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NOTES AND COMMENTS

Research in Economics

The people of Ceylon are increasingly becoming conscious of the seriousness of the economic situation that is developing in the country, and are demanding a solution to these economic problems from the economists. Concrete solutions to any particular economic problem involves in most cases political decisions Nevertheless, the economists of the country have a responsibility in analysing and clearly presenting the issues involved before the Government and the People

Immediately the issue is thus faced, two problems present themselves. Economic science as we understand it today, was evolved in the west, used to analyse economic problems of the west and is more often than not, coloured by the needs of highly industrialized societies. While the economic science written down in the best known works enable us to understand the correct methodology, the best tools of analysis and the general discipline of this mode of thought, there is in them little opportunity to understand the social, political and moral ethics on which the whole system is based. Economic science, for example, assumes that the entrepreneur is anxious to maximise profits. In a western society, where individualism has had nearly 500 years of history, this is certainly a true assumption. It is not necessary for a western economist to repeat this assumption at every turn and often enough we forget the assumption. Yet it is true, that in eastern societies, the profit motive does not go so deep or so extensively in the social fabric. The first task of the economists in our country is to utilize the methodology, tools of analysis and the discipline of Economics in the concrete situation in our country. This involves a clear insight into the assumptions of the western writers on economic science and an examination to see how far they hold true in our society.

This is where we face the second problem. Unfortunately most economists in our country are not adequately familiar with the national economic conditons. The fault howevers, is not theirs. It is the lack of the economic data for the proper understanding of economic condions. This is felt both in the attempts to solve specific economic problems such as for example "a guaranteed price for paddy" and in the attempts to bring about the general economic development of the the country. For example, no one can yet accurately say, whether it is more socially profitable to invest in food production or in the plantations. The invesment output ratio has to be worked out before any choice of ones of investment can be undertaken.

Economic research in Ceylon therefore, has to be concentrated at the present juncture on the collection of basic data. It has to be coordinated if the limited resources in men and material are to be best utilized. It has to be undertaken according to a plan worked out in terms of national needs. It has therefore to have the experience of administration, planning, business, finance and academic learning, to consider all aspects of research. This is why we believe, that the time has come to established a Council of Economic Research with representatives from the Central Bank, the Planning Secretariat, Business, Finance, the Trade Unions and the University. It is necessary that such a body should while enjoying official patronage, be untrammelled by official administrative control. The basic preparation or solving our economic problems, as we see it, is a two pronged movement first a reorientation in our economic thinking and second a national plan of basic economic research.

Control of Inflation

J. B. KELEGAMA

Inflation is a state of affairs in which there is in a particular economy, an excess of demand for goods and services over supply. Looking at it from the income side it may be said that it is a situation where money income is increasing more than in proportion to income earning activity. The excess of demand over supply may take three forms of competition to maintain or increase the real value of expenditure, the share of real national income or the output. In the first case prices rise when the consumers, firms and the State struggle to maintain or increase the real value of their expenditure in the face of declining productivity; in the second case the struggle to maintain or increase the share of real national income is illustrated when the rising cost of living leads to wage increases which in turn lead to price increases by the manufacturers and producers with the aim of maintaining their profits. In the third example the employers compete to maintain or increase output by attempting to maintain or increase the number of employees and the amount of captial, causing thereby a rise in wages, interest and rent, especially after full-employment level is reached and factors of production are scarce. Inflation therefore may be more illustratively defined as "the process resulting from competition of the State, producers or consumers in attempting to maintain total real income, total real expenditure and/or total output at a level which has become physically impossible, or in attempting to increase any of them to a level which is physically impossible," [1] This definition illustrates to a very great extent the nature of inflation. The next logical question is why is there inflation or how does inflation originate? This too has been partially answered by the definition. But in elaborating it futher it is important to distinguish between different types of inflation. This distinction is necessary not only for proper analysis but also for the applications of anti-inflationary policies; for anti-inflationary policies suitable for one type of inflation may be unsuitable for another. The two most important types of inflation are first, the income or Demand-pull Inflation, and second the Wage or Cost-push Inflation.

Income or Demand Inflation.

The essence of demand or income inflation is the excess demand for goods and services which in no way could satisfy

1. R. Turvey—Some Aspects of Inflation in a closed Economy, in Economic Journal, September 1951.

all demands at non-inflationary prices. The inevitable result is a rise of the limited supply of goods and services. The excess demand may be caused by one or more of the following factors:

(a) Private investment and consumption after full-employment level in a highly developed economy and below full-employment in an underdeveloped economy.

(b) Government's expenditure especially when mobilising scarce resources for war or economic development.

(c) Export surplus or foreign loan.

An increase in effective demand in an economy working below full-employment level and working under capacity will lead to increased employment and output instead of inflation. On the the other hand, an increase in effective demand after full-employment level is reached, when confronted by scarcities or "bottlenecks" of factors of production would clearly, in a free economy cause inflation. It should also be added that inflation may be generated even before full-employment by the existence of bottlenecks alone. This is the case in underdeveloped countries. Her the lack of a broad-based structure of production prevents an increase of employment and production in response to effective demand; the bottlenecks appear long before full-employment and the increase in effective demand results directly in inflation with little or no increase in production and employment. Full-employment may also be possible without inflation if the economy posseses a high degree of flexibility i. e. less specialised fixed factors, increasing labour force, increasing productivity and willingness to work overtime etc., but the limits of flexibility may be reached if the effective demand continues to function. The chief motive force for expansion is profits. Investment goes on increasing so long as profits increase. But this expansion cannot go on for ever; the boom must come to an end. The decline in marginal efficiency of capital caused by the lack of investment opportunities or the rise in the costs of production, ultimately brings the boom and the inflation to an end. Depression and deflation follows if no action is taken by the monetary and fiscal authorities. Thus the demand or profit inflation is self-curative; but it is difficult to say how long it will take to cure itself; this depends on the various economic factors which differ from country to country.

In a war of a large scale it is impossible to avoid inflation altogether. The taxation revenue being inadequate, the Government resorts to inflationary borrowing from banks for

the purpose of moblising resources for war. War and defence expenditure do not increase consumable output; consequently there is an expansion of effective demand without a corresponding increase in supply. The inflationary pressure may be reduced if the Government finances its military operations by borrowing genuine savings; but unfortunately genuine savings are woefully inadequate to finance a war of modern type. Since national defence becomes the predominant objective at whatever cost—inflationary borrowing in the absence of alternative sources of finance may be justified. The experienc of two world wars is sufficient testimony to the fact that no country can avoid inflation in war. This was brought home to us by the war inflation in Ceylon which was caused by the excessive issue of currency against sterling credits in the Bank of England. War expenditure increases the money income not only of soldiers and sailors, but also of millions of civilian workers in war industries and the producers of military equipment. Its inevitable result is inflation. It is also important to realize that war inflation tends to be cumulative; if the Government aims at obtaining a fixed proportion of the country's resources by creating new money, the amount of money it has to create to obtain this will increase year by year, for it is always a fixed proportion of a continuously increasing money national income that the Government has to secure. To this inflation must also be added the scarcities resulting from the lack of transport and reduced supply of cosumption goods. As a result of the war damages and the worn-out capital equipment the supply of goods may be delayed even after the war and the inflation may continue unabated.

An export surplus or a loan from a foreign country is tantamount to an increase in investment and can be inflationary. It can be argued that if the whole export surplus accrues to people who save the whole of it, then there will be no inflationary pressure. But if it accrues to those whose marginal propensity to consume is high, there is greater likelihood of inflation. The boom in the primary export markets following the Korean War in 1950, resulted in export surpluses and inflation in practically all the South Asian countries. It should be noted that while private investment and consumption are the chief causes of inflation in industrialized countries in peace time, export surpluses are the main cause of inflation in underdeveloped primary producers.

Whatever the cause of demand inflation, it is chiefly characterised by an excess of demand over supply. This is the "Inflationary Gap" which may be defined as "the excess of demand over supply at a specified price applied to total effective demand aggregate supply and some price level." Suppose that money income increases from Rs. 100 million to Rs. 125 million: of the increase of the Rs. 25 million, assume Rs. 10 million is absorbed by saving and taxation; then there is Rs. 15 million which people will spend, but for which there are no correspnding goods and services. This discrepancy of Rs. 15 million between demand and supply is the inflationary gap which in practice is not so simple to calculate.

Cost-push or Wage Inflation.

Side by side with demand inflation where prices rise in response to increase of demand, there can also exist wage or cost-push inflation where prices rise in response to increase in costs of production. Cost-push inflation may be caused by:

(a) Demand Inflation which raises prices,

(b) Increase in prices of imports of raw materials and essential goods which enter into the workers' cost of living, resulting from either inflation abroad or devaluation by the importing country,

(c) Labour scarcity and Trade Union strength,

In cost-push inflation, wages occupy the central position as they constitute the chief item in prime costs. We saw above how demand inflation raises prices of goods and services. This rise in prices reduces the real income of the wage-earners: then they agitate for and obtain higher wages; but the employers determined to keep their profit level high offset the rise in wages by raising prices of their commodities. If the rise in prices is confined to one industry, then the workers' real income will not be much affected; but in the case of general inflation, the rise in prices is infectious, the raising of the prices by the employers consequent to a rise in money wages, reduces the purchasing power of workers again; this leads to higher wages again; prices rise once more, and so on and so forth there results a spiralling inflation—a never ending wages-prices race. This type of inflation is in many respects more disastrous than demand inflation. In fact some economists maintain that the essence of inflation is a rapid and continuous rise in money wages, and that without a rise in money wages inflation cannot occur.

Apart from private effective demand, Government military expenditure too may lead to cost-push inflation, partly by generating income inflation and partly by bidding resources especially labour from the civilian sector by offering higher wages. In order to retain the workers the other industries will be compelled to raise their wages too. Military procurements set up cost-push pressure in raw materials too, e.g., rubber, tin, wool and lead required for war purposes. This causes a rise in the cost of production of civilian industries utilising such materials.

It is however important to note that wage inflation can take place in the absence of overall excess demand. Devaluation by any country or inflation in the country from which the goods are imported also raises the prices of imports. The rise in the prices of imports—especially if they are essential goods like food and clothing—raises the cost of living, and the workers begin to struggle for higher wages leading ultimately to spiralling inflation. The experience of Germany in the post-war years is a case in point; the exchange depreciation of the mark in 1921 raised the prices of imports and then the cost of living and the wages; as a result German exports were discouraged; this led to further devaluation which caused another rise in wages and prices and so on and so forth there was a spiral of devaluation and wage and price increases.

Labour scarcity by itself can be another cause of wage inflation. In Germany between 1936-38, as employment advanced, labour became scare, and the employers offered higher wages to recruit them; this caused wage inflation. In this case however, it was the employers who were responsible for the wage inflation. But it is possible for Trade Unions themselves to secure higher wages through their bargaining strength. If the higher wages are accompanied by a corresponding increase in productivity there is little possibility of inflation from the wage side; But higher wages granted without any increase in productivity will not only result in wage inflation, but also discourage exports and endanger full-employment of the economy.

We have so far discussed demand inflation and wage inflation as separate processes. But it is the interaction of both that makes inflation spiral with disastrous consequences. Excess demand makes the cost push-inflation more effective; when there is excess demand for goods and services, employers are less reluctant to grant wage increases, as they can pass the cost increase to the customer. Cost-push makes excess demand more affective, for increases in wages increase the spending power. In economically developed mixed economies it is to be expected that demand and wage inflations will always exist side by side. In under-developed economies where labour is not well organised in the form of trade unions, and under dictatorships where wage increases are prohibited under law, wage inflations are the exceptions rather than the rule.

Open and Suppressed Inflations.

A further distinction is usually made between open and suppressed Inflations. In open inflation, demand and supply are left to themselves to determine prices; it is characterized by rising prices. There is a gap between expected prices and higher actual prices, between expected purchases and the lower actual purchases. This gap is due to the fact that expectation always lags behind reality so that the purchasing power—power to obtain goods—lags behind the spending power—power to spend rupees and cents. The disappointments at the purchasing power results in a demand for higher earnings, which too are disappointed when prices rise and the purchasing power remains the same or even declines. In a suppressed inflation the excess demand is kept under control; prices are prevented from rising by control of prices by the Government as opposed to open inflation. But in both cases, excess demand exists and the consumers are disappointed in not getting the goods and services they want. In both cases the price mechanism is not allowed to govern the distribution of scarce goods among the applicants; instead, distribution is decided by Government in the case of suppressed inflation, and by the skill and good fortune of industries getting ahead of others in the expectation of price rise under open inflation.

Why is inflation bad

The main criticisms of inflation may be summarised as follows:

(a) Inflation sabotages the price mechanism; it frustrates the choice of consumers in the distribution of their income between its various uses.

(b) It pinches the purchasing power of fixed income groups: wage earners, salaried people and rentiers. It increases pari passu the incomes of the businessmen. This inequitable distribution of income creates political and social problems and inter-class conflicts. Its adverse effects on the middle-class may even endanger democracy. The reduction of the real income of the public servants breeds corruption and reduces their efficiency.

(c) It encourages imports and discourages exports thereby causing an adverse balance of payments and a drain of the foreign reserves.

(d) Inflation threatens productive efficiency in many ways. It impairs business management by taking the meaning out of the cost accounting figures; when prices are rising fast, the accountants costs get out of touch with the current situation: consequently management cannot safely gauge the efficiency of their operations by the cost showing. Futher inflation perverts business incentives from productions to speculation and the hoarding of materials and labour. The opportunity to profit from controlling supplies encourages multiplication of middlemen. Production also suffers because inflation renders no-strike agreements unattainable.

(e) It distorts production and wastes resources; the resources which should be utilised for the production of essential goods are used to produce non-essential luxuries.

(f) It cuts into the workers incentives to produce more in order to earn more. Savings lose its attractions when the purchasing power is falling and the future value of currency is in doubt. It reminds one of the story of two men in Vienna, one who saved all his earnings and the other who squandered all of his on consuming unwholesome quantities of beer, but the following day inflation assumed such large proportions that the empty beer bottles of the myopic spender were worth much more in the market than all the savings of cautious man.

(g) Inflation is unjust to creditors.

(h) It raises the cost of living of all classes.

Such an output of literature has been produced on the ill-effects of inflation that people have often failed to appreciate its advantages. The above criticisms are not true of all inflations; it is more reasonable to assume that they are more valid in advanced stages or hyper-inflations, although moderate inflation cannot be entirely free of these defects. The war and post war inflations have made many of us the victims of an inflation phobia that we tend to condemn anything like inflation. But inflation has also another side. In a period of war for instanc, the price mechanism is inadequate to induce rapidly and sufficiently enough the sudden and large shift of resources required for military operations. Apart from irksome controls this can only be done by inflation. It futher brings in wartime the necessary reduction in consumption or forced savings.

A little inflation in an under-full-employment economy or an under-developed economy, far from being a hindrance can be a positive asset. For slightly rising prices provide the necessary incentive to increased investment; resources cannot be drawn for production in a free economy without this incentive. The war inflation secured high prices for agricultural products in Ceylon and other Asian countries and led to a reduction of agricultural indebtedness to some extent; it also contributed to some reduction of unemployment and under-employment by offering work in inflation-financed war industries, and created a new business class who thrived on war contracts. It should also be noted that it was inflation that pulled agriculture out of the depression in the United States in 1942. Further a slight inflation may make the budgetary problem less difficult; for it is easier to tax high incomes resulting from inflation in order to provide interest payment of the National Debt. Of course it is difficult to say what degree of price increases is required for a healthy economy, as this depends on the particular economy and its own experience How inflation could be utilized for economic development and the various implications involved, is a large subject and it will be discussed at length in a subsequent article, at present however we are more concerned with inflationary control.

Methods of controlling Inflation.

When, why and how an inflation should be controlled depends not only on the economic climates of different countries, but also on the political and economic prejudices of the fiscal and monetary authorities. The authorities should have their objectives clearly before them when launching an anti- inflationary policy. The objective may be a stable price level with full employment or less than full employment, or full employment with a stable or rising price level, or equilibrium in the balance of payments and possibly a surpuls. The anti-inflationary methods will vary with the objectives. The force of the monetary and fiscal controls, and the extent to which they will operate succesfully, too vary from country to country. An anti-inflationary policy has to take into account the peculiar characteristics of the economy—its degree of economic development, the structure of taxation, money market, marginal propensity to import, wages-tructure, banking habit, etc. The success of an anti-inflation policy depends to a great extent on its being used at the correct time, to the right extent and in the right direction. A slight error can cause many complications which may be difficult to rectify in time. It should also be emphasized that the anti- inflationary controls discussed below are not indiscriminately applicable to all kinds or all stages of inflation; a slight inflation may not require any control at all while hyper-inflation may prove intractable to all controls. The plan here is to discuss methods of controlling inflation under the following heads; (a) monetary policy (b) fiscal policy (c) subsidies (d) ncrease in production and (e) easing labour bottlenecks.

Monetary Policy

This is especially the field of the Reserve or Central Banks, but it must at the outset be realized that monetary techniques may not be efficacious without the support of budgetary and fiscal policies. The weapons of Central Banks may for the sake of convenience be treated as quantitative and qualitative controls. The quantitative controls are the Bank Rate, Open Market Operations and Reserve Requirements. Bank Rate is expected to check inflation by raising the cost of credit. But it may be powerless if the demand for credit is insensitive to its cost; for one thing interest represents only a small fraction of the total costs of the businessmen, and for another they are normally more guided by the expected price rise than the interest. But it is possible that higher interest may deter long-term investment as housebuildings. Again while a slight rise in the interest is powerless to prevent inflation, a large rise may bring the inflation to a disastrous end; this shot-gun method is not favoured by monetary authorities as it is injurious to the whole economy. Moreover interest rate is again powerless if the Government wants to keep the prices of its securities pegged: this was the case during the Daltonian cheap money policy. It is in the Government's interest to keep interest rates low as it reduces the burden of paying for the National Debt. It should be noted that a high Bank Rate will not raise the cost of credit if the commercial banks are in a liquid position or are able to secure additional funds from other sources without going to the Central Bank at all. In such a case banks liquidity has to be reduced first. Despite all these limitations it is yet possible in some markets for the Bank Rate to have a psychological effect, but this should not be exaggerated. After a long period of disuse Bank Rate has been revived as a Central Bank weapon in many countries, and we have still to see how effective it is going to be.

More important than the cost of credit is the availability of credit; if borrowers could get adequate loans for the periods they require, their cost can be of secondary importance. The classical technique for reducing the availability of credit is open market sale whereby the Central Bank sells Government securities to the commercial banks or the public in order to reduce their liquidity. But this too is limited by the existence of large National Debts; for the sale of government securities may cause a rise in the interest rate embarrassing to the Government in its refunding operations. But in a period of favourable trade the Central Bank can sell securities without upsetting the prices if the sale is not very large. The existence of large National Debts is also a hindrance to the raising of Reserve Requirements. Raising Reserve Requirements reduces the liquidity of the commercial banks, but if they hold large amounts of Government securities they can monetize them and increase their liquidity. This is best illustrated in the case of 'the Federal Reserve System where raising Reserve Requirements had the opposite effect on the banks who sold their holdings of Governments securities to the Federal Reserve and offset the increase in reserves in 1950-51. But this could be overcome by compulsory requirements as to the holding of Government securities by the banks, funding of such securities into long-term bonds or compulsory renewal of short-term securities as they mature.

Qualitative controls limit lending of specified kinds; they are selective and not general. They should be used to check expansion of undesirable and inflationary credit without interfering with productive credit. The common methods are "Margin Requirement" applicable to Stock Exchange credit, Instalment credit and Real Estate Credit. In all these the buyers of stocks, motor cars or real estate are required to furnish themselves with a stated proportion of the prices of the goods they hope to purchase. In United States the margin requirement for stock buyers was raised to 100 per cent. in 1946; this meant that the security dealers were prohibited from lending anything to the buyer. In the case of Instalment Credit, fixing minimum down-payment percentages and maximum periods of repayment help to check inflation. Another method practised by U. S. during the War is instructing sellers to refuse credit on accounts over a month in arrears. Restriction of mortgage credit tends to limit inflation of real estate prices; this is the Regulation X in U.S. If the inflation is serious loan quotas should be applied to all commercial banks.

As the objective of monetary policy in inflation is to reduce spending relative to income, liquidity in all forms should be held down. People should be given incentives to buy Government securities or bonds and to hold them rather than cash them. For this purpose higher interest, tax privileges, a price level guarantee and low price floor are necessary. National Savings and other types of saving should all be encouraged by incentives and propaganda. Thus monetary policy can assume many forms, but it may still be inadequate; monetary policy in U.S. in 1950 tried to restrict credit, but found itself creating additional reserves of over one billion dollars. When monetary control is ineffective, the whole burden of controlling inflation falls on fiscal policy and controls.

Fiscal Policy

While monetary policy operates mainly by reducing peoples spending relative to their disposable income, fiscal policy operates chiefly by holding down their disposable income. The first and most important step that the Government should take is to budget for a surplus, as this will attack one of the roots of inflation. It should increase its revenue and reduce its expenditure with the aim of reducing effective demand. But if the reduction of effective demand creates unemployment it is prudent to use other methods like controls; at the stage of over-full-employment however reduction of effective demand is justified.

In increasing revenue personal income tax will have to bear the biggest burden. But here, there is a difference of opinion, some favour higher incomes while others maintain that lower income groups should be taxed more than the higher income groups as the marginal propensity to spend is higher among the former. It is true that the marginal propensity to spend is higher among the lower income earners but is it politically feasible to tax them? Secondly even if it is politically feasible, it is socially and economically undesirable; it is not social justice to pinch more from the poor, and it is generally accepted that taxes should be progressive; a wage tax for example will instead of reducing effective demand stimulate demand for higher wages and start the vicious cycle of wage-price inflation. It is far better to leave the spending power of the wage earners untaxed than have wage-price inflation. And most important of all there is every reson why the high incomes should be taxed in inflation. In the first place it is the businessmen who make enormous profits during inflation while the fixed income earners suffer a reduction of their real income. One may recall the large profits made by the war contractors during the war and the rubber, tea and coconut producers in the Korean boom. In modern business it is to a large extent the company or corporation which takes decisions on investment, and hence taxing of personal incomes would not reduce the incentive to produce as maintained by some, although very high taxation may reduce the will to work. Finally most of the high incomes are not saved, but used for speculation especially on real estate and spent on wasteful consumption-Rolls Royces and Cadillacs, Galle Face weddings, Benares sarees, Hemachandra jewellery and overseas holidays.

It is of interest to see how the British income tax was raised during the war inflation. In 1940 the standard rate of income tax was raised by one shilling, and the reduced rate by 9d. In 1941, the standard rate was raised from 8s. 6d. to 10s. and the reduced rate from 5s. to 6s. 6d. while income reliefs and allowances were simultaneously reduced. Though the increased taxation was inadequate to fill the inflatinary gap, it was thought unwise to increase direct taxes beyond a certain point for fear that people with heavy standing obligations such as rents, insurance, school fees, and subscriptions would supplement their income by selling capital assets.

It is argued by some that it is inadvisable to raise corporate income taxes or excess profit taxes to check inflation as production would become inefficient if industrial efficiency remains unrewarded. It is further argued that corporate savings could be made a source of voluntary lending than personal incomes, and that if incomes are heavily taxed, corporate savings may be the only source of voluntary lending, and that investment of corporate funds in Government securities could be stimulated by making tax rates, dependent on how the undistributed surpluses are used. But corporate profits cannot be allowed to go scot-free. The most important reason is that corporate taxes are closely linked with wage stabilization; wage earners may refuse to forego wage increases if employers pocket the difference. But if the employer is blocked from increasing dividends and a large proportion of the profits are taxed the wage earners may be satisfied with their wages. But still the drawbacks of high corporate taxes can be serious as mentioned above. Further high taxes weaken the incentive to hold down costs, and reduces the incentives for employers to oppose cost increasing rises of wages and material prices. Thus it is by no means easy for the Government to decide how and to what extent the corporate profits should be taxed.

As an anti-inflationary measure the actual paying out of earnings to stockholders could be limited by freezing dividends. Another method is "forced loans" from the high income groups to be repaid after the inflation has subsided. The scheme of Deferred Pay implemented in Britain during the war on Keynes's advice is similar to this. If the defferred pay scheme is not universal it penalises a section of the population. Forced loans are also open to the objection that the taxpayer might reduce his savings in other forms or even spend out of other assets. This makes it necessary to tie down other assets of all taxpayers —a scheme which is administratively unfeasible. Despite these defects the scheme can be of great use in a severe inflation. The Nigerian Marketing Board is working on somewhat similar lines, and the export earnings are prevented from exerting inflationary pressure.

Then there are the commodity taxes-excise, sales, stamps etc. Since inflation leads to a rise in the prices of most commodities there occurs windfall profits. As price control cannot effectively control the secondhand market especially in durable commodities, excise taxes could make up these windfall profits. But the revenue from this source cannot be expected to be large. The substitution of increased excise and sales taxes for some portion of income taxes is less harmful than inflationary borrowing. But the disadvantage of such taxes is that they are a net addition to the selling price, and hence are a cost-push that raises prices. The anti-inflationary strategy of commodity taxes is to create a limited cost-push for the sake of reducing the demand pull, but it may prove dangerous. Purchase taxes are also subject to the same criticism, but purchase taxes on luxuries are not open to criticism. Taxes on cigarettes, liquor and cinema seats catch the cents and rupees that will not be saved, and hence are anti-inflationery. But if these items are included in the costs of living index they might result in a demand for higher wages. It should be emphasized that indirect taxation should not penalize necessities or semi-necessities as it is socially inexpedient.

Increased taxation and budget surpluses may not be adequate to check inflation; for though effective demand is reduced, cost-push or wage inflation may still remain. The increased taxation has to be reinforced by subsidies and wage and price control.

Subsidies

While the Government subsidies to essential consumer goods reduce the cost of living and discourage pressure for higher Wages, they are likely at the same time to increase the demand-pull. The saving of the consumer on the subsidy may be used to purchase other goods. e. g., the saving on rice may be spent on toddy. Subsidies however entail State expenditure, and the way this expenditure is financed has important repercussions on the economy. If it is financed out of genuine savings, the inflationary pressure may be less; but if it is financed out of new money or bank credit, the wage inflation is stopped and deficit-induced demand inflation subsituted for it. We are then curing wage inflation by demand inflation. This is certainly a prudent policy, for:

(a) New money created for budget deficit will remain constant, while money created for wage increases will increase because of the cumulative wage-price spiral.

(b) And the more important, deficit financed demand inflation can be cured by filling the deficit by taxation whereas wage induced inflation, unless wage-price race is prevented, cannot be arrested by any means whatever. It is thus better to have the more amenable demand inflation than the intractable wage inflation.

Subsidies can also be used during inflation to increase production. If all the paddy is given the price necessary to bring the poorest farm into production, it will cost more than if a lower standard price is paid and the high-cost farms are given subsidies. Paddy purchases at the standard price plus subsidy get as much paddy but generate less in-come for paddy farmers than a higer paddy price. Consequently both demand and cost-push inflatin are reduced.

Import Surplus

An import surplus is anti-inflationary as it diverts excess demand out of the country and pari-pasu increases the supply of goods. Easing of trade barriers, reduction of tariffs and even import subsides will increase the supply of goods in the country and absorb the excess spending thereby reducing both demand and wage inflations. But there is an exception if the demand for imports is inelastic so that people spend less at the subsidized price for a larger flow of imports than for a smaller flow at the previous price, they have more spending power for domcstic goods and the demand—pull will be made stronger. An import surplus means also a reduction of the international ex-

change reserves, and if the reserves are not very high, the Government may not favour it.

Increase in Production

Increased production of consumption goods to meet the excess demand should also be a weapon in any anti-inflationery policy. Production can be increased as we mentioned above by subsidies and guaranteed minimum prices. If the inflationary gap is Rs. 15 million. it does not mean that an increase of output by Rs. 15 million will close the gap. For, to produce that extra out-put worth Rs. 15 million, input or payments to wages, raw meterials, interest, rent and profit, to the value of Rs. 15 million will have to be made. And this new income aggravates the inflation and widen the gap further. To balance the consumer goods market we must add enough output and income so that the part of the added income which is witheld from spending by taxation and savings will match up the initial gap. The increase in output needed to close a Rs. 15 milli on gap, if the marginal propensity to consume is 4/5 (four fifths) will be Rs. 75 million for out of this Rs. 15 million will be saved to match the inflationary gap.

What is needed is increase in output without an increase in demand; added output helps more against inflation if it comes from increased productivity, The anti inflationery benifits of added output are still more doubtful if business as well as consumer demand are free to expand. With larger markets and larger receipts business men will want more productive capacity; and expansion of output calls for enlarging stocks of raw materials and working capital; savings are ploughed back into investment, and inflation is aggravated. If investment is not controlled, it is possible that output expansion may have net inflationary effects instead of anti-inflationery effects.

Easing Labour Bottlenecks

Since labour scarcity is one of the causes of wage inflation the Government should take steps to improve the mobility of labour; some of the lines on which it could take action are as follows:

(a) Providing short training facilities.

(b) Establishment of efficient Employment Exchanges,

(c) Financial help to migrate to required places like Colonisation Schemes.

(d) Dispersion of public orders for goods and services.

(e) Taking juveniles into vocational training.
(f) Postponement of retirement.
(g) Reducing school leaving age,
(h) Lengthening of working day.
(i) If the labour scarcity is very acute, compulsory shifting of labour and tying workers to their jobs may be necessary. This is especially the case in war-time when there is a general man power shortage.

It should be realized that these recommendations do not apply fully to Ceylon where the problem is not labour scarcity but employment scarcity which can be remedied only by economic development.

Employment, Wages and Collective Bargaining.

With so many ominous warnings regarding the consequences of wage increases in Britain it is necessary to examine industrial relations too in this article. Full employment, stable prices, and free collective bargaining-all the three cannot be theoretically or practically achieved at the same time. Full employment with stable price level could be had if wages are fixed as under some imaginary dictatorship or, full employment can be combined with free collective bargaining by paying for it in inflation, or stable price level with free collective bragaining can be had if the economy is prepard to sacrifice full-employment. As this is too complicated a problem to be analysed here, we shall only put forward one commonly held view irrespective of it defects. This point of view was best illustrated in an article by a Special Correspondent in the issue of the Banker of February 1954. It was argued therein that industrial relations was the biggest problem for Britain in 1954. After examining the figures for cost of living and wages, the writer stated that real spending power of the workers rose by over the five and half years (1947—53) by some 4. 2 per cent., and that fully $2\frac{3}{4}$ per cent of the increase was achieved during the 18 months to April 1953; he therefore concluded that the pressure for higher wages was not caused by falling standards of living. He futher wrote, "In the last analysis pressure from Trade Unions arises because the unions consider their bargaining position strong enough to face a trial of strenght-if only round the negotiable table." His main thesis was that free collective bargaining is incompatible with the maintenance of both full employment and stable economy, and

that collective bargaining must give way to a new scheme. "The incongruous element in wage negotiation in time of full employment is not the principle of collective bargaining itself, but the form it has taken in Britain a struggle in each industry on a nation-wide scale between two colossi of labour and employing interests. The scale and scope of these bargaining units makes friction inevitable. The Union can always point to some section of its members whose conditions justify its (nation-wide) claim; and the employers organizations can always cite one or more of its member firms for which acceptance of the Unions claim would spell economic disaster." "As a solution" he argued, the evident need is for a gradual shift whenever practicable from the system of bargaining on an industry-wide basis to bargaining on the much narrower basis of homogeneous economic units which in most instances would desirably imply separate negotiations for each factory or with each employer." It was argued that this system was a great success in the United States. We do not propose to discuss this proposal here; we hope that some other contributor of this journal would complete this task.

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Propensity to Consume and the Multiplier effect in Ceylon.

K. THARMARATNAM

In this article an attempt is made to estimate and explain the Marginal Propensity to Consume and the Investment Multiplier for Ceylon. The Keynesian revolution had influenced and induced macro-economic studies in different countries such as the U. K. and the U. S. A. However no attempt has been made in Ceylon to make such a study, which I believe is mainly due to the absence of time series relating to national income, consumption and price level. Therefore the first and formidable problem is to estimate these by adopting some statistical technique. I shall deal with this problem in another article at some later date, in which I intend analysing in detail the Income and Consumer behaviour in Ceylon.

The initial task in this study is to select a period which is free of excessive impact from exogenous variables which are alien to the economic system. Unfortunately a long period free from undue exogenous influences is not available due to the impact of two world wars. Therefore, the inter-war period (1920-1938) is chosen as a fairly suitable period for economic analysis. A period of nineteen years is rather too short for a systematic study of long term influences. This fact has been severely criticized by Professor Kendall (see R. S. S. J. 1945). With this there are other statistical limitations which should be kept in mind while computing the coefficients and interpreting their significance. As far as possible all mathematical and statistical problems are relegated to Appendix A and Appendix B, in order to facilitate the non-mathematical reader to be quite at home. Those who are mathematically inclined could go through Appendix A.

It is quite apparent that human psychological reaction induces a community to increase or decrease consumption

with an increase or decrease in real income, but only at a lower rate than the increase or decrease of the latter. Though Keynes attributes the increase in consumption to an increase in income, Duesenberry's demonstration effect gives an alternative explanation relating consumption to the previous peak income level, the economic and the social complexion of the society in which the consumer lives and also the imitative tendencies of the consumer concerned. Even though these factors are of primary importance in the study of consumer behaviour, their direct impact is not taken into consideration in this study. Therefore the marginal propensity to consume is, as usual, defined as the measure of the change in consumption due to the change in income. According to Keynes the marginal propensity to consume is :—

$$\frac{dCw}{dYw} = \frac{\text{Change in consumption}}{\text{Change in income}}$$

An idea of the marginal propensity to consume is very important since it tells us how an increase in income will be divided between consumption and investment. Because:-

$$\Delta Y = \Delta C + \Delta I$$

Where ΔY – Increase in income.
ΔC – Increase in consumption.
ΔI – Increase in investment.

Therefore an idea of the marginal propensity to consume will help us in estimating the amount that could be saved which could be utilized for investment, given an adequate economic policy.

If consumption is expressed as a function of income, then the coefficient of income will give the marginal propensity to consume.

Let $C = a + bY$..................................(1)

Where C is consumption and Y is income and the equation in the assumed relationship between C and Y.

Differentiating (1), $\frac{dc}{dy} = b$..................................(2)

We know by definition that $\frac{dc}{dy}$ is the marginal propensity to consume, because it gives the change in consumption due to a change in income. It is shown in equation (2) above that $\frac{dc}{dy} = b$. which is the coefficient of Y. Therefore the coefficient of Y gives the marginal propensity to consume. Adopting the least square method the following consumption function is fitted, to the data given is Appendix B.

$$C = 20.03 + 0.8493\,Y \qquad (3)$$

According to the above function the marginal propensity to consume is 0.8493, indicating that if income increases by one unit the consumption will increase by 0.8493 of the same unit. In plain words, if the income of Ceylon increases by one rupee about 85 cents will be spent on consumption. Therefore the balance 15 cents could be used for investment. The constant indicates that Rs. 20.03 will be spent on consumption by an individual even if his income is zero. In this case the consumer has to borrow to spend.

The propensity to consume is very high in most of the under - developed countries which is mainly due to low incomes. Therefore a big slice of the increase in income is spent on consumption thereby leaving very little saving for capital formation. The Economic Commission of the United Nations had pointed out (in The Development of Underdeveloped Areas) that only about 7% of the income of the underdeveloped countries is left out for capital formation. In such a situation the maintenance of a high rate of capital formation from the income created within the country is a rather difficult proposition in most of the under-developed countries. Therefore foreign investment is the only way out to keep up the standard of living of the under-developed areas which are facing the problem of a rapidly increasing population.

In Ceylon the marginal propensity to consume is very high, even though not as high as some other under-developed countries. It has been shown in the Rural Economic Survey Report that about 92% of the rural income is spent on consumption. When the marginal propensity to consume is as high as 0.8493, only about 15% of the income created is saved and may be retained or utilized for domestic capital formation if it is not allowed to flow outside the Island. Such a low percentage, though higher than most of the under-developed countries; cannot increase investment to such a high degree in order to absorb and maintain the rapidly increasing population at a rate of 3%. Therefore recourse has to be made made to foreign capital if we were to develop our economy without cutting consumption.

When the marginal propensity to consume is high, the investment multiplier will also be very high. The investment multiplier shows to what extent income will increase due to an increase in investment. In the Keynesian function.

$$\triangle Y_w = k \triangle I_w$$

k is the investment multiplier. It can be shown * that the investment multiplier is equal to $\frac{1}{1 - MPC} = \frac{1}{MPC}$.
where, M. P. C. = Marginal propensity to consume

M. P. S. = Marginal propensity to save.

Using the estimated figures for the marginal propensity to consume, the multiplier is estimated to be = 6.223. This shows that if one rupee is invested the national income of Ceylon will increase by Rs. 6.22 cts. This is really a very high rate of income creation. Unfortunately the rate at which income is created in an open, under-developed economy is very low owing to economic and technical factors. One of the obvious factors that adversely affects this high rate of income creation in Ceylon is the high import leakage. Import leakage will help income creation only when the import content in export is high. Unfortunately the import content in export in Ceylon is very low, and as such an import leakage will have an adverse impact on the creation of income. As a good share of our income is spent on imports, it would help the generation of income in the foreign countries from where goods are imported, than to increase the economic activity and the generation of domestic income in Ceylon. Therefore the multiplier cannot be as high as 6.223.

To solve this problem allowance should be made to eliminate the impact of marginal propensity to import on the national income. When this allowance is made the multiplier is:—

$$= \frac{}{1 - (MPC - MPI)}$$

Where M.P.I. = The marginal propensity to import.
M = Imports

The marginal propensity to import could be estimated by fitting a regression line relating income and imports. The fitted function is:—

$$M = 11.74 + 0.2516\,Y \qquad (4)$$

In this function the marginal propensity to import is 0.2516. This indicates that if income increases by one unit 0.2516 of it will be spent on imports. After eliminating the effects of the marginal propensity to import the multiplier is 2.4857. This shows that if investment increases by

* See Appendix 'A'

one rupee, the national income will increase by Rs. 2.49 cts. It could be seen clearly that the import leakage has reduced the multiplier from 6.223 to 2.4857.

Assuming that these estimates are correct it could be worked out, what investment would be necessary to increase our national income to a particular level. This may help to a great deal in regulating economic activity.

In conclusion I would like to emphasise that these coefficients should not be taken as exact indicators of actual population parameters that are inherent in the economic system. There are many limitations, both relating to the method adopted, and the figures used. However, these coefficients may give an idea of the degree to which they exist in the actual eeonomic system.*

APPENDIX 'A'

SECTION 1.

Let y – income,

c – consumption,

I – investment,

s – saving,

k – multiplier,

dy – small change in income,

dc – small change in consumption

di – small change in investment

ds – small change in saving

$\frac{dc}{dy}$ – marginal propensity to consume

$\frac{dI}{dy}$ – marginal propensity to invest

$\frac{ds}{dy}$ – marginal propensity to save

$$y = c + I \quad \dots \quad \dots \quad \dots \quad (1)$$

$$dy = dc + dI \quad \dots \quad \dots \quad \dots \quad (2)$$

Dividing (2) by dy

$$1 = \frac{dc}{dy} + \frac{dI}{dy} \quad \dots \quad \dots \quad \dots \quad (3)$$

That is the marginal propensity to consume plus the marginal propensity to invest is equal to one.

$$1 - \frac{dc}{dy} = \frac{dI}{dy} \quad \dots \quad \dots \quad \dots \quad (4)$$

* I am thankful to Miss R. S. Thomas (Acting Industrial Statistician) for her valuable criticism which had helped me to modify some of my earlier views and also to Mr. Kandasamy (Statistical Investigaior) for some of the computational assistance.

Income is a function of investment.

$$y = kI \quad \dots \quad \dots \quad \dots \quad \dots \quad (5)$$

Differentiating (5) we get:—

$$\frac{dy}{dI} = k \quad \dots \quad \dots \quad \dots \quad (6)$$

$$\frac{dI}{dy} = \frac{1}{k} \quad \dots \quad \dots \quad \dots \quad (7)$$

Substituting the $\frac{1}{k}$ for $\frac{dI}{dy}$ in equation (4) we get.

$$1 - \frac{dc}{dy} = \frac{1}{k} \quad \dots \quad \dots \quad (8)$$

$$\therefore 1 - \frac{1}{k} = \frac{dc}{dy} \quad \dots \quad \dots \quad (9)$$

also from 8

$$\frac{1}{1 - \frac{dc}{dy}} = k \quad \dots \quad \dots \quad (10)$$

i. e. $\dfrac{1}{1 - \text{Marginal propensity to consume}}$ = multiplier

from equation 3

$$1 - \frac{dc}{dy} = \frac{dI}{dy} = \frac{ds}{dy} \text{ since } S = I \quad (11)$$

Substituting this in equation (10) we get

$$\frac{1}{\frac{ds}{dy}} = k \quad \dots \quad \dots \quad \dots \quad (12)$$

i. e. $\dfrac{1}{\text{Marginal propensity to save}}$ = multiplier

SECTION 2.

1. The correlation matrix for the function $c = 20.03 + 0.8493y$ is given below.

	c	y
c	1	0.9977
y	0.9977	1

The correlation coefficient (0.9977) is significant at 1 %

The Standard error of the regression coefficient = + 0.0034.

The range between which the marginal propensity to consume lies is:—
$0.8459 < \text{M. P. C.} < 0.8527$.

2. The correlatian matrix for the function $M = 11.74 + 0.2516y$ is given below:—

	1	y
I	1	0.8473
y	0.8473	1

The correlation coefficient (0.8473) is significant at 1%

The standard error of the regression coefficient $= \pm 0.0131$

The range between which the marginal propensity to import lies is:—

0.2385 ≺ M. P. I. ≺ 0-2647.

APPENDIX "B"

Disposable Income at Market Prices		Disposable National Income at 1938 Prices	Index of Price Level $(2 \div 3)$	Consumption	Real Consumption $\frac{5}{4} \times 100$	Value of Imports	Real Value of Imports $\frac{7}{4} \times 100$	Population	Per-Capita Real Disposable Income $(3 \div 9)$	Per-Capita Real Consumption $(6 \div 9)$	Per-Capita Rea Imports $(8 \div 9)$
1	2	3	4	5	6	7	8	9	10	11	12
YEAR	Rs. 1,000	Rs. Million	(1938=100)	Rs. Million	Rs. Million	Rs Million	Rs. Million	1,000		Rupees	
1920 ..	733,551	741	98.9	609	616	—	—	4,486	165	137	—
1921 ..	707,714	725	97.6	602	616	262	—	4,522	160	136	—
1922 ..	824,175	794	103.8	701	675	—	—	4,603	172	147	—
1923 ..	960,612	865	111.0	825	744	—	—	4,684	185	159	—
1924 ..	1,070,703	917	116.7	921	789	—	—	4,766	192	166	—
1925 ..	1,405,090	1,044	134.5	1,194	888	360	268	4,647	224	191	58
1926 ..	1,436,558	1,055	136.2	1,220	896	408	299	4,928	214	182	61
1927 ..	1,281,464	1,002	127.9	1,089	852	421	329	5,009	200	170	66
1928 ..	1,119,728	937	119.5	941	787	412	345	5,091	184	155	68
1929 ..	1,161,949	956	121.6	976	803	429	353	5,172	185	155	68
1930 ..	884,701	827	106.9	761	712	324	303	5,253	157	135	58
1931 ..	646,637	685	94.4	566	600	228	242	5,325	129	113	45
1932 ..	485,774	566	85.8	413	481	196	229	5,389	105	89	43
1933 ..	513,730	588	87.3	432	494	177	203	5,419	109	91	37
1934 ..	687,955	713	96.5	578	599	217	225	5,560	128	108	40
1935 ..	656,147	692	94.9	558	588	228	240	5,608	123	105	43

APPENDIX "B"

	Disposable Income at Market Prices	Disposable National Income at 1938 Prices	Index of Price Level (2÷3)	Consumption	Real Consumption $\frac{5}{4} \times 100$	Value of Imports	Real Value of Imports $\frac{7}{4} \times 100$	Population	Per-Capita Real Disposable Income 3÷9)	Per-Capita Real Consumption (6÷9)	Per-Capita Rea Imports (8÷91)
1	2	3	4	5	6	7	8	9	10	11	12
YEAR	Rs. 1,000	Rs. Million	(1938=100)	Rs. Million	Rs. Million	Rs Million	Rs. Million	1,000		Rupees	
1920 ..	733,551	741	98.9	609	616	—	—	4,486	165	137	—
1921 ..	707,714	725	97.6	602	616	262	—	4,522	160	136	—
1922 ..	824,175	794	103.8	701	675	—	—	4,603	172	147	—
1923 ..	960,612	865	111.0	825	744	—	—	4,684	185	159	—
1924 ..	1,070,703	917	116.7	921	789	—	—	4,766	192	166	—
1925 ..	1,405,090	1,044	134.5	1,194	888	360	268	4,647	224	191	58
1926 ..	1,436,558	1,055	136.2	1,220	896	408	299	4,928	214	182	61
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1934 ..	687,955	713	96.5	578	599	217	225	5,560	128	108	40
1935 ..	656,147	692	94.9	558	588	228	240	5,608	123	105	43
1936 ..	697,144	719	97.0	600	618	214	221	5,642	127	110	39
1937 ..	883,442	826	106.9	760	717	243	229	5,725	144	127	40
1938 ..	751,680	752	100.0	631	631	236	236	5,826	129	108	40
1939 ..	867,561	818	106.0	737	696	242	229	5,916	138	118	39
1940 ..	1,023,857	896	114.3	881	770	283	247	5,972	150	129	41
1941 ..	1,137,615	945	120.4	978	813	287	238	6,044	156	134	39
1942 ..	1,446,771	1,059	136.6	1,259	921	274	200	6,144	172	150	33
1943 ..	1,533,511	1,085	141.3	1,334	944	423	299	6,161	176	153	49
1944 ..	1,758,688	1,148	153.2	1,512	987	500	326	6,308	182	157	52
1945 ..	1,685,504	1,129	149.3	1,466	982	592	396	6,516	173	151	61
1946 ..	2,042,807	1,215	168.2	1,757	1,044	602	357	6,719	181	155	53
1947 ..	2,382,807	1,280	186.1	2 073	1,114	963	517	6,903	185	161	75
1948 ..	2,674,668	1,327	201 6	2,327	1,154	994	493	7,109	187	162	69
1949 ..	2,868,667	1,354	211.9	2,438	1,150	1,029	486	7,321	185	157	66
1950 ..	4,262,246	1,493	285.5	3,666	1,287	1.167	409	7,544	198	171	54
1951 ..	5,199,536	1,552	335.1	4,524	1,350	15 59	465	7,742	200	174	60
1952 ..	4,016,941	1,474	272.5	3,535	1,297	1,702	625	7,940	186	163	79
1953 ..	4,237,193	1,491	284,3	3,729	1,312	1,608	566	8,155	183	161	69

SOURCE

(1) Blue Books.
(2) Customs Returns.
(3) Registrar General's Report.
(4) Statistical Abstracts.
(5) Six year Development Proposal.

The Soap Industry in Ceylon

W. S. M. FERNANDO

The Soap and Safety Matches Industries are two of the most important of the group of Chemical products Industries which have been organised in Ceylon entirely by private enterpise. According to the results of the Ceylon Census of Industry 1952, the value of the total gross output of the soap, glycerine and perfumes industries was Rs. 23,090,985, out of which the gross value of soap produced along accounted for Rs. 18,854,454. (a) The total value of the net output of this same group of industries was Rs. 5,970,842, while the total productive capital (i.e. fixed plus working capital) invested in them was Rs. 18,950,438. The relatively high productivity of the soap industry can be gauged from the fact that while according to the Census of Industry, the average net output per person employed for industry as a whole in Ceylon, was Rs. 4,203, the net output per person employed in the soap industry alone amounted to Rs. 10,739. Similarly while the average capital invested per head for industry as a whole was Rs 7,000. the capiial per head in the soap industry alone was as high as Rs. 32,290.

II. Growth and organisation.

The majority of soap manufacturing units came into existence during the war years 1939 to 1945, when war-time restrictions on imports of soap, encouraged the local industry to supply the requirements of the domestic market. In the early stages, local factories commenced the manufacture of laundry soap on a small-scale cottage industry or workshop basis, employing the relatively simple "cold process" of manufacture which did not require elaborate and expensive plant. Thus in 1947-48 when there was a world scarcity of caustic soda, the available supplies of this chemical, which were imported by Imperial Chemical Industries Ltd; were allocated among the 224 soap manufacturies which were then known to be in operation. It has been found however that the majority of these small-scale units have since closed down, due to such factors as shortages of caustic soda, high prices of coconut oil, and lack of capital reserves.

2. The more important development in this industry was however the establishment of six large-scale mechanised soap factories between the years 1940 to 1951, financed partly by foreign and partly by local capital, which today together account for 90 per cent. of the total annual output of the soap industry. Table I (annexed) gives the geographical distribution of manufacturing units in Ceylon and of the

labour employed in these units as in 1953. It will be observed from this table, that due to such factors as easier access to raw materials, and better marketing facilities available, the majority of the manufacturing units are concentrated in the Western Province. Out of the 40 units which are known to be in operation, 6 or 15 per cent. are mechanised factory units, 23 or 57.5 per cent. are small scale workshop units and 11 or 27.5 per cent. are cottage industry units. Out of the total labour force of 815 employed by all units, 678 or 83, per cent. are Ceylonese and 137 or 16.9 per cent are non-Ceylonese.

3. The following table summarises some general results of a survey that was carried out on the soap industry in March/April 1953. (b)

Structure of soap Industry in 1952 - 53

Type of Unit	Number of operating units	Paid up capital invested (Rs.)	Labour employed		Actual output in '52	
			Total in Nos.	% of Total	Total output in Tons	% of Total
(a) Factory Units	6	9,660,600	683	83.8	11,132	90.3
(b) Work-Shop & Cottage Industry	34	224,698	132	16.20	1,201	9.7
TOTAL	40	9,885,298	815	100	12,333	100

The above figures show clearly the dominant position being held in the Soap Industry by the large factory units with respect to capital investment, labour employed and output of soap. Assuming uniformity in the number of days actually worked etc., it will be seen that in 1952 the output per labour unit in the factories was 16.3 tons of scap as compared with 9.1 tons in the workshop sector of the industry. With the exception of one establishment which is a partnership, the other five factories are run as Public or Private Companies and are therefore able to avail themselves of considerable capital reserves and of the technical economies which accompany large-scale mechanised manufacturing operations. While the small workshop units which operate mostly under individul ownership are able to produce only a limited range of laundry and toilet soap,

using coconut oil as the main fatty oil and the comparatively simple "cold process" manufacture, the factory units are able to produce a wide variety of toilet, laundry and medicated soaps of superior quality, by using mixtures of coconut oil, with certain proportions of tallow, mee oil and rosin, through the more mechanised "boiling process" of manufacture.

III. Production and Consumption of soap.

The island's annual domestic requirements of soap are at present being fully met by the output of the local industy. Imports of soap which prior to 1939 averaged 2,500 tons per annum, steadily diminished and with the growth of the local industry have now been completely displaced by local production. From July 1951 restrictions were imposed on the import of toilet soap in order to help the local industry, and no licences are now issued for the importion of soap, other than medicated soap.

2. The following figures of production show the annual rate at which the local soap industry has expanded its output of soap, since 1949.

Production of Soap (c)

YEAR	TOTAL OUTPUT (in Tons)	PERCENTAGE INCREASE 1949=100
1949	9,137	—
1950	9,314	1.9%
1951	10,419	14.1%
1952	12,333	34.9%
1953	12,338	35.0%

The island's total population which was 7.321 million in 1949 is estimated to have increased to 8.155 million in 1953—an absolute increase of 11.4 per cent., while it will be seen from the above table that the increase in the local production and therefore in the domestic consumption of soap has been 35.0 %, between these years. It is reasonable to assume therefore that the increase in production of soap since 1949, has been due both to an increase in aggregate demand resulting from the natural increase in population, and to a higher per capita consumption resulting from the greater acceptance of soap as a washing medium. Total sales of soap by manufacturers and wholesalers amounted to approximately 12,000 tons in 1953, and assuming that normal stocks of soap were carried from one year to the next by stockists and wholesalers, the island's total domestic consumption can be placed at 12,000 tons per annum. On the basis of this figure it will be seen that the current per capita consumption of soap in Ceylon runs at the rate of 3.3 lbs. The per-capita consumption of soap per annum has been estimated at 8 lbs for the countries of the West and 0.75 lbs for India and Pakistan. (h) Soap has today become a consumer article of every-day essential use, and the current rate of consumpti on in Ceylon can be expected to rise further, given the present high rate of natural increase of the country's population and the improvement that can be expected to take place in standards of living, and in their general educational and health standards. The local soap industry in 1953 produced only 63.5% of its potential capacity which has been estimated at 19,445 tons, and it should be able to expand its production in order to supply any anticipated increase in the requirements of the home market.

3. The bulk of the local output of soap consists of laundry and household soap as the following schedule shows.

Production - By different kinds of soap (d)

KIND OF SOAP	1951		1952		1253	
	Output (tons)	% of Total	Ou put (tons)	% of Total	Output (tons)	% of Total
Laundry & Household	9,182	88.12	10,833	87.83	10,882	88.19
Toilet	1,231	11.81	1,494	12.11	1.291	10.47
Medicated	6	0.07	6	0.06	165	1.34
Total	10,419	100	12,333	100	12,338	100

In addition to toilet and laundry soaps, three of the factory units engage in the manufacture of shaving soaps in cakes and sticks, which have found a good domestic market, while one manufactures crude glycerine as a by-product. Their combined output of shaving soaps is sufficient to meet the island's domestic requirements of these soaps, and compare very favourably with the imported equivalents in price and quality.

IV. Raw Material Consumption

The essential raw materials for the manufacture of soap are a fatty oil and Caustic soda. The soap industry in Ceylon is very advantageously placed regarding its requirements of a fatty oil, because it has at its disposal, plentiful local supplies of coconut oil, which because of its high saponification value (i. e. its property of readily forming soap when stirred with a solution of caustic soda) is a fatty o il which is well suited for the manufacture of all kinds of soap. (d)

2. It has been estimated that approximately 85 % of soap by weight is oil, and that approximately 65 % of the fats used in local soap manufactured is coconut oil. Approximately 5,008 tons of coconut oil was used by the soap industry for the manufacture of soap in 1953. The total quantity of coconut oil milled by all oil mills in Ceylon everaged 128,0C0 tons during the years 1950 to 1952, and the quantity of this fatty oil required annually for use by the local soap industry thus amounted to only 4 % of the island's total annual production of coconut oil.

3. Caustic soda, the other important raw material, is however a c hemical which is entirely imported and like most important chemicals was in short supply during the war years, and the immediate post-war period. It is estimated that about 13 lbs of caustic soda are required to make 1 cwt of soap, and on this basis it will be seen that the soap industry will need about 1,393 tons of caustic soda annually to produce the island's present annual requirements of soap (estimated at 12,000 tons). The world's supply position of caustic soda has improved considerably since 1953 and the soap industry now imports its requirements of this chemical freely. Thus imports of caustic soda amounted to 1,528 tons during 1953, and to 623 tons during period January to June 1954, while the wholesale price of caustic soda dropped from an average of Rs. 197.20 during the fourth quarter of 1952, to Rs- 186.00 per drum of 661 lbs during the first quarter of 1953. The Department of Industries has under construction a factory for the manufacture of Caustic soda and D. D. T. which it expects to complete within the next two years. With a potential capacity of 1,65C tons of caustic soda per annum, this factory would be able to supply the local soap industry's full requirements of caustic soda, at prices which can be expected to be lower than prices of the imported chemical.

V. Prices and Export Market

Local soap factories manufacture a wide range and variety of soaps which are availabe to the consumer, at prices which are highly competitive. Laboratory tests have proved that local toilet and laundry soaps are comparable in quality with the best imported equivalents, and that only in the cases of medicated soap do certain imported brands of soap such as Cuticura and Coal Tar Soap, possess somewhat better antiseptic properties than the local products.

2. The following schedule gives the relative prices of Toilet and Laundry soap made by Messrs. Lever Brothers — the leading soap manufacturer in Ceylon.

RETAIS PRICES OF SOAP (e)

(Annual average prices)

Type of Soap	Unit.	1944 1946	1947-1950	1952–1953 (1st quarter)	1954 Jan:–March
		cts.	cts	cts.	cts.
Toilet (Lux)	per cake	0.26	0.33	0.41	0 38
Laundry (Sunlight)	per bar *	0.38	0.48	0.61	0.55

* consists of two cakes

It will be seen that the retail prices of both Toilet and Laundry soap reached a peak in 1952 and in the first quarter 1953, the percentage increase over the average prices ruling in 1944-1946 being of the order of 45%. This sharp increase in the retail prices of soap was mainly caused by the high prices of caustic soda and coconut oil prevailing at the time, due to the continued scarcity of world supplies of caustic soda on the one hand, and the high prices being fetched by coconut oil in the domestic and international markets, on the other hand. With the end of the Korean War and the collapse of the world's commodity boom late in 1953, the position regarding the supply and prices of raw materials has eased considerably, and the local soap industry is now able to obtain cheaper supplies of both Caustic Soda and fatty oils. The retail prices of soap during the period January to March 1945 have thus shown a drop over the prices prevailing in 1952-53, and can be expected to remain stable in the near future.

3. It has already been observed that the output of the soap industry meets the full consumer requirements of the domestic market and it is therefore noteworthy that the local industry has already explored and developed export markets for its surplus output. In view of the scarcity of foreign suplies of caustic soda in 1952, the Government fixed an export quota limit of 1,000 tons of soap, since it feared that supplies of caustic soda would not be adequate to enable the local industry to produce a sufficient volume of soap to cater to domestic needs as well as to the demand of the foreign market.

4. The following figures show however that the actual export of soap has fallen short of the permissable quota limit.

Exports of Soap (Household and Laundry) (f)

Country of destination	1952 Quantity	1952 Value	1953 Quantity	1953 Value	1954 Quantity	1954 Value
	(cwts.)	(Rs.)	(cwts)	(Rs.)	(cwts.)	(Rs,)
Honkong	101	6,206	265	17,057	81	4,949
Maldive Islands	222	17,870	216	18,134	280	22 581
A.E. Sudan	4,449	255,916	8,468	528,171	279	14,018
Pakistan	606	29 636	–	–	–	–
Tanganayika	6	502	–	–	–	–
Arabia	125	6,582	–	–	18	–
India	–	–	3	195	–	3,880
Singapore	–	–	41	5,375	–	–
Burma	–	50	–	–	–	–
India Foreign	–	–	–	–	72	5,572
TOTAL ...	5,511	316,764	8,993	598,872	730	48 151

The most promising possibilities of developing export markets have hitherto been in the countries of the Middle East and of South East Asia, where per-capita consumption levels of soap are relatively lower than in Ceylon, and where with developing economies, standards of living have been gradually rising. Ceylon soaps are meeting severe competition however from soap factories which have been established in most of these countries since 1950 by Uni/Levers (g). Exports of Ceylon soap during the period January to June 1954 have thus dropped to the negligible quantity of 36 tons, and given such factors as indigenous supplies of the cheaper Palm oil available to these soap factories, especially in the Persian Gulf, it is feared that Ceylon's soap will be completely shut out of its limited export market.

VI. The Future of the Industry.

1. The limited domestic market for many manufactured articles resulting from a small population and relatively low per-capita incomes has constituted one of the principal obstacles to rapid or large-scale industrialisation in Ceylon. In the case of the Soap Industry, the relative smallness of effective consumer demand, whilst it has not deterred the establishment of the local industry, has been a major factor favouring the concentration of production in the hands of a few manufacturing firms. Thus it has already been seen that given the economics of large-scale production available to it, the mechanised factory sector has proved more efficient than the workshop and cottage industry units, and has secured a position of dominance in the industry and over the limited domestic market for soap.

2. There is now evident in the soap industry a tendency towards a further concentration of potential and actual production in the hands of a few of the more powerful factory producers of soap. Two of the large factory units already supply over 60 % of the Island's total requirements of soap, while the smaller producers are now begining to experience real difficulty in effecting even their normal sales of soap. The twin problems which face the industry, therefore, are the need to increase the existing aggregate demand for soap and to maintain a proper balance among the factory producers of soap, so that the products of any individual unit will not be forced out of the market as a result of unfair 'sales pressure' from more powerful rivals. The increase in effective aggregate demand for soap can be expected to occur mainly as a result of increasing per-capita incomes in the country and would help to ensure the further progress of the soap industry as a whole. Competition (even on an imperfect scale) among existing producers needs to be maintained on the other hand, as a means of safeguarding the long-term interest of the consumer, as well as, of those producing units which have been set up by purely indigenous capital and enterprise.

SOURCES AND REFERENCES

(a) "Census of Industry 1952"—Published by Department of Census & Statistics - Colombo.

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(c) Source — Department of Industries and "Annual Statistical Abstract of Ceylon 1954".

(d) Reginald Child — "Soap making by the 'Cold Process' — (Leaflet No. 10 - Coconut Research Scheme).

(e) Source:— "Quarterly Bulletin of Statistics" - March 1954.

(f) Source:— "Ceylon Customs Returns".

(g) Indian Soap Journal — "Vol XIX No. 7 - January 1954. Vol XIX No. 10 - April 1954.

(h) "Report of the Ceylon Coconut Commission" 1949.

Soap Industry - Geographical Distribution of Manufacturing Units in 1952 - 53

TABLE 2

Province	NUMBER AND TYPES OF UNITS Units of opeaation					LABOUR EMPLOYED BY OPERATING UNITS			Potential Producing capacity of operating units (Tons)
	Total closed down	Factory	Workshop	Cottage Industries	Total	Ceylonese	Non-Ceylonese	Total	
Western	83	5	14	9	28	584	135	717	17,606
Southern	12	–	2	—	2	6	—	6	28
Sabara-gamuwa	5	–	1	2	3	8	—	8	25
N. C. P.	–	–	1	—	1	—	4	4	60
Central	31	1	4	—	5	76	—	76	1,691
Uva	7	–	–	—	—	—	—	—	–
Eastern	3	–	–	—	—	—	—	—	–
Northern	–	–	1	—	1	4	—	4	30
N. W. P.	5	–	–	—	—	—	—	—	–
TOTAL	146	6	23	11	40	678	137	815	19,445
Percentage		15.0 %	57.5%	27.5 %	100	83.1%	16.9%	100	—

* *NOTE:—Potential producing capacity*—Producing capacity hase been computed on basis of figures declared by operating units. In the case of small-scale units where manu acture is by the "cold process" which does not require elaborate plant or machinery, producing capacity varies with the availability of raw material and on man power employed. Their producing capacity has therefore been estimated on basi. of their actual labour strength at time of survey, and on the probable maximum quantity of their soap which they could market.

Source:—**Department of Industries.**

Long-Term Contracts and Bulk Trading.

S. B. de Silva

During the War and for a few years later the trade in Ceylon's major export commodities was conducted on the basis of long-term bulk contracts with the United Kingdom Government. The following is the first of a series of articles dealing with the problem of long-term contracts and bulk purchase. The United Kingdom has been the only importing country to have extensively adopted the contracting system as a trading device, and the only country (the U.S.S.R. and the other Socialist countries apart) to have for several years retained State trading on a large scale as part of its peace-time apparatus. The present article outlines the origin and development of long-term contracts and bulk trading from the experience of the United Kingdom. Succeeding articles will be devoted to a theoretical study relating to the problem of price determination under long-term contracts, and to examining the working of Ceylon's contracts during the period of their existence. — EDITOR.

Long-term contracts are a species of bilateral commodity agreements which, soon after the outbreak of war, came into existence as a technique of trading between the United Kingdom and several countries in the British Commonwealth. The terms and conditions governing their operation were defined somewhat explicitly in relation to their periods of currency, the quantities involved and prices. The distinguishing marks of these contracts are their relatively long duration and the centralisation of trade which was conducted on a government-to-government basis rather than through the hitherto existing channels of private trade. A lack of uniformity has characterised the terminology used to describe the new trading technique. A comprehensive term that compasses its essential features, however, would be "long-term bilateral bulk purchase contract".

The term "bulk transactions" involved in these agreements cannot be too precisely defined but generally refers to relatively large quantities, such as the entire or a large portion of either the "exportable surplus" of a country or its import requirements (1). The scale of these transactions requires centralised selling and buying agencies which in the past have usually been governmental or quasi-governmental in character. An important distinction may be drawn between "once-and-for-all" transactions, affecting only a single crop year or season, and transactions which cover the produce of two seasons or more. The latter have come to be described, more or less appropriately, as "long-term contracts". The single transaction form of bulk purchase offers little of interest in the present context that is not also characteristic of "long-term" arrangements.

The period of a long-term contract may range from anything more than one production season or a series of production seasons just long enough to enable the expansion of the industry, new investment, etc., to a period that covers the entire length of a price cycle. In the latter case, at the termination of the contract, both producers and consumers would alternatively have benefited from the advantages of a stable price—which in one period would be lower than the world price and in the other higher than the world price. Each party to the contract would thus be enabled to have its fair share of gains and losses.

Intimately allied with long-term contracts is the subject of bulk trading. Despite the wide currency of the terms "bulk trade" and "bulk purchase", they do not appear to be characterised by any exactness. (2) The Report of the Select Committee on the 1948-49 Estimates of the British Food Ministry described bulk purchase as "Sole importation by the Government". In this sence, it becomes identical with State trading and the term acquires a meaning which reflects the circumstances of its origin, when it was used by the British Government during the War as a means cf controlling imports, guaranteeing supplies and ensuring the food ration.

(1) A bulk transaction may even be regarded as one which involves the major portion of the input of an industry, or its output.

(2) "You can call it centralised importing or you can call State trading, but bulk purchase in itself is not a term of any exactness. I would rather treat it as synonymous with sole importation by the Government" E. E. Bailey, Principal Finance Officer, United Kingdom Ministry of Food, in evidence before Select Committee.

In the context of the British war economy, State trading and bulk purchase were not merely similar in origin but were also analogous in aim, being linked to the policy of domestic stabilisation. Nevertheless, they are, it has been pointed out, rather different issues, the precise measure of their relationship lying in the extent to which one involves, or is based on, the other. Bulk purchases are not necessarily for any extended period forward and, therefore, do not implicitly involve long-term contracts (although many bulk purchase contracts are, in fact, long term); likewise Government monopoly may not take the form of bulk purchasing, especially if the commodities concerned are merely centrally purchased by the Government on the open market through existing or usual trade channels (though again the bulk purchase of State traded goods has been fairly general in Britain.) Thus, "it is regrettable", thinks Balogh, "that so little discrimination is made between centralised and bulk purchase" (1) Further, "bulk purchase and long-term contracts", it was observed in the House of Commons. (2) "are completely different from State trading......the handling of the trading operations of the nation by Government Departments. There are many instances where what might be called bulk contracts are at present handled by private traders."

Bulk purchase, as somewhat distinct from centralised purchasing or State Trading, signifies merely the purchase by one buyer of the whole or at least the major part of the putput of an industry. It is purely a method of procurement, which like the long-term contract may be carried out privately—or by the Government through private trade channels. (3) State trading, on the other hand, is a system where the State acts as a single organization responsible for the purchase or sale of a particular commodity or commodities, and, in this sense, may embrace any or all methods of buying including both bulk purchase and the long-term contract. They both offer, in most cases,

(1) London Times, 17th May, 1949; Idem, "bulk purchase of base metals has been discontinued and centralised purchase substituted" 24th May, 1949.

(2) Hansard, 12th May, 1950.

(3) "I do not exclude the possibility of other means, of private trade, being used to serve the same purpose (i. e. for which bulk purchase is used). All I say about it is that it would be a much more complex operation", Bailey, **op. cit.**

security of supply, greater stability to the producer, more efficient means of transportation and storage, and possibly the advantage of a lower price arising from the element of monopsony which bulk buying involves.

From a practical point of view, however, it is difficult to demarcate clearly bulk purchase from State trading. To attempt to do so would rob the terms of their current significance. The concept of bulk buying which accords with common usage, and which will be used here, is that of centralised buying of commodities by the Government, for eventual re-sale. The latter includes most forms of State trading and distinguishes bulk buying from its purely formal sense mentioned in the preceding paragraphs, which seem to emphasise the mere largeness of a purchase. It means that the entire supply of a commodity passes through the hands of a Government, or its agents, to other users. (1) What seems significant is that the Government interposes itself between producer and ultimate consumer, with a view to ensuring supplies on the most favourable terms and allocating them according to a predetermined pattern. Viewed in this light, bulk purchase becomes virtually synonymous with State-trading. In the pages which follow, the two terms will generally be used in conjunction with each other, though under the slightly wider title, State trading.

Origin & Development

The long-term contract is a child of the war-time marketing arrangements, whereby the United Kingdom Government became the sole purchaser of imported foodstuffs, in order to ensure their availability in the United Kingdom. Towards this end long-range negotiations relating to the disposal of the exportable surplus of Empire primary produce, in the event of the outbreak of war, had been conducted with the Empire countries in the months

(1) It excludes the use of the term bulk buying to describe a situation where the Government imports "in bulk" a commodity of which it is the sole user, e. g. submarines.

preceding September, 1939 (1). These outlined the general principles and the probable extent of the United Kingdom purchases. On the outbreak of the war these negotiations were renewed and established on a more definite basic criteria regarding prices, payments and other terms of sale. Three factors which contributed towards the speedy settle ment of these issues were the evolution of Empire economic co-operation in the preceding seven years, the existense of organisations in most of the Empire countries established during the previous decade to deal with the export marketing and control of primary products, and the work already done prior to the outbreak of war. These arrangements were modelled on those which proved so successful during the 1914 war, and, in the similar circumstances of the 1939 war, appeared to be mutually satisfactory to the United Kingdom and the exporting countries; the former gained complete control at favourable prices of vital commodities, subject to shipping and storage difficulties, while the latter were assured of the complete disposal of their products without recourse to the restrictive practices of the inter-war period.

State trading in Britain, even as a solution to the problem of feeding her millions in war-time, was a challenge to the traditional policy of free enterprice. Its first experience is traceable to the war of 1914-18, towards the end of which arrangements were made for the supercession of competitive private trade, at any rate in bulk foodstuffs, and the later Allied Food Council was set up in September 1918 with provisions for co-ordinated buying and allocation of food and shipping. These measures, however, were a grudging concession to economic circumstances, rather than part of any established policy; even the control of food imports and the appointment of a Food Controller, as late as December, 1916, being regarded as "a

(1) Mr. J. F. Murphy, Australian Secretary of Commerce, speaking at a dinner held in Melbourne on 14th November, 1945, said "In 1938 when I was in England with Sir Earl Page, we discussed with representatives of the British Government about twelve months in advance of the outbreak of the war what the Empire would do in regard to its major commodities in the event of war breaking out, and it was on that occasion that an agreement was reached — a verbal agreement, it was true, but nevertheless a binding agreement amongst partners in the Empire..............."

reluctant sacrifice on the altar of industrial unrest" (1) Appropriately enough the early descriptions of them bore the titles "A State Trading Adventure" (2) and "Experiments in State Control" (3) Apart from the personal ability of Lord Rhondda, their success, it is thought was the result of accident and determination. (4)

In the slump of the 1930's with its widespread unrest and economic instability, the ideal of Free Trade was abandoned as a working policy in favour of Imperial Preference. Increased emphasis also began to be laid on the need for collective action within the Empire. The Colonial Development Act of 1929, (5) which despite its litle had as its primary objective the relieving of unemployment in Great Britain, (6) indicated the trend at a date slightly preceding the onset of the depression. In addition, a series of important reports was issued which focussed attention on the extreme instability of primary produce market and the need for fostering economic development.

In the decade before the last war, policy continued in this direction but on an **ad hoc** basis. Some of the measures bore the marks of attempts at immediate self-preservation, and were restrictive in character so far as investment and production were concerned. The extension of the Colonial Development Acts, however, based upon reports on the economic conditions obtaining in the British colonies, appeared in a more permanent category.

The co-operation in Imperial economic affairs which the difficulties of the 1930's had engendered increased greatly on the outbreak of the war. Following the experien-

(1) Coller, F. H. (later Sir Frank), "A State Trading Adventure 1925."

(2) Coller, **op.cit**

(3) Lloyd, E. M. H., "Experiments in State Control", 1924.

(4) "A Supreme Case of muddling through with brilliant improvisations", Beveridge, Sir William H (later Lord) "British Food Control", 1928.

(5) Cmd 7167, H. M. S. O.

(6) Peter Ady, "The British Economy, 1945-1950", Worswick & Ady.

ces of the First World War, (1) bulk purchases to support the British Food Defence Plans (2) were speedily made and purchase contracts concluded with some Empire countries. For instance, the British Government undertook to purchase annually the entire colonial output of sugar and cocoa for the coming season, a guarantee which was renewed each year at the beginning of the season when the producer's price was also fixed. The exportable surplus of the Australian and New Zealand woolclip was also purchased by the British Government from 1939 and guarantees of this kind, of benefit to both producer and consumer, were later extended to other Commonwealth products. The remainder of this section summarises the originating causes of State trading and illustrates its growth during the Second World War with special reference to certain major products.

The origins of government bulk trading in raw materials and foodstuffs during the Second World War were similar to those during the First World War. The policy sprang from the basic fear of a possible interruption of supplies from overseas owing to physical and economic factors. Firstly, the government control of prices and the increase in shipping freights discouraged importation by private traders and the risk of maintaining expensive stocks in Britain in the face of changes in capital values. In the circumstances, the need for building strategic stocks led the Government to make precautionary purchases (3). Secondly, the prospect of a steep rise in the import prices

(1) Thus Beveridge, **op.cit.**, writing of the lessons of British food control in the war of 1914, "...State trading in food is practicable and in times of prolonged shortage is necessary. It is within the wit of man to find an alternative to competitive private enterprise with market prices as a means of obtaining and distributing food, to replace economic by human laws, to substitute managed for automatic provisioning of the people".

(2) These aimed, **inter alia**, at conserving shipping space and observing secrecy in the movement of ships.

(3) The reluctance of the private trade to make precautionary purchases was reflected in the rapid depletion of rubber stocks. This occurred despite Government requests to manufacturers and dealers to increase their stocks and when Government trading was started the stocks of several commodities were at a very low ebb.

of some commodities would have made it economically impossible for the private trader or the commercial consumer to purchase them. Government bulk buying, on the other hand, whereby stocks were pooled and the element of risk borne by the Government, considerably reduced the increase in price. Price policy was thus an important factor which determined the supersession of the private importer by the Government. Thirdly, the policy of centralising purchases was prompted by reasons of administrative convenience as well as the need to achieve economies in cost and manpower. It obviated the need for a comprehensive and rigorous system of import licensing with its attendant burden of administrative problems, and at the same time effected considerable economies in selling costs. Fourthly, during the Second World War, much more than during the First World War, there was the slow but irresistible growth of economic planning which the conditions of war induced. This led the Government to venture beyond the point of import licensing or partial intervention. Monopoly buying on government accouut thus became part of a general programme for conserving foreign exchange, timing purchases according to the availability of goods at their sources and according to shipping movements, and regulating the prices of imports as well as their disposition and use to co-ordinate with functioning of a war-time economy. The physical ownership of raw materials became almost a prerequisite for a policy of rationing and internal price control, while the whole problem of war material allocation was entwined with the wider issue of industrial priorities, e. g., the allocation of wool among its several competing uses such as the production of military clothing and equipment, the manufacture of woollen goods for export, and the needs of civilian requirements. Finally, government monopoly purchasing was an effective means of pre-empting supplies from the enemy, as well as of securing their allocation among the different Allied countries on a basis which was most favourable to the British war effort.

A factor of outstanding significance in assessing the value of State trading which developed from the war-time necessity for the centralisation and control of imports is the way in which the new policy impinged on the existing rights of the private importer and the chain of ancillary services which were rendered by the pre-war distributive trade. The point of interest is that ,while a policy of control, licensing and registration is normally alien to the concept of free enterprise on which the foundations of British business have

been expected to oppose state interference, welcomed and indeed pressed for State control. Before examining the underlying issues, a brief reference to the organisational machinery set up by the Ministry of Food for making its purchases would be both relevant and instructive.

The precise pattern of Government control differed from commodity to commodity. But despite variation in the form and degree of control, the general policy was to preserve, as far as possible, the existing organisation of the food trades. Importers, brokers, wholesalers and others displaced by the Ministries engaged in bulk purchasing were formed into associations with the ostensible object of rendering expert advice in the purchase, handling and distribution of goods. In doing so, they functioned as agents of the Ministries and the payments made to them were fixed on a level comparable with, or above, that before the war. No systematic data appear to exist on this question. Hoffman (1) is inclined to regard the margin, for the British food industry, as exceeding from 50 to 100 per cent those regarded as "just" in the United States; and also higher than those prevailing in the British import-distributing industries that do their own buying abroad. In several of the Trading Accounts of the British Government, these payments figure under the item "Commission and expenses of agents and distributors" and a Report of the Select Committee appointed by the Ministry of Food in 1950 revealed that the remuneration of these associations was in the region of £4 million a year and was fixed with the general intention of maintaining the earnings of their members at or about the pre-war level".

The remuneration was reviewed by an inter-departmental committee in 1946-47 and some adjustments were made. The Select Committee on Estimates in the Thirteenth Report of the 1950-51 Session recommended that the remuneration of the associations should be considered in connection with the general review of margins which they proposed. The Controller and Auditor-General's Report for 1950-51 commented, on the basis of a review which was then in progress, that "in certain trades some members do not work for the Ministry, others only part-time work and some are engaged largely on clerical and routine duties."

(1) Michael Hoffman, Papers and Proceedings of the 63rd Annual Meeting of the American Economic Association, 1950.
Am. Ec. R., XLI No. 2, May, 1951.

The Report further questioned whether the agency arrangements constituted the most economically efficient means of securing the services required.

The system of private ownership and private profits in the food business was, to a very large extent, preserved and the Ministry of Food accommodated itself to the highly complex organisation of the food trades without seriously disturbing the existing system of private ownership and private profit. No shop, however inefficient or superfluous, was closed down by the Ministry. As far as possible, merchants, agents, wholesalers and manufacturers were retained as independent units, doing more or less the same job as they did before the war.

The Government's intention to interfere as little as possible with existing trade practice added to the complicated nature of the system of control. Even in certain of the food industries, such as margarine, sugar and bacon curing, in which there had been a tendency towards monopoly control, the small firms had not been eliminated. In other industries where monopoly trading had not become the dominating form, an almost infinite variety of firms somehow managed to sustain a livelihood. The food trades, therefore, continued to be characterised by a number of small units existing side by side with large monopolistic undertakings. This preservation, to a very large extent, of competitive trading practices, however, burdened the Ministry with a welter of vested interests which may have reduced, from the community's point of view, the full benefits of State enterprise. (1)

The co-option of industry into the Ministry of Food. which the new policy virtually involved, is best exemplified by the commercial connections of the Commodity Controllers appointed by the Ministry. The Controllers who were selected both in the Ministry of Food as well as the Ministry of Supply, were representatives of large monopoly firms in the industry. Further, quite unlike in the First World

(1) "The regard for vested interests that has so far been a persisting feature of our war effort has to be diminished; for whatever may be said in favour of such an attitude in peace-time it cannot be consistent with our economising of skill and resources to make maximum profit and not maximum output the criterion of successful industrial management", I. Bowen and G. D. N. Worswick, The Controls and War Finance, Oxford Economic Papers, No. 4, September, 1940.

War, when the controllers were mainly selected from outside the industry to be controlled, the policy in the second was tantamount to industry controlling itself (1).

The practice of doing so was open to serious criticism in that it scarcely conduced to the making of objective policy decisions uninfluenced by the needs of vested interests. Theoretically, the commodity controllers were under the supervision of the Ministries. In practice, however, they had considerable power in fixing maximum prices, determining conditions of sale and laying down methods of supply for commodities under their control. Excluding anything of a sufficiently political and conscious character to justify the name of "economic sabotage", it is highly probable that the actions of the personnel responsible for the management of industry and the import trade would have been influenced by conditioned entrepreneurial behaviour, with its instincts of private profit-making and loyalty to their own firms than to the wider interests of the consuming public.

Not merely was the system inequitable, it was also likely to be inefficient. For instance, the controllers were prey to sectional interests in their own industries. Thus, some of the smaller margarine firms protested against having to deliver details of their trade to a representative of the powerful firm of Van Den Bergh (the Margarine Controller). Some controllers, however, avoided internecine warfare of this kind by setting up a complicated system of sectional controls with checks and counter-checks (2).

The end of the war saw a renewed interest in commodity policy. In conjunction with other measures, the use of inter-governmental trade arrangements began to be regarded as a device for ensuring a high and stable level of economic activity. The need for abandoning restrictive trade practices was recognised and attention tended to be focussed mainly on multilateral arrangements. Britain's bilateral bulk contracts, however, continued on a more

(1) The Economist, December 9, 1939.

(2) Meat control was an example of unnecessary and costly sectionalisation. The machinery through which home produced meat passed from the farm to the housewife included: Agricultural Committees, Central Slaughter Houses, Regional Wholsale Meat Supply Associations, the Ministry of Food, Area Meat Agents, Area Allocation Committees and Retailers.

extended scale than before, for after the war, owing to a general expectation that a fall in prices would succeed a temporarily delayed adjustment of supply to demand, the continuance of the contracts appeared even more advantageous than before, both to Britain and the primary producing countries.

This alteration in the fears of producers and consumers underlines an important function of the long-term contract, namely, that, over the long-run, it insures both producers and consumers against short-term changes in market conditions. Considering fluctuations in price as a reflection of market disturbances, for a long-term contract to perform its stabilising function, it should ideally be extended over the entire length of a price cycle. During one phase of the cycle, when there might be world shortages and sharp increases in prices, the contract would guarantee to consumers supplies at prices lower than what might otherwise prevail in the "free" market; conversely, during the next phase, when the "free" market seems burdened with supplies, producers would enjoy the benefits of a stable and relatively high price for the period of the contract. In either case, the contract prevents each party from exploiting existing "free" market opportunities during one or other of the two phases of the price cycle, but compensates them in the long-run by insulating them against the effects of an adverse trend in free market conditions. In other words, the enforced abstinence from short-term gains which a long-term contract imposes, at one time on producers and at another on consumers (represented by the margin between the contract price and the non-contract price,) serves as a sort of insurance premium which each side pays for the benefit of long-term stability.

The British practice has, however, been the usual starting point of suggestions for the greater use of long-term contracts to solve the agricultural problems of Western Europe. The Report of the Food and Agricultural Committee of the O. E. E. C. noted in December, 1948: (1) Section 1 Vol. III of the Interim Report "The United Kingdom has already indicated that it is prepared to consider further contracts with participating countries and their overseas territories for the purchase of essential supplies, and no doubt, other importing countries will be prepared to consider entering into similar arrangements. The Working Party recommends, therefore, that exporting countries interested in such arrangements should take the initiative in approaching importing countries likely to be interested in making further agreements in a bilateral basis."

In 1948, in 1950 and again in 1951, there were discussions in the O. E. E. C. regarding the more extensive use of such bilateral agreements. The Stikker Plan advocated the wider use of "long-term purchase contracts at reasonable prices" as a means whereby State trading countries could compensate for their "effectively low percentage of liberalisation". In October, 1950, Stikker pointed out in the O. E. E. C. Council that, so far as producers were concerned, the disadvantage of the existing long-term contracts, especially the British contracts with Holland and Denmark, lay in their price provision. "…………If we would always be able to conclude long-term contracts at reasonable prices for our agricultural products, we would have no reason for complaining, but our experience has often been to the contrary and I am afraid that representatives of other countries around this table will confirm this experience." (1) Further, The Economist, February 17, 1951, commenting on the "Plimlin Plan", referred to "a sweeping proposal to integrate European agriculture through a network of long-term contracts………these would be uniform and negotiated jointly by member countries with the object of getting European Importers and Exporters to buy and sell certain minimum quantities of food".

But as the war years receded, the case for and against long-term bulk contracts has become increasingly susceptible to judgment on economic and political grounds and, in appraising the feasibility of these contracts, considerable attention has been given to the problem whether they necessarily require the intervention, to some degree, of Governments. Not all producers and buyers necessarily regarded the stability provided by long-term contracts as sufficiently essential in itself to warrant Government intervention.

Since 1950, as suitable circumstances presented themselves, the United Kingdom Government has steadily been vacating the field of Government trading and distribution and restoring these activities to normal commercial channels. Furthermore, until 1952, expiring long-term contracts were renewed but, after that year, the tendency has been for their non-renewal. The fifteen year meat agreement concluded in 1952 was exceptional in this respect though even here explicit reference has been made to the possibility of handing back to private traders the import of meat in the United Kingdom.

(1) The Netherlands Information Bureau, Points made by Dr. D. U. Stikker………October 6, 1950, quoted in "Trade and Payments in Western Furope" Wm. Diebold.

The Place of Small Scale Industry In National Planning

F. R. JAYASURIYA & N. K. SARKAR

The monograph entitled "**Industrial Policy of The Ministry of Industries**" by Hon. Sir Kanthiah Vathianathan, Kt, C. B. E., Minister of Industries, Housing and Social Services, is an important document. Free from the verbosity and pseudo-economic theorising which characterised certain previous statements on economic planning of the government, the present booklet bases its conclusions on simple facts of past experience and practical commonsense. It describes in very frank terms the present sad state of some of the grand schemes of the past years, and presents an alternative scheme of industrial development giving to the small scale industry a position of top priority.

The social and economic variables which are called into play by efforts of development constitute a complex and interrelated whole, so that plans which are based on sectional experience run the risk of creating an unforseen situation which may lead to the defeat of the development effort. It is necessary, therefore, that every economic plan should be considered not in the light of a sectional experience but in relation to the totality of the interrelations involved in the situation. Our main criticism of this small-scale industrial development plan as drawn up by Sir Kanthiah is based on an appraisal of the dynamics of these interrelated variables which we are afraid may not support the development efforts.

First let us exmine the "sectional experiences" that caused the Ministry of Industries turn away from large-scale mechanised industries to small-scale industries. These are: (a) ......"it may be pointed out that in the large factories the capital requirements amount to nearly Rs. 10,000/- per worker, and it will be seen, therefore, that all our available capital, if invested in such projects, can never give employment to more than a few thousands, whereas what we need is industrial occupation for lakhs and lakhs of people. Apart form the high capital requirements, the operating charges of such large-scale concerns are also very large, and of the total not more than 10 or 15 per cent represents the labour pay-roll, which is quite insufficient for a country like Ceylon, where capital is very limited but man-power is plentiful." (p. 14-15) Again, in connection with the establishment of a sugar mill he says,

"But a large factory costs a very large sum. For every ton per year output, capital to the value of Rs. 3,000 is required, and a single large productive unit may well cost in the region of Rs. 50 millions. Whatever the urgencies of the situation Ceylon will find it difficult to release money on this scale." (p. 22.) In connection with the fertiliser project he says, "we are baulked by its cost. The factory would be in the Rs. 150 million bracket, and even though we spend Rs. 25 million every year on foreign fertilisers it just does not seem to be possible to find the capital funds for this factory." (p. 11.)

Thus there seem to be two reasons for turning away from large scale industries. First, that large-scale industries create a much smaller volume of employment than small-scale industries; and, second, that the large volume of capital needed for large scale factories is impossible to obtain.

A third and, we believe, subsidiary argument is advanced as follows: "large factories apparently require foreign personnel to manage them for a long time to come, and that a very substantial amount of money has to be spent on these managers, whereas in the small-scale enterprises every cent of money on personnel is retained in Ceylonese hands." (p. 15.) This cannot be regarded as a major argument. For, if the services of the foreign personnel add more to the net national output than what is paid out to them, then it becomes worthwhile to hire the services of foreign technicians rather than use less efficient methods of production and produce a lower output.

There is a **prima facie** case, however, for industries which are more labour-using and less capital-intensive and which have a shorter gestation period in under-developed countries where generally unskilled labour abound and capital is scarce. The case for this type of industry however, has generally been based, on the ground that they use in larger proportion a factor which is cheaper and that their cost of production, therefore, is likely to be less. Since capital is scarce and costly and labour is cheap, it may be profitable to use more of labour and less of capital in production. Even in this case, the criterion of choosing the type of industry, therefore, is not whether employment is created by an industry or not, but whether more value is added to the net national output per unit of capital invested.

The industrial policy of the Ministry of Industries as developed in this book, seems to suffer from confusion as to the real objective of industrial development. Is creation of more employment the primary objective of industrial development or creation of more income? If creation of employment is taken as the primary goal, then the best policy would be to develop cottage industries, or to go back even to more primitive methods of production and have every operation done by hand, thus engaging the maximum number of labourers. Such a policy even if it proves successful, will lead to a lowering of the standard of living of the people, because the net national output will diminish. Over a long period with every rise in population, the technique of production will have to be pushed to a more and more primitive stage, while per capita net output will decline under the double pressure of population increase and inefficient technique. 1

It cannot be denied, however, that the question of providing immediate employment to both the urban unemployed and the rural under-employed may become acute if export prices decline. The pressure on the government to find employment for persons who suddenly find themselves without a means of livelihood may become irresistable. Some type of unemployment relief work, therefore, may have to be found, especially for the urban workers. The urgency of such relief work will be less for rural workers, because of the larger family size and stronger family ties which make them support each other and so distribute the burden of unemployment among themselves. Thus in a depression the extent of under-employment will rise among the rural families, but the proportion of complete destitution will be less among them than in the towns. Not only will the rural families share in the misfortune of some among their members and lower the standard of living of all, but in addition an escape from the severity of the depression will be sought by substitution of food crop for cash crop and replacing work on the estate by labour in food production or other village crafts such as pottery, and bartering the produce for food. In short, partial relief

1. There may be a few cases where small scale industries may have a lower cost of production for every level of output. These exceptions are very few and they are generally highly capital and skilled labour-intensive see. J. M. Blair "Does Large Scale Enterprise Lower Cost?" American Economic Review. May 1948.

from distress will be sought in the rural areas by retreating from production for the capitalistic market and turning to subsistence farming. 2

It should be kept clearer in mind, however, that the primary objective of development policy is not employment but addition to net output. Not only so; the addition to the net output of consumption goods is not immediate but takes place after a period of years—the gestation period as it is called. Meanwhile a part of the current consumption will have to be diverted to investment. Thus during the gestation period there will be a decline of consumption. This decline in the standard of living may not, of course, be borne equally by every individual in the community. It is possible by various fiscal and other devices to shift the burden to one class or the other. In Russia and China, for example, the major part of this burden was shifted on to the richer classes, while in Japan it was borne mostly by the lower classes. In countries like Britain and France the burden was at least in part shifted on to the people in the colonies. It is futile, therefore, to expect that industrialisation could be achieved without imposing any sacrifice on and lowering the standard of living of some part or other of the community. This sacrifice will, however, be more than compensated once the consumption goods begin to come on the market, assuming, of course, that the new income has been equitably distributed.

There, thus exsist a contradiction between the long term plan of industrial development and the immediate problem of relieving unemployment. This contradiction reveals itself not only in the conflict of choice between lower and higher technological combinations of capital and labour, but also in the ratio of diversion of savings between industrial projects and unemployment relief schemes. The volume of savings even at the best of times is not very significant in the under-developed countries, and, in times of depression may altogether vanish or beco-

2. Ibid. **Report on the Relief of Distress due to sickness and shortage of Food.** Sessional Papers. V. of 1936, p. 8.

me negative. Hence the unemployment relief schemes may exhaust all the available funds so that the development projects may have to be held in abeyance. In a Parliamentary type of democracy where the planning authorities will have to go to the electorate at certain not too long intervals, the temptation will be great to hand out money in the form of unemployment relief rather than ask the people to accept a lower standard of living in order that the long term plans of industrial development may be taken in hand. Thus in these countries one may expect a shift from a higher technological plan of industrial development to a lower one as money becomes more and more scarce and the depression deepens.

We have been arguing so far on the assumption that there is a contradiction between the plans of industrial development and unemployment relief. Is it not possible to devise a scheme where these two objectives are geared together so that unemployment relief works advance the cause of industrial development? The great attraction of Sir Kanthia's plan lies in the fact that it tries this kind of synthesis and attempts to meet at the same time, the **political** demands for both industrialisation and employment. The poorer classes in Ceylon have a standard of living which cannot be reduced any further. The higher income groups on the other hand, are not saving and investing on a scale requisite to meet the needs of economic development and their association with the government is too close to permit the necessary measures to be taken to achieve this end. 3

Thus within this institutional set up a sufficient supply of capital cannot be obtained to initiate and sustain large scale industrial development. On the other hand the capital requirements of small industries

3 "...in countries which are predominantly agricultural and where land is held in large estates, the rich, who should do the saving and investment, cammonly are non-savers and spend their incomes in luxuricus living, with the result that economic d velopment of these countries is retarded." **Internatio eal Trade and Economic Development**. Jacob Viner, n Clarendon Press. Oxford. 1953. p. 106, see also Sir Ivor Jennings, **Economics of Ceylon**, "since......it (i.e saving) required a strict limitation of personal consumption and the maintenence of a low standard of living, it is unlikely that the bourgeoisie which dominates Ceylon could or would apply the same policy". p. 94. Oxford University Press. 1951.

are not excessive and does not call for any greater sacrifice, while, at the same time, they can provide jobs to the growing number of the unemployed. The small scale industry plan of the Ministry thus, fits in very well, indeed, into the political picture of contemporary Ceylon.

Political feasibility is, however, a poor criterion of economic justifiability. Judging from the purely economic stand point the plan could at best be regarded as an unemployment relief scheme rather than a serious attempt to develop industries in Ceylon. Any one familiar with the economic and social background of Ceylon and other under-developed areas would readily admit that the sum total of social effort which the small scale industries represent, is far too inadequate to break through the stagnation and cumulative degeneration that perpetuates and deepens the backwardness of these countries. All attempts to regenerate such an economy through the main lever of small-scale industries have met with failure in other countries. The case of India and Indonesia during the thirtees where such attempts were made may be cited.

The reasons for the failure of the attempts at social transformation by means of small-scale industries are not far to seek. In every case where such attempts were made the main difficulty which caused the shipwreck was the problem of markets. The cost of production in most of the standardised products is higher when produced in small scale. The division of labour, the integration of factors and the advantages of external economies cannot be availed of to the fullest extent by the small-scale producer as much as the large producer can. Not only is his cost of production higher than that of the large producer, but it is higher also in relation to the income that is generated by the processes of production. The scale and tempo of investment is not so great in case of small industries as in large ones; the rate of generation of income in consequence is not high enough in case of small industries, so that the demand for the articles produced by them may not show any rise. In the case of large-scale industries, not only is the absolute cost of production lower, but the subsequent rise in income which large scale investment generates leads to a rapid rise in the demand for the articles produced. In view of the low level of nutrition and food-consumption of the vast majority of the people in these countries, whatever small rise in income may be produced by the introduction of small industries, it is likely to be exhausted in meeting the demand for food. This surely is the reason for the failure of the cottage industries refered to by Sir Kanthiah. 4

It is the same reason which accounts for the difficulty in introducing new consumption goods industries in backward and poor countries. This further suggests that if consumption goods industries are to make any headway, they must start with the production of goods which already have a market in the country, It is for this reason that we find in many countries small scale industries making some headway by displacing the handicraft products. The partially mechanised small factory can, generally produce at a cost below the cost of the craftsman and can continue for some time till it is itself replaced by the large factory. This is what has been happening in the handloom industry of India. In Ceylon there is hardly any cottage industry which supplies any standardised article of consumption on a large scale. The scope of small scale industries, therefore, seems to be rather limited in Ceylon in this respect.

In Ceylon the major part of manufactured consumption goods consists of imports. It might be argued that a heavy tariff would secure the market to the small producer. There are two difficulties in doing this. Firstly, the rise in price may lead to consumer resistance and the market may shrink. Secondly, the income generated by the small scale investment may not be adequate to overcome the unwillingness of the buyers to buy at the high price.

Small scale industries, however, can play a very useful subsidiary role in industrial development plans. Once a plan of large-scale investment at high tempo is started, a high rate of money income is generated which creates a potential market for any commodity that may be placed in the shop-window. In view of the scarcity of capital and technicians the gap between high income that is generated and the supply of consumer goods is widened in

4. "Ceylon became studded with hundreds of training centeres for cottage industries. In retrospect, it is seen that their training centres did not produce either workers or valuable products, but merely turned out more and more teachers.........It has to be admitted that when the cottage industries left the Ministry of Industries there was being produced neither really artistic goods nor goods of real commercial value by our cottage workers," ibid. p. 6, para 9.

the earlier stages of such an investment programme. The small-scale industries can step into bridge this gap because the capital—labour ratio is much lower in small scale industries, the skill required is moderate and is easily learnt, and, the gestation period is short. Moreover, the institution of highly mechanised factories may accentuate the unemployment problem, which may be modified to some extent by these small scale firms. Small scale industries, thus, may have a place in an industrialisation plan, not as the principal, but as a secondary sphere of economic activity.

As a measure of unemployment relief, however, small scale industry comes out slightly better than the system of unemployment doles. For in case of unemployment dole the money is transferred from the producers to the non-producers, and, therefore, has a general degenerating effect on the community as a whole. In case of small industries the dole is at least hidden and appears as payment in exchange for labour. Secondly, some skill-formation may result from the efforts to run small scale industries.

Unemployment relief schemes can, however, be planned in such a way that they help the development of the technological and social conditions which favour industrial development. These technological and social conditions are the existence of roads and railways and other means of transport and communication, irrigation works and drainage, a certain level of general and technical education, certain minimum standard of health and sanitary services etc. It may be possible to design the relief works in such a way that these are constructed in the process, and, thus, help at a future date the launching of an intensive industrialisation programme.

Peradeniya.
Feb. 1955.

The Ceylon Peasant in Industry

E. B. TISSEVERASINGHE

The popular notion is that the population of Ceylon are largely peasants. This is very far from being the case, and domestic agriculture plays in fact little part in the economy of Ceylon. The latest Census (1946) recorded that of a population of 67 lakhs, less than 3 lakhs had anything to do with paddy as a principal occupation (owner, lessee, cultivator, etc.) where as the total gainfully employd exceeded 26 lakhs.

2. But there are two contrapuntal themes, also faithfully recorded in the 1946 Census. Firstly, that if we leave out the plantation workers, most of the others do nothing of any particular importance or value to the community. The sprawling and ubiquitous public service gives employment to about 2 1/2 lakhs of persons; trade to about the same number; domestic service to nearly 2 lakhs; hotel services also as much, and other big groups in similar kinds of parasitic occupations. Ceylon has apparently settled down comfortably to being a nation of hawkers, ayahs and tea-boutique keepers. None of these are very noble avocations, but the unpleasant fact is that there seem to be very little else to do, at the present. None of these major groups are really productive, although it is often argued that finance, distribution and sale is as much an organ of production as manufacture itself. The fact remains that if three-fourths of those presently engaged in these parasitic activities were to disappear overnight there would be no great loss, and those who are left can very readily take up the slack. Not so with the mechanics of manufacture, where the loss of even one unit is a very real loss.

3. Reverting to the theme of the peasantry, according to the 1946 Census again, there were 289,000 persons engaged in the production of paddy as a main occupation. This figure probably includes absentee landlords, paraveni nilakarayas, ninda lords, and thattamaru shareholders, whose right comes round only once in several years. It is very doubtful if the 626,000 acres cultivated in that year demanded the attention of more than 200,000 actual workers. Under the normal system of paddy cultivation, it calls for only 24 days of actual work. Allowing an everage of 50% extra for double-crop land and another 50% for all other land cultivation the peasants are actually employed for only about 48 days in the year, which is about one-

sixth of the total time in the year for which a person can and should expect to be productively (and remuneratively) engaged. The present paddy production in Ceylon is therefore the equivalent of only about 35,000 workers engaged fulltime. This compares very poorly with the 35 lakhs who have to be found employment of some kind or another if Ceylon is ever to enjoy reasonably good standards of living.

4. What is the answer? First of all is maximum productivity of the paddy land we already have. It has been shown in a separate paper that there is nothing impractical or unrealistic in expecting a threefold increase in our paddy production. This would solve our food problem immediately and the only problem it would create is the difficulty of selling our surplus home-grown paddy in a rice-surplus world! The aim is highly desirable and success reasonably within our grasp.

5. Nevertheless, the increased volume of work which is required to achieve the object would not give employment to more than 100,000 fulltime workers (or, of course, a proportionate number of part-time workers). We already have 300,000 paddy cultivators, and there are lakhs more straining every effort to join the ranks of goiyas. Unless one is driven to the counsel of desperation of keeping all underemployed for the sake of preventing many unemployed, there is only one way out of the difficulty, and that is to provide alternative employment.

6. Now paddy cultivation requires 10 or 12 times as many workers for a few days seasonally as are required during the slack growing period. The woman and children of a family are only an average of about 4, of whom 2 cannot contribute anything. To get the 10 or 12 workers needed, therefore it is necessary to have 4 times as many paddy workers as can be found **wholetime** (all-the-year-round) employment on paddy. This is the minimum requirement, and the 4 lakhs of people required are already there. No room can be found for any more if paddy cultivation is to be done really systematically and is not used as a way of keeping idlers out of mischief.

7. But the effect of all this is that the paddy workers will be employed for only one-fourth of their normal productive time. Either they must remain idle for 75% of their time (and of course get into mischief as a result, and a'so be reduced to a very low standard of living) or they must be found other equally (or more) remunerative occupation.

8. It has been shown in yet another paper that there is every opportunity in Ceylon of putting to good use the idle time of willing workers. There are three fields which in Ceylon are relatively virgin; if such a term is permissible. The first is agriculture-chiefly cultivation of accessory foods and animal husbandry. The second is industries of all types, large-scale, small-scale and cottage. The third field lies in between, and that is the production of agricultural goods, not for direct use, but as raw materials for industry. With agricultural occupation producing food for direct consumption this paper has no concern. Nor with pure industrial occupation as a means of using up idle manpower. Both themes are adequately covered elsewhere. We confine ourselves, therefore to the production of agricultural goods which are the raw materials of ndustry.

9. The two major crops are, of course, sugar-produc, ing plants, and cotton. There is so much to be said on both these crops that it is best to say nothing at all, and leave it for specialised treatment separately. All that needs to be borne in mind is that Ceylon has the land and the manpower and the climate to produce within this country our entire needs of sugar and textiles.

10. As for other crops they are almost innumerable and of those suitable to Ceylon they have only one factor in common, namely that they are very remunerative, and afford an excellent opportunity (the only opportunity, in fact) of using our land, labour and capital to best effect.

11. Here let us make a small calculation. Leaving aside the actual gross national product (which is known with a fair degree of accuracy) and the per capita income of various groups (which is a relatively unknown factor), almost everyone is aware of the actual daily remuneration demanded by each group, and there is also a fair guesstimate of the relative proportions of each major group. The rough figures may be taken as follows, and will probably tally close enough to the facts to afford a working basis.

	%	Daily wage Rs.
Casual labour unskilled	50	3
,, ,, semi-skilled	20	5
,, ,, skilled	10	8
White-collar workers minor	10	7
,, ,, ,, subordinate	4	12
,, ,, ,, junior staff	1	20
,, ,, ,, senior staff	0.1	30
Others ...	4.9	4
	100	

The average of this breakdown amounts to Rs. 4.91 per head per day. According to actual figures of national income, the 3.1 million gainfully employed of today earn about Rs. 4,300 millions, which, in a year of 300 working days, works out to Rs 4.62 per day, which is close enough to the computed figure, when it is remembered that the table is practically a shot in the dark, and that the national income in 1954 was probably substantially higher than it was in 1953. The difference between computation and estimation will be made up this year, it is very likely.

12. Apparently, therefore, there is no substantial unemployment in this country, and everybody is somehow earning daily the average income appropriate to his bracket. Apparently, also, there is no way of increasing the national income very greatly, as there is nobody who is available with free time. Apparently, finally, there is only one way of improving our standards, and that is by raising the quality of our work and making people pay more for it in real terms. But we **know** this is not the case, and that there is, in fact a large measure of underf employment. We know, too, that there are lakhs o- people who are eking out a miserable life. Where, then, is the fallacy, if there is one?

13. The catch is in the method of computing gross national product. This includes both goods and services. Out of the Rs. 4,300 millions total, over Rs. 2,300 million is represented by services and under Rs. 2000 millions is the value of goods. It is this Rs. 2000 millions worth of goods which alone we must take into account in judging the standard of living. The total amount of services can add up to any number of millions, and still not result in an addition of a single grain of rice or a single yard of cloth or a single tile on our roofs. Services are truly luxuries, or at most semi-essentials, to be considered only after the basic essentials of goods are provided. Services include hospitals, schools, social benefits, welfare, hotels, trade, transport, finance, police, law, parliament, administration, and the like. All very well and good, but none of them producing anything solid to handle.

14. The distinction between goods and services, does not, however, affect the question of employment. Whether in producing goods or in rendering services, it does appear that the entire productive population of Ceylon are in fact working, and there appears to be very little absolute unemployment. This accords with the periodical reassuring handouts of the Department of labour, which nobody really believes, but which do seem now to be fairly reliable. We shall, however, proceed on the assumption that there are at least 3 lakhs of persons willing and able to work, but who lack work at present. This 3 lokhs is only 10% of the productive group, and since the accuracy of our theoretical calculations is of the same order, there is no way (other than by a full-dress Census of Employment) of proving that the actual availability is anything else. To this 3 lakhs we shall add quite arbitrarily, but on fairly acceptable practical experience another 2 lakhs of persons who are really surplus in the various activities rendering services and whose energies can be switched into the production of goods.

15. We expect a definite increase in the standard of living and wage-earnings as a result. Nevertheless, in the first instance we shall have to accept the present pattern of earnings. Taking, then an average earning of Rs. 4 per day in a full year of 300 working days, we attribute Rs. 1,200 worth of work to each person, which for the 5 lakhs of productive workers we propose to employ, will result in an addition of Rs. 600 millions to the gross national product. This Rs. 600 millions is only about 13% of the present gross national product, but is 30% of the present production of goods. Since the circulation factor is at least 2 1/4 in Ceylon, the Rs. 600 millions worth of work producing goods would eventually add up to Rs. 1400 extra in the gross notional product. This, surely is not the sum of our ambitions, for we want a three-or four-fold increase in our gross national product to reach Western standards, and this means an additional Rs. 13,000 to 17,000 extra in the gross national product. But as a medium-term objective it is sufficient. If this is, successful, the rest will come snowballing on.

16. The gross return at present from agricultural land varies with the crop somewhat as follows:—

		Rs. per acre
Coconut	...	300
Paddy	...	400
Rubber	...	600
Cocoa	...	800
Tea	...	1,500
Vegetables	...	1,800
Tobacco	...	2,000

We have at present a little under 3 million acres under cultivation. At the lowest, this land should yield a minimum of Rs. 900 millions per annum. At the higest it should yield Rs. 6,000 millions. At present it actually yields about 2000 millions, We want it to yield only Rs. 600 millions more of work. These figures indicate that the short term target of Rs. 600 millions extra may be achieved with the existing land alone, without a single acre of new land or a single extra cubic foot of irrigation water. We want only Rs.600 millions more, where as in the kind of land-use alone there is a variation of Rs. 5000 millions, according to the above table. It is quite impossible to produce the extra Rs. 5000 millions of work, owing to the limitations of soil and climate. But Rs. 600 millions should sure be capable of realisation.

17. This is possible in three ways, namely, inter-planting in the standing crops, rotation of short-age crops, and finally making more intensive use of existing land. In all three cases we are only making more and better use of existing land, not demanding any new land for the purpose.

18. Let us first see what products can actually be grown. It was mentioned in the foregoing that apart from sugar and cotton there was a bewildering variety of crops to chose fron. Some are listed in the Appendix hereto. The list is by no means exhaustive, but indicates he hopes upon which this paper is based.
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19. The best chance of all is on the waste land which form so large a fraction of agricultural land in Ceylon — fences, ridges, road reservations etc, for these can be permanently cultivated. The next best are coconut lands, for there are wide spaces between trees which are fully available so long as they do not interfere with the supply of nutriment to the trees. Rubber lands are ideal for cultivation of mushrooms, cocoa, pepper, etc. Tea lands are very good for leguminous species like mulberry, indigo etc. and for livestock, all of which contribute the soil manure which is so important for good tea.

as for paddy land, the paddy is often only a single crop in the year, and the land is free for other seasonal purposes during the off season.

20. This brief outline indicates only one small section of the potentialities, namely the production of industrial raw materials by agriculture. Its limited aim is to produce Rs. 600 millions of work and thus contribute about Rs. 1400 millions to the gross national product (apart from further industrial use of the products) and thereby at least double the present standard of living of the peasant class. In doing so it merely makes use of existing resources and calls for no substantial capital investment to achieve its object.

APPENDIX

List of Some Agricultural Products of Industrial Value

A — Oil Seeds:

Till recently the under-developed countries were the sources of oil seeds which were exported to Western countries for processing. Most of these under-developed countries, however, have now rushed into the oil extracting industry with the result that in almost all these countries there is surplus crushing capacity, but insufficient oil-producing commodities. Attempts have been made to establish huge oil seed farms in Tanganyika and elsewhere, but with no success so far. There is now a far greater demand for oil seeds than for oil. Ceylon possesses ideal climates and soils for many types of oil seeds, such as Palm oil, Mee (Illupai), Caster, Linseed, Wild mustard, Rape, Sandal etc.

B — Fibres

The same situation arises with fibres where the processing capacity now exceeds the availability of natural fibres. Here again, Ceylon is in an ideal position to grow very high quality fibres. The land and the labour are there. Some of the fibres are tree-cotton (not kapok), jute, sisal, banana, pineapple, hemp, silk, wara (Erukku), flax, wool etc. Some of these are perennial and some of them annuals, and some of them seasonals. There is a place for each of these types in Ceylon.

C —Sugars:

The demand for sugar in Ceylon is equivalent to the annual production from about 100,000 acres of land. The systematic cultivation of palms like palmyrah, Kitul, Sago, wildDate (Indi) etc. can produce at least one-third of our needs. There is an expectation that Ceylon is suitable in certain parts for the cultivation of special strains of the sugar beet, and it is known that the sugarbeet in other parts of the world produces about 10 to 12 million tons of sugar a year. There are other excellent sources of sugar, such as Maize, Sorghum and even the relatively uncommon sources like pineapple and Jerusalem Artichoke. Where it is possible to spare land for intensive cultivation of sugar species, the sugarcane is unrivalled, but there are also these other sources of sugar to be cultivated on smaller pieces of land which may not support a huge factory.

D — **Fruits:**

Ceylon is a horticulturist's paradise, but singularly little use has been made of it so far. We import large quantities of canned fruits, fruit juices, fruit sauces, etc. which could quite easily be produced in this country if there is a systematic industry. Some of the fruits which can be developed are mango, pineapple, mangosteen, date, rambutan, banana, goraka and numerous other species. Here too, systematic cultivation is the answer, with small factories disposing of the products of each village as we find in Japan.

E — **Nuts:**

The edible nut is one of the most concentrated sources of protein known in the world, and is a very valuable accessory food factor in other countries. In Ceylon so far the nuts produced are too costly to serve the poor people, but that there will be a demand for them if the price is reasonable cannot be questioned. The up-country of Ceylon should be eminently suitable for Walnuts, Chestnuts, Barcelona nuts, Brazil nuts, Hazel nuts and all the other kinds of temperate-zone nuts. So far as commerce is concerned, Ceylon is still a very large supplier of Arecanuts, and the demand for this commodity is still inexhaustible.

F—**Grasses**:

A great deal of Ceylon, especially in the up-country, is underwild grasses which are of no value to anybody. Even for grazing purpose, an animal requires about 5 to 10 acres of wild grass land, while under cultivated conditions one acre can support about 30 large animals. This is entirely the answer to our cattle fodder problem. It is not often realised that animals obtain almost all their protein requirements direct from the grass. Napier and the Guinea grass varieties have been well established in Ceylon. Grasses for industrial use are Esparto, Chinagrass, Koraigrass, Rheagrass, Lemongrass, etc.

But far and away the most valuable grass in the whole world today is the Bamboo. There are hundreds of species of bambo and almost every one of them has several industrial uses. In Ceylon we have not even approached the fringe of the possible uses of bamboo, and their are millions upon millions of rupees to be made out of the

of mushrooms since they produce by nature the damp, dark, warm, steamy climates which the mushrooms require for full development. The whole of the Far East consumes mushrooms in enormous quantities, and Ceylon can certainly supply a good deal of this market. Reference has also been made to the value of bamboo sprouts as a food. Other materials of industrial value are tanning materials, gums, waxes, varnishes, copal, sago, soapnuts, and the like. This list could be expanded to great lengths, but what is mentioned is sufficient to indicate the general potentialities.

K—Livestock:

In this class too falls a number of products of which we in Ceylon do not know the value, but which are greatly appreciated in other countries and which are the basis of most valuable industries. To take Oysters for instance, they are born and grow with nature alone, and very little of man's effort is needed, although, of course, the intervention of man can produce a hundred or a thousand-fold return where nature produces only one. The edible oyster, for instance, is grown on thousands and thousands of acres of muddy land in Portugal. The pearl oyster is grown by the thousands of millions in Japan, and one of the most flourishing industries is based on this. In Malaya and China every pond is a source of fish, and the yield is several times quantity and many more times in value than what the land can furnish in vegetable products. As for poultry, it is heart-breaking to think of the import of millions of eggs when, by modern methods of deep-litter technique, every family can earn even Rs. 150/- per month. The keeping of livestock like the Angora goat, the Alpaca, the Vicuna, etc., for the sake of their valuable hair is another attractive possibility for Ceylon. Pig rearing under systematic conditions is a widely practised art in Western countries, but is scarcely known in Ceylon. Then there are the insects, the Cochineal insect and the lac insect which secrete products of high industrial value. The diversification of livestock farming on these lines is bound to result in a very large increment of national income without encroaching in any way on the existing resources or making large demands on capital.

The bamboo is one of the fastest growing species of the whole world, and produces up to 200 tons of new growth per year per acre, whereas with dry zone hard-woods one or two tons per acre per year would be good growing. There is a huge and discriminating market in the world for bamboo shoots as a direct source of food. While Japan supplies a good deal of this market, its land resources are insufficient to produce as much as she could sell and the market for bamboo shoots from Ceylon would be unlimited for all practical purposes. The use of bamboo for structural purposes and in manufacturing containers, and even for house-building purposes, is practically an unknown field in Ceylon, whereas it is well developed abroad. There can be no other agricultural activity so profitable as growing bamboo, provided of course industry is ready to use it.

G—Vegetable Dyes:

Up to about one hundred years ago, vegetable and animal dyes were pre-eminent in the whole world. The English and German synthetic industries broke the back of the vegetable dye trade which suffered an almost complete collapse. Today, however, costs have gone up so much in industrialised countries and raw materials have become progressively so much scarce that the market for vegetable dyes has been re-opened and there is every possibility of making a very handsome profit out of the production of vegetable dyes. Many of these dye plants are leguminous and contribute to the soil fertility, while at the same time yielding products of industrial value. There are many possible dyes in the world, and it is sufficient to mention only Indigo, Madder, Logwood, Saffron, Senna, ete.

H—Ayurvedic Drugs:

Owing to the systematic practice of Western medicine in Ceylon and its encouragement today by Government, Ayurveda has reached very low depths, and few of the intelligentsia take it up seriously. Even the common man who formerly never heard of Western drugs and depended entirely on his village Ayurvedic physician, is now turning more and more to the magic bullets of Western medicine. This indifference to our own Ayurvedic drugs of value is typical of our ignorance and not our advancement in knowledge, for even in countries like America where magic bullets turn up with monotonous frequency, much of the pharmacopoeia is taken up by drugs of vegetable origin. A recent article in a technical magazine deplored the fact that these drugs were becoming scarce, and some of the drug users in America are now setting up the cultivation within their own boundaries of several of the drugs which used to come from Eastern countries in times past. American cultivation methods for these drugs are however, very costly, and it is quite certain that Ceylon has a wonderful opportunity now of supplying the requirments of Western

countries even if we ourselves ignore the richness of our own medical system. A typical example is the Rauwolfia Serpentina (Rasakinda). This is a drug which is commonly used for high-blood pressure and heart trouble. It used to be available in the market at about -/20 cts. a pound. Then the Americans discovered its value, and we are told that today the price is Rs. 25/- per pound. There are many Ayurvedic magic bullets of the same type which could easily be developed. In this note we confine the possibilities only to those established drugs which are on the main Western Pharmacopoeias. A list of these drugs would include: Belladonna, Digitalis, Atropine, Menthol, Camphor, Ergot, Lipuorice, Arrow-root, Benzoin, Cassia, Walnut, Gallnut, Nelli, Musk Mallow, Nux Vomica Sorrel, Sarsaparilla, Squills, Vetiver, Wormwood, Kasa-kasa, etc. From what one reads from the journals, there is still a huge market for these products. Most surprising of all is the fact that in Ceylon Ayurvedic drugs are largely got down from India, even common things like wild-saffron and castor seed.

J—Miscellaneous:

Among the miscellaneous products of agricultural origin are to be found a large number, many of which, require some detailed treatment. Mushrooms, for instance, are highly appreciated by more than half the population of the world, and there is a simply enormous trade in them which could be made very much greater if only the mushrooms can be produced at sufficiently low cost. In America, huge factories have been built at tremendous cost merely to grow mushrooms, and it is because of the high cost of these products that the demand, which is always there, cannot be satisfied. In Ceylon, rubber estates are an ideal forecing house for the cultivation of mushrooms

The Future of the Tea Industry in Ceylon

F. R. JAYASURIYA

The continuing fall in the price of tea has caused widespread anxiety among all classes of the population, both tea growers, as well as those whose incomes are primarily derived from other sources. For tea occupies a position of such dominance in the economy of the country, that any serious decline in its price must sooner or later affect the income, purchasing power and level of employment of the community as a whole. Moreover, in so far as tea enters on a considerable scale into the business of the produce markets of the world, as well as into the economies of a number of countries, it is likely to arouse apprehensions of possible world wide economic effects. Such fears are all the more disturbing, since for many years economists have thought the world to believe that the trade cycle is a thing of the past, and that the vastly increased understanding of the economic process which we have acquired since the depression of the 1930's has provided governments with weapons which would be completely effective in combating any tendency towards a general decline in economic activity.

For Ceylon the period of prosperity which began with the outbreak of the Korean War in 1950 had the dangerous result of inducing a complacency in both government and the people, the consequences of which are only now becoming apparent. Not only was there too little of scientific thinking on economic questions among the people generally, but even among those who might have been expected to know better there was a reluctance to face what might be the less pleasent side to this passing phase of unparalled prosperity. Besides, the period of rising prices and post war scarcities, if it also meant high prices for imports of consumer goods, nevertheless yielded fabulous incomes to the producers of primary agricultural products: "The story of tea in 1954 is one of an almost uninterrupted rise in prices reaching in the closing months levels which would have been considered fabulous even a year ago. In addition Ceylon has been able to harvest a substantially increased crop so that very large profits have accrued to the producer. One would naturally have expected as a result to find an air of elation in the markets. The actual picture is very different and the reason is not far to seek. The fact of penal taxation cannot be disguised under such phrases as 'The syphoning off of excess profits' or the levelling of inequalities of income'. Not only have the government repeatedly raised the export duty on the plea that the industry could bear it, but the level of direct taxation is now so great that the bulk of the money paid out as dividends also returns to their coffers. Far from there being any elation, there is a feeling of deep misgiving about the public reaction to the very high prices established and the consequent possibility of a reduction in the level of comsumption. In addition there is a far too well founded fear that the government will be too slow to relax their demands when prices fall.

"In November when the export duty was raised to Re.1/- per pound, there was a semi official statement that the duty would be reviwed when the market average fell to Rs. 2.40 per lb. An adjustment then would appear to leave a handsome margin of profit to most estates but the essential point is missed. There would be a reasonable profit as long as estates were able to produce their present crops at present costs but, however long delayed, there must be an end to the life of a tea bush and the amount of money now left in the producers hands is ludicrously inadequate in face of replanting costs of Rs. 5,000.00 an acre. If the Government is going to continue its policy of heavy taxation is must assume the responsibility of subsidizing replanting and fresh planting or in forty years there may be no Ceylon tea industry". (Ceylon Tea Review, 1954–Forbes & Walker Ltd , p. 3. And in so far as the owners of agricultural property had an influence in determining the policies of Parliament, they were so short sighted as to imagine that the best course for them lay in endeavouring to maximise their immediate gains, by preventing any corresponding rise in wages, rather than to use the opportunity thus afforded by the period of prosperity to reduce costs, by the adoption of improved methods of cultivation, processing and the selection of better varieties of seeds and and plants, increased use of fertiliser, improvement of transport, and finally, raising the standard of education health, and training of workers.

If, then, the tea planters, and particularly the owners of large plantations, chose the easy course of trying to keep wages low in preference to increasing effeciency and improving yields, can they now complain if the State refuses to lower taxes and particularly the export duties, when the incomes of tea planters have fallen, on the ground that the already low income of the workers will not permit any greater share of the burden of State expenditure being passed on to them?

Nor is this the whole story of the present situation of the tea industry in Ceylon. For the small cultivator of tea has been much harder hit than the large estate owner, by the sudden and catastrophic fall in prices. The owner of a few acres of tea without a factory in which to prepare the green leaf for sale to the final buyer or consumer, and left at the mercy of the factory owner, is a phenemonon almost unique among agricultural producers. For the freshly plucked tea leaf is neither raw meterial nor finished product. Being highly perishable it cannot be stored, awaiting a favourable turn of the market. And not being a finished article it is not in a condition to be passed on for sale to the consumer. In periods when the demand for tea is keen and prices are high the small holder manages to obtain from the factory owner a price which enables him to eke out a bare subsistance. When prices decline, the factory owner particularliy where he is also the owner of a large plantation, tends to confine his manufacture to leaf obtained from his own crop, while those factory owners who depend mainly on bought leaf for their supplies soon find that they have run out of their capital owing to the piled up stocks of manufactured tea, and either refuse to buy any further quantities of green leaf or else offer for it a price so low that it could hardly pay a cultivator to supply leaf on those terms. Thus in the present crisis of tea, green leaf even in the hilly districts where till then fetched on the everage a price in the neighbourhood of 60 cents is now said to be selling at the incredible price or three (3) cents per pound.

Some of these factors of a temporary and adhoc character have no doubt been partly responsible for the present sudden and sharp swing of the market away from the direction in which it had been moving since the end of the war, just as the previous abnormal rise was itself partly due to similar casual and fortuitious circumstances. Thus surveying the course of tea prices during 1954, that is the period immediately preceding the present crisis, the President of the International Tea Association in Culcutta made the following observation: "From what I have said, you will realise that the rise in prices was partly due to circumstances of an extraneous nature, and that some of these circumstances – like the London Dock Strike – are quite connected with the tea industry as such. Granted that we in

North India work in areas where floods are the rule rather than the exception; granted that strikes and go slow movements are not unusual occurences; but no one would be so foolish as to regard prosperity as assured if it is in part due to labour disturbances and to the recurrence of natural calamities. The sober truth is that prices have been high, not merely because there has been an increase in demand, but also because a lot of tea which we have produced has been held up on its way to market. Regarded in this light, our prosperity, in which people believe so much more fervently than did they in our adversity, will prove less permanent than is generally expected, and it is for this reason that we have watched with concern the manner in which consumer resistance is growing and in which our liabilities are increasing."

(Quoted in 'Capital' Culcutta weekly financial review March 24. 1955.)

In the last resort, however, a rise or fall in prices must be explained by either increase or a decline in present or anticipated demand relatively to supply, and on this the pundits are either silent or equivocal, or frankly at variance, in their estimates of the present and future prospects of the industry. The President of the Indian Tea Association even appeared to look with confidence to what he regards as the increased consumption demand for tea:

"High prices, we are told, were due to an increase in demand and to the inability of the industry either to produce or to export as much tea as was required. That there has been an increase in demand is certain. In Great Britain, more tea is being consumed now than before the war, the per capita consumption having risen by three quarters of a lb. a year, so that it now stands at over ten lbs. per head. In the United States thanks to the high price of coffee and to the efforts of the Tea Council, there has been a considerable increase in the absorption. The settlement at Abadan, and the general prosperity of other Middle East oil producing countries has led to a remarkable revival of exports to those areas, which share with the Irish the reputation of the conoisseur. In all it is believed that 65,000,000 more lbs. of tea were consumed in 1954 than in 1953. This is a most welcome increase in demand".

("Capital"-Culcutta weekly financial review 24. 3. 55.)

On the other hand, in the opinion of another market authority, this appearence of increased consumption demand is illusory and misleading, and represents probably no more than an increased demand from dealers and shop-keepers for stockpiling:–

"Previous to the last war the world price of tea kept comparatively stable and the rise of 1/2 a lb. in the London auctions was, in those days, a matter for headline news, whereas nowadays a market fluctuation of 1d. a lb. does not even merit a mention in the Press and the public have now become quite accustomed to a rise or fall of 6d. to a 1 sh. a lb. for tea in the London auctions and an equivalent amount in Calcutta or Colombo. The reason for these violent fluctuations of the post war tea market is the very delicate balance between world supply and demand. Unfortunately no country has yet settled down sufficiently, since the turmoil of the second World War, to enable the tea buyers and blenders asess accurately either the number of people drinking tea, their individual financial capacity, or either per capita tea consumption. At times various figures are produced and published which show that world consumption in all countries is rising to a degree which still makes it seem level or even in excess of world production, but that these figures show in reality is not actual consumption, but a temporary absorption due to stock piling. Before the war, when tea prices were less than half what they are today, neither the small distributing shops nor the tea drinking public could afford to hold any appreciable stocks of tea. On the other hand large tea dealers and blenders were probably able to afford to hold much bigger stocks than they can at the present day, and as small shop-keepers and the tea drinkers were buying their tea for immediate use, blenders and dealers were able to assess their client's requirements in advance. If it was financially possible for big blenders and tea dealers to hold stocks of tea sufficient to keep the world tea market stable, this sould prevent the price of tea fluctuating as it had recently. As unknown stocks of tea are now held by small grocer's shops and individual tea drinkers all over the world it is impossible for the primary distributor to assess how much of tea actually is being drunk as against how much is being stock piled by his clients. And, as it is this hidden stock figure which forms the delicate balance between world production and consumption, the tea markets of the world are likely to continue to fluctuate to the detriment of the whole trade, until the per capita consumtion in all countries, can be more accurately assessed.

"For instance, when the 1954 tea market boom was at its height, the price of the packets of tea sold to the public

was forced up till, eventually the public and the small distributing shops throughout the world started to buy as fast as they could, anticipating a further rise, and this sudden buying of tea in increased quantities misled large blending houses into assuming that the consumption of tea in their various districts was rising, whereas, in fact, the heavy buying and absorption from their factories was merely stockpiling by the consumers and small shops. As soon as the price of tea dropped, however, small shopkeepers and consumers ceased to buy and subsisted on the stocks of tea they already held; thus the offtake from big blender's warehouses started to slow down giving them the idea that consumption had also started to fall. At the present time, therefore, nobody seems to be in any way certain whether or not there is an excess of tea being manufactured in relation to world consumption." (–ibid. J. Thomas & Co. Ltd- Report on Tea 1955.)

On the other hand there were some whose unbounded optimism reads strangely in the light of the change which has taken place only a few months after:–

"And now we come to those markets which in my opinion, change a generally sound position into one with the promise of years of boom prices – North Africa, the Middle East of Asia. Four things have fundamentally altered the effective demand in these areas – wealth, democracy, transport and propaganda. The development of the oil industry in the Middle East has brought tremendous wealth to countries which were previously very poor. The settlement of the Anglo - Persian dispute brings another good buyer back into the field. With the spread of democratic thought it is impossible for this wealth to be confined to a few hands and wages are rising all over the Middle East. A good deal of transient wealth followed the armies which occupied and defended these areas during the war. Now we have the Colombo Plan, India's Five Year Plan, and American Aid, all designed to raise the standards of living in Asia. Tea is the first luxury, and every man who has access to it gets his packet or drinks his cup. Roads are being improved and vehicles built which can travel where no roads are. Where they go, run the vans of the distributors seeking sales. Moreover, the market of the greatest potential value of them all is the one in which we shall never sell a pound of tea–India. If every Indian drank a lb. of tea a year there would be no exportable surplus of tea there. An increase is going on and is cumulative. One month a tea van reaches a village, the next the shop is stocking tea and the next it is in every house. Tea is not the vital export to India that it is to Ceylon and it may well be that the Indian government, will protect its internal market by limiting export licences. Indeed for the last two years they have not issued the full quota permisable under the International Agreement. The prospect for Ceylon is not only of filling and increased demand but of replacing in part Indian exports to all other conntries." (The Future of Tea. - An address given before the Tea Research Institute of Ceylon, by G. T. Kane of Forbes & Walker Ltd., PP 6.

To others, the evidence of the continuing increase in the demand for tea is so overwhelming that there is no need to take alarm. For them, the health of the industry is sound, notwithstanding any temporary decline in prices which might be due to a glut of supplies in the market - it is admitted that production in 1954 was 80,000,C00 lbs. more than in 1953 - unusually good weather conditions, or releases from stocks which had been previously piled up by distributors and shopkeepers , in anticipation of further increases in prices, or in the last resort, to consumer resistance. To quote again the testimomy of the Indian Tea Association President:-

"There are unmistakable signs that consumer resistance and buyer resistance are growing, and that the fall in the price which has followed Sir John Kotelawala's observations has been due to this resistance as much as to what was probably an intentionally provocative outburst. Moreover, there has been a great improvement in the stock position, and a greater realisation amongst the buyers that some of the causes of the 1954 shortage were of a temporary nature. We must therefore expect that prices will continue to fall, though as I have indicated, the satistical position does not warrant any serious collapse". (-Reported in "Capital" 24-3-55.)

"Consumer resistance" is a blessed word. It becomes twice blessed when harrassed leaders of industry are driven to find plausible arguments to explain away obvious signs of malaise and prop up the falling morale of buyers and consumers, no less than of producers and shippers. But what exactly does the word mean? Is it intended to state that the evidence of reduced buying on the part of the British housewife is a mere whimsicality, a change of fancy, with no real justification for it in fact, and that when the mood has passed she will once more be cheerfully paying the price which dealers choose to

charge? Or does it mean, on the other hand, that the fall in the price is a reflection of her reduced buying power, and this in turn the result of broader and more deep seated causes such as a general decline in real income due to a decline in world production and employment or to increased expenditure on armaments or an excessively high rate of capital investment and expenditure both in the advanced and in the underdeveloped countries? Nevertheless, behind the brave appearences and bland assurances one can hear the undertones of doubt, and the voice of warning begin to grow shriller and shriller:-

"There would seem to be no doubt whatsoever that world tea consumption is rising but whether it is rising as fast as world production is difficult to assess. The United Kingdom, by far the biggest consumer in the world, has a considerably increased population since the war. Due to almost total employment in that country and the great increase in the weekly pay packets of the working class family, which has enabled it to improve its standards of living, and also the large amounts of canteens serving tea and other refreshments which have come into being all over the country, the per capita consumption of tea in the United Kingdom has almost certainly risen. It would seem that considerably more tea is also being drunk on the American continent and the continent of Europe and this is probably due to a combination of the effect of the high price of coffee and the tea drinking habits acquired by those various countries during the last war. It should, however, be remembered that apart from coffe, the sale of other beverages is always being advertised in all these countries and it is only because tea has been able to overcome all competition by being the cheapest drink of its type available to the public that it has maintained its popularity for so long. Should however the price of tea ever get so high as to bring coffee or any of the other many excellent beverages on offer to the public into the competetive range, then tea consumption both in the U. K. and in all other countries might very soon fall. Since the war years, world production of tea has continued to rise steadily and as far as North East India is concerned, this has been in spite of occational bad crop years. However it must be remembered that in India, to have a climatically perfect year for the growing of tea is the exception and not the rule. Apart from the dangers, from the tea growers point of view, of having too much of rain during a cold spell or too little rain during a hot spell, the tea districts are always liable to natural calamities such as earth quakes or hail storms.

"To sum up, therefore, we consider that it is probable world production has now reached a stage when it must at least equal world consumption. It would therefore seem advisable, remembering that there are many acres of young tea which will be coming into full bearing, that the machinery for the voluntary crop regulating scheme which came into being in 1952 should be kept as a safeguard against another sudden and disastrous slump such as took place in that year. The fact that 'world production may have at least reached that debatable figure of world demand should not necessarily forecast a sign of bad times for the tea industry. On the contrary it is to be hoped that this situation will render big blending and distributing houses to procure tea at prices economic both to themselves and the producer and, at the same time, enable them to hold stocks of tea on their own account large enough to meet any sudden demand from the consumers. We base our forecast for 1955 on this hope although we anticipate a lower market than the extraordinary boom which took place in 1954, we think good and economically very satisfactory prices will be paid for well made and desirdable tea, while perhaps, the buyers in auction may be enabled to serve their public by neglecting ill manufactured and stalky grades, thus improving the blends ot tea put out to their clients. Prices should rise to very satisfactory levels when the second flush quality teas are offered in Culcutta, but there will probably be a recession in September. Should however world auction prices of tea be too dear to enable buyers of tea to hold adequate stocks, it is our fear that the tea market may fluctuate somewhat violently to the detriment of the whole trade for several years to come." (-Ibid-28-4-55.)

Nor is the disagreement confined to 'the estimates of future consumption, demand and present and potential productive capacity of the industry. There is also as the following remarks show, no unanimity of view as to what is the most suitable method of manufacture, or even what makes for quality in tea:—

"Now if we are going to take advantage of this opportunity we must know what these consumers want. The scientists have never really liked normal manufacture and have hoped to approach something more like the production line. There would be a considerable saving in building and working costs if such methods were successful and

as demand for some years has increasingly been for high percentages of B.O.P. and B.O.P. fannings, the prospects are worth examining. Roughly the process would be that instead of being spread in lofts the leaf would go into withering drums, from there to the roller where in one brief process it would be crushed and ripped, a normal fermenting and firing would follow and then, perhaps, the cea would be graded by winnowing and packed automatically......

"The real bone of contention is the rolling. Normal rolling is slow and produces a variety of grades. The tearing method without modification produces 100% broken leaf. Normal rolling bruises the cells and firing seals them with their own juices. The tearing method rips them open and firing fixes their juices on the flaky surface. Tearing produces strong coloury liquors with equal quality to normal. It is maintained by the trade and as hotly denied that these flaky teas do not keep.........

"The U.K. is still the most important world market for tea but the proportion of the worlds output consumed there is diminishing. We may have reached the end of the cycle in which the best average price was obtained for high percentages of small leaf B.O.P.'s even when of ragged appearence. The developing markets in the Middle East demand teas with a jet black leaf, a show of tip and bitter liquors. These teas are largely produced in the low country by short plucking rounds and light rolling. The obvious answer is that high and medium grown estates should concentrate or producing teas for Western markets while leaving this field to the low country producer. The fact is that even now there is not enough of this type produced and well made mid and high grown teas can enjoy the best of both worlds. Many a planter of high grown tea has boasted of the price of his fanning without realising that it is being shipped to Egypt as a result of the buyer for quality being outbid by a man who values it for its black leaf. The people who make their tea with the waters of the Nile Euphrates and Tigris, drink it largely in glasses, without milk and heavily sugared and spiced. They value most the bitter twang of well brewed tea and their taste is just as valid as ours. For years now low country teas have tended to average more than mid country teas of admittedly better quality, and at times have paid handsomely when certain estates have abandoned the search for quality and imitated low country manufacture. Without going so far as that, good plucking and normal manufature will give certain grades of high and medium grown teas access to this developing market……

"Moreover it is not only in these markets that the production line manufacture fails to satisfy the client. For instance these torn up teas cream richly. Now you might see one row of cups set out to cool in London and another in Boston. In London it would be done to select those that creamed but in Boston to reject them, for thc teas to be sold iced in glasses must be bright and transparent to make them look as attractive as they taste……

"Even the despised O.P. which now constitutes perhaps 1% of Ceylon's manufacture has its own special markets which would have to be reconquered for tea if O.P. was no longer available. The Continental drinker of thin flavoury tea with a squeezc of lemon might be lost completely. Turks and South Americans both like O.P. I confess I do not know why. It may be that the tightly rolled leaf keeps better when long distances and poor communications make for delays in reaching the consumer. It may be that the demand is part of the transition from green tea. My experience of Ceylon green teas is confined to my earliest days in the trade and the test I used to apply was that the more it looked and tasted like hot water the better it was. A light liquoring tea might suit such palates best, though I believe in South America it is brewed for a long time in large jugs and comes out very strong……

"The black leafed knobbly Pekoe is much in favour in the packet in the U.S.A. where appearence is important and though tea bags are widely used, woe betide the seller whose bag shows little fibres jutting through. For all these reasons normal manufacture is to be preferred and medium and high green estates may find it desirable to use those shorter rounds which avoid the plucking of coarse leaf and allow high B.O.P. and B.O.P.F. percentages to be produced while retaining good appearence" (T. Kane: Future of Ceylon Tea: Addrrss to the C.T.R.I. (15-3-55, pp. 6-8.)

In the light of these conflicting views and divided counsels, the task of the legislator cannot be smooth or easy. That is no reason, however, for refusing to face the issues boldly and arrive at the best possible solution in the light of the available evidence.

For Ceylon as for no other country in the world, tea constitutes the main crop upon which her economy rests. Any decline in the industry is therefore fraught with graver consequences to her general economic stability than to that of any other tea growing country. It follows that it is the duty of the Ceylon government to take the initiative in proposing any concerted plans of international regulation which might be necessary for the protection of the tea industry. Hitherto this role was played by the planting interests themselves, and owing to the fact that the chief tea producing areas in the world were under the political control of Britain, while she was at the same time the largest world market for tea, she was able to achive success. This harmony of interests no longer obtains. Not only have the British planation owners in Ceylon ceased to be, in a formal sense, the object of special concern of the governing interest, but the question is being asked whether political independence is not an empty victory without economic independence.

II

The instability associated with all industries producing luxury articles of consumption from diamond mining and jewellery making to the weaving of tapestries and production of delicate wines and perfumes is a matter of common knowledge and experience. Looked at in this light, the present phase of uncertainty through which the tea industry is passing appears no more than a repetition of past experience in a new setting.

The past history of the tea industry provides ample evidence of the unstable character of the world demand for the commodity. The following brief account of the history of tea as given by Wickizer has a moral which will not be lost on us at the present time:—

"The Dutch introduced tea to Europe in the seventeenth century, more than a thousand years after it had become an article of commerce in China. But only in the eighteenth and nineteenth centuries did tea drinking become widely popular in the Western world. The British acquired the habit and spread it throughout their Empire in the course of its development. Tea was introduced in the coffee houses which were opened in England about 1650, and, coffee was the favourite beverage for over half a century, it was gradually displaced by tea.

"After the British had become established tea growers themselves, first in India with the indigenous teas of Assam and later in Ceylon when her coffee industry was ruined by disease, the China trade began to decline. Chinese tea exports reached their peak about 295 million pounds, in 1886;

in 1889 they had declined to 225 million pounds; during 1909—1913 they averaged 199 millions; and in 1928—32 they had fallen to an average level of 105 million pounds..." (Wickizer: Tea Under International Regulationd. Stanford University, 1944 PP. 31-32.)

With regard to the changing fortunes of the tea industry in Ceylon during the present century the following observations by a well known authority make interesting reading:—

"The British tea growing industry has weathered several very severe crises in its time. The first of these to which reference should be made was in the early years of this century when the great increase in the area planted up in India and Ceylon (and also in Java) during the 'nineties led to severe over-production. In India, especially in the less favoured districts, large areas of tea were temporarily abandoned and many small growers came to grief. As there was never any doubt, however, as to the ultimate soundness of the Industry, an era of the formation of large Joint Stock Companies commenced bringing numerous seperate estates under one management. Cultivation methods were also much improved and the crisis had the good effect of putting a stop to extentions until the market for tea has developed sufficiently to keep pace with production. In Ceylon, which weathered the crisis more successfully, on the whole because the planting industry was more centralised and better organised, while the average yield of tea to the acre was at that time greater than in India, a check was at the same time given to new planting of tea by the greater interest just then commencing to be taken in rubber planting. Hence, any limiting factor which comes naturally or can be brought into play such as insufficiency of suitable land or labour, a period of unremunerative prices, lack of Capital even—or any diversion occurring at the right moment is of great importance.

"In Ceylon, the impetus given to rubber planting by the coming of the motor car diverted planting enterprise into a new channel to such an extent that the tea acreage of that country has remained stationary ever since. It is no exaggeration to say that the rubber industry saved tea—as a profitable cultivation—by preventing its extention beyond reasonable bounds. One great change brought about by the over production was the final ousting of China tea from the British markets. On the whole, the end of the crisis left the British tea growing industry in a

very strong and stable position, which lasted with minor setbacks till 1920. The second crisis that the industry has passed through during less than a quarter of century then developed. It is one from which the Industry has only just recovered, and happily it has proved of shorter duration than its predecessor."

The crisis of the 1920's, according to this writer was brought about principally by the four factors, namely, (1) a considerable increase in the cultivated area between 1907 & 1918 in Java, Sumatra, and particularly India where the increase amounted to as much as 26%, (2) growth in the practice of coarser plucking, (3) the disappearence from the market of Russia which had been purchasing annually about 100 million lbs of plantation and 60 million lbs. of China teas, and (4) the release of war stocks of tea held up in ports due to insufficiency of shipping during the war.

"At the begining of 1919 prices in London for all grades of tea were good, stocks in the United Kingdom were not excessive, but apparently no account was taken of stocks held in the producing countries, and production was continued at maximum capacity, which meant about 150,000,000, lbs. above the pre war level. The situation in producing countries was somewhat releived by increased consumption in the U.K. and by larger shipments to Australia. During 1920 stocks accumulated and the break in the market which came in that year was very severe. The trouble lay principally in the market for common teas. Heavy production, coarse plucking, and poor storage facilities had resulted in an accumulation of inferior teas...

"In 1921 planters in India and Ceylon resorted to finer plucking, and production was decreased. This not only reduced total output, but also lowered the proportion of common teas. By the end of the year the situation was much easier. In 1922 restriction of output was continued, stocks were reduced, and the year as a whole was a prosperous one."

After the virtual collapse which overtook the plantation industry in the depression of 1929 the leading tea producers' Associations in India, Ceylon and the Netherlands, enterd into an agreement for the control of exports of tea, effective as from 1st April 1933, and the governments of India, Ceylon and the Dutch East Indies passed legislation designed to give effect to the provisions of the agreement.

This agreement was made possible by the change which had come over the Dutch tea industry in the Netherlands Indies:—

"During the early years of the world depression, the position of Empire teas in British markets was considerably strenghtened by two protective measures, sterling devaluation in September 1931 and restoration of duty preference in April 1932. Dutch teas were finding fewer buyers, and the economy of the Netherlands Indies was suffering severely from a similar lack of demand for most of her important agricultural exports. A radical change in policy occured when the long standing liberal commercial policies were withdrawn and various controls in defence against a world wide trend toward economic nationalism were instituted. Whereas earlier the Dutch had been reluctant to participate in international commodtiy arrangements, they now took the initiative in the tea. situation and sought an understanding with the British. In October 1932 a plan was proposed, and by February 1933 it had been ascertained that it was favoured by more than 90% of the producers in each country. Accordingly, an agreement was entered into, effective for five years begining April 1, 1933. In November 1936 it was extended, with slight modifications, for another five years, from April 1, 1938 to the end of March 1943. The present (third) agreement is to continue for the duration of the war and two full quota years there after......"

III

What then is the remedy for the crisis which faces the tea industry in Ceylon? So far as organisation of the industry on the side of production is concerned, we must first of all distinguish between several classes and categories of tea growers. As we have noted above, the situation of the small holder of tea is very different from that of the large estate owner, and the case of the medium sized holding is different from both. A second principle of classification is that which divides the tea area into high medium and low grown teas—a division based on the altitude at which the plant is cultivated, since the price of tea depends mainly on its flavour, and the flavour is determined primarily by the height at which its cultivation is done, although quality of soil, character of plucking and efficiency of manufacture all contribute to the result. Finally we have a third basis of division, namely those holdings of

tea which are owned by Ceylonese, and those belonging to persons of foreign nationality.

The last of these categories has an important bearing on the problem of the tea industry in Ceylon, since in any scheme of the control of the industry, from the cultivation and manufacture of the leaf to the shipping and the marketing of the crop, the co-operation of the foreign owners of tea would be required. In the past the problem of international control was a relatively simple matter owing to the fact that British nationals not only owned a large part of the worlds tea acreage but the countries in which it was cultivated were colonies or territories under the political control or influence of Britain, while at the same time Britain herself was the largest single world buyer of tea for consumption as well as for re-export. Any serious conflict of interest between the producer, consumer and distributor could, therefore, be harmonised through the direct or indirect mediation of the British government. Not only so, often the same group of individuals owned or controlled all three branches of the industry, and would frequently be found to be on the boards of all three. Thus the famous British caterers and restaurant owners, Messrs. Lyons & Co. and the English and Scottish Cooperative Wholesale Society who were among the largest buyers and distributors of tea in England, also owned extensive tea plantations both in Ceylon and elsewhere. Similarly, Liptons Ltd., Brooke Bond & Co., Bosanquet & Skrine, to name only a few of the most powerful organisations, are proprietors, estate agents, shippers, and distributors at one and the same time. Although the tea producers have combined in associations for specific purposes, the concentration among producers apparently does not approach that among buyers. A certain proportion of the output of India, Ceylon, and Netherlands Indies is normally marketed through auctions in Colombo, Calcutta and Batavia for direct export, especially to the markets within the Pacific Basin. By far the greater part of each years crop, however, finds its way to London, the centre of the tea trade, where it is sold at public auction. Not only is the United Kingdom the greatest import market, but the re-export trade from London has until recent years been greater than all imports into the United States, second most important world market. "An outstanding feature of the London tea market is the remarkable degree in which the buying is now concentrated in the hands of a few powerful combinations—principally blenders and distributors of proprietory blends."

With the U.K. alone absorbing half the world the exports and re-exporting more than most countries import, it is natural for the "world price" of tea to be "made" in London. It has been estimated, however, that for 70% of the domestic distributing trade is in the hands of only four combinations. The possibilities for influencing World prices are at once apparent. The significance of strong producer organisations in the tea industry and the concentration of buyers in London is considered more fully in connection with problems of regulation and control elsewhere...

This control of both the producing and consuming ends of the economic process by the same individuals either directly or through device of interlocking ownership and directorates, is a familiar pattern of monopolistic economic organisation particularly in the under-developed countries, and in common to a large number of agricultural and mineral products such as rubber, coconut, cocoa, tobacco, tin, cotton, sugar, jute, coffee, petroleum, asphalt. Thus Dunlops, Unilevers, Imperial Chemical Industries and the Imperial Tobacco Company, are large scale producers as well as consumers of the different products in which they specialise and their monopolistic or semi-monopolistic control often cuts across national boundaries. Under these conditions any alteration of prices in favour of the consumer or the producer might often have little more significance in its long run effects than the proverbial robbing of Peter to pay Paul. Today that congruence of interests no longer obtains and the foreign interests begin to look with suspicion on any measure which the government feels compelled to take in the interests of the country's nationals. The following assessment of a position by a trained political observer Kathleen Stahl probably presents the majority European view:-

"If the British firms interested in Ceylon are considered as a whole, it may be said that their outlook in general has a tendency to be parochial. This is probably due to the fact that the territory is a small island, where many of the thriving business houses have been in the hands of the same family for two ar three generations, and are often linked by marriage with each other. In outlook these houses are practical and shrewd so far as their own businessesd are concerned, but not much interest is taken in shaping the general policy of the whole British Industry in the case of either tea or rubber.

"The outlook for the future varies from firm to firm. At one extreme there is the pessimistic view that the self government of the Ceylonese, with their avowed desire to have more control over the island's resources, will not leave room for the continued functioning of British private enterprise. At the other extreme there is the optimistic view that however strong the antipathies of the Ceylonese appeared to be from their utterances in the State Council, in actual practice it was realised that the continuance of British commercial interests would be indispensable, to the prosperity of the island for some time to come. The first view should not be given too much weight, since although it is often expressed, it is not borne out in practice by the firms who advance it. While there is no impetus for new British firms to go into Ceylon, and over the last fifteen to twenty years London has not largely bought Ceylon rupee shares, these havingbeing purchased of recent years by Indians in India, there has been no general move by existing concerns to give up their Ceylon business and the buying of new tea and rubber estates by these firms continues."

In the case of the rubber - rice pact between China and Ceylon under which China agreed to pay for our rubber a price substantially above the prevailing world price, the Ceylon government was is effect obtaining for British owning interests in Ceylon a price which they could not themselves secure from British purchases of natural rubber. In this case not only were British owners of rubber in Ceylon deriving a very substantial profit at the expense of the Chinese consumer, but thanks to the Ceylon government, were benefitting from a trade which their own government ostentatiously condemned as trading with a country guilty of "aggression". When however it was proposed that the rights of shipment of rubber to China should be progressively transferred to Ceylonese, British dealers and Shippers of rubber were quick to demur. Similarly, when the Ceylon Prime Minister, Sir John Kotelawala, recently stated in London that the price of Ceylon tea was being astificially raised to the British consumer as a result of the activities of the brokers and other middlemen, Mincing Lane lost no time in protesting against what it said were Sir John's inaccurate figures and unfair charges against the tea dirtributing interests. Reiterating their plea that it was the high rate of export duty which had raised the price of tea in Britain, they even accused Sir John of harbouring a sinister design of transferring the business of the export and sale of tea on. to Ceylonese hands.

The incident illustrates the difficulties which a country like Ceylon may have to encounter when it seeks to control the production and disposal of its commodities in the interest of its own nationals. When the large part of the Capital investment of a country is in foreign ownership as in the case of Ceylon, occations might arise where the interests of the permanent population and those of the foreign investor are in conflict, and an immediate common interest may not be easy to discover. For instance the present decision of the government to enter the tea auctions as a buyer has been resented by the British tea interests. But the decision of the government itself was promoted by the fact that for one reason or another British shippers were holding off the market at the Colombo tea auctions which were thus in danger of being reduced to a farce, while up and down the country stocks of tea were piling up and tending still further to depress the price. The situation was one of extreme gravity and the government's decision, if unprecedented, was also rendered necessary to avert the possible danger of the total collapse of the tea industry and in particular the small holder. It is significant that the government's intervention so far, has been limited to a decision to bid at the public tea auctions in Colombo for the teas of the small holder, and to providing him with credit for holding the continually expanding stocks of tea on his hands. In other words, the government has already found it necessary to come to the assistance of the small holder owing to his particularly weak and vulnerable position in the face of sharply falling prices, in comparison with the large and powerful monopoly interests both of the plantation owners and the shipping and marketing agencies in Ceylon and London. But it is clear at the same that these measures can have no more than a temporary and make shift value. The interests of the small holders cannot long be protected if the industry itself is to suffer a serious decline.

iv

Thus there are the short term interests and the long terms interests not only of the growers of tea large and small, and of the shipping and distributing organisations connected with it, but also the immediate and the ultimate interests of the permanent population of the country, whose welfare, for better or for worse, has been tied to the fortunes of the industry.

It is therefore, no longer a question merely of what price tea will fetch in the market at the present time, but what it will fetch in the future; not merely of what market there is for tea now, but how we are to retain and expand those markets. And this is a matter of long term planning which cannot be left to the independent judgement, initiative and decision of individual growers or sellers of tea, or even to the body of tea owners and distributors. It is a matter in which the whole future welfare of the population of this country is involved and as such becomes a vital interest of the government. It is no doubt the realisation of the fact which has caused the government to enter the tea market as a bidder. But if this is all that the government proposes to do, not only would it be tinkering with a serious problem, but it would also be guilty of running away from its responsibilities.

The government's present intervention then falls far short of being even a first step towards formulating a policy for the industry. At best it offers some temporary relief to the Ceylonese small estate and factory owner. The small holder, whose need of assistance is greatest, is left with the cold comfort of a pious depression of hope that some part of the subsidy will be passed on to him by its recipients.

"The big tea producers have not been greatly troubled by the slump in prices. their production costs have been low enough to enable them to keep abreast of declining prices. In any case, they made large profits during the boom to carry them through the period of slump.

"Nor do the speculators who took to buying estates during the boom in the expectation of making quick money, deserve much sympathy. They have no permanent interest in the industry, and since they entered it as a gamble, they cannot campaign if they have subtained losses.

"The producers who are genuinely in need of succour, however, are the small holders – the men with an acre or two of tea. Few of them have any reserve to tide them over the slump. There are 87,0C0 of them, and if they go under, the result will be a considerable volume of harhship. Moreover, they form an important section of the industry, since they produce 12% of Ceylon's tea. On both humanitarian and economic grounds, therefore, it is the duty of the state to assit them". (– Editorial Ceylon Daily News - Friday 20, May 1955)

Obviously the government is merely playing for time, and Micawber like waiting for something to turn up. If the hope which springs eternal in every Finance Minister's breast, that prices will once more rally is, in fact fulfilled then, perhaps that will be the end of all plans for the tea industry, until the next crisis is open us. If on the other hand prices do not show signs of early recovery, and to anticipate the worst continue to decline still futher, then at least we may expect that the government will find itself driven to examine the basic conditions upon which a stable tea industry may be established in this country.

It seems generally agreed that the present average price of Rs. 2/- per lb. for high grade teas is still high enough to leave a very comfortable margin for profit to the producer. The real problem is with regard to the lower grades where prices averaging Re. 1/- or less fail even to cover working expenses. If these estates which are mainly owned by Ceylonese are to kept in production, it will be necessary for the government to arrive early at a decision as to what is an economic price for teas of different grades, having regard to their respective costs of production, and then devise measures to maintain these prices as minima.

The problem of the small holder is, in reality, a distinct problem, the first step to the solution of which should be their organisation in co-operatives, which could undertake the manufacture and sale of the tea grown by the member culti vators. It is a matter for surprise that the government which boasts so much of its interest in cooperation should have failed to realise until recently the acute need of such assistance. It is however, a good augury for the future, that even at this late date, the government has realised its obligation and made a beginning with the establishment of these societies, as stated by the Tea Commissioner:-

"Tea small holders in Ceylon (i. e. persons owning less than 10 acres of tea) number over 87,000 and own between them about 69,700 acres of tea, or approximately 12% of the total tea area in Ceylon. The majority of these small holders is concentrated in the Central, Southern, and Sabaragamuwa Provinces. It was brought to the notice of the government, quantity and quality of tea produced by these small holders were generally very poor. The main reasons for this being poor cultivation methods, coarse plucking and packing methods, and the inability of the small holder to put back into the land for its improvement a part of the income derived from it. The small holder was generally exploited by the bought leaf factory owner to whom the majority of them were in debt without any hope of redemption owing to the high rates of interest charged. It was felt that the solution to this difficulty lay in the formation of Tea Producers' Cooperative Societies for small holders, as such Cooperative

Societies would be in a better position than individual small holders to bargain with bought leaf factory owners. It was therefore, decided to organise a network of Tea Producers' Cooperative Societies, and to assist them on the following lines:-

(a) One third of the cost of fertilisers..............borne by the government and.........balance...... in the form of the short term loan......outright grant of Rs. 30/- per acre and a loan of Rs. 60/- per acre.

(b) a...... grant...for...to prevent soil erosion.. of Rs. 60/ per acre.

(c) Short term loans of Rs. 30/- per acre.........to help in repayment...of debt.

(d) Assistance for purchase of...equipment...to provide Anti Blister Blight.

(e) A loan of Rs. 50/- to... Coop Societies...for Collecting depots...vans...weighting machines...leaf bags"-

(- Administrative Report of the Tea Controller, Ceylon for Year of Control 1953 -54.)

In a free world market, it is not possible to ensure that such minimum prices for tea, particularly for teas of lower grades, as would cover the costs of production on the smaller plantations and holdings, would be realised. The only corrective, should prices for any considerable length of time remain below costs of production, is for such estates to go out of cultivation, with all the attendant disorganisation loss and unemployment which it entails. Under a scheme of control if price variation could not be altogether eliminated, they could at any rate be minimised, and their income effects so far as the small producer was concerned be evened out between good and bad periods. In the past, it has been claimed that tea, as an industry, readily leant itself to plans of international control:-

"Many characteristics of the world tea industry make tea a commodity unusually well adapted to international control. The concentration of financial interests in two advanced countries, the heavy concentration of commercial production in a relatively limited area under British and Dutch domination, and the existance of relatively few strong grower's organisations greatly facilitate agreements upon the regulation of trade. Likewise, the concentration of buyers in London tends to make the marketing of tea a matter of more or less direct dealing between strongly organised producer interests and powerful combinations reflecting consummer interests if not representing the ultimate consumer."

This simple faith in the inevitability of powerful producer and consumer interests coming together in an agreement out of mutual interest is not borne out by the facts of the present situation, where the British consumer in the form of the British housewife is virtually demanding the elimination of the middleman's interests centred in Mincing Lane from the British trade in tea. Any future scheme of price control, therefore, which fails to take into consideration the interests on the final consumer is doomed to experience serious difficulties from the outset as a result of non cooperation and obstruction from the consumer group.

The schemes of control which have hitherto being established in the primary producing commodities, have had one serious drawback, even where they were otherwise generally successful. They had the effect sometimes deliberate at other times accidental, of being restrictive of output, not only in the short run but even as a long range policy. The attempt to maintain or raise prices arbitrarily by exploiting monopolistic advantages of artificially created scarcities cannot be justified either on economic or ethical grounds, and if persisted in, must provoke opposition and hostility on the part of consumers and in the end result in the failure of such schemes. Some of the inter - war schemes of regulation of raw material prices were notoriously guilty in this respect, and collapsed as a result. Hence, it is necessary, if we are not to repeat in mistakes of the past that some definite principles should be laid down on which such plans should in future be based.

In this connection certain proposals put forward by Mr. P. T. Bauer and Prof. E. W. Paish in an article in the Economic Journal of Dec. 1952 entitled "The Reduction of Fluctuations in the Incomes of Primary Producers" pp. 750-81 which have given rise to a lengthy and animated discussion are noteworthy. The suggestions contained therein are intended to apply in conditions where the marketing of a country's total production of commodity is not subject to central control and where a scheme of international regulation of its production and sale is not in operation, though here *is* nothing in their plan which makes it inconsistent with its application under such conditions. The proposals are a variant of the familiar floor price device, and are based on a critical examination of the working of a number of recent stabilisation schemes in West Africa.

A British government White Paper of 1946 explained the operation of the scheme as follows:-

"By fixing a steady buying price in advance of the sale of each seasons' crop the Boards will cut the link between the price of cocoa in West Africa and the day to day price on the world market. Accordingly, in some seasons when world prices are high, the price paid to the producer will be less than the average realisation on overseas sales. The Boards will, on such occassions, show a "surplus". There will however, be other seasons in which the average world price is below the price paid to producers. On these occassions the Boards will make a "Loss" which will be financed from the "surpluses" accruing in, years of high world prices. The intention is that "profits" will be utilised primarily to maintain the maximum possible stability in the price paid to the producer".

"Statement on Future Marketing of West African Cocoa Cmd. 6950 of 1946 quoted in 'Fluctuations in Incomes of Primary Producers' E. J. Dec. 1952 pp. 756.

Commenting on this Bauer and Paish write:-

"If we add to the amounts retained by the Marketing Boards the sums collected by the government in export taxes, we find that the deductions from the incomes which producers would have received if the full proceeds of their output had been allowed to reach them are well over 50%. If expressed as a % of net income, after payment of the expences of the production the rate of tax would be still higher. This is a level of taxation incurred in this country only by those who earn incomes of well over £ 5,000 a year. In recent years the average annual cash income of Nigerian ground nut producers was perhaps of the order of £5." (ibid p. 759)

The scheme put foward by these writers has provoked such wide interest that we give below in some detail the principles of its operation, as set out by the authors themselves:-

"It is thus necessary to lay down in advance clear cut mandates for those operating stabilisation schemes to ensure that accumulations should be limited and that this should be widely understood by producers. An obvious form for such a mandate would be a prescription of a formal satistical method of smoothing fluctuations, such as a moving average covering a fixed number of years; that is, producer prices will be based on the moving average of net proceeds per ton as calculated by a clearly defined formula. The number of years to be averaged and the weight to be given to each year might well vary from scheme to scheme, according to the elasticity of supply of the product. In general the higher the elasticity of supply the higher should be the weight attached to the current year, and the lower the weights, or the smaller the number, of previous years."

"In countries in which the administering authority is in direct contact with individual producers, and can keep accounts of individual deliveries and earnings, the smoothing process could be applied directly to the actual incomes earned from the production of a given product or group of products. The authority, perhaps a co-operative society, would retain part of the proceeds of the current year but simultaneously repay part of the proceeds retained in the previous years".

"Such a system of averaging applied to the income of each seperate producer, would give him a measure of insurance, not only against falls in prices and other misfortunes shared with other producers, but also against those, such as a local crop failure, which effected him alone."

"In many cases however including somewhere such a scheme is most needed there is no possibility of that direct contact between the producer and the administrating authority which would allow records to be kept of his individual deliveries. Instead, the authorities are obliged to operate entirely through the prices they pay. Even in such a case however, it is possible to introduce the principle of averaging proceeds and thus smoothing fluctuations in incomes.

"The way suggested of doing this is to fix a producer price each season calculated as the sum of two component elements. The first component would be a reaction of the estimated market price of the current-

year (or, more precisely, of the estimated net sales proceeds per ton). The second component, which would provide the smoothing element in the scheme, would be derived from the difference between the realised proceeds per ton in past years and the amounts paid out in those years on account of the first component. To obtain it, we should first substract from the agregate actual proceeds of the crop over a given number of past years the amounts paid on account of the first price component–that is to say, the aggregate of the first component of the price times the number of tons brought in each year. We then average this difference over the given number of past years, and so arrive at the aggregate amount to be distributed during the current year on account of the second component element in the price. This amount, divided by the estimated number of tons in the current crop, gives the second component element in the price per ton to be paid in the current year."

"Under this scheme producer incomes in any one year depend to a substantial extent on sums retained out of previous years incomes. These sums are exactly known and therefore producer incomes in the coming year and even in the year after that can be ascertained in advance far more closely than without such a scheme. This would considerably ease the task of those, whether merchants or government departments, whose responsibility it is to see that the supply of goods available for producers to buy is commensurate with their incomes. Where the merchants have to plan the imports of consumer goods many months ahead (as they have to in many parts of the world) the economies to be obtained by from a greater predictability of producers' incomes are very large indeed." (ibid 772)

"One of the chief difficulties in starting such a scheme de novo would be the cost of building up the necessary reserves during the first few years, unless, indeed, it was inaugerated in a period of steeply rising prices. If, however, it was given the initial help of a government guarantee it would be possible to start it from the begining as if it had been running for an indefinite period the prices paid being calculated on the basis of the size and prices of the crop in previous years. If the inaugeration of the period was followed by a period of rising prices it is unlikely that the government would be called upon to implement its guarantee; but if it were followed by a period of falling prices, the government might well be at least temporarily out of pocket. The size of the reserve required depends upon the precise variety of the scheme adopted. With the example used above the amount of the governments' contingent liability would be limited to a maximum of about the value of one years' crop, which it would incur only if the price or the output fell permanently to zero; in practice it wound be unlikely to exceed half the value of a years crop...

"The widespread adoption of schemes of this type, while primarily designed to reduce fluctuations on incomes of particular groups of producers, would also have appreciable effects on the ecconomy of the world as a whole. These effects, unlike those of restriction or buffer stocks schemes, would not take the form of changes in there relative world prices of individual primary products, or of primary products as a whole in relation to those of oth r commodities. One of their main purposes, indeed, would be to reduce to the smallest possible limits their effects on the supply and price of particular products in the world market. They might, however, very well have a considerable influence on the magnitude of the fluctuations in the general level of world prices and incomes." (ibid. pp 769–779)

Whatever be the nature of the plan which is finally adopted, it is clear that some overall planning of the future of the tea industry in Ceylon is urgently needed if the goal, which the government has set itself, of "effecting the transition from a colonial to a national economy" is to be persued in earnest. It would be ironical, indeed, if the up – country peasant evicted from his land in order to make room for the British tea planter, should now be left to famish on the little plot of village ground he has worn himself out in cultivating.

V

So long as tea is left to the price vagaries of an unregulated world market, and so long as the tea industry is allowed to remain one of the main supports of the economic life of the people, so long must we reconcile ourselves to the perpetual insecurity, and chaos, that fluctuations in the price of tea must bring into the life of every individual in this country.

But even regulation of the international price might give little comfort to Ceylon's tea growers, if the market for ow grown teas virtually disappears, while high grown teas

still command high prices. This is roughly the position in which the tea industry of Ceylon finds itself today, and the remedy, therefore, lies not merely in seeking international regulations for prices, but also in seeking that the income accruing to tea growers as a result of much regulation is eqitably distributed between the large estate owners and producers of quality teas as well as the smaller cultivators producing lower grades.

If, therefore, we are seriously interested in the future welfare and progress of the nation, it is vital that a comprehensive policy for tea should be immediately fomulated and brought into operation. It is common ground that divercification of the economy is essential and urgent, and that a programme of industrialisation designed primarily to be of an import-saving character is a necessary ingrediant in such a plan. It is also obvious that industrialisation implies a capital outlay of smaller or larger proportions, depending both on the extent of the industrialisation programme envisaged and the capital intensity of the techniques it is proposed to employ. The question, therefore is, where is this capital to be found and how is its investments to be brought about? If the investment is to be secured by encouragement of foreign capital to enter the country, then not only do we help to add to the already excessive foreign capital holding in the country with the possible danger to our political and economic independence inherent in such a course, but we may also be creating a serious problem of maintaining equilibrium in our balance of payments in face of the heavy exports which would be needed for repayment of capital and interest, and those heavy exports may produce a movement in the terms of trade against this country. On the other hand, if the capital investment is sought from the nationals of this country then, it is argued, that not only are they lacking in the technical know how of industry, but also that, without past experience in such ventures, they would be reluctant to accept the risk of investment. Above all it is pointed out that the capital is not available from the permanent inhabitants, since as a result of an inflationary situation which has existed almost continuosly since the depression of the 1930's, combined with an extravagance of living which had been maintained with the open encouragement of the British Colonial Government and, since then, with the tacit approval or connivance, of the post - Independence governments, the middle class of Ceylon are on the verge of being wipedout.

In the absence of any precise statistics relating to aggregate incomes earned by Ceylon nationals there is no means of determining the actual state of solvency of the property owning class among the Ceylonese. If, however, the number of actions filed for recovery of arrears of Income tax, the magnitude of the sums so claimed and the high economic and social standing of the persons charged with default, the situation might justifiably be regarded as alarming. Taken in conjuction with the known fact of the widespread indebtedness prevailing among the public servants and mercantile employees, and the high rate of unemployment and under - employment through out the community, the conclusion seems inescapable that neither is their any appreciable volume of accumulated savings of Ceylonese nationals which could be drawn upon for the implementation of a program of industrial development, nor is there, under present conditions any annual surplus of savings which could be utilised for such a purpose.

If the thesis that there is no Ceylonese Capitalist class as such in existance, and that the so called middle class in Ceylon is masking its penury, and, in reality living on the margin of subsistence, has any validity, and if at the same time it is admitted that economic diversification and planned industrial development are vital if some degree of stability is to be acheived, then it must follow that the new capital could only come from the sector of the economy which is in foreign ownership. Of this sector, the holding of tea constitutes by far the largest and most important part. It is the contention of certain sections of this foreign ownership that they are already so heavily burdened with taxation as to make it impossible for them to meet any further impositions. In fact, in face of the present fall in prices it is their strongly held view that they should be given further relief from the already reduced export duty. If these arguments are valid, there seems only one possible solution. This is to pay off the foreign owners of tea and then begin to set our house in order, so far as our economic affairs go. How precisely this transfer of foreign ownership should be done is a matter about which there could be considerable diversity of views. One possible method of approach would be for the government to announce that it would allocate annually Rs. 100,000,000. in bonds towards the purchase of these holdings. The duration and the interest on the bonds would be a matter to be settled in consultation with experts in the issue markets. If one may hazard a guess, a combination of offers on some such lines as the following might perhaps attract a sufficient number of takers:—

6 % Ceylon Govt: Development Bonds, tax free, redeemable 1960 issued at par.

7 % Ceylon Govt: Development Bonds, tax free, redeemable 1965 issued at par.

8 % Ceylon Govt: Development Bonds, tax free, redeemable 1970 issued at par.

The profits derived from the working of the plantation aquired under such a scheme would, of course, constitute a pool of funds from which interest and amortisation payments would be made.

Since estates would be of infinite variety from the point of view of present and future income yields, a body of expert valuers would be required to advise on the relative merits of the several offers. Some such device as this for gradual pre-emption of the foreign holdings of tea is, I believe, essential if we are ever to begin the task of industrial development in earnest. By so doing not only would the capital become available for industrial expansion, but employment at different levels of skill and talent will also be available on a substantial scale for our rapidly increasing population. As to what the total potential employment so created is likely to be is, again, a matter of conjecture, both owing to the absence of accurate figures of the foreign personal employed on the estates, as well as to a number of other matters such as the optimum size of the administrative unit decided upon. In addition employment on a proportionate scale would be available for skilled, semi-skilled, and unskilled, workers on these nationalised plantations. The increased efficiency of management resulting from the smaller average of size of the unit as compared with the present unwieldy size of many estates, would increase productivity and thus pay or more than pay the cost of the additional staff employed. As the natural and obvious corollary to such a plan of increased employment for Ceylonese in executive positions on the large estates, it should be the duty of the government to set up training centers where young men of promise could be given a sound education in the theory and practice of estate management so far as the major agricultural industries of the country are concerned.

Together with the additional employment in the new industries to be set up with the capital so obtained, this expanded employment on the newly purchased estates, would relieve the pressure of unemployment, or under-employment both open and disguised, already weighing upon the land, and thus help to raise the living standards of the population now threatened by the uncertainities of the tea market. It is even possible that this reorientation of the economy will before long yield a surplus which may be devoted to much needed relief to those Ceylonese payers of income tax for whom at present there is no solution in prospect save the grim one of selling up their lands and joining the swelling ranks of the unemployed.

vi.

Meanwhile it should be one of the first tasks of the government to appoint a fact finding commission to investigate the extent of foreign ownership in the tea industry, the average size of estates, the proportion of small holders, the comparative costs of the production of estates in these categories, as well as of high grown and low grown teas, the possibilities of rationalisation and closing down of inefficient or uneconomic concerns and concentration of production in the more efficient units, the labour conditions prevailing on the estates, the relationship of tea holdings to the village economy and so forth. In fact, it is one of the serious blemishes of the past control of rubber by the western Imperial countries, that their schemes of the control were designed to crush the smallholder out of existance * and yet in spite of all these efforts of the entire body of European rubber owners banded together in powerful international organisations, not only did the small Malayan, Indonesian, and Ceylonese producer of rubber survive, but he even excelled the big estate owner both in respect of the low cost of his production, and the rate of the increase of his output. And this was acheived in the face of what would have seemed the insurmountable handicap of being offered a regulated price of 1 1/2d. to 2d. a pound, when the European owners had declared for themselves a minimum price of 8d. per pound.**Against the background of such facts, it is necessary that a government which is obliged to protect the interests not only of the industry as a whole but also the weakest part of it; namely the small cultivator, should act quickly and with forethought and determination.

In such an inquiry attention should also be directed to the problem of marketing particularly with a view to minimising distribution costs, establishing a direct link between

* P. T. Bauer: The Rubber Industry.

** ibid. pp. 196.

producer and consumer, ascertaining what new or alternative markets should be developed for the commodity.

But above all the fundemental question to which the government must address itself is how far the present foreign ownership and control of the most important industry in the country is compatible with either its political and economtc sovereignity, or with the maintenence of stable conditions of prices, incomes and employment.

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