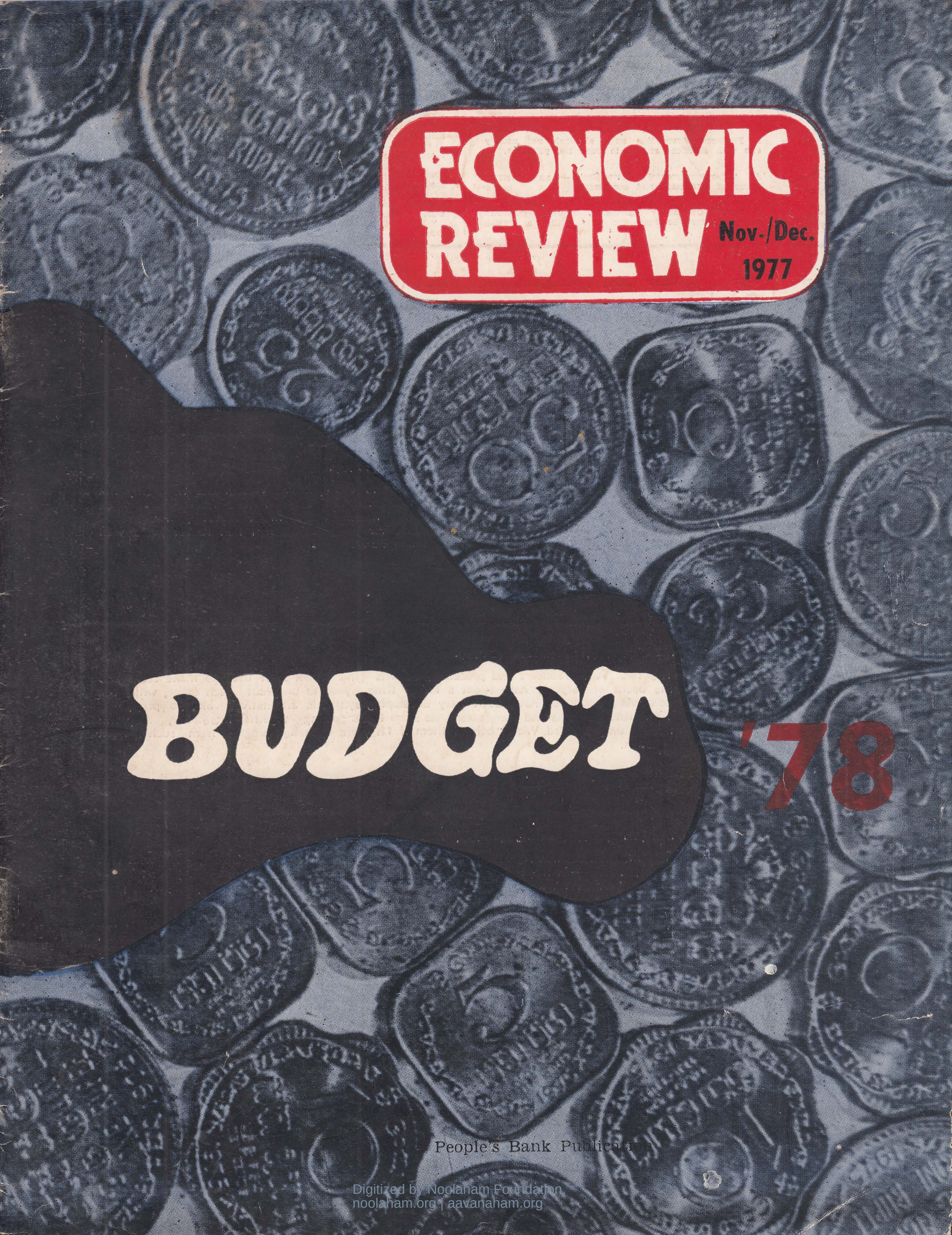
ECONOMIC REVIEW

Nov.-/Dec. 1977



BUDGET '78

People's Bank Publication

THE COMMODITIES GAMES

 = A Producers Association only, although not usually one with sufficient muscle to push the price up.

 = An 'Intergovernmental Committee' — an informal group of producers and consumers.

 = A formal Commodity Agreement, between producers and consumers to keep the price within a certain range.

Many poor countries often rely on one or two basic commodities for the majority of their export earnings. The prices of these commodities can therefore literally be a matter of life and death. The **New Internationalist** of November, 1977 has shown, through illustrations, some of the world's major commodity games. It states that the position each country takes in commodity negotiations is not just a matter of government opinion. There is a whole host of outside influences, individual and organisational, ready and willing to coach the national teams.

This position has to be seen in the context of the poor progress that UNCTAD's Common Fund Conference for Commodities made in December, 1977.

The figures in brackets indicate the percentage of world trade which developing country producers have had in recent years.

The symbols indicate where each commodity stands on the road to an international agreement.

SUGAR

Cuba (26%), Philippines (7%), Brazil (6 %), Thailand (5%).

A complex game in that an identical product comes from two different plants. 60% comes from cane and 40% from beet, although most of the sugar in international trade is cane exported by poor countries. Shortages in 1975 sent the prices rocketing to $700 per ton, with the result that everyone planted, especially the EEC. Now there is a glut and the price is down to $120 per ton.

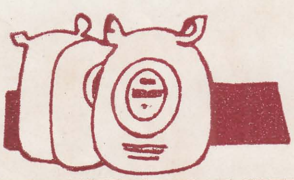
STOP PRESS — An International Sugar Agreement has just been signed.

RUBBER

Malaysia (47%), Indonesia (27%), Thailand (11%).

Natural rubber has been steadily losing ground to the synthetic version and now only has about one-third of the market. The major importers use 75% of the natural rubber for car tyres so the price is heavily dependent on the health of the motor industry. The producers have presented such a well-argued case for price stabilisation that rubber could well provide the first application to the Common Fund.

JUTE



India (42%), Bangladesh (34%).

The two main producers and processors of this (the brown stuff used to make sacks and the backs of carpets) have spent a lot of time trying to undercut each other, while the consuming countries have been busy developing synthetic alternatives like polypropylene. And although India and Bangladesh do seem to be getting together more now, they will need a united Third World behind them if they are to make progress from such a weak position.

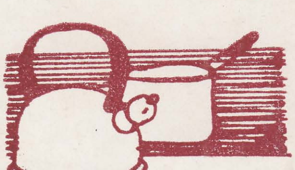
TIN

Malaysia (43%), Bolivia (14%), Thailand (10%).

The International Tin Agreement has since 1956 been the model of a trade game with well defined rules — it has buffer stocks which have successfully dampened down price fluctuations. But then tin has always been in short supply with a consistently upward price trend, so the producers have had a strong hand.

For years the US refused to join the agreement and once even tried releasing some of her large stocks to try to undermine the price. But now as a member she is struggling with Bolivia who is demanding that higher prices be set and is threatening to organise an OPEC style cartel.

ALUMINIUM



Jamaica (44%), Surinam (23%), Guyana (9%), Dominican Republic (8%).

One of the most common elements in the earth's crust; so, the extraction site is selected on the basis of quality of ore and availability of power for smelting. The decision lies very much in the hands of the multinational smelting companies who make that choice. So however aggressive her position politically, Jamaica for example has no choice but to make deals like her recent tie up with the US company, Kaiser. The companies are however wary about investment in 'unstable' countries (Alcoa had their assets in Guyana nationalised) and are increasingly looking for investment in 'safe' countries like Australia and Canada.

ECONOMIC REVIEW

Volume 3 Numbers 8 & 9 Nov./Dec. 1977

Published by the People's Bank,
Research Department,
Head Office,
Sir Chittampalam A. Gardinar Mawatha,
Colombo 2
Sri Lanka.

CONTENTS

THE ECONOMIC REVIEW is intended to promote knowledge of and interest in the economy and economic development process by a many sided presentation of views & reportage, facts and debate.

THE ECONOMIC REVIEW is a community service project of the People's Bank. Its contents, however, are the result of editorial considerations only and do not necessarily reflect Bank policies or the official viewpoint. Signed feature articles also are the personal views of the authors and do not represent the institutions to which they are attached. Similar contributions as well as comments and viewpoints are welcome.

THE ECONOMIC REVIEW is published monthly and is available both on subscription and on direct sale.

Readers Please Note

We have combined two issues,(November and December 1977), in order to catch up on our backlog in printing which had arisen through unforseen circumstances. We assure all our subscribers, however, that the validity of their annual subscriptions would extend over 12 seperate issues.

NEXT ISSUE

- Domestic Agriculture — paddy and the subsidiary food crops sector - problems and pros pects
- Banks and their role in capi tal formation
- Tax Havens — the pros and cons

DIARY OF EVENTS

Oct.

7 The Bank of England reduced its minimum lending rate from 6% to 5½%. This is the twentieth time its minimum lending rate has been reduced since October, 1976 when its interest rates were raised to a record level of 15 per cent, states a *London Times* report.

17 Radical changes in India's policies and procedures are being planned to take into account the greatly improved foreign exchange reserve position and the decision to liberalise foreign imports and industrial financing, the London *Financial Times* reported.

18 Under pressure from its major trading partners to cut its huge surplus, Japan announced plans to help reduce the surplus by increasing imports, according to *Reuter* reports from Tokyo. Japan claims a strong Yen for its massive September trade surplus of dollars 1.7 billion with exports rising by 12 per cent and imports only 3 per cent. For the first nine months of 1977 Japan's trade surplus was dollars 9.7 billion.

22 A Soviet-Singapore joint venture, Marissco, is embarking on its seafood processing and storage complex, estimated to cost as much as $ 12 million. The project will eventually be developed into a fully-integrated seafood processing facility —Singapore's first, reported the *Business Times.*

26 The National Bank of Hungary, Budapest, raised a US $ 200 million seven year term loan from American and Canadian Banks.

30 The Soviet and Brazilian Governments agreed on a credit of US $ 600 million (equivalent) to encourage the import of Soviet technology and manufactured products into Brazil.

31 Sterling, which was delinked from the dollar soared to its highest level since May, 1976, after the Bank of England let the rate float freely on October 31. It closed at 1.8405 against the dollar, up 6.33 cents from the October 28 close of $ 1.7772. In effective terms the pound leapt by 3.5 per cent to 64.6 on the trade-weighted index.

Nov.

2 The US withdrew from the ILO.

7 The Estimates of Revenue and Expenditure for the year 1978 were tabled in the National State Assembly by the Minister of Finance. Total estimated expenditure was Rs. 9,576 million and total estimated revenue Rs. 6,062 million.

8 Sri Lanka will receive 200,000 metric tons of rice from China at prices below that of the world market and also lower than that of 1976. In return Sri Lanka will supply China with 49,000 metric tons of rubber, which is a smaller quantity than that of 1976, the Minister of Trade told a press conference following his return from Peking after signing of the new trade protocol under the Sino-Lanka Rubber Rice Pact.

9 Sri Lanka signed three aid agreements in Colombo amounting to Rs. 189 million. One with Britain provided for an outright grant of Rs. 65 million towards costs of Stage II of the Mahaveli Development Project; another with Canada provides for a Commodity Loan amounting to Rs. 80.2 million; and the other with the USA for a loan of Rs. 44.2 million for the Mahaveli Ganga Irrigation Project.

15 The Minister of Finance, Mr. Ronnie de Mel, presented the first budget of the present government in the National State Assembly.

18 The International Monetary Fund had agreed to accommodate Sri Lanka to the extent of Rs. 6,000 million, the Finance Minister told the National State Assembly. He added that he needed only Rs. 1,600 million for the present operation for liberalisation. He had obtained that and more.

The Government of the Netherlands has offered Sri Lanka a special soft loan of DFL 35 million (about Rs. 283 million) for the year 1977, stated a press release from the Ministry of Planning. This loan, tied to goods of Netherlands origin, was being made available as an incidental extra contribution to strengthen the financial position of Sri Lanka.

19 The price of off-ration sugar was reduced from Rs. 5/- to Rs. 3/- per pound with immediate effect.

19 President Sadat of Egypt made his historic visit to Israel.

21 Moscow Narodny Bank, of Scotland and Morgan Grenfell of Britain agreed to a joint venture to set up a joint representation in Moscow which will oversee interests of all three banks and their customers.

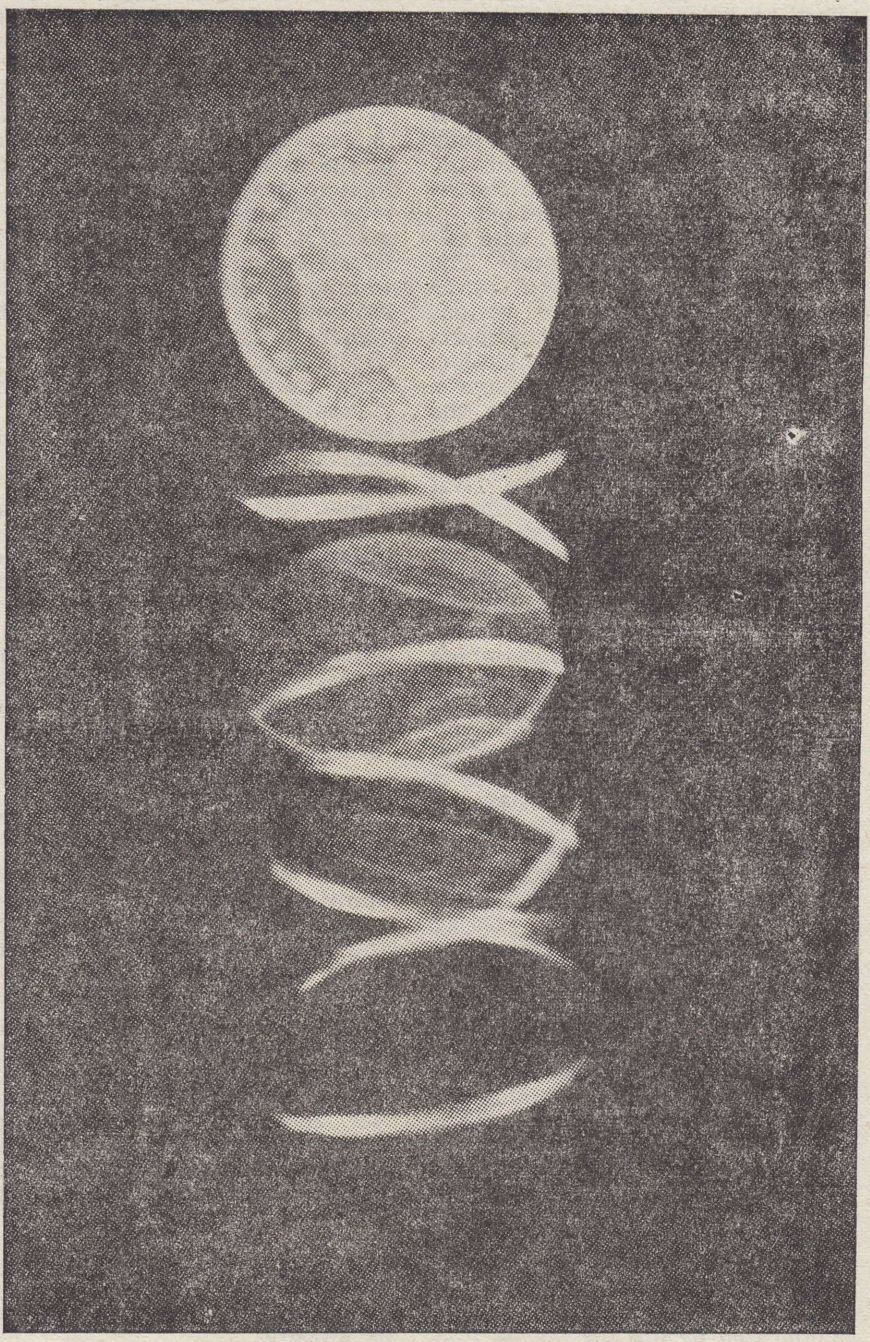
23 A joint Air Service Agreement was signed in Colombo between Sri Lanka and South Korea to operate services between and beyond their respective countries by Korean Airways on the one hand and Air Ceylon on the other.

24 Sri Lanka was close to signing an agreement with the EEC on the matter of export quotas for ready-made garments as there was a greater understanding of our position the Minister of Trade stated on his return to Colombo following talks with the Council of Ministers of the European Economic Community.

25 The US dollar was still in trouble despite more massive help from the Central Banks of Japan and Western Europe and many dealers said they believed it would continue its downward path, *Reuter* reported from London.

28 A consortium of Norwegian banks and oil companies, backed by the Norwegian government, has become the first foreign group to gain approval to develop the potentially large oil reserves off the southern shores of Vietnam. The $ 45 million package will involve $ 9 million in aid and the remainder in a 15 year loan, states a report in *Business Week.*

29 Sri Lanka will be among the 36 nations that would receive soft loans totalling $ 385 million from the European Economic Community, it was announced in Brussels.



From an internationally exhibited prize winning picture. Courtesy Photographic Society of Sri Lanka.

BUDGET 1978

The Budget is not merely a presentation of the estimated annual accounts of the government; it is a crucial statement of policy and the key instrument in implementing a comprehensive development programme of a country. The revenue proposals of a budget indicate the fiscal policies that the government intends to use in mobilizing resources of the country. Similarly, the expenditure programme outlined in the budget reflects the role of the public sector in the country's development effort. Furthermore, the impact of a budget on a country's economy would depend not only on the revenue and expenditure policies but also on the modes of financing the budget deficit. An annual budget must thus be viewed as the financial counterpart of a country's development plan.

Viewed from the above perspective the Budget for the year 1978 presented by the Minister of Finance on November 15, 1977 can be regarded as a preliminary step towards designing a development plan for Sri Lanka, rather than as an attempt to put into effect a coherent development plan. This is because the present government, that was elected to power only a few months earlier, has yet to draw up a comprehensive programme of action for development. Nevertheless, the budgetary proposals may be translated into a broader programme by the government in drawing up a long-term plan for Sri Lanka's economic and social progress.

Shift in Approach

The Budget for 1978 exhibits a distinctive shift in its approach to Sri Lanka's economic problems: namely as an attempt at liberalising the economy and allowing a free market mechanism to function. This attempt is mainly evident from the exchange reform whereby a range of activities have been decontrolled along with an upward revision in the exchange rate, and the dismantling of the price controls that existed hitherto.

The FEEC scheme, under which non-traditional exports were entitled to a premium rate for their earnings and a wider range of imports were subject to a surcharge of sixty five per cent, was abolished and the dual exchange rate was replaced by a single but revised rate of exchange. This measure was not called a devaluation of the currency but rather an unification of the exchange rate. The underlying argument for this unification of the exchange rate might have been the theoretical proposition that a sufficiently high unified rate of exchange coupled with high import tariffs should be preferred to a discriminating dual rate put into effect under a system of administrative controls such as quotas and licences. Support for such an exchange reform appears to have come from the I.M.F. (International Monetary Fund), in the form of stand-by arrangements and extended fund facilities to augment the necessary foreign exchange resources for the country's import programme.

Exchange Reforms

The overall impact of this exchange reform is difficult to assess as it will involve far reaching implications for the economy. Firstly, a higher rupee rate (at approximately Rs. 16 per U.S. $1) for local exporters should act as a stimulus to the export sector, while it should also result in higher costs in rupee terms to the import sector. The net effect on the external trade balance, however, would depend mainly on the elasticity of demand abroad for our exports and the elasticity of local demand for imports. In this context, it must be noted that along with the revision of the exchange rate, export duties and import tariffs have also been revised with a view to a siphoning off the extra rupee income of exporters into government coffers and to discourage the demand for imports. The tariffs on imported manufactures and semi-manufactures have to be effective enough if local industries are not to be endangered.

The impact of the adjustment of the exchange rate in raising import costs would vary in intensity according to each item. For those items that were subject to FEECs, even prior to the adjustment, the increase in cost is less (approximately 15 per cent) than for those items that were FEEC free earlier, as the latter category including foodstuffs, books and drugs would now find almost a hundred per cent increase in rupee costs. This could contribute to further inflation in the economy. On the other hand, liberalization of imports would facilitate more imports including consumer items, raw materials, and machinery. Due to higher supply of goods resulting from direct imports as well as from higher utilization of the capacity of local industries, the price level could come down and offset to some extent the higher import prices. It was acknowledged that one of the major reasons why local industries appear to have been operating at levels far below full capacity and providing only a minimum of employment was the lack of foreign exchange to import the raw materias they needed.

The need for exchange rate adjustments is to help exports. The argument has been that a steady inflation could turn the various incentives given against exports and increase domestic consumption, often at the expense of exports. It would also tend to raise the cost of production of that coutry's manufactures and make them uncompetitive against those of rival exporters. But an adverse impact on export supply schedules can be counteracted temporarily by exchange rate adjustments. Persistent inflation, however, would require an almost continuous process of exchange rate correction, which is seldom achieved in practice.

A further reduction or at least halting of price inflation is expected from the revised rates of Business Turnover Taxes. From a level of BTT, rising upto 35 per cent in certain cases, the rates have been brought down to a maximum of 10 per cent with three rate bands of 1%, 5% and 10%; while turnover below Rs. 100,000 a year has been exempted from BTT compared to the previous limit of Rs. 75,000.

On the other hand it should be noted that price control on most items will be abolished in accordance with the philosophy of the free market mechanism. Therefore, the final effect on the price level will be determined by a variety of factors including higher import prices, higher tariffs, a greater inflow of goods, greater competition in the market and lower BTT rates. The gross effect of these factors will be further complicated by the law reform such as abolition of all tax rebates introduced in 1976, replacement of the development rebate scheme with a new scheme of lump sum depreciation allowance, and various incentives to selected investments.

Key Social Question

While the basic format of the budgetary proposals appears to be investment and production oriented, a key social question has also been raised as to who should sacrifice or tighten their belts for the sake of capital formation and rapid growth. Although this Budget put an end to the privileges of an exclusive class by abolishing the Convertible Rupee Accounts Scheme, it has at the same time made every rupee at least partially convertible by relaxing exchange control and import control procedures on most of the invisible payments including foreign travel and on imports of even luxury commodities. In a country where the bulk of the population is poor and rural those who could make use of such luxuries would be mainly the urban higher income groups. Thus, in effect only a small segment will have the potential to convert their rupees into foreign exchange. As such the Convertible Rupee Account Scheme which was earlier tied to the economic performance of the holder, (i.e. as he has to earn CRA through exports) could be interpreted as still to be in operation and this facility is now extended to anyone who has the "actual" purchasing power to convert rupees. This facility, particularly in view of the proposal to abolish the Expenditure Tax, could tend to give further impetus to luxury consumption.

Taxation Measures

The theoretical soundness of the Expenditure Tax proposed by Kaldor and reintroduced in Sri Lanka by the previous Finance Minister lost much of its merit due to the difficulties of implementing and administering this tax. In this sense, the present decision to replace the cumbersome Expenditure Tax with a high rate of personal income taxation which will be raised from 50 per cent to 70 per cent would be a more efficient device. However, given the loopholes in the tax net and also the proposal to limit the maximum total wealth tax and income tax payable by a tax payer to 80 per cent of income from all sources, and the abolition of capital gains tax there can be doubts as to the extent to which taxation of higher groups will be effective.

The foregoing remarks can be extended further with the proposal to withdraw subsidised rice and sugar rations from those who are earning more than Rs. 3,600 per year. In this context, it can be argued that over 50 per cent of the income earners will be deprived of the rice subsidy resulting in a drop in their real income. The additional cost of these items (rice and sugar) at the current market prices to an average family could exceed the increment of Rs. 50/- granted by the government by way of a wage increase. Therefore, at most, this proposal may mean an encashment of the in-kind subsidy to the average lower income groups but not an additional income to compensate for the inflation or the (undeclared) 'devaluation' of the rupee.

In this context, it is important to recall briefly the development strategy of Sri Lanka within the last two decades. The Surveys on Consumer Finances in this country have indicated that the distribution of income has tended to show a more egalitarian pattern over the years while the rate of growth of the economy has been slow and the rate of unemployment has gone up. These trends seem to indicate a redistributive strategy, neglecting the aspects of production and employment, and one may argue that such a strategy could be a self-defeating one in the long run. If so, the alternative approach must be one that favours a growth and employment oriented development strategy. The spread effects of growth and employment would contribute to alleviate poverty and reduce income disparities. (This argument we must admit is simplistic: that which assumes development to be a zero sum game, social expenditure being counterposed with growth and development.) In this respect the Budget for 1978 deserves recognition as it has provided for an unprecedented level of capital expenditure (net of Sinking Fund contributions) — amounting to Rs. 4,787 million or 38 per cent of the total expenditure. This is the highest ever provision in any budget for capital formation in this country, and its basic aim will be to expand employment opportunities in productive areas of the economy. The Budget envisaged the creation of 100,000 jobs in the year 1978.

The setting up of a National Development Bank is another interesting proposal of this year's Budget Speech. Thus far only lip service has been paid to this idea, whereas in the current Budget proposals Rs. 390 million has been allotted for this purpose. Such a Development Bank is expected to promote and finance commercially viable projects in rural areas and also assist self-employment.

Agriculture

The production oriented nature of the Budget is further reflected in the proposals pertaining to the agricultural sector. Moving away from the consumer's rice subsidy to a great extent, the Budget has expanded the producer's subsidy by increasing the Guaranteed Price of paddy from Rs. 33 to Rs. 40 per bushel. Given the high cost of fertilizer and other imports and also in view of higher labour costs the increase in the GPS price is a realistic move. Yet, the announcement of this new price could have waited until the harvesting period, as the traders, with stocks could take advantage of the new price and mark up the price of open market rice immediately. However, all farmers would welcome the new price. The increase in the level of the fertilizer subsidy from 50 to 75 per cent would mean that the cost of fertilizer to the farmer will remain more or less the same; by this measure the farmer has been insulated from the effects of the new exchange rate which would result in higher rupee prices for fertilizer imports. Furthermore, farmers will now be benifitted by the availability of more tractors and also spare parts for tractors — although perhaps at higher prices.

Plantations

In the case of the plantation sector, the Budget has made a deliberate attempt to revitalize the production of Tea and Rubber particularly by increasing the replanting subsidies to Rs. 6,000/- and Rs. 3,000/- respectively. In view of the fact that government plans to create a large number of jobs in the plantation sector, it is important to give adequate attention to these crops.

In his tax proposals for 1978, the Minister of Finance has indicated that (5 years) tax holidays will also be granted for companies formed to engage in food production, horticulture and animal husbandry. Similar concessions will be granted to improve off shore and deep sea fishing. The fishing industry will receive the 100 per cent lump sum depreciation allowance. These proposals indicate the emphasis placed on the development of the agricultural and fisheries sectors which are vital areas of production in this country. However, it appears that the beneficiaries of the proposed tax and other incentives offered to these sectors could be the formally organized companies and such capitalistic entrepreneurs rather than the average village cultivator or small fishermen. Furthermore, such tax concessions and lump sum depreciation allowance geared to large scale investments could also discourage labour intensive techniques of production and adversely effect employment.

The impact of the reduced price of sugar might be felt by the local sugar and jaggery producers and to this extent the incomes of this rural group may be adversely affected. However, the consumer should get the benefit of this measure as the final products (using sugar) such as a cup of tea, confectionary items, aerated water etc. are expected to come down in price. This gain to the consumer will be offset, however, by the deprivation of ration sugar (at 72 cents per pound) to the majority of income earners.

Unemployment

As a token of the governments recognition of the crucial nature of the unemployment problem and also as a measure of relief to the poor income groups who may be adversely affected due to the withdrawal of the subsidized rice and sugar rations the Budget proposed an income support of Rs. 50 per month to the unemployed. The effective implementation of a scheme such as this could cause numerous problems including the problem of defining unemployment or "gainful employment". Furthermore, from a financial point of view this proposal, particularly due to the uncertainty as to when gainful employment can be found for the huge army of unemployed, could exert a heavy burden on the government's resources. A 'dole' of this kind as the income support for the unemployed is a phenomenon that the developed and industrial nations have normally provided. In the Western industrial world unemployment is mainly a frictional and temporary problem and not a structural and chronic one as in this country. Thus the commitment to an income support can lead to far reaching political implications if the subsequent governments, operating within the existing political economy, cannot continue with it.

Estimates Revised

The pre-budget estimates of revenue and recurrent expenditure which stood Rs. 6,813 million and Rs. 6,674 million respectively, were drastically revised as a result of the new budget proposals for the year 1978. The main items contributing to the upward revision in recurrent expenditure were the food subsidy, wage increase, unemployment relief, fertilizer subsidy and the subsidy to the Petroleum Corporation. Together with other items, these items had the effect of raising the recurrent expenditure level to Rs. 10,103 million reflecting an increase of Rs. 3,429 million over the pre-budget estimates.

The high level of recurrent expenditure, however, could be more than offset by the proposed revenue measures such as revised export duties and adjustments in the import tariffs. The revenue loss due to the addition of FEECs will also be compensated by these measures. The new proposals would enable the government to collect Rs. 10,830 million or Rs. 4,017 million more than the estimated pre-budget revenue figure. This is expected to bring about a current account surplus of Rs. 760 million as against the pre-budget estimate of Rs. 172 million.

The pre-budget capital expenditure figure of Rs. 3,764 million was raised to Rs. 5,879 million and this increase mainly reflects the capital commitments on account of the proposed buffer stock arrangements and the National Development Bank.

The overall budgetary position, (i.e. taking both recurrent and capital expenditure and the expected revenue into account) has therefore changed from a gap of Rs. 3,065 million to a gap of Rs. 5,180 million. This gap will be financed primarily by the rupee loans (Rs. 1,759 million), commodity aid (Rs. 1,620 million) and project aid and grants (Rs. 1,200 million). Hence, there appears to be no need for inflationary financing as in the previous years when there had been recourse to bank borrowings. Yet, the absence of inflationary financing does not necessarily mean the budget will not generate inflationary pressures.

In summary, the Budget for 1978 can be described as an interesting departure undertaken by the new government, and this departure will test the capability of the free market mechanism approach towards delivering the goods to the nation. The "goods" that the nation is eagerly expecting to receive are a higher standard of living through greater production and a lower rate of inflation, more employment opportunities and a better distribution of income. However, the question many would pose is "what price do we have to pay for these goods". The answer to this question becomes crucial not just from an economic point of view but more from a social and political perspective.

The Role of Taxation in the Development Process and the Taxation Proposals of Budget 1978

M. Manoharan

M. Manoharan, by profession a Chartered Accountant and taxation consultant, has written many papers in this field and dealt with the subject of taxation in the development process in a paper he read at a recent Commonwealth Conference of Accountants.

Mobilisation of resources for a planned economic development, guaranteed by capital accumulation and financed largely by domestic savings, has been a key objective of developmental fiscal policies of many countries, and more so of the so-called developing nations. But within this policy objective one finds much disagreement as to what constitutes the most effective policy for maximising investments for development and guiding them into productive channels. The disagreements are not based on ideological grounds alone. Even within economies and political systems following known ideologies, there are conflicts and disagreements on the specific course of developmental fiscal action to be taken.

But it is safe to say that tax models in most countries have passed the stage of remaining a mere machine, collecting revenue for governments. Taxation today is an active and creative force in economic planning and development and an important agent for social change as well.

The concept of development, oriented towards a growth of GNP alone, has also undergone considerable changes. As massive development efforts were made by some countries, their income inequalities have also continued to rise side by side. Development investments geared and guided by tax incentives, it is argued, have served to create small oases of prosperity in deserts of people living below the poverty line who are either not affected by development or are worse off than where they started. Since the aim of development is not merely to increase GNP output but the mitigation of human misery, this aspect has received the increasing attention of planners and politicians and is currently receiving acceptance. As far back as 1955, Simon Kuznets said that in the early phase of industrialisation in the underdeveloped countries, income inequalities would tend to widen before the levelling forces become strong enough first to stabilise and then to reduce income inequalities.

The aim of development in practice in spite of the stated objectives of development is more output and preferably more industrial output. The process had a hidden emphasis on achieving a high growth of national product.

In as much as taxation served as an effective instrument by way of incentives and rebates to bring about a developmental bias notwithstanding the inequity in distribution and wealth accumulation, it appears that again taxation has become the price handle with which the developmental economists and planners are trying to minimise income inequalities.

Conflicts in Scenario

In other words the scenario in which the fiscal incentives are going to function will continue to be an exercise in conflict management and the state of development, the date of taxation and the science of government will depend on the success of the exercise.

The planner in the developing economy will operate within a multitude of conflicts:

To generate and make available for economic development the maximum flow of human and material resources.

To maintain the current consumption requirements of the mass of the people.

To generate capital formation and rationalisation by way of tax incentives.

To reduce the inequality of wealth.

To minimise the abnormal gap in income standards.

To attack the conspicuous living patterns of the affluent group.

To maintain social and political justice without necessarily killing the motivation of the managerial group.

This perhaps, in my view, is the work setting of the developing economies in which environment we have to consider the taxation proposals of Budget 1978.

Overall Objectives of Budget 1978

The basic objectives of Budget 1978 are set out as follows:

Revive and resuscitate our economy which is at breaking point.

Restore vitality to our agriculture, our plantations, our industry, our fisheries and our trade.

Increase employment opportunities, particularly for the youth.

Stimulate domestic savings and investment.

Reduce the pressure on our balance of payments.

Move forward from economic stagnation to economic growth and development.

The stated objectives of the tax proposals are given below:

To simplify the tax system.

To maintain incentives for investment and development, notwithstanding higher taxes on the affluent members of our society.

Personal Income Tax

The rate of personal income tax has been raised to 70% for the Year of Assessment 1978/79. This rate may apply to employment income for the year ending March 1979 and income from other sources for the year ending March 1978.

Dr. Nicholas Kaldor and others of his school of thought, were of the view that a person need not be heavily taxed if he reinvested such income to produce economic growth. It followed therefore that persons who got a large income and used it for consumption should be penalised by way of taxes on consumption, like the expenditure tax. In other words a low tax rate in itself was considered a substantial fiscal incentive, with preventive checks on consumption and a tax on wealth. Dr. Kaldor held the view that disposable income would be directed towards development in such a pattern.

The Budgets for the year 1976 and 1977 seemed to have subscribed to this thought heavily when it reduced the income tax from 65% to 50%, abolished ceilings on income and re-introduced the expenditure tax.

The Budget for the year 1975 was proposed in an environment which stressed that savings should be enforced and consumption curtailed by a ceiling on disposable income. While making concessions for the erosion in the purchasing power of money, it placed a ceiling on the disposable income over Rs. 30,000/-. But this proposal was not implemented. Budget 1975 raised the income tax rates to 75% to compensate for the abolition of compulsory savings on the middle income group. Since in many cases capital levy payments were due in this period and compulsory savings were not refunded, the balance between developmental objectives of the private sector and the distributive social justice policy of the state was disturbed and the development process became the sole initiative of the public and banking sectors.

One of the pronounced features of the present Budget is the liberalisation of licensing procedures and import and exchange control regulations, both for capital and raw material inputs and consumption needs. It would have been in line with this concept of vitalising the economic sectors if the scheme of taxation was also allowed to follow a flexible pattern closer to Kaldor's model of taxation.

One of the vital factors that economists and policy makers should understand is the fact that in a developing economy like ours we are not only in need of foreign capital but that domestic capital too is in short supply.

In the absence of a preferential rate of taxation for development, the raising of individual rates of tax to 70 per cent at this point of time is not in keeping with the basic objectives of the Budget. The liberalisation of the economy, the massive infow of foreign capital that is expected and the unification of the exchange rates have brought the liquidity needs to a crisis point which may affect the financing of private sector development plans. It must also be noted that global inflation has already knocked the bottom of the investible capacity of the managerial and executive grades of our economy.

Proposals to limit salaries must be approached with caution. Minimising the disparity between wage levels of various grades is a laudable objective. But in developing economies that have greater need for managerial and executive talents, and have to compete with the problem of a brain drain to developed and affluent countries, this may prove to be a delicate exercise. Such rationalisation of disparities in wage scales are successfully achieved ony in developed economies.

Capital Allowances

Since enterprises do not have unlimited liquid resources the remission of taxation and capital expenditure in the year in which the capital expenditure is incurred is a positive incentive which has immediate effect. In addition to the grant of lump sum depreciation a rebate for development was also granted in the year of commencement. The general rate of rebate is 20% and a preferential rate of 40% is given for agricultural or other approved projects. In order to accelerate the process of development the present method of granting depreciation in lump sum, in place of an annual percentage of allowance for depreciation, has stimulated development in many ways in the recent past.

The existing system could be tabulated as follows:—

Type of Investment	Lump sum Depreciation	Lump sum depreciation and development rebate (Normal)	Lump sum depreciation and development rebate (Preferential)
Shortlived Equipment	8% of the cost	100% of the cost	120% of the cost
Normal Machinery	66-2/3% of the cost	86-2/3% of the cost	106-2/3% of cost
Durable Machinery	50% of the cost	70% of the cost	90% of the cost
Industrial Buildings and Warehouses	33-1/3% of the cost	53-1/3% of the cost	73-1/3% of the cost

With a view to simplifying the system of granting capital allowances and development rebates, different rate bands are abolished in the Budget 1978.

Instead, with effect from the Year of Assessment 1978/79, lump sum depreciation allowances amounting to the full cost of plant, machinery and fixtures used in a business and 50 per cent of the cost of construction of agricultural and industrial buildings will be granted. With a view to improve the housing conditions of plantation workers and urban workers a 100% depreciation on houses put up by an employer, for use of his employees other than the executive staff, is being offered.

One of the 1975 Budget proposals which was not implemented was a move to abolish capital allowances and lump sum depreciation allowances.

The grant of allowances for capital wastage and the development rebate on capital expenditure is viewed by some people critically as unsuitable for labour intensive economies.

It is argued that this method of development orientation has placed a bias in favour of capital intensive investment and in most countries such industries have to rely heavily on imported components and machinery. Thus heavy strains are placed on the scarce foreign exchange resources without sufficient impact on employment. The per capita investment has become excessive and the incentives should have been based on labour intensive mechanisation wherever labour could have substituted for the mechanisation process.

Another criticism is that with a view to postpone the tax payment process there had been uneconomic investments in machinery and transport equipment mainly to claim depreciation allowances.

These criticisms seem to overlook the fact that it is not as much a defect in the incentive mechanism as it is in other areas of the developmental policy making process. The abuses could have been checked as part of the planning institution, whereby mechanisms have been set up in most countries to grant approval for industries and projects before commencement. A lack of foresight in those desks have contributed more to the abuses than the tax mechanisms.

There could be no serious argument over the fact that this method of granting depreciation stimulated development, by channelling the profit of the boom years to development, as the investor is tempted to retain such profits over investments upon which he has control.

Tax Holiday for Profits in certain sectors

From time to time, in our fiscal history there has been a shift in the emphasis on taxation and this would continue to be so from one sector to the other. In a developing economy where new ventures have to be started such shifts are unavoidable and necessary to attract capital from traditionally safe areas to unexplored new areas. Even within a tax territory favoured treatment is given for starting industries in an agricultural area or an underdeveloped area.

A very attractive and often criticised incentive for development is the exemption of profit from taxation — what is commonly called the tax holiday. The import substitution industrial sector, the tourist hotel industry and the gem trade are some of the beneficiaries of this incentive. The tax holiday has been an effective instrument to mobilise capital, and foreign capital has found it specially advantageous to invest in this area as it ensures a quick pay back.

The World Bank was recently very critical of some aspects of these tax incentives. In the development of import substitution industries, producing consumer goods locally that have hitherto been imported, such production has enjoyed the protection of high tariff barriers. The highly protected domestic market has resulted in the prevalence of a high profit margin in addition to the attraction of the tax holiday. As a consequence of continued tariff and tax holiday incentives the domestic market became attractive, leaving very little incentives for export. Consequently, it is argued, our manufacturers found that the competition from imported goods became almost non-existent and they could sell their products at much higher prices at home than they could obtain in the world market. As raw materials and components have to be imported for the industries the strain on the economy has been very great.

But with the new Budget the Minister is granting tax holidays only to new companies formed for the purpose of carrying on an undertaking and the profits are exempt for a period of five years. This would mean that any losses arising as a result of the capital allowances in this new undertaking or as a result of the failure of the project cannot be set off against the other sources of the investor since these companies have to be new. He is to give this to the agricultural and fishing sectors which are outside the criticism of the sectors referred to by the World Bank.

The third sector to which this will apply is the small and medium scale industries situated in regions outside Colombo and the suburbs. But the products of these regional based industries will not have fiscal protection as in the past and therefore the double protection of tariff referred to by the World Bank is not applicable. The Minister has also proposed to give a new impetus to the non-traditional agricultural sector like cinnamon, citronella, pepper etc. but the details are yet to be spelled out.

Profits arising from construction and sale of small houses up-to 500 sq. ft. and exemption of half the profits on houses below 2000 sq. ft. is reintroduced in the Budget.

The tax benefits in the field of agriculture, housing and fishing have been offered in the past with almost similar incentives. But they did not have the desired impact and in some areas they failed to take off the ground. No serious study of the phenomena seems to have been made. It appears that cash subsidies may be a more effective way of mobilising these sectors than the tax incentives. Perhaps the pay back period is longer in these sectors coupled with the disadvantage of marketing problems.

PROPERTY TAXATION

Capital Gains

Taxation of unrealised capital gains arising on gifts or death posed serious problems of payment for the donors or the beneficiaries since no cash is generated in this form of inheritance. In addition to the payment of gift tax and estate duty, the payment of a capital gains tax can pose a practical liquidity problem. This is specially so after the capital levy proposals that were implemented recently. A similar proposal was made in the 1975 Budget but was not implemented.

Gift Tax and Estate Duty

Another change in the field of property ownership is the unification of the gift tax and estate duty rates. The mathematical logic of having a higher gift tax and reduced estate duty rates to equalise the net inheritance value from both forms of property transfer is in theory a necessary equaliser. But in practice steep gift tax rates, reaching upto a maximum of 100% payable out of unrealised transfers, resulted in substantial inheritance passing on death rather than during the life time of a person. The unification of the two rates would necessarily encourage distribution of the property during the life time of a person. This is a more progressive form of "inheritance transfer", and free of the legal complication of inheritance through death.

Wealth Tax

One major change in taxation of properties and wealth is the Minister's intention to restrict the total taxes on wealth and income to 80% of the assessable income. This was the original scheme under Dr. Kaldor. One of the objectives of a wealth tax is to push idle investments towards efficient sectors. By imposing the wealth tax it is expected that investors will be forced to look out for portfolios that will give a higher return, at least enough to meet the wealth tax after paying their income tax. But a relief was provided similar to the one proposed in the present Budget to avoid unnecessary hardship by restricting the taxes to 80% of the assessable income.

This concept was abolished, however, from the Year of Assessment 1972/73. Even if wealth does not yield any income, Finance Minister Dr. N. M. Perera justified a wealth tax on grounds of minimising wealth inequalities and re-distributive social justice.

In the context of the social changes like land reform, ceiling on houses and capital levy a continuing penalty on wealth ownership in years of low income or loss may look harsh and the introduction of the relief may be looked upon as a move towards tax liquidity.

By limiting the period of back assessment to three years, and removing the complicated tax incentives introduced in the 1976 Budget, and also providing a measure of tax liquidity in property taxation the Minister has simplified the overall structure. This simplification also implies a simplified role for taxation in the development process and the complications are being passed on to the monetary mechanism and import duties.

It may be argued that there is a massive reversal to the market mechanism and a confident restatement of the good years of the Keynesian school of thought in the other fields of the Budget proposals. But the Budget has maintained the basic structure of the post Kaldor scheme of taxation and the re-distributive objectives that were built into the tax system over the years, except in the field of property taxation where it seems to have followed the course of seeking a balance between earlier proposals and the need for a tax liquidity.

THE BUDGET AND CHANGES IN EXCHANGE RATES

S. S. Colombage

The adjustments in the exchange rates and liberalisation of imports were crucial measures introduced with the budget. S. S. Colombage, a senior economist with wide experience in the International Finance Division of the Central Bank, examines the background and significance of these measures.

A package of measures has been introduced in the budget to make certain reforms in the foreign trade and payments system of the country. The objectives of these revisions are (a) to allow the demand and supply forces in the foreign exchange market to determine the value of the local currency in terms of foreign currencies at a more realistic level, (b) to unify the exchange rate, and (c) to liberalise imports. Under these modifications, the Foreign Exchange Entitlement Certificates Scheme and the Convertible Rupee Accounts Scheme have been discontinued and the exchange rate of the Sri Lanka Rupee has been unified. Also, the Rupee has been allowed to float under the supervision of the monetary authorities. Another feature of the new scheme is the relaxation of import and exchange control regulations.

Exchange rate changes have crucial implications on the balance of payments of a country. The balance of payments position in Sri Lanka tended to weaken markedly since the sixties. This development resulted mainly from the fact that import payments rose faster than export earnings. The current account deficit in the balance of payments increased from Rs. 315 million in 1970 to the unprecedented level of Rs. 1,421 million in 1975. The rapid deterioration occurred in 1974, following the oil price hike, when the trade deficit more than quadrupled over the previous year. In fact, the trade deficit progressively narrowed between 1970 and 1973 when it fell from Rs. 315 million to Rs. 299 million. During 1974-75, although export earnings showed a steady increase, import payments rose even faster and caused a serious deterioration in the country's merchandise account. The balance of payments on current account improved in 1976 and 1977 mainly as a result of a decline in prices of imported commodities and higher prices of exports. The trade deficit narrowed in 1976 to Rs. 709 million from the level of Rs. 1421 million in 1975; representing a decrease of 50 per cent. The current account deficit of Rs. 50 million in 1976 appears to be substantially lower when compared with the corresponding deficit of Rs. 907 million in 1974 and Rs. 772 million in 1975.

Floating the Rupee

The floating of the Rupee has marked a deviation in the exchange rate system. It is defined that a currency is floating independently when it is not pegged, within relatively narrow margins, to any currency or composite of currencies. Until November 1977, the Rupee had been pegged to a single currency or a composite of currencies. This link of the Rupee with other currencies has been severed in the

1977 budget and the Rupee has been allowed to float. Under this floating mechanism, exchange rates for the Rupee are determined daily at meeting in the Central Bank with the representatives of commercial banks. The daily rates are fixed on the basis of demand and supply conditions in the foreign exchange market. In this process, estimates of demand for and supply of foreign exchange are derived from the buying and selling orders forwarded by importers and exporters to commercial banks. In accordance with the demand for and supply of foreign exchange, the exchange rates of the Sri Lanka Rupee, against other currencies, are daily fixed at the bankers' meeting. For instance, if the supply of foreign exchange is in excess of the demand for it on a particular day, the rupee equivalent for foreign currency tends to decline and vice versa. Thus, the daily exchange rates reflect the demand and supply situations in the foreign exchange market. The Central Bank intervenes in this operation to prevent undue erratic movements of exchange rates. Official minimum buying and maximum selling rates are published daily by the Central Bank for the U.S. Dollar, Pound Sterling, Deutsche Mark, French Franc, Japanese Yen and Indian Rupee. For other currencies, commercial banks establish rates on the basis of international value of such currencies. It is expected that this new system would develop a more commercially oriented exchange market in the country.

The first fixing of exchange rates under the new scheme took place on November 16, 1977 and a middle rate of Rs. 1,600 for 100 U.S. dollars was fixed on this date; buying and selling rates for U.S. dollars were Rs. 1,597 and Rs. 1,603 respectively. The exchange rates for other currencies have been determined in terms of the U.S. dollar.

Since mid-September, the dollar has tended to weaken against the Deutsche Mark, Pound Sterling, Swiss Franc and Japanese Yen. The dollar's decline has been mainly caused by the general feeling of anxiety that stems from the huge trade deficit building up in the United States. During the first week of December, the dollar dropped below the 2.20 Deutsche Marks level for the first time in post-war German history. In spite of a massive support from the Central Banks of Japan and Western Europe, the dollar continued its downward path in late November and early December this year. The pressure on the dollar was extreme in the money markets of London, Frankfurt and Zurich.

The daily exchange rates for the Sri Lanka Rupee varied marginally during the first six weeks of operation of the new scheme as indicated in Table 1, on page 11.

In considering the historical background of flexible rates, it appears that a small number of countries adopted floating exchange rates for limited periods during the 1950s and 1960s. Several major countries allowed their currencies to float for a few months in 1971 until the re-establishment of par values by the Smithsonian Agreement of December 18, 1971. In early 1971, major industrial countries adopted floating exchange rates. Since then a number of countries have established floating arrangements. The United States, United Kingdom, Japan, Germany, France, Canada, Nigeria, Saudi Arabia, Chile, Brazil, Philippines and Colombia are some of the countries that adopt floating rates.

Unification of the Exchange Rate

Apart from the modifications in the method of exchange rate determination, the exchange rate has also been unified in the budget. Under this measure, the Foreign Exchange Entitlement Certificate Scheme was terminated in mid-November and accordingly, an unified exchange rate is applied now for all foriegn transactions. Since the introduction of the FEEC Scheme in May 1968, a dual exchange rate system had been in operation until November 1977. The basic objectives of the scheme were (a) to promote non-traditional exports, (b) to restrain non-essential imports and (c) to divert black market foreign exchange transactions into official channels. Under this scheme, Foreign Exchange Entitlement Certificates were issued to those who surrendered foreign exchange to commercial banks against the export of certain goods and against certain inward remittances. On the other hand, payments in respect of certain imports and outward remittances in respect of most services required the surrender of Certificates. Under this system, two exchange rates were operated in foreign exchange transactions, which were divided into two groups — Group and A and Group B; transactions in Group A took place at the parity rate while those in Group B were subject to a FEEC rate of 65 per cent in addition to the par value. In general, essential imports were exempted from FEECs while non-traditional exporters were granted FEECs. The abolition of these multiple currency practices means that all foreign exchange transactions are executed at an unified exchange rate.

Past Exchange Rate Practices

Prior to the introduction of the exchange revisions in November 1977, various exchange rate systems operated in Sri Lanka from time to time. Since 1949, a fixed parity rate system was in operation until November 1971, in terms of the regulations of the International Monetary Fund. Under these rules, it was required that each member country of the IMF should declare the par value of its currency in gold or in U.S. dollars. A country was also required to consult the IMF if it wished to make a substantial change in its par value.

Since 1949 the first change in the exchange rate of the Rupee took place in November 1967 when the Rupee was devalued by 20 per cent, following the devaluation of the Pound Sterling by 14 per cent. In terms of Sterling, the resulting effective devaluation of the Rupee was about 14 per cent. It was expected that the devaluation would ease the balance of payments difficulties by way of inducing exports and restraining imports. The next change in the exchange rate system occurred when a dual exchange rate system was introduced in May 1968 as discussed above.

During the period from 1971 to 1977 the exchange rate of the Rupee was determined on a pegging basis; accordingly, between 1971 and 1976, the rupee was pegged to a major foreign currency (unitary peg) and during 1976-77, it was pegged to a basket of currencies (composite peg). In November 1971, the par value system as the basis for fixing the exchange rate for the Rupee was abandoned and it was decided to peg the Rupee to the US dollar; this action was taken in view of the decision of the U.S. Government to float the Dollar in August, 1971.

The Pound Sterling was allowed to float in June 1972 and as a result, it was difficult for Sri

TABLE I

DAILY EXCHANGE RATES SINCE NOVEMBER 16, 1977.

(Rupees per 100 units of foreign currency)

Date 1977		US Dollar Buying Rate	US Dollar Selling Rate	Pound Sterling Buying Rate	Pound Sterling Selling Rate	Deutsche Mark Buying Rate	Deutsche Mark Selling Rate
November	16	1597.00	1603.00	2900.00	2911.00	711.12	714.12
	17	1595.00	1601.00	2906.50	2917.50	711.65	714.65
	18	1595.00	1601.00	2906.10	2917.10	710.95	713.95
	21	1591.00	1597.00	2914.50	2925.50	710.90	713.90
	23	1592.00	1598.00	2895.50	2906.50	713.00	716.00
	24	1592.00	1598.00	2896.50	2907.50	714.05	717.05
	28	1592.00	1598.00	2895.50	2906.50	718.60	721.60
	29	1592.00	1598.00	2894.00	2905.00	718.40	721.40
	30	1592.00	1598.00	2889.00	2900.00	715.10	718.00
December	01	1592.00	1598.00	2892.00	2903.00	716.00	719.00
	02	1591.50	1597.50	2893.00	2904.00	720.00	723.00
	05	1591.00	1597.00	2899.50	2910.50	720.90	723.90
	06	1588.00	1594.00	2893.00	2904.00	727.00	730.00
	07	1587.00	1593.00	2907.50	2918.50	733.00	736.00
	08	1587.00	1593.00	2901.30	2912.30	733.40	736.40
	09	1587.00	1593.00	2903.50	2914.50	726.25	729.25
	12	1586.00	1592.50	2907.50	2918.50	725.40	728.40
	13	1585.50	1591.50	2907.50	2918.50	731.75	734.75
	14	1580.00	1586.00	2915.50	2926.50	742.00	745.00
	15	1577.00	1583.00	2919.00	2930.00	740.25	743.25
	16	1577.00	1583.00	2917.00	2928.00	737.00	740.00
	19	1575.00	1581.00	2922.00	2933.00	735.80	738.80
	20	1567.00	1573.00	2943.75	2954.75	744.30	747.30
	21	1567.00	1573.00	2948.25	2959.25	741.30	744.50
	22	1565.00	1571.00	2948.60	2959.60	735.70	738.70
	23	1571.50	1577.50	2924.75	2935.75	731.20	734.20
	27	1569.00	1575.00	2936.10	2947.10	730.60	733.60
	28	1566.00	1572.00	2949.00	2960.00	733.50	736.50
	29	1553.00	1559.00	2979.75	2990.75	741.00	744.00

Date 1977		French Franc Buying Rate	French Franc Selling Rate	Japanese Yen Buying Rate	Japanese Yen Selling Rate	Indian Rupee Buying Rate	Indian Rupee Selling Rate
November	16	328.75	330.25	6.5075	6.5375	184.95	185.75
	17	329.00	330.50	6.5409	6.5690	185.10	185.90
	18	328.65	330.15	6.5550	6.5850	185.10	185.90
	21	328.40	329.90	6.5600	6.5900	185.60	186.40
	23	328.95	329.85	6.6250	6.6550	184.40	185.20
	24	328.55	330.05	6.6575	6.6875	184.45	185.25
	28	328.60	330.10	6.6350	6.6650	184.35	185.15
	29	328.25	329.75	6.5935	6.6235	184.25	185.05
	30	327.60	329.10	6.5290	6.5590	184.05	184.85
December	01	327.95	329.45	6.5210	6.5510	184.10	184.90
	02	328.60	330.10	6.5660	6.5960	184.20	185.00
	05	328.25	329.75	6.5540	6.5840	184.00	184.80
	06	328.90	330.40	6.5720	6.6020	184.25	185.05
	07	328.80	330.30	6.5860	6.6160	185.10	185.90
	08	329.05	330.55	6.5710	6.6010	184.20	185.00
	09	327.65	329.15	6.5480	6.5780	184.30	185.10
	12	327.85	329.35	6.5360	6.5660	185.20	186.00
	13	328.95	330.45	6.5850	6.6150	185.10	185.90
	14	329.15	330.65	6.5850	6.6150	185.20	186.00
	15	328.95	330.45	6.6300	6.6600	185.20	186.00
	16	328.45	329.95	6.5450	6.5750	185.10	185.90
	19	328.45	329.95	6.5100	6.5400	185.40	186.20
	20	329.35	330.85	6.5130	6.5430	186.60	187.40
	21	329.85	331.35	6.5090	6.5390	186.10	186.90
	22	329.15	330.65	6.4900	6.5100	185.70	186.50
	23	328.70	330.20	6.5000	6.5300	185.50	186.30
	27	328.50	330.00	6.4990	6.5290	185.60	186.40
	28	328.50	330.00	6.5030	6.5330	184.60	185.40
	29	331.45	332.95	6.4730	6.5030	184.60	185.40

Source: *Central Bank of Ceylon.*

Lanka to maintain its trade relationships with the Sterling Area without linking the Rupee to the Pound Sterling. Therefore, the link of the Rupee with the U.S. Dollar was discontinued and the Rupee was pegged to the Pound Sterling at the rate of Rs. 15.60 = 1 Pound Sterling in July 1972.

This link with the Pound Sterling was in operation until May 1976. During this period, the value of the Pound Sterling tended to weaken in international money markets. Since the value of the Rupee in terms of other currencies was determined through the Pound Sterling, the Rupee depreciated against most of these currencies as shown in Table 2. For instance, the value of the US dollar appreciated against the Rupee from Rs. 5.95 in June 1972 to Rs. 7.71 in December 1976. This downward trend was aggravated during the first half of 1976.

In view of the decline of the Pound Sterling, it was decided in May 1976 to sever the link of the Rupee with the Pound Sterling and to link it to an appropriately weighted basket of currencies.

Theoretically, an advantage of this composite peg was that it avoided rapid fluctuations in the exchange rate since the country's currency was linked to a number of currencies and not to a single currency; comparatively, pegging to a single key currency results in variations in the exchange rate in accordance with the fluctuations in the key currency. Under this a composite peg system, the Rupee showed a marginal appreciation against the Pound Sterling while the exchange rate for the U.S. dollar remained almost stable during the period from May 1976 to March 1977 as shown in Table 3, on page 13.

From 1976 the export earnings of the country showed a marked increase and this was largely due to higher proceeds from tea and rubber: prices for tea and rubber rising in 1976 by 16 per cent and 60 per cent respectively. In the light of the higher export earnings, it was decided to appreciate the Rupee by approximately 20 per cent on March 12, 1977. Accordingly, the rupee equivalent of the U.S. dollar was reduced from Rs. 8.72 to Rs. 7.28 and that of the Pound Sterling from Rs. 14.97 to Rs. 12.51 as indicated in Table 3.

After the appreciation of the Rupee in March, the exchange rate did not change again until mid-August. Between August 1977 and November 1977, parity rates had been revised several times under the 'Crawling Peg System'. The Rupee was depreciated in terms of other currencies during this period by a carefully managed downward float mechanism as shown in Table 3. In such a situation where the exchange rate was regularly adjusted, some exporters tended to delay their shipments and certain importers attempted to expedite their import payments in the expectation of realising higher rupee values.

The exchange rate of the Rupee varied against Special Drawing Rights (SDR) since 1950 as indicated in Table 4. A hypothetical rate of 1 SDR = 1 U.S. Dollar is used here for the period prior to

TABLE 2

EXCHANGE RATES OF THE SRI LANKA RUPEE

1973 - 77 (Rupees per unit of foreign currency)

Country	Currency	1973 June	1973 Dec.	1974 June	1974 Dec.	1975 June	1975 Dec.	1976 June	1976 Dec.	1977 June	1977 November Pre-budget rates
1. Australia	Dollar	8.6669	10.0173	9.6344	8.7636	9.1813	9.6870	10.8218	9.0194	7.9974	9.5542
2. Austria	Schilling	0.3055	0.3459	0.3519	0.3554	0.4166	.4177	0.4696	0.5199	0.4275	0.5278
3. Belgium	Franc	0.1581	0.1675	0.1693	0.1704	0.1971	.1952	0.2185	0.2412	0.1981	0.2410
4. Canada	Dollar	6.1117	6.7438	6.7234	6.7856	6.6953	7.6228	8.8678	8.7499	6.9472	7.6788
5. Denmark	Krone	1.0095	1.0826	1.0872	1.0921	1.2686	1.2601	1.4143	1.5066	1.2385	1.3930
6. F. R. Germany	D. Mark	2.2287	2.5473	2.6233	2.5202	2.9476	2.9406	3.3697	3.6871	3.0362	3.7592
7. France	Franc	1.3851	1.4852	1.3230	1.4108	1.7261	1.7324	1.8322	1.6747	1.4618	1.7602
8. Hongkong	Dollar	1.1902	1.3319	1.2808	1.3198	1.3916	1.5257	1.7871	1.8674	1.5753	1.8162
9. India	Rupee	0.8298	0.8298	0.8298	0.8298	0.8258	0.8605	0.9525	0.9939	0.8233	1.0214
10 Italy	Lira	0.0104	0.0111	0.0101	0.0101	0.0110	0.0113	0.0102	0.0102	0.0082	0.0097
11. Japan	Yen	0.0231	0.0241	0.0231	0.0224	0.0234	0.0251	0.0289	0.0300	0.0258	0.0341
12. Kuwait	Dinar	—	—	—	—	—	—	—	30.8882	25.3826	30.0030
13. Malaysia	Ringgit	2.4804	2.7870	2.7417	2.7574	3.0155	2.9826	3.4189	3.5026	2.9207	3.5376
14. Netherland	Guilder	2.1496	2.3942	2.4690	2.4642	2.6598	2.8703	3.1683	3.5322	2.9139	3.5126
15. New-Zealand	Dollar	8.1111	9.6672	9.4839	8.7175	9.0283	8.0363	8.5454	8.6172	6.9764	8.4049
16. Norway	Krone	1.0682	1.1950	1.1966	1.2088	1.4202	1.3891	1.5674	1.6954	1.3820	1.5576
17. Pakistan	Rupee	0.6367	0.6753	0.6638	0.6739	0.6972	0.7704	0.8708	0.8855	0.7516	0.8658
18. Philippines	Peso	0.9043	0.9917	0.9633	0.9891	0.9759	1.0245	1.1966	1.1975	0.9799	1.1556
19. Saudi Arabia	Riyal	—	—	—	—	—	2.1818	2.4659	2.5190	2.0684	2.4320
20. Singapore	Dollar	2.4704	2.7586	2.6897	2.7501	3.0246	3.0883	3.5376	3.6112	2.9562	3.5617
21. South Africa	Rand	8.6911	10.1863	9.6845	9.5639	10.1122	8.8701	10.1741	10.1981	8.3910	9.7888
22. Sweden	Krone	1.4081	1.4917	1.4955	1.4996	1.7612	1.7489	1.9413	2.1174	1.7233	1.7814
23. Switzerland	Franc	1.9612	2.1133	2.1857	2.2674	2.7684	2.9426	3.5297	3.6287	2.8422	3.8160
24. U. Arab Emirates	Dirham	—	—	—	—	—	—	2.1195	2.2305	1.8761	2.1955
25. United Kingdom	Pound	15.6000	15.6000	15.6000	15.6000	15.6000	15.6000	15.2393	14.6101	12.5136	15.5255
26. U.S. America	Dollar	6.1021	6.7445	6.4663	6.6881	6.8677	7.7094	8.6759	8.8639	7.2817	8.5990

Source: *Central Bank of Ceylon.*

TABLE 3

EXCHANGE RATES DURING THE BASKET PEG

Effective Date		Per Pound Sterling	Per U.S. Dollar
1976	May 19	15.6000	8.6451
	June 08	15.2393	8.6759
	Sept. 23	14.8563	8.6525
	Sept. 29	14.2846	8.7287
	Oct. 12	14.4200	8.6736
	Oct. 27	13.9572	8.7753
	Nov. 12	14.2000	8.6930
	Nov. 22	14.5311	8.6559
	Dec. 01	14.6101	8.8639
1977	Jan. 06	14.8954	8.7171
	March 09	14.9670	8.7154
	March 12	12.5136	7.2817
	Aug. 19	12.7715	7.3361
	Aug. 29	13.1577	7.5562
	Sep. 07	13.5524	7.7829
	Sep. 12	14.9991	8.6053
	Oct. 31	15.1515	8.5257
	Nov. 02	15.6953	8.5000
	Nov. 04	15.5255	8.5990

Source: *Central Bank of Ceylon.*

1970. The Rupee depreciated continuously from Rs. 4.76 = 1 SDR in the period 1950-67 to Rs. 10.42 = 1 SDR in 1977.

Abolition of the CRA Scheme

Following the budget, the Convertible Rupee Accounts Scheme was discontinued in mid-November. The CRA Scheme was introduced in July 1972. It was expected that this scheme would operate as a supplementary measure to the FEEC Scheme in promoting non-traditional exports and channelling foreign exchange transactions through official means. Under the CRA Scheme, a specified amount of foreign exchange was granted to the exporters of non-traditional commodities for utilisation on imports and travel abroad. Some of the major shortcomings of the CRA Scheme were the non-availability of the benefits to producers, importation of non-essential commodities and large income accruals to a limited number of individuals. Following the termination of the scheme, the existing balances in Convertible Rupee Accounts were allowed to remain at the disposal of account holders for the purposes they were applicable to earlier. No further credits to these accounts are permitted without reference to the Central Bank. All purchases of foreign exchange to the debit of these accounts are executed at the new exchange rates.

TABLE 4

EXCHANGE RATES

Period	Rs. per unit of SDR
1950-67	4.76
1968-70	5.95
1971	6.15
1972	6.70
1973	7.60
1974	8.00
1975	8.44
1976	9.73
1977	10.42

Source: *Central Bank of Ceylon.*

Liberalisation of Imports

Import and exchange control regulations have been relaxed in the budget to facilitate the determination of the rate of exchange through demand and supply conditions in the foreign exchange market. Under this liberalisation scheme, certain commodities are allowed to be imported under a Special Import Licence without the authority of a licence issued by the Exchange Controller. Paddy, rough rice, infant's milk foods, petroleum oils, chemicals, explosives, man-made fibres, woven fabrics and motor cars are some of the items that cannot be imported under the Special Licence. Items which are not included in the restricted list can be imported on the 'over the counter basis' where individuals are allowed to open letters of credit with any commercial bank. Foreign exchange for these imports are sold by commercial banks to individuals on application. It is also proposed to restrict the public sector import monopolies and to expand the private sector participation in foreign trade.

Apart from the liberalisation of imports, controls on certain invisible payments have also been relaxed in the budget. Authorised dealers are allowed to provide foreign exchange for tickets and living expenses to travel abroad for medical treatment, official duty and other specific purposes.

Implications of Floating Rates

The case for floating rates is largely based on the view of that such a system would correct the balance of payments disequilibrium through exchange rate adjustments. Accordingly, it is argued that floating rates can be considered as an equilibrating instrument in the balance of payments. It is further claimed that daily corrections through flexible rates would avoid additional adjustment costs associated with substantial changes in the echange rates at wide time intervals and such short-term adjustments help to reach stability over the long run. Another argument in favour of floating rates is that a system equilibrating the balance of payments through a flexible exchange rate mechanism would avoid distortions that may occur as a result of an artifically high or low exchange rate or direct controls on trade and capital flows. It is also claimed theoretically that since all adjustments in a system of floating rates are effected through the exchange rate, there would be hardly any need for foreign exchange reserves. A further argument is that floating rates would eliminate illegal foreign exchange activities such as under-invoicing of exports, over-invoicing of imports and smuggling.

It has been noted in the recent exchange rate literature that the issues in favour of flexible rates need to be qualified in several respects. It has been pointed out that a well-functioning foreign exchange market is required for the smooth operation of flexible exchange rates and such a market is not in existence in many developing countries. Another point that has to be taken into consideration is that the effectiveness of the exchange rate as an equilibrating instrument of the balance of payments largely depends on among other factors, the response of imports and exports to changes in exchange rates.

It is expected that an import liberalisation programme would ease the inflationary pressures in our economy by way of providing a larger inflow of commodities. As in many other developing countries, the rapid increase in prices has been a major economic problem in Sri Lanka. The general price level of the country has risen at an annual rate of 8.4 per cent during the past ten years. The effectiveness of the import liberalisation programme in slowing down this rapid inflation depends on the nature of the interaction among a number of factors such as the exchange rates, prices of imports and the type of imports.

The Budget of '78 and the direction towards an 'Outward looking' growth strategy

Renton de Alwis

Some issues relevant to the decision to move towards an "outward looking" direction in our development strategy are discussed here by Renton de Alwis who teaches economics at the Vidyalankara Campus of the University of Sri Lanka, and specialises in resource economics.

An analysis of the Budget in terms of its immediate impact on the different levels of society is important. But it is even more important to view the overall impact of the changes intended to be brought about, by the measures in it, towards changing the direction of Sri Lanka's economy from what it was since independence. Sri Lanka in the past was clearly following an 'inward looking' approach geared towards development where the objective was to follow protectionist policies with regard to the domestic agricultural sector and the industrial sector. The tendency in past years has been to diversify export agriculture in an attempt to minimize the effect on the economy from the fluctuating earning situations in the export market for tea, coconut and rubber.

The Budget proposals covering (a) the unification of the exchange rate and floating of the rupee (b) the liberalization of imports (c) the liberalization of exchange control restrictions and (d) the proposed allocation of expenditure for the establishment of the Free Trade Zone, can all be viewed as a definite change of direction from the strategy of the past. These measures can be termed as pre-conditions for an 'outward looking' strategy geared towards economic growth. This concept is discussed by Bela Ballasa, the IBRD economist, in a 1971 paper titled "Industrial Policies in Taiwan and Korea" **Weltwirtschaftliches Archiv** 106 (1971) and reprinted in International Economics and Development, ed. L. E. Di Marco (Essays in honour of Raul Prebisch) Academic Press 1972.

Ballasa points out that the 'outward looking' strategy adopted in Taiwan and Korea, beginning in the early sixties, had as pre-conditions, entailed changes in the system of incentives in favour of exports, reduced the extent of protection in the manufacturing sector, adopted more realistic exchange rates and liberalized the import quota system and removed the prior deposit requirement on import applications. These were intended to offer possibilities through the 'outward looking' strategy to "utilize appropriately a country's resources for economic growth and to avoid the adverse effects of import substitution on production costs, technological change and product quality in particular". In his conclusion Ballasa goes on to state that "developing countries are therefore well advised to learn from the experience of Taiwan and Korea in applying export oriented policies."

Apart from the experience of these countries as experiments in adopting "outward looking" growth strategies there are also other developments on the International economic front which lead to necessitating countries of the developing world to think in terms of modern laissez faireism.

In the post war period both the developed and the developing countries have been following partial protectionist policies in terms of trade with other countries and internal economic growth and development. Such an "inward looking" approach is visible when one traces the events that led to the establishment of the EEC, OECD and also the more recent protectionist trends in the U.S. and Japan. In the developing world the need for an UNCTAD and selective regional co-operation such as LAFTA, EACSO etc. and their internal import substitution policies have been important in this regard. The more recent attempts by the developing world to co-operate in resisting the 'unfair' terms of trade offered by the developed world are manifest in actions such as the oil embargo and the formulation of the OPEC and the initiation of economic co-operation through the non-aligned movement and regional trading blocs.

These events have been the effects or the causes or both for the determination of international trade trends during the recent past. The economic performance of some of the affluent countries of the developed world has not been satisfactory during the past decade. The U.S.A. for example, has been faced with balance of payments problems and stagflation, since the dawn of the decade and even at present the U.S. dollar does not seem to have gained the confidence of international financial circles as was indicated by its recent drop to an all time low with respect to the Deutsche mark.

The reaction of the International financial and lending agencies to such a situation has been to suggest policies of removing protectionism in order to allow the free market forces to operate on the International economic front. This modern laissez faireism is reflective of the IMF's policy of adopting a method of currency floating, import liberalization and reducing the effect of the fiscal policy arm in development strategy by means of reducing government expenditure etc. The emerging importance of monetarist thinking of the Chicago School of Economists, headed by the Nobel Laureate of 1976 Dr. Friedman, can also be cited as an indication of the call for freeing of economies of protectionism and state intervention in economic activity.

In this present context of the world economy, there is virtually very little choice for a developing country that seeks "international co-operation" in its development efforts but to fall in line with the emerging 'outward looking' growth strategy thinking. While the Korean and Taiwanese examples have proved to be fruitful in terms of increased volumes and value of export goods and in terms of increases of GNP which are the indicators of economic growth; these countries are also faced with the associated problems of increased dependence on the international business cycle and on the need for an increasing volume and value of imports. This is illustrated in table 1.

In Taiwan while total exports have grown from 3.6 per cent in the period 1953 - 1960 to 23.1 per cent in the period 1960-69, the growth of imports of manufactured goods for the two periods have been 6.7 per cent and 19.2 per cent respectively. Similarly for South Korea the growth of exports for the two periods are 2.8 per cent and 38.9 per cent and imports of manufactured goods are 6.6 per cent and 26.0 per cent. Relevant figures for the developing countries, excluding Taiwan and South Korea, show only minor changes in the value of exports and imports which indicate an attempt by these countries to follow policies of least dependence on the international trade system for their development.

In Sri Lanka the situation has been similar, as can be seen by the export and import volume index presented in table 2. The export volume index figure of 81 in 1956 had reached an all time high of 105 in 1965 and an index figure of 97 for 1976; while the import volume index figures show a declining trend since 1959 from 133 in that year to 75 in 1976. The traditional indicator of economic growth (G.N.P.) shows high growth rates in the region of 9 to 10 per cent per annum for Taiwan and South Korea while the rates for all other developing countries (excluding Taiwan and Korea) were around 4.5 per cent during the past two decades. The growth rates of Sri Lanka's economy have been around 3 to 3.5 per cent during this period, according to Central Bank statistics. However, though the G.N.P. is used as an indicator of economic growth it must be remembered that it does not necessarily measure the levels of development achieved by a country for its people.

TABLE 2 — Central Bank Trade Indices (1967 = 100)

Export and Import Volume Index

Period	All Exports	All Imports
1956	81	109
1957	79	116
1958	84	118
1966	96	118
1965	105	86
1964	102	114
1963	93	93
1962	97	108
1961	90	107
1960	87	133
1959	82	136
1967	100	100
1976	97	75
1975	102	69
1974	85	56
1973	98	79
1972	97	88
1971	99	90
1970	102	102
1969	98	108
1968	103	101

Source: *Central Bank of Ceylon. Annual Report 1976.*

As "The U.S. and World Development Agenda 1977" published by the Ovreseas Development Council in March 1977 (Praeger Publishers 1977) states "The traditional measures of national economic progress - the Gross National Product (GNP) and its component elements cannot very satisfactorily measure the extent to which the human needs of individuals are being met, nor should it be expected to do so". Therefore, in place of the weak traditional measure, the ODC adopted the indicator of the Physical Quality of Life Index (PQLI) which, according to them, is based on the assumption that the needs and desires of individuals initially and at the most basic level are for longer life expectancy, reduced illness and greater opportunity. It further states that "the index does not measure the amount or the type of effort put into achieving these goals, but the extent to which they are being met - that is, it measures **results**. It acknowledges that improvements in meeting these minimum needs can be achieved in a variety of ways - by better nutrition, improved medical care, better income distribution, increased levels of education and increased employment". In table 3 the findings of the ODC are stated and in comparison with the per capital GNP indicator is seen that Sri Lanka with an average per capita G.N.P. of U.S. $ 130 has a PQLI Index rating of 83, while Korea with its relatively high per capita GNP of U.S. $ 480 enjoys a relatively lower rating of 80. On the other hand Taiwan with its very much higher capita G.N.P. of U.S. $ 810 enjoys a rating of 88.

The reasonably high PQLI rating for Sri Lanka, had been the result of continuous allocation of funds by Government in the fields of health, education and food and the emphasis laid on developing public investments based on wider considerations of social benefits, and

TABLE 1 — Average Annual Growth Rates in Taiwan, in South Korea, and in all Developing Countries (a)

	Taiwan				South Korea				Developing Countries			
	53.60	60.64	64.69	60.69	53.60	60.64	64-69	60-69	53-60	60-64	64-68	60-68
Gross Domestic Product (b)	6.9	9.6	10.2	9.9	5.0	6.3	11.4	9.2	4.9	4.8	4.8	4.8
Population	3.6	3.3	3.2	3.0	2.0	2.8	2.3	2.6	2.5	2.4	2.4	2.3
Per Capita Gross Domestic Product (b)	3.1	6.1	6.8	6.5	3.0	3.3	8.9	6.4	2.3	2.3	2.3	2.3
Agriculture (b)	3.9	5.6	4.7	5.0	2.3	6.5	3.1	4.6	2.9	3.1	2.5	2.8
Manufacturing (b)	10.1	23.0	16.1	18.0	13.6	9.7	22.0	16.0	7.2	6.8	5.8	6.3
Total Exports (c)	3.6	27.5	18.8	23.1	-2.8	38.0	39.0	38.9	6.6	5.7	6.2	5.9
Total Exports Excluding Petroleum (c)	3.6	27.5	18.8	23.1	-2.8	38.0	39.0	38.9	2.0	4.5	5.1	4.8
Exports of Manufactured Goods (c)	29.5	36.1	34.2	34.5	0.2d	89.7	55.0	69.0	6.4	9.6	13.3	11.4
Total Imports (c)	6.4	9.6	24.2	19.0	-0.0	4.2	36.0	21.0	4.8	4.0	7.0	5.5
Imports of Manufactured Goods (c)	6.7	8.7	28.5	19.2	6.6d	5.4	40.0	26.0	6.3	4.3	9.0	6.6

(a) All figures are in per cent.
(b) Constant prices.
(c) Current prices.
(d) 1954-1960.

Source — *International Economics and Development. Essays in Honour of Raul Prebisch.*

COMMENTS ON THE BUDGET

The Prime Minister

Mr. J. R. Jayewardene

This Government is aware that certain proposals mentioned in this budget will create hardships. But a scheme will be implemented to give relief to families who lose their rice and sugar subsidies. Relief will come in the form of employment to 18-year-olds and above and salary increases to such families.

The new path taken by the Government through the budget was to free exchange control because it created a scarcity of goods. So, the Government decided to remove those restrictions but offered protection to certain types of producers. The Government decided to go back to the normal rupee value and allow people to import food items, to get away from control over rice and other food items and sell goods to the people at world market prices without profit. The democratic process must be preserved.

The present budget had not in any way enlarged on the extent of the capitalist base of the former budget. It had only freed exchange and import control restrictions. The only new feature was the Free Trade Zone which would be confined to a few hundred square miles and no multi-national organisations would be allowed to operate outside that Zone.

It would be an experiment in free living with foreign investors coming here to start industrial ventures with the help of local labour and raw material.

The Government's endeavour was to find at least one or two jobs for each family. That was the only way towards development — not capitalism or socialism. The work would begin next year. That was the theme of the present budget.

* * *

The Leader of the Opposition

Mr. A. Amirthalingam

The budget speech contained references to a free economy and a free and just society, but nothing in the budget proposals would ever keep to those glorious promises. Exactly the opposite would occur as far as the poor masses of this country were concerned.

The proposals of this budget — as far as the poor man was concerned — were a complete reversal or a right-about-turn of the pledges the UNP had given. They also contained economic policies which moved in a different direction than what they did during the past 30 years. It might be that this new direction was intentional but as to whether the policies would be in the larger interests of this country, had not been thought of .

What he felt was that the Finance Minister was placing the future of this country at the mercies of the IMF, the World Bank and American Aid while real development could only be achieved through socialist planning.

* * *

Federation of Chambers of Commerce and Industry of

We wish to congratulate the Minister of Finance on his maiden budget speech which is a new milestone on the road of Sri Lanka's economic development. We welcome the more liberal policies which will activate the economy, help to provide employment, bring down the cost of living and alleviate living conditions of the masses which are crucial problems facing the Government

* * *

The Sri Lanka Consumer's and Users Federation

On the whole the budget of the new Minister assures incentives in a mixed economy. The implementation of the budget depends very much on the integrity and the efficiency of the bureaucrats in the public sector.

TABLE 3 — A comparison of performance as measured by G.N.P. and performance as measured by the Physical Quality of Life Index for Selected Countries

	Average Per Capita GNP ($)	PQLI Achievement
Lower-Income Countries	152	39
India	140	41
Kerala, India	110	69
Sri Lanka	130	83
Lower Middle-Income Countries	338	59
Malaysia	680	59
Korea, Rep of	480	80
Cuba	640	86
Upper Middle-Income Countries	1,091	67
Gabon	1,960	21
Iran	1,250	38
Algeria	710	42
Taiwan (ROC)	810	88
High-Income Countries	4,361	95
Kuwait	11,770	76
United States	6,670	96
Netherlands	5,250	99

Source *The United State and World Development Agenda 1977.*

income redistribution under "outward looking" policies. The increasing importance given to the views expressed on the physical limitations of resources on earth and the maleffects of continuous pressure on resources due to the 'rush' towards growth in the post war period has triggered the thinking of most economists to think in terms of the social costs of growth. Many development economists both in developed and developing countries have stressed the immediate need of determining the value consideration behind the concept of growth, and go on to show that any strategy for growth should be based on such a value structure.

If Sri Lanka is to determine its value structure for development based on the democraitc - socialist lines of highlighting equitable distribution of incomes and better public service sectors in health, education, transport, etc. then it's development strategy should be formulated with the definite objective of reducing social costs of rapid economic growth and uncontrolable dependence on the eve in the international economy.

The information provided by the ODC also provides an indicator by which we could guide the "outward looking" approach embedded in the budget of 1978 and try to achieve a balance in order to minimize a possible social cost element that may effect the more stable "inward looking" strategy proposed by the Mahaweli Development Scheme.

FOREIGN PRESS VIEWS

Sri Lanka floated its currency this week and lifted foreign exchange controls as part of a budget which dramatically reversed the fiscal policies of previous governments. The aim of the four month old United National Party government is to free the economy of almost all financial controls letting the market stimulate the inevstment and development that these have not promoted.

The effect of the float is a (theoretical) devaluation about 45%. The rupees previous value was 15.53 to the pound sterling. It is now floating at around 29 to the pound (16 to the dollar) for those buying foreign currencies with rupees the real effect of the change is slight.

But the Plantation Industries, still a mainstay of the economy will benefit though they will have to pay increased duties on their exports of tea, rubber and coconut.

The Economist (London)
19. 11. 77)

Judging by its initial steps, the government is particularly concerned with financial and economic problems. Submitting the 1978 budget to Parliament, Finance Minister Ronnie de Mel cited one of the Buddha's precepts:

"Divide your income into four parts: spend one part on food and clothing, two parts on promising business, and keep the last part for a lean year".

However, most Sri Lankans, and indeed the country as a whole, have as yet little possibility of following this still relevant Buddhist course. Sri Lanka has long experienced a monetary and food crisis caused by the onerous colonial legacy and continued dependence on the world capitalist market.

NEW TIMES (Moscow)

Although some form of adjustment of exchange rates and a reform of foreign trade rules were expected, the scale of devaluation undertaken by the Sri Lanka Government is shockingly large. The consequence of the present change will be that even tea and rubber producers may be tempted to undersell widely abroad in view of the higher earnings obtainable in terms of local currency. And the latest development may well depress earnings for India from tea exports which were spectacular in the first few months of the current financial year, unless price adjustments are made by way of reduction in export duty.

THE HINDU (Madras)
18. 11. 77

The substantial devaluation and the decontrol of foreign trade are truly in line with the standard prescription of advice given periodically by the World Bank and the International Monetary Fund to the developing countries.

COMMODITIES

TEA

The change with the Budget in parity rates, export duties, cesses and the ad valorem sales tax for tea saw producers, brokers and exporters adjusting to the new conditions in November. The new parity rates of exchange were almost twice as much as the prebudget rates. From November 16 therefore, buyers from Colombo were left with more rupees to operate on. But the new export duties which were raised to Rs. 15.50 per kilo for bulk tea, and Rs. 13.50 for packeted tea and tea bags, and also the increase of cesses to 70 cts. per kilo were expected to absorb most of the rupee increases resulting from the change of the parity rates. The ad valorem sales tax was also having a similar effect and commenced at over Rs. 10.15 per kilo with no ceiling as in the past.

The trade experienced unsettled conditions in the week after the Budget. There was an adverse effect on demand and an overall drop in prices with the non-participation of Iraq at the auctions; the absence of fresh buying orders of any magnitude; the limited influence of "trading buying" on the market due to the uncertainty following the changes after the budget; and the strained financial resources of local shippers with the increased rupee requirements on existing orders brought on with changes in export duty and adjustments of exchange rates.

An analysis of the direct relationship between the rupee prices of tea after and before the budgetary changes showed that, if all other factors of supply and demand etc. were equal, teas that were realising approximately Rs. 15 per kilo and above should theoretically have been able to enjoy higher rupee prices and those below Rs. 15 per kilo should have dropped proportionately. Brokers indicated that the only adverse effect could be on the teas in the lowest category where the incidence of the new export duty and cesses would amount to about 60 p. per kilo or approximately 1 US dollar, which would have left the local buyer with a marginal amount for the cost of tea at quotations prevailing prior to the changes of November 15.

At the auction of November 21, teas that previously sold at below the Rs. 13 to Rs. 14 level were discounted heavily on account of the

Cloves and Cardamoms have good prospects in the export market over the next few years, whereas Cinnamon, the major spice item exported from Sri Lanka, is likely to suffer a fall in trade. This is a major conclusion of a survey of the World Market for spices just concluded by the International Trade Centre in Geneva, covering 29 countries which accounted for nearly 85 per cent of the world's import of spices. This 1977 study sums up the position of the outlook for the various spices of interest to Sri Lanka as follows:

CINNAMON

World trade in cassia and cinnamon tended to decline in 1975, with the trade in cinnamon showing the most marked decrease. In view of the current high price levels for Sri Lanka quills and the unstable supply situation in the Seychelles, trade in cinnamon is likely to decrease further in the near future.

CARDAMOM

The future outlook for cardamom is promising and offers scope for market expansion.

PEPPER

Although demand slackened somewhat in 1974 and 1975, it is still possible to predict an increase in world imports of pepper over the next few years.

CLOVES

Import demand for cloves will remain strong for a few years, especially in the cigarette industry until Indonesia's programme to meet most of its needs (projected to end in 1980) through domestic production is completed.

increased tea export duty and cesses and a very large amount of these teas were withdrawn. However, there were indications that well made tea would appreciate in price.

By the end of November the Colombo Auctions witnessed generally lower prices for all liquoring medium and high grown teas, following the decline in prices in all world tea auction centres over the past weeks. The trade was expecting prices to rise and regain stable conditions in the next few sales of December. Also the Iraqi buyer had kept out of the last two auctions in November and the first auction of December but was expected to resume buying in the second week of December.

RUBBER

Changes in duty rates and cesses in mid November resulted in an allround increase in prices quoted for all grades of rubber in the Colombo market. Following the changes announced in the budget, the export duty for the period November 16 to 20 was declared at Rs. 6.81 per kg. from an earlier export duty of Rs. 2.25 per kg. After November 20, the export duty was worked out on a revised sliding scale based on the London weekly average c.i.f. quotation. Cesses increased by a further Rs. 10.70 per kg. to Rs. 33.05 per kg. with effect from November 16.

R.S.S. No. 1 opened at Rs. 4.72½ per kg. at the beginning of November. On November 16, however, the market was quoted at Rs. 6.14½ per kg. and improved to Rs. 6.21 per kg. in line with better overseas advices. Latex crepes which were quoted at Rs. 4.59 to Rs. 4.70 per kg. at the beginning of November went up to Rs. 6.05 to Rs. 6.31 per kg with the currency adjustment factors and also due to good short covering demand. Scrap crepes went up from Rs. 4.29 to Rs. 4.30 per kg. to reach Rs. 4.71 to Rs. 5.15 per kg. while froth and cuttings which opened at Rs 3.60 and Rs. 3.80 per kg. reached Rs. 4.69 to Rs. 4.99 at the close of the month.

COCONUT

Both coconut oil and desiccated coconut recorded a drastic fall in production during 1977. Coconut oil production had fallen over 100 per cent in the first eleven months of the year as compared with 1976. Desiccated coconut production too was down by almost 80 per cent. In terms of metric tonnes production was as follows.

	Jan.-Nov. 1976	Jan.-Nov. 1977
Coconut Oil	94,696	41,306
Desiccated Coconut	43,433	27,049

Prices too fluctuated at varying levels for each of these coconut products. In the case of desiccated coconut the average export value per metric tonne in November 1977 was Rs. 12,963 as against Rs. 9,632 in October 1977 and Rs. 8,633 in April-June 1977. November's sudden upward trend in the export value of D.C. was the outcome of the revalued currencies. This situation was far more marked in the case of coconut oil exports where the average value per metric tonne which was Rs. 4,866 in Jan.-March 1977 and Rs. 6,205 in April-June 1977 shot up to Rs. 17,257 per metric tonne in November 1977. International prices also showed an improvement over the previous few months though not as high as in the March-April period of 1977. In the local market, however, producers did not benefit from the November price boom.

The local market price for coconut oil in November 1977 was Rs. 5,242 per metric tonne, a drop over the previous months. In the case of D.C. the price per kilogramme was Rs. 6.01 only a few cents above the price of the previous months.

Export earnings too have shown a fall in 1977 when compared with the previous year, despite the high prices prevailing in 1977. The main reason was the heavy fall in the volume of exports, particularly coconut oil where only 2,000 metric tonnes were exported in 1977 as against 57,000 tonnes in 1976. In the case of D.C. too there was a fall from approximately 42,000 tonnes in 1976 to approximately 28,000 tonnes in 1977. Yet total earnings from D.C. recorded a big increase. The other significant trend emerging from the export pattern in the last two years is that coconut oil which contributed nearly 38 per cent of coconut export earnings was now contributing only 3 per cent, while D.C. which contributed 38 per cent in 1976 contributed 63 per cent in 1977. The fall in earnings from Kernel Products in 1977 was as high as 21.5 per cent; while earnings from by-products rose by 39.5 per cent. The overall fall in export value, however, was 7.5 per cent in 1977.

Details of exports upto November are given in the table below.

EXPORTS OF COCONUT PRODUCTS

	January-November 1976			January-November 1977		
	Volume (MT)	Value (Rs. Thousand)	% total value	Volume (MT)	Value (Rs Thousand)	% total value
Coconut Oil	56,837	172,295	37.5	2,082	10,542	2.5
Desiccated Coconut	42,037	167,046	36.3	28,339	266,080	62.6
Copra	1,145	6,436	1.4	150	888	0.2
Fresh Nuts	7,207,080 (Nos.)	7,911	1.7	—	—	
Sub-Total	753.39 (million nut equivalents)	353.688		210.10 (million nut equivalents)	277.511	
Mattress Fibre	44,751	35,474	7.8	46,953	41,810	9.8
Bristle Fibre	10,482	18,497	4.03	11,686	37,277	8.8
Twisted Fibre	22,968	29,221	6.4	26,006	40,363	9.5
Coir Yarn/ Twine	3,089	6,639	1.4	1,905	5,743	1.3
Coconut Shell Charcoal	23,154	9,005	2.0	25,822	17,848	4.2
Coconut Shell Flour	813	449	0.1	643	408	0.1
Coconut Shells	1,892	403	0.7	1,638	471	0.1
Shell Activated Carbon	393	2.041	0.5	373	1,836	0.5
Coconut Ekels	5,370	33,995	0.8	2,059	1,582	0.4
Total Value of By-Products	—	105,724		—	147,338	
Total Value of All-products	—	459,412		—	424,849	

MANAGEMENT

Myths and Management — the Public and the Private

What is known as "Management" are human structures, arrangements and processes that have grown up in different contexts to help enterprises achieve their objectives. Therefore, management and "successful" managerial arrangements differ according to the particular human and structural arrangements in the countries within which they operate. Thus, management of Japanese enterprises differ from those of Chinese ones just as American ones differ from the Soviets and the British from the West German ones. These differences vary in several dimensions. In the large *zaibutsu* of Japan life long employment derived from feudal origins - specially the *Oyabun-Kobun* relationship - exhibit a different managerial flavour to the hire-fire pattern usually associated with American ones. Similarly the dual vertical control of party and line in the Soviet system is different from the two-tier horizontal control systems in West Germany.

There are many myths about universally acceptable management systems. There aren't such systems; acceptable management systems varying according to social contexts. What usually goes as modern management is largely a package of techniques and processes which have grown up in USA over almost the last half century and which have been propagated by business schools and universities. Some of these techniques are to a certain extent free of their social context; for example, programming devices, bar charts, critical path analyses etc. However, some others like direct, work-study-based, results-oriented payment systems have been difficult to adopt in non-Western contexts like the Japanese context (whilst for example these methods were avidly adopted in the Soviet Union, specially in the late thirties).

In Sri Lanka, several management systems can be identified. Firstly are those derived from the feudal past operating in petty production and services such as those used by relatively rich farmers in the rural areas, and those in the majority of restaurants in the country. Secondly, are those of a colonial derived system which operated in the agency houses in the plantation sector and which, from contemporary Western standards had a primitive 19th century perspective specially in the man-management sphere. Thirdly, are those forged over the last 20 years or so of import substitution industrialization in the private sector, and often associated with a heavy managerial hand (which means actually a heavy owner hand) and a relatively cowed and underpaid labour force. Fourthly, are state sector corporations that have also grown up over the last 20 years and which are associated sometimes in the eyes of some sections of the "public" as being inefficient.

EFFICIENCY CRITERIA

How does one judge the efficiency of these various arrangements. Is the "unscrupulous" small time mudalali who runs a little restaurant, with sweated labour, working from 5 a.m. to 10 p.m. and who makes a high profit more efficient than the relatively large state corporations hemmed in by restraints of price increases, politics, minimum wages etc., and which are running at a loss. Or is the near monopolitistic new multinational firm in the consumer industry sector with relatively enlightened internal systems of payments and worker welfare and good profits as efficient as the old multinational firm in the tea plantation sector — also showing good profits — but which gets its labour force featured in a T.V. film widely seen all over the world as one living in near slave like conditions. It is difficult to judge what is efficient and what is not, because different criteria of efficiency exist. The crude single indicators of market based profit criteria have vanished even from the most capitalist of countries. Further, profit even as a crude indicator of efficiency is limited by whether the particular enterprise - whether it be private or state - is in a monopolistic situation or not. A monopolistic enterprise could to a considerable extent get away with high profits even though other indicators of efficiency like use of resources in the enterprise would not be at a maximum.

Questions and criteria of efficiency are not purely of academic interest. They are of vital importance in that of an economy like Sri Lanka. One of the recurring issues in the public eye is that of "mismanagement" of state enterprises which is often contrasted with an apparent high level of management efficiency in the private sector. How true is this?

First although the state corporations form a minor part of the economy of the country, they have a high degree of visibility in the public eye. Part of this visibility is due to the fact that state corporatons - at least some of their appointments - form an important part of the political spoils for the particular government (any government) in power. These spoils are seen either as a part of patronage in certain appointments or as services which the particular corporation bestows on a particular electorate. State corporations are as a result seen by ensuing governments as both important repositories for patronage of the particular government in power, as well as repositories of corruption due to the previous holders of power. In addition the state crporations being generally in the key and essential sectors of the economy, this ensures that they are generally kept in the public eye.

Also, unlike in the private sector the complicated tender board procedures and administrative and financial regulations of Government departments, which public sector ventures have to comply with, they are put at a distinctive disadvantage when it comes to quick business decisions.

The work of the private sector on the other hand is shrouded in greater secrecy. Although corruption in the private sector is probably higher than in the State sector which has generally speaking highly formalised checks and controls, this is rarely brought into focus, partly because what in the state sector is (quite rightly) considered corruption - like the obtaining of commissions - is considered normal business in the private sector. Further, unlike in the State sector there is no breakdown in continuity in top personnel with different governments coming into power. This often occurs in the state sector giving rise, from a positive angle, to a spring cleaning effect and, from a negative angle, to a loss of organisaitonal certainity, continuity and confidence.

The two different degrees of visibility in the private and state sectors is at least partially one reason why state corporations are preceived as being mismanaged. Apart from these perceptions how do these two sectors private and state - actually compare with each other. How trained and educated are their managers and workers; for example how well do they apply modern management techniques? A recent study conducted by Withana and Minkes on Sri Lankan management provides some data on this.

EDUCATION AND TRAINING

In comparing education of executives in government departments, corporations and private firms their study brings out some significant results. It revealed that the firms have the least qualified personnel (i.e. without a degree or professional/technical qualifications) with 64.6 per cent of their managers unqualified. In contrast at the other end of the spectrum only 19.2% are unqualified. Also the government departments and state corporations have had about 50 percent of their senior managers exposed to such modern management training as contrasted with only 25 percent of those in the private sector firms.

If the State corporations are the repository of a better educated and trained (and presumably more intelligent) management and worker, why are some of them unable to deliver of their best. There are several reasons. Perhaps the main one is that the manager of a private company is generally expected to decide on factors which are related to the company alone whereas the state enterprise manager has to manage not only the enterprise but also issues arising from the environment of the enterprise. To the latter category much parochial pressures arising from narrow particularistic policies, kith and kin, religion and caste and other externalities. There have been several studies on the management pecularities of this type of state enterprise, pecularities which incidentally also exist in other parts of South Asia. State Corporations differ on the degree to which these factors play an important part. Thus the CTB, CWE and NTC are those where externalities play a significant part whilst in less politicised corporations like Cement and Paper these externalities have traditionally played less of a part. To illustrate this phenomenon it is important to examine the case of a real enterprise, for example the National Textile Corporation.

S. E. G. Perera a former Personnel Manager of the Textile Corporation writing in the *International Labour Review* in 1969 was to observe that the management problems of the textile plant were due to bad planning. He pointed out that with the new personnel management techniques being introduced much of the instabilities of the earlier period would vanish. However, history has proved otherwise. The National Textile Corporation, specially its massive Thulhiriya plant, continues to be a very interesting study for students of management. Its output has continued to fluctuate wildly since its inception. Its labour force is highly educated, young and seemingly strongly motivated, judging from the high output when conditions are normal. Its middle and managerial cadre have all been formally trained in modern techniques and have imbibed experiences of several countries. Its choice of top (director level) management however have at times been of uneven quality. At the period of its worst performance inadequately experienced men were at the top. The functioning of the organisaiton has encountered tremendous problems, largely arising from this inept management, with well documented instances of a horrifying nature such as assaults of workers by imported thugs, as well as the setting fire of the shops nearby. The output of the factory has quite often responded very accurately to the conscious and unconscious directions from the top, varying from about 20 percent of the rated capacity when morale was low to almost the high 90's when morale was high. With an articulate, educated, trained the young work force these are very natural responses. Workers and the organisation as a whole have responded to board level management, acting responsibly when the latter was responsible and reducing their output when management seemed irresponsible. It is in this context that one has to view the very positive signs which emerged during the period August to November this year when this Corporation succeeded in raising its output. The very positive and justly proud advertisements that appeared in the newspapers signed Managing Director were but a natural expression of an organisation working towards a capacity it was expected to.

Subsequently the incumbent in the chair of Managing Director changed and there were apparent signs of a drop in performance at the Corporation. The position was then clarified. The Textile Corporation Unions have been assured that they would share in the management and administration of their institution and told that it was a policy decision to hire private firms for secretarial work at Textile Corporation factories to give employees an opportunity of learning administration and management work from them.

INTERESTING EXPERIMENT

It is in this context that an apparent decision to instal so called private sector management expertise between the Board of Management and the direct plant management assumes interesting implications.

It will therefore be interesting to follow, in the coming months the successes or otherwise of this experiment in private sector management over a highly trained group of personnel with perhaps higher managerial competence. It will be several months or years before the outcome of this experiment would be known.

The NTC example illustrates a central problem in many state corporations, a workforce of highly educated and trained personnel from workers to managers, but not operating always at optimum level. Another reason for this is often to be found in the lack of awareness of basic managerial problems by top management (namely Board members). Over the last twenty years many state corporations have been saddled at the top managerial level with persons with almost no previous experience in the working of complex institutions. Thus, often teachers or lawyers with no relevant background have been appointed. The country has invested a considerable sum of money in state corporations and their efficient management lies not with persons without experience in the sector, but with persons having that experience and capabilities to run them.

BUREAUCRACY – The Cause of Economic Cresis in Pakistan

Establishment of an Economic Crisis Board — Recommended

M. A. Hussein Mullick

Today's economic crisis in Pakistan is largely the result of the role its bureaucracy has played in the economic decision making process, according to Hussein Mullick, Professor of Economics at Quaid-i-Azam University, Islamabad. While analysing the negative role the bureaucracy has played, he advocates, as an instrument for improving the quality of decision making, the setting up of an autonomous and independent Economic Development Board and Think Cells; which have been suggested at various stages in Sri Lanka as a means of toning up our development process.

A critical look into economic development of Pakistan during the past thirty years reveals a very sad state of affairs. Not only has Pakistan failed to make adequate advance in sustaining a satisfactory rate of economic growth, but it has also failed miserably even on other fronts, such as, distributive justice or national harmonious integration. Over the past three decades, our efforts have been directed to keep our head above water and through this approach problems have been accumulating and getting more and more complicated day in and day out. As a result of this we have now an economy which is deprived of social harmony and geared more to foreign resources than to domestic resource endowment. The position on the employment front has been and it continues to be so bad that our domestic development fails to absorb the incremental labour force not to speak of the chronic backlog in this sector. At present more than 0.7 million workers are earning their bread and butter outside the borders of Pakistan. As far as the per capita income is concerned it is no more than 100 US dollars per annum, which if disaggregated comes to as low as 30 to 40 US dollars for a large majority of the population in Pakistan. Added to these problems, there is the burden of foreign debt which has by now risen to 9 billion US dollars. This much of indebtedness comes almost close to one year's GNP of Pakistan (12 billion US dollars). So far as relations between labour and employers are concerned, they too leave much to be desired.

The type of development that has been pursued during the recent past has added more towards estrangement of relations between the working class on the one hand and the richer entrepreneurial class on the other. As a consequence of this situation, capital started flying out during the early seventies and since the middle seventies even other factors of production like manpower skill and entrepreneurial talent have been leaving the country in great numbers and volume. The situation has become so critical that Government in recent years has been obliged to step up investment in the public sector. This has been done not only to strengthen the public sector but also to maintain some semblance of investment activity in the country.

From Law and Order to Development Planning

The above situation has emerged as a consequence of both direct and indirect influence of many factors emanating from political ideology, institutional constraints and due to other factors of both historical and philosophical character. One of the major causes responsible for this unsatisfactory state of affairs is the nature and art of economic decision making in Pakistan. As is well known, the bureaucracy has been the major instrument responsible for the above pattern of development. We attribute this to bureaucracy as in our view it was this institution which piloted the ship of development during the past thirty years. But this piloting of the national economy was unfortunately not oriented to liberate the country from the old colonial order. Unconsciously or consciously the bureaucracy stood for the *status quo* and if there was any development or change introduced, this too was done in league with the old or the new powerful vested interests whether it were the landed aristocracy, the new rich in the urban centres or the military personnel. Despite the launching of several five-year-plans and the promises contained in them about the emergence of an egalitarian order in the country, the fate of the common man did not undergo any positive improvement. One of the major causes for this malchange has been the role of bureaucracy in the realm of economic decision making. This institution of bureaucracy which *ab-initio* was founded to serve the interests of its founding fathers, namely, the British colonial power, involved itself in economic decision making soon after the establishment of Pakistan in 1947. It is true that in the beginning the services of the colonial bureaucrat were absolutely needed for the purpose of maintaining law and order in the young state. But the tragedy started when these bureaucrats despite their being trained as generalists were gradually given the task of handling quite sophisticated and complicated problems of economic development.

Decisions requiring expertise and sufficient research were taken by the generalists, called, civil servants. The result of this exercise was that the difficult task of economic development became more an instrument or a vehicle in the hands of bureaucrats to dole out special privileges and facilities to their friends and all others on whom they depended for support. In this way, the old social structures were further perpetuated, with of course, some minor adjustments and accommodations extended to the new business and industrial class.

Guardians of Vested Interests

With the new alliance developing between the bureaucrats on the one hand and the richer urban bourgeoisie and the politicians on the other, the task of national economic development became more and more a maiden of the vested interests rather than a new means towards achieving a liberated, a self-reliant, and, an egalitarian order. This new social equation emerging on the administrative landscape of the country became a powerful force towards stopping the natural evolutionary development namely, the de-colonisation of the inherited colonial order. The political changes introduced at the time of the establishment of Pakistan too did not do much to reform the bureaucracy. The majority of the politicians being themselves a product of the traditional feudal structure, instead of changing the colonial and authoritarian character of bureaucracy, joined hands with them. The result of this collusion was that only a small minority of powerful people was able to draw benefits from economic development while the majority of the people was deprived of its genuine share in growth and progress. During the period of Ayub Khan the role of the bureaucracy became still stronger as bureaucrats had now become free from day-to-day political pressures. In recent years, especially during the regime of the PPP, (Pakistan People's Party) although the bureaucrats lost their earlier undisputed position, these were in practice still serving the interests of the ruling class (es).

The one difference, however, was that while the bureaucrats were the sole arbiters of decision making in the past, it were now the PPP leaders whom the bureaucracy was obliged to follow. Despite all this the bureaucrats nevertheless still held a dominating position in economic decision making. This holds particularly for the period from 1973 onwards when the economic resource position of the country began to deteriorate.

Lack of Professional Expertise

As the task of law and order, on the one hand, and proper planning and development on the other, are so different from each other, it was but natural that the British trained civil servants did not succeed to foster desirable economic development. This happened as civil servants entrusted with economic tasks involving professional expertise could not easily comprehend them. As this was the situation the approach followed by the civil servants turned out to be anachronistic and as such unsuitable to meet the new challenges on the economic front. The weaknesses of the bureaucratic system were partly recognised during the early fifties when agencies like the Pakistan Industrial Development Corporation (PIDC) were established. But this 'hiving off' from the Central Government machine was an exception rather than a rule. As far as economic policy and decision making exercises were concerned, they continued to be made by bureaucrats sitting in the Government Secretariat. As the bureaucrats normally have to deal with day-to-day problems, they are practically left with very little time to think about long-term economic policy matters. Further, the intellectual wherewithal needed for long-term planning is hardly available within the bureaucracy. As a consequence *ad-hocism* is preferred over long term planning. The bureaucratic system, as it functions in various ministries is such that the man incharge of the Department is supposed to do three different functions.

1. He acts as an adviser on policy to the minister.
2. He manages the day-to-day operations of the division/department.
3. He is the accounting officer of his division/department.

All these multiple activities not only make him the most powerful man in the division/department but they also constitute a heavy burden on this single individual. Because of pressure of time and non-existence of professional expertise the man in-charge of the division/department goes on making economic decisions without understanding fully their deeper and long-term implications. This serious weakness in the system has since long been felt, but because of the powerful position of the bureaucracy no concrete steps were taken to improve the quality of economic decision making.

The only exception, however, is that of the Planning Commission which continued to function for some years but it too lost its somewhat independent position during the Bhutto regime. In this agency, serious efforts were made to provide the necessary professional expertise but this venture too did not meet with success. Despite the employment of several top economists, the Commission continued to be guided by generalists, the so called 'civil servants', who though they showed keeness to listen to the comments of economists, eventually did only that which they were convinced about or that on which they received instructions from the political leaders. As this was the case, the advice of experts could not influence the actual decisions. This exercise of decision making also failed because the expert advice of the economists could not be properly communicated to the agents of decision making.

The situation also did not improve later on when economists were more or less placed in a position to communicate their views to the ministers directly. This happened particularly during the later period of Ayub and the Bhutto era when economists became the spokesmen of the Commission but unfortunately they by now had become so badly affected by the mores of working of the *corps d'elite* that they had lost sight of objectivity and found it more convenient to obey the top civil servants or the ministers. In this way the agents of objective analysis and assessment became the justifiers of wrong decisions.

Economists Fail Too

The tragedy that fell on Pakistan as a consequence of the ill-conceived and emotionally charged decision on nationalisation by the PPP Government is a clear example of dereliction of duty on the part of economists who by virtue of being professionals should have offered the pros and cons of the exercise to the politicians. In this exercise for nationalisation, the case of nationalising thousands of cotton ginning factories, rice husking and flour mills which were first nationalised by the PPP Government and later denationalised partly by the Martial Law Administration is worth mentioning. We admit that such decisions were made mainly by the political leaders but we also know that the views of economic experts working in the Planning Commission were also sought by the political leadership at both these times. It is not wrong to say, if I may mention here, that it were perhaps the same people from amongst the economic experts who first supported the Government idea of nationalising these industries and later on provided all sorts of data, information and analysis to support the denationalisaiton.

Planners Role Condemned

Furthermore, the role played by planners deserves the greatest condemnation. For instance, the Planning Commission fixed the GNP growth rate for 1976-77 at 8 per cent; the actual performance, however, was only 1.2 per cent. No less dis-similar were the results in earlier years. Other indices of development too likewise were purposely inflated to give a good impression to the public. In this exercise, some of the senior economists, one of whom even got special promotion for distorting facts, played a leading role. While the politicians were keen to promise a better performance without, of course, any genuine prospects of their realization, the economists working in the Planning Commission did not feel shy to support them with all the necessary data, information and analysis. From amongst the bureaucrats heading and controlling the Planning Commission, there were also one or two top notch who played the leading role in this exercise of "Wilful Deception". Sensitive facts such as the rate of inflation, price index or the total amount of deficit financing were never allowed to be released for public consumption. This type of role played by both the so called economists and the top notch civil servants reflects nothing but a *prima facie* violation of the mandate given to them.

Similarly, one could also cite so many other example where bureaucrats followed the diktat of the political leaders of the governing party, despite knowing too well that such actions were going to turn out harmful to the economy. The bureaucracy, as it works, is condemned to obey the ministers, and, by tradition, it has no opinion of its own. But as the educational and professional niveau of ministers and other public representatives in the National Assembly is generally too low to comprehend all the ins and outs of an issue, the making of wrong decisions cannot be avoided.

There is also another aspect of economic decision making concerning the bureaucracy. This relates particularly to issues which although they affect the whole national economy are being dealt with by more than one bureaucraitc institution. While dealing with these issues the bureaucracy does not make an objective assessment of the problems involved; rather it tries to hoodwink facts and does not even feel shy of giving protection to those bureaucrats whom one should have normally blamed for committing mistakes.

The other aspect concerns issues such as Plan failure where the Government normally calls on the Planning Commission to find out the factors responsible for it and make suitable recommendations thereto. But as the Planning Commission itself is responsible for the Plan failure it is futile to expect that this agency will be able to make an objective assessment of the problem. The consequence of this type of approach on Pakistan has been that mistakes have been covered up (hushed up), objective analysis discouraged and the emergence of frequent crises made imminent.

Obedience or Self-Interest

It is obvious from the above analysis that the bureaucracy as it functions today has failed to offer objective economic decision making in the country. Their role has in fact largely been to obstruct change and perpetuate the **status quo.** As a civil servant in Pakistan, (by definition) has no personal views, he infrequently gives the image that he was acting strictly in accordance with the orders of his superiors. But in practice he is not such a miserable fellow. He infrequently misuses his discretionary powers and even does not hesitate to influence the political leadership. He does not welcome new ideas, hesitates to bring forth his personal initiative and doles out favours to the members of his own class or all others from whom he can expect help and support for office promotions or during times of personal crises. He does not even hesitate to exhert influence on the ministers by doing unlawful acts or through presentation of arguments in support of or in opposition to a particular economic change. This he does to protect himself, his class or the particular vested interests that he is so deeply entrenched in. As this is the 'mode of working' of bureaucracy, no wonder that it ceases to act as an active agent of change in the field of economic decision making. This type of environment is, however, not suitable for the promotion of a healthy economic development. In addition, the bureaucracy through **ad hocism** ignores long term perspective and keeps the economy engaged too much in exercises concerning short term gains. In western countries, bureaucracy has also problems of a not dissimilar nature but they have enough professional expertise available with them to examine the problems objectively. In addition, they are also favourably endowed with experts' opinion and public support or opposition from amongst the people at large which serve as a controlling organ over the major national economic decisions made by both the bureaucra cy and the ministers. Unfortunately, however, economic decision making in Pakistan is the monopoly of the generalist civil servants who neither possess the professional expertise nor are they under any control exercised by independent scholars, experts or public figures. Even scholars working in research institutes, such as the Pakistan Institute of Development Economics do not dare to offer critical views on economic decisions made by the Government. In a situation like this economic decision making in Pakistan is, therefore, carried on with the inherent weaknesses.

The bureaucrats 'mode of working' is also dubious as many of the economic decisions made by them are not explained in a scientific manner. Expressions such as "I do not agree", or "Is there a precedent?", or a simple "No" are not scientific judgements; they explain more the blind resort to discretionary powers or outright unwillingness to use personal initiative. In a country which is committed to rapid development, such administrative constraints cannot, however, be tolerated. Once the proposed "Board" (discussed below) is set up, it will also endeavour to impress upon the bureaucrats to make the least use of their discretionary powers, and, instead, decide things on merit and within the general policy framework.

Change Inevitable

The above imperfections in the system of economic decision making calls for an urgent improvement. This task, however, is not going to be an easy one as bureaucracy being too far bound up with self-aggrandisement and inadequately equipped with the needed professional expertise will oppose any change tooth and nail. They have been able to do this successfully in the past. But in view of the somewhat weakened position of the bureaucracy during the Bhutto regime and considering also the frequent concurrences of crises on the economic landscape of the country the bureaucracy cannot put up a strong opposition to drastic new reforms which have meanwhile become imminent. The time had, therefore, come to look for ways and means to remove the weaknesses inherent in the existing economic decision making process. Before coming out with our thoughts and recommendations on this point however, it would be useful to give a short review of the efforts made in the past to improve the efficiency of the bureaucratic system.

Commissions' Wrong Diagnosis

Various Commissions set up by the Government to reform bureaucracy have made a number of recommendations. But quite disappointingly these reforms have failed to hit the core of the problem, namely, that of economic decision making. As is clear from various commission reports and actions taken by the Government from time to time the reforms dealt mostly with matters concerning corruption, misuse of administrative discretion and the frequent assertion of supremacy by the elite civil servants. The efforts of these commissions were, therefore, directed to dislodge bureaucracy from its entrenched position of priviledge and make it accountable for its actions to the Government and the public at large. But the output of these exercises did not go too deep. Except for minor changes, such as, the liberal recruitment through 'lateral entry' or for that matter the subjection of all kinds of civil servants to the National Pay Scale or the newly constituted Economists' Service in the Ministry of Finance, the result of most of these efforts did not succeed in achieving one of the desired objectives, namely, the improvement in economic decision making. Even the wholesale dismissal of public servants first by Ayub and then by Yahya Khan and Bhutto also did not prove an effective deterrent against corruption. In fact the inherent insecurity injected by the above Chief Executive of the Government into the rather secure civil service led to still more corruption. This insecurity led even to an accelerated decline in the quality and content of economic decision making. The struggle undertaken through various commissions (more than a dozen since the establishment of Pakistan) against administrative corruption and bureaucratic hegemony of the elite service, namely, the C.S.P., (Civil Service of Pakistan), appears to me no more a struggle between the 'elitist and non-elitist services; as the only result that emerged from the exercises carried out by the Commission was the pulling up of the status and role of the non-CSP services and the consequential decline in the status of the elite service personnel. In my view, however, the emancipation of the non-elitist services achieved in various degrees did not make the bureaucratic system any degree more efficient, incorrupt, accessible to public or for that matter, more close to objective decision making. Quite disappointingly the newly emancipated services, in course of time, too started treading on the beaten path.

ECONOMIC CRISIS BOARD

Realising the complexity and the vast magnitude of the problem of reforming the bureaucracy in order that it becomes both an efficient and honest agent of change in the state machinery, the present author would, however, deal with the issue involved with the improvement of economic decision making. As said earlier, the present bureaucratic system as it functions today is not endowed with the required intellectual or other wherewithal to make correct economic decisions. The way present economic decision making is practised, it is more or less the flow of diktat from the politicians on the one hand and the following thereof by the bureaucrats on the other. We of course know that the civil servants follow this diktat only in latter but not in spirit.

In view of the above we strongly recommend the establishment of a new channel side by side with the existing administrative and policy making net-work of bureaucracy. The new channel will work in such a manner that it will not hinder the work of ministries or corporations; rather it will help them towards improving their efficiency in fields where they alone are not in a position to tackle a certain selected problem. The name proposed for the new agency is the **Economic Crisis Board (E.C.B.).** In contradistinction to the work of the ministry which deals with the day-to-day problems of the economy, the proposed institution will engage itself only with matters which in the opinion of the Chief Executive or in its own opinion is either too big or problematic to be tackled successfully by a ministry or a corporation. There could be many reasons for this. Some of these reasons may be cited here.

1. An individual ministry or corporation may have developed strong vested interests which it would like to protect at all costs.
2. The problem may involve more than ministry/corporation, and under the existing bureaucratic set up it may not be possible to study the problem objectively.
3. There could also emerge problems of national significance or of a long-term nature which the existing administrative set up may not be able to comprehend, not to speak of solving them.
4. The Board could also play a useful role in influencing the ministries to appoint professionals for purposes of looking after the long term policy aspects of development. At some later stage the Board may also be instrumental in 'hiving off' policy matters from day-to-day operations in ministries, agencies etc. This bifurcation is needed to eliminate unscientific decision making as well as to avoid misuse of authority or unjustified discretionary powers.

Unlike the role of the bureaucrats who are bound to work under the directions given to them by their ministers and as a consequence are in most cases liable to justify even wrong decisions, thus injuring and damaging genuine national interest, the Board will work as an independent agency mandated to examine problems objectively. The recommendations of the Board will not, however, have the character of a decision made by the Government; it will only aim at helping the Government through its objective assessment of problems. In this way the Chief Executive of Government will have at its disposal two channels providing different solutions to a particular problem. There is no doubt that the work of the ECB will improve the quality of decision making, will help not to overlook the imperatives of long-term planning, and, last but not the least, will also inspire, through its scientific and unbiased working, quite a large number of independent individuals and institutions to take up the initiative of engaging themselves in the exercise of finding the right solutions for national problems. If this is achieved, it will mean that the long held monopoly of the bureaucrats in deciding the fate of the economy will be broken, and, instead a new scientific decision making process will be set in motion which by virtue of its objective premises will allow both the channels of decisions making to compete with each other on a qualitative basis. In order to avoid the repetition of the bureaucratic hierarchical structure in which seniority of an office has precedence over objective merit, the Board will be composed of members enjoying equal status. Further the members of the Board will be drawn not from a particular class of people, such as, experts but they will be selected from various disciplines and walks of life on criteria of education, professional expertise, experience and strong commitment to building up of an economically viable and socially justifiable economy of this country. There will be two types of members of the Board; those who will be taken on a permanent basis and those who will be co-opted in various assignments. The latter will be mostly those already working in governmental institutions or the wider private sector. The Board will keep a full record of persons and institutions whose services it could draw upon as and when desired. In order to render efficient and quick service, the Board will ensure, maintenance of data and information, tank facilities, such as, typing typing, stenciling and photocopying, a good archives and a library. Further the Board will also have to be provided with supporting services of professional staff to carry out the work of collecting necessary data and information, undertaking of research and doing all other work connected with the mandate given to the Board. There will also be a small administrative section to look after the office work. In addition, there will be the need to appoint a few liaison officers to maintain proper contact between the Board on the one hand and the Ministries etc., on the other. The Board will be an autonomous agency and be given a special charter to work. It will be an independent agency and answerable only to the Chief Executive of the government. With a view to obtain the best results from the Board, the appointment of permanent members of this agency must be strictly made on merit which will include, among others, a high degree of professional expertise, rich experience, overall knowledge of the economy, and personal integrity and a very strong commitment to national progress and development. Unless the appointing authority observes the above criteria the whole purpose of having an autonomous Board mandated to offer objective advice to the Chief Executive of the government will be in vain. The present author is of the view that the amount of money that will be spent on the maintenance of the proposed venture will cost the national exchequer only an infinitesimal amount in relation to the enormous gains or benefits that it will generate for the nation. Further, the Board will also help influence indirectly a better and more critical handling of the problems by the bureaucrats. At some later stage, it will also provide recognition and appreciation to all those civil servants who through sheer hard work, dedication and a continued process of learning in their respective fields will be able to distinguish themselves from all those wasting their time in either engaging themselves from all those wasting their time in either engaging themselves in office intrigues or resorting to all kinds of malpractices detrimental to the national interest. This of course will mean the following of objective criteria to judge the work of bureaucrats.

Planning Unit

In order to make the work of the Board efficient and based on correct data and information, it is recommended that each ministry or corporation sets up a Planning Unit with a Senior Policy Adviser as its incharge. The Senior Policy Adviser will be attached directly to the Minister of the Chief Executive of a Corporation. He will be entrusted with the task of looking to, and preparing for, the future policy of this ministry or corporation. Apart from this it will also be his responsibility to ensure that day-to-day policy decisions are taken with as full a recognition as possible of likely future developments. "It would also be the job of a Senior Policy Adviser, like his staff, to know the other experts in the field, both inside and outside the service, at home and abroad, and he should be aware of all the important trends in new thinking and practice that are relevant", as stated by Lord Fulton's in his report on "The Civil Service Vol. I, Report of the Committee 1966-68". Further, he should also advise the Minister to arrange special courses and seminars for the general administration with a view to enabling them to acquire some understanding of research methods and techniques which will stand them in good stead in the performance of their office duties. Besides, the Senior Policy Adviser should maintain up-to-date information on his ministry or corporation and carry out all the necessary research work needed as an input in the process of making sound economic decisions. The utility of this Planning Unit, as also that of the Senior Policy Adviser, will also be immense for the work of the ECB as both will be able to feed the Board with all the required data, information and analysis. The establishment of the Planning Unit has become indispensable in view of the Planning Unit has become indispensable in view of the growing dependence on professional expertise for economic decision making and for purpose of replacing gradually the present unhealthy wholesale reliance by bureaucrats on *ad-hocism*.

Think Cells — Political Parties

Side by side with the establishment of the Planning Unit there is also the urgent need to let the political parties realise the need to establish "Think Cells". In Western Europe where the democratic political system has become almost a permanent feature, most of the political parties maintain their own "Think Cells". These Cells help them to have their own thinking and research done into the various social, economic and political problems confronting these parties both while in or outside the Government. In Pakistan one big tragedy that has since long befallen this country has been the absence of such "Think Cells" that the political parties even when they were governing the country were misled by bureaucracy. In order to plan the affairs of the country, each political party must have its own "Think Cells", engaged in both the day-to-day and the long term issues. In the event such "Cells" are established by the political parties in Pakistan they will then provide another organised channel to the whole process of economic decision making in the country.

Taking different issues, the country is at present passing through a critical phase not only in the political field but on several other fronts as well. One of these of course is the role of bureaucracy against which there is so much resentment from amongst the public and the different professional classes. It is no secret to mention here that the public has become highly sceptical about the role of bureaucracy in the economic planning of this country. This is the result particularly of the rather disgusting performance of planning during the last 5 to 6 years. Problems such as, inflation, lower GNP growth rates and high unemployment have disappointed many a Pakistani about the usefulness of planning in this country. As mentioned earlier these problems cannot be solved by the Planning Commission or other relevant ministries for the simple reason that they have largely emerged on account of the inability of the existing institutions to tackle them. Because of the absence of any independent autonomous agency, such as the proposed ECB, solutions of the above problems were invariably sought from those very agencies which had themselves given birth to them. This, of course, did not work and the problems continued to increase day by day.

Three Outstanding Problems

While addressing senior officials of the Federal Economic Ministries on September 8, 1977 General Mohammad Zia-ul-Haq sought help from the bureaucrats in tackling the following three problems which in his view were absolutely necessary to set the economy on an even keel.

1. The tightening of financial management.
2. Simplification of procedures, and
3. Reduction of country's dependence on foreign countries.

The present author although fully sharing the anxiety of General Haq about the urgent need to find suitable solutions to the above three problems feels that the call seems to have been addressed to wrong quarters. If bureaucrats were in a position to solve the above problems they would have long since have done this. The reality of the situation is that the bureaucrats have themselves been instrumental in creating these problems, of course partly in collusion with the earlier political regimes. If this thesis is to be accepted it would become futile to expect that the same bureaucrats would now endeavour to find solutions to the above problems.

It would not be out of place to mention here that during the Bhutto regime when some scholars strongly advocated the drastic reduction of Pakistan's dependence on foreign aid and the Government felt inclined to do this; it were the bureaucrats who told the Prime Minister that in the event he substantially cutdown the inflow of foreign aid, a collapse of Pakistan's economy was imminent. Arguments like this although not valid on objective premises, were, however, accepted on their face value by the PPP Government. As a consequence Pakistan's dependence on foreign aid went on increasing and the long cherished desire of a nationalist Pakistan to replace foreign aid with the stepping up of the mobilisation of domestic resources was thrown into the back-yard. The attitude of bureaucrats in this respect is, however, understandable. Trained as they are in the perpetuation of the *status quo* and being themthemselves the major beneficiaries of foreign aid, it was not natural that they would have given up foreign aid instead have chosen the more difficult task of mobilising domestic resources. As in the past the bureaucracy is again not going to do much to reduce Pakistan's dependence on foreign aid. It would also not be incorrect to say that Pakistan's bureaucracy specially the planners and development executives, have benefited more from disasters than from inward induced economic development. This holds particularly true for planners who were able to spend their time more rewardingly in hunting for aid in foreign countries through making extensive tours and under-taking the concomitant negotiations for aid credits and grants. These ways of mobilising resources for development are of course a shame. They cannot transform a traditionally dependent economy into a self-reliant one. On the contrary, such steps tantamount to perpetual under development.

No More Illusions

If the past could be any guide it would be illusory for the present Government or for that matter any successive governments to expect that bureaucracy will help them to make this country self-reliant, or that it shall willingly make a positive contribution.

The stark reality is that bureaucracy as an institution has failed to serve as an agent of change in achieving a self-reliant and nationally oriented development in the country. The decision to delegate the new role of development to the bureaucracy, otherwise established to look after law and order, was already misconceived. We admit that this become unavoidable at a time when Pakistan had just been established and there was no suitable alternative service available to handle the new task. But now that more than thirty years have passed and that the bureaucrats 'mode of development' has miserably failed, the time has come to establish new institutions and services especially suited for development.

The establishment of the proposed Economic Crisis Board is one among several other reforms which will be needed to ensure a satisfactory development. The proposed ECB, as outlined above, will of course not solve all the problems of development; but it will surely be instrumental towards improving the quality of economic decision making. Further, its role as an objective evaluater of various economic issues and crises will enable the professional community and experienced people and public figures to contribute freely towards solving our national economic problems. If the ECB could achieve these goals, it would mean that the traditional claim of bureaucrats to have a monopoly for solving all sorts of national problems will be exposed. Instead a climate will emerge on the economic decision making landscape of the country where it will not be the authority, excessive discretionary power or intrigues which will be decisive. On the contrary, it will be merit and scientific analysis based on expertise which will be the final arbiters.

HOTEL DEVELOPMENT

Manila: Empty rooms, Soaring debts

Ian Verchere

The August, 1977 issue of the Pacific Magazines' publication INSIGHT in a review of the tourism situation in Asia focussed specifically on the Philippines. Part of Insight's comment ran as follows:

"To the developing nations of Asia, eager to alleviate over-dependence on finite natural resources, tourism has become an increasingly popular alternative. It is today one of the fastest growth industries in the world and inevitably attracts the interest of export-motivated governments more than other less spectacular industries. Tourism can also be a highly labour-intensive industry providing much-needed jobs for semi-skilled and unskilled workers in countries with high unemployment. And unlike more traditional industries, its relief permeates downwards at relatively high speed. In the midst of all this economic euphoria, however, there has been growing scepticism in some quarters at the so-called benefits of modern tourism. An eminent critic asks why any government would want to subsidise jet-age travel when the net effect is "to ruin every landscape and every historic site to which we bring our jet liners and motor coaches?"

More pertinent — particularly to Asia's malnourished and underfed — are suggestions that tourism's economic beneficence is not nearly as gainful as its champions maintain. To support tourism and create an attractive infrastructure, the limited funds generated by local taxpayers must inevitably be channelled away from more essential sectors. It is also argued, with some justification, that development costs are deliberately narrowed — usually by tourism ministries and other vested interests — to make the creation of a local hospitality industry appear less expensive than it really is. By so doing, continues the argument, The Third World poor are often in the preposterous position of subsidising the low-cost holidays of the industrial rich.

In Manila, it is the street girls — often young students struggling through college — who are increasingly that city's principal attraction. While presidential decrees may build the flashy new hotels, it is now the bar girls who provide the promotional bait that fills them. If this isn't economic degradation, what is?".

"Few developing nations in the world have committed themselves so totally to the creation of a national tourism industry as the Philippines. For more then three years now, Manila has witnessed an unprecedented spate of hotel and infrastructure construction costing millions to the local economy. Within a year of opening, however, this dazzling array of new plant is in serious economic difficulties through a combination of massive over-building and inadequate visitor traffic. The government is attacked for skimping on promotional funds, flag carrier Philippine Airlines is accused of protectionist air policies and the Department of Tourism is harangued for being ineffectual in penetrating tough overseas markets."

In a 16-page report in INSIGHT its editor Ian Verchere examined the Philippine tourism business as it stands today. We reproduce here the section on 'Hotel Development.'

Unlike unwanted aircraft, surplus hotels are firmly rooted in national soil. Flourishing or faltering, nothing can remove their monumental presence from view; nothing that is, expect the pneumatic rattle of the demolition drill or the subtle surgery of architectural conversion. Nobody understands this better than President Ferdinand Marcos of the Philippines and the deferential functionaries of his New Society.

When Secretary of Finance Cesar Virata first penned a memorandum in 1970 on the possibility of building a conference complex, a flutter of interest twitched through the dying body of the old political order. Internationalists looked with admiration at the growing success of Third World Kenya whose facilities at Nairobi were gaining world-wide recognition as an efficient and highly desirable meeting place. Portentous international gatherings were transmitting decisions and resolutions to the world under a Nairobi dateline. Why not a similar image-building exercise for the Philippines to counter that seedy banana republic reputation?

By the time martial law was declared in September 1972, the germ of an idea had already been firmly implanted in local minds. How much easier to bring to fruition now that all power emanated from the presidential palace and there were no self-interested senators or congressmen to impede progress. Manila would become Southeast Asia's leading conference venue built to the needs of multinational meetings. And when there weren't any conferences to host, the city would be packed with droves of foreign tourists with unlimited spending power. Law and order, "the warm and friendly Filipinos" and the natural beauty of the Philippines would prove irrestible to travellers from far and wide. The formula seemed unbeatable.

By the time the deadline for the inauguration of the new amenities arrived — the World Bank meeting of September 1976 — the Philippines had invested well over P1,700 million pesos (approx. 7.5 pesos=1 US $) in this massive new tourism project and bankers around the world were already describing it as the third world's biggest gamble to date. The P750 million Philippine International Convention Centre (PICC) opened amidst a fanfare of praise from political friends and traditional foes. Although critics-particularly those from aid donor nations - made rude remarks about impoverished nations with curious priorities, most IMF delegates from abroad were impressed.

Then the band stopped playing and the delegates went home. Gone were the backslapping guests from overseas with comforting words to bolster an uneasy government's sagging spirits. Fourteen brand new hotels and their 6,395 rooms had now to be filled with an endless flow of foreign visitors if this lavish piece of Third World showmanship was not to collapse in economic ruin. These hotels, points out Virata, in a recent *INSIGHT* interview, are almost exclusively geared to the needs and tastes of the wealthy foreign traveller. In addition to enhancing the national image, he adds, the new infrastructure was created primarily to improve the economy's vacillating foreign exchange position.

Before the hotel development spree, Manila boasted three modern international class hotels: the 420-room Intercontinental, the 424-room Hilton and the 263-room Hyatt. Only the Intercontinental - comfortably parked on the edge of the flourishing Makati business district - had enjoyed an unchequered financial history. With the introduction of skilled US chain management, however, the other two properties also began to flourish and were soon servicing their debts to owners and financial masters: the Government Service Insurance System (GSIS).

As the first surge of post-martial law tourists poured into the Philippines-spurred on by reports of cheap prices, nice girls and stable government - the more tourism-oriented Hyatt and Hilton experienced a marked increase in occupancy rates. Hyatt - which inherited a 50% average occupancy when it took over the Manila property in 1970 - pushed this up to 65% in 1972, 80% in 1974, 86% in 1975 and 83% in 1976. Meanwhile, the Intercontinental - always benefiting from its proximity to the business quarter - had continued to maintain consistently high occupancies from inception.

By the time World Bank delegates arrived in September 1976 to rearrange the world's monetary affairs and talk boldly of a new economic order, Manila's three established hotels were enjoying buoyant traffic and steadily increasing yields. Like most onlookers the three US hotel chains looked on with growing discomfort as the Department of Tourism (DOT) and various state banks endorsed more and more hotel projects in the Greater Manila Area. Presidential Decree No. 535 had triggered off the room boom by announcing that government finance would be available for all hotel development projects provided they were registered and scrutinised by the DOT and that Filipinos held the majority stake and represented at least 60% of the board.

Cash Injection

Principal vehicles for lending all these millions would be the government controlled GSIS and the Development Bank of the Philippines (DBP). Loans would be for 12 years with a two-year grace period at interest rates of 12% on land portion, 14% on the construction work with an additional 2% bank service charge. When the governors of DBP - traditionally bankers to the agricultural and industrial sectors - balked at the enormous amounts involved, Central Bank Governor Gregorio Licaros soothed their troubled minds with a guarantee covering 80% of all disbursements. DBP would sell back government bonds to the Central Bank in exchange for a P800 million cash injection. The other P200 million would be the DBPs risk.

Within a few months after *PD535*, GSIS and DBP were inundated with eager loan applicants anxious to cash in on the impending hotel bonanza. Before long the seal of approval had been stamped on 14 first-class hotel projects and a number of smaller units.

Why so many so quickly? Secretary Virata cites the free enterprise principle and refusal to stop *bona fide* developers from borrowing. A senior official at the DBP, however, seems as mystified as most observers: "We were really guided in such decisions by the DOT and the National Economic Development Authority (NEDA) and their traffic projections and assessments of what the market could stand", Elsewhere critics claim that loan applicants included political friends who, despite the market overloading had to be accommodated. Since the president kept a close watch on construction progress at the PICC and held private audiences with a number of executives from international hotel chains, it must be assumed that - as with most things in the Philippines today - the buck - or the peso - stopped at the Malacanang Palace.

During the period July-June 1977, the DBP disbursed P1,074 million of approval loans totalling P1,129 million for the construction of ten first class hotels in the Manila area (see table 2). With contributions from the private sector, overall investment in the 4,421 new rooms will ultimately amount to something close to P1,670 million, of which a small portion is from overseas. In addition, GSIS has released loans totalling P734.6 million on similar terms for the construction of enlargement of four major projects in Manila providing 1,824 new rooms. A final project - the 500-room Manila Regent - is largely financed from overseas loans (P129 million) and local and foreign equity capital (P65.72 million). Before the boom began, therefore, there were 4,341 rooms in the Greater Manila Area. With the inauguration of the 6,745 rooms since September 1976, there are now about 11,086 luxury, first or second class rooms - an increase of 150%.

The only way to gauge the impact of such a sudden upsurge in capacity is through room occupancy rates and financial yield. As we saw earlier, the three original luxury class hotels were enjoying occupancies in the high 80s and 90s up until the World Bank conference in September 1976. The month after the delegates departed, however, the consolidated occupancy for 16 luxury and first class hotels in the Greater Manila Area -

TABLE 1. ESTIMATED TOURISM RECEIPTS (1965-1976)

Year	Number of Visitors	Average Length of stay	Average*Individual Daily Expenditure (US$)	Total Tourism Receipts+ (US$m)
1965	84,015	7.0 days	$30.00	$ 17.64
1966	101,695	7.3 days	$28.30	$ 21.01
1967	108,805	7.2 days	$29.50	$ 23.11
1968	112,713	7.2 days	$30.50	$ 24.75
1969	123,268	7.2 days	$30.50	$ 27.07
1970	144,071	7.3 days	$30.50	$ 32.07
1971	144,321	7.3 days	$30.50	$ 32.12
1972	166,431	7.3 days	$31.50	$ 38.27
1973	242,811	7.8 days	$33.50	$ 67.80
1974	410,138	7.8 days	$33.50	$124.24
1975	502,211	7.8 days	$34.78	$155.21
1976	615,159	—	—	$181.23
1080 (est.)	879,339	—	/	$347.06

* According to survey of out going visitors.
\+ Excludes international fare payments.

Source: *DOT; Central Bank tourism receipts are approximately 50% lower*

TABLE 2 — MAJOR HOTEL PROJECTS (1974-77)

Project (rooms)	Loan approved (banks) (Pm.)		Total project cost (Pm.)
Hotel Mirador (340)	95.0	(DBP)*	125.2
Silahis International Hotel (565)	116.8	(DBP)	151.6
Manila Mandarin Hotel (504)	119.2	(DBP)	189.2
Manila Midtown Ramada Plaza (602)	134.0	(DBP)	201.1
Manila Peninsula Hotel (544)	170.0	(DBP)	257.1
Century Park Sheraton (510)	132.5	(DBP)	200.4
Tradewinds Hotel (350)	62.2	(DBP)	85.1
Manila Carden Hotel (525)	150.5	(DBP)	233.3
Holiday Inn Hotel (369)	137.2	(DBP)	177.0
Admiral Hotel (112)	12.0	(DBP)	26.6
Regent of Manila (500)	128.9	(overseas)	194.7
Philippine Plaza Hotel (676)	380.0	(GSIS) +	380.0
Philippine Village Hotel extension (228)	68.5	(GSIS)	59.8
KBS-Kanlaon Tower (350)	60.7	(GSIS)	70.0
Manila Hotel (570)	228.7	(GSIS)	257.7

*DBP = Development Bank of the Philippines

+GSIS = Government Service Insurance System.

Sources *NEDA/DOT/PTA*

including the three pre-World Bank properties - plunged to 42.2%; by December 1976 it sank still further to a hopelessly unprofitable 38.6%, then crawled momentarily up to 59.8% through the short-lived influx of Chinese New Year traffic from neighbouring Hong Kong. Although more updated industry averages are not yet available, local hoteliers claim the situation is even more calamitous.

"Any government that allows a situation like this to occur," comments one angry general manager, "obviously has more money than brains. It is absurd to flood the market overnight with capacity in this way, because it certainly wasn't needed for the World Bank. You need at least one-year lead time to promote and prepare a major international hotel these days. Yet most general managers were not even hired until six months before their properties opened. It's a ridiculous situation".

With a fairly predictable flow of visitors, some effort was made to close ranks and maintain a rigid industry price structure. Initiated by the older pre-boom hoteliers, the idea was to maintain high yields by creating a DOT-backed "minimum promotional rate" for all classes of hotel. Although sufficient traffic could never be generated to achieve occupancies, ran the argument, at least maximum revenue could be extracted from the arrivals that did materialise. A pact was agreed and the DOT set up an enforcement unit to see that everyone knew and obeyed the rules.

By the end of June, however, pressure from hotel owners was buiding up and at least three hotels - Century Park Sheraton, The Regent and the Philippine Plaza - had broken the agreement and were offering tariffs "way below" the agreed figure of US$16 for a single and $20 for a twin. In fact, rates of $10-$12 are now being charged on rooms which need to generate $35-$45 in order to service loans and become profitable. "It really is very disappointing that our mutual defence system has collapsed like this," says Hyatt Regency general manager, Ralph Peter-Jentes, "particularly since it had government backing". With much of the risk money emanating from government coffers, these sentiments are probably shared by the government banks.

As the situation worsened in recent weeks a number of properties have laid off staff revenue to cover basic operating costs. Additional loans have been sought but with most collateral resting with the development banks, response has not been generally sympathetic.

It is against this disastrous backdrop, therefore, that Philippines' Secretary of Finance Cesar and the DBP to establish a joint Virata called upon the hotel owners working group to seek a universally acceptable formula for the restructuring of loans. "We had our first meeting in May," explains a DBP official, "and got some insight into the seriousness of the situation. If the hotel companies are to avoid defaulting on their loan contracts then something has to be done soon. The situation is quite grave".

While conceding that some criticism of the government's hotel development policy is warranted, Virata reveals that he will "probably reschedule the debts," adding that "the first three years are always the most difficult." But he makes it clear that his 1978 budget is unlikely to include any dramatic increase in the DOT's annual appropriation and that the level of expenditure on promoting travel to the Philippines abroad will, therefore, remain relatively unchanged.

Unprofessional Handling

Meanwhile, the hotel owners have been pressing hard for the banks to take a temporary equity position in their indebted properties so as to reduce the size of the loans and interest payments. However, the DBP appears so far unwilling to accommodate this type of approach, preferring rather "to restructure the loans." Because many of the developers have handled their loans very unprofessionally, however, the bank is more likely to impose rather than be imposed upon.

One of the commonest *faux pas* was not understanding that during the loan drawdown period interest would be charged and deducted from later disbursements. As a result, a P100 million loan at 12% interest drawn down in several tranches over a 12-month period would only produce P88 million (P100 million minus the P12 million interest). "By failing to digest the conditions of the loan contracts," explains a DBP source, "most of the borrowers ran out of money before they had completed their hotels. Consequently, they came running back to us for additional and more costly overrun borrowings."

Already owner of the Manila Hotel, the Hyatt Regency, the Manila Hilton and the PICC, the Philippine government may yet find itself the proud proprietor of the largest chain of hotels in South-east Asia. Which would perhaps be poetic justice.

IN DEFENCE OF THE TOURISM PLAN

Philippines Secretary of Finance Cesar Virata in an interview with "Insight" editor Ian Verchere:

Some excerpts from the interview:-

Insight: It seems pretty obvious you have created a huge surplus in hotel rooms.

Virata: That is granted. But in hotel building the problem is that you can't do it little by little. It is cheaper to over-build and then fill up rather than continue building over a long period of time. For one thing, it disturbs the occupants. And don't forget, the Philippines is largely a private enterprise economy and we cannot prevent people from investing in hotels if they want to.

Insight: But you could control the money flow since most of it was coming from government controlled banks like the DBP and the GSIS?

Virata: Yes, we could control the flows that came from the government but we could not control those who have the collateral and credit standing to borrow from private banks. Anyway, we still believe hotels are good business.

Insight: Has there been any suggestion within the government that much of this finance should have been channelled into needier sectors of the economy such as housing, health and public utilities? After all, it does seem rather ironical to find a country like the Philippines building luxurious palaces for foreigners when there is so much poverty at home?

Virata: Well, this is the problem with tourism. You are dealing with the richer strata of the world: they are the ones that can travel. And they will not travel and go to a place where they feel miserable. So you have to keep up with their standards. Hopefully, by doing that, we provide them with the type of service industry we talked about earlier and our people get employment.

Capacity utilization in Sri Lanka's hotel industry

G. M. P. de Silva

Mr. G. M. P. de Silva, Project Analysis, Development Finance Department of the Central Bank, who was on release to the Development Finance Corporation of Ceylon conducted a study on the "LEVEL OF UTILISATION OF CAPACITY AND AN ESTIMATE OF ROOM REQUIREMENTS IN THE HOTEL INDUSTRY IN SRI LANKA — 1977-82", *which was published in the April, 1977 issue of the Bank's "Staff Studies". The study which deals comprehensively with the reasons for the growth of the industry; the role of fiscal incentives; the growth of tourist traffic; and likely growth from 1976-80; factors determining growth; the relevance of seasonality in Sri Lanka's tourism to investment in hotel capacity; growth and structure of hotel capacity in Sri Lanka and estimates of room requirements and prospective hotel capacity; also contains 16 different tables which supplement the study. We reproduce here some relevant sections covering the general introduction to the study, together with his comment on the problem of excess capacity and also his final conclusion. More recent studies on this subject will be carried in a future issue.*

Between 1967-75 the hotel industry in Sri Lanka has shown a remarkable rate of growth. The tourist industry commenced on organised lines in 1967 and the growth of the industry in terms of the level of investment and new capacity created is perhaps one of the fastest rates of growth achieved in any sector of the economy in Sri Lanka. For example, in 1967 accommodation capacity in hotels approved by the Tourist Board was 770 rooms. Bulk of this capacity was in old established hotel concerns which had been in operation over a long period. By the end of 1975, there were 76 hotels in Sri Lanka suitable for the international tourist trade, with 3,673 rooms. Of these rooms 1,100 were in Colombo city, 1,689 on the beaches and 826 on the interior circuit of the ancient cities, Kandy and the hill country and 50 in the Northern Region. The annual average rate of growth of rooms in the industry worked out to a very impressive 25.0 per cent over the period. The record of the industry in terms of the volume of capital invested appears even more impressive. Table 1 summarises the available data on investment in the industry during the period 1968-75. Total investment in the industry excluding

TABLE I
INVESTMENT IN THE HOTEL SECTOR Rs. millions.

Year	No. of Rooms Completed	Capital Expenditure on hotels: Rupees	Capital Expenditure on hotels: Foreign (Net of FEECs)	Capital Expenditure on hotels: Total	Ceylon Tourist Board Expenditure on infra-structural development Resort Areas
1968	145	4.6	0.4	5.0	—
1969	120	2.1	1.2	3.3	1.8
1970	498	22.2	13.8	36.0	2.4
1971	137	6.1	0.3	6.4	1.3
1972	75	4.0	0.5	4.5	2.9
1973	591	34.8	26.1	60.9	1.9
1974	471	40.3	3.3	43.6	3.7
1975	8.11	122.1*	38.7*	160.8*	n.a.
	2,848	236.2	84.3	320.5	14.0

* Provisional

Source: *Ceylon Tourist Board.*

expenditure by government on infra - structural development amounted to Rs. 320.5 million, an annual investment of around Rs. 40 million. The foreign component amounted to about Rs. 85.0 million.

The bulk of the investment in the hotel industry came from indigenous sources, the proportion of foreign capital in the industry is very small. There are signs that the level of investment activity in the industry will continue unabated for several years to come. As at March 31, 1976 there were 33 new hotels under construction, with 1,535 rooms. This programme of construction is likely to attract an even larger volume of capital into the industry. Thus the total volume of investment in the physical assets of the industry should now be close upon Rs. 450 million.

No firm estimates are available on the volume of capital expenditure by government on infra-structural developments for the tourist industry. The available data are summarised in Table I. These consist of the development of the international airport at Katunayaka, improvements to the road and rail network and the creation of several institutions to provide trained personnel to the industry and also to act as a regulating body. Indeed, it is true that not all these infra-structural developments were undertaken to meet specific requirements of the tourist industry. Nevertheless it is true that a large part of the cost of providing them should be attributed to the tourist industry. Therefore, the total investment in the industry in current terms, once an addition is made on very rough assumptions for the portion of government investment on infra-structural development attributable to the tourist industry, should be in the region of Rs. 600 million.

The excellent growth performance of the industry is unique in the sense that no other sector of the economy has shown this level of growth in recent years. In the sixties the industrial sector grew rapidly in current terms but the period also witnessed rapid increases in prices of industrial products which reduce substantially the growth of industrial output in real terms. The growth in the manufacturing sector at constant (1959) factor cost prices averaged around 5.7 per cent per annum during the period 1959-72. In the cause of the tourist industry the direct contribution of tourism to Gross National Product at constant prices rose from Rs. 6.3 million in 1970 to Rs. 26.3 million in 1975, representing an annual average rate of growth of 32.9 per cent.

It is unlikely that the hotel industry will be able to sustain rapid growth rates beyond 1977 as it is evident that the original expectations with regard to the volume of tourist traffic in the island have not been fulfilled. Planning for investment in physical capital in the industry appears to have proceeded on the basis of the original expectations with regard to the number of tourist arrivals. As a result, there appears to be emerging in the industry a problem of over capacity. The rate of growth of investment in the industry therefore, will have to be curtailed until there are indications that the volume of traffic will increase sufficiently fast to warrant further investment.

Problem of Excess Capacity

It is quite apparent that a situation of excess capacity is emerging in the industry in the next few years. This problem is bound to be felt acutely unless there is a rapid growth in traffic over the anticipated level. According to the projections the available rooms in 1977 far exceed the number of rooms required to cater even to peak demand. Because of the extremely seasonal nature of tourist traffic it is not desirable for Sri Lanka to attempt to cater to peak demand. The more practical approach for the industry would be to carry a certain number of rooms which would ensure for the industry an acceptable rate of return on the investment. As the industry matures, the proportion of older hotels in the industry will gradually increase, the repair and maintenance and replacement costs are likely to increase; and the incidence of tax on the industry will gradually increase, the repair and maintenance and replacement costs are likely to increase; and the incidence of tax on the industry too would show an upward movement. In the context of these developments it would not be possible for any hotelier to survive in the industry at occupancy level as low as 40 per cent. A reasonable average for the industry as a whole by 1980 would be about 60 per cent.

It is possible to estimate the total number of visitors required to come into Sri Lanka to help the industry to achieve differing levels of capacity utilisation. This can be done with the help of the following formula:

$$\text{No. of tourists} = \frac{\text{No. of rooms} \times 365 \times \text{Room Occupancy rate (\%)} \times \text{Bed/Room Occupancy Ratio}}{\text{Average length of stay}}$$

Since not all tourists who come into the country stay in rooms of international standard, the level of inflow must be greater than that yielded by this formula. In the period 1937-75 roughly about one visitor out of four stayed in

ASSUMPTIONS

No. of rooms available = 4980

	1977	1978	1979	1980	1981	1982
Room Occupancy Rates (%)	52	54	56	58	60	60
Bed/Room Occupancy Ratio	1.7	1.7	1.7	1.7	1.7	1.7
Average length of stay 1	10	10	10	10	10	10
Proportion staying in approved accommodation	0.75	0.75	0.75	0.75	0.75	0.75

1. *Average length of stay of a tourist has actually shown a declining trend in the recent past. From 11.0 (nights) in 1967 it dropped to 10.3 in 1973. It has further declined to 10.2 in 1974 and 9.8 in 1975.*

RESULTS

Year (1)	Level of Room Occupancy % (2)	No. of tourists required to come into the country (3)	Ceylon Tourist Board Revised Estimate (4)	4 ÷ 3 x 100 (5)
1977	52	214,246	136,000	63.5%
1978	54	222,486	168,000	75.5%
1979	56	230,727	210,000	91.0%
1980	58	238,967	230,000	96.2%
1981	60	247,207		
1982	60	247,207		

accommodation not considered able for international tourist traffic. So the estimate yielded by the above formula must be adjusted by multiplying it by the reciprocal of the proportion of visitors staying in rooms accepted as suitable for tourist traffic. The assumptions and the results are summarised in the tables on page 31.

The results show that by 1977 Sri Lanka must achieve a level of tourist inflow which is more than doubled the level achieved in 1975. It is impossible for the industry to achieve this feat, for international tourist traffic is not likely to respond so quickly to the gradual economic recovery of the developed world. Therefore, a serious problem of over capacity is bound to trouble the industry in the next few years, with grave repercussions on the overall rate of return on the capital invested in the industry. If the expansion of capacity is held in check the problem is likely to ease somewhat in early 1980s, provided, however that the assumption on which this exercise is based are realised. Given a gradual increase in the average duration of stay and the proportion of visitors staying in approved accommodation, the industry can achieve a higher level of capacity even in the face of a static level of inflow of tourists.

Before completing this analysis, there is one limitation in the exercise which must be highlighted. The distribution of rooms under Projection I and II has been attempted on the basis of 1975 experience. By 1975, some regions were well developed to receive tourist traffic. An important exception, however, was the East Coast which is coming into the scene only now. Though the projections put room requirements at relatively low level, the pattern of tourist traffic within the country may shift in favour of the East Coast region, enabling this region to carry a higher volume of rooms. The same consideration may apply to the Northern region.

CONCLUSION

This study raises several important implications for policy in the field of tourism. Rapid growth of the industry has no doubt been facilitated by the over generous tax incentives granted and the ease with which investment in hotels could be undertaken relative to investment in industries which are characterised by complex technology. Moreover, in the initial stages, planning in the industry was based on more optimistic expectations with regard to the number of tourist arrivals in the country. All this has resulted in the emergence of a problem of over capacity in the industry. Therefore, there is a clear need both in terms of the national interest and in terms of the interest of the individual investor to slow down investment in the industry until the capacity already created could be utilised more intensively. There is evidence that excess capacity in the industry has already begun to put pressure on the hotel rates charged from clients. There is a considerable amount of competition among hotel owners to attract customers, with the result that most hotels have been forced to cut their rates well below those advertised in their brochures. This is an unhealthy development from the point of view of the national economy. Table XVI shows the earnings of the industry per visitor arrival and per visitor night.

The continued improvement of Sri Lanka's earnings per visitor and from the point of view of the national interest. Growth of total per visitor night are very important earnings could occur even in the face of a decline per visitor or per visitor night. The problem of excess capacity in the industry could certainly slow down the rate of growth of earnings per visitor and per visitor night or in extreme circumstances bring about an actual decline. Since the industry is still in its infancy, it has not exhausted the potential for improving on the levels already achieved. Any development that arrests the continued growth of these two variables is bound to conflict with the national interest.

Another aspect that should engage the attention of policy makers is the high proportion of visitors who either patronise the cheaper hotels in the country or live off the hospitality of friends and relations. The tourist industry, as an important source of foreign exchange, is already suspect on account of the very high import content of expenditure in the industry and on account of the leakage of a high proportion of its earnings into the unofficial market. If those who stay with friends and relatives form a significant proportion of the total of those who do not patronise tourist hotels, the net foreign exchange earnings from the industry as a whole could turn out to be inadequate in relation to the investment that had taken place. To the extent visitors to Sri Lanka live off our hospitality, it constitutes a drain on our resources. The net benefit from the category of visitors who choose to patronise the cheaper hotels is also likely to be very small. It is reasonable to assume that this class of tourist saves mostly on the cost of accommodation while the expenditure on food and drinks would tend to be more like that of a visitor in a tourist hotel. This means that the visitors in cheaper accommodation are really economising on expenditure such as accommodation and personal services which have a very low import content. Therefore, the import content of the expenditure of visitors in cheaper accommodation is likely to be very high as a proportion of the total expenditure for this category. In view of these considerations, an attempt should be made to reduce the proportion of visitors staying outside recognised accommodation.

Earnings Per Visitor Arrival and Per Visitor Night

Year	US $ Per Arrival	US $ Per Visitor Night
1963	63.02	
1964	60.78	
1965	64.25	
1966	67.74	
1967	51.17	4.65
1968	62.61	6.08
1969	71.19	7.12
1970	78.14	7.44
1971	85.94	8.18
1972	130.06	11.93
1973	164.57	15.98
1974		18.71
1975		22.02

Source: *Basic data from Ceylon Tourist Board Statistical Reports.*

COFFEE

Brazil (27%), Colombia (12%), Uganda (12%), Angola (6%), Ivory Coast (6%)

Distinctly different styles of play between the South American teams who produce the finer Arabica coffee, and the Africans who produce the rougher Robusta variety (better for instant coffee). One International Coffee Agreement broke down in 1972 because the US refused to compensate producers for the falling value of the dollar. The present one signed in 1976 is based on quota restrictions only, does not operate now because of the high price, and all in all is pretty useless.

TEA

Sri Lanka (32%), India (32%), Kenya (7%), Indonesia (7%)

The game everybody thought was on the way out has staged a remarkable comeback. The UK (whose 50 million people drink 200 million cups a day) has now been overtaken in consumption by India. And thanks also to the rising price of coffee, consumption is also rising in the Middle East and North America. An International Tea Agreement now seems at least possible whereas a few years ago the consuming countries would have laughed at such an idea.

COCOA

Ghana (31%), Nigeria (20%), Ivory Coast (12%), Brazil (8%)

The classic speculator's commodity with prices lurching all over the place. Despite current high prices the poor producers have a weak hand here, with a luxury product the rich could probably do without if they tried. Attempts in 1974 and 1976 to activate the existing International Cocoa Agreement have so far failed because droughts led to such shortages that the buffer stocks needed could never be established, and in any case the US refused to recognise the agreement.

COPPER

Zambia (17%), Chile (16%), Zaire (10%), Peru (5%)

A tricky game for the poor country producers if they want to form a cartel as they only have about half the world's trade. The USA, Canada, Australia, South Africa and Eastern Europe are also major producers. The metal is virtually indestructable (99% of that ever produced is still in circulation and 40% of each year's needs are actually met from scrap). There is a fairly strong producers Union CIPEC which once tried a production cutback but with inconclusive results and in which Peru is the most aggressive member with Chile dragging her heels unwilling to offend US investors.

BANANAS

Ecuador (20%), Honduras (17%), Costa Rica (13%)

A depressing game for the producers who only get about 11% of the retail price for their product. The trade is dominated by three corporations with the indicated percentages of world trade ; United Brands (Fyffes) (35%), Castle & Cook (25%), and Del Monte (10%). In 1974 a producer's union UBEC was set up to try and increase their income. One of the first things they tried was to put on an export tax. In Panama, United Brands refused to buy the bananas and let them rot. In Honduras they simply gave a $1·25m bribe to the government. There is now only a small tax.

COMMON FUND

A relatively new game, proposed by UNCTAD, that there should be a $6,000m fund created to finance buffer stocks of a total of 18 different commodities : Cocoa, coffee, tea, sugar, tin, rubber, cotton, jute, hard fibres, copper, bananas, vegetable oils, meat, tropical timber, iron ore, bauxite, manganese and phosphates. The first 10 'core commodities' to be given priority.

They argue that the finance needed for stocks of all 18 would be less than total funds needed to be set aside for each individually, for as stocks of say cocoa built up with a good harvest, stocks of rubber could be reducing, if car production went up.

Registered as a Newspaper at the G.P.O.

ECONOMIC REVIEW

Price 2/-

Printed by the Associated Newspapers of Ceylon Ltd at Lake House, D. R. Wijewardene Mawatha, Colombo 10.