continued increase in import payments, which was responsible for the merchandise account deficits was directly the result of the sustained inflationary pressures generated in the economy, primarily through budget deficits. The average deficit between 1951 - 52 and 1955 - 56 was Rs. 65·8 million per year and that between 1956 - 57 and 1960 - 61 was as much as Rs. 342·9 million per year. Between 1955 - 56 and 1959 - 60 expenditure rose at 9·8% per year, but Revenue rose at 2·8% per year only. Public Debt (Gross) rose from Rs. 1160 million in 1956 to Rs. 2230 million in 1960 ie. an increase of Rs. 1070 million, in four years, and this was made possible chiefly by the use of Treasury Bills which expanded greatly from Rs. 65 million since 1957 to Rs. 550 million in 1960. There was also an increase in the supply of money from Rs. 1,040 million in 1957 to Rs. 1,210 million in 1960 accompanied by a relative increase in currency and increased credit facilities to the public by the banking system. The Government, having exceeded its limit of foreign borrowing and domestic non-bank sources which are non-inflationary in nature resorted to the use of cash balances and bank-borrowing on a heavy scale which are inflationary in character, but this was off-set by a contraction of the external banking assets. The problem was aggravated by the fact that the greater part of the rise in total expenditure was due to an increase in current outlays, ie. about 74·4%, chiefly on education, health and food. Capital expenditure never exceeded 30% of the total budget and capital formation was only 14% of total national income. Commercial banks alone contributed towards savings. The cost of living index also rose somewhat after 1957 due to inflation. Thus everything tended to raise consumption which could only be met by increased imports which actually happened. This resulted in increased adverse balance of payments. This deficit was financed principally by drawing down external reserves. The reserves stood at the alltime peak of Rs. 1,260 million in 1945 and varied thereafter from time to time and remained at Rs. 1,080 million in 1950 and at Rs. 1,180 million in 1956, but was reduced by Rs. 700 million in quick stages to Rs. 480 million in 1960, which is roughly less than three months imports at 1960 levels. Previously the balance of trade was always favourable except in 1947, and in 1952 and 1953 because of the sudden collapse of the Korean boom, but it was continuously unfavourable since 1957 despite the fact that exports were increasing and the terms of trade were improving. This was primarily due to large deficit financing of an inflationary nature and to the large increase in outlay on consumption. Despite substantive monetary expansion, Ceylon had avoided a sharp rise in the level of domestic prices by satisfying a rise in demand out of additional imports at the expense of her external reserves. But this cannot happen indefinitely as the reserves have reached the safty level, and the only alternatives posed before the country is either increased domestic production or rise in prices and costs.

(v) It would thus appear that budgetary policy has much to do with the balance of paymens problems, and that the only way to restore equilibrium in it would be the economic development of the country without which the increased demand for consumption and capital goods can be met since the traditional exports do not expand enough to meet the situation. There is a relative decline in the demand for food and raw materials by advanced countries. Technological changes have also worked against raw material consumption. This would necessitate the improvement of an unfavourable commodity composition of exports by structural adjustments. On the other hand the demand for imports has been rising more rapidly because of an increased growth in population and because of the demand for raw materials and capital goods for rapid economic development. The payments difficulties cannot be mitigated by improvements in the terms of trade, or by a decline in the payment of foreign investment income or by the increase in the inflow of foreign aid, or by a fall in imports which is unlikely in view of developmental activities, or by a liberal import policy on the part of the industrial countries, or by allowing for a possible expansion of exports to third markets. Import substitution of manufactured consumer goods and food will be necessary if Ceylon is to develop at a reasonably rapid rate and if she is to narrow the income gap between herself and the developed countries. A formidable effort is necessary to allow for the import of capital goods. There is a choice for the industrial countris, because of adjustments, between trade and aid. The problems of Ceylon and her neighbours can be minimised through trade co-operation between them, even by overcoming areas of conflict. Thus the limitations of export expansion and the desire for economic development provide both a challenge and an opportunity for economic statesmenship both in a country like Ceylon and in the advanced countries.

CHAPTER III

THE BALANCE OF PAYMENTS

1. The Ceylon Rupee

In 1872 the Indian rupee was declared as the sole legal tender, but the rupee was subdivided to 100 cents. Though an interested section in Ceylon resented the action of the Government of India in putting an artificial value on the rupee in 1893, the Indian rupee continued to be the standard coin. But the introduction of the Ceylon currency notes in 1884 in place of the former bank notes, and especially the one-rupee and two-rupee notes in 1917, removed the necessity of the Indian silver rupee's circulation and confined it to the reserve vaults of the Treasury of Ceylon. The reserve of the Ceylon currency consisted of metallic silver rupee and securities. Ever since 1893 the question of an independent currency for Ceylon was discussed. It was considered and opposed by the Herschell's Committee of 1893 and the Currency Commission of Ceylon of 1901. The Ceylon Banking Commission of 1934 pointed out the advantages of the Indian rupee as basis of Ceylon money. But in 1936 it was proposed that Ceylon should have a seperate currency standard and that that should be linked with the Indian rupee with an optional link with the sterling if India devalued her rupee. This was the form in which the Paper Currency (Amending) Ordinance of 1939 was introduced, but subsequently the optional link was dropped. The change was nominal since Indian rupees were not in circulation. The New Currency Ordinance was passed in 1941 and became effective soon after. There were three effects of the Currency Ordinance. Firstly, it created a Ceylon rupee linked to the Indian rupee; secondly, it avoided the inconvenience of holding silver rupees, and lastly, it enabled the Board of Currency Commissioners to issue or redeem Ceylon currency against sterling or rupee credits by the establishment of a Currency Security Fund. In 1949 Ceylon devalued her currency by 30·52% along with India and England.

2. External Assets

The Second World War caused great changes in the financial conditions of the country which reflected on the foreign trade position. England required all assistance to prosecute the war but was not in a position to repay in goods for all the raw material and foodstuffs she purchased. There was increased exports from Ceylon and decreased imports. Though Ceylon had contributed her share of help and even raised funds for relending to England, the major payments for her exports and for the military defence expenditure in Ceylon incurred by England had to be met by England through some other device. This was done by the issuing of securities in England against which Ceylon gave rupees for the exporters and others in Ceylon. This process created large sterling balances which Ceylon thought might be utilised in the post-war period for the purchase of capital equipment for her economic development. High hopes in this direction were entertained in 1945 and 1946 when national finance and trade balance were both very favourable. But the food situation and the demand for foreign consumer goods created unfavourable balances during 1947 and 1948. The foreign trade crisis was relieved a little in 1948 when prices of exports had a rise and exchange control was extended to the sterling area consequent to the Financial Agreement with the U. K. in that year. This was followed by the Korean boom of 1950 - 51, its collapse in 1952 - 53, the tea boom of 1954 - 55, and the steady decline since 1956 due to budgetary expansion. The External Assets reflected the trends in the balance of trade of the country throughout the war and post-war period. It reached the peak figure of Rs. 1260 million in 1945, Rs. 1185 million in 1951, and Rs. 1179 million in 1955, but Rs. 933 million in 1941, Rs. 607 million in 1953, and the lowest figure of Rs. 481 million in 1960. The series of budgetory deficits since 1947 (excluding 1954 and 1955) had their effects on the position of the external assets through the balance of trade. Import restrictions were resorted to in order to safeguard the position of the external assets, and the stringent restrictions imposed in August 1960, had the profound effect of reducing the drop in external assets by Rs. 10 million for the last quarter of 1960 as compared to a drop of Rs. 76 million for the last quarter of 1959. The position improved only in 1963.

The Financial Agreement between Ceylon and the U. K. in 1948 provided for the release of the sterling accumulated by the Government of Ceylon during the war in seven instalments between 1950 and 1957. This was because of the dollar crisis that was facing the U. K. and the sterling area. England had more or less frozen the assets in 1947.

Ceylon was a good dollar earner for the sterling area, and the Agreement was a compromise enabling Ceylon to regulate capital transfers by exchange control. Also assets earned thereafter were not to be blocked. And now the dollar crisis has abated and Ceylon has also utilised the Sterling Balances.

The composition and liquidity of the external assets has aquired some importance in recent years because it had to bear the major effect of the impact of the budgetary, banking and monetary expansion which have taken place to an unusual degree and it would be more appropriate to pin-point the cause to budgetary deficits than to any other. The budgetary deficit averaged Rs. 65·8 million for the period 1951 - 52 to 1955 - 56, but increased to the astronomical figure of Rs. 342·9 million for the period 1956 - 57 to 1960 - 61. Fortunately by 1956 these reserves had been at a relatively high level of Rs. 1179 million but fell to Rs. 481 million in 1960 i. e., declined by Rs. 698 million. There were significant changes in the composition and liquidity pattern of the external assets, which included the holdings of Government Agencies and Institutions, the Central Bank and the Commercial Banks. The main impact of the decline in reserves was on the holdings of the banking system — particularly those of the Central Bank. This share declined from Rs. 745 million or 63% of the total in 1956 to Rs. 173 million or 36% of the total in 1960. There was a change in the liquidity pattern as well. The Central Bank's cash balances abroad declined from Rs. 544 million or 73·8% of the Central Banks International Reserve in 1956 to Rs. 95 million or 50% in 1960. At the same time holdings of foreign Government securities changed from Rs. 193 million or 26·2% in 1956 to Rs. 95 million or 50% in 1960. These figures illustrate the nature and magnitude of the problem concerning Ceylon's external reserves. This became worse by the increase in foreign liabilities in 1961 and 1962 of both short-term and long-term nature, which equalled the assets in amount at the end of 1962. Hereafter it would not be safe for the reserves to decline any further.

3. Trade and Payments Control

Exchange Control and Import and Export control were introduced in 1939 as Defence Regulations and merged into one department, but the two were separated in 1947 as separate departments for their better functioning and fulfilment of aims. The aims during the war time were different from those in the post-war period. Previous to 1939 the aim of commercial policy was one of moderate protection, with participation in Imperial Preference. The basic outlines of this policy remained the same thereafter too. Exchange control and trade control were introduced in 1939 with a view to conserving the exchange resources of the British Commonwealth. This was applied during the war to non-sterling area transactions only. All foreign resources of the sterling area were pooled and all needs of members were met out of this common pool on agreed principles. The control aimed to minimise foreign expenditures and to conserve scarce cargo space. As the war intensified and shipping space became scarcer, control was extended to imports from all sources. Surrender of foreign exchange was enforced by a system of export licences. And export licences were used restrictively to keep strategic raw materials from getting into enemy hands. These policies continued until the war ended. Thus during the war exchange and trade controls together with rationing and price control created a dearth of consumer goods, but expanded the currency and foreign assets. This situation produced an entirely new set of problems for post-war foreign trade different from that which prevailed before 1939.

During the post-war period the war time policies of exchange control and import and export control continued to occupy even greater importance in the field of foreign trade, but with changed emphasis in their aims and objectives. There were three considerations prompting the Government to give them a more permanent basis after the war:

(a) the balance of payments problem,
(b) protection to domestic industries, and
(c) Ceylonisation and diversification of trade.

The problem of the balance of payment also meant not only her own position but that of the sterling area vis-a-vis the dollar shortage. The functions of the present exchange control may be mentioned as follows:

1. To maintain Ceylon's overall balance of payments position both with the sterling area and the rest of the world,
2. to enable Ceylon to carry out the general policies of the sterling area in respect of its financial dealings with the rest of the world with a view to conserving dollar exchange,

3. to keep an account of and to mobilise all earnings of foreign exchange for the nation's need,

4. to control expenditure of foreign exchange to meet essential needs,

5. to keep a record of all movements of funds inward and outward of a capital nature,

6. to utilise foreign exchange resources for the economic development of the country, and

7. to protect and assist local industries to produce import substitute and export products.

Throughout the post-war period both exchange control and trade control were either intensified or realaxed by Parliamentary and Administrative regulations as the necessity arose in fulfilment of the three objectives mentioned above. The Financial Agreement with the U. K. limited the drawings on the assets on an agreed basis, and it became therefore necessary to extend exchange control to all financial transactions between Ceylon and the rest of the sterling area.

The Exchange Control Act of 1953 gave a permanent basis to the exchange control provisions. Exchange restrictions were extended to items under the Invisible Account as much as to Merchandise. In 1957 restrictions were introduced in respect of certain types of capital transfers and in 1959 and 1960 further restrictions to remittances and travel abroad were added. These controls were extended in 1961 and 1962 to cover the entire foreign trade and payments of the country so that a favourable balance appeared in 1963. Thus the Government was able to control financial transactions not only under Merchandise accounts but in an increasing measure under invisibles account also. In fact the period since 1954 witnessed a series of stringent corrective measures to check the adverse balance of payments position. The administration of exchange control from 1950 was the responsibility of the Central Bank. Import and Export control were exercised with a view to restoring the balance of payments position according as it rose or fell, to diverting more trade into the hands of Ceylonese, to protecting domestic industries wherever necessary and legitimate. Between 1948 and 1951 ceiling values were fixed for all items so as to limit imports to the total overall ceiling value Export control was used to secure fair prices for exporters and to prevent the export of certain dangerous drugs, but it ceased to have the restrictive intentions of the war peried. Also it was used to control the export of goods in short supply in the home market.

4. The Balance of Payments

An analysis of the Balance of Payments position during the period 1950 - 62 will enable us to assess the trends and consequences of the measures taken by the Government to conserve foreign exchange, to preserve economic stability and to promote economic development. The foreign reserves position we may note was not satisfactory because of; (1) increased foreign liabilities incurred; (2) increased vulnerability of export prices; and (3) increased demand for imports, particularly of capital goods. Therefore import restrictions became compelling in an increasing measure in the post-war period, especially as monetary expansion took place with excessive budget deficits. The increasing use of substitutes and synthetics had reduced the trade between manufacturing and primary producing countries in the twentieth century, and the countries of the Ecafe countries had suffered relatively more than other primary producing countries. There was a relative decline in the value of exports and a fall in the terms of trade so that there was continued adverse balance of trade during the period since 1957. It was unfavourable even till 1962 despite severe import restrictions, though it was only in 1963 that a turn in this was noticed. The trade balance from 1950 to 1956 was favourable except for 1952 and 1953, but this was due to time lag. From 1957 to 1962 it was unfavourable. Export prices had been falling more than import prices since 1955 and this affected the terms of trade adversely. The Government was therefore forced to correct the disequilibrium through revised import restrictions.

The position with regard to the Invisibles Account constituting Services and Donations was also forced to be kept low through Exchange Control and Payments Agreements. The deficits on account of the invisibles was brought under control since 1959 by several measures to control the various items under it. Deficits due to Private Remittances and Migrants' Transfers, and on Foreign Travel were considerably reduced, and those under Investment Income was prevented from rising. The deficits under miscellaneous account were also reduced. At the same time income under Transport and Insurance, and under Official Donations was considerably increased. Measures for these were increasingly applied since 1958 as prior to this the deficit due to Invisibles Account was very appreciable. The most important step was to halt the net outflow of foreign private capital. Thus the deficit under Invisibles Account was reduced to a negligible margin since 1958, so that trade alone presented a problem for restoring equilibrium in the Balance of Payment and this has been achieved only in 1963 with increasing trade balances after severe import restrictions were imposed in 1960, 1961 and 1962, almost covering the entire foreign trade.

The fall in External Assets as a result of Balance of Payment disequlibrium continued till 1960 till it was found to have reached a dangerously low level. Resort was made in 1961 and 1962 for increasing the external liabilities by borrowing short - term loans from the I. M. F. and by drawing on long - term loans from other countries. So much so at the end of 1962 the external liabilities of Rs. 474 million almost equalled the external assets of Rs. 504 million. It was only in 1963 that external assets showed again a tendency to rise with increased trade balances and reduced deficits under invisibles account. But a mere policy of severe import restrictions and exchange control will not last long and produce desired effects. They could have far reaching effect on the internal price level and economy, which even in the matter of foreign trade the dollar area alone is maintaining a credit balance and compensating for deficits in all other currency areas and bilateral pacts. What seem to be necessary are a policy of disinflation through budgetary control and economic policies, both internal and commercial, for the economic development of the country to diversify it and to promote better trade. An alternative to disinflation is devaluation as a measure of correcting structural disequilibrium in the Balance of Payment position, and of encouraging a large inflow of foreign capital, both for Balance of Payment purposes and for economic development.

But we may note some causes that are responsible for creating a chronic malady in the Balance of Payments position of underdeveloped countries in general and of Ceylon in particular The most important is the structural changes that are taking place in the economies of the more advanced countries resulting in the fall in demand for primary commodities. This fact also causes a fall in the terms of trade, especially as exports and imports are inelastic. Another cause is the income elastic nature of the economy which gives rise to increasing imports with deficit financing and monetary expansion. In the absence of any counterbalancing effect from increased production this creates inflationary pressure and price instability. Still another cause is the demand for imports of capital goods and raw materials for development purposes. This again creates additional pressure on foreign exchanges. Thus it would be seen that there are fundamental causes that have generated a disequilibrium in the balance of payments position of the country in recent years compelling the adoption of very severe import restrictions through import control, exchange restrictions, and increased duties.

CHAPTER IV

CONSUMPTION, SAVINGS AND INVESTMENT

1. Rise in Consumption

We shall now discuss the nature and extent of consumption, saving, and investment in relation to the problems of economic development, especially as it affects the commercial, fiscal and monetary policies of the Government. Let us start with consumption habits and outlays. The standard of living in Ceylon is relatively higher than in many of the Asian countries excluding Japan and one or two others. Her plantation industries are the equivalent of heavy industries in the advanced countries, and they constitute half the physical production of the country and are almost entirely exported. The people with their purchasing power, though very unevenly distributed, depend on the imports to satisfy their requirements of consumer goods and other needs. The Ceylon customer has great preference for goods of high quality and good taste. His demand for them is almost inelastic. There are four reasons for this. The first is that the last war left the people of the country severely restricted and curtailed in the matter of even the bare essentials like food and clothing, not to say of other things. The termination of the war released the pent-up demand for both essentials and luxuary commodities. The war conditions continued for a few years after, and their effects were not countered until after sometime. Inflation and the rise in price continued for a long time. Though they were stabilised at a higher level than before, prices had continued to rise by short spurts to date.

The second reason was the "demonstration effect". Production and consumption in the advanced countries had gone up to very high levels and people of other countries learnt to imitate these high standards of consumption. Though other habits would also very well be imitated, imitation of consumption habits was much easier and natural, and this was strengthened by the next reason. Thirdly, though Ceylon had gained independence there was a desire to develop the economy of the country and remove poverty and unemployment through six-year Investment programmes. The concept of economic planning and development, and the policies and requirements for its successful implementation were not properly understood, so that consumption levels, and therefore price levels, could not be controlled because investment opportunities and saving incentives were not provided. Frequent import restrictions had to be imposed, and price control and rationing methods proved ineffective. Fourthly, 85 per cent of the imports may be classified as essentials, leaving only 15 per cent of the imports as luxuries and non-essentials that could be manipulated, so that demand is almost inelastic, and as it exists now cannot solve the balance of payments problems to any appreciable extent. The remedy lies in the planned economic development of the country through better imaginative economic and commercial policies, especially through price control and state trading, and import restrictions and budgetary reforms.

2. Consumption and Inflation

We may briefly consider the relation between consumption and inflation. We have indicated the post-war tendency for consumption to rise and for inflation to take the upward spiral. The situation has been complicated by the excessive currency pumped into circulation in recent years While between 1947 and 1956 the increase in circulation was Rs. 30 million, the increase between 1956 and 1960 was as much as Rs. 200 million. This had increased money supply between 1956 and 1960 by Rs. 80 million. This situation was the result of deficit financing, and instead of the productive capacity of the country rising, consumption had risen and created increasad demand for imports. But fortunately prices did not rise very considerably and inflation was not very visible. The reason for this has to be noted. Normally Ceylon's balance of trade and terms of trade moved together, but recently the terms of trade remained favourable while the balance of trade continued during the last few years to be unfavourable despite the increase in exports. The explanation is that though the prices of imports rose relatively less than the prices of the exports, the volume of imports rose so high that it exceeded exports and a deficit developed, and consequently an unfavourable balance of payments. This was reflected more in the decline of the foreign assets than in the price level. During previous occasions the adverse balance arose due to the collapse in exports, but here was a situation with its lessons for the Government. Had imports been restricted to counter the unfavourable payments tendency and to safeguard foreign assets there would have been a rapid rise in prices due to the inflation. The price paid now was the fall of foreign assets below safety levels. The remedy lies in import restrictions and balanced budgets, and in increased production and investments. Production must be planned and investment opportunities and saving incentives provided. Capital can be attracted only by higher rates of interest as was evidenced recently by the Government's offer when borrowing loans. At the same time entrepreneurs should have cheap credit at the lowest rates. This implies that the Government should take the chief responsibility for providing facilities for investments at attractive rates and a money market on easy borrowing terms. The other financial institutions would follow suit. Speculative investments and speculative borrowings must be curtailed and controlled by budgetary and banking policies. Inflation leads to sharp rise of consumer goods prices with hardship for the lower income group, to excess profits involving wastage on luxury consumption and speculative stockholding, to higher wages and cost of production, and to frustration in investment by diverting resources to consumption.

3. Trends in Savings

One of the causes of stagnation in the economy is the low rate of savings and investments. We may find out why it is so, what the remedies are and how far it could be made to meet the needs of a planned development. The present levels of savings are very inadequate in quantity and quality. The average saving during the period 1950-59 may be said to be about 9 per cent of the gross National Income which is very low. Not only the total savings have been subject to severe fluctuations from year to year, but the three components of savings, viz. Government, Corporate and Household Savings, have each been fluctuating individually. It is noted that Ceylonese seem to save more out of a rise in incomes than out of a steady flow. In the Household Sector indebtedness or liabilities are on the average 40 per cent of the total assets and fluctuate considerably, and these are chiefly used for consumption purposes and thus reduce savings. Also about 80 per cent of the families in Ceylon save nothing or dis-save. Household and Corporate savings follow the pattern in the variations of export earnings. In the case of Corporate savings, the non-resident companies have decreased their retained profits in Ceylon from 1955 onwards due to the Governmental policies towards foreign investments in Ceylon. Hoardings constitute a high proportion of Household saving, and are not available for investments, but increase the potential available for consumption. Savings through insurance policies are steady, as also through other institutional channels. Speculative investments in land and buildings constitute a high proportion of assets, but have very little multiplier effect. In the Corporate sector, old companies supply their own capital out of profits and reserves, while newly developing companies struggle for capital, though they too do not welcome private sources as they do their own. Much of the Government loan fund expenditure could not be considered clearly developmental.

4. Reasons for Low Savings

Consumption has taken quite a large share of the National Income, and savings and therefore investments have been low and inadequate to meet the requirements of rapid development. It would require a very great effort to raise the rate per capita increase in income from 0·9 per cent to 2·9 per cent per year. Savings, whether private or public, have been low. Personal savings amounts to barely 2 per cent of personal income. It is hardly a picture about which a country with an underdeveloped economy can feel very happy. (But personal savings as a proportion of income before tax amounts to some 40 per cent of the personal incomes of persons in the income tax paying classes.) Even Corporate savings had fallen from Rs. 112 million in 1950 to Rs. 68 million in 1959, and Household savings had shown only a very slight increase. We have discussed earlier the trends in the various catagories of savings during the last decade, and noted that they were not encouraging. There are many reasons for the insufficiency of savings in Ceylon. They are: (1) the very heavy taxation levied on private companies and on personal incomes. Particular concessions have mitigated the effect of high taxation. But taxation reduces savings, and though it is not a basic explanation of the saving habit, the taxation system should be consistent with the policy of stimulating private savings and investments. We may say that it is the tax of companies that principally affects financing of gross capital formation and thus of its major component, gross fixed assets formation. For new companies external sources are relatively more important, i. e. from personal savings of private individuals. The relative importance of Corporate and personal tax should be according to opportunities for profitable investment. (2) The rate of interest has not been attractive for greater savings. Generally in those types of investments favoured by investors interest rates are low, and, elsewhere they are high. The Government may get its loans from banks and from those who look for a safe security, but the rest may either risk high rates or prefer to hoard in the traditional forms. Excepting in agriculture, commerce, and building, which are the traditional preferences of investors, other lines of investments find it hard to obtain funds. Investors prefer a few favourite types of investments and are reluctant to touch shares. For example, investors should prefer to put their money into houses and land where the yield may be 6 per cent or less, rather than in shares fetching yields higher than 10 per cent. The industrialist is at a much greater handicap in getting long-term credit. Even the Government would find it difficult to secure more funds for its developmental plans. Recently the Government had to increase the rate of interest for its loans. The problem is one of developing a capital market to raise adequate funds at higher rates of interest and of providing cheap credit for the investors and entrepreneurs. (3) The rise in wages rates is not linked to rise in productivity per worker, and this has discouraged savings. (4) The large profits made in the early 1950's during the Korean war commodity price boom has been another reason for the decline in savings. (5) The lack of an industrial and commercial policy is another. It is felt that only a quarter of the raw materials and capital goods imported were under 10 per cent import duty and that the bulk of them were between 10 and 30 per cent. Also an authoritative Tariff Commission is absent. (6) There is the preference for quick returns and capital gains. (7) There is a lack of technical knowledge in industry. (8) Individualiam and lack of joint efforts has been another reason. (9) Ceylonisation and Nationalisation have prevented the inflow of foreign capital. (10) Government has set bad example and demoralised the economy against saving and investment, because much of Government loan fund expenditure would not be considered clearly developmental.

5. Investments : Private and Public

We may say something about investments now. Gross investments rose from Rs. 39 million in 1938 to Rs. 559 million in 1953, i. e. from 5·9 per cent to 12·5 per cent gross national product. Volume of production increased by 48 per cent and the population by 40 per cent, so that output per head rose by 6 per cent during this period. The percentage of gross investments to national income do not compare unfavourably with those of other countries. But 1938 was an year of unemployment of men and resources, and later demand for Ceylon's products increased and output expanded, so that it is questionable whether capital formation was really high enough for that period. Moreover a proper Price Index is absent to deflate gross to net national income. Moreover private investment was not directly productive, as building constructions constituted 72 per cent of gross private investment. This is high and unsatisfactory. Nevertheless, replacements are a negligible fraction, while net investment preponderates. Thus a substantial part of gross investments is devoted to expanding the community's capital stock. The volume of investment differs considerably between different parts of the economy even if there are wide differences in coverage. The pattern of investments among companies, however, is better than the general. (We have already observed under savings that the pattern of investments are due to various habits, traditions and preferences of investors, and also due to the defective policies and tax rates of the Government. The division between private and Corporate savings and investments is important because they are influenced by different tax rates which play different roles in the economy, even though the effects of taxation on investments are not clear). Moreover Ceylonese are buying up lands which foreigners are selling, so that capital for development is not available except at high rates while at the same time a great rise in savings is necessary to reduce these rates. A rise in the rates of interest and the development of a capital market seem to be the way out for a high rate of investment adequate to raise the rate of growth of the economy at a rapid pace. Past experience may be helpful. The First Six Year Investment Progrmme for 1947 - 53 involved a total outlay of Rs. 1,250 million, and this was revised by the Colombo plan consultative Committee in 1952 for the period 1951 - 57 to Rs. 3,200 million as the total outlay. The six-year plan of 1947 - 53 was financed 67 per cent by domestic resources and 33 per cent by inflationary financing. The second six-year plan of 1954 - 60 envisaged a total outlay of Rs. 3,200 million for development, but this was scrapped with a change of Government in 1956. The new Ten-Year plan has an investment target of Rs. 13,600 million of which Rs. 8,340 million is Government investments and the rest private. With proper incentives to savings and investments from domestic and foreign sources development could take place without resort to much inflation.

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CHAPTER V

PUBLIC EXPENDITURE AND CAPITAL FORMATION

1. Some Salient Economic Features

We may start the discussion of the problems of the financing of development with the following six tables which bring out the salient features of the economy very markedly. Table I gives the growing budgetary deficits in the post-independence era and its inflationary effects.

Table 1 (In Million Rupees)

Year	Budget Deficit	Treasury Bills	Money Supply	External Assets
1950 - 51	47·8	30·0	1,006·2	1,216·8
1951 - 52	257·1	92·5	895·8	873·8
1952 - 53	231·9	184·0	826.8	640·4
1953 - 54	33·7	105·0	957·1	944·3
1954 - 55	127·6	60·0	1,072·9	1,228·8
1955 - 56	1·2	68·0	1,126·8	1,275·7
1956 - 57	196·4	65·0	1,040·1	1,061·9
1957 - 58	222·3	140·0	1,076·8	933·2
1958 - 59	413·4	320·0	1,177·7	734·0
1959 - 60	417.5	550·0	1,208·9	541·3
1960 - 61	462·5	750·0	1,288·6	531·7
1961 - 62	464·0	1,000·0	1,342·7	503·9
1962 - 63	456·9	—	—	—

Source; Central Bank of Ceylon.

This is the result of an ever-growing size of Public Expenditure which is given in Table II.

Table II

Financial year	National income	Index of growth	Current expenditure	Index of growth	Curr. exp. as a %of inco.
1949 - 50	3734	100	563	100	15
1950 - 51	4422	118	805	143	18
1951 - 52	4278	114	1,024	181	24
1952 - 53	4376	117	928	165	21
1953 - 54	4557	124	750	135	17
1954 - 55	5167	138	873	155	17
1955 - 56	4885	131	1,103	195	23
1956 - 57	4829	129	1,136	202	24
1957 - 58	5181	139	1,434	255	28
1958 - 59	5384	144	1,642	295	31
1959 - 60	5656	151	1,582	280	28
1960 - 61	5828	156	1,640	291	28

Sources: The National Income figures are from the U. N. Social Accounting Statistics. The Expenditure figures are from Ceylon Government Account I.

And this again is marked conspicuously by the expansion of food subsidy which is brought out in Table III.

Table III

	49-50	50-51	51-52	52-53	53-54	54-55
1. Goods and Services	325·7	453·1	490·8	530·6	534·5	601·3
(a) Administration	74·6	107·1	97·3	115·0	115·9	141·2
(b) Social Services	156·6	172·1	207·5	212·8	225·0	233·9
(c) Economic Services	88·4	102·1	112·2	115·4	113·3	142·1
(d) Others	6·1	71·8	73·8	87·4	80·3	83·7
2. Transfer Payments	135·4	237·7	375·2	257·6	138·5	161·0
(a) Food subsidies	35·8	131·6	247·8	127·0	12·5	36·0
(b) L. G. A. Grants	20·9	18·5	21·6	23·1	22·8	23·3
(c) Others	78·7	87·6	115·8	107·5	93·2	101·7

	55-56	56-57	57-58	58-59	59-60	60-61
1. Goods and Services	630·0	688·9	772·5	886·5	943·8	1000·5
(a) Administration	149·2	172·4	199·9	207·7	216·5	249·1
(b) Social Services	256·9	277·9	314·4	377·4	420·2	422·3
(c) Economic Services	133·1	138·0	149·1	173·1	184·5	206·2
(d) Others	90·8	100·6	109·1	128·3	122·6	122·9
2. Transfer Payments	232·8	287·8	345·7	382·9	421·6	465·5
(a) Food subsidies	79·5	105·5	112·0	146·5	193·0	200·0
(b) L. G. A. Grants	24·4	26·3	32·5	34.8	35·7	36·6
(c) Others	128.9	156·0	201·2	206·6	192·9	226·9

Source : Central Bank of Ceylon.

In Table IV below trends in National Product and Capital Formation in recent years are given in order to show the relative stagnation of the per capita income which is our prime determinant of development.

Table IV

Summary Indicators of Product and Expenditure at Current prices.

A. Values	1959	1960	1961	1962
1. Gross Natinal Product at Factor Cost prices (Rs. Million)	5,835	6,020	6,067	6,313
2. Gross Domestic Expenditure at Market prices (Rs. Million)	6,551	6,736	6,609	6,799
3. Private Consumption at Market prices (Rs. Million)	4,579	4,837	4,728	4,908
4. Public Consumption at Market prices (Rs. Million)	897	963	968	985
5. Gross Domestic Fixed Capital Formation at Market prices (Rs. Mil.)	1,033	967	904	985
6. Exports of Goods and Non-Factor Services (Rs. Million)	2,016	2,011	1,907	1,976
7. Imports of Goods and Non-Factor Services (Rs. Million)	2,176	2,209	1,972	2,068
8. Gross National Product per capita at Factor Cost prices (Rs.)	606	608	597	604
9. Gross Domestic Expenditure per capita (Rs.)	681	681	650	651

B. Index Numbers (1959=100·0)	1959	1960	1961	1962
1. Gross National Product at Factor Cost prices	100·0	103·2	104·0	108·2
2. Gross Domestic Expenditure at Market prices	100·0	102·8	100·9	103·8
3. Private Consumption at Market prices	100·0	105·6	103·3	107·2
4. Public Consumption at Market prices	100·0	107·4	107·9	109·9
5. Gross Domestic Fixed Capital Formation at Market prices	100·0	93·7	87·5	95·4
6. Exports of Goods and Non-Factor Services	100·0	99·7	94·6	98·0
7. Imports of Goods and Non-Factor Services	100·0	101·5	90·6	95·0
8. Gross National Product per capita at Factor Cost prices	100·0	100·3	98·4	99·7
9. Gross Domestic Expenditure per capita	100·0	100·0	95·5	95·6

Source: Central Bank of Ceylon.

Table V shows the growth of gross capital formation in the fifties and shows how dependent it was on the drawings of external assets.

Table V

Finance of the Gross Domestic Capital Formation

(in Rs. Million)

	1950	1951	1952	1953	1954
1. Depreciation	139	143	138	148	167
2. Savings	516	511	171	342	631
3. B. of P. deficit	−137	−89	446	158	−305
Total	518	565	755	648	493

	1955	1956	1957	1958	1959
1. Depreciation	169	183	210	235	305
2. Savings	697	603	373	333	372
3. B. of P. deficit	−323	−82	195	153	177
Total	543	704	778	721	854

Source : Central Bank of Ceylon.

Table VI is very significant in that it shows how recent experience has belied the hopes of the Ten Year Plan and how very necessary it is to curb consumption or lower the capital / output ratio if the alternative of foreign capital was not forthcoming.

Table VI

Comparative Table

	Group of Countries by average income†	Ratio of Gross Capital Formation to Gross National Product (a)	Ratio of Net Capital Formation to Net National Product (b)	Ratio of depreciation to Gross Capital Formation (c)
	1.	21·0	13·5	41·2
	2.	17·6	9·7	40·7
	3.	15·2	10·2	33·2
	4.	13·1	7·5	37·6
	(vi)	(14·4)	(8·1)	(42·3)
Ten Year plan Ceylon 1968		21·3	17·6	21·3
Increments over 57—68		51·3	42·7	21·7
Increments 57—60		—	—	—
Ceylon 1957		13·1	9·9	30·1
Ceylon 1960		14·1	10·8	34·8

	Group of countries by average income †	Incremental Capital output ratio (gross to-gross)	Incremental Capital output ratio (net to net)	Ratio of consumption to gross National Product
	1.	8·1	5·2	79·0
	2.	5·7	3·0	82·4
	3.	3·0	1·7	84·6
	4.	3·3	1·8	86·9
	(vi)	(3·3)	(1·5)	—
Ten Year plan Ceylon 1968		2·65	2·8	79·6
Increments over 57—68		—	—	58·7
Increments 57—60		3·8	3·3	109·7
Ceylon 1957		n·a	n·a	89·2
Ceylon 1960		n·a	n·a	89·4

† As grouped by Kuznets' 'Quantitative Aspects of Economics', V—Capital Formation Propositions, **Economic Development and Cultural Change**, July, 1960. Ceylon is in Group 4. Group (vi) is a smaller group which includes Ceylon.

(a) Kuznets, Table I, p.4.

(b) Kuznets Table IV, p.15.

(c) Kuznets Table IV, p.13.

These six tables taken together lead to certain irresistable conclusions on which is based our discussion of not only the financing of development but also the pattern of development and the necessary reorientation of commercial policies which alone can solve some of the bottlenecks of the economy and assure a rising per capita income, fuller employment and a balance of payments in the foreign accounts. From the figures in Table VI we can see the following:

(a) the Ten-Year Plan arrived at a proportion of Gross Capital Formation to Gross National Product in Ceylon in 1968 equal to the average proportion in the group with highest income countries in the world;

(b) the ratio of Net Capital Formation to Net National Product according to the Plan was to be far higher than the average post-war experience of even the wealthiest group of countries;

(c) the incremental capital output ratio (gross/gross and net/net) were below the average ratio of many of the groups studied by Kuznet; (Individual countries however differ widely)

(d) the ratio of consumption to Gross National Product in 1968 was to equal the average level of the group of countries with the highest income in the world. The Ten-Year Plan was therefore expecting far too much.

A few general conclusions about Ceylon's actual performance since 1957 are also possible:

1. The capital / output ratio in Ceylon has been nearly a third above the plan figures.

2. The ratio of Gross Capital Formation to National Product is in line with similar countries, but it has been achieved by disinvesting in foreign assets.

3. Net Capital Formation has been high but it appears that this is a false figure as inadequate allowance has been made for depreciation.

4. Increments of consumption since 1957 have exceeded increments in Gross National Product. Therefore capital formation increased only by the running down of the foreign assets.

5. Investments in Ceylon have been wasteful. The results regarding Capital Formation are therefore disquieting. Without restraints on consumption, the rate of growth of output will fall.

2. Deficit Financing and Social Expenditure

The experience of the fifties shows a persistent tendency towards an adverse balance of payments. Though there are many causes to this, the principal cause in Ceylon has been the large deficit financing of the Budget since 1956 which has been yawning more and more to date. Government deficit financing has caused monetary expansion with consequent pressure on imports. As the level of foreign assets declined to the low water-mark, import restrictions were introduced in 1960, 1961 and 1962 with greater stringency. This resulted in arresting the adverse balance but also resulted in exerting pressure on the domestic price level. This must be traced to the high propensity to consume which is again the result of Government budgetary policy. Monetary policy alone cannot offset the inflationary effects of the overall budget deficits which therefore must be reduced to permissable limits. This in fact has been the chief current economic problem in Ceylon. On the side of revenue export duties, income tax, and import duties have been the chief sources, but they have reached maximum limits, at current levels of development. All tax concessions and rebates have been removed except for new industries. Excise duties of different varieties have been tried but not with much success. Gift tax and wealth tax have also not yielded much revenue. Income tax of the higher groups have been raised steeply. Corporate taxes are as high as possible. New sources are also limited. It must be said that the prevailing tax burden has proved dis-incentive to savings and even created a tendency to consume capital with consequent ill-effects on investments and development. In fact the tax structure is a very iniquitous one. It has failed to satisfy the main objectives of fiscal policy. With all these the revenue of the country is unable to meet the current expenditure of the budget, let alone capital provision to meet development expenditure which is inadequate to meet the targets of the Ten-Year Plan nor even the reduced Three-Year Short-Term Programme. Capital expenditure is met from local borrowing and foreign aid and created credit and not from any Government savings. The need to axe current expenditure is evident from the necessity to curb consumption and create savings. The rate of development would otherwise be very low and dangerous. While National Income increased by 50 per cent between 1949 - 50 and 1960 - 61, current expenditure increased by 200 per cent. This expenditure which was 15 per cent of National Income rose to 30 per cent or even more if all expenditure by the Government authorities were included. While Goods and Services and Transfer Payments generally increased threefold over this period, food subsidy alone rose sixfold at the expense of other transfer payments. Hence there is an urgent need to prune expenditure on that item if development were to be seriously considered. Government expenditure on Social Services is 35 per cent of current expenditure. This is a high proportion even for U. K. and U. S., but given the current volume of tax and other revenues, Ceylon cannot afford a high scale of social services expenditure, especially in the future. The need for holding down the soaring social services expenditure would seem to be the only way out of the present impasse created by the changed financial situation.

3. National Product and Capital Formation

The present fiscal and monetary policies of the country are inadequate to meet the challenge posed by economic development. The financing of development has indeed become a problem in Ceylon because the average annual rate of growth of the economy in real terms was 3·5 per cent, or on the basis of an annual rate of increase in population of 2·6 per cent it was 0·9 per cent in per capita terms which is less than one per cent. This state of affairs was due to inadequate capital formation. While consumption (public and private) increased with National Income, capital formation remained almost stationery over the past few years. Gross National Expenditure exceeded Gross National

Product, as also the increments of consumption over Gross National Product increments. This meant that Gross National Formation was maintained by drawings on the external assets. If Gross National Expenditure was reduced to the level of the Gross National Product by cutting down savings and not consumption the Gross Capital Formation would be still lower, that is from 14 per cent to 10 to 11 per cent, which would mean an annual rate of growth of only between 2·6 and 2·9 per cent which would equal the rise in population without any increase in per capita income. The Ten-Year Plan visualised a Gross Capital Formation of 21·3 per cent, which was too high to produce a rate of growth of 5·9 per cent, but the Short - Term Plan has reduced the GCF to 16·8 per cent and the rate of growth to 4·8 per cent, that is about 2 per cent increase in per capita terms. It is hoped the present order of capital expenditure would achieve this rate of growth in the economy. Even this modest rate may not be achieved, because the provision in the Budget of capital expenditure for 1963 - 64 again falls short by a sizeable margin. Yet it might be possible to achieve fair results if certain conditions are fulfilled. The low rate in the past of less than one per cent was due to under expenditure in the capital budget as a result of administrative and planning bottlenecks. Again the magnitude of foreign aid is quite problematical. There is again the high propensity to consume and run down the external assets of the country. Further the capital provision is not made out of savings on revenue, but partly by created credit with consequent ill-effects on the economy. This again affects private savings and causes disincentives for capital accumulation and formation so that the climate for private saving and investment is lacking in the country as a result of budgetary and economic policies pursued by the Government.

It would thus be realised that even a modest rate of growth involves a large financial outlay on the part of the Government which is possible only on conditions we have discussed earliar, as otherwise both the public and the private sectors would be crippled. The 1963 - 64 Budget has narrowed the deficit but it is problematical if the expectations would prove correct. Nor has the private sector any reason to feel happier than before. Taxation is more rigorous and consumption has been unbridled. It therefore continues the vicious circle downwards without hopes for development. Production will be low and prices will mount with the passage of time. Hence our discussion of Public Expenditure and Capital Formation shows the necessity for the inflow of large foreign capital to keep up the rate of development.

4. Note on Public Expenditure

The last four chapters have indicated the genesis of the problem by showing that deficit financing led to increased consumption and to adverse balance of trade and payments. This resulted in exchange restrictions with consequent rise in prices and costs and in unemployment and idle resoures. Coupled with inadequate investments and falling income the Budget gap widened year after year. Thus deficit financing is identified as the chief cause of economic stagnation. But Public Expenditure has been growing and cannot be curbed because of universal franchise and political pressure. This has resulted in current services expanding with population growth and absorbing about three-fourth of the public outlay while leaving only a fourth · for investment expenditure. Nor are there any theories of public expenditure to guide us between current and investment expenditure or between various services or between public and private spending. Further there are no scientific means of evaluating the tax-payers' choices. But in general we have to assume even in a mixed economy that the state alone can provide the necessary technical effiici-ency for ensuring rapid development and judge it at that. Public expenditure must therefore be strictly limited to the objectives of state activities. Therefore Public expenditure must be surveyed as a whole in relation to possible resources, public services must be improved systematically, and legislative control must be complete and effective.

CHAPTER VI

PRODUCTION AND EMPLOYMENT

1. Production

In the previous two chapters we discussed the problems relating to the financing of development and laid the blame for the low rate of capital formation to the fiscal policies pursued by the Government regarding public expenditure. It had its effects on the external balance of payments and on the domestic price level. The policy of import restrictions in recent years was a result of these consequences, meant to cut down external deficits and to promote import substitution. This could under normal circumstances have created a new equilibrium but production and employment did not as experienced in the fifties and in the early sixties, expand as anticipated. This was due to both inadequate and inefficient capital investment in the public as well as the private sectors. Monetary authorities were not in a position to deal with a situation like this, either to control prices or to promote production and employment. Here again the blame for the failure to reach targets as set out in the Ten-Year Plan belongs to the Government's fiscal policies. We shall therefore briefly discuss the overall production and employment expansion since Independence and relate it to the targets laid down by the plan to be achieved by 1968 and trace the causes for the drawbacks and shortfalls. This again would be found to be principally due to the lack of adequate investments as a result of the policy of public expenditure. In the light of these discussions it would emerge that a differently oriented pattern of development would be necessary to raise the standards of living and to solve the innumerable problems of foreign trade. For it is not a fortuitious circumstance that the problems of financing the development and the pattern of development stem from the same difficulty, i. e. excessive deficit financing of public expenditure, which gives rise to a chain of effects. Current revenue is barely enough to meet current expenditure alone. The consequence is that there is inadequate capital formation and insufficient development expenditure. One is the obverse of the other. In fact current investment has to be doubled in order to reach the goals of the plan and to maintain a steady rise in per capita income. The following pages of this chapter are therefore devoted to an assessment of the progress regarding production and employment during the last decade and more. State policies to promote increased production and employment are also examined and the various reasons for the deficiencies analysed This is followed by a discussion of the pattern of development desirable for a country like Ceylon, so that the maxium results may be achieved in productivity and employment.

The achievements in production may be inferred in terms of investments in production, output and employment, and as regards output not only in value, but in volume, acreage and yield as well. We may use one or more of these in respect of the various sectors and commodities we wish to study without overlooking the need to compare their relative growths. We now know that the economy grew at an annual rate of 3·5 per cent in real terms or 0·9 per cent in per capita terms. If we divide the national product into its chief components, we may find by rough computation that between 1948 and 1960, 45 per cent of the increase in gross real product was due to an increase in the production of goods for domestic use, 35 per cent due to services, and 20 per cent due to the production of goods for export. This shows the relative rise of the domestic sector because of international trends in trade and domestic policies of development. For while the domestic sector grew at an annual rate of 1·5 per cent in per capita real terms, exports declined by 0·9 per cent annually. Taken in another way primary products declined in its share of gross national product by 0·7 per cent annually, while secondary industry rose in its share only slightly. The chief increase was in the share of services which had an average growth rate of 1·7 per cent in per capita real terms. But it would seem that the growth in national income during the past decade may be more apparent than real. There has been no doubt a significant rise in the living standards of the people. But the rise in per capita incomes may have represented goods and services that may have been required to satisfy the increase in demand due to urbanisation and development of industry. Monetization of the economy would have also caused a shift in the structure of distribution and more elaborate market organisations. These are actually costs of development. However the present rate of growth should be considered low in view of the gap in the levels of living between Ceylon and advanced countries and the fact that this gap is widening ever more.

2. Targets and Achievements

The investment, output, and employment targets are set out in Tables 8, 9 and 17 of Chapter II of the Ten-Year Plan which are reproduced below.

Table VII

Government and Private Investment by Sectors, 1959 - 68 (Inclusive)

(In Million Rupees)

Sector	Non-monetized	Government	Private	Total
Tea	—	156	351	507
Rubber	—	194	217	411
Coconut	—	41	274	315
Specific agricultural crops and animal husbandary	—	321	464	785
Irrigation	110	982	—	1,092
Fisheries	—	208	10	218
Small scale Industry	40	360	—	400
Large scale Industry	—	1,613	701	2,314
Electricity	—	826	—	826
Transport	100	1,652	194	1,946
Construction	—	90	235	325
Housing	435	908	1,382	2,725
Public Administration	100	926	—	1,026
Other Services	70	100	541	711
Total	855	8,377	4,369	13,600

Table VIII

Projected Increase in Output (1957 and 1968)

(Gross Domestic Product at Factor cost)

(1957 Prices)

	1957 (Rs. M.)	1968 (Rs. M.)	Increase (Rs. M.)	Percent Increase
Tea	1,075	1,392	317	29
Rubber	338	453	115	34
Coconut	342	469	127	37
Paddy	350	857	507	145
Other Products of Agriculture including animal husbandary	565	1,153	588	104
Fisheries	34	176	142	418
Industry	380	1,290	910	239
Construction	214	803	589	257
Electricity	20	120	100	500
Transport and communications†	258	466	208	81
Housing*	215	360	145	67
Public Administration	385	616	231	60
Other Services	799	1,290	491	61
Total	4,975	9,445	4,470	90

† Excludes transportation of Export crops.

* Include imputed rent of dwelling in the rural sector,

Table IX

Distribution of Workforce (1957 and 1968)

(In Thousands)

	1957	Percent of total	1968	Percent of total	Increase 1957-68	Per-cent Increa-ses 1957-68
Tea (Estates-only)	539	15·4	678	14·0	139	25·8
Rubber (Estates-only)	194	5·5	200	4·1	6	3·1
Coconuts	82	2·3	96	2·0	14	17·1
Total for Export crops	815	23·2	974	20·1	159	19·5
Other Agriculture*	1,046	29·8	1,304	27·0	258	24·7
Total Agriculture	1,861	53·0	2,278	47·1	417	22·4
Fisheries	79	2·3	92	1·9	13	16·4
Total Agriculture and fisheries	1,940	55·3	2,370	49·0	430	22·2
Industries Large and medium scale, small and Cottage	291	8·3	528	10·9	237	81·4
Construction	105	3·0	316	6·5	211	201·0
Electricity	4	0·1	7	0·1	3	75·0
Transport and Communications	155	4·4	209	4·3	54	34·8
Public Administration	181	5·2	290	6·0	109	60·2
Other services	719	20·5	1,065	22·0	346	48·1
Total	3,395	96·8	4,785	99·0	1,390	40·9
Unemployed	113	3·2	48	1·0	65	57·5
Grand Total	3,508	100·0	4,833	100·0	1,325	37·8

* Including employment on tea and rubber small holdings.

The above targets if realised would give a growth rate of 6 per cent in National Income and increase the per capita income by 40 per cent over the plan period. Though modest it has now become impossible of achievement. One-third of the National Income is produced by the export sector, one-third by the non-export production sector and the other third by the services and professions. Only slightly over one half of the food requirements of the population are produced locally and the other half imported. Of the imports three quarters are essential food and consumer goods, and one-tenth necessary fuels. Food imports constitute 2/5ths. of the total and cereals alone is half that quantity. Tea, Rubber and Coconuts constitute 95 per cent of the exports. While almost the entire tea and rubber are exported, only half of the Coconut products are exported, the other half being utilised for local consumption. The area under cultivation is about one-quarter of the total land area of 16 million acres, while it was only 1/5 a decade before, the increase being principally under land cultivated for paddy and to lesser extent other crops. The area under the main export crops has not shown significant increases because of war conditions and post-war re-habilitation and re-planting schemes. While the total area cultivated increased over a decade by 1/5, the volume of agricultural production increased by 1/3 during the same period. Tea increased in production by 1/2, while rubber and coconut were rather stagnant. Rice increased by 100 per cent though the area increased by one half only, principally because of better method of cultivation and of irrigation facilities. In short the increased agricultural production was due to more intensive methods applied to tea, and extensive and intensive methods applied to paddy. So far as agriculture is concerned the cultivable area could be increased to 1/3 of the total land area which means an additional one million acres from the present 1/4. This would mainly be in doubling the area of paddy cultivation. As regards more intensive methods tea production could be increased from 710 to 1,600 lbs. per acre, rubber from 375 to 1,100 lbs. per acre, coconut from 2,150 to 3,000 nuts per acre, and paddy from 32 to 48 bushels per acre, i. e. tea production could be doubled, rubber trebled, and coconut and rice increased by half as much on a reasonable scale of International standards. Land under paddy cultivation is 1/3 under major irrigation, 1/3 under minor irrigation, and the other third under rainfed and asweddumised types of cultivation. If the area under rice could be doubled and yield increased by another half, the total production of rice could be trebled, and if the population increased by 1/3 as much in another 10 years and consumption per head increased by 1/8, and the present rice production is only half the requirements, then we would attain self-sufficiency in food if that is our National objective by extending cultivation as required within 10 years without minding the cost of it. If the area is increased by half only, then in 10 years we might produce 3/4 of the required quantity and import only 1/4.

The problem of unemployment and under-employment for the increased workforce of 1·2 million in the next 10 years could be remedied by intensive and extensive methods of developing tea, rubber, coconut and rice alone. But we are here equally concerned with the marginal efficiency of labour and capital, and with the standard of living of the people, which would point to the urgent necessity of attempting to develop the industrial potential of the country. The people of the country are so used to agriculture, commerce and building, and tradition dies so hard, that enterprise in industry is not forthcoming even if investment pays. Equally responsible is the industrial, commercial and economic Policies of the Government. Nevertheless the fact remains that the index of industrial production had remained almost stationary while that of agriculture was increasing. Some industries declined and others expanded, and the war-time policy had its post-war effects, and it is very likely that given the proper atmosphere for development industrial production would go up, out-strip the rate of growth of agriculture, raise the standard of living, and provide unlimited opportunities for future employment at a time when agricultural expansion might reach its physical and productive limits. The target hopes to cut down food imports from 40 per cent in 1959 to 15 per cent of the total imports in 1968. There would be near self-sufficiency in many principal items of food except in rice in which a $\frac{3}{4}$ self-sufficiency is expected. Rice production was Rs. 31 million in 1957 and Rs. 48 million in 1962, but it may not reach the target figure of Rs. 77 million in 1968. Perhaps a $\frac{2}{3}$ rds. self-sufficiency may be reached leaving a third of the requirements to be imported by that date. In fact rice production increase has been the most conspicuous feature of the domestic sector recently due to improved methods of cultivation and irrigation. But other types of agricultural production have not shown comparable increases. Milk, meat, eggs, tobacco, potatoes, chillies, onions, coffee, sugar etc. are not likely to achieve self-sufficiency as expected. Onions must increase by ⅔ rds., chillies must double, potatoes must rise twelvefold, and sugar rise severalfold, if the targets are to be reached. Eggs may reach the desired goal, but these and other food items not mentioned here are not making necessary progress towards a fair degree of self-sufficiency so as to cut the need for imports of food items so that imports of other goods for consumption and development may take place and a balance of payments equilibrium reached. Thus agricultural production instead of taking the main strain and stress of development and relieving the foreign exchange pressure has thrown it on industry which is a weak sector now, even though some activity in this direction has been perceptibly noticed in the years since 1961. The achievements in industry are much less as compared to the targets, and with a weak export sector the problems of production and employment have assumed serious proportions.

3. Shortfalls in Production

The present acreage of paddy cultivation is a little less than one million while the target is 1½ million, and it is likely that only 2 or 3 lakhs additional acreage will be brought under cultivation on past experience. Yield per acre was expected to increase from 32 to 48 bushels and the present yield is only 38 bushels per acre. Total production is expected to rise to 77 million bushels while the present production is 48 millions. The present yield of tea is 790 lbs. per acre and of rubber 434 lbs.

per acre, and these are far below the targets as mentioned earlier despite intensive methods. Self-sufficiency in other food and cash crops will not be achieved as expected in the targets. Needless to say sugar, cotton and potatoes have been a failure, nor has much been achieved in animal husbandary. Fish production increased from $\frac{3}{4}$ to $1\frac{1}{2}$ million cwt., while the plan target is 4 million cwt. Here again the target is not likely to be achieved. The achievements in industry are much less than expected and this may be realised from the following figures of investment. Public investment in industrial corporations amounted to Rs. 200 million with employment for 5,500 persons, so that investment per head was about Rs. 36,000. In the private sector large industries drew an investment of Rs. 95 million, giving emloyment for 11,000, so that investment per head was Rs. 8,500, while small industries' investment was Rs. 31 million with employment for 6,000, giving an investment per head of Rs. 5,000. The figures for the private sector relate to the period since May, 1961, and to industries registered by the Department. Though significant progress was made in the last two years, it is not likely that the target investment of Rs. 2,200 million for all industries would be achieved.

4. State Policies and Aims

State policies to promote agricultural and industrial development have been as comprehensive as those found in most development-minded countries. Among these rice cultivation received the pride of place. Not only were acreage increased by colonisation schemes and irrigation facilities, but the large use of fertilisers, extensive credit facilities and crop insurance schemes, provision of pureline seed paddy supply scheme, salvinia eradication, guaranteed price purchase scheme, agrarian reforms and other improved techniques were among the several factors which contributed to the spectacular increase in rice production in the last few years. Sugarcane, cotton and potato cultivation did not meet with much success even though undertaken by the State. The costs were prohibitive in these. Their future may be said to be very uncertain. Animal husbandry and other food and cash crops received the attention of the State. Quotas and subsidies were introduced by the Agricultural Products Act of 1939 and the Guaranteed Price Scheme by which the State restricted the imports of such products through quotas and banning, and assured the producers a guaranteed price scheme. Marketing facilities were provided through the State Marketing Department and the Multi-purpose Co-operative Societies. Large acreage of lands were alienated to peasants under village expansion schemes and highland colonisation schemes and middleclass schemes for agricultural purposes. Considerable increase in the production of these food items have been recorded as a result, but it must be said that they fall short of the targets laid down in the Plan. Eggs and onions have done well, and milk has increased but at a heavy cost to the consumer. The traditional export products like tea, rubber and coconut have received as much attention as the other food and cash crops. A system of subsidy prevails for replanting and rehabilitation and for fertilisers. These have yielded fair results in all three. Rubber production would only show increases towards the end of the Plan period even though the scheme (1953) covering it was started much earlier than for tea (1958). But in the case of the coconut industry even though yields have gone up, the age of the trees would have an adverse effect in the future, while there is already a disease gripping it now. Government schemes have helped not only to increase yields but also employment in the estates and in the small-holdings. In addition there are laws preventing fragmentation of large tea and rubber estates. The Research Institutes for each of the industry have rendered various types of service.

Government policy regarding industrial development has been laid down in bulletins published recently. In the public sector much progress took place regarding State Industrial Corporations and their reorganisation in the last decade. Most of the large industries were reserved for State enterprise. The costs and losses were reduced, and the factories were worked to capacity. The management and control of the corporations were reorganised. The importance of industrialisation was realised as also the role of the Government in its promotions. Government also encouraged the private sector and foreign capital. Several tax concessions and duty rebates were given. Protection through quotas and high tariffs and total ban was given. Easy credit facilities were granted by the Government, banks, and other financial institutions. Technical assistance of a varied nature has been provided through specialised institutions. Thus all possible assistance and incentives have been given to the private sector. Cottage industries are being helped in many ways. All these have resulted in industrial production in the last few years rising by fifty per cent.

5. A Criticism of Agricultural and Industrial Policies

1. The Rice subsidy scheme as at present is not amenable to any economic analysis. The producer subsidy does not encourage higher yields as anything produced could be sold at Rs. 12/- a bushel. It helps the better-off farmers and does not induce new cultivation and development of submarginal lands which are potentially productive because the initial cost of clearing and developing are prohibitive. And on the other the consumer subsidy is an indiscriminate fiscal measure without being progressive while being a recurrent and growing burden to the Exchequer. Both these measures must be recast as to favour the marginal producer as against the big landlord and the poor as against the rich. This has become a drain on the Budget and a drag on development and hence calls for an urgent step to solve the underlying problems.

2. The Colonisation schemes and land alienation schemes have proved white-elephant schemes without adequate results in employment or production. The costs have far exceeded the benefits so that a variation in the emphasis and methods of the schemes would have produced greater return. This also applies to State agricultural farm schemes riddled with waste and inefficiency.

3. Though many of the policies to promote agricultural development in the matter of technique and finance have proved fairly successful, marketing

methods have raised doubts about the efficacy and profitability of many ventures, especially perishables, which rely on efficient marketing whatever the scale of production and output.

4. The undue stress and encouragement of rice cultivation has resulted in the neglect of a proper system of highland cultivation, especially in the potentially rich dry zone areas, because the Government departments had not worked out the economies of it. The premium attached to paddy cultivation encouraged investments in it with the result that there were wasteful investments on marginal lands while at the same time neglecting useful dry farming. This can mean a serious draw-back as otherwise many food import items could have been substituted with a fair degree of self-sufficiency in respect of those items.

5. Quotas and total bans generally have their own defects. Not only do they introduce an element of compulsion, they are less satisfactory than straightforward tariff protection. They do not benefit the producer or the consumer or the State. The economic implications of it are discussed under Import Restrictions elsewhere. They lead to profiteering, corruption, and undermine planned economic development. They create wastes and seek to perpetuate uneconomic activities which contribute little to National development and raise the costs of living. The Bank Mission too recommended the repeal of the Agricultural and Industrial Products (Quotas) Regulation Acts. At any rate it calls for a judicious exercise of the principle. Hence the need for an independent Tariff Board.

6. Though the Paddy Lands Act of 1958 sets out to protect the tenant cultivator from exploitation and eviction, agrarian reforms have not yet taken roots to maximise production and distribute equitably.

7. Scientific cultivation is still on the fringe of agricultural development despite intense propaganda, and it would take time to spread to produce sufficient quantitative results.

8. In the field of industry though the policy towards the private sector was well-defined and very encouraging, and foreign capital given adequate assurances regarding investment and repatriation of capital and profits, the necessary climate for investment seems to be lacking. This is an indefinable feeling and a matter of confidence on the part of the investor. The foreign investor is not so much worried about taxation and nationalisation policies as much as wage stability and political stability.

9. Though financial provision is available adequately, credit worthiness is more important, and this has resulted in the "haves" getting assistance while the 'have-nots' do not. This is a vicious circle in most underdeveloped countries. It is therefore necessary to find ways of financial assistance to those with entrepreneurial ability and zeal.

10. There is undue emphasis on import substitution based on the size of domestic market rather than on Export promotion based on available raw materials and other comparative advantages. With this must be said that large scale industries have not been planned for a balanced development based on complementarity and linkage with increasing local components.

11. If State Industrial Corporations have been reorganised as to improve their managerial control and reduce their losses and improve their efficiency, especially for capacity production, it is not understood why there should be continued losses even now, even when the entire accounts are taken into consideration. This state of affairs is even worse when the methods of accounting are found to vary from one Corporation to another, and adequately enough co-ordination has not been achieved. If what has been done is the best the State could do, there is reason to call into question the entire economic basis, i. e. cost, management, and linkage. This shows up the importance of handing over organised corporations to the private sector.

12. Industrial planning has been project-wise and not programme-wise, especially for large industries for export purposes where costs are decisive.

13. Financing has not been centralised, protective duties and concessions and rebates are not properly worked out by an independent expert body so as to co-ordinate protection, state assistance procedure has not been simplified and co-ordinated, industries have to over-stock spares and parts and thereby block capital in turn-over, repair facilities are lacking, location of industries are defective without proper transport access, large scale and small scale industries have not been co-ordinated, electricity and other rental charges are high, and other innumerable defects do exist.

14. Planning has not been comprehensive and sustained, so much so a competitive and efficient and viable industrial structure has not been established.

CHAPTER VII

INDUSTRIAL POLICY AND PROBLEMS

1. Industrial Policy

The first World War closed with the feeling that self-sufficiency was worth striving for, and this realisation created a new picture of industrialisation in some of the important Eastern countries. The recommendations of the Indian Industrial Commission fructified, especially in the creation of Provincial Departments of Industries and the adoption of the system of discriminate protection, while those of the Ceylon Industrial Commission, which made its final report in 1922, never saw the light of day. But the Great Depression soon brought home to the minds of thinking Ceylonese that the exclusive dependency on two or three major agricultural industries with concomitant fluctuations in the prices of those articles were bound to bring in future years serious repurcussions in the economy of Ceylon. The 1931 Constitution touched the pulse of the country when it added the portfolios of Commerce and Industry to that of the Registrar-General. A Bureau of Industry and Commerce was created in 1932. In 1935 the Technical Advisor on Industries issued an interim report dealing with the whole subject of industrialisation. He insisted, as had been already contemplated by the Government and recommended by the Banking Commission of 1934, that a separate Department of Industries was an imperative need. Though other departments could usefully help in the spheres of activities that came under them, they had not the time to devote to such matters, and besides a central co-ordinating organisation was essential. He also recommended Rs. 10 million for industrial development as a reasonable outlay under a four-year plan. Out of the sum voted for industries allocations were obtained to start some industries. Another important recommendation was the establishment of peripatetic demonstration parties to instruct learners for the promotion of cottage industries. In 1936 the Economic and Industrial Survey of Ceylon was undertaken. In 1938 a separate Department of Industries and Commerce was formed.

Experts on various industrial subjects were appointed to make reports on those respective industries with a view to their establishment. The war created favourable conditions for the starting of some industries and action soon followed. The Government had established one or two factories even before the war and established a few more factories during the war to make good war-time shortages. Most of the factories ran at a profit during the war-years, but in the post-war years, except a few, most of the other industries recorded continuous losses. This was realised in 1945 - 46 by the Report on Industrial Development and Policy which laid down certain guiding principles for post-war industrial development. The report deemed industrialisation to be indispensable, and demarcated industries into basic and non-basic with Government participation in the former under public corporations. The existing industries were to be reorganised or closed as circumstances and commercial principles required of them. Private enterprise was to be assisted with technical information and expert advice in addition to fiscal assistance and protection. But the impending constitutional changes prevented any implementation of their recommendations and allowed losses to continue. Nor were the new projects recommended in the post-war plan of 1945 - 46 implemented because of shortage of capital equipment in the post-war period. The Commission on Government Commercial Undertaking in 1951 analysed the causes of continual losses as high costs and inefficient organisation and not as inadequacies of pricing policy. They recommended the closure of certain activities and the transfer of others to public corporations or co-operative societies. They also stressed the need to examine new projects before implementation. During 1951 - 53 many of the industrial undertakings were closed and new projects established in their place. Others were reorganised. There were fourteen Industrial Corporations reorganised under the State as a result of the two Acts of 1955 and 1957. If costs are reduced and efficiency increased, the industries are promising, but till then, except a few the others would continue to be a drain on the General Budget. It is therefore necessary that all undertakings should be run on commercial principles.

The question of industrialisation in recent times has assumed great importance and no effort has been spared to give it the necessary momentum, because the future economic development of the country rests on its success. Many concessions were granted to private enterprise in all possible ways to attract investment into industries. An Agricultural and Industrial Credit Corporation was established as an additional credit institution to provide medium and long-term funds. It is now proposed to merge all credit institutions to make them more effective. The Government has gone further and has indicated a re-orientation of policy in respect of State participation in the Industrial development of the country by way of contributions to supplement shortages of capital, by reserving monopoly rights to industries in instances where there is a limited market, by granting generous allowances for depreciation and development, by tariff adjustments on raw materials, state marketing, protection through import control, and tariffs on imported goods and by various other methods and devices that could promote rapid industrialisation. It is hoped that the country is now on the threshold of a process of rapid industrial development under the aegis of a reoriented policy. The public sector alone is expected to enlarge its capital outlay on expansion projects and new projects a tenfold over the estimated expenditure of the Second Six-Year Plan (1954 - 60). Thus the Government was intent on making an all-out effort to effect the industrial transformation of the country.

2. Problems of Industrialisation

Notwithstanding the need for industrialisation, it is common experience that densely populated under-developed countries have just not launched on industrial development even when natural factors are available. This may be due to the difficulties of making a beginning, and in an open international system advantages gained and handicaps imposed are cumulative in their effects so that poor countries may remain poor just because they were poor to begin with. Hence the infant industry argument has proved useful in so far as it emphasises the relevance of the concept of external economies. Moreover the internationl monopolistic price discrimination exercised by established industries in advanced countries has strengthened the case for protection to infant industries. Specialisation among regions need not be accepted since it is based on existing cost relationships which are subject to change with development. Developing industries have to be assisted by the State to capture a larger share in the existing markets. This assistance may be given by the adoption of suitable commercial policies or by the adoption of forward methods of economic and financial policy. Thus demand may be made to increase with expansion in incomes and this may lead to further expansion of industries. Economic development would thereby become more in the nature of a planned effort. Moreover the lack of entrepreneurs in an underdeveloped country may require the State to undertake public enterprise so that large scale industries with modernised equipment become possible. Labour may be abundant but not skilled enough, and moreover wages and conditions of work of industrial workers may be more exacting than it is with agricultural work. Better training facilities, import of technical skill and know-how, and provision of social overheads may improve a labourer's efficiency and productivity. But the greatest obstacle to industrialiation is the supply of capital. Even the most ambitious investment programme will not remove the scarcity for capital equipment. Investment of a required order would entail pressure on consumption resulting in inflationary rise in prices which would necessitate price control and rationing. Inequality of income aggravates the problem because it promotes luxury spending rather than saving and investment. Therefore re-distribution measures and compulsory savings would help speed up development. Further capital requirements could be minimissed by choosing the type of equipment used in an industry and by the greater use of labour without effecting technological requirements. Capital cannot be limited below a level without loss in efficiency and causing disguised unemployment. The problem could be eased by supplementing domestic with foreign loans which should be used for payments abroad to purchase foreign equipment and raw materials or to finance the import of essential consumer goods in the most productive manner, as otherwise the capacity to repay is impaired. But it does not strictly follow that it should be directly used for industries which turn out export goods or import substitutes. It may be used for the creation of social overheads and external economies that indirectly develop the productive power of the Country. The only limiting condition is that the operation of all industries taken together should yield an export surplus. Hence it is that a Government to Government loan is more important than private foreign investment. Moreover the lending Country should also agree to buy more from the borrowing country when repayment starts. Thus the development of a set of complementary industries connected with a region would reduce enterprise risks for both the parties who have a joint responsibility for achieveing security which depends on the extent of co-ordination between the flow of money and the flow of trade. The World Bank may also be able to achieve this degree of security by necessary co-ordination. If capital is short of requirements, alternative assumptions of capital-labour relation may be considered according to availability of foreign capital and domestic savings for investments.

3. Industrial Finance

There are four categories of industries requiring financing for development, both in the planned and the unplanned sectors. They are the public industrial enterprise, large-scale private enterprise, medium-scale private enterprise, and small-scale and cottage industries. There are certain common types of finance for all: subscribed capital, retained profits, bank credits and trade and other short-term credit. Though savings and investments may seem to be sufficient for the present needs, future developmental plans require greater efforts, especially for industrial ventures where the investor fights shy. For this the Capital Market must be well organised and developed. The Banks should be made to extend island-wide branches and also made to advance to small industrialists on the security of stocks. But the Central Bank or the People's Bank could do this better. The establishment and fostering of a Government Bond Market and the encouragement and development of a Stock Exchange or Share Market are necessary requirements to stimulate and canalise the flow of voluntary savings for industrial investments. These markets are costly to enter for small firms. Hence the need arose for the establishment of the Development Finance Corporation. This was in addition to the Agricultural and Industrial Credit Corporation and other direct and indirect State loans provided for industrial ventures. The People's Bank is also expected to extend all types of loans to various enterprises. This is also now done by the Bank of Ceylon and other Commercial Banks. Even private "merchant banks" could help. Another measure is the need for Industrial Estates to avoid fixed capital for small firms. Yet another measure is the hire-purchase system where the Central Bank can set standard and other banks open branches for this purpose. Many of these measures are still in the process of developing and when fully matured are expected to provide not only short-term but long-term credit as well for all sorts of entrepreneurs in the field of industry. But it may be presumed that a plethora of agencies exist already for industrial finance. The need of the hour seems to be to centralise the credit facilities of all these agencies and to increase the quantum of it to meat future demand.

4. Foreign Capital

The aim of Ceylon is not only to industrialise, but to industrialise as rapidly as possible, as otherwise the explosive rate of growth of population would simply neutralise all efforts and it would take a very much longer time, say another seventy-five years, before the national income could at least be doubled. We are in urgent need of foreign capital, skill and experience. Hence foreign investments must be encouraged to flow in, and not as at present discouraged and made to flow out.

An Industrial Policy statement as in India may have salutary effects. The drawback of foreign capital investments are illusory. The public sector need not be jeorpardised nor the private sector allowed to suffer. Ceylonisation should be very gradual, and "political" guarantees are necessary. General Budgeting Policy and Wages Policy are other conditions looked into by foreign investors. Other specific incentives are also looked into. Foreign private investments could play a significant role in the development of our country if it could be encouraged to flow in on mutually beneficial conditions. But it is a fact that it has ceased to be so, and foreign loans and aids have come to take a larger share in developmental plans than foreign private investments. The International Bank, the Colombo Plan and numerous other agencies have taken their place in International Finance to supply capital and know-how to the under-developed countries of the World. Though we might accredit these organisations with good intentions and the quality of work, yet it would be difficult to express satisfaction regarding the quantity of help given by them. The problem is too immense in relation to the help offered. Of them all the International Bank has made the best performance and America has given the greatest share, though the distribution of that help is very uneven as between the recipients. Russia, China, and Canada are other important donors of capital aid. As for Ceylon foreign loans and aids have been too little to have produced any real effect on her Economic Development. The flow of foreign capital would at least have to be doubled if any tangible results are to be achieved according to the intentions of the

National Plan. It is estimated that if the present average inflow of foreign Government and Industrial capital of 13 millions is increased to 26 millions there would be some measure of development that could be fruitfully undertaken by Ceylon.

5. Foreign Aid

It is a well understood phenomenon that the free enterprise method of development has failed and that the positive role of the State has become important for the economic development of under-developed countries. Since this cannot take place without adequate financial help and technical assistance from advanced countries, all development plans of backward areas have come to depend on foreign aid. It is countered that a close examination of the so-called current 'international schemes' has made one sceptical of extravagent claims of a "new approach" or a bold new programme. But the alternative to this is the ever widening inequalities between nations and the gradual consignment of parts of the world to poverty and hunger and low standards of living. The post-war period has witnessed the practical recognition for aid from the advanced to the backward areas in the interests of World peace and prosperity. The need for foreign aid arises because backward economies are not stable, diversified and developed. They are confronted with the problem of the balance of payments consequent on development measures. Shortage of food and under-nourishment, disease and poverty are additional reasons which prompted food and medical relief on an international scale. Labour and conditions of work had to be improved and political stability had to be achieved. External economies and social overheads had to be provided for economic development. The living standards of people above subsisteance level had to be raised purely for humanitarian reasons. Moreover social and cultural developments were as important as economic development, and it was thus necessary for lifting the backward countries by bold measures of foreign aid. Foreign aid has been given by the U. N. and its specialised agencies, and by many countries, both Governmental and private. The U. S. A., the U. K., the Commonwealth, Western Europe, the Communist countries and such international private agencies like the Ford Foundation are among the sources of foreign aid. The technical assistance and financial help by the U. S. A., in promoting international economic development is the most important, with the U. K. and Colonial Countries as a good second. The International agencies rendering assistance and aid are the I.B.R.D., the I. M. F., the F. A. O., the I. L. O., the W. H. O., the U N E S C O., the Sunfed, the U. N. R. R. A., the U. N. Sub-commission on Economic Development, the International Chamber of Commerce, the Point Four, the Import-Export Bank of Washington, the Colonial Development Corporation, the Colombo Plan, the Ford Foundation, etc. The latest and most impressive is the India Aid Club of six leading countries who have joined to help India through her Third Plan. But the distribution of this aid is uneven and not uniform. The recent entry of Africa into World Politics is likely to decrease the relative claims of Asia. Ceylon has received economic and technical aid from foreign Governments and International Organisations on a Government to Government basis with satisfactory results in the form of loans, grants and lines of credit to finance projects, and especially through trade agreements for specified projects. Thus foreign aid has been mostly bilateral in character. But the recent formation of the Asian Development Institute, it is hoped. would increase aid and make it more multilateral in approach.

Foreign aid is not without its problems. Fortunately no strings are attached to many of these aids, but the quantum of aid is not satisfactory, though the International Bank and the Colombo Plan have done creditably well so far as Ceylon is concerned. Other sources have been inadequate. Foreign Aid needs not only a study of agencies and their programmes but their policies and methods as well. It should take into account the peculiarities of local conditions, see that techniques are in harmony with factor endowments, see that social changes affecting economic results are created, see that attention is paid to the internal economies of the participating countries, see that technical assistance and financial help are not necessarity linked up, see that funds match with plans, see that aid is not misused by those in power, see that proper political changes are effected, see to the administrative problems of Technical Assistance, see to the financing of technical assistance, see to the effect on Industry in the advanced countries, see to the formulation and appraisal of development projects, and see that there is Public economic control in the industrialised and the under-developed countries. Lastly foreign aid must be integrated and co-ordinated.

CHAPTER VIII

COMMERCIAL POLICIES AND PROBLEMS

1. The Tariff System

The Tariff of Ceylon is framed on a revenue yielding basis with preferences granted to Empire countries and the U. S. A. Even though there existed a Tariff Advisory Committee, there was no specifically declared policy of discriminate protection for industries by the State, but protection was granted as and when found required by the Government. The Ceylon Tariff is a two-line schedule and consists of a heterogenous collection of duties based on historical accident and administrative expendiency. Owing to the fact that industrial development was only of recent origin in Ceylon, the emphasis of policy as reflected in the tariff has been mainly to assist agricultural industries. On the other hand, materials of manufacturing industries did not find favour. Attempts were however made recently to adjust Customs duties to assist industry. The adjustment of the duty on tobacco in favour of unmanufactured tobacco at the expense of manufactured cigarettes helped towards the setting up of local Cigarertte factories. Likewise are duties on soap, printed materials and match. These effects have borne results. Since 1947, the Finance Ministers of Ceylon have expressed that revision of tariff would take into consideration the agricultural and industrial development of the Country. Increases would not be made on materials of industry and capital goods. Where necessary relief would be given and where necessary duties would be increased—

both for the object of industrial development. Notwithstanding the judicious policy of the Government it must in fairness be said that a complete review of the Customs Tariff is essential, for administrative convenience must be subordinated to the national need for protection of industries.

Customs duties have for long been constituted the bulk of Government Revenue in Ceylon. It varied between fifty and seventy-five per cent. The tariff was raised in 1922. The introduction of the Income Tax in 1932 led to the abolition of the export duties except that on tea, but they were re-introduced during the War. The share of Customs revenue however fell as a result of the increasing importance of income tax, excess profits duty, and profit tax, and to the increases in their rates.

Prior to 1922 the general rate of import duty was 7½ per cent and for machinery a very nominal rate of 2½ per cent. That year the general import tariff was raised to ten per cent ad valorum, while a few were reduced or abolished. An upward revision took place in 1926 and 1930. In 1932 the general basic rates were increased from ten to fifteen per cent ad valorum and the lower rates were abolished, and the free list revised with a view to obtaining additional revenues. In 1933 as a result of the Ottawa Agreement preference had to be shown to goods of U. K., or British Empire origin, and therefore the rates of duty on foreign goods were raised, leaving those on imperial goods at the existing level. In some cases the duties were reduced in favour of imperial goods. Preference varied from five to ten per cent. The import tariff was revised almost every year by varying degrees according to the general economic condition prevailing at the time, but generally in an upward direction with increased purchasing power, employment and pay conditions. But the Anglo-American Trade Agreement of 1938 limited the margin of preference in the case of certain classes of articles.

In the post-independence era since 1948 taxation policy in general has been motivated by considerations of correcting adverse movements in the balance of payments, reduction in the cost of living, encouragement of local industries and the higher quantum of revenue required to finance a rapidly increasing Government budget both for development and non-development purposes. During this period duties have been revised from time to time on the general basis that the burden of taxation falls lightly on necessities, less lightly on consumer goods and heavily on luxuries. In 1948 there was a general revision of import duties. In 1950 some reduction was made with a view to checking a rising cost of living, and in 1951 with a view to encouraging local industry, but since 1952 revenue considerations again dominated import duty policy. This was primarily due to increasing burden of food subsides which continues to dominate the Budget to this day. At the same time considerations of payments difficulties and incentives to local industry made the Government to raise the duties on some and reduce on others. The basic rate until now was 17½ per cent preferential and 27½ per cent general, while some luxury articles are taxed at over 100 per cent. The Tax Commission recommended the institution of a Tariff Commission and the reduction or abolition of import duties on capital goods and raw materials in the 10 - 30% tariff Class. Since 1958 the Balance of Payments problem took precedence over other considerations in the matter of import duties and exchange control, resulting in a series of measures. Though quotas and licences accounted for nearly half the trade of the country, the measures taken in 1960, 1961 and 1962 provided for sharp increases in import duties on nearly half the total value of imports. The deterioration of the Balance of Payments position led to these severe measures to protect the foreign exchanges. At the same time industrial protection and promotion was extended by altering the preferential and general duties on machinery and raw materials to 7½% and 17½% respectively. Thus from time to time the changes in the tariffs, both exports and imports, have been influenced by various considerations and exigencies.

The significant export duties are those on tea, rubber and coconut products. Export duties have also been levied on cocoa, cardamons, cinnamon, plumbago, pepper and other minor exports. The duties were nominal and were withdrawn in 1931 except for tea, but they were reintroduced from 1941. It was only in 1947 that the export duties were raised substantially on a wide range of commodities. The commodity markets boomed in 1951 due to the Korean War and export duties on all major items (products) were increased and a system of export duties on a sliding scale was introduced for tea, rubber and coconut products in order to siphon off excess profits but that on tea and coconut products was abandoned in 1953. The sliding scale was however not operative for the most part because of the early collapse of the Korean Boom. The duties on coconut products were reduced progressively afterwards because of the difficulties of the industry. Tea alone did well. The Government however had not abandoned the principle behind the sliding scale. In many instances high flat rates of export duties were replaced by low sliding scales with exemption below a floor price. A sliding scale of export duties was introduced early in 1963 for the products of coconut to help the industry. The export duties of the principal exports however fluctuated with their prices. In the post-independent era the export duties accounted for over twenty-five per cent of the total tax revenues, which are now proving a strain on the major exports of Ceylon. It must however be pointed out that the tariff policy of the country had little relation to its industrial or commercial policies though sporadic attempts were made infrequently especially in recent times.

2. Other Protective Measures

The quota system of giving protection seems to have found favour with Ceylon. The Agricultural Products (Regulations) Ordinance of 1939 imposed a quota on the imports of specified products. This had the effect of promoting the cultivation of those commodities in the country. The War forced the relaxation of the Ordinance. The Industrial Products Act was passed in 1949 but it was objected to by foreign countries in view of Ceylon's commitments under the Geneva Agreement of 1947. A few agricultural products and industrial products that were favoured have done well in some cases, though it is not possible to judge others from these results. But these have harmed the consumer more than they have benefited the producer and are indiscriminate in nature.

When all measures are taken into consideration it would seem that protection to local enterprise at present is based on the following devices:—

(1) Import control for the purpose of balancing foreign payments but indirectly helping local enterprise.

(2) Reduction of duties on certain imports which are meant for local industrial purposes determined by the Import Duty Advisory Board established in September 1948.

(3) Quantitative control of the foreign trade of Ceylon with fixed upper ceiling.

(4) The Agricultural Products (Regulation) Ordinance of 1939 and the Industrial Products Act of 1949.

(5) Raising tariff duties wherever protection is urged in the interest of local industries.

(6) Subsidies to Industries and Agriculture and essential imports, including relief and rehabilitation.

(7) Guaranteed floor prices for the maintenance of export trade and local products enjoying quota privileges.

There is no doubt that these measures have had some effect in stimulating production and cutting down imports, but without a co-ordinated economic policy it would be difficult to gauge their joint effect on the industrial development of the country as industrialisation is in its nascent stage. The historical survey of the Tariff policy points to the general conclusion that there has been no consistent tariff policy. Though there were attempts to evolve one in consonance with the needs of Industrial and Commercial development these were marred by measures of expediency to tide over monetary and economic ailments. These measures do not ensure the best use of capital and other factors of production for the true and lasting benefit of the country. The undertone of those measures was that tariff policy was more concerned with the purpose of revenue than with planned economic development. There was no co-ordination in the implementation of the tariff schedule. What is urgently needed is a tariff policy consistent with the expansion of the economy and growth of foreign trade. This presupposes the desirability of a Tariff Commission, because, a tariff policy as opposed to other types of protective measures is the most rational in theory and in practice.

3. Import Restrictions

Apart from the tendency for exports to decline relatively in the post-independence era, the high level of deficit financing and public expenditure has increased monetary expansion and consumer demand with consequent pressure on the level of total imports. This has created a recurring adverse balance of payments and a falling level of foreign assets. An alternative to the pruning of the public expenditure was the imposition of restrictions on imports into the country. There was already in existence import and export control based on quotas and duties. But the deterioration in the Balance of Payments position made it necessary to introduce stringent measures. Those introduced in the latter part of 1960 and early 1961 had some effect in arresting the adverse position, but those introduced in the latter part of 1962 had far-reaching effects. Quota licences covered nearly half the total imports, i. e. all items excluding five groups, while import duties were steeply raised on nearly half the value of imports. These of course excluded those certified as essential for purposes of local industrial development. The effects of these have been felt in 1963 with large surpluses of trade balances. But it must immediately be pointed out that this correction in the balance of payments position has created a new problem in raising the domestic price level which for want of adequate expansion in production tends to move upwards. Though production has taken place to an appreciable extent in the domestic sector, especially in the field of industry, it would not be possible to meet the displaced consumer demand and prevent prices going up. We shall therefore discuss import restrictions in relation to trade and development.

It is possible by severe import restrictions to control the balance of payments in any desired way. But this cannot prevent the effects of any monetary expansion being felt on the economy in one way or the other. The first effect we have observed is to exert pressure on the domestic price level and to cause rise in internal prices and costs. This could in turn affect the export sector and result in a decline of export receipts. Quantitative restrictions could be applied only to luxuries and non-essentials which are limited, so that further restrictions become difficult. Moreover internal development as a result of restrictions would create demand at first for capital goods and raw materials and later for additional consumer goods. Further, too much restrictions would create reaction against it and thereby cause relaxation, especially when living costs have risen. Thus quantitative restrictions cannot last long, unless import substitution took place adequately to meet the displaced demand. But this is difficult in the face of a large monetary expansion. Though there were some factors favourable to checking inflationary pressure in the immediate future, they could not afford relief in the long run. The problems of development would themselves create circumstances tending to raise domestic prices and costs. Thus monetary expansion inevitably leads to inflationary pressure in the domestic and export economy with all its consequences to production and trade. This will affect adversely the Balance of Payments as also investments. Quantitative restrictions could also result in rigidities and delays which impede the smooth flow of economic activity. These difficulties could be overcome somewhat by the use of import duties rather than by those of import quotas and licences. They siphon off the profits for the exchequer which would otherwise go to the trader, and thus they have a disinflationary effect by reducing the overall deficit of the Government. Import duties are therefore now used more often, and may be increasingly used in the future. At any rate import restrictions cannot be an answer for deficit financing which affects balance of payments continually.

Nor are the prospects of import restrictions very great with regard to its effects on protective policy. Quotas and licences for exchange purposes could only restrict luxury and non-essential goods whose development may not be the primary concern of industrial policy, and where importers are compelled to purchase a proportion of the same commodity produced locally, the lack of any standards could raise prices without promoting quality or competitive prices of local products, and thus affect the interests of consumers. The system of quotas and licences in Ceylon has given rise to uncertainties and speculations. The Industrial Products Act has therefore many defects, both in principles and in practice. Thus quantitive restrictions could produce direct effect on the conservation of foreign exchange, but it not only affects customs revenue but it also does not promote import substitutes of comparable quality and price.

Imports tariffs on the other hand could encourage import substitution without affecting the quality or price of commodities produced locally, and develop the country in such wise that any loss in revenue is made good by rise in income and profits which are taxable. But these too have serious limitations. The range of import duties are so high in Ceylon that any further rise in duties would be very prohibitive or a reduction in duties for promotion of industries would cause serious loss of revenue. This would be so with regard to machinery and raw materials, which ought to be free if development should take place. Though protective duties should be discriminatory, yet it would be necessary to give protection to a group of industries rather than to individual industries because it is not a question of "infant industry" argument but a question of "infant economy", so that protection should be comprehensive and prolonged to build up the economy to a minimum level. Otherwise protection would be ineffective. This points to the need for a Tariff Commission and for the removal of all uncertainties and inhibitions and the replacement with positive incentives for industrial growth. Protective policy must therefore be destinct from exchange policy, and import restrictions should not develop a closed economy.

4. Bilateral Trade

During the Fifties Ceylon had contracted a series of bilateral trade and payments agreements with many countries in the socialist camp and with many others in the Middle East and Europe to foster her exports which were experiencing difficulties in the traditional markets. The most noteworthy and significant of them was the Rice-Rubber pact with China. These agreements not only benefited the exports but in many cases improved the import trade so that entirely new markets were opened up for commercial intercourse. These agreements were general in some cases and specific in others. But though the trade with the bilateral countries increased considerably more in the last few years as compared to that with others in the multilateral area, the unfavourable comparison was due to import restrictions which curtailed the imports of non-essentials from the sterling and dollar areas and the E. P. U. This is seen by the fact that while imports from these sources did not rise, exports continued to rise despite the world market situation for primary products. Moreover there are limits to the expansion of bilateral trade, while the percentage of that trade to the total was a negligible fraction. Thus the importance of the traditional markets to the foreign trade of Ceylon was not very much diminished, though bilateral agreements had helped to preserve a balance between supply and demand, and therefore the prices of primary products, in the world market by serving as marginal customers. Import prices were also favourable in many cases so that the terms of trade did not turn out to be worse than what they were. Though the aid offered through them were with strings, yet it would be necessary to keep out of any political obligations implied in them.

5. Commercial Policy

The growing and widening interest in the industrial development of the country was also reflected in the commercial policy of the Government. Until recently the Dominions, the Colonies, India and the United Kingdom maintained a tariff policy in which there was no preference shown towards each other as against the non-Empire countries except in certain special cases. The Ottawa Agreement of 1932 between the Empire countries granted mutual preference in the imports of goods from one another. In the case of Colonies and Protectorates, the Agreement provided for the grant by India of preference to certain staple exports of the Colonial Empire. The system of preference came into force from January, 1933. The general rate of preference was ten per cent with certain exceptions. In the Indo-British Treaty of 1939 which replaced the Ottawa Agreement for India, provision was made for the negotiation of a separate treaty between Ceylon and India. But a trade treaty was postponed till an agreement on the political differences was amicably settled. The future course of Indo-Ceylon relations were not clarified. Until such time the schedule of preference granted to India by Ceylon and to Ceylon by India in 1932 was to remain unchanged except for some minor alterations. In the case of certain commodities it was agreed that preference would continue only so long as it was consistent with the policy of the Government concerned to levy duty on these commodities. Again, the Trade Agreement between the U. K. and the U. S. A., signed in 1938, contained a number of concessions granted to and by various other parts of the Empire. Preference was shown to certain commodities of which a considerable number came from the U. S. A. But with the saturation of the Western markets for Ceylon exports a shift to Eastern countries took place in the Fifties. This entailed bilateral trade and payments agreements. The trend towards bilateralism was accentuated by the foreign exchange difficulties and by the desire to promote new export products besides assuring a steady market for the traditional exports. These trends in the foreign trade of the country resulted in the adoption of such commercial policies.

6. Commonwealth Preference

Preferential duties were first introduced in 1933 after the Ottawa Agreement and a ten per cent margin of preference was shown to Commonwealth and Empire countries. This was meant to encourage trade within the Commonwealth owing to the Depression. But the share of Commonwealth trade had declined relatively after the War due to the diversification and Ceylonisation of trade. Reciprocal concessions were given to Ceylon's exports under Imperial Preference, but it is difficult to estimate precisely the loss in revenue and advantages or disadvantages to Ceylon from the Commonwealth Preference. In recent times Ceylon had expressed her willingness under the 1947 Geneva Tariff Reduction Agreement to reduce tariffs multilaterally. The Geneva Agreement covered tariff reductions on fifteen export items and seventy-nine import items of Ceylon. The reduction had the effect of narrowing the margin of preference enjoyed by the United Kingdom although Imperial Preference continued to exist. And now the possible entry of the U. K. into the Common Market, if unaccompanied with safeguards, would destroy the remaining preferences.

7. The GATT

Ceylon is an original member and a party to the GATT and she is obliged not to raise tariff rates on certain items above a maximum fixed and Ceylon has reached the limit of taxation on nearly all of them. But it is not possible to make precise estimate of the revenue effects of the GATT on Ceylon. If the lowering of the tariffs all round is the best incentive to the promotion of international trade, their revenue consideration would not be of paramount importance. At the same time it must be realised that the GATT recognises economic development as a case for exemption from compliance with any agreement besides the Balance of Payment difficulties. In fact Ceylon's foreign trade experience in the post-war period has compelled her to violate some of the provisions of the GATT, but the several amendments already made in the Treaty and with crucial problems facing the GATT in the near future, the future of the GATT, especially for countries like Ceylon, is in the balance.

8. Relations with Advanced Countries

We shall discuss here the problems of international multilateral trade in relation to underdeveloped countries like Ceylon. This commercial relationship of Ceylon with the advanced countries may again be discussed under two aspects: one relating to Commonwealth Preference and the Common Market, and the other relating to the evolution of policies under the G. A. T. T. The importance of this discussion may be seen by the fact that the Empire and the West constitute Ceylon's chief customers by accounting for more than three-quarters of the exports and by providing the major share of foreign capital and technical assistance.

It is well recognised that Commonwealth trade increased under Preference and helped in the economic development of its members and promoted world trade. Though the interests of the countries in the Commonwealths are not uniform, there is a desire to increase intra-Commonwealth trade and to expand world trade. Ceylon's major exports are tea, rubber, and coconut products. Tea and coconut products enjoy Imperial Preference and have developed protected markets of large size. This has meant something at a time when tropical products of underdeveloped countries are experiencing declining exports and falling prices. The formation of the European Common Market was felt as a general threat to the bargaining powers of the primary exporters of Asia (Commonwealth and non-Commonwealth) and the proposed entry of the U. K. into the Common Market as a particular threat to the Commonwealth countries. The Associated States and Territories of the U. K. would enjoy the concessions and even "reverse preference" if the U. K. had entered the Common Market, while non-Commonwealth countries would have enjoyed some concessions as a result, but Commonwealth countries would have lost the preference and be at a disadvantage. The delay in the entry has now created other favourable circumstances. The Seven-point Action programme proposed by the U. S. in 1962 and keenly advocated by the U. K. has resulted in the endorsement by the special committee of the GATT in 1963 of the general objective of free access to markets for tropical products. The U. K. and the European Common Market have worked on details to suspend tariff on tea in the course of 1964. This would open up a vast and duty-free market for Ceylon tea in Europe. As against a loss of 2 d. per pound preferential duty in the U. K., the Common Tariff of 18 per cent would be knocked off in favour of Ceylon. Much credit for this is due to the U. K. But in contrast to tea, coconut products enjoy a higher preferential duty in the U. K. than those prevailing in the Common Tariff. The U. K. is an important market for Ceylon's coconut products and the removal of these duties in the U. K. and in the Common Tariff would affect Ceylon's competitive power very much, not only in relation to other countries outside the Commonwealth like the Phillipines, but also in relation to numerous other substitutes. But this state of affairs could not continue if the new policies of the GATT were to take practical shape in the near future. Once free access to the markets of the developed countries have been achieved, the only other problem would lie in stabilising the prices of tropical products. This way would lie the future for Ceylon's coconut products. The only other important export, rubber, is already duty-free. Thus not only were the pre-war and post-war problems of the Commonwealth different, but the experience of the Fifties has forged all the under-developed countries to consider their problems unitedly and to make common approach to their solution. Commonwealth Preference therefore has to change and adapt.

The GATT was meant as a forum to study trade problems, but during the Fifties the industrial countries were more concerned about their products than with those of the less developed. But at the present moment the deterioration of prices of raw materials and primary products in the last decade has been recognised by the advanced countries, who have now realised that these difficulties resulted mainly from policies persued by them. The sluggish increase in Asian exports has been mainly due to the slower expansion of trade in primary products, low elasticity in demand for food, technological changes reducing the raw material content in manufactured goods, and the increased use of substitutes. It is also realised that the restrictions on primary products is an obstacle to world trade besides unfavourably reacting on less developed countries and on primary products exports. It is also realised that the spirit and approach of the GATT should change from being contractual to co-operation and consultation in International Trade. It is also realised that the less developed countries would not be able to afford reciprocity. This amounted to the recognition of a "double" standard in International commercial policies as between developed and developing countries. In the light of these changed attitudes it is felt that the GATT should change without being static, and that without abandoning it a new organisation more broad based and comprehensive should take its place. The seven-point programme of the U. S. may be briefly stated as follows: (1) No new barriers against exports of less developed countries. (2) Quantitative restrictions on these to be removed before end of 1965. (3) Duties on tropical products to be eliminated before end of 1965. (4) Duties on primary products important for less developed countries to be eliminated. (5) Industrialised countries should reduce duties on processed and semi-processed products from less developed countries by 50 per cent early. (6) Internal taxes and duties to be eliminated before end of 1965. (7) Industrialised countries should report progress each year. The GATT considered measures for expanding the trade of developing countries as a means of furthering their economic development. To increase the trade of the less developed countries was the biggest task. This would constitute a big effort at trade liberalisation by the GATT, especially if it included the 50 per cent linear cuts of the "Kennedy Round" without receprocity from the less developed countries. The implementation of the plan would also require the pattern of production in industrialised countries to take into account the need for such outlets. The GATT would have to modify its rules to allow preferential treatment for the processed and manufactured products of less developed countries by advanced countries. They could in effect agree on a kind of division of labour in the matter of manufactured goods. The Ecafe Conference at Manila in 1963 had forged the developing countries into a single force in order to present a united voice at the International Conference in 1964. Meanwhile there was to be a Ministerial Conference in December of 1963 with a view to speeding up Asian economic co-operation. It may thus be presumed that the advanced countries held promise of a future for the less developed countries. This hope had been strengthend by a report on compensatory financing for export shortfalls to stabilise prices and incomes of primary products and producers. It contains two alternative proposals apart from the one proposed by the I. M. F. Together they constitute a a great step forward.

9. Conclusion

Import Restrictions are bound to have immediate effects on foreign exchanges, but their long-term effects on production and trade depend on other considerations. The first of them is to formulate a proper system of protection and an effective means of administration. This should be accompanied by suitable fiscal and monetary policies to promote savings and investment. Otherwise the possibilities of using import restrictions as a means of restoring balance of payments and promoting economic development in the long run are limited. The true aims of a protectionist policy could be achieved only through the establishment of a Tariff Board or Commission. Bilateral trade and improved relations with the advanced countries through the GATT on a "double" standard of commercial policy are other measures very likely to stabilise and improve the position of the traditional exports and even new industrial products. But the most important measure would be the encouragement of foreign capital investment in public and private enterprises of a nature that would promote the export of goods which are not technically suitable as import substitutes on a national basis but which are required for the balanced development of the country and which require at least a regional market. A protectionist policy could foster them and a system of regional economic co-operation through preferential treatment could extend the frontiers of import substitutions to a wider area, so that a planned development of an entire region could take shape under a policy of tariff protection and regional preference.

CHAPTER IX

ECONOMIC PLANS AND PROPOSALS

1. Development Plans

The need for orderly social and economic development was recognised by the Government of Ceylon as early as 1931, but world depression and world war intervened. The Board of Ministers in 1943 appointed a sub-committee to draw up a comprehensive scheme for the post-war development of Ceylon. It published in 1946, a volume containing all the proposals of the various Ministers. Although the entire outlay planned in the scheme was not strictly developmental, high priority was given to agriculture, communications and works, and education. The implementation was deferred owing to impending constitutional reforms. A beginning to thinking out budgetary proposals on a long term basis was made in the budget for 1947 - 48, and a decisive step was taken in 1948 - 49 to integrate long term plans into budgetary proposals, and this resulted in the First Six-Year Plan of 1947 - 1953. This fixed the duration of time, but there was no comprehensive plan in terms of the financial outlay proposed for the period. For example, industrial development consisted of a simple list of projects with estimated cost and date of completion. The object was merely to diversify the economy. But the Colombo Plan Committee examined Ceylon's Plan in 1950 and drew a plan for the period 1951 - 57 involving a total outlay of Rs. 1,359 million. This was the first attempt of its nature. This was revised and raised to Rs. 3,200 million, and was incorporated into the Colombo Plan for Ceylon. The latter was more an expression of aspirations than an operational plan. The First Six-Year Plan, 1947 - 53, had a total outlay of Rs. 1,246 million of which Rs. 837 million was finance available out of domestic resource, Rs. 1 million out of external assistance and Rs. 408 million out of inflationary financing. External reserve fell in this period by Rs. 345 million, and internal money supply increased by Rs. 264 million. Inflationary pressure compelled Government to revise its budget for 1953 - 54 and pay off part of the banking loans by reduction in cash balances, by assistance under the Colombo Plan, and by borrowing in the London Market. 1953 - 54 had no plan because of the Korean recession. The Second Six-Year Plan of 1954 - 60 envisaged capital outlay of Rs. 2,160 million involving a total development programme of Rs. 3,231 million which the Taxation Commission of 1955 thought feasible, especially as external assets had increased by then due to the tea boom.

A change of Government in 1956 had altered considerably the scope and contents of planning in Ceylon. The Second Six-Year Plan was scrapped. The First Interim Report of the National Planning Council was published in 1957 and the Ten-Year Plan in 1959. This is a very important document and a very real attempt at planning the entire economic development of the country. Steps were being taken to implement the first stages in the plan and to get it going. This book contains several of its attitudes and approaches to the problem. If the plan were revised every 2 or 3 years it would prove a continuous plan of development, till Ceylon is able to attain an advanced stage of development. The Plan envisages a total investment of Rs. 13,600 million for the period 1959 - 68, involving a Government outlay of Rs. 8,300 million and a private outlay of Rs. 4,300 million, and a capital/output ratio of 2·6 for the whole economy. National Income is to rise by 88 per cent and per capita income by 36 per cent. In the short run agricultural development is expected to solve the balance of payment problem, but in the long run industrial development alone could do it. Hence the Plan envisages rapid industrialisation to compete with foreign industries at home and abroad. The Plan also visualises steps to be taken to balance between the supply and demand for various types of skills, and to develop a capital market. Agriculture, fisheries, transport and communications, electric power, and social development are other fields covered by the Plan and it is hoped that there would be no delay in implementing the physical and financial targets of the Plan, though the Minister of Finance changed the base year from 1959 to 1962 and used the Plan only for purposes of comparison.

2. Stages of Planning

The Post-War Development Proposals of the Board of Ministers of 1943 covered both the economic and the social spheres of the country. It dealt with the long-term problems of national development, but did not establish targets for income, employment or other economic aggregates. The First Six-Year Programme of 1948 covered new projects which the Government intended to carry out until 1953. It too was not a comprehensive plan. The Colombo Plan of 1950 presented rough estimates of amounts to be spent over a Six-Year period in major sectors of the economy, but the plan included technical aid from abroad as part of development resources. The period up to this may be regarded as the "project planning" phase, and the period which followed may be regarded as the "perspective planning" phase. The World Bank Mission Report in 1953 recommended the establishment of a planning organisation and a development programme based on priorities. It surveyed the human and material resources and analysed the various aspects of the economy. It recommended specific economic policies in each major sector, but did not suggest specific projects. This resulted in the Second Six-Year Programme of 1954. This plan too did not establish targets in income, employment, etc., but it stated its objectives in broad terms as greater industrialisation, self-sufficiency in foodstuffs, improved health and education, and the like. And it included a statement on the process of development and on the technique of programming. These are features of perspective planning and were the result of the planning organisation. There was a Planning Committee of the Cabinet and a Planning Secretariat since 1953. The National planning Council Act of 1956 replaced the Planning Committee by a Planning Council and enlarged the Planning Secretariat. The Council published the First Interim Report in 1957 and the Ten-Year Plan in 1959. This Plan was the result of all the past experiences and carried all the features of perspective planning. It was employment oriented and laid down specific targets to be achieved. The lack of implementation was due to defective machinery and political changes. It was only in 1962 that the first short-term plan was framed, but even that was not fulfilled. At any rate planning methods had changed considerably over the two decades since World War II. Planning was slow because of lack of co-ordination between departments and the decline in the status of the planning organisation. Though Ceylon was the first country in South and East Asia to launch a plan, and there were a succession of plans to date, the actual achievement have been very disappointing. Yet planning is an invaluable aid to policy. The possible reasons for this slow growth are excessive consumption, population explosion, and lack of projects for implementation. The Ministry of Planning, started in 1965, will not only formulate plans and policies but will be able to implement them. With prospects of substantial foreign aid for development, it is possible for all Departments to work enthusiastically for the economic development of the country.

3. A Criticism of the Ten-Year Plan

The implementation of the Ten-Year Plan is now observed more by its breach than by any faithful fulfilment of its targets. The Plan by itself was a very commendable document but circumstances did not permit the Government to follow it up. Instead certain old and new tendencies were allowed to develop and distort the basic postulates and aims of the Plan. Far from undertaking the sacrifices expected of the plan, the easy path to deficit financing and rising consumption was allowed to grow unchecked. Investment programmes for developmental purposes could not therefore be carried out. The Plan thus became too ambitious and unrealistic, even through the rate of growth was a modest figure of 5·9 per cent. The Plan failed to take into account the experiences of the fifties and the political tendencies of the times. The ratio of capital formation to the GNP was fixed high and the possibilities of mobilising internal resources was overstated to the extent of completely neglecting the amount of foreign aid required for the Plan projects. The approach was employment oriented without the use of any proper criterion. Instead it should have started with full investment opportunities and provided for the successive steps of physical, economical and financial planning to achieve consistency and efficiency. It did not provide for balanced growth and for the development of capital goods industries, nor did it provide complementarity and linkage. Further it did not lay enough accent on export development and stress the need to devert maximum investment resource to directly productive activities. It merely contented itself with the adoption of an import substitution process and the development of social overhead capital. One important result was that investment in capital goods industries did not show any percentage rise over the plan period and remained low. This shows that the Plan did not provide for adequate self-sustained growth. Another important result was that the Balance of Payments for Ceylon made in the Plan were highly optimistic and underrated the need for foreign capital for development projects. Moreover it dealt with development in terms of non-human capital without taking due account of the value of human capital for the rapid growth of the economy. The Plan had thus gone out of step with the prevailing trends so much so it was afterwards regarded as a mere guide and reference to ministerial plans which took the form of a Three-Year Short-Term Programme on a very much reduced capital/output ratio involving quick return schemes to provide a minimum programme of work for national development. This minimum programme is expected to raise per capita income at 2 per cent per annum instead of the 1 per cent average over the past decade, whereas the Ten-Year Plan meant an increase of $3\frac{1}{3}$ per cent per annum in per capita income. It is therefore necessary to device a method of financing and a strategy of development to make the drive for rapid economic development a reality by making suitable departures in the financing and pattern of development in view of the changing conditions of the time and the need to make substantial progress. The Ten-Year Plan nevertheless constitutes a landmark in our economic development.

4. Recent Industrial Policy

A Development Division was created in the Ministry of Industries in 1961 to evaluate and plan projects in the public sector and promote industrial development in the private sector. This coincided with the acute shortage in foreign exchange which made itself felt from 1961. It resulted in the overall regulation and control of industrial development in the private sector. Yet in spite of this control there has resulted a haphazard and lopsided pattern of industrial development. The private industry heavily depended on foreign sources for raw materials, machinery, and equipment, until such time they were made available locally. The approval of new industries was granted by a Committee which functioned between 1961 and 1963 and enjoyed sweeping powers. They lacked technical knowledge and were therefore apt to make incongruous and illogical decisions. New industries were approved till 1963 only, as foreign exchange allocation in 1964 was only 60 per cent of that in the previous year. This created the added problems of idle machinery and underemployment. Thus industrialisation had reached a tight corner with exchange restrictions. In 1965 Industrial policy had been clarified and better schemes formulated to approve new industries and to release foreign exchange. With more foreign capital and aid flowing into the country the prospects for industrialisation are brighter. The set-up of the Development Division is being reorganised to revitalise and rationalise the private sector. With this in view a separate department of industrial regulation has been organised within the Development Division. This would make its work more efficient and effective. Approval would be given to those industries based primarily on indigenous raw materials, export oriented, and agricultural based. The Industries Department requires not only a set of administrators but economic planners as well. They should have had training in planning, programming and project evaluation, and should be able to integrate the program of industrialisation with a plan of economic development. They must work closely with the Ministry of Planning and must co-ordinate policies covering all aspects of industrial development in the public and private sectors. At present the Government is establishing an Industrial Development Board to co-ordinate the work of all the agencies and divisions involved in some aspect or other of industrial promotion. This is a welcome sign as it will be able to tackle all problems of industrialisation efficiently and effectively. A policy of this nature would go a long way in enabling the Asian Development Bank and the Asian Industrial Development Council to help solve all the bottle-necks arising from problems of techinque, finance, market and payments, and integrate the industrial development plans of the Ecafe region.

Remedial Measures

The remedial measures discussed in this book are very interdependent and closely related so that they stand together as a bundle of policies whose beneficial effects on Economic Development would be felt through appropriate structural changes in the economy of the country.

Firstly, the onus of devising the financing of development and the shaping of the pattern of development falls on the broad shoulders of a planning body. The reallocation of resources and the factors of production requires careful planning with regard to balance, complementarity and linkage, and the establishment of priorities. From this flow all the details that need attention and execution, and therefore the problems, plans and policies of development form the discussion in a seperate chapter. The need for planning cannot therefore be under-estimated.

Secondly, there is the need to diversify the economy and develop both import substitution and export promotion through suitable protectionist policies and fiscal measures so that a balanced development of the economy is generated on a cumulative basis to achieve a rapid development of the economy. This does not mean self-sufficiency in any particular field, but a sufficient measure of self-sufficiency in varying degrees in the several sectors of the economy so that the composition of imports and exports are perceptibly altered in the course of years in order to enable the import of capital goods and raw materials in an increasing proportion for the development of the country. This would also diversify the exports both with regard to its composition and direction. Ceylon being a small country cannot depend on an imbred type of development and should proceed on the basis of an open economy. Hence great emphasis has been placed on industrialisation as the key problem, and export promotion as the chief means of correcting the disequilibrium in foreign exchange, and as also the means of raising the per capita income.

Thirdly, there is an urgent need to improve the Fiscal and Budgetary policies of the country so as to curb the mounting expenditure on social services and food subsidy, create a sizeable surplus on current revenue alone for purposes of capital formation, and thus avoid deficit financing of an excessive nature. This would not only curb consumption but reduce pressure on demand for imports, while at the same time increase savings and investment through private and Government sources for the development of the country so as to help reduce imports and increase exports. This would further keep inflationary tendencies down and control costs and prices, and also create the necessary climate for investment for productive purposes, both from internal and foreign sources.

Fourthly, the most important measure for producing the required structural change in the economy, so as to diversify it and produce a different pattern of foreign trade, is the urgent necessity for the massive inflow of foreign capital, both Governmental and private, to meet the investment needs of economic development because the internal resources are meagre and hesitant. In fact much of the success for the future would depend on the degree of foreign capital and aid that could be secured for development.

Fifthly, though the need for import restrictions serves the dual purpose of conserving foreign exchange and promoting import substitution, it is still very necessary to separate them from the long-term point of view, so that tariff duties should be used on a wider scale than import quotas and total bans for the proper development of both import substitutions and export promotion. This method of protection is an important measure for attaining the proper reallocation of resources and factors of production for the maximising of income through balanced development, besides eliminating the uncertainities and inefficiencies attendant on a system of import control based on quotas and licenses even though they have their limited uses. In this connection the establishment of a Tariff Board or Commission and the establishment of an industrial policy would greatly enhance confidence in investors.

Sixthly, bilateral trade has to be explored fully as a measure of stabilising export prices and preventing exploitation by monopolistic imports. There is need to diversify traditional markets and traditional channels of trade in order to gain in both exports and imports and thus improve the terms of trade as well. But it goes without saying that this method of expanding the foreign trade of the country through bilateral trade requires careful handling by avoiding the usual pitfalls attendant on these measures. Though bilateral trade may be only a small fraction of the entire trade, it is still an useful marginal one, and in many cases is unavoidable. Thus bilateral trade could, not only improve the quantum of foreign trade, but also the terms of trade, besides providing an opportunity for securing foreign Governmental loans and aid. Moreover it provides a scope for the Ceylonisation and nationalisation of trade and the elimination of monopolistic profitering and exploitation.

Seventhly, a very important measure would be the improvement in the relations with advanced countries through the GATT or a substitute body. Primary products and semi-processed commodities and certain categories of manufactured goods should be allowed either free or favourably into the markets of all advanced countries without insistence on reciprocity. The chances of this have been improved through Anglo-American pressure on Western Europe, and possibly with the Conferenc on Production and Trade in 1964 at Geneva. With this may be added the need for the stabilisation of primary commodity prices through some scheme of compensatory finance which are also being worked out under the aegis of the United Nations. This measure therefore is of great significance to the economy.

Eighthly, a small country like Ceylon can only develop an open economy primarly based on the regional market through preferential arrangements. Thus regional economic co-operation on a variety of forms is offered as a compelling measure of commercial policy for overcoming the limitations of a home market for import substitution. This problem is as yet an unexplored field and requires careful techno-economic surveys to determine the scope and nature of its usefulness.

Those eight measures constitute the main lines of solving the problems of economic development not only in the short-run but also in the long-term process. Needless to say there are innumerable ancillary and secondary measures linked to these which would strengthen the policies taken to promote production and trade. Such steps as price control and rationing, tax relief and concessions, raising the official rates of interests, techinical education, social reforms, decentralisation of planning, better pricing policy of state undertakings, land reforms, wage freeze in favoured sectors, power supply, control of monopolies, partenership in industry, grants and subsidies for rehabilation, protection and aid for industries, centralisation of financial institutions etc. would go a long way in establishing the necessary framework for ensuring the success of the policies suggested here.

CHAPTER X

THE PLANNING OF DEVELOPMENT

1. Introduction

We have discussed some of the most fundamental aspects of the economy of Ceylon. Certain symptoms of stagnation were observed as a result of the trends in the foreign trade of the country and in the fiscal policies of the Government. These gave rise to the need to diversify the structure of the economy and to find the required resources for investment for such a process of development. Otherwise consumption would be increasing and imports would be swelling with the result that the country's stock of capital would dwindle and the available foreign reserves disappear. The consequence of these process would be to further make it difficult to turn the corner. But it is possible for a Government in an underdeveloped country to correct the economic situation by fiscal and other state policies so that the pattern of development proceeds on desirable lines. Centuries-old traditions have to be changed and the structure completely altered quickly to a new pattern to meet the demand for a rising standard of living and full employment. Only a delibrate act of the state could produce the necessary conditions for such structural changes to take place entailing the big task of investment in a wide field of productive and fruitful activities.

Ceylon is ostensibly wedded to the ideals of a mixed economy and the achievement of a socialist state through democratic means. There are thus a public and a private sector, the former being planned and the latter unplanned. Nevertheless it becomes absolutely necessary to co-ordinate both sectors because development has to be balanced in order to be cumulative and rapid. Capital being scarce has to be rationalised by mobilising both domestic and foreign resources and allocating them according to the priorities and needs of a plan. This becomes more compelling with the need to change the composition and direction of the foreign trade of the country in as short a period as possible in order to arrest the adverse balance of trade so that exports are promoted to meet foreign payments and imports are changed to meet development needs. We shall therefore in this Chapter indicate some of the problems of planning, and the policies to be pursued towards these objectives of greater production and better trade. But we shall not be dealing with the machinery and technique of planning which are outside our scope.

2. Objectives of Planning

The objectives of planning may be enumerated as follows:

1. Providing employment and reducing unemployment and underemployment.
2. Aiming at equilibrium in the Balance of Payments current account.
3. Raising the standard of living.
4. Providing for the diversification of the economy.
5. Furthering the equitable distribution of the National Income.
6. Achieving an integrated and balanced development of the economy.

3. How to Plan

We would be knowing how to plan only if we learnt the case against both the free market economy and the complete direction of the economy. The case against the free market economy may be enumerated as follows :- First, income is not fairly distributed. Second, the market mechanism does not humanise wage. Third defect is the instability of the market economy. Fourth is the inadequate handling of foreign monies and trade. Fifth is the ineffective coping with major changes by the market economy. Sixth, the market economy is wasteful. Seventh, there is no perfect competition in the market economy. The opposite case of planning by direction has also its defects as follows :- First, it cannot be applied to consumption. Second, the worker demands freedom to choose his own job. Third, the firm manager should have freedom to adjust production. Fourth, the central planner cannot hope to see and provide for all the consequences of his actions. Fifth, planning by direction has to be inflexible. Sixth, fulfilment of the plan is bound to be imperfect. Seventh, it has a tendency to be procrustean. Eighth, it has a stifling effect on enterprise. Ninth, planning becomes costly in terms of resources. Tenth, it diminishes democratic control. We have therefore to steer clear of both these extremes in promoting development plans. We are fortunately placed in developing a mixed economy. Hence while retaining the general framework of the market economy, planning has to mainly rely on the use of inducements to achieve the goals. But this does not exclude the need for direction and control in relevent situations either permanently or temporarily. Price control and rationing are therefore frequently necessary in the interest of equity. Moreover planning by direction should be able to overcome immobilities and bottlenecks. But all these could be achieved only through sound and sane fiscal policies, for the main instrument of planning is the budget. Yet this may need to be supplemented by planning by direction wherever there is marked disequilibrium between demand and supply. The degree of control and direction thus becomes much more extensive in underdeveloped countries and may vary from one country to another. In Ceylon the Department of National Planning working under the Prime Minister has an advisory and co ordinating function. Though it drew a Ten-Year Plan it had to draw a less ambitious Short-Term Programme to meet the capacity of the economy and the administration. But the Department is subservient not only to the Cabinet as a whole but to individual Ministers as well. A more serious defect is that it has no regional organisations, nor is it able to mobilise public enthusiasm for achieving the targets. It may therefore be modestly stated that the development planning of the country is handicapped by technical and administrative defects. Though there may be criticisms of the Ten-Year Plan and its scope, it could yet be counted as a comparable document for useful implementation. Having thus noted why and how we should plan, we may pass on to the problems of planning relevent to our study.

4. Problems of Planning

(1) The first problem of economic planning for national development is to raise the necessary

amount of total investment that will raise the productive powers of the country. Anything that impedes this must be hastily removed. All sources must be welcomed, especially in a world where capital is scarce in relation to its demand.

(2) The second problem is to allocate these scarce resources in different directions and to determine the proportions for each one of them so that maximum returns are obtained while diversification and development proceed.

(3) The details of the different sectors must be carefully planned and the specific inducements and controls must be stated beforehand.

(4) Greater social mobility and regional economic equality is conducive towards national integration and economic growth. Vested interests that work against these must be eliminated.

(5) National consciousness must be created for progress under a planned economic development.

(6) Land reforms, health reforms, social reforms and security, and compulsory saving through restricted consumption, are some other problems.

(7) Central planning will be a difficult thing with weak administration in underdeveloped countries, and therefore a sort of super-planning has to be staged.

(8) Lastly, the population reproduction rate is of crucial importance for national economic planning. Mortality has decreased and births have increased. A population policy aimed at controlling fertility is needed.

A Plan should produce both efficiency and growth. This could be done only in the formulation of a right development pattern in terms of balance, complementarity and linkage. It should start with a physical plan, then proceed to an economic plan, and finally lead to a financial plan. This would determine the proper allocation of resources and even the transfer of resources to the right place. It might substitute a series of half-exploited investments with fully exploited items to maximise returns. But there are very many criteria which a Government may like to adopt in a comprehensive balanced economic development plan. Some projects may be intended primarily to promote some aspects of income maximisation and a rapid rate of growth or of capital formation, and others may be aimed primarily at employment absorption, or derive their importance from balance of payments effect. In the formulation of a development plan it may be desirable and necessary to apply several of the investment criteria and techniques. All of them however involve an element of judgement in investment allocations. At any rate for our purpose per capita income would appear to be a prime determinant of development pattern.

Though the amount of capital is not infinite, and it being scarce, its misuse cannot be allowed. We should not regard it as a substitute to labour, for more often they are components, so that the usual choice between labour-intensive and capital-intensive methods are irrelevent and misleading. The more labour is employed the more capital is required, and in underdeveloped countries the cost of economic development is high for various reasons.

This is an argument for greater capital investments in underdeveloped and over-populated countries. But it does not mean that capital should be used for mere labour-saving devices as in the advanced countries, because it does not alter the cost of production very much. It is therefore necessary to plan in such a way that capital and labour are combined so that the allocation of the factors of production in the various directions yield the maximum return for the investments, and yield the highest marginal productivity, so that the gap between it and cost of production is the minimum, which would therefore entail the minimum necessary protection for the projects. We should look for relative economic values in production and not to economic quantities. This would determine the extent and nature of production that should take place in agriculture and industry. But the full employment of resources should also be borne in mind in the choice of projects and the manner of production. Yet in a newly developing country it is also necessary to note that rationalisation in keeping with modern technology is necessary to gain quick footing without resort to unwarranted labour-saving devices. Thus it would seem that a rapid development of the economy would be possible only with increased capital investment.

5. Objectives of Fiscal Policy

(1) Restraining and curtailing consumption and thus transferring resources from consumption to investment;

(2) Increasing incentives to save and invest;

(3) Transferring resources from the hand of the public to the hands of the State to make possible public investment;

(4) Modifying the pattern of investment;

(5) Mitigating economic inequalities.

The Budget is the biggest lever of econmic development in backward countries. Fiscal Policy is so important that all other policies including monetary policy are a consequence of it. Government fiscal operations have a great impact on the rate of economic development. Financial stability is important for economic development and fiscal policy determines the growth of underdeveloped countries. Economic development, for example, cannot be left to a committee with capital resources, but involves the whole financial policy of the Government. The State must intervene in underdeveloped economies with a character and purpose. The Budgets of backward countries are called upon to undertake new and ever-increasing tasks and to operate as an instrument of economic policy. The problems of establishing 'Treasury Control', the relations of central and local revenues, and the extension of taxation at local levels of Government for economic development, are matters of national interest. Other problems are the budgetary, loan and monetary policies. Principally the problem is one of financing and increased rate of investment. The State has also to determine the extent of the public sector and the types of organisation and management of public enterprises. With increased trade control and State trading it might be possible to adopt a system of multiple exchange rate to solve the twin problems of balance of payments deficit and inelasticity of exports and imports. Finally it should be stated that countries at different levels of economic development have varying patterns of expenditure and resources of revenue and that there is a constant search for revenue for increased demand for public expenditure in underdeveloped countries. This pressure does not seem to abate, but it is probable that a Government which fails to produce a scientific development budget, may be reluctantly forced to cut down expenditure if it has gone as far as to produce adverse balance of payments leading to import restriction and inflation within. Thus the Budget holds the key to the change from a stagnant to a development economy, and turn a downward cumulative effect of a circular causation into an upward cumulative effect of a circular causation. Ceylon's deficit Budget and deficit financing must be arrested.

6. Other State Policies

(1) The State must endeavour to stabilise commodity prices and incomes of primary producers by International Agreements and Buffer Stocks and more especially by the establishment of an Exchange Equalisation Fund as part of the Central Bank. This is because the fluctuations in money supply is still according to the state of the balance of payments, which was characteristic of the Currency Board System, and which has not been fundamentally altered by the establishment of a Central Bank.

(2) The State must encourage the traditional exports and cut down the imports of luxuries and

semi-luxuries by tariffs and quotas and prohibitions, but imports of essentials should be allowed to keep down internal prices and cost of living, till domestic production could catch up.

(3) Price control and rationing should be adopted to keep prices within a reasonable level without curbing domestic production. This should be kept to the minimum and used discriminatingly, and should not be allowed to interfere with increased production. Paradoxically enough the State should not very much interfere with the domestic production or foreign imports of essential consumer goods, but regulate the quantity and prices of non-essential goods, both imported and locally produced.

(4) The State should adopt a policy of protection for the purpose of industrial and agricultural development. A Tariff Board with full powers is an urgent necessity for the consummation of the idea of industrialisation. A scientific tariff should take the place of the present quotas which are very pernicious in their effects on production and trade.

(5) Post-war Budgets have too much emphasised expenditure on social development instead of economic development. Expenditure on social development should be scaled down as also the heavy production on food subsidy which is an indiscriminate item of expenditure Administration is costly and wages are high due to trade union pressure. The only way to overcome public opposition or labour opposition is to adopt a scientific budget which could reveal the true position of the economy and enable economic development with increased productivity

by the correct allocation of resources and factors of production into the various projects and schemes of a State-directed and State-induced plan. Taxation has already exceeded the healthy limit of 20 per cent of national income even for a rapidly developing economy, and not more than 12 per cent should go towards current expenditure, while the remaining 8 per cent should be devoted for development.

(6) Foreign capital must be encouraged to flow in by a reassuring statement of industrial policy, and the State should concern more with industrial development than with commercial enterprise.

(7) Public co-operation and participation should be enlisted by strengthening National Savings Movement, and by organising the execution of the plan through rural and urban agencies. Propaganda should make the public 'plan conscious'. This is important.

(8) Economic factors alone are not the cause of underdevelopment, and non-economic factors go a long way in impeding progress. Social and political organisations are defective, and they should be reformed and reorganised to promote rapid economic development as otherwise the vicious circle would make the task more difficult at a later date as indeed is the case with Ceylon. Delay breeds danger Eighteen years of independence has not produced any change in the econmic landscape. Parliamentary democracy is a cause but not the sole determinant. It should be possible to develop within a democratic framework if the

necessary social and political climate are created. This is very imperative for Ceylon today.

(9) Not the least in importance is the urgent necessity to control the rapid increase in the population of the country. Many economic, social and political problems are considerably influenced by this factor. A lesser rate of growth of population would mean a greater rate of growth in the per capita national income. In the circumstances of Ceylon this is so as pointed out earlier. A successful reduction would double per capita income within less time and take the economy of the country out of the woods.

(10) A few other measures to be initiated by the State are the development of a capital market, the improvement in the efficiency of the factors of production, the curbing of luxury consumption, controlling speculation in land and stock-holding, raising interest rates, etc.

(11) Most important for the economic development of the country is the establishment of a Regional Preferential Trading System, which holds the key to the problem of industrialisation and prosperity.

7. Planning and Industrialisation

The industrial development of the country is a very important aspect determining the future of the nation. The following assumptions would therefore help us greatly :

(1) Further economic development of the country rests on industrialisation ;

(2) All other fields of economic activity have to be developed in the light of the contribution they can make to the industrialisation of Ceylon ;

(3) The export economy should be used to provide the resources needed for industrialisation ;

(4) Industrial development should increase the export surplus by developing along lines of import-substitution ;

(5) Export industries utilising imported raw materials may create further economic surplus in exports ;

(6) Increased export surplus would provide resources for the importation of machinery and other requirements needed for industrialisation, and this should be strengthened by a complete geological survey of the country ;

(7) Industrial production should meet the demand for consumer goods resulting from an increase in the standard of living ;

(8) Industrialisation requires the development of power-supply and constructional materials ;

(9) Industrialisation would require further development of agriculture ;

(10) Development should be integrated and balanced ;

(11) Balanced growth requires balance between physical requirements and financial resources ;

(12) Economic development requires the fulfilment of certain social and institutional conditions.

An immediate programme for a country like Ceylon should include the following measures: starting with the implementation of an agricultural plan; implementing power and irrigation projects already in hand; implementation of projects for production of constructional materials; improvement and development of transport; investment in new industrial enterprises including fertilisers and processing of export goods, processing of imported materials, and industrial investments designed to supply the home market with products based on domestic resources; starting with Housing, Educational and Social activities; geological survey and land-use survey; import-substituting industries with changes in tariff policy; measures to increase savings and investments and to discourage consumption; an Industrial Policy Act to state the role of the private sector; formation of Public Corporations; and creation of executive machinery for successful implementation of the Programme and the Plan, and the mobilisation of public effort and participation in the national economic plan.

8. Planning and Foreign Trade

The Planned economic development of the country would induce changes in the composition of its foreign trade very considerably. This would result in balance of payments problem abroad and inflation at home, so that what is not covered by foreign loans or gifts must be controlled and adjusted by the regulation of foreign trade and by the regulation of internal prices and investments. The mere fact of economic development will compel any underdeveloped country to apply import restrictions. These import restrictions fit into the National Plan to protect and shelter some industries, and as these develop the inflationary pressure and exchange difficulties will be relieved gradually. It may even be necessary to subsidise some exports purely for the balance of payments problem. Therefore to allow free exchange and free trade would tantamount to abandoning economic development. But as imports are substituted and exports are developed it will not be the advanced countries as other developing countries who will be in a position to absorb a greater share of the new exports, so that the process of development will be strengthened and the problem of the balance of payments greatly reduced not only by industrialisation with the help of import duties and export subsidies, but also by increasing trade with other developing countries on a greater scale, which is possible only under a system of regional preferential trade. This is in line with the law of complementarity, for trade between advanced countries is greater than the trade between primary producing countries, and the trade between primary and manufacturing countries is greater than the trade between manufacturing countries, and therefore it is likely that as industrialisation proceeds in an underdeveloped country the trade with advanced countries would fall relatively and that with other developing countries rise.

9. Limitations of Planning

It is the avowed object of planning to accelerate development, sustain the growth of the economy, increase the standard of living, and raise the material welfare of the people. A good index of this is the increase in the G. N. P., but this must grow faster than population or else the per capita income cannot increase. Again, it is not merely enough that income should increase, for there are other criteria as well, e. g., improved standards of health, improved standards of literacy, and generally better conditions of living. Other limitations to ambitions in planning are that existing circumstances determine what can be done in the near future; programmes or plans for the more distant years are bound to be more fluid than those for the immediate future; long-term plans have to be revised at intervals, and in a country as dependent as Ceylon on export incomes, there is great uncertainly about resources available in any given period. Moreover even though the belief is widely held that the resources of most underdeveloped countries are adequate if effectively used to support a substantially higher level of production and income, there are many and complex reasons why these areas have not been developed.

(a) Many cultures have placed a low value on material advance;

(b) The popular character of Governments have not always been of a sort to create popular incentives;

(c) Certain forms of social and economic organisations have offered obstruction; and

(d) In part the reasons have been physical-climate and topography, which have imposed limits on economic growth. But the biggest limitation to success in planning is the static way of life of the people of a country. Planning should overcome all these obstacles to achieve results by decentralisation and enlisting the popular support of the people for participation in a drive for rapid economic growth.

10. Conclusion

Though the Ten-Year Plan has been over-optimistic and unrealisable by itself in the light of the experience in recent years, it is yet not a difficult task to achieve its objectives if imagination and determination on the part of the Government and the people were shown, so that if a proper reorientation of the economic and commercial policies of the State were effected, it would be possible to achieve the targets and turn economic stagnation into economic development at a rapid pace. International co-operation and regional co-ordination are very necessary in addition to immense foreign capital. But investment is not the only problem Social changes and economic motivation are equally needed. And in this planning can stimulate activity in the right direction for fruitful results.

CHAPTER XI

THE PATTERN OF DEVELOPMENT

1. Introduction

It is necessary to state the background for a discussion of the pattern of development suitable for Ceylon. The country is small but densely populated and is on the highways of commerce between the East and the West. It has a well developed plantation sector whose productivity is high. It has banking and commercial facilities and a useful transport and communications service. Its health services and educational system are well advanced, and its labour laws are very modern. But its natural resources do not possess a variety of raw materials. Her present economic position is that she had so much devoted on social development during the fifties that with a relatively declining export trade there is not enough savings and investment to promote economic development in the sixties commensurate with the targets set by the Ten-Year Plan, nay even the revised Three-Year Short-term Plan. The resultant failure to grow and relative stagnation of per capita income may itself now result in non-emergence of the expected growth pattern.

The population growth of Ceylon is one of the highest in the world, being 2·6 per cent per annum. The death rate declined steeply since 1947 and the workforce is likely to exceed a 3 per cent per annum addition from 1963 onwards. Apart from the large unemployed and underemployed already in existence the additional workforce during the Plan period alone is estimated at 1·2 millions. These have to be provided with employment opportunities. The Plan computed that Agriculture alone could absorb this number in the existing and new lands for cultivation if complete development took place. But this estimate ignored the period of time required to achieve them. Further, once this was reached there was no more room for expansion in agriculture. Hence it is that purely from the point of view of employment industrialisation was a necessity. There are circumstances where this proposition would not be feasible in certain types of underdeveloped economies. But the position of Ceylon is that there are quite favourable factors to promote the development of industries side by side with agriculture. Agricultural productivity is high and the industrial content of the imports is very large. Population growth has created a surplus workforce in agriculture which could be absorbed into industry The large foreign trade of the country can be useful for the import of capital goods and raw materials for the development of industries. Thus industrial development can initially start-off on the basis of import substitution without much difficulty and on a very broad basis. The scale of industries for this may have to be mainly small-scale and the technique largely labour-intensive because of the limited market. Under such circumstances development could take the form of priorities of projects without much involvement of planning and programming. This process is made more easy by the fact that there is already a well-established infrastructure providing necessary external economies. The small-scale consumer industry thus forms a basic pattern of development.

The large industries require planning and may either meet the home market or be exported according to supply and demand. The plan however limits itself to the former category. This creates certain problems though there is tacit admission that foreign markets should also be exploited. The large industries fall under the public sector and are mainly dealt project-wise though some amount of co-ordination does exist among them. The starting of projects based on the domestic market has many defects. In the first place all imports cannot be produced locally for reasons of scale and on other grounds. In the second place substitution may increase, and not decrease, imports. In the third place the necessity to provide greater employment and the need to raise the per capita income compel the search for export markets. This is the only satisfactory way in which a small country with limited resources could solve its problems of development and trade. But there are problems attendant on this course of action. One such is the problem of cost and competitiveness in foreign markets. Industries based on domestic materials may not experience the difficulty, and those based on imported materials may gain the advantage of meeting the domestic market first and then exporting to the foreign market. Regional arrangement may solve many of these problems. There is in fact a great need to develop large-scale industries on an integrated planned basis with great care and precision in order to raise per capita income and balance foreign payments. The experience of Eastern and South - Eastern Europe shows that individual projects appear unattractive propositions because of limited size of the market, but if a number of projects are taken together, each supporting the others, the collective programme could be made profitable. This is a case for balanced development. And this is further strengthened by the greater possibilities of finding overseas markets for capital and intermediate goods than for consumer goods. This would remove one of the major defects of industrial planning in Ceylon, that is there is a great need to achieve intra-and trans-sectoral balance primarily between consumption, intermediate and capital goods. This balance mix varies with different stages of production. This sort of balanced development is necessary to promote a cumulative growth on which would rest a rapid rate of growth as well. We might even state further that investment on directly productive activities should increase at the expense of investment in social overhead capital. Thus rapid growth very much depends on balanced development and in productive investments. In the light of known progress made with regard to industrialisation, it would seem that an enclave of large industries built-in with massive foreign capital alone could maintain a high rate of investment and a desired rate of growth in per capita income. But of course investment alone does not ensure sufficient rate of growth. It only allows it. Human capital is important as well. Anyway such a large-scale industrial sector in the context of the present agricultural and industrial development programme could very well act as a leading sector and create secondary effects for greater production and fuller employment.

2. The Need for Industrialisation

(1) Since 1946 Ceylon has been experiencing a rapid growth in population at an almost explosive rate. While it has a modern death rate, it has a primitive birth rate. It is very high even by Asian standards, and it is expected to become even higher after 1963. Agriculture alone cannot provide the outlet.

(2) The present unemployed and the future work-force population of the country would find it more and more difficult to seek opportunities of employment in the traditional avenues of agricultural occupations. It might be possible, if we did not mind the cost of production, to expand cultivation both extensively and intensively to such levels that the additional work-force of about 1½ million in ten years could be absorbed in agricultural employment. We might reach maximum productivity, not to say of optimum productivity, within that period, so that after this stage of full agricultural utilisation, we would again be faced with the possibility of unemployment and lower standards of living and profession as well. The need for industrialisation would present itself then as now.

(3) It is likely that the demand for our agricultural exports may fall relatively as production of those commodities are undertaken in other newly developing areas, or as substitutes in the world market are increasingly used in their places in

those countries, or as labour and social conditions change and have their impact on the internal economy.

(4) The cost of agricultural development beyond certain limits may not be as productive as alternate sources of industrial development.

(5) Industrial development would produce certain utility projects and external economies which are as necessary for agricultural activity as vise versa.

(6) In a modern world where science and technology play such a useful role it is but natural that a society should have the beneficial impacts of an industrial set-up.

(7) Industry raises the standard of living of a people very much higher because of increasing returns, while agriculture would not be able to do so beyond a limit, especially in an over-populated country like Ceylon where there are limits to agricultural expansion.

(8) The scope for employment in Industry is unlimited while that in agriculture is limited.

(9) While the comparative cost principle applies to agriculture principally by way of nature's potentialities, it applies to industry principally through technology and skill. This gives ready opportunity for industry to develop in an under-developed but over-populated country.

(10) The counter charge that because industrialisation failed in the past it should mean that it would fail again is no serious challenge, because the eco-

nomic and commercial policies then were not what would have promoted industrial development, and there was no total planning. Industrialisation must be pursued in its own right giving room for large-scale employment opportunities in it, and in the service industries which it would make possible.

(11) Industrialisation increases International trade and does not decrease it.

(12) Since capital is required for development in all spheres, industrialisation alone can provide the means to procure it in exchange by developing industrial exports.

(13) Agricultural and raw material exports exchange for food and clothing, but only industrial exports can exchange for industrial goods (Hirschman).

(14) The terms of trade will improve with industrialisation.

(15) Economic stability could be gained through diversification of the economy.

(16) The tariff and commercial policies of Europe and America compel the adoption of a policy of industrialisation. That was the experience of the South American countries as well.

(17) Enterprising spirit in industry is very much wanting and hence this could be rectified only by industrialisation.

(18) The present export-import structure is rather inelastic and is subject to external influences, and this could be remedied only by industrialisation.

(19) Material progress requires the increasing diversion of resources towards 'tertiary' production. The more the numbers engaged in 'tertiary' activity the greater is the indication of economic progress. In under-developed countries there is a high proportion of the population engaged in the production of services, because the labour of the self-employed producer of services is offered and accepted at a price which is below the price of the labour of the wage-employed producer of goods..

(20) Available information offers an exceptional opportunity for analysing the factors affecting the degree of concentration in trading activities, especially in the external trade of tropical territories. This defect of oligopoly can be remedied by industrialisation only.

(21) Experience has failed to confirm the orthodox views regarding the levelling effects of international movements of goods, labour and capital on factoral rewards and levels of living in widely separated areas. This is mainly because private capitalism as a way of life as well as a method of production penetrates non-capitalistic societies at very different rates of speed. The Old South provides an interesting example of a delayed but successful penetration of modern capitalism into a relatively backward agrarian economy. There are forces within each region which work for and against the penetration, and then there are outside reactions to this development. This is yet another reason for a policy of deliberate industrialisation.

(22) Policies arrived at lifting production in the agricultural sector are unlikely to foster self sustaining economic growth and may even frustrate it.

(23) Technological changes are necessary for economic growth, though it is difficult to export technical 'know-how' from advanced countries. Only a policy of deliberate industrialisation can bring about the desired changes.

(24) The high standard of living in Ceylon makes it possible to start many industries of an appropriate scale. Market may enlarge as years go by and make plant capacity paying. Planning may be based on the expected demand in the future for both low and high projections.

(25) India is investing 40 per cent of the total outlay on Industries by revising and upgrading from the original figure of 15 per cent. This is very significant and a pointer for Ceylon.

(26) In the long run industry alone has to solve the problem of the balance of payments as agriculture has its limits and can do so only in the transition period.

(27) Economic advancement leads to decline in the proportion spent on food, and increasing efficiency in agriculture leads to fewer hands engaged in it. Hence as labour moves out industrialisation must provide the outlet.

(28) Per capita income in industry is more than in agriculture. This is so even in the agriculturally rich countries of the world.

(29) In over-populated under-developed countries pressure on land is great with symptoms of disguised unemployment, and since emigration is not possible industrialisation is the only remedy.

(30) Industrial advance helps in the rationalisation of agriculture. It is thus felt that industrialisation has a key role to play in the economic development of the country.

3. The Need for Agricultural Expansion

We now turn to the question of the need for expansion in agriculture as corollary to the policy of industrialisation. There are three reasons which may be examined in relation to this question. Firstly, if we suppose industrial expansion took place in a country like Ceylon, the purchasing power so created would have to be expended on other goods and services, and since the import propensity is high in this country it is possible that not less than 50 per cent of it would be devoted on imports. This would create a balance of payments difficulty as restrictions on other imports would be limited. The problem becomes worse because internal expenditure cannot increase as agriculture would not have expanded. The remedy would have to be sought in expanding the traditional exports and by growing more food to cut down imports. This problem of the balance of payments position resulting from industrial development could thus be solved only by agricultural expansion The increase in productivity in Japanese agriculture, particularly during 1880 - 1920 was very significant for Japan's industrial development. So too in Britain and Russia. Unless exports expand and imports are replaced there will be balance of payments problems, and a decline in real income will follow. It is possible to replace $\frac{2}{3}$rd of imports by domestic output, and assuming that the ratio of realised capital expenditure to imports replaced is 2 : 7, then it is possible to calculate the scope of investment programme simply to replace imports. Tne scope for industrialisation via import replacement is large. This is a cardinal point which any planning body should bear in mind. Secondly it is said that agricultural development by increasing production could not only relieve under-employment but release labour for industry. This is not a serious argument because there are enough unemployed to be absorbed in industry, apart from extensive agricultural pursuits that require more labour. What is wanted in industry is more enterprise and skill. The problem may be one of urbanisation, but not one of labour. Thirdly, agricultural expansion would provide a larger market for developing industries. The problem of a market is a complicated problem even if agricultural expansion helped it in a large way. On the one hand it may be regarded that the 10 million population of Ceylon is too small a market with its low standard of living and with uneven distribution of income with large disparities. It is computed that a sizeable self-sufficient market to suit modern methods of production should be at least 15 million with a reasonable high standard of living. Ceylon may tend towards it, but not as yet. On the other hand the marginal propensity to import is too high and the standards of living of certain sections of the population much above average, that it is possible to develop import

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substituting industries, and much more so export industries even after using imported raw materials. Another complication may arise if certain imported articles of wide consumption are specialized articles of relatively cheap price so that competitive production in those may not be possible even with protection. At any rate the efficiency of an imported article, its scale of consumption, and its size of productive technique are so interrelated that it is not possible to predict beforehand or off-hand the exact relationship between the size of the consuming population and the nature of the products to be marketed But it may generally be assumed that the home market for some may be sufficient, for some it may be desirable to seek foreign markets, while it may not be advisable to proceed with the production of some others. The technique of production and the size of the market must determine the projected industries in a plan. The pattern of industrialisation would very much depend on the commercial policy to be pursued by the State.

4. Small-Scale Industrial Development

The failure of previous industrialisation plans is directly attributable to the fact that at the prevailing stage of industrialisation in Ceylon, neither large-scale industry nor pure cottage industry, can be considered appropriate to solve Ceylonese economic and industrial problems. Ceylon's immediate industrial future is almost entirely in the field of small-scale industry. They should primarily be organised in the manner of industrial estates in all the smaller towns of the country while the basic heavy industries are centered round cities. The location is not hard and fast for the two types of industries, for some large industries may be situated out of cities and some small-scale industries situated within large cities according to their mutual relationship. Nor is the distinction synonymous with capital goods industries and consumer goods industries, since some consumer goods industries are large-scale while some capital goods are small-scale. We might enumerate the advantages of small-scale industrial development as would be experienced in Ceylon.

(1) They are less capital-intensive and more labour-intensive so that more labour would be absorbed and foreign exchange economised. But this does not mean that they should be make-work schemes.

(2) They are quick-return schemes which will avoid foreign exchange and balance of payments difficulties.

(3) There might be the social evils of urbanisation which arise by the movement of population from the rural to the urban areas, but they also keep expensive consumption habits of cities out of reach.

(4) Small towns will develop and this will reduce the cost of urbanisation as a whole.

(5) Ceylon has no coal-power, but has hydrel-power which can spread to all parts of the country with advantage, and this will help dispersal of industries.

(6) Entrepreneurial, managerial, and technical skills will be available for smaller enterprises and not for large-scale enterprises.

(7) Private enterprise in Ceylon is temperamentally individualistic, while joint enterprise is wanting. These small-scale industries will suit the individual capacity for capital outlay.

(8) Small-scale industrial development will keep trade union problems to the minimum and thus help the rapid pace of industrial development.

(9) They will meet the main consumer demand of the Ceylonese with their high propensity to import consumer goods.

(10) Advanced countries will have less cause to complain against structural changes in under-developed countries because this would reduce to the minimum their problems of foreign trade dislocation and industrial adjustment.

(11) The cost of marketing would be reduced by the establishment of industrial estates in small towns.

(12) Cottage industries will be developed on a co-ordinated basis.

(13) Economic planning and the determination of priorities and scales would be easier for the Planning Council and the Government.

(14) There would be considerable enthusiasm among the people for the planned development of the country and their participation would be assured.

(15) Administrative inefficiency, especially in under-developed countries, would be considerably avoided, so that the task of the Government would be better performed.

(16) The rationalisation of agriculture would be possible so that agricultural development would be possible without the burden of disguised unemployment.

(17) Unemployment would be removed to a very large extent.

(18) The trend towards urbanisation if not accompanied by industrialisation would spell great dangers.

(19) Technical and Scientific education in the Schools becomes possible by the development of the small scale industry.

(20) The small scale industry alone can break the economic deadlock in a small, under-developed, over-populated nation like Ceylon and pave the way for an upward spiral.

It is not possible to generalise about the types of industry, industrial technique and types of organisation which on economic grounds are to be singled out for assistance should a Government decide to embark upon a policy of encouraging industrialisation. It may seem sound to suggest that labour-intensive industries are better than capital-intensive ones, but it is known that labour is not homogeneous and efficient. Again it may seem sound to suggest that industries using local raw materials are better than others using imported raw materials but proximity to raw material is only one of many factors bearing on location of industries. Nevertheless there is the case for placing special emphasis on assistance to industries organised on the basis of relatively small-scale industrial establishments. In the conditions prevailing in many under-developed countries the development of small industry may be the most economic form of industrialisation. It may be more economic than either large-scale organised industry or cottage industry. It avoids the heavy overhead capital costs resulting from large labour forces which do not directly increase productivity. In small industries administration presents less of a problem and they provide suitable training ground for administrative responsibility. Assistance to it is based on advantages of small-scale operation in under-developed countries.

Small industries may be located so as to serve an agricultural area which produces cash crops so that transport costs are minimised. The spread of technical knowledge can be assisted with the spread of foreign technicians recruited for the purpose. Capital may be mobilised for local enterpreneurs by the other agencies, and factory buildings may be provided on a rental basis to small-scale enterprises. Tariff protection, subsidies, tax relief and marketing facilities are other methods of assistance needed to help in the establishment of small industries. Small industry represents much less of a break with previously established modes of living and therefore represents less of a strain than industrialisation in the form of large units. The industrial estate is now the established technique for developing depressed areas. The external economies are large in industrial production, and if one wishes to develop secondary industries, one must deliberately set out to create the facilities which factories use in common and which cannot be provided cheaply on a small scale.

India provides many models for Ceylon to follow in this respect. The importance attached to the Industrial Estate by India may be gauged from the fact that she proposed to establish about 1,500 of them before the end of the Third Plan. The Industrial Estate gives a chance for enterprising people without capital to commence a project and work their way up Incidentally there is relief to the educated unemployed, saving on imports and foreign exchange, and a general rise in the standard of living. Modern social and economic conditions require technological advance and rapid industrialisation of the under-developed countries. Agriculture and cottage industries alone cannot raise the standards. The small industry offers therefore the best remedy for economic development.

5. Large-Scale Industrial Development

But the problems of economic development are now such that import substitution relying on an expansion of labour-intensive small-scale consumer industries based on the home market would not be enough to cope up with the magnitude of the problem, especially in promoting internal growth and external solvency. No doubt such a step would keep in line with the present low capital/output ratio which the country is forced to adopt, make it easy for the planning body and the administrative machinery to determine a system of priorities, enable entrepreneurial and managerial and technical skill to develop as a first stage in the process of industrialisation, and finally create scope for employment absorption on a wide and varied field. This stage of development is necessary and feasible for a country like Ceylon. Moreover this does not exclude the possibilities of establishing a few large-scale industrial projects which are either consumer or producer satisfying. Such a combination of industries would lend ample scope for both the private and the public sectors to develop through co-ordination and by using the economic potential of the country in respect of its population growth and market demand. It would also relieve the pressure on the imports of essential commodities like food and clothing and other consumer articles, and make available foreign exchange for the import of machinery and raw materials for developmental purposes. Thus balance of payments equilibrium could also be achieved. But the experience of Ceylon in the past decade and more has imposed a greater burden on the need for industrialisation on a much wider and deeper basis. To repeat a few important features, we may note that the per capita income has remained stationery and capital formation has declined, because consumption has increased with national income due to fiscal policies of public expenditure leading to rising imports and then to rising costs and prices Curbs on consumption are slow and hesitant. Hence internal resources have to be greatly supplemented with external resources to raise the rate of investment and the capital/output ratio if productivity is to be increased sufficiently high to promote a rapid rate of growth in per capita income. Thus it would seem necessary to envisage the masive inflow of foreign capital to build up an enclave of large-scale industries to lift the economy by the boot-strap so that a viable export trade is developed in the process as a result of large-scale foreign investment. This as we have said is a necessity for Ceylon under the circumstances prevailing at present.

This involves a reorientation of the plans and policies of the national planning body. Rapid growth would imply a cumulative process which means a balanced development of the economy. In the context of Ceylon sufficient stress has already been made on inter-sectoral balance, but there is the need also to emphasise on intra-and trans-sectoral balance. Ceylon would yet gain in additional production, greater employment, and in the creation of other activities linked to them. All these would mean that Ceylon would be in the threshold of a big industrial era. But this implies a minimum of research and planning in this sphere of industrialisation though one could suggest as a consequence of the above discussion that a close study of the South-East Asian market requirements and the creation of an attractive investment climate for foreign investors are the first steps to it. But while planning for the home market needs to be precise, that for exports can be at best exploratory and preperatory to start with until experience could give better guidance in the promotion of exports.

We may here add the need to divert investment from social overhead capital expenditure to directly productive activities. The fifties in Ceylon saw social development of an extensive character, and it is desirable that more direct production is undertaken in the sixties. Not all social expenditure are of the productive nature, but Ceylon has been fortunate in having provided wide schemes of social progress besides creating a broad-based infrastructure and external economy. There may yet be room for certain types of social overhead capital expenditure to be made for meeting the new demands of productive activities, but it is still possible for a large diversion to take place, so that given the present scarcity of capital and the stagnant condition of the economy, a strong urgent need for conserving and utilising all available capital for direct productive activities is a compelling force to be taken into account. This would not contradict with yet another proposition that human capital as distinct from mere labour should be considered along with non-human capital as all capital in order to maximise the effect of investment and determine the pattern of development for rapid growth. A consideration of this point of view would also lead us to the acceptence of the policy discussed here.

Some implications of this policy may be considered here. Tea was erstwhile a leading sector, and in the future Ceylon may have to find out suitable leading sectors, outside the range of a balanced growth, which would promote and step up the rate of growth significantly above the target. Such sectors may arise from the use of rubber, salt, chemicals, coconut, fisheries, oil-refining and bunkering services, shipping and ship-repairing and building, etc., for which Ceylon has the necessary geographical advantage and raw material availability. The advantage could be strengthened through regional economic arrangements by which Ceylon could develop a hub of industries to serve the needs of the region as against outside competitors, in specified fields of economic activity. Ventures started in Ceylon would not only have this advantage of catering for the region, but would also enjoy fiscal policies designed to foster them, and the traditional commercial experience of many countries since Ceylon has been the centre of entrepot trade throughout history. All these advantages should go a long way in establishing necessary external economies for the growth of large-scale industrial enterprises to promote exports and raise national income They would in addition accelerate inter-industry relations by giving rise to numerous ancillary and secondary activities in the process of development. Though such a scheme may be hazardous for Ceylon to undertake, it is not a difficult task for outside interests to take up. This is so because we are concerned with per capita income as the prime determinant of development pattern. It does not mean that other countries of development have been overlooked. In the present context they are also very important, but it does not mean that they would be mutually inconsistent. The growth of technology has blurred the gaps separating small and large industrial ventures to a considerable extent so that it would be difficult to differentiate them on the basis of consumer and capital goods industries, or employment and output-creating industries respectively. In effect productivity and employment are mutually consistent. Large-scale industries even if financed by foreign aid would have great constructional and power needs which will create initial employment for a large workforce though not of a skilled type. The opportunities would be extended with the provision of certain categories of infrastructure that would be specially required for the establishment of large-scale industries, even though Ceylon has a well-developed infrastructure to provide adequate external economies. Moreover large-scale industries have secondary effects which import substitution industries cannot generate. Further as regards the balance of payments an export development economy has a greater telling effect than an import substitution process because the former is partly raw material based while the latter is entirely based on the home market demand and greatly relies on imported capital goods and raw materials. Thus Ceylon is in need of developing an open economy with capital-intensive large-scale industries for export promotion, especially between consumption, intermediate and capital goods. A shift in emphasis from consumer goods industries to intermediate and capital goods industries is very necessary if rapid growth is to be visualised. Ceylon is a small country and modern technology prohibits it from making a success of import substitution industries except in a limited way, so that rapid growth of the economy is not possible. The alternative is the development of an open economy. This is historically so for countries like Ceylon. The development of intermediate and capital goods industries with foreign capital (Government and Private) and technical assistance could develop an export trade to the markets of the region on a preferential basis. Since other countries are also likely to develop consumer industries and import capital and intermediate goods and orientate their commercial policies to that end, it would ideally fit in with the process of development in a small country like Ceylon. But a mere attainment of balance within the industrial sector would alone be not sufficient. The entire system comprising the industrial and the agricultural sectors should also attain a great degree of complementarity and linkage in all directions. This is the basis on which success in industrialisation in Ceylon would depend, for Ceylon is already a high-cost economy and there is unwillingness to forgo certain standards and concessions already achieved even on a temporary basis for the national cause of economic development.

CHAPTER XII

THE FINANCING OF DEVELOPMENT

1. Introduction

The problems of financing economic development were considered earlier. The low rate of capital formation was attributed to the deficit financing of public expenditure which created a high level of monetary demand in the economy and a continued pressure on the level of imports with consequent measures for quantitative restrictions through quotas and licenses and increased duties on imported goods. This raised internal prices and costs and not only affected the standard of living but also the exports of the country. Increased production by import substitution was inadequate to absorb the effects of a substantial monetary expansion. This again affected the Budget adversely. The scope for monetary policy alone to offset these effects were severely limited, which could only restrain secondary expansion in bank credit and direct it to useful purposes, and thus serve as supplementary to the remedial measures taken by the Government itself. The possibilities of increasing tax revenues were also limited because already 26 per cent of national income is channelled as revenue and new taxes have failed to realise expectations. Improvements in administration and elimination of tax evasion could increase revenue and there are other methods of augmenting it. But the position in Ceylon is that taxation has reached very high proportions and has led to reductions in corporate and household savings. Taxation has thus reduced private savings while public expenditure has increased the propensity to consume. In fact taxation is barely sufficient to meet current expenditure so that the entire capital expenditure had to be met through deficit financing. The scope for foreign aid and domestic non-bank sources of borrowing are also limited. Hence it is that public expenditure has to be curtailed if expansionist financing is to be avoided and capital formation is to be increased. The present rate of capital formation of 14 percent of gross national income is already inadequate when compared to the 26 percent tapped by revenue. The rate would be still lower if drawings on external assets were not possible. This has reached a low level and needs to be raised because foreign resources are necessary to finance capital goods and developmental requirements and to promote confidence in a currency to attract foreign capital. On the other hand it would be unwise to rely on increasing foreign liabilities because the amount now equals the assets and has to be repaid. This is bound to curtail the rate of capital formation. In addition to this the rapid growth of population has become a burden and a hindrance to progress because it increases the consumption needs of growing population, thus depressing the rate of investment, and diverts what little is saved on social overhead expenditure. Not only is the population growth alarming, the workforce is expected to rise faster from 1963 onwards as a result of this situation.

The present position with regard to capital formation in the public and private sectors is that consumption must be curbed or else the capital/

output ratio must be lowered. National income per capita is stagnant and capital formation is either stationery or even declining while consumption has been rising with national income. This makes it difficult for the economy to lift itself up. But the present economic and political background do not indicate any desire or will to curb public expenditure to any desired level, nor on the other hand is it possible for a lowered capital/output ratio to maintain the present per capita income and standard of living. The only alternative to any direction in public expenditure is to create an effective investment climate for a massive foreign capital investment to take place, especially as the objectives of the Government is to make a drive towards rapid economic growth. This would raise the rate of investment and the capital/output ratio and provide an enclave of large industrial enterprises for export promotion besides producing large secondary effects for the development of the economy. A leading sector of this nature is required as much as the plantations proved to be so in the past.

Ceylon will have to take decisive steps in this direction. The fifties may be regarded for the country as a decade of social development and the sixties may be regarded as one for economic development. An extensive infrastructure and wide external economies have been built up through large-scale social overhead expenditure and common facilities. The country could now afford to divert much social overhead capital to directly productive activities, and also create a climate for investment by promoting wage and political stability. An Investors' Charter is a dire need of the hour. This is strengthened by the fact that export promotion has to take precedence over import substitution in the future and that much reliance has to be placed on foreign economic assistance.

The urgency of this policy will be further realised by the fact that Ceylon had a high foreign trade/GNP ratio and prospered through its plantations. So that other types of investment and activity were not pursued, so that with the new confrontations of the world market for primary products, there is the likelihood of those countries with less favoured conditions in the past stealing a march over it with regard to diversification and development. Mere social development would not compensate for a future very much dependant on direct production. With the continued emphasis on welfare schemes the need for foreign aid and investment acquires an added urgency, and has become very compelling under the present circumstances.

2. Measures to Increase Savings

The following measures it is felt would go a long way in improving the volume and quality of saving in Ceylon, especially in view of the increasing commitments for development. As incomes rise there will be better distribution also, and therefore a rise in the ratio of savings to National Income is possible only through other factors besides natural increase in incomes.

1. The establishment of the National Provident Fund in 1958 has proved a potential source of savings. No doubt this might reduce the normal quantum of savings that might otherwise have taken

place, but the fact that it taps a wide range of income should increase net savings.

2. The establishment of a Development Savings Bank is very much in the air. The details of the scheme are rather complex and there is an element of compulsion in it. Yet there is scope for augmenting savings through it. The granting of a variety of reliefs from income tax, both corporate and personal would increase the quantum of savings.

3. The provision of Rehabilitation Schemes to meet part cost of the major export industries increases savings.

4. The subsidisation of fertilizers for paddy cultivation is yet another measure.

5. The new system of Expenditure Taxes would stimulate savings and add a substantial spur to the growth of private personal savings.

6. The establishment of a Government Investment Trust or the extension of the National Provident Fund to the private sector would improve the chances of a healthy capital market institution.

7. The extension of the hire-purchase system, and

8. The establishment of industrial estates would stimulate enterprise and be an incentive to further savings.

9. The establishment of the Peoples' Bank would go a long way in meeting the needs of long-term credit for industry and agriculture.

10. The better use of bank deposit by branch banking to reach the entire length and breadth of the country is another important measure.

11. Above all a rise in the rate of interest would develop a capital market and be an incentive to the average and the wealthy investor. Even if more funds reach the Government than required to buy Government securities, and thus create an unbalance, it would not matter, because Government can still re-lend it to the private sector through financial intermediaries of all sorts. The supply of finance need not be an insoluble problem and difficulties can be overcome. The determination and sacrifice of the people and the Government can at any time meet the demands of a planned economic development.

Changes in the relative share of wages and increased monetary cost of living will exert pressure on planning, but if financial policy could restrain monetary increases, and if particular price rises do not lead to claim for a rise in wages, any plan directed at increasing real living standards could succeed. It should be borne in mind that the lack of reliable estimates and figures need not mean lack of conviction in the ability to save and invest in bold planning. The Ten-Year Plan expects private savings to rise only from 5·5 per cent to 6·4 per cent and Government savings to rise only from 4·9 per cent to 8·7 per cent. Though not acute it is not negligible, and stronger efforts are necessary to achieve the desired rates of savings in absolute terms.

3. State Policies for Savings and Investment Development

It must be very evident that Ceylon should follow a steady and well-meaning pattern o fconsumption, savings and investment, so that production and employment rise, and also the standard of living of the people. Below we enumerate some guiding policies for the Government to follow.

1. The first requirement is the planning of the economic development of the country as a whole. That alone can generate the necessary urge and tempo.

2. Public enthusiasm should be enlisted through decentralisation and propaganda. This could change consumption and increase savings and provide the necessary atmosphere for a successful planned development.

3. Agricultural expansion can increase exports and reduce imports and help improve the balance of payments problem.

4. Industrial expansion of import substitutes can reduce imports, and export products can increase exports. This again will help improve the balance of payments problem.

5. Improved balance of payments can be utilised for the import of capital goods and raw materials.

6. Externally, however much we might like to liberalise trade and payments on a multilateral free trade basis without strain on foreign exchange and internal economy of the country, economic development would invariably necessitate, even under the

most efficiently planned scheme, the introduction of trade and exchange control. Otherwise the balance of payments will deteriorate leading to the loss of foreign assets. The stringency could be softened somewhat by multiple rates of exchange, by sizeable foreign loans and investments, and by avoiding over-capitalized investments.

7. Internally, inflationary pressure has to be expected under planned economic development and so price control and State trading and rationing measures must be established to prevent speculation, exploitation, and profiteering.

8. Investment on planned projects must be carefully made so that capital and labour get the maximum marginal return in all the directions of investment. This should be the investment criteria.

9. Investment can be maximised only by tapping both the domestic and the foreign sources as much as possible. National financial institutions as presently constituted though numerous by legislative enactments cannot cover the entire medium-term and long-term needs of agricultural and industrial development. The funds are meagre and inadequate. More savings must be attracted at higher rates of interest and borrowing facilitated at the lowest rate. This can be strengthened by controlling speculation also. Government's responsibility is great in this respect, and internal capital must be mobilized to meet the local components of development projects.

10. External Capital is very essential for any development plan. England in the early nineteenth century and Russia in the early Revolution period

were able to build internal capital for their development, but conditions there were different. We cannot afford to cut consumption below a minimum capacity as underdeveloped countries are at the subsistence level, the wages are inflexible in the urban sector, human beings cannot be made to sweat purely for the benefit of their future successors, and economic pursuit cannot be made the goal of man for the sake of capital formation. But the external capital will not come in if Discrimination, Ceylonisation, Nationalisation and Confiscation are to be practised without rhyme or reason. Nationalisation is not wise because the capital invested would get better returns elsewhere and produce other social and economic benefits to the country. Ceylonisation must be gradual and rational. In fact capital is scared and cannot be assured with all the ingenuity of comforting arguments. Nationalisation may be possible, but on international principles. In fact a code of international conduct on foreign investments would help a lot. But the fear of free flow is that more might leave the country than come in. This may be countered by the provision that capital movements could always be regulated by a Central Bank and by a gentleman's agreement.

11. A very important issue is the commercial policy of the country. This has been well stated by the Taxation Commission too. The tariff schedule is very defective, indiscriminate and inconsistant. Investors are not sure about their calculations of protection which is necessary for launching on projects. An authoritative Tariff Commission should be established.

12. Government has discouraged investment in another way. It has interfered with other producers in many fields and also reserved many projects which private investors could have undertaken. This has no bearing on the question of basic industries either.

13. In still another way Government has acted against the best interest of planning by spending hard earned capital in schemes that are clearly not developmental. This is demoralising and damaging.

14. Government saving and build-up is very important apart from those of the Household and Corporate sectors. It could be done by augmenting revenue in the following ways:— Firstly, Government enterprises should be made more remunerative on commercial principles and not allowed as a deadweight on the taxpayers; secondly, the present taxes could be improved by remedying the loopholes and increasing the yields; thirdly, new taxes including the Kaldor taxes should be implemented to augment revenue; fourthly, measures to create incentive to saving in the Corporate and the Household sectors should be made; fifthly, defects in the existing taxes and subsidies and duties should be remedied in order to increase output; and lastly, budget surplus should be built during times of prosperity and budget deficits during times of depression.

15. Inflation should not be looked down as despicable nor indulged in indiscriminately, but in a developing economy there should be provision for a gradual increase in the quantity of money and level of prices.

Thus it is clear that the State should plan both the public and private sectors, and provide the necessary stimulus to mobilise internal and external resources for the development of the country.

4. Foreign Capital

We observed that the Ten-Year Plan had overestimated the possibilities of mobilising internal resources and underrated the requirements of foreign economic assistance to maintain a reasonable rate of development. Moreover in actual experience even a modest rate of growth was found impossible and Government capital expenditure relied heavily on local borrowing and foreign aid and created credit. This led to the scaling down of the short-term investment programmes involving low capital/output ratio and quick-return schemes. The problem was further accentuated by fiscal policies that crippled the private sector and encouraged the propensity to consume. Even if social and administrative improvements were made to utilise the available resources very effectively the quantum of capital formation would be too inadequate to raise the per capita income at appreciable rates. Especially would this happen in the face of inflationary tendencies to raise the costs and prices in the economy due to severe import restrictions and efforts at increased domestic production itself. The problem is further complicated by the realisation that import substitution and consumer goods production in the light of known modern technology would not be as extensive as possible, and that an open economy has to be developed with production for export to meet the requirements of a regional market or a world market. These alone can, not only reach a foreign market, but create secondary effects to provide a multiplier effect for employment of a rapidly growing workforce. Capital-intensive projects would therefore demand a large capital investment for economic development. In the absence of domestic savings, it becomes imperative that a well-planned economic development of the country can take place only by an unprecedented inflow of foreign capital. But it has been pointed out that such inflow has been exceeded by the outflow, apart from the large dividends and profits that are drained out annually. This applies only to private capital, while loans and grants from foreign agencies and countries have been received in increasing quantity though not fully utilised for various reasons. Increased costs and lack of an investment climate would create further difficulties for large-scale foreign capital investment. But meanwhile the balance of payments position would become worse by increased pressure for relaxation due to demand for not only consumer goods but also for capital goods and raw materials for development whose prices would be rising, thus compelling a revision of the plans. Foreign borrowing may become a necessity at a future date to maintain the foreign payments alone in equilibrium because import restrictions would have reached its limits of capacity. Thus a consideration of the financing of development and the most appropriate pattern of growth for raising the standard of living and the per capita income makes us draw the conclusion that nothing short of a massive inflow of foreign capital would do. We have to determine the conditions and the extent of foreign capital that would be required for the purpose. The capacity to absorb and the capacity to repay must be borne in any evaluation of the requirements.

We now come to the very important task of relating foreign capital requirements to the problems of financing of investment and the pattern of development. The magnitude of the problem is very great in the light of the experience since Independence. Let us therefore take a hypothetical case based on current financial trends to guage the possibilities of meeting our targets from foreign sources. Taking the 1963-64 Budget proposals, which are themselves very difficult to realise on past experience, current surplus and local borrowing would amount to Rs. 250 million, leaving a further sum of Rs. 300 million to bridge the capital budgetary requirements to create a net growth rate of 2 per cent or a further sum of Rs. 600 million to step up the net rate to $3\frac{1}{3}$ per cent, as visualised by the Short-Term Projects and the Ten-Year Plan respectively. (Let us assume a stationary level for the private sector.) If the Ten-Year Plan objectives were to be realised could Government secure Rs. 600 million annually at present as additional flow of foreign capital? The Government expects Rs. 200 million as foreign aid. Indeed this sum could be doubled if the Government can effectively utilise funds already promised and plan for the utilisation of additional foreign aid. Thus Government could easily secure Rs. 400 million as foreign aid. This leaves another Rs. 200 million as desirable foreign capital required annually for the country. If the Government cannot expand adequately to invest further funds, this amount may take the form of foreign private capital. Herein lies the snag and there may be the lifting of the eye-brows. This is because experience points the other way. There is an outflow of Rs. 100 million (Rs. 35 million of capital and Rs. 65 million of profits and dividends) annually from the country. If this is utilised and the amount doubled, it would be possible to create a net inflow of Rs. 200 million as foreign private capital. How could this happen in the face of complete rejection of such a possibility. The experience in the fifties has to be explained first. Notwithstanding all assurances and guarantees foreign capital was shy because there was no scope except in commercial and engineering and certain other protected fields. The plantations were declining and heavily taxed. Small industries as import substitution concerns were risky. Costs were prohibitive for the establishment of large-scale industries to manufacture export products. No industrial policy had been shaped until recently. Big projects were reserved for the public sector and no scope for private capital was allowed. The West was engaged in reconstruction and rehabilitation and buildiug up a competitive industrial economy. And there was no climate for foreign private capital investment in Ceylon as was found in many other Ecafe countries. But things have changed and there are better scope for increased inflow of foreign capital (both Government and private). The West has so advanced that they are willing to help with more funds at easy terms and without strings, and also encourage private capital too by various devices that are now too well-known by both the donor and the receipient countries. Even more than all these changed contributing factors would be the adoption of a well-defined and clearly understood pattern of economic development.

We might address ourselves to this problem at present. We now know that domestic capital is very inadequate to raise the per capita income or to provide employment for a rapidly growing work-force except by lowering the capital/output ratio and restraining consumption. This we said could be overcome by seeking a large inflow of foreign capital, but then the capacity of the Government to step up planning and production would be difficult even with foreign-trained technical personnel. Hence even allowing for a large receipt of foreign governmental aid (grants and loans and lines of credit), the gap in the investment of development financing has to be met by the encouragement of foreign private capital inflow. This is important to keep the rate of investment high but it also fits in with the pattern of development contemplated by us. Capital-intensive industries alone can create secondary effects for expansion of production and employment, while promoting exports to the regional and the world markets, and also creating large external economies for the future development of the country. Many countries in the Ecafe region are again good examples of this sort of development and rapid rate of growth. Regional economic co-operation would strengthen this tendency. There is thus a large scope in this new field for foreign private capital investment to take place. The public sector cannot cover all enterprises. Some of the socialist countries with bilateral trade agreements are helping in the starting of big industries in the public sector. If that be so it is feasible and necessary that similar big projects be undertaken in the private sector by foreign private capital from multilateral trading countries. It would be not only good Economics but also a vindication of neutrality and a justification of mixed economy. Such a scope could not only encourage foreign private capital, but even induce foreign agencies and countries to provide funds for local entrepreneurs through the State or other institutions. Though this provision exists under certain bilateral agreements, the private sector has not made use of them. The reasons may be partly technical, partly prejudice and ignorance. In contrast multilateral funds have been mostly utilised. (It would not be possible to investigate further into this state of affairs.) The main conclusion is that the reluctance of foreign private capital or even the local private sector to invest foreign funds directly or channelled through the State may be due to the lack of climate for investment. Since it applies to local private capital as well, it would be wrong to accuse foreign private capital of being shy to invest. Experience in some of the Ecafe countries gives enough hope for what foreign capital (both government and private) could do to promote economic development in both social overhead and direct productive activities. At any rate this is a must for Ceylon in the immediate future. Otherwise standards would fall and unemployment will rise, and the problem of finding a bootstrap to pull out the country from stagnation to development would be more difficult in the future. Hence it is necessary and possible to encourage the flow of foreign private capital for the development of large-scale industries as much as we desire to increase Governmental aid from friendly countries.

5. Effect on Balance of Payments

We may also note the consequences and effects of a high rate of investment, especially of foreign capital on the balance of payments and the amount of strain that will be imposed on it. It is clear that any investment programme, even if financed out of domestic savings without inflationery financing, would cause strain on the balance of payments, except in the case of an entirely closed economy. Imports would increase whatever the ratio of capital goods imports to the investment expenditure and wherever the propensity to import consumer goods is less than unity. The deterioration in imports would be greater, the higher the proportion of capital goods imports to investment and smaller the propensity to import consumer goods. The deterioration would be still greater if part of the investment is financed from inflationery financing. It would also depend on whether the investment is directed towards the promotion of production of exports or if import substitutes, the relief to the balance of payments being greater in the latter case than in the former. Moreover, increased production of import substitutes may be much easier to achieve. Thus Ceylon with her high level of consumer imports and high level of export earnings offers scope for import substitution through capital imports But the limits to import substitution would force her to adopt export production as a policy through the possibilities offered by regional economic co-operation and liberal trade policies followed by advanced countries towards developing countries. Also the failure of Ceylon to keep her export surplus and her favourable external reserves has created a strain on her exports to earn the necessary foreign exchanges for the import of capital goods while her increasing ratio of consumer goods to GNP and a declining rate of domestic savings have further made it difficult to import investment goods. (Of course the extent of export production would depend on the extent of import substitution that can take place, which has to be established by a study of the size of the domestic market and of the ability of industries to reduce costs overtime.) The problem is further aggravated by the fact that the production of an adequate level of import substituties may not reduce the propensity to import consumer goods. Thus on all counts the situation would appear to be that any investment programme would create a strain on the balance of payments, especially with the present trends in fiscal policy and foreign trade. These have in fact made the Ten-Year Plan balance of payments projections completely unrealisable in the future. The present disequilibrium in the balance of payments could however be removed and development maintained at a reasonable rate of investment by the adoption of one or more of the following policy approaches :-

(a) domestic savings can be stepped up;

(b) exports or the inflow of capital may be increased;

(c) the import component of the investment programme may be reduced by concentrating on projects with low import content;

(d) the propensity to import may be lowered, both by the higher production of import substitutes and by the imposition of tight import controls; and

(e) the investment may be more concentrated in the production of exports and import substitutes.

All of these, except increased capital inflow, call for additional sacrifices from the people and will need to be used in combination. Amongst these measures some would provide a greater immediate relief to the balance of payments, while some would create a greater immediate stress on the economy than the others. But the present position is such that development could take place even with import restrictions and reoriented commercial policies only on the basis of a massive inflow of foreign capital because the domestic resources are inadequate to meet the requirements We have also indicated the extent of the gap to be filled through foreign sources and have indicated that it should be both Governmental and private. From the present trends we also observed that it would be possible to raise this amount from both sources together. We also pointed out the necessity to rely on foreign private capital to supply not only capital goods but also entrepreneurship and management and skilled labour to undertake industrial projects as part of the plan for a balanced development of the economy. And we were also hopeful of this if political and wage stability could be assured for foreign investors. What was also needed was an Investors' Charter. This could reverse the outflow of private capital into an inflow and assure the continuous and rapid development of the economy. We also pointed out the conditions that would make these investments productive and fruitful, so that the capacity to absorb and repay could be improved. The remedy for shortfalls in these is itself the encouragement of foreign private investments on a wide and large scale. So that I would not agree with the present critics that foreign capital should be limited and marginal, that it should be of the subsidised variety, that it should be on a governmental basis, and that private foreign capital could only be of a qualitative and not of a quantitative nature. Given better fiscal and commercial policies and improved planning technique and foreign aid utilisation there need be no inhibitory factors to limit the magnitude or composition of foreign capital for a country like Ceylon. The capacity to absorb and to repay could also be very much strengthened by various policies to promote exports and to restrain imports. These additional policies are necessary for restoring balance of payments in the long run and to promote structural changes in the economy, to raise per capita income, and to provide full employment. Thus the crucial role foreign capital could play in the economic growth of Ceylon, and what its needs and prospects are, have been fully discussed. With the announcement of UN of the development decade and the many changes in international commercial policies at the world conference on Trade and Development in 1964, the use and benefit of foreign capital assistance could be assured an important place.

CHAPTER XIII

ORIENTATION OF COMMERCIAL POLICIES

1. Introduction

The pattern development of the foreign trade of Ceylon shows the typical economy of a colony geared to that of its mother country. The plantations proved the equivalent of heavy industries and led the country to prosperity and to fair standards of living. This economic advantage was considerably strengthened by the geographical and political position which it enjoyed. Investment was therefore concentrated in the development of the plantations or in activities and public utilities directly connected with the promotion of these plantation industries, so that the need to develop non-export agriculture or manufacturing industries was not felt. Banking, trade and commerce were persued with this object of promoting exports of primary products and imports of consumer goods of all sorts. Population had not grown much and unemployment was not a pressing problem, and the administration attempted little to alter the structure of economy or the pattern of development because the benefits of the expanding plantation industries got diffused to all sectors either directly or indirectly. Emphasis was always on providing welfare needs, while agricultural and industrial activities were promoted in a permissible way through irrigation, technical advice and marketing facilities without involvement of any deliberate protectionist policies of development.

This state of affairs was found to work smoothly with the economy until the Great Depression of

1931 though some of the strains were felt even as early as the years immediately after World War I. The year 1931 is therefore significant to Ceylon. The Great Depression sent the economy down the precipice as the consequences of the fall in the world market for primary products affected all sections of the population. Unemployment became for the first time a burning question and standards of living were shattered and the folly of undue reliance on the fortunes of a few exports were bitterly experienced and felt. The Ottawa Conference was a necessary sequel to this situation, and it was devised in order to produce a cushioning effect on the economies of the countries of the Empire. But the world situation did not permit of a serious recovery since the trade of the Empire was very much influenced by conditions in the world trade. Nor were the colonies willing to accept the Ottawa Agreement as the basis of future development beyond accepting it as an emergency measure. Meanwhile constitutional reforms resulted in the granting of a measure of self-government through the Donoughmore set-up in 1931 which gave the people of the country powers to regulate their economy in the manner best suited to them. Thus economic changes and political reforms synchronised almost simultaneously. This gave rise to the beginnings of a new Industrial policy of economic development in charge of a new Department and a new Minister.

But before any headway could be made with a few industrial projects and colonisation schemes the Second Word War took place and this time Ceylon became directly involved. The plantations were completely manned to serve the aims of the War and this resulted in the exhaustion of the plantations, so that extensive rehabilitation and replanting schemes became the first call in the post-war period. Many of the War-time factories had also to be replaced. Rubber and coconut did not show any increase in physical output while the growth of tea was modest because of the position in international demand and prices. Primary products were again confronted with difficulties, especially those of Asia. Rubber had to face the synthetics, coconut had to face other substitutes, and tea other competitiors. Meanwhile imports had increased more than exports for several reasons and was met by the use of the accumulated foreign balances. Independence had been granted and foreign capital was fighting shy to come into the country for investment. Death rate had fallen and the population was increasing at 2·6 per cent annually since 1947, besides causing a rapid increase in the workforce of the population. The new democratic independence resulted in increased taxes for greater production and better distribution, and in even greater public expenditure. These forces continued to increase the propensity to consume and thereby kept up imports while exports did not rise as much. Import restrictions thus became the inevitable result of post-war economic policies since Independence was gained because exports failed to expand sufficiently to meet the import requirements of the country. This led to the production of import substitutes of agricultural and manufacturing origin. It would therefore have been the material answer to maintain and increase standards by substituting imports and promoting exports whenever possible, especially in the face of the difficulties experienced by the country's traditional exports and the large share of the essentials constituting the imports. Otherwise there would be a fall in the standards of living. Moreover the traditional exports were not only facing a difficult world situation but were reaching physical limits within the country. The problem was further aggravated by the failure to establish agreements and stabilisation schemes in these commodities. The only alternative was to develop non-export agricultural commodities and manufactured goods based on available land and market demand respectively and then to develop exports based on natural resources of geographic and strategic origin for a regional preferential market and that of the advanced countries if possible. Thus diversification and structural changes in the economy became both a historical necessity and a practical proposition.

All Governments with newly-won freedoms in the world have realised the need for diversification and structural change, and have therefore adopted in post-war years as a matter of routine a policy of conscious development which meant a full-scale planning of the entire economy because any transition involves a deliberate attempt to reallocate resources and factors of production into channels hitherto not attempted because of many immobilities even though the returns in certain favoured directions were much greater and in some others much less. The total national investment had to be so integrated as to increase the per capita income and employment opportunities so that investment could be maximised and capital/output ratio raised to a level sufficient to produce a rapid cumulative growth. Thus planned economic development becomes a sine quo non, with industrialisation holding the key to the problem of development in a small country like Ceylon. This leads us to the determination of the right correlation between the financial resources available for investment and the pattern of development in agriculture and industry that is possible under the circumstances prevailing in the country. But a policy of development requires certain conditions. The first of them is to maximise the internal resources available for investment which requires a changed policy of public expenditure. This would not only curb the tendency for increased consumption, but would restore balance of payments in the foreign account and keep the tempo of production high enough to promote better trade and higher standards. The effect of it would be felt in the private sector as much as in the public sector so that a well-balanced mixed economy could be assured. But we now know that internal resources are inadequate and that public expenditure cannot be scaled down. In addition import restrictions are likely to raise prices and costs, and affect exports as well. And in the face of an inflationary tendency import substitution could not be adequate enough to keep down prices and costs, because investment would be low. Nay, even a low capital/output ratio will not remove unemployment and under-employment which is on a vast scale, let alone affecting the per capita income. Hence economic development under prevailing conditions could be assured only if certain commercial policies are reoriented for the purpose and combined to produce a cumulative effect on investment and production so that per capita income could be raised at a rapid rate and full employment of men and resources ensured, while at the same time balance of payments equilibrium could be restored and a new pattern and direction of foreign trade evolved in keeping with the proposed structural changes in the economy.

2. Protection for Industries

Protection is required for the following reasons: (1) Raise marginal costs to the level of social costs so as to enable agricultural and industrial production and expansion to take place. (2) Shelter the infant industries against foreign competition until external economies and social overheads are created and well established. (3) Protect industries against price discrimination practised by monopolistic concerns in international markets. (4) Remove underemployment in agriculture by absorbing surplus labour into industries. (5) Develop industries to help agricultural expansion. (6) Solve the balance of payments problem arising in an expanding economy. (7) Raise the standards of living of the people by increasing their per capita income. (8) Help the nation achieve a structural change in its economy.

It is not possible to accept economic theory in the traditional sense to explain the problem of economic under-development and therefore to accept free trade as the best policy for it. Economic Theory as developed during the 20th century is little used to the study of under-developed countries. Though some of the basic concepts of the 19th century are applicable even to under-developed countries, the fact that people in poor countries live below subsistance level materially modifies the relevance of theory to actual practice. Moreover the so-called economic factors cannot be distinguished from the non-economic factors in poor countries. Further it may be noted that the theory of circular and cumulative causation explains the increasing inequalities within a country and between nations. The economic impact of colonialism must also be given great weight. In addition .need for balanced development requires protection on an extensive scale so as to foster an "infant economy" through its several stages. The fact that Ceylon needs not only development but also diversification to solve her problems of stagnation and balance of payments disequilibrium point to the necessity of adopting a policy of protection as one of several measures to reorientate her pattern of development and achieve a rapid growth in her economy.

Protection for industries should be offered in one or many ways: Tariff duties, subsidies, quotas and trade and payments restrictions. Of these a moderate tariff duty is the most straight-forward and logical method that could be applied, but at a time of emergency it cannot be expected to act swiftly to arrest a deteriorating balance of payments. A quoto system involving quantity control would serve the purpose, but it would lead to profiteering and a rise in prices. Of course a solution is to sell licences to the highest bidder, but an import duty is free from corruption and will scoop the profits from the trader and benefit the public coffers. The Industrial Products Act requires complete removal or substantial modification in its appliaction. As there are many inconsistencies in the protective policies of the Government, it is hoped that an authoritative Tariff Commission would revise Tariff Schedules and promote industrialisation without loss by way of revenue. As the pace of industrialisation proceeds the nature and composition of foreign trade would change, and even if there were to be a fall in Customs revenue leading to a temporary setback to the exchequer, it is hoped that economic development would lead to rise in incomes and to a greater revenue through income tax and excise duty.

3. Regional Economic Co-operation

The pattern of development and various economic and commercial policies that have been found suitable for Ceylon point to the efficacy of encouraging the inflow of foreign capital investment for the development of an export trade of capital, intermediate and consumer goods based on an open economy and on an expanding regional market. The gradual stepping up of regional economic co-operation in various directions and in various degrees seems to hold the promise for a secure and stable development of the economy. This in another form is import substitution based on an enlarged frontier, but at the same time opening the way for promoting international free trade eventually. But this presupposes that there is a desire by a group of countries to seek such an arrangement and benefit by it.

The proposal for a regional economic co-operation was made in 1958 but was resolved only at a meeting of the ECAFE in 1960 and later by the Parliament of Ceylon as an earnest expression of its desire to explore all avenues for it. The resolution of 1960 recommended that countries of the region should increase trade within the region in order to increase production and promote development. An expert committee had also visited the various countries of the region and made a confidential report which was under consideration by the Governments of those countries. The inspiration for this move came from the successes attendant on similar moves in Europe and South America and the fact there was now an international recognition of regional economic arrangements as the only means of making co-operation and co-ordination effective before it was done on an international scale. Further the dangers of these to the countries of underdeveloped countries, especially of the Asian region, compelled the adoption of this policy even as a defensive measure. But the differences between Europe and Asia may be noted here in order to explain certain difficulties confronting the region: (1) the importance of Agriculture in the economies of the ECAFE countries is much greater; (2) the extent of direct state control over the allocation of resources is generally much wider than in European countries; and (3) the economies of the ECAFE are not in the stage of "self-sustained" growth as are the countries of Europe. But the fact that even the Warsaw Pact countries have felt the usefulness of economic co-ordination has showed up the importance of it even to the countries of Asia and the Far East.

4. The Rationale of Co-operation

There is about 30% trade within the region, but there is a great dependance of it on advanced countries, and therefore co-operation in Asia cannot be in the development of existing patterns, but must reflect a new process of economic growth which seeks to transform old relationships. There are many reasons for this. (1) The long-term trade situation confronting the countries of the ECAFE region is not very favourable. The rate of growth of the exports of the primary exporting countries of the region has shown a tendency to fall behind not only that of the industrial countries, but also that of the primary exporting countries of other regions. The major export commodities of the ECAFE countries have been subject to wide fluctuations in volume and prices. Thus the ECAFE countries have a need to join for the purpose of securing stable and reasonable prices for their products in the world market and to divert them more and more within the region by making increasing uses for them without resorting to substitutes and synthetics from outside the region. (2) On the other, the import requirements of the region are rising steadily and causing a widening gap between exports and imports. Under such circumstances more and more use of the available productive and financial resources of the region have to be made and economic development promoted through diversion of trade within the region so as to increase export earnings. (3) There is also the need for imports of capital goods for the economic development of the countries, which has to be financed by increased exports, and this again entails greater intraregional trade. (4) Finally, there is the common need to attract foreign economic assistance of all kinds for the countries of the region. Only regional co-operation can secure the maximum amount of foreign capital and assistance which are scarce and which have to be put to the best use. There is the added advantage of securing greater aid to the region if a concerted effort were made by all. Thus it would seem that the problems of the region are very much in common and that only through regional economic co-operation could all of them be solved in any satisfactory manner, especially when the odds weigh against the region and when regional integration is taking place in other parts of the world.

There are also other considerations that compel closer economic ties between the countries of the region. A long-term view of development is necessary by taking advantage of economies of scale and intraregional division of labour to promote individual economics as well as that of the region. The present markets of many less developed countries are not wide enough to obtain economies of large scale production in many branches of industry. This applies to small countries, and big countries with low levels of income. Therefore co-operation in industry is necessary. This is more so recently as economic and technological factors point to them. Since import substitution is resorted to as a means of industrialisation by all countries, there is a tendency for intraregional trade to decline, since it affected the imports from countries of the region and increased the imports of capital goods from advanced countries. This not only aggravated the problems of foreign exchange, but also confronted import substitution with market problems. Hence a regional approach is necessary even from broader considerations. This involves the various development plans of all the countries being co-ordinated for maximum results in the fields of agriculture, industry, transport, trade and finance, so that the desire of all countries to accelerate growth and raise standards of living and levels of income may be consummated. Thus regional co-operation would expand intraregional trade and benefit not only the small countries but even the large countries of the region by removing the limitations of raw materials and markets, and promote an outlet for industrial and primary products, and at the same time curtail the use of foodstuffs and synthetics from outside the region and promote a degree of self-sufficiency in agriculture for the region as a whole. Regional economic co-operation would therefore help develop the countries and promote better intraregional trade. And on these lines of reasoning Ceylon's need for regional arrangement has become imperative, especially as she has to develop an open economy. Though the nature and extent of co-operation would have to be determined after techno-economic surveys and studies, yet it is possible to formulate broad lines of approach compatible with the objectives of the problem.

But it would not be fair to propose such a solution without noting the possibilities of overcoming the obstacles and limitations to it. (1) Political and social differences are likely to influence the scope and forms of co-operation and prevent the full benefits from being realised. But we should not over-emphasise social and cultural differences, and the differing political forms. In fact there exists certain affinities amongst groups of countries and this could be availed of. Some groupings have already been made to promote economic co-operation. (2) The purpose of economic co-operation will over-come these political and social obstacles, and even create closer affinities in other respects. Want of affinity is due to economic retardation, and modern technology and industrial development will forge greater affinity among the countries in the future. Progress is already visible and a balance between national traditions and modern requirements are emerging, and a commonness is spreading. (3) The countries of the region have similar colonial past and similar economic problems. Also they have similar plans and similar solutions. Political differences will not therefore be a barrier to co-operation. National aims depend on economic progress and this again on co-operation. However it would not be wise to minimise the difficulties in forging a close economic co-operation among the countries of the region or its sub-groupings, especially with the peculiar problems each country in the region had, which reflected itself in the pattern of trade. Yet the need for co-operation remined in the region.

5. Forms of Co-operation

Experience elsewhere both historically and currently has provided with examples of many forms of economic co-operation. Economic Union, Customs Union, and Free Trade Area are far-reaching and are therefore not suitable and possible, not only for the entire region but for groups also. This is because of unequal development apart from social and political factors. Hence other forms involving less integration may be tried by groups of countries. The use of preferential trade with gradual liberalisation of tariffs and quantitative restrictions so as to fit in with development plans of individual countries would be a very feasible measure of economic co-operation. It would also be possible to co-ordinate development plans in specific sectors or groups of like products or even individual products. Yet another devise would be to undertake joint industrial ventures amongst countries, or integrate the development of industries involving final product and components. There could also be co-operation for the stabilisation of commodity prices, co-ordination and improvement of research and training facilities, participation in the establishment of multilateral credit and payments arrangements, in the establishment of a system of automatic credits and multilateral compensation arrangements to overcome the temporary payments problems and to eliminate restrictive measures, and in the facilitation of wider travel by linking it to the payments problem. The arrangements could also be undertaken on a bilateral or multilateral basis as circumstances would permit. But the forms of co-operation must take account of two things; (1) The existence of different degrees of development among the participating countries, and (2) the need for a machinery for co-ordination of plans, because resources are allocated through plans by countries. These devices are eminently suited for adoption by the countries of the ECAFE region for promoting the development of industry and intraregional trade, though a system of preferential trade would seem to be an essential feature of the regional set-up for the early stages of an integrated planned development.

6. The Role of the Ecafe

The Ecafe Secretariat had done very extensive work in the field of regional economic co-operation. It had undertaken the important task of promoting co-operation and co-ordination among its members by working in several directions. The following are some of the types of work done:

(1) A conference of Asian Economic Planners was convened in 1961 to co-ordinate plans.

(2) A number of fields and projects for increasing economic co-operation were worked out.

(3) Help from International Agencies for assistance in projects were sought.

(4) The Secretariat Reports stressed the need for common policies and co-operative efforts by the Ecafe countries in all economic aspects, i. e., exploring avenues of intra-regional co-operation.

(5) Technical assistance from UN (BTAO) to implement regional projocts were sought.

(6) Governments were advised to carry out studies of projects.

(7) Governments were helped to make aids given more effective.

(8) The activities of other bodies in the region were followed closely and wherever possible co-operation was given.

(9) The formation of the Asian Economic Development Institute, the Asian Development Bank, and the Asian Industrial Development Council were hastened by it.

(10) It convened a ministerial meeting of Asian members in 1963 for the purpose of speeding up Asian economic co-operation, and for urging them to speak with one voice at the UN conference on Trade and Development early in 1964. Though the Ecafe has done very useful work, a separate organisation like the OEEC is required to create a wide forum for all Asia with scope for sub-groupings. This could speed up the equally important formation of selected groups depending on techno-economic surveys. This may be determined and organised officially, but time is a factor since plans will get distorted by delays. Ceylon may therefore take the initiative in this and consummate the ideal.

7. Conclusion

The main purport of this chapter has been to examine the scope and manner of a regional preferential trading system that would suit the needs of Ceylon in order to promote her economic development and solve her balance of payments disequilibrium. The problems of foreign trade necessitate a complete reorganisation of the internal economy of the country through State planning and direction. A balanced development of the economy is the sure means of raising employment and standards of living and of utilising both human and natural resources to the maximum, but the process of industrialisation is inhibited by the problems of finance and market. A regional preferential trading system is therefore the best means of ensuring an expansion of the economy and at the same time alleviating the balance of payments problem. A careful choice has to be made of the countries forming the area and of the commodities seeking preference so that regional complementarity and self-sufficiency may be attained to a fair degree by wise location of basic and other manufacturing and agricultural industries. Attention should be paid more to future patterns of industry and cost structure than to present trends. The idea of an immediate common market or supra-national institutions is far from our minds. Nor is our judgement limited by the present quantum of intraregional trade, or by the possibilities or otherwise of expanding the intra-regional trade of agricultural products alone. We have to look to the industrial development of the region in the future as well. The international position of the primary products has also to be strengthened. Mutual benefits have also to be gauged according to the size of a country and the rate of its development. The countries of the area have also to canalise their internal resources and external finance, and adopt uniform policies to secure the maximum cost/benefit. It would thus appear that the pattern of foreign trade would adjust itself to a changing economic structure and promote greater intraregional trade, especially of manufactures, so that greater equilibrium is restored to the balance of payments and better security and stability to the economy.

CHAPTER XIV

CONCLUSION

1. A Resume

We have thus discussed the problems of development of a small Asian country like Ceylon whose foreign trade forms an important sector of the economy and whose population is increasing at a rapid rate while the per capita income has of late remained stagnant. Its excessive deficit financing and high rate of consumption have caused a drain on her foreign reserves and led to severe import restrictions and a consequent rise in the cost of living. The problem of the balance of payments is not a question of merely maintaining the foreign accounts in liquidity or of cutting down imports to balance it. It is much more than that. Exports have to be expanding to keep pace with not only current import needs but also to meet the requirements of a developing economy. The traditional pattern cannot satisfy this, and hence the economy has to be diversified and developed. The growing work-force has to be found employment, and agriculture has limits to intensive and extensive expansion. Balanced development becomes necessary and hence industrialisation has an important role to play. This alone could provide employment opportunities and raise the standards of living. But since capital formation is low, it therefore becomes imperative that the problems of investment and productivity take high priority, especially as Ceylon is forced to adopt an open economy. Though domestic resources have to be mobilised the need for foreign capital becomes urgent. It is argued here that it is possible to secure adequate foreign governmental and private capital to maintain a high rate of investment to cope with the growth rate visualised by the Ten-Year Plan of Ceylon for 1959 - 68. Thus a high capital/output ratio alone could raise the per capita income and create secondary effects. This should be our main criterion. Otherwise the present position would force the investment ratio to a level that would keep the rate of growth very low. The alternative is to cut consumption drastically or face rising prices or seek foreign aid of a high order. Hence the important place for foreign capital for the development of large-scale industries which again raises the problem of the market for which regional economic co-operation alone seems to provide the answer. Thus the financing and pattern of development as pictured here would eventually alter the composition and direction of the foreign trade of the country and restore equilibrium in its balance of payments. And the economic and commercial policies discussed here offer the best course for a developing economy like Ceylon to provide higher standards and fuller employment. This should be the concern of advanced countries as well, who should take a new look at the problem. Though bilateral trade agreements have softened the impact of an adverse trade movement and offer possibilities of limited expansion in the future, the multilateral trade area still offers scope for stability and expansion in the future for both traditional and new exports if trade barriers are removed and reciprocity is not insisted upon by the developed countries. The present international atmosphere augers well for the developing countries, though it is doubtful how far the utterances of pious platitudes would be translated into action by the advanced countries. The international conference in March, 1964, at Gevena, organised by the UN, should have tested their sincerity. And if the GATT cannot do it, it is best to have a new world trade organisation to lay the foundations for the eeonomic development of backward countries. Meanwhile the countries of Asia and the Far East must learn to act together quickly, and overcome their differences, because time is a factor they must reckon. The development and trade of a small country like Ceylon therefore very much depends on the co-ordination of policies on the national, regional and international levels. The new consciousness that is emerging should be able to harness the forces of international collaboration and capitalise on it for the development of each country. And there is no other better instrument than international trade and movement of capital to foster better understanding between nations and bring them together for mutual benefit and welfare.

2. Summary of Proposals

We may sum up the eight-point policies discussed here as the way out of the present economic impasse in which Ceylon finds herself at the moment. They include economic and commercial policies, both domestic and foreign.

1. The planning of development for the diversification of the economy and for the reallocation of resources. It would also help in the co-ordination of the plans of the countries of the Ecafe

region so as to overcome the bottlenecks of the market problem. Planning could be made more effective through decentralisation and public participation.

2. The pattern of development based on balanced economic development so that intra-and trans-sectoral balance is achieved as much as inter-sectoral balance. This would assure a rapid and cumulative growth of the economy. There should be special emphasis on industrialisation as the key solution to the problems of employment and standards of living. This would give as much importance to export promotion as for import substitution and raise the per capita income.

3. The financing of development through changes in fiscal and budgetary policies to curb consumption and to increase investments. This applies to Government expenditure with special reference to social services, especially food subsidy. There is the need to create a surplus on the current revenue for capital formation besides relying on domestic and foreign borrowing and on created credit. Interest rates may be raised and a capital market developed to promote productive investments so that speculative dealings may be discouraged. Thus domestic resources have to be mobilised.

4. Foreign capital investment on a large scale can alone assure rapid development and raise the per capita income appreciably. Private capital must come in as much as Governmental or Institutional capital. The capacity to absorb and repay will be there because Ceylon has a high standard of living and an important sector of foreign trade. But she

needs an industrial policy statement to assure foreign capital investment and repatriation.

5. Import restrictions through the use of tariffs instead of quotas and licenses. It could also serve the purpose of protection for the agricultural and industrial development of the country. It would prevent malpractices, keep down domestic prices, and earn revenue for the Exchequer. But this should be administered by an independant Tariff Board or Commission in conjunction with Cabinet policy. The present tariff policy must be changed to suit future needs and be made more definite and clear.

6. Bilateral trade has its advantages both for exports and imports, and also helps in curbing monopolies. It helps in improving the volume, prices, and value of foreign trade, and in diversifying it. It also helps in developing new exports. But bilateral clearing accounts must be given a multilateral look and improved in many ways. The limitations of bilateral trade must however be noted and weighed in each instance.

7. Multilateral trade with the West offers still the best scope for the future, both for the traditional exports and for newly developing industrial manufactures of certain categories and varieties. A "double standard" in commercial policy could ensure this possibility. The West has to remove all barriers against the products of the underdeveloped countries without insisting on reciprocity. The prospects for this state of affairs are improving. This could be strengthened through Commodity

Agreement Schemes and Compensatory Finance Schemes under the UN.

8. Regional trade development to assure a market for a minimum production unit of economical size is the real remedy to the situation. The scope is great, but it requires a techno-economic survey. The area and forms of co-operation have to be determined and worked out regionally.

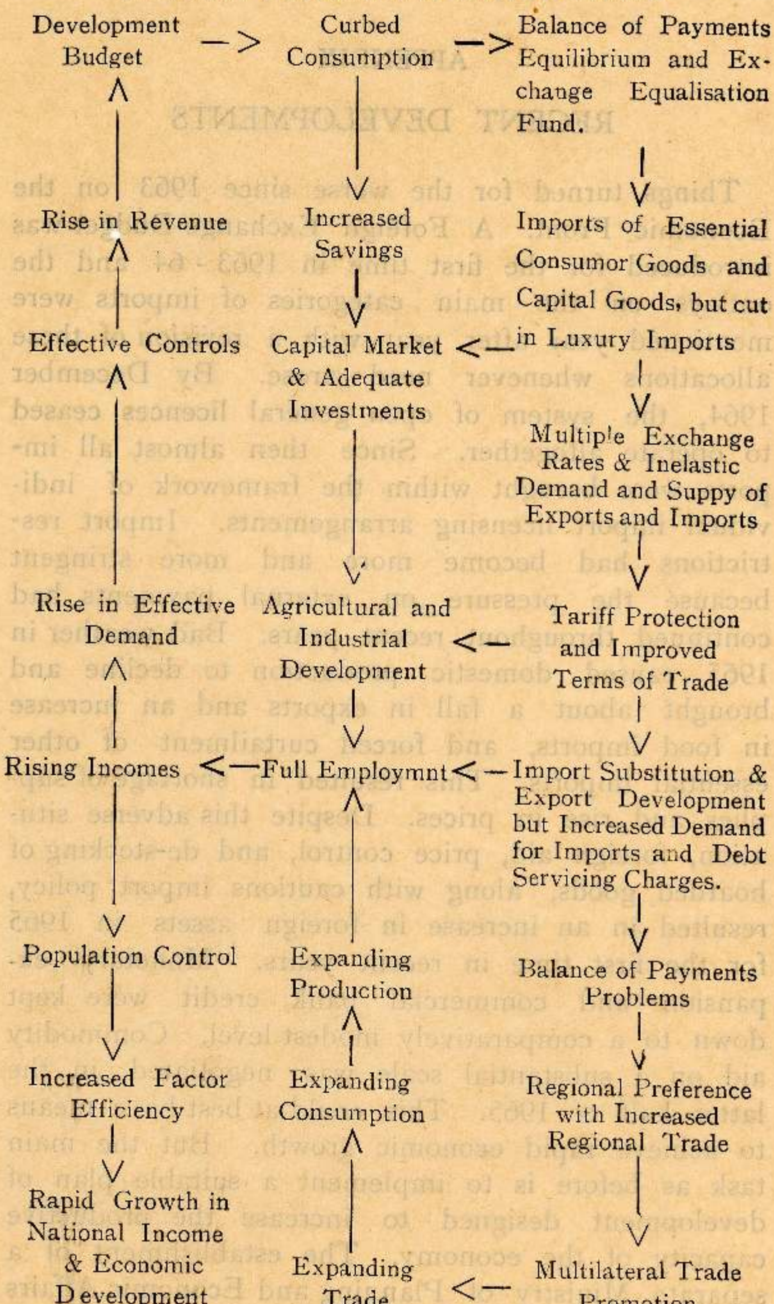
3. Circular Causation

The effects of the above policies may be indicated diagramatically as follows:

ECONOMIC STAGNATION (REAL)

Deficit Budget →	Excess Consumption →	Deficit Balance of Payments
↑	↓	↓
Fall in Revenue	Insufficient Savings	Depleting Balances
↑	↓	↓
Fall in Effective Demand	Inadequate Investment	Exchange & Trade Control
↑	↓	↓
Falling Incomes ←	Unemployment & Idle Resources ←	Rise in Prices and Costs and Restriction of Consumption in Real Terms.

ECONOMIC DEVELOPMENT (HYPOTHETICAL)



APPENDIX

RECENT DEVELOPMENTS

Things turned for the worse since 1963 on the Economic Front. A Foreign Exchange Budget was introduced for the first time in 1963 - 64 and the outlays on the main categories of imports were mentioned year after year with a revision of these allocations whenever need arose. By December 1964, the system of open general licences ceased to operate altogether. Since then almost all imports were brought within the framework of individual import licensing arrangements. Import restrictions had become more and more stringent because the pressure on external payments had continued throughout recent years. Bad weather in 1965 caused domestic production to decline and brought about a fall in exports and an increase in food imports, and forced curtailment of other essential imports. This resulted in shortage of supplies and rise in prices. Despite this adverse situation, foreign aid, price control, and de-stocking of hoarded goods, along with cautions import policy, resulted in an increase in foreign assets in 1965 for the first time in recent years. Monetary expansion and commercial bank credit were kept down to a comparatively modest level. Commodity aid on a substantial scale was negotiated in the latter half of 1965. This could at best be a means to achieve rapid economic growth. But the main task as before is to implement a suitable plan of development designed to increase the productive capacity of the economy. The establishment of a separate Ministry of Planning and Economic Affairs in 1965, it is hoped, will help in a vigorous and properly planned production drive, and thereby solve the problems confronting the economy of Ceylon.

The eight-point solution discussed in this book to promote development remains even now a wish to be consummated. Yet in recent years some effort has been made to give effect to some of the broad measures to change the face of the economy. The World Bank had sent some experts on various economic problems to assess the situation and advise the respective authorities. The Ministry of Planning has made a beginning in planning by streamlining its work through channels of planning, implementation, and foreign aid. All Ministries are now responsible to it unlike previously. The Bank Mission had emphasised the need to curb consumption and accelerate capital formation, and stressed the undue burden of the rice subsidy. Commodity aid for rehabilitation, and foreign aid for major projects, were obtained. Agricultural and Industrial production has been promoted since 1961 with vigour and enthusiasm, but administrative bottlenecks and foreign exchange difficulties have created uncertainties and hampered smooth and swift development. Tariff policy is yet to be crystalised, bilateral trade expanded, multilateral trade made more meaningful by the GATT, and regional co-operation initiated. All these are yet to be forged for the promotion of industrial development and export drive both in traditional and new commodities.

Meanwhile deficit financing of the budget leading to excessive monetary expansion must cease. This includes Government borrowing from the banking system. Financial stability has to be attained by curbing social expenditure, especially the food subsidy. Losses incurred in public utility services and public corporations must be eliminated. The IMF funds should not be used other than for helping internal financial stability or for increasing investments. Domestic savings must be accelerated in order to limit import demand and to finance the local components of development programmes. Foreign exchange must be so used as to minimise consumption to essentials and to increase investment and output. Development programmes must be planned and executed in order to speed up economic growth and maximise returns, and improve the balance of payments. And lastly import controls and price controls must be efficiently administered. Natural calamities and fall in export prices have added to the difficulties of overcoming the balance of payments problem and finding the money for projects. Yet the situation thus created must be utilised for producing for the home market, and also for export promotion. These are but some of the short-term measures urgently needed to make planning and development effective. But notwithstanding fortuitous circumstances beyond human control, the horizon is getting brighter for a more prosperous and happy economic future.

STATISTICAL TABLES

AND

BIBLIOGRAPHY

I. Indices of Trade. (1948 = 100)

Year	Value		Volume		Price		Terms of Trade
	Exports	Imports	Exports	Imports	Exports	Imports	
1938	28	24	88	92	36	26	138
1939	32	24	86	95	41	25	164
1940	38	29	87	94	44	30	147
1941	42	29	85	86	48	35	137
1942	53	30	96	57	56	52	108
1943	57	45	97	64	59	73	81
1944	67	52	94	66	68	87	78
1945	66	63	84	74	72	81	89
1946	76	70	94	79	78	83	94
1947	88	97	89	98	100	94	106
1948	100	100	100	100	100	100	100
1949	105	104	100	109	107	96	111
1950	155	117	110	121	144	98	147
1951	188	157	112	135	175	116	151
1952	149	171	117	138	136	125	109
1953	155	162	120	144	139	114	122
1954	179	141	124	143	155	100	155
1955	192	147	131	140	162	101	160
1956	172	164	125	153	152	113	135
1957	166	181	119	161	145	109	133
1958	169	173	128	163	142	95	149
1959	173	202	126	180	148	104	142
1960	181	197	132	170	148	104	142
1961	171	171	138	158	135	102	132
1962	179	167	148	154	129	100	129
1963	171	150	143	136	132	105	126
1964	186	199	154	186	132	114	116

Source: Central Bank Report, 1965.

II. Balance of Payments (1950—1965)

(In Million Rupees)

Year	Merchandise	Services	Donations	Current Account Balance	Private Capital	Changes in Foreign Reserves*	Other Official Capital*	Errors & Omissions
1950	+329	—109	— 73	+147	—20	—140		+13
1951	+342	—150	— 76	+116	—38	—107		+29
1952	—202	—140	—104	—446	+25	+372		+49
1953	— 26	— 77	— 55	—158	—38	+198		— 2
1954	+431	— 83	— 43	+305	—49	—228		—28
1955	+516	—132	— 61	+323	—57	—274		+ 8
1956	+314	—176	— 56	+ 82	—20	— 59		— 3
1957	+ 28	—184	— 40	—196	—38	+211	+ 16	+ 7
1958	+ 8	—137	— 23	—152	— 4	+156	+ 26	—26
1959	— 81	—115	— 12	—208	+ 2	+177	+ 23	+ 6
1960	—210	— 32	+ 22	—220	— 5	+193	+ 3	+29
1961	— 87	— 18	+ 11	— 94	+ 6	+ 10	+ 97	—19
1962	—143	— 4	+ 7	—140	— 2	+ 28	+ 83	+31
1963	—161	— 20	+ 13	—168	+ 1	+ 42	+121	+ 4
1964	—193	— 7	+ 40	—160	— 8	+111	+ 65	— 8
1965†	— 5	+ 16	+ 36	+ 47	—17	— 89	+ 50	+ 9

* Plus sign represents a decrease in assets or an increase in liabilities.

† Provisional.

Source: Central Bank Report, 1965.

III. Deficit Financing and External Disequilibrium

(In Million Rs.)

Year	Treasury Bills	Money Supply	Govt's cash Deficits	Changes in External Assets	Balance of Trade	Terms of Trade
1938	—	—	—	—	+ 48	138
1939	—	—	—	—	− 86	164
1940	—	—	—	− 49·3	−104	147
1941	—	—	—	+110·3	+137	137
1942	10·0	430·7	—	+ 86·7	+235	108
1943	9·5	438·3	—	+150·2	+123	81
1944	12·0	616·1	—	+288·4	+162	78
1945	9·0	729·4	—	+299·9	+ 45	89
1946	10·0	660·8	+ 63	− 49·6	+ 69	94
1947	—	562·5	−164·9	−263·0	− 74	106
1948	24·0	606·8	− 59·9	+ 41·7	+ 17	100
1949	16·2	649·4	−113·1	− 55·3	+ 34	111
1950	78·6	910·7	−154·3	+142·9	+396	147
1951	30·0	1006·2	− 47.8	+108·7	+345	151
1952	92·5	895·8	−257·1	−348·4	−200	109
1953	184·0	826·8	−231·9	−229·7	− 40	122
1954	105·0	957·1	+ 33·7	+288·0	+412	155
1955	60·0	1072·9	+127·6	+259·5	+480	160
1956	68·0	1126·8	− 1·2	+ 24·6	+106	135
1957	65·0	1040·1	−196·4	−236·2	−122	133
1958	140·0	1076·8	−222·3	− 59·8	− 6	149
1959	320·0	1177·7	−413·4	−194·5	−251	142
1960	550·0	1208·9	−417·5	−207·6	−128	142
1961	750·0	1288·6	−462·5	− 9·6	+ 30	132
1962	1000·0	1342·7	−456·1	− 27·8	+148	129
1963	1125·0	1506·0	−391·7	− 41·6	+241	126
1964	1250·0	1621·8	−461·7	−111·3	− 99	116
1965	1300·0	1715·7	−442·5	+ 88·9	n. a.	n. a.

Source: Central Bank Report, 1965.

IV. **Production Indices** (Base 1934 - 38 = 100)

Year	Tea	Rubber	Coconut	Paddy	Cocoa	Highland Crops	All Crops	All Industries (Base 1952 - 1956 = 100)
1949	130·4	147·2	80·0	138·1	65·2	60·1	120·0	—
1950	133·7	186·7	95·5	131·5	59·7	78·6	131·1	—
1951	142·5	172·7	108·4	131·5	70·8	92·2	136·4	—
1952	138·4	158·7	119·3	172·7	80·6	98·1	139·2	—
1953	149·8	162·2	113·1	130·9	76·4	97·5	139·4	—
1954	160·2	154·5	109·3	185·9	81·9	99·6	148·5	—
1955	166·0	154·3	129·4	213·4	69·4	107·6	158·6	—
1956	164·0	156·9	129·4	160·8	79·2	85·6	151·4	—
1957	173·7	161·5	129·4	182·9	72·2	70·6	158·4	108·7
1958	180·4	164·8	97·5	212·8	72·2	73·7	158·8	114·2
1959	180·4	150·8	106·8	217·8	73·2	66·7	158·9	125·1
1960	189·8	160·0	100·0	257·2	60·8	122·5	170·2	135·0
1961	198·8	158·0	121·0	258·2	73·1	127·2	178·9	141·1
1962	204·0	168·4	130·8	287·3	73·8	120·0	187·8	151·7
1963	242·3*	169·6*	137·0*	293·8*	70·9*	130·7*	194·0*	158·5
1964	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.	171·7
1965	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.	n. a.	170·4

*Provisional

Source: Statistical Abstract of Ceylon, 1964.

V (a). Foreign Private Capital

	Inflow of Foreign private capital into Ceylon	Outflow of Foreign private capital from Ceylon	Profits and Dividents sent out of Ceylon by foreign enterprises
	Rs. Million	Rs. Million	Rs. Million
1948	n. a.	n. a.	75·0
1949	3·4	27·5	35·0
1950	3·6	36·1	67·4
1951	8·7	72·5	84·4
1952	7·1	25·9	60·6
1953	3·5	28·2	54·3
1954	11·3	31·3	61·2
1955	3·4	52·4	84·9
1956	5·3	51·9	83·3
1957	3·1	44·5	81·4
1958	3·8	27·4	66·6
1959	1·9	13·6	58.4
1960	3·7	8·8	63·9
1961	3·3	10·9	49·5
1962	7·4	8·9	48·6

Source: Budget Speech of 1963.

V (b) Loans and Grants from Foreign Countries as at July 1963.

(Rs. Million)

	Country	Grants	Loans	Total	Allocated to Projects	Unallocated Balance
1.	Australia	37·7	—	37·7	35·7	2·0
2.	Britain	3·6	33·3	36·9	36·9	—
3.	Canada	111·0	57·2	168·2	150·5	17·7
4.	China	125·0	50·5	175·0	42·6	132·4
5.	Czechoslovakia	—	18·0	18·0	18·0	—
6.	Japan	1·0	—	1·0	1·0	—
7.	N. Zealand	12·5	—	12·5	12·5	—
8.	U. S. A.	68·9	75·2	144·1	115·9	28·2
9.	UN & Agencies	12·5	—	12·5	12·5	—
10.	I. B. R. D.	—	184·8	184·8	184·8	—
11.	W. Germany	8·9	48·0	56·9	56·9	—
12.	USSR	—	142·8	142·8	83·7	59·1
13.	Yogoslavia	—	73·3	73·3	5·8	67·5
14.	Poland	—	38·0	38·0	3·5	34·5
15.	India	—	50·0	50·0	—	50·0
	Total	381·1	770·6	1,151·7	760·3	391·4

Source : Budget Speech of 1963

VI (a)

Share in Intraregional Trade of Ecafe Countries

(1957—58 average)

Country	Exports Percent	Imports Percent
Burma	4·4	3·1
Cambodia	0·6	0·9
Ceylon	1·5	4·3
China: Taiwan	3·5	2·3
Malaya and Singapore	13.9	21·2
Hongkong	8·4	12·1
India	6·5	9·3
Indonesia	11·2	6·2
Iran	4·9	1·9
Japan	29·1	20·2
Republic of Korea	0·4	1·2
Laos	0·02	0·6
North Borneo	0·7	0·5
Pakistan	2·6	2·5
Phillippines	2·9	3·7
Sarawak	2·8	2·9
Thailand	6·1	5·0
South Vietnam.	0·5	2·1
Total:	100·02	100·0

Source: Ecafe Bulletin, June 1961, page 21.

VI (b) Importance of Intraregional Trade

Trade with Western Europe and with the United States of Ecafe Countries

	EXPORTS				IMPORTS			
	1957	1958	1959	Average (1957-59)	1957	1958	1959	Average (1957-59)
	(As percent of total of exports of Ecafe countries)				As percent of total of imports of Ecafe countries)			
Intra-regional	36·5	33·6	32·0	34·0	31·2	34·3	34·4	33·3
Western Europe	24·8	26·0	22·6	24·5	25·2	24·1	23·7	24·0
United States	16·3	17·6	22·0	18·6	25·7	24·1	22·1	24·0

Source: Ecafe: Asian Economic Statistics.

VI (c) Ecafe Exports of Certain Principal Commodities to the World and to other Ecafe Countries

Commodity	Total Exports of Ecafe Countries: Value (M'n $)	% of Total Ecafe Exports	Intraregional Exports: Value (M'n $)	% of Total Intra-regional Exports	As % of Total Exports
Textiles	1280·3	12·6	409·2	11·9	32·0
Rubber	1129·1	11·1	230·3	6·7	20·4
Machinery	770·2	7·6	203·9	5·9	26·5
Petroleum	647·5	6·4	244·9	7·1	37·8
Tea	535·1	5·3	25·5	0·7	4·8
Rice	365·3	3·6	277·5	8·1	76·6
Copra	264·8	2·6	73·4	2·1	27·7
Sugar	215·3	2·1	93·7	2·7	43·5
Tin	158·5	1·6	21·4	0·6	13·4
Cotton	123·7	1·2	60·9	1·8	49·0
Coconut Oil	59·2	0·6	10·3	0·3	17·2
Pepper	34·1	0·3	8·6	0·2	25·4
Others	4542·8	44·9	1782·2	51·8	34·3
Total	10,125·9	100·0	3442·4	100·0	34·0

Source : Ecafe Bulletin, June 1961, page 23.

VI (d) Distribution of Ceylon's Trade with S. E. Asia (1958 - 1960 Average)

(Value in Rupees)

Country	Imports	Exports	Balance	% of Ceylon's Total Imports	% of Ceylon's Total Eeports
Burma	118,692,744	3,222,515	−115,470,229	6·3	0·2
India	245,072,870	43,507,972	−201,564,898	12·9	2·5
Indonesia	5,144,506	1,174,092	− 3,970,414	0.3	0.1
Malaya	1,788,846	2,595,488	+ 806,642	0·1	0·1
Pakistan	19,617,863	14,971,836	− 4,646,027	1·0	0·8
Singapore	12,484,086	3,892,102	− 8,591,984	0·7	0·2
Total for this Group	402,800,915	69,364,005	−333,436,910	21·3	3·9
Ceylon's Total Trade	1,893,728,401	1,765,358,446	—	—	—

Source: Commerce Department, Ceylon.

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