A SHORT ECONOMIC SURVEY OF CEYLON

By
Professor
B. B. DAS GUPTA

THE ASSOCIATED NEWSPAPERS OF CEYLON LTD.
COLOMBO

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B. DAS GUPTA, M.A., Ph.D., B.Sc.(Econ.)
rofessor of Economics, University of Ceylon

The Associated Newspapers of Ceylon Limited, Lake House, Colombo, and Langham House, Regent Street, London, W. I

First Edition 1949

Printers:
CEYLON DAILY NEWS PRESS
LAKE HOUSE, COLOMBO

PREFACE

THIS little essay was prepared in March last, substantially in its present form though under a different title, for submission to the Economic Commission for Asia and the Far East. It is now published with certain additions and alterations so as to bring the text up to date. There is so little published material available on the economy of Ceylon that, though short and sketchy, it is hoped that it will be of some interest and use to readers.

B. B. DAS GUPTA

University of Ceylon,
Colombo.
September 1948.

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CHAPTER I

POST-WAR TRENDS AND THE POSITION IN 1947

FOR Ceylon, as for the world generally, the end of the war saw the conclusion of one economic chapter and the beginning of another. 1947 was only a part of this new Post-War Chapter. The forces which began to impinge on the economy at the end of the war continued and in some respects even gained in strength in this year. The year therefore cannot be viewed or understood in isolation. A broad account of the whole post-war period is necessary.

For Ceylon, the new forces were in general very unfavourable. Foreign income, which directly or indirectly constituted the bulk of the national income, began to fall rapidly. On the other hand foreign expenditure, which formed the bulk of the country's essential expenditure, began to rise. The whole economy therefore marched downwards.

This is reflected clearly in the country's balance of payments which fell consistently. From a handsome surplus in 1945 it turned into a heavy deficit in 1947. For a country which practically lives by foreign trade, no economic indices could be more significant. It represented falling national income and a march towards greater poverty and insecurity.

Ceylon's economy, as is well known, is an undiversified agricultural export economy. Not only does she produce only a few things, but produces them almost entirely for export. Of the four major products, tea, rubber, coconut and rice, all but rice are mainly exported. Tea and rubber, which are far and away the biggest industries, are almost wholesale exported. Of coconuts and coconut-products, about half is retained for home consumption and half exported. Rice is of course entirely retained. But it is a much smaller industry than tea, rubber or coconut. The rice output neither contributes much to the national income nor to national rice needs. Normally the country grows only between 1/4 and 1/3 of its rice requirements. The balance therefore has to be imported.

The whole economy thus hangs on exports. How important exports are is shown by the fact that normally half of the national income is directly produced by them.* Directly and indirectly together, their share is much greater, because most of the other industries and services are either created by or ancillary to them.

The country has hardly any invisible exports. On the contrary, there is a fairly heavy burden of invisible imports representing return on foreign capital invested in the country, payment for shipping, insurance, personal services, etc.

The whole national income, jointly from output exported and output retained, is small. It was Rs. 95.78 per head in 1938 and Rs. 251.65 per head in 1947, which considering the rise in prices is no real rise at all.

Since so little is produced for home consumption, the country must have a fairly high level of imports. In other words, its exports must balance (if not exceed) its imports (visible and invisible) *at a high level*. Balancing at any level is not enough. If, for instance, exports and imports both fell to zero, they would beautifully balance, but other things being equal, no greater disaster could perhaps be conceived for the country. The balance of payments, as everybody knows, always tends to balance at one level or another, but it is important what that level is.

The table below sums up the balance of payments figures for 1938 and the three post-war years.**

*See Chapter II on National Income

**Estimates by Mr. K. Williams. See also Chapter XI.

TABLE I

BALANCE OF PAYMENTS (CURRENT ACCOUNT)

Rs. Million

	EXPORTS			IMPORTS			BALANCE
	Visible	Invisible	Total	Visible	Invisible	Total	
1938	289	26	315	234	108	342	—27
1945	666	471	1,137	608	215	823	+314
1946	765	195	960	684	224	908	+52
1947	889	80	969	972	193	1,165	—196

It will be seen that the country had a substantial surplus in 1945, an almost even balance in 1946 and a heavy deficit in 1947. The deficit has been met by drawing upon foreign balances which the country accumulated during the war at great cost. This in itself is no small misfortune, for the reserves which are by no means large for an undeveloped country, could have been better spent in purchasing development goods. The present imports are mostly consumption (though essential consumption) goods. But what makes the position worse is that the deficit has arisen in spite of the fact that the real level of imports is still very low. By value, of course, both exports and imports are much higher than in 1938. But actually import prices have risen 388% and export prices 230%, and by quantity the 1947 imports are really 125% of that of 1938 and 1947 exports 114% of that of 1938.* Thus although imports are not far from the 1938 quantity (actually they were 5% less in 1946), the country has still incurred a deficit. If the deficit occurred at a high level of imports, if, for instance, it accompanied the importation of a good deal of luxury goods, its correction would have been less difficult and would have caused less real sacrifice. But imports are now still very near the 1938 level. That level can hardly be called a high level. It was almost the minimum necessary for the country.

That in spite of a greater rise in their price, imports should have still exceeded exports, reveals another inherent weakness in the country's economy. It shows that the local demand for imports is more inelastic than the foreign demand for exports. This is not surprising, since the

*For details see Chapter XI.

imports unlike the exports largely consist of primary necessities like food and clothing. A fall in the terms of trade is therefore not compensated by a change in quantities traded.

There is a minimum which the country must import for its very existence. Yet, although imports are already near that minimum level, exports cannot purchase them. It will be very difficult to cut imports any further. Already the nation is on a very low level of food and clothing. The food bill itself (food, drink and tobacco) swallowed up in 1947, 59% of the total foreign income earned by exports. If the gap between exports and imports widens at this rate, the country will soon have to face starvation.

The situation would have been less serious if the country had large foreign funds out of which it could meet the deficit. But its foreign assets are very limited. The balances which it accumulated during the war have already been largely liquidated. The total stood at the end of 1947 at Rs. 791 million which could only buy 81% of the 1947 imports. These remaining foreign assets, it is well to remember, are more than counter-balanced by the foreign debt of the country. At the end of 1947, foreign debt in the shape of foreign capital invested in sterling and rupee companies in the country was probably not below Rs. 1,200 million. A country which is a net debtor has little scope of saving itself by disinvestment of foreign assets.

CAUSES OF THE DECLINE

The cause of the decline is, broadly, falling demand for exports and rising cost of imports. Both factors are unfortunately beyond the country's control. The exports are sold competitively in the world market and Ceylon, a small supplier, has little say in determining their price and quantity. The price of imports also is settled by world conditions of demand and supply, and Ceylon, a small buyer, can do little to alter it. She is therefore helplessly at the mercy of foreign economic winds in this respect. They bring her fortune or misfortune. This is obviously a weakness inherent in an economy living on a small range of exports.

During the war, the foreign winds became suddenly very favourable. All exports were in great demand. At one stage Ceylon became the sole

supplier of natural rubber to the Allies. Not only did her exports boom and she was selling at a fairly good price* all she could produce, but large sums of money were also spent *within the country* by the Allies on military objects of one kind or another. This expenditure at its peak is estimated to have been Rs. 435 million in a year or nearly 1/4th of the estimated national income of the time. The country's aggregate foreign income thus considerably increased, and with it its total national income.

Actually, however, the boom was not so solid as it looked. It had a heavy though rather concealed debit side. In the first place, it was accompanied by much human suffering, much sweat and tears. Although foreign income grew, not much of it could be converted into foreign goods. The country was forced to go without many essential imports which were either not simply available or not allowed to come. The shortage of food and clothing particularly caused great hardship. Since the foreign income could not be spent, it piled up as foreign balances. The size of these balances, which amounted in 1945 to Rs. 1,138 million, was thus a measure not so much of prosperity but of privation caused to the country.

Secondly, in producing the foreign income, the productive equipment of the country was recklessly and destructively used. Estates were starved of fertilisers and factories of replacements. The country, in other words, used up much of its capital. The rubber industry was perhaps the worst sufferer in this respect. It is estimated that about 1/4th of the trees were slaughter-tapped. In the coconut industry also replanting was badly neglected. It is true that Ceylon did not suffer any direct damage by the war, but for a poor country like her, this capital depreciation was quite a heavy blow. She emerged from the war much poorer in equipment than, for instance, Australia which was allowed to import capital goods of all kinds and so could expand and improve her industries.

Lastly, internal inflation by which Allied purchases in Ceylon were mainly financed, damaged the economy in many ways. Money incomes in many cases could not keep pace with the rise in living costs. Many classes of earners therefore suffered. Besides disturbing

*Actually export prices were kept pegged at a much lower level than justified by supply and demand conditions.

mainly depended, was a very slow, difficult and expensive process. Although, therefore, some progress was made (according to one official estimate* the rice output in 1946 was almost double that of 1938), relatively to the needs of the country, self-sufficiency or substantial reduction of imports was still far off.

A few manufacturing industries, all designed for the home market and mostly under Government ownership, had been started during the war. They did fairly well in the sheltered market created by the war. But after the war, faced with the competition of imports, their profits and production tended to fall. They could not be expected to make any important contribution towards lifting the balance of payments.

It may be mentioned here that development plans took more concrete form in 1948. In his budget speech in July 1948, the Minister of Finance outlined a six-year plan of economic development to be completed in 1952—53. The plan was primarily designed to make the Island "self-supporting in essential foods and in the articles necessary for clothing and housing". In the field of agriculture, the plan aimed at (*a*) improvement in technique and yields and (*b*) expansion of the area of cultivation. The target was to bring 131,000 acres of new land under cultivation in six years. The most important of the agricultural schemes was the Gal Oya multiple-purpose river control scheme which aimed at colonization (by cultivators) of 65,000 acres. Animal husbandry also was to be improved, increasing (among other things) the milk production of the country up to 70 million gallons a year.

In the field of industries, the plan included the creation or expansion of 9 Government-owned factories. Their output targets, estimated costs and employment capacities were defined. The further development of cottage industries was also contemplated, but the plan did not specify here quantitatively targets or investments. Finance for this general six-year plan was to be obtained from loan funds, taxes and surpluses. No created money was contemplated.

Although more concrete than the Minister's Proposals of 1946, the new plan still remains nebulous and incomplete in many ways. For instance,

*How Lanka Fed Herself, 1947.

quantities (regarding output, investment, etc.) are given only for a few items, but not for all. Again, in the field of industries, the plan virtually limits itself to Government-owned industries, the sector of private enterprise being completely ignored. The question how the sinews of the plan in man-power, money, capital goods, foreign exchange, etc. are to be raised and the consequences of raising them in one way or another is also very insufficiently discussed. Again, no central planning department is proposed which is to watch the progress of the plan and integrate its various aspects. However, as a first step, it is a welcome move. It is to be hoped that it will fulfil its expectations.

One general obstacle to expansion of production was lack of capital and technical knowledge. The country was poor in both. In the past, development was done largely with foreign capital. But now it was neither easily available nor perhaps very welcome. The result was that the country had to depend mainly on its own slender savings. Even if the money was available, equipment and materials could not be ordered out quickly.

Another general difficulty, a legacy of the war, was inflation. Inflation, as already said, came to finance Allied war expenditure and war purchases in Ceylon. The note issue was increased against deposits of sterling in England and rupees in India. The total circulation rose from Rs. 53 million in 1939 to Rs. 449 million at the end of 1945, that is to say, more than eight times. In December 1947 it was Rs. 411.8 million. No wonder prices rose. As measured by the Colombo Working Class Cost of Living Index, the rise was from 104 in 1939 to 252 in 1947. Inflation encouraged imports and discouraged exports and home production in many ways. To encourage imports was also of course indirectly to discourage home production.

In the first place, relatively, inflation seems to have been higher in Ceylon than in the countries with which she traded. Consequently, the price-cost structure rose higher in Ceylon than in those countries. This discouraged exports and encouraged imports. It was of course by no means the only cause. Even if inflation was equal, it would not have prevented the fall in the demand for the country's *particular* exports or the rise in the costs of its *particular* imports. In other words, the particular goods which it bought and sold changed in price out of all proportion to relative inflation. But that unequal inflation, resulting in unequal change in the general price-cost structure, contributed to the disequilibrium of the balance of payments, cannot be doubted. It is difficult to see how without devaluation this particular deficit-inducing force can be removed. The Government apparently hopes that prices abroad will gradually move up and prices in Ceylon fall. But prices in Ceylon can only fall if production rises or money is withdrawn from circulation. Neither is an easy process. So far, there has been no deliberate contraction of currency. Contractions by net export (the method by which in exchange standards currency usually contracts) is precisely the painful process which the country wants to avoid. And as for increase of production, inflation itself is hampering it a lot.

Secondly, inflation created much pent-up demand which, after the war, sought outlet in imports. During the war, although money incomes went up, imports on which they could be spent were scarce. After the war imports were more available and the piled up unspent income rushed for them. This was independent of the rush for imports due to unequal price rises at home and abroad consequent on unequal inflation.

Thirdly, it thwarted and misdirected production. Although people had more money, they were not allowed to spend it freely on all articles. By rationing, price control, etc., expenditure on essential goods was largely restricted. The result was a diversion of expenditure on non-essential lines. In Ceylon's case, a good example was the effect of the controlled low price of rice. While it helped the consumer, it gave no incentive to the producer to expand production. Further, the consumer's expenditure on rice and other essential goods being kept low (by low price and low ration), he spent more of his income on non-essential things on which there was no control on spending. The result was a distortion of production. This has happened wherever inflation has not been allowed to freely work out its effects—that is to say, wherever there has been "suppressed inflation", as it is now called. After putting more money in circulation, attempts have been made to drain it off and wall it in. But money will not be so easily contained. It will, in the words of the *Economist*, 'have its revenge'.* It will leak out in most unexpected and unpleasant directions.

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*Economist—December 20, 1947.

That control of price and consumption, whatever its immediate value, may have this unhealthy effect in economies where prices still largely govern production, is now well recognized. Such control, to fulfil its ends, should cover all prices and consumption and be also accompanied by production control on a planned basis. This is one reason, among others, why all over the world some reaction is taking place against such control. In Ceylon, the most notable reaction has again been in the case of rice. Early in 1948 the control of price, consumption and procurement was considerably relaxed. The consumer was guaranteed a small rationed supply at a low subsidised price, but he was permitted to buy extra quantities in the open market at higher prices. The producer also was freed from his obligation to sell all his output to the Government (after retaining a portion for his own consumption needs) at a controlled price. He could now sell his whole output in the open market. Relaxation of food control was followed by relaxation of clothing control. On the whole 1948 has seen already an appreciable reduction of controls.

Lastly, inflation produced some labour discontent since wages in all cases did not rise as high as cost of living. This labour discontent has checked production in no small way. The man-hours lost by strikes alone have been large. The loss by indifference to work of course cannot be estimated at all.

MEASURES TO DISTRIBUTE THE BURDEN

Since thus it was impossible to correct the deficit by an immediate increase of production, the economy had to accept the blow and adjust itself to it as best it could. Various measures therefore were taken to lighten and spread the burden. The more important were the following:

1. Since aggregate imports had to be less, the more they consisted of essentials the better. Non-essentials therefore had to be cut out ruthlessly. The instruments by which this was done were import and exchange control and tariffs.

2. Goods in short supply, whether imported or local, had to meet the country's needs first of all. Therefore export control was established and the export of all essential goods was prohibited or regulated.

3. The limited (imported plus local) supply had to be shared fairly between all. This was done by price control, rationing and allocations. They applied largely to consumption goods, but important production goods also were included. The supply of fertilisers for instance was rationed out among the chief agricultural industries. To maintain low prices, subsidies were given in the case of foodstuffs.

4. To make procurement and distribution more effective, the State took over the work in large measure. The import of essential foodstuffs, for instance, was made a State monopoly. The State also largely imported textiles. The local output of rice (after leaving a margin for the producer) was entirely taken over by the State for distribution to the people.

5. To reduce the demand for imports (and also to fight inflation generally) attempts were made by taxes and loans to pump out as much excess money as possible. Savings drives were conducted for this purpose from time to time. These measures, however, did not have much effect.

6. Special assistance had to be given to the Rubber industry after its catastrophic slump in 1947. This was done by maintaining a floor price by heavy subsidies. The subsidy, it may be noted, was later removed in January 1948. But as long as it lasted it helped the industry to adjust itself to the new situation.

7. Unemployment relief had to be extended. Unemployment was of course inevitable when the export industries which provided the bulk of employment contracted in the aggregate, if not individually. But an additional factor was the demobilisation of man-power engaged in war services and war industries. From practically full employment in 1945, unemployment (as shown by registrations in the employment exchanges) stood in December 1947 at roughly 35,000. Many of course did not at all register.

Rationing, price, import, export and exchange control were of course not new. They had to be introduced during the war, though not for quite the same reason. During the war the country had enough income to buy imports, but imports were not available. In the post-war period

imports were available, but the country had not sufficient power to buy them.

Some of these measures also of course helped to increase production in certain ways, but they were primarily designed to distribute the burden of the declining balance of payments. In other words, they were meant to cushion the blow, rather than to prevent or overcome it.

THE SWING TO CONTROLLED ECONOMY

The controls changed the face of the economy to some extent. Before the war, the State seldom thought of controlling price, import or consumption in any way. But now the peculiar circumstances of the war and the post-war period compelled it to establish largely a regime of controls. Whatever circumstances prompted them, they indicated a change in the attitude of the State to economic life. Hitherto it had interfered very little with production or consumption. The system of private enterprise was allowed to function almost completely freely. But now, partly to meet a changed situation and partly consciously following a new ideology, there was a swing to planned and controlled economy. There was evidence of it in all directions. First, as already said, most of the new industries started during the war were State-owned. This itself was a new departure, as before the war the State took little active part in industry. Regarding future policy in this respect also, the Ministers' Post-War Development Proposals and the Report on Industrial Development by the Ministry of Labour, Industry and Commerce (both issued in 1946) made it clear that the policy of the Government was to nationalise the basic industries and adequately control (and where necessary, assist) the non-basic. Secondly, as also noted, apart from a hand in production, the State took over the import, internal procurement and distribution of many essential commodities. Lastly, there were these controls on price, import, export, exchange and consumption. The whole tendency was towards more control. It is doubtful if this tendency will ever be reversed. On the contrary, judging by the pronouncements of leading politicians and the results of the last elections when a large number of leftists were returned to Parliament, it will probably be strengthened. Capitalism may not be altogether scrapped, but it will probably be substantially modified. The tendency would have perhaps taken place in any case, war or no war, deficit or no deficit. But that the war and the deficit have hastened it cannot be doubted.

GOVERNMENT FINANCE

The new forces playing on the economy had their repercussions on Government finance. Since prices rose, normal Government expenditure also rose. But additional expenditure was also incurred on a very large scale to (*a*) assist farmers, fishermen and other producers to increase production, (*b*) finance the Government's own industrial undertakings many of which were not profit-making, (*c*) meet the cost of additional staff for the new Control Departments, (*d*) pay higher salaries and wages to all Government employees to compensate for increased cost of living, (*e*) subsidise the prices of the more important foodstuffs and in 1947 also the price of rubber, and (*f*) extend social services generally, in particular education and health services.

The last three represented re-distribution of national income by State action. Some re-distribution of course took place automatically as a result of the war and inflation. Inflation put up all money incomes more or less. But relatively, merchants and contractors who supplied military requirements probably gained the most. Labour engaged in war services and industries fared better than labour engaged in agriculture and non-war industries. As everywhere else, the worst sufferers were perhaps the white-collar workers in private and government service. It must be remembered, however, that although money incomes generally rose, real incomes did not do so in many cases.

The establishment of minimum wages in a number of trades and industries in 1946 and 1947 also had redistributional effects.

Although much re-distribution took place in this fashion independently of Government action, the main channel was Government subsidies on food and expanded State social services. Large sums were paid to keep the price of rice and flour low.* Social service expenditure also considerably increased, particularly through the adoption of a very bold scheme of free education (or rather free tuition) for all students from the kindergarten to the university. A further ambitious extension of social services, to

*The flour subsidy was terminated in February, 1948.

include national health and unemployment insurance, children's allowances and old age pensions, was recommended by a Commission in 1947. If these recommendations are implemented, social service expenditure would go up by another Rs. 100 million annually. That a country whose national income was small and falling, should have still done so much to improve its distribution and establish social security, reflects its growing social conscience.

The increased expenditure called for increased revenue. But the Government deliberately collected more than what was wanted and budgeted for surpluses in order to (*a*) check inflation by draining off and impounding as much excess purchasing power, as possible and (*b*) build up a reserve fund for future industrial and economic development. Of course, money for these two objects had mainly to be obtained by loans rather than by taxes. But the tax method was also used as far as possible.

All this took public revenue to a much higher level in terms of national income than before the war. In 1938, for instance, the State took roughly 20% of the estimated national income. In 1947 it was taking roughly 28%. Considering that State expenditure is still mainly consumption and not investment expenditure and considering also the ability of the State to make wise investments, it is an open question if it is not taking too much of the national income and leaving too little to 'fructify' (to use the classical term) in the pockets of the people.

The revenue, it may be noted, was mainly obtained from customs and other indirect taxes. Direct taxes contributed in 1938 16%, and in 1947 14% of the total. Since the indirect taxes were generally regressive, the tax system as a whole remained regressive. Thus, in their method of collection, the taxes contributed little to re-distribution. Re-distribution was mainly done through their spending.

POLITICAL DEVELOPMENTS

In the political field, the most important development was the country's rapid march to self-government. Before and during the war, Ceylon was a Colony of the advanced type, enjoying a large measure of internal autonomy. A new Constitution giving larger control of internal and external affairs and also introducing the Cabinet form of Government was given in 1947. This was soon followed by the grant of complete Dominion Status on February 4, 1948.

What effects independence would produce in the economic field is of course difficult to say. Independence is largely its own reward and there is hardly any point in trying to draw up a balance sheet for it. However, immediately it will probably bring more burdens than benefits. It will increase national expenditure in certain directions like defence and diplomatic representation, which can hardly be called productive. But it will enable the country to plan its economy entirely in its own interests without any control or interference any longer by the Imperial power. It will, in other words, make possible a change from a Colonial to a National economy. And that may bring rich dividends in course of time. Of course, much will depend on how the country uses its new freedom.

Another noteworthy political event was the return to Parliament in 1947 of a large contingent of leftist members. Although the party in power (the United National Party) was itself what might be called a liberal party with leftist inclinations, the presence of avowed leftists, many of whom belonged to Communist groups, was bound to have its effects on the economic policy of the country. The drift from uncontrolled capitalism is thus likely to be stronger than ever before.

CONCLUSION

To sum up, 1947 was for Ceylon a year of deepening economic troubles. Income from exports, which was the country's principal source of income, rose a little, but expenditure on imports, which was the largest head of national expenditure and nearly all of which was essential, rose more than in proportion. The result was a bigger external deficit, a sure index of further economic decline. The country did everything possible to arrest the deficit and improve trade and income, but nothing much could be done because the difficulties were mainly external and beyond its control.

When recovery and stability will come is difficult to say. So far, there are few indications that the external factors will soon become favourable. Manufacturing countries are recovering too slowly. The food exporting

countries are still far behind the world's demand for food. Import prices are thus hardly likely to fall in the near future. On the other hand, export prices are hardly likely to rise. Production in countries which compete with Ceylon is rapidly rising. Internally also, no miracle increase in production, bringing diversification or self-sufficiency, is likely in the visible future. No wonder therefore that the year 1947 ended on a note of gloom and the gloom has continued more or less during 1948.

CHAPTER II

NATIONAL INCOME

AN estimate of national income for 1947 is given below. See Table 2. For comparison, parallel estimates for 1937, 1938 and 1944 are also given. It will be well to remember the following general points about the estimates. For a detailed description of the method by which the estimates have been prepared, the reader is referred to "A Note on National Income" (Appendix A of the Social Services Commission Report 1947).

1. The estimates are all very rough. Available statistics on (*a*) production, (*b*) incomes or (*c*) consumption and saving, on which estimates are possible, are all very limited in Ceylon.

2. The estimates are made mainly on the production method. Total income from production of export goods has been taken as equal to the total value of exports. It is out of this value (less depreciation of land and capital) that all who are engaged at various stages and in various capacities in the production of export goods must get their income. The sum of their net incomes must equal the aggregate value of the exports *minus* depreciation costs. No deduction, however, could be made for depreciation, as no information on it was available. A similar procedure has been followed in estimating income from production of non-export or retained goods. In the case of producers of services, of course net output is synonymous with their net money income. In these cases (for instance trade and professions) probable average earnings have been multiplied by probable number of earners. It is possible that in trying to compute separately income from production of export goods and income from production of non-export goods, some duplication has been made.

3. The estimate for 1947 is less reliable than that of the other years because although the export figures were just published, full information on all Heads under Income from Production of Non-Export Goods was not yet available.

4. The estimates are of incomes produced within the country by residents (nationals) and non-residents (non-nationals) together. How much of the total belongs to residents and how much to non-residents is difficult to say. If what nationals brought in every year was solely and wholly their foreign income earned during the year, and what non-nationals took out was their local income, the net balance of payments on current account could be added to or subtracted from the total national income, to discover the income of nationals alone. But this is not so. An import surplus may mean that nationals are bringing not their foreign income in, but using up their accumulated foreign balances or taking loans. An export surplus correspondingly may mean that non-nationals are withdrawing their capital from the country or nationals sending capital out. In other words, it is difficult to strictly distinguish between income and capital movements. It is therefore not safe to use the balance of payments figures on current account to estimate the total income of nationals. Actually, the surplus balance in 1944 represented largely forced transfer of capital by nationals, while the deficit balance in 1947 represented largely the liquidation of their investments abroad. Unless we have full information on both income and capital movements, which unfortunately we do not have, we cannot use them to determine the total income of nationals.

5. The estimates are at 'factor cost', the effect of indirect taxes and subsidies being eliminated as far as possible.

TABLE 2 *

NATIONAL INCOME (Rs. 000,000)

Items	1937	1938	1944	1947
Income from Production of Goods Exported				
1. Tea	170,119 ...	172,421 ...	319,717 ...	566,522
2. Rubber	79,705 ...	46,732 ...	222,791 ...	137,084
3. Coconut products ...	48,466 ...	34,498 ...	53,446 ...	102,975
4. Other exports ...	11,439 ...	9,883 ...	20,632 ...	82,600
Income from Production of Goods Retained				
5. Rice	31,000 ...	22,542 ...	75,205 ...	84,956
6. Coconuts & Coconut Oil	33,000 ...	22,000 ...	64,000 ...	127,000
7. Tea	9,393 ...	7,835 ...	25,038 ...	24,000
8. Other Food crops ...	11,000 ...	11,000 ...	34,000 ...	35,000
9. Tobacco	9,770 ...	10,600 ...	40,000 ...	39,000
10. Livestock and livestock products... ...	10,000 ...	12,500 ...	27,000 ...	25,000
11. Fish and fish products ...	8,000 ...	10,000 ...	26,000 ...	30,000
12. Output of craft and factory industries ...	53,000 ...	55,000 ...	160,000 ...	160,000
13. Trade	74,000 ...	74,000 ...	160,000 ...	160,000
14. Transport ...	10,000 ...	10,000 ...	23,000 ...	26,000
15. Professions ...	13,000 ...	13,000 ...	18,791 ...	22,000
16. Domestic Service ...	12,000 ...	12,000 ...	24,000 ...	20,000
17. Lands and Buildings ...	31,550 ...	32,192 ...	36,490 ...	42,000
18. Output of Central and Local Government ...	62,695 ...	70,961 ...	145,882 ...	300,000
19. Foreign Military Expenditure in Ceylon ...	not elsewhere included ...	— ...	435,000 ...	25,000
20. Correction for indirect taxation	−74,000 ...	−70,663 ...	−125,560 ...	−273,000
Total...	604,137 ...	556,501 ...	1,785,432 ...	1,736,137

The figures show that national income fell considerably between 1944 and 1947. The fall was due mainly to (*a*) a fall in exports and (*b*) the practical disappearance of foreign military expenditure in the country. Compared to pre-war years, income in 1947 was still, in terms of money, quite high. But it is doubtful if in real terms it was appreciably or if at all higher. Prices, it should be remembered, had meanwhile gone up very high. What income in 1947 would have been if all items were valued at pre-war prices cannot be exactly stated. We have no suitably

* From—A note on National Income—
Appendix A of the Social Services Commission Report 1947 (Correction for Net Balances of Payment on Income Account is excluded).

weighted general price index to apply here. But considering that most prices went up (eliminating the effect of subsidies and taxes) by about three times, national income in physical quantity seems to have been really less than in 1938.

Sufficient data to construct an accurate picture of the distribution of the national income by industries, occupations or income groups, are unfortunately not available. The distribution of incomes above Rs. 200 per month (which is the income-tax exemption limit) is known. But not much is known about incomes below that level. But on the basis of incomes above Rs. 200 and of what little was known of incomes below that, and assuming that distribution followed Pareto's Law, the distribution of resident incomes in 1935 was roughly worked out as follows. (Estimate by Mr. K. Williams).

TABLE 3

DISTRIBUTION OF RESIDENT INCOMES

Monthly Income		No. of Incomes	Per cent. of total
Below Rs. 25		1,317,080	78.16
25 and less than	50	233,420	13.85
50 ,, ,, ,,	100	85,371	5.07
100 ,, ,, ,,	200	31,224	1.85
200 ,, ,, ,,	300	8,008	0.48
300 ,, ,, ,,	500	5,233	0.31
500 ,, ,, ,,	1,000	3,022	0.18
Over	1,000	1,742	0.10
		1,685,100	100.00

How this pattern has changed since then is difficult to say. During the war, thanks to inflation, all incomes rose more or less. But the rise was not uniform. It is very probable, however, that the lowest class (below Rs. 25) has largely disappeared,* and there has been some crowding in the top classes. But the strength of the middle brackets has probably remained more or less the same. The rise in money incomes does not of course necessarily mean any rise in real incomes.

*This is confirmed by the latest Rural Economic Surveys conducted.

CHAPTER III

POPULATION AND RESOURCES

THE last population census was taken in March 1946. A census was due in 1941, but it was not taken on account of the war. According to the 1946 census, the total population of the Island was 6,695,605. The distribution by race and religion was as follows :—

TABLE 4

RACE AND RELIGION

Race	000	Religion	000
Sinhalese ...	4,637	Buddhists ...	4,288
Ceylon Tamil ...	826	Hindus ...	1,326
Indian Tamil ...	682	Christians ...	606
Ceylon Moors and Malays ...	69	Muslims ...	433
Other Indians ...	36	Others ...	5
Others	52		

The distribution, according to age, sex, and occupation is not yet known. The figures collected have not yet been completely tabulated.

The occupational distribution has probably not much altered since 1921, when occupational returns were last collected. No occupational statistics were collected with the 1921 census, which was a skeleton undertaking because of financial difficulties. In 1921, agriculture claimed roughly 60% of the earners, industries 13%, trade and transport 11%, public service and liberal arts 3% and fishing 1%. This occupational structure must have been somewhat disturbed during the war when there was a flow of labour from agricultural and rural industries to war services and war industries. By 1947, however, this labour seems to have largely gone back to its pre-war fields of work. The war, as already observed,

has made very little permanent change in the production structure of the country. Consequently, the occupational structure is also likely to have been little permanently altered. It may be noted here that by occupation Indian Tamils are predominantly plantation labourers.

Estimated population on July 1, 1947 (that is, mid-year population), taking into consideration the effect of migration and births and deaths, was 6,879,000. The large majority of migrants move to and from India and a considerable part of them are Indian labourers.

The average density of population in 1947 was 271 per square mile.

RESOURCES

Land suitable for agriculture and forestry is the main source of wealth of the country. Mineral resources are not much to boast of. The most important minerals are plumbago, precious stones and mica, but none of these contribute much to the national income. The Island has no coal or petroleum. Iron is found in many places, but the absence of coal and the smallness of the proportion of iron in the ore makes exploitation very difficult and expensive. The basic requirements for building up a large industrial economy are thus lacking. The lack of coal can perhaps be largely made up by 'white coal' of which there are rich reserves, but so far little progress has been made in harnessing them. The Government has in hand an ambitious hydro-electric scheme, but it is not expected that even its first moderate stage will be completed before 1951. Largely (though not wholly) because of this absence of coal, petroleum and iron, power-driven industries have yet been little developed in the Island.

Fisheries are a large potential source of wealth, but because of various difficulties, not least important of which is lack of capital, they bring yet only about 1.7% of the national income of the country.

Of the total land surface of the country of 16,212,400 acres (25,331 square miles), 7,000,000 acres or nearly half cannot in any way be productively used. 4,337,000 acres (26.45% of the whole land surface) are cultivable. Of this, 3,208,000 acres were actually under cultivation in 1946.* 3,503,000 acres are under forests. The forest wealth of the country has been, because of lack of funds, very insufficiently developed

* Figure given by the 1946 Census.

yet. During the war, the forests were ruthlessly drawn upon for timber and it will probably take years before the damage is undone.

Agricultural land is mainly used for growing four major crops—tea (533,830 acres), rubber (373,243 acres), coconut (920,093 acres) and paddy (912,500 acres).*

No estimate is possible of capital resources, but that they are very poor cannot be doubted. A country whose per capita income is Rs. 251 (Rs. 95 in 1938) can hardly be expected to save much and build up large capital assets. Actually, so far, much of the development of the country has taken place with foreign capital. 80% of tea estates and 60% of rubber estates are foreign-owned. An estimate given in the Government's Post-War Development Proposals put foreign investment in companies in 1939 at Rs. 860 million out of a total of Rs. 1,018 million (that is 85%). Internationally, as already said in Chapter I, Ceylon in spite of foreign balances accumulated during the war, is still a net debtor.

*Figures given by the 1946 census.

CHAPTER IV

AGRICULTURE

STATISTICS of land utilisation have been given in the previous chapter.

Agriculture in the Island is dominated by four crops—tea, rubber, coconut and paddy. Next, but at great distance from these four, are tobacco, arecanuts, cinnamon, citronella and cocoa. For reasons of space, we shall deal only with the four major products.

Production of tea, rubber and various coconut products (if not the nut itself) involves necessarily a certain amount of processing. The industries therefore are not strictly wholly agricultural, but have also an industrial side. It is convenient, however, to deal with both sides together under Agriculture.

TEA

At the end of March 1947, the total area under tea was as follows :—

	Number	Acres
Estates (over 10 acres) ...	... 2,367	... 489,695
Small holdings ...	... 77,698	... 63,158
	Total...	552,853

80% of the estates are estimated to be foreign-owned. Labour engaged on the estates is predominantly Indian.

Total output in 1947 was estimated to be 287 million lbs. exported *plus* 15 million lbs. retained for home consumption, in all 302 million lbs.

Production and export of tea is subject to regulation by the International Tea Regulation Committee of which Ceylon is also a member. In 1942, the Committee increased Ceylon's exportable quota from 239 to 314.4 million lbs., at which figure it still stands. The quota is really too high to cramp production in any way. Actually, Ceylon has never been able to export the full quota in any year, the nearest approach being 291 million lbs. in 1946. The International Tea Agreement is due to expire on April 1, 1948. But Ceylon has agreed to extend it for another two years.

In tea, the most important event in 1947 was the re-establishment of a free market. Up to the end of 1946, Ceylon was under contract to sell her total output to the U.K. Food Ministry at fixed prices. Britain resold a certain portion for local consumption. The contract prices (which were varied from time to time according to changes in labour costs and other factors) averaged in 1941 77 cents per lb. and in 1946 Re. 1.23 per lb. This bulk sale scheme was given up on March 31, 1946 and producers were once again allowed to sell or export their produce freely. Prices jumped up, considerably proving that the contract prices were much below the level justified by world demand.

During 1947 average price (of all grades) at the end of each month was as follows :—

TABLE 5

COLOMBO TEA PRICES, 1947

	Average of all offerings Rs. per lb.
End of January	2.64
,, ,, February	1.66
,, ,, March	1.72
,, ,, April	1.68
Middle of May	1.37
End of June	1.39
,, ,, July	1.71
,, ,, August	1.54
,, ,, September	1.44
,, ,, October	1.62
,, ,, November	1.65
,, ,, December	1.60

The sudden fall in February was due partly to the normal steadying down of the market and partly to the sudden increase in the export duty from 4.84 cents to 39.84 cents per lb. The increase in the duty was

another important event in 1947. The total price that foreign buyers had thereafter to pay was thus the average given in the table *plus* the duty. It should be noted that many producers did not benefit by these prices. They had contracted voluntarily to sell to Britain at lower prices. A total of 94½ million lbs. was sold in this way in 1947.

In spite of higher prices, however, production and export in 1947 was less than in 1946. The main difficulties which the industry had to contend with were (1) insufficiency of fertilisers which had to be rationed among tea, rubber and coconut estates, (2) depreciation of factory equipment which occurred during the war and which was yet far from being made good, and (3) Blister Blight disease. The effect of the disease which was still spreading would probably be felt for years to come. Two other factors which interfered with export were the widespread strikes in May and June, particularly the Harbour Strike, and the floods in August, which cut off producing areas from Colombo for some weeks.

Some comparative figures about exports (which represents 95% of total production) and prices are given below.

TABLE 6

EXPORT AND PRICE OF TEA

	Exports (in millions) lbs.	Rs.	Average Price (high grown tea only) Rs.
1938 ...	235 ...	172	.70
1945 ...	229 ...	274	1.20
1946 ...	290 ...	378	1.28
1947 ...	287 ...	566	1.75

RUBBER

1947 was a black year for rubber. The industry was stricken by a depression and both the quantity exported and the price fell heavily. Rubber is a major earner of foreign exchange and the most important earner of dollar exchange. Its fall was a great blow to the economy of the Island.

TABLE 8

EXPORT AND PRICE OF RUBBER

	Exports Tons (000)	Rs. million	Average Price (R.S.S. No. 1) (cents per lb.)
1938	51	45	37
1945	95	208	96
1946	102	227	93
1947	81	135	64 (subsidised)

COCONUTS

The 1946 census gives the total area under coconuts as 920,093 acres. Dr. Child, the Director of the Coconut Research Institute, however, estimates it to be roughly 1,110,000 acres, three-fourths of which are in small lots of less than 20 acres each.

Regarding production, no direct statistics are available. But assuming local consumption is 130 nuts per head (fresh nuts plus nut equivalent of oil) and adding the quantity exported (nuts and nut equivalent of copra, oil and desiccated nut) to local consumption, Dr. Child estimates production in terms of nuts to have been 1,610 million in the period 1935 to 1940 and 1,824 million in the period 1940 to 1945. On this basis, one is compelled to conclude that after 1945 there has been a considerable fall in production, because the quantity exported has considerably fallen. It is true that aggregate local consumption has somewhat increased because of an increase of population, and perhaps also because of a slight increase in per head consumption produced by the shortage of other foods, but this increase cannot explain away the fall in exports. The conclusion therefore is irresistible that production has seriously fallen. The fall has apparently been due to neglect of replanting for years and current under-manuring.

The decline in productivity was the coconut industry's biggest problem during the years 1946 and 1947. Coconut, it should be remembered, is the broadest-based industry in the country. Nearly everyone in the coastal districts has some coconut interests, in estates or home gardens. Cultivation is overwhelmingly in the hands of small holders. No industry

therefore directly touches the people more than the coconut industry. It is thus vital that price and production be maintained at a high level.

Export prices, which largely set the tune for domestic prices, were rather low up to 1945. But from January 1, 1946, thanks to a five-year contract with Britain, prices were stabilised at a higher level. The terms of the contract were broadly as follows. (*a*) Britain would buy the whole of the Island's exportable copra and oil for a period of five years at a net price of Rs. 100 per candy (of 5 cwts.) of copra to the producer and a corresponding price for oil. (*b*) To ensure adequate export of copra and oil to Britain, limits were placed to the quantity of nuts, desiccated nuts and other processed coconut goods which could be exported to other countries. It may be observed here that though these other export quotas were none too high, actual exports have been below them. The contract gave the industry an assured market for five years, but not too generous a price. World prices have been appreciably higher. Consequently, on January 28, 1947, the Ceylon Government imposed an export duty of Rs. 50 per candy, which it had the right to do under the contract. Since the contract provided for a price of Rs. 100 *to the producer*, the duty in effect increased the price for Britain to Rs. 150. The Government, however, paid half of the duty to the producer and appropriated the other half to revenue. Thus, the total which the producer thereafter received was Rs. 125 per candy.

Producers were anxious to get an increase in the contract price, because (*a*) world prices were generally higher, and (*b*) production costs had gone up. But they seemed unwilling to go to the extent of cancelling the contract and taking the risk of a free market. The contract gave them security till 1950 and also a not too unreasonable price.

However, the contract was finally revised with effect from 1st July 1948. The new Agreement provides broadly as follows :—

(1) The Agreement covers purchases by U.K. and Pakistan during the period 1st July 1948 to 31st December 1950.

(2) **Provisions for 1948** — Ceylon has to supply Pakistan with 8,000 tons in terms of Oil, between 1-7-48 and 31-12-48, at the rate of £55 per ton of copra f.o.b. Ceylon ports. If Pakistan does not

take the whole or any part of this, Ceylon can dispose of the balance to any destination at any price. The U.K. is bound to accept any copra offered by the Ceylon Government at the rate of £50 per ton of copra f.o.b. Ceylon ports. But Ceylon has the liberty to sell also in the open market.

(For the rest of the year, thus, Ceylon is released from her obligation to sell the whole of her exportable surplus to U. K. She is also guaranteed a higher price for what she sells. It may be explained here that four candies make a ton. A price of £55 per ton of copra therefore means approximately Rs. 183/- per candy and £50 means Rs. 166.50 per candy. The pre-revision price on 30th June 1948 was Rs. 158/- per candy, (equivalent to £47.8.0 per ton) which was divided into (1) price paid to the producer Rs. 125 (2) export duty Rs. 25, and (3) handling charges Rs. 8. Any price higher than £47.8.0 thus means an improvement on the pre-revision price.

The quantities are in terms of oil, not copra. (6½ candies of copra make a ton of oil.)

(3) **Provisions for 1949** — Ceylon will supply the U.K. and Pakistan with 40,000 tons and 8,000 tons respectively, in terms of Oil, at £55 per ton of Copra, f.o.b. Ceylon ports. United Kingdom and Pakistan are bound to accept these at these rates. And the United Kingdom is bound to accept any quantities of Copra or Coconut Oil offered by Ceylon in excess of this quantity at £55 per ton of Copra, f.o.b. Ceylon ports, during 1949.

(This commits Ceylon to sell at most 48,000 tons, which is normally less than half of her exportable surplus, at £55 per ton of copra. The rest she can sell anywhere else if she gets a better price. U.K. however is committed to buy any excess quantity offered by Ceylon at £55.)

(4) **Provisions for 1950** — Towards the end of 1949 it is intended to discuss a fresh agreement for 5 years; but, if no agreement is concluded, the price payable by U.K. and Pakistan may be negotiated, and it shall not be more than £47/12/- and less than £47/8/- per ton of Copra f.o.b. Ceylon ports. The quantities that the parties to the contract are committed to buy or sell shall be the same as in 1949.

(This means that regarding price, Ceylon's position will not be worse than before the new contract, but may be definitely better.)

(The term "f.o.b. Ceylon ports" represents the whole of the payment which the purchasers undertake to make including all export taxes, tolls, cesses, and all other charges in Ceylon.

It will thus no longer be possible for Ceylon to collect higher prices by imposing duties.)

The contract has certainly given Ceylon better terms of sale for 1948 and 1949. She will not also be worse off in 1950 than she was before June 1948. Whether she has made the best terms possible, or whether a longer contract ensuring a stable price for a period of 5 or 7 years, would have been better for the Coconut industry, only the future course of world prices of Coconut products can reveal. It is well to remember that the world is at present suffering from an acute shortage of fats and oils, and Ceylon as a producing country, hitherto rather badly exploited, deserves to be well treated.

A notable development during 1947 was the installation of facilities in the harbour for the bulk shipment of oil. This eased to some extent the shortage of containers (steel cylinders) which has been a great handicap for the industry.

Quantities and prices of the more important varieties of exports in recent years are shown below. The great fall in 1946 and 47 will be noted.

TABLE 9

EXPORT AND PRICES OF COCONUT PRODUCTS

EXPORTS (All figures in Thousands)

	Copra		Oil		Desiccated Nut		Fresh Nut	
	Cwt.	Rs.	Cwt.	Rs.	Cwt.	Rs.	No.	Rs.
1938	1,504	8,783	1,508	14,057	594	4,399	15,955	635
1945	2,274	38,803	774	21,359	107	3,250	29,429	2,207
1946	776	16,407	861	29,758	194	16,226	10,198	714
1947	595	21,387	846	48,488	231	23,103	3,801	714

PRICES (Rs. c.)

	Copra	Oil	Desiccated Nut	Fresh Nut
	(Estate No. 1 per candy)	(White oil per ton f.o.b.)	(per lb.)	(per 1,000 nuts)
1938 ...	27.74 ...	184.22 ...	0.06 ...	26.54
1945 ...	80.44 ...	569.72 ...	0.27 ...	85.25
1946 ...	100.00 ...	691.89 ...	0.45 ...	103.54
1947 ...	123.33 ...	1,153.06 ...	0.80 ...	122.92

RICE

The 1946 census puts the total area under rice at 912,500 acres, of which perhaps some 904,414 acres were actually producing. The estimated output was 6,783,102 bushels of rice (at 7½ bushels per acre, which is regarded as the annual average for the Island).

How this acreage and output compares with present or pre-war acreage and output is difficult to say. No reliable statistics on the subject are available. An official publication,* however, says that production in 1946 was double that of the pre-war level. It is doubtful, however, if production rose as much as that. In any case, the production figure would be by itself no guide to acreage, unless it is assumed that yield per acre was the same. Whatever it was in 1946, for 1947 no figures are yet available. Because of the continued and rigorous food production drive of the Government, it is probable that acreage (and so output) was slightly higher than in 1946. But nothing is definitely known.

Rice production is difficult to expand because of (*a*) lack of suitable land, (*b*) lack of labour, and (*c*) lack of resources of the average peasant. The Government is helping by giving land, money and equipment, and also extending irrigation and marketing facilities. It has established itself a number of State Farms. It has also opened up large agricultural colonies in promising areas where settlers are given very liberal assistance. These colonisation schemes are a very interesting experiment that Ceylon

*How Lanka Fed Herself.

is conducting. But in spite of all this, there are few signs of rice production substantially increasing. The country's dependence on imports remains as great as ever.

Mention has already been made in Chapter I of the Government's six-year plan of agricultural and industrial development. On the agricultural side, the proposed programme of expansion of cultivation is as follows (vide Budget speech 1948—49).

TABLE 10

AGRICULTURAL DEVELOPMENT PLAN

(Acres)

ANNUAL DEVELOPMENT

	Paddy	Garden	Total
1947—48 ...	6,689 ...	4,659 ...	11,348
1948—49 ...	8,449 ...	4,600 ...	13,049
1949—50 ...	6,148 ...	3,591 ...	9,739
1950—51 ...	8,826 ...	5,295 ...	14,121
1951—52 ...	24,650 ...	14,790 ...	39,440
1952—53 ...	27,150 ...	16,290 ...	43,440
	81,912 ...	49,225 ...	131,137

LIVESTOCK, FISHERIES, FORESTS

Very little is known about the condition or progress of animal husbandry in the country. A census of livestock was taken with the population census in 1946. It was found that the country had altogether 736 tame elephants, 319 horses, 1,166,909 neat cattle, 410,418 buffaloes, 296,151 goats, 63,301 pigs, 33,670 rabbits and 1,479,444 fowls. Livestock is not only poor in quantity but also in quality. Its contribution to the national income is consequently small.

A fact which reflects the poor livestock resources of the country is the low consumption of milk. Per head daily consumption is estimated to be only 1.7 ozs. which is probably the lowest in the world. It is very necessary that it should be increased to at least 5 ozs. a day, which is the quantity prescribed by medical opinion for health and protection against disease. This would require raising production from the present estimated 23 million gallons a year to about 70 million gallons.

Regarding fisheries also, few statistics are available. The Director of Fisheries estimated total output of fish in 1946 to be as follows :

	Pre-war	1946
Fresh fish	5,000 tons	14,000 tons
Dried fish	3,000 ,,	8,000 ,,

Nothing is known yet about output in 1947.

Forests are all owned and managed by the Government. The total area under Production and Protection Forests was 3,570,000 acres in 1946. Total production for the year was as follows :—

	Cubic ft.
Sawn Timber	102,416
Sleepers	105,362
Round Timber	220,008
Firewood	8,585,743

Figures for 1947 are not yet available.

CHAPTER V

INDUSTRY AND MINING

THERE is not much to say about industries. Large scale power-using industry has been little developed. Before the war, the only important factories were (apart from factories which processed tea, rubber or coconut) one cotton mill, a few tile works, one or two match factories, one gas works, one or two distilleries and a few engineering works. The war gave an impetus to new industries, a number of which were started by Government and private enterprise. These concerns did fairly well during the war when foreign supplies were cut off. But with the end of the war, they have been experiencing difficulties.

Very little information is available about industrial outputs. Of private industries, perhaps the most important is the textile industry. There is one Mill producing cotton textiles. Its production is estimated to have been as follows :—

	Yarn Produced (million lbs.)	Cloth Produced (million yards)
1938 ...	1.5 ...	2.75
1947 ...	1.5 ...	3.1

Perhaps next in importance is the match industry. Its output in 1947 (from four separately owned factories) is estimated to have been 16,000 cases (each containing 50 gross boxes) valued at Rs. 1,522,000. The output of arrack (local spirit out of coconut toddy) by the distilleries was 636,302 proof gallons in 1946. No reliable or up-to-date information is available about the production of other private industries.

Very little information is also available about the Government Industrial undertakings. A summary of their financial position up to September 1945 was given in a report published in December, 1947.* It disclosed

*State-owned Factories, December 1947.

that the Hat, Quinine, Ceramic and Acetic Acid Factories had incurred losses, while the Leather, Plywood, Coir, Paper, Glass and Steel Rolling Factories had made profits. On the whole, the balance sheet of State-owned industries showed a small net profit. Since then, the position has probably deteriorated as foreign supplies have become more and more available.

The following is a list of industrial concerns at present run by the State (Budget speech 1948/1949) :—

TABLE 11

GOVERNMENT INDUSTRIAL CONCERNS

Factories	Capital Invested Rs. (000)	Date of opening
1. Plywood ...	... 586	... 1941
2. Steel Rolling	... 288	... 1942
3. Coir ...	... 184	... 1939
4. Paper ...	... 169	... 1942
5. Leather ...	... 274	... 1941
6. Quinine ...	... 124	... 1942
7. Glass ...	... 628	... 1943
8. Ceramic ...	... 525	... 1943
9. Acetic Acid	... 368	... 1942
10. Saw Mill ...	... 48	... 1942
11. Industries Workshop ...	61	... 1941
12. Carpentry Workshop ...	79	... 1945

The six-year plan of economic development outlined by the Finance Minister in his budget speech in 1948 includes the following programme of expansion or re-organization of State undertakings. The plan, as already mentioned, fixes no targets for non-Government industries :—

TABLE 12

PROGRAMME OF INDUSTRIAL DEVELOPMENT

Industry	Estimated Cost Rs. (000)	Estimated date of Completion	Capacity Per Annum
Cement Factory ...	... 13,000	... August 1949	... 100,000 tons
Glass Factory ...	... 800	... December 1949	... 2,500 ,,
Plywood Factory ...	... 1,070	... December 1949	... 400,000 chests
Steel Factory ...	... 11,500	... 1952	... 7,500 tons
Paper Factory ...	... 6,650	... 1951	... 3,000 ,,
Caustic Soda Plant	... 2,600	... 1952	... 1,500 ,,
Hydrogenated Vegetable Oil Scheme ...	... 6,500	... 1952	... 36,000 ,,
Sugar Factory ...	... 3,000	... —	... 50,000 ,,
Textile Factory :			
Initial Scheme ...	... 16,650	... 1951	... 6,000,000 yds.
Complete ...	... 66,650	... 1954	... 30,000,000 ,,

Of these, good progress has already been made with the construction of a Cement Factory. Others are still mostly in the planning stage.

Government's policy regarding ownership of industries (as given in a Report by the Ministry of Labour, Industry and Commerce in 1946*) is to nationalise all basic industries and assist and control the non-basic. Basic industries include power, iron and steel, cement, heavy chemicals, specified drugs and cotton spinning.

Not much information is available about the state of cottage industries. The more important of the industries are carpentry, coir spinning and weaving, pottery, brass and silverware making and cotton cloth weaving. The war gave a great fillip to cotton weaving and the Government is promoting its development by distributing yarn and training workers.

At present it is estimated that "ten thousand people are employed in the Textile Handloom Industry and fifty thousand in the Coir Spinning and Weaving Industry. Eight thousand textile looms with a producing capacity of ten million yards a year are working daily" (Budget speech 1948/49).

*Sessional Paper XV—1946.

The Government intends to give all reasonable protection to the home industries against foreign competition, by tariffs, import and exchange control, subsidies, guaranteed floor prices, linking imports allowed to local production, etc., all of course consistently with the country's obligations under the Havana Charter.

The foundation of all industrial development is power. Since the country has no coal or oil, the Government has taken in hand an ambitious hydro-electric scheme. The first stage of this scheme is expected to be completed in 1952.

Regarding mining, the most important mineral product is plumbago. In 1946 some 36 mines were in operation. Since the whole output is exported, production may be taken as equivalent to exports. Figures for production (exports) and prices in recent years are given below.

TABLE 13

EXPORT AND PRICE OF PLUMBAGO

		Exports			Average price
		(Cwt 000)	(Rs. 000)		(per cwt.) Rs. c.
1938	...	236	1,747	...	7.42
1945	...	156	3,560	...	22.96
1946	...	162	3,522	...	22.04
1947	...	180	3,611	...	19.47

CHAPTER VI

LABOUR AND EMPLOYMENT

LABOUR in Ceylon is mainly employed in (*a*) tea, rubber, coconut and other estates, (*b*) firms which handle the export and the import trades, (*c*) transport organisations, and (*d*) central and local government service. Since industries are very few, industrial labour as such forms only a small portion of the total wage-paid labour force. A fairly large number is also employed in non-estate agriculture such as the cultivation of paddy, but the employment here is generally seasonal and payment is partly in kind and partly in cash.

Full statistics of employment are not available, but labour employed in the estates in 1946 was as follows :—

(000)

Indian				Non-Indian				Grand
Men	Women	Children	Total	Men	Women	Children	Total	Total
203	190	62	455	56	53	17	126	581

Figures for 1947 are not yet available. How many were employed in other fields is not exactly known. The Social Services Commission* estimated the total number of people under contract of service (including not only wage but also salary earners) as 1,195,000.

Information on wages is also scanty. During the war wages rose rapidly because of several factors. There was, first, a great demand for labour for the war services and industries. Secondly, rising prices compelled workers to demand and employers to grant higher wages. The wage rise, however, seems to have generally lagged behind the price rise. Thirdly, labour became more organised, articulate and conscious of its rights. Lastly, the State was becoming more conscious of its duties to labour, and by the establishment of Wages Boards and expansion of social services gave various direct and indirect benefits to labour.

*Report of the Social Services Commission, 1947, paragraph 203.

No exact measure of the change in wages is available. No general or sectional wage index is prepared in the country for this purpose. But some idea of the change may be obtained from the minimum wage rates fixed for certain industries. So far, minimum wages have been fixed (by tripartite wage boards consisting of representatives of employers, employees and Government) in the following trades and industries:

1. Tea Growing and Manufacturing
2. Rubber Growing and Manufacturing
3. Coconut
4. Engineering
5. Printing
6. Plumbago
7. Tea Export
8. Rubber Export
9. Toddy, Arrack and Vinegar
10. Cigar Manufacturing
11. Motor Transport
12. Match Manufacturing

Precisely how many labourers are covered by these trades and industries is not known.

The rates of wages as fixed by the more important Wage Boards for unskilled (that is, the lowest grade) adult male labour and as in force at present, are as follows. Rates for women and children are appropriately less. Basic rates are supplemented by cost of living allowances which change with every change in the cost of living. The cost of living index at the end of 1947 was for estate labour 240 and for Colombo workers 252.

TABLE 14

MINIMUM WAGE RATES

Industry	Basic daily wage (cts.)	Cost of Living allowance (cts.)
Tea & Rubber Growing ...	58 ...	67 (when index is 215)
Coconut Growing ...	60 ...	65 ,, ,, ,, ,,
Coconut Manufacturing ...	103 (Colombo)...	65 ,, ,, ,, ,,
	78 (outside) ...	65 ,, ,, ,, ,,
Tea & Rubber Export ...	124 ...	62 ,, ,, ,, 200
Engineering ...	124 ...	62 ,, ,, ,, ,,

An unskilled labourer was on this scale generally getting in 1947 round about Rs. 1.50 a day in all if he worked in an estate and Rs. 2.00 if in Colombo. Before the war, he generally received 50 cents in the estates, 50—75 cents in non-estate agriculture and 50—60 cents in town.* For this particular type of labour therefore there seems to have been generally a 300% rise in wages, while the rise in the cost of living index has been a little less. It should be remembered, however, that the cost of living index is prepared upon *controlled* prices at which workers are often not able to make their purchases. In terms of actual prices which they paid, the index would be appreciably higher.

All wage boards fixed the normal working day as 9 hours, including 1 hour for a meal. Overtime rates were generally 1½ times the normal rate. The boards also generally provided for a few days of paid holiday every year.

As on employment, so on unemployment also the information available is very limited. The country has yet no unemployment insurance from which returns of the unemployed could be easily and correctly obtained. Some idea, however, can be obtained from the unemployed who registered themselves in the 11 employment exchanges in the country. At the end of 1947 the figures were as follows :—

REGISTRATION OF UNEMPLOYED

Technical and clerical ...	2,883
Skilled	7,325
Semi-skilled	8,113
Unskilled	16,423
Total...	34,744

Out of this, 5,666 were ex-servicemen. At the end of 1946, the total unemployed registered in the Exchanges were 36,544. Too much significance, however, should not be given to these figures because (*a*) many did not at all register themselves, and (*b*) some who registered were either already employed (and looking for better employment) or neglected to inform the Exchange when they found employment. Assuming that

*Ceylon Blue Book, 1938.

the figure is a correct estimate of unemployment in the country, it compares very favourably indeed with the size of the normally employed population, which was estimated by the Social Services Commission to be of the order of 1,195,000. 3% unemployment is generally regarded as more or less inevitable frictional unemployment in advanced industrial countries. The figure given by the Employment Exchanges in Ceylon is considerably less than that. The fact seems to be that unemployment in the ordinary sense of the term is not a major problem in Ceylon yet. The reasons are, first, indigenous labour can always largely return to village agriculture and industry when they are thrown out of estates or urban factories. An agricultural country has large powers of absorbing labour, although it may be on poorer terms. Secondly, Indian labour, when unemployed, largely returns to India and ceases to be a burden on the country. This is one of the advantages of using immigrant Indian labour, whatever its disadvantages. The real problem, as far as indigenous labour is concerned, seems to be not unemployment, but under-employment in the sense of employment in fields where labour's productivity and wages are low. This cannot be corrected unless more productive avenues of employment (for instance by new industries) are created and also labour becomes more mobile.

The post-war period all over the world has been marked by rising labour unrest. Ceylon has been no exception to it. During the war, all important industries, including plantations, were declared essential services and workers were deprived of the right to strike. But these restrictions went with the war. In 1946 there were 87 strikes in estates and 70 in other establishments. The total man-days lost was quite heavy. In 1947, as far as information is yet available, the figures were as follows :—

STRIKES

	Number	Man-days lost
In estates	... 53	... 11,800
Outside estates	... 52	... 199,657

Regarding workmen's compensation, figures for 1945 and 1946 were as follows :—

	No. of Accidents	Claims Paid Rs.
1945 ...	7,418	... 400,361
1946 ...	8,481	... 343,612

Mention has already been made in Chapter I of the recommendation of the Social Services Commission for establishing health and unemployment insurance, children's allowances and old age pensions. No action was taken on these recommendations in 1947. But if and when they are implemented, labour will obviously very considerably benefit.

CHAPTER VII

CONSUMPTION AND RATIONING

As already explained in Chapter I, the fall in imports necessitated price and/or distribution control of most articles. The need was of course the greatest in the case of consumption goods. But many production goods such as tools and machines, building material (iron, cement, glass, etc.) motor vehicles and fertilisers were also price-controlled or distribution controlled by a system of permits. At one stage the whole economy was bristling with controls. With the end of the war, the controls naturally began to be gradually relaxed as supplies became more available. Production goods were virtually all out of control by the end of 1946. Many consumption goods were also decontrolled. But others were still acutely in short supply and so could not be released from control.

The most important branches of consumption which still remained under control in 1947 were food, clothing and house rent.

In food, the three major items, rice (or paddy), flour, and sugar were both price and distribution-controlled. The changes in the rations of these articles during the year were as follows :—

TABLE 15

WEEKLY RATIONS

In effect from 23-12-46—

	Rice (meas.)	or	Paddy (meas.)	and	Wheat flour (lb.)
Infant	½		1		½
Child	¾		1½		¾
Ordinary Adult ...	1		2		1
Working Adult ...	1¼		2½		1¼

In effect from 20-1-47—

	Rice (meas.)	or	Paddy (meas.)	and	Wheat flour (lb.)
Infant	¾		1½		½
Child	1		2		¾
Ordinary Adult ...	1½		3		1
Working Adult ...	1¾		3½		1¼

In effect from 17-2-47—

	Rice (meas.)	or	Paddy (meas.)	and	Wheat flour (lb.)
Infant	½		1		½
Child	¾		1½		¾
Ordinary Adult ...	1		2		1
Working Adult ...	1¼		2½		1¼

One measure=32 ozs. The sugar ration throughout was ½ lb. in Colombo and ¼ lb. in other places per head per week.

Prices of rice and flour were kept at a controlled low level by Government subsidisation. The price of sugar was controlled but not subsidised. Most of the other essential foodstuffs like pulses, dried fish, currystuffs. milk foods, etc., were price (but not distribution*) controlled.

As already said, price, consumption and procurement control of rice was largely relaxed early in 1948. The consumer is now guaranteed a moderate ration (incidentally, the rationed scales are still the same as on 17-2-47) at a subsidised price (which at present is 36 cts. per measure), but can buy whatever extra quantity he likes in the open market The open market price is generally double that of the subsidised price. The producer correspondingly has been released from his obligation to sell his whole output (less his consumption requirements) to the Government. He can now sell his entire output in the open market. No special provisions have been necessary regarding wheat flour, since the greater availability of rice has altogether eclipsed the demand for wheat flour.

The relaxation, which has been possible because of the improvement in the import and stock position, is (needless to say) provisional. Control will be resumed if there is any deterioration in the supply position.

*As Co-ops. through which they were mainly retailed gave very small quantities, they were in effect also distribution-controlled.

It cannot be claimed that the ration scales ensure a sufficient intake of cereals for the average man or woman. One measure of rice and one lb. of flour means altogether only 48 ozs. of cereals per week, whereas an ordinary man should perhaps have, considering the other foods within his reach, at least 17 ozs. per day to ensure reasonable nutrition. This seems to be the verdict of expert medical opinion on the subject. It is also well to remember that the people of Ceylon are used to and keen on rice and many would not take flour. The relatively well-to-do were perhaps able to make up for the deficiency of rice by other foods, but that the low cereal ration caused great hardship to the poor cannot be doubted. The availability of open market rice in 1948 considerably improved the position, but its high price still debars many from buying a sufficient quantity.

What national rice needs altogether are depends of course on the quantity of rice that a nutritionally satisfactory diet should contain. There is room for difference of opinion on the point. However, an estimate given in the Government's Post-War Development Proposals (1946) based on an intake of 52 ozs. per day for a family of 5 (husband, wife and 3 children aged 13, 6 and 2) makes the country's total rice requirements (on the basis of 1946 population) to be 13,750,000 cwts. This is on the assumption that the country will also consume another 3,250,000 cwts. of flour. Without flour, rice consumption should obviously be much higher. In this context, the country's rice supply has apparently been even in pre-war years below the country's needs. The following figures speak for themselves.

TABLE 16

RICE SUPPLY
(in 000 cwt.)

	Import	Estimated local output	Total
1938 ...	10,449 ...	2,000 (?)...	12,449
1945 ...	3,577 ...	3,400 ...	6,977
1946 ...	5,074 ...	3,500 ...	8,574
1947 ...	5,163 ...	3,876 ...	9,039

Of other consumption goods which continued to be controlled in 1947, mention may be made of textiles, matches and kerosene. Cotton textiles of the cheaper varieties were both price and distribution (by coupons) controlled. The ration was framed on the basis of approximately 8 yards per head per year. Cloth rationing was removed in 1948. Match boxes were price controlled. Kerosene was both price and consumption controlled, the ration being 1/3 gallon per head per month. This low ration caused great hardship. House rent in towns up to 1947 was pegged at the 1942 level or assessed value, whichever was the higher. In 1947 an increase of 20% plus any increase in rates was allowed. Petrol, which was rationed since the end of 1941, was freed from control in 1948.

Rationing and price control could not of course keep the pre-war pattern of consumption unchanged. The rations in many cases were smaller. Price control also was in large measure ineffective and much recourse was made to the black market. In any case, not all articles were controlled. Quite apart from all this, the higher prices themselves compelled all consumers, particularly those whose money incomes did not rise proportionately, to re-arrange their scheme of purchases. However, how actually the pattern of consumption changed for particular types of consumers can only be discovered by new family budget enquiries.

An interesting development in Ceylon during the war was the large role which consumers' co-operative stores were called upon to play in the distribution of controlled foodstuffs. Private traders were found wanting in many ways. A good many had simply disappeared after the first Japanese bombing. The task therefore was very largely given to co-ops., most of which were specially started for the purpose. In 1947 there were altogether 3,961 co-operative stores in the Island as compared with only 24 in 1939. Whether this phenomenal growth will last is doubtful. As articles are decontrolled and private traders allowed to retail them, the monopoly advantage of the co-operatives in this respect will disappear.

CHAPTER VIII

MONEY, BANKING AND PRICES

THE currency of Ceylon is based on an exchange standard. The Ceylon rupee is issued against and redeemable in Indian rupees on demand at par in unlimited quantities. The units of currency issued are rupee notes in various denominations (rupee one and upwards) and subsidiary coins and notes on a decimal system. Ceylon, unlike India, does not use any one-rupee coins.

Since the Ceylon rupee is convertible at par into the Indian rupee, its exchange value in terms of sterling and other world currencies must always be the same as that of the Indian rupee. India has been long on the sterling exchange standard at an exchange rate of Re. 1/- =1/6*d*. Consequently, Ceylon also has been indirectly on the sterling exchange standard on this parity.

The Government manages the currency system itself. There is no central bank. Of course an exchange standard needs very little management. Expansion or contraction of currency tends to take place automatically pari passu with the growth of net export or net import (visible and invisible). Management therefore practically limits itself to the task of properly investing the foreign assets held against the note issue. In Ceylon this " management " has been vested in the hands of a Currency Board of three Officials and two non-officials appointed by the Government.

The assets of the Currency Board are partly kept in India and partly in England. A portion of the assets, determined from time to time by the Currency Authority itself, is kept in liquid form. The rest is invested in securities. Since the notes are by law only redeemable in Indian exchange, the Board need not keep any reserves of cash or bullion in Ceylon at all.

INFLATION

It is appropriate to discuss the question of inflation in this chapter, although inflation is really more a disease of the general economy than of

the monetary system. Money supply and prices react to it in various degrees, rather than cause it.

Inflation is a condition when the flow of money incomes in the economy outruns the flow of goods and services available for consumption. Basically, it is caused by an excess of investment over saving. Private or government capital expenditure (investment) not balanced by the savings of the community, creates money incomes without immediately increasing the supply of goods available for consumption. Modern banking and monetary systems make it possible for more (or less) money to be put into the income stream through investment spending than withdrawn from it as savings in the preceding period. Thus, high rates of private investment and budget deficits which create additional incomes, are usually two of the most important factors causing inflationary pressure. A third is net export which also creates additional money incomes within the country without any simultaneous increase in goods available for purchase. The pressure of demand currently arising from private investment, budget deficits and net export may be further increased by demand from accumulated liquid assets from past incomes (that is to say, delayed or pent-up demand). While the total demand for consumption goods increases in this manner, the supply may not increase or may even be falling on account of difficulties and bottle-necks of one kind or another. Unless there are large unemployed resources which can be easily harnessed for production, supply is unlikely to respond to higher prices.

The excess of demand over supply causes a rise in prices which tends to adjust the demand for consumption goods to the supply by raising profits to the point where the savings resulting from these profits are sufficient to finance the increased private and public investment. In other words, by the painful process of a rise in prices, the community is made to save as much as it invests. Capital formation and saving become equal. In the process, however, the relative share of wages in the national income falls and various other evils and inequities take place. Wage increases (which may be regarded as a form of investment by entrepreneurs), if again not offset by genuine savings, lead to a further rise in prices and the typical vicious spiral of wages and prices chasing each other develops.

Inflation is a major obstacle to economic recovery and development.

It distorts the normal price and income structure and diverts resources from the production of more essential to less essential goods. The distortion of the income structure causes much social injustice and hardship. Inflation also tends to discourage exports and encourage imports, creating or aggravating balance of payments problems. Since it discourages saving, produces labour discontent (because wages generally lag behind prices), and makes rational cost calculations impossible, it also tends to reduce production.

Open and Suppressed Inflation—Some of these evils may not arise in 'suppressed inflation' where prices are kept under control and not allowed to rise freely as in 'open inflation'. But effective and comprehensive price control is administratively very difficult to establish. In any case, suppressed inflation has also got its own special drawbacks; and all told, there is perhaps little to choose between the suppressed and the open type. From the point of view of effects on distribution of incomes, suppressed inflation is certainly better than open. In the absence of price control, prices rise more than wages. Consequently, real wages fall and real profits increase. This undesirable shift in distribution is prevented in suppressed inflation by keeping prices down by price control, rationing, subsidizing of consumer goods, etc. Since food is the most essential consumer good, food prices generally rise most in open inflation. This tends to raise incomes of agricultural producers more than that of industrial producers, a type of shift in income distribution which in the present state of the economy is perhaps not undesirable.

From the point of view of effects on the price structure, suppressed inflation, since it generally controls only the prices of essential goods and not of all goods, is likely to distort the price structure more than open inflation. The limitation of spending on essential goods diverts spending power to non-essential goods whose prices rise. Consequently, producers divert productive resources from essential to non-essential channels. Of course, when price control covers all important articles, suppressed inflation will not mean a distortion of the price and production pattern, but such all-inclusive price control is seldom possible. It may be added here that in open inflation also the prices of a few essentials are often

controlled. Consequently, open inflations are also not quite free from price distortion.

From the point of view of effects on incentives to production, open inflation seems better than suppressed. Price control by limiting prospective money profits lessens productive effort. This seems to be one reason, among others, why in Ceylon controls of agricultural price has tended recently to be relaxed. A double price system for rice has been adopted. The consumer is allowed to buy at controlled (and subsidized) low price a limited quantity; but he can, in addition, buy whatever extra quantity he wants in the open market at uncontrolled prices. As part of the same policy, the system of compulsory procurement from the farmer at a controlled price of the whole of his produce, less his personal consumption requirements, has also been given up. Open inflation not only offers a higher profit incentive, but also a higher incentive for maintaining stocks. If prices cannot be raised, traders have no incentive to maintain stocks in the face of rising demand. The fall in inventories in suppressed inflation may seriously retard production, as British experience seems to show. On the other hand, it must be pointed out that in open inflation, the normal level of stocks may be augmented by speculative hoards, which also will be an unhealthy development. However, although open inflation may sharpen incentives, it will also tend to reduce production by causing labour discontent and reduction in saving. The rise in profits may also cause diversion of resources to the production of luxury goods, thus distorting the production pattern.

Effects on foreign trade will depend on how far the national price cost structure is prevented from rising relatively to the price cost structures outside and how far the exchange rates are allowed to vary with variations in relative price cost structures. Since generally in open inflations exchange is not allowed to fall sufficiently, the over valuation of the national currency encourages imports and discourages exports. In Ceylon, although inflation has been suppressed to some extent, the suppression has not been sufficient to prevent domestic prices and costs from rising more than in countries with which trading is done. Since exchange rates have remained unchanged, it has meant a certain amount of overvaluation of the rupee.

Thus, on the whole, both open and suppressed inflations have serious disadvantages, and so far experience does not seem to show that from the production point of view one is better than the other.

Methods of Prevention and Relief—There are two possible ways of attack on inflation. One is to remove its basic causes and the other is to mitigate its effects.

The basic cause being a disequilibrium between saving and investment, it can be eliminated by cutting investment down to the level of savings or raising savings to the level of investment. Raising savings will obviously be the better strategy than cutting investment. The scope for raising savings is, however, very limited. The fall in real income consequent on the economic dislocation caused by the war has increased the propensity to consume. Regarding cutting of investment, private investment may be reduced by limiting profits (by taxation or otherwise), limiting credit facilities (by raising interest rates, quantitative credit control etc.,) or failing such financial devices, by direct control of investment by a system of permits and allocations of labour and the materials. Government expenditure can be kept down to the level of the sacrifice of consumption (that is the level of saving), made by the tax-payers and the Government's lenders, by keeping the budget balanced. If in the private sector of the economy, investment exceeds saving, surplus budgeting by the government will be necessary to compensate it. Net export can be cut down, prevented or even converted into net import by adjustments in exchange rates, tariffs, trade and exchange controls.

The problem of accumulated liquid savings may be tackled by destroying or freezing them partly or wholly, by monetary measures such as issue of new notes, (or new currency units), forced loans, blocking of accounts etc. These measures will also help to siphon off a part of currently created money incomes.

In undeveloped countries like Ceylon, limitation of investment as a policy should perhaps be adopted rather cautiously. In increased investment lies their main hope of raising their standards of living. Much of the development finance will have to be spent at home, causing inflationary pressure, although much also of course will be spent abroad. It is hardly likely that internal savings can be stepped up to the level of the large local

development expenditures necessary. Of course, the right strategy should be to try to step savings up to the level of the investment, rather than cut savings down. But failing an equation between the two, it may be worth while for these countries to face even a moderate amount of inflation rather than sacrifice development. Actually, pressure may be less than feared, since there are in these countries much unused or ill-used resources. They are not countries with full employment in the true sense of the term. Physical returns from capital investment here may thus well be above what is expected in developed countries.

Regarding budget deficits, since development is mainly contemplated to be done by the State (and not private enterprise), it is difficult to see how such undeveloped countries can escape deficit budgets.

Price Control—If the root causes cannot be attacked, the next best thing to do about inflation is to try to chain prices down by price control and other devices so as to minimize the evil effects of the pressure. Price control must go with rationing, otherwise the distribution will be haphazard. These measures will limit the spending of incomes. Prices may also be kept down by paying subsidies to producers. If the subsidies are obtained by creating deficit budgets, they will add to aggregate income and so heighten inflationary pressure. If they are obtained by taxing certain classes of earners, they will mean a reshuffle of existing incomes and the precise economic effects of the reshuffle will depend on from what classes money is taken and to what classes it is given. In any case, subsidization by itself will not reduce aggregate incomes or aggregate spending.

The limitations of price control and rationing are obvious. In the first place, it will do nothing to remove the basic causes of the pressure. The pressure will be still there, only it will be prevented from breaking out. Secondly, it will be extremely difficult to make price control effective and comprehensive, and if it is not effective and comprehensive it will have, as already explained, consequences hardly less harmful than open inflation. It will be very necessary to adopt price control along with an attack on root causes, but by itself it will obviously not be enough.

In Ceylon price controls are tending to be gradually relaxed. Whether this policy of activating pressure is right or whether controls should be continued or even tightened, is not easy to say. Since the total pressure is not too heavy, perhaps a policy of measured activation (de-control) together with a determined attack on the root causes is the best.

Wage control is a good weapon but should be used cautiously. Higher wages paid out of credit expansion would further increase inflationary pressure and produce the upward spiral of wages and prices. But where the increases are paid out of accrued profits, they would only mean a transfer of existing money incomes and not an addition to them. Such a transfer will only redress the shift in the distribution of income caused by rising prices and profits. An indiscriminate policy of wage freezing may be socially very unjust by labourers.

Food Prices—In fighting inflation, special attention should be given to the inflation of food prices. Food is generally one of the first casualties of inflationary pressure. The effects of food price inflation are also more disturbing than the effects of non-food price inflation. In the first place, it causes much social distress, specially in countries where the general level of incomes is low. Secondly, it tends to breed further inflation because (*a*) more than any other factor, it goads workers to demand higher wages which may produce the wage-price spiral, and (*b*) it brings larger incomes to farmers who generally spend a larger proportion of their incomes than producers of non-food goods. The problem is difficult because the general attack on inflation by balancing budgets and curtailing private investments carries no guarantee that the demand for food would be proportionately reduced. Budgets are usually balanced by taxing the higher incomes, which little curtail the food consumption of the well-to-do. On the other hand, a rapid stepping up of food production is extremely difficult not only because of scarcities of agricultural requisites, but also because of the low education and conservatism of the farmers, existing systems of land tenure etc., in short, the general socio-economic framework. The policy adopted in this respect should therefore be to control as tightly as possible prices by price-control and rationing while, at the same time, making every effort to increase the supplies either by domestic production or imports.

In the absence of sufficient statistics, it is not easy to say what factors have generated or are generating inflationary pressure and to what extent.

Budget deficit has not been, until quite recently, an important direct factor. Throughout the war and the post-war period, the budgets have shown small surpluses. The surpluses in recent years have been, however, more apparent than real, because large expenditures in the form of advance accounts for food subsidization have been excluded from the budgets. After writing off the accumulated expenditure on this head, the 1947—48 revised budget showed a deficit of Rs. 157 million. This amount considerably exceeds the combined surpluses of the previous war and post-war years.

A much more important factor has been Allied military expenditure in the country during the war years. The exact size of this expenditure is not known, but at its peak in the year 1944 it is estimated to have been Rupees 435 million. In 1943 it was estimated to be Rupees 264 million. In relation to the size of the national income, these were very large disbursements. This expenditure which created incomes in the country, can be called either a form of investment made on military account, or better perhaps, a form of invisible export from the country.

Quite apart from this, net export in the ordinary sense has also played a very important part. Up to 1940, the country's balance of payments on current account showed small yearly deficits. Thereafter they showed considerable and mounting surpluses. The estimated figures have been as follows :—

Table 17

BALANCE OF PAYMENTS ON CURRENT ACCOUNT

(In Million Rupees)

	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947
Exports (visible and invisible) ...	315	357	414	482	768	866	1157	1137	960	969
Imports (visible and invisible) ...	342	377	442	426	472	599	731	823	908	1165
Balance ...	—27	—20	—28	+ 56	+ 296	+ 267	+ 426	+ 314	+ 52	—196

Information on savings is incom lete, but from what statistics are available, savings seem to have lagged far behind the requirements for saving created by these inflationary factors. The net additions to saving in the form of purchase of savings certificates and savings deposits in the Post Office Savings Bank, the Ceylon Savings Bank and the commercial banks have been as follows :—

TABLE 18

ADDITIONS TO SAVINGS

(In Million Rupees)

1939	1940	1941	1942	1943	1944	1945	1946	1947
1.4	.8	-.3	-4.3	25.8	33.4	61.0	52.6	10.7

The low desire for saving (or to look at it from the opposite angle, the high propensity to consume) may be explained by (*a*) fall in real income (national income in 1947 deflated by the rise of prices was less than in 1937), (*b*) accumulation of liquid savings from past earnings (pent-up demand), and (*c*) forced deficiency in consumption in durable goods during the war years due to controls and shortage of supplies. That demand is still largely pent-up as indicated by the greater rise in note circulation than in prices, which means that purchasing power cannot be fully spent out on purchases.

The impact of the inflationary pressure on circulation and prices is shown below. As there is no general retailing price index, the cost of living index is taken as indicating changes in the real value of money.

TABLE 19

INDEX OF NOTE CIRCULATION AND COST OF LIVING

Year	Note Circulation (Gross) 1938=100 Average for year	Cost of Living Nov. 1938—Apr. 1939=100 Average for year	Ratio of Note Circulation to Cost of Living
1939	99.24	104	.95
1940	125.13	112	1.12
1941	147.53	122	1.21
1942	270.34	164	1.65
1943	387.07	196	1.97
1944	512.86	200	2.56
1945	737.34	221	3.34
1946	826.40	229	3.6
1947	771.31	252	3.06

The Table shows that inflation has been to some extent suppressed. Prices have been prevented from reacting to the full extent of the inflationary pressure. Actual expenditure has been kept down in relation to the amount which the public has desired to spend at the prevailing level of incomes by various measures of control. The result is that the real value of cash holdings has gone up. The prevailing scarcity has appeared to the consumers not as a scarcity of income or purchasing power, but of goods. At prevailing prices, the economy has got more purchasing power or liquidity than it needs. It is a situation of excessive liquidity.

Actually, the Table somewhat overstates suppression. The price index used has been prepared on the basis of controlled prices. If black market prices were taken into consideration, the index would have shown higher figures.

It is true that the rise in the real value of cash holdings does not necessarily indicate that a country is under inflationary pressure. The real value might increase because of the increase of real national income. But in Ceylon's case, real national income has not appreciably changed, indeed it seems to have slightly fallen from the pre-war level. It is thus patent that the rise in the real value of the note circulation indicates a measure of suppressed inflation.

Thus the most important development in the field of currency during the war was inflation. Currency was liberally, almost ruthlessly, inflated in order to finance Allied war expenditure in Ceylon. What happened was that Britain gave sterling to the Reserve Bank of India and got rupees created in India. This was possible under the Indian currency system. Later she gave some of these rupees to the Ceylon Currency Board and got rupees created in Ceylon. The process went on at a growing tempo from 1942 onwards. The result was that currency was inflated in Ceylon and the Currency Board accumulated rupee balances in the Reserve Bank of India. Later, for better distribution of its assets, the Currency Board transferred a large part of its Indian balances to London. Thus grew up its existing dual reserves in India and Britain.

The extent of the inflation and the size and distribution of the currency reserves from 1939 onwards are summarised in the Table below :

Table 20

NOTE ISSUE

(In Rupee Millions)

	End of Year Figures							—31st Aug.
Total Issue of Currency	1939	1942	1943	1944	1945	1946	1947	1948
Notes in circulation ...	53·2	171·2	204·4	294·3	432·7	375·0	395·6	381·2
Subsidiary coins in circulation ...	—	6·7	3·4	10·0	14·0	14·5	13·8	13·5
Subsidiary notes in circulation ...	—	6·0	6·9	4·5	2·8	3·3	2·4	2·1
	53·2	183·9	214·7	308·8	449·5	392·8	411·8	396·8
Assets								
In Ceylon :—								
Specie in Ceylon ... (including realisable value of silver) ...	14·5	1·5	—	—	—	—	—	—
Ceylon War Loan ...	—	9·3	12·0	20·3	20·5	20·6	20·6	20·3
In India :—								
Reserve Bank of India current account ...	2·0 (Imp. Bank of India)	1·6	5·4	1·7	2·1	40·2	1·9	108·6 (cash & bills)
Treasury Bills ...	6·6	13·3	5·9	5·0	7·5	7·5	121·5	—
Govt. of India Securities	3·5	76·9	98·4	120·3	61·2	45·5	37·0	36·8
In U.K. :—								
Sterling Securities ...	34·6	88·3	106·1	178·2	380·9	319·5	266·9	271·4
	61·2	190·9	227·8	325·5	472·2	433·3	447·9	437·1
Note circulation index (1938=100) ...	99	270	387	513	737	826	771	

Note—The disappearance of specie from the Assets side after 1942 is explained by the fact that after the establishment of the exchange standard in 1941, it was not necessary to hold any metallic rupees in Ceylon. The contraction of circulation in 1946 was only to be expected. The slight rise in 1947 seems to have been due to repatriation of part of their investments from India to Ceylon by banks. The repatriation was easiest done through the currency, the Currency Board receiving balances in India and Ceylon banks receiving notes in Ceylon. The reason for this movement of funds was perhaps partly the uncertainty about the future exchange value of the Indian rupee (there being talks of devaluation), and partly the fear of a ban on capital transfer from India (which was later actually imposed). Since the scope for the investment of these funds in Ceylon was very limited, they were largely carried as cash. Banking returns given later show this growth of cash. In December 1947, it will be seen there, cash stood at the unusually high figure of 32% of deposits.

This is hardly the place to discuss how far inflation was justified. To an extent it was perhaps inevitable. Britain could have obtained the necessary rupee finance in three other ways: (1) sale of British gold, (2) sale of British investments, and (3) loans and gifts from Ceylon. The third method was used to some extent. The Ceylon Government floated loans and re-lent a part of the proceeds to Britain. Surplus Government funds also (obtained by surplus budgeting) was largely kept in sterling. But the finance raised in this non-inflationary fashion was quite inadequate. Britain considered it impossible or undesirable to use the first two devices. Hence, the easy method of inflation was most used. It is well to add here that the inflation of currency was, as was to be expected, followed by a certain amount of inflation of credit also.

The impact of such large scale inflation on the economy was naturally very serious. It inflicted heavy real sacrifices on the people. Unlike loans and taxes which are collected on the basis of ability to pay, it extracted services from the least able. The real income of the wage-earners mostly fell and they were compelled to submit to ' forced saving '. In a country where workers usually are not even earning a subsistence wage, the fall in real wages meant very high human cost. The sterling (and other foreign) balances of the country in this context is thus not a measure of the country's real saving, but of its misery and privation. Some of the other evils of inflation and how it is tending to distort and diminish production and create a fundamental disequilibrium in the balance of payments have been already mentioned in Chapter I.

The higher prices called for adjustments in wages and salaries. The adjustment was made in most cases partly by raising basic wages and partly by giving cost of living allowances on a sliding scale. In very few cases, however, did the rise in wages overtake the rise in living costs.

The Sterling Balances—One important problem created by inflation was that of the future of the foreign balances against which inflation was done. A statement of the total foreign balances of the country is given in Table 21. The balances did not, of course, all grow out of inflation. As already said, Britain partly collected rupee finance in Ceylon for her excess purchases (net imports visible and invisible) by non-inflationary methods also. The Ceylon Government by surplus budgeting raised considerable sums which it, for its own convenience, deposited abroad.

It means to that extent returning notes to the Currency Board (disinflation) and transferring foreign balances from the Currency Boards to the Government's account. In this way mainly grew up the foreign holdings of the Government. The Government also raised a special rupee loan for re-lending to Britain. But this particular foreign investment is not a liquid holding and so cannot strictly be called a part of the total foreign balances. It is therefore shown separately in the table. Exporters and other earners of foreign income also retained abroad a part of their net foreign earnings, or if paid in rupees in Ceylon, transferred (or their banks transferred) a part of their rupee holdings abroad. In other words, net exports also created foreign balances to some extent without being accompanied by inflation at home. Thus grew up broadly the balances of the banks and other parties. While thus the holdings of the Currency Board at any given time indicated roughly the amount of inflation still outstanding, the holdings of the Government, the Banks and private individuals represented accumulation by normal non-inflationary methods. The main technique, however, as the figures in the table show, was inflation.

Whether they accompanied inflation or not, the fact remains that the balances were earned at a heavy cost. That a country where most people live on the margin of subsistence could pile up foreign balances of this size, itself shows what sweat and tears it must have involved. The hardship was heightened by the large use of the inflation method. Rupee finance raised for foreigners by loans or taxes would have caused much less suffering (voluntary retention abroad of earnings from net export is a form of lending). Loans come from voluntary savings. Taxes are levied according to ability, the poor being lightly treated. But inflation not only extracts services on false pretences but hits the poor the most. Wages paid by created money soon raise prices and even if wages follow, they cannot catch up with prices. Thus wage earners and all others whose incomes do not rise equally with prices are compelled to stint or 'save', if we may use the word in that sense. Any 'savings' the country might accumulate under such conditions are thus mainly forced collections from the least able. Their human cost, particularly where workers generally do not earn a living wage, is terribly high. Even under the best of methods the country's sacrifice would have been heavy, but inflation made it infinitely heavier.

TABLE 21

EXTERNAL ASSETS OF CEYLON

STERLING ASSETS—FACE VALUE (In Rupees Millions—Approximate)

	Dec. 1939 Rs.	Dec. 1945 Rs.	Dec. 1946 Rs.	Dec. 1947 Rs.	July 1948 Rs.
Government Surplus Funds ...	23,356	297,517	271,954	46,567	95,652
Commercial Banks ...	30,336	156,178	127,098	78,214	76,107*
Currency Reserves ...	33,371	372,286	303,328	261,158	261,158
Ceylon Savings Bank and Post Office Savings Bank ...	32,261	74,252	104,729	114,235	113,195
Other Government Funds ...	72,510	60,060	66,330	72,970	80,424
	191,834	960,293	873,439	573,144	626,536
Loans to U.K. Government ...	—	102,097	100,083	98,652	75,530
	191,834	1,062,390	973,522	671,796	702,066

*Excludes 6,642 in other currencies.

INDIAN RUPEE ASSETS—FACE VALUE (In Rupees Millions—Approximate)

	Dec. 1939 Rs.	Dec. 1945 Rs.	Dec. 1946 Rs.	Dec. 1947 Rs.	July 1948 Rs.
Government Surplus Funds	200	41,054	40,853	52,987	49,513
Commercial Banks	44,320	80,875	79,945	26,705	29,789
Currency Reserves	27,392	68,216	91,770	159,322	139,557
Ceylon Savings Bank and Post Office Savings Bank	200	—	—	—	—
Other Funds	335	7,024	12,572	18,539	21,346
	72,447	197,169	225,140	257,553	240,205

TOTAL FOREIGN BALANCES (U.K. & INDIA)

	Dec. 1939 Rs.	Dec. 1945 Rs.	Dec. 1946 Rs.	Dec. 1947 Rs.	July 1948 Rs.
Government Surplus Funds	23,556	338,571	312,807	99,554	145,165
Commercial Banks	74,656	237,053	207,043	104,919	105,896*
Currency Reserves	60,763	440,502	395,098	420,480	400,715
Ceylon Savings Bank and Post Office Savings Bank	32,461	74,252	104,729	114,235	113,195
Other Funds	72,845	67,084	78,902	91,509	101,770
	264,281	1,157,462	1,098,579	830,697	866,741

*Excludes 6,642 in other currencies.

It was important therefore that foreign assets earned at such high cost should be freely usable in the country's interest. But the reserves were partly frozen in 1947. Britain restricted convertibility of sterling into dollars. India also prohibited transfer of capital. The currency and other reserves thus were largely immobilized and they could not be freely used for buying essential food imports from hard currency countries. This created a growingly difficult situation for the country. Of course, the best use of the balances would be to reserve them for buying development goods when they became available. But food imports had to be given, for the time being at least, high priority and it was essential that the balances should be freely available for that purpose.

As far as balances held in England were concerned, after some negotiation, an agreement regulating their release was arrived at between Ceylon and the U.K. in May 1948. The agreement is for the rest of the year 1948. A new agreement is contemplated later. The main provisions of the agreement are as follows :—

1. The agreement will apply to the sterling held by the Government of Ceylon, the Currency Board and the commercial banks.

2. The holdings will be divided into two Accounts. The amount held in No. 1 Account will be freely withdrawable and convertible into hard currencies. The amount held in No. 2 Account will be blocked. The No. 1 Account may be said to be Ceylon's current account and the No. 2 fixed deposit account.

3. All sterling earned hereafter from current transactions (that is, currently earned sterling, as opposed to sterling obtained by loans or capital transfer from any other area) will go into No. 1 Account.

4. Out of sterling accumulated in the past, the following portions will be allowed to be transferred to No. 1 Account :—

(a) A sum of £3½ million (Rs. 46.6 million) for the rest of 1948.

(b) A sum of £4 million (Rs. 53.32 million) for use as "a working balance which may be drawn upon from time to time to meet any temporary shortage in Ceylon's available means of payment abroad". If Ceylon suddenly needs more foreign exchange to meet a rise in the price of essential food imports, she would be entitled to run down the working balance and call for an addition of £1 million to it.

(A working balance is not of course an outright grant. Apparently, the intention is that Ceylon should replenish the fund as soon as possible after drawing upon it.)

(c) Interest in full earned by the Currency Board on its assets as they stood on 3rd September 1939.

(d) Interest at the rate of one half of one per cent only on the assets acquired between 3rd September 1939 and 30th April 1948.

(Total interest earned by the Currency Board on its sterling investment in 1947—48 was roughly £570,000. Out of this, assuming investments in 1948—49 will remain the same as in 1947—48, the amount that will go into No. 1 Account under (c) and (d) will be approximately £170,000. The rest of the interest will go into the blocked No. 2 Account.

5. The other members of the Sterling Area will be—

(a) free to make payments to Ceylon in sterling in settlement of all payments for current transactions,

(b) free to convert any rupees earned in Ceylon from permitted current transactions into sterling.

(This apparently means that a British or Indian trader or investor, not resident in Ceylon, has the right to convert his profits, divided or undivided, into sterling. The earnings of any transaction which is a permitted transaction cannot be blocked by Ceylon by exchange control. Vide para VIII of the Agreement.)

6. Capital transfers (as opposed to transfers of current earnings) between Ceylon and other Sterling Area countries may however be regulated by Ceylon by exchange control. Such transfers will

ultimately be made by crediting or debiting the No. 2 Account. In the first instance, however, the transfer will be paid into or out of No. 1 Account. Later, from time to time as the net capital movement between Ceylon and the rest of the sterling area is ascertained, a sum equal to the net amount received by Ceylon will be transferred from No. 1 to No. 2 Account and a sum equal to the net amount paid out by Ceylon will be transferred from the No. 2 to No. 1 Account.

By agreement between the two Governments, particular capital movements may be excluded from the computation of net capital movements.

7. Ceylon agrees to co-operate with U.K. in conserving and strengthening the exchange resources of the sterling area. For this purpose, although her dollar earnings in 1948 are expected to be Rs. 180 million, she intends to keep her dollar expenditure to Rs. 100 million.

The agreement appears to be fair for both parties. Under it, Ceylon may have a maximum release of £3½ plus £4 plus £1 million (or Rs. 113.3 million) during the period May to December 1948. This as far as one can see, ought to be sufficient for her needs. On the other side, it may be pointed out that the agreement relates to only 1948. Uncertainty about the future rate of release therefore still remains. Another important point is that the agreement is only in respect of balances in the U.K. No agreement has yet been made with India regarding balances held there which are quite considerable (Rs. 240 million at the end of July 1948). These balances also are, on account of the strict limitation of capital transfers from India (interest transfer is freely allowed) more or less immobilized. These Indian balances are also morally, if not legally, Britain's liability, since they also arose out of Britain's and not India's purchases. India owes Ceylon because Britain owes India. It will be extremely difficult, if not impossible, for India to honour her rupee debt to us if Britain does not honour in the same terms her sterling debt to India.

Exchange Control—Partly to fulfil obligations under the Sterling Balances Agreement, but mainly to conserve the foreign exchange resources of the country, exchange control of a comprehensive and drastic character, covering remittances not only to the non-sterling but also to the sterling area countries, was established from 1st June 1948. Exchange control of course first came on the outbreak of the war, but it was partial and applied only to the non-sterling area. Even this limited control was gradually being relaxed. But now it was sweepingly tightened and extended in scope.

The new extended control will have, according to a statement issued by the Finance Minister, three main functions :—

1. To keep an account of and to mobilize all earnings of foreign exchange for the nation's need. For this purpose, exporters will be required to surrender all their foreign exchange earnings to Banks in Ceylon within six months from the date of export and the Control will obtain full returns of these earnings from the Banks. Foreign currencies earned in the form of dividends and commissions and foreign balances held by individuals will not have to be, for the time being at least, registered, but the possibility is not ignored.

2. To control expenditure of foreign exchange for the purpose of (*a*) meeting essential needs of the country first and (*b*) keeping expenditure generally within income and preventing the growth of an unfavourable balance of payments.

This will be done by controlling the foreign investments of banks and Insurance Companies, remittances of business people (remittances for bona fide commercial purposes will be allowed), remittances for travelling abroad, remittances for maintenance abroad of relatives, and remittances for transfer of capital (as distinguished from transfer of current income). It is intended, however, to allow in full remittances of dividends on Ceylon securities earned by persons abroad. (It may be mentioned here that under the Sterling Balances Agreement, remittances of current earnings by residents abroad within the Sterling area cannot be restricted).

3. To keep a record of all movements of funds, inward and outward, of a capital nature.

(Apparently the intention is not simply to keep a record of capital transfers, but also of current transfers. The line between capital and current transactions is not always easy to draw).

One is not quite sure if the imposition of exchange control on such a sweeping scale was on the whole a wise step. It is true that the gap between foreign income and expenditure was alarmingly wide, but further attempts might have been made to cut down imports by import control. Actually, it will be seen from the Table on foreign balances (Table 21) that Ceylon's sterling balances at the end of July 1948 stood higher than at the end of December 1947, apparently proving that the steps taken (by import control and otherwise) to conserve foreign exchange, were bearing fruit. The improvement was not due to exchange control, as the position was really even better before 1st June when exchange control was introduced. More liberal releases from accumulated foreign balances or even some foreign borrowing could have also tided the country over the crisis. Of course, as explained in Chapter I, the root of the trouble was the growingly unfavourable terms of trade. Further vigorous efforts to raise export prices and reduce import prices might have yielded some fruit. A further vigorous attack on inflation would have also helped. Exchange or import control, it should be remembered, will not remove the basic causes of the malady, but will only attack symptoms.

It is also well to remember that since it is not intended (or possible) to restrict the outflow of current earnings of individuals or companies resident abroad, the scope for control becomes small. In Ceylon, remittances on dividend account constitute a major item on the outward side of the balance of payments. Control also will shake the confidence of foreign investors who will want to withdraw their assets from the country. Such a tendency is already noticeable. It is obviously important that Ceylon does nothing which is avoidable to scare away foreign capital. How far control could be made effective is also not easy to say. Experience in other countries shows that it is extremely difficult to control all supply and demand of foreign exchange, and leakages create flourishing black-markets. In Ceylon also, a black market has already appeared and Indian currency is reported to be selling at a premium of 10 per cent. This means that the long-established and much-vaunted stability of the exchange value of the Ceylon rupee has in part at least gone.

If we add to this the high administrative cost of running the Control, the delay involved in getting permits, the general restriction of liberty it implies, the possibility of corruption, etc., the total social cost of the measure may outweigh its gains. As an economy depending so much on foreign trade and employing so much foreign labour, Ceylon's normal foreign economic contacts are relatively much greater than, for instance, of a country like India. Consequently, she should be careful about blocking the normal channels of contact. England, it may be mentioned, has not extended control to the sterling area.

A community which seems to have been particularly affected by exchange control is the community of Indian labourers working in Ceylon. The loss of full freedom to export their earnings and savings may well cause hardship in many cases. Eventually it may even interfere with the adequate supply of Indian labour required by Ceylon estates and also cause a straining of the relationship between Ceylon and India.

An indirect consequence of exchange control is that the currency system of Ceylon loses largely its character as an automatic exchange standard. No longer has any person the unlimited right to tender rupees in Ceylon and obtain rupees in India or tender rupees in India and obtain rupees in Ceylon.

Reserve Bank—That the exchange standard should be modified, though indirectly, is of course not surprising. Not the least of the disadvantages of the exchange standard are that (1) the whole of the currency used by the country has to be acquired by it by net exports (whereas it could have been obtained more cheaply by a fiduciary issue), (2) the foreign assets built up against the issue remain largely immobile, and (3) expansion and contraction of currency is possible only through excess of exports or imports. The general trend in Asian countries, indeed all over the world, seems therefore to be to change from exchange standards (linked to metropolitan or other

currencies) to managed monetary systems.* Ceylon also seems to be on the way to this transition. The Government has already decided to establish a Central Bank. An expert to formulate a scheme will be arriving at the end of 1948. It is not clear however whether the expert is only to prepare a Reserve Bank Scheme on the basis of the existing currency system (that will only involve a transfer of the currency administration from the Currency Board to the Bank), or if he is also to examine the existing currency system itself and make proposals for reform. It would obviously be wise to attack both problems at the same time, because banking reform without currency reform would not give the proposed Reserve Bank much power to shape the economic or monetary policy of the country. The whole question of reform, whether of currency or banking, is of course a very complex question. One wishes that its examination was entrusted to a small committee of experts instead of to a single expert as now proposed. Two heads in such a task are always better than one.

A currency problem, quite perplexing at one stage during the war, was the scarcity and dearness of silver for making subsidiary coins.**

To meet the scarcity, small change was issued partly in paper and partly in cheaper metals. At one stage, Ceylon had a 2 cent paper note, perhaps the world's smallest currency note.

For preventing hoarding and black market transactions and evasion of income-tax, notes of denominations of Rs. 500 and above were demonetized. They still remain demonetized.

The inflation, as already noted, is contributing to some extent to create a fundamental disequilibrium in the balance of payments. So far the Government has set its face against devaluation. In December 1946 Ceylon formally notified the International Monetary Fund that the par value of her rupee would be Re. 1 = 1/6 *d.* or 30.225 U.S. cents. Whether she will stick to this value or be compelled to change it, is difficult to say, but the whole question of the reform of the currency system of the

**See* Economic Survey of Asia and the Far East, Chapter on Currency and Banking, United Nations Publication 1948.

**All existing silver coins passed their melting points and consequently rapidly disappeared from circulation.

country is now engaging the attention of the Government. The Government has already declared its intention of establishing a Reserve Bank to control and co-ordinate monetary and banking policy. Whether the exchange standard will remain and in what form and what the shape of the new currency system would be will probably be decided after a thorough investigation by an expert committee.

Banking—Banking in Ceylon is mainly in foreign hands. The most important banks are branches of Indian banks or of British exchange banks. The consolidated returns of all banks in Ceylon for 1947 and some previous years are given in Table 22.

It will be seen that there was considerable expansion of bank deposits during and after the war. Actually, the index of bank deposits rose as follows. (1938=100).

	1939	1942	1943	1944	1945	1946	1947
Bank Deposit Index	123	244	280	319	435	466	523

The percentage of cash to total deposits has been as follows.

1938	1942	1943	1944	1945	1946	1947
7.26	5.54	5.25	4.95	21.64	20.75	31.88

The reasons for the extraordinary high cash reserve in 1947 have been discussed above.

Price Movements and Price-Control—During the war, when currency inflation continued unabated, prices naturally rose progressively. In 1946 and 1947 the note issue dropped somewhat, but bank deposits still continued to rise. Import prices, which are largely independent of internal currency issue, also continued to rise. Because of these reasons and the limited success of measures to drain off purchasing power and enforce price control, prices continued to rise steadily, though slowly, throughout 1946 and 1947.

No general price index is prepared in Ceylon, but the following few sectional indices which are available give a measure of the price movement that has taken place.

TABLE 22

CONSOLIDATED BANKING STATISTICS (Rs. 000s)

(END OF YEAR FIGURES)

LIABILITIES	1939	1945	1946	1947
Deposits				
Demand	123,754	460,849	483,130	468,000
Time	39,074	43,211	35,088	36,912
Savings		20,382	25,888	26,643
		524,442	544,106	531,555
Balances due to other banks ...		84,153	72,224	137,789
Other liabilities		13,275	20,908	23,875
ASSETS				
Cash in hand	9,289	113,469	112,912	169,466
Balances due from :—				
Other banks in Ceylon ...	7,376	74,525	62,695	95,407
Banks in U.K.		154,712	115,601	49,747
Banks in U.S.A.		2,935	2,969	5,948
Banks in Canada		526	1,288	589
Banks elsewhere ...		43,369	56,768	28,492
		276,067	239,321	180,183
Loans and Advances ...	29,333			
Industry		1,138	14,824	37,140
Agriculture		6,695	6,472	6,926
Other		13,591	27,358	45,781
		21,424	48,654	89,847
Bills Discounted	2,026			
Local		136	304	1,271
Sterling		4,141	10,670	28,537
Dollar		1,061	6,443	8,223
Other		361	1,231	2,840
		5,699	18,648	40,871
Investments	12,102			
Local		153,134	176,679	175,975
Other		38,362	24,972	2,887
		191,496	201,651	178,862
Other Assets		8,413	16,251	15,911
Nett Overseas Assets ...	102,711	240,283	211,796	107,233

Information available for 1939 is not so detailed as for the other years.

TABLE 23

CERTAIN PRICE INDICES

(Annual Averages)

		1939	1942	1943	1944	1945	1946	1947	2nd Quarter 1948
Import Price (1934—38=100)	...	102	239	308	399	404	423	488	525
Export Price [1934—38=100)	...	140	188	202	232	348	265	330	334
Food Import Price (1934—38=100)	...	101	246	334	573	626	634	767	850
									First half of 1948
Cost of Living 1. Colombo workers (1938—39=100)	...	104	164	196	200	221	229	252	260
					(End of year figures)				June 1948
2. Estate Labour (1939=100)	...	100	173	203	210	224	232	240	255

Reference to methods and results of price control of consumption goods has already been made in Chapter VII on Consumption. Control was widespread in 1945, but since then, there has been a fairly rapid process of decontrolling. In 1947, the most important prices controlled were those of essential foodstuffs and cotton textiles.

Foodstuffs were largely de-controlled in 1948. Textile rationing was also given up in that year.

During the war production goods, also being in acute short-supply, were largely price and distribution controlled. These were rapidly lifted after the war.

The prices of certain export goods also have been controlled at one time or another, but the object in such cases has not been to prevent a rise, but a fall. Shippers rings and other unfavourable factors were, the Government feared, keeping the prices of certain export goods too low. In such cases floor prices were fixed. In 1948 the chief articles of export to which this floor price system still applied were Cocoa, Cinnamon, Fibre and Desiccated nuts.

Wage control in the sense of freezing of wages or fixing wage ceilings has not been attempted in Ceylon.

The extent of inflation and its more important effects on the economy have been discussed in Chapter I and Chapter VIII.

CHAPTER IX

PUBLIC FINANCE

SOME account of the forces that shaped public finance in the post-war period has been given in Chapter I. Briefly, it will be recalled, Government expenditure rose because of rise of prices, increase in salaries and establishments (creation of new and expansion of old departments) and greater expenditure on economic development and social services. Apart from that, surplus balances and loan funds were used (as advances) to subsidise food and other essential requirements of the people. These advances have actually proved irrecoverable. The 1948—49 budget therefore provided for the writing off of a sum of Rs. 212 million given as food subsidy during the previous years. Government revenue increased because expenditure increased and also because the Government wanted to (*a*) drain off purchasing power to fight inflation and (*b*) accumulate reserves for future national development.

The position at a glance of the growth of revenue and expenditure since 1938—39 is shown below :—

TABLE 24

GROWTH OF REVENUE AND EXPENDITURE

(Rs. million)

			1938—39		1948—49 (Budget estimates)
Expenditure	(ordinary)	...	127.1	...	530.3
,,	(from loan funds)		5.2	...	145
Revenue	...	...	116.9	...	534.8

How expenditure has grown and changed in pattern will be seen from the tables given below.* The years are financial years, 1st October to 30th September. Figures for 1946—47 are revised estimates, for 1947—48 draft estimates.

*Most of the figures in this Chapter are from a paper on National Finance by Mr. N. U. Jayawardena read before the Royal Empire Society and from the Budget Speech of the Finance Minister 1948—49.

TABLE 25

EXPENDITURE CHARGED TO REVENUE — LOAN EXPENDITURE (Rs. million)

	Ordinary	Extra-ordinary	Total	LOAN EXPENDITURE (Rs. million)
Average for				
1936—37 to 38—39	111.8	4.6	116.4	5.2
1945—46	221.1	76.3	297.4	41.4
1946—47	274.5	75.1	349.6	77.1
1947—48	316.7	119.0	435.7	116.1

The budget for 1948—49 provides for a total expenditure of Rs. 534.8 million from current revenue and Rs. 145.0 from loan funds. Extra-ordinary expenditure is non-recurrent, such as on floods, epidemic-relief and meeting deficits in Government commercial (self-financing) undertakings like the Railway. The accounts of these self-financing bodies are not included in the picture of Government finance given above.

Cost of public service including salaries and wages, pensions and cost of living allowances has increased as follows :—

TABLE 26

COST OF PUBLIC SERVICE

	Rs. million	% of total expenditure
1938—39	56.2	44
1945—46	137.9	44
1946—47	164.7	47
1947—48	237.0	53

That the increase in public expenditure has been mainly brought about by increased expenditure on economic development and social services is indicated by the following analysis of Ordinary Expenditure. It should be remembered that much of the Extraordinary Expenditure is also on these two heads. Further, Loan Expenditure is also largely on them. The figures below therefore hardly give a correct idea of the State's increasing part and interest in economic and social services.

TABLE 27

ORDINARY EXPENDITURE (Rs. million)

	Total	Economic Development	Social Services
Average			
1936—37 to 1938—39	111.8	29.7	25.6
1945—46	221.1	73.5	77.0
1946—47	274.5	91.6	95.5
1947—48	316.7	111.7	113.5

It will be seen that outlay on economic development was four times and on social services $3\frac{1}{2}$ times as much in 1947 as in pre-war years. The budget for 1948—49 provides for the following distribution of expenditure :—

TABLE 28

DISTRIBUTION OF EXPENDITURE 1948—49

(Rs. million)

	From Current Revenue	From Loan Money	Total	Percentage to Total Expenditure
Development of National Wealth	59.1	67.5	126.6	18.7
Social Services	243.1	27.5	270.6	40.1
Utility Services	86.4	43.7	130.1	19.3
Administration	49.7	3.9	53.6	7.9
Defence and External Affairs	5.9	2.4	8.3	1.2
Legislation	4.6	—	4.6	0.7
Pensions	28.7	—	28.7	4.3
Public Debt	33.5	—	33.5	5.0
Miscellaneous	19.2	—	19.2	2.8
Total	530.3	145.0	675.2	100.0

Loan Expenditure policy has somewhat altered. Formerly loan funds were used only on projects which were directly productive, namely, those which were expected to yield revenue to cover the service of the loan. But in recent years they have been increasingly used on expenditure which is even remotely or indirectly productive. This and the State's increasing part in undertaking economic development explain the growth of aggregate loan expenditure.

TABLE 29

DISTRIBUTION OF LOAN EXPENDITURE
(Rs. million)

	Total for 1937—38 to 1938—39	Total for 1945—46 to 46—47
Irrigation ...	2·6	21·9
Agriculture and Lands ...	—	2·8
Industrial Development ...	·1	13·3
Electrical ,, ...	6·6	10·1
Public Utilities ...	6·5	3·4
Communications ...	7·9	20·6
Sanitation & Water Schemes	—	3·6
Building Schemes ...	·6	12·5
Other ...	3·7	1·0

The position of the public debt is shown below. Ceylon's national debt, it will be seen, is very small.

TABLE 30

PUBLIC DEBT (Rs. million)

	Gross debt	Sinking Fund	Net debt
On 30-9-39 ...	204	63	141
,, 30-9-45 ...	392	50	342
,, 30-9-46 ...	437	60	377
,, 30-9-47 ...	469	75	394

Rs. 100 million raised in the country and re-lent to U.K. is not included in the above figures. An important development during the war was the starting of the issue of rupee loans. Some of these loans are 'on tap', providing a constant opportunity for investment to local investors.

The growth and composition of Government revenue is summarised in the table below :—

TABLE 31

REVENUE (Rs. million)

	Total Revenue	Direct taxes	Indirect taxes	Non-tax revenue
The average 1936—37 to 1938—39 ...	116·4	18·8	65·3	32·3
1945—46 ...	348·8	110·2	170·0	68·6
1946—47 ...	457·7	98·4	292·8	66·5
1947—48 ...	489·1	92·4	330·5	66·2

The revenue estimates for 1948—49 are: Total revenue Rs. 534·8 million, of which tax revenue is Rs. 470·6 and non-tax 64·2 million.

The percentages of revenue raised by direct and indirect taxes is shown below.

TABLE 32

PERCENTAGE OF TOTAL REVENUE
(Tax and Non-Tax)

	Direct taxes	Indirect taxes
Average 1936—37 to 1938—39	16·1	56·1
1945—46 ...	31·6	48·7
1946—47 ...	22·2	63·0
1947—48 ...	14·1	68·0

In 1948—49 the proportions are going to be as follows :—

TABLE 33

PERCENTAGE OF TOTAL TAX REVENUE 1948/49

	DIRECT			INDIRECT			
	Income Tax	E.P.D. Profits Tax & other	Total	Import Duties	Export Duties	Other	Total
Percentage of Total Revenue ...	12·2	9·1	21·3	33·4	24·7	8·6	66·7

The bulk of the revenue from direct taxes is from the income tax. The bulk of the revenue from indirect taxes is from import and export duties. In the Ceylon tax system, indirect taxes have always played the more important part. It has made, as already observed, the whole tax system regressive. But that the weight of indirect taxation, already high, should have still further increased in recent years is unfortunate. But the increase is probably a passing phase. It is partly a by-product of the policy of import limitation by import duties. The increase in the tea export duty has been also a very important factor. The duty is a tax on the tea industry, probably justifiable now when the industry is doing well, but would obviously go as world competition in tea increases. In any case it is a crude method of taxing the profits of tea producers. How much of it in effect is paid by capitalists and how much by labour is difficult to say.

The increase in indirect taxes is perhaps to some extent counter-balanced by the increased expenditure on social services (health, education, etc.) and subsidisation of food. What the incidence of taxation now is on different income groups—that is, how much the State takes from each class in direct and indirect taxes—is not known. In 1938, according to an investigation which the present writer conducted,* incidence was as follows :—

TABLE 34

INCIDENCE OF TAXATION

Income per month (earned income only) Rs.	Tax burden as percentage of income: Rural earners	Urban earners
25	7·63	—
50	6·01	11.54
100	5·39	10.52
200	7·04	10.27
500	9·97	13.48
750	—	11.84
1,000	—	12.42
2,000	—	16.34
3,000	—	18.14

*Report on Incidence of Taxation, 1944, by Dr. B. B. Das Gupta.

There is reason to believe that at present in spite of heavier indirect taxation, on the whole the lower income groups are better off than before. Although more is taken, much more is probably given back.

Assuming that our estimate of Rs. 1,736 million of the national income is correct, the State is now taking away roughly 28 % of the national income. The significance of this has been discussed in Chapter I.

Mention has also been made before of the policy of deliberate surplus budgeting which the State for various reasons has followed in recent years. At the end of 1946—47 the accumulated surplus stood at Rs. 257·1 million. Much of this has been given out as advances to meet the loss in subsidising food prices. This loss up to September 1947 was Rs. 122·8 million and growing at the rate of Rs. 10·5 million a month. In September 1948 it stood at Rs. 212 million. It was always doubtful if this huge loss could ever be made good from any other source and the advances returned. In this context, the size of the surplus balances on the one hand and the figures of ordinary expenditure on the other, given in the Tables above, are to some extent fictitious. Expenditure was really higher and the surplus balances were really lower. The closing of these advance accounts and the writing off of the losses, announced by the Finance Minister in his 1948—49 budget speech, was a sound step and meant a return to the correct accounting methods. The writing off not only converted the expected revenue surplus of 1947—48 into a deficit, but also made a large inroad into the accumulated surplus funds of the Government. The total reserves at the beginning of the financial year 1948—49 now stood at Rs. 104 million.

CHAPTER X

INTERNATIONAL TRADE

FOREIGN trade has already been largely discussed in Chapter I because the general economic position of the Island hangs so largely on the position of its foreign trade. This Chapter will mainly amplify with figures the general analysis presented there.

The chief point about visible trade has been that while both imports and exports by value rose, imports proportionately rose more than exports. This turned the surplus trade balance in 1945 and 1946 into a deficit in 1947. The main reason for the increase in imports has been the rise in prices. By quantity, imports in 1947 were not much higher than imports in 1938. Exports have also mainly risen because of a rise in prices, but the rise in import prices has been far greater than the rise in export prices. In other words, the terms of trade have worsened. Actually, exports by volume were throughout the post-war period higher than in 1938.

TABLE 35

VALUE OF IMPORTS AND EXPORTS

(Rs. million)

		Total imports		Total exports		Balance of merchandise trade
1938	...	234	...	289	...	+55
1945	...	608	...	666	...	+58
1946	...	684	...	765	...	+81
1947	...	972	...	889	...	—83

The changes that have occurred are brought out vividly by indices of price and volume.

TABLE 36

INDICES OF TRADE

(1934—38 = 100)

		Export volume		Import volume		Export price		Import price
1939	...	101·7	...	105·3	...	140	...	102
1945	...	112·1	...	82·6	...	348	...	404
1946	...	126·3	...	95·3	...	265	...	423
1947	...	114·9	...	125·5	...	330	...	488

How the more important individual exports have behaved regarding quantity and price has been discussed in the Chapter on Agriculture. The most conspicuous event of course has been the decline in rubber. Among imports, the most conspicuous rise has been in Food, Drink and Tobacco. In 1938, Food was 45% of all imports. In 1947, it was 54%. But this by itself hardly gives any idea of the difficulties of the Island regarding food. Actually, the position was that less food cost more money. This will be clear from the import figures of rice which is the Island's staple food and for which it depends mainly on imports.

TABLE 37

RICE IMPORTS

(000)

		Cwt.		Rs.
1938	...	10,449	...	54,340
1945	...	3,577	...	62,510
1946	...	5,074	...	64,787
1947	...	5,163	...	134,987

As compared with 1938, the Island was paying in 1947 roughly 2½ times for half the quantity. Another great rise was in cotton textile imports.

Certain changes have also taken place in the regional distribution of trade, particularly noteworthy being the increased share of Australia in the Island's trade. But it is difficult to say how far these changes will be lasting. The changes in distribution are summed up below, with special reference to hard and soft currency earnings and spendings.

TABLE 38

TRADE DISTRIBUTION

(Rs. million)

	1939		1946		1947	
	Import	Export	Import	Export	Import	Export
U.K. ...	... 46	151	... 115	401	... 176	299
Rest of sterling area	... 112	46	... 343	171	... 440	220
Canada and New Foundland	... 1	13	... 19	13	... 65	49
U.S.A. ...	... 6	63	... 42	90	... 112	121
Rest of America (excludes Argentina and Brazil)	... ·8	2	... ·4	4	... 7	16
Switzerland ...	... ·5	·4	... 5	2	... 4	3
Rest of Europe ...	... 16	22	... 8	17	... 40	40
Rest of world ...	... 61	12	... 162	33	... 135	67
Total ...	... 243·3	309·4	... 694·4	731	... 979	815

Note—Exports exclude ship stores and bunkers, imports include specie and postal articles.

The distribution has been drawn up specially to show the foreign exchange resources and liabilities of the Island.

The tariff level has generally increased, because of the need for greater revenue and for limitation of imports. Quantitative control also has been exercised through export, import and exchange control. Regarding tariffs, certain reductions may however take place in the near future. At the end of 1947 Ceylon authenticated, though not yet signed, the Geneva Tariff Reduction Agreement. It contains, apart from the most-favoured nation clause (Imperial Preference being excepted), certain schedules of concessions mutually agreed upon. According to these concessions, 15 commodities exported by Ceylon would benefit, including tea, rubber and copra. In return, Ceylon has granted concessions to 84 commodities imported into Ceylon. Subsequent to this, however, in the budget of January 1948 duties on many imports were increased. Whether the country is moving towards freer trade or greater control is at present not quite certain.

The position of the balance of payments and the causes which have brought it to its present unfavourable state have been fairly fully discussed in Chapter I. The balance has been estimated to be as follows

for the various years.* Invisible imports, it will be seen, mainly comprise interest and dividends on foreign capital invested in the country.

(See Table 39 on Balance of Payments).

As already said, the growing deficit has been so far met by drawing upon the country's accumulated foreign balances. But there is a limit to which they can be drawn. Already, externally, checks have been placed by the countries where they are lying on their rate of withdrawal and convertibility into other currencies. Internally also, withdrawal will call for various adjustments in the economy. The withdrawal of the reserves of the Currency Board for instance will call for either currency deflation or substitution of foreign securities by Ceylon securities. In any case, the balances should obviously be reserved as far as possible for the purchase of capital goods. All told, the limit to which they can be easily and wisely drawn seems near, if not already reached.

The foreign balances position has been shown in Table 21.

The decline and the deficit in the balance of payments, as explained in Chapter I, has been mainly caused by world forces over which Ceylon has little control. Internal planning is rather helpless in this matter. For a country whose very existence depends on a sufficient level of imports, it is a most critical situation. If the country was rich, it could have faced the crisis with less concern. It could have tightened its belt further. But there is hardly any room for that. The per capita income is only Rs. 251, and evidence indicates that over 75% of the people are at or near the subsistence level. A country where poverty of such magnitude stalks the land can hardly be expected to possess any power of quick re-adjustment or recovery. It is difficult to see therefore how without liberal foreign assistance the country can tide over the difficulty or carry out any short or long period plans of reconstruction.

*These estimates have been prepared by Mr. K. Williams.

TABLE 39

BALANCE OF PAYMENTS (CURRENT ACCOUNT)

(Rs. million)

Credit	Movements				Debit	Movements			
Class	1938	1945	1946	1947		1938	1945	1946	1947
1. Merchandise ...	289	666	765	889	...	234	608	684	972
2. Interest and Dividends ...	9	26	31	25	...	56	103	142	115
3. Other Services ...	17	445	164	55	...	52	112	82	78
4. Gold Coin and Bullion ...	—	—	—	—		—	—	—	8
Total...	+315	+1137	+960	+969	...	342	823	908	1173
	—342	—823	—908	—1173					
Balance on current account ...	—27	+314	+52	—204					

Printed at the Daily News Press, Lake House, McCallum Road, Colombo, by Bernard de Silva, for The Associated Newspapers of Ceylon, Ltd.