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Editorial Statement

In undertaking the publication of an economic journal, it is necessary to state, briefly, our aims and hopes.

That there is, in our country, no regular economic publication of any type nor any periodical devoted to the study of our economic problems, should be adequate justification for the publication of this journal. But the urgency of today derives from other, very important, causes.

On the one hand, we are beginning, or should begin without further delay, to change a blind-alley economy of inherited colonial impoverishment into a modern, developing economy. A supremely arduous task, this involves a variety of features, each of which has to be studied in its social and economic aspects. A continuing, informed vigilance of the public is necessary to keep these economic tasks related to the accepted end of the procurement of the maximum welfare of every member of the economic society. It will be our constant endeavour to provide the knowledge that goes to form the educated public opinion.

On the other hand, all our present information on our economic problems issues today from governmental agencies or sources close to them. Such information is very inadequate. It is interested, and tends to be partisan. It is piecemeal and *ad hoc*. It is related less to questions of our economic development than to administrative practice and book-keeping. It is largely inexpert. There is, then, an urgent need for fuller, detailed, connected, critical information; we will endeavour to meet this need.

This journal is not a 'propaganda' publication. The only partiality we will show is the partiality of all social sciences—a preoccupation with the premises and achievement of social welfare. To that end all our printed articles will contribute—whether or not they are pioneering studies of different aspects of our social and economic problems, simplified presentations of matters of economic theory and practice, or restatements of proved economic views to suit the context of our narrow-based, agrarian economy.

This is an endeavour which every educated person will, we do not doubt, applaud and welcome. To make this a success, need we say that the active support of every interested adult is a vital condition. We would indicate that this support is not confined to paying a subscription to our journal and reading it. It is as important that every interested person should, wherever necessary or possible, share in the production of our journal by contributing to it his views, in agreement or in disagreement.

This is our aim. We hope that with the support of all friends and readers, we will gain the satisfaction of making a contribution, which must admittedly be small, but which is, in the context of our total national endeavour, vital, and necessary.

Foreword

As a teacher of economics, I naturally regard economic problems as the most important in life. The Economics Department of the University is doing its bit to solve these problems by sending out a steady stream of economics graduates into the country. This Journal is brought out by some of these young graduates. They have both brains and idealism and it is to be hoped they will make some contribution to the proper understanding and solution of the country's economic problems. Even if it does nothing else, this paper will at least help its young writers to clear up their own thoughts. For, it is writing which maketh an exact man. Nowhere is the need for clear thinking greater than in economics.

There may be such a thing as Diminishing Returns in economic research and discussion, but we in this country have certainly not reached that stage yet. This venture therefore is to be welcome. I would not hazard to predict how long it will last. The general expectation of life of learned and semi-learned periodicals in this country, particularly if they happen to deal with economic subjects is not high. But even if it does not last long it would, it is to be hoped blaze a trail for others to follow.

B. B. DAS GUPTA.

Notes and Comments

Korea

The outbreak of hostilities in Korea cannot be dismissed as merely an act of aggression, nor as merely one plot in a worldwide conspiracy of communism. While leaving this thorny problem to our readers, we only point out that the movement for the unification of Korea was a natural consequence of its dismemberment after the last war. A prey to the successive imperialisms of Russia, China and Japan, Korea looked forward to its achievement of national unity. It is admitted even by the State Dept. that the S. Korean Govt. under Sygman Rhee was pressing for the unification of the country by an invasion of N. Korea. Looked at in this light, the problem falls into its proper perspective.

ERRATA.

Page 3 para 5 line 10 for...63...read 6.3

Page 39 para 2 line 2 for...to increase the income...read to increase the real income.

Page 40 para 2 line 18 for...of population although ..read...of population. Although.

Page 41 footnote 4 line 2 for...of total population to total population...read ...of total rural population to total population.

Page 42 para 3 line 5 for...with their important...read...with their comparative....

Page 43 line 20 for weather...read...whether.

in fact an act of aggression, and that American intervention without U.N. sanction was justified. Yet, if such intervention was in the interest of democracy, and for the restoration of peace, one would expect that all attempts would be made to bring a conclusion to hostilities by negotiation—if possible. The statesmanlike offer of Pandit Nehru to secure such negotiation, and the submission of constructive and reasonable proposals as a basis for such discussion, was rejected out of hand by the U.S. It will be remembered that these proposals, at first received with welcome in Britain, were denounced vehemently when the reaction of the State Dept. was made known. This shows that the dominating interest seems not peace, but the pursuit of American power politics in the Far East, to which Britain has now perforce to subscribe.

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But looked at in the pattern of the *status quo* which the U.N.O. has been established to maintain, the invasion of S. Korea is a violation of the peace, and could be considered an act of aggression. The U.N.O., had therefore to act. But it is a significant fact that it was the U.S. that went into action—even before the U.N. could sanction such a policy. This precipitate action, one can only interpret as an attempt to force the hand of the Security Council. Being composed entirely of pensioners of the American Govt., sanction of American action was not long in forthcoming. The constitutionality of American action is claimed by reason of Article 51. But this article warrants armed action only in case of aggression against the country concerned—in this case, the U.S.A. We thus get the ridiculous position of America fighting a defensive war 6000 miles from home!

Let us grant, however, that the N. Korean invasion was in fact an act of aggression, and that American intervention without U.N. sanction was justified. Yet, if such intervention was in the interest of democracy, and for the restoration of peace, one would expect that all attempts would be made to bring a conclusion to hostilities by negotiation—if possible. The statesmanlike offer of Pandit Nehru to secure such negotiation, and the submission of constructive and reasonable proposals as a basis for such discussion, was rejected out of hand by the U.S. It will be remembered that these proposals, at first received with welcome in Britain, were denounced vehemently when the reaction of the State Dept. was made known. This shows that the dominating interest seems not peace, but the pursuit of American power politics in the Far East, to which Britain has now perforce to subscribe.

If such possibilities of settlement in Korea were to be rejected, one would at least expect that the presumably peaceloving American people would at least attempt to localize the conflict. The proposals put forward by Pandit Nehru, with their favourable reactions in Moscow, held out every prospect of preventing the impending worldwide conflagaration. The proposals which included the representation of Communist China on the Security Council, were rejected without consideration by the U.S., as being irrelevant to the issue. This attitude was echoed by Britain. The inclusion of Communist China on the Security Council, it is well known, besides being the only solution alive to realities, is the only condition on which the U.N.O. could be put on its feet again. Quite apart from this, it is the only way to localize the conflict. American diplomacy, rather than grant this reasonable request, which has now received the support of some of the leading nations in the world, goes on to describe this issue as irrelevant to the settlement of the Korean dispute.

And this brings us to the greatest danger of war. If the representation of Communist China is irrelevant to the Korean issue, it would be pertinent to ask how the entry of America into the Chinese Civil War, by the unprovoked and obviously dangerous guarantee of Formosa, was relevant to the struggle in Korea. Far from localizing the conflict, far from preserving peace, the U.S. seems to be courting war. The tubthumping U.S. Senators drunk on the heady wine of U. S. Jingoism, now go even to the extent of accusing Britain of treachery for not entering on the defence of Formosa. The guarantee of Formosa, and threats of armed intervention in Indo China are all part of this pattern of American "defensive" policy in the Far East.

The recent speech of Syngman Rhee to American diplomats and strategists in the Far East gives indications of even graver dangers to come. He demanded not the restoration of the frontier of the 38th paralell, but the occupation of N. Korea as well. If the U.S is not prepared to localize and limit the conflict there is every danger that this might be the ultimate result. The outcome could be none, other than war. For that would bring American forces to the gates of Vladivostock, the bastion of the U.S.S.R. in the East. That would lead to a defensive war on the Russian Border, and not a "defensive war" 6000 miles from home, as America claims to be waging today.

Both by its foolhardy guarantee of Formosa, and in its refusal to localize and settle the Korean conflict, the U.S. gives every indication that it is now prepared for war. The demand for $10,000 million from Congress and later $4 millions (presumably for the Korean war!) and the request for far reaching economic and military powers in the near future, would appear to be signs that America has now to choose only the time and place.

The Schuman Plan

When the idea of international Control of the European iron and steel was suggested by German Trade Unions last year, there was also the proposal of Karl Arnold for a public corporation and Zweckverband for the amalgamation of heavy industry in the Rhur, Lorraine, Belgium, Luxemburg and Saar. So the Schuman plan worked out by experts under M. Monnet, Commissioner for planning, is not new.

Before the French Parliament itself was aware of it, Adenauer was consulted. And when Adenauer had agreed to the German French entente he had the industrialists of the Ruhr and other conservative friends in complete agreement. On the side of France the proposal was hailed with enthusiasm by Lorraine owners and by Paul Reynaud. This provides an occasion for Acheson to rejoice on the prospect of Europe's most anti-Communist Adenauer in union with the French. Perhaps this was an occasion to retrieve the lost ground at home, where recently he was severely criticised for not following a sufficiently, anti-Communist policy in Europe.

The intention of the plan is to establish an European authority to deliberate and decide the fate of Europe's most vital industry. There was to be an enormous concentration of power in this authority which was to decide the employment and production policy of the united countries. Its avowed intention is not to cartelize the industry by limiting production for enhancing prices, but to expand production in an effort at a synthesis of capitalist and socialist planning in the interest of the public. It is not possible to get a clearer view of the plan since there is much vagueness in regard to various and important details.

This, however, does not preclude the possibility of a correct assessment in view of the broader concept of unification.

Judging from the figures of production export and consumption available from the Report of the Economic Commission for Europe (E.C.E.) one could hardly avoid the unpleasant truth that in whatever disguised form the unification is to take place, unless the natural flow of trade between East and West Europe is allowed, the integration of iron and steel would culminate in a cartel. With Europe's prospective production in 1952 at 70 million metric tons and consumption 57 million metric tons there would be a surplus ol 13 million metric tons. In 1948 this surplus amounted to 63 million metric tons. The surplus has to be exported, or consumed at home (the latter is inconceivable), and when these fail, as they are bound to, the inevitable decision of the authority would be the restriction of output; the prospect of which would be bleak. The excess may also be exported to under developed countries who would have to purchase them with either dollars from American aid or their national currency or it may, if the Americans would permit the free flow of trade, be absorbed by the East European countries.

American attitude at present both in regard to East-West trade and aid to underdeveloped countries does not permit anyone to be hopeful. So that we are left with two more possibilities both of which will ring hollow from a long term point of view, that of its utilization in the production of war materials for the micawber like Atlantic powers (it may be well to remember that much of the American excess finds an outlet this way) and the plain and unpleasant truth that the resort to cartelization would be the inevitable concomitant of any such unification in the present context. In order to avoid this, East-West trade should be revived with a possibility also of relieving the cold war tention. Eastern Europe remains the natural outlet for West Europe's industrial products. Apart from this, carlelization would lead in a restriction of output and reduction of employment.

France and Germany are not committed to a policy of full employment, while on the other hand the domestic policies of Britain and Norway are to maintain full employment which may be negativated if the authority is forced to call a halt to production in the less efficient mines, due to excess. And if the authority is to be a branch of the O.E.E.C., then with the prospect of American entry and eventual control all the Marshalized countries may become the 49th state.

Britain cannot hand over the control of her vital industry to an outside authority. A levelling down of wages or closing down of inefficient mines may have adverse effects upon her domestic commitments. And although France may not be committed to a policy of full employment, her unemployment problem is so serious that any further unemployment may lead to unpleasant repercussions. According to a statement by M Biscaret, which has been subsequently confirmed by the Herald Tribune, the day after the proclamation of the Schuman Plan the Monde had announced the abandonment of the coal and engineering works in central France as well as in large parts of the North and Lorraine. Already seventy mines have been closed and according to Louvel, the minister of industry, twenty five more will be closed.

The Plan may wipe out price discrimination as regards Rhur coal prices which amounts to one pound sterling more per ton in France; but in the light of the sacrifices it seems hardly worth.

Germany was lured by the prospect of sitting on any council on a footing of equality. As Deutscher Kurier on the 20th of May proclaimed that adherence to the Schuman Plan would mean the untenability of both the Occupation Statute and also the Ruhr Statute. So the different motives which whipped up the enthusiasm of the French and Germans would merely lead to a capitalist membership. Britain could not formerly join in acclaiming the proposal in the light of such mischevious intentions.

Ultimately when we weigh Mr. Achesons words that Germany and Japan must be opened to foreign investment and national sovereignity should be sacrificed to provide Germany and Japan with markets the proposal amounts to nothing more than an attempt to strengthen ties with the recent enemies; the bitter memories of Nagasaki and Hiroshima and Nurenburg can only be eclipsed with the possibility of a partnership in a new and mightier war of destruction.

No one can plead that the ex-enemy countries, Germany and Japan, should remain outside the comity of world's independent nations. It is clear that they need to be helped to reform, and come back into the civilised order. But, the path towards the end lies in the encouragement to and binding association with the ordinary working people of Germany and Japan, because they are the base and the instrument for the democratic reorganisation of their societies. It is a significant comment on the direction in which West Europe is moving, and on the planned attempt of American reaction in power in West Europe, that by this plan, they are attempting to revive and strengthen and ally themselves with precisely those forces in W. Europe that brought fascism and the last war.

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1. It is hoped that many substantial contributions from Economists and Sociologists will appear in the next issue, due to be published on October 1st.

2. We are planning to publish two select bibliographies, from the next issue onwards. The first bibliography will list select new books and articles of an economic, social and political subjects of general interest to students of economists.

The second bibliography will list select annotated lists of books and articles in periodical publications, Official and otherwise, dealing with the economic, social and political problems of Ceylon.

3. Contributions in regard to discussions arising out of the articles published in the journal are welcome.

We also welcome contributions from readers on subjects with which the journal is concerned.

National Saving and Economic Development

For an undeveloped country, we do not seem to be paying as much attention as we should to the question of domestic saving. Capital for economic development can only come either from domestic or from foreign sources. It does not seem to be sufficiently realised that whatever we were able to do in the past, we could not possibly hope to get much in the future, at least in the visible future, from foreign sources. Both the new world situation and our own attitude towards foreign capital, make that unlikely. It is therefore almost certain that we shall have to depend very largely on our own savings. That means that we must watch our rate of saving carefully and try to step it up to the highest possible level.

Actually, even in the past when conditions were most favourable for the entry and employment of foreign capital into the country, the quantity that came in was not, considering the development needs of the country, very large. The tea and the rubber industries have been of course mainly developed by foreign capital. But the development of these two industries has not necessarily meant general economic development of the country. The fact that aggregate national income is still very small, namely only Rs. 30 per head per month, shows that the country remains still extremely under-developed. The fact thus remains that in spite of almost a century of open-door for it, foreign capital did not come into the country to sufficiently develop it.

The main reason for it obviously is that the foreigner is attracted only by relative profits. He will not invest in Ceylon if he can get higher returns elsewhere. The mere prospect of profit is not enough for him. He must have profits higher than anywhere else. Consequently, he picks out only the safest and the most profitable lines of investment and avoids others. Domestic capital on the other hand is often satisfied with much lower rates of profit. Actually, no country in the world has been developed exclusively or even chiefly by foreign capital. What has generally happened in the case of countries supposed to be developed mainly by foreign capital is that capital first went into the country as foreign, but sooner or later became resident.

No estimate of total foreign investment in the country is available, but the amount invested in joint stock companies, which is the principal from in which foreign capital has been

invested, was estimated to be, at face value, at Rs. 860 million in 1939 (Post War Development Proposals, 1946). There does not seem to have been any large inflow of foreign capital since then. On the contrary, some foreigners fearing that political independence of the country would lessen their prospect of profit, have sold out and repatriated their assets. The face value of the investment therefore probably remains at present more or less the same as it did in 1939, although of course with the increase in share prices its market value must have considerably increased. But even assuming that total foreign investment in the country at market value at present is of the order of Rs. 2,000 million, which is probably an estimate on the high side, it is not very large. It is even less than one year's national income. Or, if we take another measuring rod, it is only roughly three times the annual government revenue. Relatively to total domestic investment, it may look quite substantial, but relatively to the development needs of the country it must be described as paltry.

If the flow has been limited in the past when conditions were most favourable, it is likely to be even more so in the future, because these conditions have considerably deteriorated. On the one hand, the war has caused a great world shortage of capital. Vast quantities are needed for rehabilitation and reconstruction of the war torn territories. All undeveloped countries again have become development-conscious and are clamouring for capital. It will be impossible for us in such a seller's market to obtain any large quantity of foreign capital at a cheap price. Foreign capital, it must be remembered, can only be obtained at a price. We can perhaps also of course get a certain amount as gifts in cash or kind, but we can depend little on that for any rapid or large scale development of the country. The main reliance will have to be put on capital coming in as entrepreneur or rentier capital.

On the other hand, we are ourselves, in order to safeguard our national interests, no longer willing to extend to foreign capital terms as liberal as before. We have already imposed or are contemplating to impose, various restrictions regarding fields in which it may be invested, rates of yield, remittance of profits and principal, training of local personal, partnership with local investors, etc. In other words, we are giving up the old policy of open door. We would rather delay economic development than import foreign capital on terms which savour of economic exploitation or political domination.

In this context it is clear that for development we shall have to depend very largely, if not entirely, on our own savings. No exact estimate of national saving has yet been made. However, gross capital formation at home has been estimated to be

Rs. 180 million in 1948 and Rs. 298 million (provisional figure) in 1949. (Estimate by the Director of Statistics). Assuming that 20 per cent. of this represented replacement, net domestic capital formation was Rs. 144 million in 1948 and Rs. 248 million in 1949. Adding to (or deducting from) it the net increase (or decrease) in foreign assets (again taking the Director of Statistics' figures for them) we get as total saving done by the nation Rs. 179 million in 1948 and Rs. 211 million in 1949. This means that saving was roughly at the rate of 7 per cent of the national income in 1948 and 9 per cent in 1949. It is highly doubtful if the country was able to save during these two years at such high rates. The figures are probably over-estimates. If capital formation actually took place at such high rates, there would have been more visible signs of economic development in the country and national income itself would have tended to be higher. Judging by the rate of increase of the national income, the rate of national saving in Ceylon is probably hardly more than 3 or 4 per cent. normally.

Reasons for Low Saving.

The chief reason for this low rate of saving is of course the fact that the great majority of incomes in the country are very low. No up-to-date estimate of the distribution of incomes by size is available, but an estimate made by Mr. Williams for 1935 showed that 92 per cent. of all resident incomes were below Rs. 50 a month. These incomes had obviously no saving capacity. Indeed, many of them, particularly the group below Rs. 25 per month (which itself numbered 78 per cent. of all income in the country), must have been doing negative saving.

At what height an income reaches saving ability depends of course on the size of the earner's family and the minimum normal living costs of that family. The minimum normal living costs, that is to say, the subsistence costs of a family, its costs for maintaining itself at a certain level of health and efficiency, depends on the definition of that level. Assuming a certain level, certain calculations which I made in connection with the report of the Social Service Commission, suggest that the bare subsistence costs of a family of four consisting of husband, wife and two children (this may be taken as the composition of the average family), is at 1938 prices approximately Rs. 2 a day, that is to say Rs. 60 a month. It was thus quite out of the question for incomes below Rs. 50 to save anything.

The position is perhaps little different at present. Money incomes, thanks to inflation, have of course generally increased, but so have prices. At present prices, the subsistence costs of the average family comes to be approximately Rs. 5 a day or Rs. 150 a month. Incomes below Rs. 150 cannot thus afford to save anything. The distribution of incomes at present is not known, but it is quite certain that the percentage of incomes below Rs. 150 per month is still very high, although it may not be as high as 92.

It is perhaps hardly necessary to point out that low incomes and low savings constitute a vicious circle. Low incomes keep savings low, while low saving in its turn keeps incomes low.

Although low income is the principal factor, another factor also perhaps deserves mention. This is the prevailing weakness for high living. Judging by family budget figures, the level of consumption-spending seems to be generally higher in Ceylon than in most other countries in South East Asia. The result is that even people in the higher income groups who have power to save, do not save as much as they could. This tradition of high living should obviously be liquidated if we want to develop the country with our own resources.

In recent years, this normally high propensity to spend has been accentuated by two other developments. One is that the experience of inflation which afflicted the economy between 1940—and 1947 has created some fear in the minds of the people about the stability of the value of money. Rising prices or an expectation of rising prices tend naturally to encourage spending and to discourage savings. The other is that years of supply shortages and consumption controls have created an accumulated back-log of demand for certain kinds of consumption goods which people are very anxious to satisfy now. That has stimulated spending.

At what rate the economy can and should save is not easy to say. The fact that national income is small suggests that a substantial part of it should be reserved for expenditure on current consumption, in order to maintain the health and efficiency of the people. On the other hand, the very fact that national income is low suggests that we should tighten our belts and lessen consumption expenditure to the highest degree possible in order to increase our productive equipment. All things considered, it should not perhaps be wrong or impracticable to aim at a saving rate of 8 to 10 per cent. of the national income. It would certainly involve considerable sacrifice of present consumption for the saving classes, but no progress is possible without sacrifice.

B. B. DAS GUPTA.

The Budget—An Iniquitous Transference of Wealth

In his rather laboured attempt to achieve an arithmetical balance in the budget, the Finance Minister has completely lost sight of the more fundamental necessity for a social balance. He has gained a little experience in addition and substraction at the expense of the working class and Middle classes of the country. The purpose of this article will be to show that not only has the budget granted no relief to these classes, but that it also would be an instrument for the iniquitous transference of wealth from the poorer to the richer sections of the community.

The so called relief given in the budget takes three forms; (a) subsidy (b) reduction in import duties, (c) raising of the income-tax exemption limit. Of these only the first would affect the working class. The reduction in import duties would not benefit them for the obvious reason that the commodities on which the duty has been lowered do not come within their range of consumption. The tax exemption too would give this class no relief for the equally obvious reason that even before, they were exempt from income tax. The Director of Statistics has estimated that the subsidy on imported rice and wheat would bring down the working class cost of Living Index by 8 points. Even then it remains higher (263) than the index immediately prior to devaluation (256). Thus the social injustice done to this section of the people by the devaluation of the Rupee is not corrected by this budget. In addition their income will be reduced by the lower dearness allowance they will now get due to the fall in their living index.

Effect on Middle Class

For the purpose of the present analysis the Middle Class could be divided into three groups; (1) those whose basic income and allowances amount to less than Rs 200/- per month (2) those whose total monthly remuneration is between Rs. 200/- and Rs. 400/- per month (3) those with a total monthly remuneration of more than Rs. 400/-. The first group would more or less be in the same position as the working class. In their case too the commodities on which import duties have been lowered would mostly be out of their range of consumption. The income tax relief would not affect them because their incomes were not liable to tax even before. Here again it is only the effect of the subsidy which we have to consider. An important consideration here is that the subsidy on rice and wheat would not lower their cost of living to the same extent as it would reduce that of the working class. This is so for the simple reason that the food group naturally has a lesser weightage in the middle class than in working class budget But though the actual reduction in their cost of living would be less than in that of the working class, their dearness allowance would still be calculated according to the working class index. The benefit of the lower cost of living would be more than wiped out by the lower dearness allowance they would now receive We can actually work out the effect on this group on the basis of the Ceylon Middle Class austerity budget, prepared by the General Clerical Services' Union. They have drawn up the budget for a family of three with a total monthly remuneration of Rs. 225/-. This consumption pattern may be slightly modified in the case of the income group we are considering (i.e. those with a total remuneration of less than Rs. 200/-). But, since it is the nearest approximation we can get we will base our calculations on it.

Item:—	Quantity consumed (per month)	Rate of relief due to subsidy	Total relief
1. Ration rice	15 measures	6 cts per measure	.90
2. Wheat	—	5 cts per lb.	—
3. Bread	38 lbs	5 cts. per lb.	1.90
4. Buns	$7\frac{1}{2}$ lbs	5 cts. per lb.	.38
		Total	3.18

The total extent of the relief granted by the budget to this class is Rs. 3.18. For incomes (total remuneration) over Rs 100/- per month, the present dearness allowance is Rs. 87.40. When the working class cost of living index falls by 8 points, as was estimated by the Director of Statistics, the dearness allowance would be Rs. 82.80 i.e. the allowance would be reduced by Rs. 4.60. Therefore the relief of Rs 3.18 granted by the subsidy to this class would be more than offset by the reduction of their total monthly income by Rs. 4.60. As a result of the new budget this group would be net losers to the extent of Rs. 1.42 per month. Not only is the social injustice caused by devaluation left uncorrected, but also this income group is made worse of than they were immediately prior to the budget.

To calculate the net effect of the budget on the other two income groups into which we have divided the Middle class, we will again have to take the G. C. S. U. family budgets as the basis of computation. To consider the position of our second income category (Rs. 200-400) we can use the model budget B drawn up by the G. C. S. U. for a family of three with a total monthly remuneration of Rs. 225/- (Rs. 120 basic salary—Rs 105

Table showing relief granted to Classes A & B.

Item:—	B Consumption per month	B Relief per Unit	B Total Relief Rs. cts.	A Consumption per month	A Total Relief Rs. cts.
1. Ration Rice	15 measures.	6 cts. per measure	.90	30 measures.	1.80
2. Bread	38 lbs.	5 cts. per lb.	1.90	40 lbs.	2.00
3. Wheat	—	5 cts. per lb.	—	48 lbs.	2.40
4. Buns	7½ lbs.	5 cts. per lb.	.38	9 lbs.	.45
5. Cheese	—	30 %	—	2 lbs. (Rs. 6/-)	1.80
6. Jam 1 tin	(Rs 1.10)	45 %	.50	2 tins (Rs. 2.20)	1.00
7. Cosmetics	Rs. 2	60 %	1.20	Rs. 3/-	1.80
8. Washing & Toilet Soap	Rs. 2/-	30 %	.60	Rs. 3/-	.90
9. Candles	36 cts.	15 %	.05	cts. 86	.12
10. Footwear	Rs. 4/-	2.5 %	.10	Rs. 6/-	.15
11. Haberdashery etc.	Rs. 4/-	15 %	.60	Rs. 6/-	.90
Total			6.23		13.20
12. Income tax Relief			5.00		2.00
Total relief			11.23		11.32

allowance). For the third income group (over Rs. 400/-) we use the model budget A for a family of five with a total monthly remuneration of Rs 432 (Rs. 300 basic salary & Rs. 132/- allowance) In calculating the extent of relief due to the reduction of import duties we have assumed that the benefit of the fall in duty is passed on fully to the consumer in the form of a corresponding reduction in the price of those commodities.

The table on page 12 shows the total relief granted to classes A & B, by the subsidy, the reduction in import duties and the raising of the tax exemption limit.

We have already seen that the dearness allowance on monthly incomes of over Rs. 100/- will fall by Rs. 4.60. Therefore the net relief granted by the budget to group A is Rs. 6.72 and to group B Rs. 6.63. The problem then can be simply stated as follows:—is this relief an adequate compensation for the deterioration of their living standards, both absolutely, and relatively to the other sections of the community, due to the rapidly increasing cost of living? We have only to pose the question in this form to see the absurdity of the contention that this is a common man's budget. Indeed, it is the height of impertinence for the Government to assume that a paltry Rs. 6/- a month is adequate to compensate the middle class for what they have lost. We can safely conclude that the so called relief granted to the Middle class not only fails to bring them on to an equitable basis with the other classes but it does not even take them back to their pre-devaluation position.

The indictment against the Government is not only the negative charge that the budget has granted no relief to the working and middle classes, but the more positive accusation that they have deliberately engineered the actual transference of wealth from the poorer to the richer sections of the community. This has been brought about by the following methods.

(1) Growing Public Debt.

(2) Inflation.

(3) Unjust variation in Income tax rate.

(4) Structure of taxation.

5) Reduction in import duties.

(6) Levy of an export duty instead of a profits tax.

We will now consider how each one of these brings about this iniquitous transference of wealth.

Public Debt

The gross public debt is composed of the sterling debt, the Rupee debt, and war loans. The amounts oustanding in September 30th each year are as follows:—

Rs. Million[1]

	1937	1945	1946	1947	1948	1949
Sterling debt	163	125	125	125	125	125
Rupee debt	31	267	312	344	368	424
War Loans	—	102	100	99	69	68
Gross debt	194	494	537	568	562	617

The interest payments on this public debt are as follows:—

Rs. Million

	1948—49	1950—51 (estimate)
Interest on Sterling Loans	4.6	4.6
„ „ Rupee Loans	11.9	15.1
„ „ War Loans	1.9	1.9
TOTAL	18.4	21.6

The rise in the gross public debt and the interest paid out shows that wealth is being increasingly transferred from the lower income groups who do not subscribe to the government loans to the higher income groups who do.

Inflation

The second factor that has led to the increasing transference of wealth is the growing inflation generated by the Government's unsound financial policy—viz; increased expenditure met by borrowing without a corresponding increase in the capital development of the country. In 1948, capital development amounted to Rs. 120 million, in 1949 it was only Rs. 100 million.[2] In addition to the inflationary tendencies generated by Government spending, the banks too have contributed to the inflation by financing speculative activities in connection with devaluation. The following table shows that both the Government and the banks have been guilty of bringing about this transference of wealth by providing the fuel for the inflationary fire.

1 Statistical Abstract of Ceylon 1949.

2 Hansard Vol. 8, No. 11, Appendix G.

		Active Note circulation Rs. Million.	Index	Bank clearing Rs. Million	Index
1948	1st Qr.	649.4	100.0	1129.6	100.0
	2nd „	640.0	98.5	1208.8	107.0
	3rd „	667.3	102.7	1194.8	105.7
	4th „	686.8	105.7	1204.6	106.7
1949	1st Qr.	661.1	101.8	1109.7	98.2
	2nd „	642.9	98.9	1263.1	111.8
	3rd „	665.5	102.4	1276 8	113.0
	4th „	678.1	104.4	1457.0	128.9
1950	1st Qr.	688.9	106.0	1404.5	124.3

The significance of the above table is that the new money exerted its influence not through the active circulation, but through the banks, ie. it swelled the incomes not of the poor but of the rich. It is interesting to see how the banks created this new money. The following table gives the cash holdings of the banks, (nett circulation—Active circulation) their deposits, and their reserve ratios.

		Cash Holdings	Deposits	Reserve Ratio
1948	1st Qr.	427.6	1826 9	23.4
	2nd „	452.1	1816.1	24.8
	3rd „	458.8	1871.9	24.5
	4th „	483.0	2080.7	23.2
1949	1st Qr.	494.5	2101.2	23.5
	2nd „	316.7	1791.9	17.6
	3rd „	360.8	1869.4	19.3
	4th „	681.2	2372.1	28.7
1950	1st Qr.	523.0	2778.7	18.8

The striking fact about this table is the sudden fall in the reserve ratio in the 2nd and 3rd quarters of 1949 ie. in the period immediately preceeding devaluation. The banks, therefore have financed the inflation by lowering their cash ratios. It is also significant that the banks have raised the ratio in the last quarter, clearly apprehensive of a crisis, but lowered it again in the 1st quarter of 1950 when the crisis did not materialise.

The inflation, therefore, was caused by an increase in bank money brought about by lowering of the reserve ratio in the pre-devaluation period. This money since it did not swell the active note circulation was clearly used for speculative purposes based on an intelligent, or one may even say sinister, anticipation of devaluation. It was used for speculation in the export commodities, tea, rubber and coconut, on the expectation of the devaluation of the Rupee and a consequent rise in the prices of these commodities. The following table of share price indices bears this out.

Base—Jan.-June 1939.

		Tea	Rubber	Tea cum Rubber
1949	1st Qr.	167.99	95.98	139.84
	2nd „	157.02	79.19	133.07
Devaluation :—				
	3rd Qr.	163.16	95.16	134.52
	4th „	193.26	114.62	164.89
1950	1st Qr.	206.61	134.31	181.84

The conclusion is obvious. The inflation caused by the increases in the money supply leads to a redistribution of incomes —a transference from the fixed income groups to the variable income group i.e., a transference from the poorer to the richer sections of the community. Moreover, the original increase in the money supply which caused the inflation has gone into the pockets of the speculators. Not only has the Government done nothing to curb this inflation and the consequent iniquitous transference of wealth, but it has actually contributed to the inflation by increased expenditure for non-productive purposes.

Unjust Variation in Income-tax Rate

Not only is the Finance Minister blind to this process of polarisation and increasing disparity of wealth, but he has also made his own contribution to it, by changing the income tax rates in an iniquitous manner. The change in the rates are as follows:—

Amount of Taxable Income	Old Rate	New Rate	Increase as % of Old Rate
6,000	8½%	9%	5.88%
10,000	18 %	19%	5.55%
20,000	21 %	22%	4.76%
50,000	37½%	39%	4.00%
100,000	58 %	60%	3.45%
Remainder	64 %	66%	3.13%

The last column of the above table shows the regressive and inequitable nature of the increment which decreases as the taxable income increases.

The Structure of Taxation

The percentage of indirect taxes to total tax revenue is an index of the burden of taxation on the poorer classes.

Years	% of Indirect Taxes to Total Tax Revenue
1938-39	75%
1949-50	75%
1950-51	73%

There is no perceptible change in the ratio of indirect taxes to total tax revenue. The Finance Minister has thus made no attempt to alter the structure of taxation so as to shift the burden on the higher income groups and so counter to some extent at least the iniquitous transference of wealth which is taking place. It is also significant that the burden of indirect taxation is the same today as in the earlier Colonial period.

Reduction of Import Duties

The reduction in the import duties on a number of commodities has been hailed as a concession to the Middle class. Many who do so have forgotten in ther exuberance that the total reduction amounts only to Rs. 4 million. We can see this figure in better perspective when we say that if this total amount was used to subsidise sugar, it would lower the price of sugar by 1 cent. It is also forgotten that the extent to which this reduction in duty will benefit the consumer depends on how much of it is passed on to the consumers in the form of lower prices. But what is more revealing than all this would be a classification of the consumption goods on which the duty has been lowered into those which come within the range of middle class consumption and those outside that range. The effect of the fall in the prices of production goods on different classes cannot be estimated. The following tables give an estimate of the benefit made on the assumption that the imports in 1950—51 will be the same as in 1949. The Finance Minister's estimates of the benefits are also given in the last column. The basis of his calculation is known only to himself. We have assumed further that the total tax reduction would be passed on to the consumer in the form of correspondingly lower prices.

Goods within the range of Middle Class consumption

Item:—	Rate of relief	Total relief	Finance Minister's estimate of relief
		Rs. Cts.	Rs, Cts
1. Coffee	15%	268,648.05	25,000.00
2. Aluminium cups & saucers	17½%	58,537.67	400,000.00
3. Electric lighting accessories	2.5%	64,871.43	27,000.00
4. Haberdashery & Millinery	15%	129,280.95	257,000.00
5. Hats	20%	2,023.40	—
6. Hosiery	2.5%	7,874.47	—
7. Jams Jellies & Marmalades	45%	183,167.55	124,000.00
8. Boots & Shoes not canvas	2.5%	3,515.33	53,000.00
9. Biscuits	25%	224,610.50	75,000.00
10. Cosmetics Powder etc.	60%	1092,160.29	700,000.00
Total		2,034,689.55	1,661,000.00

Goods outside the range of Middle Class consumption

Item	Rate of relief	Total relief	Finance Minister's Estimate
		Rs. Cts	Rs. Cts.
1. Prepared Cereal Food	35 %	154,724.00	50,000.00
2. Cheese	30 %	293,903.10	125,000.00
3. Cakes	25 %	191.25	—
4. Playing Cards	55 %	35,461.80	—
5. Confectionery	35 %	574,758.10	145,000.00
6. Electrical Heating & Cooking apparatus	32½%	471,768.00	—
7. Tinned fish	30 %	106,764.00	49,000.00
8. Floor cloth	15 %	1,829.85	—
9. Golf & Tennis balls	20 %	8,019.00	—
10. Refrigerators	20 %	114,229.00	—
11. Frozen & Tinned Meat Poultry Game etc,	35 %	519,978.90	400,000.00
12. Nuts used as fruits	35 %	3,532.55	—
13. Raisins	35 %	18,774.35	—
14. Art silk apparel	55 %	23,353.00	40,000.00
15. Art silk Haberdashery & Millinery	5 %	2,185.90	25,000.00
16. Cotton lace & Net	15 %	57,263.40	57,000.00
17. Wollen & Worsted Manufactures			
(a) Berlin	45 %	176,868.90	150,000.00
(b) carpets & floor rugs	60 %	49,689.00	50,000.00
(c) Scarves & shawls.	20 %	474.00	75,000.00
Total		2,613,768.10	1,166,000 00

	Total relief	Finance Minister's Estimate
Items within M. C. consumption	Rs. 2,035 Mln.	Rs. 1,661 Mln.
Items outside M.C. consumption	Rs. 2,614 Mln	Rs. 1,166 Mln.
Total	Rs. 4,649 Mln.	Rs. 2,827 Mln.
% of items within Middle class consumption to total	44%	59%

Thus according to our estimates of the total relief only 44% would affect middle class expenditure. A few further observations could be made on this subject. In the case of candles, prepared cocoa and margarine, the tax reduction has been made only in the general rate, the imports from the Commonwealth countries have been and are still free of duty. And since the imports of these goods are wholly from the Commonwealth countries in effect there is no tax relief at all. In the case of coffee (mixed or unmixed), floor cloth, hats, rubber and canvas boots and shoes, imports from the Commonwealth countries do not contribute to the tax relief because they have always been free of duty. Some of the luxury items had received relief in September 1949 and they have been given further relief eg. on refrigerators there was an initial reduction of 50% and now there has been a further reducation of 20%.

The Export Duty

In order to meet the increased expenditure due to the subsidy on rice and flour and the reduction in revenue brought about by the import duty and income tax relief, the Finance Minister increased the income tax rates on incomes of over Rs. 400 a month and levied an export duty on rubber and tea. The first, we have already shown to be iniquitious because of its regressive nature. The incidence of the export duty would be as unequal. The duty will be levied on the small producers at the same rate as on the big planters. Again, in view of the fact that the cost of production of the small owner is much greater than that of the large planter, the severity of the insidence is much greater on them. Further the bigger producers would save quite a lot on the lower dearness allowance they would now pay to their labourers

due to the fall in the cost of living index. The Finance Minister has calculated the total revenue accruing to the Government, as a result of the export duties on tea and rubber, at Rs. 74 million. The total reduction in the dearness allowance paid to estate labourers on the basis of an 8 point fall in their cost of living index is Rs. 1 Million a month (Rs. 12 Million a year)—ie. in effect the estate owners will get back Rs. 12 Million of the Rs. 74 Million they pay in the form of export duties—ie. 16% of the amount they pay. The percentage would be very much greater if we deduct from the Rs. 74 Million the duty paid by the small owners. This significantly brings out the fact that the subsidy given to the plantation labourers is in effect a subsidy to the plantation owners. The increased duty will moreover be used as an argument to resist wage increases in the tea and rubber industries if not actually to reduce wages. The duty thus will ultimately be shifted on to the small producers and the workers on the plantations. Thus the levy of an export duty is both socially unjust and unwise. A more equitable method of raising revenue would have been the direct taxation of excise profits made by all planters and capitalists who have reaped the benefits of devaluation at the expense of the rest of the community.

This criticism of the Budget has been confined to its class bias. Further criticism of the budget in relation to employment and national development will appear in a subsequent issue of this Journal.

G. V. S. de SILVA.

NOTE:—All statistics where the source has not been mentioned have been obtained from the Government Statistical Department.

The Public Accounts and Estimates Committee

In the study of British Parliamentary procedure these are two bodies that attract the least amount of attention. They function silently, unobtrusively, but not uneffectively. As elements in the control of government expenditure, they are in a sense more important than the glamorous discussions in the Committees of supply and ways and means.

It may not be out of place therefore to enquire into the workings of these two bodies. Such a study will not be without its interest, if not its lesson, for Ceylon.

Public Accounts Committee

The Public Accounts Committee is one of the sessional Committee set up by virtue of a standing order. It consists of eleven members with five (5) as quorum, according to the standing order, but in practice its membership is raised to 15, the quorum being unchanged. It is representative of the various parties according to their numerical strength. Thus during the Coalition Government, 1920 to 1922, the Committee consisted of 6 Conservatives, 5 Liberals and 4 Labour; in 1923 notwithstanding a Conservative Government the membership was 6, 4, 5, in 1924 with a Labour Government, but a minority one, the position was again 6, 4, 5, respectively; from 1924-25 to 1928-29 with an overwhelming Conservative majority in the House, the latter had 9 places, 4 were given to Labour and 2 to Liberals.

In general its members are experienced people who have consistently evinced an interest in matters involving public expenditure. Thus the chairman is a member of the opposition and whenever possible an ex-Financial Secretary to the Treasury. The Financial Secretary of the moment is always a member of it, so that he may help the committee with information, and in turn he may be benefitted by the criticism therein levelled against the departments. The standing order which provides for the nomination of the Committee makes no reference to the method of nomination. In practice the members have been the choice of the party whips.

The standing order only specifies as its duties "...the examination of the accounts showing the appropriation of the sums granted by parliament to meet the public expenditure"... In fact it has had a very much wider sphere of work than this.

We need not repeat these statements here, but we can make some observations relative to its work. It has not been possible to find out the actual length of its proceedings but it does sit frequently: in 1920 it met 29 times, in 1921, 35; 1922, 32; 1923, 27; 1924, 31; 1925, 39; 1926, 39; 1927, 32; 1928—29; 23.[1] We have reason to believe that the Committee wastes little time in unnecessary talk, and that it quickly gets to grips with the issues raised with the guidance of the Controller and Auditor-General. But as in every other Committee there is a substantial portion of slackers, few bearing the burden: thus in 1920, more than half attended less than half the meetings; in 1921, 10 participated in less than half the sittings; in 1922, 7. From 1923 we notice a distinct improvement. In that year there were only 4 such delinquents; in 1924, 5; 1924-5, 5; 1926, 4; 1927, 4; 1928-29, 3. Nevertheless the work is performed with commendable alacrity and it evokes universal satisfaction.

This is all the more surprising when we consider the fluctuations in its membership. The task of unravelling intricate financial details is never an easy task, and requires both a wide acquaintance with the Finance Accounts, and also an ability to detect the items of doubtful wisdom, which can only be acquired after long experience. A continuity of association is just that the present practice does not cater for. During the years 1920 to 1928-29 not less than 71 members have been drawn into the service of this Committee, of these more than half had only an year's service in it. No member had experienced it for more than eight years, and only 10 had more than five years connection. This must be counted as distinctly disappointing. It is not merely the havoc played by the general elections. There is a regrettable failure to appreciate the value of such a continuous contact. In the five years 1924-25 to 1928—29, 26 members were associated with its working, of this half had two or less than two years' contact. Now we cannot see any reason why 95% of the first 15 members should not have served right through the five years. It is vital for the speedy dispatch of its business and its efficient accomplishment that the Committee be composed of experienced old stagers capable at a glance of pointing out the questionable items of expenditure. We cannot exaggerate the importance of this.[2]

The Public Accounts Committee is a very valuable organ of the House, and perhaps one of the very few which is functioning

1. It is unfortunate that it should meet when the House is on, generally at question time as a result there is a continuous stream of members going in and out of the Committee—1931, Selection Committee on precedure evid: of the Auditor-General.

2. Vide: 1931 Selection Committee on procedure evidence of the Auditor-General.

satisfactorily despite the defects of its composition. Were the latter removed, we have no doubt it would be more efficient and more expeditious.

The Committee on Estimates

The Estimates Committee is also a Sessional Committee, but unlike the previous Committee it is not set up by a standing order, but by a sessional order of the House. Although regularly set up since 1921, a government can easily dispense with it by neglecting to move the requisite motion at the beginning of the session. It is a large Committee comprising 28 members—up to 1925 it consisted of 24—nominated by the parties,that is the party whips, in proportion to their numerical strength, the leading party having the strongest representation. Thus in the Coalition years 1921, 1922, the Conservatives could count 13 representatives, the Liberals having 7 and Labour 4; in 1923 they had 14 as against 5 each for the other parties, in 1924, although Labour was in office, the Tories received 12 places and 8 each for others; from 1924-25 to 1928-29, they retained a large majority with 19 seats, 2 being given to Liberals and 7 to Labour. Whatever the particular method of allocation, the policy has always been to prevent any strikingly awkward reports from the Committee by securing a substantial government majority in it. Unlike the Public Accounts Committee the chairman is always a member of the ruling party. Although the qualities demanded of its members are in many respects similar to those of the Public Accounts Committee there is no evidence to show that the same care is bestowed in their selection.

The duties of the Estimates Committee is set down as the examination of the estimates submitted to the House in order "......to suggest the form in which the Estimates shall be presented for examination, and to report what, if any, economies, consistent with the policy implied in those Estimates, may be effected therein." Considering its composition, and considering how hamstrung it is in its activity, we are not surprised. It has the power to appoint one or more sub-Committees, among whom it may apportion the estimates referred to it. These sub-Committees have all the powers granted to the full Committee. But the number of sub-Committees that can be so formed is severely limited by the House fixing their quorum at four, whereas the quorum of the full Committee is 7. This means that not more than 4 or 5 sub-Committees of 5 or 6 members each are possible, and in practice only about two sub-Committees have been formed. Is it any wonder then that the Estimates Committee cannot exceed in its scrutiny one or two departments a year? The estimates are far more difficult to tackle, and demand a much more prolonged

investigation than the Finance Accounts, yet it does not sit so frequently as the Public Accounts Committee. Thus in 1921 it held 5 meetings; in 1922, 25; 1923, 26; 1924, 25; 1924-25, 25; 1926, 26; 1927, 22; 1928, 21 and 1928-29, 5. And we have the testimony of members that a sitting of the Estimates Committee do not on the average last longer than that of the Public Accounts Committee. It seems to be thoroughly reconciled to its fate of scrutinising two departments a year, and seems to manifest no desire to break its own record.

The Committee on Estimates is greatly handicapped by the absence of an experienced official like the Auditor-General to guide its investigations. The members for their part have not attempted to counteract it; they have not displayed an excessive zeal for regular attendence. In 1921 the first year, allured perhaps by the novelty, only 5 members kept away from more than half the meetings; in 1922, 13 members did so; in 1923, the figure fell to 8; in 1924 it rose to 12; in 1924—25 to 14, so also in 1926; in 1927 it again fell to 11, but rose to 16 in the next year, and to 17 in the following year. Here again a few members do all the work that the Committee ever does. Some alleviation of this disadvantage may have been found in a greater co-operation between the two Committees by transferring some members from the Public Accounts Committee to the Estimates Committee, but then arises the difficulty of avoiding a clash in the sittings. In fact especially since 1924 through the insistence of a member, there are some members sitting on both Committees. In all 19 members have served on both Committees at one time or another during the years 1921 to 1928—29. Thus in 1921 and 1922 only 3 members belonged to both Committees; in 1923, there were 4; in 1924, 5; 1924—25 3; 1926, 5; 1927, 6; 1928, 4; 1928—29, 4. In view of the other obligations in the House, membership in both Committees does involve a considerable amount of hard-work, in fact, over-work to these members and therefore we cannot view it as a great blessing. Nevertheless greater collaboration between the two committees is very necessary, and it is better to provide this by other means which we shall presently indicate.

If in any Committee a permanency of membership is indispensable for the satisfactory performance of its work, it is in the Estimates Committee. The situation here is as deplorable as in the Public Accounts Committee, but in effect, it is worse because the task is much more difficult and the more so without the invaluable help of an expert. In the nine years 1921 to 1928—29, 98 members have served in the Committee, of these just a seventh have had more than 5 years experience, 57 have served not more than two years. The figures show a distinct improvement if we only consider the five years 1924—25 to 1928—29; out of 51 a little more than half have had not less than three years service. Still it is far from satisfactory.

That which above all has rendered all supply debates farcial is the dictum of ministerial responsibility and governmental prestige. No member dares to move a reduction in a vote, be it never so small, and notwithstanding that it is prompted by the pure desire to eliminate departmental waste, the whole machinery of the party is set in motion. Every amendment is a matter on which the government stakes its life. Then is it surprising that the 1918 Select Committee should report that owing to the fear of government defeat and resignation "......there has not been a single instance in the last 25 years when the House of Commons by its own direct action has reduced, on financial grounds, any estimates submitted to it". "The ties of party" says Durell, "are undoubtedly one of the most serious of the restrictions which are placed upon the control of the House of Commons over finance". But indeed, this attitude is in keeping with the nature of the supply debates, for since these assume the shape of attacks directed against the policy of the government, it is only natural that the latter should view the resulting division as a question of confidence. While it is itself largely a consequent, it has been the unfortunate agent for if not suppressing at least discouraging those few attempts at genuine criticism from the standpoint of pure finance which are all too rare in the House. It is clearly absurd to proceed on the basis that the government can do no wrong; that every act of negligence on the part of a particular department deserves the censure of the House. In a sense each minister is responsible for the waste and extravagance of his department, but we have not yet produced that genius or monster who could personally supervise every detail of its workings. Of what use is the parliament if it may not suggest ways and means of saving, and of avoiding superfluous expences? We must realise that this attitude is partly a matter of tradition; it is an heritage from the times when financial control, as we now understand it, scarcely mattered. However, that may be, it certainly is time that suitable changes were made to fit in with the altered circumstances.

That the House of Commons was dissatisfied with the mere allocation of money to the executive was seen by the fact that in 1864 it set up a Select Committee on Public Accounts as a direct result of the recommendation of the Public Monies Committee of 1856-7. Its duty was to examine the audited accounts, and report to the House if there were any irregularities and if the limits set by the House had been surpassed. But its work became more pronounced and grew in importance when five years later in 1866

a Comptroller and Auditor General was appointed, a person independent of the Treasury and directly responsible to the House of Commons. The Committee worked on his reports. Concerned at the beginning with the forms of presenting accounts, and their classification, the number of votes, and other questions bearing on the technique of auditing, it has gradually extended its way to include even questions of departmental extravagance, and questions relative to overlapping and redundancy. But its most important function is that of keeping watch over expenditure, to see that they are as have been sanctioned by the House, and it is here we are mostly interested. Its very name disclosed its limitations, it dealt with the accounts, and not with the estimates. Its control, if any, was after the expenses had been incurred. It has no power of its own accord to disallow any expenditure; it could only prevent future waste. The 1918 select Committee on National Expenditure recognised this defect and recommended that the Auditor General should be empowered to report to the Public Accounts Committee, "if any matters needing attention are brought to light in the course of the year", so that the latter could take action before any impropriety is committed. This suggestion has not been adopted; if it had, it may have gone some way to remedy the existing defects. Doubtless it occupies a very significant place in the machinery for supervising the executive. Prescience is best, but it is still an act of wisdom to take account of past experience and profit by it. The Public Accounts Committee performs this very valuable function of drawing attention to past mistakes, so that they may not be repeated in the future. Its comments evoke a Treasury minute either explaining and justifying the alleged shortcoming or promising to prevent its recurrence in the future. One might have expected that the House would utilise these estimates. But unfortunately the House is too much engrossed in reiterating ad nauseam "matters of greater importance", and not deigning to consider drab details these valuable reports go unused and remain neglected. So much more weight and so much more reality could be introduced into the Debates, if only proper use is made of them.

The *a posteriori* control exercised by the Public Accounts Committee leaves little to be desired, and much of this is due to the excellent work performed by the Auditor General. The appropriation accounts go to him about November, following the end of the financial year, and he clears them by March of the next year, and then they do not finally return to the House of Commons till about two years after the financial year has elapsed. From this we are not to conclude that the Auditor-General enters the field only with the accounts. Out of his staff of 230, 190 are stationed in the departments themselves, and these are engaged in a continuous audit of the department accounts; they have direct access to all the books and department records. They have the duty of seeing that the money is duly vouched and that the Authority conforms to the stipulations of the Appropriation Act. It is not to be expected that the Auditor-General will find time to examine every item. Indeed this would be a waste of time. His staff consists of experts who know where the questionable details occur, and what to skip over. Conseqnently the Auditor-General carries out a selective audit. "We lay ourselves" he has said "to cover the whole of the field of the decentralised expenditure in so many years; we pick out a certain number of establishments every year and we go round and look at them, and examine their accounts"

However efficient his work, and there is no doubt that he is instrumental in preventing extravagance and all irregularities, still it is a scrutiny of accounts. He has no power to intervene before the expenditure is made, however, unwise and undesirable it may be; no power to stay a department and report to the Public Accounts Committee in order to check it in time To say this is not to deny that the Auditor-General has helped to eliminate much waste and overlapping, and that in his enquiry he does endeavour to find out whether the department was getting value for its money, and whether alternative and cheaper methods were not available; so again if one department buys the same article more expensive that another he would not hesitate to ask the reason for the difference. Even this so-called post-mortem examination is not without its effect on future expenditure. But it cannot be treated as a substitute for the control of expenditute, and the proper scrutiny of the estimates.

It was on the strength of this realisation, and on the further conviction of the unsuitability of the whole House as an instrument of control that the 1902 Select Committee on National Expenditure advocated the appointment of the Select Committee on Estimates, whose duty was to examine the estimates submitted to the House, and to report on any possible economies that could be made. Questions of policy were beyond its range; it was to confine its consideration to details within the policy underlying these estimates. This recommendation was, however, ignored at the time and it was only in 1912 that the House was reconciled to the idea. The Committee which then came into being had a brief life, for the exigencies of the war enforced its abolition. Its short experience was disappointing, for it never found time to examine more than one or two departments for a year, and at the rate it progressed it could have covered all the departments in ten years. Once a department had been examined, it knew that its turn would not arrive for another nine years, and it was safe. Economy only once a decade. What was worse, it lulled the House into a false sense of security, inducing it to relax its own vilgilance. The members themselves made no use of the reports of the Committee, and in effect it became a body similar to the Public Accounts Committee. Much overlapping ensued between them, only the latter dealt with the finished product and the other with the raw material, but both served to help guidance in the future rather than to secure immediate economies. The Committee on Estimates was further handicapped by the absence of an expert similar to the Comptroller and Auditor General, who facilitated immensely the work of the Public Accounts Committee both by his reports and by the valuable advice rendered personally at its meetings. It had no staff, and the members of the Committee were permanently at a disadvantage in considering these complicated estimates with experts of the Treasury and of the other departments who would invariably press their points to purpose.

The 1918 Select Committee on National Expenditure resuscitated the idea, for it had found that: "The great majority of the replies to the questions which we circulated favour the principle that the estimates should be subjected to examination by a Select Committee." Since 1921 the appointment of such a Committee has been an annual feature. In 1924 when the motion was moved: "That a Select Committee be appointed to examine such of the Estimates presented to this House as may seem fit to the Committee, and to suggest the form in which the estimates shall be presented for examination, and to report what, if any, economies consistent with the policy implied in these Estimates, may be effected therein", Mr. Leif Jones opposed it on the ground that it did not embody the recommendations of the 1918 Committee on National Expenditure, namely: that the Estimates Committee should have on it some of the members of the Public Accounts Committee, so that the knowledge and experience of the latter may be useful to it, and that an independent Examiner of the Estimates corresponding to the Comptroller and Auditor-General should be attached to it. The motion was thereupon withdrawn and was resubmitted sometime later and adopted, the objections of Mr. Leif Jones being met by the inclusion of four members of the Public Accounts Committee in it. "Within limits it does perform useful work; even though it be one or two departments a year its examination is thorough; it has invaluable suggestions for a saner regrouping of estimates. It suffers from the same defects as the pre-war Estimates Committee, and every attempt to improve it has been strenuously resisted by whatever government that was in power. The Estimates Committee in its first report in 1926 suggested an increase in its numbers, so that it could "subdivide itself into sufficient sub-Committee to examine the whole estimates every year." Because, as it points out "Under existing circumstances the Estimates Committee examines the Estimates of two or three Departments every year. If a Department is exami-

-ned this year, it may therefore not expect re-examination for about seven years under normal circumstances. This is not conducive to economy, as the fact that the Estimates Committee is likely to examine a Department is in many ways as much a deterrent against excessive expenditure as the actual examination itself." The Treasury in its reply declined to accept this suggestion: "It appears to them that the Committee should aim at reviewing a group of Estimates each year so as to cover the whole field every four or five years, and should endeavour as far as possible to complete this review before the particular groups are finally disposed of in supply. This they consider the Committee should be able to do without additional members or special facilities. In particular, they do not consider that persons outside the House should be appointed to serve on Sub-Committee, but they are prepared to arrange that a Treasury witness should attend the meetings of the Committee and assist them so far as he can". That a Treasury minute should finally dispose of the recommendations of the Estimates Committee for the better exercise of parlimentary control of the public expenditure, is a crowning piece of absurdity. Has there ever been a government which wanted its own discretion fettered, and its own power curtailed? What method is feasible and desirable for the proper execution of its legitimate duties is a matter for the House alone to determine, and it would be as sensible to leave that decision to the government, or to be more exact, to the Treasury officials, as to let a criminal be his own judge.

The House never takes cognisance of the reports of the Estimates Committee in its discussions. Supply debates are not arranged so as to coincide with the reports issued by it, but the subjects are rather chosen by the opposition for their tactical value. So that to a large extent whatever value they may have, is wasted. The aforesaid Treasury minute has also turned down the suggestion of the Committee on this same occasion to give the Chairman of the Estimates Committee the option of demanding provided the Chairman of ways and means agree thereto—a day for debating its reports, if the opposition has not availed itself of its opportunities for selecting them. "The Government are not prepared to ask the House to accept the recommendations as to the discussion of the Committee's reports on Supply days............ If it be the general desire of the House to discuss the Reports of the Estimates Committee on any occasion arrangements can, no doubt, be made through the usual channels."

The opposition to the enlargement of the scope of the Estimates Committee's work or rather to its institution on a proper basis, is founded on a misconception. It is contended that it would undermine ministerial responsibility. The minister, it is assumed, would refuse to shoulder an estimate whittled down by

the Committee. If this is true, then every estimate, nay every measure, must be adopted by the House unamended in order to preserve intact, the responsibility of the ministers. The committal of any bill involves this same risk and every amendment goes some way to destroy this valued principle. We cannot accept that ministerial responsibility means the impotency of the House; we are inclined much more to believe that it implies his accountability to the legislature for his and his departments actions, and his readiness to follow the behests of the House. The latter body must always remain supreme, and the minister can only act within the discretion allotted to him. Nor can we agree with the opinion that properly constituted Committee for the examination of the full estimates would be a potential rival to the Cabinet. That depends on the strength of the Cabinet itself and its ability to command a majority in the House. That this fear was lurking in the minds of the 1902 and 1918 Select Committees on National Expenditure is evident by the fact that both definitely provided that questions of policy should be outside the purview of the Estimates Committee.

Before we can dispose of this point, we must dwell on a slight confusion of thought. Most politicians fail to distinguish between economy and control of expenditure. Economy may be indeed, would be, realised by efficient control of the executive, but large government expenditure does not necessarily mean an absence of control. A state expending large sums of money on various social services is not extravagant and uneconomic because of it, but it may be so within that expenditure. The question of control is a matter of procedural technique and of the vigilance of the House, whereas economy is a question of policy. Therefore the Estimates Committee can, if at all, be a rival to the Cabinet, if it can decide issues involving policy, from which it is, as at present constituted excluded.

From the above analysis what appears clear and distinct is the steady realisation that the actual debates in the plenum effective though they may be in focussing the attention of the country on the financial policy of the government in power, provide little or no control over governmental expenditure. These extraneous bodies like the Public Accounts and Estimates Committees have been instituted to fill up the lacuna. How inadequately we have seen.

Those who endeavour to imitate the English model must beware of these defects and strive to avoid them. In a subsequent article it shall be our aim to analyse the budgetory system in Ceylon and evaluate its adequacy.

N. M. PERERA.

Unemployment in Ceylon

The problem of unemployment in an undeveloped country such as ours is so much more complex than it is in a developed country. This is so because of the following reasons.

When we say that ours is an undeveloped economy, we mean that the country's agricultural and industrial resources remain largely unused. Where the material resources are undeveloped, labour also remains, to a corresponding degree, unused. In such an economy, the lines that divide employment from unemployment are indistinct; most often, they do not exist at all. Anyone who is not permanently unemployed or who does not state that he is unemployed is assumed to be employed. Employment is often taken to mean an odd hour's work which helps a person to find his meal of rice. Employment is the accepted assumption in a developed economy; while in an undeveloped country, unemployment prevails as a characteristic feature. Moreover, the character of employment in the former is quite different from that in the latter.

The forms of analysis and statistical investigation that are adequate in developed countries tend to confuse and obscure the problem in undeveloped countries. A case in point is the futile unemployment census undertaken in October, 1949, by the Director of Census. If it is an easy matter of statistical routine to total up at any moment the number of unemployed in Australia or the U. S. A., such a figure for Ceylon, if it could be computed at all on the same basis, will be found to have no meaning at all.

Secondly, to collect the data it will be necessary to adopt and develop a special technique appropriate to the job of assessing the extent and character of unemployment in a backward agrarian society. The governments in power in undeveloped countries lack the competence and resources necessary to undertake this work. The Government of Ceylon has not made any attempt hitherto to compute the number of our unemployed population, save the census of last October which cannot be taken seriously. In his recent book, Sir Ivor Jennings remarks that there is considerable significance in the fact that the annual compilation of statistics, the Ceylon Blue Book, contains no reference to employment or unemployment. The significance of the absence he continues, is that "there is hardly any". *sic*! Prof. Das Gupta in his Survey last year writes that "full statistics of employment are not available." A committee set up in 1936 "to investigate the problem of unemployment in Ceylon" performed the double miracle of, in the first place investigating the problem without stating or finding the number of unemployed in the country, and in the second place, of stating that the lack of accurate statistics on unemployment should not be regarded as a serious drawback, and that the remedial measures they proposed would not depend for their efficacy on such an exact estimate. The censuses of 1921 and 1949 are ignorant of this question. They deal with occupations, not with employment. They divide the population into a number of occupations, in which persons could or would work *if* employment in them was available

Thirdly, in undeveloped countries, the absence of full employment shows itself less in the numbers out of work than in the crowding of unwanted labour on the land. The fact that this unwanted labour is, in effect, unemployed remains disguised in the peculiar conditions of our backward land economy. Unemployment becomes an essential aspect of the large agrarian problem, which, in this and similarly-placed countries, has today reached the proportions of an acute crisis. A study of unemployment would, therefore, be largely a study of the prevailing agrarian economy and the pressures issuing from it, as, indeed, its solution would be at the same time a solution of our agrarian crisis. This is a much more complicated job than the statistical computation of those out of work in a developed country. The subject of our agrarian economy remains still unexplored.

These reasons show also why the recent unemployment census has proved to be of little value. According to it, 86,230 persons were unemployed on October 24, 1949, and were seeking work. All that this figure means is that these persons wanted work and were prepared to say so. This is one thing and unemployment census is quite another.

* * * *

We need other methods of carrying out a census of unemployment. An attempt is made to suggest some of them in this essay.

First, it is necessary to begin with a count, not of the unemployed, but of the employed part of our population. The total number of our adult population, between ages 15 and 64, was 3,950,000, consisting of 2,144,000 men and 1,806,000 women (census; 1946). How many of them are employed in more or less permanent jobs? It should not be difficult to collect this information. It will be safe to assume that the rest are *virtually* unemployed. Secondly we should divide employment into two sectors (1) the estates and urban areas, and (2) the rural areas. It is easier to collect information about employment in estates and towns. It also, then, becomes possible to study the specific character of our agrarian problem, without which it is impossible to assess rural unemployment.

Urban areas and Estates

The occupations which give a relatively steady employment of a more or less permanent nature are: work in the estates, in harbours and docks, in public untilities like the post office and roads etc; in the few industries; services like education and health, transport secretarial work; central and local government service. We estimate that in these occupations are engaged, according to the 1946 census and the Labour Department's administration report for 1949, about 900,000 persons, as follows:

Harbours and docks	10,079
Public utilities	18,665
Transport	68,863
Education and health	51,849
Secretarial	18,743
Government service	42,380
Army, Navy etc.	23,330
Industries	35,969
Tea and rubber export	5,756
Estates	618,921

A further 200,000 persons may be estimated to be in permanent employment of one kind or another, mostly in personal or domestic service. We get a total of 1,100,000 employed persons. Of them, roughly 450,000 may be computed as the employed population in urban areas. And some 280,000 are women. This estimate may be compared with that of the Social Services Commission, 1947, which put the total number under contract of service at 1,195,000 The population of the 22 principal towns was 800,000 (census, 1946) Adding a 200,000 for all the smaller towns, we reach the figure of 1 million as the urban population of Ceylon, of whom about 700,000 were adults. (ages 16—64) This indicates an unemployment of about 250,000 persons in the urban areas.

If the persent level of production is maintained, it may be expected that the employment figure in towns and estates could be maintained round a million, save for seasonal fluctuations and other frictional causes This means that about 250,000 persons in the towns will continue to be unemployed unless, they move back to the villages, there to add to the burden which is already too heavy for the land to bear. It must be added that the unemployment figure given above is for both men and women.

Rural Areas

Employment in towns and estates is a relatively simple matter to track and count. It is not so in the villages. A little over $4\frac{1}{2}$ million people live in the villages—we allow 1 million in the towns and 800,000 as resident estate population (census 1946). These people depend on *rural* agriculture for their living. The adult rural population in 1946 was 2,728,000, of whom about 1,400,000 were men. In regard to this rural population, unemployment takes on the character peculiar to the conditions of a backward rural economy. Here unemployment is not being out of work. It is the virtual absence of an income, the lack of a direct source of income. Computation of rural unemployment will have, therefore, to be made by studying (1) the income distribution in the villages, (2) land under cultivation, its distribution, system of tenure, agricultural productivity; (3) degree of indebtedness; and by a detailed social survey of the economic and social conditions, more specific than that undertaken in the 1936—39 by Prof. Das Gupta.

On these points very little information is available. It is not possible to do anything more than state the broad outlines of the problem.

The total cultivated area in the island for all crops, is 3,208,000 acres. We assume that any piece of cultivated land over 20 acres in extent (such a land is called an estate in the Census report) is owned by a rich plantation-owner, and gives employment to estate workers who have already been counted as part of the employed population. The balance, consisting of small holdings (under 20 acres), town and village gardens, paddy lands chenas amount to 1,866,000 acres. Can it be said that $4\frac{1}{2}$ million people find adequate income from this land, at its present primitive level of production, with no evidence of a livestock or other subsidary agricultural enterprises? Can it be said that $2\frac{3}{4}$ million adults find about $1\frac{3}{4}$ million acres of land adequate for their cultivation and living ?

The need is to undertake a two fold investigation. First, it is necessary to find out exactly how the $2\frac{3}{4}$ million adults in the rural arears are employed. A section of them will be cultivators proper, either as owners or as tenants. How many are they? How many more are employed as permanent and as seasonal workers in agriculture, outside the estates? Instead of counting the unemployed it is necessary, and, of course, easier, to count the employed. There is considerable truth in an observation which Mr. M. Rajanayagam makes in a recent report. To quote him. "Except in the plantations, hired labour is not employed regularly throughout the year. The peasent farmer hires labour only for certain operations during rush periods. During the rest of the year the whole family works on the land. Peasant farming is almost entirely family farming as the extents cultivated by each family are small and as the peasant farmer can ill afford to pay for hired labour out of his meagre returns. The wife and children of the peasant farmer spend a considerable portion of their time in cultivation." If this observation is correct, then it must be concluded that employment in the villages is available, more or less exclusively, to the cultivators, owner—and tenant, and to a small fraction of the rest, about 10%, who find work as hired labour. A dismal conclusion, indeed, but one which is nearer the truth than any other. The magnitude of unemployment can be guessed at if we remember the result of the rural survey undertaken by Prof. Das Gupta which was that in the districts surveyed only 1/6 of the families were cultivators (owner—*and* tenant.—)

The other investigation that needs to be done is to find out what part of the population could be diverted from agricultural occupations without any decrease in the total output. Mr. Rajanayagam estimates that a holding less than 7 or 8 acres per family is uneconomic and cannot give sufficient returns to maintain the family above want. On the available land about 300,000 families, or a little over 1½ million people, can be employed in economic cultivation on this assumption, provided that the land was evenly distributed.

Individuals in excess of the numbers required to carry on production at its most economic level with the existing methods—in this instance in excess if 1,500,000 persons—could earn an income only by sharing the employment of those already employed. This results in partial employment for a very large number; this semi employment is most common in the villages.

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We must now place alongside these observations, the facts collected by Prof. Das Gupta in his rural economic surveys, as these happen to be the only authentic data so far collected.

These facts, broadly, are :—

About 40% of the village population had a net income of less than Rs. 120 per year per family. It is true that the money value of these incomes have gone up since 1939, but the real value has certainly not risen. On the contrary. Prof. Das Gupta takes the view that the "national income (in 1947) in physical quantity seems to have been really less than in 1938." Of the 5950 families surveyed in 63 villages in 8 districts, only 778 families were owner—cultivators, and 274 were tenant—cultivators—a total of

1,050 families, or one sixth of the population. That is, only one-sixth of the people were directly employed in agricultural production, if we exclude the category of persons called the agricultural labour, who will be mostly estate workers and who have already been counted.

Moreover, 44% of the families in these villages owned no land whatever and a further 21% owned land under 1 acre each. There seems to be a close relation between this 44% of landless people and the 40% which we earlier noted as having an annual net income of less than Rs. 120 per family. A study of these surveys led the present writer to the following conclusion. "About 40% of the population have no obvious occupation. They, it must be concluded, are forced on to the land, without being either cultivators or workers. In other words, they are a burden on the land, a drag on its development."

The picture presented by these surveys may not be true of all the villages in the island. It was claimed by Prof. Das Gupta that it was a fair and correct picture of the economy of the districts where the villages were situated. It will be a good guess if, basing our estimate on the information available, we put down at least 2/5 of the adult rural population of the country as unemployed. Every known fact supports this estimate and no ascertained fact goes against it. This means that 1,100,000 adults in rural Ceylon are unemployed; of them about 600,000 are men.

A feature of our system of agricultural production is that outside production in the estates, employment in it is intermittent, and interrupted for long periods. During these periods even those who are counted as employed are unemployed. Their number would add considerably to that of the permanent unemployed.

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What has been attempted is to indicate the lines along which our inquiry should be directed. The two sectors of employment—1) the towns and the estates, and 2) the rural areas—have to be separately studied. In each, it is the number of employed that must first be counted. In the towns and the estates, employment is on a regular basis for a wage or salary, and a monthly check could easily be made of them. In the rural areas, employment is confined mostly to actual cultivators and a small number of agricultural workers. The rest of the adult population is unemployed, for the reason that no continuous work is, in fact, available.

The estimate, which must still remain no more than a rough assessment, based on the available data, shows only the extreme ends of the problem. In the towns and estates there are about 1,100,000 employed persons. In the villages there are over a million unemployed adults. Between the limits there must be employment of various degrees, ranging from near-full employment for a minority to near-full-unemployment for the majority, the extent and character of which we do not know yet.

It is impossible to avoid the conclusion that, at the least, about 1,150,000 adults, of whom about half will be men, are unemployed in Ceylon today. This does not mean that they idle every hour of their life. But it surely means that if they were suddenly transferred out of Ceylon, the volume of our national production will still remain unaltered.

Against this estimate must be placed the recent census figure of 86,000 unemployed. A census can serve two ends. It could provide that information to government in order that it may offer relief to the totally unemployed, or work, as part of a relief scheme, if it so wished. The recent census obviously had only this aim in view. Or, it could in addition, calculate the total amount of unused labour so that, based on this and other information about unused material resources, a government could plan the development of the country's productive economy in a desired direction and at the required pace. In writing this essay I have kept this end in view, for unless our economy is rapidly developed, it will not be possible to find work even for the present registered unemployed.

P. KANDIAH.

Some Problems of Economic Development in Ceylon

The urgency of the problem of the World's under-developed areas is now universally recognized. Practical statesmen and administrators as well as numerous International Councils have in recent years afforded ample evidence of their interest in the problem, whilst the Goverments in these lesser developed regions have themselves become increasingly aware of the need for some sort of conscious policy towards economic development. Indeed many of them have already adopted economic plans and have set up the Administrative machinery needed for their implementation.[1] Economic theory however has given comparatively little attention to this field. This is perhaps due, in part, to the preoccupation of economic science with the problems of more advanced industrial economies and also to the fact that these problems themselves have until quite recently been dealt with largely in terms of static analysis. It is also undoubtedly true that the fundamental problems of backward economies though complex are not of a type that can be successfully resolved through the medium of abstract thought. It is therefore natural that the limited literature that does exist on the subject of economic development is largely of an empirical nature. These studies have nevertheless disclosed some of the broader problems, which underdeveloped countries generally experience in common; and a general statement of some of these problems, which must necessarily precede the prescription of policies, has thereby been made possible. Here we shall attempt no more than to restate, as simply as possible, a few of these problems in terms of the economy of Ceylon.

Fundamentally the purpose of economic development is to increase the income per head so that the living standard of the people can be raised. This can, at the risk of over simplification be conveniently looked at as a problem of increasing the productivity of labour since a community can enjoy more wealth only if it produces more. In countries like ours where population is rising rather rapidly the problem of development is one of increasing the productivity of labour fast enough so as to outpace population growth.

This general problem of increasing the productivity of labour in the face of rising population may conveniently be divided up into a number of related problems. First there is the question

1. Some of these plans have been conveniently summarised by the United Nations Department of Economic Affairs in its publication—"Economic development in selected Countries—Plans, Programs and Agencies."

of the relationship between improvements in productivity or living standards and the rate of population growth itself. Second there is the problem of the directions in which the productivity is to be improved. The notion of a general increase in productivity must not be taken to mean that the working population of Ceylon must merely produce more of the goods and services it produces at the present time. This may no doubt be partly desireable but there are numerous reasons as to why in addition, goods and services of a different kind should also be produced. The question of Agri cultural or industrial development as alternatives, and the problem of what type of industry is suitable falls within this general problem of the pattern of economic development. Third we have the problem of finding practical ways and means for increasing the productivity or output in the economy. Productivity may at times be improved by relatively simple changes in techniques of production, but often technical equipment and other aids to production generally described as real capital are needed. We have therefore to face the question of how the necessary capital is to be procured and this is intimately linked with the problem of financing economic development. Finally it would be natural to ask what role the Government can play in assisting the process of development. In the four sections that follow we shall endeavour to outline in turn some of the more important realationships that are of relevance to the problems mentioned above.

I.

Many writers have drawn attention to the numerous 'vicious circles' that tend to perpetuate economic backwardness. One of the most important of these is that in the early stages of economic development population growth may possibly outrun the gains in productivity. The reason for this is essentially that economic progress raises standards of living, nutrition and public health. Infant and maternal mortality rates are as a result reduced and the expectation of life of the individual is prolonged. At the same time the customs and outlooks that influence the size of families remain unchanged over a longer period although eventually higher living standards may promote smaller families. The result is a rapid and cumulative increase in population as its age composition becomes weighted towards the younger age groups. The improvements in the standards of public health would in the long run undoubtedly tend to increase the economic efficiency of the working population, but meanwhile there is the possibility that the increase in economic productivity will be inadequate to offset the growth of population although national income in absolute terms may have increased, standards of living and real income per head may actually fall and so the health and economic efficiency of the population may once more be lowered.

All this serves to emphasise the point that if economic development is to be effective it must take place at a rate rapid enough to offset any enhanced rate of population growth.[1] Advances of a slow and piecemeal nature may in the end frustrate themselves. Improvement in the social services tend to encourage population growth and unless the rate of growth can be slowed down by conscious birth control the need of a fairly rapid spurt in development will be urgent in countries where the social services are extensive.

A glance at the population statistics in Ceylon in recent years will give us some idea of the magnitude of the problem of development. In 1948 Ceylon's total population amounted to about seven million persons. The occupied population consisted of about 2.6 million persons or 37% of the total. Since 1945 the increase in population due to an excess of births over deaths (ie., exclusively of increases or decreases due to net migration) has averaged about 2.2% per year.[2] Now if we assume that the working population also increases at the same rate we shall have about 57,000 additional workers annually who will have to be maintained in productive activity. A rate of economic development which enables us to absorb 57,000 workers annually in new employment will in other words be necessary if we are to merely prevent a deterioration in present standards of living caused by population growth. If at the same time we wish to secure a moderate improvement annually in real income per head we must also improve the productivity of the existing population. This can be achieved by transfering to new employments a part of the existing rural surplus population. We assume that a moderate population such as 1%[3] of the existing rural workers is transferred in this way we shall have an additional 18,700 workers[4] a year to be given new employment making a total 75,700.[5]

II.

The second important problem for developing countries arises in determining the pattern of economic progress. We have to

1. The organic and cumulative nature of successful economic growth is a another reason which will require relatively large investments in the initial stages of the development; particular investments give rise to related investments which are complementary to them.

2. Statistical Abstracts for 1949, Tables 21 and 28.

3. C. f. Methods of Financing Economic Development in underdeveloped countries, U.N.O. page 61.

4. Assuming that the proportion of rural occupied population to total occupied population and of total population to total population are the same. C.f. report of the Social Services Commission, page 13.

5. In this connection it is of interest to note that in the 3 years 1947—1950 64,492 families have been settled in 120,000 acres of land under the Land Development Act. This includes 5,897 families settled on 36,000 acres in the major colonization schemes.

solve the problem of what goods and services ought to be and can be produced and how markets can be found for these products. The first part of the problem is largely the affair of the technologist who tells us to what specific uses our resources can be applied. But at the same time it should be clear that the aim of development is not self sufficiency. We should be richer if we can produce more of the things we used but would also be richer if we could secure these things from abroad by exporting to outsiders what they need. Indeed there are two strong reasons that tend to make a policy of self sufficiency both undesireable and impossible. One is that such a policy would mean sacrificing the obvious advantages of international specialisation and trade which tends to increase the productivity and wealth of the various countries. The other reason is that complete self sufficiency would be technically impossible for a small country except at an extremely low standard of living.

New processess and new commodities are always arising in the outside world and there will always be some range of products that can only be obtained from abroad. To be able to purchase these we will always need to export some of our own produce and therefore it is a good thing to be able to devote a certain proportion of our resources towards production for export.

The question of industrial and agricultural development as alternatives has often been raised in public discussion. The essential point is that a country should make the best use of its available resources. This can be achieved if resources are divided between various uses in accordance with their important productivities. Many underdeveloped regions of the world today are experiencing an acute scarcity of cultivable land and to them industrialisation is the only solution to the problem of surplus population. But where undeveloped cultivable land is still available the opening up and working of these areas by economic units of production is an obvious first step.

Moreover the development of agricultural and industrial production is often complementary. High outputs in agriculture raise the standard of living of agricultural producers and therefore their purchasing power. Internal consumer markets in the country are in this way generally strengthened and the profitability of new industrial ventures correspondingly increased. In the context of the Ceylon economy there is a further important reason as to why agricultural development is almost a prerequisite for industrial growth. Almost all industrial projects today require machines and other capital equipment that can only be obtained from abroad. Apart from foreign borrowing, the foreign exchange earnings of our existing exports are the only means we

have of paying for these imports of capital goods. But an appreciable volume of imported capital goods will not be possible as long as we are forced to use our limited foreign exchange resources on imports of essential requirements in food and clothing. Hence the sooner we are able to replace food imports by imports of capital goods through our own food production, the faster the probable rate of industrial development. It is true that in the past there had been a trend in the price ratios between agricultural and manufactured goods that has been unfavourable to agriculture,[1] and also that agricultural prices have been subject to disproportionate fluctuations. The latter deficiency can only be overcome by international action under the proposed International Trade Organisation, whilst it is not impossible that the position as regards the former will be reversed as world population outstrips food supplies and newly developed countries adopt higher standards of internal consumption. Meanwhile for Ceylon the policy of self sufficiency in food has the added advantage of insuring the country against short supplies in times of war and diminished importing power in times of depression. Moreover to us, it is not a question of weather foreign countries can produce our food requirements cheaper than we can, but whether our own resources of land and labour could be put to uses where they would yield more than in food production. In the absence of sufficient markets and with the high capital cost of other ventures the existence of alternative avenues of productive employment must necessarily be limited.

In the course of economic development it would be usual to expect new enterprises to arise which would provide an adequate return on the monies invested in them. But the scope for economic enterprises is naturally small in a society where markets are small due to the poverty of the people. The problem of markets is another of those vicious circles that impede economic progress. Development is limited because markets are poor and markets are poor because there has been no development. It must be emphasized that the poorness of the market is due largely to the poverty of the population rather than to its smallness in numbers. A population of 7 million would, if wealthy, provide markets large enough to enable many industrial ventures to function at their most efficient scale. But a population of the same size whose purchasing power is small will afford no such opportunities. But it should be noted that it is the very existence of these industrial ventures that makes markets large, through the increased incomes they provide for the people engaged in them. If we could imagine for instance that a high level of economic

1. C. f. Relative Prices of Exports and Imports of under-developed countries. U. N. O. Rates, page 22.

development is reached overnight or at one stroke, we would find that the population has been enriched to an extent large enough as to afford promising markets for a wide range of enterprises. But the difficulty is in making a beginning since any single enterprise can hardly expect that the monies it spends in the form of cost returns to it in full measure in the form of increased demand for its products.

It is likely that new enterprises coming into being in a developing country will tend generally to be of two types; on the one hand new industries would tend to arise that produce commodities for which markets already exist in a country but which are supplied by imports. Thus the production of various types of foodstuffs, textiles, cement, building materials, furniture, farm equipment and other commodities in current use for which the raw materials are readily available is usually familiar in the pattern of development. On the other hand there may be a tendency for industries to grow which are chiefly concerned with the processing of products already cultivated or manufactured in the country but exported in a comparatively raw state. Theoretically there is no reason as to why new commodities ought not to be developed for export as well. But in reality it is unlikely, unless foreign capital is to play a predominant part, that entrepreneurs at home will venture out at an early stage into the uncertain field of foreign markets.

In addition to the types of Industry mentioned above in the early stages of economic development an important part of total investment is diverted towards the expansion of various public utilities—Roads, Railways, Harbours, Power Projects, Irrigation Works, etc.—which are relatively capital intensive. Large scale investments of this sort stimulates further development, both because they provide the facilities which other industries require and because during the period of construction they add to the income of the community and so increase its purchasing power. Moreover utility projects may be conveniently undertaken by the Government which is in a position to measure their usefulness in accordance with the general benefits they will confer rather than in terms of financial profits.

III.

Our third problem concerns the improvement of the Productivity of labour. Economic backwardness is characterised by the low level of output per man, and development therefore should aim at an improvment in productivity both by increasing the skill and efficiency of labour and by providing it with mechanical implements in the form of machinery and other capital

equipment. Improved labour skills are an essential part of the organic growth of the economic system and are therefore amongst the most important 'external economies' in development. For a country making a start in development, improvements in the efficiency of labour can only be secured through a conscious policy of vocational and technical education. Indeed it would not be an exaggeration to say that the shortage of technologists is likely to prove one of the most difficult bottlenecks in the economic development of Ceylon.[1] Our requirements in technical skill will at the beginning be numerically limited but nevertheless varied, and it will not be easy to establish institutions that can train a limited number of technicians in a diverse range of aptitudes. The utilisation of technologists and experts from abroad therefore is a common way through which developing countries acquire the necessary skill in the early stages of growth.

In underdeveloped countries agricultural productivity is generally low. Agrarian reform which transforms fragmented peasant holdings into economic units will often be necessary, but such a process must accompany rather than precede the creation of new avenues of employment or production in which the displaced surplus rural population may be absorbed.

The productivity of labour can also be improved by the provision of capital equipment and other aids to production. It is well known that there is a close co-relation between the level of per capita real income in a country, and the volume of capital.[2] The scarcity of capital is yet another of the vicious circles that impede economic progress. A low level of savings will permit only a low level of investment and low investment in turn means low incomes and low savings. It is through the process of investment that real capital is accumulated. And investment

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1. The shortage ot technical personnel was one of the factors which induced the International Bank for Reconstruction and Development to state in one of its reports that "the most striking lesson of the Bank's experience to date is the dearth of soundly conceived development projects ready for financing" Cf. Methods of Financing Economic Development in Underdeveloped Countries, U. N. O. 1949, page 91.

The following statement of the Minister of Agriculture on some of Ceylon's specific difficulties are relevant in this connection. " The Irrigation Department is now working with only a fraction of its sanctioned staff. I have made every conceivable effort to recruit Engineers for this Department. Advertisements have been inserted in Technical Journals in the United States, India and Pakistan, Australia, the United Kingdom and most countries of Western Europe. Our Deputy High Commissioner in London was sent to the Continent to interview prospective candidates. The International Refugee Organisation and other Organisations have been approached, but so far all my efforts have met with little success. American Engineers a number of whom are available require salaries of 4,000/—5,000/- (Rs.) a month." Hansard, 26th July 1950.

2. Cf. Buchanan: International Investment and Domestic Welfare.

consists essentially in the utilisation of a part of the community's resources in capital improvement as against immediate consumption. If all the productive resources of a community are fully employed in the production of commodities for consumption, then clearly it would be necessary to restrict consumption if a part of these resources are now to be used for capital improvment. The greater the amount of resources that can be so devoted, the greater the volume of investment, and therefore the greater the flow of commodities for consumption made possible for the future. This is the essence of the notion of saving. A community which is already poor and whose levels of consumption are on average not far from the meagre minimum required for human subsistence will find it extremely difficult to restrict consumption still further in order to provide resources for investment.[1] But if economic development is to be effective it is important that the necessary volume of investment be always forthcoming even if this is to imply, as is likely a fairly severe and continued curtailment of consumption.

We estimated earlier, on a very rough basis, that if development is to outpace population growth to even a moderate extent, new employment will have to be found for about 76,000 workers a year. It has been estimated, on the basis of investments actually made in rapidly expanding countries that it requires $ 1,000 or Rs. 4,800 investment per worker to provide capital facilities for each worker added to industrial employment.[2] A total net investment of about Rs. 365 Million equivalent to over 14% of the national income of Ceylon for 1949 will therefore be required. In fact gross investment in 1949 was Rs. 275 million or 11% of the national income, and net investment would have been even smaller.[3] The

1. The Food and Agricultural Organization in a recent report on International Investment and Financial Facilities makes the following broad estimates of saving in under-developed countries on the basis of national income studies: Under-developed countries usually have incomes per capita one tenth to one fifth as large as those of highly developed countries. With the low incomes and the low rate of saving, the savings per capita in many under-developed countries may average under 5% of those of highly developed countries......at the same time some countries, operating under a largely socialized economic system, are developing rapidly on the basis of internal savings by using strong controls to hold standards of living down to Spartan levels. Such countries, including Hungary, Poland, the Union of Soviet Socialist Republics and Jugoslavia, apparently are maintaining net saving and capital investment at percentages of national income approaching or exceeding those of many highly developed countries.

In Poland, net savings in 1948 were reported at about 17% of national income; and in Hungary at 17% in 1946/1947. Net investment in capital formation and expansion of stocks in the Union of Soviet Socialist Republics is estimated at 27% of national income in 1948.

2. Methods of Financing Economic Development in Under-developed Countries, page 61.

3. 1950-51, Budget Speech, Minister of Finance, Appendix I.

capital cost per worker applies to industrial investment in other countries, and may not of course apply to Ceylon. Nevertheless this affords some indication of either the increase in savings internally or the increase in foreign borrowing that would be necessary if a minimum rate of investment is to be attained.

Saving all the curtailment of consumption of course may be achieved in a number of ways—through, for instance, an inflationary rise in prices caused by the bidding away of factors of production from use in consumption to use in investment. It can be achieved also through rigourous taxation by the state which would then devote these funds to investment. It can, again, be achieved by an increase in the voluntary savings of the community which would enable the release of resources for investment. It is likely that in the course of development all these methods will, in part be used. One important point should however be remembered. Saving, by itself, will not ensure investment within the country. (It may however increase a country's holdings of foreign assets through the creation of an export surplus). It will merely permit the undertaking of an equivalent level of investment without serious disequilibrium in prices or in the balance of payments. To be useful increased savings must be matched by increased investment.

Apart from its own savings through the release of its productive resources, a country can also develop with the aid of capital from abroad. It is likely that any appreciable level of expenditure on investments will necessitate at some stage or other the import of machinery and other forms of capital equipment from outside. This need not be secured entirely through borrowing, for, as long as a country is an earner of foreign exchange, it can import capital equipment by reducing its imports of consumer goods. The increase of savings at home will make such a situation possible. But as we mentioned before the aggregate amount involved is likely to be too small to make an appreciable contribution to investment. It would seem therefore that borrowing from abroad is an unavoidable necessity for a developing country whose standards of living are too small to allow an adequate volume of savings and whose resources are too limited to provide, within its frontiers, all its varied requirements in capital equipment.

It must not however be thought that the purpose of foreign borrowing is solely to enable the import of capital goods. Foreign borrowing is also a method of maintaining consumption standards when internal resourses are diverted from the production of consumer goods to the production of investment goods. The reduced internal output of consumer goods can, because of foreign borrowing, be supplemented by imports of consumer goods.

Foreign borrowing involves a number of problems which ought carefully to be considered by a country seeking the aid of capital from abroad. First, there is the question of the form which this foriegn borrowing should take. Second, there is the related problem of capital ownership within the country. Third, there is the issue of determining the various uses to which foreign capital may be applied.

Foreign capital can come into a country in many forms. It would be possible for instance for the government of a developing country to raise loans in the money markets of other countries. The Ceylon Government has, in the past, issued securities in the London Money Market and so obtained funds for us in productive ventures. It was able to do this on specially favourable terms since, being a British colony, its securities enjoyed the status of trustee stock carrying a British Treasuty guarantee. It is not unlikely that Ceylon will no longer enjoy such favourable conditions in the absence of this special privilege. Moreover govermental borrowing through the issue of securities abroad has the disadvandage of creating a fixed charge on the foreign exchange resources of a country throughout the alternating phase of prosperity and depression. This can be a severe strain on the level of real income in a poor country which is heavily dependent on the imports it can purchase through its earnings of foreign exchange.

Foriegn borrowing could also be effected through certain international lending agencies such as International Bank for Reconstruction and Development.[1] This latter institution can, no doubt prove of valuable assistance to the developing countries if it is able satisfactorily to fulfil its aims and objects For not only does the bank provide capital, but it also helps, through the supply

1 The International Bank as constituted at present, suffers from two major limitations. First its own resourses are too small to meet the needs of an extensive development programme. Its funds for direct lending are very restricted and it is dependent on borrowing from private investors—an operation whose success depends on the state of the capital markets of the lending countries. Secondly, it is limited to lending for specific projects rather than for general development purposes. The committee of experts which reported to U. N. O. on full employment policies recommended that the scope and powers of the bank be extended to include both borrowing from governments and lending to government for general development purposes. Governments should in consultation determine the amount of international lending necessary to ensure equilibrium in international transactions and then make these amounts less private lending available to the International Bank for lending to under-developed countries. The Bank will pay the lending government interest rates equivalent to the rates at which the latter raised funds in its own market and charge the borrowing countries similar rates plus an amount to cover the Bank's cost and a uniform rate to cover the posssibility of default.

C.f. National and International Measures for Full Employment. Report by a group of Experts appointed by the Secretary General of U. N. O.

of technical missions and expert advice, in the formulation of development plans. The service charges of borrowing from the Bank though of a fixed nature may possibly be more flexible in times of stress but still it would not be appropriate to classify it as anything but a fixed charge. Furthur there is the question of the rate of interest which, standing as is does somewhere around 4% may be considered heavy. It would however seem desirable that a country makes the best use it can of the facilities afforded by the Bank, and in this connection Ceylon's application for membership of this institution as well of the International Monetary Fund must surely be welcomed.

Another and commoner method of foreign borrowing is through private investment of foreign individuals and firms in economic projects within a country. This can take place through the purchase by foreigners of shares and securities in the country concerned or, more usually, through the purchase of shares of concerns resident in the home country but engaged in economic activity in the developing country. The service charges of this type of capital will be of a flexible nature as it will entirely depend on the making of profits by the foreign firms. Money will be remitted abroad only in good years, whilst there is an added advantage that the country will have no commitments as regards the payment of capital unless there is voluntary purchase of capital assets by its own residents or by the state.

However, one of the most significant aspects of international capital movements in post war years has been the failure of private foreign lending to regain its inter-war levels. The general increase in risk arising through unsettled political conditions and currency difficulties in countries needing capital is a partial explanation of this feature. Suggestions for the guarantee of transfers by the governments of capital exporting and capital importing countries have been made to meet this problem. The greater part of foreign lending through public agencies, as distinct from private channels, was received by the developed countries. Even the International Bank for Reconstruction and Development devoted in 1949 only 20% of its total loans to under-developed countries.[1]

Foreign borrowing naturally involves the problem of ownership of capital assets. Capital investment through the medium of foreign firms places a proportion of the capital assets of a country in foreign hands. Ceylon has in recent history been substantially developed by foreign capital which opened up the country for the planting of tea, rubber, and to a lesser extent coconuts. It has been officially estimated that the foreign share

1. Methods of Financing Economic Development in Under-developed Countries, pages 64 and 65.

of the total capital invested in Ceylon through the medium of companies is nearly 85% and this is exclusive of the field covering banking and insurance. Apart from the impact of this feature on the share of the national income accruing to non-residents, it raises a number of difficulties of a socio-political nature. And this explains, in a large degree the misgivings of public opinion in the country on the question of a further inflow of capital from abroad. It cannot be denied that from this point of view the disadvantages of foreign capital and foreign ownership are real, particularly in the context of the form which this investment took in the past. This is not to say however that it would not be possible for the government of this country through carefully designed legislation and policy to mitigate this feature. It is usual today for governmental policy in developing countries to at once guarantee the fair treatment of foreign capital, and at the same time, to insist on certain conditions. For instance the Minister of Finance in his 1949 Budget Speech assured foreign interests that they will not be subject to any restrictions not applicable to Ceylonese enterprises. But he also emphasized that the major interests in the ownership and effective control of an undertaking should be in Ceylonese hands. Limitations were also suggested as regards the employment of non-Ceylonese where Ceylonese were available. It may be thought, with some amount of justification, that limitations of this nature particularly in regard to the ownership of capital may in effect restrict the flow of foreign investment and thereby deprive the country of the expected benefits. For example it would be difficult for Ceylonese to own shares in Companies operating in Ceylon but which are really resident abroad. It would perhaps be equally difficult for foreign persons to purchase shares in the Companies floated in Ceylon. A practical working arrangement under the conditions mentioned above would perhaps result through the co-operation of established foreign firms with persons or firms resident in Ceylon in the setting up of subsidiaries for operation in the country. There have been signs of development of this sort in recent months. The Ceylon Government itself has entered into an arrangement on these lines in the case of the proposed Air Ceylon Corporation. This will perhaps be the pattern of foreign investment in the future and it is hoped that by this means some of the undesirable features that arose in the past will be avoided. We must, however, point out that a policy which looks to foreign capital to remedy the shortage of savings at home and which at the same time relates the inflow of this capital to the availability of Ceylonese savings is in some degree incongrous. It may possibly be necessary that conditions less drastic than those requiring a major Ceylonese interest be substituted if a greater volume of foreign investment is to be secured.

The problem of the direction of foreign investment is also of relevance. In the past it has been usual for foreign capital entering a country through the medium of private firms to devote itself largely, if not exclusively, to activities producing for export. It is so freed from problems arising out of the possible inconvertibility and instability of local currencies as it is able to procure its sales receipts in the world's leading currencies if not in its own home currency. The need for investment in export industries as a condition for the satisfactory servicing of foreign capital will also be apparent when it is realised that a country will need an export surplus in order to meet the charges of foreign investment. Neverthless it is true that a developing country is usually most desirous to foster industries that could provide the country with its own needs. It may however be difficult to persuade foreign firms to interest themselves in ventures producing for the home market, and therefore it may be necessary to allocate capital borrowed from abroad through governmental agencies for this purpose. It would not of course be necessary to finance the full value of an investment project through foreign capital, as most projects involve a certain amount of expenditure within the country itself which could well be obtained from domestic sources.

IV.

It is usual for governments in under-developed countries to attempt to promote economic development in various ways. This is of course natural since in these countries facilities for development like transport and power are scarce, and a wealthy and enterprising entrepreneurial class able and willing to establish economic ventures is largely absent. The relative extent of government participation in development will ofcourse, vary from country to country, but broadly the functions of government in this sphere are fulfilled in some of the following ways: the provision of information on the natural resources of a country, both actual and potential; the construction of such facilities as transport, power, technical education, irrigation and so on which provide the basis for further development; the construction and direct management of industrial and agricultural ventures in the absence of adequate private enterprise in these fields; and, the organization of the monetary and fiscal systems to facilitate investment in both the public and private sectors of the economy.

The importance of adequate utility services and external facilities which make up the general requirements for successful industries cannot be overemphasised. One reason, for instance, as to why foreign investors do not usually partake in the production of secondary, as distinguished from primary, products in under-developed countries is that this type of facility is largely absent when compared with industrial countries. That is why the establishment of government financed Trading Estates as a technique of development in economically backward countries is widely advocated. These Trading Estates provide, for a fee sometimes, the facilities which businessmen or firms can use in common but cannot obtain for themselves individually.

The monetary and fiscal systems of under-developed countries may also be adjusted to the needs of development. In a general way, monetary and fiscal policy should be used for protecting prices and the balance of payments in periods of rapid investment. Fiscal weapons may in addition be used to release resources from consumption for investment. Tax and subsidy systems may be devised to offer special inducements to investors. Thus tax exemptions for new enterprises, and tax advantages for desireable investments are familiar measures apart from the traditional devise of protective duties. The government may also in various ways set up or support financial institutions which encourage savings as well as cheapen the cost of borrowing. The guarantee of markets to new ventures, the limitation of new entrants, the purchase of shares by the government and the introduction of suitable commercial laws are further examples of the ways in which government can stimulate development. The determination of that combination of monetary fiscal measures which is most suitable for Ceylon should be one of the tasks in which an overall planning authority should partake.

In Ceylon the Government has, in recent years, actively participated in the process of development. The official estimates of Gross National Expenditure claim that in 1949 out of a total gross capital investment of Rs. 275 Million, Rs. 122 Million or 44% was directly channelled through the Government.

In the previous year, 1948, the share of government in total gross investment was very much the same, but in 1949 there had apparently been a speeding up of investment activity as a whole—both government and private. Thus in 1948, total gross investment was 7.9% of gross national expenditure whilst in 1949 the proportion was 10.7%.[1] In the government budget however, expenditure on Development takes second place to expenditure on the Social Services. Thus, estimates for the financial year 1950—51 devote 37% of total government expenditure to the Social Services and 14% to the development of the national wealth.[2] This comparatively large expenditure on the Social Services as against development is one aspect of the high propensity to consume which is characteristic of the Ceylon economy. This is no doubt understandable in a relatively poor community where an extension of the

1. 1950—51 Budget Speech: Minister of Finance, Appendix I.
2. 1950—51 Budget Speech: Minister of Finance, Appendix E.

Social Services is, after all a manifestation of the fight against "ill fare" if it is premature to speak of welfare—in its most glaring forms Nevertheless effective and extensive social service systems are the fruits of development, and perhaps it would be in the proper order of things if the "development state," to use a clumsy phrase, was to precede the popular "welfare state."

It is common for governments in underdeveloped countries to formulate their objectives in development plans, which cover either the whole economy or the government sector alone. In general the effectiveness of planning depends on the volume of available resources both physical and financial, the degree of control the planning authority possesses over these resources, and on the performance of these resources in the uses to which they are applied. In open economies which depend largely on imports for their capital requirements, foreign exchange resources derived through exports will obviously be of vital importance. The uncertainty of foreign exchange earnings which result from unstable primary product prices is therefore a major weakness in regard to long term planning. This is a consideration which lends added weight to the importance which countries like Ceylon should show in international schemes for the stabilization of primary products as provided for under the Havanna Charter. In the absence of stability effective plans may have to be limited to shorter periods. The degree of control which the planning authority posseses over the resources in the country will depend on such factors as the relative size of the public and private sectors, the power to direct resources and so on. Where the mobility of resources is small and the power of direction is absent costly inducements may have to be provided to secure the desired pattern of resource allocation. This was indeed the experience of the Ceylon Government in the exprimental phase of its land colonization policy.

If planning is to be effective, an adequate administrative service, satisfactory statistical information and public co operation are fundamental prerequisites. Since government participation in development will tend to be more direct in underdeveloped countries the demands on the administration will be great. But administrations in underdeveloped countries are limited, at least in size and much will be lost if by ambitious and ill proportioned plans that are beyond their capacity are attempted. The importance of an adequate statistical background for planning is too obvious to need emphasis but, again the lack of accurate information is often an important practical handicap which impedes planning. Finally but most important of all, there is public co-operation. "If the people are nationalistic, conscious of their backwardness, and anxious to progress, they willingly bear great hardships and tolerate many mistakes, and they throw themselves with enthusiasm into the job of regenerating their country. Popular enthusiasm is both the lubricating oil of planning, and the petrol of economic development—a dynamic force that almost makes all things possible."[1]

GAMANI COREA.

1. W. A. Lewis—Principles of Economic Planning, page 128.

The Central Bank—An Analysis

The history of Central Banking is a comparatively short one. Although it is true that as early as 1694 the Bank of England, which gradually assumed the functions of a Central Bank and set an example to the proper functioning of Central Banks throughout the world was established, it was only at the beginning of the 20th century that some attempt seems to have been made to establish Central Banks in other parts of the world. The Brussels Conference of 1920, for example, decided that countries which did not have Central Banks should establish banks of their own. This must have provided a stimulus to Central Banking Development, for a number of countries realising the value of some form of a co-ordinating bank to organise the banking and credit activities of the nation, established Central Banks of their own. A further fillip came in 1933, when another conference held in London reiterated the need for the establishment of Central Banks in countries which had not already established them. The general consequence of this focussing of attention of financiers and statesmen was the establishment of Central Banks in most countries of the world and today with the establishment of our own Central Bank perhaps it is only Cuba, among the free nations of the world which lacks a Central Bank of its own.

The history of our own Central Bank goes to September 1945, when Mr. J. Tyagaraja introduced a motion in the State Council demanding the establishment of a Central Bank in Ceylon. Though the motion was accepted the Council was dissolved shortly after.

The next step was taken on the 25th November 1947, when in the speech from the Throne shortly after the present government assumed office, it was announced "in regard to finance my Government intends to seek expert advice with regard to changes in our financial structure which may be necessitated by the transition from a Colonial to a Free National Economy." In the speech from the Throne of 12th July 1949, a more definite statement was made when it was announced "proposals are being considered for the establishment of a Reserve Bank of Ceylon in order to centralize Ceylon's cash reserves and vest in a single authority the control of currency and credit."

The Exter Report was presented to government between October and November 1949 and on the 25th of November, it was passed by the House which in the words of the Finance Minister was "a landmark in the progress of the people of Ceylon to econonomic freedom." The Monetary Board consisting of Mr. John Exter, the Governor of the Bank, Mr. J. Tyagaraja and the Secretary to the Ministry of Finance, Sir Charles Jones started functioning from the 1st of July, of this year.

The Central Bank has therefore become an established fact; but it would not be irrelevant to consider briefly why Ceylon *should* have its Central Bank. The Central Bank has been hailed as the counterpart of our political freedom. Perhaps the most cogent reason for the establishment of a Central Bank of our own is that with political freedom we should try to break the fetters which impeded our economic progress so long as we were a subject nation. This takes us directly to the disadvantages of the currency system under which we laboured all these years. The chief defect of this system was that the Currency Board had to play a purely passive role. It could not influence the supply, availability or the cost of money in the country. In times of pressure for example the Currency Board could do nothing but merely be a spectator, for the system was such that the Currency Commissioners could issue Rupees in Ceylon only when Rupees were deposited in India, with the Reserve Bank of India. The issue of Ceylon Rupees had to be the equivalent of the Rupees Deposited in India. The result was that the powers of the Commissioners of Currency were narrowly circumscribed to the automatic issue of rupees which had to be the equivalent of the amount deposited with the Reserve Bank of India. The converse also held good in that the Commissioners had to withdraw an amount of Rupees in circulation corresponding to the amount it had to pay out in Indian Rupees from its account in the Reserve Bank of India. It is true the currency ordinance as amended in 1944 empowered the Currency Commissioners to pay out or receive *Sterling* through the Crown Agents in London but this authority was not used till the recent devaluation and the severing of the link of the Ceylon rupee with the Indian Rupee. Thus the system becomes tragically inelastic and nothing could be done to increase the availability of credit to meet the needs of an expanding economy. The result obviously is that it imposes a deflationary influence. For as population increases, and domestic trade expands an increasing supply of money is required. This could not be supplied except by depositing Rupees at the Reserve Bank of India. How could these Rupees be obtained? Only by an active balance of trade. So that the balance of trade has to be persistently favourable if there should be a continual expansion in the money supply. This is a 'costly luxury' for an economy like our own. This financial system is not sufficiently elastic for our needs.

Further it will be seen that this system has a 100% reserve because every rupee in circulation is backed by the same amount

in India. This is a wasteful system. For of the total volume of notes in circulation a certain quantum of it will always continue to be in circulation however adverse the balance of payments but a reserve has to be kept even against this "hard-core of currency."

Under this there is also no co-ordination of the activities of the various banks. The exact nature of their operation, nature of their assets, their capital etc. are often a closed book to us and the Currency Commissioners had no power to control or co-ordinate their activities. It is true that generally most of these foreign banks have maintained a high standard of business integrity but it is also true bank failures with considerable loss to depositors are not unknown, eg; the recent failure of the Exchange Bank of India and South Africa.

Again there was no permanent institution in this country to co-ordinate the accumulation of foreign Exchange reserves during times of favourable Balance of payments to meet any requirements of such exchange in times of an adverse Balance of Payments.

Under the old regime there was also no institution which could in time of need come to the banks assistance i.e., perform the function of lender of last resort. It is true that the Imperial Bank had assumed this function because it had become the clearing bank for the other commercial banks in the island. But it is also true that at times the necessity arose to import funds from India to meet the demands. This reliance on a foreign banking system is undoubtedly unsatisfactory.

Also while in the past the treasury has been the Government's fiscal agent it would have been better to have an institution for this purpose which came into frequent contact with the banking and the business world. In the past the treasury may have been an adequate instrument for Government finance. This was largely because in the past the Budget has been more or less like the balance sheet of a bank. It was just a matter of seeing whether the income was equal to the expenditure. Therefore the problem of setting up an institution to advise the government in its fiscal *policy* was largely eliminated. Today however the budget has assumed a totally different form. For example in the budget speech of 1947—48 the Finance Minister refers to only (1) the ex-expenditure which government intends to meet. (2) Moneys which Government has in reserve–surplus Balances. (3) Means whereby Government collects its income.

In the next budget speech 1948—49—"the 1st budget of free Ceylon" the Finance Minister formulating the Six Year Plan said in his speech "we have made up our minds that future progress must be according to a well defined plan devised to secure a well defined object". It is however only with the "Full Employment budget" of 1949—50 that it becomes clear that the budget is not merely an account of the income and the Expenditure of the Government but that it could be made into an instrument for the best utilization of our resources and to secure full employment. "The Government after estimating private expenditure must then propose public expenditure which will suffice together with the estimated private expenditure to secure full employment"—P. 18. Under such a plan of development there must necessarily be an institution which would come into close contact with the banking and business world but which is also the adviser to the Government on matters of public finance. Various development schemes will have to be financed and for this purpose the new Central Bank will tender it's advice to the Government regarding the nature of the securities to be floated, the rate of interest etc. These functions are far removed from those performed by the Commissioners of currency which were both narrowly limited and passive in character.

Finally under the earlier regime questions of channelling the savings of the community, provision of the credit needs of the country for our economic development were not very important. What Ceylon needs is an increase in the variety of her exports, a diversification of her economy by a vigorous policy of industrialisation and also the production of essential foodstuffs. A well developed banking and credit system is essential for this purpose. But the existing credit system as already shown is too rigid. The Pochkhanawala Banking Commission of 1934 examined this problem and urged the creation of organisations that could provide short, medium, and long term credit. The Bank of Ceylon and the Agricultural and Industrial Corporation are the results of these recommendations. The former providing the short-term credit and the latter medium and long term credit. Yet much more remains to be done in this sphere if our recources are to be fully tapped for our benefit. The Bank of Ceylon, which is a state-aided bank, apart, all other banks in Ceylon are the branches of giant international banking concerns, and have concentrated on the most profitable section of our trade i.e. foreign trade. Very little has been done to contribute to any local concerns. So that the foreign banks can never do for us what a well managed indigenous banking system could do. The State Mortgage Bank, the Loan Board, Ceylon Savings Bank and Agricultural and Industrial Credit Corporation are limited in the extent of their operations largely due to want of contact with business concerns outside Colombo. There are also the Co-operative Central Bank and Co-operative Credit Societies. They perform useful services but their sphere of activities is limited. What the country needs is a well-organised banking system to provide cheap credit for agriculture, commerce and industry. This, apart from providing cheap credit will also help the growth of the thrift habit among the people and help to eliminate the usurous middleman.

With the development and expansion of our international trade, and the increasing realisation of the effects of booms and slumps on our lopsided agricultural export economy the defects and inadequacies of the existing monetary and financial structure have become patently clear, calling for a better system, which gives us power to manage our own monetary affairs as would best suit the interests of this country. This demand for such a system grew more insistent with the winning of our political independence. It is for this purpose that the present Central Bank has been established. Its establishment then is undoubtedly a step in the right direction and has far reaching implications for the people of Ceylon. If the treasury's advice to the Government where long term planning and capital development are concerned, was inadequate, then a Central Bank having the power to determine the supply and cost of credit, acting as the co ordinating agency for the other commercial banks, become the adviser to the Government, in matters financial, acting as the depository of the nation's foreign exchange reserves etc. becomes not only desirable but also necessary. Particularly is this the case when the majority of the banks in the island are the foreign banks interested in her foreign trade and when our own banking system is in its infancy.

But the extent to which the newly established Central Bank could rectify the mistakes and atone for the inadequacies of the existing system and make a significant contribution towards our economic prosperity will largely depend on the extent to which the purposes for which this Central Bank is established could be realised, and the extent to which the hopes and aspiratrons expressed could materialise.

This takes us to the 5th clause of the Exter report which deals with the powers and objects of the Central Bank. It is precisely these objects and the extent to which the Central Bank could achieve these objects that should be examined before one assesses the significance of this new institution.

One of the objects is the preservation of the par value of the Ceylon rupee. Unless there is a persistently adverse balance of trade there should be no difficulty in maintaining the par value of our currency. The value of a Rupee has been fixed at 2.88

grains of fine gold. This is the value of the Indian rupee as well. This decision to use gold as the standard of value of currency is in accord with modern practice the world over. Where the £ Sterling in concerned £1 exchanges for 13.33 Rupees and in regard to the $ which has become even more important than the £ the Rupee—dollar exchange was $1: Rs. 3.30. After devaluation, when we devalued to the same extent as the £ the rate at which $1 exchanges is Rs. 4.78. The stabilisation of the exchanges become particularly important in a country whose foreign trade constitutes its economic life-blood. Frequent changes in these Exchanges are bound to introduce an element of uncertainty into our foreign trade. On the other hand fixity of the Exchanges imposes an undue element of rigidity into an economy. This disadvantage led to its final abandonment with the fall of the gold standard in the 1930's. The present policy is only to stabilise a currency which however is different from giving it a fixed or a constantly fluctuating ratio. Recently for example the £ was devalued in terms of the American dollar. This could not have been done under the gold standard conditions A deliberate policy of devaluing a currency in terms of another is to increase the volume of exports and reduce imports and prevent a recurring adverse Balance of Payments. In the case of Ceylon lowering the exchange value of our Rupee would not help much because though on a short term analysis the competitive position of our exports would be increased it will also increase the cost of all imports like food and clothing on which practically ½ our national income is spent. These will in turn raise our costs of production and only negative the earlier advantage. But there is no reason to doubt the Central Bank will not be able to stabilise our currency and maintain its par value.

The second object of the Central Bank is to provide for the stabilisation of domestic values. This is no doubt a laudable object. But the fundamental question arises whether the Central Bank could do this. In the past there has been no effective policy to stabilise such domestic values. Unfortunately this will be the case for a long time more. Let us examine the nature of our economy. Ours is an agricultural export economy. The greatest contribution to our national income comes from Tea, Rubber and Coconuts and the majority of the people are engaged in these industries directly or otherwise If then the prices we obtain for our export products remain stable it could be reasonably assumed that our domestic values would be also stable. In the event of a fall in their prices in world markets, and in all these cases our contribution to the world output is not sufficiently large for us to determine their prices, there would obviously be no stability in our domestic values. What then could the Central Bank do in these circumstances. It would be futile to point out that the Central Bank could pump money into the economy for the obvious reason that money could be so pumped only if there is a demand for it. This is precisely what will be lacking in the event of a slump in world markets for our products.

Then again it has been pointed out that another object of the Central Bank will be to provide for a high level of employment and real income and the full development of our productive resources. Quite a praiseworthy object no doubt and one of the objects which all Central Banks have accepted. But here again on an examination of our economic conditions one finds that to expect the Central Bank to fulfil this object, at least for quite a long time to come, is to entertain unwarranted hopes regarding the effectiveness of this new institution. While it is true that today our unemployment figures have reached dangerous proportions it would be accepted that the more fundamental problem seems to be the problem of chronic under-employment. Even at the most prosperous times quite a large number of people are under-employed. How then could this Central Bank contribute to the full development of our productive resources and the maintenance of a high level of employment ? It is true that in an advanced economy with a wide-based productive structure the provision of the necessary amount of credit at sufficiently low rates of interests would revive the business psychology of the market and stimulate the economic system towards a high level of employment and income. But the problem in Ceylon is that we do not have a broad based productive system. Cheap credit facilities act as the lubricant of the productive machine. But at the moment we do not have this productive machine. Of what use then is the lubricant ? Much has been written in recent times of the benefits a country could derive by the provision of cheap credit in conditions of under employment, that one must beware of the uncritical acceptance of ideas and theories which though they are applicable to other more advanced economic systems are not necessarly suited to an economy like our own. Mr. Exter warns us of the uncritical acceptance of Keynsian economics. As he himself points out the efficacy of cheap money policies varies widely from country to country. In the American economy for example which is largely self-sufficient and in which when there is unemployment there is also a surplus of unused machinery and equipment the provision of cheap credit facilities could be expected to remedy this situation without an undue rise in domestic prices or an unfavourable turn in the country's Balance of Payments. In Ceylon however conditions are totally different. About ½ our national income is spent on essential imports like food and clothing. Over ½ our productive resources are devoted for exports. There is a chronic shortage of capital equipment. In these conditions expansion of domestic credit would only lead to an undue rise in domestic prices and an unfavourable turn of our Balance of Payments. Confronted with these difficulties it would be interesting to see what our Central Bank would do when it has started functioning properly, to achieve its objectives.

A fundamental pre-requisite for a progressive and broad based productive system is the provision of cheap credit. It is also necessary to see that this credit could seep into the remotest corners of our economy. It has already been pointed out that the Commercial banks in Ceylon are almost entirely engaged in financing our foreign trade, and that other local institutions like Agricultural and Industrial credit Corporation, Loan Board etc. are of limited value. The Bank of Ceylon indeed is the only indigenous banking institution. It is true this is partly state owned. But it has followed a progressive policy in relation to our internal finance and has opened up a number of new branches in various parts of the island. More are yet to be opened up in areas hitherto unbanked. The Bank of Ceylon could therefore provide a valuable channel through which the credit policy of the central Bank could influence the local economy.

In the absence of a well-advanced indigenous banking system it has been suggested in some quarters that either the Central Bank should start commercial banking activities on its own by setting up a network of branches, or should establish under its direct control an institution already having such a network through which the Central Bank would be in a position to influence the economy. In the past however Central Banks have evinced a reluctance to particitate in commercial banking activities. This is due to a number of reasons. For example if there are already in existence a number of such commercial banks operating in financing the indigenous enterprises there would be no point in the Central Bank itself establishing such a network of branches on its own. Further because the capital of the Central Banks is largely the contribution of commercial banks in the form of reserves, Central Banks do not like to compete with these commercial banks which would be tantamount to using the deposits of the commercial banks against the very institutions which have provided such capital. This also may help undermine the confidence of the commercial banks in their Central Bank. Such confidence helps a Central Bank to operate efficiently and "moral suasion" is regarded as one of the "weapons" of a Central Bank.

On the other hand it may be pointed out that this reluctance on the part of Central Banks to participate directly in commercial banking is one of the principles of orthodox Central Banking. But in fact various countries have made significant departures from such orthodoxy. The recent decision of the Egyptian Government to convert the National Bank of Egypt into a Central Bank empowering it to perform Commercial banking functions is therefore of some interest. Even in India there is a considerable section of opinion which favours this type of integration in banking which they consider necessary for the industrial financing of the country. Its acceptance at the moment seems remote due to the strong opposition of vested interests. In Ceylon too there has been a glaring deficiency in institutions which could provide much needed credit facilities particularly in rural areas. It is a distressing fact that about 75% of our pepole live in a sector of the economy to which credit does not permeate. The already existing institutions have not provided this credit although co-operative credit could do much in this direction. It is true that the Exter Report provides for the Central Bank granting credit facilities to the Co-operative Federal Bank but yet this bank has not developed sufficiently to be an effective channel through which the credit operations of the Central Bank could seep into the rural economy. It is also true that an otherwise excellent report fails to make any significant suggestions for the development of an efficient and well organised system of indigenous banking.

Judged in the light of these facts the objects of the Central Bank as expressed in the Exter Report sound somewhat hollow. They would undoubtedly be realisable in a broad-based and progressive productive system. But this is a description which is not yet applicable to our own economy and to the extent that the description is inapplicable to Ceylon's economy to that extent would the usefulness of the Central Bank be limited.

It is also necessary to point out that the efficacy of our Central Bank is vastly impaired by the absence of a number of other institutions which one would normally associate with a *banking system*. A Central Bank's powers can be very effectively circumscribed if, there is no market for bills and securities. A Central Bank makes itself effective partly by operating in such bills and securities, the buying and selling of which are generally referred to as open market operations. By operating in them the Central Bank aims at increasing or decreasing the reserves of the commercial banks and because the credit structure of a bank is built up on the reserves of a bank, by influencing the reserves the Central Bank can influence the credit activities of the commercial banks. Now this argument proceeds on two assumptions—that there is an active bill market and secondly that the commercial banks are in close and intimate contact with the Central Bank. In Ceylon both are lacking. We do not have a bill market worthy of mention. Even if there is one, it is far too dull to be the means by which the Central Bank could influence the reserves of the commercial Banks. The few bills that exist are largely Government bills; foreign and trade bills being monopolised by the foreign Exchange banks. The amount of bills is also so small that if the Central Bank also starts bidding for them or disposing of them it is bound to have an inflationary or deflationary effect. As Mr. Exter has observed "The market in securities in Ceylon is yet so small that purchases or sales by the Central Bank on any considerable scale would cause wide variations in their prices." So that Open Market operations would be obviously of "limited usefulness." The market in securities has been small because the amount of savings available for investment is small. Another limitation on the development of the market has been imposed by the fact that investors are fearful of the stability and liquidity of the available securities, and because the maturity pattern of Government securities is not complete e.g. there is no security between a 90-day Treasury Bill and the long term securities. In spite of these limitations the Central Bank could help to develop and expand the existing market by trying to "broaden and stabilise the market by preventing or moderating sharp fluctuations in quotations of securities and advise the Government with respect to the maturity pattern for its new issues that will be more attractive to investors."

However without a developed Bill market the efficacy of the Central Bank is bound to be limited. This was in fact one of the reasons (there are many others) why the Reserve Bank of India though established as early as 1934 remained till last year, when the Indian Banking Companies Act was passed, only as a very weak Central Bank. Some of the conditions which impeded the growth of a bill market in India, and which therefore limited the powers of the Indian Reserve Bank, exist in Ceylon today and to that extent will limit the range of activities of our own Bank. For example both in India and Ceylon, foreign trade bills have a very narrow market because they are monopolised by the foreign Exchange Banks. Again both in India and Ceylon the domestic bill market is small and both countries lack a community of bill brokers. Discounting is done directly by the commercial banks without the intermediary of a bill broker. This practice not only does away with the bill brokers but also prevents the development of a proper bill market. While it is held that the absence of bill brokers prevents the development of a bill-market it may also be argued that absence of a bill-market prevents a rise of a community of bill brokers. It is in fact both cause and effect. But in a sense our Central Bank had greater powers than many other Central Banks as for example the authority to issue its own obligations which, in the words of the report "supplies a weapon that is missing from the armoury of most other Central Banks."

The second assumption on which the earlier argument that a Central Bank is in a position to influence the commercial banks by influencing their reserves was based, was that the commercial banks are dependent on the central bank particularly in time of a crisis when the Central Bank would be called upon to assume one of its traditional roles as lender of last resort. In Ceylon this assumption is again not likely to hold good; for the simple reason that the foreign banks are only the local branches of giant international concerns—" local tentacles of giant international octopi "—and have maintained larger reserves than they would normally require. In times of crisis or in the event of need, funds could easily be obtained from their head offices. Also these foreign banks have been in the habit of co operating among themselves so that the needs of one bank could easily be met by the surplus funds of another. In which case these banks need never approach the Central Bank and how then could the Central Bank control their credit activities.

With regard to the relationship between the Central Bank on the one hand and the Commercial Banks on the other, which the Monetary Law Bills seeks to establish, it must be pointed out that the Central Bank cannot coerce a commercial Bank into lending to anybody or in a particular direction. So that they would continue to operate in the most profitable trade—viz. our foreign trade. In this connection it has been suggested that the Bill should empower the Central Bank to compete with the commercial Banks in their own sphere of activities and force the commercial Banks to search for new fields of investment and in particular, force, through competition, to make them fill the investments lacuna in our local economy. There is much to commend in this suggestion but the Central Bank with its limited resources cannot obviously compete with such financial colossi as these international banking organizations. Logically then, having realised the importance of an efficient and co-ordinated banking system for the best economic development of a country, one is led to the conclusion that these banks, which have exerted a stranglehold on our economy, should be nationalised. But nothing seems to be further from the mind of the author of the Bill. It may be pointed out that, the Indian Government realising the important position occupied by the Mercantile Bank of India in the Indian economy, plans are a foot to take over control of this bank.

A brief reference must also be made regarding the relationship between the Central Bank vis-a-vis the Government that the Monetary Law Bill which is based on the Exter Report, seeks to establish. While in the past, Central Banks were largely private institutions, the gradual evolution of Central Banking has shown beyond all doubt, the tremendous influence that a Central

Bank can exert on the economic activities of a nation. This has led to increasing control of the activities of the Central Banks by their respective governments. For example, the Bank of England established in 1694 as a private bank was nationalised in 1946 by the Labour Government, even though for quite a long time this bank had ceased to operate for considerations of profit, and act only in the national interest. Again the Reserve Bank of India established in 1934 as a private shareholders' bank was nationalised in 1949. Our own Central Bank is a state controlled bank and the state has provided its Capital of Rs. 12 Million. The ideal relationship which should subsist between the Government and the Bank is that each should have a mutual consideration and sympathy for the views of the other. The Government should realise the fact that at the Head of the Bank are financial experts—("the Governor should be a man of recognised and outstanding competence in an understanding of the economic and financial problems of Ceylon and of unquestioned integrity and responsibility" and "should have actual financial experience")—experts who can be relied upon to act in the national interest alone. The Bank likewise should advise the Government in monetary and fiscal policies and view its needs with sympathetic consideration. "The ideal" as Mr. Exter says "is continuous and constructive co-operation."

However in the event of a lack of such "continuous co-operation" or in the event of any disagreement between the Government and the Central Bank authorities who is the ultimate authority ? This has now been definitely settled by an amendment which the Finance Minister moved in the House of Representatives—an amendment to Clause 115 which states "partly in the event of any difference of opinion between the Finance Minister and the Monetary Board......the Minister of Finance and the Board shall endeavour to reach agreement. If the Minister of Finance and the Board are unable to reach agreement......the Government accepts the responsibility for the adoption by the Board of a policy in accordance with the opinion of the Government and direct that such a policy be adopted by the Board."

It is important to analyse the implications of this amendment. It will be seen that the fundamental point in the whole amendment is the need for agreement. It is only in the absence of this agreement that the Finance Minister could issue the directive to the Board. In normal times there is no reason to doubt there will be agreement between these two authorities. Even if an immediate agreement could not be reached, there is nothing to fear as in all probability a compromise may be achieved. But what if it were a time of national financial crisis ?

Let us suppose discussion takes place as indeed it must if agreement is to be reached. In the event of failure to reach an agreement further discussion perhaps will be called for: and it is only in the absence of agreement after such careful deliberation that the Finance Minister's directive will be issued. The point is that discussion takes time, and time is an important consideration in times of crisis—particularly financial. A remedy suitable in the initial stages may be totally inadequate as the crisis deepens. More drastic measures will be called for. If in any case agreement is reached—well and good. But in the absence of this and in the event of the Finance Minister's directive being issued, the Monetary Board will be called upon to pursue a policy and a course of action with which they totally disagree and to which they are opposed. For had there not been this opposition, an agreement would have been reached earlier, obviating the need for a directive to the Board. The paradox of this is that the very people who oppose a particular policy would now be called upon to implement a policy with which they are in entire disagreement. Would it be unreasonable to expect then, that however honest and conscientious the members of the Monetary Board may be, that they will lack the necessary determination, promptness and foresight, which are all so necessary to nip the crisis in its bud ? On the other hand would it not have been better, now that the definite superiority of the Government over the Monetary Board has been expressed in categorical terms, to have incorporated the provision made in the Bank of England Nationalisation Act of 1946, empowering the Treasury to give directions to the Bank of England *from time to time* which is very different from what our own Act provides. In any case there should be no room for the Central Bank authorities to adopt an intransigent attitude, or to permit them to be on a par with Governmental authority. For if that were permitted there is always the protentiality of a crisis developing in the event of disagreement between the two. For e g., it is well known that after the First Great War when Sir Montague Norman was at the head of the Bank of England, Sir Montague was anxious to see the international stability of the £ maintained, while the Labour Government then in power wanted the maintenance of full employment even at the expense of sacrificing the £'s international stability. These differences were resolved only after a major political crisis in which the Labour Government was replaced by a Coalition Government.

In spite of the shortcoming of the amendment as we have endeavoured to show, it is therefore a step in the right direction.

These then are significant and valid limitations on the activities and functions of the Central Bank, and it certainly will be interesting to see how far these limitations will be overcome when the Bank starts functioning under Mr. John Exter, who has been endowed with the responsibility of implementing his own recommendations. Seldom has this been done. It is perhaps easy enough to criticise an existing system and recommend changes: but to implement the recommendations that one has suggested oneself, is much more difficult, and we look forward with optimism to the contribution that this new institution could make to our economic progress.

However an analysis of the Central Bank will perhaps not be Complete with a survey of its limitations only, as we have done so far. We shall accordingly refer very briefly to the merits of this excellent Report. The emphasis has been laid on the limitations in the belief that limitations are not by-passed by an over-emphasis of the Report's merits. To a consideration of there merits we shall presently turn.

The Monetary Law Bill is undoubtedly a tremendous advance on the monetary and currency system that existed prior to it. The report itself is an excellent document and the Bill has been well drafted with many directives to the Monetary Board. Two of the most far-reaching recommendations are the establishment of the Department of Bank supervision and the Department of Economic Research.

Article 28 (1) states the Department of Bank supervision will be established for purposes of "Continuous supervision and periodical examination." Both these are novel in Ceylon, for the existing banks have never been supervised and controlled, and such supervision and control are essential to maintain the confidence of the people in the banks, and also prevent the public from being the victims of mismanagement and bank failures. The recent failure of Exchange Bank of India and South Africa would perhaps not have occured had there been a proper supervision and control of these banks. The new Department will examine the books and accounts of every Commercial Bank in Ceylon, and report the results of such examination to the Governor of the Central Bank. In case of a possible bank failure the Monetary Board can suspend the activities of the Bank so threatened. The establishment of this Department will than have at least two healthy effects (1) the activities, assets, liabilities etc. of these Commercial Banks which have hitherto been a closed book to us will no longer be so and one could be able to gauge the extent and value of their operations. (2) It will undoubtedly help the evolution of a healthy banking system and "a sound banking system is essential to healthy economic development."

The Department of Economic Research is no less important. Indeed its importance cannot be over-emphasised. Its business will be to "prepare data and conduct economic research, for the guidance of the Monetary Board and the Governor in formulating, implementing, and executing policies and measures and for the information of the public in the subjects of money and banking and other economic subjects of general interest" Section 25 (1). A perennial complaint among those interested in administration and the policy-makers, is the dearth of up to date statistics "which are essential to guide aright the ship of state" (as the Director of Statistics once said). Mr. Exter himself says "it is hoped that the Central Bank will be able to demonstrate to Ceylon how much a properly organised and adequately supported research unit can contribute to the formation of policy. It may not be too much to say the solid achievements of the Central Bank in years to come will depend as much on the successful development of this department as upon anything else."

Apart from the direct supervision as exercised by the Department of Bank Supervision, the Central Bank has other means of controlling the activities of commercial banks, as for example:—

(a) The Central Bank can determine the minimnm rate at which commercial banks can buy Spot Exchange and the maximum rate at which they sell Spot Exchange. (Section 75) further every commercial bank will have to report daily its purchase and sale of foreign Exchange.

(b) Monetary Board prescribes the reserve ratios of commercial banks (92—96).

(c) The Board can fix the maximum rates of interest for loans of different type made by commercial banks.

(d) The Board can prevent commercial banks from increasing the amount of their loans and investments and prescribe limits (100).

Further the Bank will help channel the savings of the community into worthwhile investments, assist in the creation of a market for Government securities, introduce a more efficient handling of the public debt and of public finances by being the Government's fiscal agent, banker and adviser. By directing the savings of the nation and providing good securities it would help the agricultural and industrial development of Ceylon, stimulate a diversification of our economy and make it more adaptable to changing economic conditions abroad.

These are some of the main provisions, and they give an idea of the extensive control that the Central Bank will wield in the financial and economic world. If the powers are extensive it is also clear that any error or mistake made by the Monetary Board will do untold damage to our banking and financial and therefore our economic interests. Both the will and the skill are necessary: but with a judicious combination of caution and understanding. In the ultimate analysis then much will depend on the human element—the personalities on the Monetary Board and indeed as Mr. Exter says "good banking is less good law than good practice."

In conclusion, though the establishment of a Central Bank has been hailed as the harbinger of our economic freedom, as a counterpart to our political freedom the limitations to its effective operations as shown above, belie these optimistic anticipations. Though, in our present economic context, the Central Bank would be but an expensive luxury, yet it cannot be denied that its establishment is a step in the right direction, and under proper management, it is bound to make a lasting contribution to our economic progress as a free nation and to help in the "fuller use of the nation's human and material resources and a rising standard of comfort for all."

WALTER LADDUWAHETTY.

The Economics of Rupee Devaluation

This article is the text of a series of lectures delivered at the University immediately after devaluation, consequently the figures of exports and prices quoted were those prevailing at the time, any alteration would merely detract from the value of the article. The intention of the author was to explain the technicalities of devaluation and more the consequences especially on Ceylon in relation to foreign trade and standard of living; as such the value of the unaltered text is never more important than after an year or more when the full effects of devaluation have been unveiled.—Ed.

After much hesitation and influenced no doubt to a great extent by American pressure, both political and economic the British Government devalued the Pound Sterling in terms of gold by 30.5%. Hence its value in terms of the U. S. dollar which retains its previous gold value, has depreciated by an equal percentage. Ceylon too, happily pursuing a policy of "follow my leader," promptly slashed the value of the rupee by 30.5 % of its dollar equivalent. The purpose of this article is to examine the effects of devaluation of the rupee firstly on Ceylon's economy as a whole, secondly on the different income groups in the Country, and finally to consider whether the rupee devaluation was a measure justifiable not only from purely economic considerations, but also from the point of view of equity and social justice.

As a result of devaluation the exchange rate between the rupee and the dollar has been altered from Rs. 1 = 30.2 (U S cts) to Rs. 1 = 21 (U.S cts.) $ 1 = Rs. 3.80 to Rs. 4.76. In concrete terms this means that an article in Ceylon which costs Rs. 1 could be bought by an American for 30.2 cents (U.S.) before devaluation. Today he pays only 21 cents (U.S.) for the same article which still costs Re. 1 in Ceylon. It also means that today we in Ceylon have to pay Rs. 4.76 for an article which costs $ 1 in America, while before devaluation the same article still priced at $ 1 could be bought by us for Rs. 3.30. Thus, if we assume that internal prices in Ceylon and America remain unaltered, (this is not a valid assumption as will be shown later) then the effect of devaluation is that Ceylon goods will be 30.5% cheaper to Americans and American goods 44% dearer to Ceylonese. This same result could also be stated in terms of the change in the *External* purchasing powers of the two currencies. Before devaluation a dollar bought Rs. 3.30 worth of goods while today it buys Rs. 4.76 worth of goods in Ceylon—i.e., 44% more goods. Similarly it will be seen that a rupee now buys 30.5% less goods in America. With respect to the other countries too which have *not* devalued the same situation will obtain. The Pakistan rupee and the Swiss franc for instance will buy 44% more commodities in Ceylon, while our Rupee will buy 30.5% less of their products. Countries which have devalued their currencies by less than 30.5%, would find our goods cheaper while their products would be more expensive in Ceylon. The exact degree would depend on the extent of devaluation. For instance, the Western German Deutsche—Mark has been devalued by 21.4%. Hence we will be paying 13.3% more rupees for their goods while they will pay 11.8% less marks for ours. Finally there is the 3rd group of countries—consisting chiefly of the sterling area with the exception of Pakistan and Canada—which have devalued their currencies to the same extent as Ceylon. In this case the pre-devaluation exchange rates between the currencies of these countries remain unchanged. An Australian, for instance, would still have to pay the same amount of pounds (Australian) as before for an article in Ceylon. And a Ceylonese would be no better or worse off in buying Australian goods than before. It must again be emphasized, however, that this analysis of the change in the *external purchasing powers* of the various currencies after devaluation in terms of exact percentages is based on the assumption that the prices of the various commodities in these countries (i.e. the internal purchasing power of their currencies) remain the same. For, we cannot say, that since a dollar will now buy 44% more rupees than it did before, it will also buy 44% more Ceylonese goods, unless we assume that a rupee buys the same amount of goods in Ceylon as before. (i.e. that the internal purchasing power of the rupee is the same). If a rupee now buys less goods in Ceylon (i.e. if prices in Ceylon have risen), then the increase in the purchasing power of the dollar in terms of Ceylon products will be proportionately less than 44%. Or again if prices in the U S. fall, then the decrease in the purchasing power of the Ceylon rupee in terms of U S. goods will be less than 30.5%, although the decrease in terms of the U.S. dollar is still 30.5%. The Australian £ would still buy the same amount of goods in Ceylon as before and our rupee would be no better or worse off in buying Australian goods.

What then is the significance of the devaluation of the rupee for Ceylon's economy? We will consider the effects of devaluation first on our exports to the U.S., next, on our imports from the U.S. and finally on our trade with the Sterling Area. The immediate effect as we saw above would be the cheapening of our goods to America and the other countries which have not devalued, and also to Belgium, Western Germany and others which have devalued to a lesser degree than Ceylon. This obviously

would increase the demand of these countries for our exports and consequently raise the rupee prices of these exports It is the extent of this increase in the prices of our exports which is the measure of the beneficial effects of devaluation on our economy. For the economic worth of devaluation to Ceylon lies not in increasing our exports at existing prices, but in increasing those prices without reducing the exports. Ceylon does not have an export problem in the sense of an exportable surplus at existing prices. In fact at existing prices we are exporting all the rubber and Tea we produce. Our problem is to increase the prices of these exports.

In the case of rubber the price has risen from the pre-devaluation figure of 55 cts. per lb.—i.e., $16\frac{1}{2}$ (U.S. cts.) at the old exchange of Re. 1 = 32 (U S. cts.), and although it is still fluctuating it may be expected to stabilise itself at about 68 cts. per lb.—ie., 14 (U.S. cts) at the new exchange rate at Re. 1 = 21 (U.S. cts.). We cannot expect to reap the full benefits of devaluation in the form of a 44% increase in the price of rubber —ie., 79 cts. ($16\frac{1}{2}$ U.S. cts) at the new exchange rate because the fact that America can restrict her purchases of natural rubber and fall back on her synthetic industry gives her the controlling voice in determining the price of rubber. (And) she has naturally seized this opportunity to lower the *dollar price* of rubber from $16\frac{1}{2}$ to 14 (U.S. cts) A further problem which immediately crops up is; what would be the effect of this lower dollar price of rubber on the total dollar value of the rubber exports? If our rubber is to earn the same amount of dollars as before then obviously American imports of our rubber must increase by an amount sufficient to balance the $2\frac{1}{2}$ cts. (U.S) fall in the price of a lb. of rubber. In considering this problem we have to take into account what is technically termed the elasticity of American demand for our rubber. This is a measure which relates the increase in demand to the fall in price. We can then state our problem as follows: Is the elasticity of American demand for our rubber such that the 15% ($16\frac{1}{2}$—14 cts) fall in the price of rubber to U.S. Consumers will increase their demand for it by 15%? For it is only then that the fall in price will be sufficiently offset by the increase in quantity bought so as to leave the total dollar value unchanged. Here we have to take two facts into consideration. (1) This fall in the dollar price of rubber would apply equally to Malayan and Indonesian rubber since those countries too have devalued their currencies to the same extent as Ceylon. Consequently, any increase in American demand due to the lower price would be distributed between all these rubber producing countries. And if the distribution of U.S. Consumption between these countries before devaluation—when Malaya supplied 62%, Indonesia 15% and Ceylon only $7\frac{1}{2}$% of U.S. imports of natural rubber—is any indication of the distribution of her increased consumption after devaluation then Ceylon's share in this increase is obviously bound to be very small. (2) The restrictions imposed by the U.S. Government on the consumption of natural rubber will severely limit the increase in American demand for this commodity. Hence, the prospect of a 15% increase in the demand for Ceylon rubber does not seem, to say the least, very bright.

More or less the same analysis is applicable to Ceylon's tea and other exports to the U.S. The rupee prices of these commodities will rise and as we saw before, this is one of the beneficial effects of devaluation. But, as in the case of rubber, their prices will not rise by the full extent of the appreciation of the American dollar (44%) and therefore the *dollar prices* of these commodities will fall. We have therefore again to pose the same question as to what would be the effect of these lower dollar prices on the total dollar value of these imports. Is the elasticity of American demand for these products such that the increase in demand consequent on the fall in prices, is sufficient to offset this decrease in prices and so leave the total dollar value unchanged? Here again, the fall in the $ price of tea; for instance, would apply equally to Indian tea. And since American imports of Ceylon tea is but a fraction of her import of Indian tea, only a small amount of the increased American demand will accrue to Ceylon. Another important factor in the situation is the attempt of Allied headquarters in Tokyo to increase Japanese tea exports to America as one of the means of revitalizing the Japanese economy and thus making her a bastion against Communism in Asia. This may mean some sort of preferential treatment for Japanese tea, in the form of high import duties on tea from other countries and restriction of imports from those countries by means of import quotas. Here as in the case of America's careful fostering of her synthetic industry, we see the importance of political factors. Any analysis of an economic problem in terms of maximum economic advantage is bound to be misleading. For a thorough understanding of such problems they must be placed not only in their economic setting, but also in their political context. Taking into consideration the impact of all these forces, both political and economic, we cannot be too optimistic about the dollar value of our exports to the U.S. increasing or even remaining the same. There is still another factor we have to consider which should make us even still more pessimistic about any increase in the dollar earning capacity of our exports. This is the effect of devaluation on industrial production and consumption in America. As will be shown later our imports from America will decrease as a result of devaluation, we have now to pay more for U.S goods than before. There would be a similar reduction in imports from U.S. by all the other countries which have lowered the value of

their currencies in terms of the dollar. The net effect of this slashing of imports from America on American industry, employment and income will be considerable, and the present trade recession in America will be considerably aggravated and may even become a major depression. In addition, export of American capital, encouraged by devaluation of Sterling area currencies will have a deflationary effect. Before devaluation it was estimated that production and consumption in America will be 10% below that of last year. After the fall in American exports and the consequent decline of American incomes the decline in the production and consumption will be very much more than the estimated 10%. In concrete terms this means that the U.S. demand for Ceylon's rubber will be adversely affected because U.S. consumers such as automobile manufacturers who buy a large part of our rubber exports to America will curtail their purchases due to the declining foreign and home markets for their manufactures. Again U.S. consumers when they find their incomes falling will reduce their expenditure and this will react adversely on the American demand for our tea. The odds therefore seem to be heavily against an increase in the American demand for our exports sufficient to offset the fall in their dollar prices and in all probability therefore the dollar value of our exports will fall. The above analysis disposes of one of the main arguments for devaluation i e., that the dollars earned by our exports would increase due to the devaluation of the rupee.

What would be the effect of devaluation on our imports from America? There are two aspects of this question which we must consider. (1) The effect of devaluation on the dollar prices of American goods and on the rupee prices which we have to pay for these goods. (2) Its effect on the quantity of our imports from the U.S. As we saw earlier an article which is priced at $1 in America would now cost Rs. 4.76 while before devaluation we had only to pay Rs. 3.30 for it. Therefore, if American prices remained unchanged (this was an important qualification we emphasized above), a Ceylonese would have to pay 44% more rupees for the articles he buys from America, But U.S. prices will not remain at their pre-devaluation figure. There will be a number of forces tending to drive them down. If, for instance they did not fall, Ceylon and also all the other countries which have devalued to the same extent as Ceylon would find their imports from America 44% dearer. The net effect of this would be a substantial decrease in the demand for American goods and therefore a decline in industrial production, employment and incomes in America. If she is to moderate the force of this economic recession she will have to lower her dollar prices in order to make her goods competitive in the world market. On the other hand, if she does not lower her prices and exposes her economy to the full blast of the depression, then the resulting fall in American incomes would reduce American consumption. This lower demand for the products of American manufacturers would lead to a fall in the prices of these products. So that in any case American prices are bound to fall as a result of the devaluation of the currencies of the countries which bought her goods. Secondly, we saw that although the rupee price of Ceylon rubber had increased from 55 to 68 cts., the dollar price of this rubber fell from 16½ to 14 cts. (U.S.). This reduction in the dollar price applies not only to Ceylon's but also to Malayan and N.E.I. rubber. The 2½ cts, (U.S.) reduction in the price which American tyre manufacturers have to pay for a lb. of raw rubber would lower their costs of production and therefore in order to compete in the world market they could lower the dollar price of tyres without incurring much loss. This applies to all American manufacturers which use raw materials imported from countries that have devalued their currencies. For in all these cases costs of production would fall because the dollar prices which American manufacturers now pay for these raw materials is less. The fall in U.S. prices means that although imports from America would still be dearer to us, the increase in the rupee prices we pay for these goods would be less than 44%. For instance, for an article which cost $1 in America we paid Rs. 3.30 before devaluation and if the American price after devaluation is still $1 we pay Rs. 4.76 for this article. But, after devaluation the American price of this article will be lowered due to the various causes mentioned above. Suppose the price of this article in America falls to 90 cts. (U.S.). The post-devaluation rupee equivalent of this is Rs. 4.28. Hence the increase in the rupee price after devaluation is from Rs. 3.30 to Rs. 4.28 i.e., 30%, while if the price of that article did not fall to 90 cts. but remained at $1 the increase in the rupee price after devaluation would be from Rs. 3.30 to Rs. 4.76 i.e., 44%. The fall in American prices therefore will be a factor which mitigates the adverse effects of devaluation on the rupee prices of our imports from America. But it will only soften the impact of devaluation on these prices, and not completely eliminate its adverse effects. In short, we will have to pay more now for American goods, but how much more will depend on the extent by which the U.S. prices of these goods fall.

In considering the second aspect of the problem i.e., the effect of devaluation on the total quantity of our imports from America, an important factor which must be taken into account is our recent agreement with Britain to restrict our purchases from America by 25%. This 25% is only the *compulsory* lower limit: for Britain will certainly not grumble if we *voluntarily* restrict our imports from America by more than 25% and contribute the dollars we save thereby to the dollar pool. If we do so

it will not be due to the altruistic motive of helping Britain out of her difficulties (for our difficulties are as great as her's), but because the increased rupee price we have now to pay for these imports will reduce our demand for them. Whether this voluntary reduction will be more than 25% will depend on a complex of factors; viz., the extent of the increase in the rupee price of these imports, the type of goods we import from America, whether these goods could be easily obtained from other countries at cheaper rupee prices, and finally the effects of the devaluation of the rupee on the incomes of the people in Ceylon who normally buy these goods imported from America. It is difficult to forsee the final result of the implication of these forces on the voluntary reduction of our imports from America. But whatever this result may be, the fact still remains that as a result of devaluation, we have to pay higher prices for American goods. To appreciate the full significance of the adverse effects which this would have on our economy, it is necessary to consider the type of goods we import from America. The table below gives the more important commodities we imported from America in 1948, the 2nd and 3rd columns have been included to show our dependence on America for these particular goods.

Imports from America in 1948

Commodities	Value of imports from U.S. in Rs.	Value of total imports from all Countries	Value of U.S. imports as % of value of total imports
1. Cotton Piece Goods	33,543,283	113,413,515	30%
2. Tea & Other Chests	6,997,577	11,770,245	60%
3. Machinery	6,324,202	23,297,638	27%
4. Preserved Milk & Milk Foods	5,434,432	16,613,492	33%
5. Drugs & Medical Preparations	1,578,369	5,284,203	30%
6. Total	75,414,215	170,379,093	

An examination of the above table shows that we have to consider the effect of the rise in the rupee prices of American goods, firstly, on the capital development of the country; secondly on the cost of production in Ceylon and finally on our cost of living. With regard to the 1st of these we see that 27% of our total imports of machinery are imported from America. A superficial analysis would lead us to expect that as a result of the rise in the prices of these goods, a good portion of these imports would now be replaced by imports from countries which have devalued their currencies to the same extent as Ceylon and whose prices therefore to us would be lower than the American prices. For instance, if before devaluation, a machine is priced at $ 4030 in America and a similar machine costs £1000 in Britain, we could buy either of these machines for Rs. 13,333 (since before devaluation $4030 = £1000 = Rs. 13,333). If after devaluation the price of this machine in America and England remain the same i.e., ($4030 and £1000 respectively), we would now have to pay Rs. 19,183 for the American machines (since $ 1 = Rs. 4.76 and not Rs. 3.30 as before devaluation), while we would still be paying Rs. 13,333 for the British machine (because £1 still = Rs. 13.33). The price discrepancy between British and American machinery after devaluation would however not be so great as the above example suggests. For we have assumed that before devaluation British prices for machinery were competitive with American prices i.e- in other words whether we bought the British or the American machine we would pay Rs. 13,333. But this is not so for British prices were very much higher than American prices. Suppose the British price of this machine was not £ 1000 but £1150 (Rs. 15,333)—i.e., on the very moderate estimate that British prices were only 15% higher than American prices before devaluation. Again we have assumed above that after devaluation the prices of this machine in England and America will be the same. But we saw above that devaluation will result in a lowering of American prices.—Suppose the price of this machine in America falls from $ 4030 to $ 3500 (i.e. 13% fall). Just as devaluation increased the price of our tea and rubber it will similarly increase prices of British exports—Suppose the price of the machine rises from £1150 to £1208 (i.e. 5% rise). Then the prices of this machine after devaluation are—American machine $ 3,500 (Rs. 16,660) and the British machine £ 1208 (Rs. 16,106), and the di cepancy is only Rs. 554. As against this small advantage in buying from Britain there is the bigger disadvantage that the delivery of British machinary is notoriously slow. The above figures were purely hypothetical, but it is the percentages that are important and if there is any error in estimating these percentages, it is certainly in favour of Britain. A more rigorous estimate would even lead us to the ultimate result that even after devaluation the American machine was cheaper than the British. The importance of the above analysis is that the increase in the rupee prices we have to pay for American machinery will not lead to a *transference* of our demand for this machinery from America to Britain, as a superficial examination would lead us to expect but would lead to a reduction in our total import of machinery. In other words, the effecting devaluation is not that we would now be buying from Britain the machinery we bought before from America, but that we would buy less machinery both from America and Britain. There is no need to elaborate on the retarding effect which this reduction in the import of machinery will have on the capital development of the country.

The effect of the rise in the rupee prices of American goods on costs of production in Ceylon, will be again measured by the rise in the prices of its machinery used in our tea, rubber and other factories and also by the rise in the price of tea chests imported from America. In this context may also be considered the increase in the rupee prices of fertilizers imported not only from the U.S. but also from the other countries which have not devalued their currencies or done so by a lesser amount than Ceylon (because the rupee prices of their products too would rise on the basis of the same analysis as in the case of America). Fertilizer imports from these countries amounted in 1948 to Rs. 10,794,239, which is 40% of our total of fertilizer imports from all sources. The net effect of the rise in the prices of all these imports on our costs of production would be by no means small. Finally, the increase in the cost of living of the working and middle classes would be determined by the rise in the prices of the cotton goods, milk foods and medicinal drugs we import from America and also by the importance of these commodities in the consumption pattern of these classes.

We can now sum up the effect of devaluation on our economy in so far as it affects our trade with America. One of the main arguments of the protagonists of devaluation is that now we are getting higher prices for our rubber and other imports. On a superficial analysis one might be inclined to agree that this is one of the beneficial effects of devaluation. But we shall see later in the argument, Ceylon may have been better off with lower prices and non-devaluation rather than with the higher prices we receive after devaluation, because the adverse effects of devaluation are such as may wipe out any benefit that might accrue to our economy due to the higher prices of our exports. But even on the basis of the discussion so far we see that the beneficial effects of devaluation on the prices of our exports would be offset to some extent by their increased costs of production. The other argument which has been advanced for devaluation in so far as it affects our trade with America is that it will increase the dollar value of our exports and these extra dollars which we will now contribute to the dollar pool would help to easen the dollar crisis for Britain and the other Sterling area countries. But, on the contrary, our analysis has shown the magnitude of the forces operating to reduce the dollar value of our exports. On the debit side of the balance sheet are, the retardation and possibly the complete cessation of the Capital development of the country, the increase in the costs of production and the rise in the cost of living.

What would be the effect of devaluation on our economy in so far as it affects our trade with those countries which have devalued to the same extent as Ceylon? This group consists mainly of the Sterling area countries with the exception of Canada and Pakistan. Superficially, it would appear that the position would be the same as before because our rupee exchanges with these currencies at the same rates as before. But this is to make the unwarranted assumption that the fundamental change which is taking place in the pattern of world trade as a result of devaluation, will not affect the commercial relationship between the member countries of a group which plays a very important part in that trade. Devaluation would have two repercussions on trade within the Sterling area. (1) It would increase the *internal* prices of the goods of the Sterling area countries. (2) It would increase the demand of these countries for each others goods because they would all be now curtailing their imports from the countries which have not devalued to a lesser extent than 30 5%. The combined effects of these two forces on Ceylon's trade with the Sterling area would determine whether devaluation will have any beneficial effects on Ceylon's economy. Regarding the 1st of these factors, we have seen that devaluation has increased the prices of our exports. There would be a similar increase in the prices of the exports of all the other countries which have devalued to the same extent as Ceylon. But their exports are our imports. Hence, not only will the prices of our exports to the Sterling area increase but also the prices of our imports from the Sterling area will rise. Therefore, whether devaluation, in so far as it increases the prices of goods of the Sterling area, is beneficial to Ceylon depends on whether the increase in the prices of the goods we export to the Sterling area is more than the increase in the prices of the goods we import from the Sterling area. To asses the effects of devaluation therefore we must see what forces would be working to raise prices in the other Sterling area countries and whether these forces would be powerful enough to raise the prices of their exports by an amount greater than the rise in the prices of Ceylon's exports. If it could be shown that the rise in the prices of their goods (i.e. our imports) is greater than the rise in the prices of our goods, then devaluation is certainly detrimental to the exports of our economy. For there is no point in getting more for the rubber and tea we sell if we have to pay still more for the rice, flour, currystuffs, textiles and manufactures we buy. In analysing this problem we shall limit ourselves to England, Burma, India and Australia, from whom we import over 75% of our total imports from the Sterling area. Let us first consider the rise in the price of manufactured articles we buy from England. There are two forces operating which will raise the price of British manufactures: (1) The increase in the demand for these goods, due to other countries restricting their purchases of American manufactures and diverting a part of that demand to British manufactures. The increase in the price of raw materials used in British manufactures—rubber, copper, tin, zinc, aluminium etc; will also contribute to raise the prices of these articles. What would be the increase in the price of Burmese rice? Here an important consideration is the recent decision of the I.E.F.C. to suspend allocations of rice to consuming countries. The rationing of rice supplies to consuming countries was necessary to keep the price down, since demand was far in excess of supply. But once rationing is suspended the laws of supply and demand will come into operation and the price will shoot up. Certainly this is not an effect of devaluation but of the international de-rationing of rice, but the point is that since we have devalued we will have to pay more for our rice when Burma raises the price whereas if we had not devalued along with Burma, Burmese rice while it was rationed would have been 30.5% cheaper and even after it is derationed unless the Burmese price increases by 30.5%, the rupee price of rice would have been still lower. Devaluation too would have its effect in raising the price of Burmese rice because here again there would be a diversion of demand to Burma from Siam, which has devalued by a lesser extent than Burma. Our chief imports irom India are cotton goods, currystuffs and dryfish, and from Australia flour, milk foods and meat. The increase in the price we have to pay for these commodities is largely determined by the fact that in all these cases our alternate sources of supply are countries which have not devalued their currencies. For instance if the price we have to pay for American cotton goods increases by 40% after devaluation, then India could raise the price of her cotton goods by even as much as 35% and we would still have to buy from her because her price would be relatively cheaper. In the case of curry stuffs and dry fish the alternate source of supply is Pakistan which again has not devalued her currency, Australia too has a similar monopoly advantage with respect to her export of flour and milk goods because her competitors are America and Canada. And with regard to her meat exports her rival was Argentine which has adopted the Schactian policy of fixing different exchange rates for her various exports. Where she felt that her exports would meet competition she has lowered the exchange rate of her currency by as much as 47%, while in the case of those exports such as meat where she was safe from foreign competition she has maintained the same exchange rates. In effect what this means is that Argentine has not devalued her currency so far as her meat exports are concerned. We are now in a position to sum up the effects of devaluation on the prices of the goods we buy from England, Burma, India and Australia. These prices will rise due to the increase in demand for their goods, the increase in costs of production, and the monopoly advantage they have due to the fact that the alternative sources of supply of the goods we buy from them are chiefly countries which have not devalued their currencies. On the other hand there is only one force tending to drive our prices up—i.e., the increase in the demand for the products we export. And even this increase will be only in the demand of America and the countries which have not devalued, and not as we shall see presently in the demand of the countries in the Sterling area. Further even the increase in American demand for our rubber and tea would be greatly limited by the political considerations discussed above. As for any monopoly advantage increasing our prices, there will be none for the alternative sources of supply of tea and rubber are India, Malaya and Indonesia, which have all devalued their currencies. So that on balance it is fairly obvious that the rise in the price of our imports from the Sterling area will be very much more than the rise in the prices of our exports to this group of countries. And the extent of the difference between the increase in the prices of our imports from and exports to the Sterling area is a measure of the adverse effects of devaluation on our economy in so far as it affects our trade with the Sterling bloc.

The 2nd effect of devaluation on trade within the Sterling area, would be an increase in the demand for each others goods because of decreased imports from the countries which have not devalued or devalued by less than 30.5%. But would this be true of Ceylon's exports to the rest of the Sterling area? For instance will the increased prices which Britain has to pay for imports from America and the other countries which have not devalued to the extent that she has, direct the British demand for tea and rubber to Ceylon? We have only to pose the question to realize its absurdity. For Britain will not transfer her purchases of tea and rubber from America and these other countries to Ceylon for the simple reason that before devaluation she was not buying her tea and rubber from these countries but from India, Malaya, Indonesia and Ceylon. And since these other countries have devalued by as much as Ceylon, there would be no transference of purchases from them to Ceylon. On the contrary there may be a decrease in Britains total purchase of tea and rubber due to the higher prices she has now to pay for these commodities and a part of this reduction would fall on Ceylon's exports of these commodities to Britain. In the case of the other Sterling area countries too a similar position would obtain. They will not increase their purchases of Ceylon rubber and tea because none of them were buying their rubber and tea from the countries which have not devalued. While on the contrary they may actually reduce their consumption

of Ceylon Tea and rubber of their higher prices. In the case of our coconut and coconut products, however, there will be an increase in demand due to the diverting of purchases from the Phillipines which has not devalued. But there would be a counteracting influence in so far as the other Sterling area countries reduce their total demand for coconut and its produce.

To sum up, the effects of devaluation on our economy in so far as it has affected our trade with the rest of the Sterling area, are that the increase in the price of the goods we sell and due to these higher prices our exports to the Sterling area and our imports from it will decrease. The combined effect of this rise in the prices of imports and the reduction in their quantity will again impede economic development of the country, increase the cost of production and the cost of living. We could also now meet another of the arguments that has been advanced in favour of devaluation. It is that devaluation by restricting imports, would act as a protective barrier and give a fillip to the industrialization of the country. This would have been true of a country which had already made some progress in the direction of industrialization. But in the case of Ceylon which has to start from scratch and therefore import all the machinery necessary, the increased cost of this machinary would be so prohibitive as to stop any possible industrial development of the country. Moreover, the prospects of industrialization are indeed bleak so long as the Government subscribes to the contention that Ceylon was and shall always be an agricultural country, and that the fair Isle of Ceylon should not be defaced by the smoke and the grime of industrial factories, and that the innocent and complacent village lad should not be corrupted, frustrated and made rebellious by being brought to town.

If this is the net effect of devaluation, why then did we devalue? So far we have analysed the problem only in positive terms—i.e., in terms of the effects of devaluation on our economy. To grasp the problem in its entiety we must now look at the negative aspect of it and examine what the position would have been had we not devalued. Could it not be said in favour of the Government's decision that devaluation was the lesser of two evils? One of the main arguments of the Government for devaluation, as was expressed by the Finance Minister is that since over 70% of our trade is with the Sterling area it was necessary to keep in step with the other countries of that group. Let us again consider the case of imports and exports separately and see what the effect of non-devaluation would have been on them. The effect on our imports would certainly have been beneficial because of the lower rupee prices we would have had to pay for these imports. It for instance American prices remained unchanged we would be paying the same rupee prices for our imports from America, because the rupee would now exchange for the same amount of dollars as before. But we have seen that after devaluation, American prices will fall, and therefore the rupee prices of the goods we import from America would fall too. In concrete terms this means that we would be paying less for American machinery, cotton goods, milk foods and medicinal drugs. Again, if prices in the Sterling area remained unchanged, then these goods wou'd be 30.5% cheaper to us, if we had not devalued. But here again their prices would not remain static but would rise, therefore the reduction in the rupee prices we have to pay for these goods would not be as much as 30.5%. But there would still be a substantial reduction in these prices. This would mean that our imports of machinery and manufactures from Britain, rice from Burma, textiles and curry stuffs from India and flour from Australia would be very much cheaper than before. Therefore while devaluation will retard capital development, increase costs of production and cost of living, non devaluation would give an impetus to the economic development of the country, would lower costs of production and subs antially reduce the cost of living. The benefits on non devaluation in this respect are so patent that we need not elaborate on them any further.

But what would be the effect of non devaluation on our exports. This is the point at which many an argument against devaluation has reached. But let us logically examine the effect of the non devaluation of the rupee on the price of our rubber. Before devaluation Britain was paying us 10*d* a lb. of rubber (10*d* = 55 cts. before devaluation). If Ceylon did not devalue with the rest of the Sterling, then along with the U S dollar our rupee too would have appreciated by 44% in terms of the Pound. If we still wanted 55 cts. for our rubber, this would have been equivalent to 14*d* and obviously the immediate effect would be that Britain would stop her rubber purchases from Ceylon and buy Malayan rubber instead. To get back to the same competitive position as before with Malaya, we would have to offer Britain our rubber at the former price of 10*d*, and 10*d* at the new exchange rate which would obtain if we did not devalue (i.e. £1 = Rs 9.33) would be equal to 38½ cts. Therefore to compete with Malaya we would have to reduce the prices of our rubber from 55 to 38½ cts. It was the scare of this price decline which drove the Government headlong into devaluing the rupee. But in such an analysis an important factor in the situation its everlooked i.e., that the price of Malayan & Indonesian rubber will not remain at their pre ent levels and therefore the price which England will have to pay for their rubber after devaluation will be more than 10 cts After devaluation the price of Ceylon rubber has risen by 24%. A similar increase taken place in the prices of these other rubber producing

countries too. As a result of the 24% rise in price of rubber. Britain would now have to pay more than the 10*d* she paid for rubber before devaluation—i.e , 12½*d*—Therefore to get back to the same competitive position with Malaya and Indonesia, we would now have to offer our rubber to Britain not at 10*d* but at 12½*d*. And this at the new rate of exchange which would prevail if we did not devalue is equal to 49 cts in Ceylon currency. And so with a price decline of only 6 cts. instead of the anticipated 16½ cts. we would be on the same competitive level as before with Malaya and Indonesia. As against this adverse effect of a 6 cts. fall in price, rubber producers would on the other hand reap the benefits of lower production costs and lower costs of living. If we take a more optimistic estimate of the increase in the price of rubber—for instance the former Minister of Commerce and Trade expects the price of rubber to settle down at 80 cts. i.e., a 45% increase—then Britain would have to pay 45% more for her rubber i e., 14.5*d* and so the equivalent of this in Ceylon currency at the new rate of exchange which would prevail if we did not devalue is 56 cts. Thus to compete with Malayan and N E I we need not have reduced our price, but could have actually increased it by 1 cent. A similar analysis holds with respect to our rubber exports to other countries and also with regard to our other exports

A popular misconception of which even our Finance Minister must plead guilty, is that if we did nor toe the line with Britain and devalue our rupee, the value of our sterling balances would have been reduced. It would simplify the exposition if we consider the validity of the above argument, first in terms of the dollar value of our sterling assets secondly, the sterling value of these assets and finally the rupee value assets. Before devaluation £ 70 million lying to our credit in the United Kingdom was worth $ 282 million. As a result of Britain's unilateral action in devaluing her currency (for the Indian Finance Minister stated in Parliament that the Commonwealth Finance Ministers had not been consulted on the matter), she has arbitrarily reduced the dollar value of our sterling balances from $ 282 million to $ 196 (i.e., by the 30.5% by which she devalued). But it is important to realize that the dollar value of our balances would have been reduced by this amount whether Ceylon devalued or not. For the £ 70 million to be worth 30.5% less dollars it was only necessary that the Pound should have been lowered 30.5% in terms of the dollar. Whether the rupee was devalued or not is immaterial. This would have been the case even if our sterling assets were in terms of rupees and not Pounds Before devaluation the value of our £ 70 million assets was Rs. 933 and this was equal to 282 million dollars. When Ceylon devalued with Britain the value of these assets was still £70 mln. or Rs. 933 mln. But the rupee being now devalued with respect to the dollar the Rs. 933 is only equal to $ 196. If Ceylon did not devalue with Britain then the rupee value of the £ 70 million would have fallen to Rs. 653 million (i.e., 30% less). But if we did not devalue with Britain then our currency would not have been devalued with respect to the U. S. dollar—i.e., the rupee would still be worth the same amount of dollars. Hence the Rs. 653 million would be equal to $196 million. Therefore we see that whether the rupee was devalued or not the dollar value of our assets would have fallen to $196 million. This decrease depended only upon Britain's devaluing and for this reason if not for any other it was obligatory on Britain to have consulted us before she devalued her currency.

The other aspect of the argument is that the sterling value of our assets would have been reduced if we did not devalue. This however, is an absurd contention because whether Britain devalues or not or whether we devalue or not the sterling value of assets will be £ 70 million. We could buy £ 70 million worth of goods from England, we can still buy £ 70 million worth of goods and even if we did not devalue the £ 70 million lying to our credit in England would still be £ 70 million and we could therefore have bought £ 70 million worth of goods from her. It is true that after England devalued her prices have risen and therefore the £ 70 million which lies to our credit in England is worth less in terms of British goods—i.e., we can now buy less goods with this £ 70 million than we could have bought before Britain devalued due to the rise in British prices. But the increase in British prices was consequent on her devaluing. Whether Ceylon devalued or not this increase in British prices would have taken place.

The final argument is that if we did not devalue the rupee value of our sterling balances would have fallen. True, if the £70 million which was equal to Rs. 933 million, would only be equal to Rs. 653 mln. if we did not devalue. But this is immaterial from our point of view because these sterling balances are used not to buy goods in Ceylon but to buy goods from England. And the Rs. 653 million which the £ 70 million is now equal to would still buy us £ 70 million worth of goods from England, (because the Rs. 653 million = £ 70 million). Therefore contrary to the popular view, non-devaluation of the rupee along with the £ would not have reduced the amount of goods we could have bought in England or America with our sterling balances. And it is for this purpose of buying goods from other countries and not buying goods in Ceylon that the sterling balance are used.

Finally to round up the analysis it is necessary to consider briefly the effect of devaluation on the various income groups in the community. The increase in the prices of our exports would benefit the producers of tea, rubber and coconut. This group consists of the richer section of the community. Coconut was the only one of these products which was popularly thought to be owned by the middle class man. But the recent report of the coconut commission, where it is stated that only 84% of our total coconut acreage is in small holdings of under 20 acres dispels this notion. This would lead to an increase in the income of this section. But the middle and the working classes will not benefit by these price increases. On the contrary, in spite of the increase in the price of rubber, the wages board for rubber has not been re-established so that whether the benefit of these increased prices will percolate through to the labourers on the rubber estates depends only on the social conscience of the employers. It is hardly fair to leave these workers to the mercy of such a nebulous thing. The rise in the prices of the goods we buy, will however be much more than the rise in the prices of our rubber, tea and coconut exports. But the rise in incomes of the owners of the rubber, tea, and coconut estates will be offset by the rise in the cost of living. It is not possible to forecast whether the rise in their income would be sufficient to offset the increase in their costs of living and the cost of production. So that in spite of their increased incomes, it is doubtful whether on balance they would be better off than they were. But there is no doubt at all that the middle and the working classes would be worse off because their cost of living would rise without any compensating rise in their incomes. Not only, the increase in the price of imports but also the decrease in their quantities would react adversely on these two classes. The price and the decrease in the quantity of imports would mean that more money is now chasing few goods and the rise in the prices of these goods will be very much more than is warranted by devaluation because the middleman in Ceylon would make capital out of the shortage of supplies and make increasingly wide margins of profit. This will start the inflationary spiral which as is well known has adverse effects on the fixed income groups i.e., again mainly the middle and working classes.

What would have been the position if we did not devalue ? To paint the most adverse picture the prices of our exports may have been reduced by a small amount and the incomes of our producers may have been correspondingly lowered. But as against this their costs of production and the prices of the articles they bought would have been lower. Again it is difficult to say whether they would be better off or not. But here again there is no doubt whatever that the economic position of the middle and working classes would have been very much better. The enormous fall in their cost of living without a corresponding decrease in their incomes would certainly make their economic and financial lot a very much better one than it is today. Moreover, the increased capital development of the country would have absorbed a good portion of men for whom no suitable work can be found today.

It is clear from the above analysis that the verdict, from whatever point of view the question is considered, is against devaluation. In spite of the famous injunction of classical economics that the task of the economist ends when he has analysed the issue and pointed out the alternatives, and that the further task of arriving at a decision is the function of the statesman, we cannot in the face of a social injustice of such magnitude, refrain from concluding that the devaluation of the rupee was not only totally unnecessary but also that it is injurious to the economic wellbeing of the major section of the people of the country.

G. V. S. de SILVA.

What is National Income ? *

(From a statement by H. Minc, Minister of Industry and Trade, in a discussion on the National Economic plan for Poland.)

FIRST—the problem of assessment of national income. Let us define the Marxist terminology with regard to the problem of national income. Marxist terminology introduces, first of all, the total or social product, understood as the whole of material goods produced within a year. The total or social product is the sum of gross production of the various branches of national economy. In a symbolic equation the product will be expressed by the formula $C + V + S$, where C represents the value of elements of constant capital engaged in production, that is, the wear and tear of machinery, buildings, raw materials, fuel, auxiliary materials; V the value of elements of variable capital in the process of production, that is, the labour force used; and S the surplus value produced in that period by the labour force.

The first element in our terminology is thus established—the total or social product, which is the sum of gross production of the various branches of national economy. One part of this total product, the constant (C) is used for the replacement of the means of production expended in the process of production, that is, raw materials, fuel and other materials, the wear and tear of machinery, and buildings. The second part of the total or social product, the part produced by work in a given year, or otherwise the new value created in a given year, is the *national income*.

Thus we have the second element of our terminology—national income as part of the total product obtained as a result of work in a given year, as a sum of *new* values created during the year. In the symbolic presentation, national income will be equal to $V + S$. In practice it is possible to assess national income by deducting from the gross production of the various branches of national economy the total material expenditure of these branches and the total of administrative costs.

We shall introduce a third terminological element, namely, the so called net production. We shall not call the new value, produced for instance in the textile industry, the national income of the textile industry; the new value produced by the textile industry will be called the net production of the textile industry. The sum total of net productions of the various branches of national economy will give us the total national income.

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Summing up, we have the total product, or the whole of material goods produced in a given year; *national income, or a new value, created in a given year*; net production, or elements of national income in the various branches of national economy.

After establishing this terminology, let us pass to the problem of the creation of national income. It has been said that national income is the sum of new values created in a given year as a result of work expended during the year. The question arises now—is it a result of expending all kinds of work, and if not all kinds of work, which ? A result of work performed in all spheres of human activities or only in some, and, if only in some spheres, in which ?

National income arises not as a result of expending all kinds of work, but as a result of expending work which is productive in the sense of Marxist political economy. National income results from work expended not in all its spheres, but only in the sphere of material production and material services. The concept of total product and national income in Marxist doctrine refers only and exclusively to the sphere of material production.

What is productive and what non productive work ? Productive work is work in the sphere of material production. Marx defines material production as the direct harnessing by man of goods of nature. Work which is direct harnessing of the goods of nature is, in Marxist terminology, productive work, and work which does not consist in it—whether necessary or not—is only an ideal reflection of productive work. Work which does not reflect the relations of man to nature but reflects the relations of man to the community is not productive work—it is, in the Marxist sense, non-productive work.

The famous Marxist example relating to the work of book-keeping is very revealing and instructive. Marx underlines the importance of this work, but says at the same time that it consists in the ideal generalisation of production processes and only reflects the real, direct process of material production, directed to the harnessing of the goods of nature. As this is only a reflection of the real process and only generalisation of the real process, in Marxist terminology the work of book-keeping is non-productive work.

The division into productive and non-productive work has nothing to do with the division into manual and intellectual work. Marx says: "To make work productive, it is not necessary directly to work with one's hands. It suffices to be an organ of the collective worker and to perform one of his functions." The division into productive and non-productive work cannot be made according to an objective criterion. It cannot be said that productive work is only work materialised in a given object. Similarly, all work which is not materialised in a given object cannot be considered as non-productive.

To elucidate this matter further, I would like to quote an excerpt from the work of a serious Soviet student of this problem. Kronrod, entitled *Foundamental Problems of the Marxist-Leninst Theory of Productive Work:*

"A picture, a sculpture, a book are goods of nature adapted and transformed in accordance with social needs. In that character they are a result of work expended in the process of production on canvas, paints, frames, sculptor's materials, the work of typographers and printers, of workers in a paper factory, etc. But the result of the work of the writer, artist or sculptor appears in the book only in its ideal content, as the sum of ideas expressed by means of an object. The objective form does not change the character of work of a painter, writer or sculptor. Similarly, it will not change the character of the work of a musician, whether he gives a live performance before an audience, or makes a recording. The objective form means only that, with the help of matter, obtained from nature by way of productive processes on the basis of this matter, processes of spiritual creation are realised, the essence of which does not consists in direct relation of man with the nature surrounding him, but in a reflection and transformation in the human mind of the material world."

It is not the objective materialisation of work which is the criterion of division into productive and non-productive work. Not every work which produces things and is realised in things, is productive. On the other hand, there exist kinds of work which do not produce objects directly, but are doubtless kinds of productive work and are used in the sphere of material production. Such work is the work of transport, communications, signals. This is productive work consisting in man influencing the surrounding nature; it is productive work, although it does not create separate objects unrelated to processes of production. The division into productive and non-productive work is not made either according to mechanical objective criterions, or according to a mechanical division into intellectual and manual work, but according to a dialectical criterion of man's relation to nature.

The division into productive and non-productive work has nothing to do with the division into useful and useless work, that is, work useful socially and socially useless. Non-productive work—this must be emphatically stressed—does not mean work socially useless. In the sum of non-productive work we encounter work which we might vulgarly call useless and parasitical, but there also exist a number of jobs socially useful, such as the jobs of teachers, artists, writers, doctors, clerks, soldiers, etc. Certain kinds of work do not function either in the sphere of material or in the sphere of spiritual production. Some kinds of work function in the sphere of consumption, such as work in the household, which Marx compares to expenditure on consumption.

The division into productive and non-productive work is the fundamental element of dialectical materialism. "Productive workers create a material basis for the maintenance, that is, for the existence, of non-productive workers"—Marx. The division into productive and non-productive work is an important element of the Marxist differentiation between foundation and superstructure.

> Thus, the division between productive and nonproductive work—an indispensable element in the theory of the creation of national income—is at the same time a fundamental part of the Marxist theory of value and of dialectical materialism.

Income is created by productive work; productive work functions in the branches of material production. This is a living dialectical criterion, but one which does not and cannot operate automatically. An important question arises—the question of classification, which must decide what is and what is not a branch of material production. To this classification volumes have been devoted in the Soviet Union, based on research into various enterprises and various phenomena of economic activities.

In this classification there are a number of clear and uncontroversial points. It is clear that industry is a branch of material production, that agriculture, building, transport, communications, are also branches of material production. On the other hand, it is clear, too, that national defence, security, administration, health services, education, finance, schools, culture, art, science, etc., cannot be included among branches of material production.

Of course, a number of borderline instances might be found, and in those clearly a decision one way or another will not be easy. Here is an example of such a controversial problem, solved by an agreed "short cut." Public administration in the Soviet Union is included among branches of non-material production. But how should one deal with public administration in

government departments whose task is to manage directly production? Here Soviet classification applies "short cuts." It considers work in various government departments, up to and including the Central Administrations of Industry, as work in the sphere of material production. This is a "cut." There are a number of such controversial instances, but all of these constitute a small part of the problem as a whole. Somebody once said that it is also difficult to establish a definite dividing line between zoology and botany. However, we have no difficulty in saying that a cow belongs to the animal kingdom and a rose is a plant.

In the sphere of economy there exist a number of controversial and difficult matters which require detailed classification. The problem of trade is one. The functions performed by trade can be divided into two groups. To the first belong functions which are the direct extension of material production in the sphere of distribution: the storing, packing, sorting, weighing, etc., of goods. These functions create a new value, which must be included among the values created by industry. But there exist a number of other functions which dominate in trade, especially in capitalist trade, functions which result from the task of transforming commodity value to money values, or the reverse. The performance of these functions requires naturally a great outlay of work which, however, is non-productive. Marx wrote about it as follows: "Neither the difficulties of this metamorphosis nor the extent of the operation can transform this work which does not create values, but only serves to change the form of value, into work which creates values."

In the Soviet Union in recent years the total trade is included among branches of material production. It is considered there that commercial functions consist mainly in material functions, that material functions within the scope of trade are an enormous dominating part in relation to formal functions, resulting from the metamorphosis of goods into money and money into goods. In the Soviet Union commerce provides only five per cent of the material income. In the United States where, according to American statistics, the value of the part of national income provided by agriculture amounts to $14,000 million, the value provided by trade amounts to $17,400 million. It is clear that an enormous, a dominating part of these $17,400 million results not from the material functions of trade, from an addition of new values to the values created in the sphere of industrial production but from functions resulting from the formal metamorphosis of goods into money and money into goods.

A large, important, as yet untouched problem, without which no planning is possible in Poland, is to decide what place is occupied by trade in Poland's mixed economic structure, how to classify trade, how to discover in it the material processes of accruing values on the one hand and the non-productive formal functions on the other hand.

There are still other problems of classification. The division of branches of production into material and non-material ones does not exhaust the matter. Within branches of production, recognised as material, it must be decided what refers to income, to a value newly created, and what to values previously created.

In the Soviet Union a great number of books has been devoted to these problems. A detailed plan of dealing with different themes, different for every branch of production, resolves this matter in a specific way.

Further problems of classification include the rational division into branches of production and the necessary, from the Marxist point of view, division into social classes, the aim of which is to define the participation of the various social classes in the creation of national income. According to Marx's theory, the size of national income in the various years must be arranged into a dynamic series. To present the dynamics of national income undoubtedly requires the application of constant prices.

> We have stated that national income is the result of productive work in material branches of production. We have stated further that commercial profits, the services of administration, finance, income resulting from the services of the professions, civil service salaries, expenditure on militia, security, national defence, etc., are not elements creating national income. If they are not, what exactly is their nature?

The answer to this question is: *they do not contribute to the creation of national income, but are an act of consumption, of distribution of national income.*

Thus, after discussing the problem of creating national income, we pass to the problem of distribution of national income.

The Marxist theory of creation and distribution of national income differentiates between the primary and the secondary distribution of national income and paralled to it between fundamental income, which originates as a result of the primary distribution of national income and secondary income, which results from the secondary distribution of national income. As a result of the primary distribution, workers' wages, capitalist dividends, pensions, the earnings of craftsmen and of peasants are

paid out. Later comes the turn of the secondary distribution or, to be exact, of secondary distributions. On the one hand, these are made through the budget, by way of taxes and dues; on the other hand, especially in capitalist countries, by way of payments for individual services. A worker pays, for instance, his doctor's fees from his wages, a capitalist pays the services of a teacher, painter, sculptor from his profits: the State, by a secondary distribution of national income through the intermediary of the budget, pays the administration; defence, etc. As a result of secondary income, and secondary distribution of national income, the final result is achieved. This final result arises by the subtraction of the secondary from the primary income. This final result must be, according to Marxist principles, divided according to class criterions—must be ranged into a dynamic file (in constant prices). *The sum of all these operations with regard to national income and their crowning, so to speak, must be the assessment of income and expenditure, must be a clear-cut answer to the question of how much national income has been created, by whom, and how mnch they have received from it as a result of the final process of distribution.*

This is how the Marxist theory of creation and distribution of national income might be represented.

It will not be out of place to present now, even in general terms, the bourgeois theory of creation of national income. One principle lies at the source of all these theories: income is created where it is realised. Following this most general principle, the non-Marxist, bourgeois formula is: national income is the sum total of individual incomes, plus the undistributed profits of enterprises. It is clear that after what we have said here, it is easy to state that the creation of income and its distribution are mixed together here as well as primary with secondary incomes. It is clear that according to these principles, trade, finance, administration, education, culture, etc.—are all branches which create national income.

A classical example of such an approach to the problem can be found in the writings of Alfred Marshall, one of the leading lights in bourgeois political science: if, for instance, the income of a landowner is £10,000 and out of his income he pays his secretary £500 a year, and the secretary, in turn, maintains a servant, paying him £50 a year, the sum total of income, according to Marshall, is £10,550. Marx deals with this point:

> Let us suppose that that part of the social product, whose value is equal to income, diminishes as a result of the fact that during the past year a smaller amount of fresh work has been added and this newly added work was less efficient,

If capitalists and workers wanted, as before, to consume the same values as material goods, they would have to purchase fewer services of doctors, teachers, etc , and if they were forced to spend the same amount on services, etc., they would have to diminish the consumption of other things. Thus it is clear that the work of a teacher or doctor does not create a direct fund from which it can be paid. (*Theories of Surplus Value*, vol. 1.)

This much Marx said on certain respectable categories of non-productive work, namely on the work of doctors and teachers. And yet it is possible—and Marx does it with his characteristic irony—to enumerate scores of other parasitical, useless, and socially harmful categories of non-productive work. The absurdity of similar methods of assessing national income becomes apparent here in all its magnitude. The results of applying these bourgois principles when assessing national income are clear. On the one hand we have an apology for capitalism, the concealment of all parasitical, non-productive functions behind a screen of would-be creation of national income, on the other hand we have the diminution of the role of truly productive work.

One of the results of such a method of assessment is naturally the faulty interpretation of the size of national income. Let us imagine that as a result of market speculation or upsets in the commodity market, the income shown by the American capitalist method under the heading of "trade" will increase. An observer might then come to the following conclusion : the larger the margin of trade as a result of speculation, the greater the increase in national income.

Let us consider something else—war. During war, expenditure on national defence shows a violent rise. The earnings of soldiers, included by capital economists in national income, are increased. The interpretation should be thus: the greater the expenditure on defence, the greater the expenditure on the army the larger the increase in national income. The Americans have found themselves concretely facing such an absurd notion, which forced them even to introduce certain changes in deducting the earnings of members of the armed forces as elements of national income

Marx approached this problem clearly and distinctly.

The number of persons living on their income is considerable only because the efficiency of productive workers is high, and therefore the additional product on which parasites can be maintained is great. In this case, the work of productive workers is efficient not because many parasites live on the additional product, but on the contrary—the number of parasites is great because the work of productive workers is efficent. (*Theories of Surplus Value*, vol. 1.)

What are the theoretical foundations of this bourgeois method of assessing national incôme? Just as the theory of value is the basis of the Marxist method of assessing national income, so the subjective theory of value is the foundation of the bourgeois method of assessing national income; according to it income is a reward for services of the so-called factors of production—capital, land, administration, work. The bourgeois political science cannot accept any other foundation, because to accept it would mean the necessity of explaining the problem of surplus value. Therefore it must operate with "factors" of production, it must put the equation sign between the income and the service rendered.

We have seen that dialectical materialism lies at the basis of the Marxist theory of national income, that the division of work into productive and non productive and the very criterion of productive work, are means of perceiving the economic basis of society and of differentiating between foundation and superstructure. At the basis of bourgeois theories of national income lies philosophical idealism, a basic negation of differentiation between foundation and superstructure.

H. MINC.

Cost of Living Index

Cost of Living Index—Working Class—Colombo Town

Group	Average Price, November, 1938, to April, 1939=100					Average Price, November, 1942=100											
	Weight	Average				Weight	Average							1949	1950	1950	1950
		1939 *	1940	1941	1942 †		1943 †	1944	1945	1946	1947	1948	1949	Apr.	Feb.	Mar.	Apr.
Food ...	52.40	112	115	129	183	63.66	103	102	111	113	128	138	144	141	154	151	150
Fuel and Light	6.28	102	103	108	171	7.26	94	94	94	111	121	101	97	96	97	95	96
Rent ...	15.96	97	97	96	93	7.06	105	106	112	124	136	140	129	129	129	129	129
Clothing ...	8.36	112	128	153	194	8.78	138	156	165	180	213	189	156	160	150	149	151
Miscellaneous ...	17.00	104	111	116	144	13.24	118	127	158	155	157	157	148	149	155	151	154
Total ...	100.00					100.00											
Index Numbers		108	112	122	162	Index No. Nov., 1938 April, 1939 = 100	107	109	121	125	138	142	141	140	148	145	145
							197	200	221	229	252	260	258	255	271	266	266

* *Five months' average.* † *Eleven months' average.*

Export Volume Index

(Base 1934—1938 = 100)

Month	All Export Products		Tea		Rubber		All Coconut Products		Desiccated Coconut		Coconut Oil		Copra		Other Coconut Products		Other Export Products	
	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950
January	139	146	130	134	196	252	116	62	15	80	185	78	116	7	67	91	65	85
February	125		119		190		69		17		144		8		50		99	
March	109		92		168		96		15		170		59		74		109	
April	98		117		103		17		17		13		1		50		76	
May	143		172		105		91		74		174		8		59		86	
June	145		172		118		84		66		166		9		43		74	
July	139		166		97		99		35		184		53		51		80	
August	141		159		125		90		42		171		25		64		112	
September	110		109		151		61		52		52		69		73		97	
October	127		144		140		46		70		34		16		88		93	
November	130		117		158		143		80		304		2		80		133	
December	135		133		167		107		121		175		4		105		90	
Jan-April																		
1949																		
1950		118		115		164		75		16		128		46		60		87

Source: Department of Statistics, Colombo.

Average Prices of Chief Export Commodities.

	TEA			RUBBER	COCONUT				
	High	Medium	Low		Copra	Oil	D. C.	Fresh Nuts	Poonac
1950.	Rs. Cts.	Rs. Cts.	Rs. Cts.	Rs. Cts.	Rs. Cts.	Rs. Cts.	Rs. Cts.	Rs. Cts	Rs. Cts.
JANUARY	2.94	2.39	2.33	.75	191.88	1427.73	.65	190.00	92.50
FEBRUARY	3.06	2.28	2.12	.80	202.00	1358.60	.70	185.00	92.50
MARCH	2.58	2.00	1.94	.82	205.00	1275.00	.74	185.00	92.50
APRIL	2.24	1.83	1.84	.98	204.00	1383.13	.96	175.00	92.50
Jan.—April									
1938	.82	.72	.65	.32	29.28	204.31	.51	28.99	71.83
1948	1.85	1.61	1.54	.60	125.00	1022.75	.64	130.00	92.50
1949	1.85	1.58	1.58	.54	150.00	1021.75	.55	136.25	92.50
1950	2.71	2.13	2.06	.84	200.80	1361.12	.76	183.75	92.50

Volume, Price, and Terms of Trade

(Base 1934-1938 = 100)

Period	Import Volume Index		Import Price Index		Export Volume Index		Export Price Index		Terms of Trade	
	1948	1949	1948	1949	1948	1949	1948	1949	1948	1949
1st Quarter	106	132	445	438	132	125	316	316	141	139
2nd Quarter	123	138	449	412	124	129	301	309	149	133
3rd Quarter	109	98	439	416	131	130	287	314	153	132
4th Quarter	102	111	444	419	131	130	315	356	141	118
Year										
1938	98		102		103		99		103	
1947	108		413		118		300		138	
1948	110		443		129		305		145	
1949	119		423		128		324		131	

Source: Department of Statistics, Colombo.

Export Price Index

(Base 1934—1938 = 100)

Month	All Export Products		Tea		Rubber		All Coconut Products		Desiccated Coconut		Coconut Oil		Copra		Other Coconut Products		Other Export Products	
	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950
January	312	382	274	347	151	213	693	761	991	936	673	679	746	944	408	519	392	456
February	318		283		151		690		1004		645		759		418		414	
March	320		299		154		640		961		595		695		384		399	
April	314		288		154		654		831		614		799		383		358	
May	310		290		154		617		818		546		764		384		343	
June	308		288		154		613		824		545		741		391		333	
July	307		292		146		601		814		544		709		381		328	
August	317		304		149		613		795		576		729		370		342	
September	323		310		141		643		783		654		729		385		343	
October	339		326		174		631		807		665		637		408		363	
November	357		338		192		672		853		625		802		429		398	
December	380		356		205		733		932		635		925		492		414	
Jan-April																		
1949		316		286		153		669		947		632		750		398		391
1950																		

Source: Department of Statistics, Colombo.

Finance Indices

(1934-38 average=100)

Month	Note Circulation (Gross)		Note Circulation (Active)*		Total Savings†		Bank Clearings		§ Government Revenue		§ Government Expenditure	
	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950	1949	1950
January	903.3	1002.0	621.7	637.4	725 0	724.0	485.1	581.6	645.1	613.2	403.4	533.7
February ...	878.8	928.7	620.9	646.6	723.1	725.0	402.7	497.1	449.5	403.3	412.4	452.8
March ...	812.5	787.8	608.8	645.2	721.1	725 3	475.3	631.2	541.8	502.2	405.6	474.2
April ...	763.3	745.9	595.9	653.4	715.9	724.7	449.1	545.2	454.9	483.5	368.5	421.3
May ...	706.9		599.6		718.5		526.3		480.2		438.2	
June ...	685.1		604 9		715.9		562.3		624.2		380.9	
July ...	671.5		616.7		715.3		527.0		592.3		447.2	
August ...	698.7		615.0		717.2		503.3		533.0		476.4	
September ...	934.3		632.1		722.4		524.1		618.7		1640.4	
October ...	998.9		624.5		722.7		548.6		453.8		355.1	
November ...	1030.7		632.6		722.4		541.1		558.2		437.1	
December ...	1024.9		641.9		725.0		562.3		467.0		429.2	
*	*		*	*	–	*	*	*	*	*	*	*
January-April												
1938 ...		108.0		—		121.8		112.5		108.8		95.5
1948 ...		806.2		602.9		703.6		461.2		469.2		475.3
1949 ...		839.4		611.9		715.9		453.1		523.1		397.8
1950 ...		866.1		645.8		724.7		563.8		501.1		470.8

* September, 1938, to August, 1939=100.

† Nett values of savings deposits plus Saving Certificates.

§ From February, 1950, the figures are provisional.

Government of Ceylon Securities.

Rupee Loans		Date Repayable	Current Closing Prices 31-3-50		* Yield per cent		Comparative Prices				Interest payment due	TOTAL LOAN Outstanding
							Six months ago		One year ago			
			B.	T.	Earliest Redemption	Latest Redemption	B.	T.	B.	T.		Rs.
Ceylon Govt.	3½% Loan 57/62 ...	Between 15-11-1957 & 15-11-1962	104½	—	3·02	3·19	104¼	—	104¼	—	15th May & Nov.	27,941,000
Do	3½% Loan 59/64 ...	Between 1-10-1959 & 1-10-1964	103¾xd	—	3·25	3·32	103¼xd	—	103½xd	—	1st April & Oct.	10,793,700
Do	3 % War Loan 59/69 ...	Between 1-4-1959 & 1-4-1969	—	100½xd	3·19	3·10	100xd	—	100½xd	—	do	9,608,400
Do	3 % War Loan 56/60 ...	Between 1-3-1956 & 1-3-1960	101	—	2·86	2·91	100¾	—	101	—	1st March & Sept.	21,669,300
Do	2½% War Loan 1954 ...	1-4-1954	100½xd	—	2·36	—	100¼xd	—	101xd	—	1st April & Oct.	27,359,200
Do	3½% Home Def.Loan 62/67	Betwcen 1-6-1962- & 1-6-1967	104¼	—	3·19	3·26	104½	—	104	105½	1st June & Dec.	11,216,000
Do	3½% do 63/68	Between 1-6-1963 & 1-6-1968	104¼	—	3·21	3·27	104½	—	104	—	do	4,113,000
Do	3¼% do 1952	1-6-1952	102½	—	2·60	—	103	—	103	—	do	1,691,000
Do	3¼% do 1953	1-6-1953	102½	—	2·78	—	103	—	103	—	do	817,700
Do	3 % do 1950	1-6-1950	100¾	—	—	—	102	—	101½	—	do	3,767,400
Do	3½% National Loan 1964/69	Between 1-8-1964 & 1-8-1969	103½	—	3·25	3·29	103¾	—	103½	105¾	1st Feb. & Aug.	48,799,700
Do	3¼% do 1956	1-8-1956	102	—	3·00	—	102	—	101½	—	do	9,706,200
Do	3¼% do 1957	1-8-1957	102	—	3·03	—	102	—	101½	—	do	15,093,200
Do	3 % do 1953	1-8-1953	101¾	—	2·60	—	102	104	101½	—	do	82,979,100
Do	3 % do 1954	1-8-1954	102	—	2·64	—	102	—	101½	—	do	18,421,800
Do	3 % Victory Loan 1965/70	Between 15-7-1965 & 15-7-1970	99½	—	3·09	3·07	100½	—	101	—	5th Jan. & 15th July	22,827,500
Do	2½% do 1955/60	Between 15-7-1955 & 15-7-1960	100 3/8	—	2·52	2·53	99¼	—	100	—	do	20,073,600
Do	3 % National Development Loan 1965/70	Between 1-11-65 to 1-11-70	100¼	—	3·08	3·06	101	—	101¼	101¼	1st May & 1st Nov.	64,834,400
Do	2½% National Development Loan 1955/60	Between 1-11-55 to 1-11-60	—	—	—	—	—	—	100	—	do	35,165,600
Do	2½% National Development Loan 1967/72	Between 15-12-67 and 15-12-72	—	—	—	—	—	—	—	99	15th June & 15th Dec.	26,830,100
Do	2½% National Development Loan 1962/67	Between 15-12-62 and 15-12-67	—	—	—	—	—	—	—	—	do	7,147,700
Do	3 % Defence Loan	On demand; on 6 months' notice; after 10 years from date of issue	—	—	—	—	—	—	—	—	Payable half-yearly on each holding from date of purchase	9,770,300
Do	Interest Free Loan	After 1 year from date of issue on 3 months' notice; 3 years after date of issue	—	—	—	—	—	—	—	—		1,220

* Yield calculated on transfer price if available; otherwise on middle market Price. If only the buyer's or seller's price is available, then yield calculated on that price.

According to the Rules of the Colombo Brokers' Association, the buyer of Government Stock shall be entitled to interest accrued to the date of payment unless otherwise arranged.

	Rs.	c.
Gross Public Debt (including sterling loans, but excluding War Loans re-lent to the United Kingdom Government)	560,717,533	33
Less Value of Sinking Funds as at 30-9-49	105,162,115	91
Nett Public Debt ...	455,555,417	42

LOANS ON "TAP"

Rs. 77,528,200 SRI LANKA GOVERNMENT LOANS (Rs. 66,028,200 to finance Government's development plans and Rs. 11½ millions for repayment of the 3% Home Defence Loan 1949 and the 3¼ Loan 1949—51).

1. 2½% Sri Lanka Government Loan repayable between 1-3-59 and 1-3-64
2. 3 % Sri Lanka Government Loan repayable between 1-3-69 and 1-3-74

Lists opened on 4-2-49. Issue Price Rs. 100 per cent.
Interest payable on 1st March and 1st September.
Lists close on May 31, 1950, or earlier if loans are fully subscribed.

(Reproduced from the Bank of Ceylon Monthly Circular for March, 1950).

Quarterly Share Indices

Base—Jan June 1939.

1949	Tea	Rubber	Tea cum Rubber
1st Quarter	167.99	95.98	139.84
2nd ,,	157.02	79.19	133.07
3rd ,,	163.16	95.56	134.52
4th ,,	193.26	114.62	164.89
1950			
1st ,,	206.61	134.31	181.84

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